



Salles Sainz

**Grant Thornton**

Financial Statements and Independent auditor's report

Zydus Pharmaceuticals México, S. A. de C. V.

December 31, 2017 and 2016

**Zydus**  
dedicated to *life*

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## Independent auditor's report

To the Stockholders of

Zydus Pharmaceuticals México, S. A. de C. V.:

### **Opinion**

We have audited the accompanying financial statements of **Zydus Pharmaceuticals México, S. A. de C. V.** (the Company), which comprise the statements of financial position as of December 31, 2017 and 2016, and the statements of profit or loss, changes in stockholders' equity and cash flows, for the years then ended, and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of Zydus Pharmaceuticals México, S. A. de C.V. as of December 31, 2017 and 2016, and its financial performance, and its cash flows for the years then ended in accordance with Mexican Financial Reporting Standards (NIFs, *for its acronym in Spanish*).

### **Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the "Auditor's Responsibilities for the Audit of the Financial Statements" section of our report, and the corresponding "Exhibit. We are independent of the Company in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code), together with the ethical requirements that are relevant to our audit of the financial statements in Mexico in accordance with the Instituto Mexicano de Contadores Públicos A.C.'s Code of Professional Ethics (IMCP Code) and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA and IMCP Codes. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

### **Emphasis paragraph**

We draw attention to Note 10 e, which indicates that as of December 31, 2017, the Company has accumulated operating losses with a consequent deficit in Partners' equity, and as of that date, the Company's current liabilities (represented by related parties, mainly) exceeded its total assets by \$33,178,144. These conditions indicate that may cast doubt on the Company's ability to continue as a going concern. However, Cadila Healthcare Limited, India (CHL) the ultimate parent company, has indicated its intention to maintain the necessary financial support, to allow the Company to continue as a going concern.

**Responsibilities of management for the financial statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with NIFs, 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.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern and using the going concern basis of accounting, or otherwise, making the appropriate disclosures.

**Auditor's Responsibility for the financial statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

SALLES, SAINZ – GRANT THORNTON, S.C.



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C.P.C. Guadalupe Saldivar Olivares  
Partner

## Exhibit of the Independent Auditor's Report

### **Additional description of our responsibilities on the audit of the financial statements**

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive 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 for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of 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 and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on 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 financial statements 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 content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- We communicate with Management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Statements of financial position  
**As of December 31, 2017 and 2016**  
 (Stated in Mexican Pesos)

	Notes	2017	2016
<b>ASSETS</b>			
<b>Current</b>			
Cash		\$ 6,977,603	\$ 7,158,205
Accounts receivable, net	(Note 5)	45,337,320	37,812,395
Inventories, net	(Note 6)	7,651,582	12,899,472
Related parties	(Note 14)	42,048,170	29,314,896
Prepaid expenses		468,117	532,291
<b>Total currents assets</b>		<u>102,482,792</u>	<u>87,717,259</u>
<b>Non-current assets</b>			
Furniture, equipment and leasehold improvements, net	(Note 7)	512,783	548,488
Other assets		36,979	36,979
Deferred income tax	(Note 12)	22,737,460	8,582,470
<b>Total assets</b>		<u>\$ 125,770,014</u>	<u>\$ 96,885,196</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>			
<b>Liabilities</b>			
<b>Short-term</b>			
Accounts payable		\$ 4,703,209	\$ 3,403,162
Provisions	(Note 8)	1,755,798	288,000
Related parties	(Note 14)	129,107,229	117,621,811
Taxes payable		94,700	92,208
<b>Total liabilities</b>		<u>135,660,936</u>	<u>121,405,181</u>
<b>Stockholders' equity</b>			
Capital stock	(Note 10)	169,315,138	169,315,138
Accumulated losses		(179,206,060)	(193,835,123)
<b>Total Stockholders' equity</b>		<u>(9,890,922)</u>	<u>(24,519,985)</u>
<b>Total liabilities and stockholders' equity</b>		<u>\$ 125,770,014</u>	<u>\$ 96,885,196</u>

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

## Statements of profit or loss

For the years ended December 31, 2017 and 2016

(Stated in Mexican Pesos)

	Notes	2017	2016
<b>Net sales</b>		\$ 100,075,255	\$ 70,307,655
Other income		<u>29,145,978</u>	<u>41,636,788</u>
		<u>129,221,233</u>	<u>111,944,443</u>
<b>Cost of sales</b>		<u>33,128,722</u>	<u>27,591,928</u>
<b>Gross profit</b>		<u>96,092,511</u>	<u>84,352,515</u>
<b>Operating expenses:</b>			
Selling and marketing expenses		23,905,572	19,251,034
Regulation expenses		8,262,813	4,159,131
Administrative expenses		56,381,440	53,513,745
Distribution expenses		<u>4,308,577</u>	<u>4,309,994</u>
<b>Total expenses</b>		<u>92,858,402</u>	<u>81,233,904</u>
<b>Operating profit</b>		3,234,109	3,118,611
<b>Comprehensive result of financing:</b>			
Interest expense		(726,831)	(1,419,628)
Exchange loss, net		<u>(2,033,205)</u>	<u>(995,906)</u>
		<u>(2,760,036)</u>	<u>(2,415,534)</u>
<b>Profit before income tax</b>		474,073	703,077
Deferred income tax	(Note 12)	<u>(14,154,990)</u>	<u>(8,582,470)</u>
<b>Net profit for the year</b>		<u>\$ 14,629,063</u>	<u>\$ 9,285,547</u>

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

**Statements of changes in stockholders' equity**  
**For the years ended December 31, 2017 and 2016**  
 (Stated in Mexican Pesos)

	<u>Notes</u>	<u>2017</u>	<u>2016</u>
Capital stock at beginning of the year		\$ 169,315,138	\$ 149,815,138
Contributions for the year	(Note 10 a)	-	19,500,000
Capital stock at end of the year		<u>\$ 169,315,138</u>	<u>\$ 169,315,138</u>
Accumulated losses at beginning of the year		\$ (193,835,123)	\$ (203,120,670)
Net income for the year		<u>14,629,063</u>	<u>9,285,547</u>
Accumulated losses at end of the year		<u>\$ (179,206,060)</u>	<u>\$ (193,835,123)</u>
<b>Total stockholders' equity</b>		<u>\$ (9,890,922)</u>	<u>\$ (24,519,985)</u>

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



**Statements of cash flows**

**For the years ended December 31, 2017 and 2016**

(Stated in Mexican Pesos)

	<u>2107</u>	<u>2016</u>
<b>Operating:</b>		
Profit before income tax	\$ 474,073	\$ 703,077
Non-cash adjustments		
Items related to investing activities:		
Depreciation	181,707	1,060,511
Financing activities items:		
Interest expense	726,831	1,419,628
	<u>1,382,611</u>	<u>3,183,216</u>
Changes in:		
Accounts receivable	(7,524,925)	(9,762,105)
Related parties	(11,974,687)	(10,392,232)
Inventories	5,247,890	(1,713,884)
Prepaid expenses	64,174	345,467
Accounts payable	1,300,047	(1,089,576)
Provisions	1,467,798	(1,474,215)
Taxes payable	2,492	8,861
Net cash flows used in operating activities	<u>(10,034,600)</u>	<u>(20,894,468)</u>
<b>Investment:</b>		
Acquisitions of furniture and equipment	(146,002)	(76,334)
Net cash flows used in investment activities	<u>(146,002)</u>	<u>(76,334)</u>
<b>Financing:</b>		
Contributions to capital stock	-	19,500,000
Loans obtained from related parties	10,000,000	-
Net cash flows obtained from financing activities	<u>10,000,000</u>	<u>19,500,000</u>
Net change in cash	(180,602)	(1,470,802)
Cash at beginning of the year	7,158,205	8,629,007
Cash at end of the year	\$ <u>6,977,603</u>	\$ <u>7,158,205</u>

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

# **Zydus Pharmaceuticals México, S.A. de C.V.**

## **Notes to the financial statements**

### **December 31, 2017 and 2016**

(Stated in Mexican Pesos)

#### **1 NATURE OF OPERATIONS:**

Zydus Pharmaceuticals México, S. A. de C.V. (the Company), was incorporated in Mexico on July 21, 2010. The Company's main activities are import and market of a wide range of health products.

The Company started its commercial operations in June 2013; its main clients represent 48% of total sales.

The Company does not have employees and all the required services for its management and operation, are provided by Zydus Pharmaceuticals México Service Company, S.A. de C.V. through a service rendering contract, and accordingly, it is not subject to labor requirements or obligations; except for those arising from non-compliance with labor or tax pronouncements, over the administrative and operational services being provided.

The Company is a subsidiary of Zydus International Private Limited, Ireland (ZIPL).

Company's office is located at Carretera Picacho Ajusco 154 601 B, Jardines de la Montaña, Mexico City, Mexico.

#### **2 APPROVAL AND BASIS OF PREPARATION OF THE FINANCIAL STATEMENTS**

The accompanying financial statements have been prepared in accordance with the Financial Reporting Standards (NIFs, for its Acronym in Spanish) issued by the Mexican Board of Financial Reporting Standards (CINIF, for its Acronym in Spanish).

The accompanying financial statements were authorized to be issued on June 30, 2018, by Gyanesh Kumar, Finance Head, consequently, they do not reflect events beyond that date.

The General Corporate Law and the by-laws of the Company grant stockholders the possibility to amend the financial statements after their release. The accompanying financial statements will be submitted for approval at the General Stockholders' Annual Meeting.

#### **3 SIGNIFICANT ACCOUNTING POLICIES:**

The significant accounting policies used to prepare these financial statements are summarized below.

##### **a. Statements of profit or loss**

The statements of profit or loss present costs and expenses based on their function as the Company is a commercial entity, and also that this presentation is consistent with corporate accounting policies.

**b. Statements of cash flows**

The Company decided to present the statement of cash flows using the indirect method. By utilizing this method, profit or loss before income tax provision is firstly presented, and then reconciled by the changes in working capital, investing activities, and finally financing activities.

**c. Impact of inflation**

Pursuant to NIF B-10, beginning 2008, the companies incorporated before that date suspended recognition of the effects of inflation in view that they now operate in a non-inflationary economic environment. Since the Company commenced operations in 2013, it has not exceeded the threshold of 26% to recognize the effects of inflation. Accumulated inflation for the three years prior to the date of the financial statements is less than 26%.

Annual inflation in 2016, 2015, and 2014 was 3.3603%, 2.1308% y 4.0813%, respectively; therefore, accumulated inflation for the prior three-year period was 9.8710%.

**d. Cash**

Cash comprises cash on hand and bank deposits in checking accounts.

**e. Inventories**

Inventories are valued at the lower of cost or net realization value. The cost of inventories includes all expenses directly attributable to the commercialization process. The allocation formula to assign the unit cost of inventories is the first-in, first-out method. The net realization value is the estimated selling price in the normal course of operations, less any applicable selling expense.

The Company records the necessary estimates to recognize turndowns in inventory value due to impairment, obsolescence, slow-moving, and other causes which indicate the use or realization of such inventory will be lower than its carrying value.

**f. Prepayments**

Prepayments represent benefits for which, the receiving goods or services, including their inherent risk, have not yet been delivered and/or transferred to the Company.

**g. Furniture, equipment and leasehold improvements**

Furniture, equipment and leasehold improvements, are recorded at acquisition cost.

Depreciation of furniture and equipment is calculated based on the carrying value of fixed assets less estimated residual value, using the straight-line method based on the useful life thereof at the following rates:

Furniture and equipment	10%
Computer equipment	30%

Amortization of leasehold improvements is calculated based on the terms of the lease agreement, considering the period in which the Company expects to rent the facilities.

Maintenance and recurring maintenance costs are charged to operating expenses as they are incurred.

Gains or losses on disposal of machinery and equipment arise from the difference between the disposal proceeds and the carrying amount of the assets, and are recognized in profit or loss for the year.

**h. Long-lived assets value assessment**

Values of long-lived assets, tangible, are reviewed at least once a year, or when certain events or changes in the circumstances indicate that such values may not be recovered. In order to compute the impairment loss, the recoverable value must be determined which is defined as the greater of the net selling price of a cash generating unit and its value in use that is determined by the sum of discounted cash flows such unit can generate in the future, at an adequate rate of discount.

As of December 31, 2017 and 2016, the Company has not identified impairment conditions on its long-lived assets.

**i. Foreign currency transactions**

The financial statements of the Company are prepared in the currency of the primary economic environment in which the Company (its functional currency) operates. For purposes of these financial statements, the results and financial position are expressed in Mexican pesos, which is the functional currency of the Company and the presentation currency of financial statements.

In preparing the financial statements, transactions in a currency other than the functional currency of the Company (foreign currency) are recognized using the exchange rates prevailing at the dates in which operations are conducted. Exchange gains or losses form part of the comprehensive results of financing, affecting net profit or loss.

**j. Income tax, prepaid or deferred**

Provisions for income tax (ISR for its acronym in Spanish) are recorded in income for the year they become payable. Also, a deferred tax related to this item is included, arising from temporary differences resulting from comparing book and tax values of assets and liabilities, including the benefit of tax loss carryforwards. A deferred tax asset is recorded only when there is a high likelihood that it can be recovered. Deferred taxes are determined using enacted tax rates that are estimated will be effective on the dates temporary items shall be reversed or realized.

**k. Revenue recognition**

Sales are recorded upon delivery, depending on when risks and title of the goods are transferred to customers, which generally occurs when goods are delivered fulfilling purchase orders requirements. Sales discounts, quantity and price rebates are estimated based on experience and recorded in the period in which sales are recognized.

The Company performs ongoing credit evaluations of its customers' financial condition and establishes an allowance for losses on trade receivables based upon factors surrounding the credit risk of specific customers, historical trends and other information. Additionally, the Company has a policy of charging off future discounts or sales returns which is computed based on Management experience and industry trends.

**l. Use of estimates**

In preparing the financial statements, various estimates and assumptions have been used for presentation of assets and liabilities, and disclosure of contingent assets and liabilities, future cash flows, discount rates and other allowances, in order to present its financial information in conformity with Mexican Financial Reporting Standards. Actual results can differ from these estimates and assumptions.

**m. Provisions, contingent assets and liabilities-**

Provisions represent present obligations resulting from past events and are recognized when there is a probability of cash outflows, and amounts can be reliably estimated; but they can still be uncertain. A present obligation arises from legal or contractual commitments resulting from past events such as warranties, legal disputes, or onerous contracts. Provisions are not recognized for future operating losses.

**n. Comprehensive income**

The amount of comprehensive income is the result of the total performance of the Company during the years ended December 31, 2017 and 2016. Comprehensive income is basically represented by net profit for the year as shown in the statements of profit or loss.

**4 ACCOUNTING CHANGES:**

The new Financial Reporting Standards (NIF) effective January 1, 2017, had no impact on the Company's financial information.

**NIF B-13 Events subsequent to the date of the financial statements** (prospective application). If during the subsequent period (period from the date of the financial statements to the date the financial statements are approved for release), a debtor entity enters into a waiver for a long-term debt default, it may maintain such long-term classification of the debt at the date of the financial statements.

**Bulletin C-11 Equity (prospective application)**. Registration expenses on a stock exchange of shares of an entity, which at the date of such registration were already owned by investors and for which the issuing entity had already received the corresponding funds, must be recognized in profit or loss at the time of its accrual, as this is deemed as a non-equity transaction (the NIF had missed this concept). Additionally, it sets forth that any expense incurred in the repositioning of repurchased shares must be recognized as a reduction of issued and placed equity.

**5 ACCOUNTS RECEIVABLE:**

	<u>2017</u>	<u>2016</u>
<u>Trade receivables:</u>		
Trade receivables	\$ 30,774,355	\$ 21,633,353
Allowance for doubtful accounts	(717,441)	(1,442,577)
Allowance for discounts	(365,517)	(308,495)
Allowance for sales returns	(2,644,657)	(2,923,778)
Total of trade receivables, net	<u>27,046,740</u>	<u>16,958,503</u>
<u>Other receivables:</u>		
Value added tax recoverable	16,745,623	18,896,279
Income tax withholding from third parties	1,165,272	1,023,310
Miscellaneous	379,685	934,303
Total of other receivables	<u>18,290,580</u>	<u>20,853,892</u>
	<u>\$ 45,337,320</u>	<u>\$ 37,812,395</u>

**6 INVENTORIES:**

	<u>2017</u>	<u>2016</u>
Finished products	\$ 10,541,088	\$ 13,421,253
Less – Allowance for obsolete and slow-moving inventories	(2,889,506)	(521,781)
	<u>\$ 7,651,582</u>	<u>\$ 12,899,472</u>

The increase in allowance for obsolete and slow-moving inventories, is mainly due to returned products not in conditions to be sold again.

**7 FURNITURE, EQUIPMENT AND LEASEHOLD IMPROVEMENTS:**

	<u>2017</u>	<u>2016</u>
Furniture and equipment	\$ 748,171	\$ 735,371
Computer equipment	1,860,474	1,714,472
Leasehold improvements	1,397,774	1,410,573
	<u>4,006,419</u>	<u>3,860,416</u>
Less - Accumulated depreciation and amortization	<u>(3,493,636)</u>	<u>(3,311,928)</u>
	<u>\$ 512,783</u>	<u>\$ 548,488</u>

**8 PROVISIONS:**

As of December 31, 2017 and 2016, provisions refer to unpaid administrative expenses and laboratory assays in order to get permissions for products to be sold, amounting to \$1,755,798 and \$288,000, respectively.

**9 FOREIGN CURRENCY POSITION:**

As of December 31, 2017, 2016 and June 30, 2018, date of issuance of the accompanying financial statements, exchange rates per one US dollar were \$19.73, \$20.66 and \$19.6912, respectively.

As of December 31, 2017 and 2016, the following assets and liabilities are denominated in US dollars:

	<u>December 31, 2017</u>	<u>December 31, 2016</u>
Assets	2,573,282	35,785
Liabilities	(6,984,752)	(5,927,904)
Net Position	<u>(4,411,470)</u>	<u>(5,892,119)</u>

As of June 30, 2018, the foreign currency position of the Company (unaudited) is similar to the position as of December 31, 2017.

**10 STOCKHOLDERS' EQUITY:**

a Capital stock

As of December 31, 2017 and 2016, the Company's nominal capital stock is represented by two common shares, one of them with value in the amount of \$50,000, which represents the minimum fixed nominal capital, and the other one in the amount of \$169,265,138, which represents the nominal variable capital, with a par value of one peso each.

In January 14, 2016, the stockholders held a General Extraordinary Stockholders' Meeting in which it was resolved to increase the Company's nominal variable capital stock in the amount of \$7,500,000, which was fully issued and outstanding.

In April 20, 2016, the stockholders held a General Extraordinary Stockholders' Meeting in which it was resolved to increase the Company's nominal variable capital stock in the amount of \$12,000,000, which was fully issued and outstanding.

b. Legal reserve

Net profit for the year is subject to the legal provision which requires appropriating 5% of that profit to a legal reserve until that reserve equals 20% of the capital stock. The balance of the legal reserve may not be distributed to the stockholders, except as stock dividends; at December 31, 2017 and 2016, the Company has not yet created any Legal reserve.

c. Distribution of earnings

Net taxable income account (CUFIN, for its Acronym in Spanish)-

As of December 31, 2017 and 2016, there is no balance in the “net taxable income account” (CUFIN), which if it existed no income tax could be assessed on dividends or earnings distributed to stockholders up to the balance of such account.

Effective January 1, 2014, dividends paid to individuals or foreign residents are subject to an income tax at a 10% rate. This income tax is considered as a final payment, and should be withheld by the Company distributing the dividends or earnings. This new rule applies only to the distribution of dividends or earnings generated beginning January 1, 2014. The Company has no earnings available to be distributed as dividends.

In the case of non-CUFIN dividends, in addition to the above, they will continue to be subject to the payment of income tax payable by the entity, determined based on the general rate of law, which has the characteristic of being final and may be credited against Income tax for the year and the following two.

The balance of this account may be restated up to the date such dividends are distributed, by using the National Consumer Price Index (NCPI).

d. Capital Reductions

As of December 31, 2017, and 2016, the balance of the Restated Contributed Tax Account (CUCA for its acronym in Spanish) amounts to \$202,909,527 and \$190,043,577. Any reimbursement to the stockholders that exceeds the foregoing amount should be treated as a distributed earning for tax purposes.

Likewise, in the event that stockholders' equity should exceed the balance of the CUCA, the spread will be considered as a dividend or distributed earning subject to the payment of income tax. However, if such assessed earning distribution or dividend does not exceed the CUFIN balance, there will be no tax payable for the capital decrease or reimbursement.

e. Going concern

As of December 31, 2017, the Company has accumulated operating losses with a consequent deficit in Partners' equity by \$9,890,922, and as of that date, the Company's current liabilities (represented by related parties, mainly) exceeded its total assets by \$33,178,144. These conditions indicate that may cast significant doubt on the Company's ability to continue as a going concern. However, Cadila Healthcare Limited, India (CHL) the ultimate parent company, has indicated its intention to maintain the necessary financial support, to allow the Company to continue as a going concern.

After four and a half years of commencing operations, the Company has been gradually penetrating the pharmaceutical market, achieving a 30% increase in sales during 2017 as compared to 2016. Furthermore, Cadila Healthcare Limited, India (CHL) signed a Supply Agreement with the Company since 2016, to ensure that the Company earns an arm's length margin of 1% of the net sales, as shown in the statements of profit or loss for 2017 and 2016. The Company is expected to continue to generate profits based on this agreement and further actions that would be taken.

## 11 INCOME TAX:

For the years ended December 31, 2017 and 2016, the Company had a taxable income of \$8,653,309 and \$413,961, respectively, which differs from the net profit for the year, due mainly to the net effect of the provisions, allowance for doubtful accounts, allowance for obsolete inventory and provisions for accrued administrative services and non-deductible expenses. Taxable income was fully offset by operating tax loss carryforwards as of December 31, 2017 and 2016.

During 2017, 2016 and 2015 the Parent Company, Cadila Healthcare LTD made an income tax withholding in the amount of \$1,114,989, which can be applied against future taxable income during the following ten fiscal years from the year of occurrence, according to Article 5 of the Mexican Income Tax Law.

## 12 DEFERRED INCOME TAX:

As of December 31, 2017 and 2016, the deferred income tax asset derived from the difference between book and tax value of assets and liabilities, is summarized as follows:

	2017	2016
Allowance for doubtful accounts	\$ 717,441	\$ 1,442,577
Allowance for discounts	365,517	308,495
Allowance for sales returns	2,644,657	2,923,778
Allowance for obsolete and slow-moving inventories	2,889,506	521,781
Fixed assets	25,079	405,928
Provisions and other (transfer pricing adjustments)	3,111,021	1,788,000
Prepaid expenses	(322,691)	(338,882)
Excess of tax over book value of assets and liabilities, net	9,430,530	7,051,677
Tax loss carryforwards	221,203,344	215,565,558
	230,633,874	222,617,235
Income tax rate	30%	30%
Deferred income tax asset	69,190,162	66,785,171
Less: Valuation allowance	(46,452,702)	(58,202,701)
	<u>\$ 22,737,460</u>	<u>\$ 8,582,470</u>

As of December 31, 2017 and 2016, this net deferred income tax asset is mainly generated by the tax loss carryforwards, reserves of assets and provisions. However, considering the new conditions of the Company (see Note 10 e), its projections and its actual taxable income, the Company management has decided to recognize a valuation allowance for this deferred income tax asset in the amount of (\$46,452,702) and (\$58,202,701), respectively.

## 13 TAX LOSS CARRYFORWARDS:

Tax loss carryforwards can be offset against future taxable income during the following ten fiscal years. Those tax losses may be restated by using the NCPI, as of the first month of the second half of the fiscal year in which the tax loss was incurred and up to the last month of the first half of the fiscal year in which the tax loss is realized.

As of December 31, 2017, tax loss carryforwards restated at that date are summarized as follows in the next page.



Year incurred	Restated amount	Year of expiration
2011	\$ 8,220,712	2021
2012	39,559,164	2022
2013	35,318,701	2023
2014	69,410,789	2024
2015	68,239,749	2025
2016	454,229	2026
	<u>\$ 221,203,344</u>	

#### 14 RELATED PARTIES TRANSACTIONS AND BALANCES:

During the years ended December 31, 2017 and 2016, the Company carried out transactions and had balances with related parties as follows:

	2017			
	Balance Receivable	Balance Payable	Transactions	
			Revenues	Purchases and Expenses
Zydus Pharmaceuticals México Service Company, S.A. de C.V. (Affiliated) (a)	\$ -	\$ 7,498,586	\$ -	\$ 48,791,885
Zydus International Private Limited (Parent) (b)	-	121,608,643	-	726,651
Cadila Healthcare, LTD. (Ultimate Parent) (c)	<u>42,048,170</u>	<u>-</u>	<u>28,086,475</u>	<u>20,951,434</u>
	<u>\$ 42,048,170</u>	<u>\$ 129,107,229</u>	<u>\$ 28,086,475</u>	<u>\$ 70,469,970</u>
	2016			
	Balance Receivable	Balance Payable	Transactions	
			Revenues	Purchases and Expenses
Zydus Pharmaceuticals México Service Company, S.A. de C.V. (Affiliated) (a)	\$ -	\$ 6,740,000	\$ -	\$ 46,189,655
Zydus International Private Limited (Parent) (b)	-	110,881,811	-	1,319,065
Cadila Healthcare, LTD. (Ultimate Parent) (c)	<u>29,314,896</u>	<u>-</u>	<u>40,912,264</u>	<u>661,591</u>
	<u>\$ 29,314,896</u>	<u>\$ 117,621,811</u>	<u>\$ 40,912,264</u>	<u>\$ 48,170,311</u>

- a) As of December 31, 2017 and 2016, the balance payable to Zydus Pharmaceuticals México Service Company, S.A. de C.V., is related to administrative and personnel services and other expenses incurred during the year and are included within selling and marketing expenses.
- b) As of December 31, 2017 and 2016, the balance payable to Zydus International Private Limited (Parent) in the amount of \$115,902,736 and \$ 105,902,736 respectively, was mainly generated from a loan received at the interest rate of LIBOR EURO + 3,60%. As of December 31 2017 and 2016, the interests accrued amount to \$4,979,075 and \$4,878,512.

- c) As of December 31, 2017, the balance receivable from Cadila Healthcare Limited amounts to \$42,048,170, which is mainly comprised of accounts receivable from: i) reimbursement expenses arising from the transaction mentioned in Note 1 above, in the amount of \$28,527,373 and a remainder balance related to the same concept from prior years in the amount of \$34,407,875, net of the account payable arising from the purchase of goods in the amount of \$20,887,078.

As of December 31, 2016, the balance receivable from Cadila Healthcare Limited amounts to \$29,314,896, which is mainly comprised of accounts receivable from: i) reimbursement expenses arising from the transaction mentioned in Note 1 above, in the amount of \$ 40,912,264; and (ii) other expenses incurred to be reimbursed in the amount of \$609,937, net of the account payable arising from the purchase of goods in the amount of \$12,207,305.

As of December 31, 2017 and 2016, the Company has a transfer pricing study, which supports that the prices utilized in the related-party transactions are comparable to those that would be utilized with or between independent parties.

## **15 CONTINGENCIES AND COMMITMENTS:**

As of December 31, 2017 and 2016, the Company is subject to an ongoing review by the tax authorities on the taxable income determined for fiscal 2012; no conclusion has yet been arrived at.

The Company's lawyers consider that the final outcome of the ongoing claims and trials will not have a significant effect on the financial position of the Company.

## **16 CHANGES IN FINANCIAL REPORTING STANDARDS:**

At the date of authorization of these financial statements, several new and amended standards have been published by the CINIF, and they are effective on January 1, 2018. These standards and amendments have not been adopted early by the Company. Following, there is information described of those expected to be relevant to the Company's financial statements.

Management anticipates that all relevant pronouncements will be adopted for the first period beginning on or after the effective date of the pronouncement.

### **New NIFs**

The following are the main changes to the NIFs that come into effect on January 1, 2018 (with retrospective effects):

#### **NIF C-3 Accounts receivable**

- States that accounts receivable (AR) based on a contract represent a financial instrument; while others, derived from legal or fiscal provisions, although certain financial instrument characteristics may exist, they are not considered financial instruments.
- States that allowance for doubtful accounts is recognized at the moment revenue is accrued, based on expected estimated losses, and separately presented in expenses if significant within the statement of comprehensive income.
- States that, from their initial recognition (of an AR), value of money in time should be considered, as if the present value (of an AR) is significant based on its term, it should be adjusted upon such present value. Present value is significant when is arranged for full or partial payment in more than one year; as financing is assumed in the transaction.
- An analysis of changes between beginning and ending balance of any doubtful accounts allowance for each period presented should be disclosed.

#### **NIF D-1 Revenue from contracts with customers**

Adoption of this standard eliminates alternative application of International Accounting Standard IAS 18 Revenue recognition, and its interpretations.

Main changes of this standard with respect to IAS 18 are:

- a) Transferring control, rather than transferring risks and benefits of a good or the rendering of a service
- b) Requirements for identification of contractual [performance] obligations are expanded
- c) Sets forth the allocation of the amount of the transaction among performance obligations, based on independent sales prices
- d) The concept “conditioned account receivable” is introduced, to recognize that some contracts have no unconditional full right to the consideration, as it will be *conditioned* to meet another performance obligation of the same contract
- e) Sets forth drivers to recognize collection rights, to recognize the unconditional right to the consideration before the performance obligation is fulfilled.
- f) Requirements and guidance to value the variable consideration are provided (financing components, consideration other than cash, etc.).

#### **NIF D-2 Costs from contracts with customers**

Effective in conjunction with NIF D-1, supersedes Bulletin D-7, Contracts for construction and manufacturing of certain capital assets, INIF 14, Contracts for construction, sale and providing services on real estate, except for what it relates to recognition of assets and liabilities of this kind of contracts.

Recognition of costs from contracts with customers is separately pronounced in this standard, and it is expanded to all kinds of contracts with customers.

#### **NIF B-17 Fair value measurement**

This standard defines the fair value as the exit price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (i.e. a current value based on an exit price - market). In determining the fair value, the entity must use those assumptions that market participants would use to determine the price of an asset or liability in current market conditions at a given date, including risk assumptions. As a result, the entity's intention to hold an asset or liquidate, or otherwise satisfy a liability, is not material in determining fair value.

In determining fair value, an entity is required to consider the following:

- a) the particular asset or liability being valued;
- b) for a non-monetary asset, the greater and better use of the asset, and, if the asset is used in combination with other assets or on an independent basis;
- c) the market in which an orderly transaction would take place for the asset or the liability; and
- d) the appropriate valuation technique or techniques for the determination of fair value. The valuation technique or techniques used should maximize the use of relevant observable input data and minimize unobservable input data. These input data must be compatible with the input data that a market participant would use when determining the price of the asset or liability.

This Standard reconsiders the previous entry value at replacement cost as part of the cost approach in valuation techniques to determine fair value.

### **NIF C-9 Provisions, Contingencies and Commitments**

First adoption of this standard does not generate accounting changes. Main amendments of this standard are:

- a) financial liabilities are no longer addressed in this standard, rather, they were included in NIF 19,
- b) definition of liability is modified, the term virtually unavoidable was changed to probable.

### **NIF's IMPROVEMENTS 2018**

In December 2017, the following Improvements to the NIFs were promulgated, which will be effective in fiscal years beginning on January 1, 2018, allowing for their early application in some cases.

#### ***I. Improvements that arise accounting changes***

##### **NIF B-2 Statement of cash flows**

**Disclosures of liabilities arising from financing activities** – Retrospective application, effective on January 1, 2018, early adoption allowed.

Disclosure of relevant changes in liabilities allocated as financing activities is required, whether cash and cash equivalents were utilized or not. Preferably, a reconciliation between beginning and ending balance of such items should be performed, showing the following:

- I. cash flow changes;
- II. changes arising from gaining or losing control on subsidiaries and other ventures;
- III. foreign currency fluctuations;
- IV. fair value changes;
- V. changes in associated financial assets, which cash flows should be allocated as financing activities, such as financial assets used as hedging financial liabilities; and
- VI. other relevant changes.

##### **NIF C-6 Property, plant and equipment**

**Depreciation method** – Retrospective application, effective on January 1, 2018.

The depreciation method to adopt should reflect the consumption pattern of economic benefits of a component, rather than the income pattern. An asset depreciation method based on the income associated with such asset's use is not appropriate as such income may be affected by factors, different to those of the consumption pattern of economic benefits of such asset. For example, income may be affected by volume and sale prices or otherwise by inflation impact on the price component, among others.

#### ***II. Improvements that do not arise accounting changes***

##### **NIF B-15 Foreign currency translation**

**Valuation of assets and liabilities at the functional currency**

In accordance with NIF B-15, if it is required, translation from the accounting currency to the functional currency should happen first, and then functional currency should be translated to the reporting currency. Accordingly, this Improvement highlights that valuation of assets, liabilities, equity, income, costs and expenses should be performed at the functional currency, including the following among others:

- Determination of fair values in applicable items
- Assets impairment testing
- Determination of assets and liabilities arising from deferred taxes

### **Precisions to the NIF on financial instruments**

Some amendments were included to achieve consistency among all released NIF's that address financial instruments. Likewise, the requirement of fair value determination was eliminated, as this is now addressed and determined in accordance with NIF B-17 Fair Value Measurement. Improved NIF's are:

- NIF C-2 Investments in financial instruments
- NIF C-3 Accounts receivable
- NIF C-10 Derivative financial instruments and hedging relationships
- NIF C-16 Impairment of financial instruments receivable
- NIF C-19 Financial instruments payable
- NIF C-20 Financial instruments on principal and interest receivable