EMERALD HEALTH THERAPEUTICS, INC.

Consolidated Financial Statements

For the years ended December 31, 2016 and December 31, 2015.
(Expressed in Canadian Dollars)

EMERALD HEALTH THERAPEUTICS, INC.

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements have been prepared by management and are the responsibility of the Board of Directors of Emerald Health Therapeutics, Inc. (the "Company").

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and reflect management's best estimates and judgments based on currently available information. The Company has developed and maintains a system of internal controls in order to ensure, on a reasonable and cost effective basis, the reliability of its financial information.

The Board of Directors of the Company is responsible for overseeing management's performance of its responsibilities for financial reporting and internal control. The Audit Committee of the Company, which is composed of non-executive directors, meets with management as well as the external auditors to ensure that management is properly fulfilling its financial reporting responsibilities to the Directors who approve the financial statements. The external auditors have unrestricted access to the Audit Committee to discuss the scope of their audits, the adequacy of the system of internal controls and to review financial reporting issues.

The financial statements have been audited by Deloitte LLP. Their report outlines the scope of their examination and opinion on the consolidated financial statements.

March 31, 2017

/s/ Bin Huang
Bin Huang
Chief Executive Officer

/s/ Sandy Pratt
Sandy Pratt
Chief Financial Officer

Independent Auditor's Report

To the Shareholders of
Emerald Health Therapeutics, Inc.

We have audited the accompanying consolidated financial statements of Emerald Health Therapeutics, Inc., which comprise the consolidated statements of financial position as at December 31, 2016 and December 31, 2015, and the consolidated statement of loss and comprehensive loss, consolidated statements of changes in shareholders' equity and consolidated statements of cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our 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 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 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 Emerald Health Therapeutics, Inc. as at December 31, 2016 and December 31, 2015, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without modifying our opinion we draw attention to Note 1 of the consolidated financial statements, which indicates that the Emerald Health Therapeutics, Inc. has incurred losses in the amount of $9.1 million since its inception on July 31, 2007. This condition, along with other matters as set forth in Note 1 indicate the existence of material uncertainties that may cast significant doubt on the Company's ability to continue as a going concern.

/s/ Deloitte LLP

Chartered Professional Accountants
March 31, 2017
Vancouver, Canada

EMERALD HEALTH THERAPEUTICS, INC.
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(Expressed in Canadian dollars)

As at	December 31, 2016	December 31, 2015
ASSETS		
Current		
Cash	$ 3,217,205	$ 81,836
Accounts receivable (Note 4)	28,701	42,140
Biological assets (Note 5)	162,986	140,422
Inventory (Note 5)	160,048	30,644
Prepaid expenses (Note 6)	32,783	27,736
Total current assets	3,601,723	322,778
Plant and equipment (Note 7)	529,188	405,810
Intangible assets (Note 8)	45,418	1,317
Deposits on equipment (Note 7)	-	41,774
Total non-current assets	574,606	448,901
TOTAL ASSETS	$ 4,176,329	$ 771,679
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 376,339	$ 212,198
Due to related parties (Note 9)	97,696	972,677
Total current liabilities	474,035	1,184,875
SHAREHOLDERS' EQUITY		
Share capital (Note 10)	9,756,732	3,076,966
Contributed surplus	3,043,099	2,666,874
Accumulated deficit	(9,097,537)	(6,157,036)
TOTAL SHAREHOLDERS' (DEFICIT) EQUITY	3,702,294	(413,196)
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 4,176,329	$ 771,679

Nature and continuance of operations (Note 1)
Commitments (Note 13)
Events after the reporting period (Note 20)

On behalf of the Board of Directors:

/s/ Punit Dhilllon
Director

/s/ Bob Rai
Director

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

EMERALD HEALTH THERAPEUTICS, INC.
CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS
For the years ended December 31, 2016 and December 31, 2015
(Expressed in Canadian dollars)

	Year ended December 31, 2016	Year ended December 31, 2015
Revenue		
Sales	$ 253,321	$ 31,291
Cost of sales		
Cost of goods sold	193,793	27,314
Production costs	606,767	362,424
Gain on changes in fair value of biological assets	(197,293)	(185,936)
	603,267	203,802
Gross margin	(349,946)	(172,511)
Expenses		
General and administrative (Note 19)	1,220,775	1,578,848
Pre-distribution growing costs	-	194,047
Sales and marketing	271,118	166,739
Research and development	301,526	162,316
Depreciation	116,348	46,409
Share-based payments (Note 10)	680,788	1,176,401
	2,590,555	3,324,760
Loss before income taxes	2,940,501	3,497,271
Income tax expense (Note 16)	-	-
NET LOSS AND COMPREHENSIVE LOSS	2,940,501	3,497,271
Basic and diluted loss per common share	$ 0.05	$ 0.08
Weighted average number of common shares outstanding (Note 11) -basic and diluted	54,264,687	46,070,841

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

EMERALD HEALTH THERAPEUTICS, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(Expressed in Canadian dollars, except share number)

	Common Shares Without Par Value				
	Shares	Share Capital Amount	Contributed Surplus	Deficit	Total Shareholders' Equity
Balance, December 31, 2014	46,070,841	$ 3,076,966	$ 1,490,473	$ (2,659,765)	$ 1,907,674
Share-based payments	-	-	1,176,401	-	1,176,401
Net loss and comprehensive loss	-	-	-	(3,497,271)	(3,497,271)
Balance, December 31, 2015	46,070,841	$ 3,076,966	$ 2,666,874	$ (6,157,036)	$ (413,196)
Shares issued on conversion of debt	12,592,606	2,314,261	-	-	2,314,261
Shares issued on private placement	8,489,451	3,835,926		-	3,835,926
Shares issued on stock option exercise	641,800	577,739	(304,563)	-	273,176
Share issuance costs	-	(48,160)	-	-	(48,160)
Share-based payments	-	-	680,788	-	680,788
Net loss and comprehensive loss	-	-	-	(2,940,501)	(2,940,501)
Balance, December 31, 2016	67,794,698	$ 9,756,732	$ 3,043,099	$ (9,097,537)	$ 3,702,294

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

EMERALD HEALTH THERAPEUTICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2016 and December 31, 2015
(Expressed in Canadian dollars)

	Year ended December 31, 2016	Year ended December 31, 2015
Operating activities		
Net loss	$ (2,940,501)	$ (3,497,271)
Items not involving cash		
Depreciation of property, plant and equipment (Note 7)	99,444	45,559
Amortization of intangible assets (Note 8)	16,905	850
Loss on disposal of plant and equipment and intangibles (Note 8)	1,943	19,633
Gain on changes in fair value of biological assets	(22,564)	(140,422)
Share-based payments (Note 10)	680,788	1,176,401
Changes in non-cash operating working capital items (Note 12)	116,328	142,197
Net cash flows used in operating activities	(2,047,658)	(2,253,053)
Investing activities		
Purchase of plant and equipment (Note 7)	(183,225)	(270,461)
Purchase of intangible assets (Note 8)	(61,771)	-
Proceeds from disposal of plant and equipment	1,000	-
Deposits on equipment (Note 7)	-	(41,774)
Net cash flows used in investing activities	(243,997)	(312,235)
Financing activities		
Advances from related parties (Note 9)	1,552,395	928,329
Repayment of advances from related parties (Note 9)	(186,313)	-
Proceeds from private placement	3,835,926	-
Stock option exercises	273,176	-
Share issuance costs	(48,160)	-
Net cash flows generated from financing activities	5,427,024	928,329
Increase (decrease) in cash during the year	3,135,369	(1,636,959)
Cash, beginning of year	81,836	1,718,795
Cash, end of year	$ 3,217,205	$ 81,836

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

1. NATURE AND CONTINUANCE OF OPERATIONS

Emerald Health Therapeutics Inc. (the "Company") was incorporated pursuant to the *Business Corporations Act* (British Columbia) on July 31, 2007 as Firebird Capital Partners Inc. and changed its name to Firebird Energy Inc. in December 2012. On September 4, 2014, the Company completed the acquisition of all of the issued and outstanding common shares of Thunderbird Biomedical Inc. ("Thunderbird"), by way of a reverse takeover (the "RTO") under the rules of the TSX Venture Exchange (the "TSXV") and concurrently changed its name to T-Bird Pharma, Inc. Thunderbird became a wholly-owned subsidiary of the Company. In June 2015, the Company changed its name to Emerald Health Therapeutics, Inc. and Thunderbird changed its name to Emerald Health Botanicals Inc. ("Botanicals"). The Company's registered office is at Suite 2600 Oceanic Plaza, 1066 West Hastings Street, Vancouver, B.C. V6E 3X1. The Company is classified as a Tier 2 Venture Issuer on the TSXV.

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

These consolidated financial statements have been prepared by management on a going concern basis which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As at December 31, 2016, the Company had not yet achieved profitable operations and had accumulated losses of $9,097,537 (December 31, 2015 - $6,157,036) since its inception. The continuing operations of the Company are dependent upon its ability to continue to raise adequate capital and to commence profitable operations in the future and repay its liabilities arising from normal business operations as they become due. Management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the Company's ability to continue as a going concern.

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

2. SIGNIFICANT ACCOUNTING POLICIES

a) Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

The annual consolidated financial statements were authorized for filing by the Board of Directors on March 31, 2017.

b) Basis of presentation

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

All dollar amounts presented are in Canadian dollars unless otherwise specified.

c) Basis of consolidation

These consolidated financial statements include the accounts of the Company and its 100% owned subsidiary, Botanicals.

Intercompany transactions and balances between the Company and Botanicals are eliminated in full on consolidation.

d) Significant accounting judgments and estimates

The preparation of financial statements in conformity with IFRS requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported revenues and expenses during the year.

Although management uses historical experience and its best knowledge of the amount, events or actions to form the basis for judgments and estimates, actual results may differ from these estimates.

Significant estimates are evaluations and assumptions about the future and other sources of estimation uncertainty that management has made, that could result in a material adjustment to the carrying amounts of assets and liabilities. Significant estimates used in the preparation of these consolidated financial statements include, but are not limited to, the following:

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Inputs used in determining the estimated fair values of biological assets and net realizable value of inventory

The Company measures biological assets consisting of medical cannabis on plants at fair value less cost to sell up to the point of harvest. Those assumptions are described in Note 5 and include, among others, expected yield on harvest, expected selling price and remaining costs to be incurred up to the point of harvest. The Company measures inventory at the lower of cost and net realizable value and estimates selling price, the estimated costs of completion and the estimated costs necessary to make the sale.

Inputs used in determining the estimated fair values of options and warrants issued during the year

The Company has an equity-settled share-based compensation plan for directors, officers, employees and consultants. Services received, and the corresponding increase in equity, are measured by reference to the fair value of the equity instruments at the date of grant, excluding the impact of any non-market vesting conditions. The fair value of share options are estimated using Black-Scholes model on the date of grant based on certain assumptions. Those assumptions are described in Note 10 and include, among others, expected volatility, expected life of the options and number of options expected to vest. In calculating the value of the warrants, key estimates such as the volatility of the Company's stock price and the risk free interest rate are used.

Estimated useful lives of plant and equipment and intangible assets

The Company makes estimates and utilizes assumptions in determining the useful lives and residual value of plant and equipment and intangible assets and related depreciation. Uncertainties in these estimates relate to technical obsolescence that may change the utilization of certain assets.

Provisions and contingencies

The amount recognized as a provision, including legal, contractual, constructive and other exposures or obligations, is the best estimate of the consideration required to settle the related liability, including any related interest charges, taking into account the risks and uncertainties surrounding the obligation. In addition, contingencies will only be resolved when one or more future events occur or fail to occur. Therefore, assessment of contingencies inherently involves the exercise of significant judgment and estimates of the outcome of future events. The Company assesses its liabilities and contingencies based upon the best information available.

Income taxes

In assessing the probability of realizing deferred income tax assets, management makes estimates related to expectations of future taxable income, applicable tax opportunities, expected timing of reversals of existing temporary differences and the likelihood that tax positions taken will be sustained upon examination by applicable tax authorities. In making its assessments, management gives additional weight to positive and negative evidence that can be objectively verified. No deferred tax assets were recognized for the years ended December 31, 2016 or December 31, 2015.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Going concern

The Company's ability to execute its strategy by funding future working capital requirements requires judgment. Estimates and assumptions are continually evaluated and are based on historical experience and other factors, such as expectations of future events that are believed to be reasonable under the circumstances.

Impairment of plant and equipment and intangible assets

Management considers both external and internal sources of information in determining if there are any indications that the Company's plant and equipment or intangible assets are impaired. Management considers the market, economic, and legal environment in which the Company operates that are not within its control and affect the recoverable amount of its plant and equipment and intangible assets. Management considers the manner in which the plant and equipment and intangible assets are being used or are expected to be used, and indication of economic performance of the assets. 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.

e) Cash

Cash is held at major financial institutions. No amounts are considered restricted cash that is not available for use by the Company.

f) Plant and equipment

Plant and equipment is carried at cost less accumulated depreciation. Plant and equipment are depreciated over their expected lives based on the following:

- Leasehold improvements – term of the lease
- Growing equipment – 5 to 10 years straight line
- Lab equipment – 5 years straight line
- Computers – 3 years straight line

In the year of acquisition, depreciation for plant and equipment is recorded once it is available for use.

An item of plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss.

Residual values and estimated useful lives are reviewed at least annually.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

g) Intangible Assets

Intangible assets are recorded at cost and amortized over their estimated useful lives at the following annual rate:

- Computer software – 2 to 3 years straight line

h) Biological assets

The Company measures biological assets consisting of medical cannabis on plants at fair value less cost 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 market value, except for a portion which are restricted with respect to distribution due to the conditions under which they were acquired that are measured at cost.

i) Inventory

Inventories of harvested finished goods are valued at the lower of cost and net realizable value. Inventories of harvested cannabis are transferred from biological assets at their fair value at harvest, which becomes deemed cost. 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. Cost is determined using the average cost basis. Supplies and consumables are valued at cost.

j) Revenue recognition

Revenue is recognized at the fair value of consideration received or receivable. Revenue from the sale of goods is recognized when all of the following conditions have been satisfied:

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

Management deems the above to have been satisfied when the customer receives the goods.

k) Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) that has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

l) Related party transactions

Parties are considered to be related if one party has the ability, directly, or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

m) Income taxes

Income tax expense comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity. Current tax expense is the expected tax payable on taxable income for the year, using tax rates enacted or substantively enacted at period end, adjusted for amendments to tax payable with regard to previous years.

Deferred tax is recorded using the liability method, providing for temporary differences, between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Temporary differences are not provided for the initial recognition of assets or liabilities that affect neither accounting nor taxable loss, and differences relating to investments in subsidiary to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the end of the reporting period. A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized.

n) Loss per share

Basic loss per share is computed by dividing net loss for the year by the weighted average number of common shares of the Company (the “Common Shares”) outstanding during the year. The Company uses the treasury stock method for calculating diluted loss per share.

o) Segment reporting

The Company has one reportable operating segment relating to the production and sales of medical marihuana pursuant to the Access to Cannabis for Medical Purposes Regulations.

p) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at the date of inception; whether fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset, even if that right is not explicitly specified in an arrangement.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

A leased asset is depreciated over the useful life of the asset. However, if there is no reasonable certainly that the Company will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

Operating lease payments are recognized as an operating expense in profit or loss on a straight-line basis over the lease term.

q) Foreign Exchange

The functional currency of an entity is the currency of the primary economic environment in which the entity operates. The functional currency of the Company and its subsidiary is the Canadian dollar. The functional currency determinations were conducted through an analysis of the consideration factors identified in IAS 21, *The Effects of Changes in Foreign Exchange Rates.*

Transactions in currencies other than the Canadian dollar are recorded at exchange rates prevailing on the dates of the transactions. At the end of each reporting period, monetary assets and liabilities denominated in foreign currencies are translated at the period end exchange rate while non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at the exchange rates approximating those in effect on the date of the transactions. Exchange gains and losses arising on translation are included in net loss.

r) Financial instruments

Financial assets

The Company classifies its financial assets into one of the following categories as follows:

Fair value through profit or loss - This category comprises derivatives and financial assets acquired principally for the purpose of selling or repurchasing in the near term. They are carried at fair value with changes in fair value recognized in profit or loss. Cash has been classified under this category.

Loans and receivables - These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are carried at amortized cost using the effective interest method less any provision for impairment. Accounts receivable has been classified under this category.

Held-to-maturity investments - These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest method less any provision for impairment.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Financial assets (continued)

Available-for-sale - Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized in other comprehensive income (loss). Where a prolonged or significant decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from accumulated other comprehensive income (loss) and recognized in profit or loss.

All financial assets except those measured at fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is objective evidence of impairment as a result of one or more event that have occurred after initial recognition of the asset and that event has an impact on the estimated future cash flows of the financial asset or the group of financial assets.

Financial liabilities

The Company classifies its financial liabilities into one of two categories as follows:

Fair value through profit or loss - This category comprises derivatives and financial liabilities incurred principally for the purpose of selling or repurchasing in the near term. They are carried at fair value with changes in fair value recognized in profit or loss.

Other financial liabilities - This category consists of liabilities carried at amortized cost using the effective interest method. Accounts payable and accrued liabilities and due to shareholders have been classified under this category.

s) Impairment of non-financial assets

At the end of each reporting period, the Company's assets are reviewed to determine whether there is any indication that those assets may be impaired. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. The recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in profit or loss for the period. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

t) Share-based payments

The Company grants share options to purchase Common Shares to directors, officers, employees and service providers. The Board of Directors of the Company grants such options for a period of up to ten years, with vesting periods determined at its sole discretion and at prices equal to or greater than closing market price on the day before the options were granted all in accordance with the Company's stock option plan and the policies of the TSXV.

The fair value of share options granted to employees is recognized as an expense over the vesting period with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee, including directors of the Company. At each financial position reporting date, the amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest. In situations where equity instruments are issued to non-employees and some or all of the goods or services received by the entity as consideration cannot be specifically identified, they are measured at fair value of the share-based payment.

No expense is recognized for awards that do not ultimately vest except for equity settled transactions for which vesting is conditional upon a market or non-vesting condition.

Share options with a graded vesting schedule are accounted for as separate grants with different vesting periods and fair values. The fair value is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the share purchase options were granted.

Where the terms of an equity settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increase the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

When an equity award is cancelled, it is treated as if it vests on the date of the cancellation and any expense not recognized for the award is recognized immediately.

u) Warrants

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

v) 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 the development to use or sell the assets. Other development expenditures are expensed as incurred. To date, no development costs have been capitalized.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

The Company applies government contributions towards research and development directly against the applicable expenses and therefore presents the research and development expenses on a net basis. Research and development expenses are net of $44,668 in government contributions for the current year.

3. NEW ACCOUNTING PRONOUNCEMENTS

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

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

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

IFRS 16, Leases – issues in January 2016, IFRS which establishes principles for the recognition, measurement, presentation and disclosure of leases, with the objective of ensuring that lessees and lessors provide relevant information that faithfully represents those transactions. IFRS 16 applies to annual reporting periods beginning on or after January 1, 2019.

(Expressed in Canadian dollars)

4. ACCOUNTS RECEIVABLE

The accounts receivable as at December 31, 2016 of $28,701 (December 31, 2015 $42,140) primarily consisted of Goods and Service Tax ("GST") receivable from the Canada Revenue Agency.

5. BIOLOGICAL ASSETS AND INVENTORY

The Company's biological assets consist of seeds and cannabis on plants. The continuity of biological assets for the years ended December 31, 2016 and 2015 is as follows:

	December 31, 2016	December 31, 2015
Carrying amount, beginning of year	$ 140,422	$ -
Purchase (use of) seeds	(2,640)	27,270
Changes in fair value less costs to sell due to biological transformation	197,293	177,850
Transferred to inventory upon harvest	(172,089)	(64,698)
Carrying amount	$ 162,986	$ 140,422

As at December 31, 2016, included in the carrying amount of biological assets is $25,113 (2015 - $27,270) in seeds and $137,873 (2015 - $113,152) in live plants.

All of the plants are to be harvested as agricultural produce (ie. medical cannabis). All of the plants are between three and fifteen weeks from harvest.

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

- plant waste based on various stage of growth;
- yield per plant;
- selling price, less costs to sell
- percentage of costs incurred to date compared to the total costs to be incurred (to estimate the fair value of an in-process plant);
- costs incurred for each stage of plant growth.

The Company estimates the harvest yields for the plants at various stages of growth. As of December 31, 2016, it is expected that the Company's biological assets will yield approximately 80,000 (2015 – 32,800) grams. The Company's estimates are, by their nature, subject to change. Changes in the anticipated yield will be reflected in future changes in the gain or loss on changes in fair value of biological assets.

(Expressed in Canadian dollars)

5. BIOLOGICAL ASSETS AND INVENTORY (continued)

The Company's inventory is comprised of:

		December 31, 2016		December 31, 2015
Finished goods		146,056		29,894
Supplies and consumables		13,992		750
	$	160,048	$	30,644

6. PREPAID EXPENSES

The prepaid expenses as at December 31, 2016 $32,783 (2015 – $27,736) primarily consisted of prepaid insurance and rent deposits.

7. PLANT AND EQUIPMENT

		Leasehold improvements		Growing and extract equipment		Other equipment		Total
Cost								
Balance, December 31, 2014	$	148,363	$	54,713	$	17,967	$	221,043
Additions		55,597		204,200		10,664		270,461
Disposals		(19,633)		-		-		(19,633)
Balance, December 31, 2015	$	184,327		258,913	$	28,631	$	471,871
Additions		602		199,470		24,927		224,999
Disposals		-		(2,604)		(1,305)		(3,909)
Balance, December 31, 2016	$	184,929	$	455,779	$	52,253	$	692,961
Accumulated depreciation								
Balance, December 31, 2014	$	8,520		9,392	$	2,590	$	20,502
Additions		18,709		20,103		6,747		45,559
Balance, December 31, 2015	$	27,229	$	29,495	$	9,337	$	66,061
Additions		18,775		68,281		12,387		99,443
Disposals		-		(825)		(906)		(1,731)
Balance, December 31, 2016	$	46,004	$	96,951	$	20,818	$	163,773

(Expressed in Canadian dollars)

7. PLANT AND EQUIPMENT (continued)

	Leasehold improvements	Growing and extract equipment	Other equipment	Total
Net book value				
At December 31, 2015	**$ 157,098**	**$ 229,418**	**$ 19,294**	**$ 405,810**
At December 31, 2016	**$ 138,925**	**$ 358,828**	**$ 31,435**	**$ 529,188**

The deposit on equipment as at December 31, 2016 was nil (December 31, 2015 – $41,774).

8. INTANGIBLE ASSET

	Computer Software	Total
Cost		
Balance, December 31, 2014	$ 2,549	$ 2,549
Additions	-	-
Disposals	-	-
Balance, December 31, 2015	$ 2,549	$ 2,549
Additions	61,771	61,771
Disposals	(2,185)	(2,185)
Balance, December 31, 2016	$ 62,135	$ 62,135
Accumulated depreciation		
Balance, December 31, 2014	$ 382	$ 382
Additions	850	850
Disposals	-	-
Balance, December 31, 2015	$ 1,232	$ 1,232
Additions	16,906	16,906
Disposals	(1,421)	(1,421)
Balance, December 31, 2016	$ 16,717	$ 16,717
Net book value		
At December 31, 2015	**$ 1,317**	**$ 1,317**
At December 31, 2016	**$ 45,418**	**$ 45,418**

9. RELATED PARTY TRANSACTIONS

Transactions with Sciences

Amounts loaned to the Company by Emerald Health Sciences Inc. ("Sciences"), a related party of the Company, bear interest at 12% per annum and are repayable on demand. The Company also agreed to pay a fee for services provided by Sciences pursuant to a service contract based on cost.

During the year ended December 31, 2016, Sciences advanced $1,552,395 (2015 - $928,329) in funds to the Company and charged $39,561 (2015 - $8,433) in interest. Sciences also charged $146,970 (2015 $17,988) for services during the year. The advances, interest and a portion of the services fees were repaid in full by way of debt conversions (discussed below) and repayment of the final loan balance in November 2016. As of December 31, 2016, the Company owed $97,696 (2015 - $955,067) to Sciences for services and reimbursement of invoices paid on behalf of the Company, which was repaid in full subsequent to the year end.

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

In August 2016, Sciences and the Company announced a private placement of 4,077,687 units of the Company at a price of $0.205 per unit, for gross proceeds of $835,926. Each unit was comprised of one Common Share and one common share purchase warrant of the Company, with each warrant entitling the holder to acquire an additional Common Share for a period of 24 months at an exercise price of $0.27. The TSXV approved the transaction and the shares were issued in September 2016.

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

In November 2016, Sciences and the Company completed a private placement of 4,411,764 units of the Company at a price of $0.68 per unit, for gross proceeds of $3,000,000. Each unit was comprised of one Common Share and one common share purchase warrant of the Company, with each warrant entitling the holder to acquire an additional Common Share at an exercise price of $0.85 per share for a period of five years from the closing date. The TSXV approved the transaction and the shares were issued in November 2016.

As of December 31, 2016, Sciences holds an aggregate of 45,646,555 shares, representing 67.3% of the issued and outstanding Common Shares as at December 31, 2016 and 8,489,451 common share purchase warrants of the Company.

Change in Directors

In August 2016, Mr. David Raffa stepped down as a director of the Company and a new director, Mr. Bob Rai was appointed. Sciences reached an agreement directly with Mr. Raffa to purchase 4,407,708 Common

(Expressed in Canadian dollars)

9. RELATED PARTY TRANSACTIONS (continued)

Shares from Mr. Raffa. Pursuant to this agreement, Sciences purchased 2,203,854 Common Shares from Mr. Raffa in September 2016 and the remaining 2,203,854 Common Shares in October 2016.

Remuneration of directors and key management of the Company

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

	Year ended December 31, 2016	Year ended December 31, 2015
Wage and short-term benefits	369,528	312,383
Share-based payments (Note 10)	536,999	744,197
Total compensation of key management personnel	$ 906,527	$ 1,056,580

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

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

10. SHARE CAPITAL

Authorized

Unlimited number of Common Shares without par value

Unlimited number of preferred shares without par value, issuable in series

Issued

67,794,698 Common Shares (2015 – 46,070,841)

Nil preferred shares (2015 - nil)

The outstanding share capital has increased by 21,723,857 Common Shares since December 31, 2015 due to the following transactions:

- The debt conversion with Sciences in May 2016 for 8,097,651 Common Shares at a deemed price of $0.172 per share;

(Expressed in Canadian dollars)

10. SHARE CAPITAL (continued)

- The private placement with Sciences in September 2016 for 4,077,687 units of the Company at a price of $0.205 per unit, for gross proceeds of $835,926. Each unit was comprised of one Common Share and one common share purchase warrant of the Company, with each warrant entitling the holder to acquire an additional Common Share for a period of 24 months at an exercise price of $0.27;
- The debt conversion with Sciences in September 2016 for 4,494,955 Common Shares at a deemed price of $0.205 per share;
- The private placement with Sciences in November 2016 for 4,411,764 units of the Company at a price of $0.68 per unit, for gross proceeds of $3,000,000. Each unit was comprised of one common Share and one common share purchase warrant of the Company, with each warrant entitling the holder to acquire an additional Common Share at an exercise price of $0.85 for a period of five years from the closing date; and
- During the year ended December 31, 2016, 641,800 stock options were exercised ranging in exercise price from $0.175 to $0.72 for gross proceeds of $273,176.

Warrants

The Company issued the following common share purchase warrants in conjunction with private placements with Sciences. Under the residual value method, the warrants were ascribed a value of NIL.

	Number of Warrants	Weighted Average Exercise Price
Balance at December 31, 2015	-	-
Granted in September, 2016	4,077,687	$0.27
Granted in November, 2016	4,411,764	$0.85
Balance at December 31, 2016	8,489,451	$0.57

Surplus and Value Escrow Agreements

In September 2014, the Company entered into a Surplus Security Escrow Agreement and a Value Security Escrow Agreement in connection with the RTO pursuant to TSXV Policy 5.4 *Escrow, Vendor Consideration and Resale Restrictions*.

Approximately 59% of the initial outstanding Common Shares issued in September 2014 were subject to the Surplus Security Escrow Agreement and as of December 31, 2016, 14,921,222 (2015 - 21,703,596) Common Shares (55%) held under the Surplus Security Escrow Agreement remained in escrow. Approximately 11% of the initial Common Shares were subject to the Value Security Escrow Agreement and as of December 31, 2016, 1,520,256 (2015 – 3,040,508) Common Shares (30%) held under the Value Security Escrow Agreement remained in escrow.

(Expressed in Canadian dollars)

10. SHARE CAPITAL (continued)

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

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

In June 2015, the shareholders of the Company approved the termination, in certain circumstances, of the escrow agreements entered into by the Company. As of December 31, 2016, no specific transaction was being contemplated that would require the termination of the escrow agreements.

Share based payments

The Company has a stock option plan (the “Plan”) that is administered by the Board of Directors of the Company. The Board of Directors of the Company has the discretion to determine to whom options will be granted, the number and exercise price of such options and the terms and time frames in which the options will vest and be exercisable pursuant to the terms of the Plan and in accordance with policies of the TSXV. The exercise price of the options must be no less than the closing price on the day preceding the grant and the options may be exercisable for a period of up to ten years after the date of grant.

The maximum number of stock options available under the Plan is equal to 10% of the outstanding Common Shares from time to time. The number of Common Shares reserved for issue to any individual director, officer, employee or consultant will not exceed 5% of the number of then outstanding Common Shares and the number of Common Shares reserved for issue to any consultants or persons conducting investor relations activities will not exceed 2% of the number of then outstanding Common Shares.

(Expressed in Canadian dollars)

10. SHARE CAPITAL (continued)

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

	Number of Options	Weighted Average Exercise Price
Balance at December 31, 2014	2,950,000	$0.47
Granted	1,850,000	$0.44
Forfeited	(177,758)	$0.40
Expired	(272,242)	$0.59
Cancelled	(400,000)	$0.53
Balance at December 31, 2015	3,950,000	$0.44
Granted	2,725,000	$0.62
Forfeited	(25,000)	$0.72
Exercised	(641,800)	$0.43
Expired	(250,000)	$0.40
Balance at December 31, 2016	5,758,200	$0.53

During the year ended December 31, 2016, the Company granted 2,725,000 stock options to directors, employees and consultants under the Plan. The stock options granted had exercise prices of between $0.175 and $1.38, expiry dates of five years and vest over periods of up to three years. The fair values of the stock options were determined to be between $0.11 and $0.88.

Also during the year, 25,000 stock options were forfeited due to an employee termination and 250,000 stock options expired without being exercised.

The fair values of the options granted during the year ended December 31, 2016 were determined on the date of the grant using the Black-Scholes option pricing model with the following assumptions:

	Grant March 2016	Grant August 2016	Grant September 2016	Grant December 2016
Number of share options granted	300,000	400,000	1,950,000	75,000
Exercise price	$0.175	$0.335	$0.72	$1.38
Market value on grant date	$0.175	$0.335	$0.72	$1.38
Risk free interest rate	0.74%	0.66%	0.59%	1.04%
Expected life	5 years	5 years	5 years	4 years
Annualized volatility	80%	80%	80%	80%
Expected dividends	Nil	Nil	Nil	Nil

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

(Expressed in Canadian dollars)

10. SHARE CAPITAL (continued)

Stock options outstanding and exercisable at December 31, 2016 are summarized as follows:

Outstanding				Exercisable	
Exercise price	Quantity	Remaining contractual life (Years)	Weighted average exercise price	Quantity	Weighted average exercise price
$0.175	225,000	4.2	$ 0.175	8,333	$ 0.175
$0.335	360,000	2.7	$0.335	360,000	$0.335
$0.40	1,000,000	4.6	$ 0.40	855,556	$ 0.40
$0.41	300,000	3.1	$ 0.41	168,247	$ 0.41
$0.45	1,500,000	3.3	$ 0.45	1,500,000	$ 0.45
$0.55	381,500	2.9	$ 0.55	198,167	$ 0.55
$0.72	1,916,700	4.7	$ 0.72	885,450	$0.72
$1.38	75,000	5.0	$ 1.38	347	$1.38
	5,758,200	4.0	$ 0.53	3,976,100	$ 0.43

The Company recorded share-based compensation expense related to the incentive stock options of $680,788 (2015 - $1,176,401) for the year ended December 31, 2016. The expense has been charged to the consolidated statements of loss and comprehensive loss.

11. LOSS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the years ended December 31, 2016 and 2015:

	Year ended December 31, 2016	Year ended December 31, 2015
Numerator		
Net loss for the year	(2,940,501)	(3,497,271)
Denominator		
For basic and diluted - weighted average number of shares outstanding	54,264,687	46,070,841
Loss per share		
Basic	$ (0.05)	$ (0.08)
Diluted	$ (0.05)	$ (0.08)

(Expressed in Canadian dollars)

11. LOSS PER SHARE (continued)

The basic loss per share is computed by dividing the net loss by the weighted average number of Common Shares outstanding during the period. The diluted loss per share reflects the potential dilution of Common Share equivalents, such as outstanding stock options, and warrants, in the weighted average number of Common Shares outstanding during the year, if dilutive. For the year ended December 31, 2016, the Company was in a loss position and therefore all options are anti-dilutive.

12. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

The following table sets forth the changes in the non-cash operating working capital items for the years ended December 31, 2016 and 2015:

	December 31, 2016	December 31, 2015
Accounts receivable	13,439	408
Prepaid expenses	(5,047)	43,152
Inventory (Note 5)	(129,404)	(24,049)
Accounts payable and accrued liabilities	164,141	98,189
Accrued interest	(8,433)	8,433
Advances from related parties (Note 9)	81,632	16,064
	$ 116,328	$ 142,197

13. COMMITMENTS

The Company leases its production facility for $4,875 per month for an initial term from June 1, 2014 to May 31, 2019 with an option to renew for two additional five year terms. Additional premises for office space are leased for $5,190 per month, including common costs, for an initial term from March 1, 2017 to February 28, 2018 with an option to renew for an additional two year term, which the Company intends to exercise.

The Company entered purchase agreements with other Licensed Producers, based on volumes, to supplement inventory and a consulting agreement with a six-month term.

		Due by year ending			
	Total	**2017**	**2018**	**2019**	**2020**
Production facilities	$334,251	$111,113	$123,081	$89,245	$10,812
Purchase agreements	486,340	422,340	64,000	-	-
Consulting agreement	36,000	36,000	-	-	-
	$ 856,591	$569,453	$187,081	$89,245	$10,812

(Expressed in Canadian dollars)

14. FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are measured on an ongoing basis at fair value or amortized cost.

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

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

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

	December 31, 2016		**December 31,2015**	
	Fair Value	**Carrying Value**	**Fair Value**	**Carrying Value**
Financial Assets				
FVTPL:				
Cash	$3,217,205	$3,217,205	$81,836	$81,836
Loans and accounts, recorded at amortized cost:				
Accounts receivable	28,701	28,701	42,140	42,140
Financial Liabilities				
Other financial liabilities, recorded at amortized cost:				
Accounts payable and accrued liabilities	376,339	376,339	212,198	212,198
Due to related parties	97,696	97,696	981,077	972,677

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value hierarchy establishes three levels to classify the inputs to valuation techniques used to measure fair value as described below:

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

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

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

14. FINANCIAL INSTRUMENTS (continued)

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

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

	Carrying Value	Fair Value Measurement Level 1	Level 2	Level 3
As at December 31, 2016				
Financial Assets				
Cash	$ 3,217,205	$ 3,217,205	-	-
As at December 31, 2015				
Financial Assets				
Cash	$ 81,836	$ 81,836	-	-

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

<u>Currency risk</u>

The Company's functional and presentation currency is the Canadian dollar and major purchases are transacted in Canadian dollars. As a result, the Company's exposure to foreign currency risk is minimal.

<u>Credit risk</u>

The Company's cash is largely held in large Canadian financial institutions. The Company does not have any asset-backed commercial paper. The Company maintains cash deposits with Schedule A financial institutions, which from time to time may exceed federally insured limits. The Company's maximum exposure to credit risk as at December 31, 2016 is the carrying value of its financial assets.

<u>Interest rate risk</u>

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

(Expressed in Canadian dollars)

14. FINANCIAL INSTRUMENTS (continued)

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations associated with financial liabilities. As at December 31, 2016, the Company had positive working capital of $3,127,688 (2015 – negative working capital of $862,097), which is net of $97,696 (2015 - $955,067) owing to Sciences. Sciences agreed to provide funds as needed in order for the Company to continue to meet its ongoing financial obligations. The Company's ability to continue as a going concern is dependent on management's ability to raise required funding through future equity issuances and through short-term borrowing. The Company manages its liquidity risk by forecasting cash flows from operations and anticipating any investing and financing activities. Management and the Board of Directors are actively involved in the review, planning and approval of significant expenditures and commitments.

15. CAPITAL MANAGEMENT

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

16. INCOME TAXES

As the Company has recorded a net loss for accounting and income tax purposes in both 2016 and 2015, no current income tax expense has been recorded in these financial statements.

The income taxes shown in the Statements of Loss and Comprehensive Loss differ from the amounts obtained by applying statutory rates to the loss before income taxes due to the following:

	2016	**2015**
Statutory tax rate	26%	26%
Loss for the year before income taxes	$(2,940,501)	$(3,497,271)
Expected income tax recovery	(764,530)	(909,290)
Non-deductible items	127,047	307,732
Unrecognized deductible temporary differences	637,483	601,558
Deferred income tax expense	$ -	$ -

(Expressed in Canadian dollars)

16. INCOME TAXES (continued)

Deferred taxes reflect the tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes. Deferred tax assets (liabilities) at December 31, 2016 and 2015 are comprised of the following:

	2016	2015
Non-capital loss carry-forwards	1,696,687	920,227
Plant and equipment and intangibles	208	2,011
Cumulative eligible capital	14,873	15,992
Share issue costs	129,824	30,888
	1,841,592	969,118
Unrecognized deferred tax assets	(1,841,592)	(969,118)
Net deferred tax assets	$ -	$ -

The Company has operating losses carry forward of approximately $6,525,719 at December 31, 2016 (December 31, 2015 $3,539,000) which may be carried forward to apply against future year income tax for Canadian income tax purposes, subject to the final determination by taxation authorities, expiring in the following years:

Expire years	$
2033	13,424
2034	1,227,229
2035	2,641,914
2036	2,643,152
	6,525,719

17. SEGMENTED INFORMATION

The Company operates in one operating segment, being the production of medical marihuana pursuant to the Access to Cannabis for Medical Purposes Regulations. As at December 31, 2016 and 2015, all of the Company’s operations and assets are located in Canada.

18. RECLASSIFICATIONS

Certain amounts in the prior years’ financial statements have been reclassified to conform to the current period presentation. Intangible assets on the Consolidated Statements of Financial Position have been changed to disclose the information separately from plant and equipment. In addition, a portion of advances from related parties on the Consolidated Statements of Cash Flows was categorized as non-cash operating working capital versus financing activities.

(Expressed in Canadian dollars)

19. GENERAL AND ADMINISTRATIVE EXPENSES

	December 31, 2016	December 31, 2015
Wages and benefits	$ 504,422	$ 556,948
Professional and consulting fees	418,093	354,818
Office and general	201,831	590,001
Travel and accommodation	56,751	68,648
Interest on promissory note	39,678	8,433
Total general and administrative expenses	$ 1,220,775	$ 1,578,848

20. EVENTS AFTER THE REPORTING PERIOD

Financing - Prospectus Offering

On February 10, 2017, the Company completed a public financing of 10,235,000 units of the Company (each, a "Unit") on a "bought deal" basis pursuant to a supplement to a base shelf prospectus receipted in each of the provinces of Canada (other than Quebec) on January 25, 2017 at a price of $1.35 per Unit, for total gross proceeds of $13,817,250 (including the exercise in full of an over-allotment option) (the "Prospectus Offering").

Each Unit consisted of one Common Share and one-half of one common share purchase warrant of the Company. Each full warrant entitles the holder to acquire one Common Share at a price of $2.00 for a period of 24 months following the Closing Date, subject to acceleration. In the event that the closing sale price of the Common Shares on the TSXV is greater than $2.50 per share for a period of 20 consecutive trading days at any time after the closing of the Prospectus Offering, the Company may accelerate the expiry date of the warrants by giving notice to the holders thereof and in such case the warrants will expire on the 30th day after the date on which such notice is given by the Company.

In connection with the Prospectus Offering, the Company also issued to the underwriter of the Prospectus Offering a total of 307,050 compensation options. Each compensation option entitles the holder to acquire a Unit at a price of $1.35 per Unit for a period of 24 months following the closing of the Offering.

Issuance of Stock Options

Subsequent to the end of the year, the Company issued an aggregate of 875,000 stock options to purchase Common Shares, to various employees and consultants, at an average exercise price of $1.38 per share. In accordance with the Plan, the options vest over periods of up to three years and may be exercised over periods from one to five years, subject to forfeiture provisions requiring the options to expire 90 days after termination of the individual's employment.