

**XS Financial Inc.**

Financial Statements

For the Three and Six Months ended June 30, 2020 and 2019

(Unaudited)

(Expressed in United States Dollars)

**XS Financial Inc.**

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**NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying unaudited condensed interim consolidated financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these condensed interim consolidated financial statements, in accordance with standards established by CPA Canada for a review of interim financial statements by an entity's auditor.

**XS Financial Inc.**  
**Condensed consolidated statements of loss and comprehensive loss**  
**For the three and six months ended June 30, 2020 and 2019**  
**(Unaudited)**  
**(Expressed in United States dollars)**

	Note	Three months ended June 30,		Six months ended June 30,	
		2020	2019	2020	2019
<b>Revenue</b>	6	\$ 1,293,115	\$ 430,708	\$ 1,593,160	\$ 972,025
Cost of sales	7	1,293,107	551,074	1,515,389	1,185,111
<b>Gross profit (loss)</b>		8	(120,366)	77,771	(213,086)
Administrative expenses	7	554,605	1,405,787	1,013,212	2,385,711
Sales and marketing expenses	7	229,332	8,514	275,423	85,647
<b>Loss from operations</b>		(783,929)	(1,534,667)	(1,210,864)	(2,684,444)
Financing expense, net	16	138,585	218,265	266,581	443,449
Accretion expense	16	81,879	459,958	151,806	912,794
Unrealized (gain) loss in fair value change of investments	8	(89,266)	-	1,898,046	-
Change in fair value of derivative liabilities	16	-	(489,099)	-	2,817,277
Other (income) expense		(15,439)	12,624	(20,510)	20,217
<b>Loss before income tax</b>		(899,688)	(1,736,415)	(3,506,787)	(6,878,181)
Income tax expense	20	-	-	-	975
<b>Net loss</b>		<u>\$ (899,688)</u>	<u>\$ (1,736,415)</u>	<u>\$ (3,506,787)</u>	<u>\$ (6,879,156)</u>
<b>Other comprehensive loss</b>					
Items that will subsequently be reclassified to operations:					
Unrealized loss on foreign currency translation		(3,580)	-	(17,835)	-
<b>Comprehensive loss</b>		<u>\$ (903,268)</u>	<u>\$ (1,736,415)</u>	<u>\$ (3,524,622)</u>	<u>\$ (6,879,156)</u>
<b>Loss per share - basic and diluted</b>		<u>\$ (0.02)</u>	<u>\$ (0.05)</u>	<u>\$ (0.07)</u>	<u>\$ (0.21)</u>
<b>Weighted average shares outstanding:</b>					
<b>Basic and diluted</b>		<u>53,574,411</u>	<u>33,085,489</u>	<u>51,539,245</u>	<u>32,794,977</u>

Approved on behalf of the Board:

Gary Herman, Director

Stephen Christoffersen, Director

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

**XS Financial Inc.**  
**Condensed consolidated statements of financial position**  
**As of June 30, 2020 and December 31, 2019**  
**(Expressed in United States dollars)**

	Note	(Unaudited) June 30, 2020	December 31, 2019
<b>Assets</b>			
<i><b>Current assets</b></i>			
Cash		\$ 2,297,505	\$ 2,487,293
Investments	8	1,163,769	-
Trade and other receivables, net	9	102,858	124,715
Financing receivables, short-term	10	473,420	480,466
Inventories	11	36,052	36,052
Prepaid and other current assets	12	200,242	244,581
<i><b>Total current assets</b></i>		<u>4,273,846</u>	<u>3,373,107</u>
<i><b>Non-current assets</b></i>			
Servicing equipment	13	505,542	783,195
Property, plant and equipment	14	10,806	7,506
Financing receivables, long-term	10	793,645	310,798
<i><b>Total non-current assets</b></i>		<u>1,309,993</u>	<u>1,101,499</u>
<b>Total assets</b>		<u>\$ 5,583,839</u>	<u>\$ 4,474,606</u>
<b>Shareholders' equity and liabilities</b>			
<i><b>Current liabilities</b></i>			
Loans and borrowings, short-term	16	\$ 600,000	\$ 600,000
Trade and other payables	18	243,622	119,752
Accrued expenses	19	256,761	201,317
Unearned revenue	6	696,589	-
Amounts due to related parties	22	32,067	-
Redeemable common stock	16	650,000	650,000
<i><b>Total current liabilities</b></i>		<u>2,479,039</u>	<u>1,571,069</u>
<i><b>Non-current liabilities</b></i>			
Loans and borrowings, long-term	16	2,167,780	1,978,544
<b>Total liabilities</b>		4,646,819	3,549,613
<i><b>Shareholders' equity</b></i>			
Share capital	15	13,593,825	10,342,678
Reserves		3,482,455	3,234,686
Conversion feature - debentures	15	996,668	958,935
Accumulated other comprehensive loss		(42,520)	(24,685)
Accumulated deficit		(17,093,408)	(13,586,621)
<i><b>Total shareholders' equity</b></i>		<u>937,020</u>	<u>924,993</u>
<b>Total shareholders' equity and liabilities</b>		<u>\$ 5,583,839</u>	<u>\$ 4,474,606</u>

Nature of operations and background information (Note 1)  
Going concern (Note 3)  
Subsequent events (Note 24)

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

XS Financial Inc.

Condensed consolidated statements of changes in equity

For the six months ended June 30, 2020 and 2019

(Unaudited)

(Expressed in United States dollars)

	Note	Number of Common Shares	Number of Proportionate Common Shares	Share Capital	Reserves	Conversion feature for debentures	Accumulated other comprehensive loss	Accumulated deficit	Total
<b>Balance at January 1, 2019</b>		32,501,238	-	\$ 4,737,813	\$ 582,670	\$ -	\$ -	\$ (6,214,702)	\$ (894,219)
Issuance of Class A common stock	15	-	-	757,500	626,874	-	-	-	1,384,374
Fair value allocation of loan borrowing proceeds	16	-	-	-	260,745	-	-	-	260,745
Share-based incentive compensation	21	-	-	-	399,430	-	-	-	399,430
Net loss and comprehensive loss		-	-	-	-	-	-	(6,879,156)	(6,879,156)
<b>Balance at June 30, 2019</b>		<u>32,501,238</u>	<u>-</u>	<u>\$ 5,495,313</u>	<u>\$ 1,869,719</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (13,093,858)</u>	<u>\$ (5,728,826)</u>
<b>Balance at January 1, 2020</b>		29,986,764	12,507	\$ 10,342,678	\$ 3,234,686	\$ 958,935	\$ (24,685)	\$ (13,586,621)	\$ 924,993
Conversion of Sub Receipt debentures to common stock and warrants	15	48,181	-	18,332	(37,733)	37,733	-	-	18,332
Issuance of common shares to third party providers	15	950,000	-	171,000	-	-	-	-	171,000
Issuance of proportionate voting shares	15	-	10,600	3,061,815	-	-	-	-	3,061,815
Share-based incentive compensation	21	-	-	-	285,502	-	-	-	285,502
Net loss and comprehensive loss		-	-	-	-	-	(17,835)	(3,506,787)	(3,524,622)
<b>Balance at June 30, 2020</b>		<u>30,984,945</u>	<u>23,107</u>	<u>\$ 13,593,825</u>	<u>\$ 3,482,455</u>	<u>\$ 996,668</u>	<u>\$ (42,520)</u>	<u>\$ (17,093,408)</u>	<u>\$ 937,020</u>

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

**XS Financial Inc.**  
**Condensed consolidated statements of cash flows**  
**For the six months ended June 30, 2020 and 2019**  
**(Unaudited)**  
**(Expressed in United States dollars)**

	Note	Six months ended	
		June 30,	
		2020	2019
<b>Cash flows from operating activities</b>			
Loss for the period		\$ (3,506,787)	\$ (6,879,156)
Adjustments to reconcile loss to net cash flows:			
Depreciation and amortization	13,14	71,007	293,765
Gain on sale of servicing equipment to a customer	13	-	(257,535)
Loss on sale of servicing equipment and property, plant and equipment to vendors and third party buyers	13,14	54,125	20,217
Noncash finance lease income	10	(156,736)	-
Incentive compensation expense	21	285,502	399,430
Common shares, warrants and debentures issued for services	15,16	171,000	742,676
Finance and accretion expense	16	151,806	937,597
Change in fair value of embedded derivative liabilities	16	-	2,817,277
Unrealized loss in fair value change of investments	8	1,898,046	-
Purchases of equipment for finance leases	11	(792,572)	-
Proceeds from finance lease receivables	10	1,491,528	-
		(333,081)	(1,925,729)
Change in working capital items:			
Trade and other receivables	9	4,857	(8,759)
Inventories	11	-	979
Prepaid and other current assets	12	44,339	6,732
Trade and other payables	18	(33,137)	(142,374)
Accrued expenses	19	(110,287)	522,042
Unearned revenue	6	25,000	-
Amounts due to related parties	22	32,067	374,748
<b>Net cash flows used in operating activities</b>		<b>(370,242)</b>	<b>(1,172,361)</b>
<b>Cash flows from investing activities</b>			
Proceeds from the sale of servicing equipment and property, plant and equipment	13,14	394,399	46,380
Purchases of servicing equipment	13	(247,706)	(38,774)
Purchases of property, plant and equipment	14	(4,166)	-
<b>Net cash flows provided by investing activities</b>		<b>142,527</b>	<b>7,606</b>
<b>Cash flows from financing activities</b>			
Proceeds from loans and borrowings	16	55,762	1,100,000
Repayment of debt	16	-	(49,664)
<b>Net cash flows provided by financing activities</b>		<b>55,762</b>	<b>1,050,336</b>
<b>Effect of exchange rate changes on cash</b>			
		<b>(17,835)</b>	<b>-</b>
<b>Net decrease in cash</b>		<b>(189,788)</b>	<b>(114,419)</b>
<b>Cash at beginning of the the period</b>		<b>2,487,293</b>	<b>534,148</b>
<b>Cash at end of the period</b>		<b>\$ 2,297,505</b>	<b>\$ 419,729</b>
<b>Supplemental disclosure of cash flow information:</b>			
Cash paid for interest		\$ 243,054	\$ 521
<b>Supplemental disclosure of non-cash transactions:</b>			
<b>Non-cash investing and financing activities</b>			
Purchases of servicing equipment included in trade and other payables and amounts due to related parties	18,22	\$ 322,739	\$ 381,913
Issuance of proportionate common shares	15	3,061,815	-
Discount on loan borrowings proceeds	16	-	228,183
Issuance of convertible debt, net of discount of \$163,563	16	-	55,306
Issuance of warrants to service providers and consultants	15,16,17	-	866,333
Conversion of Sub Receipt convertible debt to common stock	15, 17	18,332	-
Servicing equipment sold and reduction to deferred revenue	6	-	846,109

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

## **XS Financial Inc.**

Notes to the Unaudited Condensed Consolidated Financial Statements

(Unaudited)

(Expressed in United States Dollars)

### **(1) Nature of operations and background information**

XS Financial Inc. ("XSF", or "the Company"), which changed its name from Xtraction Services Holdings Corp. on June 26, 2020 and formerly known as Caracara Silver Inc. ("Caracara") was incorporated under the laws of the Province of British Columbia on December 3, 2009, and is listed on the Canadian Securities Exchange ("CSE") under the symbol "XSF".

XSF is a specialty finance company that provides equipment leasing solutions in the United States to owner/operators of cannabis and hemp companies including cultivators, oil processors, manufacturers, testing laboratories, among others and operates in one business segment in one geographic area. Its registered office is located at 1901 Avenue of The Stars, Suite 120, Los Angeles, California 90067, USA.

Xtraction Services, Inc. ("XSI") was originally established as a Delaware limited liability company on October 9, 2017. In July 2018, XSI filed with the Secretary of State of Delaware to change its corporate status from a Delaware limited liability company to a Delaware corporation and elected to be classified as a corporation. On July 19, 2018, XSI received a Certificate of Conversion and Certificate of Incorporation from the Secretary of State of Delaware.

On March 22, 2019, XSI entered into a definitive merger agreement with Caracara pursuant to which Caracara would acquire all of the issued and outstanding common shares of XSI. The transaction was structured as a "reverse triangular merger" between XSI, Caracara and a wholly-owned subsidiary of Caracara incorporated under the laws of Delaware. On September 11, 2019, the merger became effective whereby Caracara's subsidiary acquired all of the issued and outstanding Class A and Class B common shares, stock options and warrants of XSI and the resulting issuer changed its name from Caracara Silver Inc. to Xtraction Services Holdings Corp. and continued with the business of XSI.

The accompanying condensed consolidated financial statements have been approved by the Company's board of directors and are authorized for issuance as of August 26th, 2020.

### **(2) Basis of presentation**

#### *Statement of compliance*

These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and International Accounting Standards and Interpretations (collectively IFRSs) as issued by the International Accounting Standards Board (IASB).

#### *Basis of consolidation*

Subsidiaries are entities over which the Company has control, where control is defined to exist when the Company is exposed to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are

## **XS Financial Inc.**

### Notes to the Unaudited Condensed Consolidated Financial Statements

(Unaudited)

(Expressed in United States Dollars)

consolidated from the date control is transferred to the Company, and are de-consolidated from the date control ceases.

The condensed consolidated financial statements incorporate the financial statements of the Company and its wholly owned subsidiaries, Xtraction Services, Inc. incorporated in Delaware, United States, and CSI Princesa Inc. incorporated in Ontario, Canada. The results of subsidiaries acquired or disposed of during the year are included in the condensed consolidated financial statements of loss and comprehensive loss from the effective date of acquisition up to the effective date of disposal, as appropriate.

All intercompany transactions, balances, income and expenses are eliminated upon consolidation.

#### *Functional and presentation currency*

The condensed consolidated financial statements of the Company are presented in U.S. dollars (USD). The functional currency of the Company and CSI Princesa Inc., its Canadian subsidiary, is the Canadian dollar. The functional currency of Xtraction Services, Inc. is the U.S. dollar.

#### *Basis of measurement*

The condensed consolidated financial statements have been prepared on a historical cost basis, except for certain financial instruments measured at fair value through profit and loss. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting except for cash flow information.

#### *Use of estimates and judgement*

The preparation of financial statements in compliance with adopted IFRS requires the use of certain critical accounting estimates. It also requires the management of the Company to exercise judgment in applying the Company's accounting policies. The areas where significant judgments and estimates have been made in preparing the condensed consolidated financial statements and their effect are disclosed in note 5 below.

### **(3) Going concern**

The condensed consolidated financial statements have been prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Company has incurred losses and negative cash flows from operations since inception, and has an accumulated deficit of \$17,093,408 and \$13,586,621 as of June 30, 2020 and December 31, 2019, respectively. The Company's ability to continue as a going concern is dependent upon achieving a profitable level of operations and obtaining additional financing, neither of which is assured. The Company anticipates incurring additional losses until such time that it can generate sufficient revenue from its operations to cover its expenses. Historically, the Company has been successful in obtaining enough funding for operating and capital requirements. The condensed consolidated financial statements do not give effect to any adjustments which may be necessary should the Company be



## XS Financial Inc.

### Notes to the Unaudited Condensed Consolidated Financial Statements

(Unaudited)

(Expressed in United States Dollars)

unable to continue as a going concern and be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying condensed consolidated financial statements. These adjustments could be material.

The operations of the Company are subject to certain risks and uncertainties including, among others: uncertainty of product development; technological uncertainty; commercial acceptance of any developed products; dependence on collaborative partners; uncertainty regarding patents and proprietary rights; comprehensive government regulations; market risk; and dependence on key personnel.

#### (4) Significant accounting policies

The Company has applied the same accounting policies and methods of computation in its interim condensed consolidated financial statements as in its 2019 and 2018 annual financial statements except for adoption of *IAS 1 – Presentation of Financial Statements* and *IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors* and *IFRS 3 Business Combinations* on January 1, 2020.

#### Fair value of financial instruments

As at June 30, 2020, the Company had the following financial instruments measured at fair value:

	Fair Value Measurement at Reporting Date Using			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
As of June 30, 2020:				
Assets:				
Investments (note 8)	1,163,769	\$ -	\$ -	\$ 1,163,769

As at December 31, 2019, the Company did not have any financial instruments measured at fair value.

Transfers between levels are considered to occur on the date that the fair valuation methodology changes. There were no transfers between levels during the current or comparative periods. There were no liabilities at fair value as at June 30, 2020 and December 31, 2019.

#### New standards and interpretations recently adopted

Effective January 1, 2020 the Company has adopted *IAS 1 – Presentation of Financial Statements* (“*IAS 1*”) and *IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors* (“*IAS 8*”), which were amended in October 2018 to refine the definition of materiality and clarify its characteristics. The revised definition focuses on the idea that information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements. The

## **XS Financial Inc.**

### Notes to the Unaudited Condensed Consolidated Financial Statements

(Unaudited)

(Expressed in United States Dollars)

Company has concluded there was no impact on its financial statements and related disclosures upon the adoption of the amended standards for *IAS 1* and *IAS 8*.

Effective January 1, 2020 the Company has adopted *IFRS 3 – Business Combinations (“IFRS 3”)*, which was amended in October 2018 to clarify the definition of a business. This amended definition states that a business must include inputs and a process and clarified that the process must be substantive and the inputs and process must together significantly contribute to operating outputs. In addition it narrows the definitions of a business by focusing the definition of outputs on goods and services provided to customers and other income from ordinary activities, rather than on providing dividends or other economic benefits directly to investors or lowering costs and added a test that makes it easier to conclude that a company has acquired a group of assets, rather than a business, if the value of the assets acquired is substantially all concentrated in a single asset or group of similar assets. The Company has concluded there was no impact on its financial statements and related disclosures upon the adoption of the amended standard for *IFRS 3*.

The Company had no additional new standards adopted that resulted in changes to the Company’s accounting policies for the six months ended June 30, 2020.

#### **(5) Critical accounting estimates and judgements**

In the application of the Company’s accounting policies, which are described in note 4 above, the Company’s management are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these assumptions.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Significant judgments, estimates and assumptions that have the most significant effect on the amounts recognized in the condensed consolidated financial statements are described below.

##### *Depreciation and Amortization of Servicing Equipment, Property, Plant and Equipment, and Intangible Assets and Estimate of Useful Lives*

Depreciation and amortization of servicing equipment, property, plant and equipment and intangible asset is dependent upon estimates of useful lives. The Company estimates the useful lives of these assets based on the period over which the assets are expected to be available for use. The estimated useful lives are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the relevant assets.

##### *Long-Lived Assets and Impairment*

Long-lived assets, such as servicing equipment, property, plant and equipment and finite intangible assets, are reviewed for impairment whenever events or changes in circumstances

## **XS Financial Inc.**

### Notes to the Unaudited Condensed Consolidated Financial Statements

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indicate the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, the Company estimates its recoverable amount. An impairment loss is recognized to the extent the carrying value exceeds its recoverable amount. Fair value is determined using various valuation techniques, including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary.

#### *Share-based Incentive Compensation*

The Company uses the Black-Scholes option pricing model to determine the fair value of share-based awards granted. In estimating fair value, management is required to make certain assumptions and estimates such as the expected term, volatility of the Company's future share price, risk free interest rates, future dividend yields and estimated forfeitures at the initial grant date. Changes in assumptions used to estimate fair value could result in materially different results.

#### *Derivative Liabilities*

Derivative liabilities are initially recognized at fair value on the date entered into and are subsequently remeasured to their fair value at the end of each reporting period. Changes in the fair value of any derivative instrument are recognized immediately as a component of other expense (income) in the condensed consolidated statements of loss and comprehensive loss. The fair value of the derivative liabilities are subject to measurement uncertainty due to the assumptions made for the inputs in the Black-Scholes option valuation. See notes 16 and 17.

#### *Compound Financial Instruments*

The initial recognition of the compound financial instruments requires that the liability component and the conversion feature are recognized separately. Judgement is required to determine whether the conversion feature meets the definition of equity or a derivative liability. The fair values at initial recognition is subject to measurement uncertainty. See note 16.

#### *Functional Currency Determination*

The functional currency for the Company and its subsidiaries is the currency of the primary economic environment in which the entity operates.

Determination of functional currency is conducted through an analysis of the consideration factors identified in IAS 21. The Effects of Changes in Foreign Exchange Rates and may involve certain judgments to determine the primary economic environment. The Company reconsiders the functional currency of its entities if there is a change in events and conditions which determine the primary economic environment. Significant changes to those underlying factors could cause a change to the functional currency.

## XS Financial Inc.

### Notes to the Unaudited Condensed Consolidated Financial Statements

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#### *Determination of Discount Rates*

Determination of the discount rate for term loans and convertible debentures is based on comparison to similar interest bearing debt instruments of a group of comparative companies.

#### *Determination of Financing Lease or Operating Lease*

In making the determination of whether an arrangement should be accounted for as a financing lease or an operating lease, the Company makes certain assumptions including the fair value of the equipment under lease, the interest implicit in the lease and the residual value of the equipment at the end of the lease.

#### *Expected Credit Losses*

See notes 9 and 10.

## (6) Revenue

The following table presents a disaggregation of revenue by source and timing of revenue recognition:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2020	2019	2020	2019
Revenue source:				
Financing leases (note 10)	\$ 1,149,715	\$ -	\$ 1,306,945	\$ -
Equipment sales	133,400	333,149	133,400	849,598
Royalty sales	-	76,187	-	101,055
Operating leases	-	21,372	143,250	21,372
Other revenue	10,000	-	9,565	-
	<u>\$ 1,293,115</u>	<u>\$ 430,708</u>	<u>\$ 1,593,160</u>	<u>\$ 972,025</u>
Timing of revenue recognition under IFRS 15				
from contracts with customers:				
Products and services transferred at a point in time	<u>\$ 133,400</u>	<u>\$ 333,149</u>	<u>\$ 133,400</u>	<u>\$ 849,598</u>
Services transferred over time	<u>\$ 1,159,715</u>	<u>\$ 97,559</u>	<u>\$ 1,459,760</u>	<u>\$ 122,427</u>

At June 30, 2020 the Company had unsatisfied performance obligations of \$696,589, related to a deposit received on a financing lease and proposal fees received for financing lease transactions under evaluation, which is reflected as unearned revenue in the statements of financial position.

The Company's largest revenue transaction in the three and six months ended June 30, 2019 resulted from the sale of equipment to a single customer that was fully paid in October 2018 with delivery and installation completed in November 2019.

The Company had \$nil and \$426,316 of servicing equipment (note 13) subject to revenue generated from operating lease arrangements as of June 30, 2020 and December 31, 2019, respectively.

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Notes to the Unaudited Condensed Consolidated Financial Statements

(Unaudited)

(Expressed in United States Dollars)

*Revenue concentration*

All of the Company's revenue is derived from customers in the United States with one customer representing 86% and 70% of the Company's recognized revenue in the three and six months ended June 30, 2020, respectively, and another separate customer representing 78% and 87% of the Company's recognized revenue in the three and six months ended June 30, 2019, respectively.

**(7) Expenses by nature**

The following tables presents an analysis of expense by nature:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2020	2019	2020	2019
<b>Cost of sales:</b>				
Compensation and benefits	\$ 38,495	\$ 65,273	\$ 89,485	\$ 145,928
Depreciation expense	33,507	108,853	71,007	216,579
Amortization of intangible	-	38,292	-	76,583
Equipment inventory purchases	-	267,508	-	616,919
Equipment inventory costs	1,022,512	-	1,150,209	-
Supplies and materials	(373)	28,719	551	57,572
Maintenance and repair costs	-	14,187	-	21,336
Other expenses	198,966	28,242	204,137	50,194
	<u>\$ 1,293,107</u>	<u>\$ 551,074</u>	<u>\$ 1,515,389</u>	<u>\$ 1,185,111</u>
<b>Administrative expenses:</b>				
Compensation and benefits	\$ 935	\$ 19,682	\$ 2,351	\$ 44,386
Incentive compensation	234,834	(45,894)	285,502	399,430
Contractors and outside services	31,045	52,800	61,987	138,402
Management fee	60,200	86,000	146,200	174,400
Professional fees	133,379	1,246,495	280,545	1,417,510
Office rent, utilities and expenses	17,520	12,034	25,691	36,989
Travel, meals and entertainment	1,544	5,433	8,496	27,826
Insurance	52,605	23,603	107,320	120,647
Other expenses	22,543	5,634	95,120	26,121
	<u>554,605</u>	<u>\$ 1,405,787</u>	<u>1,013,212</u>	<u>\$ 2,385,711</u>
<b>Sales and marketing expenses:</b>				
Compensation and benefits	\$ 22,334	\$ 4,014	\$ 49,745	\$ 20,165
Contractors and outside services	-	-	10,000	-
Commissions	112,760	-	112,760	-
Professional fees	27,867	(4,500)	27,867	45,833
Advertising and marketing	66,261	1,045	73,502	11,153
Trade shows	-	7,209	-	7,209
Other expenses	110	746	1,549	1,287
	<u>\$ 229,332</u>	<u>\$ 8,514</u>	<u>\$ 275,423</u>	<u>\$ 85,647</u>

## XS Financial Inc.

### Notes to the Unaudited Condensed Consolidated Financial Statements

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#### (8) Investments

In January 2020, the Company entered into a strategic partnership and cooperation agreement with KushCo Holdings Co. Inc. (“KushCo”) whereby the Company issued 10,600.3 proportionate voting shares at a share price of \$0.38CAD (\$0.29) (note 15) for total consideration of \$3,061,815 in exchange for 1,653,081 shares of KushCo valued at an amount equal to the consideration given up by the Company.

The Company recorded the shares received from KushCo as investments on the condensed consolidated statement of financial position. Investments are classified at fair value through profit or loss (FVPL). At June 30, 2020, the investment in KushCo was re-valued at \$1,163,769, with the change in fair value of \$(89,266) and \$1,898,046 reflected at FVPL in the condensed consolidated statements of comprehensive loss for the three and six months ended June 30, 2020, respectively.

#### (9) Trade and other receivables

The following table presents trade and other receivables:

	<b>June 30, 2020</b>	<b>December 31, 2019</b>
Trade receivables	\$ 52,858	\$ 124,715
Other receivables	50,000	-
	<u>\$ 102,858</u>	<u>\$ 124,715</u>

Trade receivables are measured at amortized cost net of allowance for uncollectible amounts. The Company determines its expected credit loss based on a number of factors, including length of time an account is past due, the customer’s previous loss history, and the ability of the customer to pay its obligation to the Company. The Company writes off receivables when they become uncollectible. Allowance for uncollectible accounts is included in general and administration expenses within the condensed consolidated statements of loss and comprehensive loss.

The following table presents the movement in the allowance on trade receivables from January 1, 2020 through June 30, 2020:

Balance at January 1, 2020	\$ -
Bad debt provision	40,000
Receivables written-off as uncollectible	<u>(40,000)</u>
Balance at June 30, 2020	<u>\$ -</u>

The \$50,000 of other receivables represents unbilled amounts due from third party customers related to the sale of servicing equipment (note 13). The entire \$50,000 was billed and collected in July and August 2020.

## XS Financial Inc.

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(Expressed in United States Dollars)

#### (10) Financing receivables

The following table presents financing receivables:

	<b>June 30, 2020</b>	<b>December 31, 2019</b>
Financing receivables, short-term	\$ 473,420	\$ 480,466
Financing receivables, long-term	793,645	310,798
	<u>\$ 1,267,065</u>	<u>\$ 791,264</u>

The Company has entered into lease arrangements as a lessor that are considered to be finance leases. All of the risks and rewards of ownership of the service equipment assets underlying the finance leases are substantially transferred to the lessee.

The following table presents a maturity analysis of lease receivables, including the undiscounted lease payments to be received as at June 30, 2020:

2020	\$ 461,096
2021	493,452
2022	441,471
2023	246,672
2024	114,522
Total undiscounted lease payments receivable	1,757,213
Unearned finance income	(490,148)
Net investment in lease	<u>\$ 1,267,065</u>

#### *Allowance for credit losses*

The Company measures loss allowances based on an expected credit loss ("ECL") impairment model for all financial instruments except those measured at fair value through profit and loss. Application of the model depends on the following credit stages of the financial assets:

- (i) Stage 1 - for new leases recognized and for existing leases that have not experienced a significant increase in credit risk since initial recognition, a loss allowance is recognized equal to the credit losses expected to result from defaults occurring in the next 12 months;
- (ii) Stage 2 - for those leases that have experienced a significant increase in credit risk since initial recognition, a loss allowance is recognized equal to the credit losses expected over the remaining life of the lease; and
- (iii) Stage 3 - for leases that are considered to be credit-impaired, a loss allowance equal to full life time ECLs is recognized.

Thus, the evaluation of the allowance for credit losses is performed on a lease by lease basis. Definitions of default have been selected to eliminate the judgement that may otherwise be necessary, given the diversity within the finance receivable portfolio, the lack of individual

## XS Financial Inc.

### Notes to the Unaudited Condensed Consolidated Financial Statements

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drivers of changes in credit risk across assets and over time, and the resulting inability to assess which specific assets will be rectified. For the purposes of measuring ECL, a default is defined as leases and loans that have missed one payment and are not subsequently rectified within 30 days.

The Company is entitled to repossess financed equipment if the borrower defaults on their lease obligations. Any amounts recovered from the sale of repossessed equipment are credited to the allowance for credit losses when received.

The process of estimating ECLs uses the following inputs and assumptions to reflect information about past events, current conditions and forecasts of future conditions that are not already captured in the inputs:

- Security deposits held;
- Recoveries of amounts previously written off in the last 12 months, as an estimate of recoveries for the next 12 months;
- An estimate of the effects of natural disasters and economic shocks that have occurred on credit losses in the next 12 months;
- The stage of the business cycle for the industry, which considers: the competitive environment, GDP growth, prevailing interest rates and expectations of future rates, fiscal policy and inflation rates; and
- Current delinquency trends of non-accrual and greater than 30 days delinquency rates.

Determining the inputs listed and ECLs requires significant estimation uncertainty. The estimation and application of forward-looking information requires significant judgement.

As of June 30, 2020, there are no finance receivables past due or impaired and all leases are considered to be Stage 1.

#### (11) Inventories

Inventories primarily consist of equipment and spare parts that the Company intends to either sell to customers as part of the installation of servicing equipment for customers or for repair orders.

The carrying value of spare parts inventory as of June 30, 2020 and December 31, 2019 was \$36,052. The spare parts inventory is being carried at cost, as it is the lower of cost or net realizable value.

The following table presents a continuity of inventory from January 1, 2020 through June 30, 2020:

Balance at January 1, 2020	\$ 36,052
Purchases of servicing equipment for finance leases	1,115,310
Cost of goods sold - finance leases	<u>(1,115,310)</u>
Balance at June 30, 2020	<u>\$ 36,052</u>



**XS Financial Inc.**

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**(12) Prepaid and other current assets**

The following table presents prepaid and other current assets:

	<b>June 30, 2020</b>	<b>December 31, 2019</b>
Prepaid insurance	\$ 98,057	\$ 197,313
Prepaid consulting services	-	6,250
Other	102,185	41,018
	<u>\$ 200,242</u>	<u>\$ 244,581</u>

**(13) Servicing equipment**

The following table below presents the change in carrying value of the Company's servicing equipment from January 1, 2020 through June 30, 2020:

	<b>Extraction and ancillary extraction equipment</b>	<b>Pre- Processing equipment</b>	<b>Post- Processing equipment</b>	<b>Anlytical and other equipment</b>	<b>Total</b>
<b>Cost:</b>					
Balance at January 1, 2020	\$ 638,637	\$ 14,453	\$ 239,246	\$ 39,381	\$ 931,717
Additions	-	-	246,542	-	246,542
Equipment sales	(283,720)	(12,203)	(199,866)	(2,032)	(497,821)
Finance lease sales (note 10)	-	-	(8,195)	-	(8,195)
Balance at June 30, 2020	<u>\$ 354,917</u>	<u>\$ 2,250</u>	<u>\$ 277,727</u>	<u>\$ 37,349</u>	<u>\$ 672,243</u>
<b>Accumulated Depreciation:</b>					
Balance at January 1, 2020	\$ (108,282)	\$ (1,754)	\$ (30,602)	\$ (7,884)	\$ (148,522)
Depreciation	(25,322)	(1,319)	(35,975)	(6,364)	(68,980)
Equipment sales	27,792	2,847	17,587	1,073	49,299
Finance lease sales (note 10)	-	-	1,502	-	1,502
Balance at June 30, 2020	<u>\$ (105,812)</u>	<u>\$ (226)</u>	<u>\$ (47,488)</u>	<u>\$ (13,175)</u>	<u>\$ (166,701)</u>
<b>Net book value:</b>					
Balance at December 31, 2019	\$ 530,355	\$ 12,699	\$ 208,644	\$ 31,497	\$ 783,195
Balance at June 30, 2020	249,105	2,024	230,239	24,174	505,542

All of the servicing equipment is located in the United States.

*Equipment sales*

Throughout the second quarter of 2020, the Company sold servicing equipment to third party buyers. The total of these transactions resulted in the Company receiving gross proceeds of \$133,400 with recognized losses of \$59,195 included in cost of sales within the consolidated statements of loss and comprehensive loss for three and six months ended June 30, 2020.

## **XS Financial Inc.**

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In January and February 2020, the Company sold extraction and ancillary extraction equipment back to the original supplier of the equipment, Khrysos Global Inc. (“Khrysos”), for gross proceeds of \$250,000, and received a refund on sales taxes on previously purchased servicing equipment resulting in a net gain of \$(5,070), included in other (income) expense in the condensed consolidated statements of loss and comprehensive loss for the six month ended June 30, 2020.

#### *Customer equipment sale*

Throughout 2019, the Company delivered servicing equipment associated with a customer equipment sale (note 6). During the six months ended June 30, 2019 the Company sold equipment with a net book value of \$599,406 of which \$97,597 was servicing equipment and \$501,809 was transferred from prepaid servicing equipment. The Company recorded the proceeds in revenues and recognized a gross margin on the sale of the servicing equipment of \$78,887 and \$244,453 in the three and six months ended June 30, 2019, respectively.

#### *Finance lease sales*

The Company is a lessor for lease arrangements considered to be finance leases (note 10). As a result of substantially all of the risks and rewards of ownership of the servicing equipment transferring to the lessee, the Company transfers the net book value of the servicing equipment to inventories.

#### *Prepaid servicing equipment*

Prepaid servicing equipment represents servicing equipment purchased but not yet installed or delivered at a customer site, and servicing equipment that has yet to be allocated to a specific customer site. The carrying value of prepaid service equipment at June 30, 2020 and December 31, 2019 was \$Nil. This reflects the Company's recent leasing protocols which require a signed lease agreement in order to initiate a new equipment purchase. All equipment purchases are delivered directly to customer sites.

Depreciation expense related to servicing equipment is included in cost of sales within the condensed consolidated statements of loss and comprehensive loss.

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**(14) Property, plant and equipment**

The following table below presents the change in carrying value of the Company's property plant and equipment from January 1, 2020 through June 30, 2020:

	<u>Computers</u>	<u>Machinery and equipment</u>	<u>Total</u>
<b>Cost:</b>			
Balance at January 1, 2020	\$ 8,294	\$ 3,490	\$ 11,784
Additions	5,327	-	5,327
Balance at June 30, 2020	<u>\$ 13,621</u>	<u>\$ 3,490</u>	<u>\$ 17,111</u>
<b>Accumulated Depreciation:</b>			
Balance at January 1, 2020	\$ (3,289)	\$ (989)	\$ (4,278)
Depreciation	(1,678)	(349)	(2,027)
Balance at June 30, 2020	<u>\$ (4,967)</u>	<u>\$ (1,338)</u>	<u>\$ (6,305)</u>
<b>Net book value:</b>			
Balance at December 31, 2019	\$ 5,005	\$ 2,501	\$ 7,506
Balance at June 30, 2020	8,654	2,152	10,806

All of the property, plant and equipment is located in the United States.

Depreciation expense related to property, plant and equipment is included in cost of sales expenses within the condensed consolidated statements of loss and comprehensive loss.

**(15) Share capital**

As at June 30, 2020 and December 31, 2019, the Company has an unlimited number of authorized common and proportionate voting shares with no par value. Proportionate voting shares can be converted into common shares at the option of the holders at a ratio of 1,000 to 1 upon approval of the Company's Resulting Issuer Board and satisfaction of the condition that greater than 40% of common and proportionate shareholders are US residents. On all voting matters, common shareholders are entitled to one vote and proportionate voting shareholders are entitled to 1,000 votes per proportionate voting share. Generally, in all other matters the proportionate voting shareholders have the same rights as the common shareholders and will be treated as if they were one class of shares. At June 30, 2020 and December 31, 2019, the Company had 30,984,945 and 29,986,764 issued and outstanding common shares and 23,107 and 12,207 issued and outstanding proportionate voting shares, respectively.

*Share and member unit issuances*

In January 2020, the Company issued 10,600.3 proportionate voting shares at a share price of \$0.38CAD (\$0.29) to KushCo for total consideration of \$3,061,815 in exchange for 1,653,081

**XS Financial Inc.**

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shares of KushCo valued at an amount equal to the consideration given up by the Company (note 8). On completion of the share swap, KushCo became a 19.9% shareholder of the Company.

In January and March 2020, the Company issued 22,727 and 25,454 shares of common shares, respectively, on the conversion of Sub Receipt debentures (note 16). Total shareholders' equity increased \$18,332 as a result of this conversion.

In May 2020, the Company issued a combined 950,000 common shares at a share prices ranging between \$0.26CAD (\$0.18) and \$0.30CAD (\$0.18) to two separate service providers as consideration for a finder's fee earned on a new customer lease transaction and marketing services provided. The Company recorded \$171,000 as sales and marketing expense within the condensed consolidated statements of loss and comprehensive loss for the three and six months ended June 30, 2020.

**(16) Loans and borrowings**

The following table presents loans and borrowings outstanding:

Description	Maturity date	Interest rate	June 30, 2020	December 31, 2019
Term loans:				
Archytas	November 7, 2020	18.0%	\$ 600,000	\$ 600,000
Customers Bank	April 29, 2022	1.0%	55,762	-
Convertible debentures	March 22, 2024	10.0%	218,869	218,869
Sub Receipt convertible debentures	September 11, 2024	10.0%	4,107,816	4,126,148
			4,982,447	4,945,017
Less:				
Unamortized discounts, debt issuance costs and prepaid offering costs <sup>(1)</sup>			(2,214,667)	(2,366,473)
			\$ 2,767,780	\$ 2,578,544
Non-current			\$ 2,167,780	\$ 1,978,544
Current			\$ 600,000	\$ 600,000

Note to the table:

(1) The carrying value of the \$600,000 term loan was adjusted using a discount rate of 50% to reflect the prevailing borrowing rates associated with debt acquired by companies with a similar credit risk profile as the Company. The carrying value of the convertible debentures and Sub Receipt convertible debentures issued in 2019 were adjusted using a discount rate of 25% to reflect the prevailing borrowing rates associated with debt acquired by companies with a similar credit risk profile as the Company. The debt discount is accreted over the life of the respective debt instruments using the effective interest method.

The following table below shows the change in carrying value of the Company's loans and borrowings from January 1, 2020 through June 30, 2020:

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### Notes to the Unaudited Condensed Consolidated Financial Statements

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(Expressed in United States Dollars)

	<b>Term Loans</b>	<b>Convertible debentures</b>	<b>Debt discounts and and prepaid costs</b>	<b>Total</b>
Balance at January 1, 2020	\$ 600,000	\$ 4,345,017	\$ (2,366,473) <sup>(1)</sup>	\$ 2,578,544
Borrowings	55,762	-	-	55,762
Conversion of Sub Receipt convertible debenture	-	(18,332)	-	(18,332)
Amortization and accretion of debt discounts and debt issuance costs	-	-	151,806	151,806
Balance at June 30, 2020	\$ 655,762	\$ 4,326,685	\$ (2,214,667)	\$ 2,767,780

**Notes to the table:**

- (1) Represents debt discounts for the discount on loan borrowing proceeds and convertible debt issuances, and debt issuance costs netted against the gross proceeds of the Sub Receipt debenture issuance.

***Term loans***

The \$600,000 term loan is due on or before the maturity date of November 2020 and bears interest at a rate of 18% per annum, payable monthly. In May 2020, the Company amended the term loan agreement to lower the per annum interest rate to 12% from May 1, 2020 through maturity. The Company incurred interest expense of \$21,000 and \$48,000 in the three and six months ended June 30, 2020, respectively, and \$27,000 and \$54,000 in the three and six months ended June 30, 2019, respectively, related to this loan.

In January, February March and April 2019, the Company received additional funding of \$1,100,000 in the form of term loans (“2019 term loans”) from Archytas with maturity dates ranging from September 2019 to February 2020. The 2019 term loans bore interest at a rate of 18% per annum, payable monthly. In November 2019, the Company repaid Archytas the 2019 term loans in full. The Company incurred interest expense of \$47,300 and \$76,744 in the three and six months ended June 30, 2019, respectively, in relation to these term loans.

In April 2020, the Company entered into a promissory note with a third-party lender to borrow \$55,762 under the U.S. government’s Paycheck Protection Program (“PPP”) via the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act. Under the provisions of the PPP, loan proceeds are expected to be used for payroll costs, rent and utilities. The promissory note is unsecured, with a maturity date of April 29, 2022, accrues interest at 1.00% and requires eighteen fixed scheduled monthly amortization payments commencing in November 2020. PPP borrowers may apply for loan forgiveness in an amount equal to the sum of payroll costs, rent and utilities incurred during the 24 week period following the receipt of loan proceeds, whereby not more 40% of the amount forgiven can be attributable to non-payroll costs.

***Convertible debentures***

In March and April 2019, the Company issued \$294,000CAD (\$218,869) of convertible debentures to investment advisors and brokers for services rendered in raising debt subscriptions. The convertible debentures mature after 5 years and bear interest at a rate of 10% per annum payable in cash in equal quarterly installments. The convertible debentures convert into common

## **XS Financial Inc.**

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shares and warrants at a conversion price of \$1.10CAD (\$0.82) at the holders' option prior to maturity or upon a change of control. The warrants to be received have an exercise price of a \$1.50CAD (\$1.12) and have a five-year term. Upon a change in control, the Company is required to purchase the convertible debentures at a price of 105% of the principal balance plus accrued, unpaid interest. The Company has accounted for the fair value of the convertible debt at issuance of \$218,869 as debt issuance costs, within the condensed consolidated statements of financial position and is being amortized to interest expense over the term of the Sub Receipt debentures under the effective interest rate method within the condensed consolidated statements of loss and comprehensive loss. The debt discount of \$160,499 is being amortized to interest expense over the term of the convertible debentures under the effective interest rate method within the condensed consolidated statements of loss and comprehensive loss. As of September 11, 2019, with the completion of the reverse acquisition, the debentures were re-issued through the legal parent entity and the underlying functional currency change triggered a reclassification of the debenture liability to equity. The fair value of the debenture liability as at September 11, 2019 immediately prior to the reclassification was \$145,989.

In March and April 2019, the Company completed a private placement of 5,882 subscription receipts for aggregate gross proceeds of approximately \$5,882,000CAD (\$4,500,000) and closing costs of approximately \$560,000 CAD (\$426,000). The subscription receipts were held in escrow, until satisfaction of the escrow release conditions, at which time each subscription receipt would be convertible into one 10% unsecured convertible debenture of the Company in the principal amount of \$1,000CAD ("Sub Receipt debenture"). On September 11, 2019, the escrow conditions were met, and the Company issued \$5,882,000CAD (\$4,472,085) of Sub Receipt debentures to various investors. The Sub Receipt debentures mature after 5 years and bear interest at a rate of 10% per annum payable in cash in equal quarterly installments. The Sub Receipt debentures convert into common shares and warrants at a conversion price of \$1.10CAD (\$0.82) at the holders' option prior to maturity or upon a change of control. The warrants to be received have an exercise price of a \$1.50CAD (\$1.12) and have a five-year term. Upon a change in control the Company is required to purchase the Sub Receipt debentures at a price of 105% of the principal balance plus accrued, unpaid interest.

The principal amount of the debenture was estimated at its fair value of \$2,630,804 based on a discount rate of 25%. The Company incurred debt issuance costs, netted against the gross proceeds of the issuance, of \$1,398,268CAD (\$1,060,821) in connection with the issuance of the Sub Receipt debentures, of which \$821,332CAD (\$623,112) was allocated to the debenture liability. The debt issuance costs were recorded as a discount on the Sub Receipt debentures carrying value, and are being amortized to interest expense over the life of the sub receipts convertible debentures under the effective interest rate method. The residual value of the debenture of \$1,841,281 was allocated to the conversion feature and recorded as a component of equity, net of issuance costs of \$437,709 and deferred tax impact of \$384,000.

In January and March 2020, investors exercised their conversion feature on \$25,000CAD (\$8,941) and \$28,000CAD (\$9,391) of the Sub Receipt debentures and received 22,727 and 25,454 common shares, respectively.

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#### *Embedded derivative liabilities*

The conversion feature of the Series C debentures issued in September, October and December of 2018 and subsequently converted to equity upon the merger of XSI and Caracara was considered an embedded derivative liability as the conversion price was not fixed. The Company performed a Black-Scholes model while probability weighting various expected conversion prices, resulting in a fair value of \$1,341,557 determined at issuance, and accounted for the embedded derivative liabilities as a long-term liability within the statements of financial position. In March 2019, the Company amended the conversion feature of the Series C debentures pursuant to which each holder of such debentures will receive upon conversion at price of \$0.94CAD, thereof one share of common shares and a warrant, which has a \$1.50CAD (\$1.12) exercise price and a five year term, upon conversion. On date of modification, the embedded derivative relating to the Series C debentures was revalued using Black-Scholes valuation model with the following assumptions: risk free rate – 1.77%, expected volatility – 90% and exercise price of \$0.94CAD (\$0.71).

The conversion feature of the \$294,000CAD (\$218,869) issued to investment advisors and brokers in March and April 2019 was considered an embedded derivative liability as the conversion price was denominated in a currency that was different from the functional currency at the time of issuance. On issuance date, the fair value of the embedded derivative liability was determined using the Black-Scholes option valuation model as \$135,180 with the following assumptions: risk free rate – 1.48%, expected volatility – 90% and exercise price of \$1.10CAD (\$0.82).

At June 30, 2019 the embedded derivative liabilities were re-valued at \$3,920,775, with the change in fair value of \$(477,115) and \$2,829,261 reflected in the condensed consolidated statements of loss and comprehensive loss for the three and six months ended June 30, 2019.

#### *Redeemable common stock*

In July 2018, Archytas and another member exercised the conversion feature of term loans held with the Company and received a combined 6,737,588 shares of Class A common shares. The Company classified \$650,000 of the amount converted as redeemable common shares and a liability within the condensed consolidated statements of financial position as this represents amounts subject to rescission due to an ongoing governmental investigation of the Member's finances. An escrow balance of \$650,000 is maintained by Archytas to satisfy the obligation.

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**(17) Warrants**

The following table summarizes warrant activity from January 1, 2020 through June 30, 2020:

	<u>Number of warrants</u>	<u>Weighted average exercise price per share</u>
Outstanding at January 1, 2020	8,466,908	\$ 1.13
Granted	48,181 <sup>(1)</sup>	\$ 1.10
Expired	<u>(840,250)</u>	\$ 0.80
Outstanding at June 30, 2020	<u>7,674,839</u>	\$ 1.05

Note to the table:

(1) All of the warrants granted in the six months ended June 30, 2020 were accounted for as a component of shareholders' equity.

Warrant issuances

In January and March 2020, the Company issued 48,181 of warrants related to the conversion of Sub Receipt debentures (note 16). The warrants have a term of five years and exercise price of \$1.50CAD (\$1.13 - \$1.14) per share. The warrants had a value of \$18,332 on the date of issue based on the allocation of the total carrying value of the debenture liability and conversion feature using the Black-Scholes option pricing model.

The fair value of the warrants and warrant derivative liabilities was determined using the Black-Scholes option pricing model with the following assumptions:

	<u>2020 issuances</u>
Expected dividend yield	-
Expected volatility	90.0%
Risk-free interest rate	0.8 - 1.6%
Expected term	4.5 - 4.7 years
Conversion price	\$ 1.05 - 1.16

At June 30, 2019 outstanding warrant derivative liabilities were re-valued, with the change in fair value of \$(11,984) reflected in the condensed consolidated statements of loss and comprehensive loss for the three and six months ended June 30, 2019.



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The following table presents warrants outstanding at June 30, 2020:

<b>Expiration date</b>	<b>Term (years)</b>	<b>Number of warrants outstanding</b>	<b>Number of warrants exercisable</b>	<b>Exercise price US \$</b>	<b>Exercise price CAD \$</b>
17-Oct-20	2	17,647	17,647	\$ 0.85	\$ 1.11
17-Oct-20	2	17,647	17,647	\$ 0.85	\$ 1.11
30-Oct-20	2	30,000	30,000	\$ 0.85	\$ 1.11
30-Oct-20	2	2,118	2,118	\$ 0.85	\$ 1.11
28-Nov-20	2	31,765	31,765	\$ 0.85	\$ 1.11
5-Dec-20	2	26,470	26,470	\$ 0.85	\$ 1.11
31-Dec-20	2	174,115	174,115	\$ 0.85	\$ 1.11
22-Mar-21	2	400,000	400,000	\$ 0.82	\$ 1.10
12-Apr-24	5	500,000	500,000	\$ 0.82	\$ 1.10
15-May-21	2	36,818	36,818	\$ 0.82	\$ 1.10
17-Jul-21	2	150,000	150,000	\$ 0.84	\$ 1.10
11-Sep-24	5	374,308	374,308	\$ 0.82	\$ 1.10
11-Sep-24	5	5,452,134	5,452,134	\$ 1.12	\$ 1.50
11-Sep-24	5	363,636	363,636	\$ 1.13	\$ 1.50
11-Sep-24	5	50,000	50,000	\$ 1.14	\$ 1.50
11-Sep-24	5	22,727	22,727	\$ 1.16	\$ 1.50
11-Sep-24	5	25,454	25,455	\$ 1.05	\$ 1.50
<b>Total</b>	<b>2 - 5 years</b>	<b>7,674,839</b>	<b>7,674,840</b>	<b>\$ 1.05</b>	<b>\$ 1.41</b>

The weighted average remaining time to expiry for the outstanding warrants is 3.77 years.

**(18) Trade and other payables**

The following table presents trade and other payables:

	<b>June 30, 2020</b>	<b>December 31, 2019</b>
Trade payables	\$ 242,950	\$ 119,452
Credit card payable	672	300
	<u>\$ 243,622</u>	<u>\$ 119,752</u>

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**(19) Other current liabilities**

The following table presents accrued expenses:

	<b>June 30, 2020</b>	<b>December 31, 2019</b>
Accrued insurance	\$ 64,216	\$ 152,295
Accrued professional fees	-	30,756
Accrued compensation, benefits and related taxes	5,837	9,212
Accrued servicing equipment purchases	165,731	-
Accrued other	20,977	9,054
	<u>\$ 256,761</u>	<u>\$ 201,317</u>

**(20) Income taxes**

The Company recognized a deferred income tax provision of \$Nil and \$975 for the three and six months ended June 30, 2020 and 2019, respectively.

Income tax expense is recognized based on management's estimate of the weighted average effective annual income tax rate expected for the full financial year. The estimated average annual tax rate was 26.5%, for the three and six months ended June 30, 2020 and 2019.

**(21) Share-based compensation**

In September 2019, in connection with the Caracara merger, the Company established the Omnibus Incentive Plan ("Incentive Plan") which replaced and governs all options under the Company's previously issued 2018 Stock Option Plan. The Incentive Plan provides for the granting of up to 15% of outstanding common shares and is not to exceed a maximum of 10,000,000 share-based equity incentive compensation awards such as stock options and restricted stock awards to directors, officers, employees, contractors, and advisors, as determined by the Company's board of directors.

The following table summarizes stock option activity under the Option Plan from January 1, 2020 through June 30, 2020:

	<b>Number of shares</b>	<b>Weighted average exercise price per share</b>	<b>Weighted average remaining contractual term (years)</b>
Outstanding at January 1, 2020	3,010,129	\$ 0.38	6.2
Granted	<u>1,808,889</u>	\$ 0.16	
Outstanding at June 30, 2020	<u>4,819,018</u>	\$ 0.30	5.4
Exercisable and vested at June 30, 2020	<u>3,315,458</u>	\$ 0.30	5.4

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As of June 30, 2020 there was approximately \$112,000 of unrecognized compensation expense related to unvested stock options, which is expected to be recognized over a weighted average period of 0.8 years.

The Company recorded compensation expense for stock options of \$234,834 and \$(45,894) for the three months ended June 30, 2020 and 2019, respectively, and \$285,502 and \$399,430 for the six months ended June 30, 2020 and 2019, respectively.

The following table summarizes the stock options outstanding as at June 30, 2020:

Expiry Date	Exercise Price US \$	Exercise Price CAD \$	Weighted Average		
			Remaining Contractual Life (years)	Number of Options Outstanding	Number of Options Vested
July 2028	\$ 0.60	\$ 0.78	8.05	1,055,129	528,092
November 2024	\$ 0.26	\$ 0.34	4.40	1,955,000	978,478
April 2025	\$ 0.16	\$ 0.22	4.81	1,808,889	1,808,889
	<u>\$ 0.30</u>	<u>\$ 0.39</u>	<u>5.35</u>	<u>4,819,018</u>	<u>3,315,459</u>

**(22) Related party transactions**

The following presents balances and transactions between the Company and other related parties as of June 30, 2020 and December 31, 2019, and for the three and six months ended June 30, 2020 and 2019, respectively.

*Key management personnel*

Key employees include executive management with the authority and responsibility for planning, directing and controlling the activities of the Company. The following table presents compensation and benefit expenses of key employees:

	Three months ended		Six months ended	
	June 30,		June 30,	
	2020	2019	2020	2019
Salaries, contractor costs, management fees and benefits	\$ 91,245	\$ 120,050	\$ 219,726	\$ 239,764
Incentive compensation (non-cash)	25,671	17,246	38,008	315,218
	<u>\$ 116,916</u>	<u>\$ 137,296</u>	<u>\$ 257,734</u>	<u>\$ 554,982</u>

See also notes 15, 17 and 21.

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*Related party transactions and amounts due to related parties*

The following table presents expenses incurred on behalf of the Company and assets purchased from related parties:

	<u>Archytas</u>	<u>Khrysos</u>	<u>Total</u>
Amounts due to related parties at January 1, 2019	\$ 13,000	\$ 105,654	\$ 118,654
Interest expense	138,744	-	138,744
Management fee	174,400	-	174,400
Operating expenses	-	64,604	64,604
Prepaid equipment purchases	-	286,083	286,083
Less payments to related parties	-	(3,000)	(3,000)
Amounts due to related parties at June 30, 2019	<u>326,144</u>	<u>\$ 453,341</u>	<u>\$ 779,485</u>
Amounts due to related parties at January 1, 2020	\$ -	\$ -	\$ -
Interest expense	48,000	-	48,000
Management fee	146,200	-	146,200
Less payments to related parties	(162,133)	-	(162,133)
Amounts due to related parties at June 30, 2020	<u>32,067</u>	<u>\$ -</u>	<u>\$ 32,067</u>

Effective January 2019, the Company entered into a management services agreement with Archytas at a monthly rate of \$28,667 and a term of five years, with one year automatic renewals, whereby Archytas will provide day-to-day executive management and support to the Company. Archytas is a shareholder of the Company, having been involved in the initial formation of XSI. In May and June 2020, the Company lowered the monthly rate to \$20,067 as part of a 30% cost reduction to the Company's management team, employees and external consultants. In June 2020 the management services agreement was amended to reduce the monthly rate to \$nil for July, August, and September 2020. In addition, two officers and directors of the Company are partners of Archytas. The agreement cannot be terminated until Archytas holds less than 5% of the fully diluted capital stock of the Company. As at June 30, 2020, Archytas held 20.034% of outstanding voting shares of the Company.

*Related party loans and borrowings*

The following table presents the Company's loans and borrowings, and related interest, from related parties:

	<u>June 30,</u> <u>2020</u>	<u>December 31,</u> <u>2019</u>
Archytas:		
Term loans (note 16)	\$ 600,000	\$ 600,000
Accrued interest	12,000	-
	<u>\$ 612,000</u>	<u>\$ 600,000</u>

The carrying value of the above loans and borrowings were reduced by discounts as of June 30, 2020 and December 31, 2019, respectively (note 16). In January, February, March and April 2019, the Company received additional funding of \$1,100,000 in the form of the 2019 term loans

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from Archytas with maturity dates ranging from September 2019 to February 2020 (note 16). In November 2019, the Company repaid Archytas the 2019 term loans in full.

#### *Related party sales*

In March and April 2019, the Company entered into rental lease agreements to lease extraction machines and other ancillary processing equipment to Carolina Botanical Development, LLC ("CBD LLC"). CBD LLC is a related party to the Company as a result of a shareholder of the Company also being an owner of CBD LLC. As part of the March 2019 lease agreement, CBD LLC paid \$100,000 owed to a related party of the Company, on behalf of the Company.

### **(23) Financial instrument risk exposures**

#### *Financial risk management*

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board mitigates these risks by assessing, monitoring and approving the Company's risk management processes:

#### Credit risk

Credit risk is the risk of a potential loss to the Company if a customer or third party to a financial instrument fails to meet its contractual obligations. The maximum credit exposure is the carrying amount of cash, trade and other receivables and financing receivables. The Company does not have significant credit risk with respect to customers. All cash is placed with recognized U.S. financial institutions. The Company provides credit to its customers in the normal course of business and has established credit evaluation and monitoring processes to mitigate credit risk. The Company has not recognized any loss allowance for expected credit losses on the trade and other receivables and financing receivables as of June 30, 2020. See also notes 9 and 10.

The Company's financing receivables are originated with various customers, some are smaller, often owner-operated businesses, some of whom have limited access to traditional financing. A portion of the Company's lessees are either start-up businesses that have not established business credit or more tenured businesses that have experienced some business credit difficulty at some time in their history ("non-prime"). As a result, such leases entail higher credit risk, (reflected in higher than expected levels of delinquencies and loss) relative to the prime commercial equipment finance market.

The Company is entitled to repossess financed equipment if the lessee defaults on their contract in order to minimize any credit losses.

#### Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations associated with financial liabilities. The Company manages liquidity risk through the

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management of its capital structure. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to settle obligations and liabilities when due.

At June 30, 2020, the Company had current assets of \$4,273,846 and current liabilities of \$2,479,039. All current liabilities are due within one year.

At June 30, 2020, the Company also has undiscounted loans and borrowings of \$4,982,447 of which \$600,000 are due in 2020, \$55,762 are due in 2022 if not forgiven (note 16) and \$4,326,685 are due in 2024, as follows:

	<u>Less than 6 months</u>	<u>6 months to 1 years</u>	<u>1 to 3 years</u>	<u>Over 3 years</u>
Trade and other payables	\$ 243,622	\$ -	\$ -	\$ -
Accrued expenses	256,761	-	-	-
Loans and borrowings	-	600,000	55,762	4,326,685
Balance at June 30, 2020	<u>\$ 500,383</u>	<u>\$ 600,000</u>	<u>\$ 55,762</u>	<u>\$ 4,326,685</u>

#### Market risk

##### *Currency risk*

The Company has determined its functional currency to be the Canadian dollar and U.S. dollar. The operating results and financial position of the Company are reported in U.S. dollars. The Company has minimal financial transactions denominated in currencies other than the Canadian and U.S. dollar. The Company has no hedging agreements in place with respect to foreign exchange rates. The Company believes its exposure to currency risk is not significant.

##### *Interest rate risk*

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's financial debt have fixed rates of interest and therefore expose the Company to a limited interest rate fair value risk.

#### **(24) Events after the reporting date**

##### Acquisition

On July 13, 2020, the Company acquired all of the outstanding shares of CA Licensed Lenders LLC for its California lenders license in exchange for 450,761 common shares of the Company. The common shares were valued at \$0.29CAD (\$0.21) on the date of the acquisition resulting in total consideration of \$96,078 plus transaction costs of \$13,651.

##### Coronavirus

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, which continues to spread throughout Canada and the United States. The spread of COVID-19 has caused significant volatility in Canadian, U.S. and international

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markets. There is significant uncertainty around the breadth and duration of business disruptions related to COVID-19, as well as its impact on the Canadian, U.S. and international economies and, as such, the Company is unable to determine if it will have a material impact to its operations.

*Share issuances*

In July 2020, the Company issued 119,047 of common shares to settle accounts payable related to previous marketing and advisory services.