

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Microbix Biosystems Inc.

We have audited the accompanying consolidated financial statements of Microbix Biosystems Inc. which comprise the consolidated statements of financial position as at September 30, 2017 and 2016, and the consolidated statements of (loss) income and comprehensive (loss) income, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Microbix Biosystems Inc.** as at September 30, 2017 and 2016, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Toronto, Canada
December 19, 2017

The logo for Ernst & Young LLP is written in a black, cursive script font.

Chartered Professional Accountants
Licensed Public Accountants

MICROBIX**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**

As at September 30, 2017 and 2016

Canadian Funds

	2017	2016
ASSETS		
CURRENT ASSETS		
Cash	\$ 54,460	\$ 5,415
Accounts receivable	1,337,488	2,021,872
Inventory (Note 5)	4,467,106	3,395,993
Prepaid expenses and other assets (Note 6)	152,989	55,541
Investment tax credit receivable (Note 18)	149,794	182,398
TOTAL CURRENT ASSETS	6,161,837	5,661,219
LONG-TERM ASSETS		
Deferred tax assets (Note 18)	1,580,000	1,130,000
Property, plant and equipment, net (Note 7)	12,211,770	12,251,984
Intangible assets, net (Note 8)	6,484,004	6,204,260
TOTAL LONG-TERM ASSETS	20,275,774	19,586,244
TOTAL ASSETS	\$ 26,437,611	\$ 25,247,463
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 2,841,950	\$ 1,898,515
Current portion of finance lease obligations	23,070	1,647
Current portion of long-term debt (Note 10, 27)	1,891,480	1,069,455
Current portion of debentures (Note 9)	614,563	1,595,882
Deferred revenue (Note 11)	1,145,185	683,494
TOTAL CURRENT LIABILITIES	6,516,249	5,248,993
Finance lease obligations	74,327	11,012
Non-convertible debenture (Note 9)	802,819	635,020
Convertible debentures (Note 9)	1,268,623	1,127,657
Long-term debt (Note 10)	2,600,910	2,933,040
TOTAL LONG-TERM LIABILITIES	4,746,679	4,706,729
TOTAL LIABILITIES	\$ 11,262,928	\$ 9,955,722
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 12)	\$ 31,299,416	\$ 31,299,416
EQUITY COMPONENT OF		
CONVERTIBLE DEBENTURES (Note 9)	2,903,789	2,351,425
CONTRIBUTED SURPLUS (Note 13)	8,048,315	4,937,649
ACCUMULATED DEFICIT	(27,076,837)	(23,296,749)
TOTAL SHAREHOLDERS' EQUITY	\$ 15,174,683	\$ 15,291,741
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	\$ 26,437,611	\$ 25,247,463
Commitments and Contingencies (Note 27)		
Subsequent Events (Note 29)		

On behalf of the Board:

(Signed) "William J. Gastle"

WILLIAM J. GASTLE
DIRECTOR

(Signed) "Cameron L. Groome"

CAMERON L. GROOME
DIRECTOR

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

MICROBIX**CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME**

For the year ended September 30, 2017 and 2016

Canadian Funds

	2017	2016
SALES		
Virology products and technologies	\$ 9,891,859	\$ 9,236,152
Royalties	293,939	280,985
TOTAL SALES	10,185,798	9,517,137
COST OF GOODS SOLD		
Virology products and technologies (Note 5, 17)	5,287,781	4,474,038
Royalties	85,644	63,055
TOTAL COST OF GOODS SOLD	5,373,425	4,537,093
GROSS MARGIN	4,812,373	4,980,044
EXPENSES		
Selling and business development	464,909	517,023
General and administrative	3,927,825	3,130,367
Research and development	994,584	493,610
Financial expenses (Note 20)	924,589	690,637
OPERATING INCOME (LOSS)		
BEFORE DEBT RESTRUCTURING AND SETTLEMENT EXPENSES	(1,499,534)	148,407
Debt restructuring expense (Note 9)	2,457,014	-
Settlement expense (Note 28)	273,540	-
OPERATING INCOME (LOSS) FOR THE YEAR, BEFORE INCOME TAXES	(4,230,088)	148,407
INCOME TAXES		
Deferred income taxes (Note 18)	(450,000)	(600,000)
NET INCOME (LOSS) AND COMPREHENSIVE INCOME (LOSS) FOR THE YEAR	\$ (3,780,088)	\$ 748,407
NET COMPREHENSIVE INCOME (LOSS) PER SHARE		
Basic (Note 16)	\$ (0.045)	\$ 0.009
Diluted (Note 16)	\$ (0.045)	\$ 0.009

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

MICROBIX**CONSOLIDATED STATEMENTS OF CASH FLOWS**

For the year ended September 30, 2017 and 2016

Canadian Funds

	2017	2016
OPERATING ACTIVITIES		
Net comprehensive income (loss) for the year	\$ (3,780,088)	\$ 748,407
Items not affecting cash		
Amortization and depreciation (Note 17)	510,159	413,679
Accretion of debentures	198,560	83,849
Stock options expense (Note 15)	485,086	334,750
Deferred revenue (Note 11)	461,691	493,944
Debt restructuring expense (Note 27)	2,379,776	-
Deferred tax assets (Note 18)	(450,000)	(600,000)
Change in non-cash working capital balances related to operations (Note 19)	491,863	(561,321)
CASH PROVIDED BY OPERATING ACTIVITIES	297,047	913,308
INVESTING ACTIVITIES		
Purchase of property, plant and equipment (Note 7)	(182,055)	(702,579)
Additions from internal development of intangible assets (Note 8)	(458,695)	(938,547)
CASH USED IN INVESTING ACTIVITIES	(640,750)	(1,641,126)
FINANCING ACTIVITIES		
Repayments of long-term debt (Note 10)	(340,106)	(320,270)
Repayments of debentures (Note 9)	(83,367)	(76,171)
Repayments of finance lease (Note 27)	(13,779)	(6,180)
Proceeds from equipment loans (Note 10)	-	250,000
Proceeds from credit facility (Note 10)	830,000	50,000
Proceeds from shareholder loan	-	200,000
Issue of common shares, net of issue costs	-	531,674
CASH PROVIDED BY FINANCING ACTIVITIES	392,748	629,053
NET CHANGE IN CASH DURING THE YEAR	49,045	(98,765)
CASH - BEGINNING OF YEAR	5,415	104,180
CASH - END OF YEAR	54,460	5,415

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

MICROBIX**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

As at September 30, 2017 and 2016

Canadian Funds

	SHARE CAPITAL (note 12)		CONTRIBUTED	DEFICIT	EQUITY	TOTAL
	NUMBER OF	STATED	SURPLUS		COMPONENT OF	SHAREHOLDERS'
	SHARES	CAPITAL			DEBENTURE	EQUITY
BALANCE, SEPTEMBER 30, 2015	83,204,257	\$30,990,459	\$4,380,182	\$(24,045,156)	\$2,351,425	\$13,676,910
Share issuances pursuant to private placement	1,500,000	362,069				362,069
Issuance of warrants pursuant to private placement			237,931			237,931
Share issue costs pursuant to private placement		(53,112)	(15,214)			(68,326)
Stock option expense			334,750			334,750
Net comprehensive income for the year				748,407		748,407
BALANCE, SEPTEMBER 30, 2016	84,704,257	\$31,299,416	\$4,937,649	\$(23,296,749)	\$2,351,425	\$15,291,741
Stock option expense			485,086			485,086
Issuance of warrants pursuant to refinancing of convertible debentures			245,860			245,860
Conversion of a convertible debenture to a non-convertible debenture			86,680		(86,680)	
Extinguishment of convertible debenture			2,293,040		(2,264,745)	28,295
Refinancing of convertible debentures					2,903,789	2,903,789
Net comprehensive income (loss) for the year				(3,780,088)		(3,780,088)
BALANCE, SEPTEMBER 30, 2017	84,704,257	\$31,299,416	\$8,048,315	\$(27,076,837)	\$2,903,789	\$15,174,683

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

1. NATURE OF THE BUSINESS

Microbix Biosystems Inc. (“Microbix” or the “Company”) (TSX: MBX) is incorporated under the laws of Province of Ontario. The Company develops biological products and technologies. The Virology Business (“Virology”) manufactures and develops cell culture-based biological products and technologies. The Company has developed and acquired two technologies for large markets including the thrombolytic drug, Kinlytic® (Urokinase), and an animal reproductive technology in development, LumiSort™. The Company continually invests in Virology to adopt current technologies and standards. The manufacturing facility operates under an infectious diseases biological license from the Canadian Food Inspection Agency.

The Company’s registered office and owned manufacturing facility is located at 265 Watline Avenue, Mississauga, Ontario, L4Z 1P3.

2. BASIS OF PREPARATION

The Company’s management prepared these consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”), applicable to the preparation of financial statements for the year ended September 30, 2017. The Board of Directors approved these consolidated financial statements on December 19, 2017.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**Basis of Measurement**

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value. For each entity, the Company determines the functional currency and items included in the financial statements of each entity are measured using the functional currency, which represents the currency of the primary economic environment in which each entity operates. The consolidated financial statements are presented in Canadian dollars.

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Crucible Biotechnologies Limited, which the Company has control. Control exists when the entity is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The non-controlling interest component, if any, of the Company’s subsidiaries is included in equity.

The financial statements of the Company’s subsidiary is prepared for the same reporting period as the Company, using consistent accounting policies. All intra-company balances, transactions, unrealized gains and losses resulting from intra-company transactions and dividends are eliminated in full.

There has been no business activity in the subsidiary during the year ended September 30, 2017 and 2016. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of estimates and judgments

The preparation of financial statements requires management to make estimates and judgements that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from estimates and such differences could be material.

Key areas of managerial judgements and estimates are as follows:

- i) Property, plant and equipment:
Measurement of property, plant and equipment involves the use of estimates for determining the expected useful lives of depreciable assets. Management’s judgement is also required to determine depreciation methods and an asset’s residual value and whether an asset is a qualifying asset for the purposes of capitalizing borrowing costs.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Use of estimates and judgements (Continued)**

ii) Internally generated intangible assets:

Management monitors the progress of each internal research and development project. Significant judgement is required to distinguish between the research and development phases. Development costs are recognized as an asset when the following criteria are met: (i) technical feasibility; (ii) management's intention to complete the project; (iii) the ability to use or sell; (iv) the ability to generate future economic benefits; (v) availability of technical and financial resources; (vi) ability to measure the expenditures reliably. Research costs are expensed as incurred. Management also monitors whether the recognition requirements for development assets continue to be met and whether there are any indicators that capitalized costs may be impaired. The amortization period and amortization method for intangible assets with finite useful lives are reviewed at least at the end of each reporting period.

iii) Financial assets and liabilities:

Estimates and judgements are also made in the determination of fair value of financial assets and liabilities and include assumptions and estimates regarding future interest rates, the relative creditworthiness of the Company to its counterparties, the credit risk of the Company's counterparties relative to the Company, the estimated future cash flows and discount rates.

iv) Income taxes:

The Company recognizes deferred tax assets, related tax-loss carry-forwards and other deductible temporary differences where it is probable that sufficient future taxable income can be generated in order to fully utilize such losses and deductions. This requires significant estimates and assumptions regarding future earnings, and the ability to implement certain tax planning opportunities in order to assess the likelihood of utilizing such losses and deductions.

v) Fair value of share-based compensation:

The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date on which they are granted. Estimating fair value for share-based compensation transactions requires determining the most appropriate valuation model, which is dependent on the terms and conditions of the grant. This estimate also requires determining the most appropriate inputs to the valuation model including the expected life of the share option, volatility, dividend yield and forfeiture rates and making assumptions about them.

vi) Impairments:

The recoverable amount of intangible assets and property, plant and equipment is based on estimates and assumptions regarding the expected market outlook and cash flows from each CGU.

Revenue Recognition

Revenues from product sales are recognized when persuasive evidence of an arrangement exists, the product is shipped, received or accepted by the customer, there are no future performance obligations, the purchase price is fixed and determinable, and collectability is reasonably assured.

Revenues from licensing are recognized when the service is rendered or the deliverables are substantially complete and other revenue recognition criteria are met.

For upfront, non-refundable payments received in accordance with the execution of licensing and collaboration agreements, revenue is deferred and recognized over the performance period, the period over which the Company maintains substantive contractual obligations.

Amounts the Company expects to earn in the current year are included in the current portion of deferred revenue and amounts expected to be earned in subsequent periods are recorded in long term deferred revenue. The term over which upfront fees are recognized is revised if the period over which the Company maintains substantive contractual obligations changes.

As at and for the years ended September 30, 2017 and 2016

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Cash**

Cash consists of cash on hand and deposits with banks and investments in highly liquid instruments with original maturities of three months or less. There are no cash equivalents held at September 30, 2017 or 2016.

Financial assets and liabilities

All financial instruments, including derivatives, are included on the consolidated statement of financial position and are measured either at fair market value or, in limited circumstances, at cost or amortized cost. Subsequent measurement and recognition of the changes in fair value of financial instruments depends upon their initial classifications as follows:

- Held-for-trading financial assets, measured at fair value with subsequent changes in fair value recognized in current period net income;
- Held-to-maturity assets, loans and receivables and other financial liabilities, initially measured at fair value and subsequently measured at amortized cost with changes recognized in current period net income; and
- Available-for-sale financial assets, measured at fair value with subsequent gains or losses included in other comprehensive income until the asset is removed from the consolidated statements of financial position.

The following summarizes the Company's classification and measurement of financial assets and liabilities as at June 30:

	Classification	Measurement	2017	2016
Financial assets:				
Cash	Held-for-trading	Fair value	\$ 54,460	\$ 5,415
Accounts receivable	Loans and receivables	Amortized cost	1,337,488	2,021,872
Financial liabilities:				
Accounts payable and accrued liabilities	Other liabilities	Amortized cost	2,841,950	1,898,515
Deferred revenue	Other liabilities	Amortized cost	1,145,185	683,494
Finance lease obligation	Other liabilities	Amortized cost	97,398	12,659
Non-convertible debentures	Other liabilities	Amortized cost	1,170,117	879,304
Convertible debentures	Other liabilities	Amortized cost	1,515,888	2,479,255
Long-term-debt	Other liabilities	Amortized cost	4,492,390	4,002,495
Total Financial liabilities			\$ 11,262,928	\$ 9,955,722

Transaction costs that are directly attributable to the acquisition or issuance of financial assets or financial liabilities, other than financial assets and financial liabilities measured at fair value through profit and loss ("FVTPL"), are accounted for as part of the carrying amount of the respective asset or liability at inception. Transaction costs related to financial instruments measured at amortized cost are amortized using the effective interest rate over the anticipated life of the related instrument.

Transaction costs on financial assets and financial liabilities measured at FVTPL are expensed in the period incurred. Financial assets are derecognized when the contractual rights to the cash flows from financial assets expire or have been transferred. All derivative instruments, including embedded derivatives, are recorded in the financial statements at fair value.

Inventories

Inventory is carried at the lower of cost and market. Cost consists of direct materials, direct labour and an overhead allocation and is determined on a first-in, first-out basis. Market is defined as net realizable value, which is defined as the summation of the estimated selling price less the cost to complete less the cost to sell. Management reviews its reserve for obsolete inventory annually for finished goods and work-in-process.

Property, plant and equipment

Property and equipment are measured at cost less accumulated depreciation and impairment (if any). Cost includes the cost of material, labour and other costs directly attributable to bringing the asset to a working condition for its intended use.

Depreciation is calculated at rates which will reduce the original cost to estimated residual value over the estimated useful life of each asset. Depreciation commences once the asset is available for use.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Property, plant and equipment (Continued)**

Depreciation is provided for at the following basis and rates:

Research and development equipment	Declining balance, 10-100%
Other equipment and fixtures	Declining balance, 10-30%
Buildings	Straight line, 50 years

Land is not depreciated. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted prospectively, if appropriate.

Finance lease obligation

Leases that transfer substantially all of the benefits and risks of ownership of the asset to the Company are accounted for as finance leases. At the time a finance lease is entered into, an asset is recorded together with its related long-term obligation, reflecting the fair value of future lease payments, discounted at the appropriate interest rates. Finance lease obligations are amortized over their estimated useful lives at the same rates used for other equipment and fixtures. All other leases are classified as operating leases and expensed on a straight-line basis.

Intangible assets

Intangible assets represent technology costs, patents and trademarks, and rights and licenses. Each is recorded at cost and is amortized on a straight-line basis over the term of the agreements or over the useful life of the asset. Amortization commences when the intangible asset is available for use. Intangible assets with definite lives but not yet available for use are assessed annually for impairment.

Impairment of long-lived assets

An impairment charge is recognized for long-lived assets, including intangible assets with definite lives, when an event or change in circumstances indicates that the assets' carrying value may not be recoverable. The impairment loss is calculated as the difference between the carrying value of the asset and the recoverable amount. The recoverable amount is the higher of the fair value less costs to sell and value in use.

Management has determined that no long-lived assets of the Company as at September 30, 2017 have met the criteria for impairment.

Borrowing costs

Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds. Borrowing costs directly attributable to the acquisition, construction or production of an asset that necessarily takes a substantial period of time to get ready for its intended use or sale are capitalized as part of the cost of the asset. All other borrowing costs are expensed in the period they are incurred.

Share-based compensation

The Company applies the fair value method of accounting for share-based compensation for awards granted to officers, directors and employees of the Company. The fair value of the award at the time of granting is determined using the Black-Scholes option pricing model, and recognized as a compensation expense over the vesting period with an offsetting amount recorded to contributed surplus. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value.

Share options issued to consultants of the Company are based on the fair value of the services provided. The amount of the compensation cost recognized at any date at least equals the value of the portion of the options vested at that date. When stock options are exercised, the consideration paid by employees or directors, together with the related amount in contributed surplus, is credited to share capital. When an employee leaves the Company, vested options must be exercised within 90 days, or the options expire. Any options that are unvested are reversed in the period that the employee leaves. A forfeiture rate is incorporated into the Company's assumptions. Forfeitures are estimated at the time of grant and are based on historical experience. To the extent that the actual forfeiture rate is different from the Company's estimate, share-based compensation related to these awards will be different from the Company's estimate and forfeiture rates for subsequent periods are revised.

Foreign currency translation

Foreign currency denominated revenues and expenses are translated by use of the exchange rate in effect at the end of the month in which the transaction occurs. Foreign currency denominated monetary assets and liabilities are translated at the year-end date. Exchange gains and losses arising on these transactions are included in the consolidated statements of comprehensive income for the period.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)**Income (loss) per common share**

The Company calculates basic income per share amounts for profit or loss attributable to ordinary equity holders. Basic income per share is calculated using the weighted average number of common shares outstanding during the period. Diluted income per share is calculated in the same manner as basic income per share except for adjusting the profit or loss attributable to ordinary equity holders and the weighted average number of shares outstanding for the effects of all dilutive potential ordinary shares.

Deferred taxes

Deferred income tax assets and liabilities are recognized for the estimated income tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective income tax bases. Deferred income tax assets are recognized to the extent that it is probable that future taxable income will be available against which temporary differences can be utilized. Deferred income tax assets and liabilities are measured using tax rates expected to be in effect when the temporary differences are expected to be recovered or settled. The effects of changes in income tax rates are reflected in deferred income tax assets and liabilities in the year that the rate changes are substantively enacted, with a corresponding charge to income. The amount of deferred tax assets recognized is limited to the amount that is more likely than not to be realized.

Research and development expenses

Costs associated with research and development activities are expensed during the year in which they are incurred net of tax credits earned, except where product development costs meet the criteria under IFRS for deferral and amortization.

Investment tax credits

The Company is entitled to Canadian federal and provincial investment tax credits which are earned as a percentage of eligible research and development expenditures incurred in each taxation year. Investment tax credits are accounted for as a reduction of the related expenditure for items of a current nature and a reduction of the related asset cost for items of a long-term nature. These credits are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the credits in the foreseeable future.

4. ACCOUNTING PRONOUNCEMENTS ISSUED BUT NOT YET APPLIED

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board ("IASB") or IFRS Interpretation Committee ("IFRIC") that are mandatory at certain dates or later. Management is still assessing the effects of the pronouncements on the Company. The standards impacted that may be applicable to the Company are following:

IFRS 9 - Financial Instruments

IFRS 9, Financial Instruments ("IFRS 9") was issued in final form by the IASB in July 2014 and will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets.

Most requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method be used, replacing the multiple impairment methods in IAS 39. IFRS 9 also includes requirements relating to a new hedge accounting model, which represents a substantial overhaul of hedge accounting that will allow entities to better reflect their risk management activities in the financial statements.

The most significant improvements apply to those that hedge non-financial risk, and so these improvements are expected to be of particular interest to non-financial institutions. In addition, a single, forward-looking expected loss impairment model is introduced, which will require more timely recognition of expected credit losses. IFRS 9 is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted.

The Company will continue to assess any impact on the classification and measurement of the Company's financial assets, as well as any impact on the classification and measurement of its financial liabilities.

4. ACCOUNTING PRONOUNCEMENTS ISSUED BUT NOT YET APPLIED (Continued)**IFRS 15 - Revenue from Contracts with Customers**

IFRS 15, Revenue from Contracts with Customers (“IFRS 15”) was issued by the IASB in May 2014. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. IFRS 15 supersedes the following standards: IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers, and SIC-31 Revenue - Barter Transactions Involving Advertising Services.

The Company has commenced a review process to assess any impact on its current revenue recognition policies and reporting processes.

IFRS 16, Leases

On January 13, 2016, the IASB issued IFRS 16, which outlines requirements for lessees to recognize assets and liabilities for most leases. Lessees are required to recognize the lease liability for the obligations to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Lease liability is measured at the present value of lease payments to be made over the term of the lease. The right-of-use asset is initially measured at the amount of the lease liability and adjusted for prepayments, direct costs and incentives received.

The new standard will be effective for annual periods beginning on or after January 1, 2019. Early recognition is permitted, provided the new revenue standard, IFRS 15 Revenue from Contracts with Customers, has been applied, or is applied at the same date as IFRS 16. The Company has commenced a review process to assess any impact on its current revenue recognition policies and reporting processes.

IFRS 2, Share-based Payment (“IFRS 2”)

In June 2016, the IASB issued final amendments to IFRS 2, clarifying how to account for certain types of share-based payment transactions. The amendments, which were developed through the IFRS Interpretations Committee, provide requirements on the accounting for: (i) the effect of vesting and non-vesting conditions on the measurement of cash-settled share-based payments; (ii) share-based payment transactions with a net settlement feature for withholding tax obligations; and (iii) a modification to the terms and conditions of a share-based payment that changes the classifications of the transaction from cash-settled to equity-settled. The effective date for this standard is for reporting periods beginning on or after January 1, 2018, with earlier application permitted. The Company has completed the review process to assess the impact and application of the aforementioned amendments and has determined it will have no impact on the Company.

IFRIC 22, Foreign Currency Transactions and Advance Consideration

In 2016, the IASB issued IFRIC Interpretation 22, Foreign Currency Transactions and Advance Consideration (“IFRIC 22”) which provides requirements about which exchange rate to use in reporting foreign currency transactions (such as revenue transactions) when payment is made or received in advance. IFRIC 22 is effective for annual periods beginning on or after January 1, 2018, with earlier adoption permitted. On initial application, entities have the option to apply either retrospectively or prospectively. The Company is in the process of evaluating the impact of adopting these amendments on the Company’s consolidated financial statements.

5. INVENTORIES

Inventories as at September 30 consist of the following:

	2017	2016
Raw material	\$ 379,661	\$ 253,556
Work in process	1,593,158	840,249
Finished goods	2,494,287	2,302,188
	\$ 4,467,106	\$ 3,395,993

During the year ended September 30, 2017, inventories in the amount of \$5,287,781 (2016 - \$4,474,038) were recognized as an expense through cost of sales. The allowance for inventory impairment as at September 30, 2017 was \$30,561 (2016 - \$30,561).

6. PREPAID EXPENSES AND OTHER ASSETS

Prepaid expenses and other assets as at September 30, 2017 were \$152,989 (2016 - \$55,541) and primarily consist of insurance policy premiums.

MICROBIX**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Canadian Funds

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7. PROPERTY, PLANT, AND EQUIPMENT

The freehold land and buildings have been pledged as security for bank loans under a mortgage (see Note 10). Property plant and equipment consists of:

	Building	Research & development equipment	Other equipment & fixtures	Land	Total
<u>Cost</u>					
Balance, Sept 30, 2015	\$4,551,102	\$6,227,011	\$4,348,886	\$800,000	\$15,926,999
Additions	11,281	567,301	123,997	-	702,579
Disposals	-	-	-	-	-
Balance, Sept 30, 2016	4,562,383	6,794,312	4,472,883	800,000	16,629,578
Additions	2,996	145,420	132,157	-	280,573
Disposals	-	-	-	-	-
Balance, Sept 30, 2017	4,565,379	6,939,732	4,605,040	800,000	16,910,151
<u>Accumulated depreciation</u>					
Balance, Sept 30, 2015	942,608	531,277	2,585,638	-	4,059,523
Disposals	-	-	-	-	-
Depreciation	152,504	27,822	137,745	-	318,071
Balance, Sept 30, 2016	1,095,112	559,099	2,723,383	-	4,377,594
Disposals	-	-	-	-	-
Depreciation	152,420	23,869	144,498	-	320,787
Balance, Sept 30, 2017	1,247,532	582,968	2,867,881	-	4,698,381
<u>Net book value</u>					
Balance, Sept 30, 2015	3,608,494	5,695,734	1,763,248	800,000	11,867,476
Balance, Sept 30, 2016	3,467,271	6,235,213	1,749,500	800,000	12,251,984
Balance, Sept 30, 2017	\$3,317,847	\$6,356,764	\$1,737,159	\$800,000	\$12,211,770

Included in research and development equipment is \$6,169,265 not yet available for use. Included in these amounts is directly attributable interest from borrowings to finance these asset additions of \$145,421 (2016 - \$154,492). These assets are not yet subject to depreciation. During the year, the Company entered into a five-year lease agreement for the acquisition of production equipment and \$98,518 was capitalized to Other Equipment and Fixtures.

8. INTANGIBLE ASSETS

Intangible assets are depreciated on a straight line basis at the following rates:

License agreement, LumiSort™ (Note 8a)	5%
Technology investments:	
LumiSort™ (Note 8a)	5%
Kinlytic® (Note 8b)	0%
Bioreactor (Note 8c)	7%

Intangible assets consist of:

	Capitalized development costs		Patents and trademarks		Licenses	Total
	LumiSort™ (a)	Bioreactor (c)	Kinlytic® (b)	LumiSort™ (a)	LumiSort™ (a)	
Cost						
Balance, as at September 30, 2015	30,532	1,062,426	2,770,529	2,041,777	278,528	6,183,792
Additions from internal developments	-	938,547	-	-	-	938,547
Balance at September 30, 2016	30,532	2,000,973	2,770,529	2,041,777	278,528	7,122,339
Additions from internal developments	-	87,600	308,057	73,459	-	469,116
Balance at September 30, 2017	30,532	2,088,573	3,078,586	2,115,236	278,528	7,591,455
Accumulated amortization						
Balance, as at September 30, 2015	4,725	-	-	603,495	214,251	822,471
Amortization expense	1,032	-	-	73,151	21,425	95,608
Balance at September 30, 2016	5,757	-	-	676,646	235,676	918,079
Amortization expense	991	11,603	-	155,353	21,425	189,372
Balance at September 30, 2017	6,748	11,603	-	831,999	257,101	1,107,451
Net book value						
Balance, September 30, 2015	25,807	1,062,426	2,770,529	1,438,282	64,277	5,361,321
Balance, September 30, 2016	24,775	2,000,973	2,770,529	1,365,131	42,852	6,204,260
Balance, September 30, 2017	\$23,784	\$2,076,970	\$3,078,586	\$1,283,237	\$21,427	\$6,484,004

a) Lumisort™

The Company acquired a license agreement from Sequent Biotechnologies Inc., a biotechnology company solely involved in the development and commercialization of the LumiSort™ technology under license. New intellectual property with the issue of patents has resulted from this research program. These assets are in the process of being developed and new patents are pending and under development.

The recoverable amount of the Lumisort intangible has been determined based on its fair value less cost to sell. Key assumptions include growth rates in line with industry expectations and a discount rate determined based on the Company's best estimate of a risk adjusted discount rate.

b) Kinlytic®

The Company acquired the assets and rights pertaining to development, production, and licensing of Kinlytic® from ImaRX Therapeutics, Inc. in 2008. These assets are in the process of being developed and new patents are pending and under development.

The recoverable amount of the Kinlytic® intangible has been determined based on its fair value less cost to sell. This estimate uses risk-adjusted cash flow projections based on financial budgets.

As at and for the years ended September 30, 2017 and 2016
8. INTANGIBLE ASSETS (Continued)
b) Kinlytic* (Continued)

Management made these assumptions based on probabilities of technical, regulatory and clinical acceptances and financial support. Management believes that any reasonably possible change in the key assumptions on which the recoverable amount is based would not cause the carrying amount to exceed its recoverable amount. The discount rate has been determined based on the Company's best estimate of a risk-adjusted discount rate. No amortization has been recorded, as the assets are not yet available for use.

c) Bioreactor

The Company has internally developed an improved bioreactor production process ("Bioreactor") to increase the efficiency and output of manufacturing certain virology products.

9. DEBENTURES

The Company has convertible and non-convertible debentures issued and outstanding as at September 30, 2017. The carrying values of the debt component of these debentures are as follows:

	Non-convertible Debentures		Non-convertible Debentures Total	Convertible Debentures		Convertible Debentures Total
	(a)	(b)		(c)	(d)	(e)
Date of issue	Jan, 2014	Apr, 2017		Oct, 2016	Oct, 2016	Oct, 2016
Face value	\$ 2,000,000	\$ 500,000	\$ 2,500,000	\$ 1,500,000	\$ 500,000	\$ 2,500,000
Liability component at the date of issue	928,373	268,955	-	461,550	223,050	780,750
Balance, September 30, 2017	894,955	275,162	\$ 1,170,117	470,692	247,265	\$ 1,515,888
Less: current portion	92,136	275,162	\$ 367,298	-	247,265	-
Non-current portion	802,819	-	\$ 802,819	470,692	-	\$ 1,268,623
Balance, September 30, 2017	894,955	275,162	1,170,117	470,692	247,265	1,515,888
Equity component reclassified to contributed surplus upon extinguishment	-	28,295	\$28,295	916,971	111,042	1,236,732
Equity component at September 30, 2017	-	-	-	574,435	631,222	1,698,132
Loss / (gain) on date of extinguishment - Oct 2016	-	197,578	\$ 197,578	494,575	361,460	1,528,913
Loss / (gain) on date of extinguishment - April 2017	-	(202,750)	\$ (202,750)	-	-	-
Conversion price per per common share	\$ -	\$ -		\$ 0.23	\$ 0.23	\$ 0.23
Effective interest rate charged	25.69%	30.20%		31.07%	30.20%	30.85%
Payment frequency	Quarterly	Quarterly		Quarterly	Quarterly	Quarterly
Maturity of financial instrument	Jan, 2029	Apr, 2022		Jan, 2029	Feb, 2022	Sep, 2028
Stated interest rate	9%	12%		9%	9%	9%
Terms of repayment	Principal	Interest		Interest	Interest	Interest
	and interest	only		only	only	only
Blended quarterly repayment	\$ 61,071	N/A		N/A	N/A	N/A

As at and for the years ended September 30, 2017 and 2016
9. DEBENTURES (Continued)

The Company had convertible and non-convertible debentures issued and outstanding as at September 30, 2016. The carrying values of the debt component of these debentures were as follows:

Note	Non-convertible	Convertible Debentures				Total Convertible
	Debentures	(b)	(c)	(d)	(e)	Debentures
	(a)					
Date of issue	Jan, 2014	Oct, 2006	Jan, 2014	Feb, 2007	Sep, 2008	
Proceeds of issue	\$ 2,000,000	\$ 500,000	\$ 1,500,000	\$ 500,000	\$ 2,500,000	\$ 5,000,000
Liability component at						
the date of issue	928,373	413,320	517,470	388,958	885,089	
Balance, September 30, 2016	879,304	498,786	537,686	492,812	949,971	\$ 2,479,255
Less: current portion	244,284	498,786	135,000	492,812	225,000	\$ 1,351,598
Non-current portion	635,020	-	402,686	-	724,971	\$ 1,127,657
Balance, September 30, 2016	879,304	498,786	537,686	492,812	949,971	2,479,255
Equity component at September 30, 2016	-	86,680	916,971	111,042	1,236,732	\$ 2,351,425
Conversion price per per common share	\$ -	\$ 0.90	\$ 0.35	0.90	\$ 0.65	
Effective interest rate charged	25.69%	12.00%	27.03%	13.00%	25.69%	
Payment frequency	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	
Maturity of financial instrument	Jan, 2029	Oct, 2016	Jan, 2029	Feb, 2017	Sep, 2028	
Stated interest rate	9%	9%	9%	9%	9%	
Terms of repayment	Principal and interest	Interest only	Interest only	Interest only	Interest only	
Blended quarterly repayment	\$ 61,071	N/A	N/A	N/A	N/A	

As discussed in note 10, the Company arranged a new secured revolving credit facility jointly with The Toronto-Dominion Bank (“TD Bank”) and Export Development Canada (“EDC”). To accommodate the additional security required by TD Bank and EDC, effective October 12, 2016, the Company negotiated amended terms with the holders of its issued and outstanding convertible debentures. The following debentures were amended: \$2,500,000 debenture (e) above, \$1,500,000 debenture (c) above, \$500,000 (b) above and \$500,000 (d) above, in exchange for reducing their security position to one of unlimited subordination to the credit facility lenders.

The \$2,500,000 debenture, (e) above, maturing in 2028 was originally convertible at \$0.65 per common share, and the \$1,500,000 debenture, (c) above, maturing in 2029 was originally convertible at \$0.35 per common share. The conversion price for both of these debentures has been amended to \$0.23 per common share, and these debentures are now subject to restricted conversion privileges of a combined total of 1 million shares per year for the next five years, with the remaining balances being eligible for conversion through the end of their expiry dates in 2028 and 2029, respectively.

The two \$500,000 debentures, (b) and (d) above, were originally convertible at \$0.90 per common share and matured on October 12, 2016 and February 15, 2017, respectively. The first \$500,000 debenture, (b) above has been modified to extend its maturity date to April 30, 2017 and was modified to become non-convertible. In addition, the stated interest rate was modified from 9% to 12% for the remaining term (see paragraph below for further details on this debenture). The second \$500,000 debenture, (d) above, has been modified to extend its maturity date to February 15, 2022, and the conversion price has been modified from \$0.90 to \$0.23 per common share. The debenture is now callable at the option of the holder at any time after February 15, 2017 for outstanding principal and accrued interest. In addition, the debenture holder of both \$500,000 debentures (b) and (d) received 1.5 million common share purchase warrants, with an exercise price of \$0.23 per common share and a term of five years.

9. DEBENTURES (Continued)

The Company has accounted for the modifications to each of the debentures as an extinguishment with the recognition of a new instrument. Upon extinguishment of the debentures, the Company has recognized a non-cash loss of \$2,379,776 in the consolidated statement of income and comprehensive income. The Company measured the non-cash loss based on the change in fair value of the debentures under the original terms and the modified terms. In addition, a value of \$245,860 has been ascribed to the warrants issued at the time of the grant. The value is determined using the Black-Scholes option pricing model, which is affected by the Company's share price as well as assumptions regarding a number of subjective variables.

On April 28, 2017, the Company announced it has reached an agreement with one of its debenture holders to extend the maturity date on the \$0.5 million non-convertible debenture set to mature on April 30, 2017, (b) above, to April 30, 2022. The debenture is callable at the option of the holder upon sixty days written notice to the Company. The Company has accounted for the modifications to each of the debentures as an extinguishment with the recognition of a new instrument. Upon extinguishment of the debenture, the Company has recognized a non-cash gain of \$202,750 in the consolidated statement of income and comprehensive income. In addition, as part of the amendment, the Company amended the terms of 300,000 outstanding common share purchase warrants held by the debenture holder. The terms of the warrants were modified to extend the life of the warrants from August 21, 2019 to August 21, 2022 and modify the exercise price from \$0.55 to \$0.25 per share. The modification of the debenture was accounted for as an extinguishment with recognition of a new instrument. In addition, the modification of the warrants resulted in a non-cash loss of \$28,295.

The debentures denoted as (a), (c), and (e) above are secured against the real property and the personal property of the Company including, without limiting the foregoing, a registered second mortgage on the property at 265 Watline Avenue, Mississauga, Ontario, in favour of the holder, its successors and assigns subordinate only to indebtedness to a Canadian chartered bank or similar financial institution on normal commercial terms up to their maximum principal. The debentures denoted as (b) and (d) are secured by a subordinated security agreement covering all of the Company's property and assets.

Convertible debentures contain two components: liability and equity elements. The equity element is presented in equity under the heading of "equity component of debentures". Convertible debentures are initially accounted for in accordance with their substance and are presented in the consolidated financial statements in their component parts measured at the time of issue. The debt components were valued first with the residual to shareholders' equity. The convertible debentures are convertible at the option of the holder, at any time, into fully paid and non-assessable common shares of the Company at the conversion price then in effect.

All of the debentures were issued to shareholders of the Company. A holder of a debenture has an economic interest in future earnings of the Lumisort asset and will receive a distribution equal to 10% of any future earnings that are derived from the Lumisort asset. Over the term of the convertible debentures, the debt components will be accreted to the face value of the debentures by the recording of additional interest expense using the effective interest rate, as detailed above.

10. LONG-TERM DEBT

- a) In fiscal 2009, the Company negotiated a series of loans totalling \$3,061,000 with the Business Development Bank (“BDC”) for the original purchase and build-out of its manufacturing facility.

Purchase of the building	\$ 1,500,000
Construction of manufacturing facility	1,500,000
Purchase of equipment for facility	61,000
	\$ 3,061,000

The loans are secured with the building and equipment. For loans totalling \$3,000,000, consecutive monthly principal payments of \$9,260 are due to February 2037 on the outstanding balance of \$2,268,700 (September 30, 2016 - \$2,379,820). For loans totalling \$61,000, consecutive monthly principal payments of \$725 are due to February 2017 on the outstanding balance of \$0 (September 30, 2016 - \$3,625), as this loan is now fully paid. Both of the loans have a floating interest rate based on BDC’s Floating Base Rate plus 0.5%. At September 30, 2017, the Floating Base Rate was 5.8%.

In fiscal 2015 and 2016, the Company negotiated a series of loans totalling \$1,115,000 with the BDC, for process equipment upgrades in its manufacturing facility.

Equipment for Bioreactor Project	\$ 615,000
Construction of manufacturing facility	50,000
Purchase of equipment for facility	200,000
Working capital loan	250,000
	\$ 1,115,000

For loans totalling \$615,000, consecutive monthly principal payments of \$10,250 are due to July 2020 on the outstanding balance of \$348,500 (September 30, 2016 - \$471,500). For loans totalling \$50,000, consecutive monthly principal payments of \$1,040 are due to December 2019 on the outstanding balance of \$28,080 (September 30, 2016 - \$40,560). For loans totalling \$200,000, consecutive monthly principal payments of \$3,330 are due to December 2020 on the outstanding balance of \$129,870 (September 30, 2016 - \$169,830). On October 9, 2015, the Company entered into a loan agreement with BDC for \$250,000, monthly principal payments of \$4,160 are due on December 22, 2020 on the outstanding balance of \$162,240 (September 30, 2016 - \$212,160).

All BDC loans have a floating interest rate based on BDC’s floating base rate plus 0.5% - 1.8%. At September 30, 2017, the floating base rate was 5.8%.

The commitment for the next five years and thereafter for the BDC loans is as follows:

2018	\$ 336,480
2019	336,480
2020	306,620
2021	133,590
2022	111,120
2023 and thereafter	\$ 1,713,100

- b) On October 20, 2016, the Company arranged a new revolving line of credit agreement with its Canadian chartered bank. The agreement allowed the Company to draw on to a limit of \$1,000,000 bearing interest at the bank’s prime lending rate plus 2.25%. Accounts receivable, inventory and certain property are pledged as collateral for the bank credit facility.

On April 28, 2017, the Company received approval from its Chartered Bank to increase the borrowing limit on its new credit facility to \$1.5 million. The new credit facility was implemented in October 2016 with an initial limit of \$1.0 million, replacing the Company’s previous credit facility of \$0.5 million. The newly expanded credit facility was available on May 4, 2017.

As at September 30, 2017 the Company had drawn on \$1,355,000 of the facility (2016 - \$525,000).

10. LONG-TERM DEBT (Continued)

- c) On December 31, 2015, the Company issued two outstanding shareholder loans for total proceeds of \$200,000. These loans were repaid on December 31, 2016.
- d) On May 3, 2017, the Company signed an agreement with Business Development Corporation for a new equipment credit facility in the amount of \$610,000. As of September 30, 2017 no funds have been withdrawn against this loan.
- e) On September 12, 2017, the Company issued two outstanding shareholder interest bearing loans for total proceeds of \$200,000. These loans were repaid on October 23, 2017.

11. DEFERRED REVENUE

As at September 30, 2017, the Company has received payment, in the amount of \$1,145,185 (2016 - \$683,494), for a portion of product sales that was not yet shipped. This amount has been recognized as deferred revenue under current liabilities in the consolidated statements of financial position.

12. SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares with no par value and an unlimited number of preference shares with no par value.

The number of issued and outstanding common shares and the stated capital of the Company as at September 30, 2017 are presented below:

	2017	2016
Common shares issued during the year	-	\$ 1,500,000
Proceeds, net of financing costs	-	308,957
Warrants exercised	-	-
Stock options exercised	-	-
	Number of Shares	Share Capital
Balance, September 30, 2015	83,204,257	\$ 30,990,459
Issued on private placement	1,500,000	308,957
Exercise of warrants	-	-
Exercise of stock options	-	-
Balance, as at September 30, 2016 and September 30, 2017	84,704,257	\$ 31,299,416

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13. CONTRIBUTED SURPLUS

Changes in contributed surplus up to September 30, 2017 are described as follows:

	Amount
Balance, as at September 30, 2015	\$ 4,380,182
Issuance of warrants pursuant to private placement	237,931
Share issue costs pursuant to private placement	(15,214)
Stock option expense	334,750
Balance, as at September 30, 2016	\$ 4,937,649
Issuance of warrants pursuant to refinancing of convertible debentures	245,860
Reclassification of equity portion of a convertible debenture converted to a non convertible debenture	86,680
Extinguishment of convertible debenture	2,293,040
Stock option expense	485,086
Balance, as at September 30, 2017	\$ 8,048,315

14. COMMON SHARE PURCHASE WARRANTS

A continuity of the Company's warrants outstanding as at September 30, 2017 is presented in the following table:

	Units	Weighted average exercise price
Outstanding, September 30, 2015	5,442,842	\$ 0.54
Issued	1,581,550	\$ 0.55
Expired	-	-
Outstanding, September 30, 2016	7,024,392	\$ 0.54
Issued	1,500,000	\$ 0.23
Expired	(193,079)	\$ 0.25
Outstanding, September 30, 2017	8,331,313	\$ 0.48

A summary of the Company's warrants outstanding as at September 30, 2017 is presented in the following table:

	2017			2016		
	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)
Range of exercise prices:						
\$0.45 to \$0.55	6,531,313	\$ 0.55	2.18	6,831,313	\$ 0.55	3.13
\$0.23 to \$0.44	1,800,000	0.23	3.65	193,079	0.25	0.02
	8,331,313	\$ 0.48	2.50	7,024,392	\$ 0.54	3.13

As at and for the years ended September 30, 2017 and 2016

15. STOCK OPTION PLAN

Under the Company's stock option plan, the total number of common shares available to be issued under the plan is 12,000,000 common shares. As at September 30, 2017, the Company has a total of 6,470,000 options issued and pending (2016 – 4,007,000).

The exercise price of each option equals no less than the market price at the date immediately preceding the date of the grant. In general, options issued under the plan vest and are exercisable in equal amounts in three steps, at the issue date and at the anniversary date in the subsequent two years.

The activity under the Company's stock option plan for the year ended September 30, 2017 is as follows:

	Units	Weighted average exercise price
Outstanding, September 30, 2015	4,872,000	\$ 0.45
Issued	-	-
Exercised	-	-
Expired or forfeitted	(865,000)	0.37
Outstanding, September 30, 2016	4,007,000	0.47
Issued	3,220,000	0.28
Exercised	-	-
Expired or forfeitted	(757,000)	-
Outstanding, September 30, 2017	6,470,000	0.39
Exercisable, September 30, 2017	2,300,500	\$ 0.50

The following table reflects the number of options, their weighted average price and the weighted average remaining contract life for the options grouped by price range as of September 30, 2017:

	2017			2016		
	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)
Range of exercise prices:						
\$0.54	2,920,000	\$ 0.54	3.00	2,923,000	\$ 0.54	2.79
\$0.23 to \$0.28	3,550,000	\$ 0.27	4.33	1,084,000	\$ 0.28	2.10
	6,470,000	\$ 0.39	3.73	4,007,000	\$ 0.47	2.60

The fair value of options granted during the year ended September 30, 2017 was estimated at the grant date using the Black-Scholes options pricing model, resulting in the following assumptions:

	Nov. 1, 2016	Aug. 3, 2017
Share price on issue date	\$ 0.23	\$ 0.27
Dividend yield	\$ -	\$ -
Volatility	92.9%	86.7%
Risk-free interest rate	1.40%	0.75%
Expected option life (years)	6.0	5.0
Weighted average fair value of each option (\$/option)	\$ 0.17	\$ 0.18

The volatility of the stock for the Black-Scholes options pricing model was based on 5-year historic volatility of the Company's stock price on the Toronto Stock Exchange. Management believes that the historic stock volatility provides a fair and appropriate basis of estimate for the expected future volatility of the stock. Stock options are assumed to be exercised at the end of the option's life, as management believes the probability of an early exercise is remote. During the year, the fair value of the options vested in the year were expensed and credited to contributed surplus. The Company recorded share-based compensation expense of \$485,086 (2016 - \$334,750) during 2017.

As at and for the years ended September 30, 2017 and 2016

16. INCOME (LOSS) PER SHARE

Basic income per share is calculated using the weighted average number of shares outstanding. Diluted income per share reflects the dilutive effect of the exercise of stock options, warrants and convertible debt. The following table reconciles the net income and the number of shares for the basic and diluted income (loss) per share computations:

	2017	2016
Numerator for basic income (loss) per share:		
Net income available to common shareholders	\$ (3,780,088)	\$ 748,407
Denominator for basic income per share:		
Weighted average common shares outstanding	84,704,257	84,656,531
Effect of dilutive securities:		
Warrants	294,624	20,687
Stock Options	21,792	28,571
Convertible debentures	-	-
Denominator for diluted income per share	<u>85,020,673</u>	<u>84,705,789</u>
Income per share		
Basic	(\$0.045)	\$0.009
Diluted	(\$0.045)	\$0.009

The following represents the warrants, stock options and convertible debentures not included in the calculation of diluted EPS due to their anti-dilutive impact:

	2017	2016
Pursuant to warrants	8,036,689	6,831,313
Under stock options	6,448,208	3,607,000
Pursuant to convertible debentures	19,565,217	9,242,979
	<u>34,050,115</u>	<u>19,681,292</u>

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17. EXPENSES BY NATURE

The Company has chosen to present its consolidated statements of comprehensive income (loss) based on the functions of the entity and include the following expenses by nature:

Depreciation and amortization

	2017	2016
Included in:		
Cost of goods sold	\$ 308,521	\$ 290,249
General and administrative expenses	991	1,032
Research and development expenses	200,647	122,398
Total depreciation and amortization	\$ 510,159	\$ 413,679

Employee costs

	2017	2016
Short-term wages, bonuses and benefits	\$ 4,748,874	\$ 3,586,991
Share based payments	485,086	334,750
Total employee costs	5,233,960	3,921,741

Included in:		
Cost of goods sold	2,740,641	2,168,349
Research and development expenses	682,102	347,081
General and administrative expenses	1,468,312	1,033,739
Selling and business development expenses	342,905	372,572
Total employee costs	\$ 5,233,960	\$ 3,921,741

18. INCOME TAXES

Income Taxes consist of the following, as at September 30:

	2017	2016
Provision based on combined federal and provincial statutory rates of 25.00% (2016 – 25.00%)	\$ (945,022)	\$ 37,102
Increase (decrease) resulting from:		
Non deductible expenses	552	88
Stock-based compensation	121,272	83,688
Effect of change in tax rate	-	205,745
Valuation allowance	(22,903)	(789,889)
Other	396,101	(136,734)
Current income tax expense	\$ (450,000)	\$ (600,000)

As at and for the years ended September 30, 2017 and 2016

18. INCOME TAXES (Continued)

The Company has unclaimed research and development expenses, research and development investment tax credits and accumulated losses for income tax purposes. Certain of these credits have been recognized to the extent that it is probable that there will be sufficient taxable income against which to utilize the benefits of the credits in the foreseeable future.

The accumulated non-capital losses may be used to reduce taxable income in future years and must be claimed no later than September 30:

2029	\$ 155,000
2030	476,000
2031	1,145,000
2032	1,223,000
2037	122,000
	\$ 3,121,000

The significant components of deferred income tax assets are summarized as follows:

	2017	2016
Deferred income tax assets:		
Non-capital loss carry-forwards	\$ 780,350	\$ 680,097
Difference in net book value compared to undepreciated capital cost	529,057	535,598
Deferred revenue	18,028	183,325
Unclaimed research and development expenditures	3,864,446	3,664,086
Deferred income tax liability related to debentures	(1,009,781)	(862,484)
Tax assets not recognized	(4,182,100)	(4,200,622)
Deferred tax assets	-	-

The unclaimed research and development investment tax credits before income tax effect may be carried forward and used to reduce federal income taxes. These must be claimed no later than September 30:

2022	\$ 15,000
2023	160,000
2024	149,000
2025	303,000
2026	293,000
2027	304,000
2028	395,000
2029	175,000
2030	220,000
2031	170,000
2032	123,000
2033	107,000
2034	67,000
2035	159,000
2036	126,000
2037	97,000
	\$ 2,863,000

MICROBIX**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Canadian Funds

As at and for the years ended September 30, 2017 and 2016

18. INCOME TAXES (Continued)

The associated tax benefits relating to the unclaimed credits are as follows:

	2017	2016
Unclaimed research and development tax credits	\$ 2,410,197	\$ 2,120,578
Tax assets not recognized	(830,197)	(990,578)
Deferred tax assets related to investment tax credits	\$ 1,580,000	\$ 1,130,000

19. CHANGES IN NON-CASH WORKING CAPITAL

	2017	2016
Accounts receivable	\$ 684,384	\$ (329,798)
Inventories	(1,071,113)	229,275
Prepaid expenses and other assets	(97,448)	160,848
Investment tax credits receivable	32,604	(32,148)
Accounts payable and accrued liabilities	943,435	(589,498)
	\$ 491,863	\$ (561,321)

20. FINANCIAL EXPENSES

	2017	2016
Cash interest:		
Interest on long-term debt	\$ 164,305	\$ 132,799
Interest on debentures	490,292	463,955
Other Interest	71,453	10,650
Interest income	(22)	(615)
Non-cash interest:		
Accretion on debentures	198,560	83,849
Financial expenses	\$ 924,589	\$ 690,637

21. CAPITAL MANAGEMENT

The Company's capital management objective is to safeguard its ability to function as a going concern to maintain its virology operations and to fund its development activities. Microbix defines its capital to include the revolving line of credit, shareholders' equity, the Business Development Bank capital loans, and the debentures. The capital at September 30, 2017 was \$22,153,078 (2016 - \$22,328,085).

To date, the Company has used its cash flow, common equity issues, debentures, bank mortgage and other financing to fund its activities. The equity is through private placements, the debentures are all controlled by private individuals known to the Company and the mortgage and other financing are with the Business Development Bank. If possible, the Company tries to optimize its liquidity needs by non-dilutive sources, including investment tax credits, grants and interest income. The Company has a revolving line of credit of \$1,500,000 with its Canadian chartered bank to fund its activities, Note 10(b).

The Company's general policy is to not pay dividends and retain cash to keep funds available to finance the Company's growth. However, the Board of Directors may, from time to time, choose to declare a dividend in assets if warranted by circumstances. There was no change during the year in how the Company defines its capital or how it manages its capital.

22. FINANCIAL INSTRUMENTS

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

For the years ended September 30, 2017 and 2016, the Company has carried at fair value financial instruments in Level 1. At September 30, 2017, the Company's only financial instrument measured at fair value is cash, which is considered to be a Level 1 instrument. There were no transfers between levels during the year.

The three levels are defined as follows:

- a) Level 1: Fair value is based on unadjusted quoted prices for identical assets or liabilities in active markets.
- b) Level 2: Fair value is based on inputs other than quoted prices included within Level 1 that are not observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- c) Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs.

	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets measured at fair value:				
Cash	30-Sep-17	\$ 54,460	-	-
Liabilities for which fair values are disclosed:				
Non-convertible debentures	30-Sep-17	-	-	\$ 1,170,117
Convertible debentures	30-Sep-17	-	-	1,515,888
Long-term-debt	30-Sep-17	-	\$ 4,492,390	-

	Date of valuation	Quoted prices in active markets (Level 1)	Significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets measured at fair value:				
Cash	30-Sep-16	\$ 5,415	-	-
Liabilities for which fair values are disclosed:				
Non-convertible debentures	30-Sep-16	-	-	\$ 879,304
Convertible debentures	30-Sep-16	-	-	2,479,255
Long-term-debt	30-Sep-16	-	\$ 4,002,495	-

The fair value of a financial instrument is approximated by the consideration that would be agreed to in an arm's length transaction between willing parties and through appropriate valuation methods, but considerable judgement is required for the Company to determine the value. The actual amount that could be realized in a current market exchange could be different than the estimated value.

The fair values of financial instruments included in current assets and current liabilities approximate their carrying values due to their short-term nature.

The fair value of the long-term debt is based on rates currently available for items with similar terms and maturities. The convertible and non-convertible debenture fair values are not readily determinable as the convertible debentures have been issued to shareholders of the Company. The fair values of financial instruments in other long-term liabilities approximate their carrying values as they are recorded at the net present values of their future cash flows, using an appropriate discount rate.

23. FINANCIAL RISK MANAGEMENT

The primary risks that affect the Company are set out below and the risks have not changed during the reporting periods. The list does not cover all risks to the Company, nor is there an assurance that the strategy of management to mitigate the risks is sufficient to eliminate the risk.

Risks arising from financial instruments and risk management

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange risk), credit risk and liquidity risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance.

Risk management is the responsibility of the corporate finance function. Material risks are monitored and are regularly discussed with the Audit Committee of the Board of Directors.

Credit risk

The Company's cash is held in accounts or short-term interest bearing accounts at one of the major Canadian chartered banks. Management perceives the credit risk to be low. There is a concentration of accounts receivable risk due to the few large customers comprising the Company's international customer base. In the year ended September 30, 2017, five customers accounted for 63% (2016 - five customers accounted for 59%) of revenue. The Company has had minimal bad debts over the past several years and accordingly management has recorded an allowance of \$10,000 (2016 - \$10,000).

Trade accounts receivable are aged as follows as at September 30:

	2017	2016
Current	\$ 1,094,414	\$ 1,659,260
0 - 30 days past due	176,002	96,390
31 - 60 days past due	73,268	276,222
61 days and over past due	3,804	-
Allowance for doubtful accounts	(10,000)	(10,000)
	\$ 1,337,488	\$ 2,021,872

Market risk and foreign currency risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, will affect the Company's income or the value of its financial instruments. The Company's activities that result in exposure to fluctuations in foreign currency exchange rates consist of the sale of products and services to customers invoiced in foreign currencies and the purchase of services invoiced in foreign currencies. The Company does not use financial instruments to hedge these risks. As at September 30, the significant balances, quoted in Canadian dollars, held in foreign currencies are:

	US dollars		Euros	
	2017	2016	2017	2016
Cash	\$ 52,902	\$ 5,259	\$ 5	\$ 29
Accounts receivable	458,941	1,065,198	413,117	674,433
Accounts payable and accrued liabilities	406,000	474,498	11,987	22,451

23. FINANCIAL RISK MANAGEMENT (Continued)
Market risk and foreign currency risk (Continued)

The Company's revenue and expenses by foreign currency for the year ended September 30, 2017 and 2016 are as follows:

	2017	2016
Revenue		
Euros	40%	39%
U.S. dollars	56%	56%
Expenses		
U.S. dollars	9%	7%

The impact of a 5% increase in the U.S. dollar against the Canadian dollar would result in an increase in annual U.S. dollar based revenue of about \$284,600 Cdn. The impact of a 5% increase in the Euro against the Canadian dollar would result in an increase in annual Euro based revenue of about \$201,800. Correspondingly, the impact of a 5% decrease in the U.S. dollar against the Canadian dollar would result in a loss in annual U.S. dollar based revenue of about \$284,600 Cdn. The impact of a 5% decrease in the Euro against the Canadian dollar would result in a loss in annual Euro-based revenue of about \$201,800.

Liquidity risk

Liquidity risk measures the Company's ability to meet its financial obligations when they fall due. To manage this situation, the Company projects and monitors its cash requirements to accommodate changes in liquidity needs. During the first quarter the Company implemented a new secured revolving credit facility with The Toronto-Dominion Bank ("TD Bank") and Export Development Canada ("EDC"). The new credit facility is being used to fund the Company's need for working capital to grow its existing business. Management expects this new facility will satisfy the Company's liquidity needs and help manage the liquidity risk going forward.

Interest rate risk

Financial instruments that potentially subject the Company to cash flow interest rate risk are those assets and liabilities with a variable interest rate. Interest rate risk exposure is primarily on the BDC debt that has a variable rate that is pegged to the bank rate. The rate can be fixed at the Company's option, if the outlook for interest rates should move higher. The only other variable debt the Company has is the \$1,500,000 line of credit that bears interest at the bank's prime lending rate plus 2.25%. A 1% increase in the bank rate would cost the Company approximately \$30,000 per year for BDC and about \$15,000 on the line of credit usage if it were fully used throughout the fiscal year.

24. SEGMENTED INFORMATION

The Company operates in two industries: (i) the development, manufacturing and distribution of cell-based products and technology and, (ii) the provision of facility, technical and production personnel for contract research and development. External revenue by segment is attributed to geographic regions based on the location of customers: North America, Europe and other foreign countries. The following is an analysis of the Company's revenue and profits from continuing operations by reportable segment:

	Segment revenue		Segment profit (loss)	
	2017	2016	2017	2016
Virology products and technologies	\$ 10,185,798	\$ 9,517,137	\$ (3,510,718)	\$ 872,812
Lumisort™	-	-	(269,370)	(124,405)
Kinlytic®	-	-	-	-
Total for continuing operations	<u>\$ 10,185,798</u>	<u>\$ 9,517,137</u>	<u>\$ (3,780,088)</u>	<u>\$ 748,407</u>

Segment revenue reported above represents revenue generated from external customers. There were no inter-segment sales in the current period (2016 - \$Nil).

As at and for the years ended September 30, 2017 and 2016
24. SEGMENTED INFORMATION (Continued)

The accounting policies of the reportable segments are the same as the Company's accounting policies described in Note 3. Segment profit represents the profit before tax. This is the measure reported to the chief operating decision maker for the purposes of resource allocation and assessment of segment performance.

Segmented assets and liabilities as at September 30 are as follows:

	Segment assets		Segment liabilities	
	2017	2016	2017	2016
Virology Products and Technologies	\$ 14,281,312	\$ 12,733,029	\$ 11,262,928	\$ 9,955,722
Lumisort™	7,497,713	8,613,906	-	-
Kinlytic®	3,078,586	2,770,528	-	-
	<u>\$ 24,857,611</u>	<u>\$ 24,117,463</u>	<u>\$ 11,262,928</u>	<u>\$ 9,955,722</u>

All assets are allocated to reportable segments other than current and deferred tax assets. Assets used jointly by reportable segments are allocated on the basis of the revenues earned by individual reportable segments. All liabilities are allocated to reportable segments other than borrowings and current and deferred tax liabilities. Liabilities for which reportable segments are jointly liable are allocated in proportion to segment assets.

Segmented depreciation and amortization and additions to non-current assets as at September 30 are as follows:

	Depreciation and amortization		Additions to non-current assets	
	2017	2016	2017	2016
Virology Products and Technologies	\$ 332,390	\$ 319,103	\$ 222,752	\$ 1,073,825
Lumisort™	177,769	94,576	218,880	567,301
Kinlytic®	-	-	308,057	-
	<u>\$ 510,159</u>	<u>\$ 413,679</u>	<u>\$ 749,689</u>	<u>\$ 1,641,126</u>

25. GEOGRAPHIC INFORMATION

The Company operates in three principal geographical areas – North America (country of domicile), Europe and in other foreign countries. The Company's revenue from continuing operations from external customers by location of customer's operations and information about its non-current assets by location of assets are detailed below.

	Revenue from external customers		Non-current assets	
	2017	2016	2017	2016
North America	\$ 4,082,094	\$ 3,496,147	\$ 20,275,774	\$ 19,586,244
Europe	5,470,037	5,283,841	-	-
Other foreign countries	633,667	737,149	-	-
	<u>\$ 10,185,798</u>	<u>\$ 9,517,137</u>	<u>\$ 20,275,774</u>	<u>\$ 19,586,244</u>

As at and for the years ended September 30, 2017 and 2016

26. RELATED PARTY TRANSACTIONS*Key management compensation*

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. Key management includes directors and key management executive officers. The total number of key management personnel was six during 2017 (2016 – four). Compensation for the Company's key management personnel was as follows:

	2017	2016
Short-term wages, bonuses and benefits	\$ 815,443	\$ 796,880
Share-based payments	423,599	236,329
Total key management compensation	\$ 1,239,042	\$ 1,033,209

The Company has issued and outstanding debentures with two shareholders of the Company (see Note 9). On December 31, 2015, the Company had issued two shareholder loans for total proceeds of \$200,000. On December 31, 2016, the two outstanding shareholder loans were repaid. On September 12, 2017, the Company had issued two interest bearing shareholder loans for total proceeds of \$200,000. These loans were repaid on October 23, 2017.

27. COMMITMENTS AND CONTINGENCIES*Lease commitments*

	Amount
2018	\$ 31,858
2019	27,661
2020	21,703
2021	21,240
2022 and thereafter	12,390
	<u>\$ 114,852</u>

Payments on convertible and non-convertible debentures (Principle and interest) (Note 9)

	Amount
2018	\$ 709,242
2019	709,242
2020	709,242
2021	709,242
2022 and thereafter	9,394,399
	<u>\$ 12,231,367</u>

Contingencies

The Company is party to legal proceedings arising out of the normal course of business. The results of these litigations cannot be predicted with certainty, and management is of the opinion that the outcome of these proceedings is not determinable. Any loss resulting from these proceedings will be charged to operations in the period when the loss becomes probable to occur and reasonably measurable.

28. SETTLEMENT OF DISPUTES AND LAWSUITS**Sale of Microbix' WFI business to Irvine Scientific**

On December 30, 2016, Microbix reached a final settlement with Irvine Scientific Inc. over an ongoing dispute related to the sale of the Company's Water-for-Injection business to Irvine Scientific that occurred in December 2012. Irvine Scientific had filed a Notice of Arbitration with the American Arbitration Association in New York as stipulated in its original agreement with Microbix. Prior to initiation of the arbitration proceeding, the companies agreed on final settlement terms, namely that Microbix will pay Irvine a total amount of (U.S.) \$192,500 (\$273,540 Cdn.) in the following instalments:

- December 30, 2016 - (U.S.) \$64,167
- March 31, 2017 - (U.S.) \$64,167
- June 30, 2017 - (U.S.) \$64,166

All obligations under this settlement were completed at June 30, 2017.

Settlement of Zeptomatrix Lawsuit

On October 5, 2016, Zeptomatrix Corporation filed a statement of claim against Microbix in Canadian Federal Court, alleging infringement of its Canadian patent. During fiscal 2017 Microbix defended itself against these allegations, maintaining it did not infringe this patent. On October 11, 2017 Microbix announced the court approval of a legal dispute settlement with Zeptomatrix Corporation, with the latter party's claims of patent infringement being withdrawn. The withdrawal of the lawsuit was "with prejudice", following a settlement agreement between the parties that was to Microbix' satisfaction.

29. SUBSEQUENT EVENTS

On October 18, 2017 and October 26, 2017 (the "Closing Date"), the Company completed a private placement offering of an aggregate of 11,666,633 units for total gross proceeds of \$3,499,990, net proceeds of \$3,201,997 after share issuance costs of \$297,993. Each unit consists of one common share of Microbix and one half of a common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at an exercise price of \$0.36 for three years. The financing was brokered. Cash commissions of \$299,784 were paid and an aggregate of 755,764 Broker's Warrants were issued in the private placement offering. Each Broker's Warrant entitles the holder to purchase one unit at a price of \$0.335 for a period of two years. All securities issued under the private placement will be subject to a hold period expiring four months and one day from the date of closing.