MANAGEMENT’S DISCUSSION AND ANALYSIS

The following management’s discussion and analysis (“MD&A”) of the operating results and financial position of DIRTT Environmental Solutions Ltd. and its subsidiaries (“DIRTT”, the ”Company”, “we”, “us” or “our”) was prepared as of May 3, 2017, and should be read in conjunction with the Company’s condensed consolidated financial statements and related notes for the three months ended March 31, 2017 compared to the three months ended March 31, 2016, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”). Additionally, the following discussion and analysis should be read in conjunction with the Company’s MD&A, consolidated financial statements and related notes and annual information form (“AIF”) for the year ended December 31, 2016 and other public filings available on SEDAR at www.sedar.com. This discussion addresses matters we consider important for an understanding of our financial condition and results of operations as at and for the three months ended March 31, 2017.

The Company’s reporting currency is the Canadian dollar. This MD&A contains references to Canadian dollars and United States dollars. Canadian dollars are referred to as “$” and United States dollars are referred to as “US$”. All amounts are expressed in thousands of Canadian dollars unless otherwise stated.

SPECIAL NOTE REGARDING FORWARD-LOOKING INFORMATION

Certain information and statements contained in this MD&A constitute “forward-looking information” and “forward-looking statements” (collectively, “Forward-Looking Information”) as defined under applicable Canadian securities laws and the Company hereby cautions about important factors that could cause the Company’s actual results or outcomes to differ materially from those projected in any Forward-Looking Information contained in this MD&A. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as “will likely result”, “are expected to”, “will continue”, “is anticipated”, “believes”, “estimated”, “intends”, “plans”, “projection” and “outlook”), are not historical facts and may be forward-looking and may involve estimates, assumptions and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such Forward-Looking Information.

In particular and without limitation, this MD&A contains Forward-Looking Information pertaining to the following: comments with respect to our revenue, objectives and priorities for 2017 and beyond; project timetables; the anticipated use of our credit facilities; our growth strategies and opportunities; our ability to meet working capital requirements and financial obligations; and our outlook for our operations and the Canadian, United States (the “US”) and international economies, and in particular, the US and Canadian construction industry.

With respect to Forward-Looking Information contained in this MD&A, assumptions have been made regarding, among other things:

- our ability to manage our growth;
- competition in our industry;
- our ability to enhance current products and develop and introduce new products;
- our ability to obtain components and products from suppliers on a timely basis and on favorable terms;
- our ability to obtain qualified staff and equipment in a timely and cost-efficient manner;
- the regulatory framework governing taxes in Canada, the US and any other jurisdictions where we currently or may do business in the future;
- future development plans for our assets unfolding as currently envisioned;
- future capital expenditures to be made by us;
- future sources of funding for our capital program;
- the impact of increasing competition on the Company; and
- our success in identifying risks to our business and managing the risks mentioned below.

Please refer to the AIF for a detailed discussion of the risk factors.

Since actual results or outcomes could differ materially from those expressed in the Forward-Looking Information provided by or on behalf of the Company, investors and others should not place undue reliance on any such Forward-Looking Information.

DIRTT cautions that the foregoing lists of factors are not exhaustive. Further, Forward-Looking Information is made as of the date hereof, and the Company undertakes no obligation to update Forward-Looking Information to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by applicable Canadian securities laws. New factors emerge from time to time, and it is not possible for DIRTT's management to predict all of these factors and to assess in advance the impact of each such factor on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in Forward-Looking Information. No assurance can be given that these expectations will prove to be correct and such Forward-Looking Information contained in this MD&A should not be unduly relied upon. In addition, this MD&A may contain Forward-Looking Information attributed to third party industry sources.

MARKET AND INDUSTRY DATA

Certain market and industry data contained in this MD&A is based upon information from government or other third party publications, reports and websites or based on estimates derived from such publications, reports and websites. Government and other third party publications and reports do not guarantee the accuracy or completeness of their information.

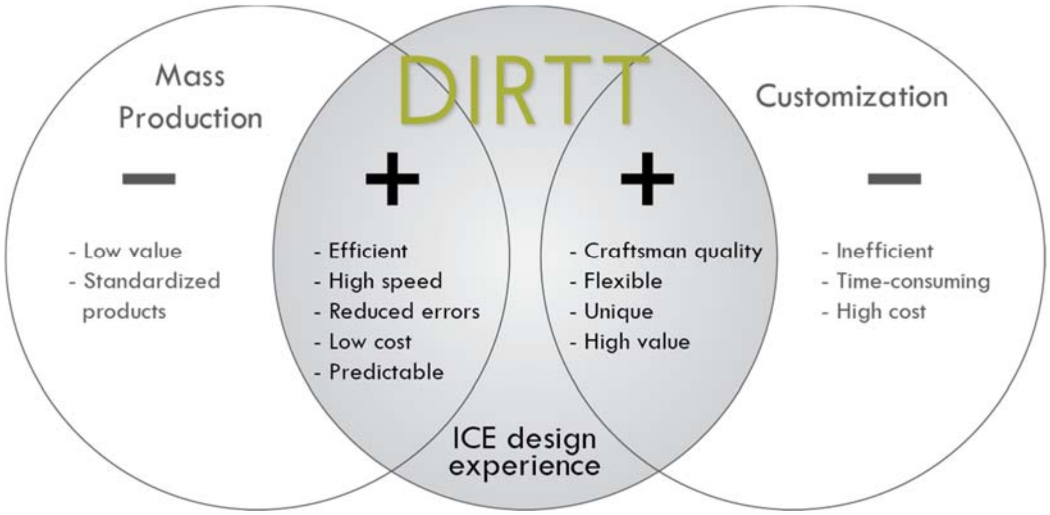
While Management believes this data to be reliable, market and industry data is subject to variations and cannot be verified with complete certainty due to limits on the availability and reliability of raw data, the voluntary nature of the data-gathering process and other limitations and uncertainties inherent in any statistical survey.

OVERVIEW

DIRTT combines its proprietary ICE® 3D design, configuration and manufacturing software ("ICE" or "ICE Software") with integrated in-house manufacturing of its innovative prefabricated custom solutions and an extensive Partners network. Our Partners are located throughout the United States, Canada and select international markets. DIRTT's suite of solutions includes DIRTT Walls, DIRTT Power, DIRTT Networks, DIRTT Millwork, DIRTT Ceilings, DIRTT Flooring, DIRTT Timber Frame and related complementary products (collectively, the "DIRTT Solutions"). We support our Partners with local DIRTT sales team members, industry specialists and business development resources. Our Partners, in turn, are required to invest in their own regional DIRTT-focused team consisting of, at a minimum, a DIRTT champion (sales role), DIRTT project manager and DIRTT designer. In addition, our Partners are required to invest in a DIRTT Green Learning Center ("GLC"), which is a display area to showcase DIRTT Solutions locally. DIRTT and our Partners utilize ICE to communicate, present, design, visualize in 3D, configure, price, engineer, specify, order and manage projects. We are underpinned by a strong entrepreneurial culture and provide a unique, end-to-end solution for the inefficient and fragmented interior construction industry.

DIRTT STANDS FOR: DOING IT RIGHT THIS TIME.

Doing It Right This Time means we believe in a better way to build. We are working to create a positive shift in the construction industry by placing as much value on the environment and people using spaces as we do on beautiful and functional design. Our goal is to build and deliver complete, engaging, well-designed, customized, sustainable, high-quality spaces faster, more efficiently and with a better overall customer experience than is available with traditional construction methods. Traditional construction often entails frequent cost overruns, inconsistent quality, delays and significant material waste. Our proprietary ICE Software delivers an automated manufacturing process (two-week or better delivery target) that significantly decreases the construction timeframe as compared to a conventional approach. With ICE, we focus on revolutionizing the interior construction industry by combining the speed, cost certainty, sustainability and modularity of prefabrication with the custom dimensions, functionality and aesthetics of skilled trade construction. By providing realistic 3D visualization, cost certainty and significantly reduced lead times, ICE enables us to deliver a superior client experience, while combining the low unit costs of mass production processes with the flexibility of individual customization. Led by our highly entrepreneurial and client-focused culture, this mass customization is the foundation of our business.



DIRTT Solutions form a comprehensive offering that allows us to address the challenges associated with traditional interior construction methods. Below is a brief description of DIRTT Solutions:

DIRTT Walls	Pre-fabricated, customized interior wall solutions that support new and legacy furniture and can support integrated technology for commercial, healthcare, education, hospitality and residential applications.
DIRTT Power	Quick-connect, pre-tested adaptable power solutions which are pre-fabricated to arrive on-site in correct lengths with factory components ready to go, which eliminates waste and provides future flexibility.
DIRTT Networks	Pre-fabricated, pre-tested and componentized approach to building sustainable network infrastructure. DIRTT includes Passive Optical Network ("PON") capabilities within its suite of solutions. This networking solution uses single mode fiber cables instead of traditional copper cables. Similar to DIRTT Power, data infrastructure components arrive on the job site pre-cut to correct lengths and with components ready to go.
DIRTT Millwork	Fully customized modular cabinetry that works for any application including healthcare, corporate, education, hospitality and residential. DIRTT Millwork integrates seamlessly with DIRTT Walls and other solutions.
DIRTT Floors	DIRTT's low profile access floor supports modular power and network infrastructure, which in turn provides flexibility for future adaptation and reconfiguration in both existing facilities and new buildings.

DIRTT Ceilings	Pre-fabricated custom ceilings that integrate with DIRTT Wall solutions (or on their own), increase speech privacy and reduce noise.
DIRTT Timber	Pre-fabricated timber construction for interior mezzanines, structural elements for low-rise buildings and other architectural elements that integrate with DIRTT Walls and other solutions. Completely customized cross-laminated timber and glulam timber solutions.

The process chart below compares a typical conventional construction approach against the DIRTT approach. With the power of ICE, DIRTT removes several common steps required in conventional construction, allowing for faster project completion.

Our revenues reflect sales to Partners for resale to their clients. We are not dependent on any one Partner, Partner's client, vertical market, industry segment or minimum job size. Our Partners' clients range from small owner-managed businesses to large multinational Fortune 500 corporations in a diverse range of vertical markets and industries including, but not limited to, healthcare, education, financial services, government and military, manufacturing, non-profit, energy, professional services, retail, and technology. As at March 31, 2017, our Partners had delivered DIRTT Solutions to more than 7,400 of their clients. For the three months ended March 31, 2017, our average project size (on a per project order basis) was approximately $79,000 (March 31, 2016 - $80,000), with the single largest project (on a per project order basis) being $0.9 million (March 31, 2016 - $1.2 million).

We have historically derived virtually all of our revenue from North America, with periodic international projects completed for North America-based Partners and international clients. Our three principal geographic locations are Canada, the US and International (outside North

America), as detailed below, and we have one operating segment. During Q1 2017 and 2016 we did not have any revenue from our International location.

	Q1 2017	Q1 2016
	($ thousands)	
Canada	11,839	8,072
US	53,220	47,851
	65,059	**55,923**

Revenue from certain international projects was included in the revenue amount for the US as these projects were sold by US-based Partners and delivered to international locations. Below is a breakdown of international projects delivered during the respective periods. The amounts for Middle East and Asia (below) are included as part of revenue for the US.

	Q1 2017	Q1 2016
	($ thousands)	
Middle East	497	4,180
Asia	45	-
	542	4,180
% of total revenue	1%	7%

FIRST QUARTER 2017 HIGHLIGHTS

Financial:

- Revenue increased by $9.1 million, or 16.3% over Q1 2016, to $65.1 million;
- Trailing 12-month revenue was $276.2 million versus $ 235.8 million in the prior 12 month period, an increase of 17.1%;
- Gross profit increased by $2.9 million, or 12.1% over Q1 2016, to $27.0 million;
- Gross profit % decreased by 150 basis points from Q1 2016 from 43.0% to 41.5%;
- Adjusted gross profit of $27.9 million and adjusted gross profit % of 42.9% (see "Non-IFRS Measures");
- Adjusted EBITDA of $4.0 million and adjusted EBITDA % of 6.2% (see "Non-IFRS Measures"); and
- Net loss was $1.4 million and net loss per share was $0.02.

Operational:

- Sales and marketing and business development headcount increased by 14.0% over Q1 2016 to 115; and
- Unveiled the Leaf™, DIRTT's answer to sustainable folding walls.

RESULTS OF OPERATIONS

The following table sets forth a summary of DIRTT's results of operations for the three months ended March 31, 2017 and 2016.

	Q1 2017	Q1 2016
	($ thousands, except per share amounts)	
Revenue	65,059	55,923
Gross profit	26,985	24,066
Gross profit %	41.5%	43.0%
Adjusted gross profit [(1)]	27,876	24,809
Adjusted gross profit % [(1)]	42.9%	44.4%
SG&A	27,983	23,146
SG&A %	43.0%	41.4%
Adjusted SG&A [(1)]	23,579	19,249
Adjusted SG&A % [(1)]	36.3%	34.4%
Operating (loss) income	(998)	920
Adjusted EBITDA [(1)]	4,009	4,578
Adjusted EBITDA % [(1)]	6.2%	8.2%
Income tax expense (recovery)	337	(29)
Net (loss) income	(1,395)	368
Net (loss) income per share - basic and diluted	(0.02)	0.00

Note:

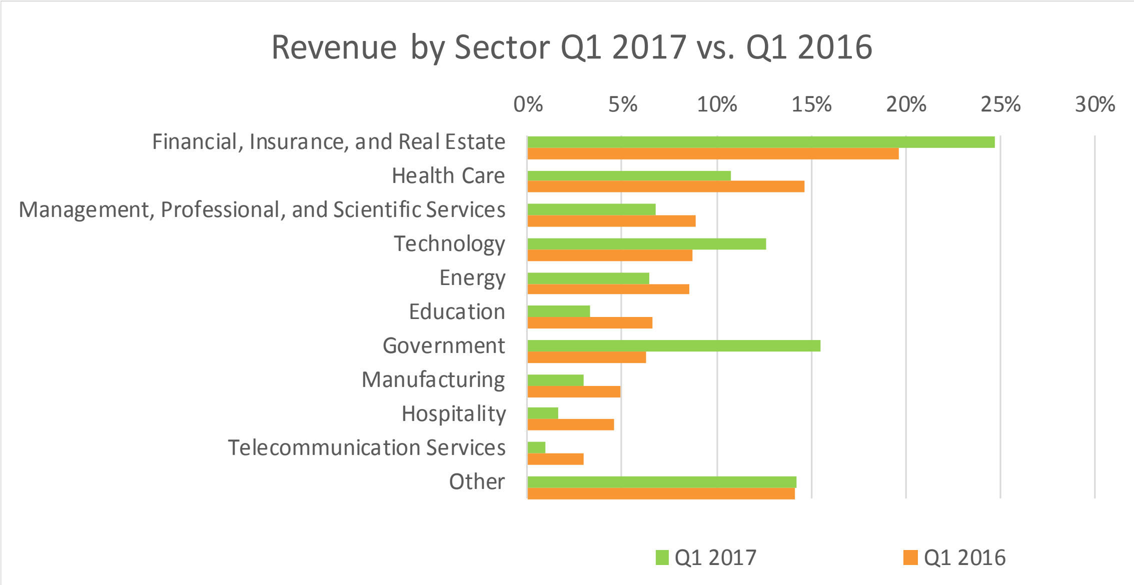
[(1)] See "Non-IFRS Measures".

Revenue

Revenue increased by $9.1 million, or 16.3%, for Q1 2017 compared with Q1 2016. This increase was achieved by a general increase in activity from small and medium-sized projects across a diverse range of industry segments including technology, which increased from 9% of total revenue in Q1 2016 to 13% in Q1 2017; and government, which increased from 6% in Q1 2016 to 16% of revenue in Q1 2017. In addition, we recorded installations revenue in Q1 2017 of $2.7 million compared with nil in Q1 2016.

The majority of our revenue is collected in US dollars, whereas our reporting currency is Canadian dollars. As a result, we are exposed to fluctuations in the US dollar against the Canadian dollar, which could have a positive or negative impact on our revenue. The recent weakening of the US dollar, which decreased from 1.3724 in Q1 2016 to 1.3238 in Q1 2017, had a negative impact on overall revenue in the period, as compared to the same quarter in the prior year.

Below is a breakdown of the percentage of revenue by sector for Q1 2017 versus Q1 2016:



Gross Profit / Adjusted Gross Profit / Gross Profit % / Adjusted Gross Profit %

Gross profit for Q1 2017 improved to $27.0 million from $24.1 million in Q1 2016, an increase of 12.1%. However, gross profit % declined by 150 basis points to 41.5% from 43.0%. The decrease in gross profit % was due primarily to changes in product/service revenue, greater volatility in the timing of monthly and quarterly production volumes, and an increase in installations revenue which typically brings a lower gross profit than our standard manufacturing process. Volatility in manufacturing volumes is evidenced by the decline from the record revenue levels achieved in both the third and fourth quarters of 2016 ($71.5 million and $78.3 million, respectively) to the seasonally lower results achieved in the first quarter of the current year.

Adjusted gross profit for Q1 2017 improved to $27.9 million from $24.8 million for Q1 2016, an increase of 12.4%. However, adjusted gross profit % declined by 150 basis points to 42.9% from 44.4% for the same reasons discussed above with respect to gross profit. See "Non-IFRS Measures" for a reconciliation of adjusted gross profit and adjusted gross profit %.

The impact of the lower US dollar to Canadian dollar average exchange rate (Q1 2017 – 1.3238; Q1 2016 – 1.3724) contributed to partially offsetting the increased gross profit and adjusted gross profit in Q1 2017 compared with Q1 2016.

SG&A Expenses / Adjusted SG&A Expenses / SG&A % / Adjusted SG&A %

Selling, general and administrative ("SG&A") % increased by 160 basis points from 41.4% to 43.0% in Q1 2017 compared with Q1 2016. SG&A expenses increased by $4.8 million, or 20.9%, for Q1 2017 compared with Q1 2016. The increase is reflective of DIRTT's improved operating results in the period, as well as ongoing investment in long-term growth initiatives. The most significant change can be attributed directly to sales-related efforts as salaries and commissions increased by $2.9 million. These costs reflect the addition of personnel focused on generating and supporting higher business volumes, and commissions on the higher revenues attained in the period. Other increases in SG&A in Q1 2017 included depreciation and amortization expense of non-manufacturing-related assets of $0.7 million, travel and marketing costs of $0.5 million, professional fees of $0.2 million, rent expense of $0.2 million, and $0.5 million in other operating expense items. These increases were offset by a decrease in stock-based compensation of $0.2 million. The increase in depreciation and amortization expense of non-manufacturing-related assets correlates with the increase in our investment in leasehold improvements along with software and product development.

Adjusted SG&A % increased by 190 basis points from 34.4% to 36.3% in Q1 2017 compared with Q1 2016. Adjusted SG&A expenses increased by $4.3 million, or 22.5%, for Q1 2017 compared with Q1 2016. The reason for the increase is the same as discussed above with respect to SG&A, excluding the impact from increased non-cash depreciation and amortization of non-manufacturing-related assets and decreased stock-based compensation expense incurred in the period. See “Non-IFRS Measures” for a reconciliation of adjusted SG&A and adjusted SG&A %.

The impact of the lower US dollar to Canadian dollar average exchange rate (Q1 2017 – 1.3238; Q1 2016 – 1.3724) contributed to partially offsetting the overall increase in SG&A and adjusted SG&A expenses across the organization for Q1 2017, as certain of these SG&A expenditures are denominated in US dollars.

Adjusted EBITDA / Adjusted EBITDA %

Adjusted EBITDA decreased slightly by $0.6 million for Q1 2017 compared with Q1 2016. Adjusted EBITDA % for Q1 2017 declined by 200 basis points from 8.2% in Q1 2016 to 6.2% in Q1 2017. The decrease in Q1 2017 was mainly due to higher adjusted SG&A expenses of $4.3 million, partially offset by higher adjusted gross profit of $3.1 million and a decrease in foreign exchange loss of $0.7 million. See “Non-IFRS Measures for a reconciliation of Adjusted EBITDA and Adjusted EBITDA %.

Gains or losses in foreign exchange (“FX”) are primarily the result of the period end revaluation of monetary assets and liabilities held within our Canadian companies. The largest component of these assets and liabilities is our holdings of US dollar cash and cash equivalents. The decrease in foreign exchange loss of $0.7 million is the result of significant fluctuations in the CAD-US exchange rate in the year-over-year periods. During Q1 2016, the US dollar decreased by $0.09 compared to year-end 2015, resulting in a $1.0 million loss on the revaluation of these monetary assets and liabilities. Conversely, the US dollar depreciated during Q1 2017 by $0.01 compared to year-end 2016, resulting in a $0.3 million loss being recognized. These amounts exclude any gains or losses resulting from the revaluation of our US dollar-denominated long-term debt, as these amounts have been re-added in the determination of Adjusted EBITDA, as per reconciliation below.

	Q1 2017	Q1 2016	Variance
	($ thousands)		
FX loss as reported	55	665	(610)
FX gain on debt revaluation	(233)	(317)	84
FX loss included in Adjusted EBITDA	**288**	**982**	**(694)**

Income Tax

Provision for income taxes comprises federal, state, local and foreign taxes based on pre-tax income. Income tax expense for Q1 2017 was $337,000 compared with income tax recovery of $29,000 for the same period in 2016. This mainly reflects the profitability of our US and Canadian subsidiaries in Q1 2017 compared to Q1 2016. We expect this trend to continue in future periods.

As at March 31, 2017, DIRTT had consolidated loss carry forwards of $22.9 million and US$3.7 million (December 31, 2016 - $21.9 million and US$3.8 million) for the Canadian and US operating segments, respectively. These losses expire in the years 2024 to 2036.

Summary of Quarterly Results

	Q1 2017	Q4 2016	Q3 2016	Q2 2016	Q1 2016	Q4 2015	Q3 2015	Q2 2015
	($ thousands, except per share amounts)							
Revenue	65,059	78,324	71,531	61,252	55,923	64,988	62,070	52,866
Gross profit	26,985	33,924	30,955	27,327	24,066	28,443	27,799	21,413
Gross profit %	41.5%	43.3%	43.3%	44.6%	43.0%	43.8%	44.8%	40.5%
Adjusted gross profit % (1)	42.9%	44.4%	44.3%	46.1%	44.4%	45.1%	45.8%	42.0%
Operating (loss) income	(998)	6,058	5,919	(216)	920	7,370	6,257	(1,131)
Adjusted EBITDA (1) (2)	4,009	11,242	11,081	4,385	4,578	9,573	11,198	2,324
Adjusted EBITDA % (1)	6.2%	14.4%	15.5%	7.2%	8.2%	14.7%	18.0%	4.4%
Net (loss) income	(1,395)	4,345	4,029	(1,458)	368	9,127	5,446	(1,363)
Net (loss) income per share - basic and diluted	(0.02)	0.06	0.05	(0.02)	0.00	0.11	0.07	(0.02)

Note:

(1) See "Non-IFRS Measures".

The construction industry has historically seen seasonal slowdowns related to winter weather conditions and holiday schedules in the fourth and first quarters. DIRTT's business has followed this seasonality, though this trend was not as prevalent in our business during the last four years. That said, we still consider this potential seasonal slowdown as a factor that could impact DIRTT production levels.

Due to the fixed nature of some of DIRTT's manufacturing costs, periods of higher revenue volume tend to generate higher gross profit and operating income. Quarters that contain consistent timing of monthly manufacturing volumes tend to generate higher gross profit than those where the timing of manufacturing levels vary significantly from month to month. Product/service revenue mix also tends to have an impact on gross profit; simplistic product/service revenue mix can result in lower gross profit, while "full solution" or more comprehensive product/service revenue mixes tend to have higher gross profit.

Changes in Financial Position

The following is a discussion of changes in the consolidated statement of financial position as at March 31, 2017.

As at	March 31, 2017	December 31, 2016	Change ($)	Change (%)	Explanation of changes
		($ thousands)			
Current assets					
Cash and cash equivalents	90,178	93,554	(3,376)	(4%)	See "Liquidity and Capital Resources"
Trade and other receivables	29,841	32,078	(2,237)	(7%)	Reflects higher revenue levels during Q4 2016
Inventory	20,769	21,421	(652)	(3%)	Reflects normal draw down of peak year-end inventory levels
Prepaids and other current assets	3,492	2,058	1,434	70%	Reflects annual insurance renewals and miscellaneous deposits/expenditures in preparation for DIRTT Connext for June 2017
	144,280	149,111			
Current liabilities					
Trade accounts payable and other liabilities	23,568	27,206	(3,638)	(13%)	Reflects timing of payment of payables and other liabilities and seasonal reduction in operating activity during Q1 2017
Customer deposits	7,296	4,224	3,072	73%	Reflects timing and type of project orders at each period end
Current portion of long-term debt	5,874	5,091	783	15%	Reflects scheduled repayments
	36,738	36,521			
Working capital					
(Current assets minus Current liabilities)	107,542	112,590	(5,048)	(4%)	

As at	March 31, 2017	December 31, 2016	Change ($)	Change (%)	Explanation of changes
	($ thousands)				
Non-current assets					
Property, plant and equipment	56,203	55,610	593	1%	Reflects additions of $3.9 million (mostly manufacturing equipment and leasehold improvements), partially offset by depreciation expense of $3.1 million and foreign exchange loss of $0.2 million.
Intangible assets	21,778	19,961	1,817	9%	Reflects additions of $3.0 million (mostly capitalized salaries and benefits related to software and product development), partially offset by amortization expense of $1.2 million
Deferred tax assets	5,815	5,652	163	3%	Insignificant change
Goodwill	1,845	1,845	-	0%	No change
Other assets	1,111	1,150	(39)	(3%)	Insignificant change
Non-current liabilities					
Deferred tax liabilities	1,145	1,170	(25)	(2%)	Insignificant change
Long-term debt	12,070	13,669	(1,599)	(12%)	Reflects scheduled repayments
Shareholders' equity					
Common share capital	195,865	195,000	865	0%	Reflects stock option exercises of $1.1 million and reduction in carrying value of share capital due to shares repurchased of $0.3 million
Warrants	-	37	(37)	(100%)	Reflects redemption of warrants in Q1 2017
Share-based payment reserve	10,921	10,253	668	7%	Reflects stock-based compensation expense, partially offset by stock option exercises during 2017
Accumulated other comprehensive income	8,319	8,719	(400)	5%	Reflects the softening of the US dollar on the translation of our US subsidiary operations
Accumulated deficit	(34,026)	(32,040)	(1,986)	6%	Net loss of $1.4 million and loss on shares repurchased of $0.6 million

LIQUIDITY AND CAPITAL RESOURCES

Summary information – Condensed consolidated statements of cash flows

	Q1 2017	Q1 2016
	($ thousands)	
Cash flows provided by operating activities before changes in non-cash working capital [(1)]	4,261	2,682
Changes in non-cash working capital	364	(1,414)
Net cash flows provided by operating activities	4,625	1,268
Deduct:		
Net cash flows used in investing activities	(6,893)	(7,285)
Net cash flows used in financing activities	(873)	(1,100)
Effect of foreign exchange on cash and cash equivalents	(235)	(765)
Decrease in cash and cash equivalents	(3,376)	(7,882)
Cash and cash equivalents, beginning of period	93,554	91,405
Cash and cash equivalents, end of period	**90,178**	**83,523**

Note:

(1) See "Non-IFRS Measures".

At March 31, 2017, we had $90.2 million in cash and cash equivalents compared with $93.6 million at December 31, 2016. At March 31, 2017, we also had access to an undrawn US$18.0 million revolving credit facility.

Looking forward to the balance of 2017, we expect to make continued investments in product and software development to further expand our solution offerings, as well as in certain manufacturing equipment to support this development. We will continue to further invest in our existing GLCs to ensure each location showcases the latest DIRTT solutions, including the annual refresh of our Chicago GLC in advance of DIRTT Connext™ in June 2017.

We believe our current cash on hand, available credit facilities and cash flow from operations provide sufficient liquidity to meet our working capital requirements, which are mainly our accounts receivable, inventory, and accounts payable and other liabilities balances that arise in the normal course of our operations; our financial obligations; and the flexibility to pursue additional growth opportunities.

In addition, we usually require a 50% deposit on certain orders which further reduces pressure on our working capital. We do not require deposits on US government orders or in some special contractual situations. Historically, we do not see a strong correlation between the customer deposits balance at the end of the period and the following period's revenue.

Net cash flows provided by operating activities

Net cash flows provided by operating activities increased by $3.4 million for Q1 2017 compared with Q1 2016. The increase was primarily due to a decreased investment in non-cash working capital items of $1.8 million and a decrease in cash taxes paid of $2.0 million during Q1 2017.

Net cash flows used in investing activities

Net cash flows used in investing activities for Q1 2017 decreased by $0.4 million compared with Q1 2016. The decrease related to a slight reduction in spend on investment in new manufacturing equipment, and in our company-owned GLCs. This decrease was partially offset by an increase in investment in product and software development as we continue our ongoing commitment to enhance and expand our solutions. Examples of this include the new residential interiors, timber frame construction and Leaf™, sustainable folding walls.

Net cash flows used in financing activities

Net cash flows used in financing activities for Q1 2017 decreased by $0.2 million compared with Q1 2016. The decrease was attributable to shares repurchased of $0.9 million under the Company's normal course issuer bid (the "NCIB") which did not occur in Q1 2016. The aforementioned decrease was offset by a cashflow increase due to issuance of share capital on exercise of stock options of $0.7 million and a decrease in loan repayments of $0.5 million compared to Q1 2016.

NON-IFRS MEASURES

Adjusted gross profit, Adjusted gross profit %, Adjusted SG&A, Adjusted SG&A %, Adjusted EBITDA, Adjusted EBITDA % and cash provided by operating activities before changes in non-cash working capital are non-IFRS measures.

Adjusted gross profit and adjusted gross profit %

Adjusted gross profit is calculated as gross profit before deducting depreciation of equipment and tooling for manufacturing-related assets that is included in cost of goods sold. Adjusted gross profit % is calculated as adjusted gross profit divided by revenue. We use this as a primary indicator of our manufacturing and operating performance. As manufacturing volumes and revenue rise, production synergies tend to permit improvements in gross profit, subject to variability in monthly manufacturing volumes and product/service revenue mix.

The following table reconciles gross profit and adjusted gross profit to the condensed consolidated statements of net (loss) income and comprehensive loss.

	Q1 2017	Q1 2016
	($ thousands)	
Revenue	65,059	55,923
Cost of goods sold ("COGS")	38,074	31,857
Gross profit	**26,985**	**24,066**
Gross profit %	**41.5%**	**43.0%**
Add back:		
Depreciation included in COGS	891	743
Adjusted gross profit	**27,876**	**24,809**
Adjusted gross profit %	**42.9%**	**44.4%**

Adjusted SG&A and adjusted SG&A %

Adjusted SG&A is a measurement of our funded SG&A costs in the period, and is calculated as SG&A before deductions for non-cash depreciation and amortization of non-manufacturing-related assets and stock-based compensation expense. Adjusted SG&A % is calculated as Adjusted SG&A divided by revenue. We use this as a measure of the efficiency and effectiveness of our sales and marketing efforts and overall administrative support efforts by comparing them to prior period results.

The following table reconciles SG&A and adjusted SG&A to the condensed consolidated statements of net (loss) income and comprehensive loss.

	Q1 2017	Q1 2016
	($ thousands)	
SG&A	27,983	23,146
Less: Depreciation included in SG&A	(3,406)	(2,725)
Less: Stock-based compensation expense included in SG&A	(998)	(1,172)
Adjusted SG&A	**23,579**	**19,249**
Adjusted SG&A %	**36.3%**	**34.4%**

Adjusted EBITDA and Adjusted EBITDA %

EBITDA represents an indication of the entity's capacity to generate income from operations before taking into account management's financing decisions and costs of consuming tangible and intangible capital assets, which vary according to their age, technological validity, and management's estimate of their useful life. Accordingly, EBITDA is earnings before interest, taxes, depreciation and amortization. Adjusted EBITDA is EBITDA plus non-cash foreign exchange gains or losses on debt revaluation; gains or losses on disposal of property, plant and equipment and intangible assets; write-off of property, plant and equipment and intangible assets; non-cash stock-based compensation expense; transaction costs, and any other non-recurring gains or losses. Adjusted EBITDA % is calculated as Adjusted EBITDA divided by revenue. We use these measures to assess our ability to generate cash flows, service debt, pay current taxes, and fund capital expenditures. Readers are cautioned that Adjusted EBITDA should not be considered as an alternative to profit as determined in accordance with IFRS.

The following table reconciles EBITDA and Adjusted EBITDA to the condensed consolidated statements of net (loss) income and comprehensive loss.

	Q1 2017	Q1 2016
	($ thousands)	
Net (loss) income for the period	(1,395)	368
Add back (deduct):		
Finance costs	148	76
Interest income	(143)	(160)
Income tax expense (recovery)	337	(29)
Depreciation included in COGS	891	743
Depreciation and amortization included in SG&A	3,406	2,725
EBITDA	**3,244**	**3,723**
Stock-based compensation	998	1,172
Non-cash foreign exchange gain on debt revaluation	(233)	(317)
Adjusted EBITDA	**4,009**	**4,578**
Adjusted EBITDA %	**6.2%**	**8.2%**

Cash provided by operating activities before changes in non-cash working capital

Cash provided by operating activities before changes in non-cash working capital is a non-IFRS performance measure that could provide an indication of our ability to generate cash flows from operations. It is calculated by re-adding the change in non-cash working capital to "net cash flows provided by operating activities," as presented in the consolidated statements of cash flows.

The following table reconciles net cash flows provided by operating activities before changes in non-cash working capital to the condensed consolidated statements of cash flows.

	Q1 2017	Q1 2016
	($ thousands)	
Net cash flows provided by operating activities	4,625	1,268
Changes in non-cash working capital	(364)	1,414
Net cash flows provided by operating activities before changes in non-cash working capital	**4,261**	**2,682**

CAPITAL RESOURCES AND MANAGEMENT

We aim to manage our capital resources to ensure financial strength and to maximize our financial flexibility. This is done by maintaining strong liquidity, and by utilizing alternative sources of capital including equity, debt and bank loans or lines of credit to fund continued growth.

We set the amount of capital in proportion to risk and based on the availability of funding sources. We manage the capital structure and make adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

To date, issuing equity has been our primary source of capital. However, additional debt and/or equity financing may be pursued in the future as deemed appropriate to balance debt and equity. In order to maintain or adjust the capital structure, we may return capital to shareholders, issue new shares, take on additional debt, or sell assets to reduce debt.

On January 6, 2017, we announced receipt of approval from the TSX to commence a NCIB with respect to our common shares (the "Common Shares"). The NCIB commenced on January 10, 2017 and will terminate on the earlier of January 9, 2018; the date on which we have purchased the maximum number of Common Shares permitted under the NCIB; or the date on which the NCIB is terminated. Under the NCIB, we may purchase in the normal course through the facilities of the TSX up to 7,141,021 Common Shares. As of the date hereof, we have purchased 134,056 Common Shares at a weighted average price of $6.70 per Common Share, including brokerage fees, for a total cost of $0.9 million through the NCIB.

In February 2017, we signed a fifth amendment to the amended and restated loan agreement with its lender, which included a change in the determination of the value of the minimum tangible net worth amount as it is reset at the end of each fiscal year. The minimum tangible net worth will be based on $135.0 million plus 50% of the consolidated net income for the fiscal year then ending less any amounts paid in connection with a normal course issuer bid to a maximum of $25.0 million. As at March 31, 2017, the adjusted minimum tangible net worth was $137.7 million.

As at March 31, 2017 and December 31, 2016, the Company's tangible net worth was $186.8 million and $168.0 million, respectively. As at March 31, 2017 and December 31, 2016, the Company is in compliance with its lender's covenants.

CONTRACTUAL OBLIGATIONS

As at March 31, 2017, we have unpaid capital expenditure commitments of approximately $1.7 million for manufacturing equipment to be delivered in 2017. We will use our current cash on hand to fund these commitments.

OUTSTANDING SHARE DATA

The total number of fully diluted outstanding and issuable Common Shares is as follows:

As at	May 3, 2017	March 31, 2017
Common shares	85,076,935	85,035,361
Stock options (1)	6,555,060	6,603,134
Total	91,631,995	91,638,495

Note:

(1) Assuming full conversion and ignoring exercise prices.

TRANSACTIONS BETWEEN RELATED PARTIES

An officer and director of the Company, Mogens Smed, purchased various DIRTT solutions from the Company for his primary residence commencing in the fourth quarter of 2016 and continuing into 2017, which DIRTT intends to showcase frequently to DIRTT clients, strategic partners and strategic partners' clients. The project was priced at materials plus 10% with the remaining terms and conditions in accordance with standard business practices. Details of the revenue earned, outstanding accounts receivable and any deposits received by the Company pursuant to this project are outlined below for the periods indicated:

	For the three months ended March 31,	
	2017	2016
	($ thousands)	
Revenue earned	366	-
As at	March 31, 2017	December 31, 2016
Outstanding accounts receivable	474	-
Deposits received	-	188

One of our Partners, Lane Office Furniture Inc., is owned by Gregory Burke, a director of the Company. The Company reported the following transactions with this Partner for the following periods:

	For the three months ended March 31,	
	2017	2016
	($ thousands)	
Revenue earned	1,688	2,066
Rebates paid	21	19
As at	March 31, 2017	December 31, 2016
Outstanding accounts receivable	666	560
Deposits received	79	-

All transactions with Lane Office Furniture Inc. have occurred in the normal course of operations at arm's length and are based on standard commercial terms.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Our activities expose us to a variety of financial risks: credit risk; liquidity risk; market risk; interest rate risk; foreign exchange risk; and commodity price risk. Our overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on our financial performance. We consider credit risk to be one of our main financial risks.

Credit risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Financial instruments exposed to credit risk include cash and cash equivalents and trade and other receivables. The credit risk on cash and cash equivalents is limited because the counterparties are chartered banks with high credit ratings assigned by national credit-rating agencies. Our credit risk is primarily concentrated in our trade receivables. The amounts disclosed in the consolidated statement of financial position are net of allowances for doubtful accounts, estimated by management based on previous experience with customers and their assessment of the current economic environment and specific customer circumstances. In order to reduce our risk, management maintains credit policies that include regular review of credit limits of individual customers and the use of accounts receivable insurance (see below) for a significant portion of trade receivables. Aging of trade receivables is systematically monitored by management. Trade balances are spread amongst a broad, geographically dispersed customer base. We do not have significant exposure to any individual customer. A number of factors are considered in determining the likelihood of impairment. We had nil bad debt expense for the quarters ended March 31, 2017 and 2016.

We also have a contract with Export Development Canada (“EDC”), Canada’s export credit agency, whereby some of our trade receivables are insured. EDC determines the coverage amount, if any, on a customer-by-customer basis. Based on our trade receivables balance as at March 31, 2017, 42.7% (December 31, 2016 – 50.7%) of that balance is covered by EDC. The majority of the remaining balance is less than 90 days old and is owed by a small number of DIRTT’s strong-performing Partners, on which the Company has a high level of confidence of collectability, and government sales that are not covered by EDC. We consider trade receivables greater than 90 days as past due and as at March 31, 2017, the amount outstanding was $5.3 million, with a net of allowance for doubtful accounts of $0.7 million (December 31, 2016 - $7.1 million and, $0.7 million, respectively). We only provide for balances that we consider to be at risk of collection. As a result, we believe that our exposure to credit risk is limited.

Fair value of financial instruments

The fair values of the Company’s financial instruments were determined as follows:

a) The carrying amounts of cash and cash equivalents; trade and other receivables; trade accounts payable and other liabilities; and customer deposits approximate fair value due to their short-term nature; and

b) The Company's current and long-term debts are carried at amortized cost. The fair values of these instruments are estimates made at a specific point in time, based on relevant market information. These estimates are based on quoted market prices for the same or similar issues or on the current rates offered to the Company for similar financial instruments subject to similar risks and maturities. The carrying amounts of these instruments approximates fair value due to their respective floating interest rates.

RISK FACTORS

Please refer to the AIF for a complete discussion of those distinctive or special characteristics of our operations and industry that may have a material impact on, or constitute risk factors in respect of, our operations and future financial performance.

OUTLOOK

Construction is a major global industry and consists of building new structures, making additions and modifications to existing structures, as well as conducting maintenance, repair and leasehold improvements on existing structures. The total US construction market was US$1.2 trillion in 2016, of which US$700 billion was attributable to non-residential building and US$463 billion was attributable to residential building [Source: US Census Bureau]. This includes both new building and renovation projects. Total US non-residential and residential construction spending is forecast to grow to US$837 billion and US$541 billion, respectively, in 2020 [Source: FMI US Markets Construction Overview 2017]. We believe conventional construction activities are fraught with challenges including cost overruns, quality issues, labor shortages and time delays. As such, we believe organizations are increasingly seeking a better way to build out their interior spaces, whether for new buildings or renovations.

Our growth strategy consists of five key initiatives: (1) increase penetration of existing markets by providing continued support and increased investment in programs to support our existing Partners throughout North America; (2) expand into new geographies, such as the Middle East, India, Southeast Asia, United Kingdom and Europe, by capitalizing on recent and continued investment alongside new international Partners; (3) penetrate new vertical markets such as the healthcare, education and residential sectors; (4) continue investment in ICE and innovative construction solutions such as Leaf™, the Enzo™ Approach, residential interiors and timber frame construction; and (5) partner with industry leaders to monetize innovative solutions – a recent example of which is the integration of ICE with SAP's enterprise resource planning system completed in January 2017.

With the recent launch of our residential and timber frame solutions, we have officially entered into these markets. We do not expect to see meaningful revenue from these markets in the near term. However, we completed our first significant residential contract for 16 duplexes in Alaska during Q2 2016.

We believe DIRTT solutions and the resulting more efficient and cost-effective construction experience are a superior alternative to conventional construction across all sectors of the construction industry. We also believe that a continued increase in global construction activity can result in an ongoing growth in revenue. We plan to invest additional resources in a variety of initiatives, including the continued development of ICE and new DIRTT solutions and test projects. This will lead to continued growth in the healthcare, education, government, corporate and residential sectors of the construction industry. Our product development team has been, and we expect will continue to be, expanded to address industry-specific challenges and opportunities.

The American Institute of Architects' ("AIA") Architecture Billings Index can be a useful leading economic indicator of how US non-residential billings activity could trend. The most recent March billings activity numbers continued to show growth nationally, building on an improving trend in February following a slower start to the year. The design activities numbers have grown nationally after being spurred by a February spike in activity. The strong readings in project inquiries and new design contracts will likely help future billings activity. Both DIRTT and the AIA believe these overall numbers point to solid fundamentals that could support growth across all segments of the building industry for the next nine to 12 months.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenue and expenses during the reporting period. The estimates and associated assumptions are continuously evaluated and are based on historical experience and various other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.

There have been no significant changes in our critical accounting estimates since December 31, 2016.

FUTURE ACCOUNTING PRONOUNCEMENTS

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following pronouncement may have an impact on the Company:

In April 2016, the IASB issued amendments to IFRS 15 "Revenue from Contracts with Customers". In May 2014, the IASB and the US Financial Accounting Standards Board issued their joint revenue recognition standard, IFRS 15, which replaces all existing IFRS and US GAAP revenue requirements. The standard applies to all revenue contracts and provides a model for the recognition and measurement of sales of some non-financial assets (e.g. disposals of property, plant and equipment). The amendments noted in April 2016 clarified three aspects of the standard (identifying performance obligations, principal versus agent considerations and licensing) and provided some transition relief for modified contracts and completed contracts. IFRS 15 is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. IFRS 15 introduces a single model for recognizing revenue from contracts with customers. This standard applies to all contracts with customers, with only some exceptions, including certain contracts accounted for under other IFRSs. The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services. This is achieved by applying the following five steps:

1. Identify the contract with a customer;
2. Identify the performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the performance obligations in the contract; and
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

The Company does not anticipate this standard will have a material impact on its consolidated financial statements. While the Company is continuing to assess all potential impacts of the standard, the Company currently believes the most significant impact relates to its ICE software license revenue. The Company expects revenue related to product sales and installations to remain substantially unchanged.

DISCLOSURE CONTROLS AND PROCEDURES

Management is also responsible for the design and effectiveness of disclosure controls and procedures to provide reasonable assurance that material information related to the Company, including its consolidated subsidiaries, is made known to the Company's certifying officers. The Company's CEO and CFO have each evaluated the design of the Company's disclosure controls and procedures as at March 31, 2017 and have concluded that these controls and procedures were appropriately designed.