CannTrust Holdings Inc.

December 31, 2016 and December 31, 2015

(Expressed in Canadian dollars)

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of CannTrust Holdings Inc.

We have audited the accompanying consolidated financial statements of CannTrust Holdings Inc., which comprise the statements of financial position as at December 31, 2016, December 31, 2015 and January 1, 2015, and the statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years ended December 31, 2016, December 31, 2015 and December 31, 2014, 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.

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 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, these consolidated financial statements present fairly, in all material respects, the financial position of CannTrust Holdings Inc. as at December 31, 2016, December 31, 2015 and January 1, 2015, and its financial performance and its cash flows for the years ended December 31, 2016, December 31, 2015 and December 31, 2014 in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates the existence of material uncertainties that may cast significant doubt about the company's ability to continue as a going concern.

Collins Barrow Toronto LLP

Chartered Professional Accountants
Licensed Public Accountants
August 11, 2017
Toronto, Ontario

CannTrust Holdings Inc.

Consolidated Statements of Financial Position
As at
(in Canadian dollars)

	December 31, 2016	Restated (Note 21) December 31, 2015	Restated (Note 21) January 1, 2015
Assets			
Current			
Cash (Note 5)	**$ 4,895,145**	$ 2,691,154	$ 2,471,493
Short term investments (Note 5)	-	300,000	500,000
Harmonized sales tax recoverable	**96,992**	54,028	118,683
Inventory (Note 6)	**3,674,635**	2,510,695	56,545
Biological asset (Note 6)	**2,320,093**	137,791	1,140,136
Accounts receivable	**140,015**	57,830	-
Prepaids	**497,975**	83,248	85,849
Total current assets	**11,624,855**	5,834,746	4,372,706
Non-current			
Investment (Note 16)	**19,313**	1	-
Restricted cash (Note 5)	**25,000**	25,000	25,000
Property and equipment (Note 7)	**5,209,440**	5,505,369	5,985,062
Total Assets	**16,878,608**	11,365,116	10,382,768
Liabilities			
Current			
Distributions payable on preference shares	-	1,667,663	806,663
Accounts payable and accrued liabilities	**2,570,965**	868,853	959,629
Convertible debt due on demand (Note 9)	**1,000,000**	-	-
Total current liabilities	**3,570,965**	2,536,516	1,766,292
Non-current liabilities			
Convertible debt (Note 9)	**1,463,947**	1,175,908	-
Class A preference shares (Note 12)	-	7,070,589	7,070,589
Redeemable shares (Note 10)	-	8,793,398	8,765,638
Derivative liability (Note 9)	**1,375,447**	1,601,345	-
Total Liabilities	**6,410,359**	21,177,756	17,602,519
Shareholders' Equity (Deficit)			
Share capital (Note 11)	**53,916,169**	6,684,903	5,744,491
Warrants (Note 13)	**3,027,398**	1,949,501	-
Deficit	**(46,475,318)**	(18,041,464)	(12,964,242)
Equity attributable to shareholders of the Company	**10,468,249**	(9,407,060)	(7,219,751)
Non-controlling interest	-	(405,580)	-
Total Shareholders' Equity (Deficit)	**10,468,249**	(9,812,640)	(7,219,751)
Total Liabilities and Shareholders' Equity	**$ 16,878,608**	$ 11,365,116	$ 10,382,768

Nature of Operations and Going Concern Assumption (Note 1)
Commitments (Note 14)
Subsequent Events (Note 20)

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

(signed) "Eric Paul" Director   (signed) "Mark Litwin" Director

CannTrust Holdings Inc.

Consolidated Statements of Loss and Comprehensive Loss
For the Years Ended December 31, 2016, December 31, 2015 and December 31, 2014
(in Canadian dollars)

	December 31, 2016	Restated (Note 21) December 31, 2015	Restated (Note 21) December 31, 2014
Revenue	**$ 4,382,088**	$ 608,768	$ -
Unrealized gain on changes in fair value of biological assets (Note 6)	**(6,838,140)**	(1,902,673)	(917,600)
Inventory write-off (Note 6)	**1,103,121**	-	-
Inventory expensed to cost of sales	**4,214,385**	635,867	-
Production costs	**3,121,848**	1,145,023	603,133
Expense (Recovery) to cost of sales, net of unrealized gain on changes in fair value of biological assets	**1,601,214**	(121,783)	(314,467)
Gross margin, including the unrealized gain on changes in fair value of biological assets	**2,780,874**	730,551	314,467
Expenses			
Amortization (Note 7)	**379,750**	1,152,503	474,543
Consultants	**29,445**	9,900	200,224
General and administrative	**727,554**	281,647	292,668
Loss on disposal of property and equipment (Note 7)	**32,816**	135,000	35,600
Management fees (Note 15)	**590,000**	520,000	331,197
Marketing and promotion	**329,866**	764,126	433,659
Professional fees	**355,768**	378,100	292,610
Rent and facilities	**83,870**	309,490	281,258
Salaries and benefits	**1,589,308**	1,889,906	1,161,219
Share based compensation	**72,000**	-	-
Loss on Equity Accounted Investment (Note 16)	**147,442**	-	-
Expenses before Financing Activities and Transaction Costs	**4,337,819**	5,440,672	3,502,978
Loss from Operations before Financing Activities and Transaction Costs	**(1,556,945)**	(4,710,121)	(3,188,511)
Interest and other expenses	**(473,961)**	(234,942)	7,153
Accretion expense	**(276,413)**	(60,766)	-
Distributions on preference shares	**(1,355,022)**	(861,000)	(806,663)
Transaction costs (Note 9)	**(396,377)**	(1,038,265)	-
Gain on revaluation of derivative liability (Note 9)	**245,657**	112,884	-
Loss on revaluation of redeemable shares (Note 10)	**(9,806,882)**	(27,760)	(8,765,636)
Net Loss and Comprehensive Loss	**$ (13,619,943)**	$ (6,819,970)	$ (12,753,657)
Net Loss and Comprehensive Loss Attributable to:			
Equity shareholders of the Company	**(12,815,159)**	(6,414,390)	(12,753,657)
Non-controlling interest	**(804,784)**	(405,580)	-
	(13,619,943)	(6,819,970)	(12,753,657)
Loss per share attributable to parent company			
Basic and diluted	**$ (0.30)**	$ (0.17)	$ (0.37)
Weighted average number of common shares outstanding	**42,597,871**	36,836,063	34,316,232

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

CannTrust Holdings Inc.

Consolidated Statements of Changes in Shareholders' Equity
For the Years Ended December 31, 2016 and December 31, 2015
(in Canadian dollars)

	Share Capital						
	Number of Common Shares	**Amount - Common Shares**	**Warrants**	**Deficit**	**Equity before Non-Controlling Interest**	**Non-Controlling Interest**	**Total**
CannTrust Inc. Balance, December 31, 2014	**29,296,313**	**$ 5,744,491**	**$ -**	**$ (12,964,242)**	**$ (7,219,751)**	**$ -**	**$ (7,219,751)**
January 2015 share issuance	222,222	200,000	-	-	200,000	-	200,000
Transfer to CannTrust Holdings Inc. (Note 1)	(2,759,909)	(1,337,168)	-	1,337,168	-	-	-
August 2015 Share cancellation (Note 11)	(200,000)	(1)	-	-	(1)	-	(1)
August 2015 Share issuance (Note 11)	675,000	497,500	-	-	497,500	-	497,500
August 2015 Warrants issued with convertible debt (Note 13)	-	-	1,169,779	-	1,169,779	-	1,169,779
November 2015 Share issuance (Note 11)	140,000	126,000	-	-	126,000	-	126,000
December 2015 Share issuance (Note 11)	2,222,222	1,454,081	-	-	1,454,081	-	1,454,081
December 2015 warrants issued with convertible debt (Note 13)	-	-	233,803	-	233,803	-	233,803
December 2015 warrants issued in private placement (Note 13)	-	-	545,919	-	545,919	-	545,919
Net loss and comprehensive loss	-	-	-	(6,414,390)	(6,414,390)	(405,580)	(6,819,970)
CannTrust Holding Inc. Balance, December 31, 2015	**29,595,848**	**$ 6,684,903**	**$ 1,949,501**	**$ (18,041,464)**	**$ (9,407,060)**	**$ (405,580)**	**$ (9,812,640)**
February 2016 Pre-emptive Rights Issuance (Note 11)	35,646	32,081	-	-	32,081	-	32,081
February 2016 warrants issued with convertible debt (Note 13)	-	-	15,922	-	15,922	-	15,922
February 2016 Share issuance to Employees (Note 11)	50,000	45,000	-	-	45,000	-	45,000
August 2016 Shares issuance as partial consideration for Bridge Financing (Note 11)	200,000	180,000	-	-	180,000	-	180,000
September 2016 Shares issuance as partial consideration for Bridge Financing (Note 11)	200,000	180,000	-	-	180,000	-	180,000
September 2016 Share issuance to Employee (Note 11)	30,000	27,000	-	-	27,000	-	27,000
October 2016 Shares issued in exchange for Class A Preferred Shares of CannTrust Inc. (Note 11)	9,039,317	8,135,386	-	(8,262,438)	(127,052)	-	(127,052)
Net loss and comprehensive loss before non-controlling interest settlement	-	-	-	(11,516,088)	(11,516,088)	(804,784)	(12,320,872)
November 2016 Shares issued to non-controlling interest of CannTrust Inc. in exchange for Shares of CannTrust Holdings Inc. (Note 11)	2,759,909	2,483,918	-	(3,694,282)	(1,210,364)	1,210,364	-
December 2016 Private Placement (Note 11)	3,416,208	4,441,070	-	-	4,441,070	-	4,441,070
December 2016 Share issuance in lieu of services (Note 11)	403,846	525,000	-	-	525,000	-	525,000
December 2016 Share issuance in consideration of surrender of Put Option (Note 11)	22,265,145	31,420,729	1,061,975	(3,661,975)	28,820,729	-	28,820,729
Share issuance costs	-	(238,918)	-	-	(238,918)	-	(238,918)
Net loss and comprehensive loss after non-controlling interest settlement	-	-	-	(1,299,071)	(1,299,071)		(1,299,071)
CannTrust Holdings Inc. Balance, December 31, 2016	**67,995,919**	**$ 53,916,169**	**$ 3,027,398**	**$ (46,475,318)**	**$ 10,468,249**	**$ -**	**$ 10,468,249**

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

CannTrust Holdings Inc.

Consolidated Statements of Cash Flows
For the Years Ended December 31, 2016 and December 31, 2015
(in Canadian dollars)

	December 31, 2016	Restated (Note 21) December 31, 2015	Restated (Note 21) December 31, 2014
Operating Activities			
Net loss	**$ (13,619,943)**	$ (6,819,970)	$ (12,753,657)
Items not effecting cash			
Amortization	**379,750**	1,152,503	474,543
Accretion expense	**276,413**	60,766	-
Gain on revaluation of biological assets	**(6,838,140)**	(1,902,673)	(917,600)
Inventory write-off	**1,103,121**	-	-
Loss on disposal of property and equipment	**32,816**	135,000	35,600
Loss on Equity Accounted Investment	**147,442**	-	-
Gain on revaluation of derivative liability	**(245,657)**	(112,884)	-
Loss on revaluation of redeemable shares	**9,806,882**	27,760	8,765,636
Non-cash transaction costs for convertible debt	**6,513**	700,759	-
Expenses settled with issuance of common shares	**957,000**	523,500	-
	(7,993,803)	(6,235,239)	(4,395,478)
Changes in non-cash working capital			
Harmonized sales tax recoverable	**(42,964)**	64,655	(27,144)
Inventory	**(1,176,230)**	(2,454,149)	(228,546)
Biological assets	**4,655,838**	2,905,018	(50,535)
Accounts receivable	**(82,185)**	(57,830)	-
Prepaids	**(414,726)**	2,600	184,304
Accounts payable and accrued liabilities	**1,702,481**	289,223	929,244
Distribution payable on preference shares	**1,355,022**	861,000	806,663
Cash flows used in operating activities	**(1,996,566)**	(4,624,722)	(2,781,492)
Investing Activities			
Purchase of property and equipment	**(1,207,840)**	(707,810)	(5,631,411)
Disposal of property and equipment	-	-	8,425
Advances to/investment in Joint Venture	**(166,755)**	-	-
Redemption of Short term investments	**300,000**	200,000	-
Cash flows used in investing activities	**(1,074,594)**	(507,810)	(5,622,986)
Financing Activities			
Issuance of shareholder debt	-	800,000	300,000
Repayment of shareholder debt	-	(200,000)	(300,000)
Proceeds from issuance of convertible debt, net of transaction costs	**1,040,918**	2,552,194	-
Issuance of share capital, net of share issue costs	**4,234,233**	2,199,999	5,744,293
Restricted cash held as collateral on credit card financing	-	-	(25,000)
Issuance of Class A preferred shares, net of share issue costs	-	-	5,070,589
Cash flows provided by financing activities	**5,275,152**	5,352,193	10,789,882
Net increase in cash	**2,203,991**	219,661	2,385,404
Cash, at beginning of year	**2,691,154**	2,471,493	86,089
Cash, at end of year	**$ 4,895,145**	$ 2,691,154	$ 2,471,493
Supplementary information			
Interest paid	**$ -**	$ -	$ 122,693
Interest received	**5,746**	-	12,847
Redeemable shares issued to settle preference shares	**10,220,450**	-	-
Common shares issued to settle preference shares	**8,135,386**	-	-
Warrants issued for the surrender of Put Right	**1,061,975**	-	-
Common shares issued to surrender put right	**2,600,000**	-	-
Common shares issued to NCI shareholders	**2,483,918**	-	-
Non-cash purchase of property and equipment	-	100,000	-
Convertible debt issued to settle shareholder debt	-	600,000	-

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

1. NATURE OF OPERATIONS AND GOING CONCERN ASSUMPTION

Nature of Operations

CannTrust Holdings Inc. ("CannTrust" or the "Company") is a Canadian company incorporated in Ontario on March 16, 2015. The Company is the parent company of CannTrust Inc., a Canadian Company incorporated in Ontario on August 16, 2013 and Elmcliffe Investments Inc., a Canadian Company incorporated on October 31, 2013. On April 30, 2015, CannTrust Inc. and the Company completed a share reorganization, whereby the Company became the parent company and majority shareholder of CannTrust Inc.

The Company is a licensed producer and distributor of medical cannabis in Canada pursuant to the provisions of the Access to Cannabis for Medical Purposes Regulations (“ACMPR”) and the Controlled Drugs and Substances Act and its Regulations. The Company began production of medicinal cannabis at its hydroponic facility located in Vaughan, Ontario in Canada and received its license from Health Canada to sell on February 9, 2015. The Company commenced sale of medicinal cannabis under the MMPR in February 2015.

The registered head office of the Company is in 3280 Langstaff Road, Building 1, Unit 1, Vaughan, Ontario, L4K 5B6.

Going Concern Assumption

The consolidated financial statements have been prepared on the going concern basis, which assumes that the Company will continue to operate for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business.

During the year ended December 31, 2016, the Company had generated revenue of $4,382,088 (2015 - $608,768, 2014 -Nil), but continues to be in a loss position, with a net loss of $13,619,943 (2015 - $6,819,970, 2014 - $12,753,657). Cash flows used in operating activities during the year ended December 31, 2016 were $1,996,566 (2015 – $4,624,722, 2014 - $2,781,492). These conditions indicate the existence of uncertainties that may cast doubt on the Company’s ability to continue as a going concern.

Included in the net loss of $13,619,943 for the year ended December 31, 2016 is a non-cash loss on revaluation of redeemable shares of $9,806,882 (2015 - $27,760, 2014 - $8,765,636). In December 2016, these redeemable shares with a fair value of $28,820,730 were reclassified as Common shares and included as Equity (see note 10(iii)).

The continued operations of the Company are dependent on its ability to generate future cash flows or obtain additional financing. As a result of the recent successful completion by the Company of a private placement on February 17, 2017 with aggregate proceeds of $25,168,200 (see note 20(iii)) together with the revenues being achieved by the Company subsequent to year end, Management is of the opinion that the Company has sufficient working capital to meet the Company’s liabilities and commitments as they become due in the normal course of business. Should additional financing be required, this may not be available on a timely basis or on terms acceptable to the Company.

The consolidated financial statements do not reflect adjustments that would be necessary if the going concern basis was not appropriate. Consequently, adjustments would then be necessary to the carrying value of assets and liabilities, the reported revenues and expenses and the balance sheet classifications used. Such adjustments, if required, could be material.

(in Canadian dollars)

2. BASIS OF PRESENTATION

Statement of Compliance

These consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and the interpretations of the IFRS Interpretations Committee (“IFRIC”). These consolidated financial statements were authorized for issue by the Board of Directors on August 11, 2017.

Continuity of Interest Basis of Accounting

On April 30, 2015 CannTrust Inc. and the Company completed a share reorganization rollover, whereby the Company became the parent company and majority shareholder of CannTrust Inc. The Company was incorporated on March 16, 2015 and was set up to complete this transaction. CannTrust Holdings Inc. did not have any other assets and liabilities prior to the transaction, and the transaction did not result in a change of control on a consolidated basis. Accordingly, the historical results and other characteristics of CannTrust Inc. are presented in the consolidated financial statements of CannTrust Holdings Inc. as a continuity of interest of CannTrust Inc.

Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries CannTrust Inc. and Elmcliffe Investments Inc. All intercompany transactions and balances have been eliminated. The financial statements of the subsidiary were consolidated in accordance with the continuity of interest basis of accounting.

The Company has control of the subsidiary and during the year there was a 7.2% non-controlling interest. On November 23, 2016, the Company entered into an agreement with the non-controlling shareholders to issue 2,759,909 common shares of CannTrust Holdings, in exchange for 2,759,909 common shares previously held in CannTrust Inc. Effective November 23, 2016, the Company owned 100% of the subsidiary. During the year, $804,784 (2015 - $405,580) of net loss and comprehensive loss was attributable to the non-controlling interest, and the accumulated non-controlling interest as at December 31, 2016 was $Nil (2015 - $405,580).

The table below provides selected financial information for the Company’s subsidiary, CannTrust Inc., on a 100% basis.

	December 31, 2016	December 31, 2015
Revenue	**$ 4,382,088**	$ 595,465
Loss and comprehensive loss	**(2,147,705)**	(5,668,782)
Current assets	**11,636,297**	5,834,932
Non-current assets	**5,379,196**	5,505,370
Current liabilities	**1,916,260**	2,393,623
Non-current liabilities	-	7,070,589

2. BASIS OF PRESENTATION (continued)

Basis of Consolidation (continued)

The audited consolidated financial statements, presented in Canadian Dollars, have been prepared on a historical cost basis except for certain financial instruments and biological assets, which are measured at fair value, as explained in the accounting policies set out in Note 3.

Functional Currency Translation

All figures presented in the consolidated financial statements and tabular disclosures to the consolidated financial statements are reflected in Canadian dollars, which is the functional currency of the Company and its subsidiary.

Foreign currency transactions are translated using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the foreign exchange rate applicable at the statement of financial position 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 costs in a foreign currency are translated used the exchange rate at the date of the transaction.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Cash

Cash includes cash on deposit at banking institutions and cash held in trust.

b. Short-term investments

Short-term investments are comprised of GIC's with terms to maturity of between three and twelve months or can be redeemed without penalty within 12 months from issuance.

c. Property and Equipment

Property and equipment are measured at historical cost less accumulated amortization and impairment losses if applicable. Amortization is provided using the following methods and terms:

Leasehold improvements	Straight-line	10 years
Equipment (Plant, Laboratory)	Straight-line	5 years
Computer equipment	Straight-line	3 years
Computer software	Straight-line	1 year
Furniture and fixtures	Straight-line	5 years

Property and equipment's estimated residual value, useful life and amortization method are reviewed at the end of each reporting period and adjusted if necessary. When parts of an item of property and equipment have different useful lives, they are accounted for as separate components of property and equipment.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

c. Property and Equipment (continued)

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

Mother plants, or bearer plants, are plants grown for the purpose of taking cuttings in order to grow more quantity of the same plant. Bearer plants are critical to the success of the business, however, are not measured for accounting purposes. Bearer plants are plants that, once mature, are held solely to grow produce over their useful life.

d. Impairment of Property and Equipment

Property and equipment are reviewed for impairment at the end of each reporting period and tested for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount of property and equipment is the greater of fair value less costs to sell and value in use. In assessing value in use, 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. Impairment losses are recognized through profit or loss.

Impairment losses may be reversed in a subsequent period where the impairment no longer exists or has decreased. The carrying amount after a reversal must not exceed the carrying amount (net of amortization) that would have been determined had no impairment loss been recognized. A reversal of impairment loss is recognized through profit and loss.

e. Investment in Joint Arrangement

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Investments in a joint venture are accounted for using the equity method and are initially recognized at cost. The entire carrying amount of the investment is tested for impairment annually.

f. Leases

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

g. Revenue Recognition

Revenue is recognized at the fair value of consideration received or receivable. Revenue from the sale of goods is generally recognized when shipped, which is generally when all 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 amounts of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the entity;
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

h. Convertible Debentures

The proceeds received on issuance of the Company's convertible debentures have been recorded as a liability on the consolidated statement of financial position. The Company has convertible debentures containing embedded derivative liabilities, which have been designated as a financial liability at fair value through profit and loss. Upon initial recognition, the fair value of the derivative liabilities were estimated using the Black-Scholes option valuation model, with the residual allocated to the principal debt. The Company revalues the derivative liability using the Black-Scholes option valuation model at each reporting period.

i. 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 market value. Unrealized gains or losses arising from changes in fair value less cost to sell during the year are included in the gross margin, including the unrealized gain on changes in fair value of biological assets, in the statement of loss and comprehensive loss.

j. Inventory

Inventories of work-in-process dried cannabis, harvested finished goods, oil and packing materials 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. Products for resale and supplies are valued at cost.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

k. Share Capital

An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all of its liabilities. Equity instruments issued by the Company are recorded at the proceeds received, net of issue costs.

For unit offerings, the Company has adopted the relative fair value method with respect to measurement of shares and warrants issued as equity units. The relative fair value method requires an allocation of the net proceeds received based on the pro rata relative fair values of the components. The fair value of the warrants is estimated using the Black-Scholes option valuation model.

Preference share capital is classified as equity if it is non-redeemable, or redeemable only at the Company's option, and any dividends are discretionary. Dividends thereon are recognized as distributions within equity upon approval by the Company's shareholders. Preference share capital is classified as a liability if it is redeemable on a specific date or at the option of the shareholders, or if dividend payments are not discretionary. Dividends thereon are recognized as distributions in profit or loss as accrued.

l. Redeemable Shares

Redeemable shares are classified as equity if they are redeemable only at the Company's option. Redeemable shares are classified as a liability if they are redeemable on a specific date or at the option of the shareholders. Redeemable shares are measured at fair value, with any resulting gain or loss recognized in profit or loss. The redeemable shares are revalued at each reporting period, until settlement.

m. Share Issuance Costs

Costs incurred in connection with the issuance of share capital are netted against the proceeds received, net of tax. Costs related to the issuance of share capital and incurred prior to issuance are recorded as deferred share issuance costs and subsequently netted against proceeds when they are received.

n. Research and Development

Research costs are expensed as incurred and are included in general and administrative expenses in the statement of loss and comprehensive loss. 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 through profit and loss as incurred. To date no development costs have been capitalized.

o. Income Taxes

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at year end, adjusted for amendments to tax payable with regards to previous years.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

o. Income Taxes (continued)

Deferred tax is provided using the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are recognized for future tax consequences attributable to temporary differences between the financial statement carrying value and tax basis of assets and liabilities and the benefit of tax losses available to be carried forward for tax purposes.

Deferred tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred income tax assets are recorded in the consolidated financial statements if realization is considered probable. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the year that the rate changes.

p. Share-based payments

In situations where equity instruments are issued to non-employees, shares issued are recognized at the fair value of services or goods received by the entity. In situations where some or all of the goods or services received by the entity as consideration cannot be estimated reliably, they are measured at the fair value of the equity instrument granted. The fair value of the share based payments is recognized together with a corresponding increase in equity over a period that services are provided or goods are received.

q. Share-based compensation - Employees

The Company has an employee stock option plan (“ESOP”) in place. 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. Fair value is measured using the Black-Scholes option pricing model. Expected forfeitures are estimated at the date of grant and subsequently adjusted if further information indicates actual forfeitures may vary from the original estimate. Any revisions are recognized in the consolidated statements of income and comprehensive income such that the cumulative expense reflects the revised estimate.

r. Loss per Share

The Company presents basic and diluted earnings per share for its common shares. Basic earnings per share is calculated by dividing the profit or loss attributable to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all diluted potential common shares. As the effect of all outstanding warrants and convertible debentures are anti-dilutive during a year when the Company incurs a loss, diluted earnings per share do not differ from basic loss per share.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

s. Financial Instruments

Financial Assets

All financial assets 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 of the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

The Company classifies its financial assets as fair value through profit or loss ("FVTPL"), loans and receivables, held to maturity or available for sale. A financial asset is classified at FVTPL if it is classified as held for trading or is designated as such upon initial recognition. Financial assets classified as FVTPL are measured at fair value with any resultant gain or loss recognized in profit or loss. Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Subsequent to initial recognition, loans and receivables are measured at amortized cost using the effective interest rate method, less any impairment losses. As at December 31, 2016 and December 31, 2015, the Company has not classified any financial assets as held to maturity or available for sale.

Transaction costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

Financial Liabilities

All financial liabilities 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 FVTPL or other liabilities. Financial liabilities classified as FVTPL are measured at fair value with any resultant gain or loss recognized in profit or loss. Transaction costs associated with FVTPL financial liabilities are expensed as incurred. Financial liabilities classified as other financial liabilities are initially measured at fair value less directly attributable transaction costs, and are subsequently measured at amortized cost using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

s. Financial Instruments (continued)

Classification of Financial Instruments

The Company has classified its financial instruments as follows:

Cash	FVTPL
Accounts receivable	Loans and receivables
Due from related parties	Loans and receivables
Restricted cash	FVTPL
Short-term investments	Loans and receivables
Accounts payable and accrued liabilities	Other financial liabilities
Convertible debt	Other financial liabilities
Class A preference shares	Other financial liabilities
Redeemable shares	FVTPL
Derivative liability	FVTPL
Distributions payable on preference shares	Other financial liabilities

Fair Value Measurement

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.

The Company categorizes its assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs used in the measurement.

Level 1: This level includes assets and liabilities measured at fair value based on unadjusted quoted prices for identical assets and liabilities in active markets that are accessible at the measurement date.

Level 2: This level includes valuations determined using directly or indirectly observable inputs other than quoted prices included within Level 1. Derivative instruments in this category are valued using models or other standard valuation techniques derived from observable market inputs.

Level 3: This level includes valuations based on inputs which are less observable, unavailable or where the observable data does not support a significant portion of the instruments' fair value.

The Company designated its cash and restricted cash as fair value through profit and loss, which are measured at fair value and classified as level 1. The Company designated the derivative liability from convertible debentures and redeemable shares as fair value through profit and loss, which are measured at fair value and classified as level 2.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

s. Financial Instruments (continued)

Cash and restricted cash are classified as level 2, and biological assets are classified as level 3.

The carrying values of the Company's accounts receivables, class A preference shares, accounts payable and accrued liabilities and convertible debt due on demand approximate their fair value due to the relatively short periods to maturity of these instruments.

There were no transfers of amounts between levels during the year.

t. 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 or common significant influence, 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. Related party transactions are measured at the exchange amounts being the amounts agreed to by the parties.

u. Segment Reporting

A segment is a component of the Company that i) engages in business activities from which it may earn revenue and incur expenses, ii) whose operating results are reviewed by the board of directors and iii) for which discrete financial information is available. Throughout the years ended December 31, 2016 and December 31, 2015, the Company operated in one segment, the production and sale of medicinal cannabis in Canada.

v. New Accounting Standards to be Adopted in the Future

At the date of authorization of these consolidated financial statements, the IASB and IFRIC has issued the following new and revised Standards and Interpretations which are not yet effective for the relevant reporting periods and which the Company has not early adopted. However, the Company is currently assessing what impact the application of these standards or amendments will have on the consolidated financial statements of the Company.

- IFRS 9 'Financial Instruments: Classification and Measurement', introduces new requirements for the classification and measurement of financial instruments, a single forward-looking expected loss impairment model and a substantially reformed approach to hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Management has not yet considered the potential impact of the adoption of IFRS 9.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

v. New Accounting Standards to be Adopted in the Future (continued)

- IFRS 15 'Revenue from Contracts with Customers' was issued by the IASB in June 2014. The objective of IFRS 15 is to provide a single, comprehensive revenue recognition model for all contracts with customers. The underlying principle is that an entity will recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. It also contains new disclosure requirements. IFRS 15 will be effective for the Company on January 1, 2018, with early adoption permitted. Management has not yet considered the potential impact of the adoption of IFRS 15.

- IFRS 16 'Leases' 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. Management has not yet considered the potential impact of the adoption of IFRS 16.

w. New Standards Adopted in Current Year

- IAS 16 'Property, Plant and Equipment' and IAS 41 'Agriculture' were amended by the IASB in June 2014. Amendments include bringing bearer plants within the scope of IAS 16, instead of IAS 41, because their operation is similar to that of manufacturing. The produce growing on bearer plants will remain within the scope of IAS 41. The effective date is for annual periods beginning on or after January 1, 2016. The adoption of these amendments in 2016 did not result in a significant change from its previous policy, as the carrying value of bearer plants is negligible.

4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of these consolidated financial statements in accordance with IFRS requires management to make estimates and assumptions based on management's best knowledge of current events and actions that the Company may undertake in the future. Actual results could differ from those estimates. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and the revision affects both current and future periods.

Significant judgments include the following:

(i) Assessing whether material uncertainties exist which would cause doubt about the Company's ability to continue as a going concern. Refer to Note 1.

(ii) Assessing whether a joint arrangement is a joint operation or a joint venture. Refer to Note 16.

(iii) The valuation and recoverability of deferred taxes. The Company has determined that the realization of certain income tax losses carried forward are not yet probable and has not recorded a deferred income tax asset relating to those losses. Refer to Note 17.

(iv) Classification/presentation of convertible debentures.

(v) Classification of preference shares and redeemable shares.

(in Canadian dollars)

4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS (continued)

Significant estimates include the following:

i. The valuation of inventory at the lower of cost and net realizable value. Refer to Note 6.

ii. The valuation of biological assets, including estimating the stage of growth up to the point of harvest, harvesting costs, selling costs, sales price, wastage and expected yields per plant. Refer to Note 6.

iii. The estimated useful lives and residual values of Property and Equipment and related amortization included in profit and loss, as well as impairment on property and equipment. Refer to Note 7.

iv. Valuation of shares issued in exchange for goods and services. Refer to Note 11.

v. Valuation of warrants and conversion option. Refer to Note 13.

vi. Valuation of redeemable shares. Refer to Note 10.

5. CASH AND SHORT-TERM INVESTMENTS

	December 31, 2016	December 31, 2015	January 1, 2015
Cash	**$ 4,895,145**	$ 2,691,154	$ 2,471,493
Short-term investment - GIC (i)	-	300,000	500,000
Restricted cash - GIC held as collateral (ii)	**25,000**	25,000	25,000
Total cash and short-term investments	**$ 4,920,145**	$ 3,016,154	$ 2,996,493

(i) The GIC was issued on December 19, 2013 and matured on December 19, 2016.

(ii) $25,000 GIC is held by the bank as collateral against credit cards issued to management of the Company at an interest rate of 1.35%. The credit card have a combined credit limit of $30,000.

The Company has a letter of credit with a large Canadian financial institution, for up to $300,000. The letter of credit has a one year expiry from the date of issue, and an automatic annual extension with 30 days' notice. The letter of credit is required as a covenant to the building lease agreement in the event of a default in lease payments. No funds have been drawn from the credit facility as at January 1, 2015, December 31, 2015 or December 31, 2016.

(in Canadian dollars)

6. INVENTORY AND BIOLOGICAL ASSETS

The Company's biological assets consist of seeds and medical cannabis plants. The continuity of the Company's biological assets for the year ended December 31 is as follows:

		December 31, 2016		December 31, 2015
Carrying amount, January 1	**$**	**137,791**	$	1,140,136
Seeds purchased (used)		**(1,611)**		61,305
Changes in fair value less costs to sell due to biological transformation		**6,838,140**		1,902,673
Transferred to inventory upon harvest		**(4,654,226)**		(2,966,323)
Carrying amount, December 31	**$**	**2,320,093**	$	137,791

As at December 31, 2016, included in the carrying amount of biological assets is $26,295 of seeds (2015 - $27,906, January 1, 2015 - $33,155) and $ 2,293,798 of live plants (2015 - $109,885, January 1, 2015 - $1,106,980).

Biological assets are classified as level 3 in the fair value hierarchy. There have been no transfers between levels. The significant assumptions used in determining the fair value of medical cannabis plants are as follows:

- wastage of plants based on their various stages;
- yield by plant;
- price per gram of yield;
- percentage of costs incurred to date compared to the costs to be incurred are used to estimate fair value of an in-process plant; and
- percentage of costs incurred for each stage of plant growth was estimated.

All of the plants are to be harvested as agricultural produce (i.e. medical cannabis) and all of the plants, on average, were 33% from harvest as at December 31, 2016 (2015 – 52%, January 1, 2015 – 11%).

The Company estimates the harvest yields for the plants at various stages of growth. As at December 31, 2016, it is expected that the Company's biological assets will yield approximately 450,000 grams (2015 - 135,000 grams, January 1, 2015 - 440,000) of biological produce, with selling prices ranging from $7.00 to $12.50 per gram, before discounts for patient assistance programs to eligible low-income patients. The Company's estimates are, by nature, subject to change. Changes in the anticipated yield will be reflected in future changes in the gain or loss on biological assets. The Company performed a sensitivity analysis on the fair value of biological assets and noted that a 10% decrease in selling prices would result in a $331,915 (2015 - $21,000, January 1, 2015 - $110,000) decrease in the fair value of the biological assets.

Inventories on hand consist of harvested finished goods, harvested cannabis in process, cannabis oils, vaporizers and packaging materials and are valued at the lower of cost and net realizable value. As at December 31, 2016, the Company held 321,517 grams of dry cannabis (2015 – 673,549, January 1, 2015 - Nil) and 226,744 grams of cannabis oils (2015 – Nil, January 1, 2015 - Nil).

(in Canadian dollars)

6. INVENTORY AND BIOLOGICAL ASSETS (continued)

Inventory is comprised of the following items:

	December 31, 2016	December 31, 2015	January 1, 2015
Vaporizors	**$ 17,002**	$ 24,380	$ -
Finished goods	**956,227**	868,383	-
Work-in-process	**2,628,509**	1,580,291	-
Packaging and labels	**72,897**	37,641	56,545
Total inventory	**$ 3,674,635**	$ 2,510,695	$ 56,545

As at December 31, 2016, included in the carrying amount of finished goods is $700,543 of dry cannabis (2015 - $868,383, January 1, 2015 - Nil) and $255,684 of cannabis oils (2015 - Nil, January 1, 2015 - Nil). As at December 31, 2016, included in the carrying amount of work-in-process is $1,503,700 of dry cannabis (2015 - $1,580,291, January 1, 2015 - Nil) and $1,124,809 of cannabis oils and coconut oil (2015 - $0, January 1, 2015 - Nil).

During the year, $1,103,121 of work-in-process and finished goods inventory was destroyed and written down to Nil.

7. PROPERTY AND EQUIPMENT

	Leasehold Improvements	Equipment	Furniture and Fixtures	Computer Hardware	Computer Software	Total
Balance at December 31, 2014	**$ 2,460,032**	**$ 3,722,708**	**$ 134,678**	**$ 127,964**	**$ 10,587**	**$ 6,455,969**
Additions	160,047	459,290	15,385	17,186	155,902	807,810
Disposals	-	(150,000)	-	-	-	(150,000)
Balance at December 31, 2015	**$ 2,620,079**	**$ 4,031,998**	**$ 150,063**	**$ 145,150**	**$ 166,489**	**$ 7,113,779**
Additions	176,277	843,155	74,690	40,180	73,537	1,207,840
Write-offs		(59,666)				(59,666)
Balance at December 31, 2016	**$ 2,796,356**	**$ 4,815,487**	**$ 224,753**	**$ 185,330**	**$ 240,026**	**$ 8,261,952**
Accumulated Amortization						
December 31, 2014	**$ (82,031)**	**$ (315,004)**	**$ (25,737)**	**$ (37,732)**	**$ (10,403)**	**$ (470,907)**
Amortization	(257,425)	(784,007)	(29,202)	(46,214)	(35,655)	(1,152,503)
Disposals	-	15,000	-	-	-	15,000
Balance at December 31, 2015	**$ (339,456)**	**$ (1,084,011)**	**$ (54,939)**	**$ (83,946)**	**$ (46,058)**	**$ (1,608,410)**
Amortization	(272,986)	(911,341)	(39,691)	(55,264)	(191,671)	(1,470,952)
Write-offs	-	26,850	-	-	-	26,850
Balance at December 31, 2016	**$ (612,441)**	**$ (1,968,502)**	**$ (94,630)**	**$ (139,210)**	**$ (237,728)**	**$ (3,052,512)**
Carrying Amounts						
Balance at December 31, 2014	$ 2,378,001	$ 3,407,704	$ 108,941	$ 90,232	$ 184	$ 5,985,062
Balance at December 31, 2015	$ 2,280,623	$ 2,947,987	$ 95,124	$ 61,204	$ 120,431	$ 5,505,369
Balance at December 31, 2016	**$ 2,183,915**	**$ 2,846,984**	**$ 130,123**	**$ 46,120**	**$ 2,298**	**$ 5,209,440**

Total amortization was $1,470,952, of which $237,060 has been capitalized to inventory, $854,142 is included within production costs, and $379,750 is included in amortization expense.

(in Canadian dollars)

8. DUE TO SHAREHOLDERS

		Due to shareholder
December 31, 2014	**$**	**-**
Issuance of bridge loan (i)		600,000
Issuance of bridge loan (ii)		200,000
Settlement of bridge loan with issuance of convertible debt (iii)		(600,000)
Settlement of bridge loan with cash (iv)		(200,000)
December 31, 2015 and December 31, 2016	**$**	**-**

(i) On May 26, 2015, CannTrust Holdings Inc. obtained a $600,000 demand bridge loan from related parties, guaranteed by CannTrust Inc., with 5% interest per month payable monthly in arrears, with a minimum interest payment of 3 months payable over the term of the loan. The loan was secured by a promissory note and general security agreement.

(ii) On July 20, 2015, CannTrust Holdings Inc. obtained a $200,000 demand bridge loan to fund day to day working capital requirements, pending receipt of up to $3,000,000 in new financing. The loan carried 5% interest payable monthly in arrears, with a minimum interest payment of 3 months payable over the term of the loan. The loan was secured by a promissory note.

(iii) On August 20, 2015, the $600,000 bridge loan (i) was settled in full by issuance of convertible debt (refer to Note 9).

(iv) On September 3, 2015, the $200,000 bridge loan (ii) was settled in full.

9. CONVERTIBLE DEBT

(i) On August 20, 2015 CannTrust Holdings Inc. issued $3,000,000 senior secured convertible debentures. The debt matures four years from closing, and is secured pursuant to a general security agreement over all property and assets of CannTrust Holdings Inc. The debt has 12% annual interest, with interest payable quarterly at the earlier of cash flow positive status of CannTrust Holdings Inc., conversion of the debentures or the maturity date. Each of the 300 debentures has been granted 4,545 warrants, exercisable by the holder for a period of 5 years from the closing date, at a price of $1.10 per common share. The debt and all accrued and unpaid interest is convertible at the option of the holder into common shares of CannTrust Holdings Inc. at a price equal to $1.10 per common share, any time prior to the occurrence of a liquidity event, as defined below. The debenture and all accrued and unpaid interest will be automatically converted into common shares of CannTrust Holdings Inc. upon the occurrence of a liquidity event at a price per common share equal to the lesser of $1.10 or a 25% discount to the price per common share upon the occurrence of the liquidity event. A liquidity event has been defined as (a) the completion of a public offering of common shares by CannTrust Holdings Inc. and listing on a Canadian or US stock exchange, (b) the sale for cash proceeds of all of the issued and outstanding shares in the capital stock of CannTrust Holdings Inc. or (c) the amalgamation or any other corporate transaction involving CannTrust Holdings Inc. with or into another entity pursuant to which the common shares of the resulting issuer from such transaction are listed on a Canadian or US stock exchange.

The $3,000,000 debenture financing includes $2,020,000 of new funding, a rollover of $600,000 of related party loans and a rollover of $380,000 unpaid management fees to related parties. The Company incurred financing costs of $60,071 in connection with these debentures. The Company determined the fair value of warrants issued in connection with these debentures

9. CONVERTIBLE DEBT (continued)

(i) (Cont'd)

to be $1,169,779 (Note 13). The conversion option has been classified as a derivative liability at fair value through profit or loss, and was valued at $1,428,441 at the date of issuance and was revalued at $1,334,577 as at December 31, 2015, and $1,133,325 as at December 31, 2016. The effective interest rate of the debentures was 54.8%.

(ii) On December 1, 2015, CannTrust Holdings Inc. obtained $600,000 of unsecured convertible debentures, of which $50,000 was provided by a related party. The notes mature on December 1, 2019 and earn interest of 12% per annum, with interest accruing quarterly and payable in cash quarterly upon the earlier of cash flow positive status, conversion of the convertible debentures and the maturity date. Each of the 60 debentures has been granted 4,545 warrants per debenture, exercisable by the holder for a period of 5 years from the closing date, at a price of $1.10 per common share. The debt and all accrued and unpaid interest is convertible at the option of the holder into common shares of CannTrust Holdings Inc. at a price equal to $1.10 per common share, any time prior to the occurrence of a liquidity event. The debenture and all accrued and unpaid interest will be automatically converted into common shares of CannTrust Holdings Inc. upon the occurrence of a liquidity event at a price per common share equal to the lesser of $1.10 or a 25% discount to the price per common share upon the occurrence of the liquidity event. A liquidity event has been defined as (a) the completion of a public offering of common shares by CannTrust Holdings Inc. and listing on a Canadian or US stock exchange, (b) the sale for cash proceeds of all of the issued and outstanding shares in the capital stock of CannTrust Holdings Inc. or (c) the amalgamation or any other corporate transaction involving CannTrust Holdings Inc. with or into another entity pursuant to which the common shares of the resulting issuer from such transaction are listed on a Canadian or US stock exchange. The Company incurred financing costs of $7,741 in connection with these debentures. The Company determined the fair value of warrants issued in connection with these debentures to be $233,803 (Note 13). The conversion option has been classified as a derivative liability at fair value through profit or loss, and was valued at $286,100 at the date of issuance and was revalued at $266,768 as at December 31, 2015, and at $226,665 as at December 31, 2016. The effective interest rate of the debentures was 54.5%.

(iii) As part of their pre-emptive rights under CannTrust Holdings Inc. Shareholders Agreement, on February 28, 2016 shareholders of the Company were issued $40,919 senior unsecured convertible debentures. The debt matures four years from closing. The debt has 12% annual interest, with interest payable quarterly at the earlier of cash flow positive status of CannTrust Holdings Inc., conversion of the debentures or the maturity date. Each of the 4.09 debentures has been granted 4,545 warrants per debenture, exercisable by the holder for a period of 5 years from the closing date, at a price of $1.10 per common share. The debt and all accrued and unpaid interest is convertible at the option of the holder into common shares of CannTrust Holdings Inc. at a price equal to $1.10 per common share, any time prior to the occurrence of a liquidity event, as defined below. The debenture and all accrued and unpaid interest will be automatically converted into common shares of CannTrust Holdings Inc. upon the occurrence of a liquidity event at a price per common share equal to the lesser of $1.10 or a 25% discount to the price per common share upon the occurrence of the liquidity event. A liquidity event has been defined as (a) the completion of a public offering of common shares by CannTrust Holdings Inc. and listing on a Canadian or US stock exchange, (b) the sale for cash proceeds of all of the issued and outstanding shares in the capital stock of CannTrust Holdings Inc. or (c) the amalgamation or any other corporate transaction involving CannTrust Holdings Inc. with or into another entity pursuant to which the common shares of the resulting issuer from

9. CONVERTIBLE DEBT (continued)

(iii) (Cont'd)

such transaction are listed on a Canadian or US stock exchange. The Company incurred financing costs of $8,636 in connection with these debentures. The Company determined the fair value of warrants issued in connection with these debentures to be $15,922 (Note 13). The conversion option has been classified as a derivative liability at fair value through profit or loss, and was valued at $19,449 on issuance, and was revalued at $15,457 at December 31, 2016. The effective interest rate of the debentures was 57.5%.

(iv) On August 9, 2016 as part of a bridge financing arrangement, an on demand $500,000 convertible promissory note was issued to a related party. The note has an interest rate of 12% per annum, and both the note and accrued interest are payable on demand and therefore recorded as a current liability. The note is convertible by the note holder at any time after the date of issuance into common shares at a conversion rate equal to the lesser of (i) $1 per common share, and (ii) the price per common share at which the common shares are issued in the next treasury financing. For the funds advanced, the note holder was issued 200,000 common shares of the Company, which were expensed as transaction costs.

(v) On September 1, 2016 as part of a second tranche to the bridge financing arrangement, a second on demand $500,000 convertible promissory note was issued to the related party. The note has an interest rate of 12% per annum, and both the note and accrued interest are payable on demand and therefore recorded as a current liability. The note is convertible by the note holder at any time after the date of issuance into common shares at a conversion rate equal to the lessor of (i) $1 per common share, and (ii) the price per common share at which the common shares are issued in the next treasury financing. For the funds advanced, the note holder was issued 200,000 common shares of the Company, which were expensed as transaction costs.

10. REDEEMABLE SHARES (See Note 21)

Cannamed Financial Corp. had an option to send a put notice to the Company requiring the Company to purchase all of the shares in the capital of the Company then owned by Cannamed Financial Corp. The purchase price payable to Cannamed Financial Corp. shall be the fair market value as of the date Cannamed Financial Corp. issued the put notice. Cannamed Financial Corp could exercise its put option at any time from and after the earlier of: (a) January 31, 2019, (b) a period of ten business days immediately following each anniversary after January 31, 2019 and (c) six months following the sale by the Company of all or substantially all of its assets where the Company has not distributed the proceeds of sale to the shareholders.

(i) On October 30, 2016, the Company entered into separate agreements with all of the Class A preference shareholders of CannTrust Inc. to issue to them an aggregate of 20,395,372 common shares of the Company, in exchange for the transfer by them to the Company an aggregate number of 7,175,001 Class A preference shares of CannTrust Inc. 11,356,055 of the common shares were issued to Cannamed Financial Corp., and thus were classified as redeemable shares, in accordance with the Unanimous Shareholders' Agreement.

(ii) Redeemable Shares are measured at fair value, with any resulting gain or loss recognized in profit or loss. The redeemable shares were revalued at each reporting period, until settlement.

(iii) On December 23, 2016, 2,000,000 common shares with a fair value of $2,600,000 and a warrant to acquire 1,000,000 common shares at $1.30 per common share for three years with a

(in Canadian dollars)

10. REDEEMABLE SHARES (continued)

fair value of $1,061,975, were issued to Cannamed Financial Corp. in consideration for the surrender by Cannamed Financial Corp. of its put rights under the Unanimous Shareholders' Agreement. Upon settlement, 20,265,145 redeemable shares with a fair value of $28,820,730 were reclassified as common shares, and a loss on settlement of $3,661,975 was recognized in the accumulated deficit.

	Redeemable Shares	
	Number of Shares	**Amount**
December 31, 2014	**8,909,090**	**$ 8,765,638**
Loss on revaluation of redeemable shares at December 31, 2015 (ii)	-	27,760
December 31, 2015	**8,909,090**	**$ 8,793,398**
October 2016 preference share exchange (i)	11,356,055	10,220,450
Loss on revaluation of redeemable shares (ii)	-	9,806,882
Settlement of redeemable shares (iii)	(20,265,145)	(28,820,730)
December 31, 2016	**-**	**$ -**

11. SHARE CAPITAL

The authorized capital stock of the Company consists of an unlimited number of common shares and unlimited number of Class A preference shares.

	Common Shares	
	Number of Shares	**Amount**
December 31, 2014 (i)	**29,296,313**	**$ 5,744,491**
January 2015 Private Placement (ii)	222,222	200,000
Transfer to CannTrust Holdings Inc. - NCI shares (iii)	(2,759,909)	(1,337,168)
August 2015 Share cancellation (iv)	(200,000)	(1)
August 2015 Share issuance (v)	675,000	497,500
November 2015 Share issuance (vi)	140,000	126,000
December 2015 Private Placement (vii)	2,222,222	1,454,081
December 31, 2015 (i)	**29,595,848**	**$ 6,684,903**
February 2016 Pre-emptive Rights Issuance (viii)	35,646	32,081
February 2016 Share issuance to Employees (ix)	50,000	45,000
August 2016 Shares issuance as partial consideration for Bridge Financing (x)	200,000	180,000
September 2016 Shares issuance as partial consideration for Bridge Financing (xi)	200,000	180,000
September 2016 Share issuance to Employee (xii)	30,000	27,000
October 2016 Shares issued in exchange for Class A Preferred Shares of CannTrust Inc. (xiii)	9,039,317	8,135,386
November 2016 Shares issued to NC of CannTrust Inc. in exchange for Shares of CannTrust Inc. (xiv)	2,759,909	2,483,918
December 2016 Private Placement (xv)	3,416,208	4,441,070
December 2016 Share issuance in lieu of services (xvi)	403,846	525,000
December 2016 Share issuance in consideration of surrender of Put Option (xvii)	22,265,145	31,420,729
Share issuance costs	-	(238,918)
December 31, 2016	**67,995,919**	**$ 53,916,169**

(i) Excludes common shares classified as redeemable shares (Note 10).

(ii) On January 15, 2015, 222,222 common shares were issued for gross proceeds of $0.90 per share.

(iii) On April 30, 2015, 35,667,716 common shares previously issued under CannTrust Inc. were reissued under CannTrust Holdings Inc. upon the share reorganization discussed in Note 1. At the time of the reorganization, 2,759,909 common shares with a carrying value of $1,337,168 were retained in the capital of CannTrust Inc. by third party shareholders.

11. SHARE CAPITAL (continued)

(iv) On August 21, 2015 200,000 common shares of CannTrust Holdings Inc. were cancelled and repurchased for $1 from a related party and allocated to the CannTrust Holdings Inc. ESOP.

(v) On August 21, 2015 675,000 common shares were issued from the CannTrust Holdings Inc. ESOP as consideration for goods and services received, as follows:

a. 375,000 common shares were issued as transaction costs in order to secure the $200,000 and $600,000 bridge loans referred to in Note 8(iii) and Note 8(iv). The value of the transaction costs could not be estimated reliably, thus the value of the shares issued was measured by reference to the fair value of the common share of the Company at the grant date. The fair value at the grant date was $0.90 per share.

b. 200,000 common shares were issued as consideration for marketing services received between January 1, 2015 and June 1, 2015. The shares were valued at $0.30 per share, as determined by the value of services received and invoiced.

c. 100,000 common shares were issued as consideration for computer software. The value of the assets received could not be estimated reliably, thus the value of the shares issued was measured by reference to the fair value of the common share of the Company at the grant date. The fair value at the grant date was $0.90 per share.

(vi) On November 11, 2015 140,000 common shares were issued from CannTrust Holdings Inc. as consideration for the purchase of biological assets. The Company was unable to obtain Health Canada approval for the purchase, and the assets had to be destroyed. The value of the destroyed plants could not be estimated reliably, thus the value of the shares issued was measured by reference to the fair value of the common share of the Company at the grant date. The fair value at the grant date was $0.90 per share.

(vii) On December 18, 2015, CannTrust Holdings Inc. issued 2,222,222 common shares in a private placement transaction to a related party at $0.90 per share, as well as one warrant to purchase 500,000 common shares at a price of $1.10 per common share for the period from December 18, 2015 to December 31, 2017 and one warrant to purchase 500,000 common shares at a price of $1.50 per common share for the period from December 18, 2015 to December 31, 2017. The common shares were valued at $1,454,081 and the warrants were valued at $545,919 (Note 13).

(viii) As part of their pre-emptive rights under CannTrust Holdings Inc. Shareholders Agreement, on February 28, 2016 shareholders of the Company were issued 35,646 common shares at $0.90 per share for total proceeds of $32,081.

(ix) On February 29, 2016, 50,000 common shares were issued to employees of the Company. The value of the shares issued was measured by reference to the fair value of the common shares of the Company at the grant date. The fair value at the grant date was $0.90 per share.

(x) On August 9, 2016 as part of a bridge financing agreement, a $500,000 convertible promissory note was issued to a related party. As partial consideration for the funds advanced, the note holder was issued 200,000 common shares of the Company. The value of the transaction costs could not be estimated reliably, thus the value of the shares issued was measured by reference to the fair value of the common shares of the Company at the grant date. The fair value at the grant date was $0.90 per share.

(in Canadian dollars)

11. SHARE CAPITAL (continued)

(xi) On September 1, 2016 as part of a second tranche to the bridge financing agreement, a $500,000 convertible promissory note was issued to a related party. As partial consideration for the funds advanced, the note holder was issued 200,000 common shares of the Company. The value of the transaction costs could not be estimated reliably, thus the value of the shares issued was measured by reference to the fair value of the common shares of the Company at the grant date. The fair value at the grant date was $0.90 per share.

(xii) On September 28, 2016, 30,000 common shares were issued to an employee of the Company. The value of the shares issued was measured by reference to the fair value of the common shares of the Company at the grant date. The fair value at the grant date was $0.90 per share.

(xiii) On October 30, 2016 the Company entered into separate agreements with all of the Class A Preference Shareholders of CannTrust Inc. to issue to them an aggregate number of 9,039,317 common shares with a fair value of $8,135,386 and 11,356,055 redeemable shares (Note 10) with a fair value of $10,220,450 of the Company in exchange for the transfer by them to the Company of an aggregate number of 7,175,001 Class A Preference shares of CannTrust Inc with a carrying value of $7,175,001 and settlement of $3,027,403 of distributions payable. A loss on settlement of $8,262,438 was recognized in the accumulated deficit.

(xiv) On November 23, 2016 the Non-Controlling Shareholders of CannTrust Inc. exchanged their 2,759,909 common shares of CannTrust Inc. with a carrying value of $1,337,168 for 2,759,909 common shares of CannTrust Holding Inc. with a fair value of $2,483,918. A loss on settlement of $3,694,282 was recognized in the accumulated deficit.

(xv) On December 23, 2016 3,416,208 common shares were issued for gross proceeds of $1.30 per share.

(xvi) On December 23, 2016 403,846 common shares were issued as consideration for unpaid management fees to related parties. The shares were valued at $1.30 per share, as determined by the value of services received and invoiced.

(xvii) On December 23, 2016 2,000,000 common shares with a fair value of $2,600,000 and a warrant to acquire 1,000,000 common shares at $1.30 per common share with a fair value of $1,061,975 were issued to Cannamed Financial Corp. in consideration for the surrender by Cannamed of its Put Rights under the Unanimous Shareholders Agreement (see Note 10). Upon settlement, 20,265,145 redeemable shares at a carrying value of $28,820,730 were reclassified as common shares, and a loss on settlement of $3,661,975 was recognized in the accumulated deficit.

12. CLASS A PREFERENCE SHARES – CannTrust Inc.

	Preference Shares	
	Number of Shares	**Amount**
December 31, 2014 and December 31, 2015 (i)	**7,175,001**	**$ 7,070,589**
October 2016 Shares acquired in exchange for Common Shares (ii)	(7,175,001)	(7,070,589)
December 31, 2016	**-**	**$ -**

(i) In the share reorganization rollover in 2015, all the Class A preference shares remained in CannTrust Inc. Included in the 7,175,001 preference shares were 4,000,000 preference shares held by Cannamed Financial Corp., which are redeemable at the option of the holder, under the same terms as the redeemable shares, described in Note 10.

(ii) On October 30, 2016, the Company entered into separate agreements with all of the Class A Preference Shareholders of CannTrust Inc. to issue to them an aggregate number of 9,039,317 common shares and 11,356,055 redeemable shares (Note 10) of the Company in exchange for the transfer by them to the Company of an aggregate number of 7,175,001 Class A Preference shares of CannTrust Inc.

(in Canadian dollars)

13. RESERVE FOR WARRANTS

The following table reflects the continuity of warrants for the year ended December 31, 2016:

	Number of Warrants	Number of common shares to be issued on exercise of warrants	Amount	Weighted average exercise price	Weighted average remaining life in years
December 31, 2014	**-**	**-**	**$ -**	**$ -**	**-**
August 2015 Warrants issued with convertible debt (i)	1,363,500	1,363,500	1,169,779	1.10	3.64
December 2015 Warrants issued with converible debt (ii)	272,700	272,700	233,803	1.10	3.92
December 2015 Warrants issued in private placement (iii)	2	1,000,000	545,919	1.30	1.00
December 31, 2015	**1,636,202**	**2,636,200**	**1,949,501**	**1.18**	**3.61**
February 2016 warrants issued with convertible debt (iv)	18,598	18,598	15,922	1.10	4.16
December 2016 Warrants issued for the surrender of Put Right (v)	1	1,000,000	1,061,975	1.30	2.98
December 31, 2016	**1,654,801**	**3,654,798**	**$ 3,027,398**	**1.21**	**3.33**

(i) In connection with the August 20, 2015 convertible debenture issuance (Note 9(i)), each debenture holder was granted 4,545 warrants per debenture, exercisable by the holder for a period of 5 years from the closing date, at a price of $1.10 per common share. The warrants were valued at $1,169,779 at the grant date using an option pricing model with the following assumptions: (i) expected dividend yield of 0%; (ii) average expected volatility of 181%; (iii) average risk-free interest rate of 0.44%; (iv) share price of $0.90; (v) forfeiture rate of 0; and (vi) expected life of five years.

(ii) In connection with the December 1, 2015 convertible debenture issuance (Note 9(ii)), each debenture holder was granted 4,545 warrants per debenture, exercisable by the holder for a period of 5 years from the closing date, at a price of $1.10 per common share. The warrants were valued at $233,803 at the grant date using an option pricing model with the following assumptions: (i) expected dividend yield of 0%; (ii) average expected volatility of 180%; (iii) average risk-free interest rate of 0.75%; (iv) share price of $0.90; (v) forfeiture rate of 0; and (vi) expected life of five years.

(iii) Warrants were issued on December 20, 2015 as part of the private placement (Note 11 (vii)). Two warrants were issued, as follows:

- One warrant to purchase 500,000 common shares at a price of $1.10 per common share for the period from December 18, 2015 to December 31, 2017. The warrant was valued at $277,815 based on the relative fair values of the share and warrant components of the offering. The fair value of the warrants has been estimated at the date of grant using an option pricing model with the following assumptions: (i) expected dividend yield of 0%; (ii) average expected volatility of 164%; (iii) average risk-free interest rate of 0.55%; (iv) share price of $0.90; (v) forfeiture rate of 0; and (vi) expected life of two years.

- One warrant to purchase 500,000 common shares at a price of $1.50 per common share for the period from December 18, 2015 to December 31, 2017. The warrant was valued at $268,104 based on the relative fair values of the share and warrant components of the offering. The fair value of the warrants has been estimated at the date of grant using an option pricing model with the following assumptions: (i) expected dividend yield of 0%; (ii) average expected volatility of 164%; (iii) average risk-free interest rate of 0.55%; (iv) share price of $0.90; (v) forfeiture rate of 0; and (vi) expected life of two years.

(in Canadian dollars)

13. RESERVE FOR WARRANTS (continued)

(iv) In connection with the February 28, 2016 convertible debenture issuance (Note 9(iii)), each debenture holder was granted 4,545 warrants per debenture, exercisable by the holder for a period of 5 years from the closing date, at a price of $1.10 per common share. The warrants were valued at $15,922 at the grant date using an option pricing model with the following assumptions: (i) expected dividend yield of 0%; (ii) average expected volatility of 179%; (iii) average risk-free interest rate of 0.56%; (iv) share price of $0.90; (v) forfeiture rate of 0; and (vi) expected life of five years.

(v) On December 23, 2016, a warrant to acquire 1,000,000 common shares at $1.30 per common share was issued to Canamed Financial Corp. as part of the consideration for the surrender by Canamed of its Put Right (Note 10(iii)). The warrant is exercisable by the holder at any time during the three-year period following its issuance. The warrant was valued at $1,061,975 at the grant date using an option pricing model with the following assumptions: (i) expected dividend yield of 0%; (ii) average expected volatility of 189%; (iii) average risk-free interest rate of 1.1%; (iv) share price of $1.30; (v) forfeiture rate of 0; and (vi) expected life of three years.

14. COMMITMENTS

The Company's commitments consist of the following:

	Total	2017	2018	2019	2020	2021	Beyond
Lease obligation	$ 3,172,619	$ 439,662	$ 441,349	$ 459,912	$ 460,756	$ 470,037	$ 900,904
Service contracts	$ 32,128	$ 19,415	$ 6,102	$ 6,102	$ 509	$ -	$ -
Total	**$ 3,204,747**	**$ 459,077**	**$ 447,451**	**$ 466,014**	**$ 461,264**	**$ 470,037**	**$ 900,904**

15. RELATED PARTY TRANSACTIONS

Preference Shares

As at December 31, 2016, NIL preference shares (2015 – 250,001, January 1, 2015 - 250,001) were issued and outstanding to related parties. As at December 31, 2016, NIL (2015 - $57,452, January 1, 2015 - $27,452) of dividends were accrued on the preference shares from related parties. During the year, $104,876 (2015 – NIL, 2014 - NIL) of accrued dividends on the preference shares to related parties were settled through the issuance of common shares.

Redeemable Shares

As at December 31, 2016, NIL redeemable shares (2015 – 8,909,090, January 1, 2015 – 8,909,090) were issued and outstanding to related parties. In addition, as at December 31, 2016, NIL (2015 – 4,000,000) preference shares were issued as redeemable shares from related parties. As at December 31, 2016, NIL (2015 - $919,232, January 1, 2015 - $439,233) of dividends were accrued on the preference shares issued as redeemable shares from related parties. During the year, $1,678,027 (2015 – NIL, 2014 - NIL) of accrued dividends on the preference shares issued as redeemable shares to related parties were settled through the issuance of common shares.

15. RELATED PARTY TRANSACTIONS (continued)

Due to Shareholders

During the year, the Company obtained NIL in bridge loans from related parties (2015 – $800,000, 2014 - $300,000), of which NIL was repaid in cash (2015 – $200,000, 2014 - $300,000), and NIL was settled by issuance of convertible debt (Note 9(i)) (2015 – $600,000, 2014 – Nil).

Convertible Debt

During the year, the Company obtained $1,000,000 (2015 - $1,030,000, 2014 - Nil) in due on demand convertible promissory notes from related parties, all of which was outstanding as at December 31, 2016. As at December 31, 2016, $210,828 (2015 - $43,328, January 1, 2015 - Nil) of interest accrued on the due on demand convertible promissory notes and convertible debt from related parties. During the year, the Company paid Nil in interest on the due on demand convertible promissory notes and convertible debt to related parties (2015 – Nil, 2014 - Nil).

Key Management Compensation

The compensation of key management of the Company totaled $430,893 in 2016 (2015 - $420,408, 2014 - $326,247), and consisted of salaries. During the year, Nil (2015 – Nil, 2014 - $92,500) severance payment was made to a former related party. There were no stock options or bonuses issued to key management. Key management includes those persons having authority and responsibility for planning, directing and controlling the activities, directly or indirectly, of the Company.

Other related party transactions

During the year, the Company incurred $590,000 (2015 - $520,000, 2014 - $331,197) of management fees to related parties, of which $266,500 (2015 - $333,000, January 1, 2015 - $300,000) was unpaid and included in accounts payable at December 31, 2016. During the year, $525,000 of management fees to related parties were settled with the issuance of common shares (Note 11(xvi)) (2015 - $380,000 of management fees to related parties were settled with the issuance of convertible debt (Note 9(i))). During the year, the Company incurred $27,501 (2015 – Nil) of consulting fees to related parties, of which Nil was unpaid and included in accounts payable at December 31, 2016. During the year, the Company incurred $192,247 of legal fees to related parties, of which $339 was unpaid and included in accounts payable at December 31, 2016.

16. JOINT VENTURE

On July 15, 2015, the Company entered into a joint venture with Club Coffee L.P., in which each entity holds 50% of the outstanding shares (100 common shares) of Cannabis Coffee & Tea Pod Company Ltd (the Joint Venture). The Joint Venture will have access to patents and IP developed by CannTrust and Club Coffee and will build a network of licensees who will be licensed to manufacture product using patents and Intellectual Property owned by the Joint Venture. The cost of the investment was nominal. During the year, the Joint Venture had a loss before tax of $294,884 (2015 - $0) of which $147,442 (2015 - $0) was the Company's share and a loss and comprehensive loss after tax of $294,884 (2015 - $0) of which $147,442 (2015 - $0) was the Company's share. The Company's interest in the Joint Venture was recorded as an investment of $19,313 as at December 31, 2016 (2015 - $1). Included in the investment balance is the net loss of $147,442 and a net receivable of $166,755.

(in Canadian dollars)

17. INCOME TAXES

The income tax provision recorded differs from the income tax obtained by applying the statutory income tax rate to the income for the year and is reconciled as follows:

	December 31, 2016	December 31, 2015	December 31, 2014
Net income (loss) before income taxes	**$ (13,619,943)**	$ (6,819,970)	$ (12,753,657)
Combined federal and provincial statutory income tax rate	**26.5%**	26.5%	26.5%
Expected recovery at statutory rate	**$ (3,609,285)**	$ (1,807,292)	$ (3,379,719)
Non-deductible expenses and other permanent differences	**1,588,058**	439,159	1,987,571
Change in deferred tax assets not recognized	**2,021,227**	1,368,133	1,392,148
Expected deferred income tax recovery	**$ -**	$ -	$ -

As at December 31, 2016, the Company has not recognized a deferred tax asset in respect of its deductible temporary differences and past losses incurred as it has not been demonstrated that the Company will be able to generate sufficient future profits to utilize this tax asset over a reasonable period of time.

Deferred taxation

	December 31, 2016	December 31, 2015	December 31, 2014
Property and equipment	**$ 651,797**	$ 202,860	$ (72,078)
Reserves and loss carry-forwards	**4,128,965**	2,594,434	1,406,259
Share issue costs	**97,672**	59,913	60,716
SR&ED expenditures	**-**	-	52,836
Deferred tax asset not recognized	**(4,878,434)**	(2,857,207)	(1,447,733)
Expected deferred income tax recovery	**$ -**	$ -	$ -

The expiry of the Company's non-capital losses are as follows:

2023	$ 239,770
2024	4,416,211
2025	5,134,335
2026	5,790,684
	$ 15,581,000

18. FINANCIAL INSTRUMENTS

Financial Risk Management Objectives and Policies

The Company manages its exposure to a number of different financial risks arising from its operations as well as its use of financial instruments including market risks (foreign currency exchange rate and interest rate), credit risk and liquidity risk through its risk management strategy. The objective of the strategy is to support the delivery of the Company's financial targets while protecting its future financial security and flexibility.

Financial risks are primarily managed and monitored through operating and financing activities. The financial risks are evaluated regularly with due consideration to changes in the key economic indicators and up-to-date market information.

A summary of the Company's risk exposures as it relates to financial instruments are reflected below:

Market Risk

Market risk is the risk or uncertainty arising from possible market price movements and their impact on the future performance of the business. These market risks are evaluated by monitoring changes in key economic indicators and market information on an on-going basis.

Currency Risk

The Company does not actively manage its foreign currency risk as this risk is deemed not material. As at December 31, 2016, December 31, 2015 and January 1, 2015, the Company did not have any financial assets or liabilities denoted in foreign currencies.

Interest Rate Risk

Interest rate risk is the risk that the cash flows of a financial instrument will fluctuate due to changes in market interest rates. Interest rate risk on the convertible debentures is limited due to the fact that they are fixed rate of interest instruments.

As at December 31, 2016, the Company had Nil (2015 - $300,000, January 1, 2015 - $500,000) in short-term investments.

Liquidity Risk

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities. As at December 31, 2016, the Company had accounts payable and accrued liabilities and distributions payable on preference shares of $2,570,965 (2015 - $2,536,516, January 1, 2014 - $1,766,292) due within 12 months and convertible debt due on demand of $1,000,000 (2015 – Nil, January 1, 2015 - Nil), and cash, short-term investments, HST recoverable and accounts receivable of $5,132,152 (2015 - $3,103,012, January 1, 2015 - $3,090,176) to meet its current obligations.

Considering the available liquidities as at December 31, 2016, the expected cash burn from operations and future commitments (refer to note 14), the Company’s exposure to liquidity risk as at December 31, 2016 is considered high. The Company expects to address this risk by raising funds through external financing as needed (refer to note 20).

(in Canadian dollars)

18. FINANCIAL INSTRUMENTS (continued)

In addition to the commitments disclosed in 14, the Company is obligated to the following contractual maturities of undiscounted cash flows:

As at December 31, 2016	Carrying amount	Contractual cash flows	Year 1	Years 2-3	Years 4 and after
Accounts payable and accrued liabilities	$ 2,570,965	$ 2,570,965	$ 2,570,965	$ -	$ -
Convertible debt due on demand	1,000,000	1,000,000	1,000,000	-	-
Convertible debt	1,463,947	4,814,151	436,910	4,335,541	41,699
Total	**$ 5,034,912**	**$ 8,385,116**	**$ 4,007,875**	**$ 4,335,541**	**$ 41,699**

Credit Risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company is not exposed to significant credit risk, as the Company's sales are typically paid at the time of transaction, with an immaterial balance to be collected at year-end.

19. CAPITAL MANAGEMENT

The Company's objectives when managing capital are to:

- Maintain a capital structure that allows it to finance its growth strategy with cash flows from its operations;
- Preserve its ability to meet its financial obligations by funding the capital needs via private sources; and
- Optimize the use of capital to provide an appropriate return on investment to its shareholders.

The Company defines its capital as shareholders' equity, preference shares and redeemable shares.

The Company is not subject to externally imposed capital requirements and there has been no change with respect to the capital management strategy during the year-ended December 31, 2016.

20. SUBSEQUENT EVENTS

(i) On January 13, 2017, a Subsidiary of the Company executed a Purchase and Sale Agreement to acquire various Greenhouse assets for $6,500,000 at closing and a $1,000,000 promissory note paid over a period of five years following the closing date. The Vendor currently carries on the business of a horticultural greenhouse and related activities in the Town of Fenwick, Ontario. The property being acquired is all zoned for cannabis production and will allow the Company to significantly expand its production. At the time that these financial statements were authorized for issue, the initial accounting for the acquisition through the allocation of the consideration paid to assets acquired and liabilities assumed is incomplete due to the short time period since acquisition.

(ii) As it is the Company's intention to utilize the purchased assets for cannabis production, on January 13, 2017 the Subsidiary of the Company executed a partial assignment of the Purchase and Sale Agreement assigning all of the rights to the Vendors existing horticultural flower business to the Assignee. In return the Assignee will be responsible for the payment for the Vendors Inventories pursuant to the Purchase and Sale Agreement.

20. SUBSEQUENT EVENTS (continued)

(iii) On February 17, 2017, the Company issued, on a private placement basis, a combination of: (i) 12,584,100 Special Warrants at a price of $2.00 per Special Warrant, with each Special Warrant exercisable into one common share of the Corporation for aggregate proceeds of $25,168,200 and (ii) 510,000 common shares of the Corporation at a price of $2.00 per share for aggregate proceeds of $1,020,000. The Corporation's Agent for the Special Warrant Financing was paid an Agent's Fee equal to 6% of the aggregate proceeds to the Corporation excluding those Special Warrants subscribed to by Employees of the Company and other persons participating on a non-brokered basis. No Fees were paid in respect of the 510,000 common shares issued. As additional consideration, the Corporation's Agent was issued that number of Broker Warrants which is equal to 6% of the number of Special Warrants sold pursuant to the Special Warrant Offering excluding those Special Warrants subscribed to by Employees of the Company and other persons participating on a non-brokered basis. No Broker Warrants were issued in respect of the 510,000 common shares issued. Each Broker Warrant is exercisable into a common share of the Corporation at an exercise price of $2.00 per share for a period of 24 months.

(iv) In March 2017, $1,776,851 of the Company's convertible debt plus outstanding accrued interest was converted into 1,712,425 common shares.

(v) In March 2017, warrants to purchase 1,000,000 common shares were exercised for gross proceeds of $1,300,000.

(vi) In March 2017, the Company issued 1,565,000 employee stock options under the Company's ESOP exercisable at $2.00 per share vesting over three years.

21. PRIOR YEAR ADJUSTMENTS

(i) Under the Unanimous Shareholders' Agreement, Cannamed had the option to send a notice requiring the Company to purchase all (but not less than all) of the shares in the capital of the Company then owned by Cannamed at the fair market value of the shares. During the year, it was noticed that the put option was not recorded as a liability to the Company in 2014 or 2015. A prior year adjustment was made to the December 31, 2015 comparable figures to record redeemable shares of $8,793,398 (2014 - $8,765,638). As a result of the prior year adjustment, the net loss and comprehensive loss and cumulative deficit in 2015 increased by $27,760 (2014 - $8,765,638). Accordingly, the loss per share increased by $0.02 per share in 2015 ($0.17 per share in 2014). There was no impact to cashflow from operating, investing or financing activities due to the adjustment in 2015 or 2014.

(ii) In the prior year audited financial statements, the principal debt, conversion option and warrants were all bifurcated as components of the debentures issued on August 20, 2015 and December 1, 2015. During the year, it was determined that the face value of the debt should be bifurcated across the principal debt and conversion option, while the warrants should be treated as transaction costs. A prior year adjustment was made to the December 31, 2015 comparable figures to decrease the convertible debt by $1,825,833, increase the derivative liability by $2,716,347 and increase the warrants by $836,676. As a result of the prior year adjustment, the net loss and comprehensive loss and cumulative deficit in 2015 increased by $1,622,869 (2014 - $Nil) attributable to equity shareholders of the Company and $104,321 attributable to non-controlling interest. Accordingly, the loss per share increased by $0.06 per share in 2015 (Nil in 2014). There was no impact to cashflow from operating, investing or financing activities due to the adjustment in 2015 or 2014.