

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

Consolidated Financial Statements
December 31, 2015 and 2014

March 1, 2016

Independent Auditor's Report

**To the Shareholders of
Profound Medical Corp.
(formerly Mira IV Acquisition Corp.)**

We have audited the accompanying consolidated financial statements of Profound Medical Corp. and its subsidiary, which comprise the consolidated balance sheets as at December 31, 2015 and December 31, 2014 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.

PricewaterhouseCoopers LLP
PwC Centre, 354 Davis Road, Suite 600, Oakville, Ontario, Canada L6J 0C5
T: +1 905 815 6300, F: +1 905 815 6499

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Profound Medical Corp. and its subsidiary as at December 31, 2015 and December 31, 2014 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, 2015 and 2014

	2015 \$	2014 \$
Assets		
Current assets		
Cash	10,522,520	406,495
Short-term investment (note 5)	10,000,000	-
HST receivable and other assets	92,479	100,640
Investment tax credits receivable	173,000	1,274,899
Deferred costs	-	565,632
Prepays and deposits	139,305	47,782
	<u>20,927,304</u>	<u>2,395,448</u>
Property and equipment (note 6)	229,112	178,628
Intangible assets (note 7)	32,500	35,000
	<u>21,188,916</u>	<u>2,609,076</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	980,278	1,616,949
Bank loan (note 8)	-	700,000
Long-term debt (note 10)	286,700	130,050
Preferred shares (note 11)	-	9,707,445
Derivatives (note 11)	-	25,719,860
	<u>1,266,978</u>	<u>37,874,304</u>
Long-term debt (note 10)	5,560,674	1,949,422
Other liability (note 10)	397,814	-
Income taxes payable (note 17)	-	726,071
	<u>7,225,466</u>	<u>40,549,797</u>
Shareholders' Equity (Deficiency)		
Share capital (note 12)	67,082,821	39,487
Contributed surplus	2,002,190	765,612
Deficit	<u>(55,121,561)</u>	<u>(38,745,820)</u>
	<u>13,963,450</u>	<u>(37,940,721)</u>
	<u>21,188,916</u>	<u>2,609,076</u>
Commitment and contingencies (note 21)		

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, 2015 and 2014

	2015 \$	2014 \$
Expenses		
Research and development (note 14)	5,136,848	2,306,683
General and administrative (note 15)	6,086,049	2,032,074
Total operating expenses	<u>11,222,897</u>	<u>4,338,757</u>
Government grants (notes 10 and 14)	<u>-</u>	<u>(167,498)</u>
Finance costs - net		
Preferred share dividend expense (note 11)	481,354	1,070,637
Interest and accretion expense (note 16)	5,625,257	1,007,750
Interest income	(137,710)	(8,527)
Listing expense (note 4)	2,058,234	-
Loss on recognition of convertible notes (note 9)	2,094,565	-
Change in fair value of convertible notes (note 9)	(334,680)	-
Gain on conversion of convertible notes (note 9)	(1,759,885)	-
(Gain) loss on extinguishment of long-term debt (note 10)	(63,568)	56,515
Change in fair value of derivatives (note 11)	(2,084,652)	1,639,382
Total finance costs	<u>5,878,915</u>	<u>3,765,757</u>
Net loss before income taxes	17,101,812	7,937,016
Part VI.1 tax expense (recovery) (note 17)	<u>(726,071)</u>	<u>267,393</u>
Net loss and comprehensive loss for the year	<u>16,375,741</u>	<u>8,204,409</u>
Basic and diluted weighted average shares outstanding (note 18)	23,683,822	2,166,766
Basic and diluted net loss per common share (note 18)	0.69	3.79

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, 2015 and 2014

	Number of shares	Share capital \$ (note 12)	Contributed surplus \$	Deficit \$	Total \$
Balance - January 1, 2014	2,166,766	39,487	575,279	(30,541,411)	(29,926,645)
Share-based payments	-	-	190,333	-	190,333
Net loss and comprehensive loss for the year	-	-	-	(8,204,409)	(8,204,409)
Balance - December 31, 2014	2,166,766	39,487	765,612	(38,745,820)	(37,940,721)
Issuance of common shares to Profound shareholders (note 4)	2,200,009	3,300,000	-	-	3,300,000
Issuance of common shares in connection with private placement net of transaction costs (note 12)	16,005,885	21,000,437	-	-	21,000,437
Issuance of common shares upon conversion of preferred shares (note 11)	16,309,894	38,669,083	-	-	38,669,083
Issuance of common shares upon conversion of convertible notes (note 9)	1,042,333	1,563,500	-	-	1,563,500
Issuance of common shares in connection with the Knight Loan (note 10)	1,717,450	2,483,810	-	-	2,483,810
Fair value of Profound compensation and share options (note 4)	-	-	145,839	-	145,839
Fair value of compensation options (note 13)	-	-	465,072	-	465,072
Share-based payments (note 13)	-	-	644,733	-	644,733
Exercise of stock options	30,990	26,504	(19,066)	-	7,438
Net loss and comprehensive 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

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, 2015 and 2014

	2015 \$	2014 \$
Cash provided by (used in)		
Operating activities		
Net loss for the year	(16,375,741)	(8,204,409)
Depreciation of property and equipment	116,525	82,396
Amortization of intangible asset	2,500	2,500
Preferred share dividend expense	481,354	1,070,637
Stock-based compensation	644,733	190,333
Loss on recognition of convertible notes	2,094,565	-
Change in fair value of convertible notes	(334,680)	-
Marketing expense	2,303,034	-
Listing expense	2,058,234	-
Gain on conversion of convertible notes	(1,759,885)	-
(Gain) loss on extinguishment of long-term debt	(63,568)	56,515
Change in fair value of derivatives	(2,084,652)	1,639,382
Government grant - long-term debt	-	(147,498)
Interest and accretion expense	5,625,257	1,007,750
Net changes in non-cash working capital balances		
Prepaid expenses and deposits	(88,490)	(3,019)
Accounts payable and accrued liabilities	(90,423)	849,798
Income taxes payable	(726,071)	267,393
Investment tax credits receivable	1,101,899	394,192
HST receivable and other assets	235,198	(85,119)
	<u>(6,860,211)</u>	<u>(2,879,149)</u>
Investing activities		
Cash acquired from Profound	1,157,535	-
Purchase of short-term investment	(10,000,000)	-
Purchase of property and equipment	(167,009)	(61,283)
	<u>(9,009,474)</u>	<u>(61,283)</u>
Financing activities		
Proceeds from bank loan	-	700,000
Proceeds from convertible notes	1,500,000	-
Proceeds from share option exercised	7,438	-
Issuance of common shares	24,008,828	-
Repayment of bank loan	(700,000)	(500,000)
Payment of long-term debt	(72,250)	-
Issuance of Series A preferred shares	-	1,750,000
Proceeds from long-term debt	4,000,000	836,700
Transaction costs paid	(2,749,984)	(19,384)
Interest paid	(8,322)	(26,285)
	<u>25,985,710</u>	<u>2,741,031</u>
Increase (decrease) in cash during the year	10,116,025	(199,401)
Cash - Beginning of year	406,495	605,896
Cash - End of year	<u>10,522,520</u>	<u>406,495</u>
Supplemental information		
Deferred costs included in accounts payable and accrued liabilities	-	546,248

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

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Notes to Consolidated Financial Statements

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1 Description of business

Profound Medical Corp. (Profound) and its subsidiary (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 3080 Yonge Street, Suite 4040, Toronto, Ontario, M4N 3N1.

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

Use of estimates and judgments

The preparation of consolidated financial statements in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board (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.

These consolidated financial statements were authorized for issue by the Board of Directors on March 1, 2016.

These consolidated financial statements comply with IFRS.

Profound Medical Corp.

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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 subsidiary of Profound is consolidated from the date the control is obtained. All intercompany transactions, balances, income and expenses on transactions with the subsidiary 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.

Foreign currency translation

Items included in the consolidated financial statements are measured using the currency of the primary economic environment in which the company operates (the functional currency). These consolidated financial statements are presented in Canadian dollars, which is Profound's functional and the company's presentation currency.

Foreign currency transactions are translated into the functional currency 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.

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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.

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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

Preferred shares contain both a financial liability and multiple embedded derivatives in accordance with the terms of the contractual arrangement. 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 is determined using pricing model techniques. It is subsequently re-measured at fair value through profit or loss.

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%
Research equipment	30%
Leasehold improvements	over the term of the lease
Computer equipment	45%
Computer software	100%

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 comprised of an exclusive licence agreement. The licence agreement is amortized on a straight-line basis in the consolidated statements of loss and comprehensive loss over its estimated useful life of 20 years.

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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.

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 profit 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 of the company.

Options currently outstanding vest over four years and have a contractual life of five 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 expenses 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.

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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 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 trial as measured by patient progression and the timing of various aspects of the 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 trials, or the services completed. Service provider status is then compared to the contractually obligated fee 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 earnings (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 options and preferred shares.

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

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adoption. In addition, the own credit 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 has not yet evaluated the impact on the consolidated financial statements.

3 Critical accounting estimates and judgments

Critical accounting judgements

- Complex financial instruments

The company makes various judgements when determining the accounting for certain complex financial instruments. 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 judgements 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 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 were 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

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on market conditions existing at the end of each reporting period. Additional information is disclosed in notes 9, 10 and 11.

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 Payment. 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 comparative figures that are presented in the consolidated financial statements are those of PMI. 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 stock options	93,577
Fair value of 73,333 Profound compensation options	52,262
Less: Cash acquired	1,157,535
Less: Prepays acquired	3,033
Less: Other assets acquired	<u>227,037</u>
Listing expense	<u>2,058,234</u>

The fair value component relating to the share options and compensation options was 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

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5 Short-term investment

Short-term investment consists 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 account with limited risk to the principal invested.

6 Property and equipment

Property and equipment consists of the following:

	Furniture and fittings \$	Research equipment \$	Leasehold improvements \$	Computer equipment \$	Computer software \$	Total \$
At December 31, 2013						
Cost	53,572	212,662	25,924	75,163	105,620	472,941
Accumulated depreciation	(20,410)	(94,649)	(7,567)	(49,933)	(100,641)	(273,200)
Net book value	33,162	118,013	18,357	25,230	4,979	199,741
Year ended December 31, 2014						
Opening net book value	33,162	118,013	18,357	25,230	4,979	199,741
Additions	-	26,099	-	14,403	20,781	61,283
Depreciation	(6,632)	(39,319)	(6,481)	(14,595)	(15,369)	(82,396)
Closing net book value	26,530	104,793	11,876	25,038	10,391	178,628
At December 31, 2014						
Cost	53,572	238,761	25,924	89,566	126,401	534,224
Accumulated depreciation	(27,042)	(133,968)	(14,048)	(64,528)	(116,010)	(355,596)
Net book value	26,530	104,793	11,876	25,038	10,391	178,628
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

Depreciation expense is included in general and administrative expenses.

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7 Intangible assets

	2015 \$	2014 \$
Licence agreement		
Cost	50,000	50,000
Accumulated amortization	17,500	15,000
	<hr/>	<hr/>
Net book value	32,500	35,000
	<hr/>	<hr/>

Amortization is included in research and development 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.

8 Bank loan

On July 25, 2014, the company entered into a non-revolving term facility in the amount of \$700,000. The facility bears interest at the prime interest rate plus a margin of 3%. The company was required to repay the loan at the earlier of February 28, 2015 or when the proceeds of the 2013 ITC claim were received. The facility was secured by a first ranking security interest on all property of the company. The company repaid its bank loan of \$700,000 on February 19, 2015.

On September 24, 2013, the company entered into a non-revolving term facility in the amount of \$500,000. The facility bore interest at the prime interest rate plus a margin of 3%. The company was required to repay the loan at the earlier of February 28, 2014 or when the proceeds of the 2012 ITC claim were received. The facility was secured by a first ranking security interest on all property of the company. The company repaid its bank loan of \$500,000 on February 19, 2014.

9 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 scheduled to mature on January 27, 2016. The Notes were subordinate to the bank loan and accrued interest at a rate of 12% per annum. All or any part of the Notes were convertible 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

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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 was recognized in the consolidated statements of loss and comprehensive loss in the amount of \$2,094,565 for the year.

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, the company recognized \$63,500 of interest expense on the Notes (note 16).

Pursuant to the terms of the Notes and in conjunction with the Transaction on June 4, 2015, the principal and accrued interest of the Notes were converted into 1,042,333 common shares at the price of \$1.50 per common share. The company recognized a gain on conversion of \$1,759,885, and \$1,563,500 was transferred to share capital which included the accrued interest of \$63,500.

The Notes are 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

10 Long-term debt

The Federal Economic Development Agency (FedDev) loan is non-secured, non-interest bearing, with financing of up to \$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 replaced the previous repayment terms of 60 monthly instalments of \$14,450. The change in repayment terms was considered to be substantial and has therefore been accounted for as an extinguishment, and the company recognized a gain of \$63,568. As at December 31, 2015, the principal balance outstanding on this loan is \$794,750 (December 31, 2014 - \$867,000).

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	May 26, 2014 \$
Cash received	86,700
Fair value of loan received	<u>(63,115)</u>
Government grant recognized	<u>23,585</u>

During the year, the company recognized \$62,184 of interest and accretion expense on this loan (2014 - \$59,576).

The Health Technology Exchange (HTX) loans are unsecured, bearing interest at 4.50% per annum, with annual repayments on March 31, 2016 for \$200,000, 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. These repayment terms are the result of an amendment agreement dated December 5, 2014. This change in repayment terms was considered to be substantial and has therefore been accounted for as an extinguishment and the company recognized a loss of \$56,515 in 2014. The company receives these loans in tranches based on qualifying expenditures incurred. The fair values and corresponding government grants for amounts received are shown below. The government grant is recognized immediately as a government grant in the consolidated statements of loss and comprehensive loss. The company determines the fair value of the loans based on the estimated future cash flows of the loan using an average discount rate of 10%. At December 31, 2015, the principal balance outstanding on this loan is \$1,500,000.

	December 5, 2014 \$	October 23, 2014 \$	July 24, 2014 \$	April 28, 2014 \$
Cash received	379,543	95,457	100,000	175,000
Fair value of loan received	<u>(317,817)</u>	<u>(80,772)</u>	<u>(83,486)</u>	<u>(144,012)</u>
Government grant recognized	<u>61,726</u>	<u>14,685</u>	<u>16,514</u>	<u>30,988</u>

During the year, the company recognized \$144,633 of interest and accretion expense on this loan (2014 - \$83,438). A reconciliation of the HTX and FedDev loans during the year is as follows:

	2015 \$	2014 \$
Opening balance	2,079,472	1,190,741
Proceeds received	-	836,700
(Gain) loss on extinguishment of long-term debt	(63,568)	56,515
Repayment	(72,250)	-
Government grant received	-	(147,498)
Accretion expense	<u>206,817</u>	<u>143,014</u>
Balance - End of year	2,150,471	2,079,472
Less: Current portion	<u>(286,700)</u>	<u>(130,050)</u>
Non-current portion	<u>1,863,771</u>	<u>1,949,422</u>

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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 upon as part of the closing of the Transaction (note 4). Repayments commence on June 30, 2017, for 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 represents a financial liability that includes embedded derivatives that require 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.

In addition, the company has 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, representing an excess of the fair value of the Knight Loan over the amount of proceeds, has been recorded as a 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:

	December 31, 2015 \$
Balance - Beginning of year	-
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 obligation	(359,016)
Transaction costs	(226,049)
Amount allocated to marketing expense	2,303,034
Interest and accretion expense	460,980
	<hr/>
Balance - End of year	<u>3,696,903</u>

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The royalty is 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 recognized \$38,798 of accretion expense on this royalty and the liability at December 31, 2015 is \$397,814.

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

	2015 \$	2014 \$
FedDev and HTX loans	2,150,471	2,079,472
Knight Loan	3,696,903	-
	<hr/>	<hr/>
Balance - End of year	5,847,374	2,079,472
Less: Current portion	(286,700)	(130,050)
	<hr/>	<hr/>
Non-current portion	5,560,674	1,949,422
	<hr/>	<hr/>

11 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 represent 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.

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On January 22, 2014, the company closed a financing round in the form of 2,187,500 Series A2 preferred shares in the amount of \$1,750,000. Pursuant to the terms of the preferred share agreement and in conjunction with the Transaction, on June 4, 2015, the preferred shares were converted into 16,309,894 common shares at the price of \$1.50 per common share.

	2015 \$	2014 \$
Balance - Beginning of year	9,707,445	7,455,469
Cash proceeds on issuance of preferred shares	-	1,750,000
Fair value of embedded derivatives on initial recognition	-	(3,737,442)
Amount transferred from derivatives upon exercise of the subscription option	-	2,330,330
Accretion expense (including accelerated accretion)	4,846,840	838,451
Accrued dividends	481,354	1,070,637
Conversion to share capital	(15,035,639)	-
	<hr/>	<hr/>
Balance - End of year	-	9,707,445
Less: Current portion	-	(9,707,445)
	<hr/>	<hr/>
Non-current portion	-	-

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	December 31, 2014
Credit spread	29%	21%
Expected volatility	102%	106%
Share price	\$1.50	\$1.50
Expected dividends	nil	nil

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

	December 31, 2015 \$	December 31, 2014 \$
Balance - Beginning of year	25,719,860	20,478,128
Change in fair value of the embedded derivatives	(2,086,416)	1,504,290
Fair value on initial recognition	-	3,737,442
Conversion to share capital	(23,633,444)	-
	<hr/>	<hr/>
Balance - End of year	-	25,719,860

The holders of preferred shares had an option to invest in the second tranche of the Series A2 preferred shares at a fixed price contingent on the achievement of a specified milestone. The third tranche of the Series A2 preferred shares was issuable at the option of the investors within 12 months of the issuance of the second tranche of the Series A2 preferred shares. These options represent derivatives measured at fair value at each

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reporting date with movements recorded in the consolidated statements of loss and comprehensive loss. The assumptions used in the fair value calculation of these options are consistent with those used above.

	2015 \$	2014 \$
Balance - Beginning of year	-	2,195,238
Change in fair value on derivatives	-	135,092
Issuance of preferred shares	-	(2,330,330)
	<hr/>	<hr/>
Balance - End of year	-	-

12 Share capital

Authorized

Unlimited common shares

Issued and outstanding (with no par value)

	December 31, 2015 \$	December 31, 2014 \$
39,473,327 (December 31, 2014 - 2,166,766) common shares	<hr/> 67,082,821	<hr/> 39,487

There are nil Series A1 preferred shares (December 31, 2014 - 2,500,000) and nil Series A2 preferred shares (December 31, 2014 - 10,812,500) issued and outstanding as at December 31, 2015. The previously issued preferred shares were converted into common shares of Profound (note 11).

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. 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 13).

On June 4, 2015, the company completed the Transaction 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.

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13 Share-based payments

Share options

As a result of the Transaction (note 4), 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, 2015, 3,407,283 options are outstanding and there were 1,325,796 share options available for grant under the Share Option Plan. 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 4), 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.

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, 2014	1,237,312	0.24
Forfeited	(5,000)	0.24
	<hr/>	
Balance - December 31, 2014	1,232,312	0.24
	<hr/>	
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
	<hr/>	
Balance - December 31, 2015	3,407,283	1.05
	<hr/>	

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The following table summarizes information about the share options outstanding as at December 31, 2015:

Exercise price \$	Number of options outstanding	Weighted average remaining contractual life (years)	Number of options exercisable
0.24	1,124,562	5.77	859,066
0.30	57,750	3.35	57,750
1.36	146,667	0.51	146,667
1.50	2,078,304	9.44	133,973
	<u>3,407,283</u>	7.74	<u>1,197,456</u>

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.

	December 7, 2015	September 8, 2015	April 30, 2015
Volatility	75%	78%	103%
Expected life of stock options	6 years	6 years	5 years
Risk-free interest rate	1.33%	1.13%	1.12%
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 \$644,733 (December 31, 2014 - \$190,333).

Compensation options

As a result of the Transaction (note 4), 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. As a result, 73,333 compensation options were issued to Profound's IPO agent.

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 were exchanged for compensation options to purchase common shares of Profound.

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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
	<hr/>	
Balance - December 31, 2015	649,568	1.48
	<hr/>	

The following table summarizes information about the compensation options outstanding as at December 31, 2015:

Exercise price \$	Number of compensation options outstanding	Weighted average remaining contractual life (years)	Number of compensation options exercisable
1.36	73,333	0.72	73,333
1.50	576,235	1.43	576,235
	<hr/>		<hr/>
	649,568	1.35	649,568
	<hr/>		<hr/>

The company estimated the fair value of the compensation options issued 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 has been recorded in contributed surplus.

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14 Research and development expenses

	2015 \$	2014 \$
Clinical trial costs	307,313	223,924
Materials	2,483,423	300,346
Consulting	232,558	350,701
Contractors	83,440	50,640
Travel	148,235	72,224
Rent	158,839	132,017
Amortization of intangible assets	2,500	2,500
Salaries and benefits	2,282,386	1,654,322
Other	135,958	60,251
Investment tax credits	(697,804)	(564,899)
Reversal of investment tax credits	-	24,657
	<hr/>	<hr/>
	5,136,848	2,306,683

The company's claim for SR&ED deductions and related expenses for income tax purposes are based on management's interpretation of the applicable legislation in the Income Tax Act (Canada).

During the year ended December 31, 2015, the company received government grants of \$nil (2014 - \$20,000).

15 General and administrative expenses

	2015 \$	2014 \$
Marketing expense	2,303,034	-
Salaries and benefits	1,343,542	458,959
Professional and consulting fees	1,092,465	931,735
Share-based compensation	644,733	190,333
Rent	59,545	33,273
Travel	279,426	199,924
Depreciation of property and equipment	116,525	82,396
Office and other	246,779	135,454
	<hr/>	<hr/>
	6,086,049	2,032,074

16 Interest and accretion expense

	2015 \$	2014 \$
HTX and FedDev loans (note 10)	206,817	143,014
Knight Loan (note 10)	460,980	-
Royalty interest accretion (note 10)	38,798	-
Preferred shares (note 11)	4,846,840	838,451
Convertible notes (note 9)	63,500	-
Other	8,322	26,285
	<hr/>	<hr/>
	5,625,257	1,007,750

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17 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:

	2015 \$	2014 \$
Net loss before income taxes	(17,101,812)	(7,937,016)
Recovery based on combined federal and provincial statutory rate of 26.5% (2014 - 26.5%)	(4,531,980)	(2,103,309)
Permanent differences	1,142,900	994,656
Change in deferred tax assets not recognized	2,598,734	1,372,165
Change in tax rates and other	64,275	3,881
Net income tax (recovery) expense	(726,071)	267,393

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 share-based compensation, preferred share dividend expense, change in fair value of derivatives, accretion expense, non-deductible marketing expense and listing expense (note 4).

The company has non-capital loss carry-forwards of approximately \$13,450,000 at December 31, 2015 that expire in varying amounts from 2028 to 2035.

The company has SR&ED expenditures of approximately \$6,370,000 at December 31, 2015, which can be carried forward indefinitely to reduce future years' taxable income.

The company has approximately \$840,000 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 2035.

In the event that the holders of Series A1 and A2 preferred shares are paid or deemed paid any amount of the cumulative dividends referred to in note 11, the company would become liable for the payment of taxes under Part VI.1 of the Income Tax Act (Canada). Depending on the tax classification of the Series A1 and A2 preferred shares, taxes under Part VI.1 are generally calculated as 25% of the amount of the dividend in excess of \$500,000. On the payment of these taxes, the company will become entitled to claim a deduction equal to three times the amount of Part VI.1 taxes actually paid. On conversion of the preferred shares (note 11), 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 (Part VI.1 tax expense for the year ended December 31, 2014, was \$267,393).

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18 Loss per share

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

	2015	2014
Numerator for basic and diluted loss per share available to common shareholders	\$16,375,741	\$8,204,409
Denominator for basic and diluted loss per share	23,683,822	2,166,766
Basic and diluted loss per share	\$0.69	\$3.79

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 stock options.

Preferred shares are not included in the calculation of diluted loss per share given their anti-dilutive effect. However on conversion, the holders are entitled to nil (2014 - 13,719,477) common shares plus an additional amount of common shares based on the accrued dividend divided by the fair value of a common share on the date of conversion.

Of the 3,407,283 (2014 - 1,232,212) stock options not included in the calculation of diluted loss per share for the year ended December 31, 2015, 1,197,456 (2014 - 740,214) were exercisable. Of the 649,568 compensation options not included in the calculation of diluted loss per share for the year ended December 31, 2015, 649,568 are exercisable.

19 Financial assets and liabilities

Classification of financial instruments

The classification of financial assets and liabilities are as follows:

	2015		
	Loans and receivables \$	Fair value through profit or loss \$	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
	<u>20,522,520</u>	<u>-</u>	<u>7,225,466</u>

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	2014		
	Loans and receivables \$	Fair value through profit or loss \$	Other financial liabilities \$
Cash	406,495	-	-
Accounts payable and accrued liabilities	-	-	1,616,949
Bank loan	-	-	700,000
Long-term debt	-	-	2,079,472
Preferred shares	-	-	9,707,445
Derivatives	-	25,719,860	-
	406,495	25,719,860	14,103,866

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 risk

Interest rate 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, 2015, the company's cash included \$5,758 (2014 - \$4,107) denominated in United States dollars and \$488 (2014 - \$1,834) denominated in euros. In addition, the company's accounts payable and accrued liabilities included \$351,794 (2014 - \$280,403) denominated in United States dollars and \$451 (2014 - \$9,177) denominated in euros.

As at December 31, 2015, if foreign exchange rates had been 5% higher, with all other variables held constant, loss before income taxes would have been \$17,300 (2014 - \$14,182) 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.

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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.

	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	-

	2014				
	Carrying amount \$	Future cash flows \$	Less than 1 year \$	Between 1 year and 5 years \$	Greater than 5 years \$
Accounts payable and accrued liabilities	1,616,949	1,616,949	1,616,949	-	-
Bank loan	700,000	700,000	700,000	-	-
Long-term debt	2,079,472	2,661,698	130,050	2,488,298	43,350
Preferred shares	9,707,445	19,800,423	-	19,800,423	-
	14,103,866	24,779,070	2,446,999	22,288,721	43,350

The derivative financial liabilities related to the Series A preferred shares (note 11) are excluded from the tables above as their settlement will not lead to a cash outflow.

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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 \$5,847,374 (2014 - \$2,079,472) and has been determined based on discounted cash flows and other assumptions which are within Level 3 of the fair value hierarchy (note 10).

The fair value of the preferred shares including the derivatives is \$nil (2014 - \$26,621,052) and has been determined using valuation techniques and assumptions as disclosed in note 11.

Fair value hierarchy

The company classifies its derivatives recognized on the consolidated balance sheets at fair value in a hierarchy based on the significance of the inputs used in making the measurements. The levels in the hierarchy are:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); or
- Level 3 - inputs for the asset or liability that are not based on observable market data (i.e. unobservable inputs).

The inputs used to value the derivatives are considered to be Level 3 in the fair value hierarchy.

20 Related party transactions

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

	2015	2014
	\$	\$
Salaries and employee benefits	1,299,855	724,791
Directors fees	76,092	78,775
Share-based compensation	594,944	111,120
	<hr/>	<hr/>
	1,970,891	914,686

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

Research and development expenses include \$6,000 of regulatory professional fees which flowed through a company controlled by an executive officer (2014 - \$5,000).

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21 Commitment and contingencies

The company has a commitment under an operating lease for the rental of office space. The future minimum obligation under the lease is as follows:

	\$
No later than 1 year	278,997
Later than 1 year and no later than 5 years	-
	<u>278,997</u>

In the normal course of business, the company may be the subject of litigation claims. While management assesses the merits of each lawsuit and defends itself accordingly, the company may be required to incur significant expenses or devote significant resources to defending itself against such claims.

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.

22 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, long-term debt and preferred shares (including related derivatives) in the definition of capital.

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

	2015 \$	2014 \$
Common shares	67,082,821	39,487
Deficit	(55,121,561)	(38,745,820)
Long-term debt	5,847,374	2,079,472
Preferred shares	-	9,707,445
derivatives	-	25,719,860
	<u>17,808,634</u>	<u>(1,199,556)</u>

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23 Segment reporting

The Chief Executive Officer is the company's chief operating decision maker (CODM). Management has determined that there is one operating segment based on the information reviewed by the CODM for the purposes of allocating resources and assessing performance.