

NOTICE

The Audited Financial Statements of The Hydrothechary Corporation (the “Corporation”) as at and for the year ended July 31, 2017 filed on SEDAR on November 2, 2017, contained an independent auditors’ report dated November 1, 2017. The Audited Financial Statements are being re-filed on SEDAR to add the audit opinion from the Corporation’s predecessor auditor covering the year ended July 31, 2016, before the effects of the adjustments to retrospectively apply the change in accounting discussed in Notes 1 and 4 to the Audited Financial Statements. The auditor’s report on the July 31, 2017 consolidated financial statements has been amended to indicate that our current auditor has audited the adjustments described in Note 1 and 4 to the consolidated financial statements that were applied to adjust the comparative information presented as at and for the year ended July 31, 2016.

In addition to the above, the following minor corrections to disclosures have been made:

- On the Consolidated Statement of Financial Position, unsecured convertible debenture which was outstanding as at July 31, 2016 has been presented as current;
- In Note 14, Expenses by Nature has been amended to correct a formatting error in the table;
- Note 15, Income taxes, certain number have been updated to reflect the tax effect of the temporary differences.

No other changes have been made to the Audited Financial Statements.

This notice does not form a part of the Audited Financial Statements.

Consolidated financial statements of

The Hydrotheccary Corporation

for the years ended July 31, 2017 and 2016

(Expressed in Canadian dollars, unless otherwise noted)

Independent Auditors' Report

To the Shareholders of The Hydrothechary Corporation:

We have audited the accompanying consolidated financial statements of The Hydrothechary Corporation, which comprise the consolidated statement of financial position as at July 31, 2017, and the consolidated statements of comprehensive loss, changes in shareholders' equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of 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 The Hydrothechary Corporation as at July 31, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Other Matter

Without modifying our opinion, we draw attention to effects of the adjustments to retrospectively apply the change in accounting discussed in Notes 1 and 4 to the consolidated financial statements which indicates that the comparative information presented as at and for the year ended July 31, 2016, has been adjusted.

The consolidated financial statements of The Hydrothechary Corporation as at July 31, 2016, before the effects of the adjustments to retrospectively apply the change in accounting discussed in Notes 1 and 4 to the consolidated financial statements, were audited by other auditors whose report dated November 18, 2016, expressed an unqualified opinion on those statements.

As part of our audit of the consolidated financial statements as at and for the year ended July 31, 2017, we audited the adjustments described in Notes 1 and 4 to the consolidated financial statements that were applied to adjust the comparative information presented as at and for the year ended July 31, 2016.

We were not engaged to audit, review, or apply any procedures to the July 31, 2016, consolidated financial statements other than with respect to the adjustment described in Notes 1 and 4 to the consolidated financial statements. Accordingly, we do not express an opinion or any other form of assurance on those financial statements taken as a whole.

Toronto, Ontario

November 1, 2017

MNP LLP

Chartered Professional Accountants

Licensed Public Accountants

Independent Auditor's Report

To the Shareholders of
The Hydrothechary Corporation

We have audited, before the effects of the adjustments to retrospectively apply the change in accounting discussed in Notes 1 and 4 to the consolidated financial statements, the accompanying consolidated financial statements of The Hydrothechary Corporation, which comprise the consolidated statement of financial position as at July 31, 2016, and the consolidated statement of comprehensive loss, the consolidated statement of changes in shareholders' equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information (the 2016 consolidated financial statements before the effects of the adjustments discussed in Notes 1 and 4 to the consolidated financial statement are not presented herein).

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements, before the effects of the adjustments to retrospectively apply the change in accounting discussed in Notes 1 and 4 to the consolidated financial statements, present fairly, in all material respects, the financial position of The Hydrothecary Corporation as at July 31, 2016 and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

s/Deloitte LLP

Chartered Professional Accountants
Licensed Public Accountants

November 18, 2016

The Hypothecary Corporation

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The Hypothecary Corporation

Consolidated statements of comprehensive loss for the years ended July 31, 2017 and 2016

(In Canadian dollars)

	2017	2016
	\$	\$
Revenue	4,096,841	1,871,781
Cost of sales		
Revaluation of biological assets (Note 6)	(5,663,161)	(595,658)
Production costs	659,339	220,433
Cost of goods sold (Note 5)	2,039,394	547,847
Loss on write down of inventory (Note 5)	613,074	464,792
Gross margin including unrealized revaluation of biological assets	6,448,195	1,234,367
Operating Expenses		
Marketing and promotion	2,986,424	1,626,079
General and administrative	3,608,595	1,614,105
Research and development	86,378	114,910
Stock-based compensation (Note 10 and 15)	658,620	293,564
Amortization of property, plant and equipment (Note 7)	359,967	126,516
Amortization of intangible assets (Note 8)	231,685	173,382
	7,931,669	3,948,556
Loss from operations	(1,483,474)	(2,714,189)
Revaluation of financial instruments (Note 9)	(9,169,275)	-
RTO listing expense (Note 4)	(951,024)	-
Foreign exchange loss	(326,981)	-
Loss on disposal of assets	(56,356)	-
Interest expense	(522,618)	(640,507)
Interest income	92,158	400
Net loss and comprehensive loss attributable to shareholders	(12,417,570)	(3,354,296)
Net loss per share, basic and diluted	(0.21)	(0.11)
Weighted average number of outstanding shares		
Basic and diluted (Note 11)	58,556,121	31,538,886

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

The Hydrothecary Corporation

Consolidated statements of financial position

as at July 31, 2017

(In Canadian dollars)

	July 31, 2017	July 31, 2016
	\$	\$
Assets		
Current assets		
Cash and cash equivalents	38,452,823	1,931,454
Short-term investment	2,871,550	-
Share subscriptions receivable	-	250,011
Accounts receivable	351,207	1,043,365
Commodity taxes recoverable	495,783	27,425
Prepaid expenses	200,677	35,737
Inventory (Note 5)	3,689,239	531,425
Biological assets (Note 6)	1,504,186	120,667
	47,565,465	3,940,084
Property, plant and equipment (Note 7)	5,849,695	2,936,226
Intangible assets (Note 8)	2,763,764	2,633,766
	56,178,924	9,510,076
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	1,672,406	1,373,499
Commodity taxes payable	-	43,863
Unsecured convertible debentures (Note 9)	-	306,205
Warrant liability (Note 9)	1,355,587	-
	3,027,993	1,723,567
Unsecured convertible debentures (Note 9)	20,711,441	-
	23,739,434	1,723,567
Shareholders' equity		
Share capital (Note 10)	45,159,336	12,756,262
Share-based payment reserve (Note 10)	1,561,587	937,065
Contributed surplus	1,774,880	89,601
Warrants (Note 10)	3,728,255	1,370,579
Deficit	(19,784,568)	(7,366,998)
	32,439,490	7,786,509
	56,178,924	9,510,076

Approved by the Board

/s/ Sébastien St-Louis _____ Director

/s/ Adam Miron _____ Director

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

The Hydrotheccary Corporation

Consolidated statements of changes in shareholders' equity for the years ended July 31, 2017 and 2016

	Number common shares	Share capital	Share-based payment reserve	Warrants	Contributed surplus	Deficit	Shareholders' equity
	#	\$	\$	\$	\$	\$	\$
Balance, July 31, 2016	39,305,832	12,756,262	937,065	1,370,579	89,601	(7,366,998)	7,786,509
Issuance of Units (Note 10)	338,274	192,253	-	61,453	-	-	253,706
Broker/finder warrants (Note 10)	-	-	-	1,236,428	-	-	1,236,428
Stock-based compensation (Note 10)	-	-	658,620	-	-	-	658,620
Exercise of stock options	162,504	136,603	(104,351)	-	-	-	32,252
Exercise of warrants	828,694	1,033,772	-	(93,858)	-	-	939,914
Shares issued for reverse acquisition	1,837,770	1,378,332	70,253	-	-	-	1,448,585
Private placement (Note 10)	8,571,432	5,000,002	-	-	-	-	5,000,002
Concurrent financing (Note 10)	20,010,000	15,007,501	-	-	-	-	15,007,501
Issuance of 2017 unsecured convertible debentures (Note 9)	-	-	-	1,084,433	1,742,779	-	2,827,212
Conversion of 2017 secured convertible debentures (Note 9)	4,678,494	11,570,911	-	-	-	-	11,570,911
Conversion of 2016 unsecured convertible debentures (Note 9)	459,990	330,404	-	69,220	(57,500)	-	342,124
Share issuance costs (Note 10)	-	(2,246,704)	-	-	-	-	(2,246,704)
Net loss	-	-	-	-	-	(12,417,570)	(12,417,570)
Balance at July 31, 2017	76,192,990	45,159,336	1,561,587	3,728,255	1,774,880	(19,784,568)	32,439,490
Balance, July 31, 2015	28,930,086	6,707,250	775,051	22,929	109,394	(4,012,702)	3,601,922
Issuance of common shares (Note 10)	1,381,866	1,023,903	-	-	-	-	1,023,903
Issuance of Units	4,697,532	2,655,776	-	848,914	-	-	3,504,690
Share issuance costs	-	(46,518)	-	-	-	-	(46,518)
Broker/finder warrants (Note 10)	-	-	-	12,503	-	-	12,503
Issuance of 2016 unsecured convertible debentures (Note 8)	-	-	-	-	70,000	-	70,000
Conversion of 2016 unsecured convertible debentures (Note 8)	99,996	63,879	-	15,047	(12,500)	-	66,426
Conversion of 2015 secured convertible debentures (Note 8)	2,210,352	1,126,421	-	424,448	(77,293)	-	1,473,576
Stock-based compensation (Note 10)	-	-	293,564	-	-	-	293,564
Issuance of common shares from deposit related proposed acquisition	1,500,000	1,000,000	-	-	-	-	1,000,000
Exercise of stock options (Note 10)	477,000	222,301	(131,550)	-	-	-	90,751
Secured convertible debenture amendment warrants	-	-	-	40,135	-	-	40,135
Unsecured convertible debenture amendment warrants	-	-	-	6,603	-	-	6,603
Issuance of common shares in exchange for services	9,000	3,250	-	-	-	-	3,250
Net loss	-	-	-	-	-	(3,354,296)	(3,354,296)
Balance at July 31, 2016	39,305,832	12,756,262	937,065	1,370,579	89,601	(7,366,998)	7,786,509

Outstanding number of shares has been retrospectively adjusted to reflect a share exchange in connection with the Qualifying Transaction (Note 1) 6 common shares of the Company for every 1 share of The Hydrotheccary Corporation, which was effected in March 2017.

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

The Hydrothecary Corporation

Consolidated statements of cash flows for the years ended July 31, 2017 and 2016

(In Canadian dollars)

	July 31, 2017	July 31, 2016
	\$	\$
Operating activities		
Net loss and comprehensive loss	(12,417,570)	(3,354,296)
Items not affecting cash		
Amortization of property, plant and equipment	359,967	126,516
Amortization of intangible assets	231,685	173,382
Loss on disposal of property, plant and equipment	56,356	
Unrealized revaluation gain on biological assets	(5,663,161)	(595,658)
Foreign exchange	(119,429)	-
Stock-based compensation (Note 10)	658,620	293,564
Accrued interest	-	221,915
Accretion of convertible debt (Note 9)	201,447	79,894
Non-cash interest expense (Note 9)	198,533	46,738
RTO listing expense	796,475	-
Revaluation of financial instruments	9,169,275	-
Non-cash marketing and promotion	-	3,250
Changes in non-cash operating working capital items		
Accounts receivable	692,158	(1,043,365)
Commodity taxes payable (recoverable)	(512,221)	118,120
Prepaid expenses	(160,044)	59,027
Investment tax credit receivable	-	40,183
Inventory	1,121,828	322,506
Accounts payable and accrued liabilities	75,034	630,605
	(5,311,047)	(2,877,620)
Financing activities		
Issuance of common shares	-	823,892
Issuance of units (Note 10)	503,717	3,504,690
Issuance of common shares - Private Placement (Note 10)	5,000,002	-
Issuance of common shares - Concurrent Financing (Note 10)	15,007,501	-
Issuance of common shares - RTO (Note 10)	647,214	-
Issuance of secured convertible debentures (Note 9)	3,780,745	-
Deposit on potential M&A transaction	-	1,000,000
Exercise of stock options	32,252	90,751
Exercise of warrants	716,926	-
Share issuance costs (Note 10)	(1,105,789)	(34,015)
Issuance of unsecured convertible debentures (Note 9)	23,589,000	420,000
Repayment of unsecured convertible debentures	-	(250,000)
Repayment of secured convertible debentures	-	(250,000)
	48,171,568	5,305,318
Investing activities		
Acquisition of short-term investment	(2,871,550)	-
Acquisition of property, plant and equipment (Note 7)	(3,105,919)	(764,486)
Purchase of intangible assets	(361,683)	(153,618)
	(6,339,152)	(918,104)
Increase in cash	36,521,369	1,509,595
Cash, beginning of year	1,931,454	421,860
Cash, end of year	38,452,823	1,931,454

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

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

1. Description of business

The Hydrothecary Corporation, formerly BFK Capital Corp. ("THCX" or "the Company"), has one wholly-owned subsidiary, 10074241 Canada Inc. ("1007"). 1007 has three wholly-owned subsidiaries 167151 Canada Inc., Banta Health Group and Coral Health Group (together "THC"). THC is a producer of medical marijuana and its site is licensed by Health Canada for production and sale. Its head office is located at 120 Chemin de la Rive, Gatineau, Quebec, Canada. THCX is a publicly traded corporation, incorporated in Ontario. The Company's common shares are listed on the TSX Venture Exchange ("TSXV"), under the trading symbol "THCX".

The Company was incorporated under the name "BFK Capital Corp." by articles of incorporation pursuant to the provisions of the *Business Corporations Act (Ontario)* on October 29, 2013, and after completing its initial public offering of shares on the TSXV on November 17, 2014, it was classified as a Capital Pool Corporation as defined in policy 2.4 of the TSXV. The principal business of the Company at that time was to identify and evaluate business or assets with a view to completing a qualifying transaction (a "Qualifying Transaction") under relevant policies of the TSXV. The Company had one wholly owned subsidiary 10100170 Canada Inc., which was incorporated with the sole purpose of facilitating a future Qualifying Transaction.

On March 15, 2017, the Company completed its Qualifying Transaction which was effective pursuant to an agreement between the Company and the legacy entity, The Hydrothecary Corporation ("Hydrothecary"). As part of the Qualifying Transaction, the Company changed its name to The Hydrothecary Corporation and consolidated its 2,756,655 shares on a 1.5 to 1 basis to 1,837,770. Following this change, Hydrothecary amalgamated with 10100170 Canada Inc. which resulted in forming a new entity, 10074241 Canada Inc. (THC). In connection with that amalgamation, THC acquired all of the issued and outstanding shares of THCX and the former shareholders of Hydrothecary issued a total of 68,428,824 post-consolidation common shares of THCX. Immediately following closing, THCX had a total 70,266,594 common shares outstanding.

Upon closing of the transaction, the shareholders of Hydrothecary owned 97.4% of the common shares of the Company and as a result, the transaction is considered a reverse acquisition of the Company by Hydrothecary. For accounting purposes Hydrothecary is considered the acquirer and THCX is considered the acquiree. Accordingly, the consolidated financial statements are in the name of The Hydrothecary Corporation (formerly BFK Capital Corp. or THCX), however they are a continuation of the financial statements of Hydrothecary. Additional information on the transaction is disclosed in Note 4.

2. Basis of presentation

Statement of compliance

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

These consolidated financial statements were approved by the Board of Directors and authorized for issue by the Board of Directors on November 1, 2017.

Basis of measurement and consolidation

The consolidated financial statements have been prepared on an historical cost basis except for biological assets, the warrant and conversion liability, which are measured at fair value on a recurring basis and include the accounts of the Company and entities controlled by the Company and its subsidiaries. They include its wholly-owned subsidiary 10074241 Canada Inc. They also include 167151 Canada Inc., Banta Health Group and Coral Health Group, three wholly-owned subsidiaries of 10074241 Canada Inc. They also include the accounts of 8980268 Canada Inc., a company for which THC holds a right to acquire the outstanding shares at any time for a nominal amount. All subsidiaries are located in Canada.

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

2. Basis of presentation (continued)

Historical cost is the fair value of the consideration given in exchange for goods and services based upon the fair value at the time of the transaction of the consideration provided.

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, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of IFRS 2 *Share-based payment* and measurements that have some similarities to fair value but are not fair value, such as net realizable value in IAS 2 *Inventories*.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

Level 1 - inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;

Level 2 - inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and

Level 3 - inputs are unobservable inputs for the asset or liability.

The preparation of these audited consolidated financial statements requires the use of certain critical accounting estimates, which requires management to exercise judgement in applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to these audited consolidated financial statements have been set out in Note 3.

Functional and presentation currency

These consolidated financial statements are presented in Canadian dollars, which is the Company and its subsidiaries' functional currency.

3. Significant accounting policies

(a) Foreign currency translation

Foreign currency transactions are translated into Canadian dollars at exchange rates in effect on the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the consolidated statement of financial position date are translated to Canadian dollars at the foreign exchange rate applicable at that date. Realized and unrealized exchange gains and losses are recognized through profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(b) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and highly liquid investments that are readily convertibles into known amounts of cash with original maturities of three months or less.

(c) Short term investments

Short term investments are comprised of liquid investments with maturities of less than six months. Short term investments are recognized initially at fair value and subsequently adjusted to fair value through profit or loss.

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

3. Significant accounting policies (continued)

(d) Biological assets

The Company measures biological assets consisting of medical cannabis plants at fair value less costs to sell up to the point of harvest, which becomes the basis for the cost of finished goods inventories after harvest. Seeds are measured at fair value. Unrealized gains or losses arising from changes in fair value less cost to sell during the year are included in the results of operations of the related year.

(e) Inventory

Inventory is valued at the lower of cost and net realizable value. Cost is determined using the weighted average method. Inventories of harvested cannabis are transferred from biological assets at their fair value at harvest, which becomes the initial deemed cost of the inventory. Any subsequent post-harvest costs are capitalized to inventory to the extent that cost is less than net realizable value. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Packaging and supplies are initially valued at cost and subsequently at the lower of cost and net realizable value.

(f) Property, plant and equipment

Property, plant and equipment is measured at cost less accumulated amortization and impairment losses. Amortization is provided using the following terms and method:

Land	Not amortized	No term
Buildings	Straight line	20 years
Furniture and equipment	Straight line	5 years
Cultivation and production equipment	Straight line	5 to 20 years
Vehicles	Straight line	5 years
Computers	Straight line	3 years
Construction in progress	Not amortized	No term

An asset's residual value, useful life and amortization method are reviewed at each financial year and adjusted if appropriate. When parts of an item of equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of equipment are determined by comparing the proceeds from disposal with the carrying amount of the equipment and are recognized in profit or loss.

Construction in progress is transferred to property, plant and equipment when the assets are available for use and amortization of the assets commences at that point.

(g) Finite life intangible asset

Finite life intangible assets are comprised of computer software and an acquired Health Canada license which was acquired as part of the Company's purchase of 167151 Canada Inc. Finite life intangible assets are recorded at cost less accumulated amortization and accumulated impairment losses. The license is amortized on a straight-line basis over twenty years. The computer software is amortized on a straight-line basis over five years. The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

(h) Impairment of long-lived assets

Long-lived assets, including property, plant and equipment and intangible assets are reviewed for impairment at the end of each financial reporting period or whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds its recoverable amount. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash-generating unit, or "CGU"). The recoverable amount of an asset or a CGU is the higher of its fair value, less costs of disposal, and its value in use. If the carrying amount

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

3. Significant accounting policies (continued)

(h) Impairment of long-lived assets (continued)

of an asset exceeds its recoverable amount, an impairment charge is recognized immediately in profit or loss by the amount by which the carrying amount of the asset exceeds the recoverable amount. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimate of recoverable amount, and the carrying amount that would have been recorded had no impairment loss been recognized previously.

(i) Leased assets

Leases are classified as an operating lease whenever the terms of the lease do not transfer substantially all of the risks and rewards of ownership to the lessee. Lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which the economic benefits are consumed.

(j) Revenue recognition

The Company only ships product when there is a reasonable expectation of payment from the customer. Accordingly, the Company recognizes revenue when it has delivered its products to its customers, the collection of payment is reasonably assured, and the amount receivable is fixed or determinable.

(k) Cost of Goods Sold

Cost of goods sold includes cost of inventory expensed, packaging costs, shipping costs and related labour.

(l) Research and development

Research costs are expensed as incurred. Development expenditures are capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development to use or sell the asset. Other development expenditures are recognized in profit and loss as incurred. To date, no development costs have been capitalized.

(m) Income taxes

The Company uses the liability method to account for income taxes. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities for accounting purposes, and the irrespective tax bases. Deferred income tax assets and liabilities are measured using tax rates that have been enacted or substantively enacted applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in statutory tax rates is recognized in profit or loss in the year of change. Deferred income tax assets are recorded when their recoverability is considered probable and are reviewed at the end of each reporting period.

(n) Share-based compensation

The Company has an employee stock option plan. The Company measures equity settled share-based payments based on their fair value at the grant date and recognizes compensation expense over the vesting period based on the Company's estimate of equity instruments that will eventually vest. Expected forfeitures are estimated at the date of grant and subsequently adjusted if further information indicates actual forfeitures may vary from the original estimate. The impact of the revision of the original estimate is recognized in profit or loss such that the cumulative expense reflects the revised estimate. For stock options granted to non-employees the compensation expense is measured at the fair value of goods and services received except where the fair value cannot be estimated in which case it is measured at the fair value of the equity instruments granted. The fair value of share-based compensation to non-employees is periodically re-measured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. Consideration paid by employees or non-employees on the exercise of

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

3. Significant accounting policies (continued)

(o) Share-based compensation (continued)

stock options is recorded as share capital and the related share-based compensation is transferred from share-based payment reserve to share capital.

(p) Loss per share

Loss per common share represents loss for the period attributable to common shareholders divided by the weighted average number of common shares outstanding during the year. Diluted loss per common share is calculated by dividing the applicable loss for the year by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the year.

(q) Financial instruments

Financial assets

The Company initially recognizes financial assets at fair value on the date that they are originated. All financial assets (including assets designated at fair value through profit or loss) are recognized initially on the date at which the Company becomes a party to the contractual provisions of the instrument. The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

Financial assets

The Company classifies its financial assets as financial assets at fair value through profit and loss or loans and receivables. A financial asset is classified at fair value through profit or loss if it is classified as held-for-trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's documented risk management or investment strategy. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

Financial liabilities

The Company initially recognizes financial liabilities at fair value less costs of financing on the date that they are originated. All financial liabilities (including liabilities designated at fair value through profit or loss) are recognized initially on the date at which the Company becomes a party to the contractual provisions of the instrument. The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled or expire.

The Company classifies its financial liabilities as either financial liabilities at fair value through profit and loss or other liabilities. Subsequent to initial recognition other liabilities are measured at amortized cost using the effective interest method. Financial liabilities at fair value are stated at fair value with changes being recognized in profit or loss.

Classification of financial instruments

The Company classifies its financial assets and liabilities depending on the purpose for which the financial instruments were acquired, their characteristics, and management intent as outlined below:

The Hypothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

3. Significant accounting policies (continued)

(q) Financial instruments (continued)

Accounts receivable	Loans and receivable
Accounts payable and accrued liabilities	Other liabilities
Convertible debentures	Other liabilities
Warrant liability	Fair value through profit or loss
Conversion feature liability	Fair value through profit or loss

Embedded derivatives

Derivatives embedded in non-derivative host contracts are treated as separate derivatives when they meet the definition of a derivative, their risks and characteristics are not closely related to those of the host contracts and the contracts are not measured at fair value through profit and loss ("FVTPL").

Compound instruments

The component parts of compound instruments (convertible debentures) issued by the Company are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. A conversion option that will be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is an equity instrument.

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible instruments. This amount is recorded as a liability on an amortized cost basis using the effective interest rate method until extinguished upon conversion or at the instrument's maturity date.

The conversion option classified as equity is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognized and included in equity, and is not subsequently remeasured. In addition, the conversion option classified as equity will remain in equity. No gain or loss is recognized in profit or loss upon conversion or expiration of the conversion option.

Transaction costs that relate to the issue of the convertible debentures are allocated to the liability and equity components in proportion to the allocation of the gross proceeds. Transaction costs relating to the equity component are recognized directly in equity. Transaction costs relating to the liability component are included in the carrying amount of the liability component and are amortized over the term of the convertible debentures using the effective interest method.

For compound instruments with non-equity derivatives, the fair value of the embedded derivative is determined first based on the contractual terms, and the initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. No borrowing costs were capitalized during the years presented.

All other borrowing costs are recognized in profit or loss in the period which they are incurred.

Effective interest method

The effective interest method is a method of calculating the amortized cost of a financial instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

3. Significant accounting policies (continued)

(q) Financial instruments (continued)

Transaction costs

Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Impairment of financial assets

Financial assets, other than those classified at fair value through profit and loss, are assessed for indicators of impairment at the end of the reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

(r) Critical accounting estimates and judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Valuation of biological assets and inventory

In calculating the value of the biological assets and inventory, management is required to make a number of estimates, including estimating the stage of growth of the cannabis, harvesting costs, selling costs, sales price and expected yields for the cannabis plant. In calculating final inventory values, management is required to determine an estimate of spoiled or expired inventory and compares the inventory cost versus net realizable value.

Estimated useful lives and amortization of property, plant and equipment and intangible assets

Amortization of property, plant and equipment and intangible assets are dependent upon estimates of useful lives, which are determined through the exercise of judgment. The assessment of any impairment of these assets is dependent upon estimates of recoverable amounts that take into account factors such as economic and market conditions and the useful lives of assets.

Share-based compensation

In calculating the share-based compensation expense, key estimates such as the value of the common share, the rate of forfeiture of options granted, the expected life of the option, the volatility of the Company's stock price and the risk-free interest rate are used.

Warrants

In calculating the value of the warrants, key estimates such as the value of the common share, the expected life of the warrant, the volatility of the Company's stock price and the risk free interest rate are used.

Provisions

Provisions are recognized when the Company has a present obligation, legal or constructive as a result of a previous event, if it is probable that the Company will be required to settle the obligation and a reliable estimate can be made of the obligation. The amount recognized is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligations. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate of the expected future cash flows.

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

3. Significant accounting policies (continued)

(r) Critical accounting estimates and judgments (continued)

Allocation of purchase price

In determining the allocation of the purchase price, estimates are used based on market research and appraisal values.

(s) Control over 8980268 Canada Inc. ("8980268")

Management of the Company assessed whether or not the Company has control over 8980268 based on whether the Company has the practical ability to direct the relevant activities of 8980268 unilaterally. In making their judgment, management considered the Company's ability to acquire the shares of 8980268 for nominal consideration at any time. Furthermore, all relevant activities require the Company's approval. After assessment, management concluded that the Company is able to direct the relevant activities of 8980268 and, therefore, has control over 8980268. The principal assets of 8980268 include the Company's land and certain buildings.

(t) Changes to accounting standards and interpretations

New and revised IFRS in issue but not yet effective

Amendments to IAS 12

Amends IAS 12 *Income Taxes* are amended to clarify the following aspects:

- J Unrealized losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use;
- J The carrying amount of an asset does not limit the estimation of probable future taxable profits;
- J Estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences; and
- J An entity assesses a deferred tax asset in combination with other deferred tax assets. Where tax law restricts the utilization of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

This amendment is applicable to annual periods beginning on or after January 1, 2017.

Disclosure Initiative (Amendments to IAS 7)

Amends IAS 7 *Statement of Cash Flows* to improve information provided to users of financial statements about an entity's financial activities by making the following changes:

- J The following changes in liabilities arising from financing activities are disclosed (to the extent necessary): (i) changes from financing cash flows; (ii) changes arising from obtaining or losing control of subsidiaries or other businesses; (iii) the effect of changes in foreign exchange rates; (iv) changes in fair values; and (v) other changes;
- J The IASB defines liabilities arising from financing activities as liabilities "for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities". It also stresses that the new disclosure requirements also relate to changes in financial assets if they meet the same definition; and
- J Changes in liabilities arising from financing activities must be disclosed separately from changes in other assets and liabilities.

This amendment is applicable to annual periods beginning on or after January 1, 2017.

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

3. Significant accounting policies (continued)

(t) Changes to accounting standards and interpretations (continued)

IFRS 15 Revenue from Contracts with Customers

IFRS 15 was issued by the IASB in May 2014 and specifies how and when revenue should be recognized based on a five-step model, which is applied to all contracts with customers. On April 12, 2016, the IASB published final clarifications to IFRS 15 with respect to identifying performance obligations, principal versus agent considerations, and licensing. IFRS 15 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

IFRS 9 Financial Instruments

IFRS 9 was issued by the International Accounting Standards Board ("IASB") in November 2009 and October 2010 and will replace IAS 39. 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. Two measurement categories continue to exist to account for financial liabilities in IFRS 9, fair value through profit or loss ("FVTPL") and amortized cost. Financial liabilities held-for-trading are measured at FVTPL, and all other financial liabilities are measured at amortized cost unless the fair value option is applied. The treatment of embedded derivatives under the new standard is consistent with IAS 39 and is applied to financial liabilities and non-derivative hosts not within the scope of the standard. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted.

IFRS 16 Leases

IFRS 16 was issued by the IASB in January 2016 and specifies the requirements to recognize, measure, present and disclose leases. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted.

The Company is assessing the impact of the new or revised IFRS standards in issue but not yet effective on its consolidated financial statements.

4. Reverse Acquisition

On March 15, 2017, BFK Capital Corp. completed its Qualifying Transaction, which was effected pursuant to an agreement between BFK Capital Corp. and Hydrothecary. Pursuant to the agreement, BFK Capital Corp. acquired all of the issued and outstanding shares of Hydrothecary. The former shareholders of Hydrothecary received an aggregate of 68,428,824 post consolidation common shares of BFK Capital Corp. for all the outstanding Hydrothecary common shares.

The transaction was a reverse acquisition of BFK Capital Corp. and has been accounted for under IFRS 2, *Share-based payment*. Accordingly, the transaction has been accounted for at the fair value of the equity instruments granted by the shareholders of Hydrothecary to the shareholders and option holders of BFK Capital Corp. The difference between the fair value of the consideration (including the outstanding options) and the fair value of BFK Capital Corp.'s net assets, has been recognized as a listing expense in the consolidated statements of comprehensive loss for the year ended July 31, 2017. The options were valued using the Black-Scholes option pricing model with the following variables: share price of \$0.75; expected life of two years; \$Nil dividends; 100% volatility; and risk free interest rate of 1.34%. Additional legal and consulting fees of \$154,549 were incurred to complete the transaction.

The results of operations of BFK Capital Corp. are included in the consolidated financial statements of THC from the date of the reverse acquisition, March 15, 2017.

The following represents managements' estimate of the fair value of the net assets acquired and total consideration transferred at March 15, 2017 as a result of the reverse acquisition.

The Hydrothecary Corporation

Notes to the consolidated financial statements

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(Audited, In Canadian dollars)

4. Reverse Acquisition (continued)

Fair value of BFK shares prior to transaction (1,837,770 at \$0.75 per share)	\$	1,378,332
Options		70,253
Total consideration transferred		1,448,585
Net assets acquired		(652,110)
Excess attributed to cost of listing		796,475
Professional, consulting and other fees		154,549
RTO Listing expense	\$	951,024

Net assets acquired include:

Cash	\$	647,214
Prepaid expense		4,896
Total net assets acquired	\$	652,110

5. Inventory

	July 31, 2017	July 31, 2016
	\$	\$
Dried cannabis	3,517,609	451,351
Oils	106,893	34,665
Packaging and supplies	64,737	45,409
	3,689,239	531,425

The inventory expensed to cost of goods sold in the year ended July 31, 2017 amounted to \$1,529,840, and \$927,195 for the year ended July 31, 2016.

During the year ended July 31, 2017, the Company recorded a write-down of inventories in the amount of \$613,074; of which \$494,810 related to inventory recalled under the Company's voluntary recall in the third quarter of 2017, and \$118,264 related to a write-down of inventories as the result of a flood at the Company's facility in the fourth quarter of 2017. The Company is in the process of filing an insurance claim to recover the amount lost in the flood. Management believes that reimbursement of the claim is likely, however the amount cannot be reasonably determined, therefore no amount related to the recovery has been recorded.

During the year ended July 31, 2016, the Company recorded a write-down of inventories in the amount of \$464,792 related to dried cannabis subject to an administrative hold by Health Canada.

6. Biological assets

The changes in the carrying value of biological assets are as follows:

	July 31, 2017	July 31, 2016
	\$	\$
Carrying amount, beginning of year	120,667	27,226
Net increase in fair value due to biological transformation less cost to sell	5,663,161	595,658
Transferred to inventory upon harvest	(4,279,642)	(502,217)
Carrying amount, end of year	1,504,186	120,667

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

6. Biological assets (continued)

The Company's biological assets consists of cannabis plants from seeds all the way through to mature plants. As of July 31, 2017, the fair value of biological assets included \$6,200 in seeds and \$1,497,986 in cannabis plants (\$7,200 in seeds and \$113,467 in cannabis plants as at July 31, 2016). The significant estimates used in determining the fair value of cannabis plants are as follows:

-) yield by plant;
-) stage of growth estimated as the percentage of costs incurred as a percentage of total cost as applied to the estimated total fair value per gram (less fulfilment costs) to arrive at an in-process fair value for estimated biological assets, which have not yet been harvested;
-) percentage of costs incurred for each stage of plant growth.
-) sales price

The Company views its biological assets as a Level 3 fair value estimate and estimates the probability of certain harvest rates at various stages of growth. As of July 31, 2017, it is expected that the Company's biological assets will yield approximately 700,169 grams of cannabis (July 31, 2016 - 143,586 grams of cannabis). The Company's estimates are, by their nature, subject to change. Changes in the anticipated yield will be reflected in future changes in the fair values of biological assets.

7. Property, plant and equipment

	Balance at July 31, 2016	Additions	Disposals	Transfers	Balance at July 31, 2017
	\$	\$	\$	\$	\$
Cost					
Land	105,000	253,405	-	-	358,405
Buildings	917,087	1,212,399	(25,000)	1,640,273	3,744,759
Furniture and equipment	320,586	649,189	(69,380)		900,395
Cultivation and production equipment	-	373,249	-	6,743	379,992
Vehicles	37,537	76,389	-	-	113,926
Computers	91,298	160,147	(17,760)	-	233,685
Construction in progress	1,647,017	605,014	-	(1,647,016)	605,015
	3,118,525	3,329,792	(112,140)	-	6,336,177

	Balance at July 31, 2016	Amortization	Disposals	Transfers	Balance at July 31, 2017
	\$	\$	\$	\$	\$
Accumulated amortization					
Buildings	54,095	146,414	(3,420)	(2,902)	194,187
Furniture and equipment	67,224	133,334	(38,292)	2,820	165,086
Cultivation and production equipment	-	23,068	-	-	23,068
Vehicles	15,535	10,054	-	-	25,589
Computers	45,445	47,097	(14,072)	82	78,552
	182,299	359,967	(55,784)	-	486,482
Net carrying value	2,936,226				5,849,695

Construction in progress includes \$72,000 of capitalized interest. As at July 31, 2017, there was \$262,502 (July 31, 2016 - \$38,629) of property, plant and equipment in accounts payable and accrued liabilities.

The Hydrothecary Corporation

Notes to the consolidated financial statements

For the years ended July 31, 2017 and 2016

(Audited, In Canadian dollars)

7. Property, plant and equipment (continued)

	Balance at July 31, 2015	Additions	Disposals	Transfers	Balance at July 31, 2016
	\$	\$	\$	\$	\$
Cost					
Land	105,000	-	-	-	105,000
Buildings	523,867	393,220	-	-	917,087
Furniture and equipment	139,217	181,369	-	-	320,586
Vehicles	37,537	-	-	-	37,537
Computers	68,353	22,945	-	-	91,298
Construction in progress	1,508,581	138,436	-	-	1,647,017
	2,382,555	735,970			3,118,525
	Balance at July 31, 2015	Amortization	Disposals	Transfers	Balance at July 31, 2016
	\$	\$	\$	\$	\$
Accumulated amortization					
Land	-	-	-	-	-
Buildings	21,612	32,483	-	-	54,095
Furniture and equipment	14,619	52,605	-	-	67,224
Vehicles	7,401	8,134	-	-	15,535
Computers	12,151	33,294	-	-	45,445
Construction in progress	-	-	-	-	-
	55,783	126,516			182,299
Net carrying value	2,326,772				2,936,226

8. Intangible assets

	Balance at July 31, 2016	Additions	Disposals/ adjustments	Balance at July 31, 2017
	\$	\$	\$	\$
Cost				
ACMPR License	2,544,696	-	-	2,544,696
Software	289,564	361,683	-	651,247
Domain names	6,596	-	6,596	-
	2,840,856	361,683	6,596	3,195,943
	Balance at July 31, 2016	Amortization	Disposals/ adjustments	Balance at July 31, 2017
	\$	\$	\$	\$
Accumulated amortization				
ACMPR License	149,008	127,901	-	276,909
Software	51,486	103,784	-	155,270
Domain name	6,596	-	6,596	-
	207,090	231,685	6,596	432,179
Net carrying value	2,633,766			2,763,764

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(Audited, In Canadian dollars)

8. Intangible assets (continued)

Software additions include \$135,487 relating to a system that is not yet available for use. Accordingly, no amortization has been taken during the year ended July 31, 2017. The Company expects that the system will be available for use in the second quarter of fiscal 2018.

Cost	Balance at July 31, 2015	Additions	Disposals/ adjustments	Balance at July 31, 2016
	\$	\$	\$	\$
License	2,544,696	-	-	2,544,696
Software	135,946	153,618	-	289,564
Domain names	6,596	-	-	6,596
Total	2,687,238	153,618	-	2,840,856

Accumulated amortization	July 31, 2015	Amortization	Disposals/ adjustments	July 31, 2016
	\$	\$	\$	\$
License	21,287	127,721	-	149,008
Software	10,440	41,046	-	51,486
Domain name	1,981	4,615	-	6,596
Total	33,708	173,382	-	207,090
Net carrying value	2,517,584			2,633,766

9. Convertible debentures

2016 Unsecured Convertible Debentures

Between March and May of 2016, the Company issued \$420,000 of non-interest bearing unsecured convertible debentures "2016 Unsecured Debentures". The principal amount of the 2016 Unsecured Debentures was convertible into units at \$0.75 per Unit. A Unit consisted of one Common Share and one Common Share purchase warrant. The warrant has an exercise price of \$0.83 and is valid for a period of two years from the date of issuance.

The Company has allocated the proceeds from issuance between the estimated value of the equity and debt components using the residual method. The Company used an effective interest rate for the debt component of 20%, which resulted in valuing the debt at \$350,000. The equity component of the instrument is valued at \$70,000.

The Company did not incur significant transaction costs for the issuance of these convertible debentures. As a result, no allocation of those costs was made to either the convertible debentures or the equity.

In July 2016, two debenture holders converted their debentures to equity. The debentures had a book value of \$66,426 (\$75,000 face value) and contributed surplus (equity component) of \$12,500. The conversion resulted in the issuance of 99,996 units at a price of \$0.75 per Unit. The 99,996 warrants issued were valued at \$15,047 using the Black-Scholes option pricing model and the following variables: stock price of \$0.60; expected life of two years; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.56%.

The Hydrothecary Corporation

Notes to the consolidated financial statements

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9. Convertible debentures (continued)

In March 2017, the remaining debenture holders converted the unsecured debentures to equity with a book value of \$342,124 (\$345,000 face value) and contributed surplus (equity component) of \$57,500.

The conversion resulted in the issuance of 459,990 Units at a price of \$0.75 per Unit. The 459,990 warrants were valued at \$69,220 using the Black-Scholes option pricing model and the following variables:

stock price of \$0.60; expected life of two years; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.59%.

The accreted interest for the year ended July 31, 2017 was \$35,919 (\$22,631 for the year ending July 31, 2016).

2017 Secured Convertible Debentures

In November 2016, the Company, issued \$4,403,893 (US\$3,275,000) principal amount of secured debentures, through a brokered private placement. The debentures bear interest at 8% per annum and mature on December 31, 2019. Interest for the first year of the term of the Debentures will be accrued and paid in arrears, following which, interest will be accrued and paid quarterly in arrears. The debentures are convertible into common shares of the Company at US\$0.70 at the option of the holder. The debentures will automatically convert to common shares after the Company becomes a reporting issuer on a Canadian or United States exchange and maintains a volume weighted average trading price of equal to or exceeding the conversion price of the debentures for 15 days. The obligations of the Company under the debentures are secured by a first priority security interest against all of the assets of the Company and mature on December 31, 2019. The debenture holders received 2,339,208 warrants, one for every two common shares that would be issued assuming full conversion of the debentures. The warrants have a three year term, expiring November 13, 2019 and have an exercise price of US\$0.76.

The Company identified embedded derivatives related to the above described debenture. These embedded derivatives included variable conversion liability and the warrant liability. The accounting treatment of the derivative financial instruments require that the Company record the fair value of the derivatives as of the inception date of the debenture and to fair value as of each subsequent reporting date.

The Company allocated the proceeds first to the warrant liability and the conversion liability based on their fair value, and the residual proceeds represented the fair value of the debenture. The fair values of the embedded derivatives were determined using the Black-Scholes option pricing model. The warrant liability was valued with a fair value of \$550,955 (US\$409,723) using the following assumptions: stock price of \$0.75 (US\$0.56); exchange rate of 1.3447; expected life of three years; \$Nil dividends; 60% volatility; and risk free interest rate of 1.25%. The conversion liability was initially valued with a fair value of \$665,632 (US\$495,004) using the following assumptions: stock price of \$0.75 (US\$0.56); expected life of 15 months; \$Nil dividends; 60% volatility; and risk free interest rate of 1.25%. The residual proceeds of \$3,187,306 (US\$2,370,273) represents the fair value of the debenture.

In connection with the closing of the debentures, the Company paid a placement agent fee of \$560,152 (US\$416,563) from the gross proceeds of the financing and incurred an additional \$62,996 of financing costs. The Company also issued broker warrants exercisable to acquire 62,381 common shares at an exercise price of US\$0.70 per share. The broker warrants were attributed a fair value of \$95,513 (US\$71,029) based on the Black-Scholes option pricing model with the following assumptions: with a stock price of \$0.75 (US\$0.56); expected life of three years; \$Nil dividends; 60% volatility; and risk free interest rate of 1.25%. The total financing costs amounted to \$718,661 and were allocated on pro-rata basis as follows: Debenture - \$520,128, Conversion liability - \$108,623, and Warrant liability - \$89,910. The issue costs allocated to the conversion liability and the warrant liability, totaling \$198,533, was included in financing charges on the statement of comprehensive loss.

Pursuant to the debenture agreement, on April 11, 2017 ("the date of conversion") the debentures automatically converted to 4,678,494 common shares at a conversion price of US\$0.70 after the

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Notes to the consolidated financial statements

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9. Convertible debentures (continued)

Company became a reporting issuer on TSXV and by maintaining a volume weighted average trading price equal to or exceeding the conversion price of the debentures for 15 days.

Up to and including the date of conversion, the accreted interest on the debenture was \$145,628 (US\$109,232), and \$70,247 for the deferred financing fees for the year ended July 31, 2017; both are recorded as interest expense on the statement of comprehensive loss. Additionally, as the debenture is a monetary liability, it was re-translated on the date of conversion resulting in a value of \$3,213,505 (US\$2,261,041), and a foreign exchange gain of \$119,429 was recorded in foreign exchange on the statement of comprehensive loss. Accordingly, the debenture at the date of conversion was valued at \$2,763,624, which consisted of the debenture value of \$3,213,505 less unamortized financing fees of \$449,881. The conversion liability was revalued on the date of conversion using the Black-Scholes option pricing model. The conversion liability was revalued to \$8,807,287 (US\$6,606,126); with a stock price of \$2.79 converted to US\$2.09; expected life of 12.6 months; \$Nil dividends; 60% volatility; and risk free interest rate of 1.25%; and USD/CAD exchange rate of 1.3332. Accordingly, the loss on the revaluation of the conversion liability was \$8,141,655, which is recorded in the revaluation of financial instruments account on the statement of comprehensive loss. Therefore, on April 11, 2017, the conversion of the debentures and the corresponding conversion liability resulted in an increase to share capital of \$11,570,911 for the 4,678,494 common shares issued.

Throughout the year, 285,708 of the warrants were exercised for total proceeds of \$292,302 (US\$217,138 based on exercise price of US\$0.76). On the various dates of exercise, the warrant liability was revalued using the Black-Scholes option pricing model. Overall, the value of the warrants exercised was \$222,988 (US\$165,182); using the following variables: stock price of US\$1.26-\$1.32; expected life of 12 months; \$Nil dividends; 60% volatility; risk free interest rate of 1.25%; and USD/CAD exchange rate of 1.3490-1.3503. The exercise of these warrants resulted in an increase to share capital of \$515,290.

The remaining warrant liability was revalued on July 31, 2017 using the Black-Scholes option pricing model. The warrant liability was revalued to \$1,355,587 (US\$1,085,772); with a stock price of US\$1.22; expected life of 12 months; \$Nil dividends; 60% volatility; risk free interest rate of 1.25%; and USD/CAD exchange rate of 1.2485. The loss on the revaluation of the warrant liability for the year-ended July 31, 2017 was \$1,027,620, which is recorded in the revaluation of financial instruments account on the statement of comprehensive loss.

2017 Unsecured Convertible Debentures

In July 2017, the Company issued \$25,100,000 principal amount of unsecured debentures, through a brokered private placement. The debentures bear interest at 8% per annum and mature on June 30, 2019. Interest will be accrued and paid semi-annually in arrears. The debentures are convertible into common shares of the Company at \$1.60 at the option of the holder. Beginning after November 19, 2017 the Company may force the conversion of the debentures on 30 days prior written notice should the daily weighted average trading price of the common shares of the Company be greater than \$2.25 for any 15 consecutive trading days. The debenture holders received 7,856,300 warrants, 313 for every \$1,000 unit. The warrants have a two year term, expiring July 18, 2019 and have an exercise price of \$2.00. Beginning after November 19, 2017 the Company has the right to accelerate the expiry of the warrants, if the closing trading price of the common shares of the Company be greater than \$2.25 for any 15 consecutive trading days.

On initial recognition, management used the residual method to allocate the fair value of the warrants and conversion option. Management calculated the fair value of the liability component as \$22,066,925 using a discount rate of 16%. The residual proceeds of \$3,033,075 were allocated between the warrants and conversion option on a pro-rata basis relative to their fair values. The fair values of the warrants and conversion option were determined using the Black-Scholes option pricing model. The warrants were valued with a fair value \$1,929,098 using the following assumptions: stock price of \$1.26; expected life of

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9. Convertible debentures (continued)

two years; \$Nil dividends; 60% volatility; and risk free interest rate of 1.27%. The conversion option was valued with a fair value of \$3,100,227 using the following assumptions: stock price of \$1.26; expected life of a year; \$Nil dividends; 60% volatility; and risk free interest rate of 1.27%. Based on the fair value of the warrants and conversion option, the residual proceeds of \$3,033,075 was allocated as \$1,163,396 to the warrants and \$1,869,679 to the conversion option.

In connection with the closing of the debentures, the Company paid a placement fee of \$1,292,010 from the gross proceeds of the financing and incurred an additional \$218,990 of financing costs. The Company also issued broker warrants exercisable to acquire 784,375 common shares at an exercise price of \$2.00 per share. The broker warrants were attributed a fair value of \$192,602 based on the Black-Scholes option pricing model with the following assumptions: stock price of \$1.26; expected life of 2 years; \$Nil dividends; 60% volatility; and risk free interest rate of 1.27%. The total financing costs amounted to \$1,703,602 and were allocated on pro-rata basis as follows: Debt - \$1,497,739, Conversion option - \$126,900, and the Warrants - \$78,963.

The accreted interest for the year ending July 31, 2017 was \$142,255.

10. Share capital

Authorized

An unlimited number of Common Shares

In the first quarter of fiscal 2016, the Company completed a private placement of 150,000 Common Shares at a price of \$0.67 per share for gross cash proceeds of \$100,000.

On April 30, 2016, the Company converted a non-refundable \$1,000,000 deposit that was previously provided by a prospective investor. Under the terms set out in the letter of interest with this investor, the deposit was converted into 1,500,000 Common Shares at a price of \$0.67 per share. The Company did not incur significant transaction costs for the issuance of these equities.

During the second and third quarters of fiscal 2016, the Company completed private placements of 1,231,866 Common Shares at a price of \$0.75 per share for gross cash proceeds of \$923,903. The Company did not incur significant transaction costs for the issuance of these equities.

During the third and fourth quarters of fiscal 2016, the Company began a private placement that resulted in 4,180,230 units at \$0.75 per unit generating gross proceeds of \$3,135,173. One unit provided the holder with one Common share and one Common Share Purchase Warrant. The Warrant entitled the holder the option to buy a Share at the price of \$0.83 for three years from date of issuance. The value of the warrants was estimated using the Black-Scholes option pricing model with the following variables: stock price of \$0.57; expected life of three years; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.60%. The value of the warrants was estimated to be \$759,409. As a result, the residual value of the Common Shares was calculated to be \$2,375,764.

During the fourth quarter of fiscal 2016, the Company issued 492,690 units at \$0.75 per unit generating gross proceeds of \$369,517. One unit provided the holder with approximately 1.05 Common Shares and 1 Common Share Purchase Warrants. The total number of Common Shares and Warrants issued, was 517,302 and 492,690, respectively. The Warrant entitled the holder the option to buy a Share at the price of \$0.83 for three years from the date of issuance. The value of the warrants is estimated using the Black-Scholes option pricing model with the following variables: stock price of \$0.57; expected life of three years; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.60%. The value of the warrants was estimated to be \$89,505. As a result, the residual value of the Common Shares was calculated to be \$280,012.

Share issue costs relating to the above equity financings amounted to \$46,518:

) \$8,868 of the costs are related to 39,414 warrants issued that have a \$0.83 exercise price and expire in July 2021. These warrants were issued to a broker in relation to the sale of 492,690 units. The

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10. Share capital (continued)

warrants were valued using the Black-Scholes option pricing model with the following variables: stock price of \$0.53; expected life of five years; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.69%.

- J \$3,635 of the costs related to 29,994 warrants issued that have a \$0.75 exercise price and a one year expiry. These warrants were issued to a financing consultant in relation to a Finders fee for the sale of 499,872 units. The warrants were valued using the Black-Scholes option pricing model and the following variables: stock price of \$0.63; expected life of one year; Nil dividends; 64.5% volatility; and risk free interest rate of 0.69%. In both cases, the warrants issued provide the holders with the option to purchase one Common Share.

During the fourth quarter of 2016, the Company converted “*Secured convertible debentures - 2015*” into 2,210,352 units at a price of \$0.67 per unit. The gross value of the conversion was \$1,473,576. Each unit consisted of one Common Share and one Common Share purchase warrant. Upon conversion the debenture was extinguished and the security has been released. The warrants were valued at \$424,448 using the Black-Scholes option pricing model and the following variables: stock price of \$0.56; expected life three years; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.59%. The residual amount of the value converted of \$1,126,421 including \$77,293 of related contributed surplus was attributed to the common shares. The following warrants are also related to the “*Secured convertible debentures - 2015*”:

- J *Broker warrants valued at issue date (fiscal 2015)* - There were also 53,286 broker warrants issued to the broker. Each warrant entitles the broker to acquire one Unit for \$0.67 and expire in two years. The value of the warrants was estimated to be \$12,726 using the Black-Scholes option pricing model and the following variables: underlying security value price of \$0.67; expected life of two years; \$Nil dividends; 65% volatility; and risk free interest rate of 1.01%. These warrants were exercised in December 2016.
- J *Amendment warrants (fiscal 2016)* - On February 19, 2016, prior to the debentures being converted, the Company negotiated an amendment with the holders of the Secured Convertible Debentures to delay the maturity date to December 17, 2016. 360,000 warrants were issued with an exercise price of \$0.75 and expire 10 months from the effective date of the amendment. The warrants were valued at \$40,135 using the Black-Scholes option pricing model and the following variables: stock price of \$0.67; expected life 10 months; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.44%.

During the third quarter of 2016, the Company repaid and extinguished the “*Unsecured convertible debentures – 2015*” debentures after the initial due date. In exchange for the late payment, the Company issued 38,148 Penalty Warrants priced at \$0.67 a share exercisable up to December 31, 2017. The Warrants were valued at \$6,603 using the Black-Scholes option pricing model and the following variables: stock price of \$0.58; expected life of 23 months; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.39%.

As described in Note 9, Convertible debentures, the Company issued unsecured debentures in the third and fourth quarters of fiscal 2016. On July 15, 2016, \$66,426 of the debentures held by two individuals were converted into 99,996 Common shares at a price of \$0.75 per unit.

In April 2016, the Company agreed to issue common shares in exchange for services rendered by two contractors. The Company issued 9,000 common shares and the gross value of the share issued totaled \$3,250. The fair value of the services provided approximated the value of the shares issued.

During the first quarter of 2017, the Company issued 338,274 units in a private placement at \$0.75 unit generating gross proceeds of \$253,706. A Unit provides the holder with one Common share and one Common Share Purchase Warrant. The warrant entitles the holder the option to buy a Share at the price of \$0.83 for three years from date of issuance. The value of the warrants was estimated using the Black-Scholes option pricing model with the following variables: stock price of \$0.57; expected life of three years;

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10. Share capital (continued)

\$Nil dividends; 64.5% volatility; and risk free interest rate of 0.60%. The value of the warrants was estimated to be \$61,453. As a result, the residual value of the Common shares was calculated to be \$192,253.

Share issue costs relating to the equity financings in the first quarter of fiscal 2017 amounted to \$6,308. \$617 of the costs were related to 2,664 warrants issued that have a \$0.83 exercise price and expire in five years. These warrants were issued to a broker in relation to the sale of 338,274 units. The warrants were valued using the Black-Scholes option pricing model and the following variables: stock price of \$0.52; expected life of five years; Nil dividends; 64.5% volatility; and risk free interest rate of 0.60%. \$97 of the costs related to 798 warrants issued that have a \$0.75 exercise price and expire in one year. These warrants were issued to a financing consultant in relation to a Finder's fee for the sale of 13,332 units. The warrants were valued using the Black-Scholes option pricing model and the following variables: stock price of \$0.63; expected life of one year; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.69%. In both cases, the warrants issued provide the holders with the option to purchase one Common Share.

During the second quarter of 2017, the Company issued 4,285,716 Common Shares at \$0.58 per Common Share for total proceeds of \$2,500,001 from a group of private investors ("Investors"). As part of the Private Placement the Investors have the right to nominate up to two Directors supported by an agreement between certain shareholders. The Investors have a call option to purchase another 4,285,716 Common Shares at a price of \$0.58 prior to May 31, 2017. The Company also has a put option to purchase another 4,285,716 Common Shares at the subscription price of \$0.58 prior to June 30, 2017, so long the Company attains revenues of \$3,500,000 between January 1, 2017 and May 31, 2017.

In connection with the closing of this placement, THC incurred share issuance costs of \$147,014 and issued 342,852 broker warrants with an exercise price of \$0.75 and a five-year term. The warrants were valued using the Black-Scholes option pricing model and the following variables: stock price of \$0.75; expected life of five years; \$Nil dividends; 73.2% volatility; and risk free interest rate of 0.75%. The value of the broker warrants was estimated to be \$152,890. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

During the second quarter of 2017, THC completed a concurrent financing through Canaccord Genuity ("Agent") pursuant to which it issued 17,517,042 Common Shares at a price of \$0.75 per shares for gross proceeds of \$13,137,782 ("Concurrent Financing"). In connection with the closing of the Concurrent Financing, THC paid the Agent a cash commission of \$803,487, equal to 7% of the gross proceeds from the Concurrent Financing, subject to a reduced commission of 3.5% for certain subscribers on a President's List of THC. THC also issued to the Agent warrants exercisable to acquire 1,071,318 Common Shares, being that number of Common Shares as was equal to 7% of the number of Common Shares sold under the Concurrent Financing, subject to a reduced percentage of 3.5% for certain subscribers on the President's List of THC, at an exercise price of \$0.75 per share and a two year term. The warrants were valued at \$323,653 using the Black-Scholes option pricing model and the following variables: stock price of \$0.75; expected life of two years; \$Nil dividends; 73.2% volatility; and risk-free interest rate of 1.25%. Additional transaction costs of \$82,329 were included in share issuance costs. The Company also issued 44,940 broker warrants with an exercise price of \$0.75 and a two year term. The warrants were valued at \$13,576 using the Black-Scholes option pricing model and the following variables: stock price of \$0.75; expected life of two years; \$Nil dividends; 73.2% volatility; and risk free interest rate of 1.25%. These warrants were recorded as a share issuance cost in the statement of changes in shareholders' equity. The agent warrants and broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

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10. Share capital (continued)

During the second quarter of 2017, the Company also issued the following warrants:

-) 203,202 warrants in exchange for services rendered by two service providers:
 - o The Company issued 120,000 warrants that have an exercise price of \$0.70 USD and expire in May 2018. The warrants were valued at \$24,411 (US\$ \$18,760) using the Black-Scholes option pricing model and the following variables: stock price of \$0.75; expected life of 18 months; \$Nil dividends; 73.2% volatility; risk free interest rate of 1.25%; and USD/CAD exchange rate of 1.3447. 30,000 warrants were exercised on April 28, 2017. These warrants were recorded as a share issuance cost in the statements of changes in shareholders equity.
 - o The Company issued another 83,202 warrants that have an exercise price of \$0.75 and expire 3 years. The warrants were valued at \$30,184 using the Black-Scholes option pricing model and the following variables: stock price of \$0.75; expected life of three years; \$Nil dividends; 73.2% volatility; and risk free interest rate of 1.25%. These warrants were recorded as a share issuance cost in the statements of changes in shareholders equity.

During the third quarter of 2017, the Company issued 2,492,958 shares for \$0.75 per share for gross proceeds of \$1,869,719. These shares were issued pursuant to an agent's option under the Concurrent Financing completed in December 2016, in which 17,400,000 shares were offered, which allowed the Agent to sell an additional number of shares equal to 15% of the number of offered shares. The Company paid share issuance costs of \$146,792 and issued 174,504 warrants to the broker. The warrants have an exercise price of \$0.75 and expire in 2 years. The warrants were valued at \$167,222 using the Black-Scholes option pricing model and the following variables: stock price of \$1.55; expected life of two years; \$Nil dividends; 73.2% volatility; and risk free interest rate of 1.25%. These warrants were recorded as a share issuance cost in the statements of shareholders equity. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

During the third quarter of 2017, the Company issued 4,285,716 Common Shares at a price of \$0.58 per share, for total proceeds of \$2,500,001, pursuant to a call option issued to a group of private investors on November 4, 2016.

As described in Note 9, Convertible debentures, the Company issued unsecured debentures in the third and fourth quarters of fiscal 2016. On March 16, 2017, \$345,000 of the debentures held by six individuals were converted into 459,990 common shares at a price of \$0.75 per unit. In relation to the conversion of this debt, 459,990 warrants were issued. The warrants were valued at \$69,220 using the Black-Scholes option pricing model and the following variables: stock price of \$0.60; expected life of two years; \$Nil dividends; 64.5% volatility; and risk free interest rate of 0.59%.

As described in Note 9, Convertible debentures, the Company issued secured debentures in the second quarter of fiscal 2017. On April 11, 2017, the debentures automatically converted to 4,678,494 common shares at a conversion price of US\$0.70 after the Company become a reporting issuer on the TSXV and maintained a volume weighted average trading price equal to or exceeding the conversion price of the debentures for 15 days.

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10. Share capital (continued)

As described in Note 9, Convertible debentures, during the fourth quarter of 2017, 7,856,300 warrants were issued in relation to the issuance of convertible debt. The allocation of the proceeds to these warrants was \$1,163,396. In relation to this financing, the Company issued 784,375 broker agent warrants that have an exercise price of \$2.00 and expire 2 years. The warrants were valued at \$192,602 using the Black-Scholes option pricing model and the following variables: stock price of \$1.52; expected life of two years; \$Nil dividends; 73.2% volatility; and risk free interest rate of 1.27%. The value of the broker warrants, and other financing costs, were allocated on a pro rata basis based on the allocated fair value of each component of this financing, as detailed in Note 9, Convertible debentures. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

In relation to the third quarter issuance of 4,285,716 Common Shares, during the fourth quarter of 2016, the Company issued 342,852 broker warrants with an exercise price of \$0.75 and a five year term from the date of listing. The warrants were valued at \$238,753 using the Black-Scholes option pricing model and the following variables: stock price of \$1.25; expected life of two years; Nil dividends; 73.2% volatility; and risk free interest rate of 1.25%. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

Throughout the year, 845,502 warrants with exercise prices ranging from \$0.75 to \$0.83 were exercised for proceeds of \$716,926 resulting in the issuance of 828,694 common shares.

Throughout the year, 162,504 options with exercise prices ranging from \$0.27 to \$0.37 were exercised for proceeds of \$32,252 resulting in the issuance of 162,504 common shares.

As at July 31, 2017, there were 76,192,990 Common Shares outstanding and 20,994,123 warrants outstanding.

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10. Share capital (continued)

The following is a summary of warrants on July 31, 2017:

	Number outstanding	Value
Warrants issued with \$0.75 Units		
Exercise price of \$0.83 expiring April 28, 2019	13,332	2,384
Exercise price of \$0.83 expiring May 3, 2019	126,000	22,528
Exercise price of \$0.83 expiring May 19, 2019	19,332	3,457
Exercise price of \$0.83 expiring June 2, 2019	999,996	178,796
Exercise price of \$0.83 expiring June 6, 2019	144,000	25,747
Exercise price of \$0.83 expiring June 8, 2019	1,333,332	248,597
Exercise price of \$0.83 expiring June 14, 2019	36,000	6,437
Exercise price of \$0.83 expiring June 16, 2019	75,000	26,820
Exercise price of \$0.83 expiring June 23, 2019	66,672	11,921
Exercise price of \$0.83 expiring June 28, 2019	266,670	47,680
Exercise price of \$0.83 expiring July 21, 2019	492,690	88,091
Exercise price of \$0.83 expiring July 22, 2019	266,676	47,681
Exercise price of \$0.83 expiring July 25, 2019	79,872	14,281
Exercise price of \$0.83 expiring July 28, 2019	420,000	75,095
Exercise price of \$0.83 expiring August 9, 2019	66,672	12,112
Exercise price of \$0.83 expiring August 12, 2019	33,336	6,056
Exercise price of \$0.83 expiring August 18, 2019	266,676	47,681
Exercise price of \$0.83 expiring August 31, 2019	39,600	7,194
Exercise price of \$0.83 expiring September 13, 2019	13,332	2,422
Exercise price of \$0.83 expiring September 26, 2019	72,000	13,080
Exercise price of \$0.83 expiring October 17, 2019	79,998	14,533
2015 secured convertible debenture warrants		
Exercise price of \$0.75 expiring July 15, 2019	2,210,358	424,448
2015 secured convertible debenture amendment warrants		
Exercise price of \$0.75 expiring August 18, 2017	237,612	26,491
2015 unsecured convertible debenture amendment warrants		
Exercise price of \$0.67	38,100	6,603
2016 unsecured convertible debenture warrants		
Exercise price of \$0.83 expiring March 16, 2019	326,658	49,157
Exercise price of \$0.83 expiring July 18, 2019	100,002	15,047
2016 secured convertible debenture warrants		
Exercise price of USD\$0.76 expiring November 19, 2019	2,053,500	1,355,586
2017 unsecured convertible debenture warrants		
Exercise price of \$2.00 expiring July 18, 2019	7,856,300	1,084,433
Broker / Consultant warrants		
Exercise price of USD\$0.70 expiring May 26, 2018	30,000	6,103
Exercise price of \$0.75 expiring March 15, 2019	1,290,762	504,452
Exercise price of \$2.00 expiring July 18, 2019	784,375	192,602
Exercise price of \$0.75 expiring November 9, 2019	83,202	30,184
Exercise price of USD\$0.70 expiring November 14, 2019	344,286	85,015
Exercise price of \$0.75 expiring July 20, 2021	39,414	8,868
Exercise price of \$0.75 expiring August 11, 2021	2,664	617
Exercise price of \$0.75 expiring November 3, 2021	342,852	152,890
Exercise price of \$0.75 expiring March 14, 2022	342,852	238,753
	<u>20,994,123</u>	<u>5,083,842</u>

The Hydrotech Corporation

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10. Share capital (continued)

	July 31, 2016 balance	Issued	Exercised	July 31, 2017 balance
Warrants issued with \$4.50 Units	4,672,920	338,274	(100,008)	4,911,186
2015 secured convertible debenture warrants	2,210,358	-	-	2,210,358
2015 secured convertible debenture amendment warrants	359,988	-	(122,376)	237,612
2015 unsecured convertible debenture amendment warrants	38,100	-	-	38,100
2016 unsecured convertible debenture warrants	100,002	459,990	(133,332)	426,660
2016 secured convertible debenture warrants		2,339,208	(285,708)	2,053,500
2017 unsecured convertible debenture warrants		7,856,300		7,856,300
Broker / Consultant warrants	122,694	3,341,791	(204,078)	3,260,407
	7,504,062	14,335,563	(845,502)	20,994,123

The Company has a service agreement under which it may be required to issue up to \$178,000 in Common Shares based on the achievement of certain objectives. The Common Shares will be issued at the volume weighted average price for the Common Shares for the preceding three months. As of July 31, 2017, the Company has not accrued anything in relation to the contract.

Stock option plan

The Company has a share option plan (the "Plan") that is administered by the Board of Directors of the Company who establish exercise prices and expiry dates, which are up to 10 years from issuance as determined by the Board at the time of issuance. Unless otherwise determined by the Board, options issued under the Plan vest over a three-year period except for options granted to consultants or persons employed in Investor Relations Activities (as defined in the policies of the Exchange) which vest in stages over 12 months with no more than ¼ of the options vesting in any three-month period. The maximum number of Common Shares reserved for issuance for options that may be granted under the Plan is 7,619,299 Common Shares as at July 31, 2017.

	July 31, 2017		July 31, 2016	
	Options issued	Weighted average exercise price	Options issued	Weighted average exercise price
		\$		\$
Opening balance beginning of the year	3,481,896	0.49	3,271,896	0.38
Granted	2,428,777	0.92	840,000	0.75
Expired	-	-	-	-
Forfeited	-	-	(153,000)	0.58
Exercised	(162,504)	0.19	(477,000)	0.19
Closing balance - end of the year	5,748,169	0.68	3,481,896	0.49

The Hydrothecary Corporation

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10. Share capital (continued)

The following table summarizes information concerning stock options outstanding as at July 31, 2017.

Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Number exercisable	Weighted average remaining contractual life (years)
\$	#		#	
0.16	1,020,000	0.32	1,020,000	0.62
0.58	1,329,396	1.71	1,159,452	2.83
0.75	2,511,996	3.94	667,496	1.86
0.90	177,777	0.02	177,777	0.04
1.27	643,000	1.12	-	-
1.55	66,000	0.11	5,500	0.02
	5,748,169	7.22	3,030,225	5.37

Stock-based compensation

For the year ended July 31, 2017, the Company recorded \$658,620 (July 31, 2016 - \$293,564) in stock-based compensation expense related to employee options, which are measured at fair value at the date of grant and are expensed over the option's vesting period. In determining the amount of stock-based compensation, the Company used the Black-Scholes option pricing model to establish the fair value of options granted by applying the following assumptions:

	2017	2016
Risk-free interest rate	1.27% - 1.73%	0.60% - 0.79%
Expected life of options (years)	3 - 7	5
Expected annualized volatility	65% - 73%	65%
Expected dividend yield	Nil	Nil

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11. Net loss per share

The following securities could potentially dilute basic net loss per share in the future but have not been included in diluted loss per share because their effect was anti-dilutive:

	July 31, 2017	July 31, 2016
	\$	\$
2016 Unsecured convertible debentures	-	459,990
2016 Warrants to be issued on conversion of unsecured convertible debentures	-	459,990
2017 Unsecured convertible debentures	15,687,500	-
Options	5,748,169	3,531,894
Warrants issued with \$0.75 Units	4,911,186	4,672,920
2015 Secured convertible debenture warrants	2,210,358	2,210,358
2015 Secured convertible debenture amendment warrants	237,612	359,988
2015 Unsecured convertible debenture amendment warrants	38,100	38,100
2016 Unsecured convertible debenture warrants	426,660	99,996
2016 Secured convertible debenture warrants	2,053,500	-
2017 Unsecured convertible debenture warrants	7,856,300	-
Convertible debenture broker/finder warrants	3,260,407	122,688
	42,429,792	11,955,924

12. Segmented information

The Company operates in one operating segment.

All property, plant and equipment and intangible assets are located in Canada.

13. Financial instruments

Interest risk

The Company's exposure to interest rate risk only relates to any investments of surplus cash. The Company may invest surplus cash in highly liquid investments with short terms to maturity that would accumulate interest at prevailing rates for such investments. As at July 31, 2017, the Company had short term investments of \$2,871,550. The Company's financial debt has a fixed rate of interest and therefore exposes the company to a limited interest risk.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's amounts receivable. As at July 31, 2017, the Company was exposed to credit related losses in the event of non-performance by the counterparties.

The Company provides credit to its customers in the normal course of business and has established a credit evaluation and monitoring processes to mitigate credit risk, but has limited risk due to the fact the majority of the sales are transacted with clients that are covered under various insurance programs.

The carrying amount of cash and cash equivalents, short term investments and accounts receivable represents the maximum exposure to credit risk and at July 31, 2017, this amounted to \$41,675,580. The cash is held by the Company's bank which is one of the largest cooperative financial groups in Canada. Since the inception of the Company, no losses have been suffered in relation to cash held by the bank. The accounts receivable balance is held with one of the largest medical insurance companies in Canada.

The Hydrothecary Corporation

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13. Financial instruments (continued)

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages its liquidity risk by reviewing on an ongoing basis its capital requirements. As at July 31, 2017, the Company had \$41,324,373 of cash and cash equivalents and short term investments.

The Company was obligated to pay accounts payable and accrued liabilities with a carrying amount and contractual cash flows amounting to \$1,672,406 due in the next 12 months.

The carrying values of cash, accounts receivable, accounts payable and accrued liabilities approximate their fair values due to their short term to maturity.

14. Expenses by nature

	2017	2016
	\$	\$
Salaries and benefits	3,092,745	1,744,524
Expensed inventory	2,076,305	927,195
Growing consumables and productions costs	1,200,902	137,286
Clinic fees	1,005,994	678,224
General and administrative	820,620	366,266
Stock based compensation	658,620	293,564
Professional fees	547,300	302,523
Facilities	499,642	63,443
Amortization of property, plant and equipment	359,468	126,516
Consulting	285,081	153,180
Travel	236,300	84,962
Amortization of intangible assets	231,685	173,381
Marketing and promotion	228,813	130,562
Total	11,243,475	5,181,627

15. Income taxes

Income tax expense varies from the amount that would be computed by applying the basic federal and provincial tax rates to loss on operations before income taxes, shown as follows:

	2017	2016
Expected tax rate	26.9%	26.9%
	\$	\$
Expected tax benefit resulting from loss	(3,327,909)	(902,306)
Permanent differences	2,922,013	84,032
Unrecognized tax loss carryforwards	340,691	785,612
Other	65,205	32,662
Income tax expense	-	-

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15. Income taxes (continued)

The following table summarizes the components of deferred tax:

	Opening	Recognized in Equity
Deferred tax assets	-	812,864
Non-capital losses carried forward	-	-
Share issue costs - equity	-	-
Deferred tax liabilities	-	-
Revaluation of financial instruments - Equity	-	(812,864)
	-	-

Deferred income taxes reflect the impact of loss carryforwards and of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. At July 31, 2017, deductible temporary differences and unused tax losses for which no deferred tax assets have been recognized are attributable to the following:

	2017	2016
	\$	\$
Losses carried forward	8,198,562	6,021,528
Research and development expenditures	74,000	74,000
Share issue costs	-	57,669
Accounting amortization in deficit (excess) of tax	1,201,803	(2,831,502)
Total	9,474,365	3,321,695

The Company has approximate non-capital losses available to reduce future years' federal and provincial taxable income which expires as follows:

2034	776,374
2035	2,275,503
2036	3,013,824
2037	4,147,970
Total	10,213,671

16. Related party disclosure

Key management personnel compensation

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling activities of the entity, directly or indirectly. The key management personnel of the Company are the members of the Company's executive management team and Board of Directors, control approximately 25.11% of the outstanding shares of the Company as at July 31, 2017 (July 31, 2016 - 40.62%).

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16. Related party disclosure (continued)

Compensation provided to key management was as follows:

	2017	2016
	\$	\$
Salary and or Consulting Fees	1,269,825	500,000
Stock-based compensation	512,056	211,849
	<u>1,781,881</u>	<u>711,849</u>

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed by the related parties.

On November 15, 2016, the Company granted certain directors and key management of the Company a total of 1,227,000 stock options with an exercise price of \$0.75 which vest over a three-year period. On July 24, 2017, the Company granted certain directors and key management of the Company a total of 125,000 stock options with an exercise price of \$1.27 which vest over a three-year period. On September 30, 2015, a Director exercised 150,000 options which had an exercise price of \$0.16. In July 2016, certain Directors and members of the executive management of the Company exercised 327,000 options for proceeds to the Company of \$65,750.

The Company leased a building to a related party for \$700 per month as part of a usufruct agreement. The related party used this property as a personal residence. On December 2, 2016, the related party and the Company reached an agreement to abandon the usufruct that gave the related party the right to use the building. In exchange for abandoning the usufruct the Company paid the related party \$46,000. Gaining access to this building provides the Company with additional office space and thereby reduces the need to rent or build additional offices.

17. Capital management

The Company's objective is to maintain sufficient capital base so as to maintain investor, creditor and customer confidence and to sustain future development of the business and provide the ability to continue as a going concern. Management defines capital as the Company's shareholders' equity. The Board of Directors does not establish quantitative return on capital criteria for management, but rather promotes year over year sustainable profitable growth. The Company currently has not paid any dividends to its shareholders. The Company is not subject to any externally imposed capital requirements.

As at July 31, 2017, total managed capital was comprised of shareholders' equity of \$32,439,490 (July 31, 2016 – \$7,786,509). There were no changes in the Company's approach to capital management during the period.

18. Commitments and contingencies

The Company has certain contractual financial obligations related to service agreements that are contingent on customer purchases.

The Company has seven long term supply arrangement and a service contracts which are operating leases. These contracts have optional renewal terms that the Company may exercise at its option. The annual minimum payments payable under these contracts over the next five years is as follows:

Fiscal Year	2018	2019	2020	2021	2022	Total
Amount	\$173,603	\$156,163	\$132,417	\$69,417	\$16,765	\$548,365

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18. Commitments and contingencies (continued)

The Company has a commitment to finance \$35,195 related to the purchase of a vehicle. The financing bears interest at 6.99%, matures August 15, 2019 and is secured by a vehicle. The Company pays principal and interest payments of \$697 per month. As at July 31, 2017, the remaining principal balance related to the financial commitment of \$16,188 is included in accounts payable. The total remaining payments are \$8,361 for 2018 and 2019 and \$697 for 2020.

Litigation

The Company is currently a party to a legal dispute with a supplier with respect to an agreement related to leasing a facility. A definitive lease agreement was contingent on the Company obtaining a license under the Marijuana for Medical Purposes Regulations (MMPR) as well as entering into a definitive lease with the proposed landlord. Neither of these conditions were met by the date agreed to in the proposal. On October 27, 2014, the proposed landlord filed a statement of claim in the amount of \$1,107,544.

The Company is currently disputing the claim, and the litigation process will continue into the foreseeable future unless a settlement can be reached between the two parties. A hearing took place during the first week of May 2017, and the Company is currently awaiting a ruling. No amount has been recorded in the consolidated financial statements due to the fact that the amount is neither determinable nor estimable at this point.

19. Subsequent events

Construction contract

In August 2017 the Company entered into a contract with Havecon Projects BV ("Havecon") for the delivery and installation of a 250,000 sq. ft. greenhouse at the Company's Gatineau facility. Construction began in the fall of 2017 and is expected to be completed in the second half of 2018.

Issue stock options

On September 8, 2017 the Company granted stock options under its stock option plan to certain of its officers to acquire a total of 650,000 common shares of the Company. In addition, the Company granted options to acquire an aggregate of 1,000 common shares of the Company to certain non-executive employees. All of the options have an exercise price of \$1.37 per share. One-third of the options will vest on the one year anniversary of the date of grant and the balance will vest quarterly over two years thereafter. The options have a term of 10 years.

Kosher certification

On September 19, 2017 the Company announced that it was granted kosher certification by the Ottawa Vaad HaKashrut. It is the only kosher certification currently granted to cannabis productions in Canada. The certification included Decarb, Elixir and the H2 line of milled products.

Appointment of Board Member

On October 5, 2017 the Company appointed Nathalie Bourque to its Board of Directors.

Groundbreaking

On October 12, 2017 the Company broke ground on its new 250,000 sq. ft expansion. The facility is expected to be completed in the second half of 2018. Once completed the expansion will increase the Company's facility size to 300,000 sq. ft and increase annual production capacity to 25,000 kilograms.

The Hydrotech Corporation

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19. Subsequent events (continued)

Bought deal financing

On October 30, 2017, the Company announced a \$60,000,000 bought deal of 60,000 convertible debenture units at a price of \$1,000 per unit. Each unit will consist of \$1,000 principal amount of 7.0% unsecured convertible debentures and 227 common share purchase warrants, which will mature two years after the closing date of the offering. The Company has also granted the underwriter the option to purchase up to an additional 9,000 units for \$1,000 each, prior to the closing of the offer. Interest will be paid semi-annually in June and December. The convertible debentures mature in three years from the closing date and may be convertible at the option of the holder at a conversion price of \$2.20 per share. The Company may force the conversion should the daily volume weighted average trading price of the common shares of the Company be greater than \$3.15 for any 10 consecutive trading days subject to 30 days' prior written notice. Each warrant has an exercise price of \$3.00 per share and a maturity of two years following the closing date of the offering. The Company may accelerate the expiry of the warrants should the daily volume weighted average trading price of the common shares of the Company be greater than \$4.50 for any 10 consecutive trading days subject to 30 days' prior written notice.