EMERALD HEALTH THERAPEUTICS, INC.
(Formerly T-Bird Pharma, Inc.)

Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2016
(Expressed in Canadian Dollars)

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS

The accompanying unaudited condensed interim consolidated financial statements of Emerald Health Therapeutics Inc. for the three and nine months ended September 30, 2016 have been prepared by Management and approved by the Board of Directors. The Company's independent auditors have not performed a review of these financial statements in accordance with the standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditor.

EMERALD HEALTH THERAPEUTICS, INC. (FORMERLY T-BIRD PHARMA, INC.)
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Unaudited – prepared by management)
(Expressed in Canadian dollars)

		September 30, 2016		December 31, 2015 (Audited)
ASSETS				
Current				
Cash	$	875,453	$	81,836
Accounts receivable (Note 5)		23,659		42,140
Inventory (Note 6)		149,437		30,644
Biological assets (Note 7)		118,444		140,422
Prepaid expenses		31,754		27,736
Total current assets		1,198,747		322,778
Plant and equipment (Note 8)		563,359		407,127
Deposits on equipment (Note 8)		15,893		41,774
		579,252		448,901
TOTAL ASSETS	$	1,777,999	$	771,679
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	$	205,275	$	212,198
Due to related parties (Note 9)		332,795		972,677
Total current liabilities		538,070		1,184,875
TOTAL LIABILITIES		538,070		1,184,875
SHAREHOLDERS’ EQUITY				
Share capital (Note 10)		6,335,962		3,076,966
Contributed surplus		3,121,080		2,666,874
Accumulated deficit		(8,217,113)		(6,157,036)
TOTAL SHAREHOLDERS’ EQUITY (DEFICIT)		1,239,929		(413,196)
TOTAL LIABILITIES AND SHAREHOLDERS’ EQUITY	$	1,777,999	$	771,679

Nature and continuance of operations (Note 1)
Commitments (Note 13)
Events after the reporting period (Note 18)

On behalf of the Board of Directors:

/s/ Punit Dhilllon — Director

/s/ Bob Rai — Director

The accompanying notes form an integral part of these consolidated financial statements

EMERALD HEALTH THERAPEUTICS, INC. (FORMERLY T-BIRD PHARMA, INC.)
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS
(Unaudited – prepared by management)
(Expressed in Canadian dollars)

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Revenue	$ 48,933	$ 7,389	$ 129,070	$ 7,389
Cost of sales				
Cost of goods sold	35,261	5,635	107,248	5,635
Production costs	139,497	136,946	395,422	204,443
Gain on changes in fair value of biological assets	6,555	4,057	(101,921)	(25,009)
Gross margin	(132,380)	(139,249)	(271,679)	(177,680)
Expenses				
General and administrative	255,797	353,450	724,443	1,231,844
Pre-distribution growing costs	-	-	-	194,047
Sales and marketing	50,718	61,139	193,398	115,841
Research and development (net of government contributions)	70,971	59,593	244,231	68,192
Depreciation	32,097	13,193	82,651	35,659
Share-based payments (Note 10)	467,878	90,406	543,675	1,138,650
	877,461	577,781	1,788,398	2,784,233
NET LOSS AND COMPREHENSIVE LOSS	1,009,841	717,030	2,060,077	2,961,913
Basic and diluted loss per common share	$ 0.02	$ 0.02	$ 0.04	$ 0.06
Weighted average number of common shares outstanding (note 11)				
-basic	54,381,242	46,070,841	49,411,725	46,070,841
-diluted	54,381,242	46,070,841	49,411,725	46,070,841

The accompanying notes form an integral part of these consolidated financial statements

EMERALD HEALTH THERAPEUTICS, INC. (FORMERLY T-BIRD PHARMA, INC.)
CONDENSED INTERIM CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(Unaudited – prepared by management)
(Expressed in Canadian dollars, except share number)

	Common Shares Without Par Value								
	Shares		Amount		Contributed Surplus		Deficit		Total Shareholders' Equity
Balance, December 31, 2014	46,070,841	$	3,076,966	$	1,490,473	$	(2,659,765)	$	1,907,674
Share-based payments	-		-		1,176,401		-		1,176,401
Net loss and comprehensive loss	-		-		-		(3,497,271)		(3,497,271)
Balance, December 31, 2015	46,070,841	$	3,076,966	$	2,666,874	$	(6,157,036)	$	(413,196)
Shares issued on conversion of debt	12,592,606		2,314,261		-		-		2,314,261
Shares issued on private placement	4,077,687		835,926				-		835,926
Shares issued on stock option exercise	125,000		139,469		(89,469)		-		50,000
Share issuance costs	-		(30,660)		-		-		(30,660)
Share-based payments	-		-		543,675		-		543,675
Net loss and comprehensive loss	-		-		-		(2,060,077)		(2,060,077)
Balance, September 30, 2016	62,866,134	$	6,335,962	$	3,121,080	$	(8,217,113)	$	1,239,929

The accompanying notes form an integral part of these consolidated financial statements

EMERALD HEALTH THERAPEUTICS, INC. (FORMERLY T-BIRD PHARMA, INC.)
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited – prepared by management)
(Expressed in Canadian dollars)

	For the three months ended September 30, 2016	For the three months ended September 30, 2015	For the nine months ended September 30, 2016	For the nine months ended September 30, 2015
Operating activities				
Net loss and comprehensive loss	$ (1,009,841)	$ (717,030)	$ (2,060,077)	$ (2,961,913)
Items not involving cash				
Depreciation (Note 8)	32,097	13,193	82,651	35,659
Gain on changes in fair value of biological assets	6,555	4,057	(101,921)	(25,009)
Share-based payments (Note 10)	467,878	90,406	543,675	1,138,650
Accrued interest	17,818	-	33,425	-
Loss on disposal of assets	-	-	1,100	-
Changes in non-cash operating working capital items (Note 12)	(35,153)	36,044	102,830	17,504
Net cash flows used in operating activities	(520,646)	(573,330)	(1,398,317)	(1,795,109)
Investing activities				
Purchase of plant and equipment (Note 8)	(12,847)	(31,388)	(198,209)	(125,984)
Deposits on equipment (Note 8)	(15,893)	(59,658)	(15,893)	(59,658)
Net cash flows used in investing activities	(28,740)	(91,046)	(214,102)	(185,642)
Financing activities				
Proceeds from private placement	835,926	-	835,926	-
Advances from related parties (Note 9)	543,833	333,408	1,550,770	333,486
Stock option exercises	50,000	-	50,000	-
Share issuance costs	(15,850)	-	(30,660)	-
Net cash flows generated from financing activities	1,413,909	333,408	2,406,036	333,486
Increase (decrease) in cash during the period	864,523	(330,968)	793,617	(1,647,265)
Cash, beginning of period	10,930	402,498	81,836	1,718,795
Cash, end of period	$ 875,453	$ 71,530	$ 875,453	$ 71,530

The accompanying notes form an integral part of these consolidated financial statements

1. NATURE AND CONTINUANCE OF OPERATIONS

Emerald Health Therapeutics Inc. (the "Company"), (formerly T-Bird Pharma, Inc.) was incorporated by articles of incorporation pursuant to the Business Corporations Act (British Columbia) on July 31, 2007 as Firebird Capital Partners Inc. and changed its name to Firebird Energy Inc. in December 2012. On September 4, 2014, the Company completed the acquisition of all of the issued and outstanding common shares of Thunderbird Biomedical Inc. ("Thunderbird"), by way of a reverse takeover under the rules of the TSX Venture Exchange (the "TSXV") and concurrently changed its name to T-Bird Pharma, Inc. Thunderbird became a wholly owned subsidiary of the Company. In June 2015, the Company changed its name to Emerald Health Therapeutics, Inc. and Thunderbird changed its name to Emerald Health Botanicals Inc. ("Botanicals"). Its registered office is at Suite 2600 Oceanic Plaza, 1066 West Hastings Street, Vancouver, B.C. V6E 3X1. The Company is classified as a Tier 2 Venture Issuer on the TSXV.

The Company owns 100% of the shares of Botanicals, a private Victoria-based company which was incorporated by articles of incorporation pursuant to the Business Corporations Act (British Columbia) on January 28, 2013. The principal business of Botanicals is the production and sale of medical marihuana pursuant to the Marihuana for Medical Purposes Regulations.

These condensed interim consolidated financial statements have been prepared by management on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As of September 30, 2016, the Company had a working capital deficiency, had not yet achieved profitable operations and had accumulated losses of $7,207,272 (December 31, 2015 - $6,157,036) since its inception. The continuing operations of the Company are dependent upon its ability to continue to raise adequate capital, which the Company was successful in completing during the current quarter and subsequent to the quarter end, and to commence profitable operations in the future and repay its liabilities arising from normal business operations as they become due. Alternative financing options may include obtaining bank credit facilities and short-term loans from related and third parties. As of September 30, 2016, the Company owed $332,795 (December 31, 2015 - $972,677) to related parties (Note 9). Management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

These condensed interim consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

2. BASIS OF PRESENTATION

Statement of Compliance

These condensed interim consolidated financial statements have been prepared in accordance with IAS 34, "Interim Financial Reporting" ("IAS 34"), as issued by the International Accounting Standards Board ("IASB"). They do not include all of the information required for full annual financial statements, and should be read in conjunction with the Company's financial statements for the year ended December 31, 2015. Accordingly, accounting policies, estimates, and judgements applied are the same as those applied in the Company's annual financial statements except with the new policies adopted in the period as discussed in Note 2. The Company assesses its accounting estimates and judgements every reporting period.

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

The condensed interim consolidated financial statements were authorized for filing by the Board of Directors on November 25, 2016.

Basis of measurement

These condensed interim consolidated financial statements have been prepared on a historical cost basis except for certain financial assets measured at fair value. These consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

All dollar amounts presented are in Canadian dollars unless otherwise specified. In addition, there may be minor differences due to rounding of numbers.

Consolidation

These condensed interim consolidated financial statements include the accounts of the Company and its 100% controlled subsidiary, Emerald Health Botanicals Inc. Intercompany transactions and balances between the Company and its subsidiary are eliminated in full on consolidation.

The Company's interim results are not necessarily indicative of its results for a full year.

3. ACCOUNTING POLICIES

These interim condensed consolidated financial statements have been prepared using the same accounting policies as those used in the Company's annual financial statements at December 31, 2015 with the exceptions noted below.

IAS 16, Property, Plant and Equipment and IAS 41, Agriculture

Applicable to annual periods beginning on or after January 1, 2016, *IAS 16, Property, Plant and Equipment and IAS 41, Agriculture* are amended to:

3. ACCOUNTING POLICIES (continued)

- Include 'bearer plants' within the scope of IAS 16 rather than IAS 41, allowing such assets to be accounted for as property, plant and equipment and measure initial recognition on a cost or revaluation basis in accordance with IAS 16;
- Introduce a definition of 'bearer plants' as a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales; and
- Clarify that produce growing on bearer plants remains within the scope of IAS 41.

The Company has determined that there is not a significant impact arising from the application of this new standard as the plants in question do not meet the definition of bearer plants introduced in the amendment.

Disclosure Initiative (*Amendments to IAS 1)*

Effective for annual periods beginning on or after January 1, 2016, IAS 1 *Presentation of Financial Statements* is amended to address perceived impediments to preparers exercising their judgement in presenting their financial reports by making the following changes:

- clarification that information should not be obscured by aggregating or by providing immaterial information, materiality considerations apply to all parts of the financial statements, and even when a standard requires a specific disclosure, materiality considerations do apply;
- clarification that the list of line items to be presented in these statements can be disaggregated and aggregated as relevant and additional guidance on subtotals in these statements and clarification that an entity's share of OCI of equity-accounted associates and joint ventures should be presented in aggregate as single line items based on whether or not it will subsequently be reclassified to profit or loss; and
- additional examples of possible ways of ordering the notes to clarify that understandability and comparability should be considered when determining the order of the notes and to demonstrate that the notes need not be presented in the order so far listed in paragraph 114 of IAS 1.

The Company has determined that there is not a significant impact arising from the application of this new standard.

Share Capital

The proceed from the exercise of stock options or warrants together with amounts previously recorded on the grant date or issue date are recorded as share capital.

The Company uses the residual value approach in respect of unit offerings whereby the amount assigned to the warrant is the excess of the unit price over the trading price of the Company's shares at the date of issuance, if any, to a maximum fair value of the warrant determined by using the Black-Scholes Option-Pricing Model.

(Expressed in Canadian dollars)

4. NEW ACCOUNTING PRONOUNCEMENTS

Standards issued but not yet effective up to date of issuance of the Company's financial statements are listed below. The Company has not yet assessed the impact of these new standards on disclosures, financial position or performance when applied at a future date. The Company intends to adopt those standards when they become effective.

IAS 34, Interim Financial Reporting – amended to clarify the meaning of "elsewhere in the interim report" and require a cross-reference. It is effective for annual periods beginning on or after July 1, 2016.

IFRS 15, Revenue from Contracts with Customers - clarifies the principles for recognizing revenue from contracts with customers. IFRS 15 will also result in enhanced disclosure about revenue, provide guidance for transactions that were not previously addressed comprehensively (i.e. service revenue and contract modifications) and improve guidance for multiple-element arrangements. The standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

IFRS 9, Financial Instruments - replaces the guidance in IAS 39 - Financial Instruments; Recognition and Measurement, on the classification and measurement of financial assets. The standard eliminates the existing IAS 39 categories of held to maturity, available-for-sale and loans and receivable. Financial assets will be classified into one of two categories on initial recognition, financial assets measured at amortized cost or financial assets measured at fair value. Gains and losses on re-measurement of financial assets measured at fair value will be recognized in profit or loss, except that for an investment in an equity instrument which is not held-for-trading, IFRS 9 provides, on initial recognition, an irrevocable election to present all fair value changes from the investment in other comprehensive income. The standard is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

5. ACCOUNTS RECEIVABLE

The accounts receivable as at September 30, 2016 $23,659 (December 31, 2015 $42,140) primarily consisted of Goods and Service Tax ("GST") receivable from the Canada Revenue Agency and amounts receivable towards a research and development project from the Government of Canada.

6. INVENTORY

The Company's inventory is comprised of:

	September 30, 2016	December 31, 2015
Finished goods	$ 143,270	$ 29,894
Other	6,167	750
	$ 149,437	$ 30,644

Included in production costs is an adjustment of $32,743 in inventory from cost to net realizable value. Prior to obtaining the authorization to sell from Health Canada in May 2015, production costs incurred in excess of net realizable value have been expensed as pre-distribution growing costs.

(Expressed in Canadian dollars)

7. BIOLOGICAL ASSETS

The Company's biological assets consist of seeds and cannabis on plants. The continuity of biological assets for the nine months ended September 30, 2016 and 2015 is as follows:

	September 30, 2016	September 30, 2015
Carrying amount, December 31, 2015	$ 140,422	$ -
Purchase (use of) seeds	(2,640)	-
Changes in fair value less costs to sell due to biological transformation	101,921	29,066
Transferred to inventory upon harvest	(121,259)	-
Carrying amount	$ 118,444	$ 29,066

As at September 30, 2016, included in the carrying amount of biological assets is $25,113 in seeds and $93,331 in live plants.

All of the plants are to be harvested as agricultural produce (ie. Medical cannabis).

The significant assumptions used in determining the fair value of medical cannabis plants are as follows:

- plant waste based on various stage of growth;
- yield per plant;
- pricing of final product;
- percentage of costs incurred to date compared to the total costs to be incurred (to estimate the fair value of an in-process plant); and
- costs incurred for each stage of plant growth.

The Company estimates the harvest yields for the plants at various stages of growth. The Company's estimates are, by their nature, subject to change. Changes in the anticipated yield will be reflected in future changes in the gain or loss on changes in fair value of biological assets.

(Expressed in Canadian dollars)

8. PLANT AND EQUIPMENT

		Leasehold improvements		Growing and extract equipment		Other equipment		Total
Cost								
Balance, December 31, 2014	$	148,363	$	54,713	$	20,516	$	223,592
Additions		55,597		204,200		10,664		270,461
Disposals		(19,633)		-		-		(19,633)
Balance, December 31, 2015	$	184,327		258,913	$	31,180	$	474,420
Additions		602		159,017		80,364		239,983
Disposals		-		-		(3,143)		(3,143)
Balance, September 30, 2016	$	184,929	$	417,930	$	108,401	$	711,260
Accumulated depreciation								
Balance, December 31, 2014	$	8,520		9,392	$	2,972	$	20,884
Additions		18,709		20,103		7,597		46,409
Balance, December 31, 2015	$	27,229	$	29,495	$	10,569	$	67,293
Additions		14,081		48,341		20,229		82,651
Disposals		-		-		(2,043)		(2,043)
Balance, September 30, 2016	$	41,310	$	77,836	$	28,755	$	147,901
Net book value								
At December 31, 2015	**$**	**157,098**	**$**	**229,418**	**$**	**20,611**	**$**	**407,127**
At September 30, 2016	**$**	**143,619**	**$**	**340,094**	**$**	**79,646**	**$**	**563,359**

Deposits on equipment as at September 30, 2016 in the amount of $15,893 (December 31, 2015 – $41,774) was used towards lab equipment received during the current period.

9. RELATED PARTY TRANSACTIONS

The balances due to related parties, with the exception of the demand loans owing to Emerald Health Sciences, Inc. ("Sciences"), a related party of the Company, are unsecured, non-interest bearing and have no specific terms of repayment.

Transactions with Sciences

Amounts loaned to the Company by Sciences bear interest at 12% per annum and are repayable on demand. The Company also agreed to pay a fee for services provided by Sciences pursuant to a service contract based on cost. As of September 30, 2016, the Company owed $315,185 for the loan and services, including accrued interest of $3,100.

(Expressed in Canadian dollars)

9. RELATED PARTY TRANSACTIONS (continued)

In March 2016, Sciences agreed to convert the debt of $1,392,796 outstanding as of February 26, 2016, the date Sciences agreed to the conversion of the debt, into 8,097,651 Common Shares at a deemed price of $0.172 per Common Share. The TSXV approved the conversion of the debt and issuance of the new shares in May 2016.

In August 2016, Sciences and the Company announced a private placement of an aggregate of up to 4,077,687 units of the Company at a price of $0.205 per unit, for gross proceeds of $835,926. Each unit was comprised of one Common Share and one Common Share purchase warrant, with each warrant entitling the holder to acquire an additional Common Share for a period of 24 months at an exercise price of $0.27. The private placement was completed on September 21, 2016.

Also in August 2016, Sciences agreed to convert additional debt outstanding in the amount of $921,465 owed by the Company to Sciences as of August 5, 2016, the date Sciences agreed to the conversion of the debt, into 4,494,955 common shares at a deemed price of $0.205 per share. The TSXV approved the conversion of the debt and issuance of the new shares in September 2016.

Sciences owns 62% of the issued and outstanding Common Shares of the Company as of September 30, 2016.

Change in Directors

In August 2016, Mr. David Raffa stepped down as a director of the Company and a new director, Mr. Bob Rai was appointed. Sciences reached an agreement directly with Mr. Raffa to purchase 4,407,708 Common Shares from Mr. Raffa. Pursuant to this agreement, Sciences purchased 2,203,854 Common Shares from Mr. Raffa in September 2016 and the remaining 2,203,854 Common Shares in October 2016.

Remuneration of directors and key management of the Company

The remuneration awarded to directors and to senior management including the Executive Chairman, the President and Chief Executive Officer and the Chief Financial Officer, includes the following:

	For the three months ended September 30,		For the nine months ended September 30,	
	2016	2015	2016	2015
Wages and short-term benefits	$ 75,412	$ 75,034	$ 226,208	$ 252,349
Share-based payments (Note 10)	415,877	52,531	467,554	691,666
	$ 491,289	$ 127,565	$ 693,762	$ 944,015

In the event that the President and Chief Executive Officer's or the Chief Financial Officer's employment agreements are terminated by the Company, other than for just cause, such officers are entitled to a minimum severance amount equal to six months of salary.

These transactions are in the normal course of the operations on normal commercial terms and conditions and at market rates, which is the amount of consideration established and agreed to by the related parties.

10. SHARE CAPITAL

Authorized
Unlimited number of common shares without par value

Issued
62,866,134 common shares (2015 – 46,070,841)

The outstanding share capital has increased by 16,795,293 common shares since December 31, 2015 due to the following transactions:

- The debt conversion with Sciences in May 2016 for 8,097,651 Common Shares at a deemed price of $0.172 per share;
- The private placement with Sciences in September 2016 for 4,077,687 units of the Company at a price of $0.205 per unit, for gross proceeds of $835,926. Each unit was comprised of one Common Share and one Common Share purchase warrant, with each warrant entitling the holder to acquire an additional Common Share for a period of 24 months at an exercise price of $0.27;
- The debt conversion with Sciences in September 2016 for 4,494,955 Common Shares at a deemed price of $0.205 per share; and
- Stock options exercised for 125,000 Common Shares at an exercise price of $0.40.

Warrants

In September 2016, the Company issued 4,077,687 warrants in conjunction with a private placement with Sciences at a price of $0.27 each. The warrants can be acquired for a period of two years from the closing date of the transaction, which was September 21, 2018. Under the residual value method, the warrants were ascribed a value of NIL

Surplus and Value Escrow Agreements

In 2014, the Company entered into a Surplus Security Escrow Agreement and a Value Security Escrow Agreement under TSXV Policy 5.4 *Escrow, Vendor Consideration and Resale Restrictions* in connection with a Reverse Takeover.

Approximately 59% of the outstanding common shares at that time were subject to the Surplus Security Escrow Agreement and as of September 30, 2016, 14,921,220 common shares (55%) held under the Surplus Security Escrow Agreement remained in escrow. Approximately 11% of the common shares were subject to the Value Security Escrow Agreement and as of September 30, 2016, 1,520,256 common shares (30%) held under the Surplus Security Escrow Agreement remained in escrow.

(Expressed in Canadian dollars)

10. SHARE CAPITAL (continued)

The Surplus Security Escrow Agreement and the Value Security Escrow Agreement are releasable in the following tranches:

	Surplus Security Escrow	Value Security Escrow
September 2014	-	10%
March 2015	-	15%
May 2015	10%	-
September 2015	10%	15%
March 2016	10%	15%
September 2016	15%	15%
March 2017	15%	15%
September 2017	40%	15%

In June 2015, the shareholders of the Company approved the termination, in certain circumstances, of the escrow agreements entered into by the Company. As of September 30, 2016, no specific transaction was being contemplated that would require the termination of the escrow agreements.

Share based payments

The Company has a stock option plan (the "Plan") that is administered by the Board of Directors of the Company who establish exercise prices, at not less than the closing market price on the day before the grant, and expiry dates, which have been set at five years from issuance.

The maximum number of stock options available under the Plan is equal to 10% of the outstanding shares of the Company from time to time. Subject to the terms of each grant as may be determined by the Board of Directors at the time options are granted, options may be exercisable for a period of up to ten years after the date of grant thereof. The number of shares reserved for issue to any individual director or officer will not exceed 5% of the number of then outstanding shares and the number of shares reserved for issue to any consultants or persons conducting investor relations activities will not exceed 2% of the number of then outstanding shares.

The Board of Directors has the discretion to determine to whom options will be granted, the number and exercise price of such options and the terms and time frames in which the options will vest and be exercisable. The exercise price of the options must be no less than the closing price on the day preceding the grant.

(Expressed in Canadian dollars)

10. SHARE CAPITAL (continued)

The changes in incentive stock options outstanding are summarized as follows:

	Number of Shares	Weighted Average Exercise Price
Balance at December 31, 2014	2,950,000	$0.47
Granted	1,850,000	$0.44
Forfeited	(177,758)	$0.40
Expired	(272,242)	$0.59
Cancelled	(400,000)	$0.53
Balance at December 31, 2015	3,950,000	$0.44
Granted	2,650,000	$0.60
Exercised	(125,000)	$0.40
Expired	(250,000)	$0.40
Balance at September 30, 2016	6,225,000	$0.51

During the nine-month period ending September 30, 2016, the Company granted 2,650,000 stock options with exercise prices of $0.175 to $0.72, vesting periods up to 36 months and five-year terms. During the same period, 125,000 stock options were exercised and 250,000 options granted to the former CEO expired without being exercised.

The fair values of the options granted in 2016 were determined on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	Grant March 2016	Grant August 2016	Grant September 2016
Number of share options granted	300,000	400,000	1,950,000
Exercise price	$0.175	$0.335	$0.72
Market value on grant date	$0.175	$0.335	$0.72
Risk free interest rate	0.74%	0.66%	0.59%
Expected life	5 years	5 years	5 years
Annualized volatility	80%	80%	80%
Expected dividends	Nil	Nil	Nil

Volatility was estimated by using the historical volatility of other companies that the Company considers comparable that have similar trading and volatility history. The expected life in years represents the period of time that options granted are expected to be outstanding. The risk-free rate is based on Canada government bonds with a remaining term equal to the expected life of the options.

(Expressed in Canadian dollars)

10. SHARE CAPITAL (continued)

Incentive stock options outstanding and exercisable at September 30, 2016 are summarized as follows:

	Outstanding			Exercisable	
Exercise price	**Quantity**	**Remaining contractual life (Years)**	**Weighted average exercise price**	**Quantity**	**Weighted average exercise price**
$0.175	300,000	4.4	$ 0.175	58,333	$ 0.175
$0.335	400,000	4.9	$0.335	400,000	$0.335
$0.40	1,125,000	2.9	$ 0.40	1,018,056	$ 0.40
$0.41	350,000	3.3	$ 0.41	189,080	$ 0.41
$0.45	1,500,000	3.5	$ 0.45	1,500,000	$ 0.45
$0.55	600,000	3.2	$ 0.55	366,667	$ 0.55
$0.72	1,950,000	5.0	$0.72	800,000	$0.72
	6,225,000	4.0	$ 0.51	4,332,136	$ 0.48

The Company recorded share-based compensation expense related to the incentive stock options of $467,878 and $90,406 for the three-month periods ended September 30, 2016 and 2015. During the quarter ended September 30, 2016, 1,200,000 options were granted to directors and employees with immediate vesting for a share-based compensation expense of $432,000. The expense was charged to the consolidated statement of loss and comprehensive loss.

(Expressed in Canadian dollars)

11. LOSS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the three and nine month periods ended September 30, 2016 and 2015:

	For the three months ended September 30,		For the nine months ended September 30,	
	2016	**2015**	**2016**	**2015**
Numerator				
Net Loss for the period	$ 1,009,842	$ 717,030	$ 2,060,078	$ 2,961,913
Denominator				
For basic- weighted average number of shares outstanding	54,381,242	46,070,841	49,411,725	46,070,841
Effect of dilutive securities incentive share options	-	-	-	-
For diluted – adjusted weighted average number of shares outstanding	54,381,242	46,070,841	49,411,725	46,070,841
Loss per share				
Basic	$ (0.02)	$ (0.02)	$ (0.04)	$ (0.06)
Diluted	$ (0.02)	$ (0.02)	$ (0.04)	$ (0.06)

The basic loss per share is computed by dividing the net loss by the weighted average number of common shares outstanding during the period. The diluted loss per share reflects the potential dilution of common share equivalents, such as outstanding stock options, and warrants, in the weighted average number of common shares outstanding during the year, if dilutive. For the periods ended September 30, 2016 and 2015, the stock options and warrants were anti-dilutive and therefore would not impact the weighted average number of common shares outstanding.

(Expressed in Canadian dollars)

12. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

The following table sets forth the changes in the non-cash operating working capital items for the three and nine month periods ended September 30, 2016 and 2015:

	For the three months ended September 30,		For the nine months ended September 30,	
	2016	**2015**	**2016**	**2015**
Accounts receivable	(1,736)	(16,572)	18,481	(8,142)
Prepaid expenses	(4,053)	(19,998)	(4,018)	(23,068)
Inventory and biological assets (Note 6)	(11,714)	(9,279)	5,106	(38,304)
Accounts payable and accrued liabilities	(38,125)	81,893	(6,924)	87,018
Advances from related parties (Note 9)	20,475	-	90,185	-
	$ (35,153)	$ 36,044	$ 102,830	$ 17,504

13. COMMITMENTS

The Company leases it premises for $4,750 per month for an initial term from June 1, 2014 to May 31, 2019 with an option to renew for an additional two, five year terms.

The Company entered purchase agreements with other Licensed Producers to supplement inventory.

		Due by year ending				
	Total	**2016**	**2017**	**2018**	**2019**	**2020 and thereafter**
Production facilities	$152,000	$14,250	$57,000	$57,000	$23,750	-
Purchase agreements	466,860	34,000	368,860	64,000	-	-
	$ 618,860	$48,250	$425,860	$121,000	$23,750	$ -

(Expressed in Canadian dollars)

14. FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are measured on an ongoing basis at fair value or amortized cost. The disclosure in the notes to these financial statements describe how the categories of financial instruments are measured and how income and expenses, including fair value gains and losses, are recognized.

As at September 30, 2016 and December 31, 2015, the classification of the financial instruments, as well as their carrying values and fair values, are shown in the table below:

	September 30, 2016		December 31,2015	
	Fair Value	**Carrying Value**	**Fair Value**	**Carrying Value**
Financial Assets				
FVTPL:				
Cash	$875,453	$875,453	$81,836	$81,836
Loans and accounts, recorded at amortized cost:				
Accounts receivable	23,659	23,659	42,140	42,140
Financial Liabilities				
Other financial liabilities, recorded at amortized cost:				
Accounts payable and accrued liabilities	205,275	205,275	212,198	212,198
Due to related parties	332,795	332,795	981,077	972,677

Fair value hierarchy financial instruments recorded at fair value at the statement of financial position dates are classified using the fair value hierarchy, which reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

Level 1 – Valuation based on quoted prices [unadjusted] in active markets for identical assets or liabilities.

Level 2 – Valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3 – Valuation techniques using inputs for the asset or liability that are not based on observable market data.

The carrying value of the cash and cash equivalents, accounts receivables, accounts payable and accrued liabilities and amounts due to related parties, approximates the fair value because of the short-term nature of these instruments.

14. FINANCIAL INSTRUMENTS (continued)

The Company's financial instruments that must be recorded at fair value are presented in the following table:

	Carrying Value	Fair Value Measurement Level 1	Level 2	Level 3
As at September 30, 2016				
Financial Assets - Cash	$ 875,453	$ 875,453	-	-
As at December 31, 2015				
Financial Assets - Cash	$ 81,836	$ 81,836	-	-

The Company is exposed to varying degrees to a variety of financial instrument related risks:

Currency risk

The Company's functional and reporting currency is the Canadian dollar and major purchases are transacted in Canadian dollars. The Company has not hedged its exposure to currency fluctuations. As a result, the Company's exposure to foreign currency risk is minimal.

Credit risk

The Company's cash is largely held in large Canadian financial institutions. The Company does not have any asset-backed commercial paper. The Company maintains cash deposits with Schedule A financial institutions, which from time to time may exceed federally insured limits. The Company's maximum exposure to credit risk as at September 30, 2016 is the carrying value of its financial assets.

Interest rate risk

Interest rate risk is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Financial assets and liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company does not hold any financial liabilities with variable interest rates. The Company does maintain bank accounts which earn interest at variable rates but it does not believe it is currently subject to any significant interest rate risk.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations associated with financial liabilities. As at September 30, 2016, the Company had positive working capital of $660,677, which is net of the demand loans of $315,185 owing to Sciences. Sciences agreed to provide funds as needed in order for the Company to continue to meet its ongoing financial obligations. The Company's ability to continue as a going concern is dependent on management's ability to raise required funding through future equity issuances and through short-term borrowing. The Company manages its liquidity risk by forecasting cash flows from operations and anticipating any investing and financing activities. Management and the Board of Directors are actively involved in the review, planning and approval of significant expenditures and commitments.

15. CAPITAL MANAGEMENT

The Corporation's objective when managing its capital is to ensure sufficient equity financing to fund its planned operations in a way that maximizes the shareholder return given the assumed risks of its operations. The Corporation considers shareholders' equity as capital. Through the ongoing management of its capital, the Corporation will modify the structure of its capital based on changing economic conditions. In doing so, the Corporation may issue new shares. Annual budgeting is the primary tool used to manage the Corporation's capital. Updates are made as necessary to both capital expenditure and operational budgets in order to adapt to changes in risk factors, proposed expenditure programs and market conditions.

16. SEGMENTED INFORMATION

The Company has one reportable operating segment of production of medical marihuana pursuant to the Marihuana for Medical Purposes Regulations. As at September 30, 2016 and December 31, 2015, all of the Company's operations and assets were in Canada.

17. RECLASSIFICATIONS

Certain amounts in the prior years' financial statements have been reclassified to conform to the current period presentation. The expense categories on the Condensed Interim Consolidated Statements of Loss and Comprehensive Loss have been changed to disclose the information by function rather than by nature of the expense.

18. EVENTS AFTER THE REPORTING PERIOD

a) Private Placement

In October 2016, the Company and Sciences announced a proposed private placement of up to 4,411,764 units of the Company at a price of $0.68 per unit for proceeds of $3 million. Each unit was comprised of one Common Share and one Common Share purchase warrant. Each warrant entitles the holder thereof to acquire an additional Common Share at a price of $0.85 per Common Share for a period of five years from the closing date. The private placement was completed on November 16, 2016. Upon completion of the private placement, Sciences held approximately 67.5% of the Common Shares (on an undiluted basis) and 71.2% of the Common Shares (on a partially-diluted basis giving effect only to the exercise of Common Share purchase warrants held by Sciences).

b) Licence Renewal

In November 2016, Health Canada renewed Botanical's Licence until May 7, 2018.