



## **Lattice Biologics Ltd.**

**Consolidated Financial Statements  
For the Years Ended September 30, 2017 and 2016  
(Expressed in U.S. dollars)**

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Lattice Biologics Ltd.

We have audited the accompanying consolidated financial statements of Lattice Biologics Ltd., which comprise the consolidated statement of financial position as at September 30, 2017 and the consolidated statements of comprehensive loss, changes in deficit and cash flows for the year then ended, and 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, 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 audit. We conducted our audit 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 is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

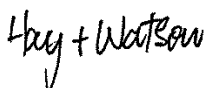
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Lattice Biologics Ltd. as at September 30, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

### *Emphasis of Matter*

Without qualifying our opinion, we draw attention to Note 1 to the consolidated financial statements which describe certain material uncertainties regarding the entity's ability to continue as a going concern.

### *Other Matter*

The consolidated financial statements of Lattice Biologics Ltd. for the year ended September 30, 2016 were audited by another auditor who expressed an unmodified opinion on those consolidated financial statements on January 30, 2017.



Chartered Professional Accountants  
Vancouver, British Columbia  
April 30, 2018

**Lattice Biologics Ltd.**  
**Consolidated Statements of Financial Position**  
**(Expressed in U.S. dollars)**  
**As at**

	<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>Assets</b>		
Current assets:		
Cash.....	\$ 18,821	\$ 53,350
Accounts receivable (Note 6).....	216,723	423,761
Prepaid expenses and other current assets.....	4,721	102,979
Inventory (Note 5).....	<u>1,847,574</u>	<u>2,197,838</u>
Total current assets.....	2,087,839	2,777,928
Property and equipment (Note 3).....	336,739	677,098
Intangible assets (Note 4).....	415,987	554,650
Goodwill (Note 4).....	<u>606,428</u>	<u>606,428</u>
Total assets.....	<u>\$ 3,446,993</u>	<u>\$ 4,616,104</u>
<b>Liabilities and Deficit</b>		
Current liabilities:		
Accounts payable and other accrued liabilities (Note 8).....	\$ 4,249,133	\$ 4,306,825
Obligations under finance lease, current portion (Note 9).....	20,395	29,441
Factoring advances (Note 10).....	108,211	124,785
Notes payable, current portion (Note 12).....	1,797,378	2,211,535
Warrant liability (Note 13).....	252,284	366,041
Provisions (Note 18).....	100,000	-
Royalty funding, current portion (Note 14).....	<u>-</u>	<u>750,000</u>
Total current liabilities.....	6,527,401	7,788,627
Obligations under finance lease, long-term portion (Note 9).....	38,900	45,808
Notes payable, long-term portion (Note 12).....	443,306	550,000
Royalty funding, long-term portion (Note 14).....	<u>700,000</u>	<u>2,123,793</u>
Total liabilities.....	<u>7,709,607</u>	<u>10,508,228</u>
Deficit:		
Share capital (Note 15).....	9,602,508	6,744,627
Warrant reserve (Note 13).....	21,862	21,862
Option reserve (Note 15).....	296,433	-
Accumulated deficit.....	<u>(14,183,417)</u>	<u>(12,658,613)</u>
Total deficit.....	<u>(4,262,614)</u>	<u>(5,892,124)</u>
Total liabilities and deficit.....	<u>\$ 3,446,993</u>	<u>\$ 4,616,104</u>

Nature of Business and Going Concern (Note 1)

Commitments, Contingencies and Provisions (Note 18)

Approved by the Board

Cheryl Farmer  
Director (Signed)

Guy Cook  
Director (Signed)

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

**Lattice Biologics Ltd.**  
**Consolidated Statements of Comprehensive Loss**  
**(Expressed in U.S. dollars)**

	<b>Years Ended September 30,</b>	
	<b>2017</b>	<b>2016</b>
Revenue.....	\$ 2,739,376	\$ 3,777,854
Cost of sales:		
Cost of sales - Exclusive of depreciation.....	2,094,583	2,881,888
Cost of sales - Depreciation.....	73,683	79,273
Total cost of sales.....	2,168,266	2,961,161
Gross profit.....	571,110	816,693
Operating expenses:		
Depreciation and amortization.....	149,811	398,594
General and administrative.....	402,306	663,081
Research and development.....	217,086	73,956
Professional fees.....	601,301	574,526
Impaired distributor acquisition.....	72,000	-
Rent.....	153,692	146,903
Salaries.....	1,067,537	1,299,986
Sales and marketing.....	468,474	1,053,984
Utilities.....	28,804	55,586
Total operating expenses.....	3,161,011	4,266,616
Loss from operations.....	(2,589,901)	(3,449,923)
Other income (expense):		
Interest and finance charges.....	(467,036)	(1,042,901)
Loss on convertible note revaluation.....	-	(61,900)
Share-based payments (Note 15).....	(296,433)	(1,388,473)
Listing expense.....	-	(1,639,390)
Loss on settlement of payables.....	(233,254)	-
Other income (expense).....	24,030	2,062
Change in fair value of warrants (Note 13).....	700,801	180,439
Impairment of property and equipment (Note 3).....	(301,589)	-
Onerous lease charge upon facility relocation.....	(64,563)	-
Gain on Grenville debt restructuring (Note 12).....	2,111,103	-
Royalty.....	(407,962)	(451,921)
Total other income (expense).....	1,065,097	(4,402,084)
Net loss and comprehensive loss.....	\$ (1,524,804)	\$ (7,852,007)
Basic and diluted income (loss) per share.....	\$ (0.02)	\$ (0.16)
Weighted average number of common shares outstanding.....	77,999,074	48,150,237

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

**Lattice Biologics Ltd.**  
**Consolidated Statements of Changes in Deficit**  
**(Expressed in U.S. dollars)**

	<u>Number of Shares</u>	<u>Number of Warrants</u>	<u>Share Capital</u>	<u>Warrant Reserve</u>	<u>Option Reserve</u>	<u>Accumulated Deficit</u>	<u>Total Deficit</u>
Balances at September 30, 2015.....	14,699	-	\$ 913,845	\$ -	\$ -	\$ (4,806,606)	\$ (3,892,761)
Share consolidation.....	(1,987)	-	-	-	-	-	-
Shares issued.....	1,987	-	1,240,205	-	-	-	1,240,205
Reverse takeover adjustment.....	39,607,192	-	954,536	-	-	-	954,536
Shares issued.....	23,515,331	182,530	3,636,041	21,862	-	-	3,657,903
Net loss for the year.....	-	-	-	-	-	(7,852,007)	(7,852,007)
Balances at September 30, 2016.....	63,137,222	182,530	6,744,627	21,862	-	(12,658,613)	\$ (5,892,124)
Shares issued.....	30,156,119	-	2,857,881	-	-	-	2,857,881
Share-based payments.....	-	-	-	-	296,433	-	296,433
Warrants expired.....	-	(182,530)	-	-	-	-	-
Net loss for the year.....	-	-	-	-	-	(1,524,804)	(1,524,804)
Balances at September 30, 2017.....	<u>93,293,341</u>	<u>-</u>	<u>\$ 9,602,508</u>	<u>\$ 21,862</u>	<u>\$ 296,433</u>	<u>\$ (14,183,417)</u>	<u>\$ (4,262,614)</u>

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

**Lattice Biologics Ltd.**  
**Consolidated Statements of Cash Flows**  
**(Expressed in U.S. dollars)**

	<b>Years Ended September 30,</b>	
	<b>2017</b>	<b>2016</b>
<b>Operating activities:</b>		
Net loss .....	\$ (1,524,804)	\$ (7,852,007)
Non-cash adjustments to reconcile net loss to net cash flows used in operations:		
Depreciation of property and equipment .....	84,832	83,801
Amortization of intangible assets .....	138,663	394,066
Bad debt expense .....	-	78,191
Debt accretion .....	124,326	518,837
Loss on convertible note revaluation .....	-	61,900
Non-cash listing expense .....	-	954,536
Change in fair value of warrants .....	(700,801)	(180,439)
Loss on settlement of payables .....	234,966	-
Loss on disposal of property and equipment .....	-	2,400
Impaired distributor acquisition .....	72,000	-
Impairment of property and equipment .....	301,589	-
Onerous lease charge upon facility relocation .....	64,563	-
Gain on Grenville debt restructuring .....	(2,111,103)	-
Share-based payments .....	296,433	1,388,473
Changes in working capital:		
Accounts receivable .....	207,038	260,742
Prepaid expenses and other assets .....	26,258	(69,618)
Inventory .....	350,264	757,804
Accounts payable and accrued liabilities and provisions .....	1,705,402	1,612,828
Factoring advances .....	(16,574)	(143,829)
Cash used in operating activities .....	<u>(746,948)</u>	<u>(2,132,315)</u>
<b>Investing activities:</b>		
Purchase of property and equipment .....	<u>(27,837)</u>	<u>(49,239)</u>
Cash used in investing activities .....	<u>(27,837)</u>	<u>(49,239)</u>
<b>Financing activities:</b>		
Issuance of common shares and warrants .....	960,000	2,313,876
Repayment of finance lease obligations .....	(34,179)	(71,765)
Proceeds from officer loans .....	-	175,000
Proceeds from notes payable .....	30,435	250,000
Repayment of notes payable .....	<u>(216,000)</u>	<u>(482,500)</u>
Cash provided by financing activities .....	<u>740,256</u>	<u>2,184,611</u>
(Decrease) increase in cash .....	(34,529)	3,057
Cash, beginning of year .....	<u>53,350</u>	<u>50,293</u>
Cash, end of year .....	<u>\$ 18,821</u>	<u>\$ 53,350</u>
<b>Supplemental Disclosures of Cash Flow Information:</b>		
Cash paid for interest .....	<u>\$ 27,667</u>	<u>\$ 170,152</u>
Cash paid for income taxes .....	<u>\$ -</u>	<u>\$ -</u>
Non-cash investing and financing activities:		
Conversion of accounts payable to equity .....	<u>\$ 821,852</u>	<u>\$ -</u>
Conversion of officer loans .....	<u>\$ -</u>	<u>\$ 1,390,507</u>
Finance lease obligation .....	<u>\$ 18,225</u>	<u>\$ 68,384</u>
Conversion of convertible investor note payable .....	<u>\$ -</u>	<u>\$ 500,000</u>

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

**Lattice Biologics Ltd.**  
**Notes to Consolidated Financial Statements**  
**Years Ended September 30, 2017 and 2016**  
**(Expressed in U.S. dollars)**

**1. NATURE OF BUSINESS AND GOING CONCERN**

Lattice Biologics Ltd. (the “Company”) develops, manufactures and markets biologic products to domestic and international markets. The Company’s products are used in a variety of applications including enhancing fusion in spine surgery, enhancing breast reconstruction post mastectomy for breast cancer patients, sports medicine applications including ACL repair, promotion of bone in foot and ankle surgery, promotion of skull healing following neurosurgery and subchondral bone defect repair in knee and other joint surgeries.

On August 3, 2015 (as amended September 3, 2015), Lattice Biologics, Inc. entered into a letter of intent to engage in an acquisition whereby Blackstone Ventures Inc. (“Blackstone”), an arm’s-length Public Corporation registered in British Columbia, Canada, would acquire all of the issued and outstanding securities of Lattice Biologics, Inc. (the “Reverse Takeover”). Lattice Biologics Inc. was incorporated under the laws of Delaware on July 18, 2013; however, Lattice Biologics, Inc. did not commence operations until September 21, 2013. The Reverse Takeover was completed on December 23, 2015 and Blackstone was renamed as Lattice Biologics Ltd. In accordance with International Financial Reporting Standards (“IFRS”) 3, Business Combinations, the substance of the transaction was a reverse takeover of a non-operating company by Lattice Biologics, Inc. and as such, the transaction did not constitute a business combination as Blackstone did not meet the definition of a business under this standard. As a result, the transaction was accounted for as an acquisition of a stock exchange listing with Lattice Biologics Inc. being identified as the acquirer, and the equity consideration transferred by Lattice Biologics, Inc. measured at fair value. Following the Reverse Takeover, Lattice Biologics, Inc. became a wholly owned subsidiary of the Company. Accordingly, the accounts of the Company consist of the consolidated balances of Lattice Biologics, Inc. and Blackstone following the Reverse Takeover and only the accounts of Lattice Biologics, Inc. prior to the Reverse Takeover. Separately, on September 20, 2013, Lattice Biologics, Inc. acquired certain assets and liabilities of International Biologics, LLC (“International Biologics”), a non-related, privately held company. The Company’s common shares are listed under the symbol “LBL” on the TSX Venture Exchange (“TSX-V”).

As described above, the former shareholders of Lattice Biologics, Inc. control the resulting entity following the Reverse Takeover. As Blackstone had no operations it did not constitute a business, and accordingly, the acquisition of Blackstone is accounted for under IFRS 2 at the fair value of the equity instruments granted to the former Blackstone shareholders, less the remaining net assets of Blackstone at the Reverse Takeover date. As Lattice Biologics, Inc. shareholders control the Blackstone entity, these financial statements present the continuation of the business of Lattice Biologics, Inc. The fair value of the consideration for the Reverse Takeover is as follows:

Deemed issuance of 3,891,141 common shares.....	\$	954,536
Issuance of 392,489 broker/agents' common shares.....		<u>96,281</u>
Total consideration.....		1,050,817
Total Consideration has been allocated as follows:		
Cash received.....		(9,460)
Accounts payable and accrued liabilities.....		203,474
Additional cash costs and other.....		<u>394,559</u>
Total listing expense.....	\$	<u><u>1,639,390</u></u>

The Company’s consolidated financial statements have been prepared on a going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. The Company incurred a net loss of \$1.5 million for the year ended September 30, 2017 and has incurred losses in the past, has an accumulated deficit of \$14.2 million at September 30, 2017 (September 30, 2016 - \$12.7 million), and has a working capital deficiency of \$4.4 million at September 30, 2017 (September 30, 2016 - \$5.0 million). These conditions reflect a material uncertainty that casts significant doubt on the Company's ability to continue as a going concern. In order to meet its obligations and realize its investment in its assets, the Company is dependent on the continued support from investors and related parties. The Company may not be able to achieve or maintain profitability and may continue to incur losses in the future. In addition, it is expected that the Company will continue to increase operating expenses as it implements initiatives to continue to grow its business.

**Lattice Biologics Ltd.**  
**Notes to Consolidated Financial Statements – Continued**  
**Years Ended September 30, 2017 and 2016**  
**(Expressed in U.S. dollars)**

The Company plans to continue to make investments to support the growth of the business and is expected to require additional funds to respond to business challenges, including the need to develop new services or enhance existing services, enhance operating infrastructure and acquire complementary businesses and technologies. Accordingly, the Company is subject to liquidity risk. Management will be required to continue to raise capital to develop, market and promote the Company's products and technology, and to maintain its ongoing operations. There is a risk that additional financing will not be available on a timely basis or on terms acceptable to the Company. These consolidated financial statements do not reflect the adjustments or reclassifications that would be necessary if the Company was unable to continue operations.

During June 2017, the Company relocated its registered office and processing facilities to 512 East Madison Avenue, Suite 101, Belgrade, Montana 59714. Prior to this relocation, the Company's registered office and processing facilities were located in Scottsdale, Arizona (see Notes 3, 18 and 21).

## **2. SIGNIFICANT ACCOUNTING POLICIES**

### **Basis of Presentation and Statement of Compliance**

These financial statements have been prepared in accordance with IFRS and the IFRS International Financial Reporting Interpretations Committee. The financial statements have been prepared under the historical cost convention, except for certain financial instruments that are measured at fair value, as discussed in the accounting policies below. The accounting policies have been consistently applied throughout the period unless otherwise stated. Certain figures have been reclassified to conform to current year's presentation. These consolidated financial statements were authorized for issue by the Board of Directors on April 30, 2018.

As discussed above, subsequent to the Reverse Takeover, these financial statements consolidate the accounts of the Company and its wholly owned subsidiary, Lattice Biologics Inc. and consist of only the accounts of Lattice Biologics, Inc. prior to the Reverse Takeover. Intercompany balances and transactions are eliminated upon consolidation. The preparation of the consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are discussed below.

### **Functional and Presentation Currency**

These consolidated financial statements are presented in United States dollars, which is also the Company's and its subsidiaries' functional currency. Unless otherwise noted as being denominated in Canadian dollars ("C\$"), all amounts presented herein are stated in United States dollars.

### **New Accounting Standards and Interpretations**

The following is a summary of new standards, amendments and interpretations that are effective for annual periods beginning on or after January 1, 2016, but did not have any material impact on the consolidated financial statements presented:

#### ***Presentation of Financial Statements***

The amendments to IAS 1 enhance financial statement disclosures and presentation.

#### ***Property, Plant and Equipment***

The amendment to IAS 16 provides clarification of acceptable methods of depreciation and amortization.

#### ***Intangible Assets***

The amendment to IAS 38 provides clarification of acceptable methods of depreciation and amortization.



**Lattice Biologics Ltd.**  
**Notes to Consolidated Financial Statements – Continued**  
**Years Ended September 30, 2017 and 2016**  
**(Expressed in US dollars)**

The following pronouncements were issued by the IASB or the IFRS Interpretations Committee. Those pronouncements that are not applicable or do not have a significant impact to the Company have been excluded from the summary below. The following have not yet been adopted and are being evaluated to determine the resultant impact on the Company.

***Financial Instruments***

IFRS 9 Financial Instruments was issued in final form in July 2014 by the IASB and will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 also includes requirements relating to a new hedge accounting model, which represents a substantial overhaul of hedge accounting which will allow entities to better reflect their risk management activities in the financial statements.

The most significant improvements apply to those that hedge non-financial risk, and so these improvements are expected to be of particular interest to non-financial institutions. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

***Leases***

In January 2016, the IASB issued IFRS 16 Lease, which requires lessees to recognize assets and liabilities for most leases. Application of the standard is mandatory for annual reporting periods beginning on or after January 1, 2019, with earlier adoption permitted, provided the new revenue standard, IFRS 15 Revenue from Contracts with Customers, has been applied or is applied at the same date as IFRS 16. The Company is currently assessing the impact of IFRS 16 on the Company's consolidated financial statements along with the planned timing of our adoption of IFRS 16.

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. The related asset is then recognized at the inception of the lease at fair value or, if lower, the present value of the lease payments plus incidental payments, if any. A corresponding amount is recognized as a finance lease liability. Lease payments are apportioned between finance expenses and reduction of the lease obligation so as to achieve a constant rate of interest on the balance of the liability. Depreciation methods and useful lives for assets held under finance lease agreements correspond to those applied to comparable assets that are owned by the Company. The corresponding finance lease liability is reduced by lease payments, net of imputed interest. All other leases are treated as operating leases with payments on such operating leases recognized as an expense on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

***Revenue from Contracts with Customers***

In May 2014, IASB issued IFRS 15 Revenue from Contracts with Customers. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. IFRS 15 supersedes the following standards: IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programs, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers, and SIC-31 Revenue—Barter Transactions Involving Advertising Services.

***Share-based Payment***

The amendments to IFRS 2 provide clarification and guidance on the treatment of vesting and non-vesting conditions related to cash-settled share-based payment transactions, on share-based payment transactions with a net settlement feature for withholding tax obligations, and on accounting for modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled. The amendments to IFRS 2 are effective for annual periods beginning on or after January 1, 2018, with earlier application permitted.

**Lattice Biologics Ltd.**  
**Notes to Consolidated Financial Statements – Continued**  
**Years Ended September 30, 2017 and 2016**  
**(Expressed in US dollars)**

*Statement of Cash Flows*

The amendments to IAS 7 provides enhancements to the disclosure regarding changes to liabilities arising from financing activities. The amendments to IAS 7 are effective for annual periods beginning on or after January 1, 2017.

**Cash**

Cash includes cash on hand, unrestricted cash, and balances with banks.

**Property and Equipment**

Property and equipment are stated at cost less accumulated depreciation and impairment losses. Depreciation is recorded as follows:

- Freezers and freeze dryers: Straight line over eight and ten years respectively
- Sensor thermometers: Straight line over ten years
- Medical tools and equipment: Straight-line over eight and ten years respectively
- Leasehold improvements: Straight line over the lease term
- Office equipment and card system: Straight line over five and fifteen years respectively

Repair and maintenance expenditures that extend the useful life of the asset are capitalized and minor repair and maintenance costs are expensed as incurred to the statement comprehensive loss. The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at the end of each reporting period. An asset's carrying amount is written down to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. Gains or losses on disposals are determined by comparing the proceeds received to the carrying amounts and are recognized within the statement comprehensive loss.

**Business Combinations**

Acquisitions are accounted for as business combinations 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 income and comprehensive income as incurred.

When the consideration transferred in a 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.

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.

The subsequent accounting for changes in the fair value of the contingent consideration that do not qualify as measurement period adjustments depends on how the contingent consideration is classified.

Contingent consideration that is classified as equity is not re-measured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is re-measured at subsequent reporting dates in accordance with IAS 39, or IAS 37 Provisions, Contingent Liabilities and Contingent Assets, as appropriate, with the corresponding gain or loss being recognized in profit or loss.

**Goodwill**

Goodwill represents the excess amount of consideration given over the fair value of the underlying 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.

**Lattice Biologics Ltd.**  
**Notes to Consolidated Financial Statements – Continued**  
**Years Ended September 30, 2017 and 2016**  
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For the purposes of impairment testing, goodwill is allocated to each of the Company's cash generating units ("CGU") that are expected to benefit from the synergies of the acquisitions. If the recoverable amount of the CGU 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. The Company operates under one CGU.

**Intangible Assets**

Intangible assets are measured at fair value on acquisition less accumulated amortization and accumulated impairment losses. Amortization is recorded as follows:

- Acquired intellectual property and operating licenses: Straight-line over seven years
- Customers lists: Straight-line over three years

The estimated useful life is reviewed at the end of each reporting period with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite lives are subject to annual impairment tests.

**Impairment of Non-Financial Assets**

The Company reviews assets such as property and equipment and intangible assets with finite useful lives for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Intangible assets with indefinite lives are tested for impairment annually or more frequently if events or changes in circumstances indicate that they may be impaired. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows, or the CGU level. The recoverable amount is the greater of an asset's fair value less the cost of disposal and value in use, (being the present value of the expected future cash flows of the relevant asset or CGU), as determined by management. Impairment losses are recognized immediately in the statement of comprehensive loss. Non-financial assets other than goodwill that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

**Provisions**

Provisions are recognized when present (legal or constructive) obligations as a result of a past event will lead to a probable outflow of economic resources and amounts can be estimated reliably. Provisions are measured at management's best estimate of the expenditure required to settle the present obligation, based on the most reliable evidence available at the reporting date, including the risks and uncertainties associated with the present obligation.

The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts. All provisions are reviewed at each reporting date and adjusted to reflect the current best estimate. In those cases where the possible outflow of economic resources as a result of present obligations is considered remote, no liability has been recognized.

**Earnings Per Share**

Basic earnings (loss) per share is calculated by dividing net earnings (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted earnings (loss) per share is calculated by dividing the applicable net earnings (loss) for the period by the sum of the weighted average number of shares outstanding during the period and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the period. For purposes of calculating earnings (loss) per share, the number of the Company's common shares outstanding have been retroactively adjusted to reflect the Reverse Takeover to the earliest period presented.

**Inventory**

Inventory consists of raw materials and finished goods. Inventory is valued at the lower of cost based on the specific identification cost and net realizable value. Net realizable value is the estimated selling price less applicable selling expenses and costs to complete. If the carrying value exceeds the net realizable value, a write-down is recognized. A reserve is taken on inventory for quantities not expected to be consumed. This reserve offsets the inventory balance. There were no reversals of inventory reserves for the periods presented.

**Lattice Biologics Ltd.**  
**Notes to Consolidated Financial Statements – Continued**  
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**Revenue Recognition**

Revenue is recognized in the statement of comprehensive loss when goods are delivered and title has passed, at which time all the following conditions are satisfied:

- The Company has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the Company; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

Revenue represents the amounts receivable after the deduction of discounts, other sales taxes, allowances given, provisions for chargebacks, other price adjustments and accruals for estimated future rebates and returns. The methodology and assumptions used to estimate rebates and returns are monitored and adjusted in light of contractual and historical information.

**Financial Instruments**

The Company classifies all financial instruments as held-to-maturity, available-for-sale, fair value through profit or loss (“FVTPL”), loans and receivables or other liabilities. Financial assets held-to maturity, loans and receivables and financial liabilities other than those classified as FVTPL, are measured at amortized cost using the effective interest method. Available-for-sale instruments are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss).

Financial liabilities are classified as either financial liabilities classified as FVTPL or other financial liabilities. Financial liabilities are classified as FVTPL when the liability is either classified as held-for-trading or it is designated as FVTPL. A financial liability may be designated at FVTPL upon initial recognition if it forms part of a contract containing one or more embedded derivatives. Instruments classified as FVTPL are measured at fair value with unrealized gains and losses recognized in net income (loss). Other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Transaction costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial liabilities are included in the initial carrying amount of the liability.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- In the principal market for the asset or liability, or
- In the absence of a principal market, in the most advantageous market for the asset or liability.

The principal or the most advantageous market must be accessible by the Company. The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorized within the fair value hierarchy, described, as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

- Level 1: Valuations based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: Valuations based on directly or indirectly observable inputs in active markets for similar assets or liabilities, other than Level 1 prices, such as quoted interest or currency exchange rates; and
- Level 3: Valuations based on significant inputs that are not derived from observable market data, such as discounted cash flow methodologies based on internal cash flow forecasts.

**Lattice Biologics Ltd.**  
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Cash is reported at level 1, warrants are classified as level 2 and convertible notes (up to the time of the Reverse Takeover) are classified as level 3. There have been no movements or reclassifications between the two levels during the past two reporting periods. The Company has classified its financial assets and liabilities as follows:

<u>Financial Instrument</u>	<u>Classification</u>
Cash.....	FVTPL
Accounts receivable.....	Loans and receivables
Accounts payable and accrued liabilities.....	Other liabilities
Officer loans.....	Other liabilities
Convertible notes.....	FVTPL
Notes payable.....	Other liabilities
Warrant liability.....	FVTPL
Royalty funding.....	Other liabilities
Factoring advances.....	Other liabilities
Finance lease obligations.....	Other liabilities

**Accounting Estimates and Judgements**

The preparation of financial statements in compliance with IFRS requires the Company’s management to make certain estimates and assumptions that they consider reasonable and realistic. Despite regular reviews of these estimates and assumptions, based in particular on past achievements or anticipations, facts and circumstances may lead to changes in these estimates and assumptions which could impact the reported amount of the Company’s assets, liabilities, equity or earnings. These estimates and assumptions notably relate to the amortization of and measurement of impairment of property and equipment and other assets, and deferred income taxes. The judgments notably relate to the assessment of going concern uncertainties, the Company’s inventory costing technique, the determination of cash generating units and review of impairment and the Company’s accounting applied to the royalty funding. The most significant estimates and judgements are described below:

- (i) *Inventory Costing Technique.* The Company uses a specific identification approach to capture the costs of raw materials and overhead to bring the inventory to its present salable condition. This specific identification approach best reflects the physical inputs of raw materials, direct labor and direct overhead.
- (ii) *Determination of Cash Generating Unit and Review of Impairment.* The Company has determined that it presently operates as one cash generating unit and has allocated goodwill to this single cash generating unit. The Company is required to test all indefinite life intangible assets at least annually.
- (iii) *Accounting for Grenville Royalty Funding and Debt Restructuring.* The Company’s royalty funding agreement with Grenville Royalty Corp (“Grenville”) has been accounted for as a financial liability and measured at fair value at initial recognition, with a re-measurement recognized in June 2017 at the time the agreement was restructured. The Company made this determination after reviewing the substance of the agreement and determining that the cash received at the inception of the arrangement did not represent advance payments for any future sales. The Company has valued the royalty agreement (i) at fair value when it initially became party to the arrangement and (ii) upon re-measurement in June 2017 for the debt restructuring with Grenville (Notes 12 and 14) using the prevailing discount rate at the applicable time (see Note 12).
- (iv) *Provision for Lease Termination.* During June 2017, the Company relocated its registered office and processing facilities from Scottsdale, Arizona to Belgrade, Montana. At such time, the Company recognized a provision for the onerous Scottsdale, Arizona lease based on management’s best estimate of unavoidable payments that are expected under the lease agreement following the facility relocation. The provision for the onerous Scottsdale, Arizona lease has been updated to reflect the agreement reached with the Company’s former landlord. (see Notes 18 and 21)

**Lattice Biologics Ltd.**  
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**3. PROPERTY AND EQUIPMENT**

Property and equipment cost is summarized as follows:

	September 30,				September 30,				September 30,
	2015	Additions	Disposals	Other	2016	Additions	Disposals	Impairment	2017
Freezers and freeze dryers.....	\$ 124,077	\$ -	\$ -	\$ 13,750	\$ 137,827	\$ -	\$ -	\$ -	\$ 137,827
Sensor thermometers.....	52,393	-	-	-	52,393	-	-	(52,393)	-
Medical tools and equipment...	217,791	88,711	-	6,450	312,952	18,225	-	-	331,177
Leasehold improvements.....	326,451	-	-	-	326,451	-	-	(326,451)	-
Office and other equipment.....	29,129	28,912	-	-	58,041	27,837	-	(15,317)	70,561
Total cost.....	\$ 749,841	\$ 117,623	\$ -	\$ 20,200	\$ 887,664	\$ 46,062	\$ -	\$ (394,161)	\$ 539,565

Impairment of property and equipment relate to the write off leasehold improvements on the Company's old premises in Scottsdale, Arizona, which it vacated in June 2017, and the write off of equipment which were damaged during the move from the Company's move from Scottsdale, Arizona to its new premises in Belgrade, Montana.

Property and equipment accumulated depreciation is summarized as follows:

	September 30,				September 30,				September 30,
	2015	Additions	Disposals	Other	2016	Additions	Disposals	Impairment	2017
Freezers and freeze dryers.....	\$ 26,179	\$ 21,448	\$ -	\$ 13,750	\$ 61,377	\$ 14,448	\$ -	\$ -	\$ 75,825
Sensor thermometers.....	11,328	5,664	-	-	16,992	5,664	-	(22,656)	-
Medical tools and equipment...	33,008	30,398	2,400	6,450	72,256	37,250	-	-	109,506
Leasehold improvements.....	27,822	21,763	-	-	49,585	16,323	-	(65,908)	-
Office and other equipment.....	5,828	4,528	-	-	10,356	11,147	-	(4,008)	17,495
Total accumulated depreciation	\$ 104,165	\$ 83,801	\$ 2,400	\$ 20,200	\$ 210,566	\$ 84,832	\$ -	\$ (92,572)	\$ 202,826

Property and equipment net book value is summarized as follows:

	September 30,	
	2017	2016
Freezers and freeze dryers.....	\$ 62,002	\$ 76,450
Sensor thermometers.....	-	35,401
Medical tools and equipment.....	221,671	240,696
Leasehold improvements.....	-	276,866
Office and other equipment.....	53,066	47,685
Total.....	\$ 336,739	\$ 677,098

Carrying amounts for property under finance leases at September 30, 2017 were \$154,913 (September 30, 2016 - \$207,862). See Note 9 for further details.

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**4. INTANGIBLE ASSETS AND GOODWILL**

The Company's goodwill and other intangible assets were recognized as a part of the September 2013 acquisition of International Biologics. Goodwill recognized was \$606,428, and amortizable intangible asset cost consists of customer lists of \$766,210 and intellectual property and licenses of \$970,637.

Amortizable intangible accumulated amortization is summarized as follows:

	<u>September 30,</u> <u>2015</u>	<u>Amortization</u>	<u>September 30,</u> <u>2016</u>	<u>Amortization</u>	<u>September 30,</u> <u>2017</u>
Customer list.....	\$ 510,806	\$ 255,404	\$ 766,210	\$ -	\$ 766,210
Intellectual property and licenses.....	<u>277,325</u>	<u>138,662</u>	<u>415,987</u>	<u>138,663</u>	<u>554,650</u>
Total accumulated depreciation.	<u>\$ 788,131</u>	<u>\$ 394,066</u>	<u>\$ 1,182,197</u>	<u>\$ 138,663</u>	<u>\$ 1,320,860</u>

Amortizable intangible carrying balances consist of intellectual property and licenses of \$415,987 at September 30, 2017 (September 30, 2016 – \$554,650). Customer lists were fully amortized at September 30, 2016.

The Company operates in one CGU. The Company performed impairment testing on its CGU to determine whether any impairment was required on its goodwill based on a value in use calculation, which uses management's cash flow projections covering a five-year period, and a discount rate of 19%. Cash flow projections are based on expected gross margins and revenue growth of the Company's product lines, including inflation, throughout the projection period, with cash-flows beyond the five-year period extrapolated using a steady 2% per annum growth rate. Management believes that any reasonable possible change in the key assumptions on which the recoverable amount is based would not cause the aggregate carrying amount of the CGU to exceed the recoverable amount of the CGU. No indicator of impairment was noted at September 30, 2017 or 2016 based on these discounted cash flow projections and the Company's market capitalization.

**5. INVENTORY**

Inventory consists of the following:

	<u>September 30,</u>	
	<u>2017</u>	<u>2016</u>
Unprocessed goods.....	\$ 1,039,215	\$ 998,172
Finished goods.....	839,029	1,215,334
Reserve.....	<u>(30,670)</u>	<u>(15,668)</u>
Total inventory.....	<u>\$ 1,847,574</u>	<u>\$ 2,197,838</u>

During the years ended September 30, 2017 and 2016, inventory recognized as cost of sales totaled \$2,094,583 and \$2,312,312, respectively. A total of \$nil and \$61,140 of inventory was charged off for the years ended September 30, 2017 and 2016, respectively.

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**6. ACCOUNTS RECEIVABLE**

Accounts receivable consists of the following:

	<u>September 30,</u>	
	<u>2017</u>	<u>2016</u>
Accounts receivable.....	\$ 323,475	\$ 488,503
Less: Allowance for doubtful accounts.....	(106,752)	(64,742)
Accounts receivable, net.....	<u>\$ 216,723</u>	<u>\$ 423,761</u>

There was \$42,010 and \$18,831 of accounts receivable written off for the years ended September 30, 2017 and 2016, respectively. A portion of the accounts receivable balance is factored (see Note 10).

**7. LONG TERM INVESTMENT**

Among the assets acquired from International Biologics in September 2013, was an 8% investment in VG Innovations (“VGI”), a third-party, privately-held Corporation. This investment was recorded at cost with a nominal value. On August 12, 2015, the Company reached an agreement with VGI and sold its 8% investment in VGI in exchange for the purchase of \$500,000 worth of bio implants product from the Company. These purchases were to take place within 12 months from August 12, 2015 (“the purchase period”) and were subject to the same technical specifications and same prices as the Company’s manufacturer prices from August 12, 2015. Minimal purchases were provided for through June 2016, at which time this purchase agreement was terminated by both parties pursuant to the terms of the agreement.

**8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

Accounts payable and accrued liabilities consist of the following:

	<u>September 30,</u>	
	<u>2017</u>	<u>2016</u>
Accounts payable.....	\$ 2,517,986	\$ 2,752,683
Accrued liabilities.....	1,677,286	1,535,467
Provision for lease termination.....	36,900	-
Shares to be issued.....	16,961	18,675
Accounts payable and accrued liabilities.....	<u>\$ 4,249,133</u>	<u>\$ 4,306,825</u>

As discussed in Note 3, during June 2017, the Company relocated its head office and processing facilities to Belgrade, Montana and vacated its Scottsdale, Arizona facility. The Company has executed a settlement agreement as a result of vacating the premises in Scottsdale, Arizona (see Note 21).



**Lattice Biologics Ltd.**  
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**9. FINANCE LEASE OBLIGATION**

The Company has entered into several finance lease obligations for various pieces of equipment. These leases bear interest at rates ranging from 15% to 22% and have terms ranging from three to four years. The following table summarizes remaining amounts due under the Company’s finance lease obligations at September 30, 2017 (for the fiscal year ending):

2018.....	\$	29,376
2019.....		29,376
2020.....		<u>16,413</u>
Total future payments.....		75,165
Less: Amounts representing interest.....		<u>(15,870)</u>
Obligations under finance lease.....		59,295
Less: Current portion.....		<u>(20,395)</u>
Long-term portion.....	\$	<u>38,900</u>

**10. FACTORING ADVANCES**

On April 17, 2015, the Company entered into a factoring arrangement of up to \$1.0 million (up to 85% of the face value of the accounts receivable assigned to be factored). The Company must offer a minimum of \$250,000 in accounts receivable to be factored on a monthly basis. Under the terms of the factoring agreement, the Company may be requested to repay any amounts owing plus applicable interest. The fees charged under this agreement are (i) an administrative fee of 0.25% on the face value of each account submitted; (ii) a discount fee of 0.25% for each fifteen-day period after the initial thirty-day period; (iii) a funding fee of 3.50% above the prime rate for each account purchased for which the Company has received an advance, which funding fee shall be calculated on net funds employed and shall in no event be less than 6.75%.

During March 2017, the Company amended this agreement to reduce the maximum credit facility to \$300,000, and the minimum monthly factored receivables balance offered to \$165,000. Following this amendment, the Company is subject only to an administrative fee of 0.40%.

The credit facility is secured by the Company’s accounts receivable. The Company is required to maintain a tangible net worth of more than negative \$5,000,000, which the Company was in compliance with as at September 30, 2017. This arrangement is being recorded as a financing from the factoring company and factoring costs are being charged to operations as incurred. At September 30, 2017, the amounts advanced under this facility totaled \$108,211 (September 30, 2016 – \$124,785).

**11. OFFICER LOANS AND CONVERSION**

During periods prior to October 1, 2015, two of the Company’s officers loaned the Company funds. These loans bore interest at a rate of 20% per annum and had a stated maturity of August 1, 2017. During August 2016, the Company and the holders of these officer loans described converted the principal and interest due at June 30, 2016 totaling \$1,390,507, into 8,568,171 shares of the Company’s common stock (Note 15). A total of \$47,436 (September 30, 2016 - \$53,774) of unpaid accrued interest was not included in this conversion and remains outstanding at September 30, 2017 and 2016. This unpaid accrued interest balance continues to accrue interest at 20% per annum and is included in accounts payable and accrued liabilities on the accompanying Consolidated Statement of Financial Position.

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**12. NOTES PAYABLE**

Notes payable consist of the following:

	<u>September 30,</u>	
	<u>2017</u>	<u>2016</u>
Assumed International Biologics loan.....	\$ 660,000	\$ 774,994
Lifeshare Transplant Donor Services.....	207,069	285,393
Redwood Fund.....	116,894	74,916
Grenville notes.....	706,721	1,076,232
Investor notes.....	<u>550,000</u>	<u>550,000</u>
Total notes payable.....	2,240,684	2,761,535
Less: Current portion.....	<u>(1,797,378)</u>	<u>(2,211,535)</u>
Long-term portion.....	<u>\$ 443,306</u>	<u>\$ 550,000</u>

***Assumed International Biologics Loan***

During September 2013, the Company assumed a non-interest bearing \$2,200,000 loan from an Officer of International Biologics. This loan originally had a maturity date of August 31, 2015; however, it was restructured on May 6, 2015 to extend the maturity date to February 2017. The restructured loan remained non-interest bearing and called for 22 monthly installments of \$50,000, which commenced on May 15, 2015. At the conclusion of the 22<sup>nd</sup> payment, the entire amount due and owing under the note shall be deemed paid in full. This loan is secured by the Company's inventory, equipment and accounts receivable. This note is currently in default as the Company has not remitted the \$50,000 monthly payment since December 2015 due to the Company's working capital deficiency; however, the Company made payments totaling \$90,000 for this note during the year ended September 30, 2017. This note has been restructured and assumed by a third party, and the carrying value of the note at September 30, 2017 is \$660,000, which represents the total balance due at such time (September 30, 2016 – \$774,994) (see Note 21).

***Lifeshare Transplant Donor Services***

On July 17, 2014, a non-related, third party vendor, LifeShare Transplant Donor Services, converted their outstanding payable balance of \$615,819 into a promissory note with a maturity date of December 26, 2014, which bears security over all assets held by the Company. The Company was unable to repay the loan by December 26, 2014 and restructured the note on May 8, 2015. The amended note bears interest at 1.5% compounded monthly, and featured two balloon payments of \$250,000 in May 2015, and the remaining balance due at maturity in August 2015. As part of this restructuring, Lifeshare still bears security over all of the Company's assets, except the Company's accounts receivable, which was released after the Company met the initial \$250,000 payment in May 2015. The Company was not able to make the August 2015 payment and the Company restructured the note once again on December 29, 2015. Following this second restructuring, \$50,000 was paid at the time of the restructuring and the remaining principal plus accrued interest was due in two separate payments on March 31, 2016 and June 30, 2016, neither of which were made. During December 2016, the Company executed a restated promissory note totaling \$295,000 that calls for monthly payments of \$10,000, interest at 5.5% and a maturity date of June 1, 2019. The Company made payments totaling \$100,000 for this restated promissory note during the year ended September 30, 2017. The note's carrying value at September 30, 2017 is \$207,069 (September 30, 2016 – \$285,393).

***Redwood Fund***

On June 26, 2015, the Company secured a note from Redwood Fund, LP, a non-related Company, in the amount of \$287,356 with an original issue discount of 13% (a resultant amount of \$250,000). This note bears interest at 24% and is secured by all assets held by the Company. In accordance with the terms of this note, the Company is currently making monthly payments of 1/5 of the interest incurred. This loan was previously due during June 2016 but has been amended and required payment in full of all outstanding principal and interest balances during September 2016. The Company has made payments totaling \$180,000 from July 1, 2016 to August 29, 2016 and was required to make additional payments totaling \$120,000 during September 2016. The Company made additional payments totaling \$20,000 during October 2016. The Company had been engaged in litigation with Redwood Fund, LP during the first half of fiscal 2017; however, this note was subsequently sold from Redwood Fund, LP to a non-controlling shareholder of the Company, and

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the matter was dismissed. The Company is currently in negotiations with the new note holder regarding repayment terms. The note's carrying value at September 30, 2017 is \$116,894 (September 30, 2016 – \$74,916).

***Grenville Notes and Restructuring***

During June 2017, the Company completed a restructuring of amounts due to Grenville, including balances due under a royalty agreement as described further in Note 14, and two notes payable, which are described as follows:

- (i) *Secured Note Payable.* On July 31, 2015, the Company received funding under a \$700,000 note payable with Grenville, which bore interest at 12.50% per annum, was secured by all assets of the Company and was convertible into additional royalty interests under certain circumstances (Note 14). No payments of principal or interest were due until July 31, 2016, at which time, all amounts outstanding were due. In connection with the loan, the Company granted 500,000 warrants at an exercise price of \$0.60, which expired during December 2016.
- (ii) *Unsecured Notes Payable.* During February and April 2016, Grenville loaned the Company \$150,000 and \$100,000, respectively. These loans bear interest at 10.50% per annum and had maturity dates of February 5, 2017 and April 6, 2017, respectively. No principal or interest amounts are due until the maturity dates of these loans.

The June 2017 Grenville debt restructuring resulted in the following:

- (i) The Secured Note Payable, which had a carrying value of approximately \$0.8 million prior to the restructuring, was amended to (i) extend the maturity date to April 24, 2022; (ii) require monthly payments of \$3,000 through the maturity date; and (iii) reduce the interest rate to 4.244% per annum;
- (ii) The Company issued 18,246,600 common shares to Grenville in consideration for the extinguishment of \$2.0 million of the royalty funding (Note 15) and \$0.7 million of overdue royalty payments;
- (iii) The Company granted a new royalty (the "New Royalty") to Grenville in consideration for the extinguishment of the remaining \$1.0 million balance of the royalty funding (Note 14). The New Royalty calls for payments to Grenville of 1.25% of the Company's revenue if certain conditions are met, which are described in further detail in Note 14.
- (iv) Certain amounts due for interest on the Unsecured Notes Payable and past royalties totaling approximately \$0.1 million were forgiven and extinguished; and
- (v) No changes were made to the Unsecured Notes Payable other than the forgiveness of prior interest as discussed above.

The June 2017 Grenville debt restructuring was accounted for as an extinguishment, as the terms of the debt and equity instruments issued were substantially different from those prior to the restructuring. Accordingly, the Company has recognized the fair value of the debt and equity instruments issued to Grenville as part of the restructuring, with a gain on restructuring recognized for the difference between the prior carrying amounts of the Grenville debt and the fair value of the debt and equity instruments issued to Grenville. The gain recognized of \$2.1 million was based on (i) a fair value of \$1.4 million for the 18,246,600 common shares issued (see Note 15); (ii) a fair value of \$0.7 million for the New Royalty (Note 14); (iii) a fair value of the modified Secured Note payable of \$0.4 million, which was discounted at approximately 20% based on interest rates management believes to be available on comparable secured debt; and (iv) amounts that were forgiven and extinguished.

The carrying value of the Secured Note Payable at September 30, 2017 was \$443,306 (September 30, 2016 – \$809,292). The carrying value of the Unsecured Notes Payable at September 30, 2017 were \$263,415 (September 30, 2016 – \$266,940).

***Investor Notes***

On January 9, 2015, the Company issued convertible notes to four separate investors totaling \$1,050,000. These notes were convertible, at the holder's option, into the Company's common shares at the time of the Reverse Takeover on December 23, 2015 at a conversion price equal to 70% of the price per share of the common stock offered to the public at such time. Upon such conversion, no further amounts are due to the holder of the note, including, but not limited to, any accrued interest due under the note. These notes bear interest at 24% and are due February 1, 2018 (see Note 21); however, the notes can be prepaid by the Company at any time following

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the Reverse Takeover. Monthly payment equal to the amount of all accrued interest on the then outstanding principal balance are due and payable in arrears on the first day of each month for the immediate preceding month beginning March 1, 2015. One of the note holders with a principal balance of \$500,000 converted their note into the Company’s common shares at the time of the Reverse Takeover (Note 15). At such time, the remaining \$550,000 of these notes relinquished their conversion rights to their notes, effectively rendering amounts due as promissory notes. The relinquishment of the conversion right was considered a substantial modification to the notes, resulting in an extinguishment of the original notes. Upon both the conversion and the relinquishment of conversion rights taking place, a loss of \$61,900 was realized as a fair value adjustment to the carrying value of the notes. Following this extinguishment, these notes are recorded at amortized cost of \$550,000, and are reflected as long-term notes payable. Prior to the Reverse Takeover, any embedded derivatives were not separated from the host contract as the entire instrument was recorded at fair value.

**13. Warrants**

The Company’s outstanding warrants that were issued in conjunction with offerings of the Company’s debt or common stock and settlement of amounts payable to service providers have been classified as liabilities in the accompanying Consolidated Statement of Financial Position as the Company’s functional currency is the United States dollar while the strike price of the warrants is denominated in Canadian dollars. Changes in the fair value of these warrants are recognized as income or loss within the Consolidated Statement of Comprehensive Loss and resulted in \$700,801 and \$180,439 of income recognized during the years ended September 30, 2017 and 2016, respectively.

Warrants issued as compensation for services rendered are classified as a warrant reserve within the Company’s deficit in the accompanying Consolidated Statement of Financial Position.

Warrants to acquire voting common shares at September 30, 2017 are summarized as follows:

<b>Date Issued</b>	<b>Exercise Price (C\$)</b>	<b>Date of Expiry</b>	<b>Outstanding and Exercisable</b>
March 31, 2016	0.30	May 2, 2019	663,129
June 29, 2016	0.20	June 29, 2019	843,376
August 8, 2016	0.20	August 8, 2019	801,363
September 15, 2016	0.27	September 15, 2019	323,625
October 12, 2016	0.27	October 18, 2019	660,387
October 21, 2016	0.27	October 24, 2019	1,278,118
December 5, 2016	0.25	December 5, 2019	1,333,196
January 19, 2017	0.27	January 23, 2020	164,243
January 24, 2017	0.27	January 24, 2020	481,798
February 10, 2017	0.27	February 16, 2020	329,130
February 21, 2017	0.27	February 27, 2020	81,292
March 31, 2017	0.27	March 31, 2020	167,270
July 17, 2017	0.25	July 17, 2020	491,363
Total warrants (all accounted for as liabilities).....			<u>7,618,290</u>

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The fair value of warrants at the time of issuance, and at September 30, 2017 and 2016 for the warrants accounted for as liabilities, was estimated using the Black Scholes model with the following significant inputs:

	<b>Issued During Fiscal 2016</b>	<b>Liabilities - September 30, 2016</b>	<b>Issued During Fiscal 2017</b>	<b>Liabilities - September 30, 2017</b>
Weighted average risk-free interest rate (%).....	0.53%	0.51%	0.71%	1.51%
Expected dividend yield (%).....	0.00%	0.00%	0.00%	0.00%
Expected stock price volatility (%).....	121%	113%	122%	116%
Weighted average warrant life in years.....	1.9	1.4	3.0	2.1
Weighted average exercise price (C\$).....	\$0.43	\$0.43	\$0.26	\$0.25
Weighted average fair value (C\$).....	\$0.13	\$0.08	\$0.15	\$0.04
Weighted average stock price (C\$).....	\$0.29	\$0.25	\$0.22	\$0.10

Expected volatility was estimated by reference to comparable listed entities and the Company incorporated the effects of early exercise in the estimate of the expected life of the warrants.

During the year ended September 30, 2017, the following warrants expired unexercised:

- 3,116,999 warrants with a strike price of \$0.60 per share that had been accounted for as liabilities in prior periods; and
- 182,530 warrants with a strike price of \$0.30 per share that are recognized within the warrant reserve as a component of deficit.

#### **14. ROYALTY FUNDING**

Following the June 2017 restructuring of the Company’s debt with Grenville (see Note 12), the Company is subject to a perpetual New Royalty that calls for payments to Grenville of 1.25% of the Company’s revenue for a given fiscal quarter, subject to the Company realizing Excess Free Cash Flow for the last day of such fiscal quarter of at least \$100,000. Excess Free Cash Flow is defined in the restructuring agreement as the amount by which the Company’s cash and cash equivalents on the last day of a given fiscal quarter exceeds the Company’s cash and cash equivalents on the last day of the immediately preceding fiscal quarter. No royalty accrues or is due for fiscal quarters in which the Company does not realize \$100,000 of Excess Free Cash Flow. Under the terms of the June 2017 Grenville debt restructuring, there are no provisions for the repurchase of the New Royalty; accordingly, any future extinguishment of the New Royalty would require separate negotiation with Grenville.

All amounts due under the royalty funding prior to the June 2017 Grenville debt restructuring (the “Previous Royalty”) were extinguished at the time of the restructuring, and the only royalty payments due to Grenville on a prospective basis are those called for by the New Royalty, which are described above. Prior to the June 2017 Grenville debt restructuring, Grenville had advanced a total of \$3.0 million to the Company under the Previous Royalty, with \$2.0 million advanced during the year ended December 31, 2014 and \$1.0 million advanced during May 2015. The first \$2.0 million resulted in a monthly royalty payment equal to \$41,667 (a “Minimum Monthly Payment”) payable up to December 31, 2015. Effective January 1, 2016, the royalty rate was to be determined based on the greater of the Minimum Monthly Payment or 6% of revenue. If revenue for the 2015 calendar year was more than \$15,000,000, the royalty rate would have been 2.74%; if 2015 revenues were less than \$8,000,000 the royalty rate would have been 6%; and if revenue was between \$8,000,000 and \$15,000,000 the royalty rate would have been calculated on a proportional basis. The Minimum Monthly Payment was increased to \$62,500 during May 2015 as a result of the additional \$1.0 million advanced at such time.

On August 1, 2015, Grenville adjusted the Minimum Monthly Payment (“Secondary Minimum Monthly Payment”) from \$62,500 to \$31,250, which was applicable up to December 31, 2015. Effective January 1, 2016 to July 31, 2016, the Company was required to pay a monthly royalty payment of the greater of the Secondary Minimum Monthly Payment of \$31,250 and a sliding scale between 1.37% and 3% of monthly revenue. After July 31, 2016, the applicable royalty rate was determined based on the greater of the Minimum Monthly Payment of \$62,500 or 6% of revenue.

The royalty funding has been, and continues to be, reflected as perpetual debt for accounting purposes, with a current portion presented based on amounts due within the next fiscal year (see Note 17).

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**15. SHARE CAPITAL**

*Authorized and Issued Share Capital*

The Company is authorized to issue an unlimited amount of voting common shares without par value, an unlimited number of non-voting restricted common shares without par value and an unlimited number of preferred shares without par value. The non-voting restricted common shares are not entitled to vote other than in connection with a change of control; however, these shares are entitled to receive dividends and are entitled, in the event of any liquidation, dissolution or winding-up or any other distribution of the assets of the Company among its shareholders for the purpose of winding up its affairs, to share rateably, together with the holders of the voting common shares. Each non-voting restricted share is convertible into one voting common share at the option of the holder, unless such conversion would result in greater than 45% of the voting common shares being held, directly or indirectly, by persons resident in the United States of America. The foregoing restriction expired 18 months from the date the non-voting restricted common shares were issued and as of the date of these financial statements, the restricted shares are exchangeable for voting common shares. Holders of the non-voting restricted common shares holding in the aggregate at least 50% of the outstanding non-voting restricted common shares may, by written consent, extend the restricted period for further 12-month periods. In the event of a take-over offer, for so long as the offer remains outstanding, holders of the non-voting restricted common shares may, subject to board approval, elect to redeem their non-voting restricted common shares at the offered take-over price, or alternatively, they may elect to convert them into voting common shares.

Activity for the Company's share capital for the year ended September 30, 2017 is summarized as follows:

	<u>Shares</u>	<u>Amount</u>
Balances, September 30, 2016.....	63,137,222	\$ 6,744,627
Shares issued through private placement (i).....	6,324,475	546,431
Shares issued to vendors for settlement of payables and services (ii).....	5,585,044	883,343
Shares issued to Grenville for debt restructuring (iii).....	<u>18,246,600</u>	<u>1,428,107</u>
Balances, September 30, 2017.....	<u>93,293,341</u>	<u>\$ 9,602,508</u>

At September 30, 2017, there were 62,552,844 voting common shares issued and outstanding and 30,740,497 non-voting restricted common shares outstanding.

- (i) During the year ended September 30, 2017, the Company closed several private placements, whereby the Company issued 6,324,475 units at a price of C\$0.20 per unit, with each unit consisting of one common share and ½ warrant, for aggregate gross proceeds of \$960,000. The 3,162,238 warrants issued under these offerings have an exercise price C\$0.265 per share, expire 36 months from the date of issuance and are classified as liabilities, as discussed in Note 13. The common shares and warrants were allocated \$546,431 and \$413,569 of the proceeds, respectively.
- (ii) During the year ended September 30, 2017, the Company issued 5,585,044 common shares and 1,824,559 warrants in settlement of various liabilities totaling \$821,851, all but \$30,574 of which was outstanding at September 30, 2016. These warrants have a strike price of C\$0.25 per share, expire three years from the date of issuance and are classified as liabilities, as discussed in Note 13. The common shares and warrants were recognized at fair value of \$883,343 and \$173,475, respectively. The difference between the total fair value of the common shares and warrants issued of \$1,056,818 and the liabilities settled of \$821,851 was recognized as a loss on settlement of payables for the year ended September 30, 2017.
- (iii) As described in Notes 12 and 14, during June 2017, the Company restructured its debt with Grenville. In connection with this restructuring, the Company issued 18,246,600 common shares to Grenville, which were recognized at fair value of \$1,428,107.

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Activity for the Company's share capital for the year ended September 30, 2016 is summarized as follows:

	<u>Shares</u>	<u>Amount</u>
Balances, October 1, 2015.....	14,699	\$ 913,845
Share consolidation (i).....	(1,987)	-
Share issuance (i).....	1,987	1,240,205
Reverse takeover adjustment (ii).....	39,607,192	954,536
Shares issued through private placement (iii).....	5,234,000	927,976
Shares issued to convertible noteholder (iv).....	3,174,603	500,000
Shares issued to Sponsor (v).....	392,489	96,281
Shares issued through private placement (vi).....	1,326,258	209,700
Shares issued through private placement (vii).....	1,686,750	162,160
Shares issued through private placement (viii).....	1,602,725	136,722
Shares issued for conversion of Officer Loans (ix).....	8,568,171	1,390,507
Shares issued for services rendered (x).....	883,085	148,268
Shares issued through private placement (xi).....	<u>647,250</u>	<u>64,427</u>
Balances, September 30, 2016.....	<u>63,137,222</u>	<u>\$ 6,744,627</u>

As of September 30, 2016, there were 31,761,574 voting common shares issued and outstanding and 31,375,648 non-voting restricted common shares outstanding.

- (i) On October 1, 2015, Lattice performed a share consolidation in which it reduced its share capital by 1,987 shares on a pro-rata basis from its existing shareholders. On the same day, the Company issued 1,987 shares to certain employees and a Director of the Company. These shares were issued prior to the Reverse Takeover and translated into 4,830,060 shares of the Company, post consolidation, on December 23, 2015. These shares were valued at C\$0.34 per share.
- (ii) On December 23, 2015, upon the completion of the Reverse Takeover, the former shareholders of Lattice Biologics, Inc. received 35,730,750 shares and the former shareholders of Blackstone retained 3,891,141 shares. All shares issued to these shareholders were valued at C\$0.34 per share.
- (iii) On December 23, 2015, concurrent with the Reverse Takeover, the Company closed a private placement, whereby the Company issued 5,234,000 units at a price of C\$0.30 per unit for proceeds of \$1,154,762, with each unit consisting of one common share and ½ warrant. The 2,616,999 warrants issued have an exercise price of C\$0.60 per share and expire 12 months from the date of issuance. The warrants were valued at \$194,646 and are classified as liabilities, as discussed in Note 13. In conjunction with this sale of units, the Company also issued 182,530 finders' warrants, with an exercise price of C\$0.30 expiring one year following the date of issuance. The finders' warrants were valued at \$21,862. The fair value of warrants and finders' warrants, have been applied against the proceeds of the issuance of the common shares.
- (iv) On December 23, 2015, concurrent with the Reverse Takeover and described further in Note 12, one of the convertible note holders of the Company enacted their conversion rights to convert the face value of the note of \$500,000 in exchange for 3,174,603 common shares.
- (v) On December 23, 2015, concurrent with the Reverse Takeover, the Company issued 392,489 shares to a service provider for acting as the Sponsor for the Transaction. The shares were valued at C\$0.34 per share.
- (vi) On March 31, 2016, the Company closed a private placement, whereby the Company issued 1,326,258 special warrants at a price of C\$0.30 per special warrant for gross proceeds of \$299,154. Each special warrant was automatically converted into a unit for no additional consideration, with each unit consisting of one common share and ½ warrant. The 663,129 warrants issued under this offering have an exercise price C\$0.30 per share, expire 36 months from the date of issuance and are classified as liabilities, as discussed in Note 13. The common shares and warrants were allocated \$209,700 and \$89,454 of the proceeds, respectively.

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- (vii) On June 29, 2016, the Company closed a private placement, whereby the Company issued 1,686,750 units at a price of C\$0.20 per unit, with each unit consisting of one common share and ½ warrant, for aggregate gross proceeds of \$260,000. The 843,377 warrants issued under this offering have an exercise price C\$0.20 per share, expire 36 months from the date of issuance and are classified as liabilities, as discussed in Note 13. The common shares and warrants were allocated \$177,160 and \$82,840 of the proceeds, respectively.
- (viii) On August 8, 2016, the Company closed a private placement, whereby the Company issued 1,602,725 units at a price of C\$0.20 per unit, with each unit consisting of one common share and ½ warrant, for aggregate gross proceeds of \$243,500. The 801,363 warrants issued under this offering have an exercise price C\$0.20 per share, expire 36 months from the date of issuance and are classified as liabilities, as discussed in Note 13. The common shares and warrants were allocated \$136,722 and \$106,778 of the proceeds, respectively.
- (ix) On August 29, 2016, the Company entered into an agreement with two of the Company’s officers to convert \$1,390,507 of officer loans into 8,568,171 common shares of the Company, which represented a C\$0.21 conversion price (Note 11).
- (x) During the fourth quarter of fiscal 2016, the Company issued 883,085 common shares in exchange for \$148,268 of services rendered.
- (xi) On September 16, 2016, the Company closed a private placement, whereby the Company issued 647,250 units at a price of C\$0.20 per unit, with each unit consisting of one common share and ½ warrant, for aggregate gross proceeds of \$100,000. The 323,625 warrants issued under this offering have an exercise price C\$0.265 per share, expire 36 months from the date of issuance and are classified as liabilities, as discussed in Note 13. The common shares and warrants were allocated \$64,427 and \$35,573 of the proceeds, respectively.

**Share Purchase Options and Equity Compensation**

Under the common share option plan (“Share Option Plan”), the Company may grant options to acquire up to 10% of the issued and outstanding common shares of the Company to directors, officers, employees, partners and service providers of the Company. The related vesting period over which share-based compensation expense is determined by the Company at the time of grant. Each share option awarded under the Share Option Plan is equity-settled and the share-based compensation expense is based on the fair value estimate on the business day prior to the grant date.

The Company’s board of directors has approved, and the Company has granted, a total of 3,300,000 options during January 2017 and at September 30, 2017, 1,699,995 of these options are exercisable. These stock options have a strike price of C\$0.30, vest at different times from January 2017 to September 2019 and expire three years from the date of vesting.

The grant date fair value of these options was estimated using the Black Scholes model with the following significant weighted average inputs and grant date fair value:

Risk-free interest rate (%).....	0.73% to 1.37%
Expected dividend yield (%).....	0.00%
Expected stock price volatility (%).....	106% to 122%
Life in years.....	3.0 - 5.6
Exercise price (C\$).....	\$0.30
Weighted average fair value (C\$).....	\$0.12
Weighted average stock price (C\$).....	\$0.23

Expected volatility was estimated by reference to comparable listed entities and the Company incorporated the effects of early exercise in the estimate of the expected life of the share purchase options.



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The Company recognized \$296,433 of share-based payment expense for the year ended September 30, 2017 for these stock options. At September 30, 2017, there is \$106,164 of unrecognized expense related to these stock options, which is expected to be recognized over the remaining vesting terms of the stock options.

**16. INCOME TAXES**

The Company's provision for income taxes differs from applying the statutory U.S. federal income tax rate to income before taxes. The primary difference results from providing for state income taxes and from deducting certain expenses for financial statement purposes, but not for federal income tax purposes.

The Company has not recognized deferred tax assets in excess of those that have been offset against deferred tax liabilities, as it is not yet probable that the Company will have substantial taxable income against which the deferred tax assets can be utilized in the near future. Deferred tax assets and liabilities have been offset where they relate to income taxes levied by the same taxation authority and the Company has the legal right and intent to offset.

The Company's income tax expense for the years ended September 30, 2017 and 2016 was nil. A reconciliation of income tax expense to the financial statements statutory tax rates is as follows:

	<b>Year Ended September 30,</b>	
	<b>2017</b>	<b>2016</b>
Net loss before taxes.....	\$ (1,524,804)	\$ (7,852,007)
Expected income taxes based on combined federal and state statutory rate of 38.84% (2016: 38.29%).....	(592,234)	(3,006,533)
Permanent differences.....	16,636	1,006,715
Effects of income tax rate change.....	(131,725)	-
Other.....	26,371	-
Change in valuation allowance.....	680,952	1,999,818
Tax expense.....	<u>\$ -</u>	<u>\$ -</u>

The following table summarizes the components of deferred taxes:

	<b>September 30,</b>	
	<b>2017</b>	<b>2016</b>
Total current assets.....	\$ 542,214	\$ 721,005
Long-term assets:		
Net operating loss carryforwards.....	4,057,564	2,852,929
Intangible assets.....	270,784	269,511
Other long-term assets.....	498,881	67,161
Total deferred tax assets.....	5,369,443	3,910,606
Long-term deferred tax liability - Debt.....	(832,936)	-
Long-term deferred tax liability - Property and equipment.....	(75,371)	(130,422)
Deferred tax assets, net.....	4,461,136	3,780,184
Less: Valuation allowance.....	(4,461,136)	(3,780,184)
Deferred tax assets, net after valuation allowance.....	<u>\$ -</u>	<u>\$ -</u>

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Changes in the Company’s deferred tax liability are as follows:

Balance, September 30, 2015.....	\$	-
Deferred tax liability incurred.....		18,214
Additional deferred tax asset recognized.....		<u>(18,214)</u>
Balance, September 30, 2016.....		-
Deferred tax liability incurred.....		777,885
Additional deferred tax asset recognized.....		<u>(777,885)</u>
Balance, September 30, 2017.....	\$	<u>-</u>

Deferred taxes are provided as a result of temporary differences that arise due to the differences between the income tax values and the carrying amount of assets and liabilities. At September 30, 2017, the Company’s estimated gross net operating losses total approximately \$10.3 million (September 30, 2016 – \$7.6 million) and expire from 2034 to 2037.

U.S. federal tax legislation was enacted in 2004 to address perceived U.S. tax concerns in “corporate inversion” transactions. A “corporate inversion” generally occurs when a non-U.S. corporation acquires “substantially all” of the equity interests in, or the assets of, a U.S. corporation or partnership, if, after the acquisition, former equity holders of the U.S. Corporation or partnership own a specific level of stock in the non-U.S. corporation. The tax consequences of these rules depend upon the percentage identity of stock ownership that results. Generally, in the “80-percent identity” transactions, i.e. former equity holders of the U.S. corporation own 80% or more of the equity of the non-U.S. acquiring entity (excluding certain equity interests), the tax benefits of the inversion are limited by treating the non-U.S. acquiring entity as a domestic entity for U.S. tax purposes. In the “60-80 percent identity” transactions, the benefits of the inversion are limited by barring certain corporate-level “toll charges” from being offset by certain tax attributes of the U.S. corporation (e.g. loss carryforwards), and imposing excise taxes on certain stock-based compensation held by “insiders” of the U.S. corporation. Separately, United States Internal Revenue Code Section 382 limits the ability to utilize net operating losses if a 50% change in ownership occurs over a three year period.

**17. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

**Fair Value**

The carrying amount of cash, accounts receivable, accounts payable and accrued liabilities, and other payables approximate their fair values due to the short-term maturities of these instruments. The long-term portions of finance lease obligations, notes payable, and royalty funding have been discounted at a rate that approximates current market rates and therefore, approximates fair values.

**Financial Risk Management**

The Company is exposed to a variety of financial risks by virtue of its activities: market risk (including currency risk and interest rate risk), fair value risk, credit risk and liquidity risk. The overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on financial performance. Risk management is carried out by management under policies approved by the Board of Directors. Management is charged with the responsibility of establishing controls and procedures to ensure that financial risks are mitigated in accordance with the approved policies.

**Market Risk**

*Currency risk:* The Company’s revenues, expenses and financing are primarily denominated in US dollars. There is minimal exposure to currency risk.

*Interest rate risk:* Interest rate risk is the risk that the future cash flows or the fair value of a financial instrument will fluctuate because of changes in market interest rates. The majority of the Company’s debt is at fixed rates and due in the short term. Accordingly, there is limited exposure to cash flow or price interest rate risk.

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**Credit Risk**

In the year ended September 30, 2017, the Company has no customers that accounted for more than 10% of sales (year ended September 30, 2016 – two customers). The Company mitigates this risk by evaluating the outstanding balances on a regular basis and abiding by the credit limit that is dictated by the customer’s credit rating. At September 30, 2017, the Company has \$38,413 of receivables past due (September 30, 2016 - \$117,592).

**Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet its obligations as they fall due. The Company manages its liquidity risk by forecasting cash flows from operations and anticipated investing and financing activities. Senior management is also actively involved in the review and approval of planned expenditures.

At September 30, 2017, the Company has current liabilities of \$6.5 million (September 30, 2016 - \$7.8 million) due within 12 months and has cash of less than \$0.02 million (September 30, 2016 – less than \$0.1 million) to meet its current obligations. At September 30, 2017, the Company has a working capital deficiency of \$4.4 million (September 30, 2016 - \$5.0 million) and accordingly, the Company is subject to liquidity risk. Management plans to continue to raise capital to develop, market and promote its products and technology to maintain its ongoing operations.

**Capital Management**

The Company’s objective is to develop a strong capital base to sustain future development and growth of the business. The Company manages its capital by maintaining a flexible capital structure which optimizes the cost of capital at an acceptable level of risk and makes adjustments on it in the light of changes in economic conditions and the risk characteristics of its underlying assets. The Company’s capital base is currently represented by total deficit, notes payable, and royalty funding. Management reviews the Company's business plans as part of its strategic initiatives in conjunction with its financial forecast. There has been no change in the capital management policies of the Company during the current fiscal year.

The Company regularly monitors and reviews the amount of capital in proportion to risk and future development. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

The Company has no additional externally imposed capital requirements other than as disclosed in Note 10.

The Company’s debt and royalty funding obligations are due as follows for the years ending September 30:

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>Thereafter</u>
Notes payable (i).....	\$ 1,797,378	\$ -	\$ -	\$ -	\$ 443,306	\$ -
Accounts payable and other accrued liabilities...	4,249,133	-	-	-	-	-
Factoring advances.....	108,211	-	-	-	-	-
Finance leases.....	20,395	24,246	14,654	-	-	-
Royalty (ii).....	-	-	-	-	-	-

- (i) The balance due in 2022 is presented on a discounted basis (see Note 12). This note calls for monthly payments of interest of \$3,000 with a balloon payment in 2022 of approximately \$0.8 million.
- (ii) Royalties under the New Royalty are contingent upon meeting a minimum Excess Free Cash Flow and do not accrue if such minimum is not met. See Note 14 for the terms of the royalty agreement and New Royalty.

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**18. COMMITMENTS, CONTINGENCIES AND PROVISIONS**

**Commitments**

The Company is committed to leases of its premises and equipment. Minimum lease payments for the years ending September 30 are as follows:

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>Thereafter</u>	<u>Total</u>
Equipment.....	\$ 22,836	\$ 3,806	\$ -	\$ -	\$ -	\$ 26,642
Premises - Montana.....	42,489	-	-	-	-	42,489
Premises - Arizona.....	36,900	95,400	47,700	-	-	180,000

During June 2017, the Company relocated its head office and processing facilities to Belgrade, Montana and vacated its Scottsdale, Arizona facility. The Company has executed a settlement agreement as a result of vacating the premises in Scottsdale, Arizona (see Note 21).

The June 2017 lease for the Belgrade, Montana facility calls for minimum monthly payments of \$4,721 and expires June 30, 2018 with an option to renew for an additional year under certain circumstances. The Company is in ongoing negotiations to extend the lease to a multi-year lease.

**Contingencies and Provisions**

During October 2016, a distributor of the Company's products filed a claim in the amount of approximately \$90,000 related to commissions the distributor claimed to be due. The Company has recognized an accrual for the commissions the distributor claims are due at both September 30, 2017 and September 30, 2016; however, the Company does not believe its exposure to this matter to be greater than the amount accrued.

During October 2016, a member of the Company's SAB filed a claim in the amount of \$40,000 for unpaid services. The Company has recognized a total of approximately \$6,000 relative to this matter, which management believes is the accurate amount due, and expects to prevail in this matter relative to any additional amounts the SAB member believes are due.

During January 2017, the Company received notice from a vendor for breach of contract. The Company has deemed the suit without merit. The Company has recorded a provision of \$100,000 to cover professional fees and potential settlement costs relating to this matter.

In the ordinary course of business activities, the Company may be contingently liable for litigation and claims with customers, vendors and former employees. Management believes that adequate provisions have been recorded in the accounts where required.

**19. RELATED PARTY TRANSACTIONS**

For the years September 30, 2017 and 2016, two of the Company's officers, who are key management personnel, elected to defer payment of their salaries totaling \$509,656 and \$499,300, respectively, resulting in a total balance due such officers of \$1,008,956 and \$499,300, respectively. These balances are included in accounts payable and accrued liabilities on the accompanying Consolidated Statements of Financial Position. The Company also had notes payable due these two officers, which are described in Note 11, which were converted to equity. At September 30, 2017, the Company also owes one of these individuals \$51,961 for reimbursable expenditures and \$47,463 for interest associated with the notes payable discussed in Note 11 (September 30, 2016 – \$53,774 for both individuals), which are also included in accounts payable and other accrued liabilities on the accompanying Consolidated Statements of Financial Position.

During June 2017, an officer and director of the Company entered into the Belgrade, Montana facility lease for the benefit of the Company (see Notes 3, 18 and 21). This officer and director has personally guaranteed this lease and there is no additional compensation contemplated to this individual beyond the payments required to the lessor under the terms of the lease agreement.

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**20. ENTERPRISE WIDE DISCLOSURES**

The Company operates as one reportable segment and generates substantially all revenues in the United States of America. Information on the Company's revenue is as follows:

	<b>Years Ended September 30,</b>			
	<b>2017</b>		<b>2016</b>	
ADM dermis.....	\$ 548,722	20.0%	\$ 450,706	12.0%
DBM putty.....	139,015	5.0%	553,018	15.0%
Bone scaffold.....	1,740,152	64.0%	2,718,556	72.0%
Other.....	311,487	11.0%	55,574	1.0%
Total revenue.....	<u>\$ 2,739,376</u>	100.0%	<u>\$ 3,777,854</u>	100.0%

**21. SUBSEQUENT EVENTS**

In October 2017, the Company settled \$16,961 in accounts payable due to a service provider by issuing 164,959 common shares.

In October 2017, the Company reached a settlement on \$49,414 in amounts due to a service provider. This amount is recorded in accounts payable at year end. Payment terms are \$4,000 per month starting October 1, 2017. Should these required payments not be met, the Company will be required to pay \$49,414 plus interest at a rate of 10% per annum, accruing from October 3, 2017, net of any payments made.

During February 2018, the Company executed a promissory note with Eurofins VRL, Inc. to satisfy debt of \$79,836. Payment terms are 24 monthly payments of \$3,611 and interest is at 8% per annum.

During March 2018, a claim was filed for unpaid services in the amount of \$402,400. This amount is recorded in accounts payable at year end. The Company is currently negotiating a settlement agreement.

During April 2018, the holder of the Assumed International Biologics Loan (see Note 12) transferred the loan in the amount of \$660,000 to a third party. Repayment terms are \$3,000 per month beginning May 15, 2018 until repaid in full.

During April 2018, the Company entered into an agreement to satisfy any potential liability with the former landlord in Scottsdale, Arizona for approximately \$180,000 to be paid over 2 years. Payment terms include \$9,000 due April 1, \$4,000 per month May 1 through July 1, with regular monthly payments of \$7,950 starting August 1, 2018 for twenty months. Prepayment clauses allow for discounted payment plan with accelerated payments. Should these required payments not be met, the Company will be required to pay \$225,000 plus interest at a rate of 10% per annum, accruing from April 1, 2018, net of any payments made.

During April 2018, the Company received a judgment notice of \$60,000 from a vendor. The Company is continuing negotiations to reach a settlement agreement.

During April 2018, the Company agreed to pay a distributor for commissions in the amount of \$37,200. Payment terms are \$3,100 per month starting June 1, 2018. Should these required payments not be met, the Company will be required to pay \$37,200 plus interest at a rate of 10% per annum, accruing from November 10, 2017, net of any payments made.

The Company is currently restructuring certain notes that expired February 1, 2018 (see Note 12).