Adastra

Adastra Labs Holdings Ltd.
(formerly Arrowstar Resources Ltd.)

Consolidated Financial Statements

For the period ended December 31, 2019 and for the period from incorporation on June 18, 2019 to April 30, 2019

(Expressed in Canadian Dollars)

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
Adastra Labs Holdings Ltd.

Opinion

We have audited the accompanying consolidated financial statements of Adastra Labs Holdings Ltd. (the "Company"), which comprise the consolidated statement of financial position as at December 31, 2019 and April 30, 2019, and the consolidated statements of loss and comprehensive loss, changes in equity, and cash flows for the eight months ended December 31, 2019, and the period from incorporation on June 18, 2018 to April 30, 2019, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2019 and April 30, 2019, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 1 of the consolidated financial statements, which indicates that the Company incurred net losses since inception and as of December 31, 2019, the Company's current liabilities exceeded its current assets by $471,084. As stated in Note 1, these events and conditions indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Other Information

Management is responsible for the other information. The other information obtained at the date of this auditor's report includes Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management’s Discussion and Analysis prior to the date of this auditor’s report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor’s report is Dylan Connelly.

“DAVIDSON & COMPANY LLP”

Vancouver, Canada

Chartered Professional Accountants

June 12, 2020

Consolidated Statements of Financial Position

As at December 31, 2019 and April 30, 2019

	Note	**December 31, 2019 $**	April 30, 2019 $
Assets			
Current assets			
Cash		2,376,826	2,362,494
Receivables and prepayments	4	461,167	36,965
Marketable securities	5	1,500	-
		2,839,493	2,399,459
Non-current assets			
Deposits	6	4,000	20,823
Property plant and equipment	6	8,507,517	3,834,236
		8,511,517	3,855,059
Total assets		**11,351,010**	6,254,518
Liabilities and equity			
Current liabilities			
Accounts payable and accrued liabilities		873,402	137,044
Mortgage Payable	12	2,437,175	2,407,463
		3,310,577	2,544,507
Non-current liabilities			
Convertible debenture	13	2,955,511	-
Total liabilities		**6,266,088**	2,544,507
Equity			
Share capital	7	8,348,407	4,614,000
Debenture reserves	13	298,461	-
Deficit		(3,561,946)	(903,989)
Total equity		**5,084,922**	3,710,011
Total liabilities and equity		**11,351,010**	6,254,518

Nature of operations and going concern	**1**
Events after the reporting period	**15**

Approved on behalf of the Board of Directors on June 12, 2020:

"Andrew Hale" **Director** *"Blaine Bailey"* **Director**

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

Adastra Labs Holdings Ltd. (formerly Arrowstar Resources Ltd.)

Consolidated Statements of Changes in Equity

For the years ended December 31, 2019 and April 30, 2019

	Number of shares	Share capital	Debenture Reserves	Deficit	Total equity
	#	$	$	$	$
Issuance of incorporation share	1	1	-	-	1
Cancellation of incorporation share	(1)	(1)	-	-	(1)
Shares issued for cash - private placements	81,138,333	4,614,000	-	-	4,614,000
Loss and comprehensive loss	-	-	-	(903,989)	(903,989)
April 30, 2019	81,138,333	4,614,000	-	(903,989)	3,710,011
May 1, 2019	81,138,333	4,614,000	-	(903,989)	3,710,011
Convertible debenture - pre RTO	-	-	298,461	-	298,461
Reverse acquisition transaction (Note 3):					
Issuance of shares pursuant to reverse acquisition	21,656,034	1,082,802	-	-	1,082,802
Private placement units issued	5,892,455	2,651,605	-	-	2,651,605
Loss and comprehensive loss	-	-	-	(2,657,957)	(2,657,957)
December 31, 2019	**108,686,822**	**8,348,407**	**298,461**	**(3,561,946)**	**5,084,922**

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

	Note	For the eight months ended December 31, 2019 $	For the period from incorporation on June 18, 2018 to April 30, 2019 $
Expenses			
Advertising and promotion		56,817	-
Accretion	13	13,259	12,218
Depreciation	6	78,172	51,974
Insurance		18,820	3,867
Management fees	9	-	39,638
Office expeses		179,938	114,424
Professonal fees and consulting	9	447,784	253,860
Rent		10,806	29,029
Research expenses		-	4,336
Travel		20,273	40,001
Wages and salaries	9	302,513	300,267
Loss from operating expenses		**(1,128,382)**	(849,614)
Interest expense	12,13	(227,955)	(63,165)
Interest income		7,764	8,790
Listing expense	3	(1,309,384)	-
Loss and comprehensive loss for the year		**(2,657,957)**	(903,989)
Loss per share			
Weighted average number of common shares outstanding			
- basic #	**8**	**82,487,647**	13,265,014
- diluted #	**8**	**82,487,647**	13,265,014
Basic loss per share $	**8**	(0.03)	(0.07)
Diluted loss per share $	**8**	(0.03)	(0.07)

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

Consolidated Statements of Cash Flows

	Note	For the eight months ended December 31, 2019	For the period from incorporation on June 18, 2018 to April 30, 2019
Operating activities			
Loss and comprehensive loss for the year		(2,657,957)	(903,989)
Adjustments for non-cash items:			
Depreciation		78,172	51,974
Accretion		13,259	12,218
Interest expense		227,955	63,165
Interest income		(7,764)	(8,790)
Listing expense		1,309,384	-
Net change in non-cash working capital items	11	(396,493)	100,079
		(1,433,444)	(685,343)
Financing activities			
Issue of units for cash		2,651,605	4,614,000
Proceeds - mortgage		-	2,446,000
Borrowing costs mortgage		-	(50,755)
Interest paid - mortgage		(134,530)	(63,165)
Convertible debenture		3,177,000	-
		5,694,075	6,946,080
Investing activities			
Acquisition property plant and equipment		(4,365,559)	(3,886,210)
Equipment deposits		-	(20,823)
Interest income		7,764	8,790
Cash acquired on reverse acquisition		111,496	-
		(4,246,299)	(3,898,243)
Net increase in cash and cash equivalents		14,332	2,362,494
Cash, beginning of year		2,362,494	-
Cash, end of year		**2,376,826**	2,362,494
Supplemental cash flow information	11		

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

1. Nature of operations and going concern

Adastra Labs Holdings Ltd. (formerly Arrowstar Resources Ltd.) (the "Company" or "Arrowstar") was incorporated under the laws of the province of British Columbia on October 14, 1987. The Company changed its name to Adastra Labs Holdings Ltd., on December 19, 2019. The Company is an extraction and processing solutions company. The Company's mission is to develop and deploy large-scale cannabis and hemp extraction technologies and provide turn-key processing solutions to help licensed standard and micro-cultivators maximize the value of every harvest. The Company is listed on the Canadian Securities Exchange ("CSE") under the symbol "XTRX".

The Company's registered and records office is 5451 275th Street, Langley City, British Columbia, V4W 3X8.

On October 19, 2019, Health Canada issued a Analytical testing license on the Company's facility to Chemia Analytics Inc., ("Chemia"). Chemia is a wholly owned subsidiary of the Company. Subsequent to year end, Health Canada issued a Standard Processing License on the Company's facility to Adastra labs Inc., ("Labs"). Labs is a wholly owned subsidiary of the Company.

On December 20, 2019, Arrowstar acquired all of the issued and outstanding common shares of Adastra Labs Holdings (2019) Ltd. ("Adastra") a private British Columbia cannabis extraction and processing solutions company incorporated on June 18, 2018. The acquisition was completed by entering into a share exchange agreement whereby the parties completed a business combination by way of a transaction that constituted a reverse takeover ("RTO") of the Company by Adastra (the "Transaction"). The Transaction was accounted for as an RTO of Arrowstar by Adastra for accounting purposes, with Adastra being identified as the accounting acquirer, and accordingly, these financial statements are a continuation of Adastra. The net assets of Arrowstar at the date of the RTO are deemed to have been acquired by Adastra (Note 3). These consolidated financial statements (the "financial statements") include the results of operations of Arrowstar since December 20, 2019. The comparative figures are those of Adastra prior to the RTO. At the time of the transaction the Company changed its financial year end from April 30 to December 31.

These financial statements are prepared on the basis that the Company will continue as a going concern, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of operations. These financial statements do not include any adjustments relating to the recoverability and classification of assets and liabilities that might be necessary should the Company be unable to continue in existence.

The Company's ability to continue as a going concern is dependent on its ability to generate positive cash flows from operations, complete additional financings, and/or extend or modify its mortgage payable (note 12).

As at December 31, 2019, the Company had a working capital deficit of $471,084 (April 30, 2019 - $145,048) and has incurred losses since inception. These events and conditions indicate a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. If the going concern assumption were not appropriate for these financial statements it could be necessary to restate the Company's assets and liabilities on a liquidation basis.

2. Significant accounting policies

(a) Basis of presentation

These financial statements have been prepared in accordance with International Financial Reporting Standards and Interpretations (collectively, "IFRS"), as issued by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC") and have been applied consistently by the Company and its subsidiaries.

These financial statements have been prepared on an historical cost basis, except for financial instruments which are classified as fair value through profit or loss ("FVTPL"). In addition, these financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

All amounts on these financial statements are presented in Canadian dollars which is the functional currency of the Company and its subsidiaries (note 2(b)).

2. Significant accounting policies (continued)

(b) Principles of consolidation

These financial statements include the financial information of the Company and its subsidiaries.

The financial statements include the following entities:

Adastra Labs Holdings Ltd. (formerly Arrowstar Resources Ltd.)	Legal parent company
Adastra Labs Holdings (2019) Ltd. (formerly Adastra Labs Holdings Ltd.)	Holding company
Adastra Labs Inc.	Extraction and concentrates production company
Chemia Analytics Inc.	Cannabis testing an analysis laboratory company
1178562 B.C. Ltd.	Facility owner
Adastra Brands Inc.	Intellectual property company

Subsidiaries are entities controlled by the Company and are included in the financial statements from the date that control commences until the date that control ceases. The accounting policies of subsidiaries are changed where necessary to align them with the policies adopted by the Company.

These financial statements account for Arrowstar as a controlled entity (accounting acquiree) requiring consolidation since the date of the RTO (Notes 1 and 3), effective December 20, 2019.

(c) New accounting standards

The Company adopted the following accounting standards that are effective for accounting periods beginning on or after January 1, 2019:

<u>IFRS 16 - *Leases*</u>

IFRS 16 specifies how to recognize, measure, present and disclose leases. The new standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Consistent with its predecessor, IAS 17 the new lease standard continues to require lessors to classify leases as operating or finance. IFRS 16 is to be applied retrospectively for annual periods beginning on or after January 1, 2019.

The most significant effect of the new standard will be the lessee's recognition of the initial present value of unavoidable future lease payments as right-of-use ("ROU") assets and lease liabilities on the statement of financial position, including those for most leases that would formerly have been accounted for as operating leases.

The adoption of IFRS 16 requires the Company to make judgments that affect the valuation of the lease liability and the valuation of the ROU asset. These include determining contracts that are within the scope of IFRS 16; determining the contract term; and determining the interest rate used for the discounting of future cash flows.

The Company does not have any leases and accordingly, there was no impact to the Company's financial statements as a result of adopting this new standard.

<u>New Interpretation IFRIC 23 - *Uncertainty over Income Tax Treatments*</u>

On June 7, 2017, the IASB issued IFRIC Interpretation 23, *Uncertainty over Income Tax Treatments*. IFRIC 23 provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments.

There was no impact to the Company's financial statements as a result of adopting this new standard.

2. Significant accounting policies (continued)

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

The information about significant areas of estimation uncertainty considered by management in preparing these financial statements is as follows:

Acquisitions

Determination of whether a set of assets acquired and liabilities assumed constitute the acquisition of a business or asset requires the Company to make certain judgments as to whether or not the assets acquired and liabilities assumed include the inputs, processes and outputs necessary to constitute a business as defined in IFRS 3 – Business Combinations. If an acquired set of assets and liabilities includes goodwill, the set is presumed to be a business. Based on an assessment of relevant facts and circumstances, the Company concluded that the acquisition disclosed in Note 3 was acquisitions of assets. The values assigned to common shares and the allocation of the purchase price to the net liabilities in the acquisition are based on numerous estimates and judgements of the relative fair values of net liabilities.

Property, Plant and Equipment

The estimated useful lives of property plant and equipment are reviewed by management and adjusted if necessary. To estimate property, plant and equipment's useful life, management must use its past experience with the same or similar assets, review engineering estimates and industry practices for similar pieces of property, plant and equipment and/or apply statistical methods to assist in its determination of useful life. Additionally, management makes estimates with respect to the fair value of equipment acquired for non-monetary consideration. The Company assesses fair value by comparing market prices for similar types of property, plant and equipment.

The information about significant areas of judgment considered by management in preparing these financial statements is as follows:

Income taxes

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in profit or loss both in the period of change, which would include any impact on cumulative provisions, and in future periods. Deferred tax assets (if any) are recognized only to the extent it is considered probable that those assets will be recoverable. This involves an assessment of when those deferred tax assets are likely to reverse and a judgment as to whether or not there will be sufficient taxable profits available to offset the tax assets when they do reverse. This requires assumptions regarding future profitability and is therefore inherently uncertain. To the extent assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in respect of deferred tax assets as well as the amounts recognized in profit or loss in the period in which the change occurs.

Going concern

The assessment of the Company's ability to continue as a going concern as discussed in Note 1 involves judgment regarding future funding available for its operations and working capital requirements.

2. Significant accounting policies (continued)

Property, Plant and Equipment

Property, plant and equipment is measured at cost less accumulated depreciation and impairment losses. The cost of an item of property, plant and equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. No depreciation is recorded in the year of disposal.

Depreciation is recognized over the following terms, intended to depreciate the cost of property, plant and equipment, less its residual values if any, over its estimated useful lives:

Furniture and equipment	20% declining balance
Leasehold improvements	10 years straight line
Buildings	20 years straight line
Extraction equipment	20% declining balance
Laboratory equipment	20% declining balance
Computer software	20% declining balance

Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. Repairs and maintenance costs are charged to profit or loss during the period they are incurred. Any gain or loss on the disposal or retirement of equipment is recognized in profit or loss.

Share capital

Common shares are classified as shareholders' equity. Transaction costs directly attributable to the issue of common shares are recognized as a deduction from shareholders' equity. Common shares issued for consideration other than cash, are valued based on their market value at the date the shares are issued.

The Company has adopted a residual value method with respect to the measurement of warrants attached to private placement units. The residual value method first allocates value to the more easily measurable component based on fair value and then the residual value, if any, to the less easily measurable component. The Company considers the fair value of common shares issued in the private placements to be the more easily measurable component. The balance, if any, is allocated to the attached warrants. Any fair value attributed to the warrants is recorded as warrant reserve.

Share-based payment transactions

The Company has a stock option plan that provides for the granting of options to Officers, Directors, related company employees and consultants to acquire shares of the Company. The fair value of the options is measured on grant date and is recognized as an expense with a corresponding increase in contributed surplus as the options vest.

Options granted to employees and others providing similar services are measured at grant date at the fair value of the instruments issued. Fair value is determined using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted. The amount recognized as an expense is adjusted to reflect the actual number of share options that are expected to vest. Each tranche in an award with graded vesting is considered a separate grant with a different vesting date and fair value. Each grant is accounted for on that basis.

Options granted to non-employees are measured at the fair value of the goods or services received, unless that fair value cannot be estimated reliably, in which case the fair value of the equity instruments issued is used. The value of the goods or services is recorded at the earlier of the vesting date, or the date the goods or services are received.

Over the vesting period, share-based payments are recorded as an operating expense and as contributed surplus. When options are exercised the consideration received is recorded as share capital and the related share-based payments originally recorded as contributed surplus are transferred to share capital. When an option is cancelled or expires, the initial recorded value is reversed from contributed surplus and credited to deficit.

2. Significant accounting policies (continued)

Loss per share

Basic loss per share is computed by dividing the net loss attributable to common shareholders by the weighted average number of common shares outstanding during the reporting period.

Diluted loss per share is computed similar to basic loss per share except that (i) net loss attributable to common shareholders are adjusted for the dilutive effect of warrants and stock options. Under this method, the Company assumes that outstanding dilutive stock options and warrants were exercised and that the proceeds from such exercises (after adjustment of any unvested portion of stock options) were used to acquire common shares at the average market price during the reporting periods. For the period presented, diluted loss per share equals basic loss per share as there were no dilutive stock options or warrants outstanding.

Financial instruments

Effective June 18, 2018 (date of incorporation), the Company adopted IFRS 9, Financial Instruments (“IFRS 9”). IFRS 9 provides three different measurement categories for non-derivative financial assets – subsequently measured at amortized cost, fair value through profit or loss (“FVTPL”) or fair value through other comprehensive income – while all non-derivative financial liabilities are classified as subsequently measured at amortized cost. The category into which a financial asset is placed and the resultant accounting treatment is largely dependent on the nature of the business of the entity holding the financial asset. All financial instruments are initially recognized at fair value.

<u>Financial assets</u>

Measurement

The Company initially recognizes financial assets on the trade date, which is the date that the Company becomes a party to the contractual provisions of the instrument. The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred. Any interest in such transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability. The Company classifies all of its financial assets, except cash, as subsequently measured at amortized cost. Cash is classified as FVTPL. All financial assets that do not meet the criteria to be recognized as subsequently measured at amortized cost or subsequently measured at fair value through other comprehensive income are classified as FVTPL.

Impairment of financial assets at amortized cost

An ‘expected credit loss’ impairment model applies which requires a loss allowance to be recognized based on expected credit losses. The estimated present value of future cash flows associated with the asset is determined and an impairment loss is recognized for the difference between this amount and the carrying amount as follows: the carrying amount of the asset is reduced to estimated present value of the future cash flows associated with the asset, discounted at the financial asset’s original effective interest rate, either directly or through the use of an allowance account and the resulting loss is recognized in profit or loss for the period.

In a subsequent period, if the amount of the impairment loss related to financial assets measured at amortized cost decreases, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

<u>Financial liabilities</u>

The Company measures all of its financial liabilities as subsequently measured at amortized cost. Financial liabilities are recognized initially at fair value, net of transaction costs incurred, and are subsequently measured at amortized cost. Any difference between the amounts originally received, net of transaction costs, and the redemption value is recognized in profit and loss over the period to maturity using the effective interest method.

2. Significant accounting policies (continued)

Impairment of non-financial assets

The carrying amount of the Company's long-lived assets is reviewed for an indication of impairment at the end of each reporting period. If an indication of impairment exists, the Company makes an estimate of the asset's recoverable amount. Individual assets are grouped for impairment assessment purposes at the lowest level at which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets (cash generating units "CGU"). The recoverable amount of an asset group is the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows are adjusted for the risks specific to the CGU and are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money.

Where the carrying amount of an asset group exceeds its recoverable amount, the CGU is considered impaired and is written down to its recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated to reduce the carrying amounts of the assets in the CGU on a pro rata basis.

An assessment is made at each reporting date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognized.

Income taxes

Income tax comprises current and deferred income taxes. Current income tax and deferred income tax are recognized in profit or loss, except to the extent that they relate to items recognized directly in shareholders' equity.

Current income tax is the expected tax payable or receivable on the taxable profit or loss for the year, using tax rates enacted or substantively enacted at the reporting date, adjusted for any amendments to tax payable in respect of previous years.

Deferred income tax is provided for, based on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. The carrying amount of deferred income tax assets is reviewed at the end of each reporting period and recognized only to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists

to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

3. Reverse acquisition

As described in note 1, on December 20, 2019, Arrowstar and Adastra completed the Transaction which constituted a reverse acquisition.

The Transaction resulted in the shareholders of Adastra obtaining control of the combined entity by obtaining control of the voting rights, governance and management decision making processes, and the resulting power to govern the financial and operating policies of the combined entity.

The transaction constitutes an RTO of Arrowstar by Adastra and has been accounted for as a reverse acquisition transaction in accordance with the guidance provided in IFRS 2, *Share-based payments*. As Arrowstar did not qualify as a business according to the definition in IFRS 3, the RTO does not constitute a business combination; rather it is treated as an issuance of common shares by Adastra for the net assets of Arrowstar and Arrowstars public listing, with Adastra as the continuing entity. Accordingly, no goodwill was recorded with respect to the transaction as it does not constitute a business.

For accounting purposes, Adastra was treated as an accounting parent company (legal subsidiary) and Arrowstar has been treated as the accounting subsidiary (legal parent) in these financial statements. As Adastra was deemed to be the acquirer for accounting purposes, its assets, liabilities and operations since incorporation are included in these financial statements at their historical carrying values. Arrowstar's results of operations have been included from December 20, 2019.

	December 20, 2019
Net assets (liabilities) of Arrowstar acquired:	**$**
Cash	111,496
Receivables	10,802
Other assets	7,504
Accounts payable	(356,384)
Net liabilities acquired	**(226,582)**
Consideration paid in RTO of Arrowstar:	**$**
Common shares (fair value 21,656,034 common shares at $0.05 per share)	1,082,802
Total consideration paid	**1,082,802**
Listing expense	**1,309,384**

The Transaction was measured at the fair value of the shares that Adastra would have had to issue to the shareholders of Arrowstar, to give the shareholders of Arrowstar the same percentage equity interest in the combined entity that results from the reverse acquisition had it taken the legal form of Adastra acquiring Arrowstar.

4. Receivables and prepayments

Receivables and prepayments consist of the following:

	December 31, 2019	April 30, 2019
	$	$
Sales tax recoverable	303,708	28,283
Prepaid expenses	157,459	8,682
	461,167	36,965

5. Marketable securities

On November 8, 2011, the Company received 10,000 shares in Dunnedin Ventures Inc. as part of a property option agreement. The shares were valued at $1,500 at the RTO date and included in other assets. December 31, 2019 their fair market value remains $1,500.

6. Property and equipment

	Land	Building	Furniture and equipment	Computer software	Laboratory equipment	Extraction equipment	Building improvements	Total
	$	$	$	$	$	$	$	$
Cost								
June 18, 2018 (incorporation)	-	-	-	-	-	-	-	-
Additions	1,592,232	1,982,512	11,823	-	-	-	299,643	3,886,210
April 30, 2019	1,592,232	1,982,512	11,823	-	-	-	299,643	3,886,210
Accumulated depreciation								
June 18, 2018 (incorporation)	-	-	-	-	-	-	-	-
Depreciation	-	49,563	2,411	-	-	-	-	51,974
April 30, 2019	-	49,563	2,411	-	-	-	-	51,974
Cost								
April 30, 2019	1,592,232	1,982,512	11,823	-	-	-	299,643	3,886,210
Additions	-	16,816	47,619	12,105	62,295	1,048,502	3,564,116	4,751,453
December 31, 2019	**1,592,232**	**1,999,328**	**59,442**	**12,105**	**62,295**	**1,048,502**	**3,863,759**	**8,637,663**
Accumulated depreciation								
April 30, 2019	-	49,563	2,411	-	-	-	-	51,974
Depreciation	-	73,116	5,056	-	-	-	-	78,172
December 31, 2019	**-**	**122,679**	**7,467**	**-**	**-**	**-**	**-**	**130,146**
Net book value								
April 30, 2019	1,592,232	1,932,949	9,412	-	-	-	299,643	3,834,236
December 31, 2019	**1,592,232**	**1,876,649**	**51,975**	**12,105**	**62,295**	**1,048,502**	**3,863,759**	**8,507,517**

Some of the Company's property, plant and equipment was not yet in use as at December 31, 2019 and April 30, 2019. Depreciation is taken when items are in the location and condition necessary for it to be capable of operating in a manner intended by management.

As at December 31, 2019, the Company had paid cash deposits for additional cannabis extraction equipment in the amount of $Nil (April 30, 2019 - $20,823). Other deposits totaled $4,000 (April 30, 2019 - $nil) at the RTO date and were included in deposits.

7. Share capital

Transactions for the issue of share capital during the period ended December 31, 2019:

(i) On December 20, 2019, the Company closed 5,892,456 unit offering at a price of $0.45 per unit for gross proceeds of $2,651,605, with each unit consisting of one (1) common share of the Company and one underlying share purchase warrant exercisable at $0.60 for three years from the date of closing December 20, 2022. The warrants were given a value of $nil using the residual value method.

Transactions for the issue of share capital during the period ended April 30, 2019:

(i) On June 20, 2018, the Company issued 1 common share for $1 on incorporation, the Company cancelled the incorporation share on February 7, 2019;

(ii) On February 7, 2019, the Company closed a private placement for the issuance of 26,000,000 common shares at a price of $0.005 per share for gross proceeds of $130,000;

(iii) On February 28, 2019, the Company closed a private placement for the issuance of 21,750,000 common shares at a price of $0.02 per share for gross proceeds of $435,000;

(iv) On March 7, 2019, the Company closed a private placement for the issuance of 21,053,333 common shares at a price of $0.075 per share for gross proceeds of $1,579,000;

(v) On March 31, 2019, the Company closed a private placement for the issuance of 8,203,333 common shares at a price of $0.15 per share for gross proceeds of $1,230,500; and

(vi) On April 30, 2019, the Company closed a private placement for the issuance of 4,131,667 common shares at a price of $0.30 per share for gross proceeds of $1,239,500.

Escrowed shares

The Company entered into an Escrow Agreement in connection with closing the RTO on December 20, 2019, in relation to certain of its common shares which were placed in escrow. Pursuant to the Escrow Agreement the escrowed common shares are subject to a timed release schedule whereby a 10% portion of the escrow shares will be released beginning on listing date, and 15% every six months thereafter until January 6, 2023.

As at December 31, 2019, 26,000,000 common shares were held in escrow (2019 – nil).

7. Share capital (continued)

Stock options

The Company has an incentive stock option plan (the "Plan") which provides for the granting of options. Under the Plan the maximum number of stock options issued cannot exceed 10% of the Company's currently issued and outstanding common shares. Options granted under the Plan may have a maximum term of ten years. A participant, who is not a consultant conducting investor relations activities, who is granted an option that is exercisable at the market price at the date of grant, will have their options vest immediately, unless otherwise determined by the Board of Directors. Options granted at below market prices will vest one-sixth every three months.

A participant who is a consultant conducting investor relations activities who is granted an option under the Plan will become vested with the right to exercise one-quarter of the option upon conclusion of every three months subsequent to the grant date. All options are to be settled by physical delivery of shares.

During the periods ended December 31, 2019 and April 30, 2019, there were no options granted or outstanding

Warrants

As an incentive to complete a private placement the Company may issue units which include common shares and common share purchase warrants. Using the residual value method, the Company determines whether a value should be allocated to the warrants attached to private placement units. Finders' warrants may be issued as a private placement share issue cost and are valued using the Black-Scholes option pricing model.

A summary of the status of the Company's warrants as at December 31, 2019 and April 30, 2019 and changes during the years then ended is as follows:

	Period ended December 31, 2019		Period ended April 30, 2019	
	Warrants #	Weighted average exercise price $	Warrants #	Weighted average exercise price $
Warrants outstanding, beginning of year	-	-	-	-
Replaced on RTO	1,519,200	0.92	-	-
Issued - attached to units	5,892,455	0.60	-	-
Warrants outstanding, end of year	**7,411,655**	**0.73**	-	-

As at December 31, 2019, the Company had warrants outstanding and exercisable as follows:

Warrants outstanding #	Warrants exercisable #	Exercise Price $	Expiry date	Weighted average remaining life (years)
496,100	496,100	1.00	February 20, 2020	0.14
1,023,100	1,023,100	1.50	April 26, 2020	0.32
5,892,455	5,892,455	0.60	December 2, 2022	2.97
7,411,655	**7,411,655**			2.41

8. Loss per share

The calculation of basic loss per share for the period ended December 31, 2019 was based on the loss attributable to common shareholders of $2,657,957 (April 30, 2019 - $903,989), and a weighted average number of common shares outstanding of 103,082,977 (April 30, 2019 – 13,265,014).

All warrants outstanding as at December 31, 2019 and April 30, 2019, were excluded from the diluted weighted average number of common shares calculation as their effect would have been anti-dilutive.

9. Related party payables and transactions

A number of key management personnel and Directors hold positions in other entities that result in them having control or significant influence over the financial or operating policies of these entities. There were no loans to key management personnel or Directors, or entities over which they have control or significant influence during the periods ended December 31, 2019 or April 30, 2019.

The following related parties transacted with the Company or Company controlled entities during the years:

(a) Andrew Hale is a Director and the Company's President and CEO.

(b) Blaine Bailey is a Director and Chairman of the Company's Audit Committee. He controls Promaid Services Ltd. ("Promaid.") which provides the Company with financial services.

(c) Stephen Brohman is the Company's CFO. He is a principal of Donaldson Brohman Martin CPA Inc. ("DBM CPA") a firm in which he has significant influence. DBM CPA provides the Company with accounting and tax services.

(d) George Routhier is a Company Director. He is the owner of Pipedreemz Inc. ("Pipedreemz"), which provides advisory services to the Company.

The aggregate value of transactions and outstanding balances with key management personnel and Directors and entities over which they have control or significant influence were as follows:

	Transactions period ended December 31, 2019 $	Transactions period ended April 30, 2019 $	**Balances outstanding December 31, 2019 $**	Balances outstanding April 30, 2019 $
DBM CPA	107,298	35,906	-	9,236
Andrew Hale	120,115	182,224	-	-
Pipedreemz	17,500	-	-	-
	244,913	218,130	**-**	9,236

All related party balances are unsecured and are due within thirty days without interest.

The transactions with the key management personnel and Directors are included in operating expenses as follows:

(a) Consulting fees

- Includes the advisory services of Director, George Routhier, charged to the Company by Pipedreemz.

(b) Professional fees

- Includes the accounting and tax services of the Company's CFO, Stephen Brohman, charged to the Company by DBM CPA.

(g) Wages and salaries

- Includes charges by Andrew Hale for salaries paid to Officer.

10. Income taxes

A reconciliation of income taxes at statutory rates with the reported taxes for the periods ended December 31, 2019 and April 30, 2019, is as follows:

	December 31, 2019 $	April 30, 2019 $
Loss for the period	(2,657,957)	(903,989)
Expected income tax (recovery)	(718,000)	(244,000)
Other	80,000	3,000
Permanent differences	353,000	-
Change in recognized deductible temporary differences	285,000	241,000
Total income tax expense (recovery)	-	-

The Company's unused temporary differences, and unused tax losses that have not been included on the statements of financial position as at December 31, 2019 and April 30, 2019 are as follows:

	December 31, 2019 $	Expiry Date Range	April 30, 2019 $	Expiry Date Range
Property, plant and equipment	137,000	N/A	52,000	N/A
Non-capital loss carry forwards	1,814,000	2039 to 2039	840,000	2038

Tax attributes are subject to review, and potential adjustment, but tax authorities.

.

11. Supplemental cash flow information

Changes in non-cash operating working capital during the periods ended December 31, 2019 and April 31, 2019 were comprised of the following:

	December 31, 2019 $	April 30, 2019 $
Receivables and prepayments	(411,396)	(36,965)
Accounts payable and accrued liabilities	14,903	137,044
Net change	**(396,493)**	100,079

The Company incurred non-cash financing and investing activities during the periods ended December 31, 2019 and April 30, 2019 as follows:

	December 31, 2019 $	April 30, 2019 $
Non-cash financing activities		
Debenture reserves	298,461	-
	298,461	-
Non-cash investing activities		
Equipment purchases included in accounts payable	385,894	-
	385,894	-

During the period ended December 31, 2019 amounts paid for interest was $134,530 (April 30, 2019 - $63,165). No amounts were paid for income tax expenses.

12. Mortgage payable

On January 7, 2019, the Company entered a mortgage for $2,446,000 which bears interest at the rate of 8.25% per annum, calculated monthly. The mortgage matures on February 1, 2020 and can be repaid before maturity without penalty and is secured by the mortgage property and building improvements.

The mortgage payable is recorded at amortized cost and bears an effective interest rate of 10.44% as at December 31, 2019 and April 30, 2019.

The carrying value of the mortgage payable at December 31, 2019 and April 30, 2019 was $2,437,175 and $2,407,463. Included in mortgage payable on initial recognition were the related mortgage transaction costs of $50,755 which are amortized over the term of the mortgage using the effective interest rate method.

The Company maintains minimum interest only payments of $16,816 per month. As at December 31, 2019 the total non-discounted remaining scheduled payments related to the mortgage including interest payments, total $2,479,633. Total interest expense during the period ended December 31, 2019 was $164,242 (April 30, 2019 - $63,125).

On February 1, 2020, the Company renewed the mortgage of $2,446,000 which bears interest at the rate of 8.00% per annum, calculated monthly. The mortgage matures on February 1, 2021 and can be repaid before maturity without penalty and is secured by the mortgage property and building improvements.

13. Convertible debenture

On October 31, 2019, the Company closed a 7,060,000 convertible debenture unit offering at a price of $0.45 per debenture unit for gross proceeds $3,177,000. Each debenture consists of a 12% secured convertible debenture with a maturity of two years from the date of issuance. If the holder converts their debenture unit they are entitled to one common share and one share purchase warrant exercisable at $0.75 per share exercisable two years from the date of the convertible debenture closing October 31, 2021 at the holders discretion.

If the closing price of the Common Shares of the Company is higher than $1.00 for any 10 consecutive trading days the expiry date of the Warrants may be accelerated to the 30th day after the date of a news release announcing such acceleration. The debentures will be secured to the facility subordinate to the mortgage currently on the facility.

13. Convertible debenture (continued)

As the debentures are convertible into common shares, the liability and equity components are presented separately on the consolidated statement of financial position. The initial carrying amount of the financial liability was determined by discounting the stream of future payments of interest and principal at a market interest rate of 16% totaling $2,878,539. Using the residual method, the carrying amount of the conversion feature is the difference between the principal amount and the initial carrying value of the financial liability. The equity component is recorded in debenture reserves on the consolidated statement of financial position totaling $298,461. The debentures, net of the equity component are accreted using the effective interest method over the term of the debentures, such that the carrying amount of the financial liability will equal the principal balance at maturity.

The Company recorded interest expense of $63,713 and accretion expense of $13,259 related to the convertible debenture during the period ended December 31, 2019 (April 30, 2019 - $nil).

14. Financial risk management

Capital management

The Company defines capital as the components of shareholders' equity. The Company's objectives when managing capital are to support further advancement of the Company's business objectives, as well as to ensure that the Company is able to meet its financial obligations as they come due.

The Company manages its capital structure to maximize its financial flexibility making adjustments to it in response to changes in economic conditions and the risk characteristics of the underlying assets and business opportunities. The Company relies on the expertise of the Company's management to sustain the future development of the business. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the period ended December 31, 2019. The Company is not subject to externally imposed capital requirements.

Financial instruments - fair value

The Company's financial instruments consist of cash, receivables, marketable securities, deposits, accounts payable and accrued liabilities, mortgage payable and convertible debenture.

The carrying value of receivables, accounts payable and accrued liabilities, and accounts payable approximated their fair value because of the short-term nature of these instruments. Mortgage payable and convertible debenture values approximate fair value due to their market rates of interest charged.

Financial instruments measured at fair value on the consolidated statements of financial position are summarized into the following fair value hierarchy levels:

Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 1 $	Level 2 $	Level 3 $	Total $
December 31, 2019				
Cash	2,376,826	-	-	2,376,826
Marketable securities	1,500	-	-	1,500
Deposits	4,000	-	-	4,000
April 30, 2019				
Cash and cash equivalents	2,362,494	-	-	2,362,494
Deposits	20,823	-	-	20,823

14. Financial risk management (continued)

Financial instruments - risk

The Company's financial instruments are exposed to certain financial risks, including credit risk, interest rate risk, market risk, liquidity risk and currency risk.

(a) Credit risk

The Company is exposed to credit risk by holding cash. This risk is minimized by holding the funds in Canadian banks and credit unions or with Canadian governments. The Company has minimal receivable exposure, and its various refundable credits are due from Canadian governments.

(b) Market risk

The Company is exposed to market risk because of the fluctuating values of its publicly traded marketable securities. The Company has no control over these fluctuations and does not hedge its investments. Based on the December 31, 2019 value of marketable securities every 10% increase or decrease in the share prices of these companies would have impacted loss for the year, up or down, by approximately $70 (April 30, 2019 - $nil) before income taxes.

(c) Liquidity risk

Liquidity risk is the risk that the Company is unable to meet its financial obligations as they come due. The Company manages this risk by careful management of its working capital to ensure its expenditures will not exceed available resources.

(d) Currency risk

The Company is not exposed to currency risk.

15. Events after the reporting period

(a) On January 3, 2020, the common shares of the Company have been approved for listing on the Canadian Securities Exchange on January 6, 2020.

(b) On January 31, 2020, the Company announced 7,570,000 stock options to certain directors, officers, employees and consultants. The options expire five years from the date of grant, vest automatically upon grant and are exercisable at a price of $0.45 per common share.

(c) In March 2020 the World Health Organization declared coronavirus COVID-19 a global pandemic. This contagious disease outbreak, which has continued to spread, and any related adverse public health developments, has adversely affected workforces, economies, and financial markets globally, potentially leading to an economic downturn. It is not possible for the Company to predict the duration or magnitude of the adverse results of the outbreak and its effects on the Company's business or results of operations at this time.