

Interim Condensed Consolidated Financial Statements of

ESPIAL GROUP INC.

Quarters ended June 30, 2016 and 2015

(Unaudited)

ESPIAL GROUP INC.
Interim Condensed Consolidated Financial Statements
For the Quarters ended June 30, 2016 and 2015

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ESPIAL GROUP INC.

Interim Condensed Consolidated Balance Sheets

(In Canadian Dollars)

(Unaudited)

	June 30, 2016	December 31, 2015
CURRENT ASSETS		
Cash and cash equivalents	\$ 45,734,745	\$ 49,947,096
Accounts receivable	7,120,369	8,397,948
Investment tax credits receivable	573,396	413,920
Prepaid expenses and other assets	652,973	734,906
	54,081,483	59,493,870
Equipment (Note 6)	1,186,548	1,062,544
Intangible assets (Note 6)	1,434,373	1,658,610
Goodwill (Note 6)	3,632,604	3,632,604
	\$ 60,335,008	\$ 65,847,628
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 2,765,718	\$ 3,165,144
Deferred revenue	2,700,827	3,690,638
Total Liabilities	5,466,545	6,855,782
COMMITMENTS (Note 8)		
SHAREHOLDERS' EQUITY		
Share capital (Note 4)	126,611,309	126,583,844
Share based payments reserve	14,822,466	14,059,806
Deficit	(86,565,312)	(81,651,804)
	54,868,463	58,991,846
	\$ 60,335,008	\$ 65,847,628

APPROVED BY THE BOARD



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See accompanying notes



Peter Seeligsohn

ESPIAL GROUP INC.

Interim Condensed Consolidated Statements of Income and Loss and Comprehensive Income and Loss

(In Canadian Dollars)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Revenue				
Software	\$ 2,499,924	\$ 1,709,951	\$ 4,940,663	\$ 4,122,978
Professional services	776,708	2,700,101	2,448,733	4,572,807
Support and maintenance	1,272,138	1,090,203	2,483,356	2,220,347
Total revenue	4,548,770	5,500,255	9,872,752	10,916,132
Cost of revenue	1,242,571	1,472,712	3,171,554	2,642,099
Gross margin	3,306,199	4,027,543	6,701,198	8,274,033
Expenses				
Sales and marketing	1,417,853	1,202,748	2,682,296	2,348,834
General and administrative	1,005,962	902,947	1,870,710	1,692,988
Research and development	3,440,721	2,028,129	6,330,937	3,921,400
Amortization of intangible assets	174,683	168,442	349,366	329,662
	6,039,219	4,302,266	11,233,309	8,292,884
Loss before other income (expense)	(2,733,020)	(274,723)	(4,532,111)	(18,851)
Interest income	85,216	88,586	171,948	124,976
Foreign exchange gain (loss)	(212,132)	1,750	(435,682)	105,506
Income (loss) before taxes	(2,859,936)	(184,387)	(4,795,845)	211,631
Income tax expense	(86,040)	(93,448)	(117,663)	(130,241)
Net income (loss) and comprehensive income (loss)	\$ (2,945,976)	\$ (277,835)	\$ (4,913,508)	\$ 81,390
Income (loss) per common share - basic	\$ (0.08)	\$ (0.01)	\$ (0.13)	\$0.00
Weighted average number of common shares outstanding - basic (Note 5)	37,362,471	32,747,824	37,358,859	29,944,872
Income (loss) per common share - diluted	\$ (0.08)	\$ (0.01)	\$ (0.13)	\$0.00
Weighted average number of common shares outstanding - diluted (Note 5)	37,362,471	32,747,824	37,358,859	31,721,566
See accompanying notes				

ESPIAL GROUP INC.

Interim Condensed Consolidated Statements of Cash Flows

(In Canadian Dollars)
(Unaudited)

	Six Months Ended	
	June 30, 2016	June 30, 2015
CASH (USED IN) PROVIDED BY OPERATING		
Net (loss) income	\$ (4,913,508)	\$ 81,390
Items not affecting cash		
Depreciation of property and equipment	148,613	99,413
Amortization of intangible assets	349,366	329,662
Share-based compensation expense	774,919	746,280
Provisions	-	(83,913)
	(3,640,610)	1,172,832
Changes in non-cash operating working capital items (Note 7)	(189,201)	(2,559,744)
	(3,829,811)	(1,386,912)
INVESTING		
Purchase of equipment	(272,617)	(77,848)
Purchase of intangibles	(125,129)	(42,629)
Purchase of business, net of cash acquired	-	(1,806,453)
	(397,746)	(1,926,930)
FINANCING		
Proceeds from options exercised	15,206	365,845
Proceeds from warrants exercised	-	350,988
Proceeds from equity financing	-	35,000,000
Costs of share issuance	-	(2,383,312)
	15,206	33,333,521
Cash and cash equivalents (outflow) inflow	(4,212,351)	30,019,679
Cash and cash equivalents, beginning of period	49,947,096	18,111,324
Cash and cash equivalents, end of period	\$ 45,734,745	\$ 48,131,003
Supplementary information:		
Interest received	\$ 171,948	\$ 136,251
Taxes paid	\$ (117,663)	\$(130,241)

See accompanying notes

ESPIAL GROUP INC.

Interim Condensed Consolidated Statements of Shareholders' Equity

(In Canadian Dollars, except share amounts)
(Unaudited)

	Common Shares			Share-based payment reserve	(Deficit)	Shareholders' Equity
	Number	Amount	Warrants			
Balance at December 31, 2014	26,886,267	\$91,072,570	\$928,063	\$12,986,590	(\$82,923,812)	\$22,063,411
Share-based compensation	-	-	-	320,863	-	320,863
Warrants exercised	100,000	101,864	(29,864)	-	-	72,000
Options exercised	378,180	489,863	-	(219,309)	-	270,554
Net and comprehensive income	-	-	-	-	359,225	359,225
Balance at March 31, 2015	27,364,447	\$91,664,297	\$898,199	\$13,088,144	(\$82,564,587)	\$23,086,053
Share-based compensation	-	-	-	425,417	-	425,417
Proceeds from share issuance	8,750,000	32,616,688	-	-	-	32,616,688
Warrants exercised	172,627	412,478	(133,490)	-	-	278,988
Options exercised	101,027	172,332	-	(77,041)	-	95,291
Net and comprehensive loss	-	-	-	-	(277,835)	(277,835)
Balance at June 30, 2015	36,388,101	\$124,865,795	\$764,709	\$13,436,520	(\$82,842,422)	\$56,224,602
Balance at December 31, 2015	37,348,057	\$126,583,844	\$ -	\$14,059,806	(\$81,651,804)	\$58,991,846
Share-based compensation	-	-	-	389,456	-	389,456
Options exercised (Note 4)	10,458	17,030	-	(7,600)	-	9,430
Net and comprehensive loss	-	-	-	-	(1,967,532)	(1,967,532)
Balance at March 31, 2016	37,358,515	\$126,600,874	\$ -	\$14,441,662	(\$83,619,336)	\$57,423,200
Share-based compensation	-	-	-	385,463	-	385,463
Options exercised (Note 4)	9,729	10,435	-	(4,659)	-	5,776
Net and comprehensive loss	-	-	-	-	(2,945,976)	(2,945,976)
Balance at June 30, 2016	37,368,244	\$126,611,309	\$ -	\$14,822,466	(\$86,565,312)	\$54,868,463

See accompanying notes

ESPIAL GROUP INC.

Notes to Interim Condensed Consolidated Financial Statements

for the three and six months ended June 30, 2016 and 2015 (unaudited)
(In Canadian Dollars, except share amounts)

1. DESCRIPTION OF BUSINESS

Espial Group Inc. (“Espial” or the “Company”) develops set top box (“STB”) and multiscreen client software solutions as well as back-office TV delivery systems for TV service providers and Smart TV manufacturers, using HTML5 as a key ingredient in high performance, cloud based TV user experiences. Leveraging open standards, including HTML5 and the RDK stack, Espial client solutions deliver exceptional user experiences with fast performance, elegant design and ease-of-use on STBs and Smart TV’s. This allows customers to reinvent their business model by providing consumers powerful interfaces that enable rich user experiences, innovative new Web services, TV programming, On-Demand content, and service provider apps.

The Company’s address and principal place of business is 200 Elgin Street, Suite 1000, Ottawa, Ontario, K2P 1L5, Canada.

2. BASIS OF PRESENTATION

(a) Statement of Compliance

The unaudited interim condensed consolidated financial statements have been prepared in accordance with International Accounting Standards (“IAS”) 34 *Interim Financial Reporting as issued by the International Accounting Standards Board (“IASB”)* and do not include all information required for full annual financial statements for International Financial Reporting Standards (“IFRS”). These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes included in the Annual Report for the year ended December 31, 2015 and were prepared using the same accounting policies, except as described below.

These unaudited interim condensed consolidated financial statements were approved and authorised for issue by the Board of Directors on, August 3, 2016.

(b) Basis of Measurement

These unaudited interim condensed consolidated statements have been prepared on a historical cost basis. The policies were consistently applied to all the periods presented unless otherwise noted. All figures presented in the interim condensed consolidated financial statements and tabular disclosures to the interim condensed consolidated financial statements are reflected in Canadian dollars, which is the functional currency of the Company and each of its subsidiaries.

(c) Basis of Consolidation

These interim condensed consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its wholly owned subsidiaries), Espial Inc., Espial DE, Inc, Espial (UK) Limited, Espial SAS, Espial Group Limited and Espial Limited. All intercompany balances and revenue and expense transactions have been eliminated on consolidation.

(d) Significant Accounting Policies

Except as disclosed below, the accounting policies applied in these unaudited interim condensed consolidated financial statements are the same as those applied in the Company’s consolidated financial statements as at and for the year ended December 31, 2015.

ESPIAL GROUP INC.

Notes to Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2016 and 2015 (unaudited) (In Canadian Dollars, except share amounts)

3. NEW AND REVISED IFRS ACCOUNTING PRONOUNCEMENTS

The following is a list of standards and amendments that have been issued but not yet adopted by the Company.

IFRS 15: Revenue from Contracts with Customers

In April 2016, the International Accounting Standards Board issued narrow scope amendments to IFRS 15 Revenue from Contracts with Customers. The amendments clarify how to identify a performance obligation (the promise to transfer a good or a service to a customer) in a contract. They also help determine whether a company is a principal (the provider of a good or service) or an agent (responsible for arranging for the good or service to be provided); and determine whether the revenue from granting a license should be recognized at a point in time or over time. In addition to the clarifications, the amendments include two additional reliefs to reduce cost and complexity for a company when it first applies the new Standard. Similar to the standard, the prospective application date of these amendments is for annual periods beginning on or after January 1, 2018. Early adoption is allowed. The Company does not intend to adopt these amendments in fiscal 2016 and is currently evaluating the impact of adoption of these amendments on the consolidated financial statements.

IFRS 2: Share Based Payment

In June 2016, the International Accounting Standards Board issued amendments to IFRS 2 Share-based Payment. The amendments, which were developed through the IFRS Interpretations Committee, provide requirements on the accounting for the effects of vesting and non-vesting conditions on the measurement of cash-settled share-based payments. They also provide guidance on the accounting for share-based payment transactions with a net settlement feature for withholding tax obligations; and a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled. These amendments are to be applied prospectively for annual periods beginning on or after January 1, 2018. Early adoption is allowed and specific transitional provisions apply. The Company does not intend to adopt these amendments in fiscal 2016 and is currently evaluating the impact of adoption of these amendments on the consolidated financial statements.

4. SHARE CAPITAL

Share capital consists of an unlimited number of common shares of which 37,368,244 common shares were issued and outstanding at June 30, 2016 (December 31, 2015 – 37,348,057).

Stock option plans

As at June 30, 2016, there were 2,802,162 options for common shares remaining available for issuance under the 2007 option plan. Options are granted periodically and vest over four years. One quarter of the options vest after 12 months and the remainder vest in thirty-six equal tranches over the three years thereafter. The maximum term of these options is ten years. The Company uses the Black-Scholes option pricing model to value the options at the time of grant.

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Notes to Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2016 and 2015 (unaudited) (In Canadian Dollars, except share amounts)

Management periodically reviews the estimates used for calculating the fair value of options, volatility is calculated at the time of option grant using historical share price trading activity, ranging from 71% to 91%; risk-free interest rate is based on the government of Canada bond rate, estimated at 0.66% at the time of issue; dividend yield is NIL%; expected life of each option is 1.5 years after vesting. The forfeiture rate was estimated at 10%.

During the three months ended June 30, 2016, there were 5,000 options granted. The per share fair value of stock options granted during the three months ended June 30, 2016 was \$1.34. During the six months ended June 30, 2016, there were 700,000 options granted. The per share fair value of stock options granted during the six month period ended June 30, 2016 was \$1.20

The following table summarizes information about option activity for the six months ended June 30, 2016 and for the year ended December 31, 2015.

	Number of Options	Weighted-average Exercise Price
Outstanding, at December 31, 2015	4,012,119	\$2.25
Granted	695,000	\$1.99
Exercised	(10,458)	\$0.90
Forfeited	(17,917)	\$2.62
Outstanding, at March 31, 2016	4,678,744	\$2.22
Granted	5,000	\$2.21
Exercised	(9,729)	\$0.59
Forfeited	(2,528)	\$1.32
Outstanding, at June 30, 2016	4,671,487	\$2.22

	Number of Options	Weighted-average Exercise Price
Outstanding, at December 31, 2014	3,508,000	\$1.78
Granted	1,047,500	\$2.96
Exercised	(491,425)	\$0.77
Forfeited	(51,956)	\$2.05
Outstanding, at December 31, 2015	4,012,119	\$2.25

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Notes to Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2016 and 2015 (unaudited) (In Canadian Dollars, except share amounts)

The following table summarizes information about stock options outstanding at June 30, 2016:

Range of Exercise Prices	Options Outstanding		Options Exercisable	
	Number Outstanding	Weighted Average Remaining Life	Number Outstanding	Weighted Average Exercise Price
\$0.26 - \$1.00	1,360,169	4.2	1,299,850	\$0.85
\$1.01 - \$2.00	894,500	8.6	146,996	\$1.63
\$2.01 - \$4.00	2,299,539	8.1	937,140	\$2.92
\$4.01 - \$7.00	107,847	1.5	107,847	\$6.75
	4,671,487	6.9	2,491,833	\$1.93

5. EARNINGS (LOSS) PER SHARE

The following table summarized the calculation of the weighted average number of basic and diluted common shares for the three and six months ended June 30:

Three months ended June 30	2016	2015
Issued common shares at April 1	37,358,515	27,364,447
Effect of shares issued from share offering	-	5,230,978
Effect of shares issued from warrants	-	130,557
Effect of shares issued from options	3,956	21,842
Weighted average number of basic and diluted common shares at June 30	37,362,471	32,747,824

Options that are anti-dilutive are not included in the computation of diluted earnings per share. For the three months ended June 30, 2016 and 2015, due to the net losses, all options were excluded from the calculation of diluted earnings per share because they are anti-dilutive.

Six months ended June 30,	2016	2015
Issued common shares at January 1	37,348,057	26,886,267
Effect of shares issued from share offering	-	2,658,840
Effect of shares issued from warrants	-	135,421
Effect of shares issued from options	10,802	264,344
Weighted average number of basic common shares at June 30	37,358,859	29,944,872
Effect of warrants on issue	-	654,015
Effect of share options on issue	-	1,122,679
Weighted average number of diluted common shares at June 30	37,358,859	31,721,566

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Notes to Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2016 and 2015 (unaudited) (In Canadian Dollars, except share amounts)

For the six months ended June 30, 2016, due to the net loss, all options were excluded from the calculation of diluted earnings per share because they are anti-dilutive. For the six months ended June 30, 2015, 312,899 stock options were excluded from the calculation of diluted earnings per share because they are anti-dilutive.

6. SEGMENTED INFORMATION

The Company operates in one operating segment: computer software solutions. The Company engages in business activities from which it earns license, support and professional services revenues and incurs expenses.

Revenues from external customers are attributed to geographic areas based on the location of the contracting customers. The following table sets forth external revenue by geographic areas:

	Three months ended		Six months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Europe	\$ 3,006,557	\$ 3,393,826	\$ 6,413,737	\$ 6,306,906
Asia Pacific	854,997	528,631	1,968,017	1,689,909
North America	687,216	1,577,798	1,490,998	2,919,317
	\$ 4,548,770	\$ 5,500,255	\$ 9,872,752	\$ 10,916,132

For the three months ended June 30, 2016, the Company had two customers that individually accounted for 20% and 17% of revenue. For the three months ended June 30, 2015, the Company had two customers that individually accounted for 23% and 21% of revenue. For the six months ended June 30, 2016, the Company had two customers that individually accounted for 23% and 14% of revenue and for the six months ended June 30, 2015, the Company had two customers that individually accounted for 21% and 16% of revenue. As at June 30, 2016 three customers accounted for 35%, 30% and 8% of accounts receivable.

As at December 31, 2015 three customers accounted for 24%, 13% and 11% respectively of accounts receivable.

The following table sets forth property and equipment attributable to Canada (the Company's country of domicile), the United States, the United Kingdom and France. The four regions hold all of the Company's equipment.

	June 30, 2016	December 31, 2015
Canada	\$885,763	\$788,634
United States	82,537	94,183
United Kingdom	197,886	157,644
France	20,362	22,083
	\$1,186,548	\$1,062,544

The following table sets forth intangible assets attributable to Canada (the Company's country of domicile), the United States and the United Kingdom. The three regions hold all of the Company's intangible assets.

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Notes to Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2016 and 2015 (unaudited) (In Canadian Dollars, except share amounts)

	June 30, 2016	December 31, 2015
Canada	\$ 683,625	\$ 681,310
United States	1,660	1,953
United Kingdom	749,088	975,347
	<u>\$ 1,434,373</u>	<u>\$ 1,658,610</u>

The goodwill of \$3,632,605 is attributable to Canada, \$291,796, and the United States \$3,340,808.

7. CHANGES IN NON-CASH OPERATING WORKING CAPITAL ITEMS

	Six months	
	June 30, 2016	June 30, 2015
Accounts receivable	\$ 1,277,579	\$ (1,289,920)
Investment tax credits receivable	(159,476)	(150,938)
Prepaid expenses and other assets	81,933	(79,820)
Accounts payable and accrued liabilities	(399,426)	(542,999)
Deferred revenue	(989,811)	(496,067)
	<u>\$ (189,201)</u>	<u>\$ (2,559,744)</u>

8. COMMITMENTS

The Company has entered into several operating leases for office space and various equipment leases. The Company rents premises in Canada, the United States and the United Kingdom under operating leases, which expire at varying dates up to June 2024. The lease agreements provide for base rent plus the Company's proportionate share of taxes and operating costs. The leases do not contain contingent rent clauses, purchase options, escalation clauses, or any restrictions regarding further leasing or additional debt.

The equipment leases are all for periods of three years or less, contain purchase options at fair value at termination of lease, do not contain any contingent rent clauses, escalation clauses, any restrictions regarding dividends, further leasing or additional debt.

The Company's minimum lease commitments over the remaining life of the leases are as follows:

2016	\$ 438,236
2017	799,410
2018	784,211
2019	785,916
2020 to 2024	<u>3,274,978</u>
	<u>\$6,082,751</u>

Lease payments recognized as an expense during the three month periods ended June 30, 2016 and 2015 were \$366,375 and \$250,782 respectively. Lease payments recognized as an expense

ESPIAL GROUP INC.

Notes to Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2016 and 2015 (unaudited) (In Canadian Dollars, except share amounts)

during the six month periods ended June 30, 2016 and 2015 were \$594,689 and \$445,017 respectively.

9. EMPLOYEE BENEFITS EXPENSE

The following table presents the employee benefits earned by the employees during the periods noted below:

	Three Months ended		Six Months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Salaries	\$ 3,387,894	\$ 2,706,105	\$ 6,652,538	\$ 5,209,334
Benefits	617,489	423,517	1,294,968	862,770
Variable compensation and other labour costs	480,242	439,095	725,042	762,554
Share based payments	385,463	425,417	774,919	746,280
	\$ 4,871,088	\$ 3,994,134	\$ 9,447,467	\$ 7,580,938

The following table presents the share-based compensation expense by function during the periods noted below:

	Three Months ended		Six Months ended	
	June 30, 2016	June 30, 2015	June 30, 2016	June 30, 2015
Sales and marketing	\$ 90,479	\$ 65,710	\$ 175,057	\$ 92,908
General and administration	222,916	289,737	451,492	548,440
Research and development	72,068	69,970	148,370	104,932
	\$ 385,463	\$ 425,417	\$ 774,919	\$ 746,280

10. SUBSEQUENT EVENT

On June 29, 2016 the Company entered into an agreement pursuant to which Espial will acquire certain assets of ARRIS Group related to the business of developing, distributing, and supporting the software products marketed to multiple system operators as the Whole Home Solution ("WHS"). The WHS is comprised of a cloud-hosted software to TV service provider customers, client software incorporated into various set-top-boxes and gateways, and client software licensed for download onto PC browsers and IOS and Android smart phones and tablets for use in connection with the WHS system.

The proposed acquisition of WHS will expand the Company's solution portfolio with a cloud-hosted Video-as-a-Service platform that is complimentary to and will leverage Espial's current solutions for next-generation IP video services. Additionally, the Company will gain a broad base

ESPIAL GROUP INC.

Notes to Interim Condensed Consolidated Financial Statements for the three and six months ended June 30, 2016 and 2015 (unaudited) (In Canadian Dollars, except share amounts)

of new customer relationships and further scales its integration, operations, and software development teams.

The acquisition will be accounted for using the acquisition method of accounting, whereby the results of operations of the acquired assets are included in the Company's consolidated financial statement from the acquisition date and the related identifiable assets acquired and liabilities assumed are recorded at their fair values on the date of acquisition. The purchase price is estimated to be \$1.00 plus working capital and other possible adjustments. The actual purchase price, and allocation of the purchase price, will be finalized later in fiscal year 2016 as additional information such as the allocation to the net assets acquired becomes available.