Nuvo Research Inc. Second Quarter Report 2014

Management's Discussion and Analysis (MD&A)

July 30, 2014 / The following information should be read in conjunction with the Nuvo Research® Inc. (Nuvo or the Company) Consolidated Financial Statements for the year ended December 31, 2013 which were prepared in accordance with International Financial Reporting Standards (IFRS) and filed on SEDAR on February 20, 2014. Additional information relating to the Company, including its Annual Information Form (AIF), can be found on SEDAR at www.sedar.com.

All amounts in the MD&A, Condensed Consolidated Interim Financial Statements and related Notes are expressed in Canadian dollars, unless otherwise noted.

All common share numbers are adjusted for the 2013 share consolidation on a basis of 65 pre-consolidation common shares for one post-consolidation common share (Consolidation).

Forward-looking Statements

Certain statements in this MD&A constitute forward-looking statements within the meaning of applicable securities laws. Forward-looking statements include, but are not limited to the Company's anticipated use of proceeds from the Private Placement, the Company's future share price and the Company's possible election to accelerate the expiry date of any of the warrants or the brokers warrants and similar statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "outlook", "objective", "may", "will", "expect", "intend", "estimate", "anticipate", "believe", "should", "plans" or "continue", or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those contemplated by such statements. Factors that could cause such differences include general business and economic uncertainties and adverse market conditions, as well as other risk factors included in the Company's Annual Information Form dated February 20, 2014 under the heading "Risks Factors" and as described from time-to-time in the reports and disclosure documents filed by the Company with Canadian securities regulatory agencies and commissions. This list is not exhaustive of the factors that may impact the Company's forward-looking statements. These and other factors should be considered carefully and readers should not place undue reliance on the Company's forward-looking statements. As a result of the foregoing and other factors, no assurance can be given as to any such future results, levels of activity or achievements and neither the Company nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements. The factors underlying current expectations are dynamic and subject to change. Although the forward-looking information contained in this MD&A is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements. All forward-looking statements in this MD&A are qualified by these cautionary statements. The forward-looking statements contained herein are made as of the date of this MD&A and except as required by applicable law, the Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Key Developments

During the quarter and prior to the release of the second quarter results:

Pennsaid® 2%

- Mallinckrodt informed the Company that it received approval for the physician sample packet (a 2 gram unit dose format) for Pennsaid 2% and expects to start dispensing these samples in the third quarter.

WF10™

- The Company has enrolled 121 of 160 patients for the Phase 2 WF10 clinical trial for the treatment of allergic rhinitis and expects the trial to be completed by the end of the year with top-line results available in the first quarter of 2015.

Overview

Background

Nuvo is a publicly traded, Canadian specialty pharmaceutical company with a diverse portfolio of products and technologies. The Company operates two distinct business units: the Topical Products and Technology (TPT) Group and the Immunology Group. The TPT Group has four U.S. Food and Drug Administration (FDA) approved commercial products, a pipeline of topical and transdermal products focusing on pain and dermatology and four drug delivery platforms that support the development of patented formulations that can deliver actives into or through the skin. The Immunology Group has two commercial products, a development program for the treatment of allergic rhinitis and an immune system modulation platform that has the potential to support treatments for a broad range of immune system related disorders.

As of June 30, 2014, the Company and its subsidiaries employed a total of 69 full-time employees at its head office in Mississauga, Ontario, its manufacturing and research facility in Varennes, Québec, its OXO-K993 manufacturing facility in Wanzleben, Germany and its research and development (R&D) facility in Leipzig, Germany.

Topical Products and Technology Group

The Company is developing drugs for a variety of therapeutic areas with a focus on delivering drugs topically into and through the skin directly to the desired site or transdermally into the bloodstream with resulting systemic activity, if desirable. Unlike oral medications, the Company's commercial topical products do not rely on bloodstream circulation to reach affected parts of the body, as they offer site-specific treatment while limiting systemic exposure to the active drug; thereby, reducing the potential for systemic side effects, adverse events and potential drug-drug interactions.

Topical Products and Technology Group Licensed Products:

The following table summarizes our licensed products, where our partners are working to obtain regulatory approval:

Brand	Therapeutic Area	Licensee or Distributor	Licensed Territories	Intellectual Property[1]
Pennsaid	Osteoarthritis of the knee	NovaMedica LLC	Russia; some Community of Independent States	None.
Pennsaid 2%	Osteoarthritis of the knee	Paladin Labs Inc.	Canada, South Africa, Israel and CNS and South America	Six patents granted worldwide[1] expiring in 2027, as well as 7 pending applications.
		NovaMedica LLC	Russia; some Community of Independent States	One patent granted in Russia expiring in 2027.
Rapydan[2]	Local Dermal Analgesia (Patch)	Eurocept B.V.	Russia, Turkey, Israel and People's Republic of China	Seven patents granted worldwide[1] with latest expiry in 2019.
Heated Lidocaine/ Tetracaine Patch		Paladin Labs Inc.	Canada	

[1] Worldwide refers to one or more countries other than Europe and the U.S.
[2] Rapydan is the brand name for the heated lidocaine/tetracaine patch (HLT Patch) in the respective jurisdiction.

Topical Products and Technology Group Commercial Products:
The following table summarizes our commercialized products:

Brand	Therapeutic Area	Licensee or Distributor	Licensed Territories	Intellectual Property
Pennsaid	Osteoarthritis of the knee	Mallinckrodt, Inc.	United States	Four granted U.S. patents listed in the FDA's Orange Book with latest expiry in 2030, as well as other pending applications.
		Paladin Labs Inc.	Canada	None.
		Vianex S.A.	Greece	None.
		Italchimici S.p.A.	Italy	None.
		Movianto UK Limited	U.K.	None.
Pennsaid 2%	Osteoarthritis of the knee	Mallinckrodt, Inc.	United States	Six granted U.S. patents listed in the FDA's Orange Book with latest expiry in 2030, as well as other allowed and pending applications.
Synera[1]	Local Dermal Analgesia (Patch)	Galen US Incorporated	United States	Nine granted U.S. patents of which seven have been listed in the FDA's Orange Book with latest expiry in 2020.
Rapydan[1]		Eurocept B.V.	Europe	Two granted European patents validated in 10 countries with latest expiry in 2019.
Synera/Rapydan			United States / Europe	Method of manufacturing patents that expire 2019 (U.S.) and 2020 (Europe).
Pliaglis	Local Dermal Analgesia (Peelable Cream)	Galderma Pharma S.A.[2]	United States	Two granted U.S. patents listed in the FDA's Orange Book with latest expiry in 2019.
			Europe	Two granted European patents validated in 18 countries with latest expiry in 2020.
			Worldwide[3]	Four patents granted worldwide[3] with latest expiry in 2020.

[1] Synera and Rapydan are the brand names for the heated lidocaine/tetracaine patch (HLT Patch) in the respective jurisdictions.
[2] Galderma currently sells Pliaglis in the U.S., Western Europe and Argentina and launched in Brazil in March 2014. Galderma plans to launch in Canada and Columbia in 2014. The Company expects Galderma to file for marketing approval in other countries around the world, including other South American countries, select Asian countries, South Africa and Australia.
[3] Worldwide refers to one or more countries other than Europe and the U.S.

Pennsaid
Pennsaid, the Company's first commercialized topical pain product, is used to treat the signs and symptoms associated with knee osteoarthritis (OA). OA is the most common joint disease affecting middle-age and older people. The drug combines the transdermal carrier (containing dimethyl sulfoxide, popularly known as DMSO), with diclofenac sodium, a leading non-steroidal anti-inflammatory drug (NSAID) and delivers the active drug through the skin directly to the site of inflammation and pain.

Since 2012, four patents related to Pennsaid have been issued by the United States Patent and Trademark Office (USPTO) with expiry dates in 2029 and 2030 (Pennsaid Patents). Mallinckrodt, Inc. (Mallinckrodt), the licensee for Pennsaid and Pennsaid 2%, listed the Pennsaid Patents in the FDA's Orange Book. The Orange Book listing required any Abbreviated New Drug Application (ANDA) applicant seeking FDA approval for a generic version of Pennsaid, prior to expiration of the patent, to provide a certification notice to Nuvo and Mallinckrodt of its ANDA before it can obtain FDA approval. Prior to the Orange Book listing of the Pennsaid Patents, there was no such requirement imposed on the generic applicants. The Pennsaid Patents issued by the USPTO do not automatically prevent a generic version of Pennsaid from being approved by the FDA or if approved, from being sold in the U.S. However, it does provide the Company with the opportunity to commence legal action against the ANDA applicants for patent infringement.

Subsequent to the Orange Book listing, Nuvo and Mallinckrodt have received Paragraph IV certification notices from eleven companies advising Nuvo and Mallinckrodt that they each filed an ANDA with the FDA seeking approval to market a generic version of Pennsaid prior to expiration of the Pennsaid Patents. One of the applicants subsequently withdrew from the process. Nuvo and Mallinckrodt filed patent infringement complaints with the courts against five of the generic companies, Apotex Inc. and Apotex Corp. (together Apotex); Lupin Ltd and Lupin Pharmaceuticals (together Lupin); Taro Pharmaceutical Industries, Ltd. and Taro Pharmaceuticals U.S.A., Inc. (together Taro); Amneal Pharmaceuticals LLC (Amneal); and Metrics, Inc., d/b/a Coastal Pharmaceuticals (Coastal). In January 2013, Nuvo and Mallinckrodt entered into a settlement agreement with Apotex (Apotex Settlement Agreement). Under the terms of the Apotex Settlement Agreement, Nuvo and Mallinckrodt granted a license to Apotex that permits Apotex, upon approval of its ANDA by the FDA, to launch its generic version of Pennsaid on or after April 1, 2014. Apotex received approval for their generic version of Pennsaid in May 2014 and launched in late May 2014. In 2013 and 2014, Nuvo and Mallinckrodt entered into settlement agreements with the generic companies, Lupin, Coastal and Amneal with respect to their ANDA filings with the FDA seeking approval to market a generic version of Pennsaid. A patent infringement complaint is pending against Taro. Paddock LLC (Paddock) received a tentative approval of their ANDA on December 26, 2013. In December 2013, IGI Laboratories, Inc. (IGI) filed a complaint against Nuvo and Mallinckrodt seeking a declaratory judgment of non-infringement of two of Nuvo's U.S. patents. Nuvo and Mallinckrodt entered into a settlement agreement with IGI with respect to this declaratory judgment action in June 2014. In May 2014, IGI received a tentative approval of their ANDA. It is the Company's belief that Paddock's approval and IGI's approval are tentative, as Apotex is the first ANDA filer for a generic version of Pennsaid, and as such, is eligible for a period of 180-day generic drug marketing exclusivity from subsequent generic versions of the same drug. Such exclusivity, unless forfeited or otherwise relinquished, continues for 180 days from the first commercial marketing of the Apotex drug product which occurred in late May 2014. Nuvo and Mallinckrodt have not filed patent infringement complaints at this time against the remaining generic companies.

In February 2014, Taro received approval in Canada for a generic version of Pennsaid which they launched in March. There has been minimal financial impact on the Company's revenue stream since the launch and it is not known what the future impact will be to our Canadian revenue stream of this generic. In addition, there is a second generic version of Pennsaid that is approved in Canada. It is not known if, or when, this generic version of Pennsaid will be sold in the Canadian market.

Pennsaid 2%

Pennsaid 2% is a follow-on product to original Pennsaid. Pennsaid 2% is an NSAID containing 2% diclofenac sodium compared to 1.5% for original Pennsaid. It is more viscous than original Pennsaid, is supplied in a metered dose pump bottle and has been approved in the U.S. for twice daily dosing compared to four times a day for Pennsaid. This provides Pennsaid 2% with advantages over Pennsaid and other competitor products and with patent protection.

Pennsaid 2% was approved on January 16, 2014 in the U.S. for the treatment of pain of OA of the knee and is not currently approved for sale or marketing in any other jurisdiction. In July 2014, the FDA approved the Supplemental New Drug Application (sNDA) for the physician sample configuration. It is expected that the samples which are 2ml unit doses will be available in the third quarter of 2014.

Additional clinical and non-clinical studies, beyond those that have been conducted by Mallinckrodt, may be required to support applications for the regulatory approval of Pennsaid 2% in other countries in which the Company, or other licensees and distributors, could potentially market the product. The Company has been advised by regulatory authorities in Canada and the United Kingdom that the data from the Phase 2 study conducted by Mallinckrodt is insufficient to support approval of Pennsaid 2% in their respective countries and that additional clinical studies will be required. There can be no assurance that the current trials and studies will be sufficient for regulatory authorities in any jurisdiction or that all studies will yield successful results or that the required regulatory approvals will be obtained.

HLT Patch

The heated lidocaine/tetracaine patch (HLT Patch) is a topical patch that combines lidocaine, tetracaine and heat, using proprietary Controlled Heat-Assisted Drug Delivery (CHADD™) technology. The CHADD unit generates gentle heating of the skin and in a well-controlled clinical trial demonstrated that it contributes to the efficacy of the HLT Patch. The HLT Patch resembles a small adhesive bandage in appearance and is applied to the skin 20 to 30 minutes prior to painful medical procedures, such as venous access, blood draws, needle injections and minor dermatologic surgical procedures.

In the U.S., the HLT Patch is marketed under the brand name Synera. Synera is approved in the U.S. to provide local dermal analgesia for superficial venous access and superficial dermatological procedures, such as excision, electrodessication and shave biopsy of skin lesions. In July 2013, the Company sold the rights to market and sell Synera in the U.S. to Galen US Incorporated (Galen) for its current indication (see Significant Transactions – 2013 – Synera U.S. Licensing Agreement). In March 2014, the FDA approved a prior approval supplement that requested the removal of the "not for home use" condition from the label.

Pliaglis

Pliaglis is a topical local anaesthetic cream that provides safe and effective local dermal analgesia on intact skin prior to superficial dermatological procedures, such as dermal filler injection, pulsed dye laser therapy, facial laser resurfacing and laser-assisted tattoo removal. This product consists of a proprietary formulation of lidocaine and tetracaine that utilizes proprietary phase-changing topical cream Peel technology. The Peel technology consists of a drug-containing cream which, once applied to a patient's skin, dries to form a pliable layer that releases drug into the skin. Pliaglis should be applied to intact skin for 20 to 30 minutes prior to superficial dermatological procedures and for 60 minutes prior to laser-assisted tattoo removal. Following the application period, Pliaglis forms a pliable layer that is easily removed from the skin allowing the dermatological procedure to be performed with minimal to no pain.

Galderma Pharma S.A. (Galderma), a global pharmaceutical company specialized in dermatology, holds the worldwide sales and marketing rights for Pliaglis. Galderma launched Pliaglis in the U.S. in March 2013 through a third-party distributor to take orders for the product and in January 2014, Galderma hired a small sales force to start marketing Pliaglis. Galderma launched Pliaglis in the E.U. in April 2013. In South America, under the terms of the licensing agreement, Nuvo was entitled to receive a milestone payment totaling US$2.0 million upon marketing approval in the second approved country in South America. In September 2013, Galderma received marketing approval in Brazil, entitling Nuvo to the US$2.0 million milestone payment which was received in the first quarter of 2014. Galderma launched Pliaglis in Brazil in March 2014.

In October 2009, Galderma and ZARS Pharma, Inc. (ZARS) negotiated a first amendment to the North American Pliaglis License Agreement and the Rest of World Pliaglis Licensing Agreement (the Pliaglis First Amendment). Under the terms of the First Pliaglis Amendment, ZARS received a cash payment of US$6 million in exchange for agreeing to a downward adjustment to the royalty rates it was to receive on the global net sales of Pliaglis. These reduced royalty rates continue until such time as Pliaglis achieves a predetermined monetary milestone that is based on the cumulative aggregate sales of Pliaglis and the difference between the original and the adjusted royalty rates. In addition, if this milestone is not achieved by April 2015, the royalty rates will be reduced further until such time as the target is reached, subject to a minimum annual royalty rate being paid to the Company. Upon the sales thresholds being met, the royalty rates revert back to the amounts specified under the original agreements. The Company anticipates that the predetermined monetary milestone will not be achieved by April 2015 at which time the royalty rates received on net sales of Pliaglis will decline.

Mallinckrodt Dispute History

Under the terms of a U.S. licensing agreement dated June 15, 2009 (Pennsaid U.S. Licensing Agreement), Mallinckrodt and Nuvo negotiated and agreed to a development plan for Pennsaid 2% (the Pennsaid 2% Development Plan). The Pennsaid 2% Development Plan described specific development activities to be conducted by Mallinckrodt and timelines for carrying out of those activities. The Pennsaid

2% Development Plan included a Phase 2 clinical trial, which if successful, was to be followed immediately by two Phase 3 clinical trials. The Company estimates the cost of conducting the two Phase 3 clinical trials to be approximately US$40 million.

Under the terms of the Pennsaid U.S. Licensing Agreement, Mallinckrodt assumed full responsibility for managing, planning, executing and paying for all development activities for Pennsaid 2%. Although Nuvo has four of eight seats on the Pennsaid Joint Steering Committee (Pennsaid JSC) which was established as per the Pennsaid U.S. Licensing Agreement with Mallinckrodt to monitor and provide advice respecting the commercialization plans for Pennsaid and the development of Pennsaid 2%, the Company, with certain exceptions, no longer controls the execution of the clinical development program for Pennsaid 2% or the commercialization of Pennsaid and Pennsaid 2%. Those responsibilities have been contractually assumed by Mallinckrodt. The Company, via the Pennsaid JSC, does have approval rights with respect to any material changes to the Pennsaid 2% Development Plan. Any such changes require the unanimous approval of the Pennsaid JSC.

The Phase 2 clinical study was successfully conducted by Mallinckrodt during the first half of 2011, which was later than contemplated by the Pennsaid 2% Development Plan. In June 2011, Mallinckrodt provided the Company with the Phase 2 clinical trial top-line results that demonstrated Pennsaid 2% met its primary endpoint of reducing OA pain in the knee greater than a placebo vehicle control with a p-value of 0.042. By September 2011, Mallinckrodt was significantly behind the timelines set out in the Pennsaid 2% Development Plan which had provided that the two Phase 3 pivotal clinical trials were to have commenced in November 2010, but no later than February 2011. The date of Mallinckrodt's commencement of the Phase 3 clinical trials was very important to the Company, so much so, that the Company had insisted that a specific termination provision be included in the Pennsaid U.S. Licensing Agreement that would allow the Company to terminate the Pennsaid U.S. Licensing Agreement as it relates to Pennsaid 2% and to a reversion of the Pennsaid 2% U.S. marketing rights to the Company, if the two Phase 3 clinical trials were not commenced within 20 months of the date of the agreement. The Pennsaid U.S. Licensing Agreement was dated June 15th, 2009, which meant there was a contractual right to terminate the agreement if the two Phase 3 clinical trials were not initiated by February 15, 2011.

In June 2011, Mallinckrodt advised the Company that it wished to pursue an sNDA regulatory approval pathway for Pennsaid 2% supported by the data from the Phase 2 clinical study, rather than a New Drug Application (NDA) supported by two Phase 3 clinical trials, as outlined by the Pennsaid 2% Development Plan. Mallinckrodt advised the Company that it believed data obtained through the Phase 2 clinical trial could be used to support the sNDA and that conducting the two Phase 3 clinical trials was not required. Mallinckrodt further advised the Company that it believed that an sNDA could be filed sooner with the FDA than an NDA, that the FDA review would be expected to be shorter with an sNDA and; therefore, that Pennsaid 2% could be approved more quickly than if Mallinckrodt followed the NDA pathway. Mallinckrodt then formally requested that the Company and its representatives on the Pennsaid JSC consent to this change to the Pennsaid 2% Development Plan. The Company declined to provide its requested consent. The Company advised Mallinckrodt that in its view, the revised regulatory pathway proposed by Mallinckrodt was riskier than the pathway contemplated by the Pennsaid 2% Development Plan, that the successful Phase 2 study had never been designed or powered as a pivotal study to support approval, that Nuvo would be deprived of the benefit of the Phase 3 clinical trial data that, under the terms of the Pennsaid U.S. Licensing Agreement, it was entitled to use to support applications for regulatory approval of Pennsaid 2% in territories outside of the U.S. and that in the Company's view, Mallinckrodt's decision was being driven by its failure to meet the timelines set out in the Pennsaid 2% Development Plan and its desire to save the US$40 million cost of conducting the two Phase 3 clinical trials that the Company had negotiated for, as part of the consideration for the grant of U.S. marketing rights to Mallinckrodt. Notwithstanding that Nuvo did not provide its consent to the change in the Pennsaid 2% Development Plan, as requested by Mallinckrodt, Mallinckrodt proceeded to file an sNDA supported by the Phase 2 clinical study data without the benefit of the data from two Phase 3 clinical trials. The Company has specifically reserved its legal rights pursuant to the Pennsaid U.S. Licensing Agreement, including its right to claim damages, to terminate the Pennsaid U.S. Licensing Agreement as to both Pennsaid and Pennsaid 2% for material breach by Mallinckrodt and to terminate the Pennsaid U.S. Licensing Agreement as it relates to Pennsaid 2% by the failure of Mallinckrodt to commence two

Phase 3 clinical trials within 20 months of the date of the Pennsaid U.S. Licensing Agreement. Mallinckrodt has advised Nuvo that it does not believe that it is in breach of the Pennsaid U.S. Licensing Agreement and has rejected Nuvo's position.

On April 10, 2013, Nuvo delivered a formal notice of material breaches (NOMB) to Mallinckrodt that, pursuant to the terms of the Pennsaid U.S. Licensing Agreement, is a pre-condition to Nuvo commencing formal legal proceedings for breaches of the Pennsaid U.S. Licensing Agreement. The NOMB was intended to give Mallinckrodt an opportunity to cure the breaches alleged by Nuvo. The time periods set out in the NOMB expired without any response by Mallinckrodt to remedy the alleged breaches. In August 2013, the Company commenced legal action against Mallinckrodt (see Litigation – Mallinckrodt).

In May 2012, Mallinckrodt submitted an sNDA for Pennsaid 2% to the FDA. Mallinckrodt advised the Company that in July 2012, the FDA requested that Mallinckrodt withdraw the sNDA and refile it as an NDA. Mallinckrodt complied with the request and resubmitted the application as an NDA on July 15, 2012. Mallinckrodt advised Nuvo that the FDA accepted the NDA for Pennsaid 2% for review. The FDA set a Prescription Drug User Fee Act (PDUFA) date of March 4, 2013 for action on the submission. Mallinckrodt received a Complete Response Letter (CRL) to the NDA for Pennsaid 2% in which the FDA confirmed the only substantive additional requirement was the completion of a pharmacokinetic (PK) study comparing Pennsaid 2% to original Pennsaid. Mallinckrodt had completed a similar PK study that was filed with the NDA; however, the FDA rejected its results because product samples were not retained at the clinic site as required by the study protocol and the FDA regulations. Mallinckrodt advised Nuvo that it successfully completed the additional PK study as required by the FDA in the CRL. On August 7, 2013, Mallinckrodt submitted the study to the FDA to address the CRL. The FDA approved the sale and marketing of Pennsaid 2% in the U.S on January 16, 2014. The FDA granted a period of 3-year marketing exclusivity for Pennsaid 2% pursuant to the "Hatch-Waxman Act". The FDA's decision to grant 3-year marketing exclusivity would prevent the FDA from approving an ANDA for a generic version of Pennsaid 2% until at least 3 years after the FDA approved the drug product.

Although the Company has patent protection and Hatch-Waxman exclusivity for Pennsaid 2%, a generic company can submit an ANDA to the FDA. If a generic Company files an ANDA with the FDA, they will have to provide a certification notice to Nuvo and Mallinckrodt of its ANDA before it can obtain FDA approval. The patents issued by the USPTO do not automatically prevent a generic version of Pennsaid 2% from being approved by the FDA or if approved, from being sold in the U.S. However, it does provide the Company with the opportunity to commence legal action against the ANDA applicants for patent infringement.

Mallinckrodt commenced the marketing and sale of Pennsaid 2% in the U.S. in February 2014.

In July 2014, Nuvo delivered an additional NOMB letter to Mallinckrodt. As mentioned above, one purpose of the NOMB letter was to give Mallinckrodt an opportunity to cure the continuing breaches of the Pennsaid U.S. Licensing Agreement and the additional breaches subsequent to the April 10, 2013 NOMB letter. In July 2014, Nuvo amended its Complaint to among other things, include allegations related to Mallinckrodt's failure to use Diligent Efforts to launch and market Pennsaid 2% (see Litigation – Mallinckrodt).

Mallinckrodt's failure to use Diligent Efforts to develop, launch and market Pennsaid 2%, the entry of Apotex's generic version of Pennsaid in the U.S. market and/or the potential entry of two other generic companies who have received tentative approvals from the FDA for their generic versions of Pennsaid could have a significant adverse effect on sales of Pennsaid 2% and the resulting level of royalties and milestone payments earned by the Company.

Pipeline Expansion and Early Stage Drug Development

The Company has a broad portfolio of development stage products and four proprietary platform technologies, which include multiplexed molecular penetration enhancers (MMPE™), CHADD, Peel and DuraPeel™. These platforms are the focus of the development of products for pain, dermatological,

central nervous systems (CNS) and endocrinology conditions. The Company is actively seeking co-development partners to advance its pipeline products.

Topical Products and Technology Product Candidate Development Pipeline:
The following table summarizes our key product candidates:

Product	Therapeutic Area	Stage of Development	Technology	Intellectual Property[1]
HLT Patch (lidocaine 70mg / tetracaine 70mg)	Acute Musculoskeletal Pain	Phase 2 clinical trial	CHADD	Applications pending in 9 countries including U.S. and EP with latest anticipated expiry in 2031.
Flexicaine (lidocaine 7%/ tetracaine 7% cream)	Postherpetic Neuralgia	Phase 2 clinical trial	Peel	Patent granted in AU expiring 2030. Applications allowed in CN, AU and pending in 9 other countries including U.S. and EP. Latest anticipated expiry date is 2031.
TAC DuraPeel (Triamcinolone Acetonide 0.5%)	Hand Dermatitis	Phase 2 clinical trial	DuraPeel	Patents granted in AU, CN, CA and the U.S. through 2025. Applications pending in 8 countries including U.S. and allowed in EP with latest anticipated expiry in 2031.
Ropivacaine DuraPeel (6.5% Ropivacaine)	Neuropathic Pain	Phase 2 clinical trial	DuraPeel	Patents granted in AU, CN, CA and the U.S. through 2025. Applications pending in U.S., EP, CN, HK and JP with latest anticipated expiry date in 2027.
Alprazolam Patch (1% alprazolam)	Anxiety Disorder	Multiple Phase 1 clinical trials	Patch	Applications pending in EP and U.S. Anticipated expiry date is 2028.
Testosterone DuraPeel[2]	Male HRT Therapy	Pre-clinical	DuraPeel	Patents granted in AU, CN, and CA. Applications pending in U.S., EP, CN, HK and JP with latest anticipated expiry date in 2027.
Risperidone Patch (2% risperidone)	Schizophrenia	Pre-clinical	Patch	Applications pending in EP and U.S. Latest anticipated expiry date is 2028.
Ibuprofen Foam (5% ibuprofen)	Acute Pain	Pre-clinical	Other	Applications pending in EP, CA and U.S. Anticipated expiry date is 2031.
Terbinafine solution (terbinafine 10% solution)	Onychomycosis	Pre-clinical	Other	Applications pending in 6 countries including U.S. and EP Latest anticipated expiry date is 2030.

[1] Region and country abbreviations defined as follows: Australia (AU), Canada (CA), China (CN), Europe (EP), Hong Kong (HK), Japan (JP), United States (U.S.).
[2] Concentration of Testosterone DuraPeel not yet determined.

Topical and Transdermal Drug Delivery Technology

CHADD
The CHADD unit consists of a powder-filled pouch laminated between a top cover film with oxygen-regulating holes and a bottom film with a pressure-sensitive adhesive layer that generates heat when exposed to air. When the CHADD patch is removed from its hermetically sealed pouch, oxygen in ambient air flows into the heat-generating powder, initiating an oxidative reaction. After an initial rise in temperature, the mild heat generated by the CHADD unit will reach and maintain a controlled temperature range for a predetermined period of time. The CHADD unit may either be incorporated directly into the drug-containing patch as with the HLT Patch or placed on top of a transdermal drug patch to initiate temporary increases in drug concentrations. CHADD units can be customized to achieve the specific temperature and duration of heating required for therapy. Depending on the intended application, a CHADD unit can be designed to deliver heat for periods from 20 minutes to 12 hours.

Peel
The proprietary phase-changing cream technology has been used in the Company's Peel drug delivery technology. Peel consists of a drug-containing cream which, once applied to a patient's skin, dries to form a pliable layer that releases drug into the skin. Peel based products can remain on the skin for periods from 20 minutes to 2 hours, depending on the desired effect. After the desired effect is achieved,

the Peel product can be easily removed from the skin. This drug delivery technology is well suited for drugs that require a single, short-term application, such as local anesthetics applied before a painful procedure and for uneven, irregular or contoured surfaces. Other uses of the technology include treatment of chronic pains, such as neuropathic pains, that require multiple daily applications of the drug-containing cream.

DuraPeel

The DuraPeel technology consists of a drug, containing solid-forming formulation which is spread onto a patient's skin where, within a few minutes, it forms a pliable layer that is not inadvertently removed by touching or contact with clothing. DuraPeel formulations include a two-solvent system: a volatile solvent system that evaporates quickly and a non-volatile solvent system that evaporates more slowly. Once applied, the volatile solvent(s) in the formulation dries and the product forms a pliable layer. The non-volatile solvent(s) remains in the formulation, allowing for sustained drug delivery. While the Peel technology allows for short-term drug delivery for periods of up to an hour, the DuraPeel technology allows for predictable drug delivery for up to 12 hours. Following the desired treatment time, the DuraPeel product can be easily peeled or washed from the skin. As with the Peel technology, DuraPeel based formulations can be applied over uneven, irregular or contoured surfaces of the body.

MMPE

This technology uses special combinations of molecular penetration enhancers (MPE) to permeate the skin to enhance delivery of a given drug. Certain MPEs can interact with molecules in the stratum corneum (the outer layer of the skin) to enhance its permeability. The Company believes that an effective way to enhance the stratum corneum's permeability is to use cocktails of different MPEs which it terms MMPEs.

Immunology Group

The Immunology Group is focused on the R&D of WF10, a composition for the treatment of immune related diseases. The immune system provides an essential defence to micro-organisms, cancer and substances it sees as foreign and potentially harmful. WF10, a solution of OXO-K993 containing stabilized chlorite ions, focuses on supporting the immune system by targeting the macrophage, a type of white blood cell that coordinates much of the immune system, to regulate normal immune function.

Immunology Group Product Candidate Development and Commercial Product Pipeline:

The following table summarizes our development pipeline and commercial products:

Product Candidate/ Brand	Targeted Indication/ Indication	Stage of Development	Intellectual Property[1]
WF10 and derivative forms	Allergic rhinitis	Phase 2 clinical trial	Two granted U.S. patents that can potentially be listed in the FDA's Orange Book upon NDA approval, with latest expiry in 2029. Pending patent applications in EP and CA.
Reformulated WF10	Liposomal composition – platform technology	Preclinical	Applications pending in 15 countries including U.S. and EP. Anticipated expiry date is 2032.
Oxo-Foam	Wound healing	Preclinical	Patent applications pending in 9 countries including U.S. and EP. Anticipated expiry date is 2031.
Immunokine	Treatment for post radiation cystitis and diabetic foot ulcers	Commercialized in Thailand	None.
Oxoferin	Topical wound healing agent	Commercialized in 7 territories in EP, Asia and South America	None.

[1] Region and country abbreviations defined as follows: Canada (CA), Europe (EP), United States (U.S.).

WF10 Development

WF10's mode of activity is believed to be based on how macrophages regulate the immune system. Research suggests that, in some cases, WF10 may rebalance improperly functioning immune systems.

The drug has potential applications in adjuvant cancer therapy, diseases related to immune deficiencies and the management of chronic viral infections.

The Company believes that WF10 has commercial potential in the U.S. market as a treatment for allergic rhinitis and has conducted preliminary third-party market research that supports its belief. The combination of patent coverage and market potential has led the Company to conduct a confirmatory Phase 2 study for the treatment of allergic rhinitis with WF10. In December of 2013, Germany's drug regulatory body, the BfArM, authorized the Company to execute the confirmatory Phase 2 clinical trial. The trial is a 160-subject, randomized, double blind, placebo-controlled, 4-arm multi-centre trial to assess the efficacy and safety of a regimen of five WF10 infusions for the treatment of patients with moderate to severe persistent allergic rhinitis. The Company started enrolment in March 2014 and has enrolled over 120 patients to-date. The Company expects the study to be completed in late 2014 and top-line results to be available in the first quarter of 2015.

In July 2012, the Development Bank of Saxony (SAB) agreed to provide the Company with an additional €4.4 million of funding for the further development of its improved reformulated versions of WF10 (Reformulated WF10). The SAB funding will be used to support a number of preclinical studies relating to both WF10 and Reformulated WF10 for which the Company filed a U.S. provisional application in December 2011. These studies are being conducted by the Company in partnership with the University of Leipzig and the Fraunhofer Institute and are focused on demonstrating the efficacy, safety and stability of Reformulated WF10. The total cost of this development program is estimated to be €6.3 million and the SAB committed to provide up to €4.4 million in funding to support these projects, €3.7 million of which will be provided to the Company's co-operative partners and €0.7 million which will be provided directly to the Company. The funding will take the form of a non-repayable reimbursement of specific development monies expended by the Company until October 2014. The SAB agreed to extend the original funding period which would expire in July 2014 to October 2014. The Company has certain contractual obligations to the SAB, including the obligation to provide matching funding from its own resources of €1.9 million.

Regardless of the future development plans for WF10, a number of additional studies will need to be conducted before WF10 can be submitted for regulatory approval for the treatment of allergic rhinitis or any other illness and there can be no assurance that the results of these additional studies will be favourable or that regulators will approve WF10 for these or other purposes. Any such studies and approvals would be expected to take a number of years.

Oxoferin™
Oxoferin, a topical wound healing agent, is a diluted form of WF10, a chlorite-based, immunomodulating drug. The product has also been licensed to Ranbaxy Laboratories Limited (Ranbaxy) for Malaysia, the Philippines, Vietnam, Singapore and other Indochina countries and Algeria, Tunisia and Morocco. In February 2014, Ranbaxy received approval to market Oxoferin in Morocco and they expect to launch in this region in the second half of 2014. The product has not been approved or marketed in any of the other territories and Ranbaxy is at various stages in pursuing these necessary marketing approvals. In 2014, the licensing agreement for Russia was terminated.

Litigation

From time-to-time, during the ordinary course of business, the Company is threatened with, or is named as, a defendant in various legal proceedings including lawsuits based upon product liability, personal injury, breach of contract and lost profits or other consequential damage claims.

Mallinckrodt
On August 20, 2013, the Company commenced legal action against Mallinckrodt by filing a Complaint in the U.S. District Court for the Southern District of New York (the Action).

The Complaint asserts that Mallinckrodt has breached its contractual obligations to Nuvo, as set out in the Pennsaid U.S. Licensing Agreement pursuant to which Nuvo licensed to Mallinckrodt the rights to sell and market Pennsaid and Pennsaid 2% in the U.S. in return for certain obligations undertaken by Mallinckrodt.

The Complaint asserts that Mallinckrodt breached the Pennsaid U.S. Licensing Agreement in several respects, including, among others:

- Mallinckrodt willfully failed to conduct two Phase 3 clinical studies required under the Pennsaid U.S. Licensing Agreement that are critical to a) securing an indication and product label for Pennsaid 2% in the U.S. that is equivalent to those for Pennsaid; b) providing evidence of robust efficacy of Pennsaid 2% for marketing in the U.S. and throughout the world, and c) obtaining regulatory approval for Pennsaid 2% outside the U.S.;
- Mallinckrodt made significant, negligent errors in certain clinical studies for which it was responsible, including failure to properly conduct PK studies which led to the delay of the FDA's approval of Pennsaid 2% in the U.S.;
- Mallinckrodt willfully failed to apply requisite efforts to commercialize Pennsaid in the U.S. resulting in significantly lower sales and royalties payable to the Company; and
- Mallinckrodt has willfully refused to pay the full milestone payments due to Nuvo under the Pennsaid U.S. Licensing Agreement.

Nuvo is seeking damages of not less than US$100 million and a declaration that it is entitled to terminate the Pennsaid U.S. Licensing Agreement which would result in the rights to sell and market Pennsaid and/or Pennsaid 2% in the U.S. reverting to Nuvo. While the litigation is ongoing, Mallinckrodt continues to sell Pennsaid and Pennsaid 2% in the U.S.

On November 1, 2013, Mallinckrodt filed an Answer and Counterclaim in the Action. In its Answer, Mallinckrodt denies Nuvo's assertions. Mallinckrodt's Counterclaim sets forth a single cause of action for breach of contract, and seeks unspecified damages, as well as declaratory relief. The Company believes that it has substantial defenses to the Counterclaim raised in the Action which it intends to vigorously defend.

In July 2014, Nuvo amended its Complaint to among other things include allegations related to Mallinckrodt's failure to use Diligent Efforts to launch and market Pennsaid 2%.

Nuvo and Mallinckrodt have agreed to a joint discovery schedule in which document discovery was substantially completed by June 2014 and all fact discovery is to be completed by December 2014. According to the current schedule, we anticipate a trial would take place no sooner than 2015.

Liquidity

The Company has incurred substantial losses since its inception, as it has invested significantly in drug development activities and other legacy ventures. At June 30, 2014, the Company had an accumulated deficit of $236.6 million, including a net loss of approximately $2.3 million and $5.1 million for the three and six months ended June 30, 2014. As at June 30, 2014, the Company had cash and cash equivalents of $10.7 million.

The Company expects that it will continue to incur losses as its revenue streams are not yet sufficient to fund: its operations, the infrastructure necessary to support a public company and the costs of selectively advancing its drug development pipeline. The Company's ability to continue as a going concern depends on:

- the ability of Mallinckrodt to successfully launch Pennsaid 2%, including the switch in the U.S. market from Pennsaid to Pennsaid 2%, as the Company earns revenue in the form of royalties and product sales and has the ability to earn sales milestone payments;

- the commercial success of Pennsaid outside of the U.S., as the Company earns revenue in the form of product sales in all territories and royalties and product sales in Canada;
- the continued financial impact on revenue and cash flows from the generic version of Pennsaid that launched in the U.S. in May 2014 that has negatively impacted Pennsaid scripts;
- the entry of additional generic versions of Pennsaid into the U.S. market, as this may significantly reduce revenue and cash flow;
- the financial impact of the generic version of Pennsaid that launched in Canada in March 2014, as this may reduce revenue and cash flow;
- the commercial success of Synera in the U.S. and Rapydan in the E.U., as the Company earns revenue in the form of royalties and has the ability to earn sales milestone payments;the success of the Company's Phase 2 clinical study using WF10 as a treatment for moderate to severe allergic rhinitis;
- the commercial success of Pliaglis in the U.S. and E.U. and Galderma's ability to successfully launch Pliaglis in Brazil and other markets, as the Company earns royalties on this product and Galderma's ability to get marketing approvals in other geographic regions; and
- its ability to secure additional licensing fees, secure co-development agreements, obtain additional capital, gain regulatory approval for other drugs and ultimately achieve profitable operations.

The Company currently anticipates that its cash and cash equivalents together with the revenues it expects to generate from product sales of Pennsaid and Pennsaid 2%, royalty payments from Pennsaid, Pennsaid 2%, the HLT Patch and Pliaglis will be sufficient to fund operations into 2015.

Nonetheless, companies in the pharmaceutical R&D industry typically require periodic funding in order to develop drug candidate pipelines until such time as at least one drug candidate has been successfully commercialized such that they are receiving sufficient revenue to fund their operations. Nuvo has not yet reached this stage and; therefore, the Company monitors on a regular basis, its liquidity position, the status of its partners' commercialization efforts, the status of its drug development programs, including cost estimates for completing various stages of development, the scientific progress on each drug candidate, the potential to license or co-develop each drug candidate and continues to actively pursue fund raising possibilities through various means. There can be no assurance that additional financing would be available on acceptable terms, or at all, when and if required. If adequate funds were not available when required, the Company may have to substantially reduce or eliminate planned expenditures, terminate or delay clinical trials for its product candidates, curtail product development programs designed to expand the product pipeline or discontinue certain operations. If the Company is unable to obtain additional financing when and if required, the Company may be unable to continue operations.

The Condensed Consolidated Interim Financial Statements do not include adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

Selected Financial Information

in thousands (except per share)

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
	$	$	**$**	$
Operations				
Product sales	**2,205**	1,670	**3,361**	2,274
Royalties	**1,478**	1,481	**2,875**	2,865
Research and other contract revenue	**180**	84	**327**	262
Licensing fees	**-**	85	**57**	170
Total Revenue	**3,863**	3,320	**6,620**	5,571
Total operating expenses	**6,034**	5,624	**11,677**	11,040
Loss from operations	**(2,171)**	(2,304)	**(5,057)**	(5,469)
Other (income) expenses	**108**	(113)	**(56)**	(36)
Loss before income taxes	**(2,279)**	(2,191)	**(5,001)**	(5,433)
Income taxes	**28**	29	**49**	57
Net loss	**(2,307)**	(2,220)	**(5,050)**	(5,490)
Other comprehensive income (loss)	**(99)**	350	**(12)**	668
Total comprehensive loss	**(2,406)**	(1,870)	**(5,062)**	(4,822)
Share Information				
Net loss per share				
Basic and diluted	**($0.23)**	($0.25)	**($0.53)**	($0.63)
Average number of common shares outstanding for the period				
Basic and diluted	**10,240**	8,807	**9,556**	8,807

Financial Position	**As at June 30, 2014** **$**	As at December 31, 2013 $
Cash and cash equivalents	**10,707**	12,621
Total assets	**19,126**	21,621
Finance lease & other obligations, including current portion	**4,358**	5,441
Total liabilities	**8,987**	9,423
Total equity	**10,139**	12,198

Non-IFRS Financial Measure

The Company discloses non-IFRS measures that do not have standardized meanings prescribed by IFRS, but are considered useful by management, investors and other financial stakeholders to assess the Company's performance and management from a financial and operational standpoint. Total operating expenses is defined as the sum of: cost of goods sold, R&D expenses, sales and marketing (S&M) expenses, general and administrative (G&A) expenses and interest expense, net of interest income. Loss from operations is defined as total revenue, less total operating expenses, and the Company considers it a useful measure as, it provides investors with an indication of the operating

performance by the Company before considering gains or losses from foreign exchange or items that are non-recurring transactions.

Fluctuations in Operating Results
The Company's results of operations have fluctuated significantly from period-to-period in the past and are likely to do so in the future. The Company anticipates that its quarterly and annual results of operations will be impacted for the foreseeable future by several factors including: the level of Pennsaid's Canadian net sales and in the U.S., net sales of Pennsaid and Pennsaid 2% which impacts royalty revenue and payments, the timing and amount of royalties and other payments received pursuant to current and future collaborations and licensing arrangements, including those for Pliaglis and the HLT Patch and the progress and timing of expenditures related to R&D efforts. Due to these fluctuations, the Company believes that the period-to-period comparisons of its operating results are not necessarily a good indicator of future performance.

Significant Transactions

2014

Private Placement
On March 31, 2014, the Company completed a non-brokered private placement (Private Placement), pursuant to which an aggregate of 1,390,000 units of the Company were issued at a price of $2.25 per unit for gross proceeds of $3.1 million ($2.9 million net of issuance costs). Each unit consists of one common share of the Company and one-half of one common share purchase warrant of the Company (Unit). The Company issued 695,000 common share purchase warrants (Private Placement Warrants).

The Private Placement Warrants entitles the holder to purchase one common share of the Company at a price of $3.00 for a 24-month period. The Private Placement Warrants are subject to an acceleration feature, where the Company at its option, can force the exercise of the Private Placement Warrants if the ten-day volume weighted share price for the Company's common shares is equal to or exceeds $3.50 on the Toronto Stock Exchange (TSX) at any time during the warrant term. If the acceleration feature is used, any Private Placement Warrants that are not exercised during this period will expire.

In connection with the Private Placement, finder's fees were paid consisting of (a) a 6% cash commission amounting to $0.2 million, and (b) broker warrants to purchase Units at a price of $2.54 per Unit (Broker Warrants), equal to 6% of the number of Units issued. The finder's fee was paid on Units purchased by new investors and not on Units purchased by management or its advisors. The Company issued 78,233 Broker Warrants.

2013

Synera U.S. Licensing Agreement
In the third quarter of 2013, the Company entered into a product acquisition and license agreement with Galen that sold the exclusive rights to sell and market Synera in the U.S. for its current indication. Under the terms of the agreement, Galen made an upfront payment to Nuvo of US$4.5 million (Galen Upfront Payment) on closing and Nuvo receives royalties of 10% of net sales and is eligible to receive a US$5.0 million milestone payment upon gross annual sales reaching US$25.0 million and a further US$5.0 million upon gross annual sales reaching US$50.0 million.

Paladin Loan
In the third quarter of 2013, the Company and Paladin completed an amendment to the May 2012 loan agreement with Paladin (Paladin Debt) to borrow an additional $4.0 million (the Third Tranche) upon the achievement of predefined milestones. This increased the total debt available under the agreement to $12.0 million (Amended Paladin Debt). The second tranche of $4.0 million was advanced on closing of the Amended Paladin Debt. Under the terms of the Amended Paladin Debt, when the second tranche was drawn by Nuvo, Paladin was issued warrants to acquire 50,000 Nuvo common shares at $1.82 per

share which represented 130% of the 5-day trailing value weighted average trading price (VWAP) of Nuvo common shares on the TSX. The warrants will expire on July 10, 2016. If Nuvo exercises its option to draw down the Third Tranche of the loan, Paladin will be entitled to be issued warrants to acquire an additional 50,000 Nuvo common shares at 130% of the 5-day trailing VWAP of Nuvo common shares, as of the date that Nuvo draws the Third Tranche. The warrants will expire 3 years from their date of issue. The loan is collateralized by a charge over Nuvo's assets, excluding the Immunology Group's assets.

Under the terms of the Amended Paladin Debt, the Company must pay 10% of all royalty payments and milestones received by the Company on the sale of Synera in the U.S. by Galen, excluding the Galen Upfront Payment for the acquisition of the U.S. rights for Synera. In addition, upon drawing the second tranche of $4.0 million, the 10% payment related to the $6.0 million in milestone payments from Galderma was not applied to the second tranche of debt, as per the terms of the original Paladin Debt.

Under the terms of the Amended Paladin Debt, the default provision for a generic entry of Pennsaid in the U.S. was amended so that a default may occur when a generic version of Pennsaid becomes available and/or is marketed for commercial sale in the U.S. prior to the launch of Pennsaid 2%. Pennsaid 2% was launched on February 10, 2014, so this default provision is no longer applicable. However, the agreement contains other default provisions that are typical of this type of financing and in the case of default, amounts owing may become due and payable.

Pennsaid Russia Licensing Agreement

In the fourth quarter of 2013, the Company entered into a supply and distribution agreement providing NovaMedica LLC (NovaMedica) with the exclusive rights to market and sell Pennsaid and Pennsaid 2% in Russia and some of the Community of Independent States (CIS). Under the terms of the agreement, NovaMedica made an upfront payment to Nuvo of US$0.5 million and Nuvo will manufacture and supply Pennsaid and Pennsaid 2% to NovaMedica and will share in the profits. NovaMedica is responsible for conducting required clinical studies and obtaining regulatory approval for the products in the licensed territories. The Company is entitled to receive a milestone payment of US$0.5 million when predefined sales targets for Pennsaid 2% have been achieved.

Results of Operations

Product Sales

in thousands

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
	$	$	**$**	$
Pennsaid 2% sales	**417**	-	**1,051**	-
Pennsaid sales	**1,668**	1,259	**2,053**	1,410
HLT patch sales	**-**	295	**-**	564
WF10 sales	**120**	116	**257**	300
Total product sales	**2,205**	1,670	**3,361**	2,274

Product sales for the three and six months ended June 30, 2014 were $2.2 million and $3.4 million compared to $1.7 million and $2.3 million for the three and six months ended June 30, 2013.

Pennsaid 2% sales

Sales of Pennsaid 2% were $0.4 million and $1.1 million for the three and six months ended June 30, 2014 compared to $nil for the three and six months ended June 30, 2013.. Pennsaid 2% was approved

and launched by Mallinckrodt in the U.S. in the first quarter of 2014. All sales of Pennsaid 2% are for the U.S. market.

Pennsaid sales
Sales of Pennsaid increased to $1.7 million and $2.1 million for the three and six months ended June 30, 2014 compared to $1.3 million and $1.4 million for the three and six months ended June 30, 2013. The increase in the three months ended June 30, 2014 was primarily attributable to an increase in sales of $0.4 million to the Company's Greek partner and $0.4 million to the Company's Canadian partner, partially offset by a $0.5 million decrease in sales in the U.S. Sales in the U.S. declined in the quarter due to the impact of the launch of Pennsaid 2% in the U.S. as our licensee in the U.S. is working to switch the market from Pennsaid to Pennsaid 2% and the impact of the generic version of Pennsaid that launched in the quarter.

Geographically for the three and six months ended June 30, 2014, sales in the U.S. were $0.2 million and $0.4 million or 11% and 18% of total Pennsaid product sales [June 30, 2013 - $0.7 million and $0.7 million or 56% and 50%], sales in the E.U. were $1.1 million and $1.2 million or 68% and 56% of Pennsaid product sales [June 30, 2013 - $0.6 million and $0.7 million or 44% and 50%] and sales in Canada were $0.4 million and $0.5 million representing 21% and 26% of Pennsaid product sales [June 30, 2013 - nil].

In the U.S., Pennsaid sales are declining in absolute amount and as a percentage of Pennsaid's total product sales for two key reasons: Mallinckrodt launched Pennsaid 2% in February 2014 and is working to switch the market from Pennsaid to Pennsaid 2% and Apotex received approval of their ANDA for a generic version of Pennsaid in May 2014 and they launched in May 2014. In addition, there are two other generic companies, Paddock and IGI who have received tentative approvals of their ANDAs for a generic version of Pennsaid in the U.S. It is the Company's belief that these approvals are tentative as Apotex is the first ANDA filer for a generic version of Pennsaid and, as such, is eligible for a period of 180-day generic drug marketing exclusivity from subsequent generic versions of the same drug. Such exclusivity, unless forfeited or otherwise relinquished, continues for 180 days from the first commercial marketing of the Apotex drug product.

The Company expects that product sales in Canada may decline in absolute amount and as a percentage of Pennsaid's total product sales, as a competitor's generic version of Pennsaid was launched in Canada in the first quarter of 2014 and a second generic version of Pennsaid is approved in Canada, but has not launched.

WF10 sales
Sales of WF10 for the three months ended June 30, 2014 were $120,000 compared to $116,000 for the three months ended June 30, 2013. The increase in sales related to the launch of Oxoferin (a topical wound healing agent, which is a diluted form of WF10) in Morocco by Ranbaxy and higher sales to the Company's distributors in Pakistan and Indonesia. Partially offsetting these increases was lower sales to the Company's distributor in Venezuela.

Sales of WF10 for the six months ended June 30, 2014 were $257,000 compared to $300,000 for the six months ended June 30, 2013. The decrease is due to lower sales to its distributor in Venezuela, which was slightly offset by increased sales to its distributor in Pakistan and the launch in Morocco.

HLT Patch sales
There were no product sales for the HLT Patch for the three and six months ended June 30, 2014 compared to product sales of $0.3 million and $0.6 million for the three and six months ended June 30, 2013. In July 2013, the Company sold the U.S. rights for Synera to Galen (see Significant Transactions – 2013 – Synera U.S. Licensing Agreement) and now receives a royalty on net sales in the U.S. market instead of product sales as it did prior to the sale to Galen.

Other Revenue
in thousands

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
	$	$	**$**	$
Royalties	**1,478**	1,481	**2,875**	2,865
Research and other contract revenue	**180**	84	**327**	262
Licensing fees	**-**	85	**57**	170
	1,658	1,650	**3,259**	3,297

Royalty Revenue
Royalty revenue is the most important source of ongoing revenue the Company receives, as there are nominal costs associated with this revenue. The Company currently receives royalties from: Mallinckrodt, its U.S. licensee for Pennsaid and Pennsaid 2%, Paladin, its Canadian licensee for Pennsaid, Galderma, its global licensee for Pliaglis, Eurocept, its European licensee for Rapydan and Galen, its U.S. licensee for Synera. Royalties from each licensee are determined using agreed upon formulas based on a definition of the licensee's net sales as defined in each licensing agreement. The Company recognizes royalty revenue based on the net sales of each licensee.

Royalty revenue was unchanged at $1.5 million and $2.9 million for the three and six months ended June 30, 2014 and June 30, 2013.

Pennsaid Royalties

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Pennsaid U.S. scripts	**14,000**	36,000	**38,000**	79,000
Pennsaid U.S. 150ml bottles dispensed	**18,000**	49,000	**48,000**	106,000

In the U.S., according to IMS Data, approximately 14,000 and 38,000 Pennsaid prescriptions were dispensed in the three and six months ended June 30, 2014 compared to 36,000 and 79,000 prescriptions in the three and six months ended June 30, 2013. Royalty revenue on U.S. net sales of Pennsaid decreased to $0.3 million and $0.8 million for the three and six months ended June 30, 2014 compared to $1.1 million and $2.3 million for the three and six months ended June 30, 2013. The decrease in Pennsaid prescriptions and royalty revenue was related to the launch of Pennsaid 2% that occurred in February 2014 as Mallinckrodt is working to switch the market from Pennsaid to Pennsaid 2% and the launch of a generic version of Pennsaid in the U.S. market in May 2014 by Apotex. Under the terms of the licensing agreement with Mallinckrodt, upon the launch of a generic version of Pennsaid in the U.S., the royalty rate the Company receives on the net sales of Pennsaid decreased from 20% to 15% of net sales. The royalty rate for Pennsaid 2% remains at 20%.

Royalty revenue on Canadian net sales of Pennsaid was consistent at $0.3 million and $0.5 million for the three and six months ended June 30, 2014 and 2013.

Pennsaid 2% Royalties

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
Pennsaid 2% U.S. scripts	**18,000**	-	**24,000**	-
Pennsaid 2% U.S. 150ml bottles dispensed	**22,000**	-	**30,000**	-

On February 10, 2014, Pennsaid 2% was launched in the U.S. and according to IMS Data, a provider of dispensed prescription data, approximately 18,000 and 24,000 Pennsaid 2% prescriptions were dispensed in the three and six months ended June 30, 2014. For each prescription, approximately 1.23 and 1.25 bottles of Pennsaid 2% were dispensed during the three and six months ended June 30, 2014.

Royalty revenue on U.S. net sales of Pennsaid 2% was $0.8 million and $1.4 million for the three and six months ended June 30, 2014 compared to $nil for the three and six months ended June 30, 2013.

Pliaglis Royalties
Royalties related to the global net sales of Pliaglis were $30,000 and $61,000 for three and six months ended June 30, 2014 compared to $26,000 and $69,000 for three and six months ended June 30, 2013. In the current quarter, Galderma continued the launch of Pliaglis in Brazil which commenced in late March. In the comparative period, royalties related to the initial launch quantities to support the launch of Pliaglis in the U.S. and the E.U.

HLT Patch Royalties
Royalties related to sales of Synera in the U.S. and Rapydan in the E.U. were $57,000 and $122,000 for the three and six months ended June 30, 2014. Royalties were insignificant for the three and six months ended June 30, 2013 as the Company only started earning royalties on U.S. net sales of Synera on July 10, 2013, the date the Company sold Synera to Galen (see Significant Transactions – 2013 – Synera U.S. Licensing Agreement).

Research and Other Contract Revenue
Research and other contract revenue for the three and six months ended June 30, 2014 was $180,000 and $327,000 compared with $84,000 and $262,000 for the three and six months ended June 30, 2013. These revenues were mainly derived from development services provided by the Company to Mallinckrodt.

License Fees
License fees were $nil and $0.1 million for the three and six months ended June 30, 2014 compared to $0.1 million and $0.2 million for the three and six months ended June 30, 2013. For both periods, the entire license fee revenue related to the recognition of a portion of the upfront fees received from Paladin in 2005 for the Canadian marketing rights for Pennsaid which is consistent with the comparative period. The amortization of this license fee ended in February 2014.

Significant Customers
As the Company sells product and receives royalties in a limited number of markets through exclusive agreements, it receives most of its revenue from a limited number of customers. Revenue, derived from the Company's current four largest customers (excluding upfront payments and milestones from licensing arrangements), is illustrated in the following table:

	Three months ended		Six months ended	
in thousands, except percentages	**June 30, 2014**	June 30, 2013	**June 30, 2014**	June 30, 2013
	$	$	**$**	$
Four largest customers	**3,621**	2,838	**6,118**	4,590
% of total revenue	**94%**	86%	**92%**	82%
Largest customer as % of total revenue	**49%**	58%	**59%**	58%

Operating Expenses
in thousands

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
	$	$	**$**	$
Cost of goods sold	**1,498**	1,520	**2,707**	2,492
Research and development	**1,492**	1,508	**3,379**	3,380
General and administrative	**2,897**	2,349	**5,270**	4,642
Sales and marketing	**-**	162	**-**	339
Interest expense (income), net	**147**	85	**321**	187
Total operating expenses	**6,034**	5,624	**11,677**	11,040

Total operating expenses for the three and six months ended June 30, 2014 were $6.0 million and $11.7 million, an increase from $5.6 million and $11.0 million for the three and six months ended June 30, 2013. The increase was primarily due to an increase in the G&A costs in the quarter.

Cost of Goods Sold (COGS)
COGS for the three months ended June 30, 2014 and June 30, 2013 was unchanged at $1.5 million. In the quarter, the increased costs associated with higher Pennsaid product sales (to distributors outside of the U.S.) and Pennsaid 2% product sales were offset by the savings realized in U.S. Synera sales as the marketing rights for Synera were sold to Galen in July 2013 and the Company no longer incurs costs associated with Synera.

For the current three month period, the gross margin on product sales was $0.7 million or 32% compared to $0.2 million or 9% in the comparative period.

For the six months ended June 30, 2014, COGS increased to $2.7 million compared to $2.5 million for the six months ended June 30, 2013 due to increased Pennsaid and Pennsaid 2% product sales. For the current six month period, the gross margin on product sales was $0.7 million or 19% compared to a negative gross margin of $0.2 million in the comparative period.

Research and Development
R&D expenses were unchanged at $1.5 million and $3.4 million for the three and six months ended June 30, 2014 and June 30, 2013. In the quarter, the costs associated with the Company's Phase 2 clinical trial for WF10 were offset by the savings realized from the closure of the Company's facility in Salt Lake City and the TPT Group office in 2013.

In the Immunology Group, R&D expenses were $1.0 million and $2.4 million for the three and six months ended June 30, 2014 compared to $0.6 million and $1.2 million for the three and six months ended June 30, 2013. The increase in spending related to the advancement of the development program of WF10 for both the U.S. market for original WF10 and the development of reformulated versions of WF10 as a platform technology for the global market. The majority of the cost increase was related to the 160-subject, randomized, double blind, placebo-controlled, 4-arm multi-centre trial that will assess the efficacy and safety of a regimen of five WF10 infusions for the treatment of patients with moderate to severe persistent allergic rhinitis. The Company commenced enrollment in March and has enrolled 121 patients in the clinical trial at 15 sites in Germany. The Company expects the trial to be completed in late 2014 with top-line results available in the first quarter of 2015.

In the TPT Group, R&D expenses were $0.5 million and $1.0 million for the three and six months ended June 30, 2014 compared to $0.9 million and $2.2 million for the three and six months ended June 30, 2013. The decrease in spending related to the savings realized from the closure of the Company's facility in Salt Lake City and the TPT Group office in 2013 and lower drug development spending. The TPT

Group's R&D expenditures in the current three and six month periods primarily related to the costs of the R&D facility at Varennes and the Company's share of the post approval commitment for Pliaglis. The R&D facility is focused on the collaboration agreement with Ferndale Laboratories, Inc. to develop two topical dermatology products. The drug spending in the comparative period related to investigator initiated studies for the HLT Patch. The Company's strategy is to find co-development partners to advance the pipeline products in the TPT Group.

R&D expenditures vary depending on the stage of development of drug products and candidates in the Company's pipeline and management's allocation of the Company's resources to these activities in general and to each drug specifically. The Company will continue to incur additional costs in the future as the WF10 development program advances.

General and Administrative
G&A expenses were $2.9 million and $5.3 million for the three and six months ended June 30, 2014 compared to $2.3 million and $4.6 million for the three and six months ended June 30, 2013. The increase in the three and six months periods primarily related to an increase in stock-based compensation and professional fees related to the Company's litigation with Mallinckrodt partially offset by a decrease in non-cash charges related to amortization of the Company's intangible assets.

Sales and Marketing
S&M expenses were $nil for the three and six months ended June 30, 2014 compared to $0.2 million and $0.3 million for the three and six months ended June 30, 2013. In July 2013, the Company sold the U.S. rights to Synera to Galen (see Significant Transactions – 2013 – Synera U.S. Licensing Agreement). Subsequent to the transaction, the Company eliminated its S&M infrastructure.

Interest
Interest expense was $0.2 million and $0.4 million for the three and six months ended June 30, 2014 compared to $0.1 million and $0.2 million for the three and six months ended June 30, 2013. The Company incurs a 15% per annum interest cost related to the outstanding loan with Paladin (See – Significant Transactions – 2013 – Paladin Loan) and non-cash accretion charges on the five-year consulting agreement as part of the consideration paid for the 2011 acquisition of the non-controlling interest in Nuvo Research AG. The increase in interest expense related to the larger outstanding loan balance as the Company drew the second $4.0 million tranche of the Paladin Loan in the third quarter of 2013.

Interest income increased to $28,000 and $49,000 for the three and six months ended June 30, 2014 compared to $14,000 and $24,000 for the three and six months ended June 30, 2013, as there were larger balances in the interest bearing Canadian bank accounts.

The aggregate result was net interest expense of $0.1 million and $0.3 million for the three and six months ended June 30, 2014 compared to net interest expense of $85,000 and $187,000 for the three and six months ended June 30, 2013.

Loss from Operations
Loss from operations was $2.2 million and $5.1 million for the three and six months ended June 30, 2014 compared to $2.3 million and $5.5 million for the three and six months ended June 30, 2013. The decreased loss from operations was attributable to higher revenue from product sales partially offset by an increase in G&A expenses.

Foreign Currency Loss (Gain)
The Company experienced a net foreign currency loss of $108,000 for the three months ended June 30, 2014 compared with a foreign currency gain of $113,000 for the three months ended June 30, 2013. In the quarter, a stronger Canadian dollar versus the U.S. dollar and euro decreased the value of U.S. dollar and euro denominated cash and receivables. In the comparative period, the stronger U.S. dollar and euro increased the value of U.S. dollar and euro denominated cash and receivables.

For the six months ended June 30, 2014, net foreign currency gains were $56,000 compared to $36,000 for the six months ended June 30, 2013. In both periods the stronger U.S. dollar and euro increased the value of the U.S. dollar and euro denominated cash and receivables.

Net Loss and Total Comprehensive Loss
in thousands

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
	$	$	**$**	$
Net loss before income taxes	**(2,279)**	(2,191)	**(5,001)**	(5,433)
Income taxes	**28**	29	**49**	57
Net loss	**(2,307)**	(2,220)	**(5,050)**	(5,490)
Unrealized gains (losses) on translation of foreign operations	**(99)**	350	**(12)**	668
Total comprehensive loss	**(2,406)**	(1,870)	**(5,062)**	(4,822)

Net Loss
Net loss was $2.3 million for the three months ended June 30, 2014 compared to $2.2 million for the three months ended June 30, 2013. The slight increase in net loss was attributable to a foreign currency loss in the quarter compared to a foreign currency gain in the comparative period, which offset the improvement realized in the loss from operations.

Net loss was $5.1 million for the six months ended June 30, 2014 compared to $5.5 million for the six months ended June 30, 2013. The decrease in net loss was attributable to a decrease in loss from operations in the six-month period.

Total Comprehensive Loss
Total comprehensive loss was $2.4 million for the three months ended June 30, 2014 compared $1.9 million for the three months ended June 30, 2013. The current three-month period includes a $0.1 million unrealized loss on the translation of foreign operations versus an unrealized gain of $0.4 million in the comparative period.

Total comprehensive loss was $5.1 million for the six months ended June 30, 2014 compared to $4.8 million for the six months ended June 30, 2013. The current six-month period includes a nominal unrealized loss on the translation of foreign operations versus an unrealized gain of $0.7 million in the comparative period.

Net Loss Per Common Share
Net loss per common share on both a basic and diluted basis was $0.23 and $0.53 for the three and six months ended June 30, 2014 versus net loss per share of $0.25 and $0.63 for the three and six months ended June 30, 2013.

The weighted average number of common shares outstanding on a basic and diluted basis was 10.2 million and 9.6 million for the three and six months ended June 30, 2014. For the three and six months ended June 30, 2013, the weighted average number of common shares outstanding on a basic and diluted basis was 8.8 million.

Segments
On a segmented basis, the TPT Group, which includes all Pennsaid, Pennsaid 2%, Pliaglis and the HLT Patch activities, incurred a net loss before income taxes of $0.7 million and $1.6 million for the three and six months ended June 30, 2014 compared to $1.3 million and $3.6 million for the three and six months ended June 30, 2013. The decrease in net loss in the TPT Group related to the increased Pennsaid and

Pennsaid 2% product sales, savings from closing the Company's facility in Salt Lake City and the TPT Group office in 2013 and decreased R&D expenses related to the HLT Patch. The Immunology Group, which includes all WF10 activities, incurred a loss before income taxes of $1.6 million and $3.4 million for the three and six months ended June 30, 2014 compared to $0.9 million and $1.8 million the three and six months ended June 30, 2013. The increase in net loss in the Immunology Group was due to the increased R&D expenses related to the phase 2 clinical study for WF10.

Liquidity and Capital Resources

in thousands

	Three months ended		Six months ended	
	June 30, 2014	June 30, 2013	**June 30, 2014**	June 30, 2013
	$	$	**$**	$
Net loss	**(2,307)**	(2,220)	**(5,050)**	(5,490)
Items not involving current cash flows	**359**	352	**417**	758
Cash used in operations	**(1,948)**	(1,868)	**(4,633)**	(4,732)
Net change in non-cash working capital	**(743)**	(161)	**1,042**	981
Cash used in operating activities	**(2,691)**	(2,029)	**(3,591)**	(3,751)
Cash used in investing activities	**(63)**	(38)	**(118)**	(73)
Cash provided by (used in) financing activities	**(690)**	(484)	**1,744**	(865)
Effect of exchange rates on cash and cash equivalents	**(70)**	122	**51**	103
Net change in cash and cash equivalents during the period	**(3,514)**	(2,429)	**(1,914)**	(4,586)
Cash and cash equivalents, beginning of period	**14,221**	9,992	**12,261**	12,149
Cash and cash equivalents, end of period	**10,707**	7,563	**10,707**	7,563

Cash and Cash Equivalents

Cash and cash equivalents were $10.7 million as at June 30, 2014, a decrease of $1.9 million compared to $12.6 million as at December 31, 2013, primarily as a result of proceeds from the Company's Private Placement (See – Significant Transactions – 2014 – Private Placement).

Operating Activities

Cash used in operations was consistent at $1.9 million for the three months ended June 30, 2014 and June 30, 2013.

Cash used in operations was $4.6 million for the six months ended June 30, 2014 compared to $4.7 million for the six months ended June 30, 2013. The decrease in cash used in operations primarily related to the $0.4 million decrease in net loss in the current period and was partially offset by a $0.3 million decrease in non-cash items.

Overall cash used in operating activities increased by $0.7 million to $2.7 million for the three months ended June 30, 2014 compared to $2.0 million for the three months ended June 30, 2013 primarily due to the increased investment in non-cash working capital. The investment in non-cash working capital related to a $1.2 million increase in accounts receivable due to higher Pennsaid and Pennsaid 2% product sales. In the comparative period, the Company made a nominal investment in non-cash working capital.

For the six months ended June 30, 2014, cash used in operating activities decreased by $0.2 million to $3.6 million versus $3.8 million for the six months ended June 30, 2013 due to the $0.1 million improvement in cash used in operations. For the six-month period, the $1.0 million recovery in non-cash working capital was attributable to a $1.0 million decrease in accounts receivable primarily due to the receipt of the US$2.0 million milestone payment from Galderma for the marketing approval of Pliaglis in Brazil. In 2013, the $1.0 million recovery of non-cash working capital was primarily attributable to the receipt of the US$1.0 million milestone payment from Galderma related to Pliaglis in the E.U.

Investing Activities

Net cash used in investing activities totaled $63,000 and $118,000 for the three and six months ended June 30, 2014 compared to $38,000 and $73,000 for the three and six months ended June 30, 2013. Cash used in investing activities was primarily attributable to the acquisition of property, plant and equipment for production and laboratory equipment acquired by the Company's manufacturing facility in Varennes, Québec to prepare for the launch of Pennsaid 2% in the U.S.

Financing Activities

Net cash used in financing activities totaled $0.7 million for the three months ended June 30, 2014 compared to $0.5 million for the three months ended June 30, 2013. In both periods, cash used in financing activities related to payments towards the Company's loan with Paladin (See – Significant Transactions – 2013 – Paladin Loan) and payments towards the five-year consulting agreement recognized as part of the non-controlling interest in 2011.

Net cash provided by financing activities totaled $1.7 million for the six months ended June 30, 2014 compared to net cash used in financing activities of $0.9 million for the six months ended June 30, 2013. In the first quarter of 2014, the Company raised $2.9 million net of financing fees through the Private Placement (See – Significant Transactions – 2014 – Private Placement). This increase in cash was partially offset by payments towards the Company's loan and payments towards the five-year consulting agreement recognized as part of the non-controlling interest in 2011. In the comparative period, cash used in financing activities related to payments towards the Company's loan and payments for the five-year consulting agreement.

Selected Quarterly Information (unaudited)

The following is selected quarterly financial information for the last eight quarterly reporting periods.

in thousands (except per share data)	September 30, 2013	December 31, 2013	March 31, 2014	**June 30, 2014**
	$	$	$	**$**
Revenue	9,137 [1] [2]	3,701	2,757	**3,863**
Net loss before income taxes	(2,919) [1] [2] [3]	(1,909)	(2,722)	**(2,279)**
Net loss per common share				
Basic and diluted	(0.34)	(0.22)	(0.31)	**(0.23)**

	September 30, 2012	December 31, 2012	March 31, 2013	June 30, 2013
	$	$	$	$
Revenue	3,500 [5]	3,564	2,251	3,320
Net loss before income taxes	(1,958) [5] [7]	(11,150) [4] [7]	(3,242)	(2,191)
Net loss per common share				
Basic and Diluted	(0.23) [5] [6] [7]	(1.28) [4] [6] [7]	(0.37) [6]	(0.25)

[1] *The quarter ended September 30, 2013 includes US$2.0 million in licensing fees from Galderma representing the milestone payment for the marketing approval of Pliaglis in Brazil.*

[2] *The quarter ended September 30, 2013 includes the Galen Upfront Payment (see Significant Transactions – 2013 – Synera U.S. Licensing Agreement).*

[3] *Net loss before income taxes included a $6.4 million impairment charge on intangible assets related to Pliaglis and the HLT Patch.*

[4] *Net loss before income taxes included an $11.9 million impairment charge on intangible assets related to Pliaglis and the HLT Patch and goodwill related to the acquisition of ZARS in 2011.*

[5] *The quarter ended September 30, 2012 includes US$1.0 million in licensing fees from Galderma representing the milestone payments for the marketing approval of Pliaglis in the third E.U. country.*

[6] *In May 2013 the Company completed a share consolidation on the basis of sixty-five (65) old common shares for one (1) new common share. All numbers reflect this consolidation.*

[7] *Net loss before income taxes includes the gains on the contingent consideration related to the acquisition of ZARS.*

Financial Instruments

Risk Factors

The following is a discussion of liquidity, credit and market risks and related mitigation strategies that have been identified. This is not an exhaustive list of all risks nor will the mitigation strategies eliminate all risks listed.

Liquidity Risk

While the Company had $10.7 million in cash and cash equivalents at June 30, 2014, it continues to have an ongoing need for substantial capital resources to research, develop, commercialize and manufacture its products and technologies, including the costs associated with the Phase 2 clinical study for WF10 and the costs associated with the current litigation with Mallinckrodt. Other than the U.S. and Canada, the Company only has limited participation in Pennsaid sales revenues in countries where it is currently marketed. In Canada, the Company receives royalties based on Canadian net sales, but the market is relatively small and these funds are used entirely towards repayment of the Amended Paladin Debt. In Canada, a generic version of Pennsaid was approved and launched in the first quarter of 2014; this generic may have an impact on the Company's cash flows and revenues. In the U.S., the Company receives royalties based on net sales of Pennsaid and Pennsaid 2%. In May 2014, Apotex launched their generic version of Pennsaid in the U.S. The generic launch has impacted Nuvo as follows: pursuant to

the licensing agreement with Mallinckrodt, the royalty rate for Pennsaid decreased from 20% to 15% of net sales and scripts for Pennsaid decreased significantly after the launch, negatively impacting royalty revenue, product sales and cash flows from Pennsaid in the U.S. The royalty rate for Pennsaid 2% remains unchanged at 20%. In addition, Pennsaid is subject to additional generic risk in the U.S., as two other generic companies have received tentative approvals for their Abbreviated New Drug Applications (ANDAs). In total, eleven companies have filed ANDAs in the U.S. (including one company that has withdrawn its ANDA) for approval to market a generic version of Pennsaid. Pennsaid 2%, the follow-on product to Pennsaid, has patent protection that expires in April 2028 and was launched by Mallinckrodt in February 2014. The launch of Apotex's generic version of Pennsaid, as well as any future launch of a generic version of Pennsaid in the U.S., could materially impact revenues of Pennsaid 2% and the Company's future cash flows would be negatively impacted as the Company could lose all or a significant portion of its royalties and potential milestone payments. In addition, minimal royalty revenues are being generated by the HLT Patch and Pliaglis. The Company earns royalties generated on the net sales of the HLT Patch in the U.S. from Galen and in Europe from Eurocept. The Company licensed Pliaglis' worldwide sales and marketing rights to Galderma. Pliaglis was launched in the U.S. in March 2013, in the E.U. in April 2013 and in Brazil in March 2014. The Company earns royalties on the net sales of Pliaglis. The Company's revenues may not be sufficient to provide the capital required for the Company to be self-sustaining without the need for future financings.

The Company has contractual obligations related to accounts payable and accrued liabilities, purchase commitments and finance lease and other obligations of $8.5 million that are due in less than a year and $3.1 million of contractual obligations that are payable from 2016 to 2017.

Credit Risk

The Company's cash and cash equivalents subject the Company to a significant concentration of credit risk. At June 30, 2014, the Company had $10.2 million invested with one financial institution in various bank accounts as per its practice of protecting its capital rather than maximizing investment yield through additional risk. This financial institution is a major Canadian bank which the Company believes lessens the degree of credit risk. The remaining $0.5 million of cash and cash equivalent balances are held in bank accounts in various geographic regions outside of Canada.

The Company, in the normal course of business, is exposed to credit risk from its global customers most of whom are in the pharmaceutical industry. The accounts receivable are subject to normal industry risks in each geographic region in which the Company operates. In addition, the Company is exposed to credit related losses on sales to its customers outside North America and the E.U. due to potentially higher risks of enforceability and collectability. The Company attempts to manage these risks prior to the signing of distribution or licensing agreements by dealing with creditworthy customers; however, due to the limited number of potential customers in each market, this is not always possible. In addition, a customer's creditworthiness may change subsequent to becoming a licensee or distributor and the terms and conditions in the agreement may prevent the Company from seeking new licensees or distributors in these territories during the term of the agreement. At June 30, 2014, the Company's four largest customers located in North America and the E.U. represented 83% [December 31, 2013 - 88%] of accounts receivable, and accounts receivable from customers located outside of North America and the E.U. represented 8% [December 31, 2013 - 8%] of accounts receivable.

Pursuant to their collective terms, accounts receivable are aged as follows:

in thousands	**June 30, 2014**	December 31, 2013
	$	$
Current	**2,809**	4,031
0-30 days past due	**290**	34
61-90 days past due	**88**	-
Over 90 days past due	**109**	124
	3,296	4,189

Interest Rate Risk

All finance lease and other obligations are at fixed interest rates.

Currency Risk

The Company operates globally, which gives rise to a risk that earnings and cash flows may be adversely affected by fluctuations in foreign currency exchange rates. The Company is primarily exposed to the U.S. dollar and euro, but also transacts in other foreign currencies. The Company currently does not use financial instruments to hedge these risks. The significant balances in foreign currencies are as follows:

	Euros		U.S. Dollars	
in thousands	**June 30, 2014 €**	December 31, 2013 €	**June 30, 2014 $**	December 31, 2013 $
Cash and cash equivalents	**640**	1,039	**938**	1,536
Accounts receivable	**812**	322	**1,682**	3,496
Other current assets	**262**	150	**-**	-
Accounts payable and accrued liabilities	**(562)**	(326)	**(843)**	(1,440)
Finance lease and other long-term obligations	**-**	-	**(334)**	(384)
	1,152	1,185	**1,443**	3,208

Based on the aforementioned net exposure as at June 30, 2014, and assuming that all other variables remain constant, a 10% appreciation or depreciation of the Canadian dollar against the U.S. dollar and euro would have resulted in the following changes in total comprehensive income (loss) as follows:

in thousands	**Comprehensive Income (Loss)**	
Canadian Dollar	**Appreciates 10%**	**Depreciates 10%**
Versus U.S. dollar	140	(171)
Versus euro	153	(187)

In terms of the euro, the Company has three significant exposures: its net investment and net cash flows in its European operations, its euro denominated cash and cash equivalents held in its Canadian operations and sales of Pennsaid by the Canadian operations to European distributors. In terms of the U.S. dollar, the Company has five significant exposures: its net investment and net cash flows in its U.S. operations, its U.S. dollar denominated cash and cash equivalents held in its Canadian operations, the cost of running trials and other studies at U.S. sites, the cost of purchasing raw materials either priced in U.S. dollars or sourced from U.S. suppliers that are needed to produce Pennsaid, Pennsaid 2% or other products at the Canadian manufacturing facility and revenue generated in U.S. dollars, including royalties and milestone payments received from licensing agreements with Mallinckrodt, Galderma, Galen and Eurocept and product sales to Mallinckrodt.

The Company does not actively hedge any of its foreign currency exposures given the relative risk of currency versus other risks the Company faces and the cost of establishing the necessary credit facilities and purchasing financial instruments to mitigate or hedge these exposures. As a result, the Company does not attempt to hedge its net investments in foreign subsidiaries.

The Company does not currently hedge its euro cash flows. Sales to European distributors for Pennsaid are primarily contracted in euros. The Company receives payments from the distributors in its euro bank accounts and uses these funds to pay euro denominated expenditures and to fund the net outflows of the European operations as required. Periodically, the Company reviews the amount of euros held, and if they are excessive compared to the Company's projected future euro cash flows, they may be converted into U.S. or Canadian dollars. If the amount of euros held is insufficient, the Company may convert a portion of other currencies into euros.

The Company does not currently hedge its U.S. dollar cash flows. The Company's U.S. operations have net cash outflows and currently these are funded using the Company's U.S. dollar denominated cash and cash equivalents and payments received under the terms of the licensing agreements with Mallinckrodt, Galderma and Galen. Periodically, the Company reviews its projected future U.S. dollar cash flows and if the U.S. dollars held are insufficient, the Company may convert a portion of its other currencies into U.S. dollars. If the amount of U.S. dollars held is excessive, they may be converted into Canadian dollars or other currencies, as needed for the Company's other operations.

Contractual Obligations

The following table lists the Company's contractual obligations for the twelve-month periods ending June 30 as follows:

in thousands	**Total**	**2015**	**2016**	**2017 and thereafter**
	$	$	$	$
Finance lease obligations	**4**	3	1	-
Operating leases	**493**	223	173	97
Purchase obligations	**1,845**	1,845	-	-
Other obligations[(1)]	**9,259**	6,422	2,731	106
	11,601	8,493	2,905	203

(i) Other obligations include accounts payable, accrued liabilities and other obligations.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

Related Party Transactions

For the three months ended June 30, 2014, the Company had no related party transactions. For the six months ended June 30, 2014, certain officers of the Company participated in the Private Placement (See – Significant Transactions – 2014 – Private Placement) and acquired 67,768 Units on the same terms as the other purchasers. Proceeds raised from the Company's officers totaled $152,000.

In the comparative period the Company had a consulting arrangement with one of its independent directors that was terminated in the third quarter of 2013. Expenses under this agreement for the three and six months ended June 30, 2013 were $15,000 and $30,000.

Outstanding Share Data

The number of common shares outstanding as at June 30, 2014 was 10.2 million compared to 8.8 million at December 31, 2013. The increase was due to the issuance of approximately 1.4 million shares issued with the Company's Private Placement (See – Significant Transactions – 2014 – Private Placement).

As at June 30, 2014, there were 964,335 options outstanding of which 592,364 were vested. Stock options increased in the quarter as 211,800 options were granted, 7,689 options were forfeited and 431 options expired.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of Condensed Consolidated Interim Financial Statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenue and expenses during the reporting periods. The Company's actual results could differ from these estimates and such differences could be material. All significant accounting policies, estimates and judgments are disclosed in Note 3, "Summary of Significant Accounting Policies" of the Company's Consolidated Financial Statements for the year ended December 31, 2013.

Recent Accounting Pronouncements

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board (IASB) or IFRS Interpretations Committee (IFRIC) that are mandatory for fiscal periods beginning on January 1, 2014 or later. The standards impacted that may be applicable to the Company are as follows:

IFRS 9 – Financial Instruments

In October 2010, the IASB issued IFRS 9 *Financial Instruments* which replaces IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. This new standard is effective for the Company's interim and annual Consolidated Financial Statements commencing January 1, 2018.

IFRS 15 – Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15, which covers principles for reporting about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. IFRS 15 is effective for annual periods beginning on or after January 1, 2017. The Company is in the process of reviewing the standard to determine the impact on the consolidated financial statements.

Other accounting standards or amendments to existing accounting standards that have been issued, but have future effective dates, are either not applicable or are not expected to have a significant impact on the Company's financial statements.

The Company assesses the impact of adoption of future standards on its Consolidated Financial Statements, but does not anticipate significant changes in 2014.

Management's Responsibility for Financial Reporting

Disclosure Controls

Disclosure controls and procedures (DCP) are designed to provide reasonable assurance that information required to be disclosed by the Company in its filings under Canadian securities legislation is recorded, processed, summarized and reported in a timely manner. The system of DCP includes, among other things, the Company's Corporate Disclosure and Code of Conduct and Business Ethics policies, the review and approval procedures of the Corporate Disclosure Committee and continuous review and monitoring procedures by senior management.

As at December 31, 2013, the system of DCP has been evaluated, under the supervision of the Company's Chairman and Co-Chief Executive Officer, President and Co-Chief Executive Officer and Vice President and Chief Financial Officer. Based on this evaluation, the Company's management has concluded that the DCP are effective and provide reasonable assurance that all material information relating to the Company would be made known to them. While the Co-Chief Executive Officers and the Chief Financial Officer believe that the Company's DCP provide reasonable assurance, they are also

aware that any control system can only provide reasonable, not absolute, assurance of achieving its control objectives.

Internal Controls Over Financial Reporting
Management is also responsible for the design of internal controls over financial reporting (ICFR) within the Company, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. Due to its inherent limitations, ICFR may not prevent or detect misstatements. In addition, the design of any system of control is based upon certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all future events, no matter how remote or that the degree of compliance with the policies or procedures may not deteriorate. Accordingly, even effective ICFR can only provide reasonable, not absolute, assurance of achieving the control objectives for financial reporting.

The design and operating effectiveness of the Company's ICFR were evaluated, under the supervision of the Company's Chairman and Co-Chief Executive Officer, President and Co-Chief Executive Officer and Vice President and Chief Financial Officer, in accordance with criteria established in the 1992 Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and Multilateral Instrument 52-109 as at December 31, 2013, which included the Company's changes related to its conversion to IFRS. Based on this evaluation, the Company's management has concluded that ICFR are effective and provided reasonable assurance that its financial reporting is reliable.

Changes to Internal Controls Over Financial Reporting
In 2013, the Committee of Sponsoring Organizations of the Treadway Commission issued an updated Internal Control Framework known as COSO (2013). The Company is expected to transition to this updated framework on or before December 15, 2014, the required transition date, and is currently considering the impact that COSO (2013) will have on its internal controls over financial reporting.

Risk Factors

Prospects for companies in the biotechnology and pharmaceutical industry generally may be regarded as uncertain given the nature of the industry and, accordingly, investments in biotechnology and pharmaceutical companies should be regarded as speculative. R&D involves a high and significant degree of risk. An investor should carefully consider the risks and uncertainties discussed in detail in the MD&A filed on SEDAR on February 20, 2014 for the year ended December 31, 2013 and the "Risk Factors" section of the Company's AIF filed February 20, 2014 before making an investment decision.

Additional Information

Additional information relating to the Company, including the Company's most recently filed AIF and Management Information Circular, can be found on SEDAR at www.sedar.com.

NUVO RESEARCH INC.
CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION

Unaudited	*Notes*	**As at June 30, 2014**	As at December 31, 2013
(Canadian dollars in thousands)		**$**	$
ASSETS			
CURRENT			
Cash and cash equivalents		**10,707**	12,621
Accounts receivable	*16*	**3,296**	4,189
Inventories	*4*	**1,256**	990
Other current assets	*5*	**824**	541
TOTAL CURRENT ASSETS		**16,083**	18,341
Property, plant and equipment	*6*	**1,336**	1,411
Intangible assets	*7*	**1,707**	1,869
TOTAL ASSETS		**19,126**	21,621
LIABILITIES AND EQUITY			
CURRENT			
Accounts payable and accrued liabilities		**4,629**	3,925
Current portion of finance lease and other obligations	*9*	**1,796**	2,114
Deferred revenue	*8*	**-**	57
TOTAL CURRENT LIABILITIES		**6,425**	6,096
Finance lease and other obligations	*9*	**2,562**	3,327
TOTAL LIABILITIES		**8,987**	9,423
EQUITY			
Common shares	*10*	**231,650**	229,068
Contributed surplus	*10*	**13,994**	13,573
Accumulated other comprehensive income (AOCI)		**1,074**	1,086
Deficit		**(236,579)**	(231,529)
TOTAL EQUITY		**10,139**	12,198
TOTAL LIABILITIES AND EQUITY		**19,126**	21,621

Commitments (Note 15)
See accompanying Notes.

NUVO RESEARCH INC.
CONSOLIDATED INTERIM STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

Unaudited	Notes	Three Months Ended June 30		Six Months Ended June 30	
		2014	2013	**2014**	2013
(Canadian dollars in thousands, except per share and share figures)		**$**	$	**$**	$
REVENUE					
Product sales		**2,205**	1,670	**3,361**	2,274
Royalties		**1,478**	1,481	**2,875**	2,865
Research and other contract revenue		**180**	84	**327**	262
Licensing fees	*8*	**-**	85	**57**	170
Total revenue		**3,863**	3,320	**6,620**	5,571
OPERATING EXPENSES					
Cost of goods sold	*4,11,13*	**1,498**	1,520	**2,707**	2,492
Research and development expenses	*5,11,13*	**1,492**	1,508	**3,379**	3,380
General and administrative expenses	*11,13*	**2,897**	2,349	**5,270**	4,642
Sales and marketing expenses	*13*	**-**	162	**-**	339
Interest expense		**175**	99	**370**	211
Interest income		**(28)**	(14)	**(49)**	(24)
Total operating expenses		**6,034**	5,624	**11,677**	11,040
OTHER EXPENSES (INCOME)					
Foreign currency loss (gain)		**108**	(113)	**(56)**	(36)
Net loss before income taxes		**(2,279)**	(2,191)	**(5,001)**	(5,433)
Income taxes		**28**	29	**49**	57
NET LOSS		**(2,307)**	(2,220)	**(5,050)**	(5,490)
Other comprehensive income (loss) to be reclassified to net income (loss) in subsequent periods					
Unrealized gains (losses) on translation of foreign operations		**(99)**	350	**(12)**	668
TOTAL COMPREHENSIVE LOSS		**(2,406)**	(1,870)	**(5,062)**	(4,822)
Net loss per common share –					
Basic and diluted	*12*	**(0.23)**	(0.25)	**(0.53)**	(0.63)
Average number of common shares outstanding (in thousands)					
basic and diluted		**10,240**	8,807	**9,556**	8,807

See accompanying Notes.

NUVO RESEARCH INC.
CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN EQUITY

Unaudited *(Canadian dollars in thousands, except for number of shares)*	**Common Shares**		**Contributed Surplus**	**AOCI**	**Deficit**	**Total**
	(000s)	**$**	**$**	**$**	**$**	**$**
Notes	*10,11*	*10,11*	*9,10,11*			
Balance, December 31, 2012	8,735	228,705	13,495	420	(221,151)	21,469
Stock option compensation expense	-	-	44	-	-	44
Unrealized gains on translation of foreign operations	-	-	-	318	-	318
Performance stock unit compensation expense	-	-	39	-	-	39
Shares issued under Share Bonus Plan	11	67	(67)	-	-	-
Net loss	-	-	-	-	(3,270)	(3,270)
Balance, March 31, 2013	8,746	228,772	13,511	738	(224,421)	18,600
Stock option compensation expense	-	-	78	-	-	78
Unrealized gains on translation of foreign operations	-	-	-	350	-	350
Performance stock unit compensation expense	-	-	24	-	-	24
Net loss	-	-	-	-	(2,220)	(2,220)
Balance, June 30, 2013	8,746	228,772	13,613	1,088	(226,641)	16,832
Stock option compensation expense	-	-	51	-	-	51
Unrealized losses on translation of foreign operations	-	-	-	(2)	-	(2)
Performance stock unit compensation expense	-	-	21	-	-	21
Warrants issued	-	-	30	-	-	30
Shares issued under Share Bonus Plan	18	142	(142)	-	-	-
Employee contributions to Share Purchase Plan	43	77	-	-	-	77
Employer's portion of Share Purchase Plan	43	77	-	-	-	77
Net loss	-	-	-	-	(4,888)	(4,888)
Balance, December 31, 2013	8,850	229,068	13,573	1,086	(231,529)	12,198
Shares issued, net of issue costs	1,390	2,582	-	-	-	2,582
Warrants issued, net of issuance costs	-	-	281	-	-	281
Stock option compensation expense	-	-	70	-	-	70
Unrealized gains on translation of foreign operations	-	-	-	87	-	87
Performance stock unit compensation expense	-	-	6	-	-	6
Net loss	-	-	-	-	(2,743)	(2,743)
Balance, March 31, 2014	10,240	231,650	13,930	1,173	(234,272)	12,481
Stock option compensation expense	-	-	59	-	-	59
Unrealized losses on translation of foreign operations	-	-	-	(99)	-	(99)
Performance stock unit compensation expense	-	-	5	-	-	5
Net loss	-	-	-	-	(2,307)	(2,307)
Balance, June 30, 2014	**10,240**	**231,650**	**13,994**	**1,074**	**(236,579)**	**10,139**

See accompanying Notes.

NUVO RESEARCH INC.
CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

		Three Months Ended June 30		Six Months Ended June 30	
Unaudited		**2014**	2013	**2014**	2013
(Canadian dollars in thousands)	***Notes***	**$**	$		
OPERATING ACTIVITIES					
Net loss		**(2,307)**	(2,220)	**(5,050)**	(5,490)
Items not involving current cash flows:					
Depreciation and amortization	*13*	**183**	454	**367**	702
Deferred license revenue recognized	*8*	**-**	(86)	**(57)**	(171)
Equity-settled stock-based compensation	*11*	**64**	102	**140**	185
Unrealized foreign exchange loss (gain)		**100**	(128)	**(113)**	20
Inventory write-down	*4*	**-**	-	**23**	-
Interest and accretion of long-term other obligations		**16**	16	**33**	33
Other		**(4)**	(6)	**24**	(11)
		(1,948)	(1,868)	**(4,633)**	(4,732)
Net change in non-cash working capital	*14*	**(743)**	(161)	**1,042**	981
CASH USED IN OPERATING ACTIVITIES		**(2,691)**	(2,029)	**(3,591)**	(3,751)
INVESTING ACTIVITIES					
Acquisition of property, plant and equipment	*6*	**(63)**	(38)	**(118)**	(73)
CASH USED IN INVESTING ACTIVITIES		**(63)**	(38)	**(118)**	(73)
FINANCING ACTIVITIES					
Issuance of common shares	*10*	**-**	-	**2,863**	-
Repayment of finance lease and other obligations	*9*	**(690)**	(484)	**(1,119)**	(865)
CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES		**(690)**	(484)	**1,744**	(865)
Effect of exchange rate changes on cash and cash equivalents		**(70)**	122	**51**	103
Net change in cash and cash equivalents during the period		**(3,514)**	(2,429)	**(1,914)**	(4,586)
Cash and cash equivalents, beginning of period		**14,221**	9,992	**12,621**	12,149
CASH AND CASH EQUIVALENTS, END OF PERIOD		**10,707**	7,563	**10,707**	7,563
***Interest paid*[1]**		***168***	*89*	***352***	*189*
***Interest received*[1]**		***26***	*15*	***49***	*20*
***Income taxes paid*[1]**		***26***	*28*	***61***	*48*

1. Amounts paid and received for interest and paid for income taxes were reflected as operating cash flows in the Consolidated Interim Statements of Cash Flows.

See accompanying Notes.

NUVO RESEARCH® INC.
NOTES TO THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

Unless noted otherwise all amounts shown are in thousands of Canadian dollars

1. NATURE OF BUSINESS AND GOING CONCERN ASSUMPTION

Nuvo Research Inc. (Nuvo or the Company) is a publicly traded, Canadian specialty pharmaceutical company with a diverse portfolio of products and technologies. The Company operates two distinct business units: the Topical Products and Technology (TPT) Group and the Immunology Group. The TPT Group has four U.S. Food and Drug Administration (FDA) approved commercial products, a pipeline of topical and transdermal products focusing on pain and dermatology and four drug delivery platforms that support the development of patented formulations that can deliver actives into or through the skin. The Immunology Group has two commercial products, a development program for the treatment of allergic rhinitis and an immune system modulation platform that has the potential to support treatments for a broad range of immune system related disorders. The Company's registered office and principal place of business is located at 7560 Airport Road, Unit 10, Mississauga, Ontario L4T 4H4.

Topical Products and Technology Group
The Company has four commercialized products: Pennsaid®, Pennsaid 2%, the heated lidocaine/tetracaine patch (HLT Patch) and Pliaglis.

Pennsaid, the Company's first commercialized pain product, is used to treat the signs and symptoms of osteoarthritis (OA) of the knee. Pennsaid, combines a transdermal carrier with diclofenac sodium, a leading non-steroidal anti-inflammatory drug (NSAID), and delivers the active drug through the skin directly to the site of pain. Pennsaid is approved and marketed in a number of countries, including the United States, Canada, Greece, Italy and the United Kingdom and is manufactured by the Company for sale to all global licensing and distribution partners. Pennsaid is sold and marketed in the U.S. by Mallinckrodt Inc. (Mallinckrodt).

Pennsaid 2% is the follow-on product to Pennsaid and was approved by the U.S. FDA on January 16, 2014. Mallinckrodt launched the commercial sale and marketing of Pennsaid 2% in the U.S. on February 10, 2014. Pennsaid 2%, which is used to treat the pain of OA of the knee and is more viscous than Pennsaid, is supplied in a metered dose pump bottle and has been approved for twice daily dosing compared to four times a day for Pennsaid. Pennsaid 2% is not approved in any countries, outside the U.S. Pennsaid 2% is manufactured by the Company for sale to Mallinckrodt.

The HLT Patch is a topical patch that combines lidocaine, tetracaine and heat, using proprietary "Controlled Heat Assisted Drug Delivery" (CHADD™) technology. The CHADD unit generates gentle heating of the skin, and in a well-controlled clinical trial, demonstrated that it contributes to the efficacy of the HLT Patch. The HLT Patch is used to provide rapid, local dermal analgesia prior to potentially painful needle related procedures such as venous access, blood draws, needle injections and minor dermatologic surgical procedures, such as shave biopsy and excision. The HLT Patch (marketed under the name Rapydan in the European Union) is approved and marketed in a number of countries in the E.U. by the Company's European-based licensee, Eurocept International B.V. (Eurocept) and in the U.S. was marketed by Nuvo until July 2013 when the Company sold the U.S. rights to the HLT Patch (marketed under the name Synera in the U.S.) for its current indication to Galen US Incorporated (Galen). The HLT Patch is manufactured by a third-party contract manufacturing organization (CMO) located in the U.S. for all markets.

Pliaglis is a topical local anesthetic phase-changing cream that provides safe and effective local dermal anesthesia on intact skin prior to painful cosmetic procedures, such as dermatologic laser surgery and dermal filler injections. This product consists of a proprietary formulation of lidocaine and tetracaine that utilizes the Company's Peel technology. Worldwide marketing rights for Pliaglis have been licensed to Galderma S.A. (Galderma), a global pharmaceutical company specialized in dermatology. Galderma launched the commercial sale and marketing of Pliaglis in the U.S. and in the E.U. in 2013 and Brazil in March 2014.

Immunology
The Company's immunology assets are all based on WF10™, a composition for the treatment of immune related diseases. The immune system provides an essential defense to microorganisms, cancer and substances it sees as foreign and potentially harmful. WF10, a solution of OXO-K993 containing stabilized chlorite ions, focuses on supporting the immune system by targeting the macrophage, a type of white blood cell that coordinates much of

the immune system, to regulate normal immune function. Oxoferin™, a diluted form of WF10, is a topical wound healing agent that has been commercialized in a limited number of countries in the E.U., Asia and South America. Research and development (R&D) activities surrounding WF10 for use in additional indications are ongoing. In December 2013, Germany's drug regulatory body the BfArM, authorized the Company to execute a confirmatory Phase 2 clinical trial. The trial is a 160-subject, randomized, double blind, placebo-controlled, 4-arm multi-centre trial to assess the efficacy and safety of a regimen of five WF10 infusions for the treatment of patients with moderate to severe persistent allergic rhinitis. Enrolment in the trial commenced in March 2014.

OXO-K993 is manufactured by the Company and WF10 and Oxoferin are manufactured by a CMO for sale to all global partners.

Going Concern

These Condensed Consolidated Interim Financial Statements have been prepared on a going-concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. At June 30, 2014, the Company had an accumulated deficit of $236,579 including a net loss of $5,050 during the first six months of 2014. The Company's ability to continue as a going concern depends on:

- the ability of Mallinckrodt to successfully launch Pennsaid 2%, including the switch in the U.S. market from Pennsaid to Pennsaid 2%, as the Company earns revenue in the form of royalties and product sales and has the ability to earn sales milestone payments;
- the commercial success of Pennsaid outside of the U.S., as the Company earns revenue in the form of product sales in all territories and royalties and product sales in Canada;
- the continued financial impact on revenue and cash flows from the generic version of Pennsaid that launched in the U.S. in May 2014 that has negatively impacted Pennsaid scripts;
- the entry of additional generic versions of Pennsaid into the U.S. market, as this may significantly reduce revenue and cash flow;
- the financial impact of the generic version of Pennsaid that launched in Canada in March 2014 as this may reduce revenue and cash flow;
- the commercial success of Synera in the U.S. and Rapydan in the E.U., as the Company earns revenue in the form of royalties and has the ability to earn sales milestone payments;
- the success of the Company's Phase 2 clinical study using WF10 as a treatment for moderate to severe allergic rhinitis;
- the commercial success of Pliaglis in the U.S. and E.U. and Galderma's ability to successfully launch Pliaglis in Brazil and other markets, as the Company earns royalties on this product and Galderma's ability to get marketing approvals in other geographic regions; and
- its ability to secure additional licensing fees, secure co-development agreements, obtain additional capital, gain regulatory approval for other drugs and ultimately achieve profitable operations.

Whether and when the Company can achieve the above is uncertain.

There can be no assurance that the Company will have sufficient capital to fund its ongoing operations or develop or commercialize any further products without future financings. There can be no assurance that additional financing will be available on acceptable terms or at all. If adequate funds are not available or the Pennsaid 2% launch in the U.S. is not successful or Pennsaid franchise revenues in the U.S. decline or if the launch of a generic version of Pennsaid in Canada reduces revenue or if the revenues related to the HLT Patch do not increase in the U.S. or in key E.U. markets or if Pliaglis is not commercially successful in the U.S., E.U., and Brazil or if the Company is unable to avoid an event of default on the Paladin Debt, the Company may have to substantially reduce or eliminate planned expenditures, terminate or delay clinical trials for its product candidates, curtail product development programs designed to expand the product pipeline or discontinue certain operations. If the Company is unable to obtain additional financing when and if required, the Company may be unable to continue operations. These material uncertainties cast significant doubt upon the Company's ability to continue as a going concern.

These Condensed Consolidated Interim Financial Statements do not include any adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern.

2. BASIS OF PREPARATION

Statement of Compliance

The Company prepares its Condensed Consolidated Interim Financial Statements in accordance with IAS 34 - Interim Financial Reporting. Accordingly, these Condensed Consolidated Interim Financial Statements do not include all disclosures required for annual financial statements and should be read in conjunction with the annual Consolidated Financial Statements of the Company for the year ended December 31, 2013 which are available on SEDAR at www.sedar.com.

The preparation of financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity or areas where assumptions and estimates are significant to the financial statements, were the same as those that applied to the Company's annual Consolidated Financial Statements as at and for the year ended December 31, 2013.

Basis of Measurement

These Condensed Consolidated Interim Financial Statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value. Items included in the financial statements of each consolidated entity in the Company are measured using the currency of the primary economic environment in which the entity operates (the functional currency). These Condensed Consolidated Interim Financial Statements are presented in Canadian dollars, which is the Company's functional currency.

Basis of Consolidation

These Condensed Consolidated Interim Financial Statements include the accounts of the Company and all of its subsidiaries as follows:

	% Ownership	
	June 30, 2014	December 31, 2013
Nuvo Research America, Inc. and its subsidiaries: Nuvo Research US, Inc., ZARS Pharma, Inc., and ZARS (UK) Limited	**100%**	100%
Dimethaid (UK) Ltd.	**100%**	100%
Dimethaid Immunology Inc.	**100%**	100%
Nuvo Research AG and its subsidiaries: Nuvo Manufacturing GmbH and Nuvo Research GmbH	**100%**	100%

The Company controls the subsidiaries above with the power to govern their financial and operating policies. All significant inter-company balances and transactions have been eliminated upon consolidation.

Significant Accounting Policies

All significant accounting policies have been applied on a basis consistent with those followed in the most recent annual Consolidated Financial Statements. The policies applied in these Condensed Consolidated Interim Financial Statements are based on International Financial Reporting Standards (IFRS) issued and outstanding as at July 30, 2014, the date the Board of Directors approved these Condensed Consolidated Interim Financial Statements. During the period, the Company adopted IAS 32 *Offsetting Financial Assets and Liabilities* and this adoption did not have a material impact on these Condensed Consolidated Interim Financial Statements.

Accounting Standards Issued But Not Yet Applied

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board (IASB) or IFRS Interpretations Committee (IFRIC) that are mandatory for fiscal periods beginning on January 1, 2014 or later. The standards impacted that may be applicable to the Company are as follows:

IFRS 9 – Financial Instruments

In October 2010, the IASB issued IFRS 9 *Financial Instruments* which replaces IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. This new standard is effective for the Company's Interim and Annual Consolidated Financial Statements commencing January 1, 2018.

IFRS 15 – Revenue from Contracts with Customers

In May 2014, the IASB issued IFRS 15, which covers principles for reporting about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. IFRS 15 is effective for annual periods beginning on or after January 1, 2017. The Company is in the process of reviewing the standard to determine the impact on the consolidated financial statements.

Other accounting standards or amendments to existing accounting standards that have been issued, but have future effective dates, are either not applicable or are not expected to have a significant impact on the Company's financial statements.

The Company assesses the impact of adoption of future standards on its Consolidated Financial Statements, but does not anticipate significant changes in 2014.

3. CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the Condensed Consolidated Interim Financial Statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from estimates and such differences could be material. The significant estimates and judgments made by management are discussed in the annual Consolidated Financial Statements for the year ended December 31, 2013.

4. INVENTORIES

Inventories consist of the following as at:

	June 30, 2014	December 31, 2013
	$	$
Raw materials	**521**	393
Work in process	**95**	204
Finished goods	**640**	393
	1,256	990

During the three and six months ended June 30, 2014, inventories in the amount of $1.3 million and $2.2 million [$1.3 million and $2.1 million for the three and six months ended June 30, 2013] were recognized as cost of goods sold. During the three and six months ended June 30, 2014, $nil and $23 of raw materials in the TPT Group were written down [$nil during the three and six months ended June 30, 2013]. In the Immunology Group, no amounts were written down during the three and six months ended June 30, 2014 and 2013. For both the TPT Group and Immunology Group, no reversals of prior write-downs occurred during the three and six months ended June 30, 2014 and 2013.

5. OTHER CURRENT ASSETS

Other current assets consist of the following as at:

	June 30, 2014	December 31, 2013
	$	$
Other receivables[(i)]	**528**	296
Prepaid expenses	**251**	198
Deposits	**45**	47
	824	541

(i) Includes $383 [December 31, 2013 - $219] related to R&D expenditures which the Company is eligible for reimbursement under funding agreements with the Development Bank of Saxony (SAB) for the development of WF10 related projects. The amounts reimbursed are included in R&D expenses.

6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment (PP&E) consists of:

	Land	Buildings	Leasehold Improvements	Furniture & Fixtures	Computer Equipment	Production Laboratory & Other Equipment[(i)]	Total
Cost	**$**	**$**	**$**	**$**	**$**	**$**	**$**
Balance, December 31, 2013	124	2,082	114	271	1,004	3,522	7,117
Foreign exchange movements	-	(2)	-	-	-	(1)	(3)
Additions	-	15	-	-	7	96	118
Balance, June 30, 2014	**124**	**2,095**	**114**	**271**	**1,011**	**3,617**	**7,232**
Accumulated depreciation							
Balance, December 31, 2013	-	1,570	114	268	958	2,796	5,706
Foreign exchange movements	-	(2)	-	-	-	(2)	(4)
Depreciation expense	-	29	-	2	17	146	194
Balance, June 30, 2014	**-**	**1,597**	**114**	**270**	**975**	**2,940**	**5,896**
NBV at December 31, 2013	124	512	-	3	46	726	1,411
NBV at June 30, 2014	**124**	**498**	**-**	**1**	**36**	**677**	**1,336**

(i) Production, laboratory and other equipment at June 30, 2014 included cost of $56 [December 31, 2013 - $56] and accumulated depreciation of $54 [December 31, 2013 - $53] for assets under finance leases. Depreciation of PP&E was $1 for the three and six months ended June 30, 2014 [$nil and $1 for the three and six months ended June 30, 2013] related to assets under finance leases.

7. INTANGIBLE ASSETS

	Pliaglis Intellectual Property	HLT Patch Intellectual Property	Total
Cost	**$**	**$**	**$**
Balance, December 31, 2013	16,141	1,551	17,692
Foreign exchange movements	52	5	57
Balance, June 30, 2014	**16,193**	**1,556**	**17,749**
Accumulated amortization			
Balance, December 31, 2013	14,791	1,032	15,823
Foreign exchange movements	44	2	46
Amortization expense	125	48	173
Balance, June 30, 2014	**14,960**	**1,082**	**16,042**
Net carrying amount as at December 31, 2013	1,350	519	1,869
Net carrying amount as at June 30, 2014	**1,233**	**474**	**1,707**

The HLT Patch and Pliaglis have been commercialized in several markets and amortization of the Company's intellectual properties will continue until their current patents expire in July 2019 for the HLT Patch and September 2019 for Pliaglis. Amortization of intangible assets is included in general and administrative (G&A) expenses in the Consolidated Interim Statements of Loss and Comprehensive Loss.

8. DEFERRED REVENUE

Under the Canadian licensing arrangements with Paladin in 2005 and 2006, certain payments were received for the Canadian marketing rights to Pennsaid. All amounts were amortized to income systematically based on the expected performance period. During the three and six months ended June 30, 2014, the Company recorded licensing revenue of $nil and $0.1 million [$0.1 million and $0.2 million for the three and six months ended June 30, 2013] pertaining to amounts received in 2005. At June 30, 2014, the Company's deferred revenue balance

was $nil as the amortization term for the Canadian licensing arrangements had ended [December 31, 2013 - $0.1 million].

9. FINANCE LEASE AND OTHER OBLIGATIONS

Finance lease and other obligations consist of the following as at:

	June 30, 2014	December 31, 2013
	$	$
Other Loan [(i)]	**3,998**	5,028
Long-term consulting agreement from acquisition of non-controlling interest [(ii)]	**356**	408
Finance lease obligations	**4**	5
	4,358	5,441
Less amounts due within one year	**1,796**	2,114
Long-term balance	**2,562**	3,327

(i) Other loan

In May 2012, the Company signed a loan agreement with Paladin, its Canadian licensing partner for Pennsaid and the HLT Patch that was amended in July 2013 (Loan Agreements). Under this loan facility, the Company can borrow up to $12.0 million from Paladin in three equal tranches of $4.0 million each (Paladin Debt). The first tranche was advanced on closing of the May 2012 agreement, the second tranche was advanced on closing of the July 2013 amendment and the third tranche could be drawn by the Company, at Nuvo's option, upon the achievement of predefined milestones. The loan bears interest at a rate of 15% per annum and matures on May 25, 2016. The loan is collateralized by a charge over the assets of the TPT Group. Under the terms of the Loan Agreements, the Company must pay 10% of all royalty payments received by the Company on the sale of Pennsaid and Pennsaid 2% in the U.S.; 10% of all royalty and milestone payments received by the Company on the sale of Pliaglis; excluding the US$6.0 million in Pliaglis milestone payments and 10% of all royalty payments and milestones received by the Company on the sale of Synera in the U.S. by Galen, excluding the US$4.5 million upfront payment for the acquisition of the U.S. rights for Synera. In addition, Paladin will offset and retain 100% of the royalties payable to the Company on Canadian distribution of Pennsaid and the HLT Patch when approved and launched in Canada.

Under the terms of the Loan Agreements, when the second tranche was drawn by Nuvo, Paladin was issued warrants to acquire 50,000 Nuvo common shares at $1.82 per share which represented a 130% premium to the 5-day trailing value weighted average trading price (VWAP) of Nuvo common shares on the Toronto Stock Exchange (TSX). The warrants expire July 10, 2016. If Nuvo exercises its option to draw down the third tranche of the loan, Paladin will be entitled to receive warrants to acquire an additional 50,000 Nuvo common shares at a 130% premium to the 5-day trailing VWAP of Nuvo common shares, as of the date that Nuvo draws the third tranche. The warrants will expire 3 years from their date of issue.

The fair value of the warrants issued with the second tranche was measured using the Black-Scholes option pricing model at a value of $0.60 per warrant using the following inputs: share price - $1.45, strike price - $1.82, expected life - 3 years, risk-free interest rate - 1.25%, and a volatility factor of 71.56%. The total warrant value of $30 was recorded as a discount to the second tranche and will be amortized as interest over the life of the warrants. The unamortized discount as at June 30, 2014 was $20.

In addition, under the terms of the amended loan agreement, the default provision for a generic entry of Pennsaid in the U.S. was amended so a default may occur when a generic version of Pennsaid becomes available and/or is marketed for commercial sale in the U.S. prior to the launch of Pennsaid 2%. Pennsaid 2% was launched on February 10, 2014, so this default provision is no longer applicable. However, the agreement contains other default provisions that are typical of this type of financing and in the case of default, amounts owing may become due and payable.

The timing of the future payments of the loan is based on management's best estimate of future royalty revenue. Changes to these estimates could significantly affect the outstanding value of the loan at each reporting date.

The estimated future payments on the loan, including interest, are as follows for the twelve-month periods ending June 30:

	$
2015	2,176
2016	2,571
Total payments	4,747
Less discount and interest (approximately 15%)	749
Present value of obligation	3,998
Less current portion	1,675
Long-term balance	**2,323**

(ii) Long-term consulting agreement from acquisition of non-controlling interest

In December 2011, the Company increased its ownership in Nuvo Research AG to 100% by acquiring the 40% interest held by the minority owner. The consideration transferred to the non-controlling interest included a 5-year, US$150 per annum consulting agreement with the former minority shareholder, discounted at 15.5% and fair valued at US$519 ($528).

The future payments on the consulting obligation are as follows for the twelve-month periods ending June 30:

	$
2015	160
2016	160
2017	106
Total payments	426
Less amount representing interest (approximately 15.5%)	70
Present value of obligation, including accretion	356
Less current portion	118
Long-term balance	**238**

10. CAPITAL STOCK

Authorized

- Unlimited first and second preferred shares, non-voting, non-participating, issuable in series, number, designation, rights, privileges, restrictions and conditions are determinable by the Company's Board of Directors.
- Unlimited common shares, voting, without par value.

Private Placement

On March 31, 2014, the Company completed a non-brokered private placement (Private Placement), pursuant to which an aggregate of 1,390,000 units of the Company were issued at a price of $2.25 per unit for gross proceeds of $3.1 million ($2.9 million net of issuance costs). Each unit consists of one common share of the Company and one-half of one common share purchase warrant of the Company (Unit). The Company issued 695,000 common share purchase warrants (Private Placement Warrants).

The Private Placement Warrants entitles the holder to purchase one common share of the Company at a price of $3.00 for a 24-month period. The Private Placement Warrants are subject to an acceleration feature where the Company, at its option, can force the exercise of the Private Placement Warrants if the ten-day volume weighted share price for the Company's common shares is equal to or exceeds $3.50 on the TSX at any time during the warrant term. If the acceleration feature is used, any Private Placement Warrants that are not exercised during this period expire.

In connection with the Private Placement, a finder's fee consisting of (a) a 6% cash commission amounting to $0.2 million, and (b) broker warrants to purchase Units at a price of $2.54 per Unit (Broker Warrants), equal to 6% of the number of Units issued. The finder's fee was paid on Units purchased by new investors and not on Units purchased by management or its advisors. The Company issued 78,233 Broker Warrants.

The fair value of the Private Placement Warrants and the Broker Warrants was determined using the Binomial Lattice valuation model. The Binomial model was believed by management to be the best available technique for these compound units because, in addition to providing for inputs such as trading market values, volatilities and risk-free rates, the Binomial Lattice model also embodied simulated warrant values considering the acceleration feature and the probability of exercise. In addition to the strike price for the Private Placement Warrants and the Broker Warrants, the following inputs were used in the model: volatility factor of 80%, risk-free rate of 1.02%, and a 24-month life. The Private Placement Warrants were valued at $0.55 per unit, the Broker Warrants were valued at $0.81 per unit and the embedded warrant within the Broker Warrant was valued at $0.55 per unit.

The proceeds, net of commissions and fees, in addition to Broker Warrants were allocated between common shares and warrants based on relative fair values of common shares and warrants. The Company recorded $2.6 million in common shares and $0.3 million was recorded in the warrant reserve, within contributed surplus in the Consolidated Interim Statements of Financial Position.

Warrants

The warrants outstanding by tranche are as follows:

Expiry dates	Expiry Date	Exercise price	**June 30, 2014**	December 31, 2013
Private Placement Warrants	March 31, 2016	$3.00	**695,000**	-
Broker Warrants[(i)]	March 31, 2016	$2.54	**78,223**	-
Paladin Warrants[(ii)]	July 10, 2016	$1.82	**50,000**	50,000
			823,223	50,000

(i) Entitles the holder to purchase a Unit consisting of one common share of the Company and one-half of one common share purchase warrant of the Company

(ii) See Note 9 for a description of the Paladin Warrants

All warrants are exercisable on issuance. Changes in the number of warrants outstanding were as follows:

	Number of warrants	**Weighted average exercise price**
		$
Balance, beginning of the year	**50,000**	**1.82**
Issued	**773,223**	**2.95**
Balance, March 31 and June 30, 2014	**823,223**	**2.88**

At grant date, the fair value of the warrants was recorded in Contributed Surplus on the Consolidated Interim Statements of Financial Position.

11. STOCK-BASED COMPENSATION AND OTHER STOCK-BASED PAYMENTS

The Company has six stock-based compensation plans: the Share Option Plan, the Share Purchase Plan and the Share Bonus Plan, each a component of the Company's Share Incentive Plan, the Deferred Share Unit (DSU) Plan for non-employee directors, the DSU Plan for Employees and the Share Appreciation Rights (SARs) Plan. Full descriptions of the six stock-based compensation plans are included in Note 11 "Stock-Based Compensation and Other Stock-Based Payments" to the Company's annual Consolidated Financial Statements for the year ended December 31, 2013.

Share Option Plan

The following is a schedule of the options outstanding as at:

	Number of Options	Range of Exercise Price	Weighted Average Exercise Price
	000s	$	$
Balance, December 31, 2013	785	1.96 – 37.05	8.91
Forfeiture	(24)	5.53	5.53
Balance, March 31, 2014	761	1.96 – 37.05	9.01
Granted	212	3.39	3.39
Forfeiture	(8)	8.13 – 13.00	12.02
Expired	(1)	37.05	37.05
Balance, June 30, 2014	**964**	**1.96 – 25.35**	**7.74**

The following table summarizes the outstanding and exercisable options held by directors, officers, employees and consultants as at June 30, 2014:

	Outstanding			Exercisable	
Exercise Price Range	Number of Options	Remaining Contractual Life	Weighted Average Exercise Price	Vested Options	Weighted Average Exercise Price
$	(000s)	(years)	$	(000s)	$
1.96 – 5.53	398	9.3	3.26	95	3.96
6.50 – 8.13	172	7.0	6.74	103	6.90
8.78 – 25.35	394	2.6	12.70	394	12.70
	964	**6.2**	**7.74**	**592**	**10.29**

The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Options are valued with a calculated forfeiture rate of 7.0% [December 31, 2013 - 7.0%], and the remaining model inputs for options granted during the quarter ended June 30, 2014 were:

Options	Grant Date	Share Price	Exercise Price	Risk-free Interest Rate	Expected Life	Volatility Factor	Fair Values
(000s)		$	$	%	(years)	%	$
212	May 6, 2014	3.20	3.39	1.1 - 1.4	2 - 5	71 - 78	1.26 – 1.85

Share Bonus Plan

A Performance Share Unit (PSU) provides an employee with an opportunity to earn common shares of the Company if certain PSU objectives are achieved. If these PSU objectives are achieved, the PSUs are earned PSUs (Earned PSUs). Each Earned PSU then vests over the subsequent two calendar years in three equal instalments. One PSU has a value equal to one Nuvo common share.

2012 PSUs

In the first quarter of 2013, the Board of Directors assessed the PSU objectives at the end of the performance period, December 31, 2012 and determined that 32,565 of the 47,730 PSUs granted on March 29, 2012 were Earned PSUs (2012 PSUs). These 2012 PSUs had an aggregate value of $201, but were adjusted to $185 after certain PSUs were forfeited in December 2013. During the three and six months ended June 30, 2014, $5 and $11 of the aggregate value of the 2012 PSUs was recognized as compensation expense with a corresponding credit to contributed surplus [$64 for the year ended December 31, 2013]. As at December 31, 2013, the first and second tranches of the 2012 PSUs had vested and were issued in common shares with $128 transferred from contributed surplus to common shares. The remaining aggregate value for the 2012 PSUs of $11 will be amortized over the remaining vesting period which ends on December 31, 2014. There are 10,855 PSUs remaining to be issued upon vesting in 2014.

Deferred Share Unit Plan

Directors

On January 1, 2009, the Company established the DSU Plan, a share-based compensation plan for non-employee directors. Under the DSU Plan, non-employee directors can be allotted and can elect to receive a portion of their annual retainers and other Board-related compensation in the form of DSUs. One DSU has a cash value equal to the market price of one of the Company's common shares and the number of DSUs issued to a director's DSU account for any payment is determined using the five-day volume weighted average price of the Company's common shares immediately preceding the payment date.

Employees

On June 18, 2013, the Company established an employee DSU Plan that allows employees to elect to have a portion of their quarterly earnings issued in units of the DSU Plan. Consistent with non-employee directors, one DSU has a cash value equal to the market price of one of the Company's common shares. The number of units to be credited to an employee will be calculated by dividing the elected portion of the compensation payable to the employee by the five-day VWAP of the Company's common shares immediately preceding the close of each quarter.

Upon issuance, the fair value of the DSUs is recorded as compensation expense and the DSU accrual is established. At all subsequent reporting dates, the DSU accrual is adjusted to the market value of the underlying shares and the adjustment is recorded as compensation cost. Within a specified time after retirement or termination, non-employee directors and employees receive a cash payment equal to the market value of their DSUs. For the three months and six months ended June 30, 2014, an expense of $233 and $578 was recorded in G&A as compensation expense related to DSUs. The charge for the three and six months ended June 30, 2014 consisted of $135 and $355 for the fair value of the DSU's issued for director fees and employee compensation, combined with a $98 and $223 increase in the aggregate DSU accrual to the market value of the underlying shares for the three and six months ended June 30, 2014. The DSU accrual is included in accounts payable and accrued liabilities.

The following table summarizes the outstanding DSUs and related accrual as at June 30, 2014:

	Number of DSUs	Market Values	Accrual
	000s	$	$
Balance, December 31, 2013	208	2.15	449
Issued for employee compensation	35	2.59	89
Issued for directors' fees	61	2.03 - 2.59	131
Adjustment to market value	-	-	125
Balance, March 31, 2014	304	2.61	794
Issued for employee compensation	36	2.85	104
Issued for directors' fees	11	2.85	31
Adjustment to market value	-	-	98
Balance, June 30, 2014	**351**	**2.92**	**1,027**

Stock Appreciation Rights Plan

On October 30, 2013, the Company established the SARs Plan for directors, officers, employees or designated affiliates to provide incentive compensation based on the appreciation in value of the Company's common shares. Under the SARs Plan, participants receive, upon vesting, a cash amount equal to the difference between the SARs fair market value and the grant price value, also known as the intrinsic value. Fair market value is determined by the closing price of the Company's common share on the TSX on the day preceding the exercise date. SARs vest in tranches prescribed at the grant date and each tranche is considered a separate award with its own vesting period and grant date fair value. Until SARs vest, compensation expense is measured based on the fair value of the SARs at the end of each reporting period, using a Black-Scholes option pricing model. The fair value of the liability is remeasured at the end of each reporting date and adjusted at the settlement date, when the intrinsic value is realized. The SARs accrual is included in accounts payable and accrued liabilities.

Fair values of each tranche issued and outstanding in the year is measured at June 30, 2014 using the Black-Scholes option pricing model with the following inputs:

SARs (000s)	Grant Date	Exercise Price $	Risk-free Interest Rate %	Expected Life (years)	Volatility Factor %	Fair Values $
606	October 30, 2013	1.85	1.03	1 - 3	68 - 78	1.18 – 1.72
318	April 4, 2014	3.39	1.03	1 - 4	68 - 78	0.40 – 1.42

The following table summarizes the outstanding SARs and related accrual at June 30, 2014:

	Number of SARs 000s	Fair Values $	Accrual $
Balance, December 31, 2013	606	0.76 – 1.11	50
Adjustment to market value	-	-	126
Balance, March 31, 2014	606	1.05 – 1.51	176
Granted	318	0.40 – 1.42	36
Adjustment to market value	-		149
Balance, June 30, 2014	**924**	**0.40 – 1.72**	**361**

Summary of Stock-Based Compensation

	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	**2014**	2013
	$	$	**$**	$
Stock option compensation expense under the Share Option Plan	**59**	78	**129**	122
PSU compensation expense under the Share Bonus Plan	**5**	24	**11**	63
DSUs – issued for settlement of directors' fees	**31**	-	**162**	100
DSUs – issued for employee compensation	**104**	-	**193**	-
DSUs – adjustment to market value	**98**	(139)	**223**	(182)
SARs compensation expense	**185**	-	**311**	-
Stock-based compensation expense	**482**	(37)	**1,029**	103
Recorded in the Consolidated Interim Statements of Loss and Comprehensive Loss as follows:				
Cost of goods sold	**2**	-	**4**	-
Research and development expenses	**46**	18	**82**	28
General and administrative expenses	**434**	(55)	**943**	75
	482	(37)	**1,029**	103

12. NET LOSS PER COMMON SHARE

The following table presents the maximum number of shares that would be outstanding if all dilutive and potentially dilutive instruments were exercised or converted as at:

	June 30, 2014	June 30, 2013
	000s	000s
Common shares issued and outstanding	**10,240**	8,746
Stock options outstanding (Note 11)	**964**	745
Warrants (Note 10)	**823**	-
PSUs outstanding (Note 11)	**11**	31
	12,038	9,522

13. EXPENSES BY NATURE

The Consolidated Interim Statements of Loss and Comprehensive Loss include the following expenses by nature:

(a) Employee costs:

	Three Months Ended June 30		Six Months Ended June 30	
	2014	2013	**2014**	2013
	$	$	**$**	$
Short-term employee wages, bonuses and benefits	**2,025**	2,296	**4,145**	4,840
Share-based payments	**396**	99	**733**	178
Post-employment benefits	**2**	5	**12**	35
Termination benefits	**-**	15	**-**	441
Total employee costs	**2,423**	2,415	**4,890**	5,494
Included in:				
Cost of goods sold	**579**	486	**1,135**	945
Research and development expenses	**739**	863	**1,515**	2,282
Sales and marketing expenses	**-**	86	**-**	207
General and administrative expenses	**1,105**	980	**2,240**	2,060
Total employee costs	**2,423**	2,415	**4,890**	5,494

(b) Depreciation and amortization:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	**2014**	2013
	$	$	**$**	$
Cost of goods sold	**68**	62	**136**	123
Research and development expenses	**21**	29	**42**	57
General and administrative expenses (i)	**94**	363	**189**	522
Total depreciation and amortization	**183**	454	**367**	702

(i) G&A expenses include $86 and $173 of amortization of intangible assets for the three and six months ended June 30, 2014 [$341 and $477 of amortization of intangible assets for the three and six months ended June 30, 2013].

14. NET CHANGE IN NON-CASH WORKING CAPITAL

The net change in non-cash working capital consists of:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	**2014**	2013
	$	$	**$**	$
Accounts receivable	**(1,169)**	33	**956**	1,477
Inventories	**181**	(234)	**(293)**	(247)
Other current assets	**(86)**	42	**(291)**	179
Accounts payable and accrued liabilities	**331**	(2)	**670**	(428)
Net change in non-cash working capital	**(743)**	(161)	**1,042**	981

15. COMMITMENTS

The Company has commitments under research and other service contracts and minimum future rental payments under operating leases for the twelve months ending June 30 as follows:

	Research and Other Service Contracts	Operating Leases	Total
	$	$	$
2015	1,845	223	2,068
2016	-	173	173
2017 and thereafter	-	97	97
	1,845	493	2,338

For the three and six months ended June 30, 2014, payments under operating leases totaled $36 and $84 [$53 and $111 for the three and six months ended June 30, 2013].

16. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Risk Factors

The following is a discussion of liquidity, credit and market risks and related mitigation strategies that have been identified. This is not an exhaustive list of all risks nor will the mitigation strategies eliminate all risks listed.

Liquidity Risk

While the Company had $10.7 million in cash and cash equivalents at June 30, 2014, it continues to have an ongoing need for substantial capital resources to research, develop, commercialize and manufacture its products and technologies, including the costs associated with the Phase 2 clinical study for WF10 and the costs associated with the current litigation with Mallinckrodt. Other than the U.S. and Canada, the Company only has limited participation in Pennsaid sales revenues in countries where it is currently marketed. In Canada, the Company receives royalties based on Canadian net sales, but the market is relatively small and these funds are used entirely towards repayment of the Amended Paladin Debt. In Canada, a generic version of Pennsaid was approved and launched in the first quarter of 2014; this generic may have an impact on the Company's cash flows and revenues. In the U.S., the Company receives royalties based on net sales of Pennsaid and Pennsaid 2%. In May 2014, Apotex launched their generic version of Pennsaid in the U.S. The generic launch has impacted Nuvo as follows: pursuant to the licensing agreement with Mallinckrodt, the royalty rate for Pennsaid decreased from 20% to 15% of net sales and scripts for Pennsaid decreased significantly after the launch, negatively impacting royalty revenue, product sales and cash flows from Pennsaid in the U.S. The royalty rate for Pennsaid 2% remains unchanged at 20%. In addition, Pennsaid is subject to additional generic risk in the U.S., as two other generic companies have received tentative approvals for their Abbreviated New Drug Applications (ANDAs). In total, eleven companies have filed ANDAs in the U.S. (including one company that has withdrawn its ANDA) for approval to market a generic version of Pennsaid. Pennsaid 2%, the follow-on product to Pennsaid, has patent protection that expires in April 2028 and was launched by Mallinckrodt in February 2014. The launch of Apotex's generic version of Pennsaid, as well as any future launch of a generic version of Pennsaid in the U.S., could materially impact revenues of Pennsaid 2% and the Company's future cash flows would be negatively impacted as the Company could lose all or a significant portion of its royalties and potential milestone payments. In addition, minimal royalty revenues are being generated by the HLT Patch and Pliaglis. The Company earns royalties generated on the net sales of the HLT Patch in the U.S. from Galen and in Europe from Eurocept. The Company licensed Pliaglis' worldwide sales and marketing rights to Galderma. Pliaglis was launched in the U.S. in March 2013, in the E.U. in April 2013 and in Brazil in March 2014. The Company earns royalties on the net sales of Pliaglis. The Company's revenues may not be sufficient to provide the capital required for the Company to be self-sustaining without the need for future financings.

The Company has contractual obligations related to accounts payable and accrued liabilities, purchase commitments and finance lease and other obligations of $8.5 million that are due in less than a year and $3.1 million of contractual obligations that are payable from 2015 to 2017.

Credit Risk

The Company's cash and cash equivalents subject the Company to a significant concentration of credit risk. At June 30, 2014, the Company had $10.2 million invested with one financial institution in various bank accounts as per its practice of protecting its capital rather than maximizing investment yield through additional risk. This

financial institution is a major Canadian bank which the Company believes lessens the degree of credit risk. The remaining $0.5 million of cash and cash equivalent balances are held in bank accounts in various geographic regions outside of Canada.

The Company, in the normal course of business, is exposed to credit risk from its global customers most of whom are in the pharmaceutical industry. The accounts receivable are subject to normal industry risks in each geographic region in which the Company operates. In addition, the Company is exposed to credit related losses on sales to its customers outside North America and the E.U. due to potentially higher risks of enforceability and collectability. The Company attempts to manage these risks prior to the signing of distribution or licensing agreements by dealing with creditworthy customers; however, due to the limited number of potential customers in each market, this is not always possible. In addition, a customer's creditworthiness may change subsequent to becoming a licensee or distributor and the terms and conditions in the agreement may prevent the Company from seeking new licensees or distributors in these territories during the term of the agreement. At June 30, 2014, the Company's four largest customers located in North America and the E.U. represented 83% [December 31, 2013 - 88%] of accounts receivable, and accounts receivable from customers located outside of North America and the E.U. represented 8% [December 31, 2013 - 8%] of accounts receivable.

Pursuant to their collective terms, accounts receivable are aged as follows:

	June 30, 2014	December 31, 2013
	$	$
Current	**2,809**	4,031
0-30 days past due	**290**	34
61-90 days past due	**88**	-
Over 90 days past due	**109**	124
	3,296	4,189

Interest Rate Risk
All finance lease and other obligations are at fixed interest rates.

Currency Risk
The Company operates globally, which gives rise to a risk that earnings and cash flows may be adversely affected by fluctuations in foreign currency exchange rates. The Company is primarily exposed to the U.S. dollar and euro, but also transacts in other foreign currencies. The Company currently does not use financial instruments to hedge these risks. The significant balances in foreign currencies are as follows:

	Euros		U.S. Dollars	
	June 30, 2014	December 31, 2013	**June 30, 2014**	December 31, 2013
	€	€	**$**	$
Cash and cash equivalents	**640**	1,039	**938**	1,536
Accounts receivable	**812**	322	**1,682**	3,496
Other current assets	**262**	150	**-**	-
Accounts payable and accrued liabilities	**(562)**	(326)	**(843)**	(1,440)
Finance lease and other long-term obligations	**-**	-	**(334)**	(384)
	1,152	1,185	**1,443**	3,208

Based on the aforementioned net exposure as at June 30, 2014, and assuming that all other variables remain constant, a 10% appreciation or depreciation of the Canadian dollar against the U.S. dollar and euro would have resulted in the following changes in total comprehensive income (loss) as follows:

	Comprehensive Income (Loss)	
Canadian Dollar	**Appreciates 10%**	**Depreciates 10%**
Versus U.S. dollar	140	(171)
Versus euro	153	(187)

In terms of the euro, the Company has three significant exposures: its net investment and net cash flows in its European operations, its euro denominated cash and cash equivalents held in its Canadian operations and sales of Pennsaid by the Canadian operations to European distributors. In terms of the U.S. dollar, the Company has

five significant exposures: its net investment and net cash flows in its U.S. operations, its U.S. dollar denominated cash and cash equivalents held in its Canadian operations, the cost of running trials and other studies at U.S. sites, the cost of purchasing raw materials either priced in U.S. dollars or sourced from U.S. suppliers that are needed to produce Pennsaid, Pennsaid 2% or other products at the Canadian manufacturing facility and revenue generated in U.S. dollars, including royalties and milestone payments received from licensing agreements with Mallinckrodt, Galderma, Galen and Eurocept and product sales to Mallinckrodt.

The Company does not actively hedge any of its foreign currency exposures given the relative risk of currency versus other risks the Company faces and the cost of establishing the necessary credit facilities and purchasing financial instruments to mitigate or hedge these exposures. As a result, the Company does not attempt to hedge its net investments in foreign subsidiaries.

The Company does not currently hedge its euro cash flows. Sales to European distributors for Pennsaid are primarily contracted in euros. The Company receives payments from the distributors in its euro bank accounts and uses these funds to pay euro denominated expenditures and to fund the net outflows of the European operations as required. Periodically, the Company reviews the amount of euros held, and if they are excessive compared to the Company's projected future euro cash flows, they may be converted into U.S. or Canadian dollars. If the amount of euros held is insufficient, the Company may convert a portion of other currencies into euros.

The Company does not currently hedge its U.S. dollar cash flows. The Company's U.S. operations have net cash outflows and currently these are funded using the Company's U.S. dollar denominated cash and cash equivalents and payments received under the terms of the licensing agreements with Mallinckrodt, Galderma and Galen. Periodically, the Company reviews its projected future U.S. dollar cash flows and if the U.S. dollars held are insufficient, the Company may convert a portion of its other currencies into U.S. dollars. If the amount of U.S. dollars held is excessive, they may be converted into Canadian dollars or other currencies, as needed for the Company's other operations.

17. SEGMENTED INFORMATION

Segments

From a financial perspective, executive management uses the net loss before income taxes to assess the performance of each segment.

The following tables show certain information with respect to operating segments:

Three months ended June 30, 2014	**TPT Group $**	**Immunology Group $**	**Total $**
Total revenue[(1)]	**3,743**	**120**	**3,863**
Depreciation of property, plant and equipment and amortization of intangible assets	**176**	**7**	**183**
Interest income (expense)	**475**	**(447)**	**28**
Interest expense	**175**	**-**	**175**
Net loss before income taxes	**(658)**	**(1,621)**	**(2,279)**
Assets	**17,511**	**1,615**	**19,126**
Property, plant and equipment	**1,286**	**50**	**1,336**
Additions to property, plant and equipment	**61**	**2**	**63**

Three months ended June 30, 2013	TPT Group $	Immunology Group $	Total $
Total revenue[(1)]	3,204	116	3,320
Depreciation of property, plant and equipment and amortization of intangibles	448	6	454
Interest income (expense)	310	(296)	14
Interest expense	99	-	99
Net loss before income taxes	(1,296)	(895)	(2,191)
Assets	20,882	1,637	22,519
Property, plant and equipment	1,407	61	1,468
Additions to property, plant and equipment	23	15	38

Six months ended June 30, 2014	TPT Group $	Immunology Group $	Total $
Total revenue[(i)]	**6,363**	**257**	**6,620**
Depreciation of property, plant and equipment and amortization of intangible assets	**354**	**13**	**367**
Interest income (expense)	**927**	**(878)**	**49**
Interest expense	**370**	**-**	**370**
Net loss before income taxes	**(1,564)**	**(3,437)**	**(5,001)**
Assets	**17,511**	**1,615**	**19,126**
Property, plant and equipment	**1,286**	**50**	**1,336**
Additions to property, plant and equipment	**113**	**5**	**118**

Six months ended June 30, 2013	TPT Group $	Immunology Group $	Total $
Total revenue[(i)]	5,271	300	5,571
Depreciation of property, plant and equipment and amortization of intangibles	691	11	702
Interest income	590	(566)	24
Interest expense	211	-	211
Net loss before income taxes[(ii)]	(3,620)	(1,813)	(5,433)
Assets	20,882	1,637	22,519
Property, plant and equipment	1,407	61	1,468
Additions to property, plant and equipment	57	16	73

(i) The Immunology Group currently derives all of its revenue from product sales.

Geographic Information

The Company's revenue is derived from sales to and licensing revenue derived from external customers located in the following geographic areas:

	Three months ended June 30,		Six months ended June 30,	
	2014	2013	**2014**	2013
	$	$	**$**	$
United States	**1,950**	2,225	**3,984**	3,788
Europe	**1,166**	561	**1,272**	704
Canada	**620**	398	**1,095**	723
Other foreign countries	**127**	136	**269**	356
	3,863	3,320	**6,620**	5,571

The geographic location of the Company's PP&E is as follows as at:

	As at June 30, 2014	As at June 30, 2013
	$	$
Canada	**1,281**	1,374
United States	**5**	33
Europe	**50**	61
	1,336	1,468

Significant Customers

For the three months ended June 30, 2014, the Company's four largest customers (excluding upfront payments and milestones from licensing arrangements) represented 94% [June 30, 2013 - 86%] of total revenue and the Company's largest customer represented 49% [June 30, 2013 - 58%] of total revenue. The Company's largest customers are in the TPT Group.

18. RELATED PARTY TRANSACTIONS

For the three months ended June 30, 2014, the Company had no related party transactions. For the six months ended June 30, 2014, certain officers of the Company participated in the Private Placement described in Note 10 and acquired 67,768 Units on the same terms as the other purchasers. Proceeds raised from the Company's officers totalled $152.