

Profound Medical Corp.

Interim Condensed Consolidated
Financial Statements
(Unaudited)
September 30, 2017

Profound Medical Corp.
Interim Condensed Consolidated Balance Sheets
(Unaudited)

	September 30, 2017 \$	December 31, 2016 \$
Assets		
Current assets		
Cash	16,307,428	20,833,061
Trade and other receivables (note 5)	2,576,170	266,336
Investment tax credits receivable	180,000	264,000
Inventory (note 6)	1,062,446	416,823
Prepaid expenses and deposits	641,827	696,909
	<u>20,767,871</u>	<u>22,477,129</u>
Property and equipment (notes 4 and 7)	1,810,625	953,029
Intangible assets (notes 4 and 8)	5,424,108	262,685
Goodwill (note 4)	3,409,165	-
	<u>31,411,769</u>	<u>23,692,843</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	4,712,012	1,771,427
Customer deposits	-	259,293
Deferred revenue	149,298	-
Long-term debt (note 10)	4,920,830	2,877,050
Provisions (note 9)	42,923	-
Other liabilities (notes 10 and 11)	479,022	39,357
	<u>10,304,085</u>	<u>4,947,127</u>
Long-term debt (note 10)	452,347	3,760,826
Provisions (note 9)	682,013	39,619
Other liabilities (notes 10 and 11)	1,592,463	109,044
	<u>13,030,908</u>	<u>8,856,616</u>
Shareholders' Equity		
Share capital (note 12)	98,386,770	83,272,678
Contributed surplus	5,738,976	3,000,563
Accumulated other comprehensive income (loss)	(3,206)	11,316
Deficit	(85,741,679)	(71,448,330)
	<u>18,380,861</u>	<u>14,836,227</u>
	<u>31,411,769</u>	<u>23,692,843</u>
Liquidity and management actions (note 3)		
Commitments and contingencies (note 20)		

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 September 30, 2017 \$	Three months ended September 30, 2016 \$	Nine months ended September 30, 2017 \$	Nine months ended September 30, 2016 \$
Revenue				
Products	1,452,773	-	2,925,536	-
Services	12,639	-	88,532	-
	1,465,412	-	3,014,068	-
Cost of sales	1,185,674	-	1,968,258	-
Gross profit	279,738	-	1,045,810	-
Expenses				
Research and development (note 14)	2,812,684	2,506,112	7,113,785	7,229,806
General and administrative (note 15)	1,631,967	998,795	4,478,566	2,848,075
Selling and distribution (note 16)	703,783	274,726	2,751,435	734,448
	5,148,434	3,779,633	14,343,786	10,812,329
Finance costs (note 17)	659,902	302,122	1,080,038	840,228
Finance income	(8,524)	(25,270)	(89,318)	(123,785)
Net finance costs	651,378	276,852	990,720	716,443
Loss before income taxes	(5,520,074)	(4,056,485)	(14,288,696)	(11,528,772)
Income taxes	-	4,723	4,653	9,380
Net loss for the period	(5,520,074)	(4,061,208)	(14,293,349)	(11,538,152)
Item that may be reclassified to profit or loss				
Foreign currency translation adjustment	3,674	(5,341)	(14,522)	(10,495)
Net loss and comprehensive loss for the period	(5,516,400)	(4,066,549)	(14,307,871)	(11,548,647)
Basic and diluted weighted average shares outstanding (note 18)	61,614,117	39,482,212	57,456,823	39,476,278
Basic and diluted net loss per common share (note 18)	(0.09)	(0.10)	(0.25)	(0.29)

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

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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	-	-	-	-	(11,538,152)	(11,538,152)
Foreign currency translation adjustment	-	-	-	(10,495)	-	(10,495)
Exercise of stock options	12,250	6,860	(3,185)	-	-	3,675
Share-based compensation (note 13)	-	-	501,035	-	-	501,035
Balance - September 30, 2016	39,485,577	67,089,681	2,500,040	(10,495)	(66,659,713)	2,919,513
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	-	-	-	-	(14,293,349)	(14,293,349)
Foreign currency translation adjustment	-	-	-	(14,522)	-	(14,522)
Exercise of share options	411,800	271,471	(171,170)	-	-	100,301
Share-based compensation (note 13)	-	-	973,336	-	-	973,336
Issuance of common shares on acquisition (note 4)	7,400,000	7,844,000	-	-	-	7,844,000
Issuance of units on bought deal financing (note 12)	10,000,000	6,998,621	1,936,247	-	-	8,934,868
Balance - September 30, 2017	73,117,377	98,386,770	5,738,976	(3,206)	(85,741,679)	18,380,861

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)

	Nine months ended September 30, 2017 \$	Nine months ended September 30, 2016 \$
Cash provided by (used in)		
Operating activities		
Net loss for the period	(14,293,349)	(11,538,152)
Depreciation of property and equipment	271,225	113,336
Amortization of intangible assets	218,408	7,889
Share-based compensation	973,336	501,035
Interest and accretion expense	1,135,008	840,152
Change in fair value of contingent consideration	52,342	-
Transaction costs related to business acquisition (note 4)	716,767	-
Net change in non-cash working capital balances		
Prepaid expenses and deposits	55,082	(687,200)
Accounts payable and accrued liabilities	2,892,346	1,088,126
Provisions	685,317	40,594
Inventory	(645,623)	-
Investment tax credits receivable	84,000	(25,000)
Trade and other receivables	(2,309,834)	(63,780)
Deferred revenue	149,298	-
Customer deposits	(259,293)	-
	<u>(10,274,970)</u>	<u>(9,723,000)</u>
Investing activities		
Transaction costs related to business acquisition (note 4)	(716,767)	-
Sale of short-term investment	-	10,000,000
Purchase of intangible assets	(34,080)	(139,679)
Purchase of property and equipment	(414,949)	(831,113)
	<u>(1,165,796)</u>	<u>9,029,208</u>
Financing activities		
Payment of long-term debt and interest	(2,429,230)	(265,025)
Payment of other liabilities	(7,742)	-
Proceeds from share options exercised	100,301	3,675
Issuance of common shares	10,000,000	-
Transaction costs paid	(748,196)	-
	<u>6,915,133</u>	<u>(261,350)</u>
Decrease in cash during the period	<u>(4,525,633)</u>	<u>(955,142)</u>
Cash - Beginning of period	<u>20,833,061</u>	<u>10,522,520</u>
Cash - End of period	<u>16,307,428</u>	<u>9,567,378</u>
Supplemental information		
Intangible asset additions (recoverable) included in accounts payable and accrued liabilities	(26,684)	80,875
Property and equipment additions included in provisions	-	111,100
Transaction costs included in accounts payable and accrued liabilities	316,936	-

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

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Notes to Interim Condensed Consolidated Financial Statements

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September 30, 2017

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, treatment of uterine fibroids and palliative pain treatment of bone metastases.

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 November 7, 2017.

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

Certain prior year amounts have been reclassified for consistency with the current period's presentation. These reclassifications had no effect on the reported results of operations, only classifications of certain operating expenses. Specifically, expenses have been allocated to general and administrative expense and selling and distribution expense, whereas these were previously all recognized in general and administrative expense. This allocation was to align the expenses with the related functional departments.

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.

Business combinations

The acquisition during the three-month period ended September 30, 2017 has been accounted for as a business combination using the acquisition method. The consideration transferred in a business combination is measured at fair value at the date of acquisition. Acquisition-related transaction costs are recognized in the interim condensed consolidated statements of loss and comprehensive loss as incurred. At the acquisition date, the identifiable assets acquired and the liabilities assumed are initially recognized at their fair value. Goodwill is measured as the excess of the sum of the consideration transferred and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and liabilities assumed. When the consideration transferred by the Company in a

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business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Changes in the fair value of the contingent consideration that qualify as measurement period adjustments are adjusted retrospectively, with corresponding adjustments against goodwill. Changes in fair value that are not considered measurement adjustments are recognized in the interim condensed consolidated statements of loss and comprehensive loss. Measurement period adjustments are adjustments that arise from additional information obtained during the 'measurement period' (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date.

Other than measurement period adjustments, contingent consideration that is classified as a financial asset or a financial liability is remeasured at subsequent reporting dates, with the corresponding gain or loss being recognized in the interim condensed consolidated statements of loss and comprehensive loss.

Goodwill

Goodwill represents the excess fair value of consideration transferred over the fair value of the underlying net assets in a business combination and is measured at cost less accumulated impairment losses. Goodwill is not amortized but is tested for impairment on an annual basis or more frequently if there are indications that goodwill may be impaired. For the purposes of impairment testing, goodwill is allocated to each of the Company's cash generating units (CGU) or group of CGUs that are expected to benefit from the synergies of the acquisition. If the recoverable amount of the CGU or group of CGUs is less than the carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill and then to other assets of the CGU or group of CGUs.

Identifiable intangible assets

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

The major categories of intangible assets are amortized as follows:

Exclusive licence agreement	20 years
Brand	5 years
Proprietary technology	5 years
Software	5 years

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.

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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. Under the terms of the Company's partnership agreements, the Company retains a percentage of all amounts earned with the remaining percentage due to the partner. Accordingly, associated product sales are recognized net of the amounts due to the partner.

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 respective 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

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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. The Company is in the process of evaluating the impact of this 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 (IFRIC) 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 is in the process of evaluating the impact of this standard. The Company has determined that it will apply this standard on a fully retrospective basis.

- 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, except for its low value leases, on the consolidated balance sheet upon adoption.

- IFRIC 23, Uncertainty over Income Tax Treatments (IFRIC 23)

In June 2017, the IASB issued IFRIC 23, Uncertainty over Income Tax Treatments, with a mandatory effective date of January 1, 2019. The interpretations provide guidance on how to value uncertain income tax positions based on the probability of whether the relevant tax authorities will accept the Company's tax treatments. A company is to assume that a taxation authority with the right to examine any amounts reported to it will examine those amounts and will have full knowledge of all relevant information when doing so. IFRIC 23 is to be applied by recognizing the cumulative effect of initially applying these guidelines in opening retained earnings without adjusting comparative information. The extent of the impact of the adoption of IFRIC 23 has not yet been determined.

3 Liquidity and management actions

The Company manages liquidity risk by monitoring actual and projected cash flows. A cash flow forecast is performed regularly to ensure that the Company has sufficient cash to meet operational needs while maintaining sufficient liquidity.

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The Company will need additional capital to fund research and development activities and any significant expansion of operations. Potential sources of capital could include equity and/or debt financings, the collection of revenues resulting from commercialization activities and/or new strategic partnerships. The Company currently has sufficient cash on hand to continue operations until at least November 2018.

There can be no assurance that the Company will be able to obtain sufficient capital to meet any or all of the Company's needs. The availability of equity or debt financing will be affected by, among other things, the results of the Company's research and development, the ability to obtain regulatory approvals, the market acceptance of its products, the state of the capital markets generally, strategic alliance agreements and other relevant commercial considerations. In addition, if the Company raises additional funds by issuing equity securities, its existing security holders will likely experience dilution, and any incurrence of additional debt would result in increased debt service obligations and could require the Company to agree to operating and financial covenants that would restrict its operations. Any failure on the Company's part to raise additional funds on terms favorable to it, or at all, may require it to significantly change or curtail its current or planned operations in order to conserve cash until such time, if ever, that sufficient proceeds from operations are generated, and could result in the Company not taking advantage of business opportunities, the termination or delay of clinical trials for its products, the curtailment of its product development programs, the sale or assignment of rights to its technologies and/or products and the inability to file market approval applications at all or in time to competitively market its products.

4 Business combination

On July 31, 2017, the Company entered into an Asset and Share Purchase Agreement (the Agreement) to acquire all of the issued and outstanding shares and certain assets of the Royal Philips' (Philips) Sonalleve MR-HIFU business (Sonalleve MR-HIFU). Under the terms of the Agreement, Philips transferred its Sonalleve MR-HIFU assets to Profound for an upfront consideration of 7,400,000 common shares of Profound. The Agreement includes certain contingent consideration payments payable monthly in euros tied to future revenue levels of the Sonalleve MR-HIFU business summarized as follows:

- 5% of revenue between the date of acquisition and December 31, 2017;
- 6% of revenue during the year ending December 31, 2018;
- 7% of revenue during the years ending December 31, 2019 and 2020; and
- if total revenues are in excess of a defined amount from the date of acquisition to December 31, 2020 then the Company will be required to pay 7% of revenue from the date of acquisition to December 31, 2019.

As a condition of closing, the Company committed to repay all amounts outstanding under the Knight Loan (note 10) on or before July 31, 2018. Subsequent to September 30, 2017, the Agreement was amended with Philips to require full repayment of the Knight Loan on or before December 31, 2018.

The non-exclusive strategic sales relationship with Philips was expanded to include distribution of Sonalleve MR-HIFU. Under the terms of the Agreement, Philips will also provide other services, including, but not limited to, manufacturing and installation of Sonalleve MR-HIFU for a certain period of time at market rates.

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The Company accounted for this transaction as a business combination and has applied the acquisition method of accounting in accordance with IFRS 3, Business Combinations. The preliminary purchase price allocation of assets acquired and liabilities assumed and the fair value of the total consideration transferred are as follows:

	\$
Assets acquired and liabilities assumed	
Cash	183,988
Accounts payable and accrued liabilities	(183,988)
Property and equipment (note 7)	713,872
Intangible assets (note 8)	5,372,435
Goodwill	3,409,165
	<hr/>
	9,495,472
	<hr/>
Consideration paid or payable	
Common shares issued	7,844,000
Fair value of contingent consideration	1,651,472
	<hr/>
	9,495,472
	<hr/>

Goodwill of \$3,409,165 arising from the acquisition is attributable to the acquired workforce and synergies expected from combining the operations of the Company.

The contingent consideration is classified as a level 3 financial liability within the fair value hierarchy given its fair value is estimated using the discounted value of estimated future payments. The key assumptions in valuing the contingent consideration include: estimated projected net sales; the likelihood of certain contingent milestones being reached; and a discount rate of 15%. During the three-month period ended September 30, 2017, the change in fair value of the contingent consideration was a loss of \$52,342.

Had the Sonalleve MR-HIFU business been consolidated from January 1, 2017, the interim condensed consolidated statements of loss and comprehensive loss would be pro-forma revenue of \$4,993,368 and a pro-forma net loss and comprehensive loss of \$17,143,326 for the nine-month period ended September 30, 2017.

During the period from July 31, 2017 to September 30, 2017, there was revenue of \$1,350,053 and a net loss and comprehensive loss of \$536,846 recorded in the interim condensed consolidated statements of loss and comprehensive loss related to the former Sonalleve MR-HIFU business.

Acquisition-related costs of \$716,767 have been charged to general and administrative expenses in the interim condensed consolidated statements of loss and comprehensive income.

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5 Trade and other receivables

The trade and other receivables balance comprises the following:

	September 30, 2017 \$	December 31, 2016 \$
Trade receivables	2,063,314	-
Indirect tax receivables	512,856	266,336
	<u>2,576,170</u>	<u>266,336</u>

Trade receivables include the gross revenue amount billed to customers and certain amounts which are included in deferred revenue. Included in accounts payable and accrued liabilities is an amount of \$332,645 payable to the same counterparty as the corresponding trade receivables as there is no legal right of offset with respect to the receivable and payable balances.

6 Inventory

	September 30, 2017 \$	December 31, 2016 \$
Raw materials	635,923	307,643
Finished goods	651,444	237,408
Inventory provision	(224,921)	(128,228)
	<u>1,062,446</u>	<u>416,823</u>

During the three and nine months ended September 30, 2017, \$1,112,579 and \$1,463,726 of inventory was recognized in cost of sales, respectively. The increase in the inventory provision for the nine months ended September 30, 2017 of \$96,693 was recognized in cost of sales.

7 Property and equipment

Property and equipment consist of the following:

	Furniture and fittings \$	Research and manufacturing equipment \$	Leasehold improvements \$	Computer equipment \$	Computer software \$	Total \$
As at January 1, 2017						
Cost	235,169	402,292	578,561	192,681	176,462	1,585,165
Accumulated depreciation	(61,968)	(221,897)	(48,413)	(123,396)	(176,462)	(632,136)
Net book value	<u>173,201</u>	<u>180,395</u>	<u>530,148</u>	<u>69,285</u>	<u>-</u>	<u>953,029</u>

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	Furniture and fittings \$	Research and manufacturing equipment \$	Leasehold improvements \$	Computer equipment \$	Computer software \$	Total \$
Period ended						
September 30, 2017						
Opening net book value	173,201	180,395	530,148	69,285	-	953,029
Additions	-	254,376	140,181	20,392	-	414,949
Acquisition (note 4)	-	713,872	-	-	-	713,872
Depreciation	(28,739)	(157,165)	(47,219)	(38,102)	-	(271,225)
Closing net book value	144,462	991,478	623,110	51,575	-	1,810,625
As at September 30, 2017						
Cost	235,169	1,370,540	718,742	213,073	176,462	2,713,986
Accumulated depreciation	(90,707)	(379,062)	(95,632)	(161,498)	(176,462)	(903,361)
Net book value	144,462	991,478	623,110	51,575	-	1,810,625

8 Intangible assets

Intangible assets consist of the following:

	Exclusive licence agreement \$	Software \$	Proprietary technology \$	Brand \$	Total \$
As at January 1, 2017					
Cost	50,000	249,858	-	-	299,858
Accumulated amortization	(20,000)	(17,173)	-	-	(37,173)
Net book value	30,000	232,685	-	-	262,685
Period ended September 30, 2017					
Opening net book value	30,000	232,685	-	-	262,685
Additions	-	34,080	-	-	34,080
Acquisition (note 4)	-	-	4,489,295	883,140	5,372,435
Disposals	-	(26,684)	-	-	(26,684)
Amortization	(1,875)	(37,452)	(149,643)	(29,438)	(218,408)
Closing net book value	28,125	202,629	4,339,652	853,702	5,424,108
As at September 30, 2017					
Cost	50,000	257,254	4,489,295	883,140	5,679,689
Accumulated amortization	(21,875)	(54,625)	(149,643)	(29,438)	(255,581)
Net book value	28,125	202,629	4,339,652	853,702	5,424,108

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9 Provisions

	Asset retirement obligation \$	Revenue share obligation \$	Warranty provision \$	Total \$
As at January 1, 2017	39,619	-	-	39,619
Additions	-	639,003	42,923	681,926
Accretion expense	3,391	-	-	3,391
As at September 30, 2017	43,010	639,003	42,923	724,936
Less: Current portion	-	-	42,923	42,923
Non-current portion	43,010	639,003	-	682,013

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. The provision was determined using future revenue forecasts related to the revenue share agreement and a discount rate of 11%. This provision represents the Company's estimated shortfall of revenue share payments over the term of this agreement. If the revenue forecast were to decrease or increase by 10% then the revenue share obligation would increase or decrease by \$39,460. The amount has been included in selling and distribution expenses in the interim condensed consolidated statements 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.

10 Long-term debt

A summary of long-term debt is as follows:

	September 30, 2017 \$	December 31, 2016 \$
FedDev and HTX loans	1,589,772	2,027,893
Knight Loan	3,783,405	4,609,983
Balance - End of period	5,373,177	6,637,876
Less: Current portion	4,920,830	2,877,050
Non-current portion	452,347	3,760,826

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The Federal Economic Development Agency (FedDev) loan is unsecured and non-interest bearing, with total proceeds of \$867,000. Repayments of \$14,450 commenced on April 1, 2015 followed by 48 monthly instalments of \$7,225 from May 1, 2015 to April 1, 2019 and 11 monthly instalments of \$45,977 from May 1, 2019 to March 1, 2020. As at September 30, 2017, the principal balance outstanding on this loan is \$643,025 (December 31, 2016 - \$708,050).

During the three and nine months ended September 30, 2017, the Company recognized \$13,408 and \$40,820 of interest and accretion expense on this loan, respectively (three and nine months ended September 30, 2016 - \$14,180 and \$43,081, respectively).

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 repayment on March 31, 2018 of \$800,000 plus accrued interest. As at September 30, 2017, the principal balance outstanding on this loan was \$800,000 (December 31, 2016 - \$1,300,000).

During the three and nine months ended September 30, 2017, the Company recognized \$25,270 and \$86,084 of interest and accretion expense on these loans, respectively (three and nine months ended September 30, 2016 - \$34,429 and \$71,767, respectively).

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

	Nine months ended September 30, 2017 \$	Year ended December 31, 2016 \$
Balance - Beginning of period	2,027,893	2,150,471
Repayment	(565,025)	(286,700)
Interest and accretion expense	126,904	164,122
	<hr/>	<hr/>
Balance - End of period	1,589,772	2,027,893
Less: Current portion	1,137,425	586,700
	<hr/>	<hr/>
Non-current portion	452,347	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 commenced 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 products 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

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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).

As part of the Agreement (note 4), the Company is required to repay all amounts outstanding under the loan agreement with Knight on or before December 31, 2018.

A reconciliation of the Knight Loan balance is as follows:

	Nine months ended September 30, 2017 \$	Year ended December 31, 2016 \$
Balance - Beginning of period	4,609,983	3,696,903
Repayment	(1,864,205)	-
Interest and accretion expense	1,037,627	913,080
	<hr/>	<hr/>
Balance - End of period	3,783,405	4,609,983
Less: Current portion	3,783,405	2,290,350
	<hr/>	<hr/>
Non-current portion	-	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 three and nine months ended September 30, 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 expense of \$41,388 and recovery of \$32,914, respectively (three and nine months ended September 30, 2016 - accretion expense of \$19,530 and \$56,106, respectively). The current portion of this liability as at September 30, 2017 is \$67,244 (December 31, 2016 - \$39,357) and the non-current portion is \$40,501 (December 31, 2016 - \$109,044) and is included within other liabilities on the interim condensed consolidated balance sheets.

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11 Other liabilities

	Knight royalty payable \$ (note 10)	Contingent consideration \$ (note 4)	Deferred rent \$	Total \$
As at January 1, 2017	148,401	-	161,320	309,721
Additions	-	1,651,472	96,026	1,747,498
Amounts paid	(7,742)	-	-	(7,742)
Change in fair value	-	52,342	-	52,342
Accretion expense	(32,914)	-	-	(32,914)
Foreign exchange loss	-	2,580	-	2,580
As at September 30, 2017	107,745	1,706,394	257,346	2,071,485
Less: Current portion	67,244	411,778	-	479,022
Non-current portion	40,501	1,294,616	257,346	1,592,463

Knight royalty payable

As part of the Knight Loan, Knight was granted a royalty of 0.5% on net sales resulting from global sales of the Company's products for the duration of the Knight Loan.

Deferred rent

The deferred rent obligation is related to the Company's straight line rent accrual for its current premises. The deferred rent obligation as at December 31, 2016 is included in accounts payable and accrued liabilities.

12 Share capital

Common shares

Authorized

Unlimited common shares

Issued and outstanding (with no par value)

	September 30, 2017 \$	December 31, 2016 \$
73,117,377 (December 31, 2016 - 55,305,577) common shares	98,386,770	83,272,678

On September 20, 2017, the Company closed a bought deal financing, resulting in the issuance of 10,000,000 units at a price of \$1.00 per unit for gross proceeds of \$10,000,000 (\$8,934,868, net of cash transaction costs). Each unit consisted of one common share of the Company and one-half of one warrant, with each whole

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warrant entitling the holder to acquire one common share at a price of \$1.40 per common share until the date that is 36 months from the closing of the bought deal financing.

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

Warrants

As a result of the bought deal financing, 5,000,000 warrants were issued.

A summary of the warrants is shown below:

	Number of warrants	Weighted average exercise price \$	Weighted average remaining contractual life (years)
Balance - January 1, 2017	-	-	-
Granted	5,000,000	1.40	2.97
Balance - September 30, 2017	5,000,000	1.40	2.97

The company estimated the fair value of the warrants issued using the Black-Scholes option pricing model with the following assumptions.

	September 30, 2017
Share price on date of issuance	\$0.95
Volatility	77%
Expected life of warrants	3 years
Risk-free interest rate	1.56%
Dividend yield	-

The fair value of the warrants issued as part of the bought deal financing was \$1,936,247 or \$0.39 per warrant and was recorded in contributed surplus.

13 Share-based compensation

Compensation expense related to share options for the three and nine months ended September 30, 2017 was \$422,311 and \$973,336, respectively (three and nine months ended September 30, 2016 - \$134,450 and \$501,035, respectively).

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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	1,483,583	1.09
Exercised	(411,800)	0.24
Forfeited/expired	(1,101,343)	1.42
	<hr/>	
Balance - September 30, 2017	4,660,279	1.12

The following table summarizes information about the share options outstanding as at September 30, 2017:

Exercise price \$	Number of options outstanding	Weighted average remaining contractual life (years)	Number of options exercisable
0.24	670,000	4.04	640,312
0.30	21,000	1.57	21,000
0.97	66,000	9.57	-
1.10	1,971,724	9.21	-
1.35	132,500	8.91	75,084
1.46	964,055	8.89	262,973
1.50	835,000	7.93	430,858
	<hr/>		
	4,660,279	8.13	1,430,227

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

	January 26, 2017	April 25, 2017
Volatility	99%	97%
Expected life of share options	6 years	6 years
Risk-free interest rate	1.35%	1.37%
Dividend yield	-	-

During the nine months ended September 30, 2017, the 576,235 compensation options expired.

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14 Research and development expenses

	Three months ended September 30, 2017 \$	Three months ended September 30, 2016 \$	Nine months ended September 30, 2017 \$	Nine months ended September 30, 2016 \$
Salaries and benefits	1,339,072	949,125	3,035,074	2,679,347
Clinical trial costs	390,075	157,629	1,731,830	580,741
Consulting fees	279,321	453,126	939,290	871,260
Materials	370,779	731,291	625,501	2,380,172
Other	8,951	136,484	193,800	303,207
Travel	78,390	42,740	246,840	181,677
Share-based compensation	26,448	21,740	89,341	83,584
Rent	188,144	85,405	249,248	255,159
Depreciation of property and equipment	4,048	-	7,155	-
Amortization of intangible assets	188,474	1,627	189,724	2,877
Contractors	-	4,824	-	92,761
Investment tax credits	(61,018)	(77,879)	(194,018)	(200,979)
	<u>2,812,684</u>	<u>2,506,112</u>	<u>7,113,785</u>	<u>7,229,806</u>

15 General and administrative expenses

	Three months ended September 30, 2017 \$	Three months ended September 30, 2016 \$	Nine months ended September 30, 2017 \$	Nine months ended September 30, 2016 \$
Professional and consulting fees	543,750	303,030	1,631,365	867,612
Salaries and benefits	318,643	299,897	1,105,197	867,716
Share-based compensation	388,305	110,470	853,138	411,861
Office and other	129,304	121,269	323,924	315,083
Rent	59,962	58,034	185,658	121,751
Depreciation of property and equipment	152,109	47,861	262,718	111,765
Travel	31,206	52,220	91,638	146,273
Amortization of intangible assets	8,688	6,014	24,928	6,014
	<u>1,631,967</u>	<u>998,795</u>	<u>4,478,566</u>	<u>2,848,075</u>

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16 Selling and distribution expenses

	Three months ended September 30, 2017 \$	Three months ended September 30, 2016 \$	Nine months ended September 30, 2017 \$	Nine months ended September 30, 2016 \$
Revenue share obligation (note 9)	50,798	-	663,226	-
Salaries and benefits	343,225	191,843	854,598	387,087
Professional and consulting fees	128,778	30,287	477,905	170,772
Marketing	32,219	191	232,017	7,999
Travel	87,332	21,589	268,523	76,332
Office and other	53,170	28,576	162,504	86,668
Commission expense (recovery)	(551)	-	62,712	-
Share-based compensation	8,812	2,240	29,950	5,590
	<u>703,783</u>	<u>274,726</u>	<u>2,751,435</u>	<u>734,448</u>

17 Finance costs

	Three months ended September 30, 2017 \$	Three months ended September 30, 2016 \$	Nine months ended September 30, 2017 \$	Nine months ended September 30, 2016 \$
HTX and FedDev loans (note 10)	38,678	48,609	126,904	114,848
Knight loan (note 10)	526,139	233,975	1,037,627	669,198
Royalty interest accretion (recovery) (note 10)	41,388	19,530	(32,914)	56,106
Change in fair value of contingent consideration (note 4)	52,342	-	52,342	-
Provisions (note 9)	1,161	-	3,391	-
Foreign exchange (gain) loss	194	8	(107,312)	76
	<u>659,902</u>	<u>302,122</u>	<u>1,080,038</u>	<u>840,228</u>

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18 Loss per share

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

	Three months ended September 30, 2017	Three months ended September 30, 2016	Nine months ended September 30, 2017	Nine months ended September 30, 2016
Net loss for the period	\$(5,520,074)	\$(4,061,208)	\$(14,293,349)	\$(11,538,152)
Denominator for basic and diluted loss per share	61,614,117	39,482,212	57,456,823	39,476,278
Basic and diluted loss per share	\$(0.09)	\$(0.10)	\$(0.25)	\$(0.29)

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, warrants and compensation options.

Of the 4,660,279 share options and 5,000,000 warrants (September 30, 2016 - 4,155,698 share options and 576,235 compensation options) not included in the calculation of diluted loss per share for the period ended September 30, 2017, 6,430,277 were exercisable (September 30, 2016 - 2,177,577).

19 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 September 30, 2017 \$	Three months ended September 30, 2016 \$	Nine months ended September 30, 2017 \$	Nine months ended September 30, 2016 \$
Salaries and employee benefits	239,386	284,068	786,803	768,888
Termination benefits	-	-	138,125	-
Directors' fees (recovery)	19,740	(47,713)	61,729	35,037
Share-based compensation	400,649	126,007	897,203	460,216
	<u>659,775</u>	<u>362,362</u>	<u>1,883,860</u>	<u>1,264,141</u>

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

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20 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 \$360,000 related to prepaid rent for this lease that is drawn down at \$10,000 per month effective October 1, 2016. The future minimum obligations are as follows:

	\$
No later than 1 year	405,838
Later than 1 year and no later than 5 years	2,186,251
Later than 5 years	<u>2,313,871</u>
	<u>4,905,960</u>

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 9).

21 Segment information

The Company's operations are categorized into one industry segment, being medical devices focused on magnetic resonance guided ablation procedures. The Company had historically been managed in Canada until the acquisition of Sonalleve MR-HIFU, and as a result the Company is now managed geographically in Canada, Germany and Finland.

For the three-month period ended September 30, 2017:

	Canada \$	Germany \$	Finland \$	Total \$
Revenue	1,438,913	26,499	-	1,465,412
Cost of sales	<u>1,167,125</u>	<u>18,549</u>	<u>-</u>	<u>1,185,674</u>
Gross profit	<u>271,788</u>	<u>7,950</u>	<u>-</u>	<u>279,738</u>
Expenses				
Research and development	2,500,254	-	312,430	2,812,684
General and administrative	1,518,065	-	113,902	1,631,967
Selling and distribution	<u>203,782</u>	<u>445,326</u>	<u>54,675</u>	<u>703,783</u>
	<u>4,222,101</u>	<u>445,326</u>	<u>481,007</u>	<u>5,148,434</u>
Segment loss	<u>(3,950,313)</u>	<u>(437,376)</u>	<u>(481,007)</u>	<u>(4,868,696)</u>
Net finance costs				<u>651,378</u>
Net loss for the period				<u>(5,520,074)</u>

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Other financial information by segment as at September 30, 2017:

	Canada	Germany	Finland	Total
	\$	\$	\$	\$
Total assets	30,269,601	384,004	758,164	31,411,769
Goodwill and intangible assets	8,833,273	-	-	8,833,273
Property and equipment	1,172,252	4,273	634,100	1,810,625
Amortization of intangible assets	218,408	-	-	218,408
Depreciation of property and equipment	188,909	2,544	79,772	271,225
Intangible assets and goodwill additions or acquisition	8,815,680	-	-	8,815,680
Property and equipment additions or acquisition	409,966	4,984	713,872	1,128,822

