Alkalon A/S

Naverland 1, 14., 2600 Glostrup

Company reg. no. 30 27 38 26

Annual report

1 January - 31 December 2016

The annual report have been submitted and approved by the general meeting on the 14 June 2017.

Bjarne Carsten Pedersen
Chairman of the meeting

Notes to users of the English version of this document:

- To ensure the greatest possible applicability of this document, British English terminology has been used.
- Please note that decimal points remain unchanged from the Danish version of the document. This means that for instance DKK 146.940 is the same as the English amount of DKK 146,940, and that 23,5 % is the same as the English 23.5 %.

Contents

Management's report

The board of directors and the managing director have today presented the annual report of Alkalon A/S for the financial year 1 January to 31 December 2016.

The annual report has been presented in accordance with the Danish Financial Statements Act.

We consider the accounting policies used appropriate, and in our opinion the annual accounts provide a true and fair view of the company's assets and liabilities and its financial position as on 31 December 2016 and of the company's results of its activities in the financial year 1 January to 31 December 2016.

We are of the opinion that the management's review includes a fair description of the issues dealt with.

The annual report is recommended for approval by the general meeting.

Glostrup, 14 June 2017

Managing Director

Bjarne Carsten Pedersen

Board of directors

Nicholas Cecil Marks Chairman of the Board	Mark Rupert Tucker	Rasmus Forup Helmich
Robin James Scott Cridland	Peter Sølbeck	

Independent auditor's report

To the shareholders of Alkalon A/S

Opinion

We have audited the annual accounts of Alkalon A/S for the financial year 1 January to 31 December 2016, which comprise accounting policies used, profit and loss account, balance sheet and notes. The annual accounts are prepared in accordance with the Danish Financial Statements Act.

In our opinion, the annual accounts give a true and fair view of the company's assets, liabilities and financial position at 31 December 2016 and of the results of the company's operations for the financial year 1 January to 31 December 2016 in accordance with the Danish Financial Statements Act.

Basis for opinion

We conducted our audit in accordance with international standards on auditing and the additional requirements applicable in Denmark. Our responsibilities under those standards and requirements are further described in the below section “Auditor’s responsibilities for the audit of the annual accounts”. We are independent of the company in accordance with international ethics standards for accountants (IESBA's Code of Ethics) and the additional requirements applicable in Denmark, and we have fulfilled our other ethical responsibilities in accordance with these standards and requirements. We believe that the audit evidence obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter

Without qualifying our opinion, we draw attention to note 1 in the annual accounts in which the management outlines its expectations to the significantly improved earnings that are a precondition for the value of the tax asset of DKK 4,582,900 recognised in the balance sheet.

The management's responsibilities for the annual accounts

The management is responsible for the preparation of annual accounts that give a true and fair view in accordance with the Danish Financial Statements Act. The management is also responsible for such internal control as the management determines is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the management is responsible for evaluating the company’s ability to continue as a going concern, and, when relevant, disclosing matters related to going concern and using the going concern basis of accounting when preparing the annual accounts, unless the management either intends to liquidate the company or to cease operations, or if it has no realistic alternative but to do so.

Auditor’s responsibilities for the audit of the annual accounts

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor’s report including an opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with international standards on auditing and the additional requirements applicable in Denmark will always detect a material misstatement when it exists. Misstatements may arise due to fraud or error and may be considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions made by users on the basis of the annual accounts

As part of an audit conducted in accordance with international standards on auditing and the additional requirements applicable in Denmark, we exercise professional evaluations and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement in the annual accounts, whether due to fraud or error, design and perform audit procedures in response to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting a misstatement resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of the internal control relevant to the audit 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 company’s internal control.

- Evaluate the appropriateness of accounting policies used by the management and the reasonableness of accounting estimates and related disclosures made by the management.

- Conclude on the appropriateness of the management’s preparation of the annual accounts being based on the going concern principle and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may raise significant doubt about the company’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor’s report. However, future events or conditions may cause the company to cease to continue as a going concern.

- Evaluate the overall presentation, structure and contents of the annual accounts, including the disclosures in the notes, and whether the annual accounts reflect the underlying transactions and events in a manner that gives a true and fair view.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in the internal control that we identify during our audit.

Independent auditor's report

Statement on the management's review

The management is responsible for the management's review.

Our opinion on the annual accounts does not cover the management’s review, and we do not express any kind of assurance opinion on the management's review.

In connection with our audit of the annual accounts, our responsibility is to read the management’s review and in that connection consider whether the management’s review is materially inconsistent with the annual accounts or our knowledge obtained during the audit, or whether it otherwise appears to contain material misstatement.

Furthermore, it is our responsibility to consider whether the management's review provides the information required under the Danish Financial Statements Act.

Based on the work we have performed, we believe that the management's review is in accordance with the annual accounts and that it has been prepared in accordance with the requirements of the Danish Financial Statement Acts. We did not find any material misstatement in the management's review.

Copenhagen, 14 June 2017

BUUS JENSEN
State Authorised Public Accountants
Company reg. no. 16 11 90 40

Ulrik Nørskov
State Authorised Public Accountant

Company data

The company	Alkalon A/S Naverland 1, 14. 2600 Glostrup	
	Company reg. no.	30 27 38 26
	Domicile:	Glostrup
	Financial year:	1 January - 31 December
Board of directors	Nicholas Cecil Marks, Chairman of the Board Mark Rupert Tucker Rasmus Forup Helmich Robin James Scott Cridland Peter Sølbeck	
Managing Director	Bjarne Carsten Pedersen	
Auditors	BUUS JENSEN, Statsautoriserede revisorer	

The principal activities of the company

Alkalon's activities are to develop, register and commercialize new generic NRT products to the pharmaceutical industry and retailers around the world.

Uncertainties as to recognition or measurement

A deffered tax asset of DKK 4.582.900 has been incorporated into the annual accounts which, in all material respects, concerns unutilized tax losses. The deferred tax asset has been measured based on then management's expectations to the company's future earnings. Based on the above, the management is of the opinion that the measurement is reasonable and justifiable.

Development in activities and financial matters

The gross profit for the year is DKK 4.582.028 against DKK 4.000.763 last year. The results from ordinary activities after tax are DKK -683.188 against DKK -1.402.480 last year.

During 2016 Alkalon managed to increase product sales with +9% compared to 2015 (including Revolymer business for the last 2 months of 2015) and at the same time secure the merger with Revolymer which was closed Nov 2, 2016 and secure and transfer production to a new Contract Manufacturer. A planned introduction into new sales channels from late 2016 failed and will be delayed to later 2017 or start 2018. The reason was unforeseen difficulties to get the right approvals on time and a fast access to market failed and resulted in a negative impact on 2016 results of DKK 1.055.488, as already produced products had to be destroyed. Based on above major activities to secure future strong growth plans both the management and board of directors consider the results acceptable.

Capital resources:
Due to the result for the financial year 2016 including an increasing liquidity requirement due to changes in the company's forward-looking business, a cash capital increase of DKK 3.5 million was completed in May 2017. The company's shareholders will provide additional capital resources in the form of loans during June 2017, furthermore the company's bank has committed to increasing its current credit facilities. On this basis, the management expects that the enterprise is able to maintain sufficient cash resources to carry out the operating activities planned for the coming financial year.

The expected development

Management is very positive about the future sales and profit as we have very strong plans and initiatives in place to grow our business significantly in the coming years. We expect the growth in product sales will continue in 2017 with double digit growth after the Canadian businessius integrated and new customers are expected by the end of 2017.s. Within the coming 5-7 years the company aim to reach 10% market-share in the global gum segment for nicotine replacement products with an improved margin. In parallel the management is focusing on a tight control of all investments in a prioritized fashion to ensure a strong profitable growth scenario.

Furthermore ,the management is working on other strategic initiatives that can ensure a stronger cash resource to secure the strong growth rates.

Management's review

The management expects a positive operating result in 2017. Operating result os expected to improve further during the next 2-3 years, which expectedly will result in a utilization of the deferred tax asset.

Accounting policies used

The annual report for Alkalon A/S is presented in accordance with those regulations of the Danish Financial Statements Act concerning companies identified as class B enterprises.Furthermore, the company has chosen to comply with some of the rules applying for class C enterprises.

The accounting policies used are unchanged compared to last year, and the annual accounts are presented in Danish kroner (DKK).

Recognition and measurement in general

Income is recognised in the profit and loss account concurrently with its realisation, including the recognition of value adjustments of financial assets and liabilities. Likewise, all costs, these including depreciation, amortisation, writedown, provisions, and reversals which are due to changes in estimated amounts previously recognised in the profit and loss account are recognised in the profit and loss account.

Assets are recognised in the balance sheet when the company is liable to achieve future, financial benefits and the value of the asset can be measured reliably.

Liabilities are recognised in the balance sheet when the company is liable to lose future, financial benefits and the value of the liability can be measured reliably.

At the first recognition, assets and liabilities are measured at cost. Later, assets and liabilities are measured as described below for each individual accounting item.

Certain fixed asset investments and liabilities are measured at amortised cost, by which method a fixed, effective interest is recognised during the useful life of the asset or the liability. Amortised cost is recognised as the original cost with deduction of any payments and additions/deductions of the accrued amortisation of the difference between cost and nominal amount. In this way capital losses and capital profits are spread over the useful life.

At recognition and measurement, such predictable losses and risks are taken into consideration, which may appear before the annual report is presented, and which concerns matters existing on the balance sheet date.

Translation of foreign currency

Transactions in foreign currency are translated by using the exchange rate prevailing at the date of the transaction. Differences in the rate of exchange arising between the rate at the date of transaction and the rate at the date of payment are recognised in the profit and loss account as an item under net financials.

Debtors, creditors, and other monetary items in foreign currency are translated by using the closing rate. The difference between the closing rate and the rate at the time of the occurrence or the recognition in the latest annual accounts of the amount owed or the liability is recognised in the profit and loss account under financial income and expenses.

Fixed assets and other non-monetary assets acquired in foreign currency and which are not considered to be investment assets purchased in foreign currencies are measured at the exchange rate on the transaction date.

The profit and loss account

Gross profit

The gross profit comprises the net turnover, changes in inventories of finished goods and work in progress, work performed for own purposes and capitalised, other operating income, and external costs.

The net turnover is recognised in the profit and loss account if delivery and risk transfer to the buyer have taken place before the end of the year, and if the income can be determined reliably and is expected to be received. The net turnover is recognised exclusive of VAT and taxes and with the deduction of any discounts granted in connection with the sale.

Costs of sales includes costs for the purchase of raw materials and consumables less discounts and changes in inventories.

Other external costs comprise costs for distribution, sales, advertisement, administration, premises, loss on debtors, and operational leasing costs.

Staff costs

Staff costs include salaries and wages including holiday allowances, pensions and other costs for social security etc. for staff members. Staff costs are less public reimbursements.

Depreciation, amortisation and writedown

Depreciation, amortisation and writedown comprise depreciation on, amortisation of and writedown relating to intangible and tangible fixed assets respectively.

Net financials

Net financials include interest income, interest expenses, and realised and unrealised capital gains and losses concerning financial assets and liabilities. Financial income and expenses are recognised in the profit and loss account with the amounts that concerns the financial year.

Results from equity investments in group enterprises

After full elimination of intercompany profit or loss and deduction of amortisation of consolidated goodwill, the equity investment in the individual group enterprises are recognised in the profit and loss account at a proportional share of the group enterprises' results after tax.

Tax of the results for the year

The tax for the year comprises the current tax for the year and the changes in deferred tax, and it is recognised in the profit and loss account with the share referring to the results for the year and directly in the equity with the share referring to entries directly on the equity.

The balance sheet

Intangible fixed assets

Development projects, patents, and licences

Development costs comprise e.g. salaries, wages, and amortisation which directly and indirectly refer to the development activities.

Clearly defined and identifiable development projects are recognised as intangible fixed assets provided that the technical feasibility, sufficient resources, and a potential market or a development opportunity can be demonstrated, and provided that it is the intention to produce, market or utilise the project. It is, however, a condition that the cost can be calculated reliably and that a sufficiently high degree of certainty indicates that future earnings will cover the costs for production, sales, and administration. Other development costs are recognised in the profit and loss account concurrently with their realisation.

Development costs recognised in the balance sheet are measured at cost with deduction of accrued depreciation and writedown.

After completion of the development work, capitalised development costs are amortised on a straight line basis over the estimated financial useful life. Usually, the amortisation period is 5 years.

Gain and loss from the sale of development projects, patents, and licenses are measured as the difference between the sales price with deduction of sales costs and the book value at the time of the sale. Gain or loss are recognised in the profit and loss account as other operating income or other operating expenses respectively.

Goodwill

Goodwill is amortised over its estimated useful life, which is determined on the basis of the management's experience with the individual business areas. Goodwill is amortised on a straight-line basis over the amortisation period, which is 5 years. The amortisation period is determined on the basis of an expected payback period, being the longer for strategical acquirees with a strong market position and an expected long-term earnings profile.

Tangible fixed assets

Tangible fixed assets are measured at cost with deduction of accrued depreciation and writedown.

The basis of depreciation is cost with deduction of any expected residual value after the end of the useful life of the asset.

The cost comprises the acquisition cost and costs directly attached to the acquisition until the time when the asset is ready for use.

Depreciation takes place on a straight line basis and based on an evaluation of the expected useful life:

Other plants, operating assets, fixtures and furniture	3-5 years

Minor assets with an expected useful life of less than 1 year are recognised as costs in the profit and loss account in the year of acquisition.

Profit or loss deriving from the sales of tangible fixed assets is measured as the difference between the sales price reduced by the selling costs and the book value at the time of the sale. Profit or losses are recognised in the profit and loss account as other operating income or other operating expenses.

Inventories

Inventories are measured at cost on basis of the FIFO method. In case the net realisable value of the inventories is lower than the cost, writedown takes place to this lower value.

The cost for trade goods, raw materials, and consumables comprises the acquisition cost with the addition of the delivery costs.

The net realisable value for inventories is recognised as the market price with deduction of completion costs and selling costs. The net realisable value is determined taking into consideration the negotiability, obsolescence, and development of the expected market price.

Debtors

Debtors are measured at amortised cost which usually corresponds to face value. In order to meet expected losses, writedown takes place at the net realisable value.

Accrued income and deferred expenses

Accrued income and deferred expenses recognised under assets comprise incurred costs concerning the next financial year.

Available funds

Available funds comprise cash at bank and in hand.

Corporate tax and deferred tax

Current tax receivable and tax liabilities are recognised in the balance sheet at the amount calculated on the basis of the expected taxable income for the year adjusted for tax on previous years' taxable income and prepaid taxes. Tax receivable and tax liabilities are set off to the extent that legal right of set-off exists and if the items are expected to be settled net or simultaneously.

Deferred tax is measured on the basis of all temporary differences in assets and liabilities with a balance sheet focus.

Deferred tax is measured based on the tax rules and tax rates applying under the legislation on the balance sheet date and prevailing when the deferred tax is expected to be released as current tax.

Liabilities

Financial liabilities related to borrowings are recognised at the received proceeds with the deduction of transaction costs incurred. In following periods, the financial liabilities are recognised at amortised cost, corresponding to the capitalised value by use of the effective interest. The difference between the proceeds and the nominal value is recognised in the profit and loss account during the term of the loan.

Other liabilities are measured at amortised cost which usually corresponds to the nominal value.

Profit and loss account 1 January - 31 December

All amounts in DKK.

Note		2016	2015
	Gross profit	**3.296.880**	**4.000.763**
3	Staff costs	-4.619.547	-4.634.434
	Depreciation, amortisation and writedown relating to tangible and intangible fixed assets	-141.489	-16.023
	Operating profit	**-1.464.156**	**-649.694**
	Income from equity investments in group enterprises	0	-6.054
	Other financial income	6.744	3.902
4	Other financial costs	-518.579	-750.634
	Results before tax	**-1.975.991**	**-1.402.480**
	Results from ordinary activities after tax	**-1.975.991**	**-1.402.480**
	Results for the year	**-1.975.991**	**-1.402.480**
	Proposed distribution of the results:		
	Allocated from results brought forward	-1.975.991	-1.402.480
	Distribution in total	**-1.975.991**	**-1.402.480**

Balance sheet 31 December

All amounts in DKK.

Note	Assets	2016	2015
	Fixed assets		
5	Goodwill	3.053.128	0
6	Development projects in progress and prepayments for intangible fixed assets	1.767.109	0
	Intangible fixed assets in total	4.820.237	0
7	Other plants, operating assets, and fixtures and furniture	522.672	18.567
	Tangible fixed assets in total	522.672	18.567
	Fixed assets in total	**5.342.909**	**18.567**
	Current assets		
	Raw materials and consumables	414.362	0
	Work in progress	1.990.593	66.320
	Manufactured goods and trade goods	3.701.098	278.767
	Inventories in total	6.106.053	345.087
	Trade debtors	10.369.057	6.660.693
	Deferred tax assets	4.582.900	4.582.900
	Other debtors	652.416	139.052
	Accrued income and deferred expenses	0	311.450
	Debtors in total	15.604.373	11.694.095
	Available funds	12.017	6.650
	Current assets in total	**21.722.443**	**12.045.832**
	Assets in total	**27.065.352**	**12.064.399**

Balance sheet 31 December

All amounts in DKK.

Note	Equity and liabilities	2016	2015
	Equity		
8	Contributed capital	2.949.318	2.078.479
10	Results brought forward	8.527.205	355.519
	Equity in total	**11.476.523**	**2.433.998**
	Liabilities		
	Bank debts	5.609.140	5.142.724
	Prepayments received from customers	0	116.909
	Trade creditors	9.233.693	2.147.220
	Debt to associated enterprises	0	1.310.198
	Other debts	745.996	913.350
	Short-term liabilities in total	15.588.829	9.630.401
	Liabilities in total	**15.588.829**	**9.630.401**
	Equity and liabilities in total	**27.065.352**	**12.064.399**

1 Uncertainties concerning the enterprise's ability to continue as a going concern

2 Uncertainties concerning recognition and measurement

11 Mortgage and securities

12 Contingencies

Notes

All amounts in DKK.

	2016	2015

1. Uncertainties concerning the enterprise's ability to continue as a going concern

Due to the result for the financial year 2016 including an increasing liquidity requirement due to changes in the company's forward-looking business, a cash capital increase of DKK 3.5 million was completed in May 2017. The company's shareholders will provide additional capital resources in the form of loans during June 2017, furthermore the company's bank has committed to increasing its current credit facilities. On this basis, the management expects that the enterprise is able to maintain sufficient cash resources to carry out the operating activities planned for the coming financial year.

2. Uncertainties concerning recognition and measurement

A deffered tax asset of 4.582.900 DKK has been incorporated into the annual accounts which, in all material respects, concerns unutilized tax losses. The deferred tax asset has been measured based on then management's expectations to the company's future earnings. Based on the above, the management is of the opinion that the measurement is reasonable and justifiable.

3. Staff costs

	2016	2015
Salaries and wages	4.008.140	4.107.811
Pension costs	313.160	287.549
Other costs for social security	38.471	37.853
Other staff costs	259.776	201.221
	4.619.547	**4.634.434**
Average number of employees	6	6

4. Other financial costs

	2016	2015
Other financial costs	518.579	750.634
	518.579	**750.634**

All amounts in DKK.

		31/12 2016	31/12 2015
5.	**Goodwill**		
	Additions during the year	3.158.408	0
	Cost 31 December 2016	**3.158.408**	**0**
	Amortisation and writedown for the year	-105.280	0
	Amortisation and writedown 31 December 2016	**-105.280**	**0**
	Book value 31 December 2016	**3.053.128**	**0**
6.	**Development projects in progress and prepayments for intangible fixed assets**		
	Additions during the year	1.767.109	0
	Cost 31 December 2016	**1.767.109**	**0**
	Book value 31 December 2016	**1.767.109**	**0**
7.	**Other plants, operating assets, and fixtures and furniture**		
	Cost 1 January 2016	776.128	776.128
	Additions during the year	540.314	0
	Cost 31 December 2016	**1.316.442**	**776.128**
	Depreciation and writedown 1 January 2016	-757.561	-741.538
	Depreciation and writedown for the year	-36.209	-16.023
	Depreciation and writedown 31 December 2016	**-793.770**	**-757.561**
	Book value 31 December 2016	**522.672**	**18.567**
8.	**Contributed capital**		
	Contributed capital 1 January 2016	2.078.479	2.078.479
	Cash capital increase	870.839	0
		2.949.318	**2.078.479**

Notes

All amounts in DKK.

		31/12 2016	31/12 2015
9.	**Share premium account**		
	Share premium account for the year	10.147.677	0
	Transfer to results brought forward	-10.147.677	0
		0	**0**
10.	**Results brought forward**		
	Results brought forward 1 January 2016	355.519	1.757.999
	Profit or loss for the year brought forward	-1.975.991	-1.402.480
	Premium regarding to capital increase	10.147.677	0
		8.527.205	**355.519**

11. Mortgage and securities

For bank debts, t.kr. 5.609, the company has provided security in company assets representing a nominal value of t.kr. 9.500.

12. Contingencies

Contingent liabilities

Leasing liabilities

The Company has entered into lease agreements for premises with an annual rent of approx. t.kr. 267. If the lease is terminated the rent obligation is t.kr. 67.