Profound Medical Corp.
(formerly Mira IV Acquisition Corp.)

Consolidated Financial Statements
December 31, 2016 and 2015

March 6, 2017

Independent Auditor's Report

To the Shareholders of
Profound Medical Corp.

We have audited the accompanying consolidated financial statements of Profound Medical Corp. and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2016 and 2015 and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity (deficiency) and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

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

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Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Profound Medical Corp. and its subsidiaries as at December 31, 2016 and 2015 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

Profound Medical Corp.

Consolidated Balance Sheets

As at December 31, 2016 and 2015

	2016 $	2015 $
Assets		
Current assets		
Cash	20,833,061	10,522,520
Short-term investment (note 5)	-	10,000,000
HST receivable and other assets	266,336	92,479
Investment tax credits receivable	264,000	173,000
Inventory (note 6)	416,823	-
Prepaid expenses and deposits (note 22)	696,909	139,305
	22,477,129	20,927,304
Property and equipment (note 7)	953,029	229,112
Intangible assets (note 8)	262,685	32,500
	23,692,843	21,188,916
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	1,771,427	980,278
Customer deposits	259,293	-
Long-term debt (note 11)	2,877,050	286,700
Other liability (note 11)	39,357	-
	4,947,127	1,266,978
Long-term debt (note 11)	3,760,826	5,560,674
Provisions (note 9)	39,619	-
Other liability (note 11)	109,044	397,814
	8,856,616	7,225,466
Shareholders' Equity		
Share capital	83,272,678	67,082,821
Contributed surplus	3,000,563	2,002,190
Foreign currency translation reserve	11,316	-
Deficit	(71,448,330)	(55,121,561)
	14,836,227	13,963,450
	23,692,843	21,188,916
Commitments and contingencies (note 22)		

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

Profound Medical Corp.

Consolidated Statements of Loss and Comprehensive Loss

For the years ended December 31, 2016 and 2015

	2016 $	2015 $
Expenses		
Research and development (note 15)	9,988,693	5,136,848
Selling, general and administrative (note 16)	5,651,721	6,086,049
Total operating expenses	15,640,414	11,222,897
Finance costs - net		
Interest and accretion expense (note 17)	829,899	5,625,257
Interest income	(157,598)	(137,710)
Listing expense (note 4)	-	2,058,234
Loss on recognition of convertible notes (note 10)	-	2,094,565
Change in fair value of convertible notes (note 10)	-	(334,680)
Gain on conversion of convertible notes (note 10)	-	(1,759,885)
Gain on extinguishment of long-term debt (note 11)	-	(63,568)
Change in fair value of derivatives (note 12)	-	(2,084,652)
Preferred share dividend expense (note 12)	-	481,354
Total finance costs	672,301	5,878,915
Loss before income taxes	16,312,715	17,101,812
Income tax expense (recovery) (note 18)	14,054	(726,071)
Net loss for the year	16,326,769	16,375,741
Item that may be reclassified to profit or loss		
Foreign currency translation adjustment	11,316	-
Net loss and comprehensive loss for the year	16,338,085	16,375,741
Basic and diluted weighted average shares outstanding (note 19)	41,510,145	23,683,822
Basic and diluted net loss per common share (note 19)	0.39	0.69

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

Profound Medical Corp.

Consolidated Statements of Changes in Shareholders' Equity (Deficiency)

For the years ended December 31, 2016 and 2015

	Number of shares	Share capital $	Contributed surplus $	Deficit $	Foreign currency translation reserve $	Total $
Balance - January 1, 2015	2,166,766	39,487	765,612	(38,745,820)	-	(37,940,721)
Issuance of common shares to Profound shareholders	2,200,009	3,300,000	-	-	-	3,300,000
Issuance of common shares in connection with private placement net of transaction costs (note 1)	16,005,885	21,000,437	-	-	-	21,000,437
Issuance of common shares on conversion of preferred shares (note 12)	16,309,894	38,669,083	-	-	-	38,669,083
Issuance of common shares on conversion of convertible notes (note 10)	1,042,333	1,563,500	-	-	-	1,563,500
Issuance of common shares in connection with the Knight loan (note 11)	1,717,450	2,483,810	-	-	-	2,483,810
Fair value of Profound compensation and share options	-	-	145,839	-	-	145,839
Fair value of compensation options	-	-	465,072	-	-	465,072
Share-based payments (note 14)	-	-	644,733	-	-	644,733
Exercise of share options	30,990	26,504	(19,066)	-	-	7,438
Net loss for the year	-	-	-	(16,375,741)	-	(16,375,741)
Balance - December 31, 2015	39,473,327	67,082,821	2,002,190	(55,121,561)	-	13,963,450
Foreign currency translation adjustment	-	-	-	-	11,316	11,316
Share-based payments (note 14)	-	-	1,001,558	-	-	1,001,558
Exercise of share options	12,250	6,860	(3,185)	-	-	3,675
Issuance of common shares on public offerings (note 13)	15,820,000	16,182,997	-	-	-	16,182,997
Net loss for the year	-	-	-	(16,326,769)	-	(16,326,769)
Balance - December 31, 2016	55,305,577	83,272,678	3,000,563	(71,448,330)	11,316	14,836,227

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

Profound Medical Corp.

Consolidated Statements of Cash Flows

For the years ended December 31, 2016 and 2015

	2016 $	2015 $
Cash provided by (used in)		
Operating activities		
Net loss for the year	(16,326,769)	(16,375,741)
Depreciation of property and equipment	167,335	116,525
Amortization of intangible assets	19,673	2,500
Loss on disposal of property and equipment	10,248	-
Share-based compensation	1,001,558	644,733
Preferred share dividend expense	-	481,354
Loss on recognition of convertible notes	-	2,094,565
Gain on extinguishment of long-term debt	-	(63,568)
Change in fair value of convertible notes	-	(334,680)
Change in fair value of derivatives	-	(2,084,652)
Selling, general and administrative expenses	-	2,303,034
Listing expense	-	2,058,234
Gain on conversion of convertible notes	-	(1,759,885)
Interest and accretion expense	829,899	5,625,257
Net change in non-cash working capital balances		
Investment tax credits receivable	(91,000)	1,101,899
HST receivable and other assets	(173,857)	235,198
Prepaid expenses and deposits	(557,604)	(88,490)
Inventory	(416,823)	-
Accounts payable and accrued liabilities	775,781	(90,423)
Customer deposits	259,293	-
Income tax payable	-	(726,071)
	(14,502,266)	(6,860,211)
Investing activities		
Cash acquired from Profound	-	1,157,535
Sale (purchase) of short-term investment	10,000,000	(10,000,000)
Purchase of intangible assets	(223,174)	-
Purchase of property and equipment	(863,991)	(167,009)
	8,912,835	(9,009,474)
Financing activities		
Proceeds from convertible notes	-	1,500,000
Issuance of common shares	17,402,000	24,008,828
Proceeds from long-term debt	-	4,000,000
Payment of long-term debt	(286,700)	(72,250)
Transaction costs paid	(1,219,003)	(2,749,984)
Repayment of bank loan	-	(700,000)
Proceeds from share option exercised	3,675	7,438
Interest paid	-	(8,322)
	15,899,972	25,985,710
Increase in cash during the year	10,310,541	10,116,025
Cash - Beginning of year	10,522,520	406,495
Cash - End of year	20,833,061	10,522,520
Supplemental information		
Transaction costs included in accounts payable and accrued liabilities	-	545,876
Intangible asset additions included in accounts payable and accrued liabilities	26,684	-
Property and equipment additions included in provisions	37,509	-

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

1 Description of business

Profound Medical Corp. (Profound) and its subsidiaries (together, the company) was incorporated under the Ontario Business Corporations Act on July 16, 2014 as Mira IV Acquisition Corp. (Mira IV) and was classified as a Capital Pool Company as defined pursuant to Policy 2.4 of the TSX Venture Exchange (the Exchange).

On June 4, 2015, Profound closed its qualifying transaction (the Transaction) with Profound Medical Inc. (PMI), a biotechnology company developing a treatment to ablate the prostate gland in prostate cancer patients, pursuant to which the shareholders of PMI completed a reverse asset acquisition of Profound. The company's registered address is 2400 Skymark Avenue, Unit 6, Mississauga, Ontario, L4W 5K5.

Prior to the completion of the Transaction, on April 30, 2015, PMI completed a brokered private placement of subscription receipts for gross proceeds of $24,008,828, representing 16,005,885 subscription receipts at a price of $1.50 per subscription receipt. Each subscription receipt issued in the private placement was exchangeable for one common share in the capital of PMI upon the satisfaction of certain conditions related to the Transaction. In conjunction with the private placement, a total of 576,235 compensation options were granted to the agents, with each compensation option exercisable into one common share at a price of $1.50 for a period of two years.

In connection with the Transaction, Profound changed its name to Profound Medical Corp. from Mira IV Acquisition Corp. and consolidated its common shares prior to completion of the Transaction on the basis of one post-consolidation common share for every 13.6363 pre-consolidation common shares. Following these changes, PMI amalgamated with Mira IV Subco Inc., a wholly owned subsidiary of Profound formed solely for the purposes of facilitating the Transaction. Pursuant to the amalgamation, the shareholders of PMI received one common share of Profound for each common share of PMI. As a result of the Transaction, PMI is now a wholly owned subsidiary of Profound.

On June 8, 2015, the shares of Profound commenced trading on the Exchange under the ticker symbol PRN.

2 Summary of significant accounting policies and basis of preparation

Basis of preparation

The company prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. The Board of Directors approved these consolidated financial statements on March 6, 2017.

The significant accounting policies used in the preparation of these consolidated financial statements are described below.

These consolidated financial statements comply with IFRS.

Use of estimates and judgments

The preparation of consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of 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 consolidated financial statements are disclosed in note 3.

Consolidation

Subsidiaries are all entities over which the company has control. The company controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The wholly owned subsidiaries of Profound are consolidated from the date the control is obtained. All intercompany transactions, balances, income and expenses on transactions with the subsidiaries are fully eliminated.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker has been identified as the chief executive officer and the chief operating officer.

Foreign currency translation

The company has a functional currency of Canadian dollars and the functional currency of each subsidiary is determined based on facts and circumstances relevant for each subsidiary. Where the company's presentation currency of Canadian dollars differs from the functional currency of a subsidiary, the assets and liabilities of the subsidiary are translated from the functional currency into the presentation currency at the exchange rates at the reporting date. The income and expenses of the subsidiaries are translated at rates approximating the exchange rates at the dates of the transactions. Exchange differences arising on the translation of the consolidated financial statements of the company's subsidiaries are recognized in other comprehensive loss.

Foreign currency transactions are translated into the functional currency of the company or its subsidiaries, using the exchange rates prevailing at the dates of these transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in currencies other than an entity's functional currency are recognized in the consolidated statements of loss and comprehensive loss, within general and administrative expenses.

Investment tax credits

The benefits of investment tax credits (ITCs) for scientific research and experimental development (SR&ED) expenditures are recognized in the year the qualifying expenditure is made providing there is reasonable assurance of recoverability. The ITCs recorded are based on management's estimates of amounts expected to be recovered and are subject to audit by taxation authorities. The ITCs reduce the research and development expenses to which they relate.

Financial instruments

Financial assets and liabilities are recognized when the company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the consolidated balance sheets when there is a legally enforceable and unconditional right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

At initial recognition, the company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

- Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short term, or if designated so on initial recognition. Derivatives are also included in this category.

  Financial instruments in this category are recognized initially and subsequently measured at fair value. Transaction costs are expensed in the consolidated statements of loss and comprehensive loss. Gains and losses arising from changes in fair value are presented in the consolidated statements of loss and comprehensive loss in the year in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond 12 months of the year-end dates, which is classified as non-current.

- Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method, less a provision for impairment.

- Other financial liabilities at amortized cost: Financial liabilities at amortized cost are initially recognized at the amount required to be paid less, when material, a discount to reduce the liability to fair value. Subsequently, the liability is measured at amortized cost using the effective interest method.

- Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

Impairment of financial assets

At each reporting date, the company assesses whether there is objective evidence that a financial asset (other than a financial asset measured at fair value through profit or loss) is impaired. For financial assets carried at amortized cost, impairment loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Financial liabilities and equity instruments

- Classification as debt or equity

  Instruments issued by the company are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

- Preferred shares and the Knight loan

  The preferred shares and the Knight loan both contain a financial liability and multiple embedded derivatives in accordance with the terms of the contractual arrangements. At the date of issue, the embedded derivatives and the host financial liability are recorded at fair value. The financial liability is subsequently measured on an amortized cost basis using the effective interest method over the expected life. The fair value of the embedded derivatives was determined using pricing model techniques. They are subsequently re-measured at fair value through profit or loss.

Inventory

Inventories are valued at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Cost is determined using the first-in, first-out (FIFO) method for finished goods and weighted average cost for raw materials.

Property and equipment

Property and equipment are stated at cost, less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the consolidated statements of loss and comprehensive loss during the year in which they are incurred.

The major categories of property and equipment are depreciated as follows:

Furniture and fittings	20% per year
Research equipment	30% per year
Leasehold improvements	over the term of the lease
Computer equipment	45% per year
Computer software	100% per year

Residual values, methods of depreciation and useful lives of the assets are reviewed annually and adjusted if appropriate.

Identifiable intangible assets

The company's intangible assets are stated at cost, less accumulated amortization and are amortized on a straight-line basis in the consolidated statements of loss and comprehensive loss over their estimated useful lives.

The major categories of intangibles are amortized as follows:

Exclusive licence agreement	20 years
Software	5 years

Impairment of non-financial assets

Property and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or CGUs). The recoverable amount is the higher of an asset's fair value, less costs of disposal and value in use (being the present value of the expected future cash flows of the relevant asset or CGU). An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount.

The company evaluates impairment losses for potential reversals when events or circumstances warrant such consideration.

Provisions

A provision is recognized when the company has a legal or constructive obligation as result of a past event, it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

Income taxes

Income taxes are accounted for using the liability method. Deferred tax assets and liabilities are recognized for the differences between the tax basis and carrying amounts of assets and liabilities, for operating losses and for tax credit carry-forwards. Deferred tax assets are recognized to the extent that it is probable that future taxable income will be available against which temporary differences can be utilized. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws.

Share-based compensation

The company grants share options periodically to certain employees, directors, officers and advisers.

Options currently outstanding vest over four years and have a contractual life of ten years. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value. Fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period by increasing contributed surplus based on the number of awards expected to vest.

Leases

Leases are classified as finance leases when the lease arrangement transfers substantially all of the risks and rewards related to the ownership of the leased asset. All other leases are treated as operating leases. Payments on operating lease agreements are recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

Research and development costs

Research costs are charged to expense as incurred. Development costs are deferred and amortized when the criteria for deferral are met, otherwise they are expensed as incurred. No development costs have been deferred to date.

Clinical trial expenses result from obligations under contracts with vendors, consultants and clinical site agreements in connection with conducting clinical trials. The financial terms of these contracts are subject to negotiations, which vary from contract to contract and may result in payment flows that do not match the periods over which materials or services are provided to the company. The appropriate level of clinical trial expenses is reflected in the company's consolidated financial statements by matching period expenses with period services and efforts expended. These expenses are recorded according to the progress of the clinical trial as measured by patient progression and the timing of various aspects of the clinical trial. Clinical trial accrual estimates are determined through discussions with internal clinical personnel and outside service providers as to the progress or state of completion of clinical trials, or the services completed. Service provider status is then compared to the contractually obligated fees to be paid for such services. During the course of a clinical trial, the company may adjust the rate of clinical expense recognized if actual results differ from management's estimates.

Government grants

Grants from the government are recognized at their fair value where there is a reasonable assurance that the grant will be received and the company will comply with all attached conditions.

Loans received from government entities are recognized initially at fair value with the difference between the fair value of the loan and the amount received being recognized in the consolidated statements of loss and comprehensive loss in government grants immediately to the extent that the loan reimburses previously incurred expenses.

Loss per share

Basic loss per share is calculated by dividing the net loss by the weighted average number of common shares outstanding during the year. Diluted loss per share is calculated by dividing the applicable net loss by the sum of the weighted average number of shares outstanding during the year and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the year. The computation of diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect of the share options and compensation options.

Accounting standards issued but not yet adopted

- IFRS 9, Financial Instruments (IFRS 9)

  The final version of IFRS 9, Financial Instruments, was issued by the International Accounting Standards Board (IASB) in July 2014 and will replace International Accounting Standard (IAS) 39, Financial Instruments: Recognition and Measurement. IFRS 9 introduces a model for classification and measurement, a single, forward-looking expected loss impairment model and a substantially reformed approach to hedge accounting. The new single, principle-based approach for determining the classification of financial assets is driven by cash flow characteristics and the business model in which an asset is held. The new model also results in a single impairment model being applied to all financial instruments, which will require more timely recognition of expected credit losses. It also includes changes in respect of own credit risk in measuring liabilities elected to be measured at fair value, so that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognized in profit or loss. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, however, is available for early adoption. In addition, the own credit risk changes can be early applied in isolation without otherwise changing the accounting for financial instruments. The company is yet to assess the full impact of IFRS 9 and has not yet determined when it will adopt the new standard.

- IFRS 15, Revenue from Contracts with Customers (IFRS 15)

  This standard replaces IAS 11, Construction Contracts, IAS 18, Revenue, and International Financial Reporting Interpretations Committee 13, Customer Loyalty Programmes. This standard outlines a single comprehensive model for entities to account for revenue arising from contracts with customers. The latest date of mandatory implementation of IFRS 15 is January 1, 2018. The company has not yet evaluated the impact on the consolidated financial statements.

- IFRS 16, Leases (IFRS 16)

  On January 13, 2016, the IASB published a new standard, IFRS 16, Leases. The new standard will eliminate the distinction between operating and finance leases and will bring most leases on the consolidated balance sheets for lessees. This standard is effective for annual reporting periods beginning on or after January 1, 2019. The company intends to adopt IFRS 16 in its consolidated financial statements for the annual period beginning January 1, 2019, and will recognize assets and liabilities for all leases on the consolidated balance sheet.

- IFRS 2, Share-based Payments (IFRS 2)

  In June 2016, the IASB issued final amendments to IFRS 2, clarifying how to account for certain types of share-based payment transactions. The amendments, which were developed through the IFRS Interpretations Committee, provide requirements on the accounting for: (i) the effect of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; (ii) share-based payment transactions with a net settlement feature for withholding tax obligations; and (iii) a modification to the terms and conditions of a share-based payment that changes the classifications of the transaction from cash-settled to equity-settled. This standard is effective for annual reporting periods beginning on or after January 1, 2018. The company has not yet evaluated 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 consolidated financial statements

3 Critical accounting estimates and judgments

Critical accounting judgments

- Complex financial instruments

  The company makes various judgments when determining the accounting for certain complex financial instruments in 2015. The convertible notes represented a financial liability that included embedded derivatives related to the conversion options that required separation. The company elected an accounting policy choice to measure the convertible notes at fair value without separating the embedded derivatives. The company also applied judgments when allocating the fair value of the Knight Loan. The amount in excess of the proceeds received has been recorded as a general and administrative expense in 2015 and represents additional value provided to the company as a result of the Knight relationship.

Critical accounting estimates

The company makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are addressed as follows:

- Fair value of derivative liabilities, convertible notes and the Knight Loan

  The fair value of the derivative liabilities and convertible notes was determined using valuation techniques. The Knight Loan represents a financial liability and has various components and assumptions. The company uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period. Additional information is disclosed in notes 10, 11 and 12.

4 Qualifying transaction

The Transaction constitutes a reverse acquisition by PMI of Profound, a non-operating public enterprise. Profound, being an accounting acquiree, did not meet the definition of a business under IFRS 3, Business Combinations, and therefore the Transaction did not qualify as a business combination. PMI is deemed to have issued equity to the holders of the equity interests of Profound. Consequently, the Transaction is accounted for as a continuation of the consolidated financial statements of PMI, together with a deemed issuance on June 4, 2015 of shares and options by the resulting company for the net assets and the listing status of Profound accounted for in accordance with IFRS 2, Share-based Payments. The identifiable assets and liabilities of Profound are recognized at fair value as at the acquisition date, with the excess of the fair value of the equity interest over the fair value of the net assets issued charged to the consolidated statements of loss and comprehensive loss as listing expense.

The consolidated statements of loss and comprehensive loss includes the full results of PMI for the period from January 1, 2015 to June 4, 2015.

	June 4, 2015 $
Fair value of 2,200,009 Profound shares	3,300,000
Fair value of 146,667 Profound share options	93,577
Fair value of 73,333 Profound compensation options	52,262
Less: Cash acquired	1,157,535
Less: Prepaids acquired	3,033
Less: Other assets acquired	227,037
Listing expense	2,058,234

The fair value components relating to the share options and compensation options were determined using the Black-Scholes option pricing model using the following assumptions:

	Share options	**Compensation options**
Volatility	103%	103%
Expected life of options	1.0 years	1.3 years
Risk-free interest rate	1.12%	1.12%
Dividend yield	nil	nil

5 Short-term investments

Short-term investments consist of guaranteed investment certificates with maturities of three months to one year, liquid investments that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value. The objectives for holding short-term investments are to invest excess cash resources in investment vehicles that provide a better rate of return compared to interest bearing bank accounts with limited risk to the principal invested.

6 Inventory

	2016 $	2015 $
Finished goods	545,051	-
Inventory provision	(128,228)	-
Total inventory	416,823	-

7 Property and equipment

Property and equipment consist of the following:

	Furniture and fittings $	Research equipment $	Leasehold improvements $	Computer equipment $	Computer software $	Total $
Year ended December 31, 2015						
Opening net book value	26,530	104,793	11,876	25,038	10,391	178,628
Additions	29,676	10,979	-	58,725	67,629	167,009
Depreciation	(8,274)	(33,085)	(6,481)	(24,481)	(44,204)	(116,525)
Closing net book value	47,932	82,687	5,395	59,282	33,816	229,112
At December 31, 2015						
Cost	83,248	249,740	25,924	148,291	194,030	701,233
Accumulated depreciation	(35,316)	(167,053)	(20,529)	(89,009)	(160,214)	(472,121)
Net book value	47,932	82,687	5,395	59,282	33,816	229,112
Year ended December 31, 2016						
Opening net book value	47,932	82,687	5,395	59,282	33,816	229,112
Additions	151,921	152,552	552,637	44,390	-	901,500
Disposals	-	-	-	-	(10,248)	(10,248)
Depreciation	(26,652)	(54,844)	(27,884)	(34,387)	(23,568)	(167,335)
Closing net book value	173,201	180,395	530,148	69,285	-	953,029
At December 31, 2016						
Cost	235,169	402,292	578,561	192,681	176,462	1,585,165
Accumulated depreciation	(61,968)	(221,897)	(48,413)	(123,396)	(176,462)	(632,136)
Net book value	173,201	180,395	530,148	69,285	-	953,029

Depreciation expense of $2,780 (2015 - $nil) is included in research and development expenses and depreciation expense of $164,555 (2015 - $116,525) is included in selling, general and administrative expenses.

8 Intangible assets

Intangible assets consist of the following:

	Licence Agreement $	Software $	Total $
Year ended December 31, 2015			
Opening net book value	35,000	-	35,000
Amortization	(2,500)	-	(2,500)
Closing net book value	32,500	-	32,500
At December 31, 2015			
Cost	50,000	-	50,000
Accumulated amortization	(17,500)	-	(17,500)
Net book value	32,500	-	32,500
Year ended December 31, 2016			
Opening net book value	32,500	-	32,500
Additions	-	249,858	249,858
Amortization	(2,500)	(17,173)	(19,673)
Closing net book value	30,000	232,685	262,685
At December 31, 2016			
Cost	50,000	249,858	299,858
Accumulated amortization	(20,000)	(17,173)	(37,173)
Net book value	30,000	232,685	262,685

Amortization of $2,500 (2015 - $2,500) is included in research and development expenses and amortization of $17,173 (2015 - $nil) is included in selling, general and administrative expenses.

The company has a licence agreement (the licence) with Sunnybrook Health Sciences Centre (Sunnybrook), pursuant to which Sunnybrook licenses to the company certain intellectual property. Pursuant to the licence, the company has exclusively licensed-in rights that enable the company to use Sunnybrook's technology for MRI-guided trans-urethral ultrasound therapy. Under the licence, the company is subject to various obligations, including milestone payments of up to $250,000 (upon FDA approval) and legal costs associated with patent application preparation, filing and maintenance. Subject to certain buy out provisions as defined in the licence, the company has the option to acquire ownership of the licensed technology and intellectual property. In addition, the company has a further option to acquire rights to improvements to the relevant technology and intellectual property. If the company fails to comply with any of its obligations or otherwise breaches this agreement, Sunnybrook may have the right to terminate the licence.

9 Provisions

	2016 $	2015 $
Balance - Beginning of year	-	-
Addition	37,509	-
Accretion expense	2,110	-
Balance - End of year	39,619	-
Less: Current portion	-	-
Non-current portion	39,619	-

Provisions of $39,619 (2015 - $nil) are comprised of an asset retirement obligation related to the company's leasehold improvements.

10 Convertible notes

On January 27, 2015, PMI closed a financing of secured convertible notes (the Notes) with the existing preferred shareholders in the principal amount of $1,500,000, which were to mature on January 27, 2016. The Notes accrued interest at a rate of 12% per annum. All or any part of the Notes could have been converted at any time after February 20, 2015 at a conversion price per preferred share equal to the Series A2 preferred share conversion price at the option of the holder. In accordance with the original terms of the Notes, in the event that a qualifying financing occurs, all of the Notes would automatically convert into the class or series of preferred shares, common shares or units acquired by the new investors at a price per share or unit equal to 75% of the price paid. On April 20, 2015, the Notes were amended to eliminate the discount such that the Notes automatically convert at a price per common share or unit equal to 100% of the price paid by the new investors.

The Notes represented a financial liability that included embedded derivatives related to the conversion options that required separation. The company had elected an accounting policy choice to measure the Notes at fair value without separating the embedded derivatives. The Notes were re-measured at fair value at each period with any changes recognized in the consolidated statements of loss and comprehensive loss. On initial recognition, the fair value of the Notes was estimated at $3,594,565 due to the significant value associated with the conversion features, and the difference between the fair value and the amount of proceeds of $1,500,000 was recognized in the consolidated statements of loss and comprehensive loss in the amount of $2,094,565 during the year ended December 31, 2015.

During the period from January 27, 2015 to June 4, 2015, the company recognized a gain on change in fair value on the Notes of $334,680 and the fair value of the Notes at June 4, 2015 was $3,259,885.

During the year ended December 31, 2015, the company recognized $63,500 of interest expense on the Notes (note 17).

Pursuant to the terms of the Notes and in conjunction with the Transaction (note 1) on June 4, 2015, the principal and accrued interest of the Notes were converted into 1,042,333 common shares at a price of $1.50 per common share and $1,563,500 was transferred to share capital. A fair value gain on conversion of the Notes of $1,759,885 was recognized in the consolidated statements of loss and comprehensive loss for the year ended December 31, 2015.

The Notes were considered a Level 3 financial instrument in the fair value hierarchy because there are significant unobservable inputs. The assumptions used in the calculation of fair value are as follows:

	January 27, 2015	**June 4, 2015**
Credit spread	23%	29%
Expected volatility	106%	102%
Share price	$1.50	$1.50
Expected dividends	nil	nil

11 Long-term debt

A summary of the long-term debt is as follows:

	2016 $	**2015 $**
FedDev and HTX loans	2,027,893	2,150,471
Knight loan	4,609,983	3,696,903
Balance - End of period	6,637,876	5,847,374
Less: Current portion	(2,877,050)	(286,700)
Non-current portion	3,760,826	5,560,674

The Federal Economic Development Agency (FedDev) loan is unsecured and non-interest bearing, with total proceeds of $867,000. Repayments of $14,450 commenced on April 1, 2015, followed by 48 monthly instalments of $7,225 from May 1, 2015 to April 1, 2019, and 11 monthly instalments of $45,977 from May 1, 2019 to March 1, 2020. These repayment terms are the result of an amendment to the agreement dated June 2, 2015 and replace the previous repayment terms of 60 monthly payments of $14,450. As at December 31, 2016, the principal balance outstanding on this loan is $708,050 (2015 - $794,750).

During the year, the company recognized $57,076 of interest and accretion expense on this loan (2015 - $62,184).

The Health Technology Exchange (HTX) loans with total proceeds of $1,500,000 are unsecured, bearing interest at 4.50% per annum, with remaining annual repayments on March 31, 2017 for $500,000 and March 31, 2018 for $1,094,698 representing the balance of the obligations under each of the loan agreements including accrued interest to March 31, 2018. As at December 31, 2016, the principal balance outstanding on this loan was $1,300,000 (2015 - $1,500,000).

During the year, the company recognized $107,046 of interest and accretion expense on these loans (2015 - $144,633).

A reconciliation of the FedDev and HTX loans is as follows:

	2016 $	2015 $
Balance - Beginning of year	2,150,471	2,079,472
Gain on extinguishment of long-term debt	-	(63,568)
Repayment	(286,700)	(72,250)
Interest and accretion expense	164,122	206,817
Balance - End of year	2,027,893	2,150,471
Less: Current portion	(586,700)	(286,700)
Non-current portion	1,441,193	1,863,771

On April 30, 2015, PMI signed an agreement with Knight Therapeutics Inc. (Knight) to provide a secured loan of $4,000,000 (the Knight Loan) for an initial period of four years with an interest rate of 15% per annum, with payments of interest and principal deferred until June 30, 2017. The company has the option to extend the loan for up to four successive additional 12-month periods subject to certain conditions. The Knight Loan was drawn on as part of the closing of the Transaction (note 1). Repayments commence on June 30, 2017 with a payment of $1,427,258 followed by seven quarterly instalments of $285,714 plus accrued interest from September 30, 2017 to March 31, 2019, and a final instalment of $2,052,603 on June 3, 2019. As part of the agreement, Knight was also granted a royalty of 0.5% on net sales resulting from global sales of the company's product for the duration of the Knight Loan (the royalty). In addition, the company also entered into a distribution, licence and supply agreement with Knight pursuant to which Knight will act as the exclusive distributor of the company's product in Canada for an initial ten-year term, renewable for successive ten-year terms by either party. In connection with these arrangements, the company issued to Knight 4% of the common shares of the company (1,717,450 common shares) after giving effect to the Transaction (the Knight shares).

The Knight Loan represented a financial liability that includes embedded derivatives that required separation. The prepayment and extension features represent embedded derivatives that are combined for measurement purposes and are recorded at fair value on initial recognition. The embedded derivatives are remeasured at fair value at each period with any changes recognized in the consolidated statements of loss and comprehensive loss. The host financial liability component is recorded as the residual amount net of transaction costs on initial recognition and is accreted to the principal amount over the contractual life using the effective interest rate method. At December 31, 2016 the fair value of the embedded derivatives was $nil (2015 - $nil).

In addition, the company recorded in share capital the fair value of the Knight shares issued concurrently with the Knight Loan and recorded a financial liability for the fair value of the royalty. The amount of $2,303,034 in excess of proceeds received of $4,000,000 was recorded as a selling, general and administrative expense and represents additional value provided to the company as a result of the Knight relationship.

A reconciliation of the Knight Loan balance including the allocation to the various components net of transaction costs allocated using the relative fair value method is as follows:

	2016 $	2015 $
Balance - Beginning of period	3,696,903	-
Cash proceeds on issuance of Knight Loan	-	4,000,000
Embedded derivatives asset	-	1,764
Fair value of Knight shares	-	(2,483,810)
Fair value of royalty	-	(359,016)
Transaction costs	-	(226,049)
Selling, general and administrative expense	-	2,303,034
Interest and accretion expense	913,080	460,980
Balance - End of period	4,609,983	3,696,903
Less: Current portion	(2,290,350)	-
Non-current portion	2,319,633	3,696,903

The royalty was initially recorded at fair value and subsequently carried at amortized cost using the effective interest rate method. The initial fair value of the royalty was determined using future revenue forecasts for the term of the loan and a discount rate of 18%. During the year, the company revised the fair value of the royalty, using future revenue forecasts for the term of the loan and a discount rate of 18%, and recognized an interest accretion recovery of $249,413 (2015 - accretion expense of $38,798). The current portion of this liability as at December 31, 2016 is $39,357 (2015 - $nil) and non-current portion is $109,044 (2015 - $397,814).

12 Preferred shares

The Series A preferred shares were convertible, at the option of the holder, into common shares at a conversion ratio of 1:1 plus that number of common shares calculated as equal to, at the date of conversion, the result of dividing (a) an amount equal to 8% per annum compounded annually on the initial purchase price of the Series A preferred shares (and less any dividends previously paid on the Series A preferred shares) by (b) the fair value of a common share, subject to anti-dilution adjustments. The Series A preferred shares convert automatically into common shares on the earlier of: (a) the closing of a qualified IPO (as such term is defined in the share terms with respect to the Series A preferred shares); or (b) the approval of the holders of at least 70% of the outstanding Series A preferred shares. On conversion, an amount equal to 8%, compounded annually, on the initial purchase price, less any dividends previously paid on such shares is converted into common shares based on the fair value of a common share with an option for the holder to sell the shares back to the company immediately following conversion for a cash payment.

The Series A preferred shares were redeemable for cash at the option of the holders of at least 70% of the Series A preferred shares requesting redemption. The Series A preferred shares were redeemable on or after the fifth anniversary of the most recent date on which the Series A preferred shares were issued. The redemption price would have been equal to the initial purchase price plus an amount equal to 8%, compounded annually on the initial purchase price, less any dividends previously paid on such shares.

Preferred shares represented a financial liability that includes multiple embedded derivatives that require separation. The conversion and redemption features represent embedded derivatives that are combined for measurement purposes and are recorded at fair value on initial recognition. The embedded derivatives are remeasured at fair value at each period with any changes recognized in the consolidated statements of loss and comprehensive loss. The host financial liability component is recorded as the residual amount net of transaction costs on initial recognition and is accreted to the redemption price of the preferred shares over their expected life using the effective interest rate method.

Pursuant to the terms of the preferred share agreement and in conjunction with the Transaction (note 1), on June 4, 2015, the preferred shares were converted into 16,309,894 common shares at the price of $1.50 per common share.

	2016 $	2015 $
Balance - Beginning of year	-	9,707,445
Accretion expense (including accelerated accretion)	-	4,846,840
Accrued dividends	-	481,354
Conversion to share capital	-	(15,035,639)
Balance - End of year	-	-

The embedded derivatives were valued using an option pricing model and were considered a Level 3 financial instrument in the fair value hierarchy because there are significant unobservable inputs. The assumptions used in the option pricing model for each period were as follows:

	June 4, 2015
Credit spread	29%
Expected volatility	102%
Share price	$1.50
Expected dividends	nil

The following is a reconciliation of the movement in the embedded derivatives:

	2016 $	2015 $
Balance - Beginning of year	-	25,719,860
Change in fair value of the embedded derivatives	-	(2,086,416)
Conversion to share capital	-	(23,633,444)
Balance - End of year	-	-

13 Share capital

Authorized
Unlimited common shares

Issued and outstanding (with no par value)

	2016 $	2015 $
55,305,577 (2015 - 39,473,327) common shares	83,272,678	67,082,821

On April 30, 2015, PMI completed a brokered private placement of subscription receipts for gross proceeds of $24,008,828 ($21,000,437, net of transaction costs), representing 16,005,885 subscription receipts at a price of $1.50 per subscription receipt. Each subscription receipt issued in the private placement was exchangeable for one common share of PMI upon the satisfaction of certain conditions related to the Transaction (note 1). In conjunction with the private placement, a total of 576,235 compensation options were granted to the agents with each compensation option exercisable into one common share at a price of $1.50 for a period of two years (note 14).

On June 4, 2015, the company completed the Transaction (note 1) resulting in the issuance of 2,200,009 common shares to the former Profound shareholders, the issuance of 16,005,885 common shares on exchange of the subscription receipts issued in the private placement, the issuance of 1,042,333 common shares upon conversion of the principal and accrued interest of the Notes at the price of $1.50 per common share, the issuance of 16,309,894 upon conversion of the preferred shares and accrued dividends at the price of $1.50 per common shares, and the issuance of 1,717,450 common shares to Knight representing 4% of the common shares of the company after giving effect to the Transaction.

On November 14, 2016, the company closed a bought deal prospectus offering (the offering), resulting in the issuance of 15,820,000 common shares, at a price of $1.10 per common share for gross proceeds of $17,402,000 ($16,182,997, net of transaction costs).

14 Share-based payments

Share options

As a result of the Transaction (note 1), effective June 4, 2015, the company adopted a new share option plan (the Share Option Plan). All grants of share options to employees, officers and consultants after June 4, 2015 are made from the Share Option Plan. The maximum number of common shares reserved for issuance under this plan is 4,733,079 common shares or such other number as may be approved by the holders of the voting shares of the company. As at December 31, 2016, 4,689,839 options are outstanding. Each option granted allows the holder to purchase one common share, at an exercise price not less than the lesser of the closing trading price of the common shares on the TSX Venture Exchange, on the date a share option is granted and the volume-weighted average price of the common shares for the five trading shares immediately preceding the date the share option is granted. Share options granted under the Share Option Plan generally have a maximum term of 10 years and vest over a period of up to four years. In addition to the time-based vesting schedule, under the previous share option plan, the company has also granted share options subject to a modified vesting schedule based on the company achieving certain milestones relating to its technology.

As a result of the Transaction (note 1), effective June 4, 2015, each former Profound share option holder received one share option to purchase common shares of the company for every 13.6363 share options they exchanged in the Transaction. In addition, 73,334 share options were cancelled as part of the Transaction. As a result, 146,667 share options were issued to former Profound share option holders. These share options expired during the year.

A summary of the share option changes during the years presented and the total number of share options outstanding as at those dates are set forth below:

	Number of options	Weighted average exercise price $
Balance - January 1, 2015	1,232,312	0.24
Granted	2,384,364	1.50
Exercised	(30,990)	0.24
Forfeited	(325,070)	1.50
Profound share options (after consolidation)	146,667	1.36
Balance - December 31, 2015	3,407,283	1.05
Balance - January 1, 2016	3,407,283	1.05
Granted	1,650,696	1.33
Exercised	(12,250)	0.30
Forfeited/expired	(355,890)	1.44
Balance - December 31, 2016	4,689,839	1.13

The following table summarizes information about the share options outstanding as at December 31, 2016:

Exercise price $	Number of options outstanding	Weighted average remaining contractual life (years)	Number of options exercisable
0.24	1,124,562	4.85	995,528
0.30	45,500	2.26	45,500
1.10	554,141	9.99	-
1.35	132,500	9.73	-
1.46	964,055	9.72	-
1.50	1,869,081	8.57	698,339
	4,689,839	8.06	1,739,367

The company estimated the fair value of the share options granted during the year using the Black-Scholes option pricing model with the following weighted average assumptions. Due to the absence of company specific volatility rates, the company chose comparable companies in the medical device industry.

	May 4, 2016	July 9, 2016	August 22, 2016	September 15, 2016	November 24, 2016
Volatility	73%	73%	101%	99%	99%
Expected life of share options	6 years	6 years	6 years	6 years	6 years
Risk-free interest rate	1.18%	0.89%	0.86%	0.82%	0.94%
Dividend yield	nil	nil	nil	nil	nil

	April 30, 2015	September 8, 2015	December 7, 2015
Volatility	103%	78%	75%
Expected life of share options	5 years	6 years	6 years
Risk-free interest rate	1.12%	1.13%	1.33%
Dividend yield	nil	nil	nil

Compensation expense related to share options recorded in the consolidated statements of loss and comprehensive loss for the year was $1,001,558 (2015 - $644,733).

Compensation options

As a result of the Transaction (note 1), effective June 4, 2015, each former Profound compensation option holder received one compensation option to purchase common shares of Profound for every 13.6363 compensation options they exchanged in the Transaction (note 1). As a result, 73,333 compensation options were issued to Profound's IPO agent. These compensation options expired during the year.

In connection with the private placement, PMI issued 576,235 compensation options to the agents to purchase common shares of PMI which upon completion of the Transaction (note 1) were exchanged for compensation options to purchase common shares of Profound.

A summary of the compensation option changes during the year and the total number of compensation options outstanding is set forth below:

	Number of compensation options	Weighted average exercise price $
Balance - January 1, 2015	-	-
Granted	576,235	1.50
Profound compensation options (after consolidation)	73,333	1.36
Balance - December 31, 2015	649,568	1.48
Balance - January 1, 2016	649,568	1.48
Expired	(73,333)	1.36
Balance - December 31, 2016	576,235	1.50

The following table summarizes information about the compensation options outstanding as at December 31, 2016:

Exercise price $	Number of compensation options outstanding	Weighted average remaining contractual life (years)	Number of compensation options exercisable
1.50	576,235	0.43	576,235

The company estimated the fair value of the compensation options issued during the year ended December 31, 2015 as part of the private placement using the Black-Scholes option pricing model with the following weighted average assumptions. Due to the absence of company specific volatility rates, the company chose comparable companies in the medical device industry.

Volatility	103%
Expected life of compensation options	2 years
Risk-free interest rate	1.12%
Dividend yield	nil

The fair value of the compensation options issued as part of the private placement was $465,072 and was recorded in contributed surplus during the year ended December 31, 2015.

15 Research and development expenses

	2016 $	2015 $
Materials	3,125,364	2,483,423
Salaries and benefits	3,680,727	2,282,386
Share-based compensation	109,328	-
Consulting fees	1,156,548	232,558
Travel	259,553	148,235
Rent	334,403	158,839
Other	431,901	135,958
Clinical trial costs	1,016,182	307,313
Contractors	136,386	83,440
Amortization of intangible assets	2,500	2,500
Depreciation of property and equipment	2,780	-
Investment tax credits	(266,979)	(697,804)
	9,988,693	5,136,848

The company's claim for scientific research and experimental development deductions and related expenses for income tax purposes is based on management's interpretation of the applicable legislation in the Income Tax Act (Canada).

16 Selling, general and administrative expenses

	2016 $	2015 $
Salaries and benefits	1,961,474	1,343,542
Professional and consulting fees	1,474,716	1,092,465
Marketing expense (note 11)	-	2,303,034
Share-based compensation	892,230	644,733
Travel	323,688	279,426
Rent	226,475	59,545
Office and other	581,162	246,779
Depreciation of property and equipment	164,555	116,525
Amortization of intangible assets	17,173	-
Loss on disposal of property and equipment	10,248	-
	5,651,721	6,086,049

17 Interest and accretion expense

	2016 $	2015 $
HTX and FedDev loans (note 11)	164,122	206,817
Knight Loan (note 11)	913,080	460,980
Royalty interest accretion (note 11)	(249,413)	38,798
Provisions (note 9)	2,110	-
Preferred shares (note 12)	-	4,846,840
Convertible notes (note 10)	-	63,500
Other	-	8,322
	829,899	5,625,257

18 Income taxes

Income tax expense differs from the tax recovery amount that would be obtained by applying the statutory income tax rate to the respective year's net loss before income taxes as follows:

	2016 $	2015 $
Net loss before income taxes	(16,312,715)	(17,101,812)
Recovery based on combined federal and provincial statutory rate of 26.5% (2015 - 26.5%)	(4,322,869)	(4,531,980)
Permanent differences	(802,664)	1,142,900
Change in deferred tax assets not recognized	4,789,529	2,598,734
Change in tax rates, true-ups and other	350,058	64,275
Net income tax expense (recovery)	14,054	(726,071)

Deferred tax assets are recognized for tax loss carry-forwards to the extent that the realization of the related tax benefit through future taxable profits is probable. The company did not recognize deferred tax assets that can be carried forward against future taxable income.

Permanent differences are primarily comprised of non-refundable tax credits and deductible finance fees not recorded in the consolidated statements of loss and comprehensive loss offset by non-deductible share-based compensation and accretion expense. In 2015, the permanent differences were primarily comprised of share-based compensation, preferred share dividend expense, change in fair value of derivatives, accretion expense, non-deductible marketing expense and listing expense.

The company has non-capital loss carry-forwards of approximately $24,440,000 at December 31, 2016 that expire in varying amounts from 2028 to 2036.

The company has SR&ED expenditures of approximately $11,600,000 at December 31, 2016, which can be carried forward indefinitely to reduce future years' taxable income.

The company has approximately $1,830,000 of federal and provincial tax credits that are available to be applied against federal and provincial taxes otherwise payable in future years and expire in varying amounts from 2028 to 2036.

If the holders of the preferred shares were paid, or deemed to have been paid, any dividends on such shares, the company would have become liable for the payment of taxes under Part VI.1 of the Income Tax Act (Canada). On conversion of the preferred shares, no dividends were paid or deemed paid and therefore the company reversed the taxes payable amount on the consolidated balance sheet and recognized a Part VI.1 tax recovery for the year ended December 31, 2015 of $726,071.

19 Loss per share

The following table shows the calculation of basic and diluted loss per share:

	2016 $	2015 $
Net loss for the year	16,326,769	16,375,741
Basic and diluted weighted average number of shares outstanding	41,510,145	23,683,822
Basic and diluted loss per share	0.39	0.69

For the years noted above, the computation of diluted loss per share is equal to the basic loss per share due to the anti-dilutive effect on the share options and compensation options.

Of the 4,689,839 (2015 - 3,407,283) share options and 576,235 (2015 - 649,568) compensation options not included in the calculation of diluted loss per share for the year ended December 31, 2016, 2,315,602 (2015 - 1,847,024) were exercisable.

20 Financial assets and liabilities

Classification of financial instruments

The classification of financial assets and liabilities is as follows:

	2016	
	Loans and receivables $	**Other financial liabilities $**
Cash	20,833,061	-
Accounts payable and accrued liabilities	-	1,771,427
Long-term debt	-	6,637,876
Other liability	-	148,401
	20,833,061	8,557,704

	2015	
	Loans and receivables $	**Other financial liabilities $**
Cash	10,522,520	-
Short-term investment	10,000,000	-
Accounts payable and accrued liabilities	-	980,278
Long-term debt	-	5,847,374
Other liability	-	397,814
	20,522,520	7,225,466

Credit risk

Credit risk is the risk of a financial loss to the company if a counterparty to a financial instrument fails to meet its contractual obligation. The company is exposed to credit risk on its cash and short-term investment balances. The company's cash management policies include ensuring that cash is deposited in Canadian chartered banks.

Market risk

Market risk is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, including interest rate risk and foreign currency risk.

- Interest rate price risk

  Interest rate price risk is the risk the cash flows of a financial instrument will fluctuate due to changes in market interest rates. The company is not exposed to such fluctuations relating to the long-term debt, as it either bears no interest or bears interest at a fixed rate.

- Foreign currency risk

  Foreign currency risk occurs as a result of foreign exchange rate fluctuations between the time a transaction is recorded and the time it is settled.

  The company purchases goods and services denominated in foreign currencies and, accordingly, is subject to foreign currency risk. As at December 31, 2016, the company's cash included ($98,567) (2015 - $5,758) denominated in United States dollars, $22,321 (2015 - $488) denominated in euros and $878 (2015 - $nil) denominated in British pounds. In addition, the company's accounts payable and accrued liabilities included $607,537 (2015 - $351,794) denominated in United States dollars and $179,462 (2015 - $451) denominated in euros.

  As at December 31, 2016, if foreign exchange rates had been 5% higher, with all other variables held constant, loss before income taxes would have been $35,569 (2015 - $17,300) higher, mainly as a result of the translation of foreign currency denominated cash and accounts payable and accrued liabilities.

  The company does not use derivatives to reduce exposure to foreign currency risk.

Liquidity risk

Liquidity risk is the risk the company will encounter difficulties in meeting its financial liability obligations as they come due. The company has a planning and budgeting process in place to help determine the funds required to support the company's normal operating requirements on an ongoing basis.

The company controls liquidity risk through management of working capital, cash flows and the availability and sourcing of financing. The company's ability to accomplish all of its future strategic plans is dependent on obtaining additional financing or executing other strategic options; however, there is no assurance that the company will achieve these objectives.

The following table summarizes the company's significant contractual, undiscounted cash flows related to its financial liabilities.

					2016
	Carrying amount $	Future cash flows $	Less than 1 year $	Between 1 year and 5 years $	Greater than 5 years $
Accounts payable and accrued liabilities	1,771,427	1,771,427	1,771,427	-	-
Long-term debt	6,637,876	8,608,401	2,877,050	5,731,351	-
Other liability	148,401	230,375	39,357	191,018	-
	8,557,704	10,610,203	4,687,834	5,922,369	-

					2015
	Carrying amount $	Future cash flows $	Less than 1 year $	Between 1 year and 5 years $	Greater than 5 years $
Accounts payable and accrued liabilities	980,278	980,278	980,278	-	-
Long-term debt	5,847,374	8,069,307	286,700	7,782,607	-
Other liability	397,814	736,337	-	736,337	-
	7,225,466	9,785,922	1,266,978	8,518,944	-

Fair value

The fair values of cash, short-term investment and accounts payable and accrued liabilities approximate their carrying values, due to their relatively short periods to maturity.

The fair value of the long-term debt is $6,637,876 (2015 - $5,847,374) and has been determined based on discounted cash flows and other assumptions which are within Level 3 of the fair value hierarchy (note 11).

21 Related party transactions

Key management includes the company's directors and senior management team. The remuneration of directors and the senior management team was as follows during the years ended December 31:

	2016 $	2015 $
Salaries and employee benefits	1,247,563	1,299,855
Director's fees	63,616	76,092
Share-based compensation	862,798	594,944
	2,173,977	1,970,891

Executive employment agreements allow for additional payments in the event of a liquidity event, or if the executive is terminated without cause.

Transactions

Research and development expenses include $nil of regulatory professional fees which flowed through a company controlled by an executive officer (2015 - $6,000).

Research and development expenses include $13,333 of director fees related to the company's US subsidiary paid to an individual related to an executive officer (2015 - $nil).

22 Commitments and contingencies

The company has commitments under operating leases for the rental of office space. On March 28, 2016, the company signed a lease for new office space and took possession of this office space effective July 1, 2016. Included in prepaid expenses and deposits is an amount of $450,000 related to prepaid rent for this lease that is drawn down at $10,000 per month. The future minimum obligation under these leases is as follows:

	$
No later than 1 year	395,317
Later than 1 year and no later than 5 years	2,056,779
Later than 5 years	2,747,722
	5,199,818

In 2016, the company signed an agreement that includes revenue sharing with a minimum amount payable of US$3,500,000 over the next five years.

In the event the company repays the Knight Loan before the end of the term, it would be subject to a prepayment fee. The prepayment fee is the greater of the total unpaid annual interest that would have been payable during the year in which the prepayment is made and (a) $400,000 - if repaid between May 22, 2016 and May 21, 2017; or (b) $200,000 - if repaid between May 22, 2017 to maturity.

All directors and officers of the company are indemnified by the company for various items including, but not limited to, all costs to settle lawsuits or actions due to their association with the company, subject to certain restrictions. The company has purchased directors' and officers' liability insurance to mitigate the cost of any potential future lawsuits or actions. The term of the indemnification is not explicitly defined, but is limited to events for the period during which the indemnified party served as a director or officer of the company. The maximum amount of any potential future payment cannot be reasonably estimated but could have a material adverse effect on the company.

The company has also indemnified the underwriters in relation to the offering disclosed in note 13 and their respective affiliates and directors, officers, employees, shareholders, partners, advisers and agents and each other person, if any, controlling any of the underwriters or their affiliates against certain liabilities.

23 Capital management

The company's capital management objectives are to safeguard its ability to continue as a going concern and to provide returns for shareholders and benefits for other stakeholders by ensuring it has sufficient cash resources to fund its research and development activities, to pursue its eventual commercialization efforts and to maintain its ongoing operations. The company includes its share capital, deficit and long-term debt in the definition of capital.

A summary of the company's capital structure is as follows:

	2016 $	2015 $
Common shares	83,272,678	67,082,821
Deficit	(71,448,330)	(55,121,561)
Long-term debt	6,637,876	5,847,374
	18,462,224	17,808,634

24 Segment reporting

The chief executive officer and the chief operating officer are the company's chief operating decision makers (CODM). Management has determined that there are two geographic segments, Germany and Canada, which are aggregated into one segment. The CODM reviews the consolidated operating results regularly to make decisions about the allocation of the company's resources and to assess overall performance.

25 Subsequent event

On January 26, 2017, the shareholders approved the adoption of certain amendments to the company's stock option plan. The amendment increased the number of shares available for grant to 7,189,725. On December 21, 2016, 1,417,583 share options were granted to an executive officer contingent on the amendments to the stock option plan being approved. Subsequent to the approval, these share options were granted.