



Lattice Biologics Ltd.

**Unaudited Condensed Interim Consolidated Financial Statements
Fiscal 2018 First Quarter
For the Three Months Periods Ended December 31, 2017 and 2016
(Expressed in U.S. dollars)**

To the Shareholders of Lattice Biologics Ltd.:

Under National Instrument 51-102, Part 4, subsection 4.3 (3)(a), if an auditor has not performed a review of the interim consolidated financial statements, they must be accompanied by a notice indicating that the consolidated financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed interim consolidated financial statements have been prepared by the Company's management and approved by the Board of Directors of the Company.

The Company's independent auditors have not performed a review of these consolidated financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim consolidated financial statements by an entity's auditor.

April 30, 2018

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

Assets	December 31, 2017 (Unaudited)	September 30, 2017
Current assets:		
Cash.....	\$ 9,117	\$ 18,821
Accounts receivable (Note 6).....	224,550	216,723
Prepaid expenses and other current assets.....	10,451	4,721
Inventory (Note 5).....	1,786,198	1,847,574
Total current assets.....	2,030,316	2,087,839
Property and equipment (Note 3).....	336,269	336,739
Intangible assets (Note 4).....	381,322	415,987
Goodwill (Note 4).....	606,428	606,428
Total assets.....	<u>3,354,335</u>	<u>\$ 3,446,993</u>
Liabilities and Deficit		
Current liabilities:		
Accounts payable and accrued liabilities (Note 7).....	4,358,204	\$ 4,249,133
Obligations under finance lease, current portion (Note 8).....	21,291	20,395
Factoring advances (Note 9).....	105,319	108,211
Notes payable, current portion (Note 10).....	1,809,949	1,797,378
Warrant liability (Note 11).....	98,361	252,284
Provisions (Note 16).....	100,000	100,000
Total current liabilities.....	6,493,124	6,527,401
Obligations under finance lease, long-term portion (Note 8).....	33,228	38,900
Notes payable, long-term portion (Note 10).....	465,364	443,306
Royalty funding, long-term portion (Note 12).....	700,000	700,000
Total liabilities.....	<u>7,691,716</u>	<u>7,709,607</u>
Deficit:		
Share capital (Note 13).....	9,619,469	9,602,508
Warrant reserve (Note 11).....	21,862	21,862
Option Reserve.....	337,431	296,433
Accumulated deficit.....	(14,316,143)	(14,183,417)
Total deficit.....	<u>(4,337,381)</u>	<u>(4,262,614)</u>
Total liabilities and deficit.....	<u>\$ 3,354,335</u>	<u>\$ 3,446,993</u>

Nature of Business and Going Concern (Note 1)
 Commitments, Contingencies and Provisions (Note 16)

Approved by the Board

Cheryl Farmer
 Director (Signed)

Guy Cook
 Director (Signed)

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

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

	Three Months Ended	
	December 31,	
	2017	2016
Revenue.....	\$ 362,137	\$ 891,451
Cost of sales:		
Cost of sales - Exclusive of depreciation.....	111,314	545,050
Cost of sales - Depreciation.....	12,624	19,781
Total cost of sales.....	123,938	564,831
Gross profit.....	238,199	326,620
Operating expenses:		
Depreciation and amortization.....	37,298	37,039
General and administrative.....	34,793	91,546
Research and development.....	541	135,436
Professional fees.....	26,940	161,443
Rent.....	8,749	44,975
Salaries.....	235,230	321,327
Sales and marketing.....	26,950	151,582
Utilities.....	3,129	11,500
Total operating expenses.....	373,630	954,848
Loss from operations.....	(135,431)	(628,228)
Other income (expense):		
Interest and finance charges.....	(110,220)	(167,041)
Share based payments (Note 13).....	(40,998)	-
Loss on settlement of payables.....	-	(247,237)
Other income (expense).....	-	5,628
Change in fair value of warrants (Note 11).....	153,923	43,850
Royalty.....	-	(220,462)
Total other expense.....	2,705	(585,262)
Net loss and comprehensive loss.....	<u>\$ (132,726)</u>	<u>\$ (1,213,490)</u>
Basic and diluted loss per share.....	<u>\$ (0.00)</u>	<u>\$ (0.02)</u>
Weighted average number of common shares outstanding.....	<u>93,454,714</u>	<u>67,511,699</u>

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

Lattice Biologics Ltd.
Unaudited Condensed Interim 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, 2017.....	93,293,341	-	\$ 9,602,508	\$ 21,862	\$ 296,433	\$ (14,183,417)	\$ (4,262,614)
Shares issued.....	164,959	-	16,961	-	-	-	16,961
Share-based payments.....	-	-	-	-	40,998	-	40,998
Net loss for the period.....	-	-	-	-	-	(132,726)	(132,726)
Balances at December 31, 2017.....	<u>93,458,300</u>	<u>-</u>	<u>\$ 9,619,469</u>	<u>\$ 21,862</u>	<u>\$ 337,431</u>	<u>\$ (14,316,143)</u>	<u>\$ (4,337,381)</u>

	<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, 2016.....	63,137,222	182,530	\$ 6,744,627	\$ 21,862	\$ -	\$ (12,658,613)	\$ (5,892,124)
Shares issued.....	8,696,187	-	1,139,332	-	-	-	1,139,332
Net loss for the period.....	-	-	-	-	-	(1,213,490)	(1,213,490)
Balances at December 31, 2016.....	<u>71,833,409</u>	<u>182,530</u>	<u>\$ 7,883,959</u>	<u>\$ 21,862</u>	<u>\$ -</u>	<u>\$ (13,872,103)</u>	<u>\$ (5,966,282)</u>

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

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

	Three Months Ended December 31,	
	2017	2016
Operating activities:		
Net loss.....	\$ (132,726)	\$ (1,213,490)
Non-cash adjustments to reconcile net loss to net cash flows used in operations:		
Depreciation of property and equipment.....	15,256	22,154
Amortization of intangible assets.....	34,665	34,666
Debt accretion.....	53,629	85,627
Change in fair value of warrants.....	(153,923)	(43,850)
Loss on settlement of payables.....	-	247,237
Share-based payments.....	40,998	-
Changes in working capital:		
Accounts receivable.....	(7,827)	53,363
Prepaid expenses and other assets.....	(5,730)	(25,806)
Inventory.....	61,376	(124,961)
Accounts payable and accrued liabilities and provisions.....	123,032	504,853
Factoring advances.....	(2,892)	(62,288)
Cash used in operating activities.....	<u>25,858</u>	<u>(522,495)</u>
Investing activities:		
Purchase of property and equipment.....	(14,786)	(25,678)
Cash used in investing activities.....	<u>(14,786)</u>	<u>(25,678)</u>
Financing activities:		
Issuance of common shares and warrants.....	-	590,000
Repayment of finance lease obligations.....	(4,776)	(16,968)
Repayment of notes payable.....	(16,000)	(75,000)
Cash provided by financing activities.....	<u>(20,776)</u>	<u>498,032</u>
Increase (decrease) in cash.....	(9,704)	(50,141)
Cash, beginning of period.....	18,821	53,350
Cash, end of period.....	<u>\$ 9,117</u>	<u>\$ 3,209</u>
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest.....	<u>\$ -</u>	<u>\$ 16,636</u>
Cash paid for income taxes.....	<u>\$ -</u>	<u>\$ -</u>
Non-cash investing and financing activities:		
Company securities issued for settlement of payables.....	<u>\$ 16,961</u>	<u>\$ 711,845</u>
Finance lease obligation.....	<u>\$ -</u>	<u>\$ (18,225)</u>

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

Lattice Biologics Ltd.
Unaudited Condensed Interim Consolidated Notes to Financial Statements
Three Months December 31, 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. The Company’s common shares are listed under the symbol “LBL” on the TSX Venture Exchange (“TSX-V”). The Company’s registered office and processing facilities are located at 512 East Madison Avenue, Suite 101, Belgrade, Montana 59714. Prior to June 2017, the Company’s registered office and processing facilities were located in Scottsdale, Arizona (see Notes 3, 7 and 17).

The Company’s condensed consolidated interim 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 from operations of \$0.1 million for the three months ended December 31, 2017, a net loss and comprehensive loss of \$1.5 million for the year ended September 30, 2017 and has incurred losses in the past, has an accumulated deficit of \$14.3 million at December 31, 2017 (September 30, 2017 - \$14.2 million), and has a working capital deficiency of \$4.5 million at December 31, 2017 (September 30, 2017 - \$4.4 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.

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.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Statement of Compliance

These condensed interim consolidated financial statements are unaudited and have been prepared in accordance with International Accounting Standards (“IAS”) 34, Interim Financial Reporting, as issued by the International Accounting Standards Board (“IASB”). These interim financial statements do not include all the disclosures required by International Financial Reporting Standards (“IFRS”) for annual financial statements and accordingly should be read in conjunction with the Company’s audited consolidated financial statements for the year ended September 30, 2017 prepared in accordance with IFRS as issued by the IASB. The consolidated 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. These condensed interim consolidated financial statements were authorized for issue by the Board of Directors on April 30, 2018.

These condensed interim consolidated financial statements consolidate the accounts of the Company and its wholly owned subsidiary, Lattice Biologics Inc. Intercompany balances and transactions are eliminated upon consolidation. The preparation of the condensed interim 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 condensed interim consolidated financial statements are discussed below.

Lattice Biologics Ltd.
Unaudited Condensed Interim Consolidated Notes to Financial Statements – Continued
Three Months Ended December 31, 2017 and 2016
(Expressed in US dollars)

Functional and Presentation Currency

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

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.

Revenue Recognition

Revenue is recognized in the condensed interim consolidated 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.

Share-based Payments

Expense for stock options granted is recognized, together with a corresponding increase in the option reserve in equity, over the period in which the performance and / or service conditions are fulfilled by the grantee. The cumulative expense recognized for stock options to each reporting date reflects the portion of the performance and / or service conditions completed to such time, and the Company's best estimate of the number of stock options that will ultimately vest. Accordingly, the expense for a given period generally represents the portion of the performance and / or service conditions completed during the period. Generally, except for awards with market based vesting conditions, the Company recognizes share-based payment expense for awards that ultimately vest, and recognizes no expense for awards that do not ultimately vest.

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.

Lattice Biologics Ltd.
Unaudited Condensed Interim Consolidated Notes to Financial Statements – Continued
Three Months Ended December 31, 2017 and 2016
(Expressed in US dollars)

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 condensed interim consolidated 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.

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:

Financial Instrument	Classification
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.

Lattice Biologics Ltd.**Unaudited Condensed Interim Consolidated Notes to Financial Statements – Continued****Three Months Ended December 31, 2017 and 2016****(Expressed in US dollars)**

- (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 of the effectiveness of the debt restructuring with Grenville. 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 10 and 12) using the prevailing discount rate at the applicable time.
- (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 16 and 18)

3. PROPERTY AND EQUIPMENT

Property and equipment cost is summarized as follows:

	September 30,				September 30,			December 31,
	2016	Additions	Disposals	Impairment	2017	Additions	Disposals	2017
Freezers and freeze dryers.....	\$ 137,827	\$ -	\$ -	\$ -	\$ 137,827	\$ -	\$ -	\$ 137,827
Sensor thermometers.....	52,393	-	-	(52,393)	-	-	-	-
Medical tools and equipment...	312,952	18,225	-	-	331,177	-	-	331,177
Leasehold improvements.....	326,451	-	-	(326,451)	-	-	-	-
Office and other equipment.....	58,041	27,837	-	(15,317)	70,561	-	-	70,561
Construction in progress.....	-	-	-	-	-	14,786	-	14,786
Total cost.....	\$ 887,664	\$ 46,062	\$ -	\$ (394,161)	\$ 539,565	\$ 14,786	\$ -	\$ 554,351

Property and equipment accumulated depreciation is summarized as follows:

	September 30,				September 30,			December 31,
	2016	Additions	Disposals	Impairment	2017	Additions	Disposals	2017
Freezers and freeze dryers.....	\$ 61,377	\$ 14,448	\$ -	\$ -	\$ 75,825	\$ 3,312	\$ -	\$ 79,137
Sensor thermometers.....	16,992	5,664	-	(22,656)	-	-	-	-
Medical tools and equipment...	72,256	37,250	-	-	109,506	9,312	-	118,818
Leasehold improvements.....	49,585	16,323	-	(65,908)	-	-	-	-
Office and other equipment.....	10,356	11,147	-	(4,008)	17,495	2,632	-	20,127
Total accumulated depreciation	\$ 210,566	\$ 84,832	\$ -	\$ (92,572)	\$ 202,826	\$ 15,256	\$ -	\$ 218,082

Lattice Biologics Ltd.
Unaudited Condensed Interim Consolidated Notes to Financial Statements – Continued
Three Months Ended December 31, 2017 and 2016
(Expressed in US dollars)

Property and equipment net book value is summarized as follows:

	December 31, 2017	September 30, 2017
Freezers and freeze dryers.....	\$ 58,690	\$ 62,002
Medical tools and equipment.....	212,359	221,671
Office and other equipment.....	50,434	53,066
Construction in progress.....	14,786	-
Total.....	<u>\$ 336,269</u>	<u>\$ 336,739</u>

Carrying amounts for property under finance leases at December 31, 2017 totaled \$186,042 (September 30, 2017 - \$194,051). See Note 8 for further details.

4. INTANGIBLE ASSETS AND GOODWILL

Gross amortizable intangible assets cost consist of customer lists of \$766,210 and intellectual property and licenses of \$970,637 at December 31, 2017 and December 31, 2016.

Amortizable intangible accumulated amortization is summarized as follows:

	September 30, 2016	Amortization	September 30, 2017	Amortization	December 31, 2017
Customer list.....	\$ 766,210	\$ -	\$ 766,210	\$ -	\$ 766,210
Intellectual property and licenses.....	415,987	138,663	554,650	34,665	589,315
Total accumulated depreciation....	<u>\$ 1,182,197</u>	<u>\$ 138,663</u>	<u>\$ 1,320,860</u>	<u>\$ 34,665</u>	<u>\$ 1,355,525</u>

Amortizable intangible carrying balances consist of intellectual property and licenses of \$381,322 at December 31, 2017 (September 30, 2017 – \$415,987). Customer lists were fully amortized at September 30, 2016.

The Company operates in one CGU and performs annual impairment testing on its CGU at September 30 to determine whether any impairment was required on its goodwill based on a value in use calculation, which uses management’s cash flow projections, which are described more fully in the Company’s annual report for the year ended September 30, 2017. 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:

	December 31, 2017	September 30, 2017
	(Unaudited)	
Unprocessed goods.....	\$ 1,054,887	\$ 1,039,215
Finished goods.....	761,981	839,029
Reserve.....	(30,670)	(30,670)
Total inventory.....	<u>\$ 1,786,198</u>	<u>\$ 1,847,574</u>

Lattice Biologics Ltd.**Unaudited Condensed Interim Consolidated Notes to Financial Statements – Continued****Three Months Ended December 31, 2017 and 2016****(Expressed in US dollars)****6. ACCOUNTS RECEIVABLE**

Accounts receivable consists of the following:

	December 31, 2017	September 30, 2017
	(Unaudited)	
Accounts receivable.....	\$ 331,302	\$ 323,475
Less: Allowance for doubtful accounts.....	<u>(106,752)</u>	<u>(106,752)</u>
Accounts receivable, net.....	<u>\$ 224,550</u>	<u>\$ 216,723</u>

A portion of the accounts receivable balance is factored (see Note 9).

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following:

	December 31, 2017	September 30, 2017
	(Unaudited)	
Accounts payable.....	\$ 2,509,137	\$ 2,517,986
Accrued liabilities.....	1,812,167	1,677,286
Provision for lease termination.....	36,900	36,900
Shares to be issued.....	<u>-</u>	<u>16,961</u>
Accounts payable and accrued liabilities.....	<u>\$ 4,358,204</u>	<u>\$ 4,249,133</u>

As discussed in Note 3 and 17, 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 18).

8. FINANCE LEASE OBLIGATIONS

The Company is subject to various finance lease arrangements, which are discussed more fully in the Company's annual consolidated financial statements for the year ended September 30, 2017.

9. 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%.

Lattice Biologics Ltd.**Unaudited Condensed Interim Consolidated Notes to Financial Statements – Continued****Three Months Ended December 31, 2017 and 2016****(Expressed in US dollars)**

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 December 31, 2017. This arrangement is being recorded as a financing from the factoring company and factoring costs are being charged to operations as incurred. At December 31, 2017, the amounts advanced under this facility totaled \$105,319 (September 30, 2017 – \$108,211).

10. NOTES PAYABLE

Notes payable consist of the following:

	December 31, 2017	September 30, 2017
	(Unaudited)	
Assumed International Biologics loan.....	\$ 660,000	\$ 660,000
Lifeshare Transplant Donor Services.....	212,443	207,069
Redwood Fund.....	125,340	116,894
Grenville notes.....	727,530	706,721
Investor notes.....	<u>550,000</u>	<u>550,000</u>
Total notes payable.....	2,275,313	2,240,684
Less: Current portion.....	<u>(1,809,949)</u>	<u>(1,797,378)</u>
Long-term portion.....	<u>\$ 465,364</u>	<u>\$ 443,306</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 22nd 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 December 31, 2017 is \$660,000, which represents the total balance due at such time (September 30, 2017 – \$660,000) (See Note 18).

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 \$10,000 for this restated promissory note during the three months ended December 31, 2017. The note's carrying value at December 31, 2017 is \$212,443 (September 30, 2017 – \$207,069).

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

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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 the matter was dismissed. The Company is currently in negotiations with the new note holder regarding repayment terms. The note's carrying value at December 31, 2017 is \$125,340 (September 30, 2017 – \$116,894).

Grenville Notes

During June 2017, the Company completed a restructuring of amounts due Grenville, including balances due under a royalty agreement as described further in Note 12, and two notes payable, which are described in further detail in the Company's annual report for the year ended September 30, 2017. The resulting notes payable from this restructuring are summarized as follows:

- (i) The Secured Note Payable matures April 24, 2022, requires monthly payments of \$3,000 through the maturity date and bears interest at a rate of 4.244% per annum. This note is recorded at a discount, which originated at the time of the June 2017 restructuring with Grenville, with the total amount due at maturity of approximately \$0.8 million. As a result of this discount, the carrying amount of the Secured Note Payable was \$457,139 at December 31, 2017 (September 30, 2017 - \$443,306).
- (ii) The Unsecured Notes Payable total \$250,000 in principal, bear interest at 10.50% per annum and have a balance of \$270,391 at December 31, 2017 (September 30, 2017 - \$263,415).

Investor Notes

As of December 31, 2017 and September 30, 2017, the Company has \$550,000 of principal due on notes payable outstanding to investors, which were issued on January 9, 2015, bear interest at 24% per annum payable monthly and are due February 1, 2018; however, due to the Company's working capital deficiency, monthly interest payments have been limited in fiscal 2017 and thus far in fiscal 2018. These investor notes are described in greater detail in the Company's annual financial statements for the year ended September 30, 2017.

11. Warrants

The Company's outstanding warrants that were issued in conjunction with offerings of the Company's debt or common stock, or as settlement for liabilities incurred, have been classified as liabilities in the accompanying Unaudited Condensed Interim Consolidated Statements 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 Unaudited Condensed Interim Consolidated Statement of Comprehensive Loss and resulted in the recognition of income of \$153,923 and \$43,850 for the three months ended December 31, 2017 and 2016, respectively.

Warrants directly issued as compensation for services rendered are classified as a warrant reserve within the Company's deficit in the accompanying Unaudited Condensed Interim Consolidated Statements of Financial Position.

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Warrants to acquire voting common shares at December 31, 2017 are summarized as follows:

<u>Date Issued</u>	<u>Exercise Price (C\$)</u>	<u>Date of Expiry</u>	<u>Outstanding and Exercisable</u>
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>

The fair value of these warrants at December 31, 2017 and September 30, 2017 was estimated using the Black Scholes model with the following significant assumptions:

	<u>Liabilities - September 30, 2017</u>	<u>Liabilities - December 31, 2017</u>
Weighted average risk-free interest rate (%).....	1.51%	1.66%
Expected dividend yield (%).....	0.00%	0.00%
Expected stock price volatility (%).....	116%	117%
Weighted average warrant life in years.....	2.1	1.8
Weighted average exercise price (C\$).....	\$0.25	\$0.25
Weighted average fair value (C\$).....	\$0.04	\$0.02
Weighted average stock price (C\$).....	\$0.10	\$0.06

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.

12. ROYALTY FUNDING AND NEW ROYALTY

Following the June 2017 restructuring of the Company's debt with Grenville (see Note 10), 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.

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13. 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 three months ended December 31, 2017 is summarized as follows:

	<u>Shares</u>	<u>Amount</u>
Balances, September 30, 2017.....	93,293,341	\$ 9,602,508
Shares issued to vendors for services (i).....	164,959	16,961
Balances, December 31, 2017.....	<u>93,458,300</u>	<u>\$ 9,619,469</u>

At December 31, 2017, there were 62,717,803 voting common shares issued and outstanding and 30,740,497 non-voting restricted common shares outstanding.

- (i) During the three months ended December 31, 2017, the Company issued 164,959 common shares in satisfaction of balances payable to a vendor totaling \$16,961.

Activity for the Company's share capital for the three months ended December 31, 2016 is summarized as follows:

	<u>Shares</u>	<u>Amount</u>
Balances, September 30, 2016.....	63,137,222	\$ 6,744,627
Share issued through private placement (i).....	3,877,010	334,780
Shares issued to vendors for settlement of payables and services (ii).....	4,819,177	804,552
Balances, December 31, 2016.....	<u>71,833,409</u>	<u>\$ 7,883,959</u>

- (i) During the three months ended December 31, 2016, the Company closed several private placements, whereby the Company issued 3,877,010 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 \$590,000. The 1,938,505 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 11. The common shares and warrants were allocated \$334,780 and \$255,220 of the proceeds, respectively.
- (ii) During the three months ended December 31, 2016, the Company issued 4,819,177 common shares and 1,333,196 warrants in settlement of various liabilities totaling \$711,845, which were 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 11. The common shares and warrants were recognized at fair value of \$804,552 and \$154,530, respectively. The

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difference between the total fair value of the common shares and warrants issued of \$804,552 and the liabilities settled of \$711,845 was recognized as a loss on settlement of payables for the three months ended December 31, 2016.

Share Purchase Options and Share-based Payments

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 December 31, 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 Company recognized \$40,998 of share-based payment expense for the three months ended December 31, 2017 for these stock options. At December 31, 2017, there is \$65,166 of unrecognized expense related to these stock options, which is expected to be recognized over the remaining vesting terms of the stock options.

14. INCOME TAXES

Information on statutory tax rates and deferred taxes is outlined in the Company’s September 30, 2017 audited consolidated financial statements.

15. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

The carrying amount of cash, accounts receivables, 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

For the three months ended December 31, 2017, the Company had no customer that accounted for more than 10% of sales (year ended September 30, 2017 – no customer). 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 December 31, 2017, the Company has \$23,600 of receivables past due (September 30, 2017 – \$38,413).

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 December 31, 2017, the Company has current liabilities of \$6.5 million (September 30, 2017 – \$6.5 million) due within 12 months and has cash of less than \$0.01 million (September 30, 2017 – less than \$0.1 million) to meet its current obligations. At December 31, 2017, the Company has a working capital deficiency of \$4.5 million (September 30, 2017 - \$4.4 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 9.

The Company’s debt and royalty funding obligations are due as follows for the years ending December 31:

	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>Thereafter</u>
Notes payable (i).....	\$ 1,809,949	\$ -	\$ -	\$ -	\$ 465,364	\$ -
Accounts payable and other accrued liabilities ...	4,358,204	-	-	-	-	-
Factoring advances.....	105,319	-	-	-	-	-
Finance leases.....	21,291	25,329	7,899	-	-	-
Royalty (ii).....	-	-	-	-	-	-

- (i) The balance due in 2022 is presented on a discounted basis (see Note 10). 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 12 for the terms of the royalty agreement and New Royalty.

Lattice Biologics Ltd.**Unaudited Condensed Interim Consolidated Notes to Financial Statements – Continued****Three Months Ended December 31, 2017 and 2016****(Expressed in US dollars)****16. COMMITMENTS, CONTINGENCIES AND PROVISIONS****Commitments**

The Company is committed to leases of its premises and equipment. Minimum lease payments for the remainder of fiscal 2018 and successive fiscal years are as follows:

	Remainder of 2018	2019	2020	2021	2022	Total
Equipment.....	\$ 17,127	\$ 3,806	\$ -	\$ -	\$ -	\$ 20,933
Premises - Montana.....	28,326	-	-	-	-	28,326
Premises - Arizona.....	36,900	95,400	47,700	-	-	180,000

As described in Notes 3, 7 and 17, 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 18).

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 (see Note 17).

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 December 31, 2017 and September 30, 2017; 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.

17. RELATED PARTY TRANSACTIONS

For the three months ended December 31, 2017, two of the Company's officers, who are key management personnel, elected to defer payment of their salaries totaling \$110,025, resulting in a total balance due such officers of \$1,179,325 at December 31, 2017 (September 30, 2017 - \$1,069,300). These balances are included in accounts payable and other accrued liabilities on the accompanying Unaudited Condensed Interim Consolidated Statements of Financial Position. At December 31, 2017, the Company also owes one of these individuals \$51,961 for reimbursable expenditures and \$49,847 for interest, which is also included in accounts payable and other accrued liabilities on the accompanying Unaudited Condensed Interim Consolidated Statements of Financial Position, which is associated with a note payable that was converted to equity during the year ended September 30, 2016 (September 30, 2017 – \$51,961 and \$47,463 respectively).

During June 2017, an officer and director of the Company entered into the Belgrade, Montana facility lease for the benefit of the Company. 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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18. SUBSEQUENT EVENTS

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).