cipher
PHARMACEUTICALS INC

2014 Annual Report

BUILDING

A CUSTOMER CENTRIC DERMATOLOGY COMPANY ACROSS NORTH AMERICA

Cipher Pharmaceuticals is a rapidly growing specialty pharmaceutical dermatology company, with a robust and diversified portfolio of commercial and late-stage products. Cipher acquires first-in-class or best-in-class products and transformative compounds that fulfill high unmet medical needs. Our experienced management team has a proven track record of successfully managing the required clinical development and regulatory approval processes and marketing products either directly or through partners. Cipher is well-capitalized to drive sustained earnings growth by leveraging our proven clinical development capabilities and efficient commercial execution. With four transactions announced in 2015 (as of the printing of this report), we are on pace to achieve our goal of expanding our Canadian dermatology franchise, building a U.S. commercial presence and ultimately, becoming the most customer-centric dermatology company in North America.

NET REVENUE

20% / 49%*

EBITDA

12% / 52%*

EXPENSES

39%

CASH BALANCE

118%

2013 2014 millions $ CAD

* Adjusted for one-time milestone in 2013

EXPANDED PRODUCT PORTFOLIO

	PRODUCT	INDICATION	STATUS
DERMATOLOGY PRODUCTS	ABSORICA™ EPURIS®	Severe nodular acne	Marketed by Sun Pharma in the U.S. Marketed by Cipher Pharmaceuticals in Canada
	BETEFLAM®	Plaque psoriasis	Under review by Health Canada
	DERMADEXIN™ PRURIDEXIN™	Seborrheic dermatitis Chronic pruritis	CE Mark Under EU registration
	OZENOXACIN	Impetigo	2nd Phase-3 ongoing
	CF101	Plaque psoriasis	Phase-2/3
	ASF-1096	Discoid lupus erythematosus	Phase-2
	NANOLIPOLEE-007	Melanoma	pre-IND
OTHER PRODUCTS	LIPOFEN®	High cholesterol	Marketed by Kowa Pharmaceuticals in the U.S.
	CONZIP® DURELA®	Once-daily treatment of moderately severe pain	Marketed by Vertical Pharmaceuticals in the U.S. Marketed by Medical Futures in Canada

GROWTH STRATEGY

OUR APPROACH TO VALUE CREATION

CANADA
Derm Focus

Acquisitions:
Accretive in 2 yrs

Licensing:
Cash Flow 2 yrs, NPV 5 yrs

TRANSFORMATIVE
Efficient Technology

Low Cost
Acquisitions

Long Term
Value Drivers

USA
Derm Focus

Acquisitions:
Accretive in 2 yrs

Licensing:
Cash Flow 2 yrs, NPV 5 yrs

LETTER TO SHAREHOLDERS

Dear Shareholders:

In my first annual letter to shareholders, I'm pleased to report it was an excellent year for Cipher, with revenue, EBITDA and cash growing strongly.

The primary driver of this growth was the continued expansion of our isotretinoin product, which is marketed under the brand Absorica™ in the U.S. By December 2014, Absorica achieved 20% market share. For the full year, revenue from this product was $22.5 million, an increase of 42% over 2013, excluding the impact of the non-recurring milestone payment we recognized in Q4 2013. Building on the strong performance to date, we continue to work with our marketing partner, Sun Pharma, on strategies to increase market share. In its first full year on the market, Epuris® (the brand name for our isotretinoin product in Canada) reached 15.5% market share based on successful execution by our sales team and the growth of the overall isotretinoin market. In 2014 this brand generated $2.1 million in net revenue, a five-fold increase over 2013, through market share penetration and market expansion.

In 2014, we extended the reach of our isotretinoin franchise with out-licensing transactions for Brazil and Chile. In both markets, regulatory reviews are underway. We expect the product will be commercialized in Chile later this year and in Brazil in 2016. These deals will generate additional high-margin revenue and increase the aggregate value of our isotretinoin franchise.

It was also a strong year for our Lipofen® product. Our partner, Kowa, launched an authorized generic version in Q2 2014, which performed above our expectations. Net revenue from the product was $5.6 million in 2014, a 65% increase over the prior year.

These product achievements translated into strong financial performance in 2014 and set us up for continued growth in 2015 and beyond. Total revenue for 2014 was $32.3 million, an increase of 20% compared with $27.0 million in 2013. When adjusted for the impact of a $5.3 million non-recurring milestone payment recognized in Q4 2013, year-over-year total revenue growth was 49%. Adjusted EBITDA rose 12% to a record $22.4 million versus $20.0 million in 2013. Net income in 2014 was $20.7 million, or $0.82 per basic share, compared to net income of $25.0 million, or $1.02 per basic share in 2013. In 2014, the Company recognized a net deferred tax asset that contributed $0.3 million to net income, compared with a net deferred tax asset of $6.6 million in 2013. Excluding the impact of the deferred tax asset and one-time milestone payment, net income in 2013 would have been $13.1 million, or $0.53 per basic share. On a like-for-like basis, the $0.53 per share for 2013 compares to $0.81 per share for 2014.

When I joined Cipher in 2014, my mandate was to chart a new path forward for the company – one that included building a commercial presence in the U.S. and a more diversified product portfolio and revenue base. In November 2014, we listed the company's shares on NASDAQ (CPHR) and began further engaging the U.S. capital markets. Since then, we have set a goal of becoming the most customer-centric dermatology company in North America.

We've established a three-pronged growth strategy, and in recent months numerous business development successes have moved us significantly closer to that goal.

1. Acquire dermatology companies and/or products in the U.S. and establish commercial infrastructure
    - Acquired worldwide rights to three products focused on inflammatory dermatological diseases (Dermadexin, Pruridexin, and ASF-1096) from Astion Pharma. Commercialization efforts will focus on the U.S. initially.
2. Expand Canadian dermatology franchise
    - Licensed the Canadian rights to Ozenoxacin, a topical treatment for adult and paediatric patients with impetigo
    - Licensed the Canadian rights to CF101, a novel treatment for moderate to severe psoriasis and rheumatoid arthritis
    - Announced that Beteflam Patch has been accepted for review by Health Canada.
3. Acquire potentially transformative technology that can be commercialized efficiently
    - Acquired seven pre-clinical compounds for the treatment of melanoma and other skin cancers from Melanovus Oncology Inc.

Our business development activity is very robust. With strong financial performance, access to capital, and a talented team, we are in an excellent position to deliver continued growth and achieve our goals. We look forward to updating you on our progress during the year. Thank you for your continued support.

Sincerely,

"Signed"

Shawn Patrick O'Brien
President and Chief Executive Officer

April 1, 2015

MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2014

The following is a discussion and analysis of the operating results and financial position of Cipher Pharmaceuticals Inc. ("Cipher" or "the Company") for the year ended December 31, 2014. This document should be read in conjunction with the audited financial statements and the accompanying notes, which have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. Additional information about the Company, including the annual financial statements and Annual Information Form for the year ended December 31, 2014, is available on SEDAR at www.sedar.com.

The discussion and analysis within this MD&A are as of February 24, 2015.

Caution Regarding Forward-Looking Statements

This document includes forward-looking statements within the meaning of certain securities laws, including the "safe harbour" provisions of the Securities Act (Ontario) and other provincial securities law in Canada and U.S. securities laws. These forward-looking statements include, among others, statements with respect to our objectives, goals and strategies to achieve those objectives and goals, as well as statements with respect to our beliefs, plans, objectives, expectations, anticipations, estimates and intentions. 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 applicability of patents and proprietary technology; patent litigation and patent infringement; regulatory approval of products in the Company's pipeline; marketing of products; meeting projected drug development timelines and goals; product liability and insurance; dependence on strategic partnerships and licensees; concentration of the Company's revenue; substantial competition and rapid technological change in the pharmaceutical industry; the the publication of negative results of clinical trials of the Company's products; the ability to access capital; the ability to attract and retain key personnel; changes in government regulation or regulatory approval processes; dependence on contract research organizations; third party reimbursement; the success of the Company's strategic investments; the achievement of development goals and time frames; the possibility of shareholder dilution; market price volatility of securities; and the existence of a significant shareholder.

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 our Annual Information Form and under "Business Risks" and elsewhere in the following Management's Discussion and Analysis of Operating Results and Financial Position for the year ended December 31, 2014, and elsewhere in our filings with Canadian securities regulators. Except as required by Canadian or U.S. securities laws, 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.

Overview

Cipher is a growing specialty pharmaceutical company focused on dermatology. The Company acquires products that fulfill high unmet medical needs, manages the required clinical development and regulatory approval process, and markets those products either directly or through partners. Cipher's key product, a novel version of the acne medication isotretinoin, is marketed as Absorica™ in the U.S. and Epuris® in Canada. Since the Company was founded in 2000, Cipher has achieved regulatory marketing approval in the U.S. and Canada for all three original products and completed eight marketing partnerships, generating growing revenue streams and shareholder value. Cipher is building its dermatology franchise through product licensing and acquisitions.

Products

ABSORICA™/ EPURIS® (CIP-ISOTRETINOIN):

CIP-ISOTRETINOIN is an innovative formulation of the active ingredient isotretinoin, which is used in the treatment of severe acne. CIP-ISOTRETINOIN, which is based on the same oral Lidose® drug delivery system used with Lipofen, has been in-licensed from Galephar Pharmaceutical Research Inc. ("Galephar"). The Company's marketing rights to this product include the Americas and a majority of the Pacific Rim. CIP-ISOTRETINOIN provides more consistent absorption under fed and fasted conditions, as compared to existing isotretinoin products. Due to its high lipophilicity, oral absorption of isotretinoin is enhanced when given with a high-fat meal. CIP-ISOTRETINOIN is bioequivalent to Accutane® (isotretinoin) capsules when both drugs are taken with a high-fat meal. However, when both drugs are taken under fasted conditions, CIP-ISOTRETINOIN provides 83% greater absorption than Accutane (isotretinoin) capsules.

The product was launched by Cipher's U.S. distribution partner Ranbaxy Laboratories Inc. ("Ranbaxy") in Q4 2012 under the trade name Absorica. Cipher was issued a product patent (Patent Number 7,435,427) from the U.S. Patent and Trademark Office in 2008. A second product patent (Patent Number 8,367,102) was issued in 2013 and a third patent (Patent Number 8,952,064) was issued in February 2015. The three patents are formulation-related patents describing the product ingredients.

According to IMS, the U.S. isotretinoin market was US$630 million in 2014, an increase of 9% over the prior year, with prescriptions growing by 4% on a year-over-year basis.

CIP-ISOTRETINOIN was also approved by Health Canada in Q4 2012 under the trade name Epuris. Cipher launched the product in Canada in June 2013 with its own sales force. According to IMS, the Canadian market for isotretinoin in 2014 was $16.4 million, an increase of 7% over 2013.

LIPOFEN® (CIP-FENOFIBRATE):

Lipofen is a novel formulation of the active ingredient fenofibrate, which is used in the treatment of hyperlipidemia, a cholesterol disorder. Hyperlipidemia is a condition characterized by high levels of low-density lipoprotein ("LDL") cholesterol and/or triglycerides (a type of fat found in the blood). Fenofibrate is known to lower LDL cholesterol and triglycerides and increase high-density lipoproteins ("HDL"), known as "good cholesterol". Fibrates have proven to be superior in lowering triglycerides and raising HDL levels. Lipofen targets a large market. Lipofen is the first product from the Company's pipeline to receive U.S. Food and Drug Administration ("FDA") approval. Cipher's U.S. marketing and distribution partner for Lipofen is Kowa Pharmaceuticals America, Inc. ("Kowa"). The agreement with Kowa, which was executed in 2007, is for a period of ten years and they have the right to extend the term for two additional two-year periods.

According to IMS, the hyperlipidemia market in the U.S. exceeds US$12.6 billion and is made up of three primary groups of drugs: statins, fibrates and the prescription DHA/EPA (omega 3) market. The market for existing fenofibrate formulations in the U.S. exceeded US$1.26 billion during 2014, down from US$1.68 billion the previous year.

CONZIP® / DURELA® (CIP-TRAMADOL ER):

CIP-TRAMADOL ER is a novel, biphasic, extended-release formulation of the active ingredient tramadol, which is used for the management of moderate to moderately severe pain. CIP-TRAMADOL ER uses oral controlled-release beads, a drug delivery technology licensed from Galephar. The novel formulation delivers rapid absorption, similar absorption under different dietary conditions, and 24-hour coverage, supporting ease-of-use for physicians and a high level of compliance among chronic pain sufferers.

The product was launched in the U.S. in September 2011 by Vertical Pharmaceuticals Inc. ("Vertical") under the trade name ConZip. According to IMS, the U.S. market in 2014 for extended release formulations of tramadol exceeded US$76 million which represents 1.8% of the total tramadol immediate-release and extended-release prescription market.

The product was launched in Canada in March 2012 by Medical Futures Inc. ("Medical Futures") under the trade name Durela. According to IMS, the Canadian market for extended-release tramadol was $27 million in 2013. Patents have been issued both in the U.S. and Canada for the product.

Product Update

ABSORICA™/ EPURIS® (CIP-ISOTRETINOIN):

Absorica

Absorica is marketed in the U.S. by Ranbaxy, a wholly owned subsidiary of Ranbaxy Laboratories Limited (“Ranbaxy SA”), under a distribution and supply agreement which was signed in 2008. The agreement provided for various milestone payments and a royalty percentage in the mid-teens on net sales.

Absorica was released in the U.S. market in late November 2012. The product has performed well since launch, achieving 20% market share by December 2014, based on total isotretinoin prescriptions (source: IMS). In Q3 2014, Ranbaxy launched two new strengths of Absorica (25 mg and 35 mg) to provide further flexibility to physicians in the weight-based dosing of isotretinoin.

The overall U.S. isotretinoin market continues to grow, with prescriptions increasing by 4% in 2014 versus 2013 (source: IMS). Total U.S. isotretinoin prescriptions increased in Q4 2014 compared to Q3 and Q2 2014, which is consistent with predictable historical seasonal patterns seen in the isotretinoin market for over 20 years.

In September 2013, Ranbaxy received a Paragraph IV Certification Notice of filing from Watson Laboratories, Inc. (now Actavis) of an Abbreviated New Drug Application ("ANDA") to the FDA for a generic version of Absorica. Ranbaxy and Cipher intend to vigorously defend Absorica's intellectual property rights and pursue all available legal and regulatory pathways in defense of the product. The costs of the proceeding are being borne by Ranbaxy. The Markman (pre-trial) hearing is scheduled for April 2, 2015.

Absorica is currently protected by three issued patents, two of which are listed in the FDA's Approved Drug Products List (Orange Book), which expire in September 2021. There are two additional new product patent applications pending with the U.S. Patent and Trademark Office.

Cipher has been advised by Ranbaxy that the Paragraph IV filing has no impact on the current sales and marketing plans for the product and that Ranbaxy plans to continue to invest significantly in Absorica.

Epuris

Epuris was approved by Health Canada in Q4 2012 and launched by Cipher in June 2013. The Company has deployed a field sales force of seven representatives. In the 15-month period following launch, Epuris achieved market penetration of 15.5% as of December 2014 (source: IMS) with 40% growth in net sales in Q4 2014 compared to Q3 2014. Feedback from the Canadian dermatology community continues to be encouraging.

LIPOFEN® (CIP-FENOFIBRATE):

Lipofen was launched in the U.S. market in late 2007 and prescriptions have grown as Kowa increased coverage of the primary care physicians in its targeted regions and expanded its sales force, which has grown to approximately 250 representatives. During Q2 2014, Cipher and Kowa agreed to preemptively launch an authorized generic version of Lipofen in advance of the expiration of the product patent in January 2015. Combined performance for the product during Q4 2014 was encouraging and total prescriptions (Lipofen plus the authorized generic) remained stable compared to the preceding quarter.

CONZIP® / DURELA® (CIP-TRAMADOL ER):

ConZip

ConZip, the Company’s extended-release tramadol product for the treatment of moderate to moderately severe chronic pain in adults, received FDA approval in 2010. In Q2 2011, Cipher entered into a distribution and supply agreement with Vertical, a U.S.-based specialty pharmaceutical company. Cipher receives a royalty on net sales in the mid-teens and is eligible to receive future sales milestone payments, contingent upon the achievement of certain future net sales targets.

ConZip was launched by Vertical in September 2011 with a dedicated sales force of 60 representatives. Vertical’s sales force has reached 75 representatives and in 2013, Avista Capital Partners, a U.S.-based private equity firm, acquired a controlling equity interest in Vertical. In Q4 2014, ConZip prescriptions increased by 10% compared to Q4 2013.

Durela

In Q3 2011, Cipher received Health Canada approval for Durela and completed a Canadian distribution and supply agreement with Medical Futures. Cipher receives a double-digit royalty on net sales and is eligible to receive future milestone payments contingent upon the achievement of cumulative net sales targets. Medical Futures launched the product in March 2012 with a dedicated sales

force of 22 representatives and achieved a market share of 4.9% by the end of 2014. Sales of Durela in Q4 2014 were 18% higher than Q4 2013 and for the full year 2014, sales were 44% higher than 2013.

NEW PRODUCTS AND OUT-LICENSING ACTIVITIES:

In Q3 2012, Cipher obtained exclusive license and distribution rights in Canada to market the Beteflam Patch (previously named the Betesil Patch), a novel, patent-protected, self-adhesive medicated plaster for the treatment of inflammatory skin conditions such as plaque psoriasis, from Institut Biochemique SA (“IBSA”). Based on feedback from Canadian dermatologists, the Beteflam Patch is expected to provide distinct advantages over existing treatment options, particularly for patients who suffer from plaque psoriasis in hard to treat areas such as knees and elbows. The efficacy and safety of the product has been established in two successful European phase III trials and one successful phase IV trial conducted by IBSA and it is currently marketed in several European countries. In Q4 2014 Cipher submitted the Beteflam regulatory package, which successfully passed screening and is under review by Health Canada.

In December 2014, Cipher acquired the assets of Melanovus Oncology Inc. ("Melanovus"), a Pennsylvania-based life sciences company. The assets include seven pre-clinical compounds for the treatment of melanoma and other cancers. The lead product candidate, Nanolipolee-007, is a liposomal formulation of a plant-derived compound that is a first-in-class cholesterol-transport inhibitor which has demonstrated anti-proliferative activity against certain melanoma cell lines (including B-raf resistant strains) in-vitro as well as in early in-vivo mouse studies. Cipher will pursue pre-clinical studies leading to Investigational New Drug status with the FDA, Health Canada and other health authorities. The plan for the development of the remaining compounds in the portfolio has not yet been established.

Subsequent to year end, Cipher in-licensed the Canadian rights to Ozenoxacin, a topical treatment for adult and paediatric patients with impetigo, from Ferrer, a privately-held Spanish pharmaceutical company. Ferrer commenced a second phase III trial of Ozenoxacin in June 2014. The multicenter, randomized, double-blinded, clinical study comparing Ozenoxacin one per cent cream versus placebo will be conducted in approximately 412 patients aged two months and older with a clinical diagnosis of non-bullous or bullous impetigo. Ferrer anticipates that the second phase III trial will be completed by the end of Q1 2015.

Cipher continues to pursue marketing partners for CIP-ISOTRETINOIN in other territories, including Latin America. In Q2 2014, Cipher entered into a distribution and supply agreement with Laboratorios Andrómaco S.A. ("Andrómaco") under which Cipher granted Andrómaco the exclusive right to market, sell and distribute Cipher's isotretinoin capsules in Chile. With over 70 years of experience, Andrómaco is a leader in the production and marketing of pharmaceutical products in Chile and certain other Latin American countries. Once regulatory approval is granted, it is expected that Cipher's product will be marketed under the brand name Lisacne-CIP, replacing Andrómaco's current isotretinoin product, Lisacne. Andrómaco is majority owned by Grünenthal GmbH, Germany. Under the terms of the agreement, Cipher will supply finished product to Andrómaco and product manufacturing will be fulfilled by Cipher's partner, Galephar.

In Q3 2014, Cipher entered into a definitive distribution and supply agreement with Ranbaxy SA under which Cipher has granted Ranbaxy SA the exclusive right to market, sell and distribute Cipher’s isotretinoin capsules in Brazil. Ranbaxy SA plans to promote the product through a brand dermatology division in Brazil. Cipher’s isotretinoin formulation is expected to be the flagship product in Ranbaxy SA’s dermatology franchise in Brazil, once it achieves regulatory approval. Brazil is the largest isotretinoin market in Latin America, with annual sales exceeding $50 million, and the market has been growing steadily. Under the terms of the agreement with Ranbaxy SA, Cipher has received an up-front payment and is eligible for additional pre-commercial milestone payments. Cipher will supply the finished product to Ranbaxy SA and product manufacturing will be done by Cipher's partner, Galephar. Ranbaxy SA will be responsible for all regulatory-related activities associated with gaining and maintaining regulatory approval of the product in Brazil.

In addition, the Company is pursuing the acquisition or in-licensing of new late-stage to commercial-stage dermatology product candidates.

Growth Strategy

In addition to anticipated growth from our existing products and licensing agreements, led by Absorica, we have built a commercial sales and marketing presence in Canada and our lead product, Epuris, was launched in June 2013. This will be complemented by the Beteflam Patch, should it receive Health Canada approval. In addition, Cipher plans to use its established infrastructure in Canada to add dermatology products through product development and/or acquisitions. In January 2015, the Company announced the acquisition of the Canadian commercial rights for the novel antibacterial compound Ozenoxacin for the treatment of impetigo, The Company also plans to use its proven clinical development capabilities to in-license and develop dermatology assets for North America and expand its commercial infrastructure in the U.S. and Canada accordingly. In late Q4 2014, the Company acquired seven pre-clinical compounds for the treatment of melanoma and other cancers from Melanovus, including the related intellectual

property from The Penn State Research Foundation. Lastly, we plan to continue to leverage our regulatory approvals in the U.S. and Canada to pursue licensing agreements in other markets for our isotretinoin and tramadol products, where economically viable.

NASDAQ Listing

In Q4 2014 Cipher was successful in obtaining approval for a listing on NASDAQ and trading on the NASDAQ Global Market commenced on November 24, 2014 under the symbol "CPHR". In conjunction with the NASDAQ listing, the Company changed its trading symbol on the TSX from "DND" to "CPH". As the Company executes its growth strategy, a NASDAQ listing should provide access to a broader range of investors and, over time, greater liquidity.

Selected Annual Information

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

FINANCIAL INFORMATION (IN THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS):

For the years ended December 31,

	2014	2013	2012
Total revenue	32,287	27,011	8,458
Income	20,651	24,967	2,544
Basic earnings per share	0.82	1.02	0.10
Diluted earnings per share	0.79	0.97	0.10
Total assets	76,689	55,550	21,955

The fluctuations in reported results during these periods resulted primarily from the following factors:

- Following the launch of Absorica in late 2012, revenue from 2013 forward reflects the impact of the growing revenue stream from this product;
- In 2013, a US$5 million milestone was earned based on the cumulative net sales of Absorica;
- In 2013, the Company recognized a deferred tax asset that contributed $6.6 million to net income; and
- In 2014, the Company recognized a deferred tax asset that contributed $0.3 million to net income.

Review of Operating Results

REVENUE (IN THOUSANDS OF DOLLARS):

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
Licensing revenue	30,218	26,596	3,622	14
Product revenue	2,069	415	1,654	399

Total revenue in 2014 was $32.3 million compared to $27.0 million in 2013, an increase of 20%. The main growth drivers were continued growth from the Company's isotretinoin products, Absorica in the U.S. and Epuris in Canada. The Company's 2013 results included a $5.3 million non-recurring milestone. Adjusting for the impact of this non-recurring item, year-over-year total revenue growth was 49%.

In Q4 2014, total revenue was $8.5 million compared to $7.2 million in the comparable period last year (adjusted for the non-recurring item), an increase of 18% over the prior period.

Revenue for Absorica was $22.5 million in 2014, compared to $15.9 million in 2013 (adjusted for the non-recurring milestone). The 42% growth in revenue was driven by steady market penetration during 2014 compared to 2013 as well as continued growth in the overall U.S. isotretinoin market.

Revenue for Lipofen was $5.6 million in 2014, an increase of $2.2 million or 65% compared to 2013. An authorized generic version of the product was launched by Cipher's U.S. marketing partner in Q2 2014, and the product continues to perform well.

Revenue from the Company's extended-release tramadol product (ConZip in the U.S. and Durela in Canada) was $2.1 million in 2014, compared to $2.0 million in 2013.

Epuris was launched in June 2013 and is the first product marketed by Cipher's Canadian sales and marketing organization. Product revenue for Epuris was $2.1 million in 2014, a five-fold increase over 2013 as the market share grew from 5.5% at the end of 2013 to 15.5% at the end of 2014. Cost of product sold was $563 thousand for the year and the product realized a gross margin of 73% for the year.

RESEARCH AND DEVELOPMENT EXPENSE (IN THOUSANDS OF DOLLARS):

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
Research and development	1,227	1,389	(162)	(12)

Research and development ("R&D") expense represents the cost of the Company's drug development activities. R&D expense during 2014 was $1.2 million, compared to $1.4 million in 2013.

SELLING AND MARKETING EXPENSE (IN THOUSANDS OF DOLLARS):

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
Selling and marketing	2,285	2,048	237	12

Selling and marketing expense in Q4 2014 was $0.6 million, compared to $0.4 million in the fourth quarter of 2013. The increase in 2014 reflects additional sales and marketing efforts towards Epuris promotion in Canada.

For the year ended December 31, 2014, selling and marketing expense was $2.3 million, an increase of $0.2 million, compared to 2013. The Canadian sales and marketing organization infrastructure related to Epuris was in place for the full year in 2014 whereas in 2013 it was only in place for eight months, offset by the one-time product launch expenses incurred for Epuris in 2013.

GENERAL AND ADMINISTRATIVE EXPENSE ("G&A") (IN THOUSANDS OF DOLLARS):

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
General and administrative	7,673	4,166	3,507	84

G&A expense in Q4 2014 was $2.6 million, compared to $1.0 million in the fourth quarter of 2013. The increase in G&A reflects additional resources for business development activities as well as increased stock option expense due to the increase in the share price compared to the prior year. In addition, certain expenses were incurred in Q4 2014 related to the NASDAQ listing approval, the product acquisitions announced in January and other initiatives related to future growth opportunities for the Company.

For the year ended December 31, 2014, G&A expense was $7.7 million, an increase of $3.5 million, compared to 2013. In addition to the items in Q4 2014 described above, $1.3 million in severance costs were incurred in 2014 related to the departure of the former President and CEO as well as one other executive officer.

AMORTIZATION OF INTANGIBLE ASSETS (IN THOUSANDS OF DOLLARS):

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
Amortization of intangible assets	758	1,108	(350)	(32)

The Company began amortizing the intangible rights for CIP-TRAMADOL ER in Q3 2011, and for CIP-ISOTRETINOIN amortization began in Q1 2009. The decrease in amortization expense in 2014 is a result of extending the estimated period of useful life for the tramadol product by one additional year.

Intangible assets have a finite life and are amortized using the straight-line method over their estimated period of useful life. Intangible assets are reviewed for impairment when events or other changes in circumstances indicate that the carrying amount of the assets may not be recoverable.

INTEREST INCOME (IN THOUSANDS OF DOLLARS):

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
Interest income	540	253	287	113

Interest is earned on the Company's cash and cash equivalents balance. The increase in interest income in 2014 compared to 2013 was a result of significantly higher cash balances during the year and a slight improvement in interest rates available.

ADJUSTED EBITDA (IN THOUSANDS OF DOLLARS):

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
ADJUSTED EBITDA	22,403	20,044	2,359	12

EBITDA is a non-IFRS financial measure. The term EBITDA (earnings before interest, taxes, depreciation and amortization) does not have any standardized meaning under IFRS and therefore may not be comparable to similar measures presented by other companies. Cipher defines Adjusted EBITDA as earnings before interest expense, income taxes, depreciation of property and equipment, amortization of intangible assets and non-cash share-based compensation.

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

The following is a summary of how EBITDA and Adjusted EBITDA are calculated (in thousands of dollars):

	2014	2013
Net income	20,651	24,967
Add back (deduct)		
Depreciation	16	16
Amortization	758	1,108
Deferred tax	(330)	(6,556)
EBITDA	21,095	19,535
Plus: Share-based compensation	1,308	509
Adjusted EBITDA	22,403	20,044

Adjusted EBITDA in 2014 was $22.4 million, an increase of $2.4 million over 2013, reflecting the increase in revenue compared to the prior year. If the one-time milestone of $5.3 million is deducted from 2013 Adjusted EBITDA, the year-over-year the increase was 52%.

INCOME TAXES:

Management uses estimates when determining deferred income taxes. These estimates are used to determine the recoverability of tax loss carry forward amounts, research and development expenditures and investment tax credits. Significant judgment is required regarding future profitability of the Company to be able to recognize deferred taxes. Changes in market conditions, changes in tax legislation, patent challenges and other factors, including the approval or launch of generic versions of any of the Company's products, could adversely affect the ongoing value of deferred taxes. The carrying amount of deferred income tax assets is reassessed at each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to utilize all or part of the deferred income tax assets. Unrecognized deferred income tax assets are reassessed at each reporting period and are recognized to the extent that it is probable that there will be sufficient taxable profits to allow all or part of the asset to be recovered.

In 2014, as a result of certain positive market conditions for existing products, the Company recognized an additional deferred tax asset on the balance sheet of $5.1 million and a corresponding tax recovery on the statement of earnings and comprehensive income. In 2014, deferred income tax expense of $4.8 million was recorded, resulting in a net deferred tax balance of $6.9 million as of December 31, 2014.

The Company has approximately $6.0 million of unrecognized deferred income tax assets, which have not been recognized in the financial statements. These assets consist of intangible assets and investment tax credits which are available to reduce taxable income in future years.

EARNINGS PER SHARE:

For the years ended December 31,

	2014	2013	$ change in 2014	% change in 2014
Income - in thousands of dollars	20,651	24,967	(4,316)	(17)
Basic earnings per share	0.82	1.02		
Diluted earnings per share	0.79	0.97		

Basic earnings per share is calculated using the weighted average number of shares outstanding during the year. Diluted earnings per share is calculated taking into account dilutive instruments, such as options, that are outstanding.

Net income in Q4 2014 was $3.6 million, or $0.14 per basic share, compared to net income of $17.0 million, or $0.69 per basic share in Q4 2013.

Net income in 2014 was $20.7 million, or $0.82 per basic share, compared to net income of $25.0 million, or $1.02 per basic share in 2013. In 2013, the Company recognized a deferred tax asset of $6.6 million in Q4 and also earned a $5.3 million one-time sales milestone for Absorica. Excluding the impact of these two items, net income in 2013 would have been $13.1 million, or $0.53 per basic share. On a like-to-like basis, the aforementioned $0.53 earnings per share for 2013 compares to $0.81 for 2014.

The weighted average number of shares outstanding for the year ended December 31, 2014 was 25,336,068 (2013 - 24,558,716).

Summary of Quarterly Results

QUARTERLY STATEMENTS OF INCOME (IN THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS):

For the year ended December 31, 2014

	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014 Total
Licensing revenue	7,539	8,237	6,699	7,743	30,218
Product revenue	340	498	512	719	2,069
Cost of product sold	100	149	135	179	563
Research & development	358	306	267	296	1,227
Selling and marketing	513	605	552	615	2,285
General and administrative	1,795	1,672	1,568	2,638	7,673
Amortization of intangible assets	190	189	189	190	758
Interest income	103	121	146	170	540
Income before income taxes	5,026	5,935	4,646	4,714	20,321
Income tax expense (recovery)	1,160	1,430	(4,010)	1,090	(330)
Income	3,866	4,505	8,656	3,624	20,651
Basic earnings per share	0.15	0.18	0.34	0.14	0.82
Diluted earnings per share (1)	0.15	0.17	0.33	0.14	0.79

(1) Due to rounding, earnings per share for individual quarters may not sum to earnings per share for the year

For the year ended December 31, 2013

	Q1	Q2	Q3	Q4	2013 Total
Licensing revenue	3,293	5,459	5,592	12,252	26,596
Product revenue	-	88	44	283	415
Cost of product sold	-	27	12	103	142
Research & development	308	341	388	352	1,389
Selling and marketing	373	742	497	436	2,048
General and administrative	889	1,159	1,163	955	4,166
Amortization of intangible assets	277	277	277	277	1,108
Interest income	55	60	64	74	253
Income before income taxes	1,501	3,061	3,363	10,486	18,411
Recovery of income taxes	-	-	-	6,556	6,556
Income	1,501	3,061	3,363	17,042	24,967
Basic earnings per share	0.06	0.13	0.14	0.69	1.02
Diluted earnings per share	0.06	0.12	0.13	0.66	0.97

For the year ended December 31, 2012

	Q1	Q2	Q3	Q4	2012 Total
Licensing revenue	1,811	1,629	2,118	2,900	8,458
Research & development	471	348	335	363	1,517
Selling, general and administrative	1,016	861	799	851	3,527
Amortization of intangible assets	225	245	277	278	1,025
Interest income	26	35	47	47	155
Income	125	210	754	1,455	2,544
Basic and diluted earnings per share (2)	0.01	0.01	0.03	0.06	0.10

(2) Due to rounding, earnings per share for individual quarters may not sum to earnings per share for the year

The fluctuations in reported results for the last eight quarters resulted primarily from the following factors:

- Licensing revenue reflects the impact of the growing revenue stream from Absorica;
- Product revenue reflects the growth in market penetration for Epuris in which was launched in Canada in mid-2013 and is the only product currently sold directly by the Company;
- In Q4 2013, a US$5 million milestone was earned, based on the cumulative sales of Absorica;
- In Q4 2013, the Company recognized a deferred tax asset, which contributed $6.6 million to net income. This represents an EPS impact of $0.27 per basic share;
- In Q3 2014, the Company recognized a deferred tax asset, which contributed $5.1 million to net income. This represents an EPS impact of $0.20 per basic share; and
- In Q4 2014, the Company incurred SG&A expenses of approximately $0.8 million related to the NASDAQ listing, product acquisition costs and other expenses related to growth opportunities.

Liquidity and Capital Resources

As at December 31, 2014, the Company has cash and cash equivalents of $52.6 million, compared to $47.6 million as at September 30, 2014 and $24.2 million as at December 31, 2013. The Company's continued strong EBITDA performance resulted in the $5.0 million increase in cash in the fourth quarter.

The balance of accounts receivable was $14.3 million at December 31, 2014, compared to $22.5 million as at December 31, 2013. During Q1 2014 a US$10 million milestone for Absorica was collected.

The balance of accounts payable and accrued liabilities was $11.3 million at December 31, 2014 compared to $12.4 million as at December 31, 2013. During Q1 2014, the 50% share of the US$10 million milestone was paid to the Company's commercial partner (Galephar).

Deferred revenue relates to amounts received in advance of recognition as revenue. The balance of $2.7 million at December 31, 2014 relates to the up-front licensing payments and pre-commercialization milestone payments received by Cipher under the CIP-ISOTRETINOIN and CIP-TRAMADOL ER distribution and supply agreements, net of revenue recognized to date. The deferred revenue balance at December 31, 2013 was $4.4 million and the decrease in 2014 relates to revenue recognized during the year.

Future cash requirements will depend on a number of factors, including 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.

As at December 31, 2014, there are no capital lease contractual obligations. The only significant operating lease contractual obligations are related to the Company's office location. The lease for the Company's current premises expires in May 2015 and the new lease, which commences June 1, 2015, expires at the end of December 2018.

Share Capital

The Company is authorized to issue an unlimited number of preference shares, issuable in series, and an unlimited number of voting common shares. At December 31, 2014 the Company had 25,672,699 common shares issued and outstanding. Subsequent to year-end, 217,081 common shares were issued under the Company option plan and 2,036 common shares were issued under the employee and director share purchase plan, bringing the total number of common shares issued and outstanding to 25,891,816 as of the date of this MD&A.

A total of 516,000 stock options were granted during 2014, with exercise prices of $8.13, $7.43 and $8.76. During the year, 668,058 shares were issued as a result of the exercise of stock options and 28,680 shares were issued under the employee and director share purchase plan.

Share-based compensation expense in 2014 was $1.3 million, compared to $0.5 million in 2013, which reflects the impact of the increase in the Company's share price on share-based compensation expense for the newly-granted stock options.

Galephar Pharmaceutical Research Inc.

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 territories. In accordance with the Agreement, the Company retains 50% of all revenue from licensing and distribution arrangements with respect to the CIP Products, with the other 50% due to Galephar. Where the Company has opted to market and sell a CIP Product directly in a territory, the Company pays a royalty 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.

Critical Accounting Estimates

A summary of significant accounting policies is included in Note 3 of the Company's 2014 audited financial statements. Critical accounting estimates require management to make certain judgments and estimates, which may differ from actual results. Accounting estimates are based on historical experience and other factors that management believes to be reasonable under the time frame and circumstances. Changes in management's accounting estimates can have a material impact on the financial results of the Company. The Company's critical accounting estimates are included in Note 4 of the Company's 2014 audited financial statements and are described below.

REVENUE RECOGNITION:

Management evaluates the multiple elements and units of accounting which are included within certain licensing and distribution agreements. The recognition of revenue on up-front licensing payments and pre-commercialization amounts are over the estimated period that the Company maintains contractual obligations. The estimated periods are reviewed at least annually and are updated if expectations change as a result of licensing partner interactions, product commercial obsolescence or other factors. It is possible that these factors may cause significant changes in the Company's recognition of revenue in the future.

DEFERRED INCOME TAXES:

Management uses estimates when determining deferred income taxes. These estimates are used to determine the recoverability of tax loss carry forwards, research and development expenditures and investment tax credits. Significant judgment is required to determine the probable future cash flows in order to recognize the deferred tax asset. Changes in market conditions, changes in tax legislation, patent challenges and other factors, including the approval or launch of generic versions of any of the Company's products, could adversely affect the ongoing value of deferred tax assets. The carrying amount of deferred income tax assets is reassessed at each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to utilize all or part of the deferred income tax assets. Unrecognized deferred income tax assets are reassessed at each reporting period and are recognized to the extent that it is probable that there will be sufficient taxable income for the asset to be recovered.

INTANGIBLE ASSETS:

Management estimates the useful lives of intangible assets based on the period during which the assets are expected to be available for use and also estimates their recoverability to assess if there has been an impairment. The amounts and timing of recorded expenses for amortization and impairments of intangible assets for any period are affected by these estimates. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence, generic threats and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's intangible assets in the future.

FUNCTIONAL CURRENCY:

Management uses judgment when determining its functional currency. This determination includes an assessment of the indicators as prescribed in IAS 21, *The Effects of Changes in Foreign Exchange Rates*. However, applying the factors in IAS 21 does not always result in a clear indication of functional currency. Where IAS 21 factors indicate differing functional currencies, management uses judgment in the ultimate determination of the functional currency. Significant judgment is required in this overall assessment of the indicators and determination of the Company's functional currency.

Financial Instruments

CREDIT RISK EXPOSURE:

The only financial instruments that potentially subject the Company to credit risk are accounts receivable. The collectability of accounts receivable is reviewed on a regular basis.

FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES:

The fair values of accounts receivable, accounts payable and accrued liabilities included in the balance sheets approximate their carrying amounts due to the relatively short period of maturity of the instruments.

FOREIGN EXCHANGE FORWARD CONTRACTS:

The Company may enter into foreign exchange forward contracts to minimize transaction exposures and the resulting volatility in earnings. To mitigate exchange-rate risk, the Company may utilize foreign exchange forward contracts. During the fourth quarter of 2014, the Company entered into a foreign exchange forward contract related to certain licensing revenues of US$4 million which were earned during the quarter. The contract matured on February 12, 2015 at an exchange rate of 1.1598 against the U.S. dollar. The foreign exchange forward contract has been marked-to-market as at December 31, 2014 resulting in an insignificant foreign exchange loss.

Business Risks

FINANCIAL:

As at December 31, 2014, the Company had cash and cash equivalents of $52.6 million. The Company expects these funds will be sufficient to fund current product development and operating costs.

PATENT INFRINGEMENT:

There has been substantial litigation in the pharmaceutical industry concerning the manufacture, use and sale of new products that are the subject of conflicting patent rights. Regardless of FDA approval, should anyone commence a lawsuit with respect to any alleged patent infringement by the Company, the uncertainties inherent in patent litigation make the outcome of such litigation difficult to predict.

While the Company's products are patented and listed in the FDA Orange Book, the patents can be challenged and generic products can be approved under an Abbreviated New Drug Application ("ANDA"). In the United States, under the "Hatch-Waxman Act", the FDA can approve an ANDA, for a generic version of a branded drug. In place of clinical studies, an ANDA applicant usually needs only to submit pharmacokinetic data demonstrating that its product has the same active ingredient(s) and is bioequivalent to the branded product. This is referred to as the ANDA process. The "Hatch-Waxman Act" requires an applicant for a drug that relies, at least in part, on the patent of a branded drug, to notify the sponsor of the branded drug of their application and potential infringement of a patent. Upon receipt of this notice, the sponsor of the branded drug has 45 days to bring a patent infringement suit in federal district court against the applicant seeking approval of a product covered by the patent. If such a suit is

commenced and the ANDA was filed after the patent had been listed in the FDA Orange Book, then the FDA is generally prohibited from granting approval of the ANDA until the earliest of 30 months from the date the FDA accepted the application for filing, or the conclusion of litigation in the generic's favour, or expiration of the patent. The approval or launch of generic versions of any of the Company's products in any market could have an adverse effect on the Company's future revenues.

Information related to the Paragraph IV filing by Watson Laboratories, Inc. (now Actavis) is included in a previous section of this MD&A.

CONCENTRATION OF REVENUE:

A significant proportion of the Company's revenue is currently derived from one customer. The loss of that source of revenue for any reason would have a significant impact on the future cash flow and the financial position of the Company.

PRODUCT:

The Company’s products are manufactured by third parties and, except for Epuris, are sold by distribution partners. Should a product recall for regulatory or quality reasons occur, the cost of such recall and the potential interruption of the Company’s revenues streams could have an adverse effect on the financial results of the Company.

DEPENDENCE ON STRATEGIC PARTNERSHIPS AND LICENSEES:

The Company's success depends, in large measure, on its ability to conclude in-licensing, development, manufacturing, marketing, and distribution agreements with other pharmaceutical companies. Factors that may affect the success of the Company's collaborative efforts with pharmaceutical company partners include the following:

- The Company's partners may be pursuing alternative technologies or developing alternative products, either on their own or in collaboration with others, that may be competitive with the products on which they are collaborating with the Company, which could affect their commitment to the Company's product development efforts;
- The Company's technology/manufacturing partners may not be able to adequately supply its products in commercial quantities, which would adversely affect revenues. The Company’s manufacturing partner, Galephar, currently manufactures all of the Company’s products. In the event of an extended supply disruption at the Galaphar manufacturing facilities in Puerto Rico, there would be an adverse impact on Cipher’s financial perfomance;
- Reductions in marketing or sales efforts or a discontinuation of marketing or sales of the Company's products by its commercial partners may reduce future revenues, which are based on a percentage of net sales by these partners; and
- The collaboration agreements with the Company’s partners can be terminated by either party in the case of a material default in the terms of the agreements. Should one of these agreements be terminated, it could be difficult for the Company to attract new partners and it may adversely affect how the Company is perceived in the business and financial communities.

The development of pharmaceutical products is a process that requires large investments and can take years to complete. Projects can be abandoned along the way or regulatory authorities can refuse to approve new products. With respect to projects the Company initiates, the Company will attempt to minimize risk through the judicious selection of product candidates.

DEPENDENCE ON CROs:

The Company’s contract research organization providers (“CROs”) depend on strict government regulation of the pharmaceutical research process, particularly in the U.S., where there has been a continuing trend towards increased regulation. Any changes in regulation, including a relaxation in regulatory requirements or the introduction of a simplified drug approval procedure, could materially and adversely affect the demand for the services offered by the Company. The failure by the Company or its CROs to comply with applicable regulations could result in the termination of ongoing research or the disqualification of data for submission to regulatory authorities. Furthermore, the issuance of a notice of filing by the FDA to either the Company or its suppliers based upon a material violation by the Company or its suppliers of Good Clinical Practice standards or Good Laboratory Practice standards could materially and adversely affect the Company.

REGULATION:

The cost of complying with government regulation can be substantial. Government authorities in the U.S., Canada and comparable authorities in foreign countries also regulate the research and development, manufacture, testing, and safety of pharmaceutical products, as well as the approval and commercialization of such products. The regulations applicable to the Company's existing

and future products may change. There can be long delays in obtaining required clearances from regulatory authorities in any country after applications are filed. Government agencies in the U.S., Canada and other countries in which the Company intends to carry on business regulate pharmaceutical products intended for human use. Regulations require extensive clinical trials and other testing and government review and final approval before the Company can market its products.

Requirements for approval vary widely from country to country outside of the U.S. and Canada. Whether or not approved in the United States or Canada, regulatory authorities in other countries must approve a product prior to the commencement of marketing the product in those countries. The time required to obtain any such approval may be longer or shorter than in the U.S. and Canada.

Any failure or delay in obtaining regulatory approvals could adversely affect the market for any products the Company develops and therefore its business, results of operations, financial condition and cash flows.

Disclosure Controls and Procedures

Cipher's management is responsible for establishing and maintaining disclosure controls and procedures to ensure that information required to be disclosed to satisfy the Company's continuous disclosure obligations is recorded, processed, summarized and reported as required by applicable Canadian securities legislation. Management has carried out an evaluation of the effectiveness as of December 31, 2014 of the design and operation of the disclosure controls and procedures, as defined in *National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings*, under the supervision and with the participation of the President and Chief Executive Officer ("CEO"), and the Chief Financial Officer ("CFO"). Based on this evaluation, the CEO and CFO concluded that the disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by the Company to satisfy its continuous disclosure obligations and are effective in ensuring that information required to be disclosed in the reports that the Company files is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Board of Directors has reviewed and approved the Company's policy regarding corporate Disclosure Controls and Procedures. Management has certified that as at December 31, 2014 the design and operation of the disclosure controls and procedures continues to be effective.

Cipher's management is responsible for designing and implementing internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's reporting and the preparation of financial statements for external purposes in accordance with IFRS. As required under *National Instrument 52-109*, the Company, under the supervision and with the participation of the CEO and the CFO, has carried out a review of its internal controls over financial reporting. Based on this evaluation, the Company's CEO and CFO concluded that the Company has designed and implemented such internal controls over financial reporting so as to provide reasonable assurance regarding the reliability of the Company's reporting and the preparation of financial statements for external purposes and that there were no changes in the Company's internal control over financial reporting that occurred during the year ended December 31, 2014 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting. In assessing its internal controls over financial reporting, the Company utilizes the Internal Control - Integrated Framework (1992) as released by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). In 2013, COSO released the Internal Control - Integrated Framework (2013). As at December 31, 2014, the Company continues to utilize the 1992 framework, and has implemented a plan to change over to the Internal Control - Integrated Framework (2013) by Q2 2015.

Independent Auditor's Report

To the Shareholders of
Cipher Pharmaceuticals Inc.

We have audited the accompanying financial statements of Cipher Pharmaceuticals Inc., which comprise the balance sheets as at December 31, 2014 and December 31, 2013 and the statements of earnings and comprehensive income, changes in equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

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

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

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

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

Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of Cipher Pharmaceuticals Inc. as at December 31, 2014 and December 31, 2013 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

(Signed) "PricewaterhouseCoopers LLP"

Chartered Professional Accountants, Licensed Public Accountants

Oakville, Ontario
February 24, 2015

Cipher Pharmaceuticals Inc.

Balance Sheets

As at December 31
(in thousands of Canadian dollars)

	Note	2014	2013
		$	$
ASSETS			
Current assets			
Cash and cash equivalents		52,631	24,179
Accounts receivable	6,7	14,316	22,507
Inventory		240	311
Prepaid expenses and other assets		881	391
		68,068	47,388
Property and equipment, net	8	26	24
Intangible assets, net	9	1,709	1,582
Deferred tax asset	14	6,886	6,556
Total Assets		76,689	55,550
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities	6,7,10	11,255	12,398
Current portion of deferred revenue		1,527	2,280
		12,782	14,678
Deferred revenue		1,168	2,114
Total Liabilities		13,950	16,792
SHAREHOLDERS' EQUITY			
Share capital	11	14,217	10,696
Contributed surplus		2,904	3,095
Retained earnings		45,618	24,967
Total Shareholders' Equity		62,739	38,758
Total Liabilities and Shareholders' Equity		76,689	55,550

The accompanying notes are an integral part of these financial statements

Approved on behalf of the Board:

(signed) "Gerald McDole"

Gerald McDole
Chair of the Board

(signed) "Stephen R. Wiseman"

Stephen R. Wiseman
Director

Cipher Pharmaceuticals Inc.

Statements of Earnings and Comprehensive Income

For the years ended December 31
(in thousands of Canadian dollars, except per share data)

	Note	2014	2013
		$	$
Revenues			
Licensing revenue	7	30,218	26,596
Product revenue		2,069	415
		32,287	27,011
Expenses			
Cost of product sold		563	142
Research and development		1,227	1,389
Selling and marketing		2,285	2,048
General and administrative		7,673	4,166
Amortization of intangible assets		758	1,108
Interest income		(540)	(253)
	12	11,966	8,600
Income before income taxes		20,321	18,411
Recovery of income taxes	14	(330)	(6,556)
Income and comprehensive income for the year		20,651	24,967
Basic earnings per share	15	0.82	1.02
Diluted earnings per share	15	0.79	0.97

The accompanying notes are an integral part of these financial statements

Cipher Pharmaceuticals Inc.

Statements of Changes in Equity

For the years ended December 31
(in thousands of Canadian dollars)

	Note	Share Capital	Contributed Surplus	Retained Earnings (Deficit)	Total Shareholders' Equity
		$	$	$	$
Balance, January 1, 2014		10,696	3,095	24,967	38,758
Income and comprehensive income for the year		-	-	20,651	20,651
Exercise of stock options		3,199	(1,451)	-	1,748
Shares issued under the share purchase plan		322	-	-	322
Share-based compensation - stock option plan		-	1,260	-	1,260
Balance, December 31, 2014		14,217	2,904	45,618	62,739
Balance, January 1, 2013		50,339	33,227	(71,160)	12,406
Income and comprehensive income for the year		-	-	24,967	24,967
Exercise of stock options		1,335	(614)	-	721
Shares issued under the share purchase plan		182	-	-	182
Share-based compensation - stock option plan		-	482	-	482
Reduction of stated capital	11	(41,160)	(30,000)	71,160	-
Balance, December 31, 2013		10,696	3,095	24,967	38,758

The accompanying notes are an integral part of these financial statements

Cipher Pharmaceuticals Inc.

Statements of Cash Flows

For the years ended December 31
(in thousands of Canadian dollars)

	Note	2014	2013
		$	$
Cash provided by (used in)			
Operating activities			
Income for the year		20,651	24,967
Items not affecting cash:			
Depreciation of property and equipment	8	16	16
Amortization of intangible assets	9	758	1,108
Share-based compensation - share purchase plan	11	48	27
Share-based compensation - stock option plan	11	1,260	482
Deferred tax	14	(330)	(6,556)
		22,403	20,044
Changes in non-cash operating items:			
Accounts receivable	7	8,191	(19,322)
Inventory		71	(311)
Prepaid expenses and other assets		(490)	(179)
Accounts payable and accrued liabilities	7	(1,143)	9,590
Deferred revenue		(1,699)	(2,347)
Net cash generated from operating activities		27,333	7,475
Investing activities			
Purchase of property and equipment	8	(18)	(15)
Acquisition of intangible assets	9	(885)	-
Net cash used in investing activities		(903)	(15)
Financing activities			
Proceeds from shares issued under the share purchase plan	11	274	155
Proceeds from exercise of stock options	11	1,748	721
Net cash generated from financing activities		2,022	876
Increase in cash and cash equivalents		28,452	8,336
Cash and cash equivalents, beginning of year		24,179	15,843
Cash and cash equivalents, end of year		52,631	24,179

The accompanying notes are an integral part of these financial statements

1 NATURE OF OPERATIONS

Cipher Pharmaceuticals Inc. ("Cipher" or "the Company") is a specialty pharmaceutical company focused on dermatology. Cipher acquires products that fulfill high unmet medical needs, manages the required clinical development and regulatory approval process, and markets those products either directly or through partners. Cipher is building its dermatology franchise through product licensing and acquisitions. Cipher was incorporated under the Business Corporations Act of Ontario on January 9, 2004 and is located at 5650 Tomken Boulevard, Mississauga, Ontario.

2 BASIS OF PREPARATION

The Company prepares its financial statements in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board. The Board of Directors approved these financial statements on February 24, 2015.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies used in the preparation of these financial statements are described below.

Basis of measurement

The financial statements have been prepared under the historical cost convention, except for certain financial instruments, which are measured at fair value as described below.

Translation of foreign currencies

The financial statements are presented in Canadian dollars, which is the Company's functional currency. Revenues and expenses denominated in foreign currencies are translated into Canadian dollars using the exchange rate in effect at the transaction date. Monetary assets and liabilities are translated using the rate in effect at the balance sheet date and non-monetary items are translated at historical exchange rates. Related exchange gains and losses are included in the determination of income for the year.

Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial assets and liabilities are offset, and the net amount reported in the balance sheet, when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short term. The Company does not have any instruments classified in this category. Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the statements of earnings and comprehensive income. Gains and losses arising from changes in fair value are presented in the statements of earnings and comprehensive income in the period in which they arise.

(ii) Available-for-sale investments: These investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company does not have any instruments classified in this category. Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from changes in fair value are recognized in other comprehensive income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of earnings and comprehensive income and are included in other gains and losses.

(iii) Loans and receivables: These are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise cash and cash equivalents and accounts receivable, and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.

(iv) Financial liabilities at amortized cost: This category includes accounts payable and accrued liabilities. Accounts payable and accrued liabilities are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, accounts payable are measured at amortized cost using the effective interest method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

Derivative financial instruments and hedging activities

Derivatives are initially recognized at fair value on the date derivative contracts are entered into and are subsequently re-measured at their fair value. The method of recognizing the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. When derivatives are designated as hedges, the Company classifies them as: (i) hedges in the change in fair value of recognized assets or liabilities or firm commitments (fair value hedges) or (ii) hedges of the variability in highly probable future cash flows attributable to a recognized asset or liability or a forecast transaction (cash flow hedges).

At the inception of a hedge accounting relationship, the Company documents the relationship between the hedging instrument and the hedged item, as well as the risk management objectives and strategy for undertaking the hedge transaction. This process includes linking all derivatives to specific assets and liabilities on the balance sheets or to specific firm commitments or forecast transactions. The Company also assesses, both at the inception of the hedge and on an ongoing basis, whether the derivatives that are used are effective in offsetting changes in fair values or cash flows of hedged items. All derivatives are recorded at fair value. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the statements of earnings and comprehensive income, together with any changes in the value of the hedged asset or liability that are attributable to the hedged risk. The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognized in other comprehensive income and are reclassified to the statements of earnings and comprehensive income in the periods when the hedged item affects the statements of earnings and comprehensive income. When a fair value or cash flow hedge no longer meets the criteria for hedge accounting or when there is an ineffective portion to a hedge, a gain or loss is recognized in the statements of earnings and comprehensive income.

Impairment of financial assets
At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired. If such evidence exists, the Company recognizes an impairment loss. Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Cash and cash equivalents
Cash and cash equivalents includes deposits held at call with banks and other short-term, highly liquid investments readily convertible to cash on hand and are subject to an insignificant risk of changes in value.

Accounts receivable
Accounts receivable consist of amounts due from licensing partners for royalties and product sales in the normal course of business and other amounts such as interest receivable.

Inventory
Inventory, which is comprised of finished goods, is valued at the lower of cost and net realizable value. Cost is determined using the weighted-average cost method. Net realizable value is the estimated selling price less applicable selling expenses. If the carrying value exceeds net realizable amount, a write-down is recognized. The write-down may be reversed in a subsequent period if the circumstances which caused it no longer exist.

Prepaid expenses and other assets
Prepaid expenses consist of amounts paid in advance for items that have future value to the Company, such as insurance policy payments, U.S. Food and Drug Administration fees, database subscription fees and other items paid in advance. Other assets consist of lease and utility deposits.

Property and equipment
Property and equipment are recorded at historical cost less accumulated depreciation and accumulated impairment losses. The useful lives of property and equipment are reviewed at least once per year. Depreciation is computed using the straight-line method, using the following estimated useful lives of the assets or lease terms:

Computer equipment	3 years
Furniture and fixtures	5 years
Leasehold improvements	over the term of the lease

Intangible assets
Intangible assets include product rights that consist of marketing and other rights relating to products and licensing rights and these are recorded at cost less accumulated amortization and accumulated impairment losses. Intangible assets have a finite life and are amortized using the straight-line method over their estimated period of useful life. Amortization commences on the earlier of the date of regulatory (generally, U.S. Food and Drug Administration) approval for marketing the related product or upon substantive revenue being generated from the product under a commercial licensing agreement. Should amortization commence as a result of generating revenue, the amortization period would include the time prior to regulatory approval. The useful lives of the intangible assets are reviewed at least once per year.

Impairment of non-financial assets
Non-financial assets, which include property and equipment and intangible assets, are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized when the carrying amount of a non-financial asset exceeds the sum of the estimated present value of the expected future cash flows from the non-financial asset. The Company evaluates impairment losses for potential reversals when events or circumstances warrant such consideration.

Accounts payable and accrued liabilities
Accounts payable are obligations to pay for goods and services that have been incurred in the ordinary course of business from suppliers and are classified as current liabilities if payment is due within one year or less. If not, they are presented as non-current liabilities.

Deferred revenue
Deferred revenue consists of amounts received from licence partners in advance of revenue recognition. Amounts expected to be recognized within one year or less are classified as current liabilities with the balance being classified as non-current liabilities.

Share capital
Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity.

Revenue recognition
Revenue comprises the fair value of the consideration received or receivable for the sale of products or delivery of services in the ordinary course of the Company's activities. The Company recognizes revenue when the amount of revenue can be reliably measured, it is probable that future economic benefit will flow to the entity and when specific criteria have been met for each of the activities as described below.

The Company recognizes revenue from licensing and distribution agreements, which may include multiple elements. Agreements containing multiple elements are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the customer and whether there is objective and reliable evidence of the fair value of the undelivered element. The consideration received is allocated among the separate elements based on each element's fair value. The applicable revenue recognition criteria are then applied to each unit of accounting. Otherwise, the applicable revenue recognition criteria are applied to combined elements as a single unit of accounting. The contractual obligations associated with these agreements vary and may include: planning and managing clinical trials, responsibility for regulatory filings with the key regulatory authorities, maintaining intellectual property and, in all cases, managing product supply arrangements for finished goods.

The Company records revenue on a gross basis for sales in which the Company acts as the principal (product revenue) and on a net basis (licensing revenue) for sales in which the Company in substance acts as an agent in the transaction. For all licensing partners, in accordance with the terms of the respective agreements, the Company is required to arrange for the supply of finished product from Galephar Pharmaceutical Research Inc. ("Galephar"). Under the terms of the Company's arrangement with Galephar, the Company retains 50% of all amounts earned under the licensing and distribution agreements with the other 50% due to Galephar. Accordingly, associated licensing revenues are recognized net of the amounts due to Galephar.

Licensing revenue: Licensing revenue is comprised of up-front payments, pre-commercialization milestones, post-commercialization milestones, royalties and product supply fees. For up-front licensing payments and pre-commercialization milestones, revenue is deferred and recognized on a straight-line basis over the estimated term that the Company provides services and when the costs of fulfilling the Company's contractual obligations can be measured reliably. Post-commercialization milestone payments are recognized as revenue when the underlying condition is met, the milestone is not a condition of future deliverables and collectability is reasonably assured. Otherwise, these milestone payments are recognized as revenue over the remaining term of the underlying agreement or the estimated service term for which the Company maintains contractual obligations. Royalty revenue is recognized in the period in which the Company earns the royalty. Product supply fees are recognized when the finished products are shipped from Galephar to the Company's licensing partners, at which time ownership is transferred. Up-front payments, pre-and post-commercialization milestones, royalties and product supply fees represent the Company's 50% share of revenue from agreements with licensing partners, after amounts due to Galephar.

Product revenue: Product revenue is recognized when it is probable that the economic benefits will flow to the Company, the significant risks and benefits of ownership are transferred (upon delivery of product to the Company's customers), the price is fixed or determinable and collectability is reasonably assured. Product revenue is measured based on the price specified in the sales contract and is net of sales discounts, returns, credits and allowances. Revenue is reduced for estimated customer returns, rebates and other similar allowances based on historical information and consideration of the type of customer, type of transaction and the specifics of each arrangement.

Amounts received in advance of recognition as revenue are included in deferred revenue.

Cost of sales
Cost of sales includes the cost of finished goods, royalties to license holders and direct overhead expenses necessary to acquire the finished goods. Cost of sales also includes the cost to distribute products to customers, inbound freight costs, warehousing costs and other shipping and handling costs.

Research and development
The Company conducts research and development programs and incurs costs related to these activities, including employee compensation, materials, professional services and services provided by contract research organizations. Research and development costs, net of related tax credits and contractual reimbursements from development partners, are expensed in the periods in which they are incurred.

Income taxes
Income tax comprises current and deferred tax. Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the end of the reporting period and any adjustment to tax payable in respect of previous years. Deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the balance sheet date and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable that the assets can be recovered.

Share-based compensation - stock option plan
The fair value of options granted to employees and directors is estimated on the date of the grants using the Black-Scholes option pricing model. Stock options vest over four years (25% per year), expire after ten years and can only be settled for shares. Each tranche in an award is considered as a separate award with its own vesting period and grant date fair value. Share-based compensation expense is recognized over the tranche's vesting period based on the number of awards expected to vest, by increasing contributed surplus. The number of awards expected to vest is reviewed annually, with any impact being recognized immediately. Share-based compensation expense is included in selling, general and administrative expense in the statements of earnings and comprehensive income and in contributed surplus in the balance sheets. The consideration received on the exercise of stock options is credited to share capital at the time of exercise.

Earnings per share
Basic earnings per share ("EPS") is calculated using the treasury stock method, by dividing the net income for the year by the weighted average number of common shares outstanding during the year. Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments.

Accounting standards issued but not yet adopted
IFRS 15 *Revenue from Contracts with Customers*: This standard replaces International Accounting Standards ("IAS") 11 *Construction Contracts,* IAS 18 *Revenue* and IFRIC 13 *Customer Loyalty Programmes*. This standard outlines a single comprehensive model for entities to account for revenue arising from contracts with customers. The latest date of mandatory implementation of IFRS 15 is January 1, 2017. The Company has not yet evaluated the impact on the financial statements.

IFRS 9 *Financial Instruments:* The final version of IFRS 9, *Financial Instruments*, was issued by the IASB in July 2014 and will replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 introduces a model for classification and measurement, a single, forward-looking 'expected loss' impairment model and a substantially reformed approach to hedge accounting. The new single, principle based approach for determining the classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. The new model also results in a single impairment model being applied to all financial instruments, which will require more timely recognition of expected credit losses. It also includes changes in respect of own credit risk in measuring liabilities elected to be measured at fair value, so that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, however is available for early adoption. In addition, the own credit changes can be early applied in isolation without otherwise changing the accounting for financial instruments. The Company is yet to assess the full impact of IFRS 9 and has not yet determined when it will adopt the new standard.

4 CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The Company makes estimates and judgments concerning the future that will, by definition, seldom equal actual results. The following are the critical estimates and judgments applied by management that most significantly affect the Company's financial statements. The critical estimates and judgments that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed below.

(i) Revenue recognition: Management evaluates the multiple elements and units of accounting included within certain licensing and distribution agreements. The recognition of revenue on up-front licensing payments and pre-commercialization amounts are over the estimated period that the Company maintains contractual obligations. The estimated periods are reviewed at least annually and are updated if expectations change as a result of licensing partner interactions, product commercial obsolescence or other factors. It is possible that these factors may cause significant changes in the Company's recognition of revenue in the future.

(ii) Deferred income taxes: Management uses estimates when determining deferred income taxes. These estimates are used to determine the recoverability of tax loss carry forward amounts, research and development expenditures and investment tax credits. Significant judgment is required to determine the probable future cash flows in order to recognize the deferred tax asset. Changes in market conditions, changes in tax legislation, patent challenges and other factors, including the approval or launch of generic versions of any of the Company's products, could adversely affect the ongoing value of deferred tax assets. The carrying amount of deferred income tax assets is reassessed at each reporting period and reduced to the extent that it is no longer probable that sufficient taxable income will be available to utilize all or part of the deferred income tax assets. Unrecognized deferred income tax assets are reassessed at each reporting period and are recognized to the extent that it is probable that there will be sufficient taxable income for the asset to be recovered.

(iii) Estimated useful lives of intangible assets: Management estimates the useful lives of intangible assets based on the period during which the assets are expected to be available for use and also estimates their recoverability to assess if there has been an impairment. The amounts and timing of recorded expenses for amortization and impairments of intangible assets for any period are affected by these estimates. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence, generic threats and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's intangible assets in the future.

(iv) Functional currency: Management uses judgment when determining its functional currency. This determination includes an assessment of the indicators as prescribed in IAS 21, *The Effects of Changes in Foreign Exchange Rates*. However, applying the factors in IAS 21 does not always result in a clear indication of functional currency. Where IAS 21 factors indicate differing functional currencies, management uses judgment in the ultimate determination of the functional currency.Significant judgment is required in this overall assessment of the indicators and determination of the Company's functional currency.

5 RISK MANAGEMENT

Financial 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 and market risk. The Company's overall risk management program and business practices seek to minimize any potential adverse affects on the Company's financial performance.

(i) Credit risk
Cash - the Company's cash and cash equivalents balance is on deposit with a Canadian chartered bank that has a DBRS rating of "AA" for deposits and senior debt.
Accounts receivable - the Company licenses its products to distribution partners in major markets. The credit risk associated with the accounts receivable pursuant to these agreements is evaluated during initial negotiations and on an ongoing basis. The accounts receivable balance at December 31, 2014 is concentrated between two distribution partners. Both have been partners of the Company for over five years with no defaults in the past. As of December 31, 2014, no accounts receivable were impaired or past due. The Company's two largest customers comprise 71% and 21% of licensing revenue (respectively 80% and 13% in 2013).

(ii) Liquidity risk
The Company has no long term debt. Accounts payable and accrued liabilities are settled in the regular course of business based on negotiated terms with trade suppliers. All components of the balance of $11,255 as at December 31, 2014 are expected to be settled in less than one year. The carrying value approximates fair value as the impact of discounting is not significant. Management forecasts cash flows in order to monitor liquidity requirements and ensure that the Company has sufficient cash to meet operational needs.

(iii) Market risk
Currency risk - the majority of the Company's revenue and a portion of its expenses are denominated in US currency. The accounts receivable balance at December 31, 2014 includes a total of US$11,663 and accounts payable and accrued liabilities includes a total of US$6,410. A change of 10 basis points in the US/CDN exchange rate on December 31, 2014 balance would have had a $53 impact on net income.

Capital risk management
Shareholders' equity is managed as the capital of the Company. The Company's objective when managing capital is to safeguard its ability to continue as a going concern in order to provide returns for shareholders and to maintain an optimal capital structure to minimize the cost of capital. In order to maintain or adjust the capital structure, the Company may issue new common shares from time to time.

6 FINANCIAL INSTRUMENTS

Under certain agreements, the Company has the right to set-off financial assets with financial liabilities with respect to advances, rebates and licensing payments. At December 31, 2014, the Company had gross financial assets of $905 and gross financial liabilities of $7,601 related to Galephar. The net amount of $6,696 owing to Galephar has been recorded in accounts payable and accrued liabilities at December 31, 2014 (gross financial assets of $957 and gross financial liabilities of $9,458 for a net amount of $8,501 owing at December 31, 2013).

During the fourth quarter of 2014, the Company entered into a foreign exchange forward contract related to certain licensing revenues of US$4 million which were earned during the quarter. The contract matures on February 12, 2015 at an exchange rate of $1.1598 against the US dollar. The foreign exchange forward contract has been marked-to-market as at December 31, 2014 resulting in a nominal foreign exchange loss.

7 LICENSING AGREEMENTS

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. Where the Company has opted to market and sell a CIP Product directly in a territory, the Company pays a royalty 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. 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 and CIP-TRAMADOL ER in Canada, the U.S. and Central and South America.

In Q4 2013, as a result of the cumulative sales performance of Absorica (CIP-ISOTRETINOIN), the Company achieved a $10,636 milestone under the distribution and supply agreement with its marketing partner. In Q4 2013 the Company recorded $5,318 in licensing revenue to reflect its share of the milestone and $10,636 was recorded in accounts receivable with $5,318 recorded in accounts payable and accrued liabilities, reflecting the share of the payment owed to Galephar.

(in thousands of Canadian dollars, except per share amounts)

8 PROPERTY AND EQUIPMENT

	December 31, 2014		December 31, 2013	
	Cost	Accumulated Depreciation	Cost	Accumulated Depreciation
Computer equipment	$ 142	$ 116	$ 124	$ 100
Furniture and fixtures	129	129	129	129
Leasehold improvements	67	67	67	67
	338	$ 312	320	$ 296
Accumulated depreciation	(312)		(296)	
	$ 26		$ 24	

9 INTANGIBLE ASSETS

The Company has entered into the Agreement with Galephar for the rights to package, test, obtain regulatory approvals and market the CIP Products in various countries. The recoverability of the cost of the CIP Product rights is dependent upon sufficient revenues being generated from the related products.

In 2012, the Company paid an up-front fee of $100 to acquire the exclusive license and distribution rights in Canada to market the Betesil Patch. As at December 31, 2014, certain milestones remain outstanding, including Health Canada approval and accordingly, amortization of these licensing rights has not yet begun.

In 2014, the Company acquired the assets of Melanovus Oncology, Inc. The assets included seven pre-clinical compounds for the treatment of melanoma and other cancers as well as an exclusive global license to a library of compounds and related intellectual property from The Penn State Research Foundation. The transaction included a payment of $593 (US$510) for the asset purchase and an up-front license fee of $292 (US$252) to The Penn State Research Foundation. The licensing agreement provides for future payments based on clinical development and regulatory milestones as well as royalties on commercial sales. As at December 31, 2014 amortization of these licensing rights has not yet begun.

	CIP Product Rights	Licensing Rights	Total
As at January 1, 2013			
Cost	$ 7,036	$ 100	$ 7,136
Accumulated amortization	(4,446)	-	(4,446)
Net book value	$ 2,590	$ 100	$ 2,690
For the year ended December 31, 2013			
Opening net book value	$ 2,590	$ 100	$ 2,690
Amortization	(1,108)	-	(1,108)
Net book value	$ 1,482	$ 100	$ 1,582
As at December 31, 2013			
Cost	$ 7,036	$ 100	$ 7,136
Accumulated amortization	(5,554)	-	(5,554)
Net book value	$ 1,482	$ 100	$ 1,582
For the year ended December 31, 2014			
Opening net book value	$ 1,482	$ 100	$ 1,582
Additions	-	885	885
Amortization	(758)	-	(758)
Net book value	$ 724	$ 985	$ 1,709
As at December 31, 2014			
Cost	$ 7,036	$ 985	$ 8,021
Accumulated amortization	(6,312)	-	(6,312)
Net book value	$ 724	$ 985	$ 1,709

The Company has considered indicators of impairment as of December 31, 2013 and December 31, 2014 and no indicators were identified.

10 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	As at Dec 31, 2014	As at Dec 31, 2013
Trade accounts payable	$ 9,581	$ 11,627
Accrued liabilities	1,674	771
	$ 11,255	$ 12,398

11 SHARE CAPITAL

Authorized share capital
The 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.

Issued share capital
The following is a summary of the changes in share capital from January 1, 2013 to December 31, 2014:

	Number of common shares (in thousands)	Amount $
Balance outstanding - January 1, 2013	24,435	50,339
Options exercised in 2013	503	1,335
Shares issued in 2013 under the share purchase plan	38	182
Reduction of stated capital	-	(41,160)
Balance outstanding - December 31, 2013	24,976	10,696
Options exercised in 2014	668	3,199
Shares issued in 2014 under the share purchase plan	29	322
Balance outstanding - December 31, 2014	25,673	14,217

Reduction of Stated Capital
On May 3, 2013, by way of a special resolution of the shareholders of the Company, the legal stated capital in the common shares of the Company was reduced by $71,160 which represented the deficit of the Company as at December 31, 2012. As a result, the Company reclassified the shareholders' equity portion of the balance sheet with a reduction in deficit by $71,160 and a corresponding reduction of contributed surplus by $30,000 and share capital by $41,160.

Share purchase plan
The Company has an Employee and Director Share Purchase Plan ("ESPP") to allow 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. The shares issued under the ESPP are new shares issued from treasury and the maximum number of shares that can be issued under the ESPP is one million. During 2014, 28,680 shares were issued (38,510 in 2013) under the ESPP for proceeds of $274 ($155 in 2013). Included in share-based compensation expense is $48 ($27 in 2013) which is the discount on the shares issued under the ESPP during the year. As at December 31, 2014, 687,794 common shares reserved for ESPP purchases remain available.

Stock option plan
The following is a summary of the changes in the stock options outstanding from January 1, 2013 to December 31, 2014:

	Number of options (in thousands)	Weighted average exercise price $
Balance outstanding - January 1, 2013	1,786	2.20
Granted in 2013	342	3.36
Exercised in 2013	(504)	1.43
Cancelled in 2013	(5)	1.87
Balance outstanding - December 31, 2013	1,619	2.68
Granted in 2014	516	8.41
Exercised in 2014	(668)	2.62
Cancelled in 2014	(183)	5.03
Balance outstanding - December 31, 2014	1,284	4.68

At December 31, 2014, 644,297 options were fully vested and exercisable (995,618 at December 31, 2013).

During 2014, the Company granted 516,000 stock options under the stock option plan, with exercise prices of $8.13, $7.43 and $8.76, 25% of which vest on either February 28, March 18 or June 30 of each year for the next four years, commencing in 2015, and expire in 2024. Total compensation cost for these stock options is estimated to be $3,266, which will be recognized on a graded basis over the vesting period of the stock options.

The stock options were valued using the Black-Scholes option pricing model, at $6.09, $5.75 and $6.62 per option, with the following assumptions. Expected volatility is based on the Company's historical volatility, while estimated forfeitures are not considered significant.

Risk-free interest rate	1.86%, 1.88%, 1.76%
Expected life	6.6 years
Expected volatility	86.2%, 91.2%, 87.6%
Expected dividend	Nil

During 2014, 668,275 stock options were exercised in exchange for 668,058 common shares. The Company's stock option plan provides that an option holder may elect to receive an amount 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. The total cash consideration received by the Company for stock option exercises in 2014 was $1,748 ($721 in 2013).

The following is a summary of the outstanding options as at December 31, 2014:

Expiry date	Exercise price $	Number of options (in thousands)		
		Vested	Unvested	Total
March 23, 2016	4.12	40	-	40
June 28, 2016	4.00	100	-	100
September 13, 2016	2.90	69	-	69
March 9, 2017	3.90	175	-	175
February 28, 2018	1.05	50	-	50
November 6, 2019	0.55	20	-	20
February 19, 2020	1.60	56	-	56
March 11, 2021	1.16	53	19	72
January 10, 2022	0.89	-	6	6
February 24, 2022	1.20	44	37	81
March 5, 2023	2.88	24	142	166
August 6, 2023	7.00	10	30	40
February 28, 2024	8.13	3	136	139
March 18, 2024	7.43	-	20	20
June 27, 2024	8.76	-	250	250
		644	640	1,284

12 EXPENSES BY NATURE

	Year Ended Dec 31, 2014	Year Ended Dec 31, 2013
Employees salaries and other short term benefits	$ 3,020	$ 2,561
Directors fees	359	275
Share-based compensation	1,308	509
Depreciation of property and equipment	16	16
Amortization of intangible assets	758	1,108
Professional and consulting fees	2,681	2,375
Contract sales	988	530
Facility rent	73	73
Cost of inventory expensed	563	142
Listing fees (TSX and NASDAQ)	195	50
Travel expenses	312	144
Insurance	371	177
Foreign exchange gain	(845)	(164)
Severance costs	1,335	-
Interest income	(540)	(253)
Other expenses	1,372	1,057
	$ 11,966	$ 8,600

(in thousands of Canadian dollars, except per share amounts)

13 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:

	Year Ended Dec 31, 2014	Year Ended Dec 31, 2013
Salaries and short-term employee benefits, including bonuses	$ 1,541	$ 1,395
Directors fees	359	275
Share-based compensation	1,177	459
Severance costs	1,335	-
	$ 4,412	$ 2,129

The severance costs include amounts related to the former President and Chief Executive Officer and one other officer during the year. The Company's executive agreements provide for additional payments in the event of a change of control event or for termination without cause.

14 INCOME TAXES

The components of the deferred income tax recovery are as follows:

	Year Ended Dec 31, 2014	Year Ended Dec 31, 2013
Deferred income tax recovery	$ (330)	$ (6,556)

The income tax expense (recovery) differs from the amount computed by applying the statutory income tax rate to the income for the year. The sources and tax effects of the differences are as follows:

	Year Ended Dec 31, 2014	Year Ended Dec 31, 2013
Statutory income tax rate of 26.5% applied to income for the year (2013 - 26.5%)	$ 5,385	$ 4,879
Permanent differences	343	158
Change in enacted income tax rates and other items	(137)	36
Change in deferred tax assets not recognized	(5,921)	(11,629)
Recovery of income taxes	$ (330)	$ (6,556)

At each balance sheet date, the Company assesses whether the realization of future tax benefits is sufficiently probable to recognize a deferred tax asset. This assessment requires the exercise of judgement, which includes a review of projected taxable income. In 2014 the Company recognized an additional deferred tax asset on the balance sheet of $330, arising from accumulated losses carried forward from previous years, and a corresponding deferred tax recovery on the statements of earnings and comprehensive income.

Deferred income tax assets of the Company are comprised of the following:

	As at Dec 31, 2014	As at Dec 31, 2013
Non-capital losses	$ 5,012	$ 6,556
Tax credits	780	-
Temporary differences	1,094	-
	$ 6,886	$ 6,556

The movement in the deferred income tax asset is as follows:

	Year Ended Dec 31, 2014	Year Ended Dec 31, 2013
As at January 1	$ 6,556	$ -
Tax provision	(4,740)	-
Recognition of previously unrecognized tax assets	5,070	6,556
As at December 31	$ 6,886	$ 6,556

(in thousands of Canadian dollars, except per share amounts)

The significant components of unrecognized deferred tax assets are summarized as follows:

	As at Dec 31, 2014	As at Dec 31, 2013
Non-capital losses	$ -	$ 3,392
Temporary differences	3,931	5,716
Tax credits	2,089	2,832
	$ 6,020	$ 11,940

The Company has non-capital loss carry forwards of $12,860 as at December 31, 2014 with expiry dates between 2028 and 2031.

The Company has Scientific Research and Experimental Development ("SR&ED") expenditures of $17,628 which can be carried forward indefinitely to reduce future years' taxable income.

The Company has $3,603 of investment tax credits on SR&ED expenditures that are available to be applied against federal taxes otherwise payable in future years and expire in varying amounts from 2022 to 2031.

15 EARNINGS PER SHARE

Earnings per share is calculated using the weighted average number of shares outstanding. The weighted average number of shares outstanding for the year ended December 31, 2014 was 25,336,068 (for the year ended December 31, 2013 - 24,558,716).

Diluted earnings per share is calculated using the weighted average number of shares outstanding taking into consideration the weighted average impact of dilutive securities, such as stock options. The dilutive weighted average for the year ended December 31, 2014 was 26,278,503 (for the year ended December 31, 2013 - 25,678,420).

16 COMMITMENTS AND CONTINGENCIES

The Company has entered into operating leases for its office facilities with the following minimum annual payments:

2015: $153
2016: $225
2017: $232
2018: $232

Directors and officers are indemnified by the Company for various items including, but not limited to, costs to settle lawsuits or actions due to their association with the Company, subject to certain restrictions. The Company has purchased directors and officers liability insurance to mitigate the cost of any potential future lawsuits or actions. The term of the indemnification covers the period during which the indemnified party served as a director or officer of the Company.

In the normal course of business, the Company has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with advisors and consultants, leasing contracts, license agreements, information technology agreements and various product, service, data hosting and network access agreements. These indemnification arrangements may require the applicable entity to compensate counterparties for losses incurred by the counterparties as a result of breaches in representations, covenants and warranties provided by the Company or as a result of litigation or other third party claims or statutory sanctions that may be suffered by the counterparties as a consequence of the relevant transaction. In some instances, the terms of these indemnities are not explicitly defined.

17 SEGMENTED INFORMATION

The President & Chief Executive Officer is the Company's chief operating decision maker. The Company's operations are categorized into one industry segment, being specialty pharmaceuticals. All of the Company's assets, including capital and intangible assets, are in Canada. All product revenue is derived from Canada, while virtually all licensing revenue is derived from the United States.

CORPORATE DIRECTORY

DIRECTORS

Gerald McDole
Chair of the Board

Stefan Aigner, M.D., CFA
Director

William Claypool, M.D.
Director

John Mull, M.D., F.R.C.P. (C)
Director

Stephen R. Wiseman, CPA, CA
Director

Thomas Wellner
Director

OFFICERS

Shawn Patrick O'Brien
President and Chief Executive Officer

Norman Evans, CPA, CA
Chief Financial Officer

Joan Chypyha
Vice President, Marketing and Sales

SENIOR MANAGEMENT

Shawn Patrick O'Brien
President and Chief Executive Officer

Norman Evans, CPA, CA
Chief Financial Officer

Linda Angaritis
Vice President, Global Regulatory Compliance and Quality

Lynne Bulger
Vice President, Medical Affairs

Joan Chypyha
Vice President, Marketing and Sales

Peter Weiler
Vice President, Business Development

SHAREHOLDER INFORMATION

Stock Exchange Listing
The Company's common shares are listed on the Toronto Stock Exchange under the symbol "CPH" and on NASDAQ under "CPHR".

Shareholder Inquiries
Inquiries regarding change of address, transfer requirements or lost certificates should be directed to the Company's transfer agent.

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