

## Management's Discussion and Analysis of Financial Condition and Results of Operations of Profound Medical Corp. for the Three and Six Months Ended June 30, 2018

The following Management's Discussion and Analysis ("MD&A") prepared as of August 14, 2018 should be read in conjunction with the June 30, 2018 unaudited interim condensed consolidated financial statements and related notes of Profound Medical Corp. (the interim financial statements) ("Profound", the "Company", "us" or "our"). The interim financial statements of Profound and related notes were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS") applicable to the preparation of interim financial statements, including International Accounting Standard ("IAS") 34, Interim Financial Reporting. Unless stated otherwise, all references to "\$" are to Canadian dollars. In this MD&A, unless the context requires otherwise, references to "we" or "our" are references to Profound.

### FORWARD-LOOKING STATEMENTS

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This MD&A contains "forward-looking statements" which include all statements other than statements of historical fact contained in this MD&A, such as statements that relate to the Company's current expectations and views of future events. Often, but not always, forward-looking statements can be identified by the use of words such as "may", "will", "expect", "anticipate", "predict", "aim", "estimate", "intend", "plan", "seek", "believe", "potential", "continue", "is/are likely to", "is/are projected to" or the negative of these terms, or other similar expressions intended to identify forward-looking statements. These forward-looking statements include, among other things, statements relating to:

- the completion of the TACT Pivotal Clinical Trial (as defined herein) and the timing thereof;
- the submission of an application to the FDA (as defined herein) for approval to market the TULSA-PRO<sup>®</sup> in the United States;
- the use of proceeds of the 2018 Offering (as defined herein);
- expectations regarding current and future clinical trials and the costs thereof;
- expectations regarding reoccurring revenue generated from sales;
- expectations regarding regulatory approvals;
- expectations regarding the safety, efficacy and advantages of our products;
- expectations regarding our products fulfilling unmet clinical needs;
- expectations regarding the Company's relationship with Philips (as defined herein);
- expectations regarding the use of our products including treating conditions that our products do not currently treat;
- plans for and timing of expansion of our product and service offerings;
- the Company's mission and future growth plans;
- our ability to attract and develop and maintain relationships with suppliers, manufacturers, distributors, strategic partners, physicians/clinicians, etc.;
- our ability to attract and retain personnel;
- expectations regarding growth in our product markets, sales and competitive position;
- our ability to raise debt and equity capital to fund future product development;
- anticipated trends and challenges in Profound's business and the markets in which we operate;
- ability to integrate acquired businesses, including the Sonalleve<sup>®</sup>, new products and services offerings; and
- expectations regarding the additional consideration to be paid to Philips pursuant to the Sonalleve<sup>®</sup> Transaction (as defined herein).

Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of Profound to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements, including those factors discussed in the section entitled "Risk Factors" in the Company's Annual Information Form prepared as of April 20, 2018 for the year ended December 31, 2017 (the "AIF") available on SEDAR at [www.sedar.com](http://www.sedar.com), such as:

- successful completion of clinical trial phases with respect to Profound's devices;
- risks related to the integration of business and products acquired by the Company, including the Sonalleve<sup>®</sup>, with the current businesses and product offerings of the Company;
- obtaining regulatory approvals in relevant jurisdictions to market Profound's devices;
- risks related to the regulation of Profound, including the healthcare market;
- lack of funding may limit the ability to commercialize and market Profound's devices;
- fluctuating input prices, international trade and political uncertainty;
- healthcare regulatory regime may affect financial viability;
- reimbursement models in relevant jurisdictions may not be advantageous;
- risks related to managing growth;
- competition may limit the growth of Profound;
- reliance on third parties and risks related to the transition of manufacturing and installation services;
- if Profound breaches any of the agreements under which it licenses rights from third parties, Profound could lose license rights that are key to its business;

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- loss of key personnel may significantly harm Profound's business;
- past performance is not indicative of future performance; and
- history of negative operating cash flow.

Forward-looking statements contained herein are made as of the date of this MD&A and Profound disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or results or otherwise, unless required by applicable law. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements due to the inherent uncertainty in them.

## BUSINESS OVERVIEW

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Profound (TSX: PRN; OTCQX: PRFMF) develops, manufactures and markets a therapeutic platform that provides the precision of real-time magnetic resonance ("MR") imaging combined with the safety and accuracy of directional and focused ultrasound technology for incision-free ablation of diseased tissue. Profound's TULSA-PRO® is a catheter based magnetic resonance imaging ("MRI") guided robotic ablation system that combines real time temperature map and thermal ultrasound with process control software for precise ablation of diseased prostate from the inside out while minimizing side effects and healthy tissue damage. The Company acquired the Sonalleve® focused ultrasound system in 2017 from Koniuklijke Philips N.V. ("Philips") to create a MR-guided therapeutic ultrasound platform that can offer ablative therapies for use in the treatment of multiple disease conditions, broadening the scope of the Company's long-term product offerings.

The Company's TULSA-PRO® technology is designed to provide a minimally invasive and precise ablation of the prostate while simultaneously protecting critical surrounding anatomy from potential side effects. TULSA-PRO® provides the surgeons with the flexibility to personalize the treatment to the patient's specific anatomy and pathology thus enabling prostate ablation for patients with localized prostate cancer in a whole gland to targeted (focal) approach, as well as ablative therapies for the treatment of benign prostatic hyperplasia ("BPH"). In the Phase I clinical trial results published in 2016, TULSA-PRO® demonstrated accurate and precise ablation of targeted prostate tissue, while providing a well-tolerated favourable safety profile with minor impact on urinary, erectile and bowel function at 12 months. TULSA-PRO® ablation clinical trial protocol (the "TACT Pivotal Clinical Trial"), is a prospective, open-label, single-arm pivotal clinical study, of 110 prostate cancer patients across 13 research sites in the United States, Canada and Europe. The TACT Pivotal Clinical Trial completed patient enrolment of 115 patients in February 2018, and if successful, it is expected to support Profound's application to the U.S. Food and Drug Administration ("FDA") for clearance to market this technology in the United States. In May 2018, initial data from the TACT Pivotal Clinical Trial was presented at the AUA conference, with median PSA reduction to-date reported as 95% (nadir 0.36 ng/ml), and 95% (109 out of 115) patients reported as having met the PSA endpoint, of at least a 75% reduction in PSA. TULSA-PRO® is CE marked for ablation of targeted benign and malignant prostate tissue. The TULSA-PRO® system received CE Certificate of Conformity from its notified body in the European Union in April 2016 and initiated its pilot commercial launch within the jurisdiction in Q4 2016. The Company also continues to invest in additional research and development, clinical studies, and acquisitions in order to expand the applications of its platform technology and its sales.

### Business Update

Over time, surgery has evolved from an 'open' technique, to 'laparoscopic,' to robotic surgery. The surgeon's motivation behind this evolution has been to perform procedures that reduce invasiveness, improve clinical outcomes, and reduce recovery times. Profound is now taking this concept to the next level by enabling incision-free, precise and customized procedures, that are real-time MR-guided ultrasound ablations performed with the TULSA-PRO® and Sonalleve® systems. These incision-free flexible procedures offer surgeons the option of providing precise and customized procedures that further reduce invasiveness, offer the potential to improve clinical outcomes and further reduce hospital stays and patient recovery times.

TULSA-PRO® revenue usually include the sale of the capital equipment, procedure related sales of disposable single use components of the system, and service revenue for ongoing maintenance of the system. Profound is currently pursuing a commercial launch of TULSA-PRO® in CE marked jurisdictions. The key customer segments targeted by Profound include academic/university/clinical leadership hospitals as well as private clinics with access to MRI scanners. Profound collaborates with its strategic partners Philips and Siemens Healthcare GmbH ("Siemens") for lead generation and distribution of the capital equipment. Profound is establishing its own direct sales and marketing teams for sales of the capital and disposable components of TULSA-PRO®. The primary focus of the direct sales team is to cultivate adoption of the TULSA technology, support clinical customers TULSA- PRO® procedures and increase the utilization of the systems and disposable components. Recurring revenue are expected to be generated from the sale of disposables and service.

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Sales of Sonalleve<sup>®</sup> currently are primarily a one-time capital sale with limited recurring service revenue. Given that it is currently only compatible on the Philips MRI scanners, Profound relies primarily on its strategic partnership with Philips for lead generation and sale of the capital units. With regulatory approval for sale in a number of jurisdictions, the 2018 focus will be primarily in Europe and Asia. In May 2018, Chinese Food and Drug Administration ("CFDA") approved Sonalleve<sup>®</sup> for the non-invasive treatment of uterine fibroids.

Profound continues to focus on further demonstrating the clinical and economic value of the products, including a focus on reimbursement for TULSA-PRO<sup>®</sup> and Sonalleve<sup>®</sup> procedures.

On May 21, 2018, Dr. Laurence Klotz presented preliminary results of the TACT Pivotal Clinical Trial across 13 research sites in the United States, Canada and Europe. The primary efficacy endpoint of the TACT Pivotal Clinical Trial is the proportion of patients achieving a post-treatment prostate-specific antigen ("PSA") reduction of no less than 75% of their pre-treatment baseline value. The Company's pre-established performance goal for the success proportion is 50% of patients. Based on a preliminary analysis performed by the Company, of the 115 evaluable patients, the median PSA reduction to-date was 95% and 95% (109 out of 115) had achieved the PSA reduction success proportion. The primary safety endpoint is the frequency and severity of adverse events, with additional secondary endpoints focused on quality-of-life side effects commonly associated with current prostate cancer therapies, such as erectile dysfunction and urinary incontinence. As the standard evaluation period for these side effects is 12 months post-treatment, the sample size of evaluable patients is not yet large enough to assess.

If successful, the TACT Pivotal Clinical Trial is expected to support Profound's application to the FDA for approval to market the TULSA-PRO<sup>®</sup> system in the United States. Based on a new predicate device cleared by the FDA in October 2015, Profound intends to pursue a 510(k) submission of the TULSA-PRO<sup>®</sup> system with the FDA as a Class II device.

In 2017, Profound made significant reimbursement progress in Germany for TULSA-PRO<sup>®</sup>. TULSA-PRO<sup>®</sup> received a dedicated procedure code in Germany, securing an initial Diagnosis-Related Group payment of €3,963 starting in January 1, 2018. The Company believes that this reimbursement will help to offset approximately 40-60% of the cost of the procedure and is working closely with clinicians and reimbursement consultant to further enhance reimbursement.

Sonalleve<sup>®</sup> currently does not have significant reimbursement in the European markets.

The Company is engaged in further reimbursement activities for the United States market and key European markets.

### Sonalleve<sup>®</sup> Transaction

On July 31, 2017, Profound closed an asset and share purchase agreement (the "**Agreement**") with Philips in order to expand the existing collaboration and acquired Philip's Sonalleve<sup>®</sup> MR-HIFU business (the "**Sonalleve<sup>®</sup> Transaction**"), establishing Profound as a market leader in MR-ultrasound ablation therapy.

Under the terms of the Agreement, Philips transferred its Sonalleve<sup>®</sup> assets to Profound for upfront consideration of 7,400,000 common shares ("**Common Shares**") in the capital of Profound. Under the Agreement, the earn-out provisions include a requirement that Profound pay additional consideration of: (i) 5% of Net Sales occurring after July 31, 2017 for the calendar year 2017; (ii) 6% of Net Sales occurring in the calendar year 2018; and (iii) 7% of Net Sales occurring in calendar years 2019 and 2020. To the extent that the cumulative Net Sales for the full calendar years 2017 through 2020 exceeds €45,300,000, Profound will be required to pay an additional earn-out equal to 7% of Net Sales for the period beginning after July 31, 2017 through December 31, 2019. For the year ended December 31, 2017, Profound paid €37,059 as part of the earn-out provision.

"**Net Sales**" include the revenue (less any royalties) received by Profound or its affiliates or others on their behalf in respect of the sale or transfer of Sonalleve<sup>®</sup>, any subsequent, successor or next-generation product the treatment technology which is primarily based on Sonalleve<sup>®</sup> and which utilizes intellectual property rights acquired under the Agreement or any future product that combines the technologies of Sonalleve<sup>®</sup> and TULSA-PRO<sup>®</sup> and any amounts received by Profound with respect to service agreements, but does not include any revenue with respect to disposables.

As part of the Sonalleve<sup>®</sup> MR-HIFU Transaction, Philips and Profound expanded their non-exclusive strategic sales relationship for Profound's TULSA-PRO<sup>®</sup> system to include distribution of Sonalleve<sup>®</sup>.

The Sonalleve<sup>®</sup> Transaction has expanded Profound's core competency in MR-ultrasound ablation therapy. Management believes that Profound is now the only company to provide a therapeutics platform that provides the precision of real-time MR imaging combined with the safety and ablation power of directional (inside-out) and focused (outside-in) ultrasound technology for the incision-free ablation of diseased tissue.

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#### **Sales Strategy**

Profound sells capital equipment and disposables, which are sold on a per patient basis. The Company has partnered with Philips and Siemens for sales of its capital equipment, while it intends to sell the disposables to the end users, directly. As of January 1, 2018, the capital parts of the TULSA-PRO<sup>®</sup> system and Sonalleve<sup>®</sup> are available through the Philips sales catalog. Similarly, as of April 1, 2018, TULSA-PRO<sup>®</sup> systems are available for sale through the Siemens sales catalog. The catalogs provide access and enables the sales teams of each company to provide quotations for potential sales, in those jurisdictions where the product is approved for sale by regulatory bodies. Profound is in the process of training the sales teams from both companies and expects to work closely with them to help build a pipeline of potential buyers of the Company's technologies.

The Company continues to pursue growth opportunities both organically, increasing its existing business by gaining new customers, increasing product and service penetration with existing clients, as well as through transactions in which the Company acquires new operating entities. Over the past year, the Company has enhanced its corporate development capabilities to execute transactions, through significant investments in people, technology and other organizational resources, and has developed techniques, processes and other intellectual capital, all with the objective of creating a powerful combination of real-time MR-guidance imaging platforms and ultrasound for delivering non-invasive ablative tools to clinicians.

#### **Competition**

##### TULSA-PRO<sup>®</sup>

The most widely used treatment options for prostate cancer are currently: (1) watchful waiting/active surveillance; (2) radical prostatectomy (includes open, laparoscopic and robotic procedures); (3) radiation therapies including, external beam radiation therapy ("EBRT"), brachytherapy and high dose radiation ("HDR"); (4) cryoablation and (5) trans-rectal HIFU. In addition to these widely used treatment options, certain adjunct or less common treatments are used or are under development, such as androgen deprivation therapy ("ADT") and proton beam therapy.

Active surveillance is generally recommended for patients who have been diagnosed with earlier stage, lower risk, disease where the possibility of side effects from intervention may outweigh the expected benefit of the chosen procedure. For clinicians and patients, the gap between active surveillance and the most commonly utilized treatment options of surgery/radiation therapy with the possibility of substantial side effects, create an unmet need for treatment options that could address the cancer with a more favourable side-effect profile.

Profound believes that its TULSA-PRO<sup>®</sup> system will become a compelling option for clinicians in treating prostate cancer with a favorable side-effect profile, fulfilling an unmet clinical need. Profound believes that the flexibility of the TULSA-PRO<sup>®</sup> system will allow Profound to demonstrate its use as a tool to treat the whole or a customized partial prostate gland with greater speed, accuracy, less side effects and precision than many of the current commonly utilized procedures. Profound believes that it will possibly be able to generate clinical data to demonstrate a clear safety advantage without compromising efficacy.

Profound believes that the TULSA-PRO<sup>®</sup> system may provide a treatment option that could fulfill an unmet clinical need by providing an ablation tool for prostate cancer while minimizing potential side effects. Profound believes that the TULSA-PRO<sup>®</sup> system may overcome certain limitations of HIFU, such as complications associated with trans-rectal delivery and limitations relating to prostate size. As noted above, Profound believes that a transurethral (inside out) ablation approach with millimetre accuracy has advantages over HIFU in treating the whole gland safely.

##### Sonalleve<sup>®</sup>

The treatment of uterine fibroids usually depends on the symptoms of the patient, size of the fibroid, desire for future pregnancy, and preference of the treating gynecologist. Most common treatment options for uterine fibroids include: (1) hormonal medications including gonadotrophin-releasing hormone ("Gn-RH") agonists; (2) progesterone releasing intra-uterine devices; (3) surgical procedures such as hysterectomy and myomectomy; and (4) uterine artery embolization.

Profound believes that the Sonalleve<sup>®</sup> system may provide a treatment option that is more convenient and comfortable with less side effects than surgical procedures, such as hysterectomy or myomectomy.

For a detailed description of competition associated with the Company, refer to the "Competition" section of the AIF, which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

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## HIGHLIGHTS

- On July 11, 2018, Profound graduated to the Toronto Stock Exchange.
- On June 14, 2018, Profound disclosed the annual meeting of shareholders voting results and welcomed two industry veterans, Dr. Arthur Rosenthal and Brian Ellacott, as independent Directors to its board.
- On May 21, 2018, Profound announced the initial data from the TACT Pivotal Clinical Trial presented at American Urological Association 2018.
- On May 9, 2018, Profound obtained the Chinese Food and Drug Administration approval for Sonalleve®.
- On May 1, 2018, Profound further strengthened of management team with the appointment of Aaron Davidson as Chief Financial Officer and Senior Vice-President of Corporate Development.
- On April 25, 2018, Profound press released that they would present at the 2018 Bloom Burton & Co. Healthcare Investor Conference.
- On April 23, 2018, Profound hired the accomplished international medical device industry executive, Ian Heynen, Senior Vice-President Sales & Marketing, to lead Profound Medical's sales and marketing function.

## SELECTED FINANCIAL INFORMATION

The following selected financial information as at and for the six month periods ended June 30, 2018, 2017, and 2016, have been derived from the interim financial statements and should be read in conjunction with those interim financial statements and related notes. The results of acquisitions are added from their respective dates of completion.

	For the six month periods ended June 30,		
	2018	2017	2016
	\$	\$	\$
Revenue	589,678	1,548,656	-
Operating expenses	10,464,550	9,195,352	7,032,696
Finance costs	476,408	339,342	439,591
Net loss for the period	10,769,214	8,773,275	7,476,944
Basic and diluted loss per share	0.12	0.16	0.19
Total assets	46,069,919	15,945,066	14,780,540
Total non-current liabilities	1,398,498	3,167,661	4,525,918

Over the past year, the Company has enhanced its corporate development capabilities to execute transactions, through significant investments in people, technology and other organizational resources. Since the Company remains in its pilot sales launch phase and is in the process of training its sales partners, revenue on a quarter over quarter basis are expected to fluctuate in the near term. The period ended June 30, 2017 was the first year of commercial sales.

On July 31, 2017, Profound closed an asset and share purchase agreement with Philips in order to expand the prior collaboration and acquired Philip's Sonalleve® MR-HIFU business, establishing Profound as a market leader in MR-ultrasound ablation therapy. The Sonalleve® Transaction has led to a higher net loss for the period ended June 30, 2018 of \$10,769,214 compared to the net loss of \$8,773,275 for the comparable period in 2017 and \$7,476,944 in 2016 due to increased operations.

The Company reported total assets of \$46,069,919 for the period ended June 30, 2018 as compared to \$15,945,066 in the comparable period of 2017. The increase was primarily related to the acquisition of inventory, property and equipment, intangible assets (including goodwill) and net proceeds from the 2018 Offering that was completed in the period. Total non-current liabilities were lower than in the comparable period of 2017 and 2016, resulting primarily from the long-term debt and other liabilities becoming current.

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**RESULTS OF OPERATIONS**

	Three months ended				Six months ended			
	June 30		Change		June 30		Change	
	2018	2017		%	2018	2017		%
	\$	\$	\$		\$	\$	\$	
<b>Revenue</b>	<b>213,343</b>	957,139	(743,796)	-78%	<b>589,678</b>	1,548,656	(958,978)	-62%
<b>Cost of sales</b>	<b>126,259</b>	471,359	(345,100)	-73%	<b>357,334</b>	782,584	(425,250)	-54%
<b>Gross profit</b>	<b>87,084</b>	485,780	(398,696)	-82%	<b>232,344</b>	766,072	(533,728)	-70%
<b>Expenses</b>								
Research and development	<b>2,347,909</b>	2,417,972	(70,063)	-3%	<b>4,864,690</b>	4,301,101	563,589	13%
General and administrative	<b>2,236,529</b>	1,728,585	507,944	29%	<b>3,539,733</b>	2,846,599	693,134	24%
Selling and distribution	<b>1,113,225</b>	897,153	216,072	24%	<b>2,060,127</b>	2,047,652	12,475	1%
<b>Total operating expenses</b>	<b>5,697,663</b>	5,043,710	653,953	13%	<b>10,464,550</b>	9,195,352	1,269,198	14%
Finance costs	<b>313,606</b>	130,436	183,170	140%	<b>633,569</b>	420,136	213,433	51%
Finance income	<b>(117,357)</b>	(32,229)	(85,128)	264%	<b>(157,161)</b>	(80,794)	(76,367)	95%
<b>Net finance costs</b>	<b>196,249</b>	98,207	98,042	100%	<b>476,408</b>	339,342	137,066	40%
<b>Loss before income taxes</b>	<b>5,806,828</b>	4,656,137	1,150,691	25%	<b>10,708,614</b>	8,768,622	1,939,992	22%
<b>Income tax expense</b>	<b>24,200</b>	2,356	21,844	927%	<b>60,600</b>	4,653	55,947	1202%
<b>Net loss attributable to shareholders for the period</b>	<b>5,831,028</b>	4,658,493	1,172,535	25%	<b>10,769,214</b>	8,773,275	1,995,939	23%
<b>Other comprehensive loss</b>								
<b>Item that may be reclassified to profit or loss</b>								
Foreign currency translation adjustment - net of tax	<b>57,943</b>	15,556	42,387	272%	<b>14,695</b>	18,196	(3,501)	-19%
<b>Net loss and comprehensive loss for the period</b>	<b>5,888,971</b>	4,674,049	1,214,922	26%	<b>10,783,909</b>	8,791,471	1,992,438	23%
<b>Basic and diluted net loss per common share</b>	<b>0.05</b>	0.08	(0.03)	-38%	<b>0.12</b>	0.16	(0.04)	-31%

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#### **Revenue**

For the three months ended June 30, 2018, the Company recorded revenue totaling \$213,343 with \$170,931 from the sale of products and \$42,412 from installation and training services, related to the commercial sales of the systems and disposables. For the three months ended June 30, 2017, the Company recorded revenue totaling \$957,139, with \$919,845 from the sale of products and \$37,294 from installation and training services. The Company sold the systems and disposables through its partnership agreements with Siemens and Philips. The decrease in revenue was the result of a lack of new system sales in Q2 2018. Since the Company remains in its pilot sales launch phase and is in the process of training its sales partners, revenue on a quarter over quarter basis are expected to fluctuate in the near term.

For the six months ended June 30, 2018, the Company recorded revenue totaling \$589,678, with \$543,425 from the sale of products and \$46,253 from installation and training services, related to the commercial sales of the systems and disposables. For the six months ended June 30, 2017, the Company recorded revenue totaling \$1,548,656, with \$1,472,763 from the sale of products and \$75,893 from installation and training services. The Company sold the systems and disposables through its partnership agreements with Siemens and Philips. The decrease in revenue was the result of a lack of new system sales in 2018. Since the Company remains in its pilot sales launch phase and is in the process of training its sales partners, revenue on a quarter over quarter basis are expected to fluctuate in the near term.

#### **Gross Margin**

For the three months ended June 30, 2018, the Company recorded a cost of sales of \$126,259, related to the commercial sale of systems and disposables, which reflects a 41% gross margin. For the three months ended June 30, 2017, the Company recorded a cost of sales of \$471,359, related to the commercial sale of systems and disposables, which reflects a 50% gross margin. These costs include cost of finished goods, inventory provisions, royalties, warranty, freight and direct overhead expenses. The gross margin was lower in Q2 2018 due to changes in the product mix as a result of the Sonalleve<sup>®</sup> Transaction and lower gross margin on disposables compared to the systems.

For the six months ended June 30, 2018, the Company recorded a cost of sales of \$357,334, related to the commercial sale of the systems and disposables, which reflects a 39% gross margin. For the six months ended June 30, 2017, the Company recorded a cost of sales of \$782,584, related to the commercial sale of systems and disposables, which reflects a 49% gross margin. These costs include a cost of finished goods, inventory provisions, royalties, warranty, freight and direct overhead expenses. The gross margin was lower in 2018 due to changes in the product mix as a result of the Sonalleve<sup>®</sup> Transaction and lower gross margin on disposables compared to the systems.

#### **Operating Expenses**

##### ***Research and development***

Our research and development ("R&D") expenses are comprised of costs incurred in performing R&D activities, including new product development, continuous product improvement, and investment in clinical trials and related clinical manufacturing costs, materials and supplies, salaries and benefits, contract research costs, patent procurement costs, and occupancy costs.

For the three months ended June 30, 2018, R&D expenses were lower by \$70,063 compared to the three months ended June 30, 2017. Overall, the decrease in R&D spending was attributed to improvement in product quality and functionality. Clinical trial costs, materials and consulting fees decreased by \$553,162, \$59,138 and \$169,755, respectively. These costs were lower as a result of the completion of the TACT Pivotal Clinical Trial enrollment initiatives and the insourcing manufacturing insourcing project. Offsetting these amounts was an increase in salaries and benefits and rent by \$356,605 and \$80,230, respectively, due to a higher number of R&D personnel and new facilities in Finland. Amortization of intangible assets increased by \$272,635 due to the Sonalleve<sup>®</sup> Transaction and amortization of the acquired intangible assets.

For the six months ended June 30, 2018, R&D expenses were higher by \$563,589 compared to the six months ended June 30, 2017. Overall, the increase in R&D spending was attributed to the Sonalleve<sup>®</sup> Transaction, which occurred after Q2 2017. Salaries and benefits and rent increased by \$1,068,223 and \$134,574, respectively. These costs were higher compared to the six months ended June 30, 2017, due to a higher number of R&D personnel, new initiatives with the Sonalleve<sup>®</sup> product and new facilities in Finland. Offsetting these amounts was a decrease in clinical trial costs, materials, consulting fees and share based compensation by \$763,295, \$275,468, \$106,245 and \$48,158, respectively, resulting from the completion of the TACT Pivotal Clinical Trial enrollment initiatives, insourcing manufacturing project and the forfeiture of certain share options. Amortization of intangible assets increased by \$543,135 due to the Sonalleve<sup>®</sup> Transaction and amortization of the acquired intangible assets.

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#### ***General and administrative expenses***

Our general and administrative (“G&A”) expenses are comprised of management costs, including salaries and benefits, various management and administrative support functions and other operating and occupancy costs.

G&A expenses for the three months ended June 30, 2018 were higher by \$507,944 compared to the three months ended June 30, 2017. Consulting fees and share-based compensation expense decreased by \$103,403 and \$205,138, respectively, due to decreased legal fees in Q2 2018 compared to the prior year and a decrease in share-based compensation expense this quarter due to a one-time award to company executives in 2017. These costs were offset by an increase in salaries and benefits and travel by \$673,481 and \$61,254, respectively, due to increased G&A personnel, bonus payments and salary increases. Depreciation expense increased by \$78,777 primarily due to leasehold improvements for the new facility that were constructed in the latter part of 2017.

G&A expenses for the six months ended June 30, 2018 were higher by \$693,134 compared to the six months ended June 30, 2017. Salaries and benefits, travel and office and other increased by \$504,264, \$62,498 and \$98,469, respectively, due to increased number of G&A personnel, bonus payments, salary increases, the inclusion of Sonallevé® operations and increased travel to customer sites. These costs were offset by a decrease in consulting fees, share-based compensation expense and rent by \$47,335, \$49,458 and \$42,099, respectively, on account of decreased legal fees, share based compensation expense and lower utility bills and repairs to the facilities. Depreciation expense increased by \$165,657 primarily due to leasehold improvements for the new facility that were constructed in the latter part of 2017.

#### ***Selling and distribution expenses***

Our selling, marketing and distribution expenses are comprised of business development costs related to the market development activities and commercialization of our systems, including salaries and benefits, management and support functions and other operating and occupancy costs.

Selling and distribution expenses for the three months ended June 30, 2018 were higher by \$216,072 compared to the three months ended June 30, 2017. Salaries and benefits, travel and officer and other increased by \$238,424, \$56,019 and \$32,870, respectively. The increase is attributable to additional direct sales force personnel, increased marketing-related efforts and product branding development. These costs were offset by a decrease in consulting fees of \$41,682 and a reduced revenue share obligation expense of \$76,266 related to the Siemens shortfall of revenue share payments compared to the minimum amounts contractually stipulated.

Selling and distribution expenses for the six months ended June 30, 2018 were higher by \$12,475 compared to the six months ended June 30, 2017. Salaries and benefits, travel and share based compensation increased by \$420,817, \$40,373 and \$26,553, respectively, due to additional direct sales force personnel, increased marketing-related efforts and product branding development. These costs were offset by a reduced revenue share obligation expense of \$465,511 related to the Siemens shortfall of revenue share payments compared to the minimum amounts contractually stipulated.

#### **Finance costs**

Finance costs are primarily comprised of interest and accretion expenses relating to the following: (i) the Federal Economic Development Agency Loan (as defined herein) accreting to the principal amount repayable; (ii) the Health Technology Exchange Loan (as defined herein) accreting to the principal amount repayable and its related interest expense; (iii) the Knight Loan (as defined herein) accreting to the principal amount repayable and its related interest expense; (iv) the 0.5% royalty liability to Knight Therapeutics Inc. (“Knight”) accreting to the estimated amount payable; and (v) the change in fair value of the contingent consideration payable to Philips.

Finance costs for the three months ended June 30, 2018 were higher by \$183,170 compared to the three months ended June 30, 2017. During the three months ended June 30, 2018, the Company recognized \$50,920 of foreign exchange loss and a \$73,193 gain on the change in fair value to the contingent consideration. The Company recognized an increase in the Health Technology Exchange and Federal Economic Development Agency Loans interest and accretion expense of \$39,511, resulting from accelerated accretion.

Finance costs for the six months ended June 30, 2018 were higher by \$213,433 compared to the six months ended June 30, 2017. During the six months ended June 30, 2018, the Company recognized \$133,412 of foreign exchange loss, a \$24,546 gain on the change in fair value to the contingent consideration and an increase in the Health Technology Exchange and Federal Economic Development Agency Loans interest and accretion expense of \$20,627. This was offset by a decrease in the Knight Loan interest and accretion expense by \$94,743, respectively, resulting from monthly and quarterly repayments of the loan balances resulting in less interest offset by higher accretion expense due to accelerated accretion.



## Profound Medical Corp.

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#### Net loss

Net loss for the three months ended June 30, 2018 was \$5,831,028 or \$0.05 per common share, compared to a net loss of \$4,658,493 or \$0.08 per common share for the three months ended June 30, 2017. The increase in net loss was primarily attributed to an increase in G&A expenses of \$507,944, an increase in selling and distribution expenses of \$216,072, an increase in net finance costs of \$98,042 and a decrease in gross profit of \$398,696. These were partially offset by a decrease in R&D expenses of \$70,063.

Net loss for the six months ended June 30, 2018 was \$10,769,214 or \$0.12 per common share, compared to a net loss of \$8,773,275 or \$0.16 per common share for the six months ended June 30, 2017. The increase in net loss was primarily attributed to an increase in R&D expenses of \$563,589, an increase in G&A expenses of \$693,134, an increase selling and distribution expenses of \$12,475, an increase in net finance costs of \$137,066 and a decrease in gross profit of \$533,728.

#### SUMMARY OF QUARTERLY FINANCIAL RESULTS

The summary financial information provided below is derived from the Company's interim financial statements for each of the last eight quarters that are prepared under IFRS in Canadian dollars.

	2018		2017				2016	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
	\$	\$	\$	\$	\$	\$	\$	\$
Revenue	213,343	376,335	1,890,482	1,465,412	957,139	591,517	-	-
Cost of sales	126,259	231,075	1,063,950	1,185,674	471,359	311,225	-	-
Gross profit	87,084	145,260	826,532	279,738	485,780	280,292	-	-
Operating expenses	5,697,663	4,766,887	5,155,423	5,148,434	5,043,710	4,151,642	4,828,085	3,779,633
Net finance costs	196,249	280,159	130,632	651,378	98,207	241,135	(44,142)	276,852
Loss before income taxes	5,806,828	4,901,786	4,459,523	5,520,074	4,656,137	4,112,485	4,783,943	4,056,485
Income tax expense	24,200	36,400	69,470	-	2,356	2,297	4,674	4,723
Net loss for the period	5,831,028	4,938,186	4,528,993	5,520,074	4,658,493	4,114,782	4,788,617	4,061,208
Loss per common share								
Basic and diluted	0.05	0.06	0.06	0.09	0.08	0.07	0.10	0.10

The first quarter of 2017 was the initial pilot launch of The TULSA-PRO<sup>®</sup> system after receiving CE Certificate of Conformity from its notified body in the European Union.

The third quarter of 2017 was impacted by the Sonallevé<sup>®</sup> acquisition that took place on July 31, 2017.

The second quarter of 2018 was affected by increased management compensation due to the hiring of key management personnel.

#### LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2018, the Company had cash of \$31,995,919 compared to \$11,103,223 at December 31, 2017.

##### Federal Economic Development Agency Loan

Pursuant to a loan agreement dated December 16, 2011, the Federal Economic Development Agency provided the Company with an unsecured and non-interest bearing loan of \$867,000 (the "Federal Economic Development Agency Loan"). As at June 30, 2018, the principal balance outstanding on the Federal Economic Development Agency Loan is \$578,000 (December 31, 2017 - \$621,350). Subsequent to the period ended, the loan was fully repaid.

## **Profound Medical Corp.**

### Management's Discussion and Analysis

For the three and six months ended June 30, 2018 and 2017

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#### Health Technology Exchange Loan

Pursuant to a loan agreement dated May 25, 2011, as amended April 1, 2012, and a loan agreement dated May 31, 2014, the Health Technology Exchange provided the Company with an unsecured loan of \$1,500,000 bearing interest at 4.5% per annum (the "**Health Technology Exchange Loan**"). The final payment of \$1,094,698 including accrued interest was made on March 31, 2018. As at June 30, 2018, the principal balance outstanding on the Health Technology Exchange Loan was nil (December 31, 2017 - \$800,000).

#### Knight Loan

Pursuant to a loan agreement dated April 30, 2015, Knight provided the Company with a secured loan of \$4,000,000 bearing interest at 15% per annum (the "**Knight Loan**"). As at June 30, 2018, the principal balance outstanding on the Knight Loan was \$2,857,143 (December 31, 2017 - \$3,428,571). Subsequent to the period ended, the full amount of the Knight Loan, including prepayment fees, was repaid for a total payment of \$3,188,023.

In addition to the Knight Loan, the Company granted Knight a 0.5% royalty on total net sales of all products until the original maturity date of the Knight Loan. The royalty was initially recorded at fair value and subsequently carried at amortized cost using the effective interest rate method. The initial fair value of the royalty was determined using future revenue forecasts for the term of the Knight Loan and a discount rate of 18%. During the three and six months ended June 30, 2018, the Company revised the fair value of the royalty, using future revenue forecasts for the term of the Knight Loan. The current portion of this liability as at June 30, 2018 is \$82,178 (December 31, 2017 - \$68,922) and non-current portion is nil (December 31, 2017 - \$27,972).

#### CIBC Loan

On July 30, 2018, the company signed a term loan agreement with CIBC Innovation Banking ("**CIBC**") to provide a secured loan for total initial gross proceeds of \$12,500,000 maturing on July 29, 2022 with an interest rate based on prime plus 2.5%. The company is required to make interest only payments until October 31, 2019 and monthly repayments of the principal of \$378,788 plus accrued interest will commence on October 31, 2019. All obligations of the company under the term loan agreement are guaranteed by current and future subsidiaries of the company and include security of first priority interests in the assets of the company and its subsidiaries. The company has the ability to draw an additional \$6,250,000 subject to the achievement of certain financing and product development milestones. In connection with this term loan agreement, the company also issued 321,714 common share purchase warrants to CIBC at an exercise price of \$0.97.

#### **Cash Flow**

The Company manages liquidity risk by monitoring actual and projected cash flows. A cash flow forecast is performed regularly to ensure that the Company has sufficient cash to meet operational needs while maintaining sufficient liquidity.

The Company may require additional capital to fund R&D activities and any significant expansion of operations. Potential sources of capital could include equity and/or debt financings, development agreements or marketing license agreements, the collection of revenue resulting from future commercialization activities and/or new strategic partnership agreements to fund some or all costs of development. There can be no assurance that the Company will be able to obtain the capital sufficient to meet any or all of the Company needs. The availability of equity or debt financing will be affected by, among other things, the results of our R&D, our ability to obtain regulatory approvals, the market acceptance of our products, the state of the capital markets generally, strategic alliance agreements and other relevant commercial considerations. In addition, if the Company raises additional funds by issuing equity securities, existing security holders will likely experience dilution, and any incurring of indebtedness would result in increased debt service obligations and could require the Company to agree to operating and financial covenants that would restrict operations. Any failure on the Company's part to raise additional funds on terms favorable to the Company or at all may require the Company to significantly change or curtail current or planned operations in order to conserve cash until such time, if ever, that sufficient proceeds from operations are generated, and could result in the Company not being in a position to take advantage of business opportunities, in the termination or delay of clinical trials for our products, in curtailment of product development programs designed to identify new products, in the sale or assignment of rights to technologies, product and/or an inability to file market approval applications at all or in time to competitively market products.

**Profound Medical Corp.**

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	Three months ended		Six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	\$	\$	\$	\$
Cash provided by (used in) operating activities	(5,414,430)	(4,039,816)	(9,135,773)	(7,907,539)
Cash provided by (used in) in investing activities	-	(251,439)	-	(313,792)
Cash provided by (used in) financing activities	(604,614)	(1,934,313)	30,028,469	(1,945,263)
<b>Net increase (decrease) in cash</b>	<b>(6,019,044)</b>	<b>(6,225,568)</b>	<b>20,892,696</b>	<b>(10,166,594)</b>

Net cash provided by (used in) operating activities for the three months ended June 30, 2018 was \$5,414,430 versus \$4,039,816 for the three months ended June 30, 2017. The principal increased uses of the operating cash flows during this period related to additional costs associated with Sonallevé® that were not present in 2017 and increased workforce costs.

Net cash provided by (used in) operating activities for the six months ended June 30, 2018 was \$9,135,773 versus \$7,907,539 for the six months ended June 30, 2017. The principal uses of the operating cash flows during this period related to additional costs associated with Sonallevé® that were not present in 2017 and increased workforce costs.

Net cash provided by (used in) investing activities for the three months ended June 30, 2018 was nil versus \$251,439 for the three months ended June 30, 2017. This change primarily related to fewer purchases of property and equipment and intangible assets during the three months ended June 30, 2018 compared to the three months ended June 30, 2017.

Net cash provided by (used in) investing activities for the six months ended June 30, 2018 was nil versus \$313,792 for the six months ended June 30, 2017. This change primarily related to fewer purchases of property and equipment and intangible assets during the six months ended June 30, 2018 compared to the six months ended June 30, 2017.

Net cash provided by (used in) financing activities for the three months ended June 30, 2018 were \$604,614 versus \$1,934,313 for the three months ended June 30, 2017. These cash flows related to repayments on the Federal Economic Development Agency Loan and the Knight Loan. The change related to the repayment commencement of the Knight Loan for \$1,427,258 in 2017.

Net cash provided by (used in) financing activities for the six months ended June 30, 2018 were \$30,028,469 versus \$(1,945,263) for the six months ended June 30, 2017. These cash flows related to repayments on the Health Technology Exchange Loan, Federal Economic Development Agency Loan and the Knight Loan and gross proceeds from the 2018 Offering, as defined herein, less cash transactions costs paid.

**Contractual obligations**

The following table summarizes the Company's significant contractual obligations:

	Carrying amount \$	Future cash flows \$	Less than 1 Year \$	June 30, 2018	
				Between 1 year and 3 years \$	Greater than 4 years \$
Accounts payables and accrued liabilities	2,761,152	2,761,152	2,761,152	-	-
Long-term debt	3,716,865	3,766,023	3,766,023	-	-
Other liabilities	1,638,626	2,043,339	697,081	1,346,258	-
<b>Total</b>	<b>8,116,643</b>	<b>8,570,514</b>	<b>7,224,256</b>	<b>1,346,258</b>	<b>-</b>

## Profound Medical Corp.

### Management's Discussion and Analysis

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#### Use of Proceeds

##### 2018 Offering

The Company received net proceeds of \$32,044,305 from the public offering of units completed on March 20, 2018 (the "2018 Offering"). Each unit consisted of one Common Share and one-half of one warrant of the Company. The following table compares the intended use of net proceeds with the actual expenditures as at June 30, 2018, by which time the proceeds from the 2018 Offering were partially expended.

	Estimated per 2018 Offering	Total spending as at June 30, 2018
To support certain costs and expenses of other clinical trial support and the ongoing TACT Pivotal Clinical Trial follow up and finalization		
Patient follow up costs (based on an agreed amount for each patient with the participating hospitals)	\$2,100,000 to \$2,700,000	\$655,000
Increased personnel requirements and employee travel expenses related to support of the clinical procedures for patients	\$1,200,000 to \$1,500,000	\$695,000
Ongoing expansion of infrastructure to execute on global sales and marketing plans with respect to the TULSA-PRO <sup>®</sup> system and Sonalleve <sup>®</sup> MR-HIFU system		
TULSA-PRO <sup>®</sup> sales and marketing activities	\$3,300,000 to \$3,800,000	\$333,000
Sonalleve <sup>®</sup> MR-HIFU sales and marketing activities	\$2,000,000 to \$2,200,000	\$646,000
To support ongoing research and development and continue to invest in additional research and development and acquisitions in order to expand the applications for current and future platforms	\$6,400,000 to \$7,100,000	\$1,252,000
For general corporate purposes		
Scheduled repayment under the Knight Loan and other indebtedness	\$4,200,000	\$859,000
Material and inventory purchases	\$3,800,000 to \$4,100,000	\$1,155,000
General working capital purposes	\$2,000,000 to \$2,200,000	\$423,000
Totals		\$6,018,000

Although it is intended the remainder of the net proceeds from the 2018 Offering of \$26,026,305 will be used as set out above based on the current knowledge and planning of the Company's management, there may be circumstances where, for sound business reasons, a reallocation of funds may be deemed prudent or necessary and the use of proceeds may vary materially from that set forth above.

#### Non-IFRS Financial Measures

Non-IFRS measures are not recognized measures under IFRS and do not have a standardized meaning prescribed by IFRS. These measures are defined with reference to the nearest comparable IFRS measure in order that a reconciliation to the nearest comparable IFRS measure can be completed. Accordingly, these measures may not be comparable to similar measures presented by other companies. We use non-IFRS measures in order to provide additional financial information to complement the closest IFRS measures in order to provide investors with a further understanding of our operations from management's perspective. Investors should not consider that these non-IFRS measures are a substitute for analyses of the financial information that we report under IFRS. We use these non-IFRS measures in order to provide investors with a supplemental measure of our operating performance and thus highlight trends in our business that may not otherwise be apparent when relying solely on IFRS measures.

The Company's working capital (defined as current assets less current liabilities) is a non-IFRS financial measure. The working capital as at June 30, 2018 is set forth in the table below. The Company defines working capital as current assets less current liabilities, with the exclusion of deferred revenue. Deferred revenue represents the excess of amounts billed and revenue earned on service contracts. The amount is amortized into revenue as services are rendered, in accordance with the revenue recognition policies described in the Company's interim financial statements.

## Profound Medical Corp.

### Management's Discussion and Analysis

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Deferred revenue is a non-cash liability and therefore management believes that adding back the deferred revenue provides a more accurate reflection of the liquidity and working capital position of the Company.

	June 30, 2018	December 31, 2017
	\$	\$
Current assets	36,626,054	17,602,066
Less: Current liabilities	8,661,190	10,725,193
Working capital	27,964,864	6,876,873
Add back: Deferred revenue	269,836	241,316
<b>Net working capital</b>	<b>28,234,700</b>	<b>7,118,189</b>

Working capital has increased by \$21,116,511 to a surplus of \$28,234,700 at June 30, 2018 compared to the surplus of \$7,118,189 at December 31, 2017. The change in working capital is due to a decrease in current liabilities of \$2,064,003, which was primarily the result of quarterly repayment of the Knight Loan and full repayment of the Health Technology Exchange Loan. Accounts payable and accrued liabilities decreased by \$2,320,552 due to the timing of payments made to certain vendors. The increase in working capital correlates to the increased cash balance of \$31,995,919 resulting from the 2018 Offering for net proceeds of \$32,044,305.

## COMMITMENTS & CONTINGENCIES

The Company has commitments under operating leases for the rental of office space. On March 28, 2016, the Company signed a lease for office space and took possession of this office space effective July 1, 2016. Included in prepaid expenses and deposits is an amount of \$270,000 related to prepaid rent for this lease that is drawn down at \$10,000 per month starting October 1, 2016. The future minimum obligation are as follows:

	\$
No later than 1 year	482,512
Later than 1 year and no later than 5 years	2,239,050
Later than 5 years	1,880,021
	<u>4,601,583</u>

In 2016, the Company signed an agreement that includes revenue sharing with a minimum amount payable of US\$3,500,000 over a five year period.

All directors and officers of the company are indemnified by the company for various items including, but not limited to, all costs to settle lawsuits or actions due to their association with the company, subject to certain restrictions. The company has purchased directors' and officers' liability insurance to mitigate the cost of any potential future lawsuits or actions. The term of the indemnification is not explicitly defined, but is limited to events for the period during which the indemnified party served as a director or officer of the company. The maximum amount of any potential future payment cannot be reasonably estimated but could have a material adverse effect on the company.

The company has also indemnified certain lenders and underwriters in relation to certain debt and equity offerings and their respective affiliates and directors, officers, employees, shareholders, partners, advisers and agents and each other person, if any, controlling any of the underwriters or lenders or their affiliates against certain liabilities.

## FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, trade and other receivables, investment tax credit receivable, accounts payable and accrued liabilities, long-term debt, provisions, other liabilities and taxes payable. The fair values of these financial instruments, except long-term debt, provisions and other liabilities, approximate carrying value because of their short-term nature. Financial assets measured at amortized cost include cash, trade and other receivables and investment tax credit receivable.

Financial liabilities measured at amortized cost include accounts payable and accrued liabilities, long-term debt, provisions, other liabilities and taxes payable. Amortization is recorded using the effective interest rate method.

## Profound Medical Corp.

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The Company's financial instruments are exposed to certain financial risks including credit risk, liquidity risk, currency risk and interest rate risk. There have been no significant changes to those risks impacting the Company since December 31, 2017, nor has there been a significant change in the composition of its financial instruments since December 31, 2017.

## RELATED PARTY TRANSACTIONS

Key management includes the Company's directors and senior management team. Additional information on the senior management team can be found in the Company's AIF. The remuneration of directors and the senior management team were as follows:

	Three months ended		Six months ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	\$	\$	\$	\$
Salaries and employee benefits	705,127	219,928	908,853	547,417
Termination benefits	-	-	114,750	138,125
Directors fees	20,084	19,739	40,031	41,989
Share-based compensation	228,792	423,403	401,596	496,554
<b>Total</b>	<b>954,003</b>	<b>663,070</b>	<b>1,456,230</b>	<b>1,224,085</b>

Executive employment agreements allow for additional payments in the event of a liquidity event, or if the executive is terminated without cause.

## OUTSTANDING SHARES

As at August 14, 2018, the date of this MD&A, the Company had the following securities outstanding:

	Number
Common Shares	108,043,939
Share purchase options	5,387,779
Warrants	22,571,714

## OFF BALANCE SHEET ARRANGEMENTS

The Company has no off-balance sheet arrangements other than those disclosed in this MD&A.

## CRITICAL ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of interim financial statements in conformity with IFRS requires management to make estimates and judgements that affect the reported amounts of assets and liabilities at the date of the interim financial statements, and the reported amounts of revenue and expenses during the period. Actual results could differ from these estimates. As additional information becomes available or actual amounts are determinable, the recorded estimates are revised and reflected in operating results in the period in which they are determined.

### Critical accounting judgments

#### *Complex financial instruments*

The Company makes various judgments when determining the accounting for certain complex financial instruments. The Company has concluded that the contingent consideration in a business combination represents a financial liability measured at fair value through profit or loss. The revenue share obligation represents an executory contract and is accounted for as a best estimate provision.

## **Profound Medical Corp.**

### Management's Discussion and Analysis

For the three and six months ended June 30, 2018 and 2017

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#### *Accounting for acquisitions*

The Company assesses whether an acquisition should be accounted for as an asset acquisition or a business combination under IFRS 3. This assessment requires management to assess whether the assets acquired and liabilities assumed constitute a business as defined in IFRS 3 and if the integrated set of activities, including inputs and processes acquired, is capable of being conducted and managed as a business and the Company obtains control of the business. The Company's acquisition has been accounted for as a business combination.

#### *Accounts receivable and allowance for credit losses*

Accounts receivable are generally non-interest bearing, unsecured obligations due from customers. The Company makes a provision to allow for potentially uncollectible amounts owed from customers. The allowance is reviewed by management periodically based on an analysis of the age of the outstanding accounts receivable. The balance of accounts receivable after the allowance for credit losses represents management's estimate of the net realizable value of receivables after discounts and contractual adjustments.

#### *Impairment of goodwill and long-lived assets*

Management tests at least annually whether goodwill suffered any impairment. Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

Management makes key assumptions and estimates in determining the recoverable amount of the Company's cash generating units ("CGUs") or groups of CGUs, including future cash flows based on historical and budgeted operating results, growth rates, tax rates and appropriate after-tax discount rates.

The Company evaluates its long-lived assets (property and equipment) and intangible assets, other than goodwill, for impairment whenever indicators of impairment exist. The accounting standards require that if the sum of the undiscounted expected future cash flows from a long-lived asset or definite-lived intangible asset is less than the carrying value of that asset, an asset impairment charge must be recognized. The amount of the impairment charge is calculated as the excess of the asset's carrying value over its fair value, which generally represents the discounted future cash flows from that asset.

## **Critical accounting estimates**

#### *Revenue share obligation*

The revenue share obligation provision was determined using future revenue forecasts relating to the revenue share agreement and a discount rate of 11%. The Company uses its judgment to select a variety of methods and make assumptions that are mainly based on market conditions existing at the end of each reporting period. If the revenue forecast were to decrease or increase by 10% then the revenue share obligation would increase or decrease by \$8,113 in the selling and distribution interim financial statement line with the offset to provisions.

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

The Company reviews amortized non-financial assets for impairment whenever events or changes in circumstances indicate the carrying amount of the assets may be impaired. It also reviews goodwill annually for impairment. If the recoverable amount of the respective non-financial asset is less than its carrying amount, it is considered to be impaired. In the process of measuring the recoverable amount, management makes assumptions about future events and circumstances. The actual results may vary and may cause significant adjustments.

#### *Accounting for acquisitions and contingent consideration*

Areas of estimation include the determination and fair value measurement of the contingent consideration, which includes the Company developing its best estimate of projected revenue, the probability of the contingency being achieved, and the discount rate of 15%. Management is also required to make estimates of the fair value of assets acquired and liabilities assumed. The interim financial statement line items affected by any change in estimate would be other liabilities and finance costs.

## **Profound Medical Corp.**

### Management's Discussion and Analysis

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#### *Clinical trial expenses*

Clinical trial expenses are accrued based on the services received and efforts expended pursuant to agreements with clinical trial sites and other vendors. In the normal course of business the Company contracts third parties to perform various clinical trial activities. The financial terms of these agreements vary from contract to contract, are subject to negotiation and may result in uneven payment flows. Payments under the contracts depend on factors such as the achievement of certain events, the successful enrollment of patients or the completion of certain portions of a clinical trial. The Company determines the accrual by reviewing contracts, vendor agreements and through discussions with internal personnel and external clinical trial sites as to the progress or stage of completion of the clinical trial and the agreed-upon fees to be paid for such services. Actual costs and timing of the clinical trial is uncertain, subject to risks and may change depending on a number of factors. Any changes in clinical trial expenses affect the research and development and the accounts payable and accrued liabilities financial statement line items.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

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### **Accounting standards issued but not yet adopted**

#### **IFRS 16, Leases**

On January 13, 2016, the International Accounting Standards Board ("**IASB**") published a new standard, IFRS 16, Leases ("**IFRS 16**"). The new standard will eliminate the distinction between operating and finance leases and will bring most leases on the consolidated balance sheet for lessees. This standard is effective for annual reporting periods beginning on or after January 1, 2019. The Company intends to adopt IFRS 16 in its interim financial statements for the annual period beginning January 1, 2019, and will recognize assets and liabilities for all leases, except for its low value leases, on the consolidated balance sheet upon adoption.

#### **IFRIC 23, Uncertainty over Income Tax Treatments**

In June 2017, the IASB issued IFRIC 23, Uncertainty over Income Tax Treatments ("**IFRIC 23**"), with a mandatory effective date of January 1, 2019. The interpretations provide guidance on how to value uncertain income tax positions based on the probability of whether the relevant tax authorities will accept the Company's tax treatments. A company is to assume that a taxation authority with the right to examine any amounts reported to it will examine those amounts and will have full knowledge of all relevant information when doing so. IFRIC 23 is to be applied by recognizing the cumulative effect of initially applying these guidelines in opening deficit without adjusting comparative information. The extent of the impact of the adoption of IFRIC 23 has not yet been determined.

## **RISK FACTORS**

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For a detailed description of risk factors associated with the Company, refer to the "Risk Factors" section of the AIF, which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

In addition, we are exposed to a variety of financial risks in the normal course of operations, including risks relating to cash flows from operations, liquidity, capital reserves, market rate fluctuations and internal controls over financial reporting. Our overall risk management program and business practices seek to minimize any potential adverse effects on our consolidated financial performance. Financial risk management is carried out under practices approved by our audit committee. This includes reviewing and making recommendations to the board of directors regarding the adequacy of our risk management policies and procedures with regard to identification of the Company's principal risks, and implementation of appropriate systems and controls to manage these risks.

## **ADDITIONAL INFORMATION**

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Additional information relating to the Company, including the AIF, is available on SEDAR at [www.sedar.com](http://www.sedar.com). The Common Shares are listed for trading on the Toronto Stock Exchange under the symbol "PRN."