Notes – applicable to both consolidated and parent company financial statements

Note 1 Accounting and valuation principles

General information

This annual report and consolidated financial statements concerns the Swedish parent Company Xspray Pharma AB (publ), corporate ID number 556649-3671 and the start-up subsidiary Xspray Pharma Futurum AB, corporate ID number 559178-7642.

The parent Company is a public limited Company whose shares are listed on the ABC, registered and domiciled in Stockholm, Sweden The Company's head office is located on Råsundavägen 12, SE 169 67 Solna.

At the end of December 2018, Xspray Pharma AB (publ) acquired a newly incorporated subsidiary, dormant for the time being, to prepare the Group for possible future structural needs. No business activity has taken place in the subsidiary; all business is pursued in the parent Company Xspray Pharma AB (publ).

The nature of the business

Xspray Pharma AB has developed a patented technology, RighSize, for the production of hybrid nano particles, HyNap.

Xspray's technology allows new and existing drug substances to be developed with better properties. It can be used to produce improved versions of established drugs, to extend a product's lifetime or in certain cases produce a variant comparable to an established product.

Xspray's technology has been applied to both new and existing drug substances. The Company is close to the commercialization of the product platform through an application for an established drug for the treatment of cancer.

General Information, compliance with IFRS and the going concern principal.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), published by the International Accounting Standards Board (IASB) as adopted by the European Union (EU). The consolidated financial statements also comply with recommendations from the Swedish Financial Reporting Board RFR1, Supplementary rules for consolidated financial statements. In addition, the Company follows Swedish Financial Reporting Board RFR2, Accounting for Legal Entities.

The Parent Company has prepared its annual report in compliance with the Swedish Annual Accounts Act and Swedish Financial Reporting Board recommendation RFR 2 Accounting for Legal Entities.

The differences between the consolidated and parent Company accounting policies are described below.

Xspray does not divide its operations into different lines of business, This reflects the Company's organization and reporting system. The chief operating decision maker is the Chief Executive Officer. The Group is not anticipated to have any direct revenues until its products are launched on the market.

The financial statements have been prepared under the proviso that the Group conduct its business according to the going concern principle.

The financial statements for Xspray Pharma for the financial year ending on December 31, 2018 have been approved by the Board of directors and Chief Executive Officer and will be presented to the Annual General Meeting on May 23, 2019 for adoption. The parent Company Xspray Pharma AB (publ) is a Swedish public limited Company, domiciled in Stockholm, Sweden.

Change of accounting policies and valuation principles

During the last quarter, the Company switched to applying IFRS with the adjustments required by RFR 2 Accounting for Legal Entities. The Company will also switch to an income statement layout classified by function.

The effects of these changes and further information about the accounting policies are described in more detail below and in note 24. During previous periods, financial statements were prepared in accordance with the Swedish Annual Accounts Act and K3.

At the end of 2018, the parent Company acquired a newly incorporated subsidiary, dormant for the time being, to prepare the Group for possible future structural needs. No business activity has taken place in the subsidiary; all business is pursued in the parent Company Xspray Pharma AB (publ). Accordingly, Xspray is presenting consolidated financial statements for the first time. Because the acquisition date is at the end of 2018 and no business activities have yet been pursued in the subsidiary, no consolidated income statement has been prepared for 2018. This provides a more accurate picture of the operations as the number of transactions is limited and 2018 operations as a whole are reported in the parent Company's statements. The consolidated balance sheet will be prepared as per the closing date 12/31/2018.

Standards, changes and interpretations of standards that have not yet come into force or been applied in advance by the Group

A number of new or amended IFRSs have not yet come into force and have not been applied in advance when preparing the consolidated and parent Company financial statements. The new IFRS thought to affect the Group's accounting in the future is IFRS 16 Leases. According to the new standard, lessees must report the obligation to pay lease charges as a leasing liability in the balance sheet. The right to use the underlying asset during the term of the lease is reported as an asset. Depreciation of the asset is reported in the income statement as interest on the leasing liability. Paid lease charges are reported partly as payment of interest, and partly as an amortization of the leasing liability. The standard exempts leases with a lease term shorter than 12 months (short-term leases) and leases in respect of low-value assets. The new standard does not entail any major differences for lessors. IFRS 16 comes into force in the financial year beginning January, 2019 or later and will be applied by the Group as of January 1, 2019.

The Group applies the simplified transition method.

It is thought the standard will initially entail reporting leases as assets and liabilities in the balance sheet, especially those reported as operational leases in these financial statements. This will also mean splitting their reported expenses between interest expense and depreciations.

The exemptions in RFR 2 concerning leases will be applied in the parent company. All leases are reported in the parent Company under the rules for operational leasing. This means the parent company's accounting policies for leases will remain unchanged. See also note 5.

Important accounting policies

The Group's financial statements were prepared using the accruals concept and based on cost. Monetary amounts are expressed in Swedish crowns (SEK) and rounded to the nearest thousand unless otherwise indicated.

Non-current assets and non-current liabilities consist in all material respects of amounts that are expected to be recovered or settled more than twelve months from the closing date. Current assets and current liabilities consist in all material respects of amounts that are expected to be recovered or settled within twelve months of the closing date.

Basis for consolidation

Subsidiaries

Subsidiaries are companies in which Xspray Pharma AB has a controlling influence. An investor has a controlling influence over a company when said investor is exposed to, or has the right to, variable rates of return from his participation in the company and is able to affect the rate of return through his influence.

Subsidiaries are reported according to the acquisition method, wherein the acquisition of a subsidiary is regarded as a transaction through which the Group indirectly acquires the subsidiary's assets and assumes its liabilities. In the acquisition analysis, the fair value of the acquired identifiable assets and assumed liabilities and any holdings without a controlling influence are determined on the day of acquisition. Transaction expenditures, with the exception of transaction expenditures attributable to the issuance of equity instruments or debt instruments that arise, are reported directly in profit/loss for the year. In a business combination where the transferred compensation exceeds the fair value of acquired assets and assumed liabilities reported separately, the difference is reported as goodwill.

A subsidiary's financial statements are included in the consolidated financial statements from the acquisition date until the date when controlling influence no longer exists.

Participations in subsidiaries are reported in the parent Company according to the cost method. This means transaction expenditures are included in the carrying amount for holdings in subsidiaries.

Transactions eliminated on consolidation

Intra-group receivables and liabilities, income or expenses, as well as unrealized gains or losses arising from transactions between Group companies, are eliminated in their entirety when preparing the consolidated financial statements. Unrealized losses are eliminated in the same way, but only to the extent that no impairment loss is necessary

Currency translations

Transactions in foreign currency

Foreign currency transactions are translated into the functional currency at the exchange rate prevailing on the transaction date. Monetary assets and liabilities in foreign currency are translated to the functional currency at the exchange rate prevailing on the closing date. Exchange rate differences that arise from translations are reported under profit/loss for the year. Exchange-rate gains and losses on operating receivables and liabilities are reported under operating profit/loss while exchange-rate gains and exchange-rate losses on financial receivables and liabilities are reported as financial items.

Revenues

Because the Group does not enter into contracts with its customers where the Group's right to payment, when performance of the contract is completed, is dependent upon anything other than the passage of time, the Group does not currently report any contract assets.

Xspray does not divide its operations into different lines of business, and this reflects the Company's organization and reporting system. The chief operating decision maker is the Chief Executive Officer. The Group does not anticipate having any direct revenues until its products are launched on the market.

Revenue is recognized when the amount can be measured reliably and it is probable that future economic benefits will flow to the Group and the Company. Revenue comprises the fair value of what is received or will be received for services sold in day-to-day operations. Revenue is recognized exclusive of value-added tax, returns and discounts, and after elimination of intra-group sales.

Xspray Pharma is a product development Company with multiple product candidates in clinical development. Xspray Pharma uses its innovative, patented RightSize® technology to develop improved and generic versions of marketed drugs, primarily protein kinase inhibitors (PKIs) for the treatment of cancer. The segment is the second largest in oncology, and drug prices are very high. Thanks to its innovative technology, Xspray Pharma is able, through licensing to suitable pharmaceutical companies, gain entry as the first competitor to today's original drugs before their secondary patents expire. The Company's first product candidates comprise HyNap-Dasa, HyNap-Sora and HyNap-Nilo. The goal is to become the leader in the development of protein kinase inhibitors already marketed for the treatment of cancer, which numbered 39 in 2018. The launch of HyNap-Dasa, the first product candidate, is planned for 2021. The substance patent for Sprycel® (dasatinib) expires at the end of 2020, and the secondary patents in 2026, which offers Xspray Pharma's HyNap-Dasa a period of five years in a semi-exclusive position before other competitors gain access to the market. The Company has patented the production technology, the equipment and the resulting products.

Sales are not expected to increase before 2021, when the Company plans to launch the first product on the market under the current business plan.

Financial income

Financial income consists of interest income and exchange rate gains. Interest income is reported in accordance with the effective interest method. Effective interest is the interest that discounts estimated future receipts and payments during the anticipated term of the financial instrument to the financial asset's or liability's reported net value. The calculation comprises all charges paid or received by contractual parties that form part of the effective interest, transaction expenses and all other premiums and discounts.

Dividends received are reported when the right to receive the dividend is determined. Exchange rate gains and losses are reported net.

Operating expenses

Operating expenses are reported in the income statement when the service is used or when the event has occurred.

Borrowing costs

Borrowing costs that are directly attributable to the acquisition, erection or manufacture of qualifying assets, are capitalized during the time period necessary for completing and preparing the asset for its intended use or sale. Other borrowing costs are expensed in the period during which they occur and are reported under Financial expenses. The Group currently has no borrowing costs.

Leasing

Leases in which the lessor in principle retains all risks and benefits associated with the rights of ownership are classed as operational in the legal entity. Leasing charges are expensed on a straight-line basis in the income statement during the leasing period. Initially, any incentives received upon signing the lease are taken into account.

Employee benefits

Current employee compensation

Current employee compensation such as pay, social security charges, vacation pay and bonuses are expensed during the period when the employees perform the services.

Pensions

The Group's pension commitments only include defined contribution plans. A defined contribution pension plan is one where the Group pays fixed premiums to a separate legal entity. The Group has no legal or informal obligation to pay additional fees if the legal entity does not have sufficient assets to pay all employee benefits associated with the employee's service during the current or earlier periods. Thus the Group has no additional risk. The Group's obligations in respect of the fees to the defined contribution plan are reported as expenses in profit/loss for the year as they are earned by employees in the performance of services for the Group during a period.

Stock-based compensation

For certain key individuals, the Group has share-related compensation that is settled using shares in the parent Company (warrants) which are thus booked against equity. The option price in all option programs was determined at fair value according to the Black & Scholes valuation model. See also note 7.

Taxes

Income taxes consist of current tax and deferred tax. Income taxes are reported in the income statement except when the underlying transaction is reported in equity, in which case the associated tax effect is reported under other comprehensive income and equity.

Current tax is tax that must be paid or received in respect of the current year by applying the tax rates that were enacted, or announced, as of the closing date. Adjustments current tax attributable to prior periods are also reported under current tax.

Deferred tax is reported in its entirety according to the balance sheet method on all temporary differences arising between the taxable value of assets and liabilities and its carrying amount. Temporary differences attributable to participations in subsidiaries that are not expected to be reversed in the foreseeable future are disregarded.

Valuation of deferred tax is based on how the underlying assets or liabilities are expected to be realized or settled. Deferred tax is calculated according to the tax rates and regulations adopted or announced as of the closing date and which are expected to apply when the deferred tax asset concerned is realized or the deferred tax liability settled. Deferred tax assets are reported net against deferred tax liabilities only if they can be paid with a net amount.

Deferred tax assets in respect of deductible temporary differences and loss carryforwards are reported only to the extent that it is likely they will be utilized. The value of deferred tax assets is reduced when it is no longer considered likely that they can be utilized. Because of the connection between reporting and taxation, deferred tax assets are not disclosed as being attributable to untaxed reserves.

Public subsidies

Subsidies received refers to awarded or previously accrued EU subsidies for the financial year.

Fixed assets

Intangible assets

Intangible assets with a limited lifetime are reported at cost less depreciations and any impairment charges. Intangible fixed assets are depreciated systematically over the asset's estimated useful life. Useful life is reviewed at every balance sheet date and adjusted as necessary. Depreciation commences upon completion. When the depreciable amounts of the assets are determined, the asset's residual value is taken into account where applicable.

Development expenditures are capitalized when they fulfill IAS 38 criteria and amount to significant sums for the development investment as a whole.

Otherwise, development expenditures are expensed as normal operating expenses. The most important criteria for capitalization are the demonstrable future earnings (market), cost-saving or cash flow potential of the end product under development and the existence of technological and financial conditions for completing development work once started. The Group only has internally developed intangible assets. Cost includes consists chiefly of direct personnel costs arising in the work and relevant invoiced development costs.

The following useful lifetimes are applied:

Expenditures for development and similar work brought forward	5 years
Concessions, patents, licenses, brands and similar rights	5 years

Property, plant and equipment

Property, plant and equipment comprises fixtures and fittings and is reported in the consolidated accounts at cost less accumulated depreciations and any impairment charges. Cost includes the purchase price and expenditures directly attributable to an asset in order to bring it to the position and condition necessary for use in accordance with the purpose of the acquisition.

The carrying amount of an asset is removed from the balance sheet when the asset is retired or disposed of or when no future economic benefits are anticipated from the use or retirement/disposal of the asset. Gains and losses that arise from the disposal or retirement of an asset consist of the difference between the sales price and the asset's carrying amount less deductions for direct selling expenses. Profit and loss are reported as other operating income/expense.

Depreciation is calculated on a straight-line basis over the asset's calculated useful life. The estimated useful life of the Group's property, plant and equipment is five years. The depreciation methods, residual values and useful lifetimes are reviewed at the end of each year.

Impairment of non-financial assets

Assets with an indefinite useful life such as the Group's intangible assets where depreciation has not yet begun as they are not yet in use, are reviewed at least annually with regard to any need for impairment and when an indication for impairment is present. Assets are considered for impairment whenever events or changes in circumstances indicate that the asset's carrying amount is not recoverable.

An impairment loss is reported in the amount by which the asset's carrying amount exceeds its recovery value. The recoverable value is the asset's fair value less selling expenses or its value-in-use, whichever is the higher. When assessing the need to recognize impairment, assets are grouped at the lowest levels at which there are separately identifiable cash-flows (cash generating units).

The Company uses the cash flow model to test the value of intangible assets. The value of development projects in progress is derived by calculating anticipated future cash flows at present value to take development risks into account. The valuation considers cash flow for the next five years and does not include calculation of any residual value thereafter.

Previously reported impairments are reversed if the recoverable value is considered to exceed the carrying amount. However, reversal does not take place at an amount greater than that which the carrying amount would have been, had the impairment not been reported in earlier periods. However, impairment of any goodwill is never reversed.

See also note 9.

Financial instruments

Reporting and valuation at initial recognition

Financial assets and liabilities are reported when the Group becomes party to an agreement in respect of the financial instrument's agreed conditions.

Financial assets are removed from the statement of financial position when the contractual rights in respect of the financial asset expire, or when the financial asset and all significant risks and benefits are transferred.

A financial liability is removed from the statement of financial position when it is extinguished, i.e. when it is discharged, canceled or expires.

Classification and valuation of financial assets upon initial recognition

Except for accounts receivable that do not include a significant financing component and which are measured at the transaction price under IFRS 15, all financial assets are measured at fair value adjusted for transaction expenses (where applicable).

Financial assets other than those identified and effective as hedging instruments, are classified in the following categories:

- Accrued acquisition cost
- Fair value via the income statement
- Fair value via other comprehensive income

During the periods covered by the financial statements, the Company has had no financial assets categorized as measured at fair value via profit/loss or fair value via other comprehensive income.

The classification is determined by:

- the Company's business model for the administration of the financial asset, and
- the properties of the contractual cash flows from the financial asset

All revenues and expenses in respect of financial assets reported in the income statement are classified as Financial expenses, Financial income or Other financial items except when it concerns the impairment of accounts receivable classified as Other expenses.

Because of the relationship between reporting and taxation, the IAS 39 rules on financial instruments are not applied in the parent company as a legal entity. Instead, the parent company applies the cost method in accordance with the Swedish Annual Accounts Act. Non-current financial assets are thus measured in the parent company at cost less any impairments, or as current financial assets, whichever is the lower.

Subsequent valuation

Financial liabilities appraised at amortized cost

Financial assets are measured at amortized cost if the assets meet the following conditions and are not reported at fair value via the income statement:

- they are held within the framework of the business model whose objective is to hold the financial assets and collect the contractual cash flows, and
- the contractual conditions for the financial assets give rise to cash flows that are only payments for the capital amount and not interest on the outstanding principal.

After initial recognition, they are measured at amortized cost using the effective interest method. Discounting is omitted if its effect is insignificant. The Group's cash and cash equivalents, accounts receivable and most other receivables belong to this category of financial instrument.

Impairment of financial assets

IFRS 9's impairment rules use more forward-looking information to report anticipated credit losses using the expected credit loss (ECL) model. It replaces IAS 39's earlier impairment model. The financial assets subject to the new model for expected credit losses are bonds and debt instruments measured at amortized cost or fair value via other comprehensive income; accounts receivable, contract assets reported and measured according to IFRS 15, loan obligations and certain financial guarantees (for the issuer) not measured at fair value via the income statement.

The Group no longer needs to first identify a credit loss event to report a credit loss. Instead, the Group considers more comprehensive information when assessing credit risk and evaluating expected credit losses such as previous occurrences, current circumstances and reasonable, well-founded prognoses that affect the anticipated ability to obtain future cash flows from the asset.

When taking a more forward-looking approach, a distinction is made between:

- financial instruments that have not deteriorated significantly in credit quality since initial recognition or which have low credit risk (Stage 1) and
- financial instruments that have deteriorated significantly in credit quality since initial recognition or whose credit risk is not low (Stage 2).

Stage 3 refers to financial assets where the Company on the reporting date has objective evidence of a reduction in value (that a credit loss event has taken place). In the first category, the expected credit losses for 12 months are reported, while in the second category, the anticipated credit losses for the remaining term are reported. The expected credit losses are evaluated on the basis of probability-weighted amounts of estimated credit losses over the anticipated term of the financial instruments.

Accounts receivable, other receivables and contract assets

The Group uses a simplified method for reporting accounts receivable, other receivables and contract assets and reports expected credit losses for the remaining term. This is where the anticipated shortcomings in contractual cash flows are found given the risk of nonpayment at some time during the lifetime of the financial instrument. The Group uses its historical experience, external indications and forward-looking information to calculate the expected credit losses with the aid of a provision matrix. Because they have common credit attributes, the Group assesses the impairment of accounts receivable collectively where the receivables are grouped based on the number of overdue days.

Classification and valuation of liabilities

The Group's financial liabilities include loans, trade accounts payable, other liabilities and derivative instruments. Financial liabilities are initially measured at fair value adjusted for transaction expenses. Following initial recognition, financial liabilities are valued at amortized cost with the aid of the effective interest method.

Cash and cash equivalents

Cash and cash equivalents consist of bank balances and current investments with an original due date of three months or less.

Dividends

Dividends to the parent company's shareholders are reported as liabilities in the consolidated financial statements during the period in which the dividend is approved.

Provisions

A provision differs from other liabilities due to uncertainty about the payment date or the amount required to settle the provision. A provision is reported in the balance sheet when there is an existing legal or informal obligation as a result of an event that has occurred and it is probable that an outflow of financial resources will be required to settle the obligation and a reliable estimate of the amount can be made. A provision is made in an amount that is the best estimate of what is required to settle the existing obligation on the closing date. If the point in time when payment takes place has a material effect, the provision is calculated by discounting the anticipated future cash flows.

Contingent liabilities

A contingent liability is reported when there is a possible obligation that arises from past events and whose existence is confirmed only by the occurrence of one or more uncertain future events or when there is an obligation that is not reported as a liability or provision because it is not likely that an outflow of resources will be required.

Equity, reserves and dividends

Equity consists of the following items:

Equity representing the nominal value of issued and registered shares.

Other contributed capital consists of premiums received for new issues of capital share. Any transaction expenses associated with the new share issue are deducted from the capital contribution with account taken of any income tax effects.

The parent company also has a *Fund for development expenditures*, which is grown annually by the amount capitalized in respect of the Company's own development efforts. The fund is reduced annually by depreciation of the capitalized development work.

The statutory reserve, which originated when there was a requirement under the Swedish Companies Act to make provisions to a reserve fund.

Retained earnings/accumulated deficit, i.e. all gains/losses brought forward and capitalized compensation for the current and earlier periods, and the acquisition of own shares.

Significant estimations

Preparing the financial statements in accordance with IFRS, requires Company management to make estimations, assessments and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenues and expenses. Actual outcomes may deviate from these estimations.

Uncertainty in estimations

The estimations and assumptions are evaluated on an ongoing basis. Changes in estimations are reported in the period in which the change is made if the change only affects that period, or in the period in which the change is made and future periods if the change affects both the current and future periods.

The source of uncertainties in estimations that entail a significant risk of substantial adjustment to the value of an asset or liability during the coming financial year are impairment tests for intangible assets with a non-determined period of use.

Assessment is necessary to determine whether or not requirements for the capitalization of development expenditures have been met. After capitalization, compliance with the accounting requirements for development expenses will continue to be monitored as well as if there are indications that the capitalized expenditures may be exposed to diminution of value. The Company has capitalized intangible assets that are not yet completed. At a minimum, such assets must be tested for impairment annually in order to calculate their recovery value. To do this, an estimation must be made of future cash flows attributable to the asset or the cash-generating unit to which the asset is attributable when it is completed. These estimates and assessments relate to such things as the anticipated sales price for the product, anticipated market penetration, anticipated development, sales and marketing expenses and the anticipated probability that the product will proceed through the remaining development stages. The assumptions are based on industry and market-specific data and are prepared by Company management and reviewed by the Board. For further information about testing intangible assets with an indefinite useful life for impairment, refer to note 9.

A further source of uncertainty is the assessment of the extent to which deferred tax assets may be reported based on an assessment of the likelihood of the Company's future taxable revenues against which deferred tax assets may be exercised. Furthermore, important considerations are necessary when assessing the effect of certain legal and financial limitations or uncertainties in different jurisdictions.

Risks and uncertainty factors

Commercial risks

n addition to financial risks, commercial risks are primarily linked to research and development efforts. In general, the development of drugs is associated with very high risk. The R&D efforts necessary for a drug candidate to gain approval for use as a drug carry many risks including delays in product development, higher-than-anticipated expenses, failure of the drug candidates to meet efficacy expectations and other.

The pharmaceutical industry is characterized by global competition, rapid technological development and extensive investment requirements. There are competitors with significant financial resources and there is a risk that competitors develop drugs that have a negative impact on the Company's competitive situation.

When a drug is approved, there is still a risk that national or international sales fail to meet expectations and the product does not become commercially successful. A drug's market acceptance and sales are dependent on a number of factors including product characteristics, clinical documentation and outcomes, competing products, distribution channels, availability, price, subsidies/reimbursements, and sales and marketing initiatives. These circumstances can have a negative effect on the Group's future operations, financial position and profitability.

Xspray is at risk of a lawsuits for patent infringement by original companies with the additional risk of a up to 30 months stay on the launch of its products. Xspray is actively engaged in strengthening its patent portfolio to protect itself against such delays.

Financial risks and procedures for asset management

The Group's activities expose it to various financial risks such as market risk (currency risk in cash flow), credit risk and liquidity risk.

Market risk consists mainly of currency risks. The Company collaborates with international parties and has some exposure to fluctuations in different currencies, in particular USD and EUR. Currency risk arises through future business transactions and the carrying amount of assets and liabilities. The current extent of the Company's operations means that its net exposure in foreign currencies is limited.

The credit risk for cash and cash equivalents is considered to be negligible as the counterparties are reputable banks with high credit ratings from external evaluators.

Financing risk constitutes the ability to finance projects to commercialization.

Liquidity risk is the Company's potential inability to meet its obligations. The Company manages this risk by monitoring and forecasting payments and receipts in day-to-day operations. The Company does not pursue active trade in financial assets for the purpose of speculation.

The objective of asset management is to ensure that operations are financed through equity.