Building a Dermatology Growth Company

cipher™ PHARMACEUTICALS

2016 SECOND QUARTER REPORT

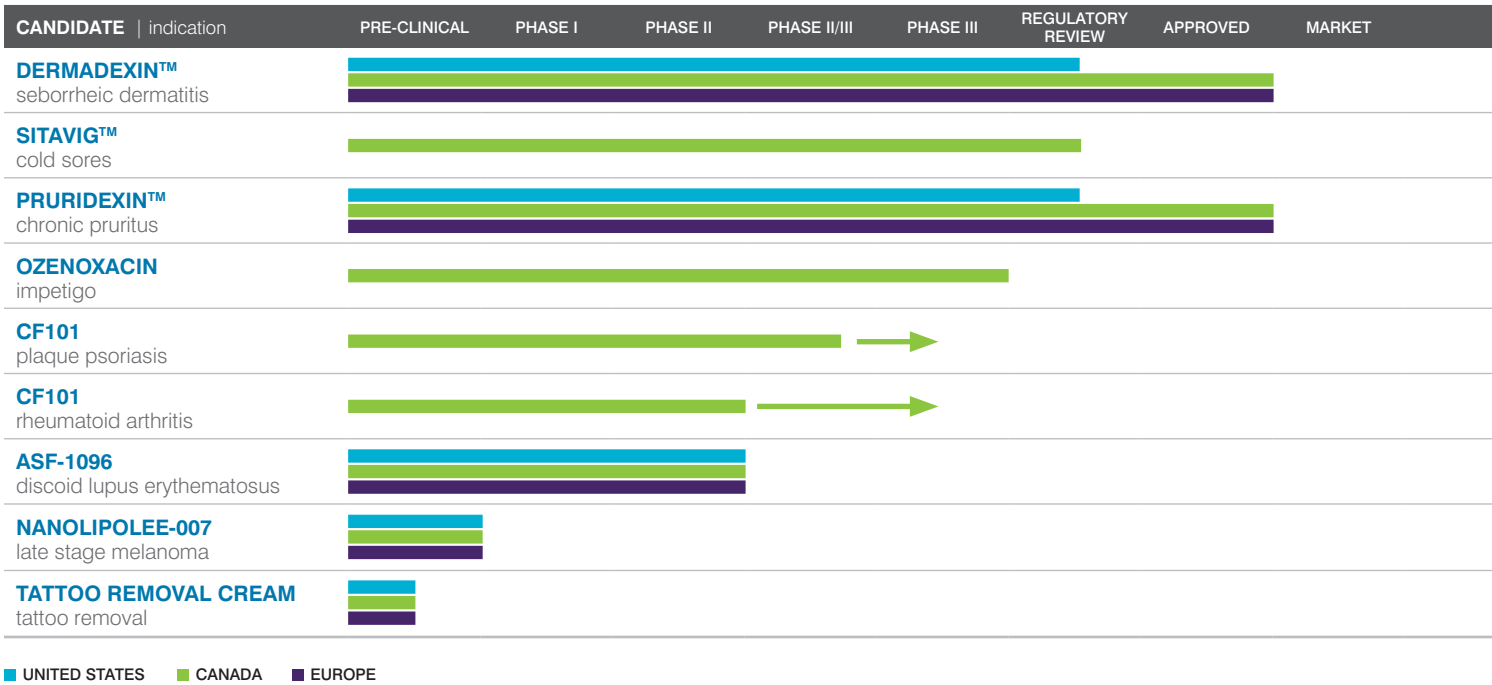
GROWING PRODUCT PORTFOLIO

Cipher has a growing commercial portfolio.

PRODUCT/BRAND	INDICATION	COMMERCIAL STATUS
ABSORICA®	Severe nodular acne	Marketed by Ranbaxy Laboratories, a Sun Pharma Company, in the U.S.
SITAVIG®	Recurrent Herpes Labialis	Marketed by Cipher in the U.S. Accepted for review by Health Canada in Q1 2016.
NUVAIL™ **BIONECT®** **CLN8™** **INOVA®** **PRO:12 MOUSSE™** **AL12™ LOTION** **UMECTA®** **ACLARO®**	Nail Dystrophy Dermal Ulcers Mild/Moderate Onychomycosis Acne Dry Skin Dry Skin Keratosis Hyperpigmentation	Marketed by Cipher in the U.S.
EPURIS® **VANIQA®** **ACTIKERALL®** **BETEFLAM™**	Severe nodular acne Enzyme inhibitor for hair growth Hyperkeratotic actinic keratosis Plaque psoriasis	Marketed by Cipher in Canada.
LIPOFEN®	High cholesterol	Marketed by Kowa Pharmaceuticals in the U.S.
CONZIP®	Once-daily treatment of moderately severe pain	Marketed by Vertical Pharmaceuticals in the U.S.
DURELA®	Once-daily treatment of moderately severe pain	Marketed by Aralez Pharmaceuticals in Canada.
ULTRAGESIC®	Once-daily treatment of moderately severe pain	Marketed by Tecnofarma in Argentina.

ROBUST LATE-STAGE PIPELINE

We have a robust pipeline of late-stage products that are nearing commercialization. Based on our current portfolio, we are expecting nine launches from five products in 2016 and 2017.



LETTER TO SHAREHOLDERS

Dear Shareholder:

It was a solid second quarter for Cipher, with multiple highlights in each of our three businesses. This translated into improved financial results across most key metrics. Total revenue rose 32% to $11.7 million; Adjusted EBITDA[1] improved 73% to $2.7 million; and we continued to generate cash flow from operations of $3.1 million while investing in our U.S. and Canadian operations and capabilities. We ended the quarter with $30.8 million in cash and cash equivalents, up from $27.2 million at year end.

It was a solid second quarter for Cipher, with multiple highlights in each of our three businesses.

Looking at our U.S. business, product revenue in the second quarter increased roughly 80% over Q2 2015. Importantly, we saw growth in the three main brands: Sitavig®, Nuvail™ and Bionect®. Net sales for Sitavig, our breakthrough treatment for cold sores, were $1.1 million in the quarter, which was more than double Q2 2015 and a 26% increase from $0.9 million in Q1 2016. Total prescriptions increased 36% versus Q2 2015. Nuvail and Bionect performed well in the second quarter. Net revenue from Nuvail rose 79% year-over-year and by 6% over Q1 2016 to $0.9 million, while net revenue from Bionect increased to $1.0 million, from $0.4 million in Q1 2016. Overall, the U.S. business is well positioned for increased organic growth. In addition, we continue to search for products to acquire and integrate into our U.S. operations.

Our Canadian business continued to perform well in the second quarter, with 51% growth in product revenue in local currency. These results were driven by Epuris®, which had net sales of $1.0 million in the quarter, up from $0.7 million in the same period last year. Market share for the product increased to 24% in Q2 2016 compared with 17% in Q2 2015. For the year-to-date period, Epuris prescriptions increased by 50% over 2015. Expanding our Canadian commercial portfolio is a key growth priority, and we continue to execute on this plan. We've had multiple commercialization and regulatory milestones in the past several months. Beteflam™ was launched in April; Dermadexin™ and Pruridexin™ were approved in Canada, ahead of our expectations, and we are anticipating launching these in Q1 2017; and Ozenoxacin was recently accepted for review by Health Canada with a target approval date in Q2 2017. In total, we expect to have at least eight products in the Canadian market in 2017.

1) 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, taxes, depreciation, amortization, non-cash share-based compensation, changes in fair value of derivative financial instruments and foreign exchange gains and losses from the translation of Canadian cash balances. Refer to page 15 for a summary of how EBITDA and Adjusted EBITDA are calculated.

Over the past year Cipher has been transformed from a royalty stream business with no pipeline into an integrated dermatology growth company.

It was also a very strong quarter for our royalty business, with licensing revenue up 18% to $7.4 million. Revenue for Absorica® was $5.7 million in Q2 2016 compared to $5.1 million in Q2 2015. Finished goods product shipments that were delayed in Q1 2016 were all delivered during Q2 2016. It was also a good quarter for our other royalty products, with combined revenues of $1.7 million from Lipofen® and ConZip®/Durela®, up 42% from the same period last year.

Over the past year, we have transformed Cipher from a royalty stream business with no pipeline into an integrated dermatology growth company. While we are still early in the execution of our plan, management is confident the business is well positioned for improved performance.

Underpinned by strong cash flows from our royalty stream products and a solid balance sheet, we will continue to advance our strategy to capitalize on the opportunity we see to build a leading dermatology company in North America.

Sincerely,

"Signed"

Shawn Patrick O'Brien
President and Chief Executive Officer

August 23, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2016

The following is a discussion and analysis of the operating results and financial position of Cipher Pharmaceuticals Inc. and its subsidiaries ("Cipher" or "the Company") for the period ended June 30, 2016. This document should be read in conjunction with the unaudited condensed interim consolidated 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 applicable to the preparation of interim financial statements, including IAS 34, Interim Financial Reporting. Additional information about the Company, including the annual financial statements and Annual Information Form for the year ended December 31, 2015, is available on SEDAR at www.sedar.com and on EDGAR at http://www.sec.gov/edgar/searchedgar/companysearch.html.

The discussion and analysis within this MD&A are as of August 9, 2016. All dollar figures are stated in U.S. dollars unless otherwise indicated.

Caution Regarding Forward-Looking Statements

This document includes forward-looking statements within the meaning of 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, our ability to enter into in-licensing, development, manufacturing and marketing and distribution agreements with other pharmaceutical companies and keep such agreements in effect; our dependency on a limited number of products; integration difficulties and other risks if we acquire or in-license technologies or product candidates; reliance on third parties for the marketing of certain products; the product approval process is highly unpredictable; the timing of completion of clinical trials; reliance on third parties to manufacture our products; we may be subject to product liability claims; unexpected product safety or efficacy concerns may arise; we generate license revenue from a limited number of distribution and supply agreements; the pharmaceutical industry is highly competitive; requirements for additional capital to fund future operations; dependence on key managerial personnel and external collaborators; no assurance that we will receive regulatory approvals in the U.S., Canada or any other jurisdictions; certain of our products are subject to regulation as controlled substances; limitations on reimbursement in the healthcare industry; limited reimbursement for products by government authorities and third-party payor policies; various laws pertaining to health care fraud and abuse; reliance on the success of strategic investments and partnerships; the publication of negative results of clinical trials; unpredictable development goals and projected time frames; rising insurance costs; ability to enforce covenants not to compete; risks associated with the industry in which it operates; we may be unsuccessful in evaluating material risks involved in completed and future acquisitions; we may be unable to identify, acquire or integrate acquisition targets successfully; operations in the U.S.; inability to meet covenants under our credit facilities; compliance with privacy and security regulation; our policies regarding returns, allowances and chargebacks may reduce revenues; certain regulations could restrict our activities; additional regulatory burden and controls over financial reporting; reliance on third parties to perform certain services; general commercial litigation, class actions, other litigation claims and regulatory actions; being a foreign private issuer may limit the information available to U.S. shareholders; we may lose our foreign private issuer status which could result in significant additional costs; the potential violation of intellectual property rights of third parties; our efforts to obtain, protect or enforce our patents and other intellectual property rights related to our products; changes in U.S., Canadian or foreign patent laws; litigation in the pharmaceutical industry concerning the manufacture and supply of novel and generic versions of existing drugs; inability to protect our trademarks from infringement; shareholders may be further diluted; volatility of our share price; a significant shareholder; we do not currently intend to pay dividends; our operating results may fluctuate significantly; and our debt obligations will have priority over the Common Shares in the event of a liquidation, dissolution or winding up.

We caution that the foregoing list of important factors that may affect future results is not exhaustive. When reviewing our forward-looking statements, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. Additional information about factors that may cause actual results to differ materially from expectations, and about material factors or assumptions applied in making forward-looking statements, may be found in the "Risk Factors" section of our Annual Information Form, under "Risk Factors" and elsewhere in our Management's Discussion and Analysis of Operating Results and Financial Position for the year ended December 31, 2015, and elsewhere in our filings with Canadian and U.S. 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 (NASDAQ:CPHR; TSX:CPH) 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. Through multiple transactions and significant regulatory progress, 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.

Growth Strategy

With a mandate to leverage Cipher's existing core capabilities, infrastructure and existing product portfolio (led by a novel version of the acne medication isotretinoin, which is marketed as Absorica® in the U.S. and Epuris® in Canada), in fiscal 2014 the Company implemented a three-pronged growth strategy, enabling its transformation from a royalty revenue company into a pure play dermatology company and significantly improving its long-term growth opportunities. The three components of the growth strategy are:

- Building a larger dermatology franchise in Canada through a combination of in-licensing and acquisitions (acquisitions would be accretive within two years);
- Acquiring and developing potentially transformative technology that can be commercialized efficiently in North America; and
- Establishing a commercial operation in the U.S. through M&A and build a leading dermatology franchise in that country.

Cipher completed seven transactions in 2015, acquiring 15 dermatology products, the majority of which are either commercial or late-stage pre-commercial, significantly expanding its product portfolio. These acquisitions support all three components of Cipher's growth strategy.

The following is a summary of the transactions completed in 2015 and 2016:

- acquired seven pre-clinical compounds for the treatment of melanoma and other cancers from Melanovus Oncology, Inc. ("Melanovus"), including the related intellectual property from The Penn State Research Foundation
- licensed the Canadian commercial rights for the novel antibacterial compound Ozenoxacin for the treatment of impetigo
- licensed the Canadian distribution rights to CF101, a novel chemical entity being developed by Can-Fite Biopharma ("Can-Fite") for moderate to severe plaque psoriasis and rheumatoid arthritis
- acquired the worldwide rights to three products from Astion Pharma, a Denmark-based specialty pharmaceutical. The three products, Dermadexin™, Pruridexin™, and ASF-1096, strengthened Cipher's dermatology product pipeline and, if approved, would present a sizable market opportunity.
- acquired the Canadian distribution rights to Vaniqa® and Actikerall® from Almirall S.A. Both products had already been approved by Health Canada. Cipher began marketing Vaniqa in Canada in May 2015 and Actikerall was launched in February 2016.
- In April 2015, we delivered on our strategic priority of establishing a U.S. commercial sales and marketing capabilities through the acquisition of Innocutis Holdings, LLC ("Innocutis"). Innocutis has nine branded dermatology products, led by Sitavig, a breakthrough treatment for cold sores. Cipher plans to leverage the U.S. sales platform to launch its other products into the U.S. market. In January 2016 we launched Bionect Foam in the U.S.
- In May 2016, Cipher licensed the worldwide rights to develop, market and sell an investigational tattoo removal cream from Dalhousie University. The product candidate is currently at the pre-clinical stage of development.

Looking ahead, we plan to continue on this growth trajectory as we focus on investing in the short-term to maximise the potential of our existing products, while at the same time, identifying opportunities to acquire additional late-stage dermatology products to further strengthen our existing product portfolio. We will also continue to leverage our regulatory approvals in the U.S. and Canada to pursue licensing agreements in other markets, where economically viable.

Athyrium Debt Facility

In conjunction with the Innocutis acquisition, Cipher closed on a private offering of $100 million in aggregate principal amount of Senior Secured Notes due 2020 (the "Notes"), provided by investment funds managed by Athyrium Capital Management (together, "Athyrium"). The Company has drawn $40 million, which was used to fund the majority of the purchase price for Innocutis and the balance of the Notes expired on June 30, 2016. As a result of the expiry of the Notes, the Company wrote off debt issuance costs in the amount of $1.8 million in Q2 2016. The Notes bear interest at a fixed rate of 10.25% per annum, payable quarterly in arrears on the last day of each quarter, and will mature five years from the date of issuance, unless earlier repurchased. The Notes are interest-only and are secured by assets of the Company, subject to certain exceptions. The Notes have certain restrictive covenants, including quarterly consolidated net revenue, minimum cash balance and consolidated leverage ratio. As at June 30, 2016 the Company is in compliance with all covenants.

In connection with the offering, Cipher issued Athyrium 600,000 common share purchase warrants. The warrants are exercisable at $9.22 (equal to the five-day volume-weighted average price on the Toronto Stock Exchange prior to closing, converted to U.S. dollars) and expire seven years following issuance.

Commercial Products Update

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”) a Sun Pharma Company, in Q4 2012 under the trade name Absorica. The product has performed well since launch, achieving 18.1% market share by December 2015, based on total isotretinoin prescriptions (source: IMS).

According to IMS, the U.S. isotretinoin market was over US$680 million in 2015, an increase of 8.1% over the prior year, with prescriptions growing by 8.6% on a year-over-year basis. Total isotretinoin prescriptions for Q2 2016 were 13% higher than the same period last year (source: IMS). Publicly reported Absorica prescriptions declined by 12% in Q2 2016 compared to Q2 2015 (source: IMS) however, prescriptions through non-IMS reporting specialty pharmacies, along with price increases, are reflected in the 13% increase in licensing revenue reported in Q2 2016 versus Q2 2015.

Absorica is currently protected by five issued patents which are listed in the FDA's Approved Drug Products List (Orange Book) which expire in September 2021. Cipher was issued a product patent (Patent Number 7,435,427) from the U.S. Patent and Trademark Office in 2008 with a second patent (Patent Number 8,367,102) issued in 2013. A third patent (Patent Number 8,952,064) was issued in February 2015 and the fourth and fifth patents (Patent Numbers 9,078,925 and 9,089,534) were issued in July 2015. The five patents are formulation-related patents describing the product ingredients. There is one additional new Absorica patent application pending with the U.S. Patent and Trademark Office.

In October 2015, the Company, along with Ranbaxy and Galephar, entered into a Settlement Agreement with Actavis Laboratories F1, Inc., Andrx Corp., Actavis, Inc. and Actavis Pharma, Inc. ("Actavis") that dismissed a patent litigation suit. As part of the Settlement Agreement, Cipher, Ranbaxy and Galephar entered into a non-exclusive license agreement with Actavis under which Actavis may begin selling its generic version of Absorica® in the U.S. on December 27, 2020 (approximately nine months prior to the expiration of the patents in September 2021), or earlier under certain circumstances.

CIP-ISOTRETINOIN was also approved by Health Canada in Q4 2012 under the trade name Epuris and Cipher launched the product in Canada in June 2013 with its own sales force. According to IMS, the Canadian market for isotretinoin in 2015 was CDN$17.5 million, an increase of 6.5% over 2014. In Q2 2016, isotretinoin prescriptions in Canada increased by 10.4% compared to Q2 2015.

For the year-to-date period to June 30, 2016, Epuris prescriptions grew by 50% over the same period last year. Epuris market share continues to grow in 2016, achieving a prescription market share of 24% in June 2016 (source: IMS) compared with 17% in June 2015.

Core Dermatology Products

Q2 2015 financial information includes results of U.S. operations starting April 13, 2015, the date of the Innocutis acquisition.

SITAVIG®

Sitavig, which was launched in July 2014, is a unique, timed-release, mucoadhesive buccal tablet containing 50 mg of acyclovir indicated for the treatment of herpes labialis (cold sores). Administration of a single Sitavig tablet enables the active ingredient to penetrate the surrounding tissues in significantly higher concentrations than is possible through systemic delivery. Sitavig is the only treatment for herpes labialis that is proven to increase the time between oral herpes outbreaks and decrease the number of oral herpes outbreaks.

Cipher is pursuing several strategies to capitalize on this market opportunity and increase market penetration of Sitavig. Sitavig currently has a 30% share of the branded topical market within our targeted universe. Currently, 81% of the Sitavig total prescriptions come from dermatology. Cipher is implementing an aggressive sales and marketing approach to enhance the dermatology position. In addition, historically, the product has only been marketed to dermatologists, however, there is also a large non-dermatology component to the herpes labialis market. Cipher plans to broaden the potential of the product by expanding promotional efforts into other specialities and primary care, as well as using marketing, non-personal promotion and actively seeking partnerships to grow the non-dermatology market for Sitavig. Total Sitavig prescriptions grew 36% in Q2 2016 versus Q2 2015 (source: PHAST & ASPN data).

NUVAIL®

Nuvail is a polymer solution (poly-ureaurethane) indicated for managing the signs and symptoms of nail dystrophy. The product is applied once-daily and dries with a clear matte finish.

The prescription nail dystrophy market is relatively small in the U.S. with $4.3 million in 2015 sales. Nuvail maintained a 66% share of the nail dystrophy market in Q2 2016. Nuvail net revenue was up over 79% in Q2 2016 over Q2 2015 and up 6% versus Q1 2016, although prescriptions decreased by 23% in the same period, reflecting the continued impact of two topical onychomycosis ("OM") treatments which were launched in late 2014. OM and nail dystrophy are common comorbidities. It appears that these OM treatments are competing with products indicated for nail dystrophy by only addressing the issue of fungus and not nail dystrophy. Cipher will focus on nail dystrophy which is often a pre-cursor to fungus infections. Nail dystrophy is seen in mycotic, psoriatic and brittle nails. It is estimated that 20% of adults in the U.S. have Brittle Nail Syndrome.

BIONECT®

Bionect is a topical hyaluronic acid ("HA") indicated for the treatment of signs and symptoms of skin irritation. The topical HA market was approximately $2.8 million in 2015. Bionect maintained 96% share of the topical HA market in Q2 2016. Prescriptions declined by 12% in Q2 2016 versus Q1 2016. To enhance the brand positioning, a new formulation of the product, Bionect Foam, was launched in January 2016.

BETEFLAM™ PATCH

In 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. Beteflam was launched in Canada in April 2016 and the initial response from dermatologists has been positive.

ACTIKERALL™

Actikerall™ (0.5% fluorouracil and 10% salicylic acid) is indicated for the topical treatment of slightly palpable and/or moderately thick hyperkeratotic actinic keratosis (Grade I/II) of the face, forehead, and balding scalp in immunocompetent adult patients. Actinic keratosis, also known as solar keratosis, is a skin condition caused by exposure to ultraviolet radiation. Cipher acquired Actikerall™ from Almirall S.A. in May 2015 and the product was launched in the Canadian market in February 2016. As of June 2016, Actikerall had garnered a 3.1% share of the actinic keratosis market.

VANIQA™

VANIQA is a prescription cream clinically proven to reduce the growth of unwanted facial hair in women. VANIQA cream is an enzyme inhibitor and works by blocking an enzyme necessary for hair to grow. The product was approved by Health Canada in May 2001. Cipher acquired Vaniqa™ from Almirall S.A. in May 2015 and launched in the Canadian market the same month. Vaniqa prescriptions have grown 2.3% in the last twelve month period (source: IMS).

Other Royalty Products

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. Cipher's U.S. marketing and distribution partner for Lipofen is Kowa Pharmaceuticals America, Inc. ("Kowa").

According to IMS, the hyperlipidemia market in the U.S. exceeded $12.6 billion in 2015 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. was $1.0 billion during 2015, down from $1.2 billion in the previous year.

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. In Q2 2014, Cipher and Kowa agreed to pre-emptively launch an authorized generic version of Lipofen in advance of the expiration of the product patent in January 2015. Prescriptions for Lipofen and the authorized generic were down 21% in Q2 2016 versus Q2 2015 reflecting reduced commercial effort by Kowa, however, the product continues to be a steady source of cash flow for Cipher, generating approximately $1.0 million in net revenue per quarter.

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 received FDA approval in 2010. In Q2 2011, Cipher entered into a distribution and supply agreement with Vertical Pharmaceuticals Inc. ("Vertical"), a U.S.-based specialty pharmaceutical company and the product was launched in the U.S. in September 2011 under the trade name ConZip. According to IMS, the U.S. market in 2015 for extended release formulations of tramadol exceeded US$60 million which represents 1.7% of the total tramadol immediate-release and extended-release prescription market. An authorized generic version of the product was launched by Cipher in the U.S. market in July 2015 through Vertical. Combined prescriptions for ConZip and the authorized generic were up 32% in Q2 2016 versus Q2 2015, generating approximately $0.6 million of net revenue per quarter.

Cipher received Health Canada approval for CIP-TRAMADOL ER in 2011 and completed a Canadian distribution and supply agreement with Medical Futures Inc. ("Medical Futures"). The product was launched in Canada in March 2012 under the trade name Durela. In June 2015, Medical Futures was acquired by Tribute Pharmaceuticals Canada Inc. ("Tribute") which has increased their commercial effort on Durela and during the same month POZEN Inc. announced the acquisition of Tribute, which is now complete. Effective February 5, 2016, the new combined company is now named Aralez Pharmaceuticals Inc. According to IMS, the Canadian market for extended-release tramadol was approximately CDN$27 million in 2015, which was unchanged from 2014. Patents that expire in 2022 have been issued both in the U.S. and Canada for the product.

Cipher, through their licensing partner, Tecnofarma International, launched CIP-TRAMADOL ER in May 2016 in Argentina. This licensing agreement was signed in April 2013 and extends across 18 Latin American countries. Further countries within the territory are expected to commercialize CIP-TRAMADOL ER throughout 2017 and 2018.

Pre-Commercial Products

OZENOXACIN

In 2015, Cipher in-licensed the Canadian rights to Ozenoxacin, a topical treatment for adult and paediatric patients with impetigo, from Ferrer International SA (“Ferrer”), a privately-held Spanish pharmaceutical company. During Q3 2015, Ferrer successfully completed the second Phase III clinical trial for Ozenoxacin. Subsequent to quarter end, Cipher’s New Drug Submission for Ozenoxacin was accepted for review by Health Canada. If approved, the Company is targeting a product launch in 2017. Cipher is not responsible for any future development costs, should any be required.

DERMADEXIN™, PRURIDEXIN™ AND ASF-1096

In 2015, Cipher further strengthened its product pipeline by acquiring the worldwide rights to three products from Astion Pharma ("Astion"), a Denmark-based specialty pharmaceutical company. The three products are focused on inflammatory dermatological diseases: Dermadexin, Pruridexin, and ASF-1096. Dermadexin and Pruridexin target common, chronic conditions that are insufficiently addressed today. In Q3 2015, Cipher received an Acceptance Review Notification for its 510(k) submissions for both Dermadexin and Pruridexin to the FDA. Cipher is responding to the FDAs request for more information and clarification. In April 2016, Cipher received Health Canada approvals (via Natural and Non-Prescription Health Products Directorate “NNHPD”) for DexiDerm SD Cream and DexiDerm AD Cream (also known as Dermadexin and Pruridexin) and expects to launch the products in Canada in the first half of 2017. Dexiderm CD and Dexiderm Scalp are currently under review by NNHPD. European approval of Helioclin® Pruritus SD Cream (also known as Pruridexin) was received in March 2016. Cipher has an orphan drug indication in the EU for ASF-1096, a product candidate that has promise as a treatment for a highly disfiguring rare disease, discoid lupus erythematosus, with no current cure as well as other potential rare conditions. Cipher will pursue an efficient drug development program to support the approval of ASF-1096 in the North American and European markets.

CF101

In 2015, Cipher in-licensed the Canadian distribution rights to CF101, a novel chemical entity being developed by Can-Fite for moderate to severe plaque psoriasis and rheumatoid arthritis. CF101 completed a Phase II/III double-blind, placebo-controlled study, which was designed to test the efficacy of CF101 in patients with moderate to severe plaque psoriasis. Top-line results from the trial were published by Can-Fite at the end of March 2015. Interim results from this Phase II/III trial and final results from the prior Phase II trial in psoriasis were both positive showing that CF101 effectively improved disease symptoms. In addition, at the end of 2013, Can-Fite completed a Phase IIb study for CF101 for active rheumatoid arthritis (“RA”), and has now completed the study design for a Phase III program. Can-Fite plans to start enrolling patients into the Phase III RA program and start the psoriasis Phase III program in the second half of 2016. The timeline to regulatory submissions to Health Canada will be determined by the successful completion of these registration clinical trial programs. Cipher is not responsible for any of these development costs.

NANOLIPOLEE-007

In 2014, Cipher acquired the assets of Melanovus, a Pennsylvania-based life sciences company. The assets include seven pre-clinical compounds for the treatment of melanoma and other cancers, with world-wide rights. 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 studies. Cipher is engaged in pre-clinical studies for its oral and IV formulations which may lead to Investigational New Drug status with the FDA, Health Canada and other health authorities. The plan for the development of the remaining six topical and oral skin cancer compounds in the portfolio has not yet been established.

Out-Licensing Activities

Cipher continues to pursue marketing partners for CIP-ISOTRETINOIN in other territories, including Latin America. In 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. The registration process is completed for 10 mg, 20 mg and 30 mg strengths and it is expected that Cipher's product will be marketed, in the first half of 2017, under the brand name Lisacne-CIP, replacing Andrómaco's current isotretinoin product, Lisacne. Andrómaco is owned by Grünenthal GmbH, Germany. Under the terms of the agreement, Cipher achieved a modest regulatory milestone payment in Q3 2015 and is eligible for an additional commercial milestone payment. Cipher will supply finished product to Andrómaco and product manufacturing will be fulfilled by Cipher's partner, Galephar.

In 2014, Cipher entered into a definitive distribution and supply agreement with Ranbaxy Laboratories Limited ("Ranbaxy India"), a Sun Pharma Company, under which Cipher granted them the exclusive right to market, sell and distribute Cipher's isotretinoin capsules in Brazil. Ranbaxy India plans to promote the product through a brand dermatology division in Brazil. 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, Cipher received an up-front payment and is eligible for additional pre-commercial milestone payments. Cipher will supply the finished product and product manufacturing will be done by Cipher's partner, Galephar. Ranbaxy India will be responsible for all regulatory-related activities associated with gaining and maintaining regulatory approval of the product in Brazil.

In June 2016, Cipher entered into a definitive licensing agreement with Edesa Biotech Inc. ("Edesa"), under which Cipher granted Edesa the exclusive right to develop, market and sell ASF-1096 for the treatment of anorectal indications. Under the terms of the agreement, Cipher is eligible to receive clinical, regulatory and commercial milestone payments, along with a royalty on net sales.

In-Licensing Activities

The Company continues to pursue the acquisition or in-licensing of new late-stage to commercial-stage dermatology product candidates.

In May 2016, Cipher licensed the worldwide rights to develop, market and sell an investigational tattoo removal cream from Dalhousie University. The product candidate is currently at the pre-clinical stage of development.

Review of Operating Results

Q2 2015 financial information includes results of U.S. operations starting April 13, 2015, the date of the Innocutis acquisition.

REVENUE (IN THOUSANDS OF U.S. DOLLARS)

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Licensing revenue	13,392	13,063	329	3
Product revenue	7,400	3,172	4,228	133
Total revenue	20,792	16,235	4,557	28

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Licensing revenue	7,444	6,318	1,126	18
Product revenue	4,253	2,517	1,736	69
Total revenue	11,697	8,835	2,862	32

Total revenue in Q2 2016 was $11.7 million compared to $8.8 million in Q2 2015, an increase of 32%. Total product revenue increased 69% over Q2 2015 to $4.3 million. Product revenue from U.S. operations was $3.2 million in Q2 2016 compared to $1.8 million in Q2 2015. Product revenue from Canadian products was $1.1 million compared to $0.7 million in Q2 2015. The year-over-year growth in Canadian product revenue was greater than 50%. Licensing revenue was $7.4 million compared to $6.3 million in Q2 2015, an increase of 18%.

Licensing Revenue

Revenue for Absorica was $5.7 million in Q2 2016 compared to $5.1 million in Q2 2015. Finished goods product shipments which were delayed in Q1 2016 were caught up during the second quarter.

Revenue for Lipofen was $1.0 million in Q2 2016 compared to $0.9 million in Q2 2015. The product continues to perform adequately, despite the fact our partner, Kowa, has decreased their commercial efforts.

Revenue from the Company's extended-release tramadol product (ConZip in the U.S. and Durela in Canada) was $0.7 million in Q2 2016, compared to $0.3 million in Q2 2015. Cipher's U.S. partner, Vertical, launched an authorized generic version of the product in mid-2015 which has contributed to the year-over-year growth.

Product Revenue

Product revenue growth in Q2 2016 compared to Q2 2015 was primarily a result of the products acquired with the acquisition of Innocutis in April 2015. Product revenue from U.S. operations was $3.2 million in Q2 2016, an increase of 80% compared to Q2 2015. The net revenue by product in Q2 2016 was Sitavig $1.1 million, Nuvail $0.9 million, Bionect $1.0 million and other brands $0.2 million. Management has taken actions to improve U.S. gross margins, which is reflected in Q2 2016 results and will continue. Bionect, Sitavig and Nuvail revenue increased $0.6 million, $0.4 million and $0.2 million respectively in Q2 2016 versus Q1 2016, driven by active programs to improve product margins and market demand.

Product revenue from Canadian products in Q2 2016 was $1.1 million compared to $0.7 million in Q2 2015. Canadian product revenue increased by more than 50% in Q2 2016 compared to Q2 2015. Canadian product revenue performance was driven by Epuris, which had net sales of $1.0 million in Q2 2016. Vaniqa, Actikerall and Beteflam made up the balance of product revenue. Actikerall and Beteflam were both launched in 2016 in the Canadian market.

RESEARCH AND DEVELOPMENT EXPENSE (IN THOUSANDS OF U.S. DOLLARS)

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Research and development	623	868	(245)	(28)

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Research and development	327	509	(182)	(36)

Research and development ("R&D") expense represents the cost of the Company's drug development activities. R&D expense in Q2 2016 was $0.3 million, compared to $0.5 million for the same period in 2015.

SELLING AND MARKETING EXPENSE (IN THOUSANDS OF U.S. DOLLARS)

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Selling and marketing	7,302	2,888	4,414	152

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Selling and marketing	3,495	2,413	1,082	45

Selling and marketing expense in Q2 2016 was $3.5 million, compared to $2.4 million in Q2 2015. The increase is primarily attributable to the acquisition of Innocutis in April 2015. The U.S. based sales and marketing expenses are mainly focused on driving the growth of Sitavig, Nuvail and Bionect through an internal sales force and enhanced marketing efforts.

GENERAL AND ADMINISTRATIVE EXPENSE (“G&A”) (IN THOUSANDS OF U.S. DOLLARS)

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
General and administrative	8,637	6,281	2,356	38

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
General and administrative	4,940	3,478	1,462	42

General and administrative (“G&A”) expense in Q2 2016 was $4.9 million, compared to $3.5 million in Q2 2015. Expenses incurred by U.S. operations in Q2 2016 were $2.0 million ($1.0 million in Q2 2015).

AMORTIZATION OF INTANGIBLE ASSETS (IN THOUSANDS OF U.S. DOLLARS)

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Amortization of intangible assets	3,089	1,357	1,732	128

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Amortization of intangible assets	1,610	1,221	389	32

The increase in amortization expense is primarily a result of the amortization of the intangible assets acquired in the Innocutis acquisition, which totalled $1.3 million in Q2 2016 ($0.9 million in Q2 2015).

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.

FINANCE COSTS (IN THOUSANDS OF U.S. DOLLARS)

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Interest on senior secured notes	4,476	968	3,508	362
Change in fair value of derivative financial instrument	126	(392)	518	n.m.
Interest Income	(48)	(231)	183	n.m.
Total finance costs	**4,554**	**345**	**4,209**	**1,220**

n.m. not meaningful

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Interest on senior secured notes	3,143	968	2,175	225
Change in fair value of derivative financial instrument	44	(392)	436	n.m.
Interest Income	(11)	(96)	85	n.m.
Total finance costs	**3,176**	**480**	**2,696**	**561**

n.m. not meaningful

Finance costs include interest on senior secured notes net of the gain from the change in the fair value of warrants and interest income earned on surplus cash balances. In Q2 2016, interest on senior secured notes of $3.1 million includes the write-off of the debt issuance costs of $1.8 million. The prior period figures include interest expense starting April 13, 2015 as the debt under the senior secured notes of $40 million was drawn down in conjunction with the Innocutis acquisition in 2015. The interest rate on the debt is 10.25%. In Q2 2016, the loss from the change in the fair value of the warrants in the amount of $44 thousand was due to an increase in stock price during the quarter.

INCOME TAXES

Income tax expense is recognized based on domestic and international statutory income tax rates in the jurisdictions in which the Company operates. These rates are then adjusted to effective tax rates based on management's estimate of the weighted average annual income tax rate expected for the full year in each jurisdiction taking into account taxable income or loss in each jurisdiction and available utilization of deferred tax assets. Deferred tax assets are recognized to the extent that it is probable that the asset can be recovered. The income tax expense relates to a drawdown of the deferred tax asset of the Canadian operations.

NET INCOME (LOSS) EARNINGS (LOSS) PER SHARE

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Income (loss) - in thousands of U.S. dollars	(6,065)	1,945	(8,010)	n.m.
Basic earnings (loss) per share	(0.23)	0.08		
Diluted earnings (loss) per share	(0.23)	0.07		

n.m. not meaningful

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
Loss - in thousands of U.S. dollars	(3,371)	(558)	(2,813)	(504)
Basic loss per share	(0.13)	(0.02)		
Diluted loss per share	(0.13)	(0.02)		

n.m. not meaningful

Basic earnings (loss) per share is calculated using the weighted average number of shares outstanding during the period. Diluted earnings (loss) per share is calculated taking into account dilutive instruments that are outstanding. For the three and six month periods ended June 30, 2016, the computation of diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect of the stock options and RSUs.

Net loss in Q2 2016 was $3.4 million, or ($0.13) per basic share, compared to a net loss of $0.6 million, or ($0.02) per basic share, in Q2 2015.

The weighted average number of shares outstanding for the three month period ended June 30, 2016 was 26,171,530 (2015 - 25,919,087). The dilutive weighted average number of shares outstanding for the three month period ended June 30, 2016 was 26,933,363 (2015 - 26,474,471).

ADJUSTED EBITDA (IN THOUSANDS OF U.S. DOLLARS)

For the six month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
ADJUSTED EBITDA	2,416	5,559	(3,143)	(57)

For the three month periods ended June 30,

	2016	2015	$ change in 2016	% change in 2016
ADJUSTED EBITDA	2,743	1,586	1,157	73

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, income taxes, depreciation of property and equipment, amortization of intangible assets, non-cash share-based compensation, changes in fair value of derivative financial instruments and foreign exchange gains and losses from the translation of Canadian cash balances.

The Company considers Adjusted EBITDA as a key metric in assessing business 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:

For the six month periods ended June 30,

	2016	2015
Net income (loss)	(6,065)	1,945
Add back		
Depreciation and amortization	3,183	1,370
Interest expense	4,428	737
Income taxes	622	1,430
EBITDA	**2,168**	**5,482**
Change in fair value of derivative	126	(392)
Gain from the translation of Canadian cash balances	(1,421)	(451)
Share-based compensation	1,543	920
Adjusted EBITDA	**2,416**	**5,559**

For the three month periods ended June 30,

	2016	2015
Net loss	(3,371)	(558)
Add back		
Depreciation and amortization	1,668	1,231
Interest expense	3,132	872
Income taxes	460	358
EBITDA	**1,889**	**1,903**
Change in fair value of derivative	44	(392)
(Gain) loss from the translation of Canadian cash balances	20	(451)
Share-based compensation	790	526
Adjusted EBITDA	**2,743**	**1,586**

Adjusted EBITDA in Q2 2016 was $2.7 million, an increase of $1.2 million or 73% compared to Q2 2015.

Summary of Quarterly Results

QUARTERLY STATEMENTS OF EARNINGS (LOSS) (IN THOUSANDS OF U.S. DOLLARS, EXCEPT PER SHARE AMOUNTS)

For the six month period ended June 30, 2016

	Q1 2016	Q2 2016	2016 YTD Total
Licensing revenue	5,948	7,444	13,392
Product revenue	3,147	4,253	7,400
Cost of products sold	970	1,060	2,030
Research and development	296	327	623
Selling and marketing	3,807	3,495	7,302
General and administrative	3,697	4,940	8,637
Amortization of intangible assets	1,479	1,610	3,089
Interest on senior secured notes	1,333	3,143	4,476
Change in fair value of warrants	82	44	126
Interest income	(37)	(11)	(48)
Loss before income taxes	(2,532)	(2,911)	(5,443)
Income tax expense	162	460	622
Loss for the period	(2,694)	(3,371)	(6,065)
Basic loss per share	(0.10)	(0.13)	(0.23)
Diluted loss per share	(0.10)	(0.13)	(0.23)

For the year ended December 31, 2015

	Q1 2015	Q2 2015	Q3 2015	Q4 2015	2015 Total
Licensing revenue	6,745	6,318	6,263	6,637	25,963
Product revenue	655	2,517	2,197	3,077	8,446
Cost of products sold	187	934	847	557	2,525
Research and development	359	509	509	766	2,143
Selling and marketing	475	2,413	2,595	3,328	8,811
General and administrative	2,803	3,478	5,347	4,966	16,594
Amortization of intangible assets	136	1,221	1,338	1,709	4,404
Interest on senior secured notes	-	968	1,543	1,313	3,824
Change in fair value of warrants	-	(392)	(2,116)	134	(2,374)
Interest income	(135)	(96)	(82)	(58)	(371)
Income (loss) before income taxes	3,575	(200)	(1,521)	(3,001)	(1,147)
Income tax expense (recovery)	1,072	358	695	(5,041)	(2,916)
Income (loss) for the period	2,503	(558)	(2,216)	2,040	1,769
Foreign currency translation adjustment	(4,688)	-	-	-	(4,688)
Income (loss) and comprehensive income (loss) for the period	(2,185)	(558)	(2,216)	2,040	(2,919)
Basic earnings (loss) per share	0.10	(0.02)	(0.09)	0.08	0.07
Diluted earnings (loss) per share (1)	0.09	(0.02)	(0.09)	0.08	0.07

(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, 2014

	Q1 2014	Q2 2014	Q3 2014	Q4 2014	2014 Total
Licensing revenue	6,833	7,553	6,152	6,818	27,356
Product revenue	308	457	470	633	1,868
Cost of product sold	91	137	124	158	510
Research and development	324	281	245	261	1,111
Selling and marketing	465	554	507	543	2,069
General and administrative	1,627	1,534	1,440	2,322	6,923
Amortization of intangible assets	172	173	174	167	686
Interest income	93	111	134	150	488
Income before income taxes	4,555	5,442	4,266	4,150	18,413
Income tax expense (recovery)	1,051	1,311	(3,682)	960	(360)
Income for the period	3,504	4,131	7,948	3,190	18,773
Other comprehensive income (loss)	(1,379)	1,488	(2,421)	(1,847)	(4,159)
Income and other comprehensive income	2,125	5,619	5,527	1,343	14,614
Basic earnings per share (2)	0.14	0.16	0.31	0.12	0.74
Diluted earnings per share	0.13	0.16	0.30	0.12	0.71

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

Liquidity and Capital Resources

As at June 30, 2016, the Company has cash and cash equivalents of $30.8 million, compared to $27.2 million as at December 31, 2015. During the quarter ended June 30, 2016 the Company generated net cash from operating activities of $3.1 million and $4.5 million for the six month period ended June 30, 2016.

The balance of accounts receivable was $17.5 million at June 30, 2016, compared to $16.3 million as at December 31, 2015.

The balance of accounts payable and accrued liabilities was $16.1 million at June 30, 2016 compared to $13.4 million as at December 31, 2015. The balance of provisions was $5.2 million at June 30, 2016 compared to $4.4 million as at December 31, 2015. The changes in both of these balances reflects normal fluctuations in business operations.

Deferred revenue primarily relates to amounts received in advance of recognition as revenue. The balance of $0.6 million at June 30, 2016 relates primarily to the up-front licensing payments and pre-commercialization milestone payments received by Cipher under the CIP-ISOTRETINOIN distribution and supply agreement, net of revenue recognized to date. The deferred revenue balance at December 31, 2015 was $0.8 million and the decrease relates to revenue recognized during the period.

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.

The only lease contractual obligations are related to the Company's office locations and a fleet lease. The lease for the Company's Canadian premises expires at the end of December 2018. The lease for the Company's U.S. premises expires in January 2023.

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 June 30, 2016, the Company had 26,188,151 common shares issued and outstanding. Subsequent to quarter-end, 7,506 common shares were issued under the employee and director share purchase plan, bringing the total number of common shares issued and outstanding to 26,195,657 as of the date of this MD&A.

A total of 40,000 stock options were granted during Q2 2016 with an exercise price of CDN$7.59. For the six month period ended June 30, 2016, a total of 543,457 stock options were granted.

A total of 3,000 Restricted Share Units ("RSUs") were granted during Q2 2016. For the six month period ended June 30, 2016, a total of 252,891 RSUs were granted.

No Performance Share Units ("PSUs") were granted during Q2 2016. For the six month period ended June 30, 2016, a total of 102,474 PSUs were granted.

Share-based compensation expense in Q2 2016 was $0.8 million, compared to $0.5 million in Q2 2015. The Company's long term incentive programs were extended to the new employees who joined following the Innocutis acquisition in Q2 2015.

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.

Financial Instruments

At June 30, 2016, financial instruments consisted of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, other long term liability, senior secured notes and a derivative financial instrument. The derivative financial instrument is measured at fair value with any changes recognized through the statement of earnings (loss) and comprehensive income (loss) and is classified as Level 2 in the fair value hierarchy. Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and other long-term liability are measured at amortized cost and their fair values approximate carrying values due to their relatively short periods of maturity.

The senior secured notes are measured at amortized cost. At June 30, 2016, the fair value of the senior secured notes approximates their face value of $40.0 million. The fair value is based on cash flows discounted using a rate based on the borrowing rate.

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

Risk Factors

Reference is made to the description of risk factors with respect to the Company and its business in the Company’s most recently filed Annual Information Form filed on SEDAR at www.sedar.com and in the corresponding Form 40-F, and to related information in other filings with Canadian and U.S. securities regulatory authorities.

Disclosure Controls and Procedures

There have been no changes in the Company’s internal control over financial reporting during the most recent interim period ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

As of the end of the period covered by this MD&A and the accompanying condensed interim consolidated financial statements, the Company’s management evaluated the design of its disclosure controls and procedures and internal controls over financial reporting. Based on that evaluation, the Company’s CEO and CFO have concluded that the Company’s disclosure controls and procedures and internal controls over financial reporting have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of condensed interim consolidated financial statements for external purposes in accordance with IFRS as at June 30, 2016

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Cipher Pharmaceuticals Inc.

Condensed Interim Consolidated Financial Statements

For the Three and Six Months Ended June 30, 2016
(Unaudited)

Cipher Pharmaceuticals Inc.
Consolidated Balance Sheets

As at June 30, 2016 and December 31, 2015
(in thousands of United States dollars - unaudited)

	Note	2016	2015
		$	$
ASSETS			
Current assets			
Cash and cash equivalents		30,785	27,182
Accounts receivable		17,523	16,303
Inventory		1,464	1,248
Prepaid expenses and other assets	3	2,234	4,045
		52,006	48,778
Property and equipment, net		857	286
Intangible assets, net	5	43,099	46,114
Goodwill		6,112	6,112
Deferred tax assets	10	7,734	8,356
Total Assets		109,808	109,646
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities	6	16,097	13,354
Provisions		5,216	4,423
Current portion of deferred revenue		339	743
		21,652	18,520
Deferred revenue		235	102
Senior secured notes, net of issuance costs	3	35,171	34,578
Derivative financial instrument	3	1,884	1,758
Other long term liability		777	431
Total Liabilities		59,719	55,389
SHAREHOLDERS' EQUITY			
Share capital	7	15,676	14,947
Contributed surplus		5,531	4,363
Accumulated other comprehensive loss		(9,514)	(9,514)
Retained earnings		38,396	44,461
Total Shareholders' Equity		50,089	54,257
Total Liabilities and Shareholders' Equity		109,808	109,646

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

Cipher Pharmaceuticals Inc.

Consolidated Statements of Earnings (Loss) and Comprehensive Income (Loss)

Three and six month periods ended June 30, 2016 and 2015
(in thousands of United States dollars, except per share data - unaudited)

	Note	Three months June 30, 2016	Three months June 30, 2015	Six months June 30, 2016	Six months June 30, 2015
		$	$	$	$
Revenues					
Licensing revenue		7,444	6,318	13,392	13,063
Product revenue		4,253	2,517	7,400	3,172
Net revenues		11,697	8,835	20,792	16,235
Cost of products sold		1,060	934	2,030	1,121
Gross profit		10,637	7,901	18,762	15,114
Expenses					
Research and development		327	509	623	868
Selling and marketing		3,495	2,413	7,302	2,888
General and administrative		4,940	3,478	8,637	6,281
Amortization of intangible assets		1,610	1,221	3,089	1,357
Total operating expenses	8	10,372	7,621	19,651	11,394
Finance costs					
Interest on senior secured notes	3	3,143	968	4,476	968
Change in fair value of derivative financial instrument		44	(392)	126	(392)
Interest income		(11)	(96)	(48)	(231)
		3,176	480	4,554	345
Income (loss) before income taxes		(2,911)	(200)	(5,443)	3,375
Income taxes	10	460	358	622	1,430
Income (loss) for the period		(3,371)	(558)	(6,065)	1,945
Item that may be reclassified to profit or loss					
Foreign currency translation adjustment		-	-	-	(4,688)
Income (loss) and comprehensive income (loss) for the period		(3,371)	(558)	(6,065)	(2,743)
Basic earnings (loss) per share	11	(0.13)	(0.02)	(0.23)	0.08
Diluted earnings (loss) per share	11	(0.13)	(0.02)	(0.23)	0.07

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

Cipher Pharmaceuticals Inc.

Consolidated Statements of Changes in Shareholders' Equity

Six month periods ended June 30, 2016 and 2015
(in thousands of United States dollars - unaudited)

Product revenue	2,038	5,362	7,400
Net revenues	$ 15,430	$ 5,362	$ 20,792
Segment profit (loss) including amortization	$ 7,190	$ (8,079)	$ (889)
Finance costs			(4,554)
Income taxes			(622)
Loss for the period			$ (6,065)

For the six month period ended June 30, 2015

	Canada	United States	Total
External revenue by segment			
Licensing revenue	$ 13,063	$ -	$ 13,063
Product revenue	1,415	1,757	3,172
Net revenues	$ 14,478	$ 1,757	$ 16,235
Segment profit (loss) including amortization	$ 6,466	$ (2,746)	$ 3,720
Finance costs			(345)
Income taxes			(1,430)
Income for the period			$ 1,945

Other financial information by segment:

	Canada	United States	Total
Total assets as at June 30, 2016	$ 58,819	$ 50,989	$ 109,808
Total assets as at December 31, 2015	$ 59,869	$ 49,777	$ 109,646

Cipher Pharmaceuticals Inc.
Consolidated Statements of Cash Flows

Six month periods ended June 30, 2016 and June 30,2015
(in thousands of United States dollars - unaudited)

	Note	2016	2015
		$	$
Cash provided by (used in)			
Operating activities			
Income (loss) for the period		(6,065)	1,945
Items not affecting cash:			
Depreciation of property and equipment		94	13
Amortization of intangible assets	5	3,089	1,357
Share-based compensation - share purchase plan	7	42	15
Share-based compensation	7	1,501	905
Foreign exchange gain on cash and cash equivalents		(1,421)	(451)
Change in fair value of derivative		126	(392)
Interest on senior secured notes	3	4,476	900
Deferred income taxes	10	622	1,354
Changes in non-cash operating items:			
Accounts receivable		(1,220)	(424)
Inventory		(216)	(254)
Prepaid expenses and other assets		1	(169)
Accounts payable and accrued liabilities		2,699	(114)
Provisions		793	51
Other long term liability		229	283
Deferred revenue		(271)	(556)
Net cash generated from operating activities		4,479	4,463
Investing activities			
Purchase of property and equipment		(493)	(42)
Acquisition of intangible assets		(74)	(7,351)
Acquisition of Innocutis, net of cash acquired		-	(45,413)
Net cash used in investing activities		(567)	(52,806)
Financing activities			
Proceeds from senior secured notes		-	40,000
Interest and financing costs paid		(2,073)	(4,704)
Repayment of finance lease liability		(11)	-
Proceeds from shares issued under the share purchase plan		239	83
Proceeds from exercise of stock options		115	576
Net cash generated from (used in) financing activities		(1,730)	35,955
Increase (decrease) in cash and cash equivalents		2,182	(12,388)
Impact of foreign exchange on cash and cash equivalents		1,421	(3,326)
Cash and cash equivalents, beginning of period		27,182	45,368
Cash and cash equivalents, end of period		30,785	29,654

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

1 NATURE OF OPERATIONS

Cipher Pharmaceuticals Inc. ("Cipher") and its subsidiaries (together the "Company") is a specialty pharmaceutical company focused on dermatology. The Company acquires products that fulfill unmet medical needs, manages the required clinical development and regulatory approval process, and markets those products either directly or through partners. The Company is building its dermatology business through product licensing and acquisitions. Cipher was incorporated under the Business Corporations Act of Ontario on January 9, 2004 and is located at 2345 Argentia Road, Mississauga, Ontario.

2 BASIS OF PREPARATION

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), applicable to the preparation of interim financial statements, including IAS 34, *Interim Financial Reporting*. These condensed interim consolidated financial statements should be read in conjunction with the Company's annual financial statements for the year ended December 31, 2015, which were prepared in accordance with IFRS as issued by the IASB. The Board of Directors approved these condensed interim consolidated financial statements on August 9, 2016.

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, 2018. The Company has not yet evaluated the impact on the consolidated 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.

IFRS 16, *Leases*: On January 13, 2016, the IASB published a new standard, IFRS 16, *Leases*. The new standard will eliminate the distinction between operating and finance leases and will bring most leases on the balance sheet for lessees. This standard is effective for annual reporting periods beginning on or after January 1, 2019. The Company has not yet evaluated the impact on the consolidated financial statements.

Comparative figures

In connection with the preparation of the condensed interim consolidated financial statements of the Company for the quarter ended June 30, 2016, the Company identified certain reclassifications in its previously issued condensed interim consolidated statements of cash flows for the quarter ended June 30, 2015. The reclassifications relate to an overstatement of cash used in operating activities by $451 related to the foreign exchange gain on cash and cash equivalents and a corresponding understatement of the impact of foreign exchange on cash and cash equivalents.

3 FINANCIAL INSTRUMENTS AND SENIOR SECURED NOTES

In connection with the acquisition of Innocutis Holdings, LLC ("Innocutis"), the Company closed a private offering of $100,000 in aggregate principal amount of Senior Secured Notes due in 2020 ("Notes"). The Company received an initial draw down of $40,000, which was used to fund the majority of the purchase price for Innocutis. The balance of the Notes were not drawn as of June 30, 2016 and expired on that date. The Notes bear interest at a fixed rate of 10.25% per annum payable quarterly and will mature in five years, unless repurchased earlier. The Notes are secured by all present and future assets of the Company and have certain restrictive covenants, including quarterly consolidated net revenue, minimum cash balance and consolidated leverage ratio. As at June 30, 2016 the Company is in compliance with all covenants.

In connection with the offering, the Company issued 600,000 common share purchase warrants to the lender with an option for a cashless exercise in which the settlement price caused the conversion ratio to be variable. Accordingly, the warrants are classified as a financial liability. Gains and losses on re-measurement are presented separately in the statements of earnings (loss) and comprehensive income (loss). The exercise price of the warrants is $9.22 (equal to the five day volume-weighted average price on the Toronto Stock Exchange prior to closing, converted to U.S. dollars) and expire seven years from the date of issuance. A pricing model with observable market-based inputs was used to estimate the fair value of the warrants issued. The estimated fair value of the warrants at April 13, 2015, December 31, 2015 and June 30, 2016 were $4,132, $1,758 and $1,884, respectively.

The variables used to compute the fair value as at April 13, 2015, December 31, 2015 and June 30, 2016 are as follows:

	April 13, 2015	Dec 31, 2015	June 30, 2016
Share price	$9.22	$4.68	$5.22
Expected life	7.0 years	7.0 years	7.0 years
Expected volatility	83.6%	79.1%	83.5%

The following is the continuity of the Notes from January 1, 2015 to June 30, 2016:

Balance January 1, 2015	$ -
Draw down of Notes	40,000
Fair value of warrants on initial recognition	(4,132)
Deferred financing cost	(2,119)
Interest expense	2,995
Interest paid	(2,995)
Accretion expense	829
Balance December 31, 2015	34,578
Interest expense	2,073
Interest paid	(2,073)
Accretion expense	593
Balance June 30, 2016	$ 35,171

Total debt issuance costs associated with the Notes of $2,119 have been netted against the Notes on the consolidated balance sheets. Additional debt issuance costs of $1,810 which were included in prepaid expenses and other assets as at December 31, 2015, were written off in Q2 2016, and are included in interest on senior secured notes in the statements of earnings (loss), as the availability of the additional $60 million of the undrawn portion of the Notes expired on June 30, 2016.

Fair value of financial instruments

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

At June 30, 2016, the Company's financial instruments consisted of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, other long term liability, the Notes and derivative financial instrument. The derivative financial instrument is measured at fair value with any changes recognized through the statements of earnings (loss) and comprehensive income (loss) and is classified as Level 2 (as defined under IFRS). Cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and other long term liability are measured at amortized cost and their fair values approximate carrying values due to their relatively short periods to maturity.

The Notes are measured at amortized cost. At June 30, 2016, the fair value of the Notes approximates the face value of $40,000. The fair value is based on cash flows discounted using a rate based on the borrowing rate.

4 LICENSING AGREEMENTS WITH GALEPHAR

In 2002, the Company entered into a Master Licensing and Clinical Supply Agreement ("the Agreement") with Galephar, a Puerto Rico based pharmaceutical research and manufacturing company. Under the Agreement, the Company acquired the rights to package, test, obtain regulatory approvals and market CIP-FENOFIBRATE, CIP-ISOTRETINOIN and CIP-TRAMADOL ER ("the CIP Products") in various countries. In accordance with the Agreement, the Company retains 50% of all revenue from licensing and distribution arrangements entered into with respect to the CIP Products, with the other 50% due to Galephar. 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.

5 INTANGIBLE ASSETS

In Q2 2016, the Company acquired the worldwide rights from Dalhousie University to develop and commercialize an investigational tattoo removal cream product. An upfront payment of $74 was made upon execution of the agreement and the transaction includes potential milestones of up to CDN$3,600 based on future regulatory and commercial sales milestones, as well as royalties on commercial sales.

The following is a summary of the changes in intangible assets for the six month period ended June 30, 2016:

	Product Rights and Other	Licensing and Intellectual Property Rights	Total
As at January 1, 2016			
Cost	$ 47,467	$ 8,024	$ 55,491
Accumulated amortization	(8,782)	(595)	(9,377)
Net book value	$ 38,685	$ 7,429	$ 46,114
For the six months ended June 30, 2016			
Opening net book value	$ 38,685	$ 7,429	$ 46,114
Additions	-	74	74
Amortization	(2,554)	(535)	(3,089)
Net book value	$ 36,131	$ 6,968	$ 43,099
As at June 30, 2016			
Cost	$ 47,467	$ 8,098	$ 55,565
Accumulated amortization	(11,336)	(1,130)	(12,466)
Net book value	$ 36,131	$ 6,968	$ 43,099

The Company has considered indicators of impairment for finite lived intangible assets as of June 30, 2016 and no indicators were identified.

6 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES AND PROVISIONS

	As at June 30, 2016	As at Dec 31, 2015
Trade accounts payable	$ 12,361	$ 10,725
Accrued liabilities	3,736	2,629
	$ 16,097	$ 13,354

Provisions relate to estimates made for returns, rebates and other price adjustments. Although the estimates for rebates and other price adjustments relate to revenue recognition transactions, namely product sales, the payments made for the underlying transactions are made directly to the claimants concerned and not to the original customer. Actual costs for these charges and estimates are recorded in accounts payable and accrued liabilities. The recorded provisions are for the uninvoiced portion of these costs and estimates. The provision for product returns relates to potential returns due to expiration or other return rights under the terms of distribution and supply agreements with customers. The adequacy of the provisions are evaluated based on product sales activity, pricing and estimates of expiring products in the distribution chain.

7 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, 2015 to June 30, 2016:

	Number of common shares (in thousands)	Amount $
Balance outstanding - January 1, 2015	25,673	13,438
Options exercised in 2015	315	1,101
Shares issued in 2015 under the share purchase plan	70	408
Balance outstanding - December 31, 2015	26,058	14,947
Options exercised in Q1 2016	40	223
Shares issued in Q1 2016 under the share purchase plan	39	167
Shares issued in Q1 2016 under the RSU plan	25	204
Options exercised in Q2 2016	7	21
Shares issued in Q2 2016 under the share purchase plan	19	114
Balance outstanding - June 30, 2016	26,188	15,676

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. As at June 30, 2016, 559,411 common shares reserved for ESPP purchases remain available under the plan.

During the three month period ended June 30, 2016, 19,489 shares were issued under the ESPP (5,555 in Q2 2015). Included in share-based compensation expense is $17 ($8 in Q2 2015), which is the discount on the shares issued during the period. During the six month period ended June 30, 2016, 57,701 shares were issued under the ESPP (8,885 in 2015). Included in share-based compensation expense is $42 ($15 in 2015), which is the discount on the shares issued during the period.

Stock option plan

The following is a summary of the changes in the stock options outstanding from January 1, 2015 to June 30, 2016:

	Number of options (in thousands)	Weighted average exercise price $
Balance outstanding - January 1, 2015	1,284	4.03
Granted in 2015	533	9.79
Exercised in 2015	(315)	1.96
Forfeited in 2015	(88)	8.33
Balance outstanding - December 31, 2015	1,414	6.39
Granted in Q1 2016	503	4.91
Exercised in Q1 2016	(40)	3.00
Forfeited in Q1 2016	(24)	7.06
Granted in Q2 2016	40	5.89
Exercised in Q2 2016	(7)	1.66
Forfeited in Q2 2016	(92)	7.28
Balance outstanding - June 30, 2016	1,794	5.73

At June 30, 2016, 746,101 options were fully vested and exercisable (551,466 at June 30, 2015).

During Q2 2016, the Company granted 40,000 stock options under the stock option plan. The options vest over a four year period based on the grant date, at 25% per year and have a ten year life. Expected volatility is based on the Company's historical volatility, while estimated forfeiture are not considered significant. There is no expected dividend. The exercise price and Black Scholes assumptions are as follows

Grant Date	Number Granted	Exercise Price	Black Scholes Value	Risk-free Interest Rate	Expected Life	Expected Volatility
May 9, 2016	40,000	CDN$7.59	CDN$5.22	1.18%	6.1 years	80.0%

Total compensation cost for these stock options is estimated to be $162 which will be recognized on a graded basis over the vesting period of the stock options. The total expense for stock options for the three month period ended June 30, 2016 is $476 ($507 in Q2 2015). The total expense for stock options for the six month period ended June 30, 2016 was $1,054 ($896 in 2015).

Restricted Share Unit (RSU) and Performance Share Unit (PSU) Plan

On May 13, 2015, the Company adopted a RSU and PSU plan. RSUs and PSUs are notional share units exchangeable for common shares of the Company. RSUs are granted to all employees and directors of the Company and PSUs are granted to certain executives. RSUs granted to employees vest over a three year period and RSUs granted to directors vest over a one year period. PSUs vest based upon the achievement of financial performance goals for the Company for the three year periods ended December 31, 2017 and December 31, 2018.

The PSUs have both performance conditions and market conditions as defined under IFRS 2, *Share-Based Payments*. At June 30, 2016, the performance conditions component of the PSUs have a fair value of $nil. The fair value of the market condition component of the PSUs was calculated using a Monte-Carlo simulation model which provides a valuation based on a number of future probabilities and scenarios based on the Company's share price performance against certain comparable indices.

A summary of the RSUs and PSUs granted and outstanding as at June 30, 2016 is as follows:

	RSUs	PSUs
	Number of Units (in 000's)	Number of Units (in 000's)
Balance - January 1, 2016	59	25
Granted in Q1 2016	250	103
Vested in Q1 2016	(25)	-
Forfeited in Q1 2016	(2)	(1)
Granted in Q2 2016	3	-
Forfeited in Q2 2016	(29)	(19)
Balance - June 30, 2016	256	108

The total expense for RSUs and PSUs for the three month period ended June 30, 2016 was $296 ($9 in Q2 2015). The total expense for the six month period ended June 30, 2016 was $447 ($9 in 2015).

8 EXPENSES BY NATURE

	Three Months June 30, 2016	Three Months June 30, 2015	Six Months June 30, 2016	Six Months June 30, 2015
Employees salaries and other short term benefits	$ 3,187	$ 2,342	$ 6,723	$ 3,155
Directors fees and expenses	83	73	158	145
Share-based compensation	790	525	1,543	920
Depreciation of property and equipment	58	10	94	13
Amortization of intangible assets	1,610	1,221	3,089	1,357
Professional and consulting fees	2,619	1,756	4,981	3,297
Contract sales	-	233	-	431
Facility rent	110	41	212	56
Listing fees (TSX and NASDAQ)	54	30	157	127
Travel expenses	465	405	972	523
Insurance	152	168	289	296
Foreign exchange gain	(39)	(532)	(934)	(712)
Severance costs	18	293	111	293
Recruitment fees	143	65	244	65
Data management subscriptions and market research	236	174	539	258
Other transaction related costs	-	300	-	300
Regulatory and patent maintenance costs	218	70	375	184
Other expenses	668	447	1,098	686
	$ 10,372	$ 7,621	$ 19,651	$ 11,394

9 COMPENSATION OF KEY MANAGEMENT

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

	Three Months June 30, 2016	Three Months June 30, 2015	Six Months June 30, 2016	Six Months June 30, 2015
Salaries and short-term employee benefits, including bonuses	$ 551	$ 388	$ 937	$ 705
Directors fees	75	71	146	141
Share-based compensation	434	472	835	748
	$ 1,060	$ 931	$ 1,918	$ 1,594

The amounts for the three and six month periods ended June 30, 2015 have been revised to exclude compensation of certain vice presidents who were previously included in key management disclosure.

10 INCOME TAXES

Management uses estimates when determining current and 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 probability of the Company to be able to realize 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.

Income tax expense is recognized based on the best estimate of the weighted average annual income tax rate expected for the full financial year.

Income tax expense as reported differs from the amount that would be computed by applying the combined Canadian federal and provincial statutory income tax rates to income before income taxes. The reasons for the differences are as follows:

	Three Months June 30, 2016	Three Months June 30, 2015	Six Months June 30, 2016	Six Months June 30, 2015
Income (loss) before income taxes	$ (2,911)	$ (200)	$ (5,443)	$ 3,375
Tax provision at the statutory income tax rate of 26.5%	$ (771)	$ (53)	$ (1,442)	$ 894
Permanent differences	159	127	268	424
Effect of tax rates in foreign jurisdictions	(432)	(277)	(928)	(277)
Effect of currency translation adjustment	42	(166)	(483)	(166)
Change in deferred tax assets not recognized - United States	1,440	1,004	3,185	1,004
Other	22	(277)	22	(449)
Income tax expense	$ 460	$ 358	$ 622	$ 1,430

The movement in the deferred income tax asset for the six month periods ended June 30, 2016 and 2015 is as follows:

	Six Months June 30, 2016	Six Months June 30, 2015
As at January 1	$ 8,356	$ 5,936
Tax provision	2,563	(426)
Foreign exchange	-	(408)
Deferred tax assets not recognized	(3,185)	(1,004)
As at June 30	$ 7,734	$ 4,098

11 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 three months ended June 30, 2016 was 26,171,530 (for the three months ended June 30, 2015 - 25,919,087). The weighted average number of shares outstanding for the six months ended June 30, 2016 was 26,129,099 (for the six months ended June 30, 2015 - 25,878,902).

Diluted earnings per share is calculated using the weighted average number of shares outstanding taking into consideration the weighted average impact of dilutive securities. For the three and six month periods ended June 30, 2016, the computation of diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect of the stock options. The dilutive weighted average number of shares outstanding for the three months ended June 30, 2016 was 26,933,363 (for the three months ended June 30, 2015 - 26,474,471). The dilutive weighted average number of shares outstanding for the six months ended June 30, 2016 was 26,673,865 (for the six months ended June 30, 2015 - 26,503,509).

12 COMMITMENTS AND CONTINGENCIES

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.

In the normal course of business, the Company may be the subject of litigation or other potential claims. While management assesses the merits of each lawsuit and defends itself accordingly, the Company may be required to incur significant expenses or devote significant resources to defending itself against litigation. At June 30, 2016 the total accrual was $100 (December 31, 2015 - nil).

13 SEGMENTED INFORMATION

The Company's operations are categorized into one industry segment, being specialty pharmaceuticals. The Company is managed geographically in Canada and the United States, which commenced in Q2 2015 with the acquisition of Innocutis. Before the acquisition of Innocutis the Company only had one geographical segment.

For the three month period ended June 30, 2016

	Canada	United States	Total
External revenue by segment			
Licensing revenue	$ 7,444	$ -	$ 7,444
Product revenue	1,093	3,160	4,253
Net revenues	$ 8,537	$ 3,160	$ 11,697
Segment profit (loss) including amortization	$ 3,868	$ (3,603)	$ 265
Finance costs			(3,176)
Income taxes			(460)
Loss for the period			$ (3,371)

For the three month period ended June 30, 2015

	Canada	United States	Total
External revenue by segment			
Licensing revenue	$ 6,318	$ -	$ 6,318
Product revenue	760	1,757	2,517
Net revenues	$ 7,078	$ 1,757	$ 8,835
Segment profit (loss) including amortization	$ 3,026	$ (2,746)	$ 280
Finance costs			(480)
Income taxes			(358)
Loss for the period			$ (558)

For the six month period ended June 30, 2016

	Canada	United States	Total
External revenue by segment			
Licensing revenue	$ 13,392	$ -	$ 13,392
Product revenue	2,038	5,362	7,400
Net revenues	$ 15,430	$ 5,362	$ 20,792
Segment profit (loss) including amortization	$ 7,190	$ (8,079)	$ (889)
Finance costs			(4,554)
Income taxes			(622)
Loss for the period			$ (6,065)

For the six month period ended June 30, 2015

	Canada	United States	Total
External revenue by segment			
Licensing revenue	$ 13,063	$ -	$ 13,063
Product revenue	1,415	1,757	3,172
Net revenues	$ 14,478	$ 1,757	$ 16,235
Segment profit (loss) including amortization	$ 6,466	$ (2,746)	$ 3,720
Finance costs			(345)
Income taxes			(1,430)
Income for the period			$ 1,945

Other financial information by segment:

	Canada	United States	Total
Total assets as at June 30, 2016	$ 58,819	$ 50,989	$ 109,808
Total assets as at December 31, 2015	$ 59,869	$ 49,777	$ 109,646

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CORPORATE DIRECTORY

DIRECTORS

Dr. Stefan Aigner
Director

Mark Beaudet
Director

Christian Godin
Director

Dr. John Mull
Chair

Thomas Wellner
Director

Stephen Wiseman
Director

Harold Wolkin
Director

OFFICERS

Shawn Patrick O'Brien
President and
Chief Executive Officer

Norman Evans CPA, CA
Chief Financial Officer

SENIOR MANAGEMENT

Shawn Patrick O'Brien
President and
Chief Executive Officer

Norman Evans CPA, CA
Chief Financial Officer

Ralph Bohrer
General Manager and
President, Cipher US

Joan Chypyha
General Manager and
President, Cipher Canada

Brian Rosenberger
Vice President, Alliance &
Strategic Portfolio Management

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.

Transfer Agent
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Services Inc.
100 University Ave., 9th floor
North Tower
Toronto, Ontario M5J 2Y1
T: 1·800·564·6253
www.computershare.com/service

Legal Counsel
Goodmans LLP

Auditors
PricewaterhouseCoopers LLP

INVESTOR RELATIONS

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