

DIRTT Environmental Solutions Ltd.

Unaudited Condensed Consolidated Financial Statements

For the three and six months ended June 30, 2017 and 2016

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DIRTT Environmental Solutions Ltd.
Condensed Consolidated Statements of Financial Position
(Unaudited - Stated in thousands of Canadian dollars)

As at	June 30, 2017	December 31, 2016
	Notes	
	\$	\$
ASSETS		
Current Assets		
Cash and cash equivalents	77,944	93,554
Trade and other receivables	29,280	32,078
Inventory	21,263	21,421
Prepays and other current assets	2,504	2,058
Total Current Assets	130,991	149,111
Non-current Assets		
Property, plant and equipment	56,403	55,610
Intangible assets	23,387	19,961
Deferred tax assets	7,570	5,652
Goodwill	1,845	1,845
Other assets	1,156	1,150
Total Assets	221,352	233,329
LIABILITIES		
Current Liabilities		
Trade accounts payable and other liabilities	22,131	27,206
Customer deposits	6,609	4,224
Current portion of long-term debt	5,371	5,091
Total Current Liabilities	34,111	36,521
Non-current Liabilities		
Deferred tax liabilities	1,155	1,170
Long-term debt	10,706	13,669
Total Liabilities	45,972	51,360
SHAREHOLDERS' EQUITY		
Common share capital	196,069	195,000
Warrants	-	37
Share-based payment reserve	11,415	10,253
Accumulated other comprehensive income	7,254	8,719
Accumulated deficit	(39,358)	(32,040)
Total Shareholders' Equity	175,380	181,969
Total Liabilities and Shareholders' Equity	221,352	233,329
Commitments	12	

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

DIRTT Environmental Solutions Ltd.

Condensed Consolidated Statements of Loss and Comprehensive Loss

(Unaudited - Stated in thousands of Canadian dollars)

	Notes	For the three months ended June 30,		For the six months ended June 30,	
		2017	2016	2017	2016
		\$	\$	\$	\$
Revenue		70,006	61,252	135,065	117,175
Cost of goods sold		40,138	33,925	78,212	65,782
Gross profit		29,868	27,327	56,853	51,393
Expenses					
Selling, general and administrative		32,925	27,543	60,908	50,689
Operating (loss) income		(3,057)	(216)	(4,055)	704
Other expenses (income)					
Foreign exchange loss		38	341	93	1,006
Interest income		(141)	(148)	(284)	(308)
Finance costs		168	62	316	138
Other expenses		65	255	125	836
Loss before tax		(3,122)	(471)	(4,180)	(132)
Income taxes					
Current tax expense		1,556	1,680	2,098	2,219
Deferred tax recovery		(1,801)	(693)	(2,006)	(1,261)
Net income tax (recovery) expense		(245)	987	92	958
Net loss for the period		(2,877)	(1,458)	(4,272)	(1,090)
Other comprehensive loss					
Items that will be reclassified to profit or loss:					
Exchange differences on translation of foreign operations		(1,065)	1	(1,465)	(1,945)
Comprehensive loss for the period		(3,942)	(1,457)	(5,737)	(3,035)
Loss per share					
Basic and diluted		(0.03)	(0.02)	(0.05)	(0.01)
Weighted average number of shares outstanding					
Basic	7	85,025,719	84,597,751	84,986,856	84,564,661
Diluted	7	85,025,719	84,597,751	84,986,856	84,564,661

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

DIRTT Environmental Solutions Ltd.

Condensed Consolidated Statements of Changes in Equity

(Unaudited - Stated in thousands of Canadian dollars, except for share data)

	Common share capital	Common share capital	Warrants	Share-based payment reserve	Accumulated other comprehensive income	Accumulated deficit	Total equity
	#	\$	\$	\$	\$	\$	\$
As at December 31, 2015	84,501,488	193,984	37	6,865	9,277	(39,324)	170,839
Net loss for the period	-	-	-	-	-	(1,090)	(1,090)
Other comprehensive loss for the period	-	-	-	-	(1,945)	-	(1,945)
Total comprehensive loss for the period	-	-	-	-	(1,945)	(1,090)	(3,035)
Stock-based compensation	-	-	-	2,343	-	-	2,343
Issued on exercise of stock options	133,641	437	-	(124)	-	-	313
As at June 30, 2016	84,635,129	194,421	37	9,084	7,332	(40,414)	170,460
As at December 31, 2016	84,878,891	195,000	37	10,253	8,719	(32,040)	181,969
Net loss for the period	-	-	-	-	-	(4,272)	(4,272)
Other comprehensive loss for the period	-	-	-	-	(1,465)	-	(1,465)
Total comprehensive loss for the period	-	-	-	-	(1,465)	(4,272)	(5,737)
Stock-based compensation	-	-	-	1,996	-	-	1,996
Issued on exercise of stock options	683,259	2,795	-	(834)	-	-	1,961
Shares repurchased	(765,419)	(1,763)	-	-	-	(3,046)	(4,809)
Issued on exercise of warrants	50,325	37	(37)	-	-	-	-
As at June 30, 2017	84,847,056	196,069	-	11,415	7,254	(39,358)	175,380

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

DIRTT Environmental Solutions Ltd.
Condensed Consolidated Statements of Cash Flows
(Unaudited - Stated in thousands of Canadian dollars)

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
	\$	\$	\$	\$
Cash flows from operating activities:				
Net loss for the period	(2,877)	(1,458)	(4,272)	(1,090)
Adjustments:				
Depreciation included in cost of goods sold	833	899	1,724	1,642
Depreciation and amortization included in selling, general and administrative	3,626	2,806	7,032	5,531
Stock-based compensation	998	1,171	1,996	2,343
Finance costs	168	62	316	138
Income tax (recovery) expense	(245)	987	92	958
Non-cash foreign exchange (gain) loss on debt revaluation	(266)	11	(499)	(306)
Non-cash foreign exchange (gain) loss	(250)	261	(160)	183
Net change in non-cash working capital relating to operating activities	(721)	9,864	(357)	8,450
Cash taxes paid	(1,914)	(990)	(1,895)	(2,968)
Other non-cash adjustments	35	55	35	55
Net cash flows (used in) provided by operating activities	(613)	13,668	4,012	14,936
Cash flows from investing activities:				
Purchase of property, plant and equipment	(3,930)	(5,707)	(7,817)	(10,575)
Capital expenditures on internally generated intangible assets	(2,891)	(1,822)	(5,897)	(4,245)
Other	101	10	101	16
Net cash flows used in investing activities	(6,720)	(7,519)	(13,613)	(14,804)
Cash flows from financing activities:				
Issuance of shares on exercise of stock options	1,155	186	1,961	313
Shares repurchased	(3,910)	-	(4,809)	-
Proceeds of long-term debt	-	5,349	-	5,349
Repayment of long-term debt	(1,477)	(1,116)	(2,109)	(2,267)
Interest paid on long-term debt	(168)	(62)	(316)	(138)
Net cash flows (used in) provided by financing activities	(4,400)	4,357	(5,273)	3,257
Effect of foreign exchange on cash and cash equivalents	(501)	(157)	(736)	(922)
Net (decrease) increase in cash and cash equivalents	(12,234)	10,349	(15,610)	2,467
Cash and cash equivalents, beginning of period	90,178	83,523	93,554	91,405
Cash and cash equivalents, end of period	77,944	93,872	77,944	93,872
Cash and cash equivalents consists of:				
Cash	13,566	11,373	13,566	11,373
Short-term investments	64,378	82,499	64,378	82,499
	77,944	93,872	77,944	93,872

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

DIRTT Environmental Solutions Ltd.
Notes to the Condensed Consolidated Financial Statements
June 30, 2017 (Unaudited)

1. GENERAL INFORMATION

DIRTT Environmental Solutions Ltd. (“DIRTT” or the “Company”) is a leading technology-driven manufacturer of highly customized interiors. DIRTT combines its proprietary 3D design, configuration and manufacturing software (“ICE®” or “ICE Software”) with integrated in-house manufacturing of its innovative prefabricated interior construction solutions and an extensive Partners network. ICE provides accurate design, drawing, specification, pricing and manufacturing process information, allowing rapid production of high-quality custom solutions using fewer resources than traditional manufacturing methods. ICE was developed by Ice Edge Business Solutions Ltd. (“Ice Edge”), a wholly owned subsidiary of DIRTT, and its wholly owned subsidiary, Ice Edge Business Solutions, Inc.

ICE is also licensed to unrelated companies and Partners through Ice Edge.

The address of DIRTT’s registered office is 7303 - 30th Street S.E., Calgary, AB, Canada T2C 1N6.

DIRTT trades on the Toronto Stock Exchange (“TSX”) under the symbol “DRT”.

2. SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies applied in the preparation of these condensed consolidated financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

Statement of compliance

These condensed consolidated financial statements have been prepared in accordance with International Accounting Standard 34 Interim Financial Reporting (“IAS 34”). Accordingly, certain information and footnote disclosure normally included in annual financial statements prepared in accordance with International Financial Reporting Standards (“IFRS”) have been omitted or condensed, and the condensed consolidated financial statements should be read in conjunction with the Consolidated Financial Statements of the Company for the year ended December 31, 2016.

The condensed consolidated financial statements were approved by the Board of Directors and authorized for issue on August 2, 2017.

Basis of measurement

These condensed consolidated financial statements have been prepared using the same policies and methods as those used in the audited consolidated financial statements for the year ended December 31, 2016.

Seasonality

Sales of the Company’s products are driven by consumer and industrial demand for interior construction solutions. The timing of customer’s construction projects can be influenced by a number of factors including the prevailing economic climate and weather. Seasonality of construction results in demand for the Company’s products to be typically stronger in the third and fourth quarters and less strong in the first and second quarters of its fiscal cycle.

DIRTT Environmental Solutions Ltd.
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3. ADOPTION OF NEW AND REVISED IFRS

The Company has adopted the new and revised accounting pronouncements outlined below, and has determined these standards did not have a material impact upon adoption on January 1, 2017.

In December 2016, the International Accounting Standards Board (“IASB”) issued narrow-scope amendments to IFRS 1, IAS 28 and IFRS 12 as part of its annual improvements process, “Annual Improvements to IFRS (2014-2016)”. The IASB uses the annual improvements process to make non-urgent but necessary amendments to IFRS. The amendment to IFRS 12 was effective January 1, 2017.

In January 2016, the IASB issued amendments to IAS 12 “Income Taxes”. The amendments were related to the recognition of deferred tax assets for unrealized losses, which clarified how to account for deferred tax assets related to debt instruments measured at fair value. The amendments were effective for annual periods beginning on or after January 1, 2017, with earlier application permitted.

In January 2016, the IASB also issued amendments to IAS 7 “Statement of Cash Flows”. The amendments will require entities to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including changes arising from cash flows and non-cash changes. The amendments were effective for annual periods beginning on or after January 1, 2017, with earlier application permitted.

4. RECENT 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 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;

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4. RECENT ACCOUNTING PRONOUNCEMENTS (CONTINUED)

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.

5. LONG-TERM DEBT

As at	June 30, 2017	December 31, 2016
	(\$ thousands)	
Capital financing facility, secured by a charge on all assets including manufacturing equipment, with 36 monthly payments of US\$139 plus interest at floating rates, which is based on the lender's US prime rate minus 0.25%. This facility matures on April 1, 2018.	1,802	2,984
Term loan, secured by a charge on all assets including manufacturing equipment, with 60 monthly payments of US\$21 plus interest at floating rates, which is based on the lender's US prime rate minus 0.25%. This facility matures on December 1, 2018.	2,109	2,349
Capital financing facility, secured by a charge on all assets including manufacturing equipment, with 48 monthly payments of US\$208, commencing on April 1, 2017, plus interest at floating rates, which is based on the lender's US prime rate minus 0.25%. This facility matures on March 1, 2021.	12,166	13,427
	16,077	18,760
Less: Current portion of long-term debt	(5,371)	(5,091)
Long-term debt	10,706	13,669

In February 2017, the Company 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 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 June 30, 2017, the adjusted minimum tangible net worth was \$133.8 million. At June 30, 2017 and December 31, 2016, \$nil had been borrowed against the US\$18.0 million revolving operating facility. Advances under the revolving operating facility are subject to interest at the lender's prime rate minus 0.25% for Canadian dollar advances and the US prime rate minus 0.25% for US dollar advances and are repayable at any time.

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6. SHARE-BASED TRANSACTIONS

The Company has a stock option plan which was approved by the Board of Directors and by its shareholders at the annual and special meeting of shareholders held on May 5, 2016, whereby the aggregate number of shares reserved for issuance shall not exceed 10% of the issued and outstanding common shares as at the time of grant of any options. Options granted under the plan generally have a term of five years and vest 1/3 every year over a three-year period from the date of grant.

The following summarizes options granted, exercised, forfeited and expired during the periods:

	Number of options	Weighted average exercise price \$
Outstanding at December 31, 2015	5,752,419	4.68
Granted	2,500	6.62
Exercised	(133,641)	2.34
Forfeited	(69,485)	5.31
Outstanding at June 30, 2016	5,551,793	4.73
Outstanding at December 31, 2016	6,867,752	5.04
Granted	57,500	6.35
Exercised	(683,259)	2.87
Forfeited	(126,999)	5.55
Expired	(1,600)	1.50
Outstanding at June 30, 2017	6,113,394	5.28

Range of exercise prices outstanding at June 30, 2017:

Range of exercise prices	Options outstanding			Options exercisable		
	Number outstanding	Weighted average remaining contractual years	Weighted average exercise price \$	Number exercisable	Weighted average remaining contractual years	Weighted average exercise price \$
\$2.93 - \$4.93	1,766,780	2.0	3.57	1,766,780	2.0	3.57
\$4.94 - \$6.94	4,344,114	3.6	5.98	936,056	2.9	6.09
\$6.95 - \$7.01	2,500	3.4	7.01	834	3.4	7.01
Total	6,113,394			2,703,670		

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7. BASIC AND DILUTED LOSS PER SHARE

The calculation of basic and diluted loss per share for the three and six months ended June 30, 2017 was based on the net loss of \$2.9 million and \$4.3 million, respectively (June 30, 2016 – \$1.5 million, \$1.1 million), and a weighted average number of common shares outstanding of 85.0 million (June 30, 2016 – 84.6 million).

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
Weighted average shares outstanding	85,025,719	84,597,751	84,986,856	84,564,661
Stock options	-	-	-	-
Convertible warrants	-	-	-	-
Diluted shares outstanding	85,025,719	84,597,751	84,986,856	84,564,661

As the Company was in a loss position for the three and six months ended June 30, 2017 and 2016, all stock options were excluded from the diluted weighted average number of common shares calculation as their effect would have been anti-dilutive. For the three and six months ended June 30, 2017, 4.9 million (2016 – 2.8 million) and 5.1 million (2016 – 2.8 million), respectively, options were excluded from the dilutive weighted average number of common shares calculation as their effect would have been anti-dilutive to the net loss per share.

8. SEGMENT REPORTING

The Company has one operating segment and operates in three principal geographic locations, Canada, the United States (“US”), and International. For the three and six months ended June 30, 2017 and 2016, the majority of revenue from international projects are included in the US revenue amount as these projects are sold by US-based Partners and are delivered to international locations. The Company’s revenue from operations from external customers, based on location of operations, and information about its non-current assets, are detailed below.

Revenue from external customers

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
	(\$ thousands)		(\$ thousands)	
Canada	13,065	4,984	24,904	13,056
US	56,539	56,268	109,759	104,119
International	402	-	402	-
	70,006	61,252	135,065	117,175

DIRTT Environmental Solutions Ltd.
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8. SEGMENT REPORTING (CONTINUED)

Selected Condensed Consolidated Statement of Financial Position Information – Non-current assets

As at	June 30, 2017	December 31, 2016
	(\$ thousands)	
Canada	62,772	58,328
US	19,608	19,709
UK	411	529
	82,791	78,566

The amounts above exclude deferred tax assets.

9. TRANSACTIONS AND BALANCES WITH RELATED PARTIES

The Company reported the following activities with a certain officer of the Company during the respective periods:

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
	(\$ thousands)			
Revenue earned	380	-	746	-
As at			June 30, 2017	December 31, 2016
Outstanding accounts receivable			730	-
Deposits received			-	188

The above transactions were priced at materials plus 10% with the remaining terms and conditions in accordance with standard business practices. Of the \$0.7 million outstanding accounts receivable noted in the above chart, \$0.5 million was related to third-party purchases made on behalf of the officer. The Company also incurred \$0.4 million in labor, installation and other services as a non-monetary benefit to the officer.

One of the Company's Partners is owned by a director of the Company. The Company reported the following activities with this Partner during the respective periods:

	For the three months ended June 30,		For the six months ended June 30,	
	2017	2016	2017	2016
	(\$ thousands)			
Revenue earned	1,738	3,063	3,426	5,129
Rebates paid	36	7	57	26
As at			June 30, 2017	December 31, 2016
Outstanding accounts receivable			171	560
Deposits received			60	-

DIRTT Environmental Solutions Ltd.

Notes to the Condensed Consolidated Financial Statements June 30, 2017 (Unaudited)

10. CAPITAL MANAGEMENT

As at June 30, 2017, the Company has \$175.4 million (December 31, 2016 - \$182.0 million) of total capital resources, comprised of Shareholders' Equity. The Company also has total debt of \$16.1 million (December 31, 2016 - \$18.8 million).

The Company aims to manage its capital resources to ensure financial strength and to maximize its financial flexibility 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.

In February 2017, the Company 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 is based on \$135.0 million plus 50% of 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 June 30, 2017, the adjusted minimum tangible net worth was \$133.8 million.

As at June 30, 2017 and December 31, 2016, the Company's tangible net worth was \$181.3 million and \$168.0 million, respectively. As at June 30, 2017 and December 31, 2016, the Company is in compliance with all of its lender's covenants.

11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks: credit risk, liquidity risk, market risk, interest rate risk, foreign exchange risk and commodity price risk. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company considers credit risk to be one of its main financial risks.

Credit risk

The Company's principal financial assets are cash and cash equivalents, and trade and other receivables.

The Company's credit risk is primarily concentrated in its trade receivables. The amounts disclosed in the condensed consolidated statement of financial position are net of allowances for doubtful accounts, estimated by the management of the Company based on previous experience with customers and their assessment of the current economic environment and specific customer circumstances. In order to reduce its 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 customer base which is geographically dispersed. The Company does not have significant exposure to any individual customer. A number of factors are considered in determining the likelihood of impairment. The Company had nil bad debt expense for the three and six months ended June 30, 2017 and 2016.

DIRTT Environmental Solutions Ltd.
Notes to the Condensed Consolidated Financial Statements
June 30, 2017 (Unaudited)

11. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

The Company also has a contract with Export Development Canada (“EDC”), Canada’s export credit agency, whereby some of its trade receivables are insured. EDC determines the coverage amount, if any, on a customer-by-customer basis. Based on the Company’s trade receivables balance as at June 30, 2017, 63.1% (December 31, 2016 - 50.7 %) of that balance is covered by EDC. Substantially all 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. The Company considers trade receivables greater than 90 days as past due and as at June 30, 2017, the amount outstanding was \$1.3 million, net of allowance for doubtful accounts of \$0.7 million (December 31, 2016 - \$7.1 million, \$0.7 million). The Company only provides for balances it considers to be at risk of collection. As a result, the Company believes that its exposure to credit risk is limited.

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.

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.

12. COMMITMENTS

As at June 30, 2017, the Company has unpaid capital expenditure commitments of approximately \$1.9 million for manufacturing equipment to be delivered by end of 2017.