

Consolidated Financial Statements of

HARRYS MANUFACTURING INC.

July 31, 2020 and 2019

Expressed in Canadian Dollars



DALE MATHESON CARR-HILTON LABONTE LLP
CHARTERED PROFESSIONAL ACCOUNTANTS

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Harrys Manufacturing Inc.

Opinion

We have audited the consolidated financial statements of Harrys Manufacturing Inc. (the “Company”), which comprise the consolidated statements of financial position as at July 31, 2020 and 2019, and the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (collectively referred to as the “financial statements”).

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at July 31, 2020 and 2019, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

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 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 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 is sufficient and appropriate to provide a basis for our opinion.

Material Uncertainty Related to Going Concern

We draw attention to Note 2 to the financial statements, which describes events or conditions that 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 comprises the information included in Management's Discussion and Analysis.

Our opinion on the 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 financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the 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 Financial Statements

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

In preparing the 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 Financial Statements

Our objectives are to obtain reasonable assurance about whether the 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 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 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 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 financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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 David Goertz.

DMCL

DALE MATHESON CARR-HILTON LABONTE LLP
CHARTERED PROFESSIONAL ACCOUNTANTS
Vancouver, BC

November 30, 2020



An independent firm
associated with Moore
Global Network Limited

HARRYS MANUFACTURING INC.
Consolidated Statements of Financial Position
Expressed in Canadian dollars

As at	Note	July 31, 2020	July 31, 2019
		\$	\$
ASSETS			
Current			
Cash		239,121	526,682
Receivables	5	5,645	6,707
Prepaid expense	9	29,425	-
Total current assets		274,191	533,389
Property and equipment	6	115,591	812,856
Right-of-use asset	7	265,943	-
Total assets		655,725	1,346,245
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities	8	31,998	29,767
Wages payable	9	53,016	200,187
Current portion of lease liability	10	8,670	-
Total current liabilities		93,684	229,954
Lease liability	10	263,966	-
Total liabilities		357,650	229,954
SHAREHOLDERS' EQUITY			
Share capital	11	20,015,764	19,490,552
Reserves	11	3,280,628	2,940,202
Deficit		(22,998,317)	(21,314,463)
Total shareholders' equity		298,075	1,116,291
Total liabilities and shareholders' equity		655,725	1,346,245

Nature and continuance of operations (Note 1)
Going concern (Note 2)
Commitments (Note 14)
Subsequent events (Note 16)

On behalf of the Board of Directors:

"Kevin Kohanik" Director _____
"Michael Young" Director

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

HARRYS MANUFACTURING INC.
Consolidated Statements of Loss and Comprehensive Loss
Expressed in Canadian dollars

	Note	Year ended July 31, 2020	Year ended July 31, 2019
		\$	\$
Revenue		–	7,500
Expenses			
Consulting fees		201,466	121,750
Depreciation	6, 7	248,848	193,344
Management fees	9	149,700	388,234
Office and administrative		116,034	58,055
Professional fees		99,514	113,497
Research and development		–	2,137
Share-based payments	9, 11	390,638	1,137,688
Salaries and wages	9	–	71,091
Shareholder communications		3,091	4,000
Transfer agent and filing fees		52,177	43,745
		1,261,468	2,133,541
Net loss before other items		(1,261,468)	(2,126,041)
Other items			
Interest expense	10	(21,022)	(1,221)
Interest income		249	–
Impairment of goodwill	4	–	(11,945,531)
Impairment of equipment	6	(578,209)	–
Reversal of wages payable	9	176,596	–
Net and comprehensive loss		(1,683,854)	(14,072,793)
Basic and diluted loss per common share		(0.02)	(0.19)
Weighted average number of common shares outstanding, basic and diluted		73,644,910	72,736,340

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

HARRYS MANUFACTURING INC.
Consolidated Statements of Changes in Equity
Expressed in Canadian dollars

	Share Capital			Reserves	Deficit	Shareholders' Equity
	Number of Common shares	Amount	Amount			
		\$	\$	\$	\$	\$
Balance, as at July 31, 2018	49,316,258	9,497,915	1,810,116	(7,241,670)	4,066,361	
Shares issued to acquire HIMI	28,500,100	9,975,035	–	–	9,975,035	
Shares issued for cash upon the exercise of stock options	100,000	17,602	(7,602)	–	10,000	
Share-based payments	–	–	1,137,688	–	1,137,688	
Net loss for the year	–	–	–	(14,072,793)	(14,072,793)	
Balance, as at July 31, 2019	77,916,358	19,490,552	2,940,202	(21,314,463)	1,116,291	
Shares returned for cancellation	(8,000,000)	–	–	–	–	
Shares issued for cash upon the exercise of stock options	475,000	105,212	(50,212)	–	55,000	
Units issued for cash at \$0.06 per share	7,000,000	420,000	–	–	420,000	
Share-based payments	–	–	390,638	–	390,638	
Net loss for the year	–	–	–	(1,683,854)	(1,683,854)	
Balance, as at July 31, 2020	77,391,358	20,015,764	3,280,628	(22,998,317)	298,075	

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

HARRYS MANUFACTURING INC.
Consolidated Statements of Cash Flows
Expressed in Canadian dollars

	Year ended July 31, 2020	Year ended July 31, 2019
	\$	\$
Operating activities		
Net loss for the year	(1,684,854)	(14,072,793)
Adjustment for non-cash items:		
Share-based payments	390,638	1,137,688
Depreciation	248,848	193,344
Interest expense on lease liability	21,022	-
Impairment of goodwill	-	11,945,531
Impairment of equipment	578,209	-
Reversal of wages payable	(176,596)	-
Changes in non-cash working capital items:		
Receivables	1,062	449,519
Prepaid expense	(29,425)	31,250
Accounts payable and accrued liabilities	2,231	(698,095)
Wages payable	29,425	(14,381)
Net cash used in operating activities	(618,440)	(1,027,937)
Investing activities		
Cash acquired upon acquisition of HIMI	-	18,549
Purchase of equipment	(120,621)	-
Net cash provided by (used in) investing activities	(120,621)	18,549
Financing activities		
Proceeds received from share issuances	475,000	10,000
Lease repayments	(23,500)	-
Net cash provided by financing activities	451,500	10,000
NET CASH OUTFLOW	(287,561)	(999,388)
Cash, beginning of year	526,682	1,526,070
Cash, end of year	239,121	526,682
Non-cash activities:		
Value of shares issued for acquisition of HIMI	-	9,975,035

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

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

1. Nature and continuance of operations

Harrys Manufacturing Inc. (the “Company”) was incorporated under the laws of the Province of British Columbia on July 31, 2007, formerly under the name of Westridge Resources Inc. (“Westridge”). The Company’s common shares are listed for trading on the Canadian Securities Exchange (the “CSE”) under the symbol “HARY”.

On January 22, 2018, and as amended on March 30, 2018, the Company entered into a definitive agreement with Harrys International Manufacturing Inc. (“HIMI”) (the “Share Exchange Agreement”). Pursuant to the Share Exchange Agreement, the Company acquired all of the issued and outstanding common shares of HIMI in exchange for common shares of the Company (the “Acquisition”, Note 4). HIMI’s principal business was the sale and distribution of tobacco products exclusively to purchasers located outside of Canada and the United States. The Acquisition closed on October 4, 2018 and the Company changed its name from Westridge Resources Inc. to Harrys Manufacturing Inc. The Company has recently transitioned its efforts to focus on tobacco sales in Canada.

The head office and registered address and records office of the Company are located at Suite 1070 - 1055 West Hastings Street, Vancouver, BC V6E 2E9.

The consolidated financial statements were authorized for issuance on November 30, 2020 by the Board of Directors.

Impact of COVID-19 on the Financial Position of the Company

In December 2019, a strain of novel coronavirus (now commonly known as “COVID-19”) was reported to have surfaced in Wuhan, China. COVID-19 has since spread rapidly throughout many countries, and, on March 11, 2020, the World Health Organization declared COVID-19 to be a pandemic. In an effort to contain and mitigate the spread of COVID-19, many countries, including Canada and the United States, have imposed unprecedented restrictions on travel, and there have been business closures and a substantial reduction in economic activity in countries that have had significant outbreaks of COVID-19.

At this time the Company remains open for business, however, significant uncertainty remains as to the potential impact of the COVID-19 pandemic on our operations, and on the global economy as a whole. Government-imposed restrictions on travel and other “social-distancing” measures such restrictions on assembly of groups of persons, have the potential to disrupt government agencies who the Company does business with, supply chains for materials used to manufacture products and sales channels for our products, as well as may result in labor shortages.

It is currently not possible to predict how long the pandemic will last or the time that it will take for economic activity to return to prior levels. Management continues to monitor the COVID-19 situation closely and intends to follow health and safety guidelines as they evolve.

2. Basis of preparation

Going Concern

These consolidated financial statements have been prepared on the assumption that the Company will continue as a going concern, meaning it will continue in operation for the foreseeable future and will be able to realize assets and discharge liabilities in the ordinary course of operations. Different bases of measurement may be appropriate if the Company is not expected to continue operations for the foreseeable future. To date the Company has incurred losses and further losses are expected in the future. Management is aware, in making its assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the Company’s ability to continue as a going concern, and therefore, it may be unable to realize its assets and discharge its liabilities in the normal course of business.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

2. Basis of preparation (continued)

Going Concern (continued)

The Company's continuation as a going concern is dependent upon its ability to attain profitable operations and generate funds from there and/or raise equity capital or borrowings sufficient to meet its current and future obligations. Management intends to finance operating costs over the next twelve months from working capital and if necessary from loans from directors and companies controlled by directors and/or private placement of common shares. Management cannot provide assurance that the Company will ultimately achieve profitable operations or become cash flow positive, or raise additional debt and/or equity capital. Management believes that the Company's capital resources should be adequate to continue operation and maintaining its business strategy. However, if the Company is unable to achieve profitability or raise additional capital, management expects that the Company may need to curtail operations, liquidate assets, seek additional capital on less favourable terms and/or pursue other remedial measures. These consolidated financial statements do not include any adjustments related to the recoverability and classification of assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

Statement of compliance and principals of consolidation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, HIMI. All intercompany transactions and balances have been eliminated on consolidation.

These consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information. In addition, these consolidated financial statements are prepared on a historical cost basis except for financial instruments classified as fair value through profit or loss ("FVTPL"), which are stated at their fair value, as explained in the accounting policies in Note 3. Certain comparative figures on statements of loss and comprehensive loss were reclassified in order to conform with current year presentation.

The significant accounting policies that have been applied in the preparation of these consolidated financial statements are summarized below.

3. Significant accounting policies

These accounting policies have been used throughout all periods presented in the consolidated financial statements.

Significant judgments, estimates and assumptions

The preparation of the Company's consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the 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. Actual results could differ from these estimates by a material amount. Matters that require management to make significant judgments, estimates and assumptions in determining carrying values include, but are not limited to:

Share-based payments

Share-based payments are determined using the Black-Scholes Option Pricing Model based on estimated fair values of all share-based awards at the date of grant. The Black-Scholes Option Pricing Model utilizes assumptions such as expected price volatility, the expected life of the option and the number of options that may be forfeited. Changes in these input assumptions may affect the fair value estimate.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Significant judgments, estimates and assumptions (continued)

Useful life and recovery of long-lived assets

Management estimates the useful life of long-lived assets based on the period during which the assets are expected to be available for use. The amounts and timing of recorded expenses for depreciation for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of technical or commercial obsolescence, and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's long-lived assets in the future.

The assessment of any impairment of long-lived assets is dependent upon estimates of recoverable amounts that takes into account factors such as economic and market conditions, timing of cash flows, the useful lives of assets and their related salvage values.

Deferred taxes

The Company recognizes the deferred tax benefit of deferred tax assets to the extent their recovery is probable. Assessing the recoverability of deferred tax assets requires management to make significant estimates of future taxable profit. In addition, future changes in tax laws could limit the ability of the Company to obtain tax deductions from deferred tax assets.

Going concern

These consolidated financial statements have been prepared in accordance with IFRS on a going concern basis, which assumes the realization of assets and discharge of liabilities in the normal course of business within the foreseeable future. Management uses judgment in determining assumptions for cash flow projections, such as anticipated financing, anticipated sales and future commitments to assess the Company's ability to continue as a going concern. A critical judgment is that the Company continues to raise funds going forward and satisfy their obligations as they become due.

Business Combinations

In a business combination, all identifiable assets, liabilities and contingent liabilities acquired are recorded at their fair values. One of the most significant estimates relates to the determination of the fair value of these assets and liabilities. Management exercises judgment in estimating the probability and timing of when earn-outs are expected to be achieved which is used as the basis for estimating fair value. For any intangible asset identified, depending on the type of intangible asset and the complexity of determining its fair value, an independent valuation expert or management may develop the fair value, using appropriate valuation techniques, which are generally based on a forecast of the total expected future net cash flows. The evaluations are linked closely to the assumptions made by management regarding the future performance of the assets concerned and any changes in the discount rate applied.

The determination of whether a set of assets acquired and liabilities assumed constitute a business may require the Company to make certain judgments, taking into account all facts and circumstances. A business is presumed to be an integrated set of activities and assets capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or economic benefits. The acquisition of HIMI is determined to constitute a business combination (Note 4).

Leases

The measurement of the right-of-use asset ("ROU"), lease liability, and the resulting interest expense and depreciation expense are determined with the application of the rate implicit in the lease, unless this cannot readily be determined, in which case the lessee's incremental borrowing rate is used instead. The incremental borrowing rate is defined as the rate that the lessee would have to pay to borrow over a similar term and with similar security, the fund necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment. The incremental borrowing rate involves estimate and judgements including economic environment, term, currency and the underlying risk inherent to the asset.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Accounting Policy Implemented on August 1, 2019

Effective August 1, 2019, the Company adopted IFRS 16 – *Leases* (“IFRS 16”) which replaced IAS 17 – *Leases* and IFRIC 4 – *Determining Whether an Arrangement Contains a Lease*. IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases. IFRS 16 eliminates the classification of leases as either operating leases or finance leases for a lessee. Instead, all leases are treated in a similar way to finance leases applied in IAS 17. IFRS 16 does not require a lessee to recognize assets and liabilities for short-term leases (i.e. leases of 12 months or less), leases with certain variable lease payments and leases of low-value assets.

The Company applied IFRS 16 using the modified retrospective method, which did not result in material opening adjustment. At inception of a contract, the Company will assess whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The Company assesses whether the contract involves the use of an identified asset, whether the right to obtain substantially all of the economic benefits from use of the asset during the term of the arrangement exists, and if the Company has the right to direct the use of the asset. The Company has implemented the following accounting policies under the new standard:

Right-of-use asset

The calculated ROU asset is initially recorded at cost, which comprises the initial amount of the lease liability and any initial direct costs incurred less any lease payments made at or before the initial adoption date. The ROU is depreciated on a straight-line basis over the shorter of the estimated useful life of the asset or the lease term. The lease term includes periods covered by an option to extend if the Company’s intention is to exercise that option. The ROU asset is periodically reduced by impairment losses, if any, and adjusted for re-measurements of the lease obligation.

Lease liability

The Company incorporates both the lease and non-lease components as part of the total lease payment, as the Company elected not to separate non-lease components. The lease liability is measured at the present value of the expected lease payments over the lease term, discounted at the interest rate implicit in the lease; if the rate cannot be determined, the incremental borrowing rate is used. The liability is increased for the passage of time and payments on the lease are offset against the lease liability. The liability is subsequently re-measured when there is a change in the lease agreement, such as a change in future lease payments or if the Company decides to purchase, extend or terminate the lease option. When the lease liability is re-measured, an adjustment is applied to the carrying value of the ROU asset.

Foreign currency translation

The functional currency of the Company is the Canadian dollar, and the consolidated financial statements are presented in Canadian dollars.

Transactions and balances

Foreign currency transactions are translated into functional currency using the exchange rates prevailing at the date of the transaction. Foreign currency monetary items are translated at the period-end exchange rate. Non-monetary items measured at historical cost continue to be carried at the exchange rate at the date of the transaction. Non-monetary items measured at fair value are reported at the exchange rate at the date when fair values were determined.

Exchange differences arising on the translation of monetary items or on settlement of monetary items are recognized in profit or loss in the consolidated statement of loss and comprehensive loss in the period in which they arise, except where deferred in equity as a qualifying cash flow or net investment hedge.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Property and Equipment

Property and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset only when it is probable that future economic benefits associated with the item will flow to the Company and the costs of the item can be reliably measured. All other repairs and maintenance are charged to the consolidated statement of loss and comprehensive loss during the financial period in which they are incurred.

Depreciation of property and equipment is based on the estimated useful lives of the assets using the following rates:

Asset	Rate	Method
Furniture and fixture	5 years	Straight-line
Manufacturing equipment	5 years	Straight-line
Leasehold improvements	Term of lease	Straight-line

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount and are recognized in the consolidated statement of loss and comprehensive loss.

Revenue Recognition

The Company adopted IFRS 15 *Revenue from Contracts with Customers* effective August 1, 2018, which establishes a five-step model to account for revenue arising from contracts with customers:

- identify the contract with a customer;
- identify the performance obligations in the contract;
- determine the transaction price, which is the total consideration provided by the customer;
- allocate the transaction price among the performance obligations in the contract based on their relative fair values; and
- recognize revenue when the relevant criteria are met for each performance obligation.

The Company generates revenue principally from the sale and distribution of tobacco cigarettes. Revenue is recognized at a point of time when the control of the products has transferred to an external party, when all significant contractual obligations have been satisfied and there is no unfulfilled obligation that could affect the customer's acceptance of the products. These are generally met when products are shipped to the customer, the risks of obsolescence and loss have been transferred to the customer, and either the customer has accepted the products in accordance with the sales order, the acceptance provisions have lapsed, or the Company has objective evidence that all criteria for acceptance have been satisfied.

Revenue is measured based on the price specified and provided to the customer.

Share-based payments

The Company operates an employee stock option plan. Share-based payments to employees are measured at the fair value of the instruments issued and amortized over the vesting periods. Share-based payments to non-employees are measured at the fair value of goods or services received or the fair value of the equity instruments issued, if it is determined that the fair value of the goods or services cannot be reliably measured, and are recorded at the date the goods or services are received. The corresponding amount is recorded to contributed surplus. The fair value of options is determined using a Black-Scholes Option Pricing Model which incorporates all market vesting conditions. The number of shares and options expected to vest is reviewed and adjusted at the end of each reporting period such that the amount recognized for services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Share purchase warrants

The Company bifurcates units consisting of common shares and share purchase warrants using the residual value approach whereby it measures the common share component of the unit at fair value using market prices. The difference between this value and the unit value is then allocated to the warrant with the value of the warrant component being credited to reserves. When warrants are exercised, the corresponding residual value, if any, is transferred from reserves to share capital.

Financial instruments

Financial instruments are accounted for in accordance with IFRS 9 *Financial Instruments: Classification and Measurement*.

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

(i) Recognition and classification

The Company's financial instruments consist of cash, receivables, accounts payable and accrued liabilities, and wages payable. Receivables are initially recognized when they are originated. All other financial assets and liabilities are initially recognized when the Company becomes a party to the contractual provisions of the instrument.

On initial recognition, a financial asset is classified as measured at: amortized cost; fair value through other comprehensive income ("FVOCI") – debt investment; FVOCI - equity investment; or fair value through profit or loss ("FVTPL"). Financial assets are not reclassified subsequent to their initial recognition unless the Company changes its business model for managing financial assets in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model.

Financial liabilities are classified as measured at amortized cost or FVTPL. A financial liability is classified as at FVTPL if it is classified as held-for-trading, it is a derivative or it is designated as such on initial recognition.

Financial assets / liabilities	Classification
Cash	FVTPL
Receivables	Amortized costs
Accounts payable and accrued liabilities	Amortized costs
Wages payable	Amortized costs

(ii) Measurement

Financial assets: Initial measurement

A financial asset (unless it is a trade receivable without a significant financing component) or financial liability is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition or issue. A trade receivable without a significant financing component is initially measured at the transaction price.

Financial assets: Subsequent measurement and gains and losses

Financial assets at amortized cost: These assets are subsequently measured at amortized cost using the effective interest method. The amortized cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment are recognized in the consolidated statement of loss and comprehensive loss. Any gain or loss on derecognition is recognized in the consolidated statement of loss and comprehensive loss

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Financial instruments (continued)

(ii) Measurement (continued)

Financial liabilities

Financial liabilities at FVTPL are measured at fair value and net gains and losses, including any interest expense, are recognized in the consolidated statement of loss and comprehensive loss. Other financial liabilities are subsequently measured at amortized cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognized in the consolidated statement of loss and comprehensive loss. Any gain or loss on derecognition is also recognized in the consolidated statement of loss and comprehensive loss.

(iii) Derecognition

Financial assets

The Company derecognizes a financial asset when the contractual rights to the cash flows from the financial 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 or in which the Company neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset. The Company enters into transactions whereby it transfers assets recognized in its consolidated statement of financial position but retains either all or substantially all of the risks and rewards of the transferred assets. In these cases, the transferred assets are not derecognized.

Financial liabilities

The Company derecognizes a financial liability when its contractual obligations are discharged or cancelled, or expire. The Company also derecognizes a financial liability when its terms are modified and the cash flows of the modified liability are substantially different, in which case a new financial liability based on the modified terms is recognized at fair value.

On derecognition of a financial liability, the difference between the carrying amount extinguished and the consideration paid (including any non-cash assets transferred or liabilities assumed) is recognized in the consolidated statement of loss or comprehensive loss.

Write-off

The gross carrying amount of a financial asset is written off (either partially or in full) to the extent that there is no realistic prospect of recovery. This is generally the case when the Company determines that the debtor does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off. However, financial assets that are written off could still be subject to enforcement activities in order to comply with the Company's procedures for recovery of amounts due.

Impairment of financial assets

The Company recognizes a loss allowance for expected credit losses on financial assets that are measured at amortized cost. At each reporting date, the Company measures the loss allowance for the financial asset at an amount equal to the lifetime expected credit losses if the credit risk on the financial asset has increased significantly since initial recognition. If at the reporting date, the financial asset has not increased significantly since initial recognition, the Company measures the loss allowance for the financial asset at an amount equal to the twelve month expected credit losses.

The Company shall recognize in the statements of loss or comprehensive loss, as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognized.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Comprehensive loss

Comprehensive loss is the change in shareholders' equity during a period from transactions and other events and circumstances from non-owner sources, such as any unrealized gains and losses in financial assets classified as FVOCI. The Company had no comprehensive loss transactions during the years ended July 31, 2020 and 2019.

Income taxes

Current tax:

Current tax assets and liabilities for the current period are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted, at the reporting date, in the countries where the Company operates and generates taxable income.

Current tax relating to items recognized directly in other comprehensive income or equity is recognized in other comprehensive income or equity and not in profit or loss. Management periodically evaluates positions taken in the tax returns with respect to situations in which applicable tax regulations are subject to interpretation and establishes provisions where appropriate.

Deferred tax:

Deferred tax is provided using the liability method 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 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 tax asset to be utilized.

Deferred 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 tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

Loss per share

The Company presents basic and diluted loss per share data for its common shares. Basic earnings per share is calculated by dividing the profit or loss attributable to the common shareholders of the Company by the weighted average number of common shares outstanding during the reporting period. Diluted earnings per share is calculated by adjusting the profit or loss attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares, which comprise share options granted.

Related party transactions

Parties are considered related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered related if they are subject to common control. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Business Combinations

A business combination is a transaction or event in which an acquirer obtains control of one or more businesses and is accounted for using the acquisition method. The total consideration paid for the acquisition is the aggregate of the fair values of assets acquired, liabilities assumed, and equity instruments issued in exchange for control of the acquiree at the acquisition date. The acquisition date is the date when the Company obtains control of the acquiree. The identifiable assets acquired and liabilities assumed are recognized at their acquisition date fair values, except for deferred taxes and share-based payment awards where IFRS provides exceptions to recording the amounts at fair value. Goodwill represents the difference between total consideration paid and the fair value of the net identifiable assets acquired. Acquisition costs incurred are expensed to profit or loss.

Contingent consideration is measured at its acquisition date fair value and is included as part of the consideration transferred in a business combination, subject to the applicable terms and conditions. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IFRS 9 with the corresponding gain or loss recognized in profit or loss.

Based on the facts and circumstances that existed at the acquisition date, management will perform a valuation analysis to allocate the purchase price based on the fair values of the identifiable assets acquired and liabilities assumed on the acquisition date. Management has one year from the acquisition date to confirm and finalize the facts and circumstances that support the finalized fair value analysis and related purchase price allocation. Until such time, these values are provisionally reported and are subject to change. Changes to fair values and allocations are retrospectively adjusted in subsequent periods.

In determining the fair value of all identifiable assets acquired and liabilities assumed, the most significant estimates generally relate to contingent consideration and intangible assets. Management exercises judgment in estimating the probability and timing of when earn-outs are expected to be achieved, which is used as the basis for estimating fair value. Identified intangible assets are fair valued using appropriate valuation techniques which are generally based on a forecast of the total expected future net cash flows of the acquiree. Valuations are highly dependent on the inputs used and assumptions made by management regarding the future performance of these assets and any changes in the discount rate applied.

Acquisitions that do not meet the definition of a business combination are accounted for as asset acquisitions. Consideration paid for an asset acquisition is allocated to the individual identifiable assets acquired and liabilities assumed based on their relative fair values. Asset acquisitions do not give rise to goodwill.

Goodwill

Goodwill represents the excess of the purchase price paid for the acquisition of a business over the fair value of the net tangible and intangible assets acquired. Goodwill is allocated to the cash-generating unit ("CGU") or CGUs which are expected to benefit from the synergies of the combination.

Impairment of Goodwill and Indefinite Life Intangibles

Goodwill and indefinite life intangibles are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired.

Impairment is determined for goodwill and indefinite life intangibles by assessing if the carrying value of a CGU or group of CGUs, including the allocated goodwill, exceeds its recoverable amount determined as the greater of the estimated fair value less costs of disposal and the value-in-use. Impairment losses recognized in respect of a CGU or group of CGUs are first allocated to the carrying value of goodwill and indefinite life intangibles and any excess is allocated to the carrying amount of assets in the CGU. Any impairment loss is recognized in the consolidated statements of loss and comprehensive loss in the period in which the impairment is identified. Impairment losses on goodwill and indefinite life intangibles are not subsequently reversed.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

3. Significant accounting policies (continued)

Impairment of non-financial assets

At each financial position reporting date the carrying amounts of the Company's long-lived assets are reviewed to determine whether there is any indication that those assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. The recoverable amount is the higher of fair value less costs to sell and value in use, which is the present value of future cash flows expected to be derived from the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in the profit or loss for the year.

For the purposes of impairment testing, individual assets are allocated to cash-generating units. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

Provisions

Liabilities are recognized when the Company has a present obligation (legal or constructive) that has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation. A provision is a liability of uncertain timing or amount.

Provisions are measured as the expenditure expected to be required to settle the obligation at the reporting date. In cases where it is determined that the effects of the time value of money are significant, the provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects the current market assessment of the time value of money and the risks specific to the obligation.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

4. Acquisition of HIMI

Pursuant to the terms of the Share Exchange Agreement, the Company issued 28,500,100 common shares at \$0.35 per share in exchange for 28,500,100 Class A common shares of HIMI, which represented 100% of the issued and outstanding shares of HIMI. In addition, as a condition precedent to the closing of the Share Exchange Agreement, the Company advanced to HIMI an aggregate amount of \$2,400,000 pursuant to a loan agreement entered on January 4, 2018 between the Company and HIMI. The transaction closed on October 4, 2018.

In accordance with IFRS 3 *Business Combinations*, the purchase agreement was deemed a business combination for accounting purposes. Assets acquired and liabilities assumed are reported at their fair values as at the closing date.

The purchase price allocation (“PPA”) is as follows:

Purchase Price	
Common share issued to acquire HIMI	28,500,100
Closing price of HMI on October 4, 2018	\$ 0.35
Total	\$ 9,975,035
Value of assets less liabilities	
Cash	\$ 18,549
Amounts receivable	449,398
Equipment (Note 6)	1,006,200
Accounts payable and accrued liabilities	(707,721)
Wages payable	(214,568)
Loan payable	(2,522,354)
	(1,970,496)
Goodwill	11,945,531
Reconciliation to Purchase Price	\$ 9,975,035

The Company estimated the fair value of HIMI’s equipment upon acquisition to be USD\$780,000 (\$1,006,200). The excess of the consideration paid over the fair value of the identifiable assets (liabilities) acquired were recognized as goodwill, which primarily consisted of the assembled workforce.

From the date of the acquisition to July 31, 2019, the acquired business contributed \$7,500 of revenue and a net loss of \$565,231.

As at July 31, 2019, management determined that there existed significant uncertainty as to whether the Company would be able to derive future positive cash flows from this CGU; therefore, the Company recognized an impairment charge of \$11,945,531 and reduced the carrying value of goodwill to nil.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

5. Receivables

		July 31, 2020	July 31, 2019
Recoverable sales taxes	\$	5,645	\$ 6,707
	\$	5,645	\$ 6,707

6. Property and Equipment

	Leasehold Improvements \$	Furniture and Fixtures \$	Manufacturing Equipment \$	Total \$
Cost:				
Balance, July 31, 2018	–	–	–	–
Additions (Note 4)	–	–	1,006,200	1,006,200
Balance, July 31, 2019	–	–	1,006,200	1,006,200
Additions	109,056	11,565	–	120,621
Balance, July 31, 2020	109,056	11,565	1,006,200	1,126,821
Accumulated depreciation:				
Balance, July 31, 2018	–	–	–	–
Depreciation	–	–	193,344	193,344
Balance, July 31, 2019	–	–	193,344	193,344
Depreciation	3,634	1,396	234,647	239,677
Impairment	–	–	578,209	578,209
Balance, July 31, 2020	3,634	1,396	1,006,200	1,011,230
Carrying amounts:				
Balance, July 31, 2019	–	–	812,856	812,856
Balance, July 31, 2020	105,422	10,169	–	115,591

During the year ended July 31, 2020, an impairment of \$578,209 (2019 – nil) is recorded to reduce the carrying value of equipment to nil.

7. Right-of-use Asset

	Building \$
Cost	
Balance at July 31, 2019	–
Addition (Note 10)	275,114
Balance at July 31, 2020	275,114
Accumulated amortization	
Balance at July 31, 2019	–
Addition	9,171
Balance at July 31, 2020	9,171
Carrying amount	
Balance at July 31, 2019	–
Balance at July 31, 2020	265,943

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

8. Accounts Payable and Accrued Liabilities

	July 31, 2020	July 31, 2019
Accounts payable	\$ 15,998	\$ 4,500
Accrued liabilities	16,000	25,267
	\$ 31,998	\$ 29,767

9. Related Party Transactions and Balances

Related party transactions

The Company incurred key management compensation as follows:

Year ended July 31,	2020	2019
Management fees accrued or paid to President and CEO, CFO and directors	\$ 149,700	\$ 386,734
Management fees accrued or paid to former directors	-	1,500
Interest paid to President and CEO	1,338	-
Share-based payments	79,705	655,593
Total fees paid to related parties	\$ 230,743	\$ 1,043,827

During the year ended July 31, 2020, the President and CEO of the Company advanced payments of \$66,884 in total on behalf of the Company towards the leasehold improvement costs. As of July 31, 2020, the Company has fully repaid the amount outstanding plus \$1,338 for interest incurred.

On January 16, 2020, the Company granted 500,000 stock options exercisable at \$0.16 per share for five years after the date of grant to the CFO of the Company. The Company recorded \$79,705 (2019 - \$655,593) in share-based payments related to the grant of these stock options.

On April 1, 2020, the Company entered into an agreement to lease a distribution warehouse facility with a company controlled by the family of the President and CEO of the Company. Refer to Note 10.

Wages Payable

As at July 31, 2020, \$33,794 (2019 - \$148,793) in wages payable is outstanding in relation to transactions with related parties, which are non-interest bearing, unsecured and due on demand.

During the year ended July 31, 2020, the Company reversed wages payable of \$176,596 (2019 – nil) related to management fees incurred previously as it was determined the Company would not be required to pay the amount accrued. As a result, \$29,425 was adjusted to prepaid expense for the associated taxes and deductions previously remitted the government authority that was determined to be overpayment.

10. Lease Liability

On April 1, 2020, the Company entered into a lease agreement with a company controlled by the family of a related party (Note 9) for inventory warehouse space located at 30445 Progressive Way, Abbotsford, British Columbia. The lease is for a 10-year term, expiring on March 31, 2030, with one 5-year renewal option and an option for the Company to terminate the lease anytime with 60 days' notice. The base rent is \$5,875 plus tax per month during the term of the lease.

Management has determined the lease is enforceable for the Company as lessee because there is more than insignificant economic penalty if to terminate the lease and therefore recognized the underlying right-of-use asset and lease liability on the consolidated statements of the financial position. The lease liability was discounted using the Company's estimated incremental borrowing rate of 23%.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

10. Lease Liability (continued)

	\$
Lease liability as at July 31, 2019	–
Add: lease liability incurred	275,114
Less: lease payments	(23,500)
Interest expense	21,022
Lease liability as at July 31, 2020	272,636
Less: current portion of lease liability	(8,670)
Lease liability	263,966

The Company's future minimum lease payments for the leased space are as follows:

	\$
Fiscal year ending July 31, 2021	70,500
Fiscal year ending July 31, 2022	70,500
Fiscal year ending July 31, 2023	70,500
Fiscal year ending July 31, 2024	70,500
Fiscal year ending July 31, 2025	70,500
Fiscal years ending July 31, 2026 to 2030	329,000
Total lease payments	681,500
Amount representing interest over the term of the lease	(408,864)
Present value of net lease payments	272,636

11. Share Capital and Reserves

(a) Authorized:

Unlimited number of common shares without nominal or par value.

(b) Issued:

As at July 31, 2020, there were 77,391,358 (July 31, 2019 – 77,916,358) issued and outstanding common shares.

As at July 31, 2020, there were 8,061,045 (July 31, 2019 – 21,435,075) shares held in escrow. Escrow releases will be scheduled as follows, 10% will be released upon completion of the Acquisition followed by six subsequent releases of 15% every nine months thereafter. On October 11, 2019, 8,000,000 common shares held in escrow were returned to the Company and cancelled. During the year ended July 31, 2020, 5,374,030 shares were released from escrow.

(c) Share transactions

During the year ended July 31, 2020

On October 11, 2019, the Company cancelled 8,000,000 common shares held in escrow for nil consideration.

On February 4, 2020, the Company issued 175,000 common shares upon the exercise of 175,000 stock options at \$0.10 per share to the CFO of the Company for proceeds of \$17,500. At the time of issue, the options were valued at \$13,303 and credited to reserves. Upon exercise, this amount was taken out of reserves and added to the value received for shares issued.

On February 24, 2020, the Company issued 100,000 common shares upon the exercise of 100,000 stock options at \$0.125 per share for proceeds of \$12,500. At the time of issue, the options were valued at \$11,970 and credited to reserves. Upon exercise, this amount was taken out of reserves and added to the value received for shares issued.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

11. Share Capital and Reserves (continued)

(c) Share transactions (continued)

During the year ended July 31, 2020 (continued)

On April 17, 2020, the Company completed a non-brokered private placement of 7,000,000 units at a price of \$0.06 per unit for proceeds of \$420,000. Each Unit consisted of one common share and one full share purchase warrant, each warrant entitling the holder thereof to purchase one additional common share at a price of \$0.12 per share until October 18, 2020. Nil value was attributed to the warrants as a component of the units.

On June 29, 2020, the Company issued 200,000 common shares upon the exercise of 200,000 stock options at \$0.125 per share for proceeds of \$25,000. At the time of issue, the options were valued at \$24,939 and credited to reserves. Upon exercise, this amount was taken out of reserves and added to the value received for shares issued.

During the year ended July 31, 2019

On October 4, 2018, the Company issued 28,500,100 common shares at \$0.35 per share in exchange for 28,500,100 Class A shares of HIMI pursuant to the acquisition described in Note 4.

On November 5, 2018, the Company issued 100,000 common shares upon the exercise of 100,000 stock options at \$0.10 per share for proceeds of \$10,000. At the time of issue, the options were valued at \$7,602 and credited to reserves. Upon exercise, this amount was taken out of reserves and added to the value received for shares issued.

(d) Share purchase warrants

The changes in warrants during the years ended July 31, 2020 and 2019 were as follows:

	July 31, 2020		July 31, 2019	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Warrants outstanding, beginning of the year	11,926,715	\$ 0.40*	11,926,715	\$ 0.40*
Issued	7,000,000	0.12	-	-
Expired	(681,978)	0.50	-	-
Warrants outstanding, end of the year	18,244,737	\$ 0.29	11,926,715	\$ 0.40*

A summary of the Company's outstanding warrants as at July 31, 2020 is as follows:

Number of warrants	Exercise price *	Expiry date *
3,082,165	\$ 0.39	January 12, 2021
6,289,072	0.39	January 12, 2021
1,873,500	0.39	January 12, 2021
7,000,000	0.12	October 18, 2020
18,244,737	\$ 0.29	

* On November 15, 2019, the Company amended the exercise price and term of an aggregate of 11,244,737 common share purchase warrants issued in connection with the non-brokered private placements that closed on December 4, 2017, December 19, 2017 and January 12, 2018. The exercise price of the Warrants was re-priced to \$0.39 from \$0.50 and the term was extended to January 12, 2021. Finder's Warrants issued in connection with the Offerings were not amended. The weighted average exercise prices have been amended to reflect this repricing.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

11. Share Capital and Reserves (continued)

(e) Stock options

The Company has a stock option plan under which it is authorized to grant options to the Company's officers, directors, employees and consultants enabling them to acquire up to 10% of the issued and outstanding common shares of the Company. Under the plan, the exercise price of each option equals the market price of the Company's shares, less applicable discount, as calculated on the date of grant. The options can be granted for a maximum term of 10 years with vesting determined by the board of directors.

On January 16, 2020, the Company granted 500,000 stock options to the CFO of the Company and 750,000 stock options to a consultant of the Company. The stock options are exercisable at \$0.16 per share for five years after the date of grant. The options vested upon grant.

On December 18, 2019, the Company granted 450,000 stock options exercisable at \$0.25 per share for five years after the date of grant. The options vested upon grant.

On September 4, 2019, the Company granted 700,000 stock options exercisable at \$0.125 per share for five years after the date of grant. The options vested upon grant.

On July 5, 2019, the Company granted 1,000,000 stock options exercisable at \$0.125 per share for five years after the date of grant. The options vested upon grant.

On November 16, 2018, the Company granted 4,525,000 stock options exercisable at \$0.30 per share for five years after the date of grant. The options vested upon grant. These options were cancelled during the year ended July 31, 2019.

A summary of stock option transactions during the years ended July 31, 2020 and 2019 were as follows:

	July 31, 2020		July 31, 2019	
	Number of Options	Weighted average exercise price	Number of Options	Weighted average exercise price
Outstanding, beginning of the period	1,615,000	\$ 0.15	2,490,000	\$ 0.28
Granted	2,400,000	0.17	5,525,000	0.27
Cancelled	–	–	(6,300,000)	0.31
Exercised	(475,000)	0.12	(100,000)	0.10
Outstanding, end of the period	3,540,000	\$ 0.17	1,615,000	\$ 0.15
Exercisable, end of the period	3,540,000	\$ 0.17	1,615,000	\$ 0.15

The weighted average trading price of the Company's shares at the time of exercise was \$0.22 (2019 - \$0.31).

The following stock options were outstanding and exercisable as at July 31, 2020:

Number of Options	Exercise price	Expiry date
240,000	\$ 0.17	January 17, 2022
200,000	0.30	February 3, 2022
800,000	0.125	July 5, 2024
600,000	0.125	September 4, 2024
450,000	0.25	December 18, 2024
1,250,000	0.16	January 16, 2025
3,540,000	\$ 0.17	

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

11. Share Capital and Reserves (continued)

(f) Reserves

Reserves relates to stock options, agents' unit options, and compensatory warrants that have been issued by the Company. The Company uses the Black-Scholes valuation model to value stock options.

Share-based payments recognized and expensed during the year ending July 31, 2020 was \$390,638 (2019 - \$1,137,688).

The following weighted average assumptions were used for the Black-Scholes valuation of stock options granted or vested during the year ending July 31, 2020 and 2019:

	July 31, 2020	July 31, 2019
Risk-free interest rate	1.47%	1.67%
Expected life of options	5 years	5 years
Annualized volatility	261%	257%
Forfeiture rate	0%	0%
Dividend rate	0%	0%

(g) Loss per share

The calculation of basic and diluted loss per share for the year ended July 31, 2020 was based on the weighted average number of common shares outstanding of 73,644,910 (2019 – 72,736,340).

12. Financial Risk Management

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board of Directors has established the Audit and Risk Management Committee, which is responsible for developing and monitoring the Company's compliance with risk management policies and procedures. The committee reports regularly to the Board of Directors on its activities.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities. The Company, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

(a) Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company's primary exposure to credit risk is on its cash held in bank accounts. The majority of cash is deposited in bank accounts held with major banks in Canada. As most of the Company's cash is held by one bank there is a concentration of credit risk. This risk is managed by using major banks that are high credit quality financial institutions as determined by rating agencies. The Company also has minimal risk relating to smaller amounts of refundable sales taxes.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

12. Financial Risk Management (continued)

(b) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company has a planning and budgeting process in place to help determine the funds required to support the Company's normal operating requirements on an ongoing basis. The Company ensures that there are sufficient funds to meet its short-term business requirements, taking into account its anticipated cash flows from operations and its holdings of cash and similar source.

As at July 31, 2020, the Company's liabilities consisted of accounts payable and accrued liabilities of \$31,998 (2019 – \$29,767) and wages payable of \$53,016 (2019 - \$200,187). The Company's cash was \$239,121 (2019 - \$526,682) at July 31, 2020 and was sufficient to fulfil these liabilities.

Historically, the Company's sole source of funding has been the issuance of equity securities for cash, primarily through private placements, and loans from related parties. The Company's access to financing is always uncertain. There can be no assurance of continued access to significant funding.

(c) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market price risk is comprised of three types of market price changes: foreign currency exchange rates, interest rates and commodity prices.

(i) Foreign currency exchange risk

Foreign currency risk is the risk that the fair values of future cash flows of a financial instrument will fluctuate because they are denominated in currencies that differ from the respective functional currency. The Company's risk to foreign exchange is limited since it holds only Canadian dollars.

(ii) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company does not carry significant financial instruments that are exposed to interest rate risk. The amount advanced from a related party which was at a fixed interest rate and was repaid in full within the year (Note 9), In addition, the Company manages interest rate risk by maintaining an investment policy that focuses primarily on preservation of capital and liquidity. Accordingly, the Company is not subjected to interest rate risk.

(iii) Commodity price risk

The Company does not hold any financial instruments that have direct exposure to commodity or other price risks.

13. Capital Disclosures

The Company manages its capital in a manner consistent with the risk characteristics of the assets it holds. All financing, including equity and debt, are analyzed by management and approved by the Board of Directors.

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern and provide returns for shareholder. The Company is meeting its objective of managing capital through its detailed review and performance of due diligence on all potential acquisitions, preparing short-term and long-term cash flow analysis to ensure an adequate amount of liquidity and monthly review of financial results. The Company considers cash, shareholder loans and shareholders' equity (deficiency) to be capital. The Company does not have any externally imposed requirements on its capital.

There have been no changes in the Company's approach to capital management from the previous years.

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

14. Commitments

- (a) On November 16, 2018, the Company entered into a sales and distribution agreement. Pursuant to the agreement, the Company granted distribution rights to sell products manufactured by the Company in Asia and Europe for a term of two years.
- (b) On December 18, 2019, the Company signed and announced an Independent Sales Agreement (the "Agreement") with a consultant (the "Consultant") who will act as the Company's exclusive distributor and sales agent in Canadian retail markets for a term of one year. Pursuant to the Agreement, the Company granted the Consultant 250,000 stock options exercisable at \$0.25 per share until December 18, 2024. In addition, the Company agreed to pay the Consultant \$5,000 per month for three months.
- (c) On April 21, 2020, the Company entered into an exclusive distribution agreement with a distributor party for an initial term of 10 years. Pursuant to the agreement, the Company appointed the party as the exclusive agent to distribute, market sell and supply tobacco products manufactured by the Company for sale in Canada and granted the agent a non-exclusive, non-transferable, royalty-free license to use any all trademarks and trade names owned by the Company.

15. Income Taxes

Income tax expense varies from the amount that would be computed by applying the expected basic federal and provincial income tax rates for Canada at July 31, 2020 at 27% (2019 – 27%) to income before income taxes.

	July 31, 2020	July 31, 2019
Net loss for the year	\$ (1,683,854)	\$ (14,072,793)
Expected income tax recovery at statutory rate	\$ (455,000)	\$ (3,800,000)
Tax effect of:		
Non-deductible expenditures	106,000	3,452,000
Change in tax rates	-	131,000
Change in unrecognized deductible temporary differences	328,000	217,000
Other	21,000	-
Provision for income tax expense	\$ -	\$ -

The significant components of the Company's unrecognized deferred tax assets and liabilities are as follows:

	July 31, 2020	July 31, 2019
Deferred tax assets:		
Share issue costs	\$ 62,000	\$ 87,000
Property and equipment	184,000	(16,000)
Non-capital losses available for future periods	1,292,000	1,139,000
Total deferred tax assets	1,538,000	1,210,000
Unrecognized deductible temporary differences	(1,538,000)	(1,210,000)
Net deferred income tax assets	\$ -	\$ -

HARRYS MANUFACTURING INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2020 and 2019

(Expressed in Canadian dollars unless otherwise noted)

15. Income Taxes (continued)

The significant components of the Company's unrecognized temporary differences and tax losses are as follows:

	July 31, 2020	Expiry Dates	July 31, 2019	Expiry Dates
Share issue costs	\$ 229,000	2021-2022	\$ 347,000	2020-2022
Property and equipment	683,000		(64,000)	
Non-capital losses available for future periods	4,784,000	2027-2040	4,556,000	2027-2039
	<u>\$ 5,696,000</u>		<u>\$ 4,839,000</u>	

16. Subsequent Events

- Subsequent to the year ended July 31, 2020, the Company issued 3,767,000 shares upon the exercise of warrants at \$0.12 per share.
- Pursuant to an exclusive manufacturing agreement dated November 19, 2020, the Company issued to the exclusive manufacturer 500,000 share purchase warrants exercisable for five years at \$0.15 per share.
- Subsequent to the year ended July 31, 2020, 500,000 of options were expired following the termination of a consulting agreement.