



Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)

Consolidated Financial Statements
For the Year Ended September 30, 2016 and
Nine Months Ended September 30, 2015
(Expressed in U.S. dollars)

Independent Auditors' Report

To the Shareholders of Lattice Biologics Ltd. (formerly Blackstone Ventures Inc.):

We have audited the accompanying consolidated financial statements of Lattice Biologics Ltd., which comprise the consolidated statement of financial position as at September 30, 2016 and September 30, 2015, and the consolidated statements of comprehensive loss, deficit and cash flows for the year ended September 30, 2016, and the nine-month period ended September 30, 2015, 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

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, 2016 and September 30, 2015, and its financial performance and its cash flows for the year and period then ended, in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without modifying our opinion, we draw your attention to Note 1 of the consolidated financial statements which describe the conditions which cast significant doubt about the Company's ability to continue as a going concern.



Toronto, Ontario
January 30, 2017

Chartered Professional Accountants
Licensed Public Accountants

Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)
Consolidated Statements of Financial Position
(Expressed in U.S. dollars)
As at

	September 30,	
	2016	2015
Assets		
Current assets:		
Cash.....	\$ 53,350	\$ 50,293
Accounts receivable (Note 6).....	423,761	762,694
Prepaid expenses and other current assets.....	102,979	33,361
Inventory (Note 5).....	2,197,838	2,955,642
Total current assets.....	2,777,928	3,801,990
Property and equipment (Note 3).....	677,098	645,676
Intangible assets (Note 4).....	554,650	948,716
Goodwill (Note 4).....	606,428	606,428
Total assets.....	<u>\$ 4,616,104</u>	<u>\$ 6,002,810</u>
Liabilities and Deficit		
Current liabilities:		
Accounts payable and accrued liabilities (Note 8).....	\$ 4,306,825	\$ 2,633,314
Obligations under finance lease, current portion (Note 9).....	29,441	62,722
Factoring advances (Note 10).....	124,785	268,614
Notes payable, current portion (Note 12).....	2,211,535	1,782,060
Warrant liability (Note 13).....	366,041	-
Royalty funding, current portion (Note 14).....	750,000	437,500
Total current liabilities.....	7,788,627	5,184,210
Obligations under finance lease, long-term portion (Note 9).....	45,808	15,908
Officer loans (Note 11).....	-	1,032,219
Notes payable, long-term portion (Note 12).....	550,000	238,841
Convertible notes payable (Note 12).....	-	988,100
Royalty funding, long-term portion (Note 14).....	2,123,793	2,436,293
Total liabilities.....	<u>10,508,228</u>	<u>9,895,571</u>
Deficit:		
Share capital (Note 15).....	6,744,627	913,845
Warrant reserve (Note 13).....	21,862	-
Accumulated deficit.....	<u>(12,658,613)</u>	<u>(4,806,606)</u>
Total deficit.....	<u>(5,892,124)</u>	<u>(3,892,761)</u>
Total liabilities and deficit.....	<u>\$ 4,616,104</u>	<u>\$ 6,002,810</u>

Nature of Business and Going Concern (Note 1)
Commitments and Contingencies (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.
(formerly Blackstone Ventures Inc.)
Consolidated Statements of Comprehensive Loss
(Expressed in U.S. dollars)

	Year Ended September 30, 2016	Nine Months Ended September 30, 2015
Revenue.....	\$ 3,777,854	\$ 3,017,516
Cost of sales:		
Cost of sales - Exclusive of depreciation.....	2,881,888	2,384,954
Cost of sales - Depreciation.....	79,273	55,237
Total cost of sales.....	2,961,161	2,440,191
Gross profit.....	816,693	577,325
Operating expenses:		
Depreciation and amortization.....	398,594	298,643
General and administrative.....	737,037	338,145
Professional fees.....	574,526	433,144
Rent.....	146,903	124,927
Salaries.....	1,299,986	896,162
Sales and marketing.....	1,053,984	408,109
Utilities.....	55,586	58,541
Total operating expenses.....	4,266,616	2,557,671
Loss from operations.....	(3,449,923)	(1,980,346)
Other income (expense):		
Interest and finance charges.....	(1,042,901)	(658,966)
Loss on convertible note revaluation (Note 12).....	(61,900)	(36,988)
Share based payments (Note 15).....	(1,388,473)	-
Listing expense.....	(1,639,390)	(163,287)
Other income (expense).....	2,062	-
Change in fair value of warrants.....	180,439	-
Gain on convertible note revaluation.....	-	61,900
Royalty.....	(451,921)	(412,824)
Total other expense.....	(4,402,084)	(1,210,165)
Net loss and comprehensive loss.....	<u>\$ (7,852,007)</u>	<u>\$ (3,190,511)</u>
Basic and diluted loss per share.....	<u>\$ (0.16)</u>	<u>\$ (0.09)</u>
Weighted average number of common shares outstanding.....	<u>48,150,237</u>	<u>35,112,838</u>

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

Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)
Consolidated Statements of Changes in Deficit
(Expressed in U.S. dollars)

	Number of Shares	Number of Warrants	Share Capital	Warrant Reserve	Accumulated Deficit	Total Deficit
Balances at January 1, 2015.....	20,500	-	\$ 1,430,000	\$ -	\$ (1,536,189)	\$ (106,189)
Shares issued.....	3,599	-	139,552	-	-	139,552
Shares repurchased.....	(9,400)	-	(655,707)	-	(79,906)	(735,613)
Net loss for the period.....	-	-	-	-	(3,190,511)	(3,190,511)
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.....	<u>63,137,222</u>	<u>182,530</u>	<u>\$ 6,744,627</u>	<u>\$ 21,862</u>	<u>\$ (12,658,613)</u>	<u>\$ (5,892,124)</u>

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

Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)
Consolidated Statements of Cash Flows
(Expressed in U.S. dollars)

	Year Ended September 30, 2016	Nine Months Ended September 30, 2015
Operating activities:		
Net loss	\$ (7,852,007)	\$ (3,190,511)
Non-cash adjustments to reconcile net loss to net cash flows from operations:		
Depreciation of property and equipment	83,801	58,331
Amortization of intangible assets	394,066	295,549
Bad debt expense	78,191	3,737
Finance lease interest	-	15,788
Debt accretion	518,837	314,310
Loss (gain) on convertible note revaluation	61,900	(61,900)
Loss on modification of notes payable	-	36,988
Non-cash listing expense	954,536	-
Change in fair value of warrants	(180,439)	-
Loss on disposal of property and equipment	2,400	-
Share-based payments	1,388,473	39,552
Changes in working capital:		
Accounts receivable	260,742	35,152
Prepaid expenses and other assets	(69,618)	3,728
Inventory	757,804	388,516
Accounts payable and accrued liabilities	1,612,828	280,217
Factoring advances	(143,829)	268,614
Cash used in operating activities	(2,132,315)	(1,511,929)
Investing activities:		
Purchase of property and equipment	(49,239)	(41,426)
Cash used in investing activities	(49,239)	(41,426)
Financing activities:		
Issuance of common shares and warrants	2,313,876	100,000
Repayment of finance lease obligations	(71,765)	(74,550)
Proceeds from officer loans	175,000	150,000
Proceeds from convertible notes payable	-	1,050,000
Proceeds from notes payable	250,000	932,118
Royalty funding	-	999,975
Repayment of notes payable	(482,500)	(778,477)
Repayment of officer loans	-	(307,903)
Shares repurchased	-	(735,613)
Cash provided by financing activities	2,184,611	1,335,550
Increase (decrease) in cash and cash equivalents	3,057	(217,805)
Cash and cash equivalents, beginning of period	50,293	268,098
Cash and cash equivalents, end of period	\$ 53,350	\$ 50,293
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	\$ 170,152	\$ 271,158
Cash paid for income taxes	\$ -	\$ -

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

Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)
Notes to Consolidated Financial Statements
Year Ended September 30, 2016 and Nine Month Period Ended September 30, 2015
(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>

During 2015, the Company changed its fiscal year end to September 30 from December 31. As a result of this change in fiscal year end, the reporting periods for the Company’s Consolidated Statements of Comprehensive Loss, Consolidated Statements of Deficit and Consolidated Statements of Cash Flows are for the nine months ended September 30, 2015 and year ended September 30, 2016.

Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)
Notes to Consolidated Financial Statements – Continued
Year Ended September 30, 2016 and Nine Month Period Ended September 30, 2015
(Expressed in U.S. dollars)

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 \$7.9 million for the year ended September 30, 2016 and has incurred losses in the past, has an accumulated deficit of \$12.7 million at September 30, 2016 (September 30, 2015 - \$4.8 million), and has a working capital deficiency of \$5.0 million at September 30, 2016 (September 30, 2015 - \$1.4 million). These conditions reflect a material uncertainty that casts significant doubt to 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.

The Company's registered office is located at 16701 North 90th St, Suite 101 Scottsdale, Arizona 85260, United States of America. The Company's secondary office is located at 1413-181 University Ave, Toronto, Ontario M5H 3M7, Canada.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Statement of Compliance

These financial statements have been prepared in accordance with IFRS and the 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 January 30, 2017.

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.

Future Accounting Changes

The following pronouncements were issued by the IASB or the IFRIC. 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.

Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)
Notes to Consolidated Financial Statements – Continued
Year Ended September 30, 2016 and Nine Month Period Ended September 30, 2015
(Expressed in US dollars)

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.

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.

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: Over the lease term
- Office equipment and card system: Straight line over five and fifteen years respectively

Lattice Biologics Ltd.
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Notes to Consolidated Financial Statements – Continued
Year Ended September 30, 2016 and Nine Month Period Ended September 30, 2015
(Expressed in US dollars)

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 amount, and are recognized within the statement comprehensive loss.

Leases

Leases are classified as finance leases when the lease arrangement transfers substantially all of the risks and rewards related to the ownership of the leased asset. 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.

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.

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.

Lattice Biologics Ltd.
(formerly Blackstone Ventures Inc.)
Notes to Consolidated Financial Statements – Continued
Year Ended September 30, 2016 and Nine Month Period Ended September 30, 2015
(Expressed in US dollars)

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.
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Notes to Consolidated Financial Statements – Continued
Year Ended September 30, 2016 and Nine Month Period Ended September 30, 2015
(Expressed in US dollars)

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.

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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:

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.
- (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 Royalty Funding.* The Company’s royalty funding agreement has been accounted for as a financial liability and measured at fair value at initial recognition. 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 at fair value when it became party to the arrangement using the prevailing discount rate at the time.
- (iv) *Accounting for Convertible Notes.* The Company’s convertible notes agreements have been accounted for as a financial liability and measured at fair value at initial recognition. As the conversion option was impacted by the public offering pricing, it failed the fixed for fixed criteria. Management also designated the entire instrument as FVTPL. Accordingly, the entire instrument was recorded at fair value (see Note 12); however, following the Reverse Takeover, the note holders who did not convert relinquished their conversion rights. As this event was considered a settlement of the original debt, the notes have subsequently been carried at the amortized balance due on such notes and are classified as “notes payable” following the Reverse Takeover.

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3. PROPERTY AND EQUIPMENT

Property and equipment cost is summarized as follows:

	January 1, 2015	Additions	Disposals	September 30, 2015	Additions	Disposals	Other	September 30, 2016
Freezers and freeze dryers	\$ 124,077	\$ -	\$ -	\$ 124,077	\$ -	\$ -	\$ 13,750	\$ 137,827
Sensor thermometers	52,393	-	-	52,393	-	-	-	52,393
Medical tools and equipment...	176,365	41,426	-	217,791	88,711	-	6,450	312,952
Leasehold improvements	326,451	-	-	326,451	-	-	-	326,451
Office and other equipment	29,129	-	-	29,129	28,912	-	-	58,041
Total cost	<u>\$ 708,415</u>	<u>\$ 41,426</u>	<u>\$ -</u>	<u>\$ 749,841</u>	<u>\$ 117,623</u>	<u>\$ -</u>	<u>\$ 20,200</u>	<u>\$ 887,664</u>

Property and equipment accumulated depreciation is summarized as follows:

	January 1, 2015	Additions	Disposals	September 30, 2015	Additions	Disposals	Other	September 30, 2016
Freezers and freeze dryers	\$ 10,094	\$ 16,085	-	\$ 26,179	\$ 21,448	\$ -	\$ 13,750	\$ 61,377
Sensor thermometers	7,080	4,248	-	11,328	5,664	-	-	16,992
Medical tools and equipment...	14,427	18,581	-	33,008	30,398	2,400	6,450	72,256
Leasehold improvements	11,499	16,323	-	27,822	21,763	-	-	49,585
Office and other equipment	2,734	3,094	-	5,828	4,528	-	-	10,356
Total accumulated depreciation	<u>\$ 45,834</u>	<u>\$ 58,331</u>	<u>\$ -</u>	<u>\$ 104,165</u>	<u>\$ 83,801</u>	<u>\$ 2,400</u>	<u>\$ 20,200</u>	<u>\$ 210,566</u>

Property and equipment net book value is summarized as follows:

	September 30,	
	2016	2015
Freezers and freeze dryers	\$ 76,450	\$ 97,898
Sensor thermometers	35,401	41,065
Medical tools and equipment	240,696	184,783
Leasehold improvements	276,866	298,629
Office equipment	47,685	23,301
Total	<u>\$ 677,098</u>	<u>\$ 645,676</u>

Carrying amounts for property under finance leases at September 30, 2016 were \$207,862 (September 30, 2015 - \$165,932). See Note 9 for further details.

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.

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Amortizable intangible accumulated amortization is summarized as follows:

	<u>January 1, 2015</u>	<u>Amortization</u>	<u>September 30, 2015</u>	<u>Amortization</u>	<u>September 30, 2016</u>
Customer list.....	\$ 319,254	191,552	\$ 510,806	\$ 255,404	\$ 766,210
Intellectual property and licenses.....	173,328	103,997	277,325	138,662	415,987
Total accumulated depreciation	<u>\$ 492,582</u>	<u>\$ 295,549</u>	<u>\$ 788,131</u>	<u>\$ 394,066</u>	<u>\$ 1,182,197</u>

Amortizable intangible carrying balances are summarized as follows:

	<u>September 30,</u>	
	<u>2016</u>	<u>2015</u>
Customer list.....	\$ -	\$ 255,404
Intellectual property and licenses.....	554,650	693,312
Total.....	<u>\$ 554,650</u>	<u>\$ 948,716</u>

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, 2016 or 2015 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>2016</u>	<u>2015</u>
Unprocessed goods.....	\$ 998,172	\$ 1,614,864
Finished goods.....	1,215,334	1,340,778
Reserve.....	(15,668)	-
Total inventory.....	<u>\$ 2,197,838</u>	<u>\$ 2,955,642</u>

During the year ended September 30, 2016, inventory recognized as cost of sales totaled \$2,312,312. During the nine months ended September 30, 2015, inventory recognized as cost of sales totaled \$2,384,954. A total of \$61,140 of inventory was charged off for the year ended September 30, 2016. No inventory was charged off in the nine months ended September 30, 2015.

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6. ACCOUNTS RECEIVABLE

Accounts receivable consists of the following:

	September 30,	
	2016	2015
Accounts receivable.....	\$ 488,503	\$ 779,312
Less: Allowance for doubtful accounts.....	(64,742)	(16,618)
Trade and other receivables, net.....	<u>\$ 423,761</u>	<u>\$ 762,694</u>

There was \$18,831 and \$3,737 of accounts receivable written off for the year ended September 30, 2016 and the nine months ended September 30, 2015, 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:

	September 30,	
	2016	2015
Accounts payable.....	\$ 2,752,683	\$ 2,408,452
Accrued liabilities.....	1,535,467	224,862
Shares to be issued.....	18,675	-
Accounts payable and accrued liabilities.....	<u>\$ 4,306,825</u>	<u>\$ 2,633,314</u>

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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 26% 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, 2016 (for the fiscal years ending):

2017.....	\$	38,417
2018.....		22,416
2019.....		22,416
2020.....		<u>11,208</u>
Total future payments.....		94,457
Less: Amounts representing interest.....		<u>(19,208)</u>
Obligations under finance lease.....		75,249
Less: Current portion.....		<u>(29,441)</u>
Long-term portion.....	\$	<u>45,808</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%. The credit facility is secured by the Company's accounts receivable. As part of the covenants of the agreement, the Company must maintain a tangible net worth of more than negative \$3,500,000; however, at September 30, 2016, the Company was in violation of this covenant but such violation has been waived by the lender. 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, 2016, the amounts advanced under this facility totaled \$124,785 (September 30, 2015 – \$268,614).

11. OFFICER LOANS AND CONVERSION

During calendar 2013 and 2014, an Officer of the Company loaned the Company a total of \$900,000. This loan bore interest at 20% per annum and had a maturity date of August 1, 2017. This loan was secured by all assets of the Company. The loan's carrying value at September 30, 2015 was \$874,243, inclusive of accrued interest.

During the nine month period ended September 30, 2015, another Officer of the Company loaned the Company \$150,000. In the quarter ending December 31, 2015, the same Officer loaned an additional \$175,000 bringing the total loan principal to \$325,000. This loan also bore interest at 20% per annum and had a maturity date of August 1, 2017. This loan was secured by all assets of the Company. The loan's carrying value at September 30, 2015 was \$157,976, inclusive of accrued interest.

During August 2016, the Company and the holders of the officer loans described above 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 \$53,774 of unpaid accrued interest was not included in this conversion, and remains outstanding at September 30, 2016. These balances accrue interest at 20% per annum, and are 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:

	September 30,	
	2016	2015
Assumed International Biologics loan.....	\$ 774,994	\$ 791,987
Lifeshare Transplant Donor Services.....	285,393	304,411
Redwood Fund.....	74,916	254,741
Grenville notes.....	1,076,232	669,762
Investor notes.....	550,000	-
Total notes payable.....	2,761,535	2,020,901
Less: Current portion.....	(2,211,535)	(1,782,060)
Long-term portion.....	<u>\$ 550,000</u>	<u>\$ 238,841</u>

Assumed International Biologics Loan

During September 2013, the Company assumed a \$2,200,000 loan from an Officer of International Biologics . This loan is non-interest bearing and was valued using a discount rate of 8%. 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; however, the payment terms were restructured resulting in 22 monthly instalments 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. The note's carrying value at September 30, 2016 is \$774,994 (September 30, 2015- \$791,985).

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. This note is currently in default as the Company was not able to make the payment due on March 31, 2016 or June 30, 2016 due to the Company's working capital deficiency. The note's carrying value at September 30, 2016 is \$285,529 (September 30, 2015- \$304,411).

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 note's carrying value at September 30, 2016 is \$74,916 (September 30, 2015- \$254,741). 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 of \$20,000 during October 2016 and, as of the date of these financial statements, is in litigation regarding remaining balances due. The Company believes its exposure to this matter to be limited to amounts recognized for the note payable due Redwood Fund, LP.

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Grenville Notes

On July 31, 2015, the Company secured a \$700,000 note from Grenville Royalty Corp (“Grenville”, a non-related Company), which bears interest of 12.50%. No payments of principal or interest were due until July 31, 2016, at which time, all amounts outstanding were due. This note is secured by all assets of the Company pursuant to a General Security Agreement dated July 31, 2015 between the Company and Grenville. In connection with the loan, the Company granted 500,000 warrants at an exercise price of \$0.60 on December 23, 2015, exercisable for a period of 12 months following the date of completion of the Reverse Takeover. At any time on or after July 31, 2016, the outstanding debt may be converted into additional royalty interests (see Note 15). The note’s carrying value at September 30, 2016 is \$809,292 (September 30, 2015- \$669,762). No payments have been made on this note to the date of these financial statements and the Company obtained a waiver for its default related to its failure to make required payments under this note payable when due. Management is currently in discussions with Grenville regarding the timing of payments due under this note payable.

During February and April 2016, Grenville loaned the Company an additional \$150,000 and \$100,000, respectively. These loans bear interest at 10.50% per annum and have 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 loans may be prepaid by the Company in whole, or in part, without notice, penalty or bonus. The carrying value of these notes totaled \$266,940 at September 30, 2016.

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 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; however, the notes can be prepaid by the Company at any time following 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. At September 30, 2015, these notes were carried at fair value of \$988,100, which is net of \$61,900 of a change in fair value recorded in profit and loss for the nine months ended September 30, 2015, and are reflected as long-term convertible notes payable on the accompanying Consolidated Statements of Financial Position. Prior to the Reverse Takeover, any embedded derivatives were not separated from the host contract as the entire instrument was recorded at fair value. Management determined the fair value of these instruments at September 30, 2015 using the following assumptions:

- (i) At initial recognition, the fair value of the note equaled the payable amount as this reflected the amount of cash required to settle the liability at inception.
- (ii) At September 30, 2015, the Company employed a valuation technique to model the expected value of the liability given observable and non-observable inputs. The key assumptions in this model are as follows:

Offering price of the shares.....	\$	0.23
Exercise (conversion) price.....	\$	0.16
Discount rate.....		27%
Risk-free interest rate.....		0.54%
Expected volatility.....		61%
Expected life in years.....		2.3
Expected dividend yield.....		0%

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The inputs above reflected information management had at the valuation date, about the timing of the initial public offering and the incremental cost of debt at such time.

13. Warrants

The Company's outstanding warrants that were issued in conjunction with offerings of the Company's debt or common stock 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 \$180,439 of income recognized during the year ended September 30, 2016.

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, 2016 were as follows:

<u>Date Issued</u>	<u>Exercise Price (CDN\$)</u>	<u>Date of Expiry</u>	<u>Outstanding and Exercisable</u>
Warrant liabilities:			
December 23, 2015	\$ 0.60	December 23, 2016	2,616,999
December 23, 2015	0.60	December 23, 2016	500,000
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
Total warrants accounted for as liabilities			<u>5,748,492</u>
Warrant reserve within deficit:			
December 23, 2015	0.30	December 23, 2016	<u>182,530</u>
Total warrants			<u><u>5,931,022</u></u>

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

	<u>Year Ended September 30, 2016</u>	
	<u>Upon Issue</u>	<u>Year-End Value</u>
Weighted average risk-free interest rate (%).....	0.53%	0.51%
Expected dividend yield (%).....	0.00%	0.00%
Expected stock price volatility (%).....	121%	113%
Weighted average warrant life in years.....	1.9	1.4
Weighted average exercise price (CDN\$).....	\$0.43	\$0.43
Weighted average grant date / period-end fair value (CDN\$).....	\$0.13	\$0.08

Expected volatility was estimated by reference to comparable listed entities including those of which the Company's share price was based on.

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14. ROYALTY FUNDING

During the year ended December 31, 2014, the Company secured an advance of \$2,000,000 from Grenville, in exchange for a gross sales royalty payable. On this advance, each monthly royalty payment will be 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.

On May 8, 2015, Grenville elected to purchase an additional royalty from the Company. The aggregate funds advanced increased from \$2,000,000 to \$3,000,000 and the Minimum Monthly Payment was increased to \$62,500.

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 Amount of \$31,250 and a sliding scale between 1.37% and 3% of monthly revenue. After July 31, 2016, the applicable royalty rate will be determined based on the greater of the Minimum Monthly Payment of \$62,500 or 6% of revenue. The Company is currently in discussions with Grenville regarding the timing and amounts due under this agreement.

The Company has the right to buy down 50% (and no more or less) for the aggregate installment amount advanced to the Company multiplied by 50%, once Grenville has received aggregate royalty payments of \$6,000,000. If the buy-down option is exercised and completed, the aggregate installment amount and Minimum Monthly Payment will thereafter be reduced by 50%. The Company also has the right to buyout the royalty in the event a change of control of the Company or a sale of substantially all of the assets of the Company. The buyout amount would equal the greater of (i) 2x the Aggregate installment amount or (ii) a formula determined by the Aggregate Installment Amount divided by \$20,000,000 multiplied by 0.8 multiplied by the net equity value of the Company (or the purchase price in the case of an asset sale), as determined by the royalty agreement.

The royalty funding has been reflected as perpetual debt for accounting purposes. Until such time as the Company buys out all or a portion of the royalty, the principal will continue to be reflected in the original funded amount, less any transaction costs which will be amortized on an effective yield basis. A portion of this principal amount will be shown as current, reflecting the minimum payments due within the next fiscal year (see Note 17).

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 will expire in 18 months from the date the non-voting restricted common share was issued. 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.

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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).....	647,250	64,427
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 officers 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.

Activity for the Company's share capital for the nine months ended September 30, 2015 is summarized as follows:

	<u>Shares</u>	<u>Amount</u>
Balances, January 1, 2015.....	20,500	\$ 1,430,000
Shares repurchased (i).....	(9,400)	(655,707)
Issuance of common shares (ii).....	3,599	139,552
Balances, September 30, 2015.....	<u>14,699</u>	<u>\$ 913,845</u>

- (i) During January 2015 and February 2015, the Company repurchased a total of 9,400 shares (22,849,789 shares on a post Reverse Takeover basis) at a weighted average price of \$78.26 per common share for a total price of \$735,613. The reduction in share capital was calculated based on a weighted share cost of \$69.76 per share resulting in a decrease of \$655,707.
- (ii) During February 2015, the Company issued 2,775 shares (6,745,549 shares on a post Reverse Takeover basis) for total proceeds of \$100,000 to an officer of the Company. During August 2015, the Company issued 824 shares (2,003,003 shares on a post Reverse Takeover basis) for services related to debt raises, which totaled \$39,552.

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.

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There were no share purchase options outstanding at September 30, 2016, however, the Company's board of directors has approved, and the Company has granted, a total of 3,300,000 options during January 2017 (Note 21). 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. These stock options were issued to members of the Company's Scientific Advisory Board ("SAB") and were called for as part of various agreements with the SAB members that were entered into prior to September 30, 2016, but were contingent upon the approval of the Company's board of directors. Accordingly, a grant date had not been met for accounting purposes until this board of director approval, at which time the underlying option agreements were issued to the SAB members. As such, the Company has not recognized any expense for these grants to January, 2017.

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 year ended September 30, 2016 and nine months ended September 30, 2015 was nil. A reconciliation of income tax expense to the financial statements statutory tax rates is as follows:

	Year Ended September 30, 2016	Nine Months Ended September 30, 2015
Net loss before taxes	\$ (7,852,007)	\$ (3,190,511)
Expected income taxes based on combined federal and state statutory rate of 38.29%	(3,006,533)	(1,221,647)
Permanent differences	1,006,715	40,084
Change in valuation allowance	1,999,818	1,181,563
Tax expense	<u>\$ -</u>	<u>\$ -</u>

The following table summarizes the components of deferred taxes:

	September 30, 2016	2015
Total current assets	\$ 721,005	\$ 26,422
Long-term assets:		
Net operating loss carryforwards	2,852,929	1,663,234
Intangible assets	269,511	184,184
Other long-term assets	67,161	18,734
Total deferred tax assets	3,910,606	1,892,574
Long-term deferred tax liability - Property and equipment	(130,422)	(112,208)
Deferred tax assets, net	3,780,184	1,780,366
Less: Valuation allowance	(3,780,184)	(1,780,366)
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.....	<u>\$</u>	<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, 2016, the Company's estimated gross net operating losses total approximately \$7.6 million (September 30, 2015 – \$4.3 million) and expire from 2034 to 2036.

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 receivables, accounts payable and accrued liabilities, due to related parties and other payables approximate their fair values due to the short-term maturities of these instruments. The long-term portions of finance lease obligation, officer loans, 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, 2016, the Company has two customers that accounted for more than 10% of sales (nine month period ended September 30, 2015 – 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, 2016, the Company has \$117,592 (September 30, 2015 - \$271,023) of receivables past due.

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, 2016, the Company has current liabilities of \$7.8 million (September 30, 2015 - \$5.2 million) due within 12 months and has cash of less than \$0.1 million (September 30, 2015 – less than \$0.1 million) to meet its current obligations. The Company has converted approximately \$0.7 million of these current liabilities to equity from October 1, 2016 to January 30, 2017. At September 30, 2016, the Company has a working capital deficiency of \$5.0 million (September 30, 2015 - \$1.4 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 shareholders' equity, officer loans, 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 is in default of certain covenant violations relate to the Company's debt, which are discussed in Notes 10 and 12.

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:

	2017	2018	2019	2020	2021	Thereafter
Notes payable.....	\$ 2,211,535	\$ 550,000	\$ -	\$ -	\$ -	\$ -
Accounts payable and accrued liabilities.....	4,306,825	-	-	-	-	-
Factoring advances.....	124,785	-	-	-	-	-
Finance leases.....	29,441	16,143	18,969	10,696	-	-
Royalty (i).....	750,000	750,000	750,000	750,000	750,000	750,000/annum

(i) Based on minimum royalty (see Note 14)

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18. COMMITMENTS AND CONTINGENCIES

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>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>Thereafter</u>	<u>Total</u>
Equipment.....	\$ 22,836	\$ 22,836	\$ 3,806	\$ -	\$ -	\$ -	\$ 49,478
Premises.....	270,439	276,765	264,171	266,914	273,679	196,946	1,548,914

Contingencies

On September 17, 2015, DCI Donor Services, Inc. (“DCIDS”) filed a complaint against the Company in the Superior Court of the State of Arizona and for the county of Maricopa. DCIDS alleges that the Company owes DCIDS \$187,800 for services previously provided by DCIDS in connection with the procurement of tissue. The Company and DCIDS settled this matter in the third quarter of fiscal 2016, and at September 30, 2016 the Company had accrued approximately \$60,000 for this issue, which was paid during October 2016 in full satisfaction of this matter. These amounts were accrued at September 30, 2016 in accounts payable and accrued liabilities on the accompanying Consolidated Statement of Financial Position.

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 September 30, 2016; however, the Company does not believe its exposure to this matter to be greater than 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 November 2016, a note holder of the Company filed a notice of default for nonpayment of approximately \$75,000. The Company has recognized an accrual for this amount and is currently negotiating repayment terms to satisfy this debt obligation.

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 year September 30, 2016, two of the Company’s officers, who are key management personnel, elected to defer payment of their salaries totaling \$499,300, which is the balance due such officers at September 30, 2016. 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.

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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:

	Year Ended		Nine Months	
	September 30,		Ended	
	2016		September 30,	
			2015	
ADM dermis.....	\$	450,706	12.0%	\$ 161,313 5.0%
DBM putty.....		553,018	15.0%	114,551 4.0%
Bone scaffold.....		2,718,556	72.0%	2,715,608 90.0%
Other.....		55,574	1.0%	26,044 1.0%
Total revenue.....	\$	<u>3,777,854</u>	100.0%	<u>\$ 3,017,516</u> 100.0%

21. SUBSEQUENT EVENTS

From October 1, 2016 to January 30, 2017, the Company raised \$1,033,778 from the issuance of 5,168,890 common shares and 2,584,445 warrants in various private placement transactions. These warrants have a strike price of C\$0.265 and expire three years from the date of issuance. From October 1, 2016 to January 30, 2017, the Company also issued 4,857,241 common shares and 1,333,196 warrants in satisfaction of various liabilities totaling approximately \$0.7 million, which were outstanding at September 30, 2016. These warrants have a strike price of C\$0.25 per share and expire three years from the date of issuance.

During January 2017, the Company finalized grants for stock options to members of the Company's Scientific Advisory Board, which is discussed in more detail in Note 15.