iCo Therapeutics Inc.
(a development stage company)

Financial Statements
December 31, 2013 and 2012
(in Canadian dollars)

April 24, 2014

Independent Auditor's Report

To the Shareholders
of iCo Therapeutics Inc.

We have audited the accompanying financial statements of iCo Therapeutics Inc., which comprise the balance sheets as at December 31, 2013 and December 31, 2012 and the statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

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

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

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

PricewaterhouseCoopers LLP
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Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of iCo Therapeutics Inc. as at December 31, 2013 and December 31, 2012 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

(signed) PricewaterhouseCoopers LLP

Chartered Accountants

iCo Therapeutics Inc.

(a development stage company)

Balance Sheets

As at December 31, 2013 and 2012

(in Canadian dollars)

	Note	2013 $	2012 $
Assets			
Current assets			
Cash and cash equivalents		1,104,584	599,457
Short-term investments		798,805	660,739
Taxes and other receivables	5	128,560	25,118
Deferred financing		22,604	22,604
Prepaid expenses		14,365	30,934
		2,068,918	1,338,852
Other investments	4	1,705,191	1,432,657
Equipment	6	6,423	8,125
Intangible assets	7	148,472	233,801
		3,929,004	3,013,435
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	8	2,630,406	963,731
Shareholders' Equity			
Capital stock	9	23,836,143	19,978,848
Contributed surplus	9	3,154,094	2,403,324
Warrants	9	1,118,877	559,083
Accumulated other comprehensive income		-	250,776
Accumulated deficit		(26,810,516)	(21,142,327)
		1,298,598	2,049,704
		3,929,004	3,013,435

Commitments and contingencies (note 16)

Subsequent events (note 19)

Approved by the Board of Directors

(signed) William Jarosz Director (signed) Andrew Rae Director

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

iCo Therapeutics Inc.

(a development stage company)

Statements of Loss and Comprehensive Loss

For the years ended December 31, 2013 and 2012

(in Canadian dollars)

	Note	2013 $	2012 $
Expenses			
Research and development	12	4,075,840	2,287,148
General and administrative	13	2,061,405	1,374,710
Foreign exchange loss (gain)		222,366	(7,468)
		6,359,611	3,654,390
Gain on other investments	4	982,189	-
Impairment on other investments	4	(458,879)	-
Other income	16	151,004	3,876
Interest income		17,108	7,831
		691,422	11,707
Loss for the year		5,668,189	3,642,683
Other comprehensive (loss) income			
Items that may be subsequently reclassified to profit or loss:			
Changes in fair value of other investments		(250,776)	212,256
Total comprehensive loss		5,918,965	3,430,427
Basic and diluted loss per share		(0.09)	(0.07)
Weighted average number of shares (basic and diluted)		61,484,576	49,499,654

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

iCo Therapeutics Inc.

(a development stage company)

Statements of Changes in Shareholders' Equity

For the years ended December 31, 2013 and 2012

(in Canadian dollars)

	Number of shares	Capital stock $	Contributed surplus $	Warrants $	Accumulated other comprehensive income (loss) $	Accumulated deficit $	Shareholders' equity $
Balance - December 31, 2011	46,632,301	17,587,930	2,228,455	335,529	38,520	(17,499,644)	2,690,790
Private placement (note 9)	5,675,332	2,165,430	-	388,469	-	-	2,553,899
Share issue costs	-	(289,914)	-	(36,579)	-	-	(326,493)
Exercise of warrants (note 9)	1,300,994	515,402	-	(47,705)	-	-	467,697
Expired warrants	-	-	80,631	(80,631)	-	-	-
Share-based payments	-	-	94,238	-	-	-	94,238
Other comprehensive income	-	-	-	-	212,256	-	212,256
Loss for the year	-	-	-	-	-	(3,642,683)	(3,642,683)
Balance - December 31, 2012	53,608,627	19,978,848	2,403,324	559,083	250,776	(21,142,327)	2,049,704
Private placement (note 9)	9,655,771	2,965,205	-	-	-	-	2,965,205
Allocation of warrants	-	(795,582)	-	795,582	-	-	-
Exercise of warrants (note 9)	4,446,832	1,629,672	-	(195,297)	-	-	1,434,375
Expired warrants	-	-	40,491	(40,491)	-	-	-
Exercise of options	100,000	58,000	(29,000)	-	-	-	29,000
Share-based payments	-	-	739,279	-	-	-	739,279
Other comprehensive loss	-	-	-	-	(250,776)	-	(250,776)
Loss for the year	-	-	-	-	-	(5,668,189)	(5,668,189)
	14,202,603	3,857,295	750,770	559,794	(250,776)	(5,668,189)	(751,106)
Balance - December 31, 2013	67,811,230	23,836,143	3,154,094	1,118,877	-	(26,810,516)	1,298,598

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

iCo Therapeutics Inc.

(a development stage company)

Statements of Cash Flows

For the years ended December 31, 2013 and 2012

(in Canadian dollars)

	2013 $	2012 $
Cash flows from operating activities		
Loss for the year	(5,668,189)	(3,642,683)
Items not affecting cash		
Amortization	87,031	87,809
Share-based payments	739,279	94,238
Gain on other investments	(982,189)	-
Impairment on other investments	458,879	-
Unrealized foreign exchange loss	127,815	8,201
	(5,237,374)	(3,452,435)
Changes in non-cash working capital		
Taxes and other receivables	(103,442)	1,037
Deferred financing	-	(22,604)
Prepaid expenses	16,569	15,280
Accounts payable and accrued liabilities	1,561,533	697,754
	(3,762,714)	(2,760,968)
Cash flows from investing activities		
Purchase of equipment	-	(2,975)
(Purchase) redemption of short-term investments	(138,066)	410,112
	(138,066)	407,137
Cash flows from financing activities		
Exercise of warrants	1,434,375	467,697
Exercise of options	29,000	-
Net proceeds from issuance of units	2,965,205	2,227,406
	4,428,580	2,695,103
Effect of foreign currency exchange rates on cash and cash equivalents	(22,673)	2,637
Increase in cash and cash equivalents	505,127	343,909
Cash and cash equivalents - Beginning of year	599,457	255,548
Cash and cash equivalents - End of year	1,104,584	599,457
Supplementary information		
Cash received for interest within operating activities	17,108	7,831

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

(in Canadian dollars)

1 Nature of operations

iCo Therapeutics Inc. (“iCo” or the “Company”) is a development stage pharmaceutical company focused on the reprofiling and repositioning of drugs and drug candidates with a previous clinical history for new disease indications. iCo’s current business strategy is to acquire the rights to drugs and drug candidates from third parties and run human clinical trial programs for new disease indications, with an emphasis on ophthalmology. The Company currently has three compounds under development. The first, iCo-007, is an anti-sense molecule that the Company believes reduces levels of a key protein associated with diabetic retinopathy. The Company completed a Phase I, open label, dose-escalating clinical trial at four trial sites in the United States using a single injection of iCo-007 in patients with diffuse diabetic macular edema (“DME”) which met its primary end point of safety. The Company subsequently initiated a Phase II clinical trial for iCo-007 in patients with DME (the “iDEAL” Study”) and announced on September 26, 2011, research and collaboration with Juvenile Diabetes Research Foundation (“JDRF”) to support the Phase II trial. On June 18, 2013 the Company announced that it had completed enrollment for the iDEAL Study and subsequently on March 5, 2014, the Company announced the final month eight patient visit in the iDEAL Study. Next steps include data queries and subsequent data lock. Once these activities are complete, the results will be analyzed and top-line results will be made public, which the Company expects to be in the second quarter of 2014.

iCo-008 is a monoclonal antibody that the Company plans to take into clinical trials for vernal keratoconjunctivitis (“VKC”) and possibly age related macular degeneration. On December 8, 2010, the Company also signed an option to license the systemic applications of iCo-008 to IMMUNE Pharmaceuticals Corp. (“IMMUNE”). The option to convert to a full licence was exercised by IMMUNE on June 24, 2011. On February 21, 2013, IMMUNE announced it was initiating a Phase II clinical trial with iCo-008 (“Bertilimumab”) in patients with ulcerative colitis. The Phase II program was further expanded to examine Bertilimumab for the treatment of bullous pemphigoid, a rare auto-immune condition that affects the skin and causes the formation of blisters.

The Oral AmpB program (formerly “iCo-009”) is an experimental oral formulation of Amphotericin B that is at a pre-clinical stage.

The Company is considered to be in the development stage as most of its efforts have been devoted to research and development, raising capital, recruiting personnel and long-term planning. The Company is publicly traded on the TSX Venture Exchange under the symbol “ICO” and the OTCQX under the symbol “ICOTF”. The Company is incorporated and domiciled in British Columbia, Canada. The address of its head office is Suite 1300, 777 Dunsmuir Street, Vancouver, British Columbia, V7Y 1K2.

(in Canadian dollars)

2 Significant accounting policies

Basis of presentation and statement of compliance

The financial statements of iCo have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The financial statements have been prepared on a historical cost basis except for the other investments which are recorded at fair value. The financial statements are presented in Canadian dollars which is the Company's functional currency.

These financial statements were approved by the Board of Directors for issue on April 24, 2014.

Critical accounting estimates and judgments

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Critical accounting estimates and assumptions

The preparation of financial statements in accordance with IFRS requires the Company's management to make estimates and assumptions that affect the amounts reported in these financial statements and notes. The Company regularly reviews its estimates; however, actual amounts could differ from the estimates used and, accordingly, materially affect the results of operations. Areas requiring management to make significant estimates include the clinical trial accruals and valuation of investment in IMMUNE.

Further details of the nature of these assumptions and conditions may be found in the relevant notes to the financial statements. Key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year include the clinical trial accruals and fair value of other investments.

a) Clinical trial accruals

Management examines the accruals in relation to clinical trials on a monthly basis based on the number of patients enrolled in the trials and the stage in the trials. Accruals are based on information obtained from various clinics and estimated costs based on the stage of treatment. Refer to note 8 for details regarding the estimates used related to clinical trial accruals.

(in Canadian dollars)

b) Fair value of other investments

The fair value of the other investments is determined by using valuation techniques. The Company uses its estimates and judgment to select a variety of methods as prescribed under the accounting standards. At year-end management used market value for the shares and Black Scholes model for the warrants to determining the fair value of the other investments. Refer to note 4 for details regarding the estimates used related to fair value of other investments.

Critical judgments in applying accounting policies

Areas requiring management to make significant judgments include the impairment of intangible assets and valuation of investment in IMMUNE.

a) Impairment of intangible assets

The Company assesses at least every reporting period whether there are indicators of impairment in accordance with the accounting policy stated in the note referenced in these financial statements. Based on the current status of the trials, there were no indicators of impairment identified by management at year-end.

b) Fair value of other investments

Management applied judgment with respect to the terms of the Warrants. Refer to note 4.

Cash and cash equivalents

Cash and cash equivalents consist of cash on deposit and highly liquid short-term interest bearing securities with maturities at the date of purchase of three months or less. Cash and cash equivalents are held at recognized Canadian financial institutions. Interest earned is recognized in the statement of loss.

Foreign currency translation

The financial statements are presented in Canadian dollars, the Company's functional currency.

Foreign currency transactions are translated into Canadian dollars using the exchange rates at the date of the transactions or valuation where items are re-measured. Foreign exchange gains or losses resulting from the settlement of transactions and from the translation at year-end rates of monetary assets and liabilities denominated in foreign currencies are recognized in the statement of loss.

(in Canadian dollars)

Current and deferred income taxes

The Company follows the liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current period. Future income tax assets and liabilities are recognized in the current period for temporary differences between the tax and accounting basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes. Future income tax assets and liabilities are measured using substantively enacted tax rates and laws expected to apply in the years in which those temporary differences are expected to be recovered or settled. The effect of a change in tax rates on future income tax assets and liabilities is recognized in operations in the period that includes the substantive enactment.

Financial instruments

Financial instruments are classified into the following categories: available-for-sale investments, loans and receivables, financial liabilities at amortized cost and financial assets at fair value through profit or loss. Management determines the classification of its financial assets at initial recognition.

At initial recognition, the Company classifies its financial instruments in the following categories:

a) Available-for-sale investments: Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company's available-for-sale assets comprise investments in equity securities. This is classified as “other investments” within current assets.

   Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from re-measurement are recognized in other comprehensive income except for exchange gains and losses on the translation of debt securities, which are recognized in the statement of loss. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of loss and are included in other gains and losses (net). Available-for-sale investments are classified as non-current, unless an investment matures within 12 months, or management expects to dispose of it within 12 months.

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

(in Canadian dollars)

c) Financial liabilities at amortized cost: Financial liabilities at amortized cost comprise accounts payable, which are initially recognized at the amount required to be paid, less, when material, a discount to reduce the payables to fair value. Subsequently, accounts payable are measured at amortized cost using the effective interest method.

d) Financial assets at fair value through profit or loss ("FVTPL"): Financial assets at FVTPL are financial assets held for trading. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term. Derivatives are also categorized as held for trading unless they are designated as hedges. Assets in this category are classified as current if expected to be settled within 12 months otherwise they are classified as noncurrent. The Company's non-current portion of other investments ("IMMUNE Warrants") are classified as FVTPL and re-measured each reporting period with the fair value gains and losses recorded in the statement of loss.

Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset (other than a financial asset classified as fair value through profit or loss) is impaired.

For equity securities, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired.

If such evidence exists, the Company recognizes an impairment loss, as follows:

a) Financial assets carried at amortized cost: The impairment loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

b) Available-for-sale financial assets: The impairment loss is the difference between the original cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of loss. This amount represents the loss in accumulated other comprehensive income that is reclassified to net loss.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

(in Canadian dollars)

Equipment

Equipment is stated at cost less accumulated amortization and any accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount and recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Amortization methods, useful lives and residual values are reviewed at each annual reporting date and adjusted if appropriate. Amortization is recorded on a straight-line basis over the estimated lives of the equipment as follows:

Computer equipment	3 years
Computer software	2 years
Office equipment	5 years

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in the statement of loss as other gains (losses).

Intangible assets (including research and development expenses)

Intangible assets include patent rights and technology rights that have been acquired from third parties. The Company's intangible assets are shown separately at historical cost. The Company's intangible assets have a finite useful life and are carried at cost less accumulated amortization. Amortization is calculated using the straight-line method to allocate the cost of the licences over their estimated useful lives of nine to 11 years.

Research and development expenses include payroll, employee benefits, share-based payments, and other headcount-related expenses associated with product research and other activities. Research and development expenses also include third-party activities and clinical trial expenses. Such costs related to product development are included in research and development expense until the point that technological feasibility is reached, which for the Company's products, is generally shortly before the products are approved by the authorities. Once technological feasibility is reached, such costs are capitalized and amortized to cost of revenue over the estimated lives of the products.

Expenditures associated with the maintenance of the licensing are expensed as incurred. Other development expenditures that do not meet the criteria for capitalization are recognized as an expense when incurred. Costs previously recognized as an expense are not recognized as an asset in a subsequent period.

(in Canadian dollars)

Impairment of non-financial assets

The Company periodically reviews the useful lives and the carrying values of its long-lived assets. Long-lived assets are reviewed for impairment upon the occurrence of events or changes in circumstances indicating that the carrying value of the asset may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGU). The recoverable amount is the higher of an asset's fair value less costs to sell and value in use (being the present value of the expected future cash flow of the relevant asset or CGU). Any impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

Provisions

Provisions for research and development and general operations are recognized when the Company has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognized even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Share-based payments

The Company grants share-based options to directors, officers, employees and consultants as consideration for work or services performed. Compensation expense is recorded for share-based grants that vest in instalments over the vesting period as separate arrangements.

When the share-based options are exercised, the Company issues new shares. The proceeds are credited to capital stock (note 9). Upon exercise, the amount previously recognized in contributed surplus is transferred to capital stock.

The expense is recognized over the vesting period, which is the period over which all the vesting conditions are to be satisfied.

Loss per share

Basic and diluted loss per share is calculated by dividing net loss for the period attributable to the Company by the weighted average number of common shares outstanding and the dilutive impact of outstanding warrants and options during the period.

(in Canadian dollars)

3 New and revised IFRS affecting amounts reported and or disclosures in the financial statements

a) New and revised standards adopted

Amendments to International Accounting Standards (“IAS”) 1 on presentation of items of other comprehensive income

The amendments retain the option to present profit or loss and other comprehensive income either in one continuous statement or in two separate but consecutive statements. Items of other comprehensive income are required to be grouped into those that will and will not be subsequently reclassified to income. Tax on items of other comprehensive income is required to be allocated on the same basis. The measurement and recognition of items of income and other comprehensive income are not affected by the amendments. The Company has classified all items of other comprehensive income as those that may subsequently be reclassified to income.

IFRS 10 - Consolidated Financial Statements

IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the financial statements of the parent company. The standard provides additional guidance to assist in the determination of control where this is difficult to assess. The application of IFRS 10 did not have a material impact on the financial statements.

IFRS 12 - Disclosure of Interests in Other Entities

IFRS is a disclosure standard and is applicable to entities that have interests in subsidiaries, joint arrangements, associates or unconsolidated structured entities. IFRS 12 establishes disclosure objectives and specifies minimum disclosures that entities must provide to meet those objectives. The objective of IFRS 12 is that entities should disclose information that helps users of financial statements evaluate the nature of and risks associated with its interests in other entities and the effects of those interests on their financial statements. The application of IFRS 12 did not have a material impact on the financial statements.

IFRS 13 - Fair Value Measurement

IFRS 13 defines fair value, establishes a single IFRS framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies to IFRSs that require or permit fair value measurements or disclosures about fair value measurements (and measurements, such as fair value less costs to sell, based on fair value or disclosures about those measurements), except in specified circumstances. The application of IFRS 13 did not have a material impact on the financial statements.

(in Canadian dollars)

b) Accounting standards issued and not yet applied

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2014, and have not been applied in the preparing these financial statements. Those which may be relevant to the Company are set out below. The Company does not plan to adopt these standards early.

IFRS 9 - Financial instruments

IFRS 9 addresses the classification, measurement and recognition of financial assets and financial liabilities. IFRS 9 was issued in November 2009 and October 2010. It replaces the parts of lAS 39 that relate to the classification and measurement of financial instruments. IFRS 9 requires financial assets to be classified into two measurement categories: those measured at fair value and those measured at amortized cost. The determination is made at initial recognition. Where the fair value option is taken, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch. The Company does not expect IFRS 9 to have a material impact on financial statements and will also consider the impact of the remaining phases of IFRS 9 when completed by the IASB.

Amendment to IAS 32 - Financial instruments: Presentation

This amendment updates the application guidance in IAS 32 to clarify some of the requirements for offsetting financial assets and financial liabilities on the balance sheet. The Company does not expect the amendments to IAS 32 to have a material impact on the financial statements.

Amendments to IAS 36 - Impairment of Assets

These amendments address the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less costs of disposal. The Company does not expect the amendments to IAS 36 to have a material impact on the financial statements.

(in Canadian dollars)

4 Other investments

As part of an exclusive licence agreement entered into on June 24, 2011, with IMMUNE Pharmaceutical Inc., a private Israeli company (the "IMMUNE Licence Agreement") the Company received 600,000 IMMUNE common shares ("IMMUNE Shares") and 200,000 IMMUNE Warrants in addition to certain other cash consideration.

The following table represents the changes in the level 3 investments for the year:

	Shares	Warrants	$
Balance - December 31, 2012	600,000	200,000	1,432,657
Effect of merger and anti-dilution (note a)	54,486	(76,351)	798,001
Change in fair value of derivative (note b)	-	-	184,188
Change in fair value of common shares (note b, c)	-	-	(709,655)
Balance - December 31, 2013	654,486	123,649	1,705,191

a) The IMMUNE Shares contained certain anti-dilution features such that the Company's equity position in IMMUNE would be maintained at 6.14%, subject to certain conditions. Subsequently, the Company has been issued an additional 458,621 IMMUNE Shares for a total holding of 1,058,621 IMMUNE Shares.

On August 26, 2013 (merger date), IMMUNE completed a merger (the "Merger") with EpiCept Corporation ("Epicept"), a public company traded on the OTCQX market in the United States. The new entity changed its name to Immune Pharmaceuticals, Inc. and now trades under the symbol IMNP. Under the Merger, IMMUNE shareholders received an approximate 81% ownership position of the combined company (subject to certain adjustments) and accordingly, at completion of the Merger, the Company's ownership of IMMUNE Shares was 654,486. Further, the Company's IMMUNE Warrant ownership was reduced from 600,000 warrants to 123,649 warrants. IMMUNE's share price as at the merger date was US dollars (US)$3.48 (OTCQX).

b) The fair value of the IMMUNE Shares has been determined based on the number of IMMUNE Shares held at December 31, 2013, multiplied by the share price of US$2.30(OTCQX). A discount factor of 5% has been applied to adjust the value because the shares are not freely tradable until February 25, 2014. The IMMUNE Warrants were valued at year end using the Black Scholes option pricing model. The inputs used for the model are as follows: stock price US$2.19, strike price US$2.63, term of 2 years, volatility of 137% and a risk free interest rate of 1.13%.

c) At December 31, 2013, the Company determined that the decline in fair value of the shares from the merger date was considered significant. This resulted in the fair value gain losses recorded in other comprehensive loss within equity to be reclassified to the statement of loss. The amount recycled to the statement of loss totaled $458,879.

(in Canadian dollars)

5 Taxes and other receivables

	2013 $	2012 $
Taxes (HST/GST)	14,205	21,432
Other receivable (i)	114,355	3,686
	128,560	25,118

i) Receivables in the amount of $99,181 (2012 - $1,544) are related to National Research Council of Canada's Industrial Research Assistance Program ("IRAP") grant. The receivable was received in February 2014.

6 Equipment

	January 1, 2013 Opening cost $	Additions $	Closing cost $	Opening amortization $	Amortization $	Closing amortization $	December 31, 2013 Net $
Computer equipment	43,469	-	43,469	35,344	1,702	37,046	6,423
Computer software	14,708	-	14,708	14,708	-	14,708	-
Office equipment	4,989	-	4,989	4,989	-	4,989	-
	63,166	-	63,166	55,041	1,702	56,743	6,423

	January 1, 2012 Opening cost $	Additions $	Closing cost $	Opening amortization $	Amortization $	Closing amortization $	December 31, 2012 Net $
Computer equipment	40,494	2,975	43,469	33,022	2,322	35,344	8,125
Computer software	14,708	-	14,708	14,652	56	14,708	-
Office equipment	4,989	-	4,989	4,886	103	4,989	-
	60,191	2,975	63,166	52,560	2,481	55,041	8,125

(in Canadian dollars)

7 Intangible assets

	January 1, 2013							December 31, 2013
	Opening cost $	Disposals $	Closing cost $	Opening amortization $	Amortization $	Disposals $	Closing amortization $	Net $
ISIS (iCo-007)	599,071	-	599,071	471,326	64,196	-	535,522	63,549
MedImmune	232,467	-	232,467	126,411	21,133	-	147,544	84,923
	831,538	-	831,538	597,737	85,329	-	683,066	148,472

	January 1, 2012							December 31, 2012
	Opening cost $	Disposals $	Closing cost $	Opening amortization $	Amortization $	Disposals $	Closing amortization $	Net $
ISIS (iCo-007)	599,071	-	599,071	407,131	64,295	-	471,326	127,745
MedImmune	232,467	-	232,467	105,278	21,133	-	126,411	106,056
	831,538	-	831,538	512,409	85,428	-	597,737	233,801

8 Accounts payable and accrued liabilities

	2013 $	2012 $
Trade payables	273,494	119,047
Accruals related to clinical expenses (i)	2,318,669	764,865
Other accruals	38,243	79,819
	2,630,406	963,731

i) Of the accruals related to clinical expenses, $2,318,669 (2012 - $764,865) relate to expenses incurred for the Company’s Phase II clinical trial payable to JDRF. These accruals are due over the next twelve-month period. At December 31, 2013, patient enrolment for the iDEAL trial was complete.

(in Canadian dollars)

9 Capital stock

Authorized
Unlimited number of common shares with no par value

Issued and outstanding

	Number of shares	Amount $
Balance - December 31, 2011	46,632,301	17,587,930
Shares issued (a)	5,675,332	2,553,899
Share issue costs (a)	-	(289,914)
Attributable to warrants (a)	-	(388,469)
Transfer from warrants on exercise of warrants	1,300,994	515,402
Balance - December 31, 2012	53,608,627	19,978,848
Shares issued (b)	9,655,771	3,379,520
Share issue costs (b)	-	(414,315)
Attributable to warrants (b)	-	(795,582)
Exercise of warrants	4,446,832	1,434,375
Transfer from warrants on exercise of warrants	-	195,297
Exercise of options	100,000	29,000
Transfer from contributed surplus on the exercise of options	-	29,000
Balance - December 31, 2013	67,811,230	23,836,143

a) On July 13, 2012, the Company completed a private placement (the “Offering”) for gross proceeds of $2,553,899 through the issuance of 5,675,332 units (“Units”) at a price of $0.45 per Unit. Each Unit comprised one common share and one common share purchase warrant (“Warrant”). Each Warrant is exercisable at $0.60 for a period of two years.

The Company also issued 454,026 Agent Units which are exercisable at $0.45 into one common share plus a common share purchase warrant exercisable at $0.60 into one common share for a period of two years from closing of the Offering (the “Compensation Warrant”). Consequently, an additional 454,026 common shares and 454,026 Compensation Warrants were also issued in respect of the Agent Units as part of the Offering.

The Warrants were valued utilizing the Black-Scholes option pricing model and the Agent Units were valued separately utilizing the Cox, Ross and Rubinstein binomial tree model. The Warrants were valued at $417,435 and the Agent Units were valued at $86,011. The Agent Units are costs of the Offering, of which $72,928 was allocated to capital stock and $13,083 was allocated to Warrants. The Company also incurred cash share issuance costs of $326,493, which was allocated to the common shares and Warrants. The key assumptions used to estimate the fair value of Warrants and Agent Units were: dividend yield 0%; volatility 110.6%; and risk-free interest rate 1%.

(in Canadian dollars)

b) On May 10, 2013, the Company announced that it issued 9,655,771 Units at a price of $0.35 per unit for aggregate gross proceeds of $3,379,520. Each Unit includes one common share and one common share purchase warrant (a "Warrant"). Each Warrant is exercisable at a price of $0.40 for a period of five years from the closing of the Offering. The selling group was paid a cash commission equal to 8% of the gross proceeds of the Offering and receive that number of Compensation Warrants equal to 5% of the number of Units sold pursuant to the Offering. The Compensation Warrants have the same terms and conditions as the Warrants included in the Units.

The Warrants were valued utilizing the Black-Scholes option pricing model. The Warrants were valued at $866,670 and the Compensation Warrants were valued at $46,623. The Compensation Warrant costs of the Offering of $34,667, was allocated to share capital and $11,956 was allocated to Warrants. The Company also incurred cash share issuance cost of $414,315 which was allocated to the Common share and Warrants. The key assumptions used to estimate the fair value of Warrants and Agent Units were: dividend yield 0%; volatility 82%; and risk-free interest rate 1.00%.

Stock options

Under the stock option plan, the aggregate number of common shares reserved for issuance is 4,000,000.

	Number of stock options outstanding	Weighted average exercise price $
Balance - December 31, 2011	1,950,000	0.49
Granted	75,000	0.30
Forfeited	(50,000)	0.39
Expired	(15,000)	1.00
Balance - December 31, 2012	1,960,000	0.39
Granted	1,140,000	0.72
Exercised	(100,000)	0.29
Expired	(35,000)	0.98
Balance - December 31, 2013	2,965,000	0.51

(in Canadian dollars)

	Options outstanding			Options exercisable	
Range of exercise price $	Number outstanding at December 31, 2013	Weighted average remaining contractual life (years)	Weighted average exercise price $	Number exercisable at December 31, 2013	Weighted average exercise price $
0.18 - 0.30	1,125,000	2.54	0.28	1,125,000	0.28
0.40 - 0.60	740,000	1.15	0.54	713,333	0.54
0.73	1,100,000	4.06	0.73	733,333	0.73
	2,965,000	2.76	0.51	2,571,666	0.48

For the year ended December 31, 2013, the Company recognized $738,250 (2012 - $88,201) in share-based compensation for options granted to directors, officers and employees, and recognized $1,069 (2012 - $6,037) in share-based compensation for stock options granted to non-employees.

The fair value of each option granted is estimated as at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2013	2012
Dividend yield	0%	0%
Expected volatility	150 - 153%	161%
Risk-free interest rate	1.37-1.72%	1.49%
Forfeiture rate	0%	0%
Expected life (years)	5	5

Warrants

	Number of warrants	Transfer to capital stock on exercise of warrants $	Amount $
Balance - December 31, 2011	6,002,000		335,529
Private placement (a)	7,037,410		388,469
Warrants issued for share issue costs	-	0.45 - 0.60	(36,579)
Exercise of warrants	(1,300,994)	0.25 - 0.60	(47,705)
Expired warrants	(235,000)	0.61	(80,631)
Balance - December 31, 2012 (issued and outstanding)	11,503,416		559,083
Private placement (b)	10,138,560	0.40	866,670
Warrants issued for share issue costs	-		(71,088)
Exercise of warrants	(4,446,832)	0.30 - 0.60	(195,297)
Expired warrants	(933,000)	0.30	(40,491)
Balance - December 31, 2013 (issued and outstanding)	16,262,144		1,118,877

(in Canadian dollars)

Contributed surplus

	$
Balance - December 31, 2011	2,228,455
Share-based payments	94,238
Expired warrants	80,631
Balance - December 31, 2012	2,403,324
Share-based payments	739,279
Exercise of options	(29,000)
Expired warrants	40,491
Balance - December 31, 2013	3,154,094

10 Related party transactions

During the year ended December 31, 2013:

a) the Company incurred consulting fees with a director totalling US$25,000 (2012 - US$25,000). The amounts outstanding as at December 31, 2013 totalled US$nil (2012 - US$6,250). All transactions were recorded at their exchange amounts. The amounts bear no interest and are unsecured with no terms of repayment.

b) the Company incurred directors' fees totalling $36,000 (2012 - $33,000). The amounts outstanding as at December 31, 2013 totalled $nil (2012 - $ 18,000). All transactions were recorded at their exchange amounts. The amounts bear no interest and are unsecured with no terms of repayment.

c) the Company issued 1,065,000 options to directors and officers of the Company to purchase common shares of the Company (2012 - 50,000).

11 Compensation of key management

Key management includes the Company's directors and executive officers.

	2013 $	2012 $
Salaries	534,583	465,000
Consulting and directors fees	61,745	58,000
Share-based payments	688,972	84,576
	1,285,300	607,576

(in Canadian dollars)

12 Research and development

	2013 $	2012 $
Wages and salaries (including share-based payments)	487,807	280,303
Research projects and clinical expenses	3,232,798	1,656,550
Intellectual property	166,044	153,521
Travel	31,731	60,748
Facilities	72,131	50,523
Amortization and other	85,329	85,503
	4,075,840	2,287,148

13 General and administrative

	2013 $	2012 $
Wages and salaries (including share-based payments)	1,022,053	481,519
Professional fees	790,060	687,920
Travel	159,814	139,650
Facilities	87,776	63,140
Amortization	1,702	2,481
	2,061,405	1,374,710

14 Income taxes

The Company has the following non-capital losses available to reduce taxable income of future years:

Expiry date	$
2015	337,073
2026	1,844,870
2027	3,254,319
2028	2,850,647
2029	2,392,171
2030	2,989,348
2031	2,244,591
2032	3,646,878
2033	5,189,073

(in Canadian dollars)

Unrecognized deferred tax assets comprise the following:

	2013 $	2012 $
Non-capital losses carried forward	6,434,735	4,889,977
Share costs and other	148,674	102,287
Equipment	246,264	215,035
Scientific research and experimental development costs	127,760	122,846
Other investments	74,415	-
	7,031,848	5,330,145

The income tax benefit of these tax attributes has not been recorded in these financial statements because of the uncertainty of their recovery.

The Company's effective income tax rate differs from the statutory income tax rate of 25.75% (2012 - 25%). The differences arise from the following items:

	2013 $	2012 $
Loss before tax	(5,668,189)	(3,642,683)
Income tax at statutory rate	(1,459,559)	(910,671)
Income tax benefit not recognized	1,701,703	976,475
Change in future tax rate	(213,206)	-
Permanent differences	171,579	27,750
Other	(200,517)	(93,554)
	-	-

15 Segmented information

The Company identifies its operating segments based on business activities, management responsibility and geographical location. The Company operates within a single operating segment, being the research and development of ophthalmic indications, and operates in one geographic area, being Canada. All of the Company's assets are located in Canada.

(in Canadian dollars)

16 Commitments and contingencies

a) Lease commitments

The Company's operating lease agreement for office space expires on May 31, 2014. The future minimum annual lease payment under the lease is as follows:

	$
2014	23,230

Rent expense for the year ended December 31, 2013 amounted to $58,370 (2012 - $53,027).

b) Contractual commitments

The Company may be required to make milestone, royalty, and other research and development funding payments under research and development collaboration and other agreements with third parties. These payments are contingent upon the achievement of specific development, regulatory and/or commercial milestones. The Company has not accrued for these payments as of December 31, 2013 due to the uncertainty over whether these milestones will be achieved. The Company's significant contingent milestone, royalty and other research and development commitments are as follows:

ISIS

In connection with the licensing agreement between ISIS and the Company, the Company may be required to make additional contingent payments of up to US$22 million upon the achievement of certain development and commercialization milestones of iCo-007 in its first ocular indication. In addition, the Company may be required to pay royalties on future revenues. The Company may also be required to make additional contingent payments upon the achievement of certain development and commercialization milestones of iCo-007 in other ocular and non-ocular disease indications.

MedImmune

In connection with the licensing agreement between MedImmune and the Company, the Company was required to make upfront payments totalling US$400,000, of which the last payment was made in December 2007. The Company may be required to make additional contingent payments of up to US$7 million upon the achievement of certain development and commercialization milestones. In addition, the Company may be required to pay royalties on future revenues. The Company may also be required to make additional contingent payments upon the achievement of certain development and commercialization milestones for products developed outside the ocular field.

(in Canadian dollars)

University of British Columbia ("UBC")

On May 6, 2008, the Company signed an agreement with UBC for the exclusive worldwide licence to iCo-009 (the "UBC Licence"). In consideration for the UBC Licence, the Company paid UBC an initial licence fee of $20,000 and is required to pay annual fees to UBC for maintaining the licence until such time as a New Drug Application ("NDA") for iCo-009 is approved. The Company is required to make additional contingent payments of up to $1,900,000 in aggregate upon the achievement of certain development and commercialization milestones and is also required to pay royalties on future revenues. The UBC Licence additionally obligated the Company to contribute research funding (which may be in the form of direct payments from the Company or indirect payments, such as securing research grants) to UBC for the iCo-009 program.

Clinical trials

The Company entered into an agreement with JDRF for work related to the iCo-007 clinical trial. The agreement involves incremental holdbacks as well as other milestone expenses associated with the clinical trial. The total amount of those expenses is not yet measurable and is dependent on a number of criteria and deliverables from JDRF before the Company will incur the full expense.

On May 31, 2012, the Company was awarded a $1.1 million three-year, non-repayable financial contribution from the National Research Council of Canada's Industrial Research Assistance Program ("IRAP") to support iCo's Oral Amphotericin B ("Amp B") delivery system as novel treatment for patients with Human Immunodeficiency Virus ("HIV"). The funding will support feasibility testing and pre-clinical toxicology studies, as well as human safety and efficacy clinical trials to examine the role of the Amp B delivery system in potentially treating patients with latent HIV reservoirs. Under the grant, up to 75% of the costs of the project may be claimed subject to the $1.1 million maximum. The Company submits monthly expenditure claims that are subject to IRAP approval and subsequent reimbursement. For the year ended December 31, 2013, iCo has recognized $141,081 (2012 - $3,876) of the IRAP grant.

17 Financial instruments and financial risk management

Fair value

Financial instrument disclosures establish a fair value hierarchy that requires the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The Company primarily applies the market approach for recurring fair value measurements. This section describes three input levels that may be used to measure fair value:

Level 1 - unadjusted quoted prices in active markets for identical assets or liabilities. An active market for the asset or liability is a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide information on an ongoing basis. The Company does not have any financial instruments in this category.

(in Canadian dollars)

Level 2 - quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 - unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Financial instruments whose carrying value approximates fair value

Cash and cash equivalents, short-term investments and other receivables are financial instruments whose fair value approximates their carrying value due to their short-term maturity. The input level used by the Company to measure fair value of its cash and cash equivalents and short-term investments is Level 2 as they are valued using observable market data.

The fair value of accounts payable may be less than its carrying value due to liquidity risk.

The common shares of IMMUNE have been recorded at their fair value on the date they were acquired. Management has classified these shares as available-for-sale. The Company uses Level 3 inputs to value these instruments. The shares of IMMUNE are now traded in the market, however; there is an applied discount rate applied due to a restriction period.

The following table presents the Company's assets and liabilities that are measured at fair value at December 31, 2013 and 2012.

			At December 31, 2013
	Level 1 **$**	**Level 2** **$**	**Level 3** **$**
Assets			
Available for sale - equity	-	-	1,521,003
Fair value through profit or loss	-	-	184,188

			At December 31, 2012
	Level 1 **$**	**Level 2** **$**	**Level 3** **$**
Assets			
Available for sale - equity	-	-	1,432,656
Fair value through profit or loss	-	-	1

There were no transfers between levels in the current year.

(in Canadian dollars)

Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices, will affect the Company's income or valuation of its financial instruments.

The Company is exposed to financial risk related to fluctuation of foreign exchange rates. Foreign currency risk is limited to the portion of the Company's business transactions denominated in currencies other than the Canadian dollar, primarily expenses for research and development incurred in US$. The Company believes that the results of operations, financial position and cash flows would be affected by a sudden change in foreign exchange rates, but would not impair or enhance its ability to pay its US$. The Company manages foreign exchange risk by maintaining US$ cash on hand to fund its short-term US$ expenditures. As at December 31, 2013, US$ denominated cash and short-term investments totalled US$567,625. The US$ denominated accounts payable and accrued liabilities exposure is US$2,247,796.

The other investment of IMMUNE is denominated in US$. A change in share price and foreign exchange would have the following impact:

			2013
	Other investments shares $	Other investments warrants $	Other investments Total $
5% increase in share price and foreign exchange rate	1,676,906	205,048	1,881,954
5% decrease in share price and foreign exchange rate	1,372,705	163,368	1,536,073

a) Foreign exchange risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Balances in foreign currencies at December 31, 2013 and 2012 are as follows:

	2013 US balance $	2012 US balance $
Cash and cash equivalents	567,625	93,350
Accounts payable and accrued liabilities	(2,247,796)	(808,975)
	(1,680,171)	(715,625)

(in Canadian dollars)

Based on the US$ balance sheet exposure at December 31, 2013, with other variables unchanged. The effect of 10% change in exchange rates on the net current monetary (liabilities)/assets would be $168,017 (2012 - $71,563).

b) Interest rate risk

The Company is subject to interest rate risk on its cash and cash equivalents and short-term investments and believes that the results of operations, financial position and cash flows would not be significantly affected by a sudden change in market interest rates relative to the investment interest rates due to the short-term nature of the investments. The only financial instruments that expose the Company to interest rate risk are its cash and cash equivalents and short-term investments. Cash and cash equivalents in excess of day-to-day requirements are placed in short-term deposits with high quality credit financial institutions and earn interest at rates available at that time.

As at December 31, 2013, cash and cash equivalents held in Canadian dollar savings accounts or short-term investments are $1,299,663. The interest rates range from 0.0% to 1.3%.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in raising funds to meet cash flow requirements associated with financial instruments.

The Company continues to manage its liquidity risk by monitoring its cash flows and investments regularly, comparing actual results with budgets and future cash requirements.

The following table summarizes the relative maturities of the financial liabilities of the Company:

	Maturity	
	Less than one year $	Greater than one year $
Accounts payable and accrued liabilities	2,630,406	-

Credit risk

Credit risk arises from cash and cash equivalents, deposits with banks and financial institutions, as well as outstanding receivables. The Company invests its excess cash in short-term Guaranteed Investment Certificates. The Company has established guidelines relative to diversification, credit ratings and maturities that maintain safety and liquidity. These guidelines are periodically reviewed by the Company's Board of Directors and modified to reflect changes in market conditions.

(in Canadian dollars)

The Company limits its exposure to credit risk, with respect to cash and cash equivalents, by placing them with high quality credit financial institutions. The Company's cash equivalents consist primarily of operating funds and deposit investments with commercial banks. Of the amounts with financial institutions on deposit, the following table summarizes the amounts at risk should the financial institutions with which the deposits are held cease trading:

	Cash and cash equivalents and short-term investments $	Insured amount $	Non-insured amount $
CIBC	1,538,157	100,000	1,438,157
Raymond James	3,055	3,055	-
Manulife	362,177	362,177	-
	1,903,389	465,232	1,438,157

18 Capital management

The Company considers its capital stock, contributed surplus and warrants as capital. As at December 31, 2013, the amount of capital totalled $28,109,114 (2012 - $22,941,255).

The Company manages its capital structure in order to ensure sufficient resources are available to meet day-to-day operation requirements, further develop its existing technology, advance its clinical trials and continue as a going concern.

In order to maintain or adjust the capital structure, the Company may issue new shares or sell assets. Total capital is calculated as the Company's own equity.

The Company is not subject to any externally exposed capital requirements.

19 Subsequent events

As of April 24, 2014, 340,000 warrants have been exercised since year-end resulting in $136,000 additional capital.

On January 27, 2014, the Company issued 16,206,483 units at a price of $0.4165 per unit for aggregate gross proceeds of $6.75 million. Each unit is comprises one common share of the company and three-quarters of one common share purchase warrant. Each warrant is exercisable at a price of $0.539 and entitles the holder to acquire one common share for a period of five years following the date of issuance of the Warrant.

As at April 23, 2014, the closing price of IMMUNE shares was US$3.96 on the OTCQX.