

PyroGenesis Canada Inc.

**Condensed
Interim Financial Statements**

Three and six months ended June 30, 2018 and 2017

(Unaudited)

CONDENSED INTERIM FINANCIAL STATEMENTS

The accompanying unaudited financial statements of Pyrogenesis Canada Inc. have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these unaudited condensed interim financial statements for the period ended June 30, 2018.

PyroGenesis Canada Inc.
Condensed Interim Statements of Financial Position
(unaudited)

| | June 30, 2018 | December 31, 2017 |
|---|--------------------|--------------------|
| | \$ | \$ |
| Assets | | |
| <i>Current assets</i> | | |
| Cash | 84,124 | 622,846 |
| Accounts receivable [note 4] | 493,140 | 437,869 |
| Costs and profits in excess of billings on uncompleted contracts [note 5] | 415,561 | 115,226 |
| Investment tax credits receivable | 491,451 | 797,832 |
| Prepaid expenses | 576,041 | 401,405 |
| Inventories | 611,359 | 123,735 |
| Total current assets | 2,671,676 | 2,498,913 |
| <i>Non-current assets</i> | | |
| Deposits | 57,530 | 57,530 |
| Property plant and equipment | 3,076,837 | 2,247,494 |
| Intangible assets | 515,841 | 404,013 |
| Investments | 408,000 | 561,000 |
| Total assets | 6,729,884 | 5,768,950 |
| Liabilities | | |
| <i>Current</i> | | |
| Accounts payable and accrued liabilities [note 6] | 5,652,004 | 5,481,245 |
| Billings in excess of costs and profits on uncompleted contracts [note 7] | 64,918 | 1,846,715 |
| Term loans | 247,200 | 537,400 |
| Current portion of long-term debt [note 8] | 524,946 | 120,374 |
| Convertible debentures [note 9] | - | 3,916,549 |
| Total current liabilities | 6,489,068 | 11,902,283 |
| <i>Non-current</i> | | |
| Long-term debt [note 8] | 25,008 | 10,290 |
| Convertible debentures [note 9] | 2,521,101 | - |
| Total liabilities | 9,035,177 | 11,912,573 |
| Shareholders' deficiency [note 10] | | |
| Common shares | 35,779,917 | 30,240,844 |
| Warrants reserve | 963,002 | 96,021 |
| Contributed surplus | 6,477,808 | 6,122,794 |
| Equity portion of convertible debentures [note 9] | 213,529 | 572,582 |
| Other equity | 24,844 | 24,844 |
| Deficit | (45,764,393) | (43,200,708) |
| Total shareholders' deficiency | (2,305,293) | (6,143,623) |
| Total liabilities and shareholders' deficiency | 6,729,884 | 5,768,950 |

Going concern disclosure, related party transactions and subsequent events [notes 1, 13, and 16]

Approved on behalf of the Board:

[Signed by P. Peter Pascali] P. Peter Pascali

[Signed by Alan Curleigh] Alan Curleigh

PyroGenesis Canada Inc.
Condensed Interim Statements of Financial Position
(unaudited)

| | <u>Three months ended June 30,</u> | | <u>Six months ended June 30,</u> | |
|--|------------------------------------|-------------|----------------------------------|-------------|
| | 2018 | 2017 | 2018 | 2017 |
| | \$ | \$ | \$ | \$ |
| Revenue [note 15] | 1,421,352 | 2,173,397 | 3,481,954 | 3,869,535 |
| Cost of sales and services [note 12] | 924,954 | 1,130,295 | 2,279,650 | 1,950,559 |
| Gross margin | 496,398 | 1,043,102 | 1,202,304 | 1,918,976 |
| Expenses (income) | | | | |
| Selling, general and administrative [note 12] | 1,473,093 | 1,133,456 | 2,831,462 | 2,282,371 |
| Research and development | 404,017 | 62,143 | 456,515 | 130,207 |
| Net finance costs (income) [note 12] | 154,178 | 456,087 | 478,012 | 413,591 |
| | 2,031,288 | 1,651,686 | 3,765,989 | 2,826,169 |
| Net loss and comprehensive loss | (1,534,890) | (608,584) | (2,563,685) | (907,193) |
| Basic and diluted loss per share | (0.012) | (0.006) | (0.021) | (0.009) |
| Weighted average number of common shares outstanding - basic and diluted | 122,071,350 | 104,547,016 | 119,231,100 | 103,526,411 |

The accompanying notes form an integral part of the financial statements.

PyroGenesis Canada Inc.

Condensed Interim Statements of Changes in Shareholders' Deficiency

(unaudited)

| | Number of Class A common shares | Class A common share capital | Warrants reserve | Contributed surplus | Equity portion of convertible debentures | Other Equity | Deficit | Total |
|---|------------------------------------|---------------------------------|---------------------|------------------------|--|-----------------|---------------------|--------------------|
| | | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Balance - December 31, 2017 | 112,698,081 | 30,240,844 | 96,021 | 6,122,794 | 572,582 | 24,844 | (43,200,708) | (6,143,623) |
| Private placement [note 10] | 6,721,429 | 3,758,523 | 761,477 | - | - | - | - | 4,520,000 |
| Share issue expenses | - | (246,143) | - | - | - | - | - | (246,143) |
| Issuance of broker warrants | - | (24,929) | 24,929 | - | - | - | - | - |
| Shares issued upon exercise of warrants [note 10] | 1,797,500 | 725,146 | (96,021) | - | - | - | - | 629,125 |
| Share issued in settlement of convertible debenture [note 9 and 10] | 1,258,333 | 578,404 | 176,596 | - | - | - | - | 755,000 |
| Shares issued upon exercise of stock options [note 10] | 420,000 | 175,490 | - | (70,490) | - | - | - | 105,000 |
| Share-based payments | - | - | - | 425,504 | - | - | - | 425,504 |
| Issuance of convertible debenture [note 9] | - | - | - | - | 213,529 | - | - | 213,529 |
| Reimbursement of convertible debenture [note 9] | - | 572,582 | - | - | (572,582) | - | - | - |
| Comprehensive loss during the period | - | - | - | - | - | - | (2,563,685) | (2,563,685) |
| Balance – June 30, 2018 | 122,895,343 | 35,779,917 | 963,002 | 6,477,808 | 213,529 | 24,844 | 45,764,393 | (2,305,293) |
| Balance - December 31, 2016 | 101,858,434 | 25,442,906 | 901,211 | 5,679,580 | 572,582 | 24,844 | (37,026,405) | (4,405,282) |
| Shares issued upon exercise of warrants | 2,930,357 | 1,025,611 | (289,004) | - | - | - | - | 736,607 |
| Shares issued upon exercise of stock options | 383,000 | 129,420 | - | (54,230) | - | - | - | 75,190 |
| Share purchase warrant expired | - | - | (108,192) | 108,192 | - | - | - | - |
| Share-based payments | - | - | - | 273,595 | - | - | - | 273,595 |
| Comprehensive loss during the period | - | - | - | - | - | - | (907,193) | (907,193) |
| Balance – June 30, 2017 | 105,171,791 | 26,597,937 | 504,015 | 6,007,137 | 572,582 | 24,844 | (37,933,598) | (4,227,083) |

The accompanying notes form an integral part of the financial statements.

PyroGenesis Canada Inc.

Condensed Interim Statements of Cash Flows

(unaudited)

| | <u>Three months ended June 30,</u> | | <u>Six months ended June 30,</u> | |
|---|------------------------------------|--------------------|----------------------------------|------------------|
| | <u>2018</u> | <u>2017</u> | <u>2018</u> | <u>2017</u> |
| | \$ | \$ | \$ | \$ |
| Cash flows provided by (used in) | | | | |
| Operating activities | | | | |
| Net loss | (1,534,890) | (608,584) | (2,563,685) | (907,193) |
| Adjustments for: | | | | |
| Share-based payments | 295,541 | 135,444 | 425,504 | 273,595 |
| Depreciation on property plant and equipment | 40,529 | 29,250 | 70,246 | 54,448 |
| Finance costs [note 12] | 220,178 | 160,009 | 325,012 | 318,182 |
| Change in fair value of investments | (66,000) | 296,078 | 153,000 | 95,735 |
| | (1,044,642) | 12,197 | (1,589,923) | (165,233) |
| Net change in non-cash operating working capital items [note 11] | (1,761,529) | (665,047) | (2,399,455) | 504,727 |
| Interest paid | (150,557) | (83,260) | (151,046) | (167,004) |
| | (2,956,728) | (736,110) | (4,140,424) | 172,490 |
| Investing activities | | | | |
| Purchase of property and equipment | (209,124) | (363,861) | (838,413) | (756,375) |
| Additions to deferred development costs | (57,518) | (192,017) | (111,828) | (192,017) |
| | (266,642) | (555,878) | (950,241) | (948,392) |
| Financing activities | | | | |
| Repayment of term loans | - | (120,000) | (290,200) | (160,000) |
| Proceeds from loans | 400,000 | - | 400,000 | - |
| Repayment of capital lease obligations | (3,057) | (2,261) | (5,137) | (3,014) |
| Proceeds from issuance of shares – Private placement [note 10] | 2,439,999 | - | 4,520,000 | - |
| Share issue costs [note 10] | (117,353) | - | (246,143) | - |
| Proceeds from issuance of shares upon exercise of warrants [note 10] | - | 318,750 | 629,125 | 736,607 |
| Proceeds from issuance of shares upon exercise of stock options [note 10] | 31,500 | 75,190 | 105,000 | 75,190 |
| Net proceeds from the issuance of convertible debentures [note 9 and 1] | 1,216,417 | - | 2,684,298 | - |
| Reimbursement of convertible debentures | (3,245,000) | - | (3,245,000) | - |
| | 722,506 | 271,679 | 4,551,943 | 648,783 |
| Net increase (decrease) in cash | (2,500,864) | (1,020,309) | (538,722) | (127,119) |
| Cash - beginning of period | 2,584,988 | 1,278,447 | 622,846 | 385,257 |
| Cash - end of period | 84,124 | 258,138 | 84,124 | 258,138 |
| Supplemental cash flow disclosure | | | | |
| Non-cash transactions: | | | | |
| Issuance of share upon exercise of warrants and stock options | 166,511 | - | 166,511 | - |
| Issuance of shares in settlement of account payable related to long-term debt [note 10] | 1,329,999 | - | 1,329,999 | - |
| Issuance of shares in settlement of convertible debentures [note 9] | 755,000 | - | 755,000 | - |
| Issuance of broker warrants[note 10] | 14,008 | - | 24,929 | - |
| Purchase of equipment under capital lease obligations | 24,008 | - | 24,008 | 25,521 |
| Investment received in payment of contracts | - | 170,000 | - | 170,000 |

The accompanying notes form an integral part of the financial statements.

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 *(unaudited)*

1. Nature of operations and going concern disclosure

(a) Nature of operations

PyroGenesis Canada Inc. (the "Company"), incorporated under the laws of the Canada Business Corporations Act, was formed on July 11, 2011. The Company owns patents of advanced waste treatment systems technology and designs, develops, manufactures and commercialises advanced plasma processes and systems. The Company is domiciled at 1744 William Street, Suite 200, Montreal, Quebec. The Company is publicly traded on the TSX Venture Exchange under the Symbol "PYR". During the Company received approval to trade on the OTCQB in the USA under the symbol "PYRNF".

(b) Going concern

These condensed interim financial statements have been prepared on the going concern basis, which presumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

The Company is subject to a number of risks and uncertainty associated with the successful development of its products and with the financing requirements of its operations. The achievement of profitable operations is dependent upon future events, including successful development and introduction of new products to its family of products and obtaining adequate financing.

The Company has incurred, in the last several years, operating losses and negative cash flow from operations, resulting in an accumulated deficit of \$45,764,393 as at June 30, 2018. Furthermore, as at June 30, 2018, the Company's current liabilities and expected level of expenses for the next twelve months exceed cash on hand of \$84,124. The Company currently has no committed sources of financing available. The Company has relied upon external financings to fund its operations in the past, primarily through the issuance of equity, debt, and convertible debentures, as well as from investment tax credits.

The Company's business plan is dependent upon raising additional funds to finance operations within and beyond the next twelve months. While the Company has been successful in securing financing in the past, raising additional funds is dependent on a number of factors outside the Company's control, and as such there is no assurance that it will be able to do so in the future. If the Company is unable to obtain sufficient additional financing, it may have to curtail operations and development activities, any of which could harm the business, financial condition and results of operations.

These conditions indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue operating as a going concern and realise its assets and settle its liabilities and commitments in the normal course of business.

The condensed interim financial statements have been prepared on a going concern basis and do not include any adjustments to the amounts and classifications of the assets and liabilities that might be necessary should the Company be unable to achieve its plan and continue in business. If the going concern assumption were not appropriate for these condensed interim financial statements then adjustments would be necessary to the carrying value of assets and liabilities, the reported expenses and the condensed interim statements of financial position classifications used. Such adjustments could be material.

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

2. Basis of preparation

(a) Statement of compliance:

These condensed interim financial statements of the Company have been prepared in accordance with International Accounting Standard (“IAS”) 34 – *Interim Financial Reporting*. These condensed interim financial statements do not include all of the necessary information required for full annual financial statements in accordance with International Financial Reporting Standards (“IFRS”) and should be read in conjunction with the Company’s audited annual financial statements for the year ended December 31, 2017.

These condensed interim financial statements were approved and authorized for issuance by the Board of Directors on August 21, 2018.

(b) Functional and Presentation Currency

These condensed interim financial statements are presented in Canadian dollars, which is the Company’s functional currency.

(c) Basis of measurement

These condensed interim financial statements have been prepared on the historical cost basis except for investments which are accounted for at fair value.

3. Significant accounting judgments, estimates and assumptions

The accounting judgments, estimates and assumptions applied by the Company in these condensed interim financial statements are the same as those applied by the Company in its audited annual financial statements as at and for the year ended December 31, 2017.

4. Accounts receivable

Details of accounts receivable were as follows:

| | June 30, 2018 | December 31, 2017 |
|----------------------|---------------|-------------------|
| | \$ | \$ |
| 1 – 30 days | 44,909 | 263,005 |
| 30 – 60 days | 299,041 | 127,086 |
| 61 – 90 days | 4,586 | - |
| Greater than 90 days | 27,145 | 4,101 |
| Total | 375,681 | 394,192 |
| Other receivable | 117,459 | 43,677 |
| | 493,140 | 437,869 |

There is no allowance for doubtful accounts recorded as at June 30, 2018 and December 31, 2017.

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

5. Costs and profits in excess of billings on uncompleted contracts

As at June 30, 2018, the Company had six contracts with total billings of \$3,824,629 which were less than total costs incurred and had recognized cumulative revenue of \$4,240,190 since those projects began. This compares with seven contracts with total billings of \$106,097 which were less than total costs incurred and had recognized cumulative revenue of \$221,323 from three contracts as at December 31, 2017.

6. Accounts payable and accrued liabilities

| | June 30, 2018 | December 31, 2017 |
|---|------------------|-------------------|
| | \$ | \$ |
| Accounts payable trade | 1,544,578 | 747,325 |
| Accrued liabilities | 1,893,305 | 1,295,628 |
| Settlement agreement payable to a company under common control of the controlling shareholder and CEO | 1,885,644 | 3,215,643 |
| Accounts payable to the controlling shareholder | 176,887 | 205,641 |
| Accounts payable to a trust beneficially owned by the controlling shareholder | 151,590 | 17,008 |
| | 5,652,004 | 5,481,245 |

The fair value of the settlement agreement payable to a company under common control to the controlling shareholder and CEO of \$3,215,643 related to the Balance of sale payable to a company under common control of the controlling shareholder and CEO (see note 8). This amount payable was partially settled by the issuance of 1,899,999 units as part of the private placements of \$1,326,999 issued on February 9, 2018. The balance of \$1,888,644 will be settled upon the issuance of additional units.

7. Billings in excess of costs and profits on uncompleted contracts

The amount to date of costs incurred and recognized profits less recognized losses for construction projects in progress amounted to \$157,799 (Dec 31, 2017 - \$3,657,621).

Payments received on contracts in progress were \$92,881 (Dec 31, 2017 - \$5,184,336 in cash and \$320,000 of other assets).

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

8. Long-term debt

| | June 30, 2018 | December 31, 2017 |
|---|---------------|-------------------|
| | \$ | \$ |
| Balance of sale payable to company under common control | 111,928 | 111,928 |
| Term loans, bearing interest at 7% | 400,000 | - |
| Obligations under finance lease | 38,026 | 18,736 |
| | 549,954 | 130,664 |
| Instalments due within one year | 524,946 | 120,374 |
| Long-term debt | 25,008 | 10,290 |

The balance of sale payable to a company under common control of the controlling shareholder and CEO ("Balance of sale") arose from the purchase of the intangible assets in March 2011 and was originally payable in monthly installments of \$40,000 from April 1, 2011 until December 31, 2040 and does not carry any interest. Various amendments occurred since 2011 to modify the terms and conditions of the amounts due on the Balance of sale. Following the provisions of the latest amendment dated December 31, 2015 the remaining Balance of sale is payable in monthly installments of \$100,000. The face value of the Balance of sale on at December 31, 2017 is \$111,928 (2016 - \$478,416) and the carrying amount is determined using an effective interest rate of 15%.

Following the amended purchase agreement, in the event of any change within the Company that would be considered material by the holder of the Balance of Sale, such as a significant financial development, any and all amounts outstanding will become immediately due and payable on the date of the material change.

In April 2018, a claim of \$5,420,000, has been notified by the company under common control in connection with the share for debt conversion transaction that took place in 2014 over the Balance of sale. The claim and the Balance of sale of \$111,928 outstanding as at December 31, 2017 have been settled as follows: (i) on February 9 and March 7, 2018, issuance of 1,899,999 units at a value of \$0.70 per unit with each unit consisting of 1 common share of the Company and 1 common share purchase warrant which entitles the holder to purchase 1 common share at a price of \$1.25 until August 9th, 2019, and (ii) on April 30, 2018, issuance of 3,385,715 units at a value of \$0.59 per unit with each unit consisting of 1 common share of the Company and 1 common share purchase warrant which entitles the holder to purchase 1 common share at a price of \$0.85 until April 19, 2020.

On April 30, 2018, the Company and the company under control of the controlling shareholder and CEO entered into a settlement agreement to resolve a claim in the amount of \$5,420,000 made by the company under control of the controlling shareholder and CEO in connection with the share for debt conversion transaction between the parties that that took place in 2014. Under the share for debt conversion, the Company issued 7,500,000 common shares in 2014 to settle \$6,000,000 of the carrying value of the Balance of sale payable.

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

8. Long-term debt (continued)

The settlement agreement provides for the issuance of units by the Company having a value of \$3,215,643 to the company under common control of the controlling shareholder and CEO (note 6).

9. Convertible debentures

On April 2, 2018, the Company redeemed \$3,245,000 of the \$4,000,000 unsecured convertible debenture issued on March 30, 2015 maturing on March 30, 2018. The remaining balance of \$755,000 was redeemed on April 19, 2018, by the issuance of 1,258,333 units to a related party of the controlling shareholder and CEO (note 10).

On April 2, 2018, the Company completed a \$3,000,000 non-brokered private placement of 9.5% non-secured convertible debentures. The convertible debentures bear interest at the rate of 9.5% per annum, with interest payable in cash on a quarterly basis, and mature on March 29, 2020. Each Debenture is convertible into common shares of the Company at a conversion price of \$0.80 per common share. The convertible debentures and the common shares issuable on conversion of the Debentures will be subject to a statutory hold period of four months and one day from the closing date of the Offering. In connection with the convertible debenture, the Company paid finder fees in the amount of \$180,000 to the agent. Total transaction costs amount to \$315,702 are allocated between liability and equity component. On March 19, 2018, the Company received an amount of \$1,510,000 as partial proceeds and \$1,490,000 on April 2, 2018 for net total proceeds of \$2,684,298.

At the issuance date the convertible debentures were recorded as follows:

| | \$ |
|---|-----------|
| Debt component, net of transactions cost of \$290,589 | 2,470,769 |
| Conversion option recognized in equity, net of transaction cost of \$25,113 | 213,529 |
| Net proceeds | 2,684,298 |

The debt component is being accreted using the effective interest rate method:

| | June 30, 2018 | December 31, 2017 |
|-------------------------------|------------------|----------------------|
| | \$ | \$ |
| Balance, beginning of period | - | 3,605,897 |
| Debt component | 2,470,769 | - |
| Effective interest accretion | 50,332 | 310,652 |
| Balance, end of period | 2,521,101 | 3,916,549 |

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

10. Shareholders' equity

Issuance of shares

On April 19, 2018, the Company issued an amount of 1,258,333 units to a related party of the controlling shareholder and CEO to redeem the remaining balance of \$755,000 of the \$4,000,000 unsecured convertible debenture. The Company also issued 1,850,000 units to an unrelated party at a price of \$0.60 per unit, for gross proceeds of \$1,110,000. Each unit consists of one common share of the Company and one common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$0.85 until April 19th, 2020. Each unit will be subject to a statutory hold period of four months and one day from the date of closing. In connection with the private placement, the Company paid finder fees in the amount of \$89,478 and issued 74,000 finder's compensation warrants to the agents. The fair value of the share purchase warrants and the finder's compensation warrants was estimated at \$259,632 and \$14,008, respectively by applying the Black-Scholes option pricing model.

On February 9, 2018 and March 7, 2018, the Company issued an amount of 1,899,999 units to a company under common control of the controlling shareholder and CEO under a settlement agreement (see note 6, 8 and 13) and 2,971,430 units to an unrelated party for an aggregate amount of 4,871,429 units at a price of \$0.70 per Unit, for gross proceeds of \$3,410,000. Each unit consists of one common share of the Company and one Common Share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$1.25 until August 9th, 2019. Each unit will be subject to a statutory hold period of four months and one day from the date of closing. In connection with the private placement, the Company paid finder fees in the amount of \$127,750 and issued 88,000 finder's compensation warrants to the agents. The fair value of the share purchase warrants and the finder's compensation warrants was estimated at \$501,845 and \$10,921, respectively by applying the Black-Scholes option pricing model.

The fair value of the share purchase warrants and the finder's compensation warrants issued was measured as follows based on the Black-Scholes option pricing model:

| | April 19, 2018 | February 9, 2018 |
|--|----------------|------------------|
| Date of issuance | | |
| Exercise price (\$) | 0.85 | 1.25 |
| Weighted-average issuance date market price (\$) | 0.62 | 0.70 |
| Expected life (months) | 24 | 18 |
| Expected volatility (%) | 71.9 | 71.9 |
| Semi-annual weighted-average risk-free interest rate (%) | 1.74 | 1.74 |
| Dividend yield (%) | 0 | 0 |

On January 25 and 26, 2018, the Company issued 1,797,500 common shares upon the exercise of warrants for net proceeds of \$629,125. The fair value of the warrants of \$96,021 which was accounted for as contributed surplus has been reclassified as capital shares.

During the period January 29 to March 12, 2018, 245,000 stock options were exercised for net proceeds of \$73,500. The amounts credited to share capital from the exercise of stock options include an ascribed value from contributed surplus of \$49,490.

On June 26, 2018, 175,000 stock options were exercised for net proceeds of \$31,500. The amounts credited to share capital from the exercise of stock options include an ascribed value from contributed surplus of \$21,000.

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

10. Shareholders' equity (continued)

Stock options plan

As at June 30, 2018, an amount of \$287,839 remains to be amortized in future periods (until May 2023) related to the grant of stock options.

The following table sets out the activity in stock options during the six months ended June 30, 2018:

| | Number of options | Weighted average exercise price |
|----------------------------|-------------------|---------------------------------|
| | | \$ |
| Options, December 31, 2017 | 9,376,000 | 0.32 |
| Granted | 950,000 | 0.63 |
| Exercised | (420,000) | (0.25) |
| Forfeited | (160,000) | (0.30) |
| Balance, June 30, 2018 | 9,746,000 | 0.40 |

On May 10, 2018 the Company granted 250,000 stock options to its newest independent member and Audit Committee Chair. The stock options have an exercise price of \$0.52 per Common Share and are exercisable over a period of 60 months. The stock options are granted in accordance with the Company's stock option plan. The options have a five-year term and are exercisable at a price of \$0.52 per share. The fair value of the stock options was estimated at \$0.37 per option by applying the Black-Sholes option pricing model, using an expected time-period of 5 years, a risk-free interest rate of 2.06%, a volatility rate of 74% and a 0% dividend factor.

On April 3, 2018, the Company granted 500,000 stock options to a consultant, to promote the business interests of the Company worldwide. The stock options have an exercise price of \$0.70 per Common Share and are exercisable over a period of 18 months. The stock options are granted in accordance with the Company's stock option plan. The fair value of the stock options was estimated at \$0.43 per option by applying the Black-Sholes option pricing model, using an expected time-period of 5 years, a risk-free interest rate of 2.06%, a volatility rate of 74% and a 0% dividend factor.

On February 9, 2018, the Company issued 200,000 stock options to an officer with an exercise price of \$0.60 and are exercisable over a period of 60 months. The fair value of the stock options was estimated at \$0.37 per option by applying the Black-Sholes option pricing model, using an expected time-period of 5 years, a risk-free interest rate of 2.06%, a volatility rate of 74% and a 0% dividend factor.

The fair value of the stock options was measured based on the Black-Scholes option pricing model using the following assumptions:

| | May 10, 2018 | April 3, 2018 | February 9, 2018 |
|--|--------------|---------------|------------------|
| Date of issuance | | | |
| Exercise price (\$) | 0.52 | 0.70 | 0.60 |
| Weighted-average issuance date market price (\$) | 0.32 | 0.25 | 0.37 |
| Expected life (years) | 5 | 1.5 | 5 |
| Expected volatility (%) | 74 | 74 | 74 |
| Risk-free interest rate (%) | 2.21 | 1.79 | 2.06 |
| Dividend yield (%) | 0 | 0 | 0 |

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

10. Shareholders' equity (continued)

As at June 30, 2018, the outstanding options, as issued under the stock option plan to directors, officers, employees and consultants for the purchases of one common share per option, are as follows:

| Issue date | Number of options | Exercise price | Number of exercisable options (1) | Expiry date |
|--------------------|-------------------|----------------|-----------------------------------|--------------------|
| | | \$ | | |
| February 12, 2015 | 2,065,000 | 0.30 | 2,065,000 | February 12, 2020 |
| September 25, 2016 | 3,975,000 | 0.18 | 3,975,000 | September 25, 2021 |
| October 20, 2016 | 56,000 | 0.18 | - | October 20, 2021 |
| October 25, 2016 | 100,000 | 0.19 | 30,000 | October 25, 2021 |
| November 3, 2017 | 2,600,000 | 0.58 | 1,220,000 | November 3, 2022 |
| February 9, 2018 | 200,000 | 0.60 | 20,000 | February 9, 2023 |
| April 30, 2018 | 500,000 | 0.70 | 500,000 | October 3, 2019 |
| May 10, 2018 | 250,000 | 0.52 | 125,000 | May 10, 2023 |
| | 9,746,000 | 0.36 | 7,935,000 | |

(1) At June 30, 2018, the weighted average price of the exercisable options was \$0.31.

Share purchase warrants

The following table reflects the activity in warrants during the six months ended June 30, 2018 and the number of issued and outstanding share purchase warrants at June 30, 2018:

| | Number of warrants December 31, 2017 | Issued | Exercised | Number of warrants June 30, 2018 | Price per warrant | Expiry date |
|--|--------------------------------------|-----------|-------------|----------------------------------|-------------------|--------------|
| | | | | | \$ | |
| Private placement – July 26, 2016 ¹ | 1,797,500 | - | (1,797,500) | - | - | - |
| Issuance of units – February 9, 2018 | - | 4,871,429 | - | 4,871,429 | 1.25 | Aug 9, 2019 |
| Broker warrants – February 9, 2018 | - | 88,000 | - | 88,000 | 1.25 | Aug 9, 2019 |
| Issuance of units – April 19, 2018 | - | 3,108,333 | - | 3,108,333 | 0.85 | Apr 19, 2020 |
| Issuance of broker warrants – April 19, 2018 | - | 74,000 | - | 74,000 | 0.85 | Apr 19, 2020 |
| | 1,797,500 | 8,141,762 | (1,797,500) | 8,141,762 | 1.09 | |

¹ Upon the exercise of the warrants, an amount of \$96,021 was reclassified from the share purchase warrants reserve to the common shares.

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 *(unaudited)*

11. Supplemental disclosure of cash flow information

Net changes in non-cash components of operating working capital

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|------------------|---------------------------|----------------|
| | 2018 | 2017 | 2018 | 2017 |
| | \$ | \$ | \$ | \$ |
| Decrease (increase) in: | | | | |
| Accounts receivable | (73,434) | (82,898) | (55,271) | (700,387) |
| Costs and profits in excess of billings on uncompleted contracts | (225,397) | (322,536) | (300,335) | 144,719 |
| Inventory | (386,006) | - | (487,624) | - |
| Investment tax credits receivable | (39,064) | (136,994) | 306,381 | (269,240) |
| Prepaid expenses | 100,148 | 134,971 | (214,400) | 71,145 |
| Increase (decrease) in: | | | | |
| Accounts payable and accrued liabilities | (579,139) | 37,830 | 133,591 | 119,134 |
| Billings in excess of costs and profits on uncompleted contracts | (558,637) | (295,420) | (1,781,797) | 1,139,356 |
| | (1,761,529) | (665,047) | (2,399,455) | 504,727 |

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

12. Other information

For the three and the six months ended June 30, 2018, depreciation on property and equipment expensed as general and administrative amounted to \$40,529 and \$70,246 (2017 - \$29,250 and \$54,448), employee benefits totaled \$1,280,974 and \$2,536,283 (2017 - \$1,273,200 and \$2,478,793) and share-based compensation expense was \$295,541 and \$425,504 (2017 - \$135,444 and \$273,595).

Financing income and finance costs include the following items:

| | <u>Three months ended June 30,</u> | | <u>Six months ended June 30,</u> | |
|---|------------------------------------|-------------|----------------------------------|-------------|
| | <u>2018</u> | <u>2017</u> | <u>2018</u> | <u>2017</u> |
| | \$ | \$ | \$ | \$ |
| Finance income | | | | |
| Adjustment to the fair value of investments | 66,000 | (296,078) | (153,000) | 95,735 |
| Finance costs | | | | |
| Interest on convertible debentures | 75,015 | 75,015 | 75,015 | 150,030 |
| Accretion of convertible debentures | 123,957 | 76,507 | 207,408 | 150,852 |
| Interest on long-term debt | - | 8,487 | - | 16,974 |
| Interest on term loans | 18,870 | - | 39,764 | - |
| Other interest | 2,336 | - | 2,825 | - |
| | 220,178 | 160,009 | 325,012 | 317,856 |
| Net finance (income) and finance expenses | 154,178 | 456,087 | 478,012 | 413,591 |

13. Related party transactions

During the three and the six months ended June 30, 2018, the company concluded the following transactions with related parties:

Rent and property taxes were charged by a trust beneficially owned by the controlling shareholder and CEO of the Company in the amount of \$78,045 and \$130,265 respectively, (2017 - \$52,512 and \$105,382). A balance due of \$151,590 (2017 - \$17,008) is included in accounts payable and accrued liabilities.

Interest of \$Nil and \$14,171, (2017 - \$14,171 and \$28,342) was charged on the \$755,000 convertible debentures held by company under common control of the controlling shareholder and CEO. Accreted interest related to the convertible debenture held by a company under common control amounted to \$Nil (2017 - \$11,234).

A balance due to the controlling shareholder and CEO of the Company amounted to \$176,887 (December 31, 2017 - \$205,641) and is included in accounts payable and accrued liabilities.

The balance of sale (note 8) due to a company under common control of the controlling shareholder and CEO, was \$111,928 (December 31, 2017 - \$111,928), and is included in long term debt. Accreted interest related to the balance of sale amounted to \$Nil (2017 - \$41,250).

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Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

13. Related party transactions (continued)

As discussed in notes 8, and 10, the Company and a company under common control of the controlling shareholder and CEO entered into a settlement agreement with respect to the balance of sale payable. On February 9, 2018, 1,899,999 common shares were issued as a partial settlement of the balance of sale payable. The final settlement occurred on April 30, 2018.

The key management personnel of the Company are the members of the Board of Directors and certain executive officers. During the three and six months ended June 30, 2018, total compensation to key management consisted of the following:

| | Three months ended June 30, | | Six months ended June 30, | |
|-----------------------|-----------------------------|---------|---------------------------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| | \$ | \$ | \$ | \$ |
| Salaries | 126,000 | 137,515 | 250,000 | 259,469 |
| Pension contributions | 2,040 | 2,030 | 4,080 | 4,009 |
| Other benefits | 3,140 | 10,371 | 6,521 | 20,521 |
| Total compensation | 131,180 | 149,716 | 260,601 | 283,999 |

A balance of \$302,096 of key management compensation is included in accounts payable and accrued liabilities as at June 30, 2018 (December 31, 2017 - \$72,617).

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

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14. Financial instruments

As part of its operations, the Company carries a number of financial instruments. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments except as otherwise disclosed. The Company's overall risk management program focuses on the unpredictability of the financial market and seeks to minimize potential adverse effects on the Company's financial performance. The Company does not use derivative financial instruments to hedge these risks.

Foreign currency risk

The Company enters into transactions denominated in US dollars for which the related revenues, expenses, accounts receivable and accounts payable and accrued liabilities balances are subject to exchange rate fluctuations.

As at June 30, 2018, the following items are denominated in foreign currencies:

| | US | CDN |
|--|----------------|----------------|
| | \$ | \$ |
| Cash | 33,049 | 43,520 |
| Accounts receivable | 173,930 | 229,031 |
| Accounts payable and accrued liabilities | 254,787 | 335,504 |
| Total | 461,766 | 608,055 |

As at December 31, 2017, the following items are denominated in foreign currencies:

| | US | CDN |
|--|----------------|----------------|
| | \$ | \$ |
| Cash | 287,269 | 360,379 |
| Accounts receivable | 294,347 | 369,258 |
| Accounts payable and accrued liabilities | (210,230) | (263,733) |
| Total | 371,386 | 465,904 |

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Sensitivity analysis

At June 30, 2018, if the US Dollar changes by 10% against the Canadian dollar with all other variables held constant, the impact on before-tax gain or loss for the six months ended June 30, 2018 would have been \$61,000 (December 31, 2017 – \$46,000).

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

14. Financial instruments (continued)

Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The maximum credit risk to which the Company is exposed as at June 30, 2018 represents the carrying amount of cash, account receivable and deposits.

Credit concentration

During the three and the six months ended June 30, 2018, three customers accounted for 82% and 86% respectively of revenues from operations.

| | Three months ended June 30, 2018 | | Six months ended June 30, 2018 | |
|------------|-------------------------------------|------------------------|-----------------------------------|------------------------|
| | Revenues | % of total revenues | Revenues | % of total revenues |
| | \$ | % | \$ | % |
| Customer 1 | 179,150 | 13 | 706,595 | 20 |
| Customer 2 | 188,187 | 13 | 745,814 | 21 |
| Customer 3 | 801,890 | 56 | 1,538,550 | 44 |
| Total | 1,169,227 | 82 | 2,990,959 | 86 |

Two customers accounted for 81% (December 31, 2017 – two customers for 89%) of the accounts receivable, representing the Company's major credit risk exposure. Credit concentration is determined based on customers representing 10% or more of total revenues and/or total accounts receivable. The Company believes that there is no unusual exposure associated with the collection of these receivables. The Company manages its credit risk by performing credit assessments of its customers and provides allowances for potentially uncollectible accounts receivable. The Company does not generally require collateral or other security from customers on accounts receivable.

Fair value of financial instruments

Financial instruments are comprised of cash, accounts receivable, investments, accounts payables and accrued liabilities, loans, long-term debt and convertible debentures. There are three levels of fair value that reflect the significance of inputs used in determining fair values of financial instruments:

- Level 1 — quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 — inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices).
- Level 3 — inputs for the asset or liability that are not based on observable market data.

The fair values of cash, accounts receivable, accounts payable and accrued liabilities, loans, convertible debentures and finance lease approximate their carrying amounts due to their short-term maturities. Investments are valued at fair value are classified as Level 1.

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

14. Financial instruments (continued)

Interest rate risk

Interest rate risk is the risk that the value of a financial instrument might be adversely affected by a change in interest rates. Changes in market interest rates may have an effect on the cash flows associated with some financial assets and liabilities, known as cash flow risk, and on the fair value of other financial assets or liabilities, known as price risk, and on the fair value of investments or liabilities, known as price risks. The Company is exposed to a risk of fair value on the convertible debentures as those financial instruments bear interest at fixed rates.

Price risk

Other price risk is the risk that the fair value or future cash flows of a financial instruments will fluctuate because of changes in market price (other than those arising from foreign currency risk and interest risk), whether those changes are caused by factors specific to the individual financial instrument or its issuers or factors affecting all similar financial instruments traded in the market. The most significant exposure to other price risk for the Company arises from the investments. If equity prices had increased or decreased by 5% as at June 30, 2018, with all other variables held constant, the Company's investments would have increased or decreased respectively, by approximately \$20,000 (December 31, 2017 - \$28,000).

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivery of cash or another financial asset. The Company's ability to continue as a going concern is dependent on management's ability to raise required funding through future equity and / or debt issuances and to generate positive cash flows from operations (see note 1 b). The Company manages its liquidity risk by forecasting cash flows from operations and anticipating any investing and financing activities. Management and the Board of Directors are actively involved in the review, planning and approval of significant expenditures and commitments.

The following table summarizes the contractual maturities of financial liabilities as at June 30, 2018:

| | Total | 6 months or less | 6 to 12 months | 1-3 year | 4-5 year |
|--|------------------|---------------------|-------------------|------------------|--------------|
| | \$ | \$ | \$ | \$ | |
| Accounts payable and accrued liabilities | 5,652,004 | 5,652,004 | - | - | - |
| Capital lease obligations | 43,294 | 7,209 | 13,881 | 12,259 | 9,945 |
| Term loans | 677,533 | 261,200 | 14,000 | 402,333 | - |
| Long-term debts | 111,928 | 111,928 | - | - | - |
| Convertible debentures | 3,498,750 | 142,500 | 142,500 | 3,213,750 | - |
| | 9,983,509 | 6,174,841 | 170,381 | 3,628,342 | 9,945 |

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 (unaudited)

15. Segment information

The Company operates in one segment, based on financial information that is available and evaluated by the Company's Board of Directors.

The Company's head office is located in Montreal, Quebec. The operation of the Company is located in one geographic area: Canada. The following is a summary of the Company's geographic information:

| | Three months ended June 30, | | Six months ended June 30, | |
|---------------------------------|-----------------------------|------------------|---------------------------|------------------|
| | 2018 | 2017 | 2018 | 2017 |
| | \$ | \$ | \$ | \$ |
| Revenue from external customers | | | | |
| Canada | 886,195 | 544,276 | 1,663,313 | 709,344 |
| United States | 321,191 | 1,625,578 | 1,038,506 | 3,080,076 |
| Europe | - | - | - | - |
| Asia | 25,779 | - | 34,321 | 28,255 |
| Mexico | 188,187 | 3,543 | 745,814 | 51,860 |
| | 1,421,352 | 2,173,397 | 3,481,954 | 3,869,535 |

The following is a summary of the Company's revenue by product line:

| | Three months ended June 30, | | Six months ended June 30, | |
|--|-----------------------------|------------------|---------------------------|------------------|
| | 2018 | 2017 | 2018 | 2017 |
| | \$ | \$ | \$ | \$ |
| Sales of goods under long-term contracts | 166,177 | 698,483 | 742,551 | 1,713,415 |
| Services | 1,255,175 | 1,474,914 | 2,739,403 | 2,156,120 |
| | 1,421,352 | 2,173,397 | 3,481,954 | 3,869,535 |

PyroGenesis Canada Inc.

Notes to Condensed Interim Financial Statements

June 30, 2018 *(unaudited)*

16. Subsequent events

On July 3, 2018, the Company granted stock options to acquire up to 300,000 common shares of the Company to the Chair of the Audit Committee of the Board of Directors. The stock options have an exercise price of \$0.51 per common share and are exercisable over a period of five (5) years. The options are granted in accordance with the Company's stock option plan.

On August 13, 2018, the Company increased its ownership in HPQ Silicon Resources Inc ("HPQ") to 9.6% (12.03% fully diluted) by acquiring 16,250,000 units (the "Unit") of HPQ in a private placement at a price of 0.12\$ per Unit for total investment of \$1,950,000. Each Unit consists of one common share (a "Common Share") of HPQ and one Common Share purchase warrant (a "Warrant"). Each Warrant entitles the Company to purchase one Common Share at a price of \$0.17 for a period of 36 months pursuant from the issue date.