

MICROBIX BIOSYSTEMS INC.



FIRST INTERIM REPORT

For the three months
ended December 31, 2015



MESSAGE TO SHAREHOLDERS

We have had a challenging start to fiscal 2016 as our largest customer reduced their order flow to adjust inventory levels in response to a temporary change in market demand. This resulted in a significant decline in our first quarter sales compared to last year. However, sales in the first few weeks of the second quarter have returned to normal levels and we still expect that full year Virology product sales will be higher in 2016 than last year's sales of \$8.2 million.

Our new bioreactor manufacturing process for Virology products is currently being converted from the development platform to full production and this transition will be complete before the end of February. The new manufacturing process will generate significant cost savings and increased production capacity, ultimately contributing productivity improvements of up to \$2 million annually once it is fully implemented in fiscal 2017.

In early February we announced the initiation of our new Zika virus development program. We intend to develop and launch a range of products, including native molecular controls, live and inactivated forms of the antigen, and related biological materials. We will use our established development platform for Dengue Fever and our unique expertise amongst the global virology industry to help combat this crisis, as this virus continues to spread throughout the Americas.

Negotiations continue with a short list of companies that are interested in investing to complete the remaining development and commercialization of the LumiSort

technology. There are many complexities in these negotiations that have contributed to an extension of the timeline beyond our original expectations. However, we are making good progress towards a deal and I maintain we are on track to provide the best outcome for Microbix and to unlock the maximum value for our shareholders.

We have been very active in the past few weeks working with a small group of partner candidates to help complete their assessment of the Kinlytic opportunity. We continue working to secure the right group of partners to help develop and commercialize Kinlytic®, including investors interested in providing non-dilutive funding to return this life saving therapeutic to market. This group includes parties that are interested in working with Microbix to re-launch Kinlytic® in the U.S., Canada and international markets, as well as various government funding sources that have already expressed conditional interest in the venture. I remain confident that we will be successful in securing strong commercialization partners for Kinlytic®.

We are making good progress towards securing strategic partnerships for both LumiSort and Kinlytic and I remain optimistic that we will realize our objective of converting these opportunities into commercial realities in 2016.



VAUGHN C. EMBRO-PANTALONY
PRESIDENT AND CHIEF EXECUTIVE OFFICER

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
FOR THE THREE MONTHS ENDED DECEMBER 31, 2015 AND 2014**

Canadian Funds

The Company's Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited Consolidated Interim Financial Statements and notes and should also be read in conjunction with the audited Consolidated Financial Statements, notes and MD&A for the year ended September 30, 2015, prepared in accordance with International Financial Reporting Standards ("IFRS") and filed on Sedar. Additional information relating to the Company, including its Annual Information Form ("AIF"), can be found on SEDAR at www.sedar.com. Reference to "we", "us", "our", or the "Company" means Microbix Biosystems Inc. unless otherwise stated. All amounts are presented in Canadian dollars unless otherwise stated. Statements contained herein, which are not historical facts, are forward looking statements that are subject to certain risks and uncertainties that could cause actual results to differ materially from those set forth or implied. These forward-looking statements involve risks and uncertainties, including the difficulty in predicting product approvals, acceptance of and demand for new products, the impact of the products and pricing strategies of competitors, delays in developing and launching new products, regulatory enforcement, changes in operating results and other risks, some or any of which could make the results differ materially from those discussed or implied in the forward-looking statements. The Company disclaims any intent or obligation to update these forward-looking statements.

The Management Discussion and Analysis is dated February 10, 2016.

COMPANY OVERVIEW

Microbix Biosystems Inc. (Microbix or the Company) (TSX: MBX) develops biological products and technologies. The Company has a Virology Products (Virology) business including the manufacturing and sale of cell culture-based biological products, including one of the world's most expansive sources of Infectious Disease Antigens targeted at the diagnostics market. The Company also has VIRUSMAX (a virus yield enhancement technology), and Kinlytic[®] (a thrombolytic drug), and is developing LumiSort[™] a semen sexing technology.

Revenue from the Virology business which is expected to continue growing for the foreseeable future, is used for operating and debt service costs, and to fund the Company's development programs. Additional equity and/or debt may be raised to finance development of new products and technologies. Management has discretion to reduce development investment to manage the liquidity needs of the Company.

The Company owns and operates a Virology manufacturing facility at 265 Watline Avenue in Mississauga, Ontario. The facility has an infectious diseases biological license from the Canadian Food Inspection Agency. The Company's administrative offices are located at 211 Watline Avenue.

FIRST QUARTER ENDING DECEMBER 31, 2015

Virology product revenue was \$1,063,405 in the first quarter of fiscal 2015 versus 2014's \$1,995,833. While the first quarter of each fiscal year is seasonally the lowest one for sales, this quarter's sales were down more significantly because the Company's largest customer rescheduled sales to the second quarter of fiscal 2016 in response to a change in their customer's demand plans. In contrast to the first quarter, as explained further in the Outlook section on page 3, sales in the next three quarters are expected to average about \$2.5 million per quarter.

Correspondingly, gross margin was significantly reduced with the decrease in sales. However, expenses at \$785,874 were also lower than 2014's \$1,037,632 mostly due to the significant reduction in legal costs with the conclusion of the VIRUSMAX litigation in the latter half of fiscal 2015. With the lower sales and gross margin the Company realized a net loss of \$338,420 (2014 - \$1,940 net profit).

Cash used by operations was \$31,698 compared to \$195,206 provided by operations for the same period last year. Cash used in investing activities was \$676,784 versus 2014's \$1,160,306, a decrease mostly due to the completion of the Lumisort™ prototype in fiscal 2015, leaving only the ongoing development of the new automation process for manufacturing Virology products. Cash provided by financing activities was \$670,735 primarily from a private placement raise and an additional equipment loan offset partially by \$110,939 of debt repayment. In summary, the fourth quarter's net cash flow was slightly negative at \$37,747 (2014 - \$ 244,037 positive).

CHANGES IN FINANCIAL POSITION

	As at Dec 31, 2015 \$	As at Dec 31, 2014 \$
Cash	66,433	791,393
Accounts receivable	646,618	1,599,732
Total current assets	5,109,114	4,481,235
Total assets	23,532,918	18,842,233
Total current liabilities	4,123,302	2,121,935
Total liabilities	9,577,913	8,228,633
Total shareholders' equity	13,955,005	10,613,600
Current ratio	1.24	2.11
Debt to equity ratio	0.69	0.78

SELECTED QUARTERLY FINANCIAL INFORMATION

	Dec-31-13 \$	Mar-31-14 \$	Jun-30-14 \$	Sep-30-14 \$	Dec-31-14 \$	Mar-31-15 \$	Jun-30-15 \$	Sep-30-15 \$	Dec-31-15 \$
SALES	1,927,885	2,073,097	2,039,935	2,355,879	1,995,833	2,544,900	2,219,019	2,114,160	1,063,405
Operating Income	214,406	269,620	294,561	(302,963)	90,553	86,335	147,769	123,434	(428,420)

OUTLOOK**Canadian Funds**

The business of Microbix described in these documents is the result of years of investment in research and development, which has delivered products and technologies that have received wide customer acceptance and experienced continued growth in demand. Microbix has both the manufacturing capacity and the scientific capability to support this growth, including the continuous demand for competitive process improvements, as well as new products.

Virology product revenues are on track to reach \$2.5 million in the next quarter and are projected to exceed \$9 million on a full year basis in fiscal 2016. Additionally, the Company continues to expand its conventional antigen product line having announced the launch of its molecular diagnostic products, new strains of Dengue Fever antigens, Toxoplasmosis in the past year, and most recently has initiated a Zika Virus development program. A net favourable currency effect, due to the weakening Canadian dollar versus the U.S. dollar (54% of sales) is augmenting profit projections.

The Company's bioreactor automation platform is expected to be operational in February 2016 which will reduce the manufacturing costs and increase production capacity. As the Company transfers production to this new platform management expects to achieve improved profitability in the Virology business.

Discussions continue with potential partners interested in returning Kinlytic® to the U.S. and Canadian markets, as well as other countries. These partner candidates would be expected to contribute to the overall investment needed to develop and commercialize Kinlytic® in 36 months. Management expects to close a partnership during fiscal 2016.

In recent weeks, LumiSort partnering negotiations have accelerated with a short list of global animal genetics companies to finance the remaining development, field trials and commercialization of the LumiSort instrument.

TREND INFORMATION

Recent spending patterns are no indication of future expenditures. Investment in the new products and technologies is at the discretion of management. The Company is not aware of any material trends related to its business that have not been discussed in this Management Discussion and Analysis dated February 10, 2016.

LIQUIDITY, CASH FLOW AND CAPITAL RESOURCES

The consolidated interim financial statements have been prepared in accordance with the International Financial Reporting Standards ("IFRS") on a going concern basis, which presumes the Company will continue operating for the foreseeable future and will be able to realize a return on its assets and discharge its liabilities and commitments in the normal course of business.

The Company has incurred historical operating losses resulting in an accumulated deficit of \$24,383,576 as at December 31, 2015. However, the Company has been profitable in each of the last three fiscal years.

Management continuously monitors the financial position of the Company with respect to working capital needs, as well as long-term capital requirements compared to the annual operating budget. Variances are highlighted and actions are taken to ensure the Company is appropriately capitalized.

Sources and Uses of Cash

In the three months ended December 31, 2015, the Company's cash flow was negative at \$37,747 (2014 – \$244,037 positive).

In the current quarter, cash used by operations was \$31,698 versus cash provided by operations of \$195,206 in 2014. The largest use of cash in the quarter was the decrease in accounts payable offset partially by a smaller increase in inventories due to a one time delay of shipments to the Company's largest customer. Shipments resumed to this customer in the first week of the second quarter of fiscal 2016. As sales are projected to average \$2.5 million in each of the next three quarters, inventories are scheduled to reduce significantly in the next few months and cash flow over fiscal 2016 is expected to be positive overall.

During the current quarter, the Company invested \$676,784 in plant and equipment, of which 60% was to install the new bioreactor manufacturing platform expected to be operational by the end of the next quarter. Total cash expenditures on plant and equipment in each of the next three quarters are expected to be lower than the first Quarter's spend.

In the current quarter, cash of \$670,735 was provided by a private placement and an equipment loan to fund completion of the Company's investment objectives, offset partially by debt repayment of \$110,939.

Future Liquidity and Capital Needs

Microbix primarily funds new product development activities and capital expenditures from the profits earned by its Virology business and, periodically, from additional equity and/or debt. The Virology business is expected to be profitable in the next three quarters and capital investment is projected to be significantly lower going forward. It is the opinion of management that these developments will reduce the cash burn and capital needs of the Company and improve its overall liquidity position.

Outstanding Share Capital

Share capital issued and outstanding as at February 10, 2016 was \$31,522,133 for 84,704,257 common shares.

RISKS AND UNCERTAINTIES

The Company is exposed to business risks, both known and unknown, which may or may not affect its operations. Management works continuously to mitigate unacceptable risk, while still allowing the business to grow and prosper. These risk factors include the following:

A significant portion of Virology Product sales are dependent on key clients, open borders, international transportation systems, and access to raw materials.

A significant share of the Company's Virology products sales are sold to a few key customers globally. These products contributed a significant share of the revenue in the first quarter of fiscal 2016. The loss of a key customer, or restrictions on export, import, or international transportation of its products, raw materials or insufficient marketing resources, could materially impact revenue and profitability.

Environmental, safety and other regulatory

Microbix' research and manufacturing operations involves potentially hazardous materials. The Company takes extensive precautions to appropriately manage these materials as regulated by the applicable environmental and safety authorities. Changes to environmental and safety legislation may limit the Company's activities or increase costs. An environmental accident could adversely impact its operations. Microbix' diagnostic products are not regulated by governments in Canada or other jurisdictions. Commercialization of certain products requires approval of regulatory agencies such as the FDA, in which case Microbix will not receive revenue until regulatory approval is obtained.

Manufacturing of Kinlytic®

The Company has entered into confidentiality agreements with several parties and advanced discussions are continuing with a select group of potential partners interested in returning Kinlytic to the U.S. and Canadian markets, and ultimately to Europe, Asia and developing world markets. There is no assurance the Company will be successful in this endeavour.

Vaccine Technology

The Company owns a proprietary vaccine technology (VIRUSMAX) that has a global patent estate. In 2014 the Company successfully defended its European patents at the European Patent Office hearing, following the filing of an Opposition by Novartis Vaccines & Diagnostics. Subsequently in 2014 the Company filed patent infringement actions against Novartis in the US and Europe. In 2015 a decision was rendered by the U.S. Court in favour of Novartis. The Company did not appeal the decision and the action against Novartis has ceased.

LumiSort™ Technology

The Company has developed a proprietary semen sexing technology that has a global patent estate. In fiscal 2014 and 2015 the Company built and successfully tested a prototype instrument that confirms the key patent claims. The Company is currently working to secure a partner within the animal genetics industry to fund the remaining development, conduct field trials and launch a commercial instrument. There is no assurance the Company will be successful in this endeavour.

Products in development

The Company has several products under development. It is impossible to ensure that these development activities will result in the completion of new commercial products. If the Company is unable to develop and commercialize products, it will be unable to recover the related research and development, and investment.

Product commercialization requires strategic relationships

To commercialize large market products in development, Microbix may need to establish strategic partnerships, joint ventures or licensing relationships with pharmaceutical, biotechnology or animal genetics companies. It is possible the Company may be unable to negotiate mutually acceptable terms.

Operating and capital requirements

Microbix earns a profit on the sale of its Virology Products, which is a major source of funding for its research and development activities. The Company believes that cash generated from operations is sufficient to meet normal operating and capital requirements. However, the Company may need to raise additional funds to advance its research and development programs, to protect and enforce patents and other intellectual property rights, or to invest in acquisitions, new technologies and new market developments. Additional financing may not be available, and even if available, may not be offered on acceptable terms.

The Company's success depends on the successful commercialization of our technology

The successful commercialization of products under development is key to Microbix' success. Product development in the pharmaceutical and biotechnology industry is highly uncertain and there is no guarantee of market acceptance.

Failure to obtain and protect intellectual property could adversely affect business

Microbix' future success depends, in part, on its ability to obtain patents, or licenses to patents, maintain trade secret protection and enforce its rights against others. The Company's intellectual property includes trade secrets and know-how that may not be protected by patents. There is no assurance that the Company will be able to protect its trade secrets. To help protect its intellectual property, the Company requires employees, consultants, advisors and collaborators to enter into confidentiality agreements. However, these agreements may not adequately protect trade secrets, know-how or other proprietary information in the event of any unauthorized use or disclosure. Protection of intellectual property may also entail prosecuting claims against others who the Company believes are infringing its rights. Involvement in intellectual property litigation could result in significant costs, adversely affecting the development of products or sales of the challenged product, or intellectual property, and divert the efforts of its scientific and management personnel, whether or not such litigation is resolved in the Company's favour.

Microbix will continue to face significant competition

Competition from life sciences companies, and academic and research institutions is significant. Many competitors have substantially greater product development capabilities and financial, scientific, manufacturing, sales and marketing resources than Microbix. While the Company continues to expand its technological capabilities in order to remain competitive, Microbix' competitors are also making significant investments in research and development activities, and in intellectual property, which could make it more difficult for Microbix to commercialize its products and technologies.

LONG-TERM DEBT**Business Development Corporation Debt**

In fiscal 2009 the Company negotiated a series of loans totalling \$3,410,000 with the Business Development Bank (BDC) for the original purchase and build-out of its manufacturing facility.

	\$
Purchase of the building	1,500,000
Construction of manufacturing facility	1,500,000
Purchase of equipment for facility	410,000
	<u>3,410,000</u>

The loans are secured with the building and equipment.

For loans totalling \$3,350,000, consecutive monthly principal payments of \$9,260 are due to February 2037 on the outstanding balance of \$2,574,280 (Sept 30, 2014 – \$2,602,060).

For loans totalling \$60,000, consecutive monthly principal payments of \$725 are due to February 2017 on the outstanding balance of \$18,850 (Sept 30, 2014 - \$21,025).

During the first quarter of fiscal 2015, the Company received an additional \$613,684 loan (net of costs) from BDC with a maturity of July, 2020 with monthly repayments of principal and interest of \$10,250 starting in August, 2015. The funds from this loan are being used to upgrade the Company's production process.

All of the above loans have a floating interest rate based on BDC's Floating Base Rate plus 0.5%. At December 31, 2014 the Floating Base Rate was 5.0%.

The primary risks affecting the Company are summarized below and have not changed during the fiscal year. The list does not cover all risks, nor is there an assurance that the strategy of management to mitigate the risks is sufficient to eliminate the risk.

Credit risk

The Company's customers are primarily large multi-national companies with strong credit ratings therefore management perceives the credit risk to be low. Typically the outstanding accounts receivable balance is concentrated with a few large customers representing the majority of the value. At December 31, 2015, five customers accounted for 73% (2014 – four customers accounted for 82%) of the outstanding balance. The Company has had minimal bad debts over the past several years and accordingly management has recorded an allowance of \$18,295 (2014 - \$1,018).

Currency risk

The Company is exposed to currency risk given its global customer base. Over 90% of its revenue is denominated in either U.S. dollars or Euros. The Company does not use financial instruments to hedge this currency risk. At December 31, 2015, the significant balances, quoted in Canadian dollars, held in foreign currencies are:

	US dollars		Euros	
	Dec 31, 2015	Dec 31, 2014	Dec 31, 2015	Dec 31, 2014
Cash and cash equivalents	319,439	319,439	489	-
Accounts receivable	432,887	432,887	-	723,238
Accounts payable and and accrued liabilities	564,246	564,246	-	105,903

The impact of a 15 cent increase in the Canadian dollar against the US dollar would result in a revenue loss of about 4%. The impact of a 15 cent increase in the Canadian dollar against the Euro would result in a revenue loss of about 14%.

Liquidity risk

Liquidity risk measures the Company's ability to meet its financial obligations when they fall due. To manage this situation, the Company projects and monitors its cash requirements to accommodate changes in liquidity needs.

Interest rate risk

Financial instruments that potentially subject the Company to interest rate risk include those assets and liabilities with a variable interest rate. Exposure to interest rate risk is primarily on the BDC debt that has a variable rate pegged to the bank rate. The rate can be fixed, if the outlook indicates interest rates will move higher. The only other variable debt the Company has is the \$500,000 line of credit that bears interest at the bank's prime lending rate plus 2.25%. A 1% increase in the bank rate would cost the Company approximately \$32,000 per year for BDC and about \$5,000 on the line of credit usage.

Market risk

Market risk reflects changes in pricing for both Virology products and raw materials based on supply and demand criteria; also market forces can affect foreign currency exchange rates as well as interest rates which could affect the Company's financial performance or the value of its financial instruments. Microbix products are valuable components in our customers' products and cannot be easily replaced. The Company works closely with customers to ensure its products meet their specific criteria.

Fair value

The Company records all financial assets and liabilities at their fair value.

CRITICAL ACCOUNTING ESTIMATES

The preparation of these consolidated interim financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The Company's audited consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") and the reporting currency is Canadian dollars. On an on-going basis, management bases its estimates on historical and other experience and assumptions, which it believes are reasonable in the circumstances. The significant accounting policies that the Company believes are the most critical in fully understanding and evaluating the reported financial results include:

Intangible Assets

Intangible assets include technology costs, patents, trademarks and licenses. Each is recorded at cost and amortized on a straight-line basis over the term of the agreements.

Intangible assets with indefinite lives are not amortized but are assessed for impairment on an annual basis.

Impairment of Long-lived Assets

The Company reviews the carrying value of non-financial assets with definite lives for potential impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying value of non-financial assets with indefinite lives, and of non-financial assets with definite lives but are not ready for use, are assessed at least annually for impairment based on the impairment test on cash-generating units (CGUs). The impairment test on CGUs is carried out by comparing the carrying amount of the CGU and its recoverable amount. The recoverable amount of a CGU is the higher of fair value less costs to sell and its value in use. This complex valuation process entails the use of methods such as the discounted cash method which requires numerous assumptions to estimate future cash flows. The recoverable amount is impacted significantly by the discount rate selected to be used in the discounted cash flow model, as well as the quantum and timing of risk-adjusted future cash flows and the growth rate used for the extrapolation.

The impairment loss is calculated as the difference between the fair value of the asset and its carrying value. Management has determined that no long-lived assets of the Company as at December 31, 2015 have met the criteria for impairment.

Non-Convertible and Convertible Debentures

Management determines the fair value of the debenture using valuation techniques. Those techniques are significantly affected by the estimated assumptions used, including discount rates, expected life and estimates of future cash flows.

Deferred Income Taxes

Deferred income tax assets and liabilities are recognized for the estimated income tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective income tax bases. Deferred income tax assets and liabilities are measured using tax rates expected to be in effect when the temporary differences are expected to be recovered or settled. The effects of changes in income tax rates are reflected in future income tax assets and liabilities in the year that the rate changes are substantively enacted.

Share-Based Payments

The Company applies the fair value method of accounting for stock-based compensation for awards granted to officers, directors, employees and consultants of the Company. The fair value of the award at the time of granting is determined using the Black-Scholes option pricing model, and recognized as a compensation expense on a straight-line basis over the vesting period with an offsetting amount recorded to contributed surplus. The amount of the compensation cost recognized at any date at least equals the value of the portion of the options vested at that date. When stock options are exercised, the consideration paid by employees or directors, together with the related amount in contributed surplus, is credited to capital stock. When an employee leaves the Company, vested options must be exercised within 90 days, or the options expire. Any options that are unvested are reversed in the period that the employee leaves.

FINANCIAL INSTRUMENTS

The fair value of a financial instrument is approximated by the consideration that would be agreed to in an arm's length transaction between willing parties and through appropriate valuation methods, but considerable judgment is required for the Company to determine the value. The actual amount that could be realized in a current market exchange could be different than the estimated value.

The carrying amounts of cash and cash equivalents, accounts receivable, bank indebtedness and accounts payable and accrued liabilities approximate fair value due to the short-term maturities of these instruments. Based on available market information, the fair value of the obligation under capital lease approximates its carrying value.

The fair value of the long-term debt is based on rates currently available for items with similar terms and maturities. The fair value of the liability for each convertible debenture has been calculated and the residual is accounted for in equity.

The Company does not have any off balance sheet financial instruments.

Disclosure Controls

The Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in the National Instrument 52-109 Certification of Disclosure in Issuer's Annual Filings (NI 52-109F1). As at December 31, 2015, management has concluded that the disclosure controls are effective in providing reasonable assurance that information required to be disclosed in the Company's reports is recorded, processed summarized and reported within the time periods specified in the Canadian Securities Administrator's rules and forms.

Internal Controls Over Financial Reporting

The design of internal controls over financial reporting ("ICFR") within the company is a management responsibility to provide reasonable assurance that the reliability of financial reporting and that the preparation of financial statements for external purposes is in accordance with generally accepted accounting principles of IFRS. While the CEO and CFO believe that the internal controls are adequate to provide the above information, the process to evaluate and document all policies and procedures that could impact financial reporting is continuously reviewed with consultation with the Audit Committee. Shareholders should be aware that Microbix is a small company without the department resources associated with larger firms. Management is using the Committee of Sponsoring Organization of the Treadway Commission ("COSO") Framework and has concluded that the Internal Control over Financial Reporting ("ICFR") as defined in NI 52-109 is effective as at the period ended December 31, 2015.

Examination by the Chief Executive Officer and the Chief Financial Officer showed that there were no changes to the internal controls over financial reporting during the period ended December 31, 2015 that have materially affected, or are reasonably thought to materially affect, the internal control over financial reporting.

RECENT ACCOUNTING PRONOUNCEMENTS

Periodically new standards, interpretations, amendments and improvements to existing standards are issued by the International Accounting Standards Board (IASB) or IFRS Interpretation Committee (IFRIC) that become mandatory at certain dates. Management routinely assesses the impact of these pronouncements on the Company. There are no pending standards that may be applicable to the Company.

IFRS 7 – Financial Instruments: Disclosures

In December 2011, the IASB amended IFRS 7 to provide additional information about offsetting of financial assets and financial liabilities. Additional disclosures will be required to enable users of financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position. The amendments are effective for annual periods beginning on or after January 1, 2013. There was no impact to the financial statements as a result of the adoption of this update.

IFRS 9 – Financial Instruments

IFRS 9, issued in November 2009 and amended in October 2010, introduced new requirements for the classification and measurement of financial assets and the classification and measurement of financial liabilities and for their de-recognition.

All recognized financial assets within the scope of IAS 39 Financial Instruments: Recognition and Measurement are to be subsequently measured at amortized cost or fair value. Specifically, debt investments that have contractual cash flows that are solely payments of principal and interest are generally measured at amortized cost at the end of subsequent periods. All other debt and equity investments are measured at their fair value at the end of subsequent periods.

IFRS 9 – Financial Instruments (continued)

With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability, that is attributable to changes in the credit risk of that liability, is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss.

The directors anticipate that the application of IFRS 9 in the future may have an impact on amounts reported in respect of the Company's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed.

IFRS 10 - Consolidated Financial Statements

In May 2011, the IASB issued IFRS 10, which establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 supersedes International Accounting Standards ("IAS") 27, Consolidated and Separate Financial Statements and Standing Interpretations Committee ("SIC") 12, Consolidation – Special Purpose Entities. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. There was no impact to the Company's interim financial statements as a result of adopting this standard.

IFRS 11 - Joint Arrangements

In May 2011, the IASB issued IFRS 11, Joint Arrangements. This standard separates joint arrangements into joint ventures and joint operations and provides guidance on accounting for these types of arrangements. IFRS 11 is effective for annual periods beginning on or after January 1, 2013. There was no impact to the Company's interim financial statements as a result of adopting this standard.

IFRS 12 - Disclosures of interests in other entities

In May 2011, the IASB issued IFRS 12, which outlines the disclosure requirements for interests in subsidiaries and other entities to enable users to evaluate the risks associated with interests in other entities and the effects of those interests on an entity's financial position, financial performance and cash flows. IFRS 12 supersedes IAS 27, Consolidated and Separate Financial Statements and SIC-12, Consolidation – Special Purpose Entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. There was no impact to the Company's interim financial statements as a result of adopting this standard.

IFRS 13 - Fair value measurement

In May 2011, the IASB issued IFRS 13, Fair Value Measurement. This standard defines fair value, sets out a single IFRS framework for measuring fair value and outlines disclosure requirements about fair value measurements. IFRS 13 is effective for annual periods beginning on or after January 1, 2013, with early adoption permitted. This IFRS is to be applied prospectively as of the beginning of the annual period in which it is initially applied. Disclosure requirements do not need to be applied to the comparative periods prior to initial application. There were no impacts to the consolidated interim financial statements as a result of the adoption of this standard.

Pursuant to National Instrument 51-102, Part 4, sub section 4.3(3)(a) issued by the Canadian Securities Administrators, if an audit has not performed a review of the interim financial statements, the interim financial statements must be accompanied by a notice indicating that they have not been reviewed by the auditor.

MICROBIX**CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION****As at December 31, 2015 and September 30, 2015**

	As at December 31, 2015 \$	Canadian Funds As at September 30, 2015 \$
Unaudited		
ASSETS		
CURRENT ASSETS		
Cash	66,433	104,180
Accounts receivable	646,618	1,692,074
Inventory (note 5)	4,019,836	3,625,268
Prepaid expenses and other assets (note 6)	125,977	216,389
Investment tax credit receivable (note 18)	250,250	150,250
TOTAL CURRENT ASSETS	5,109,114	5,788,161
LONG-TERM ASSETS		
Deferred tax asset	620,000	530,000
Property, plant and equipment (note 7)	12,024,429	11,867,476
Intangible assets (note 8)	5,779,375	5,361,321
TOTAL LONG-TERM ASSETS	18,423,804	17,758,797
TOTAL ASSETS	23,532,918	23,546,958
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	2,042,224	2,488,013
Current portion of finance lease obligation	6,340	6,180
Current portion of long-term debt (note 10)	740,225	757,430
Current portion of debentures (note 9)	1,136,242	694,284
Deferred revenue (note 11)	198,271	189,550
TOTAL CURRENT LIABILITIES	4,123,302	4,135,457
Finance lease obligation	11,013	12,658
Non-convertible debenture (note 9)	674,827	690,062
Convertible debentures (note 9)	1,527,251	1,966,536
Long-term debt (note 10)	3,241,520	3,065,335
Deferred revenue (note 11)	-	-
TOTAL LONG-TERM LIABILITIES	5,454,611	5,734,591
TOTAL LIABILITIES	9,577,913	9,870,048
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (note 12)	31,522,133	30,990,459
EQUITY COMPONENT OF CONVERTIBLE DEBENTURES (note 9)	2,351,425	2,351,425
CONTRIBUTED SURPLUS (note 13)	4,465,023	4,380,182
ACCUMULATED DEFICIT	(24,383,576)	(24,045,156)
TOTAL SHAREHOLDERS' EQUITY	13,955,005	13,676,910
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	23,532,918	23,546,958


WILLIAM J. GASTLE

DIRECTOR


VAUGHN EMBRO-PANTALONY

DIRECTOR

The accompanying notes and summary of significant accounting policies are an integral part of these consolidated interim financial statements.

MICROBIX**CONSOLIDATED INTERIM STATEMENTS OF COMPREHENSIVE INCOME****For the Three Months Ended December 31****Canadian Funds**

Unaudited	2015 \$	2014 \$
SALES		
Virology products and technologies	1,009,316	1,876,431
Licensing fees	-	-
Royalties	54,089	119,402
Research and development contracts	-	-
Total Sales	1,063,405	1,995,833
COST OF GOODS SOLD		
Virology products and technologies (note 17)	687,375	843,768
Royalties	18,576	23,880
Research and development contracts	-	-
Total Cost of Goods Sold	705,951	867,648
GROSS MARGIN	357,454	1,128,185
EXPENSES		
Selling and business development (note 17)	141,379	237,756
General and administrative (note 17)	425,672	583,336
Research and development (note 17)	39,190	50,762
Financial expenses (note 19)	179,633	165,779
Total Expenses	785,874	1,037,632
NET COMPREHENSIVE OPERATING INCOME FOR THE PERIOD	(428,420)	90,553
INCOME TAXES		
Deferred income taxes	(90,000)	-
Current income taxes	-	88,613
NET COMPREHENSIVE INCOME FOR THE YEAR	(338,420)	1,940
NET COMPREHENSIVE INCOME PER SHARE		
Basic (note 16)	(0.004)	-
Diluted (note 16)	(0.004)	-

The accompanying notes and summary of significant accounting policies are an integral part of these consolidated interim financial statements.

MICROBIX**CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS****For the Three Months Ended December 31****Canadian Funds**

	2015	2014
Unaudited	\$	\$
OPERATING ACTIVITIES		
NET INCOME FOR THE YEAR	(338,420)	1,940
Items not affecting cash		
Amortization and depreciation (Note 17, 23)	101,780	101,524
Accretion of debentures (Note 9)	5,870	5,794
Stock options expense (Note 15)	84,841	127,738
Deferred revenue (Note 11)	8,720	-
Deferred tax asset	(90,000)	-
Change in non-cash working capital balances (Note 18)	195,511	(41,790)
CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	(31,698)	195,206
INVESTING ACTIVITIES		
Purchase of property and equipment (Note 7)	(234,829)	(1,160,306)
Additions from internal development of intangible assets (Note 8)	(441,955)	-
CASH USED IN INVESTING ACTIVITIES	(676,784)	(1,160,306)
FINANCING ACTIVITIES		
Repayments of credit facility	(30,315)	-
Repayments of long term debt (Note 10)	(60,705)	(29,955)
Repayments of convertible and non-convertible debentures (Note 9)	(18,432)	(16,864)
Payments of finance lease	(1,487)	(255)
Proceeds from issuance of convertible debenture (Note 9)	-	-
Proceeds from equipment loans (Note 10)	250,000	613,684
Proceeds from issuance of credit facility (Note 10)	-	-
Proceeds from exercise of warrants, net of issue costs (Note 14)	-	548,977
Issue of common shares, net of issue costs (Note 12)	531,674	92,910
CASH PROVIDED BY FINANCING ACTIVITIES	670,735	1,208,497
Effect of foreign currency exchange rate changes on cash and cash equivalents		640
NET CHANGE IN CASH AND - DURING THE YEAR	(37,747)	244,037
CASH - BEGINNING OF YEAR	104,180	547,356
CASH - END OF YEAR	66,433	791,393

The accompanying notes and summary of significant accounting policies are an integral part of these consolidated interim financial statements.

MICROBIX
CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
As at December 31, 2015 and September 30, 2015
Canadian Funds

	SHARE CAPITAL (note 12)		CONTRIBUTED SURPLUS	DEFICIT	EQUITY COMPONENT OF DEBENTURE	TOTAL SHAREHOLDERS' EQUITY
	NUMBER OF SHARES	STATED CAPITAL \$				
Unaudited		\$	\$	\$	\$	\$
BALANCE, DECEMBER 31, 2014	78,016,116	28,397,555	4,521,820	(24,657,200)	2,351,425	10,613,600
Share issuances pursuant to stock options exercised	2,177,000	1,497,003	(594,527)			902,476
Share issuances pursuant to conversion of warrants	3,011,141	1,189,457				1,189,457
Stock option expense		(93,556)	452,889			359,333
Net comprehensive income for the year				612,044		612,044
BALANCE, SEPTEMBER 30, 2015	83,204,257	\$30,990,459	\$4,380,182	(24,045,156)	2,351,425	13,676,910
Share issuances pursuant to stock options exercised						
Share issuances pursuant to conversion of warrants						
Stock option expense			84,841			84,841
Share issuances pursuant to private placement	1,500,000	600,000				600,000
Share issue costs pursuant to private placement		(68,326)				(68,326)
Net comprehensive income for the year				(338,420)		(338,420)
BALANCE, SEPTEMBER 30, 2015	84,704,257	31,522,133	4,465,023	(24,383,576)	2,351,425	13,955,005

The accompanying notes and summary of significant accounting policies are an integral part of these consolidated interim financial statements.

1. NATURE OF THE BUSINESS

Microbix Biosystems Inc. (“Microbix” or the “Company”) (TSX: MBX), develops biological products and technologies. The Virology Business (“Virology”) manufactures and develops cell culture-based biological products and technologies. The Company has developed and acquired three technologies for large markets including Virus Yield Enhancement Technology, Virusmax®, the thrombolytic drug, Kinlytic® (Urokinase), and an animal reproductive technology in development, LumiSort™. The Company continually invests in Virology to adopt current technologies and standards. The manufacturing facility operates under an infectious diseases biological license from the Canadian Food Inspection Agency.

The Company operates the Virology Business in its owned manufacturing facility at 265 Watline Avenue, Mississauga, Ontario, L4Z 1P3.

2. BASIS OF PREPARATION

The Company’s management prepared these consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board (“IASB”) applicable to the preparation of financial statements for the three months ended December 31, 2015. The Board of Directors approved these consolidated financial statements on February 10, 2016.

3. SUMMARY SIGNIFICANT ACCOUNTING POLICIES**Basis of Measurement**

The consolidated financial statements have been prepared under the historical cost convention, except for the revaluation of certain financial assets and financial liabilities to fair value. Items included in the financial statements of each consolidated entity in the Company are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Canadian dollars, which is the Company’s functional currency.

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Crucible Biotechnologies Limited. There has been no business activity in the subsidiary during the three months ended December 31, 2015, and 2014. All significant intercompany transactions and balances have been eliminated upon consolidation.

Use of estimates and judgements

The preparation of financial statements requires management to make estimates and judgements that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from estimates and such differences could be material.

Key areas of managerial judgements and estimates are as follows:

i) Property, plant and equipment:

Measurement of property, plant and equipment involves the use of estimates for determining the expected useful lives of depreciable assets. Management’s judgement is also required to determine depreciation methods and an asset’s residual value and whether an asset is a qualifying asset for the purposes of capitalizing borrowing costs.

ii) Internally generated intangible assets:

Management monitors the progress of each internal research and development project. Significant judgement is required to distinguish between the research and development phases. Development costs are recognized as an asset when the following criteria are met: (i) technical feasibility; (ii) management’s intention to complete the project; (iii) the ability to use or sell; (iv) the ability to generate future economic benefits; (v) availability of technical and financial resources; (vi) ability to measure the expenditures reliably. Research costs are expensed as incurred. Management also monitors whether the recognition requirements for development assets continue to be met and whether there are any indicators that capitalized costs may be impaired.

iii) Revenue recognition:

The Company conducts its activities pursuant to contracts with customers and under which revenues and costs are recognized using the percentage-of-completion method. The nature of these contracts requires the use of estimates of a contract’s total costs and revenues upon completion. Estimated revenues upon completion are adjusted according to order changes, claims, penalties and contractual terms providing for price adjustments. Management must exercise its judgement to determine if it is probable that additional revenues related to order changes and claims will be realized, and these amounts, if it is probable that they will be realized, are included in estimated revenues upon completion.

3. SUMMARY SIGNIFICANT ACCOUNTING POLICIES (continued)**Use of estimates and judgements (continued)****iv) Financial assets and liabilities:**

Estimates and judgements are also made in the determination of fair value of financial assets and liabilities and include assumptions and estimates regarding future interest rates, the relative creditworthiness of the Company to its counterparties, the credit risk of the Company's counterparties relative to the Company, the estimated future cash flows and discount rates.

v) Impairment of non-financial assets:

The Company reviews the carrying value of non-financial assets with definite lives for potential impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying value of non-financial assets with indefinite lives, and non-financial assets with definite lives but not ready for use, are assessed at least annually for impairment based on the impairment test on cash-generating units ("CGUs"). The impairment test on CGUs is carried out by comparing the carrying amount of the CGU and its recoverable amount. The recoverable amount of a CGU is the higher of fair value, less costs to sell and its value in use. This complex valuation process entails the use of methods such as the discounted cash method which requires numerous assumptions to estimate future cash flows. The recoverable amount is impacted significantly by the discount rate selected to be used in the discounted cash flow model, as well as the quantum and timing of risk-adjusted future cash flows and the growth rate used for the extrapolation.

vi) Income taxes:

The Company recognizes deferred tax assets, related tax-loss carry-forwards and other deductible temporary differences where it is probable that sufficient future taxable income can be generated in order to fully utilize such losses and deductions. This requires significant estimates and assumptions regarding future earnings, and the ability to implement certain tax planning opportunities in order to assess the likelihood of utilizing such losses and deductions.

vii) Going concern:

The Company makes significant judgements with respect to uncertainties in the ability of the Company to continue as a going concern based on estimates of future operations. The ability of the Company to continue as a going concern is dependent on the successful generation of revenue and financing.

Revenue recognition

Revenues from product sales are recognized when persuasive evidence of an arrangement exists, the product is shipped, the purchase price is fixed and determinable, and collectability is reasonably assured.

Revenues from licensing are recognized when the service is rendered or the deliverables are substantially complete and other revenue recognition criteria are met.

Revenues from research and development contracts are recognized based on the percentage of completion method, measured by the percentage of costs incurred over the estimated total costs for each contract. Contract costs include all direct material and labour costs and those indirect costs related to contract performance. Provisions for estimated losses on incomplete contracts are made in the period in which such losses are determined.

Revenues from royalties are recognized on the accrual basis in accordance with the substance and terms of the agreement, when royalties from the collaborative partner are determinable and collection is reasonably assured.

For upfront, non-refundable payments and milestone payments received in accordance with the execution of licensing and collaboration agreements, revenue is deferred and recognized over the performance period, the period over which the Company maintains substantive contractual obligations.

Amounts the Company expects to earn in the current year are included in the current portion of deferred revenue and amounts expected to be earned in subsequent periods are included in deferred revenue (Note 11). The term over which upfront fees are recognized is revised if the period over which the Company maintains substantive contractual obligations changes.

3. SUMMARY SIGNIFICANT ACCOUNTING POLICIES (continued)***Cash***

Cash consists of cash on hand and deposits with banks and investments in highly liquid instruments with original maturities of three months or less. There are no cash equivalents held at December 31, 2015 or 2014.

Financial assets and liabilities

All financial instruments, including derivatives, are included on the consolidated statement of financial position and are measured either at fair market value or, in limited circumstances, at cost or amortized cost. Subsequent measurement and recognition of the changes in fair value of financial instruments depends upon their initial classifications as follows:

- Held-for-trading financial assets, measured at fair value with subsequent changes in fair value recognized in current period net income;
- Held-to-maturity assets, loans and receivables and other financial liabilities, initially measured at fair value and subsequently measured at amortized cost with changes recognized in current period net income; and
- Available-for-sale financial assets, measured at fair value with subsequent gains or losses included in other comprehensive income until the asset is removed from the consolidated statements of financial position.

The following summarizes the Company's classification and measurement of financial assets and liabilities:

	Classification	Measurement	2015	2014
			\$	\$
Financial assets:				
Cash	Held-for-trading	Fair value	66,433	104,180
Accounts receivable	Loans and receivables	Amortized cost	646,618	1,692,074
Financial liabilities:				
Accounts payable and accrued liabilities	Other liabilities	Amortized cost	2,042,224	2,488,013
Finance lease obligation	Other liabilities	Amortized cost	17,353	18,838
Non-convertible debentures	Other liabilities	Amortized cost	919,111	934,346
Convertible debentures	Other liabilities	Amortized cost	2,419,209	2,416,536
Long-term-debt	Other liabilities	Amortized cost	3,981,745	3,822,765
Total Financial liabilities			\$9,379,642	\$9,680,498

Transaction costs that are directly attributable to the acquisition or issuance of financial assets or financial liabilities, other than financial assets and financial liabilities measured at fair value through profit and loss ("FVTPL"), are accounted for as part of the carrying amount of the respective asset or liability at inception. Transaction costs related to financial instruments measured at amortized cost are amortized using the effective interest rate over the anticipated life of the related instrument.

Transaction costs on financial assets and financial liabilities measured at FVTPL are expensed in the period incurred. Financial assets are derecognized when the contractual rights to the cash flows from financial assets expire or have been transferred. All derivative instruments, including embedded derivatives, are recorded in the financial statements at fair value.

Inventory

Inventory is carried at the lower of cost and market. Cost consists of direct materials, direct labour and an overhead allocation and is determined on a first-in, first-out basis. Market is defined as net realizable value, which is defined as the summation of the estimated selling price less the cost to complete less the cost to sell. Management reviews its reserve for obsolete inventory annually for finished goods and work-in-process.

3. SUMMARY SIGNIFICANT ACCOUNTING POLICIES (continued)***Property and equipment***

Property and equipment are measured at cost less accumulated depreciation and impairment (if any). Cost includes the cost of material, labour and other costs directly attributable to bringing the asset to a working condition for its intended use.

Depreciation is calculated at rates which will reduce the original cost to estimated residual value over the estimated useful life of each asset. Depreciation commences once the asset is available for use.

Depreciation is provided for at the following basis and rates:

Research and development equipment	Declining balance, 10-100%
Other equipment and fixtures	Declining balance, 10-30%
Leasehold improvements	Lesser of estimated useful life and lease term
Buildings	Straight line, 50 years

Land is not depreciated. Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted prospectively, if appropriate.

Convertible debentures

The convertible debenture can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value. The liability component of the convertible debenture is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially as the difference between the fair value of the convertible debenture as a whole and the fair value of the liability component.

The liability component accretes up to the principal balance at maturity with the accretion expense included in financial expenses in the consolidated statements of comprehensive income.

The equity component is not re-measured subsequent to initial recognition. The equity component will be reclassified to share capital on conversions. Any balance that remains after the settlement of the liability is transferred to contributed surplus. The equity portion is recognized net of deferred income taxes.

Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Leases

Leases are classified as either capital or operating based on their nature. Leases that transfer substantially all of the benefits and risks of ownership of the asset to the Company are accounted for as finance leases. At the time a finance lease is entered into, an asset is recorded together with its related long-term obligation, reflecting the fair value of future lease payments, discounted at the appropriate interest rates. Finance lease obligation are amortized over their estimated useful lives at the same rates used for other equipment and fixtures. All other leases are classified as operating leases and expensed on a straight line basis.

Intangible assets

Intangible assets represent technology costs, patents and trademarks, and rights and licenses. Each is recorded at cost and is amortized on a straight-line basis over the term of the agreements or over the useful life of the asset. Amortization commences when the intangible asset is available for use. Intangible assets with definite lives but not yet available for use are assessed annually for impairment.

Impairment of long-lived assets

An impairment charge is recognized for long-lived assets, including intangible assets with definite lives, when an event or change in circumstances indicates that the assets' carrying value may not be recoverable. The impairment loss is calculated as the difference between the carrying value of the asset and the recoverable amount. The recoverable amount is the higher of the fair value less costs to sell and value in use.

Management has determined that no long-lived assets of the Company as at December 31, 2015 have met the criteria for impairment.

3. SUMMARY SIGNIFICANT ACCOUNTING POLICIES (continued)***Share-based compensation***

The Company applies the fair value method of accounting for share-based compensation for awards granted to officers, directors and employees of the Company. The fair value of the award at the time of granting is determined using the Black-Scholes option pricing model, and recognized as a compensation expense over the vesting period with an offsetting amount recorded to contributed surplus. Each tranche in an award is considered a separate award with its own vesting period and grant date fair value.

Share options issued to consultants of the Company are based on the fair value of the services provided. The amount of the compensation cost recognized at any date at least equals the value of the portion of the options vested at that date. When stock options are exercised, the consideration paid by employees or directors, together with the related amount in contributed surplus, is credited to share capital. When an employee leaves the Company, vested options must be exercised within 90 days, or the options expire. Any options that are unvested are reversed in the period that the employee leaves. No valuation allowance has been made for the expected forfeitures upon issuance of stock options with vesting periods, due to minor expectation of such events.

Foreign currency translation

Foreign currency denominated revenues and expenses are translated by use of the exchange rate in effect at the end of the month in which the transaction occurs. Foreign currency denominated monetary assets and liabilities are translated at the year-end date. Exchange gains and losses arising on these transactions are included in the consolidated statements of comprehensive income for the year.

Income per common share

The Company calculates basic income per share amounts for profit or loss attributable to ordinary equity holders. Basic income per share is calculated using the weighted average number of common shares outstanding during the period. Diluted income per share is calculated in the same manner as basic income per share except for adjusting the profit or loss attributable to ordinary equity holders and the weighted average number of shares outstanding for the effects of all dilutive potential ordinary shares.

Deferred taxes

Deferred income tax assets and liabilities are recognized for the estimated income tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective income tax bases. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which temporary differences can be utilized. Deferred income tax assets and liabilities are measured using tax rates expected to be in effect when the temporary differences are expected to be recovered or settled. The effects of changes in income tax rates are reflected in deferred income tax assets and liabilities in the year that the rate changes are substantively enacted.

Borrowing costs

Borrowing costs incurred for the construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the assets for their intended use or sale. All other borrowing costs are recognized in the consolidated statements of comprehensive income using the effective interest method. Interest has been capitalized at the rate of interest applicable to the specific borrowings financing the asset.

Research and development expenses

Costs associated with research and development activities are expensed during the year in which they are incurred net of tax credits earned, except where product development costs meet the criteria under IFRS for deferral and amortization.

Investment tax credits

The Company is entitled to Canadian federal and provincial investment tax credits which are earned as a percentage of eligible research and development expenditures incurred in each taxation year. Investment tax credits are accounted for as a reduction of the related expenditure for items of a current nature and a reduction of the related asset cost for items of a long-term nature. These credits are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilize the benefits of the credits in the foreseeable future.

4. ACCOUNTING PRONOUNCEMENTS ISSUED BUT NOT YET APPLIED

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the International Accounting Standards Board ("IASB") or IFRS Interpretation Committee ("IFRIC") that are mandatory at certain dates or later. Management is still assessing the effects of the pronouncements on the Company. The standards impacted that may be applicable to the Company are following:

IAS 1 - Presentation of Financial Statements

IAS 1, Presentation of Financial Statements was amended by the IASB in December 2014. The amendments are designed to further encourage companies to apply professional judgement in determining what information to disclose in their financial statements.

For example, the amendments make clear that materiality applies to the whole of financial statements and that the inclusion of immaterial information can inhibit the usefulness of the financial disclosures. Furthermore, the amendments clarify that companies should use professional judgement in determining where and in what order information presented in the financial disclosures. The amendments are effective for annual periods beginning on or after January 1, 2016. Earlier application is permitted.

IAS 16 and IAS 38 – Property, Plant and Equipment and Intangible Assets

IAS 16 and IAS 38, Property, Plant and Equipment and Intangible Assets were amended by IASB in December 2013. The amendments clarify that the use of revenue-based methods to calculate the depreciation of an asset are not appropriate because revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits embodied in the asset. The IASB also clarified that revenue is generally presumed to be an inappropriate basis for measuring the consumption of the economic benefits embodied in an intangible asset. This presumption, however, can be rebutted in certain limited circumstances.

IFRS 9 - Financial Instruments

IFRS 9, Financial Instruments was issued in final form by the IASB in July 2014 and will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets.

Most requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9. The new standard also requires a single impairment method be used, replacing the multiple impairment methods in IAS 39. IFRS 9 also includes requirements relating to a new hedge accounting model, which represents a substantial overhaul of hedge accounting which will allow entities to better reflect their risk management activities in the financial statements.

The most significant improvements apply to those that hedge non-financial risk, and so these improvements are expected to be of particular interest to non-financial institutions. In addition, a single, forward-looking expected loss impairment model is introduced, which will require more timely recognition of expected credit losses. IFRS 9 is effective for annual period beginning on or after January 1, 2018. Earlier application is permitted.

IFRS 15 - Revenue from Contracts with Customers

IFRS 15, Revenue from Contracts with Customers was issued by the IASB in May 2014. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. The new standard is effective for annual periods beginning on or after January 1, 2018. Earlier application is permitted. IFRS 15 supersedes the following standards: IAS 11 Construction Contracts, IAS 18 Revenue, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers, and SIC-31 Revenue - Barter Transactions Involving Advertising Services.

4. INVENTORY

Inventories as at December 31, 2015 and 2014 consist of the following:

	2015 \$	2014 \$
Raw material	671,825	461,051
Work in process	787,386	455,102
Finished goods	2,560,625	734,860
	4,019,836	1,651,013

During the three months ended December 31, 2015, inventories in the amount of \$301,561 (2014 - \$487,096) were recognized as an expense through cost of sales. The allowance for inventory impairment as at December 31, 2015 was \$53,597 (2014 - \$27,993).

6. PREPAID EXPENSES AND OTHER ASSETS

Prepaid expenses and other assets as at December 31, 2015 were \$125,977 (2014 - \$280,342 in Current Assets and \$232,019 in Long-term Assets) and primarily consist of insurance policy premiums.

7. PROPERTY, PLANT AND EQUIPMENT

The freehold land and buildings have been pledged as security for bank loans under a mortgage (see Note 10). Property plant and equipment consists of:

	Building	Research & development equipment	Other equipment & fixtures	Land	Leasehold improvements	Total
<u>Cost</u>	\$	\$	\$	\$	\$	\$
Balance, Sep 30, 2015	4,551,102	6,227,011	4,348,886	800,000	-	15,926,999
Additions	1,730	198,502	34,597	-	-	234,829
Disposals	-	-	-	-	-	-
Balance, Dec 31, 2015	4,552,832	6,425,513	4,383,483	800,000	-	16,161,828
<u>Accumulated depreciation</u>						
Balance, Sep 30, 2015	942,608	531,277	2,585,638	-	-	4,059,523
Disposals	-	-	-	-	-	-
Depreciation	38,078	6,956	32,842	-	-	77,876
Balance, Dec 31, 2015	980,686	538,233	2,618,480	-	-	4,137,399
<u>Net book value</u>						
Balance, Sept 30, 2015	3,608,494	5,695,734	1,763,248	800,000	-	11,867,476
Balance, Dec 31, 2015	3,572,147	5,887,280	1,765,003	800,000	-	12,024,429

Included in research and development equipment is \$5,655,045 and in other equipment and fixtures \$696,433 related to assets not yet available for use. Included in these amounts is directly attributable interest from borrowings to finance these asset additions of \$67,500 and \$15,713 respectively. These assets are not yet subject to depreciation.

8. INTANGIBLE ASSETS

Intangible assets are depreciated on a straight line basis at the following rates:

License agreement, LumiSort™ (Note 8a)	5%
Technology investments	
LumiSort™ (Note 8a)	5%
Kinlytic® (Note 8b)	0%
Bioreactor (Note 8c)	0%

Intangible assets consist of:

	Capitalized development costs		Patents and trademarks		Licenses	Total
	LumiSort™	Bioreactor	Kinlytic®	LumiSort™	LumiSort™	
	(a)	(c)	(b)	(a)	(a)	
Cost	\$	\$	\$	\$	\$	
Balance at September 30, 2015	30,532	1,062,427	2,770,529	2,041,777	278,528	6,183,792
Additions from internal developments	-	441,955	-	-	-	441,955
Balance at December 31, 2015	30,532	1,504,382	2,770,529	2,041,777	278,528	6,625,747
Accumulated amortization						
Balance at September 30, 2015	4,725	-	-	603,495	214,251	822,471
Amortization expense	258	-	-	18,287	5,356	23,901
Balance at December 31, 2015	4,983	-	-	621,782	219,607	846,372
Net book value						
Balance, September 31, 2015	25,807	-	2,770,529	1,438,282	64,277	5,361,321
Balance, December 31, 2015	25,549	1,504,382	2,770,529	1,419,995	58,921	5,779,375

(a) LumiSort™

The Company acquired a license agreement from Sequent Biotechnologies Inc. (“Sequent”), a biotechnology company solely involved in the development and commercialization of the Lumisort™ technology under license. New intellectual property with the issue of patents has resulted from this research program. These assets are in the process of being developed and new patents are pending and under development.

(b) Kinlytic®

The Company acquired the assets and rights pertaining to development, production, and licensing of Kinlytic® from ImaRX Therapeutics, Inc. in 2008. These assets are in the process of being developed and new patents are pending and under development.

The recoverable amount of the Kinlytic® intangible has been determined based on its fair value less cost to sell. This estimate uses risk-adjusted cash flow projections based on financial budgets.

Management made these assumptions based on probabilities of technical, regulatory and clinical acceptances and financial support. Management believes that any reasonably-possible change in the key assumptions on which the recoverable amount is based would not cause the carrying amount to exceed its recoverable amount.

(c) Bioreactor

The Company has internally developed an improved bioreactor production process (“Bioreactor”) to increase the efficiency and output of manufacturing certain virology products. As at December 31, 2015, the process is still being developed.

9. DEBENTURES

The Company has convertible and non-convertible debentures issued and outstanding as at year-end. The carrying values of the debt component of these debentures are as follows:

	Non-convertible Debentures	Convertible Debentures					Convertible Debentures Total
Date of issue	Jan, 2014	Jan, 2014	Feb, 2007	Oct, 2006	Feb, 2006	Sep, 2008	
Proceeds of issue	\$2,000,000	\$1,500,000	\$500,000	\$500,000	\$2,000,000	\$2,500,000	
	\$	\$	\$	\$	\$	\$	\$
Balance, October 1, 2015	934,346	528,603	474,294	483,723	-	929,916	2,416,536
Accretion expense	45,836	34,143	12,075	11,897	-	57,057	115,173
Repayments	(61,071)	(33,750)	(11,250)	(11,250)	-	(56,250)	(112,500)
Balance, December 31, 2015	919,111	528,996	475,119	484,370	-	930,723	2,419,209
Less: current portion	244,284	135,000	45,000	486,958	-	225,000	891,958
Non-current portion	674,827	393,996	430,119	(2,588)	-	705,723	1,537,251
Note	(a)	(b)	(c)	(d)	(e)	(f)	

The debentures denoted (a), (b), and (f) are secured against the real property and the personal property of the Company including without limiting the foregoing, a registered second mortgage on the property at 265 Watline Avenue, Mississauga, Ontario in favour of the holder, its successors and assigns subordinate only to indebtedness to a Canadian chartered bank or similar financial institution on normal commercial terms up to their maximum principal.

The debentures denoted (c) and (d) are secured by a subordinated security agreement covering all of the Company's property and assets.

The debenture denoted (e) was extinguished in the prior fiscal year. Upon extinguishment, the Company allocated the consideration paid along with transaction costs incurred consistent with the method used in the allocation of proceeds between debt and equity when the debenture was originally issued. The result of this allocation was a \$Nil gain in the consolidated statement of comprehensive income and recognition of \$1,071,626 of contributed surplus.

All of the debentures were issued to a shareholder of the Company.

9. DEBENTURES (continued)

Over the term of the convertible debentures, the debt components will be accreted to the face value of the debentures by the recording of additional interest expense using the effective interest rate, as detailed below:

Note	(a)	(b)	(c)	(d)	(e)	(f)
Date of issue	Jan, 2014	Jan, 2014	Feb, 2007	Oct, 2006	Feb, 2006	Sep, 2008
Face value	\$ 2,000,000	\$ 1,500,000	\$ 500,000	\$ 500,000	\$ 2,000,000	\$ 2,500,000
Issue costs	\$ -	\$ 65,559	\$ -	\$ -	\$ -	\$ -
Liability component at:						
the date of issue	\$ 928,373	\$ 517,470	\$ 388,958	\$ 413,320	\$ 735,086	\$ 885,089
the report date	\$ 919,111	\$ 528,996	\$ 475,119	\$ 484,370	\$ -	\$ 930,723
Equity component at:						
the date of issue	N/A	\$ 916,971	\$ 111,042	\$ 86,680	\$ 1,264,914	\$ 1,614,911
the report date	N/A	\$ 916,971	\$ 111,042	\$ 86,680	\$ 1,071,626	\$ 1,236,732
Conversion price per common share	\$ -	\$ 0.35	\$ 0.90	\$ 0.90	\$ 0.90	\$ 0.65
Effective interest rate charged	25.69%	25.69%	13.00%	12.00%	25.69%	25.69%
Payment frequency	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly	Quarterly
Maturity of financial instrument	Jan, 2029	Jan, 2029	Feb, 2017	Oct, 2016	Jan, 2028	Sep, 2028
Stated interest rate	9%	9%	9%	9%	9%	9%
Terms of repayment	Principal and interest	Interest only	Interest only	Interest only	Interest only	Interest only
Blended quarterly repayment	\$ 61,071	N/A	N/A	N/A	N/A	N/A

As the issuance of the non-convertible debenture denoted as (a) and the cancellation of the convertible debenture denoted as (e), were transacted with the same shareholder and represented a substantial modification in the terms, the non-convertible debenture is being accounted for in accordance with its substance and is presented in the financial statements as new debt, measured at fair value at the time of the issue.

10. LONG-TERM DEBT

In fiscal 2009 the Company negotiated a series of loans totalling \$3,410,000 with the Business Development Bank (BDC) for the original purchase and build-out of its manufacturing facility.

	\$
Purchase of the building	1,500,000
Construction of manufacturing facility	1,500,000
Purchase of equipment for facility	410,000
	3,410,000

The loans are secured with the building and equipment. For loans totalling \$3,350,000, consecutive monthly principal payments of \$9,260 are due to February 2037 on the outstanding balance of \$2,463,160 (September 30, 2015 - \$2,490,940). For loans totalling \$60,000, consecutive monthly principal payments of \$725 are due to February 2017 on the outstanding balance of \$10,150 (September 30, 2015 - \$12,325). Both of the loans have a floating interest rate based on BDC's Floating Base Rate plus 0.5%. At December 31, 2015 the Floating Base Rate was 4.7%.

10. LONG-TERM DEBT (continued)

In fiscal 2015 the Company negotiated a series of loans totalling \$865,000 with the Business Development Bank (BDC) for process equipment upgrades in its manufacturing facility.

	\$
Equipment for Bioreactor Project	615,000
Construction of manufacturing facility	50,000
Purchase of equipment for facility	200,000
	865,000

For loans totalling \$615,000, consecutive monthly principal payments of \$10,250 are due to July 2020 on the outstanding balance of \$563,750 (September 30, 2015 - \$594,500). The loan has a floating interest rate based on BDC's Floating Base Rate plus 0.5%.

For loans totalling \$50,000, consecutive monthly principal payments of \$1,040 are due to December 2019 on the outstanding balance of \$50,000 (September 30, 2015 - \$Nil). For loans totalling \$200,000, consecutive monthly principal payments of \$3,330 are due to December 2020 on the outstanding balance of \$200,000 (Sept 30, 2015 - \$Nil). These loans have a floating interest rate based on BDC's Floating Base Rate plus 0.5%. At December 31, 2015 the Floating Base Rate was 5.0%.

On October 9, 2015, the Company entered into a loan agreement with BDC for \$250,000, monthly principal payments of \$1,104 are due December 22, 2020. The loan has a floating interest rate based on BDC's Floating Base Rate plus 0.5%. At the date of the agreement the Floating Base Rate was 4.70%.

The commitment for the next five years for the BDC loans is as follows:

	\$
2016	295,540
2017	288,010
2018	286,560
2019	286,560
2020	222,830
2021 and thereafter	1,907,560

On April 16, 2015, the Company entered into a revolving line of credit agreement with its Canadian chartered bank. The agreement allows the Company to draw on to a limit of \$500,000 bearing interest at the bank's prime lending rate plus 2.25%. Accounts receivable and property, plant and equipment are pledged as collateral for the bank credit facility. As at December 31, 2015, the Company had drawn on \$265,000 of the facility.

11. DEFERRED REVENUE

In 2007, the Company entered into an agreement with the Animal Fine Breeding Station (partner) of Hebei Province in China, as the exclusive distributor of Microbix' proprietary Semen Sexing Technology ("SST"). Under the terms of the agreement, the Company had received a non-refundable payment of \$400,000 US and will receive an additional payment upon a milestone achievement. Royalty fees and payment for materials will be made with product sales. This payment was being accounted for in accordance with its substance and was presented in the prior year financial statements as long term deferred revenue on the consolidated statement of financial position. In 2015 the Company advised the partner that the SST program has been abandoned as the Company has gone in a different direction with the recent completion of its Lumisort prototype technology. With SST development permanently cancelled, the non-refundable deposit was recorded as revenue in the consolidated statements of comprehensive income.

As at December 31, 2015, the Company has received payment, in the amount of \$198,271 (2015 - \$Nil), for a portion of product sales which was not yet shipped. This amount has been recognized as deferred revenue under the current liabilities in the consolidated statements of comprehensive income.

12. SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares with no par value and an unlimited number of preference shares with no par value. The number of issued and outstanding common shares and the stated capital of the Company as at December 31, 2015 are presented below:

	Number of Shares	Stated Capital (\$)
Balance, September 30, 2015	83,204,257	30,990,459
Exercise of warrants	-	-
Exercise of stock options	-	-
Share issuances pursuant to private placement	1,500,000	531,674
Balance, December 31, 2015	84,704,257	31,522,133

13. CONTRIBUTED SURPLUS

Changes in contributed surplus up to December 31, 2015 are described as follows:

	\$
Balance, September 30, 2015	4,380,182
Stock options exercised	-
Stock option expense	84,841
Balance, December 31, 2015	4,465,023

14. COMMON SHARE PURCHASE WARRANTS

A continuity of the Company's warrants outstanding as at December 31, 2015 and September 30, 2015 is presented in the following table:

	Units	Weighted average exercise price \$
Outstanding, September 30, 2015	5,442,842	\$ 0.54
Issued	1,581,550	\$ 0.55
Exercised	-	\$ -
Expired	-	\$ -
Outstanding, September 30, 2015	7,024,392	\$ 0.54

A summary of the Company's warrants outstanding as at September 30, 2015 and 2014 is presented in the following table:

	December 31, 2015			September 30, 2015		
	Number outstanding	Weighted average exercise price \$	Weighted average remaining contractual life years	Number outstanding	Weighted average exercise price \$	Weighted average remaining contractual life years
Range of exercise prices:						
\$0.55	1,581,550	\$ 0.55	4.97			
\$0.47 to \$0.55	5,249,763	\$ 0.55	3.67	5,249,763	\$ 0.55	3.92
\$0.24 to \$0.40	193,079	\$ 0.25	0.92	193,079	\$ 0.25	0.17
	5,024,392	\$ 0.54	3.82	5,442,842	\$ 0.54	3.82

15. STOCK OPTION PLAN

On March 5, 2013, the shareholders of the Company approved a resolution to amend the Company's stock option plan. This amendment changed the total number of common shares available to be issued under the plan from a maximum of 10,000,000 to a maximum of 12,000,000 common shares. Under the plan, the Company has a total of 4,872,000 options issued and pending (2014 – 4,354,000).

On January 16, 2015, the Board of Directors amended the Company's stock option plan. The amendment added a provision regarding change of control and the ability for non-executive directors who have resigned to exercise vested options up to the date of resignation.

Change in control is defined as: (i) the acquisition, directly or indirectly of holdings greater than 20% of the outstanding common shares; (ii) resolution of the shareholders of the Corporation, more than 51% of the then incumbent Board of Directors of the Corporation, or election of majority of the members of the Company's Board of Directors who were not members of the Company's incumbent board at the time preceding such election; (iii) the consummation of a sale of all or substantially all of the assets of the Company; or (iv) reorganization, amalgamation or mergers.

When a change in control happens, the holders of options which have not vested shall be deemed to be fully vested and exercisable for the sole purposes of participating in the change of control transaction. If a change of control transaction is not completed or does not occur, then the optioned shares shall be returned to the Company and reinstated as authorized but unissued common shares, and the terms of the option set forth in the plan shall apply to the option. If any optioned shares are returned, the Company shall refund the exercise price to the holder for such optioned shares.

The exercise price of each option equals no less than the market price at the date immediately preceding the date of the grant. In general, options issued under the plan vest and are exercisable in equal amounts in three steps, at the issue date and at the anniversary date in the subsequent two years. Management does not expect any stock options issued in the year and remaining unvested at the year-end to be forfeited before they vest.

The activity under the Company's stock option plan for the three months ended December 31, 2015 is as follows:

	Units	Weighted average exercise price \$
Outstanding, September 30, 2015	4,872,000	\$ 0.45
Issued	-	\$ -
Exercised	-	\$ -
Expired or forfeited	-	\$ -
Outstanding, September 30, 2015	4,872,000	\$ 0.45

The exercise price of each option equals the closing market price of the Company's capital stock on the day preceding the grant date.

15. STOCK OPTION PLAN (continued)

The following table reflects the number of options, their weighted average price and the weighted average remaining contract life for the options grouped by price range as of December 31, 2015 and September 30, 2015:

	December 31, 2015			September 30, 2015		
	Number outstanding	Weighted average exercise price \$	Weighted average remaining contractual life years	Number outstanding	Weighted average exercise price \$	Weighted average remaining contractual life years
Range of exercise prices:						
\$0.33 to \$0.55	2,985,000	\$ 0.33	2.99	2,985,000	\$ 0.33	3.14
\$0.26 to \$0.32	1,887,000	\$ 0.32	0.44	1,887,000	\$ 0.32	0.54
	4,872,000	\$ 0.45	3.43	4,872,000	\$ 0.45	3.68

The fair value of options granted during the three months ended December 31, 2015 was estimated at the grant date using the Black-Scholes options pricing model, resulting in the following weighted-average assumptions:

	Amount
Share price on issue date	\$ 0.54
Dividend yield	\$ -
Volatility	93.3%
Risk-free interest rate	1.40%
Expected option life (years)	5.0
Weighted average fair value of each option (\$ / option)	0.40

The volatility of the stock for the Black-Scholes options pricing model was based on 5-year historic volatility of the Company's stock price on the Toronto Stock Exchange. Management believes that the historic stock volatility provides a fair and appropriate basis of estimate for the expected future volatility of the stock. Stock options are assumed to be exercised at the end of the option's life, as management believes the probability of an early exercise is remote. During the period, the fair value of the options vested in the year were expensed and credited to contributed surplus.

16. INCOME PER SHARE

Basic income per share is calculated using the weighted average number of shares outstanding. Diluted income per share reflects the dilutive effect of the exercise of stock options, warrants and convertible debt. The following table reconciles the net income and the number of shares for the basic and diluted loss per share computations:

	As at December 31	
	2015	2014
Numerator		
Numerator for basic and diluted earnings per share:		
Net income available to common shareholders (\$)	\$(338,420)	\$1,940
Denominator for basic earnings per share:		
Weighted average common shares outstanding	84,531,214	77,133,616
Effect of dilutive securities:		
Warrants	42,236	2,628,377
Stock Options	129,859	2,811,796
Convertible Debentures	-	5,103,699
Denominator for diluted earnings per share	84,703,309	87,677,488
Earnings per share		
Basic	(\$0.004)	\$0.000
Diluted	(\$0.004)	\$0.000

The following represents the warrants, stock options and convertible debentures not included in the calculation of diluted EPS due to their anti-dilutive impact:

	As at December 31	
	2015	2014
Pursuant to warrants	6,831,313	-
Under stock options	3,788,000	-
Pursuant to convertible debentures	7,000,000	1,111,111
	17,619,313	1,111,111

17. EXPENSES BY NATURE

The Company has chosen to present its consolidated statements of comprehensive income based on the functions of the entity and include the following expenses by nature:

Depreciation and amortization

	Three months ended Dec 31,2015 \$	Three months ended Dec 31,2014 \$
Short-term wages, bonuses and benefits	816,745	815,574
Share based payments	84,841	127,738
Total employee costs	901,586	943,312
Included in:		
Cost of goods sold	537,284	536,380
Research and development	61,160	85,646
General and administrative expenses	216,751	242,052
Selling and business development	86,391	79,235
Total employee costs	901,586	943,313

a) Depreciation and amortization

	Three months ended Dec 31,2015 \$	Three months ended Dec 31,2014 \$
Included in:		
Cost of goods sold	70,922	70,586
General and administrative expenses	258	210
Research and development	30,600	30,728
Total depreciation and amortization	101,780	101,524

18. CHANGES IN NON-CASH WORKING CAPITAL

	Three months ended Dec 31,2015 \$	Three months ended Dec 31,2014 \$
Accounts receivable	1,045,456	541,775
Inventory	(394,568)	(52,584)
Prepaid expenses & other assets	90,412	(4,235)
Investment tax credit receivable	(100,000)	(15,124)
Accounts payable and accrued liabilities	(445,789)	(511,622)
	195,511	(41,790)

19. FINANCIAL EXPENSES

	Three months ended Dec 31, 2015 \$	Three months ended Dec 31, 2014 \$
Cash interest		
Interest on long-term debt	45,659	43,889
Interest on debentures	121,389	156,707
Interest other	7,329	-
Interest income	(614)	(40,611)
Non-cash investing and financing activities:	-	
Accretion on debentures	5,870	5,794
Financial expenses	179,633	165,779

20. CAPITAL MANAGEMENT

The Company's capital management objective is to safeguard its ability to function as a going concern to maintain its virology operations and to fund its development activities. Microbix defines its capital to include the revolving line of credit, shareholders' equity, the Business Development Bank capital loans, and the debentures. The capital at December 31, 2015 was \$21,353,863 (2014 - \$17,621,753).

To date, the Company has used common equity issues, debentures, bank mortgage and other financing to fund its activities. The equity is through private placements, the debentures are all controlled by private individuals known to the Company and the mortgage and other financing are with the Business Development Bank. If possible, the Company tries to optimize its liquidity needs by non-dilutive sources, including investment tax credits, grants and interest income. The Company has a revolving line of credit of \$500,000 with its Canadian chartered bank, Note 10.

The Company's general policy is to not pay dividends and retain cash to keep funds available to finance the Company's growth. However, the Board of Directors may, from time to time, choose to declare a dividend in assets if warranted by circumstances. There was no change during the year in how the Company defines its capital or how it manages its capital.

21. FINANCIAL INSTRUMENTS

The fair value of a financial instrument is approximated by the consideration that would be agreed to in an arm's length transaction between willing parties and through appropriate valuation methods, but considerable judgement is required for the Company to determine the value. The actual amount that could be realized in a current market exchange could be different than the estimated value.

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities approximate fair value due to the short-term maturities of these instruments.

The fair value of the long-term debt is based on rates currently available for items with similar terms and maturities. The convertible and non-convertible debenture fair values are not readily determinable as the convertible debentures have been issued to shareholders of the Company.

22. FINANCIAL RISK MANAGEMENT

The primary risks that affect the Company are set out below and the risks have not changed during the reporting year. The list does not cover all risks to the Company, nor is there an assurance that the strategy of management to mitigate the risks is sufficient to eliminate the risk.

Credit risk

The Company's cash and cash equivalents are held in accounts or short-term interest bearing accounts at one of the major Canadian chartered banks. Management perceives the credit risk to be low. There is a concentration of accounts receivable risk due to the few large customers comprising the Company's international customer base. In the three months ended December 31, 2015, 5 customers accounted for 73% (2014 - four customers account for 83%) of revenue. The Company has had minimal bad debts over the past several years and accordingly management has recorded an allowance of \$18,295 (2015 - \$1,018).

Trade accounts receivable are aged as follows at December 31:

	Three months ended Dec 31, 2015 \$	Three months ended Dec 31, 2014 \$
Current	560,318	1,041,738
0-30 days past due	40,825	175,861
31-60 days past due	43,945	68,084
61 days and over past due	1,530	250,103
	646,618	1,535,786

Currency risk

Through its global sales the Company is exposed to currency risk, through fluctuations in the exchange rate affecting sales and receivables denominated in US dollars and Euros. The Company does not use financial instruments to hedge these risks. At December 31 the significant balances, quoted in Canadian dollars, held in foreign currencies are:

	US dollars		Euros	
	Dec 31, 2015	Dec 31, 2014	Dec 31, 2015	Dec 31, 2014
Cash	107,094	319,439	489	-
Accounts receivable	500,626	432,887	-	732,238
Accounts payable and accrued liabilities	542,726	564,246	-	105,903

The impact of a 15 cent increase in the Canadian dollar against the US dollar would result in a revenue loss of approximately 4%. The impact of a 15 cent increase in the Canadian dollar against the Euro would result in a revenue loss of approximately 14%.

22. FINANCIAL RISK MANAGEMENT (continued)***Liquidity risk***

Liquidity risk is the risk that the Company will encounter difficulties in meeting its financial liability obligations as they become due. The Company has a planning and budgeting process in place to help determine the funds required to support the normal operating requirements on an ongoing basis. The Company has financed its cash requirements primarily through issuance of securities, short-term borrowings, long-term debt and debentures. The Company controls liquidity risk through management of working capital, cash flows and the availability of sourcing of financing. Financial liabilities are due as follows:

	< 1 year \$	1-2 year \$	3-5 year \$	> 5 years \$
Accounts payable and accrued liabilities	1,671,587	-	-	-
Leases	25,822	12,899	3,096	-
Convertible and non-convertible debentures	1,186,742	1,715,984	1,208,484	8,793,831
Long-term debt	536,046	989,687	834,968	2,944,163

Interest rate risk

Financial instruments that potentially subject the Company to cash flow interest rate risk are those assets and liabilities with a variable interest rate. Interest risk exposure is primarily on the BDC debt that has a variable rate that is pegged to the bank rate. The rate can be fixed, if the outlook for interest rates should move higher. The only other variable debt the Company has is the \$500,000 line of credit that bears interest at the bank's prime lending rate plus 2.25%. A 1% increase in the bank rate would cost the Company approximately \$30,000 per year for BDC and about \$5,000 on the line of credit usage if it were fully used throughout the fiscal year.

Market risk

Market risk is the risk that changes in product prices based on supply and demand criteria, foreign exchange rates and interest rates will affect the Company's income or the value of the financial instruments held. Microbix products are valuable components in many of our customers' products and not easily replaced. The Company works closely with key customers to ensure our products meet critical customer results.

Fair value

The Company categorizes its financial assets and liabilities measured at the fair value into one of three different levels depending on the observation of the inputs used in the measurement.

For the 2015 and 2014 fiscal periods, the Company has carried at fair value financial instruments in Level 1. At December 31, 2015, the Company's only financial instruments are cash which are considered to be Level 1 instruments. There were no transfers between levels during the year.

The three levels are defined as follows:

- Level 1: Fair value is based on unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2: Fair value is based on inputs other than quoted prices included within Level 1 that are not observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: Fair value is based on valuation techniques that require one or more significant unobservable inputs.

23. SEGMENTED INFORMATION

The Company operates in two industries: the development, manufacturing and distribution of cell based products and technology and, provision of facility, technical and production personnel for contract research and development. External revenue by segment is attributed to geographic regions based on the location of customers: North America, Europe and Other foreign countries. The following is an analysis of the Company's revenue and results from continuing operations by reportable segment for the three months ended December 31:

	Segment revenue		Segment profit	
	Dec 31, 2015	Dec 31, 2014	Dec 31, 2015	Dec 31, 2014
	\$	\$	\$	\$
Virology Products and Technologies	1,063,405	1,995,833	(338,420)	1,940
Lumisort TM	-	-	-	-
Kinlytic [®]	-	-	-	-
Total for continuing operations	1,063,405	1,995,833	(338,420)	1,940

Segment revenue reported above represents revenue generated from external customers. There were no inter-segment sales in the current period (2014 - \$Nil).

The accounting policies of the reportable segments are the same as the Company's accounting policies described in Note 3. Segment profit represents the profit before tax earned by each segment without allocation of central administration costs and directors' salaries, share of profits of associates, gain recognised on disposal of interest in former associate, investment income, other gains and losses as well as finance costs. This is the measure reported to the chief operating decision maker for the purposes of resource allocation and assessment of segment performance.

Segmented assets and liabilities as at December 31 are as follows:

	Segment assets		Segment liabilities	
	Dec 31, 2015	Dec 31, 2014	Dec 31, 2015	Dec 31, 2014
	\$	\$	\$	\$
Virology Products and Technologies	13,770,412	11,107,797	8,802,528	8,351,561
Lumisort TM	6,991,978	4,120,602	775,384	1,518,487
Kinlytic [®]	2,770,529	2,770,529	-	-
Total for continuing operations	23,532,918	17,998,928	9,577,913	9,870,048

All assets are allocated to reportable segments other than interests in associates and current and deferred tax assets. Assets used jointly by reportable segments are allocated on the basis of the revenues earned by individual reportable segments. All liabilities are allocated to reportable segments other than borrowings and current and deferred tax liabilities. Liabilities for which reportable segments are jointly liable are allocated in proportion to segment assets.

23. SEGMENTED INFORMATION (continued)

Segmented depreciation and amortization and additions to non-current assets as at December 31 are as follows:

	Depreciation and amortization		Additions to non-current assets	
	Dec 31, 2015	Dec 31, 2014	Dec 31, 2015	Dec 31, 2014
	\$	\$	\$	\$
Virology Products and Technologies	78,136	77,880	478,282	148,492
Lumisort TM	23,644	23,644	198,502	1,011,814
Kinlytic [®]	-	-	-	-
Total for continuing operations	101,780	101,524	676,784	1,160,306

24. GEOGRAPHIC INFORMATION

The Company operates in three principal geographical areas – North America (country of domicile), Europe and in other foreign countries. The Company's revenue from continuing operations from external customers by location of operations and information about its non-current assets by location of assets are detailed below.

	Revenue from external customers		Non-current assets	
	Dec 31, 2015	Dec 31, 2014	Dec 31, 2015	Dec 31, 2014
	\$	\$	\$	\$
North America	311,587	263,985	18,423,804	14,360,999
Europe	610,540	1,694,994	-	-
Other foreign countries	141,278	36,854	-	-
	1,063,405	8,396,796	18,423,804	13,291,902

25. RELATED PARTY TRANSACTIONS
Key Management Compensation

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company. Key management includes four directors, of which three are executive officers. Compensation for the Company's key management personnel was as follows:

	Three months ended 2015	Three months ended 2014
	\$	\$
Short-term wages, bonuses and benefits	189,055	189,055
Termination benefits	-	-
Share based payments	-	-
Total key management compensation	189,055	189,055

26. COMMITMENTS AND CONTINGENCIES*Lease commitments*

	Amount
	\$
2016	25,822
2017	6,817
2018	6,082
2019	3,096
2020	-
	<u>41,817</u>

Lease commitments

	Amount
	\$
2016	1,186,742
2017	111,742
2018	604,242
2019	604,242
2020	604,242
2021 and thereafter	8,793,831
	<u>11,905,041</u>

Contingencies

The Company is party to legal proceedings arising out of the normal course of business. The results of these litigations cannot be predicted with certainty, and management is of the opinion that the outcome of these proceedings is not determinable. Any loss resulting from these proceedings will be charged to operations in the period when the loss becomes probable to occur and reasonably measurable.

MICROBIX

DIRECTORS

Peter M. Blecher
Ontario, Canada
Staff Emergency Physician
Lakeridge Health Hospital

Mark A. Cochran
Virginia, USA
Managing Director
Johns Hopkins Medicine

Vaughn C. Embro-Pantalony ^{(1) (2)}
Ontario, Canada
Chief Executive Officer and President
Microbix Biosystems Inc.

William J. Gastle ⁽²⁾
Ontario, Canada
Executive Chairman
Microbix Biosystems Inc.

Cameron Groome ⁽¹⁾
Ontario, Canada
Pharmaceutical Executive

Martin A. Marino ^{(1) (2)}
Ontario, Canada
Pharmaceutical Executive

Andrew C. Pollock ^{(1) (2)}
Ontario, Canada
Marketing Executive

Joseph D. Renner ⁽²⁾
New Jersey, USA
Pharmaceutical Executive

⁽¹⁾Member of Audit Committee.

⁽²⁾Member of the Human Resources,
Compensation and Governance Committee.

CORPORATE INFORMATION

Corporate Counsel *Boyle & Co. LLP*

Auditors *Collins Barrow Toronto LLP
Chartered Accountants*

Transfer Agent *Canadian Stock Transfer Company Inc.
as the Administrative Agent for
CIBC Mellon Trust Company
416-682-3860 1-800-387-0825*

Bankers *Bank of Montreal*

Head Office *Microbix Biosystems Inc.
265 Watline Avenue, Mississauga,
Ontario Canada L4Z 1P3
Tel: 905-361-8910
Fax: 905-361-8911
www.microbix.com*

NOTICE OF ANNUAL MEETING

The Annual Meeting of the Shareholders will be held
at the University Club, 380 University Avenue, Toronto,
Ontario on Wednesday, April 6, 2016 at 1:00 PM.

SENIOR MANAGEMENT

William J. Gastle
Executive Chairman

Vaughn C. Embro-Pantalony
President and Chief Executive Officer

Charles S. Wallace
Chief Financial Officer

Dr. Mark Luscher
Senior Vice-President, Scientific Affairs

Phillip Casselli
Senior Vice-President, Sales & Business Development

Kevin J. Cassidy
Vice President, Biopharmaceuticals

Christopher B. Lobb
General Counsel & Secretary



265 Watline Avenue,
Mississauga, ON
Canada L4Z 1P3
Tel: 905-361-8910
Fax: 905-361-8911
1-800-794-6694
Web Site: www.microbix.com