Profound Medical Corp.

Interim Condensed Consolidated
Financial Statements
(Unaudited)
March 31, 2017

Profound Medical Corp.

Interim Condensed Consolidated Balance Sheets
(Unaudited)

	March 31, 2017 $	December 31, 2016 $
Assets		
Current assets		
Cash	16,892,035	20,833,061
Trade and other receivables (note 3)	728,590	266,336
Investment tax credits receivable	330,000	264,000
Inventory (note 4)	864,680	416,823
Prepaid expenses and deposits (note 14)	737,723	696,909
	19,553,028	22,477,129
Property and equipment	927,556	953,029
Intangible assets	284,159	262,685
	20,764,743	23,692,843
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	2,351,518	1,771,427
Customer deposits	-	259,293
Deferred revenue	47,154	
Long-term debt (note 6)	4,290,366	2,877,050
Provisions (note 5)	16,698	-
Other liability (note 6)	25,000	39,357
	6,730,736	4,947,127
Long-term debt (note 6)	2,624,950	3,760,826
Provisions (note 5)	458,553	39,619
Other liability (note 6)	120,410	109,044
	9,934,649	8,856,616
Shareholders' Equity		
Share capital	83,305,277	83,272,678
Contributed surplus	3,079,253	3,000,563
Accumulated other comprehensive income	8,676	11,316
Deficit	(75,563,112)	(71,448,330)
	10,830,094	14,836,227
	20,764,743	23,692,843
Commitments and contingencies (note 14)		

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

Profound Medical Corp.

Interim Condensed Consolidated Statements of Loss and Comprehensive Loss
(Unaudited)

	Three months ended March 31, 2017 $	Three months ended March 31, 2016 $
Revenue		
Products	552,918	-
Services	38,599	-
	591,517	-
Cost of sales	311,225	-
Gross profit	280,292	-
Expenses		
Research and development (note 8)	1,883,129	2,507,599
General and administrative (note 9)	1,118,014	934,784
Selling and distribution (note 10)	1,150,499	160,439
Total operating expenses	4,151,642	3,602,822
Finance costs (note 11)	289,700	283,961
Finance income	(48,565)	(50,564)
Net finance costs	241,135	233,397
Loss before income taxes	4,112,485	3,836,219
Income tax expense	2,297	-
Net loss for the period	4,114,782	3,836,219
Item that may be reclassified to profit or loss		
Foreign currency translation adjustment	2,640	2,887
Net loss and comprehensive loss for the period	4,117,422	3,839,106
Basic and diluted weighted average shares outstanding (note 12)	55,314,825	39,473,327
Basic and diluted net loss per common share (note 12)	0.07	0.10

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

Profound Medical Corp.

Interim Condensed Consolidated Statements of Changes in Shareholders' Equity
(Unaudited)

	Number of shares	Share capital $	Contributed surplus $	Accumulated other comprehensive income (loss) $	Deficit $	Total $
Balance - January 1, 2016	39,473,327	67,082,821	2,002,190	-	(55,121,561)	13,963,450
Net loss for the period	-	-	-	-	(3,836,219)	(3,836,219)
Foreign currency translation adjustment				(2,887)	-	(2,887)
Share-based payments	-	-	209,114	-	-	209,114
Balance - March 31, 2016	39,473,327	67,082,821	2,211,304	(2,887)	(58,957,780)	10,333,458
Balance - January 1, 2017	55,305,577	83,272,678	3,000,563	11,316	(71,448,330)	14,836,227
Net loss for the period	-	-	-	-	(4,114,782)	(4,114,782)
Foreign currency translation adjustment	-	-	-	(2,640)	-	(2,640)
Exercise of share options	38,562	32,599	(21,874)	-	-	10,725
Share-based payments	-	-	100,564	-	-	100,564
Balance - March 31, 2017	55,344,139	83,305,277	3,079,253	8,676	(73,563,112)	10,830,094

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

Profound Medical Corp.

Interim Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three months ended March 31, 2017 $	Three months ended March 31, 2016 $
Cash provided by (used in)		
Operating activities		
Net loss for the period	(4,114,782)	(3,836,219)
Depreciation of property and equipment	54,001	25,316
Amortization of intangible assets	12,351	625
Share-based compensation	100,564	209,114
Non-cash interest and accretion expense	296,124	283,961
Deferred revenue	47,154	
Net change in non-cash working capital balances		
Trade and other receivables	(462,254)	(52,894)
Investment tax credits receivable	(66,000)	(55,000)
Inventory	(447,857)	-
Prepaid expenses and deposits	(40,814)	(232,009)
Accounts payable and accrued liabilities	577,451	433,856
Customer deposits	(259,293)	-
Provisions	435,632	-
	(3,867,723)	(3,223,250)
Investing activities		
Purchase of intangible assets	(33,825)	(42,176)
Purchase of property and equipment	(28,528)	(51,755)
	(62,353)	(93,931)
Financing activities		
Payment of long-term debt	(21,675)	(221,675)
Proceeds from share options exercised	10,725	-
	(10,950)	(221,675)
Decrease in cash during the period	(3,941,026)	(3,538,856)
Cash - Beginning of period	20,833,061	10,522,520
Cash - End of period	16,892,035	6,983,664

The accompanying notes are an integral part of these interim condensed 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. The company is a biotechnology company developing a treatment to ablate the prostate gland in prostate cancer patients.

The company's registered address is 2400 Skymark Avenue, Unit 6, Mississauga, Ontario, L4W 5K5.

2 Basis of preparation and summary of significant accounting policies

These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB), applicable to the preparation of interim financial statements, including International Accounting Standard (IAS) 34, Interim Financial Reporting. These interim condensed consolidated financial statements should be read in conjunction with the company's annual financial statements for the year ended December 31, 2016, which were prepared in accordance with IFRS.

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors on May 9, 2017.

The interim condensed consolidated financial statements were prepared on a going concern basis under the historical cost convention.

The accounting policies adopted are consistent with those of the previous financial year except as noted below. Amendments to IFRS effective for the financial year ending December 31, 2017 did not have a material impact on the company.

Revenue

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the company and the revenue can be reliably measured, regardless of when the payment is being made. Revenue is measured at the fair value of the consideration received or receivable, taking into account contractually defined terms of payment and excluding taxes or duties. The specific recognition criteria described below must also be met before revenue is recognized.

- Product sales
    - Product sales to customers

      Revenue from the sale of medical devices and consumables is recognized when the significant risks and rewards of ownership of the products have passed or transferred to the customer, collection of the related receivable is probable, the sales price is fixed or determinable and customer acceptance has occurred.

- Product sales under partnership agreements

  Revenue is recognized on the sale of medical devices or consumable products as per the terms of the respective contracts, which is generally at the time that the company has transferred the risks of ownership to its partners, who maintain the business relationship with the end customer.

Multiple element arrangements

The company may enter into arrangements in which it commits to providing products and services to its customers at different points in time. Revenue recognition for these arrangements is determined based on evaluation of the individual elements of the arrangements. If the element delivered has stand-alone value to the customer and the fair value associated with the undelivered element can be measured reliably, the amount recognized as revenue for each element is the fair value of the element in relation to the fair value of the arrangement as a whole. Otherwise, the arrangement is treated as one unit of account and revenue is deferred and recognized over the remaining term of the arrangements, commencing when all elements are delivered.

Service revenue

Service revenue related to installation and training is recognized once the services are performed and customer acceptance is received. Service revenue related to extended warranty service, is deferred and recognized on a straight-line basis over the extended warranty period covered by the agreement.

Cost of sales

Cost of sales includes the cost of finished goods, inventory provisions, royalties, warranty expense, freight and direct overhead expenses necessary to acquire the finished goods.

Accounting standards issued but not yet adopted

- IFRS 9, Financial Instruments (IFRS 9)

  The final version of IFRS 9, Financial Instruments, was issued by IASB in July 2014 and will replace 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 has yet to assess the full impact of IFRS 9.

- 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 interim condensed 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 sheet 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.

3 Trade and other receivables

The trade and other receivables balance is comprised of the following:

	March 31, 2017 $	December 31, 2016 $
Trade receivables	268,145	-
Indirect tax receivables	449,632	266,336
Other	10,813	-
	728,590	266,336

4 Inventory

	March 31, 2017 $	December 31, 2016 $
Raw materials	501,805	307,643
Finished goods	560,802	237,408
Inventory provision	(197,927)	(128,228)
	864,680	416,823

During the period ended March 31, 2017, $212,810 (March 31, 2016 - $nil) of inventory was recognized in cost of sales. The increase in the inventory provision of $69,699 was recognized in cost of sales.

5 Provisions

	Asset retirement obligation $	Revenue share obligation $	Warranty provision $	Total $
Balance - Beginning of period	39,619	-	-	39,619
Addition	-	417,834	16,698	434,532
Accretion expense	1,100	-	-	1,100
Balance - End of period	40,719	417,834	16,698	475,251
Less: Current portion	-	-	(16,698)	(16,698)
Non-current portion	40,719	417,834	-	458,553

Asset retirement obligation

The asset retirement obligation is related to the company's leasehold improvements.

Revenue share obligation

The company has certain minimum amounts payable under a revenue sharing agreement. This provision represents the company's estimated shortfall of revenue share payments over the term of this agreement. The amount has been included in selling and distribution expenses in the interim condensed consolidated statement of loss and comprehensive loss.

Warranty provision

The warranty provision is related to the company's estimate of future warranty obligations on product sales which generally have a term of one year.

6 Long-term debt

A summary of long-term debt is as follows:

	March 31, 2017 $	December 31, 2016 $
FedDev and HTX loans	2,056,172	2,027,893
Knight Loan	4,859,144	4,609,983
Balance - End of period	6,915,316	6,637,876
Less: Current portion	(4,290,366)	(2,877,050)
Non-current portion	2,624,950	3,760,826

The Federal Economic Development Agency (FedDev) loan is unsecured, 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. As at March 31, 2017, the principal balance outstanding on this loan is $686,375 (December 31, 2016 - $708,050).

During the period ended March 31, 2017, the company recognized $13,805 of interest and accretion expense on this loan (March 31, 2016 - $14,539).

The Health Technology Exchange (HTX) loans with total proceeds of $1,500,000 are unsecured, bearing interest at 4.50% per annum, with the remaining repayments on April 30, 2017 of $500,000 and the balance of the obligation including accrued interest payable on March 31, 2018. As at March 31, 2017, the principal balance outstanding on this loan was $1,300,000 (December 31, 2016 - $1,300,000). Subsequent to period end the $500,000 was paid.

During the period ended March 31, 2017, the company recognized $36,149 of interest and accretion expense on these loans (March 31, 2016 - $38,415).

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

	Three months ended March 31, 2017 $	Year ended December 31, 2016 $
Balance - Beginning of period	2,027,893	2,150,471
Repayment	(21,675)	(286,700)
Interest and accretion expense	49,954	164,122
Balance - End of period	2,056,172	2,027,893
Less: Current portion	(1,587,491)	(586,700)
Non-current portion	468,681	1,441,193

On April 30, 2015, Profound Medical Inc. (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. 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).

A reconciliation of the Knight Loan balance is as follows:

	Three months ended March 31, 2017 $	Year ended December 31, 2016 $
Balance - Beginning of period	4,609,983	3,696,903
Interest and accretion expense	249,161	913,080
Balance - End of period	4,859,144	4,609,983
Less: Current portion	(2,702,875)	(2,290,350)
Non-current portion	2,156,269	2,319,633

The royalty was initially recorded at fair value and was 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 period ended March 31, 2017, 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 $2,991 (March 31, 2016 - accretion expense of $17,886). The current portion of this liability as at March 31, 2017 is $25,000 (December 31, 2016 - $39,357) and the non-current portion is $120,410 (December 31, 2016 - $109,044).

7 Share-based payments

Compensation expense related to share options recorded in the interim condensed consolidated statement of loss and comprehensive loss for the period ended March 31, 2017 was $100,564 (March 31, 2016 - $209,114).

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

	$	Weighted average exercise price $
Balance - January 1, 2017	4,689,839	1.13
Granted	1,417,583	1.10
Exercised	(38,562)	0.28
Forfeited/expired	(1,101,343)	1.42
Balance - March 31, 2017	4,967,517	1.06

The following table summarizes information about the share options outstanding as at March 31, 2017:

Exercise price $	Number of options outstanding	Weighted average remaining contractual life (years)	Number of options exercisable
0.24	1,043,238	4.56	999,609
0.30	21,000	2.07	21,000
1.10	1,971,724	9.71	-
1.35	132,500	9.41	-
1.46	964,055	9.39	-
1.50	835,000	8.43	330,616
	4,967,517	8.31	1,351,225

The company estimated the fair value of the share options granted during the period 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.

	January 26, 2017
Volatility	99%
Expected life of share options	6 years
Risk-free interest rate	1.35%
Dividend yield	-

8 Research and development expenses

	Three months ended March 31, 2017 $	Three months ended March 31, 2016 $
Salaries and benefits	842,756	834,782
Clinical trial costs	639,029	247,932
Consulting fees	170,603	160,636
Travel	76,325	97,960
Materials	55,380	1,018,454
Share-based compensation	33,284	31,602
Rent	30,040	50,104
Depreciation of property and equipment	1,553	-
Amortization of intangible assets	625	625
Contractors	-	52,936
Other	99,534	67,568
Investment tax credits	(66,000)	(55,000)
	1,883,129	2,507,599

9 General and administrative expenses

	Three months ended March 31, 2017 $	Three months ended March 31, 2016 $
Salaries and benefits	515,023	302,729
Professional and consulting fees	302,197	300,158
Office and other	88,814	55,683
Rent	61,785	19,645
Share-based compensation	55,180	177,512
Depreciation of property and equipment	50,899	25,316
Travel	36,564	53,741
Amortization of intangible assets	7,552	-
	1,118,014	934,784

10 Selling and distribution expenses

	Three months ended March 31, 2017 $	Three months ended March 31, 2016 $
Revenue share obligation (note 5)	417,834	-
Commission expense	61,840	-
Salaries and benefits	246,686	25,644
Professional and consulting fees	171,857	71,721
Travel	98,515	30,895
Marketing	91,084	1,014
Office and other	51,744	31,165
Share-based compensation	10,939	-
	1,150,499	160,439

11 Finance costs

	Three months ended March 31, 2017 $	Three months ended March 31, 2016 $
HTX and FedDev loans (note 6)	49,954	52,954
Knight Loan (note 6)	249,161	213,121
Royalty interest accretion (recovery) (note 6)	(2,991)	17,886
Provisions (note 5)	1,100	-
Foreign exchange gain	(7,524)	-
	289,700	283,961

12 Loss per share

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

	Three months ended March 31, 2017	Three months ended March 31, 2016
Net loss for the period	$4,114,782	$3,836,219
Basic and diluted weighted average number of shares outstanding	55,314,825	39,473,327
Basic and diluted loss per share	$0.07	$0.10

For the periods noted above, 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.

Of the 4,967,517 share options and 576,235 compensation options not included in the calculation of diluted loss per share for the period ended March 31, 2017, 1,927,460 were exercisable (March 31, 2016 - 1,659,460).

13 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:

	Three months ended March 31, 2017 $	Three months ended March 31, 2016 $
Salaries and employee benefits	327,489	244,497
Termination benefits	138,125	-
Directors' fees	22,250	41,375
Share-based compensation	73,151	192,587
	561,015	478,459

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

14 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 $420,000 related to prepaid rent for this lease that is drawn down at $10,000 per month effective October 1, 2016. The future minimum obligations under these leases are as follows:

	$
No later than 1 year	398,824
Later than 1 year and no later than 5 years	2,099,937
Later than 5 years	2,603,105
	5,101,866

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 (note 5).