



## **Convvalo Health International, Corp.**

### **Condensed Consolidated Interim Financial Statements**

#### **2017 Second Quarter**

*For the Periods Ended  
August 31, 2016 and 2015  
(Unaudited)*

*(Expressed in Canadian Dollars in Thousands)*

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# Convalo Health International, Corp.

## Condensed consolidated interim statements of financial position

As of August 31, 2016 (unaudited) and February 29, 2016  
(CAD \$000s)

	August 31, 2016	February 29, 2016
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$11,625	\$19,417
Restricted cash (Note 4)	590	371
Accounts receivable, net (Note 4 and 5)	7,841	6,439
Prepaid expenses	746	710
Other current assets	341	25
<b>Total current assets</b>	<b>\$21,143</b>	<b>\$26,962</b>
<b>Long-term</b>		
Property, plant and equipment (Note 4 and 6)	\$6,778	\$4,172
Deposits and other assets	353	323
Goodwill (Note 4 and 7)	9,938	10,265
Intangible assets, net (Note 4 and 7)	2,565	3,288
Deferred tax assets	532	544
<b>Total long-term assets</b>	<b>\$20,166</b>	<b>\$18,592</b>
<b>TOTAL ASSETS</b>	<b>\$41,309</b>	<b>\$45,554</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$3,530	\$3,380
Current portion of finance leases (Note 8)	166	46
<b>Total current liabilities</b>	<b>\$3,696</b>	<b>\$3,426</b>
<b>Long-term liabilities</b>		
Long-term portion of finance leases (Note 8)	\$2,265	\$73
Deferred tax liabilities	140	138
<b>Total long-term liabilities</b>	<b>\$2,405</b>	<b>\$211</b>
<b>TOTAL LIABILITIES</b>	<b>\$6,101</b>	<b>\$3,637</b>
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 9)	\$40,242	\$40,235
Contributed surplus	3,560	2,330
Accumulated other comprehensive gain	2,545	3,933
Accumulated deficit	(11,139)	(4,581)
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>\$35,208</b>	<b>\$41,917</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$41,309</b>	<b>\$45,554</b>

Approved on behalf of the Board

*David Costine*  
Director [signed]

*Nitin Kaushal*  
Director [signed]

**Convalo Health International, Corp.**  
**Condensed consolidated interim statements of income/loss and comprehensive income/(loss)**

For the three and six months ended August 31, 2016 and August 31, 2015  
 Unaudited  
 (In CAD \$000s)

	Three months ended August 31, 2016	Three months ended August 31, 2015	Six months ended August 31, 2016	Six months ended August 31, 2015
<b>Revenues</b>	<b>\$7,434</b>	\$5,674	<b>\$14,722</b>	\$7,993
<b>Cost of services</b>	<b>2,407</b>	2,026	<b>5,365</b>	2,737
<b>Cost of services – nonrecurring costs</b>	<b>544</b>	-	<b>1,015</b>	-
<b>Gross profit</b>	<b>\$4,483</b>	\$3,648	<b>\$8,342</b>	\$5,256
<b>Expenses</b>				
Facilities	969	469	1,702	699
Sales and marketing	1,265	514	2,578	845
Insurance	249	63	434	85
General and administrative	788	826	1,160	837
Billing and other outside services	943	710	1,727	1,262
Depreciation and amortization	428	44	801	53
Interest expense/(income)	(23)	(11)	(22)	(17)
New facility start-up costs and nonrecurring cost	930	152	3,491	409
Reserve for disputed pricing and bad debt	852	-	1,799	-
Transaction costs	-	32	-	32
<b>Net (loss)/income before stock based compensation</b>	<b>(\$1,918)</b>	\$849	<b>(\$5,328)</b>	\$1,051
Stock based compensation (Note 4)	672	1,319	1,230	1,518
<b>Net (loss)/income</b>	<b>(\$2,590)</b>	(\$470)	<b>(\$6,558)</b>	<b>(\$467)</b>
<b>Other comprehensive income/(loss)</b>				
Cumulative translation adjustment	99	1,834	(1,487)	2,350
<b>Comprehensive income/(loss)</b>	<b>(\$2,491)</b>	\$1,364	<b>(\$8,045)</b>	\$1,883
<b>Basic and diluted loss per share (Note 17)</b>	<b>(\$0.011)</b>	(\$0.002)	<b>(\$0.029)</b>	(\$0.003)

# Convalo Health International, Corp.

## Condensed consolidated interim statements of changes in equity

For the six months ended August 31, 2016 and year ended February 29, 2016

Unaudited  
(CAD \$000s)

	Shares	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive gain (loss)	Total equity
<b>Balance February 28, 2015</b>	<b>108,812,050</b>	<b>\$7,479</b>	<b>\$488</b>	<b>(\$2,106)</b>	<b>\$240</b>	<b>\$6,101</b>
Net loss	-	-	-	(2,475)	-	(2,475)
Other comprehensive gain	-	-	-	-	3,693	3,693
Private placement- bought deal (net of costs) (Note 9 (vi))	43,125,000	10,547	5,236	-	-	15,783
Warrants exercised/expired (net of costs)	62,029,000	17,361	(5,527)	-	-	11,834
Options exercised (Note 10)	2,000,000	348	(143)	-	-	205
Shares issued for purchase of Harmony Hollywood, LLC and Reflections Recovery (Note 9)	12,000,000	4,500	-	-	-	4,500
Option related compensation (Note 4)	-	-	2,276	-	-	2,276
<b>Balance February 29, 2016</b>	<b>227,966,050</b>	<b>\$40,235</b>	<b>\$2,330</b>	<b>(\$4,581)</b>	<b>\$3,933</b>	<b>\$41,917</b>
Net loss	-	-	-	(6,558)	-	(6,558)
Other comprehensive gain	-	-	-	-	(1,388)	(1,388)
Warrants exercised/expired (net of costs)	66,500	7	-	-	-	7
Option related compensation (Note 4)	-	-	1,230	-	-	1,230
<b>Balance August 31, 2016</b>	<b>228,032,550</b>	<b>\$40,242</b>	<b>\$3,560</b>	<b>(\$11,139)</b>	<b>\$2,545</b>	<b>\$35,208</b>

# Convalo Health International, Corp.

## Condensed consolidated interim statements of cash flows

For the six months ended August 31, 2016 and August 31, 2015

Unaudited  
(CAD \$000s)

	Three months ended August 31, 2016	Six months ended August 31, 2016	Three months ended August 31, 2015	Six months ended August 31, 2015
<b>Operating activities</b>				
Net loss	(\$2,590)	(\$6,558)	(\$470)	(467)
<b>Items not affecting cash:</b>				
Stock based compensation	672	1,230	1,319	21
Bad debt and reserve for disputed pricing	852	1,799	-	-
Non-cash transaction fee	-	-	(304)	(304)
Depreciation and amortization	429	795	44	53
	(\$637)	(\$2,735)	\$589	\$698
<b>Changes in working capital:</b>				
Accounts receivable	(1,556)	(3,504)	(498)	(915)
Prepaid expenses, deposits and other assets	(151)	(424)	(248)	(320)
Accounts payable and accrued liabilities	434	734	(335)	(54)
<b>Cash used in operating activities</b>	<b>(\$1,910)</b>	<b>(\$5,928)</b>	<b>(\$492)</b>	<b>(1,986)</b>
<b>Investing activities</b>				
Cash paid for acquisitions, net of cash acquired	-	-	(7,143)	(7,143)
Repayments/(advances) of loan receivable, net	-	-	-	-
Purchases of property, plant and equipment (Note 6)	(460)	(2,957)	(453)	(512)
<b>Cash flow used in investing activities</b>	<b>(\$460)</b>	<b>(\$2,957)</b>	<b>(\$7,596)</b>	<b>(7,655)</b>
<b>Financing activities</b>				
Cash acquired in amalgamation (Note 2)	-	-	304	304
Proceeds from private placements (Note 9)	-	-	274	18,941
Proceeds from long term loans	1,886	1,886	-	-
Proceeds from warrants and options exercised, net of issue costs (Note 10)	-	7	-	7,730
<b>Cash flow provided by financing activities</b>	<b>\$1,886</b>	<b>\$1,893</b>	<b>\$2,444</b>	<b>\$26,975</b>
Effect of foreign exchange rates on cash	(10)	(581)	1,498	1,883
<b>Increase in cash and cash equivalents</b>	<b>(\$494)</b>	<b>(\$7,573)</b>	<b>(\$6,012)</b>	<b>19,217</b>
Cash and restricted cash, beginning of period	12,709	19,788	30,632	5,403
<b>Cash and restricted cash, end of period</b>	<b>\$12,215</b>	<b>\$12,215</b>	<b>\$24,620</b>	<b>24,620</b>

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

Unaudited  
(CAD \$000s)

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### 1. Incorporation and operations

Convalo Health International, Corp. (the "Company" or "Convalo") was incorporated under the Business Corporations Act (British Columbia) ("BCBCA") on June 7, 2013. On February 11, 2015 as a result of the Amalgamation transaction described in Note 2, Convalo obtained the listing status of Valiant Minerals Ltd. ("Valiant"), on the NEX trading board of the TSX Venture Exchange (the "Exchange"). Convalo trades under the trading symbol "CXV."

Convalo is focused on the United States detoxification and outpatient rehabilitation market. The Company operates high-end treatment centers in California and Oregon. In the state of California, treatment centers are located in Los Angeles, Orange County, Corona and San Diego. In the state of Oregon, the centers are located in Portland and the Company's headquarters and registered address is 448 South Hill Street Los Angeles, CA.

### 2. Amalgamation and private placement

On February 11, 2015 Convalo and Valiant Minerals Ltd. ("Valiant"), a corporation incorporated under the BCBCA and listed on the Exchange, completed a triangular amalgamation (the "Amalgamation"), whereby Valiant amalgamated as a wholly owned subsidiary of Convalo, 0986282 B.C. Ltd. (the "Amalgamation Entity"), to form an amalgamated corporation (named Convalo Health International Corp.). As a result of the Amalgamation, all of the property and assets of Valiant and the Amalgamation Entity became the property and assets of Convalo Health International Corp., and all of the liabilities and obligations of Valiant and the Amalgamation Entity became liabilities of Convalo Health Corp. Following the Amalgamation, Convalo obtained the listing status on the Exchange and Valiant ceased to be a reporting issuer.

### 3. Basis of presentation

#### **Statement of compliance**

These condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting. Accordingly, they do not include all of the information required for full annual financial statements required by International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC"). These unaudited condensed interim consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements for the fifteen months ended February 29, 2015.

The condensed consolidated interim financial statements were approved and authorized for issue by the Board of Directors on October 28, 2016.

#### **Basis of presentation and measurement**

The condensed consolidated interim financial statements are prepared on a going concern basis and have been presented in Canadian dollars (in thousands), except for share and per share information. These condensed consolidated interim financial statements have been prepared under the historical cost convention, except for the measurement of certain financial instruments at fair value as required by IFRS.

#### **Basis of consolidation**

The Company consolidates all subsidiaries. As such, assets, liabilities, revenues and expenses of all subsidiaries have been consolidated. All inter-company transactions and balances with subsidiaries have been eliminated. The functional currency for Convalo Health International, Corp. is Canadian dollars.

The consolidated entities include the following wholly-owned subsidiaries:

<i>Entity</i>	<i>Country of domicile</i>	<i>% ownership</i>	<i>Functional currency</i>
Convalo Health International Corp.	Canada	100%	Canadian dollars
Accredited Rehab and Treatment Services, LLC	United States	100%	United States dollars
BLVD Centers Inc.	United States	100%	United States dollars
CBD Laboratories, Inc.	United States	100%	United States dollars
Convalo Health, Inc.	United States	100%	United States dollars
Harmony Hollywood, LLC	United States	100%	United States dollars
Reflections Recovery, LLC	United States	100%	United States dollars
San Diego Detox, Inc.	United States	100%	United States dollars
Portland Detox & Residential, Inc.	United States	100%	United States dollars

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

Unaudited  
(CAD \$000s)

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As of August 31, 2016 and 2015, and for all the periods then ended, all of the Company's revenues were earned and all of the Company's non-current assets were located in the United States.

### **Reporting Currency**

All values are in Canadian dollars (\$) in thousands, unless specifically indicated otherwise. United States dollars are indicated as US\$.

## **4. Summary of significant accounting policies**

The condensed consolidated interim financial statements include the following significant accounting policies:

### **Revenue recognition**

The Company's revenues primarily consist of service charges related to providing addiction treatment and related services to clients in both inpatient and outpatient settings. The majority of the Company's revenues are reimbursable by commercial payors, at out-of-network rates, with the remaining revenues payable directly by the Company's clients. The Company bills commercial payors, once insurance has been verified and services have been performed, based on usual and customary rates for each service. These billed rates are discounted to expected reimbursement rates (or net realizable value) as determined by management after taking into account the type of services provided and the historical collections received from the commercial payors for each service, on a per facility basis. Revenue from commercial payors is recognized based on these expected reimbursement rates at the time services are provided. Revenue from clients is recognized based on collections, once services have been completed. Collections occur upon admission and/or are billed and collected once a client discharges from treatment. From time to time, the Company provides free care to a limited number of clients, which are referred to as scholarships. The Company does not recognize revenues for scholarships provided.

### **Cash and restricted cash**

Cash comprise cash on hand and demand deposits that are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value. Cash held in trust or escrow, or that the Company is otherwise restricted from using, is classified as restricted cash and shown separately on the consolidated statements of financial position.

### **Accounts receivable**

Accounts receivable are recorded at the time revenue is recognized and are presented on the statements of financial position net of allowance for doubtful accounts. The Company performs regular analyses to evaluate the net realizable value of accounts receivable as of the statement of financial position date. Specifically, the Company considers historical realization data, accounts receivable aging trends, other operating trends and relevant business conditions.

### **Income taxes**

The Company and its subsidiaries are generally taxable under the statutes of their country of incorporation. Current income tax assets and liabilities for the current and prior period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the reporting date in the countries where the Company operates and generates taxable income. Current income tax relating to items recognized directly in equity is recognized in equity and not in the statement of loss and comprehensive income. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate. The Company follows the liability method of accounting for deferred taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to the temporary differences between the carrying value of the assets and liabilities on the financial statements and their respective tax bases.

Deferred tax liabilities are recognized for all taxable temporary differences, except where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss or in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and the carry forward of unused tax credits and unused tax losses can be utilized.

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

Unaudited

(CAD \$000s)

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The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the reporting date.

Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to offset current income tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Tax benefits acquired as part of a business combination, but not satisfying the criteria for separate recognition at that date, would be recognized subsequently if information about facts and circumstances changed. The adjustment would either be treated as a reduction to goodwill if it occurred during the measurement period or in the statement of loss and comprehensive income, when it occurs subsequent to the measurement period.

### **Property, plant and equipment**

Property, plant and equipment is stated at cost less accumulated depreciation. Major renewals and improvements are charged to the property accounts, while maintenance and repairs, which do not extend the useful life of the respective assets, are expensed as incurred. All assets having limited useful lives are depreciated from the date of acquisition using the straight-line method over their estimated useful lives.

The methods of depreciation and useful life applicable for each class of asset are as follows:

	<b>Method</b>	<b>Useful life</b>
Furniture and fixtures	Straight-line	3 - 7 years
Computer hardware	Straight-line	3 years
Vehicles	Straight-line	5 years
Leasehold improvements	Straight-line	Term of lease
Buildings	Straight-line	27 - 28 years

Land owned by the Company is not depreciated.

Useful lives, components, the depreciation method and residual amounts are reviewed annually. Such a review takes into consideration the nature of the assets and the intended evolution of the technology. Gains or losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in net income (loss).

### **Intangible assets**

The Company has recorded various intangible assets consisting primarily of non-compete agreements, customer relationships and software.

Non-compete agreements are the value associated with the non-compete agreements entered into by the sellers of acquired companies.

Customer relationships are the value given in the purchase price allocation to the long-term associations with referral sources such as doctors, medical centers, etc.

Finite life intangible assets are amortized on a straight-line basis over the estimated useful lives of the related assets as follows:

Customer relationships	5 years
Non-compete agreements	5 years
Software	3 years



# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

Unaudited

(CAD \$000s)

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At the end of each reporting period, the Company assesses whether there has been any indication that an asset may be impaired. If an impairment indicator exists, the asset's recoverable amount is determined and compared to the carrying amount of the asset. If the recoverable amount is lower, any difference between the carrying amount and the recoverable amount is written off to the consolidated statements of loss and comprehensive income as an impairment charge.

### **Goodwill**

Goodwill represents the difference between the purchase price for acquisitions and the fair value of identifiable tangible and intangible assets acquired. All of the Company's goodwill arose as a result of the acquisitions of Harmony Hollywood, LLC and Accredited Rehab and Treatment Services, LLC on June 29, 2015 (Note 7). The goodwill arose as a result of synergies expected to benefit all of Convalo, including the addition of key management personnel and merging of all operations. As a result, the lowest level cash generating unit at which goodwill is monitored for internal management purposes is at the total Company level.

Goodwill is not amortized but is tested for impairment annually or more frequently when there is an indication that the goodwill may be impaired. The recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill and then to the other assets on a pro-rata basis based on the carrying amount of each asset. Any impairment loss for goodwill is recognized directly in profit or loss. An impairment loss recognized for goodwill is not reversed in subsequent periods. There was no impairment loss recorded in the six months ended August 31, 2016.

### **Acquisition accounting**

The Company accounts for business acquisitions where control is acquired as business combinations under IFRS 3, *Business Combinations*, which requires the allocation of the purchase price to the various tangible and intangible assets and liabilities of the acquired business at their respective fair values with excess recorded as goodwill. The Company uses all available information to determine the fair values of the various tangible and intangible assets and liabilities acquired.

### **Option related compensation and warrants**

The Company measures share based payments to employees and contractors by reference to the fair value of the equity instruments at the date on which they are granted or committed. The fair value of shares is based on recent transactions with arm's length parties. The Company uses the Black-Scholes option pricing model to determine the fair value of options and warrants. The inputs into the Black-Scholes model, including the expected life of the instrument, expected volatility, risk-free interest rate, dividend yield and expected forfeiture rate are determined by reference to the underlying terms of the instrument, the Company's experience with similar instruments and observable market data. The assumptions used for estimating fair value of share based payments, options and warrants are disclosed in Note 11. The value of options is expensed on a graded basis over the vesting or service period for each tranche. Warrants are issued in connection with common stock issuances and accordingly the fair value of warrants is netted off against the proceeds from the issuance and recorded as contributed surplus. Stock based compensation for the three and six months ended August 31, 2016 were \$672 and \$1,230, respectively. For the three and six months ended August 31, 2015, stock based compensation totalled \$1,319 and \$1,518, respectively.

### **Basic and diluted loss per share**

The Company presents basic and diluted loss per share data for its common shares, calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted loss per share is determined by adjusting the loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential securities, which are comprised of stock options and warrants. Diluted loss per share is not shown where the effects of the above adjustments are anti-dilutive.

### **Foreign currency translation**

Each entity in the group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded by the Company's entities in their respective functional currency at rate prevailing at the date of the transaction.

The assets and liabilities of foreign operations are translated into Canadian dollars at the rate of exchange prevailing at the reporting date and their statements of loss are translated at the average rate of exchange for the period being reported. The

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

Unaudited

(CAD \$000s)

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exchange differences arising on the translation are recognized in other comprehensive income (loss). On disposal of a foreign operation, the component of other comprehensive income (loss) relating to that particular foreign operation is recognized in profit or loss.

### **Functional Currency**

The Company determines the functional currency for each entity by performing an assessment of the primary economic environment in which each entity operates. The determination of functional currency affects how the Company translates foreign currency balances and transactions. As an investment holding company, management of Convalo Health International, Corp. considered the currency that primarily influences the issuance of shares, outstanding options, incurring of costs and inter-company receivables, all of which are in Canadian dollars. Management thus concluded that the functional currency of Convalo Health International, Corp. is Canadian dollars. For Convalo Health, Inc. and its U.S. subsidiaries the Company reviewed the indicators that primarily influence or determine the selling price of its services and the cost of providing those services to be United States dollars.

### **Leases**

The economic ownership of a leased asset is transferred to the lessee if the lessee bears substantially all the risks and rewards related to the ownership of the leased asset. The related asset is then recognized at the inception of the lease at the fair value of the leased asset or, if lower, the present value of the lease payments plus incidental payments, if any. A corresponding amount is recognized as a finance leasing liability, irrespective of whether some of these lease payments are payable up-front at the date of inception of the lease. Leases of land and building are classified separately and the minimum lease payments are allocated between the land and building elements in proportion to the relative fair values of the leasehold interests at the inception of the lease.

Assets under finance lease are amortized on a straight-line basis, over the shorter of the useful life and the lease term. The depreciation policy for depreciable leased assets is consistent with that for depreciable assets that are owned by the Company. The corresponding finance leasing liability is reduced by lease payments less finance charges, which are expensed as part of finance costs.

All other leases are accounted for as operating leases, and payments are expensed on a straight-line basis over the term of the lease. Associated costs, such as maintenance and insurance, are expensed as incurred.

### **Financial instruments**

#### *Financial assets and liabilities*

The Company classifies its financial assets as [i] financial assets at fair value through profit or loss, [ii] loans and receivables or [iii] available-for-sale, and its financial liabilities as either [i] financial liabilities at fair value through profit or loss or [ii] other financial liabilities. Appropriate classification of financial assets and liabilities is determined at the time of initial recognition or when reclassified in the statement of financial position.

Financial instruments are recognized when the Company becomes a party to the contractual provisions of the instrument.

#### *Financial assets at fair value through profit or loss ("FVTPL")*

Financial assets at FVTPL include financial assets held-for-trading and financial assets designated upon initial recognition as FVTPL. Financial assets are classified as held-for-trading if they are acquired for the purpose of selling or repurchasing in the near term. This category includes derivative financial instruments entered into that are not designated as hedging instruments in hedge relationships as defined by IAS 39.

Financial assets at FVTPL are carried in the statement of financial position at fair value with changes in the fair value recognized in the statement of loss and comprehensive loss. Transaction costs on FVTPL are expensed as incurred.

Derivatives embedded in host contracts are accounted for as separate derivatives and recorded at fair value if their economic characteristics and risks are not closely related to those of the host contracts and the host contracts are not held-for-trading. These embedded derivatives are measured at fair value with changes in fair value recognized in the statement of loss and comprehensive income. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

#### *Loans and receivables*

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

Unaudited

(CAD \$000s)

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Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at fair value plus transaction costs. They are subsequently measured at amortized cost using the effective interest method less any impairment. The effective interest amortization is included in finance costs in the statement of loss and comprehensive loss. The losses arising from impairment are recognized as finance costs in the statement of loss and comprehensive loss.

### *Derecognition*

A financial asset is derecognized when the rights to receive cash flows from the asset have expired or when the Company has transferred its rights to receive cash flows from the asset.

### *Impairment of financial assets*

The Company assesses at each reporting date whether there is any objective evidence that a financial asset or a group of financial assets is impaired. A financial asset is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that has occurred after the initial recognition of the asset, an incurred 'loss event', and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

For financial assets carried at amortized cost, the Company first assesses whether objective evidence of impairment exists for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Company determines that no objective evidence of impairment exists for an individually assessed financial asset, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has occurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows. The present value of the estimated future cash flows is discounted at the financial asset's original effective interest rate.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognized in profit or loss. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of finance costs.

Loans and receivables together with the associated allowance are written off when there is no realistic prospect of future recovery. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to finance costs.

### *Other financial liabilities*

Financial liabilities are measured at amortized cost using the effective interest method. All financial liabilities are initially measured at fair value. Transaction costs related other financial liabilities are included in the value of the instruments and amortized using the effective interest method. The effective interest expense is included in finance costs.

### *Financial instrument classification*

The Company has designated its cash, restricted cash, accounts receivable and loans receivable as loans and receivables and accounts payable and accrued liabilities as other financial liabilities. The Company has designated its finance leases as other financed liabilities.

### *Derecognition*

A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expired.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

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liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statement of comprehensive income.

### *Interest income and expense*

For all financial instruments measured at amortized cost, interest income or expense is recorded using the effective interest method, which is the rate that discounts the estimated future cash payments or receipts through the expected life of the financial instrument or a shorter period, where appropriate, to the net carrying amount of the financial asset or liability. Interest income and expense is included in finance cost.

### *Fair value of financial instruments*

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. The fair value of financial instruments that are traded in active markets at each reporting date is determined by reference to quoted market prices, without any deduction for transaction costs.

For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques that are recognized by market participants. Such techniques may include using recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis or other valuation models.

For those financial instruments where fair value is recognized in the statement of financial position the methods and assumptions used to develop fair value measurements have been classified into one of the six levels of the fair value hierarchy for financial instruments:

Level 1 includes quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 includes inputs that are observable other than quoted prices included in Level 1.

Level 3 includes inputs that are not based on observable market data.

The following methods and assumptions were used to estimate the fair values:

Cash and restricted cash, accounts receivable and accounts payable and accrued liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

### ***Impairment of non-financial assets***

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If such an indication exists, the asset's recoverable amount is estimated in order to determine the extent of the impairment loss, if any. Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the the "cash-generating unit" (CGU) to which the asset belongs. Where a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual CGU's, or they are allocated to the smallest group of CGU's for which a reasonable and consistent allocation basis can be identified.

The recoverable amount is the higher of an asset's or CGU's fair value less costs to sell and its value in use. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

Value in use is determined by discounting estimated future cash flows using a pre-tax discount rate that reflects the current market assessment of the time value of money and the specific risks of the asset. In determining fair value less costs to sell, recent market transactions are taken into account, if available. If no such transactions can be identified, an appropriate valuation model is used. The recoverable amount of assets that do not generate independent cash flows is determined based on the CGU to which the asset belongs.

The Company bases its impairment calculation on detailed budgets and forecast calculations which are prepared separately for each of the Company's CGUs to which the individual assets are allocated.

An impairment loss is recognized in the statements of loss and comprehensive income if an asset's carrying amount or that of the CGU to which it is allocated is higher than its recoverable amount. Impairment losses of CGUs are first charged against the carrying value of the goodwill balance included in the CGU and then against the value of the other assets, in proportion to

# Convalo Health International, Corp.

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their carrying amount. In the statements of loss and comprehensive income, the impairment losses are recognized in those expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the Company estimates the asset's or CGU's recoverable amount. A previously recognized impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized for the asset in prior years. Such a reversal is recognized in the statements of loss and comprehensive income.

### ***Use of estimates and judgments***

The preparation of consolidated financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reporting period. Actual results may differ from those estimates.

The following are the significant estimates that the Company has made in preparing the consolidated financial statements:

#### *Recognition of revenues*

Revenues from commercial payors are recognized based on expected realizable rates using historical collections rates by payor for each service provided. If no collections data is available for a payor (for example where the payor is new to the Company), the Company uses the Company-wide average reimbursement rate for that particular service. If commercial payors change their reimbursement rates for services already provided but not yet reimbursed, or a new payor rate is different from the estimated rate used, revenue is adjusted to account for the new rates. Because of continuing changes in the health care industry and third party reimbursement, it is possible the Company's estimates could change, which could have a material impact on the Company's recorded revenues and earnings.

#### *Valuation of accounts receivable*

The Company records bad debt expense based on the Company's historical experience of denials from commercial insurers. Denials can be as a result of termed policies, client deductibles not met, client maximum benefits limit met, etc. In addition, management reviews accounts receivable in detail at each reporting period and provides for specific accounts that are deemed to not be collectible. Because of continuing changes in the health care industry and third party reimbursement, it is possible that the Company's estimates could change, which could have a material impact on our operations and cash flows. If circumstances related to certain customers change or actual results differ from expectations, the Company's estimate of the recoverability of receivables could fluctuate from that provided for in the consolidated financial statements. A change in estimate could impact expenses and accounts receivable.

#### *Valuation of deferred income tax assets*

The Company assesses the probability of taxable profits being available in the future based on its budget forecasts. These forecasts are adjusted to take account of certain non-taxable income and expenses and specific rules on the use of unused credits and tax losses. When a forecast shows a net profit, the Company considers that the use of deferred income taxes is probable and recognizes the benefit. When management believes that the benefits will not be realized, the deferred income tax asset is not recognized.

#### *Identification of cash-generating units*

The Company has allocated its tangible and intangible assets to the smallest identifiable group of assets that generate cash inflows and that are largely independent of the cash inflows from other assets. The Company applied judgment to determine its cash-generating units.

#### *Impairment of goodwill and intangible assets*

The Company tests whether goodwill or intangible assets are impaired in accordance with International Accounting Standard ("IAS") 36, Impairment of Assets. The recoverable amount of cash-generating units is determined based on a value in use calculation. The method requires an estimate of future cash flows and the selection of a suitable discount rate in order to calculate the net present value of the cash flows.

#### *Stock based compensation*

The Company uses the Black-Scholes option pricing model to determine the fair value of the Company's issued stock options

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

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and warrants as prescribed by IFRS 2. The Black-Scholes option pricing model requires management to make various estimates about certain inputs into the model, including the expected option life, expected volatility, risk-free interest rate and expected dividend yield. A change in any of these estimates at the time the underlying options or warrants were issued would have impacted the Company's equity and ongoing stock-based compensation expense.

### Segment reporting

IFRS 8 requires operating segments to be determined based on the Company's internal reporting to the Chief Operating Decision Maker ('CODM'). The CODM has been determined to be the CEO as he is primarily responsible for the allocation of resources and the assessment of performance.

The CODM uses operating profit, as reviewed at monthly business review meetings, as the key measure of the Company's results as it reflects the Company's underlying performance for the period under evaluation. Operating profit is defined as profit on operations before interest, taxes, stock-based compensation, amortization of intangibles and impairment expenses.

The CODM's primary focus for review and resource allocation is the Company as a whole and not any component part of the business. All revenue streams for the business are managed centrally by functional teams (Sales and marketing, Billing and Collections and Finance) that have responsibility for the whole of the Company's location portfolio. Although some discrete financial information is available to provide insight to the management team of the key performance drivers, location profit is not part of the CODM's review. Having considered these factors, management has determined that the Company comprises one operating segment under IFRS 8. As such, the disclosures required under IFRS 8 for the consolidated financial statements are shown on the face of the consolidated statements of loss and comprehensive income and consolidated statements of financial position.

### 5. Accounts receivable

Accounts receivable, net	August 31, 2016	February 29, 2016
Gross receivables	\$10,587	\$7,386
Allowance for doubtful accounts	2,746	947
<b>Balance, ending</b>	<b>\$7,841</b>	<b>\$6,439</b>

  

Allowance for doubtful accounts	For the six months ended August 31, 2016	Year ended February 29, 2016
Balance, beginning	947	-
Increase in provision	1,799	947
<b>Balance, ending</b>	<b>\$2,746</b>	<b>\$947</b>

### 6. Property, plant and equipment

Net property, plant and equipment as of August 31, 2016	Cost	Accumulated depreciation	Net
Vehicles	\$326	(\$50)	\$276
Furniture and fixtures	699	(60)	639
Computer hardware	429	(45)	384
Leasehold improvement	1,221	(147)	1,074
Buildings	3,120	(48)	3,072
Land	1,333	-	1,333
<b>Net carrying amount</b>	<b>\$7,128</b>	<b>(\$350)</b>	<b>\$6,778</b>

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

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Net property, plant and equipment as of February 29, 2016	Cost	Accumulated depreciation	Net
Vehicles	\$231	(\$23)	\$208
Furniture and fixtures	468	(25)	443
Computer hardware	143	(25)	118
Leasehold improvement	681	(49)	632
Buildings	2,223	(7)	2,216
Land	555	-	555
<b>Net carrying amount</b>	<b>\$4,301</b>	<b>(\$129)</b>	<b>\$4,172</b>

### Cost: As of August 31, 2016

	At February 29, 2016	Additions	Disposals	Foreign exchange impact	At August 31, 2016
Vehicles	\$231	\$102	\$-	(\$7)	\$326
Furniture and fixtures	468	244	-	(13)	699
Computer hardware	143	288	-	(2)	429
Leasehold improvement	681	557	-	(17)	1,221
Building	2,223	961	-	(64)	3,120
Land	555	789	-	(11)	1,333
<b>Total Cost</b>	<b>\$4,301</b>	<b>\$2,941</b>	<b>\$</b>	<b>(\$114)</b>	<b>\$7,128</b>

### Accumulated depreciation: As of August 31, 2016

	At February 29, 2016	Depreciation	Disposals	Foreign exchange impact	At August 31, 2016
Vehicles	(\$23)	(\$27)	\$ -	\$-	(\$50)
Furniture and fixtures	(25)	(35)	-	-	(60)
Computer hardware	(25)	(20)	-	-	(45)
Leasehold improvement	(49)	(98)	-	-	(147)
Building	(7)	(41)	-	-	(48)
Land	-	-	-	-	-
<b>Total Accumulated Depreciation</b>	<b>(129)</b>	<b>\$(221)</b>	<b>\$</b>	<b>\$-</b>	<b>\$(350)</b>

## 7. Goodwill and Intangible assets

# Convalo Health International, Corp.

## Notes to the consolidated financial statements

For the six months ended August 31, 2016 and August 31, 2015

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Cost	Goodwill	Non-competete agreements	Software	Customer relationships	Sub-total Intangibles with finite lives	Total
Balance February 29, 2016	\$10,265	\$291	\$37	\$3,465	\$3,793	\$14,058
Additions	-	-	16	-	16	16
Effect of changes in exchange rates	(327)	(10)	(2)	(110)	(122)	(449)
<b>Balance August 31, 2016</b>	<b>\$9,938</b>	<b>\$281</b>	<b>\$51</b>	<b>\$3,355</b>	<b>\$3,687</b>	<b>\$13,625</b>

Accumulation Amortization	Goodwill	Non-competete agreements	Software	Customer relationships	Sub-total Intangibles with finite lives	Total
Balance February 29, 2016	\$ -	(\$39)	(\$5)	(\$461)	(\$505)	(\$505)
Amortization expense	-	(30)	(5)	(572)	(607)	(607)
Effect of changes in exchange rates	-	(5)	(2)	(3)	(10)	(10)
<b>Balance August 31, 2016</b>	<b>\$ -</b>	<b>(\$74)</b>	<b>(\$12)</b>	<b>(\$1,036)</b>	<b>(\$1,122)</b>	<b>(\$1,122)</b>

### Net Carrying Amount

<b>Balance August 31, 2016</b>	<b>\$9,938</b>	<b>\$207</b>	<b>\$39</b>	<b>\$2,319</b>	<b>\$2,565</b>	<b>\$12,503</b>
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## 8. Finance and Capital leases and loans

	August 31, 2016	February 29, 2016
Finance and Capital leases (a)	<b>\$2,431</b>	\$119
Less:		
Current portion of finance leases	<b>(166)</b>	(46)
<b>Long-term portion of finance leases</b>	<b>\$2,265</b>	\$73

(a) Various finance and capital lease obligations bearing at fixed rates between 2.9%- 6.99%, payable in monthly payments due between 2017 and 2018.

## 9. Share capital

	August 31, 2016	February 29, 2016
<i>Authorized</i>		
Unlimited voting common shares without par value		
<i>Issued</i>		
228,032,550 voting common shares (2014 – 71,089,550)	<b>\$40,242</b>	\$40,235

### Changes to share capital:

	Number of shares	Amount
<b>Balance at November 30, 2013</b>	<b>37,534,300</b>	<b>37,534,300</b>
Shares issued through private placement, net of costs (i)	3,100,250	3,100,250
Shares issued to third parties in exchange for services (ii)	12,600,000	12,600,000



# Convalo Health International, Corp.

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Subscription receipts for shares in escrow, net of costs (iii)	17,855,000	17,855,000
<b>Balance at November 30, 2014</b>	<b>71,089,550</b>	<b>71,089,550</b>
Shares issued to Valiant shareholders (Amalgamation) (iv)	5,900,000	5,900,000
Shares issued through Valiant private placement, net of costs (v)	29,070,000	29,070,000
Shares issued through bought deal private placement (vi)	43,125,000	43,125,000
Exercise of options (vii)	2,000,000	2,000,000
Exercise of warrants (vii)	64,781,500	64,781,500
Shares issued for purchase of Harmony Hollywood and ARTS (viii)	12,000,000	12,000,000
<b>As of February 29, 2016</b>	<b>227,966,050</b>	<b>227,966,050</b>
Exercise of warrants (ix)	66,550	66,550
<b>As of August 31, 2016</b>	<b>228,032,550</b>	<b>228,032,550</b>

- (i) On December 10, 2013, the Company issued 3,000,000 voting common shares for gross proceeds of \$300. Each common share included one half warrant to purchase an additional common share at a price of \$0.20 expiring the earlier of June 10, 2016 and 90 days following a liquidity event and one half warrant to purchase an additional common share at a price of \$0.20 expiring the earlier of June 10, 2016 and 12 months following a liquidity event. In conjunction with the offering, the Company issued 210,000 broker warrants with an exercise price of \$0.10 expiring December 10, 2015. The warrants were valued at \$4. On April 16, 2014, the Company issued 100,250 voting common shares for gross proceeds of \$10. Each common share included one warrant to purchase an additional common share at a price of \$0.20 expiring the earlier of October 16, 2015 or 10 business days after going public transaction. Costs directly attributable to the issuances amounted to \$27.
- (ii) During 2014, the Company issued 10,600,000 voting common shares in exchange for services rendered, which was recorded in business development expense. During the period, the Company also issued 2,000,000 voting common shares to a lessor pursuant to a lease agreement. The amount was included in deposits and is amortized over the term of the lease. The fair value of the shares was estimated at \$0.10 per share based on recent transactions with arm's length parties.
- (iii) During 2014, the Company issued subscription receipts for the issuance of 17,855,000 voting common shares for gross proceeds of \$1,800. Each subscription receipt included one half warrant to purchase an additional common share at a price of \$0.20 expiring the earlier of 18 months from the date of issuance and 90 days following a liquidity event and one half warrant to purchase an additional common share at a price of \$0.20 expiring the earlier of 18 months from the date of issuance and 12 months following a liquidity event. Proceeds related to the subscription receipts were refundable if a liquidity event was not completed within 24 months of the issuance of the receipt. Restricted cash at November 30, 2014 included \$277 related to this transaction that was released upon completion of the Amalgamation transaction. In conjunction with the offering, the Company issued 1,207,850 broker warrants with an exercise price of \$0.10 expiring two years from the issue date. The warrants were valued at \$25. Costs directly attributable to the issuance amounted to \$224. These subscription receipts were converted into common shares following the Amalgamation transaction.
- (iv) On February 11, 2015, the Company issued 5,900,000 shares value at \$0.10 per share to Valiant shareholders in connection with the Amalgamation transaction described in Note 2.
- (v) In conjunction with the Amalgamation, Valiant completed a non-brokered private placement of 58,140,000 subscription receipts at a price of \$0.05 per subscription receipt for aggregate gross proceeds of \$2,907. Each subscription receipt issued in connection with the private placement entitled the holder, just prior to the Amalgamation, to acquire one common share in the capital of Valiant and (i) one-half of one transferable share purchase warrant (a "Valiant A Warrant"), with each whole Valiant A Warrant entitling the holder to acquire one Valiant Share at a price of \$0.10 per share until the date that is the earlier of (a) thirty (30) months from the date of issuance, and (b) ninety (90) days following the Amalgamation, and (ii) one-half of one transferable share purchase warrant (a "Valiant B Warrant"), with each whole Valiant B Warrant entitling the holder thereof to acquire one Valiant Share at a price of \$0.10 per share until the date that is the earlier of (a) thirty (30) months from the date of issuance, and (b) twelve (12) months following the Amalgamation. In connection with the private placement 3,978,800 broker warrants were issued at an exercise price of \$0.05 per Valiant share exercisable for a period of 24 months. Pursuant to the Amalgamation each Valiant share, A Warrant and B Warrant issued pursuant to a subscription receipt, and each broker warrant issued pursuant to the private placement was exchanged for similar

# Convalo Health International, Corp.

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securities of Convalo on a one for two bases, and with the exercise price of the warrants increased by 100%. As a result, immediately following the Amalgamation, Convalo issued 29,070,000 shares at \$0.10 per share, 29,070,000 warrants exercisable at \$0.10 per share and 1,989,400 broker warrants exercisable at \$0.10 per share. The warrants issued were valued at \$17 and the broker warrants were valued at \$43. Costs directly attributable to the private placement amounted to \$199.

- (vi) On April 22, 2015 (the "Closing"), the Company closed on a bought deal private placement of 43,125,000 units. Each Unit consists of one common share in the capital of Convalo issued at \$0.40 per common share, and one warrant of Convalo. Each Warrant entitles the holder thereof to acquire one common share for an exercise price of \$0.50 per common share for a period of 36 months following the closing of the offering. The expiry date of the Warrants may be accelerated by Convalo at any time following the six-month anniversary of the Closing and prior to the expiry date of the Warrants if the volume-weighted average trading price of the Company's common shares is greater than \$0.60 for any 20 consecutive trading days. In addition, in connection with the bought deal, the Company issued 3,018,750 compensation options to the underwriters. Each compensation option entitles the holder to purchase one unit (a "Unit") consisting of a) one common share in the capital of Convalo and b) one common share purchase warrant at an exercise price of \$0.50 per common share on or before April 22, 2018. The compensation options are exercisable at a price per Unit of \$0.40 and expire on April 22, 2018. The Company received gross proceeds of \$17,250 in connection with the bought deal private placement and incurred cash share issuance costs of \$1,467. The warrants issued were valued at \$5,103 and the broker warrants were valued at \$133.
- (vii) During the fifteen months ended February 29, 2016, a total of 60,944,550 warrants and 3,836,950 broker warrants were exercised at a weighted average exercise price of \$0.19 per share for total net proceeds of \$12,324. Costs directly attributable to the conversion into common stock amounted to \$242. During the fifteen months ended February 29, 2016 the vesting of 6,000,000 options was accelerated, of these options 2,000,000 options were exercised at a weighted average exercise price of \$0.10 per share for total proceeds of \$205, resulting in additional option expense of \$143 which is included on the financial statements.
- (viii) On June 30, 2015, the Company completed the acquisition of Hollywood Detox Center and Accredited Rehab and Treatment Services (ARTS). As part of the purchase the Company issued 12,000,000 common shares to Hollywood Detox and ARTS shareholders at a fair value of \$0.375 per share (Note 7).
- (ix) During the six months ended August 31, 2016 66,500 warrants were exercised at a weighted average exercise price of \$0.10 per share for total net proceeds of \$7. Cost directly attributed to the conversion into common stock amounted to \$nil.

### 10. Options and warrants

#### *Options*

Subsequent to the Amalgamation transaction, the Company implemented an incentive stock option plan that provides that the Board of Directors of Convalo may from time to time, in its discretion and in accordance with Exchange requirements, grant to directors, officers and employees and consultants of Convalo, non-transferable options to purchase Convalo shares, provided that the number of Convalo shares reserved for issuance will not exceed 10% of the total issued and outstanding Convalo shares, exercisable for a period of up to ten (10) years from the date of the grant. The number of Convalo shares reserved for issuance to any individual director or officer of Convalo will not exceed 5% of the issued and outstanding Convalo shares and the total number of options awarded to any one consultant in any twelve month period shall not exceed 2% of the issued and outstanding shares of Convalo at the date that the particular option was granted without consent being obtained from the Exchange. The exercise price of any options granted under the Convalo option plan shall not be less than the closing price of Convalo shares on the day preceding the day on which the directors grant such options, less any discount permitted by the Exchange. Options held by a director or employee who ceases to be employed by Convalo expire one year from the date the director or ceases to be a director of Convalo or the employee ceases to be employed by Convalo.

On June 24, 2016, the shareholders approved a new 20% fixed number stock option plan (the "2016 Option Plan") at Convalo's Annual & Special Meeting of Shareholders. The 2016 Option Plan reserves 45,606,510 common shares and replaces Convalo's 10% rolling stock option plan.

#### *Changes to stock options:*

<i>Number of options</i>	<i>Weighted average exercise price</i>
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# Convalo Health International, Corp.

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<b>Outstanding at November 30, 2013</b>	-	<b>\$ -</b>
Options granted, cancelled, expired & exercised	-	-
<b>Outstanding at November 30, 2014</b>	-	<b>\$ -</b>
Options granted	21,560,000	0.33
Options cancelled	(1,865,000)	(0.23)
Options exercised	(2,000,000)	(0.10)
<b>Outstanding at February 29, 2016</b>	<b>17,695,000</b>	<b>\$0.36</b>
Options granted	9,410,000	<b>\$0.24</b>
Options cancelled	(2,240,000)	(0.23)
<b>Outstanding at August 31, 2016</b>	<b>24,865,000</b>	<b>\$0.32</b>
<b>Exercisable at August 31, 2016</b>	<b>8,228,333</b>	<b>\$0.23</b>

### Details of stock options outstanding at August 31, 2016:

<i>Exercise price</i>	<i>Number of options outstanding</i>	<i>Number of options exercisable</i>	<i>Expiry date</i>
\$0.10	5,050,000	4,350,000	February 11, 2025
\$0.55	7,850,000	2,616,667	May 19, 2025
\$0.32	250,000	83,333	May 19, 2020
\$0.47	1,200,000	733,333	July 13, 2020
\$0.25	300,000	300,000	August 20, 2020
\$0.38	45,000	45,000	August 31, 2020
\$0.27	960,000	-	October 21, 2020
\$0.29	100,000	-	January 14, 2021
\$0.24	4,110,000	100,000	March 1, 2021
\$0.24	5,000,000		March 1, 2026
\$0.28	24,865,000	8,228,333	

The estimated fair value of options is expensed on a graded basis over the vesting or service period for each tranche. The vesting period approximates three years for all issued and outstanding option compensation. For the three and six months ended August 31, 2016, option related payments expense totalled \$672 and \$1,230, respectively and were recorded relating to the fair value of options vested. For the three and six months ended August 31, 2015, option related payments totalled \$1,319 and \$1,518, respectively.

The fair value of the Company's stock options was determined using the Black-Scholes option pricing model using the following assumptions:

	August 31, 2016
Expected option life	5 – 10 years
Expected volatility	40.4%-64.7%
Risk-free interest rate	0.74%-1.83%
Dividend yield	Nil
Weighted average share price at grant date	\$0.33
Weighted average exercise price	\$0.28
Estimated forfeiture rate	0%

Expected volatility was estimated by reference to comparable listed entities since the Company's own shares have limited trading history.

### Warrants

Warrants to acquire voting common shares outstanding and exercisable at August 31, 2016 and February 29, 2016 were as follows:

# Convalo Health International, Corp.

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	<i>Number of warrants</i>	<i>Weighted average exercise price</i>
Warrants exercisable	16,999,000	\$0.19
Warrants held in escrow (i)	17,855,000	0.20
<b>Outstanding at November 30, 2014</b>	<b>34,854,000</b>	<b>\$0.19</b>
Warrants issued (ii) (iii)	76,340,650	0.38
Warrants exercised	(64,781,500)	0.19
Warrants cancelled (iv)	(43,125,000)	0.50
<b>Outstanding and exercisable at February 29, 2016</b>	<b>3,288,150</b>	<b>\$0.39</b>
Warrants exercised (v)	(66,500)	0.10
<b>Outstanding and exercisable at August 31, 2016</b>	<b>3,221,650</b>	<b>\$0.39</b>

- (i) Included in warrants outstanding at November 30, 2014 are warrants to acquire 17,855,000 common shares pursuant to an issue of subscription receipts. These subscription receipts and warrants were held in escrow and were released in February 2015 upon the conversion of the subscription receipts to common shares following the Amalgamation.
- (ii) In connection with the February 2015 private placement completed as part of the Amalgamation, the Company issued warrants to purchase 29,070,000 common shares at an exercise price of \$0.20 per share and broker warrants purchasing 1,989,400 common shares at a price of \$0.10 per common share.
- (iii) In connection with the bought deal private placement in April, 2015, the Company issued warrants to purchase 43,125,000 common shares at \$0.50 and 3,018,750 compensation options to the underwriters. Each compensation option entitles the holder to purchase one unit (a "Unit") consisting of a) one common share in the capital of Convalo and b) one common share purchase warrant at an exercise price of \$0.50 per common share on or before April 22, 2018. The compensation options are exercisable at a price per Unit of \$0.40 for a period of 36 months following the closing of the offering. These warrants are subject to acceleration at the Company's option after six months if Convalo's share price achieves a volume-weighted average trading price greater than \$0.60 for 20 consecutive trading days since closing.
- (iv) In October 2015, the Company confirmed that the expiry date of certain outstanding warrants, exercisable for 43,125,000 common shares of the Company at \$0.50 per share, were accelerated to November 17, 2015, pursuant to the terms of the warrant certificates. The acceleration is a result of the Company's share price achieving a volume-weighted average trading price greater than \$0.60 for 20 consecutive trading days around the time of closing of the Harmony Hollywood, LLC and Accredited Rehab and Treatment Services, LLC acquisition, which was announced on May 20, 2015. The warrants were originally issued pursuant to the Company's bought-deal private placement (refer Note 10 (vi)). Warrants cancelled in connection with this transaction resulted in the reversal of \$5,164 placed back into share capital with the offsetting entry being made to contribute surplus.
- (v) During the six months ended August 31, 2016, 66,500 warrants were exercised at a weighted average exercise price of \$0.10 per share for total net proceeds of \$7.

Warrants outstanding at August 31, 2016 expire at various dates through February 2025.

The fair value of the warrants issued in connection with the private placement was calculated using the Black-Scholes option pricing model with the following assumptions:

Expected warrant life	1.75 years
Expected volatility	41%
Risk-free interest rate	0.43%
Dividend yield	Nil
Share price at grant date	\$0.10
Exercise price	\$0.10

The fair value of the broker warrants issued in connection with the above offering was estimated using the Black Scholes

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model with the following significant assumptions:

Expected warrant life	0.25 - 1 years
Expected volatility	41%
Risk-free interest rate	0.43%
Dividend yield	Nil
Share price at grant date	\$0.10
Exercise price	\$0.20

The fair value of the warrants issued in connection with the bought deal private placement was calculated using the Black-Scholes option pricing model with the following assumptions:

Expected warrant life	3 years
Expected volatility	50%
Risk-free interest rate	0.66%
Dividend yield	Nil
Share price at grant date	\$0.40
Exercise price	\$0.50

The fair value of the compensation options issued to underwriters in connection with the bought deal private placement was calculated using the Black-Scholes option pricing model with the following assumptions:

Expected warrant life	3 years
Expected volatility	50%
Risk-free interest rate	66%
Dividend yield	Nil
Share price at grant date	\$0.40
Exercise price	\$0.50

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### 11. Expenses by nature

	Three months ended August 31, 2016	Three months ended August 31, 2015
Included in cost of services:		
Employee salary and benefits	\$1,577	\$1,082
Direct Client service cost	1,014	865
Outside services- clinical	360	79
	<b>\$2,951</b>	<b>\$2,026</b>
Included in general and administrative:		
Employee salary and benefits	\$700	\$459
All other	88	367
	<b>\$788</b>	<b>\$826</b>
Included in facilities:		
Rent	666	313
Supplies and services	102	156
Employee salary and benefits	179	-
All other	22	-
	<b>\$969</b>	<b>\$469</b>
Included in sales and marketing:		
Employee salary and benefits	\$598	\$270
Advertising	539	186
All other	128	58
	<b>\$1,265</b>	<b>\$514</b>
Included in billing and other outside services:		
Outside billing expense	\$319	\$526
Other outside services	624	184
	<b>\$943</b>	<b>\$710</b>

### 12. Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current year. Deferred income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes are measured using the current or substantively enacted tax rates expected to apply when the differences reverse. A deferred tax asset is recognized to the extent that the recoverability of deferred income tax assets is considered probable.

The Company's provision for (recovery of) income taxes differs from the amount that is computed by applying the combined federal and state statutory income tax rate of 40% in the United States to the Company's net income (loss) before income taxes as follows:

Deferred tax assets and liabilities have been offset where they relate to income taxes levied by the same taxation authority and the Company has the legal right and intent to offset. It is more probable than not that the Company will utilize available non-capital loss carry-forwards and deferred tax assets to offset the anticipated future taxable profits. Therefore, a net deferred income tax asset is being recognized for US non-capital tax loss carry-forwards and other available tax assets.

#### Unrecognized deferred tax assets

Deferred taxes are provided as a result of temporary differences that arise due to the differences between the income tax values and the carrying amount of assets and liabilities.

The Canadian non-capital loss carry forwards expire noted in the table below. The US loss carry-forwards expire as noted in 2035. Share issuance and financing costs will be fully amortized in 2019. The remaining deductible temporary differences may be carried

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forward indefinitely. Deferred tax assets have not been recognized in respect of these items because it is not probable that future profit will be available against which the Company can utilize the benefits therefrom.

The Company's Canadian non-capital income tax losses expire as follows:

Year	Non-Capital Income tax loss
2034	726
2035	40
<b>Total</b>	<b>\$ 766</b>

### 13. Financial instruments and financial risk management

#### *Foreign currency risk*

A significant portion of the Company's revenues are transacted in U.S. dollars and as a result, fluctuations in the rate of exchange between the U.S. dollar and Canadian dollar can have a significant impact on the Company's cash flows and reported results. As a majority of the Company's operating expenses are also in United States dollars, operational foreign currency risk is limited.

Included in the condensed consolidated statement of financial position at August 31, 2016, are the following assets and liabilities denominated in U.S. dollars: cash of USD \$7,519, accounts receivable of USD \$5,793 and accounts payable and accrued liabilities of USD \$2,784. At February 29, 2015, the Company had cash of USD \$14,429.

The Company's revenues and expenses denominated in U.S. dollars for the three month period ended August 31, 2016 were USD \$5,549 and USD \$6,934, respectively. Accordingly, a 10 percent increase or decrease in the value of the U.S. dollar relative to its Canadian counterpart would result in an \$154 increase or decrease in net income.

#### *Fair value*

The fair values of cash, restricted cash, accounts receivable and accounts payable and accrued liabilities approximate their carrying values given their short-term maturities.

#### *Credit risk*

Credit risk is the potential that customers or a counterparty to a financial instrument fail to meet their obligation to the Company.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of trade accounts receivable as the Company's revenues are concentrated to California. The Company had many customers during the course of the year and believes that there is minimal risk associated with collection of these amounts. The Company manages its credit risk by ensuring the eligibility of its patients for insurance or other coverage prior to admittance.

As explained in Note 3, revenue is estimated to be the amount collectible from the insurer. As of August 31, 2016 one commercial payor individually represented 20% of outstanding accounts receivable. Given the counterparties in these transactions, which are generally large, financially stable commercial insurers, the Company considers the credit quality of these receivables to be high. Credit risk is generally limited to the risk that the estimated amount of revenue that can be collected is not accurate.

Reserve for disputed pricing recorded during the six months ended August 31, 2016 was \$1,799, for the six months ended August 31, 2015 the reserve for disputed pricing expense was \$nil.

# Convalo Health International, Corp.

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### Liquidity risk

Liquidity risk is the risk the Company will encounter difficulties in meeting its financial liability obligations as they become due. The Company manages its liquidity risk through cash management. In managing liquidity risk, the Company maintains access to equity markets, the availability of which is dependent on market conditions. The Company monitors its requirements through the use of rolling future net cash flow projections and budgets and believes it has sufficient funding through its current cash position to continue operating for the foreseeable future. All financial liabilities, except for \$379 related to capital lease obligations which are due in the next 2 years, are current and due within the next twelve months.

### Other risk

The Company is not exposed to any significant interest rate risk as it does not have any borrowings and loans receivable that carry fixed rates of interest. The Company is not exposed to any significant price risk or other financial risks due to the nature of its business

## 14. Capital management

The Company's objectives in managing capital are to maintain a strong capital base so as to preserve investor and creditor confidence; to ensure sufficient liquidity to service its debts, support capital projects and growth-oriented acquisitions; and to provide a return to shareholders.

Capital is used by the Company to finance capital expenditures and fund acquisitions that add to its ability to generate returns and meet long-term strategic growth objectives.

The Company sets the amount and type of capital required relative to its assessment of risk and manages the capital structure and makes adjustments to it in light of changes to economic conditions and the risk characteristics of the underlying assets. In order to maintain or modify its capital structure, the Company may adjust or defer the amount of dividends paid to shareholders, issue new shares, seek other forms of financing, or sell assets to reduce debt.

The Company manages its share capital, contributed surplus, deficit and long-term debt as capital.

## 15. Related party transactions

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including executive directors. The total compensation of key management personnel are as follows:

	Three months ended August 31, 2016	Year ended February 29, 2016
Salaries and short term benefits	\$43	\$537
Stock based compensation	23	1,533
	<b>\$66</b>	<b>\$2,070</b>

## 16. Commitments

### Leases

The Company has property under operating leases. For the three and six months ended August 31, 2016, the Company incurred rent expense of \$930 and \$1,398, respectively, included in Facilities expense.

Minimum aggregate payments on all operating leases in the future as of August 31, 2016 are as follows:

Within 12 months	\$2,071
One to five years	5,498
<b>Total commitments</b>	<b>\$7,569</b>



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In March 2016, the Company entered into a five-year master lease agreement with a Real Estate Investment Fund (the "RE Fund" or "Lessor"). The agreement covers the next eight inpatient pods, potentially including up to 16 properties, that the Company desires to utilize for inpatient services as part of its expansion plans. Subject to certain limitations, the agreement requires the RE Fund, as lessor, to purchase properties identified by the Company and to lease those properties to the Company for a period of five years, after which, the Company has the option to extend each lease for an additional five years, acquire all the properties at a guaranteed return to the RE Fund or let the leases lapse. The leases also contain an early termination right for the Company, which the Company may exercise after one year, provided the Company acquires the leased property from the RE Fund. As part of securing this agreement, the Company will issue 8,700,000 shares to the RE Fund. The agreement allows the Company to support its expansion plans without having to utilize its own cash or access outside financing.

### 17. Loss per share

Income/Loss per share is based on the consolidated net loss for the period divided by the weighted average number of shares outstanding during the period. Diluted loss per share is computed in accordance with the treasury stock method and based on the weighted average number of shares and dilutive share equivalents.

For the six months ended August 31, 2016 and August 31, 2015, respectively, the outstanding warrants and options were excluded from the calculation of diluted loss per share because their effect is anti-dilutive.

The following reflects the earnings and share data used in the basic and diluted loss per share computations:

	Three months ended August 31, 2016	Three months ended August 31, 2015	Six months ended August 31, 2016	Six months ended August 31, 2015
Net loss	(\$2,590)	(470)	(\$6,558)	(467)
Basic weighted average number of shares	228,032,550	210,076,588	228,011,005	180,914,860
Basic and diluted loss per share	(\$.011)	(\$.002)	(\$.029)	(\$.003)

### 18. Contingencies

From time to time the Company is subject to audits by commercial insurers. These audits typically cover claims upon which payment has already been made to the Company. As of August 31, 2016 and through the date of this report, the Company is subject to two such audits.

The first audit covers the period November 2014 through December 2015. Total reimbursements under this audit amount to \$2,943, of which \$824 was paid to ARTS in the period prior to the Company's acquisition of that business. In March, 2016, the Company responded to the audit's request for information. The Company believes that the reimbursements were appropriate for the services provided and are properly supported by the appropriate medical documentation. As of the date of this report the Company has not received any further inquiry from the insurer following the Company's response. The possibility of repayment of some or all of the amounts under audit is not determinable at this time and accordingly no provision has been established.

In January, 2016, the Company received a demand for repayment of \$902 of reimbursements made to Harmony Hollywood, the majority of which was made prior to the Company's acquisition of that business. The request alleges that Harmony Hollywood was not appropriately licensed for the services that were provided. Except for \$7, which the Company has acknowledged it owes, the Company believes the request is without merit and in March responded to the demand. As of the date of this report the Company has not received any further inquiry from the insurer following the Company's response. No provision has been established against this claim as the likelihood of settlement of some or all of the demand is not determinable at this time.

### 19. Accounting standards issued but not yet effective

The International Accounting Standards Board has issued several new standards and amendments that will be effective on various dates. The listing below is of standards, interpretation and amendments issued which the Company reasonably expects to be applicable at a future date. The Company intended to adopt those standards when they become effective. The impact on

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the Company is currently being assessed.

Amendments to IFRS 7, Financial Instruments: Disclosures (“IFRS 7”). The Company will be required to adopt amendments to IFRS 7, requiring increased disclosure regarding derecognition of financial assets and the continuing involvement accounting for annual periods beginning on or after January 1, 2016. Management is currently evaluating the potential impact, if any that the adoption of IFRS 7 will have on the Company’s consolidated financial statements.

### IFRS 9 Financial Instruments

In July 2014, the International Accounting Standards Board (“IASB”) issued the final version of IFRS 9 (2014) as a complete standard including the requirements previously issued and the additional amendments to introduce a new expected loss impairment model and limited changes to the classification and measurement requirements for financial assets. This Standard will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 (2014) is effective for reporting periods beginning on or after January 1, 2018 with early adoption permitted. The Company has yet to assess the impact of the new standard on its results of operations, financial position and disclosures.

### IFRS 15 Revenue from Contracts with Customers

In May 2014, the International Accounting Standard Board (“IASB”) issued a new International Financial Reporting Standard (“IFRS”) on the recognition of revenue from contracts with customers. IFRS 15 specifies how and when entities recognize revenue, as well as requires more detailed and relevant disclosures. The standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. The Company has yet to assess the impact of the new standard on its results of operations, financial position and disclosures.

IFRS 16, Leases (“IFRS 16”) was issued by the IASB on January 13, 2016. The Company will be required to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The new standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. This standard substantially carries forward the lessor accounting requirements of IAS 17, while requiring enhanced disclosures to be provided by lessors. Management is currently evaluating the potential impact, if any, that the adoption of IFRS 16 will have on the Company’s financial statements.

Amendments to IAS 1, Presentation of Financial Statements (“IAS 1”). The Company will be required to adopt amendments to IAS 1, which includes amendments to further encourage companies to apply judgment in determining what information to disclose in their financial statements for annual periods beginning on or after January 1, 2016. Management is currently evaluating the potential impact, if any, that the amendments to IAS 1 will have on the Company’s financial statements.