

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020 AND 2019**

The following Management's Discussion and Analysis ("MD&A") of the financial condition and results of the operations of XS Financial Inc. ("XSF", the "Company", "our" or "we") constitutes management's review of the factors that affected the Company's financial and operating performance for the three and nine months ended September 30, 2020 and 2019. This MD&A has been prepared in compliance with the requirements of National Instrument 51-102 – Continuous Disclosure Obligations. This discussion should be read in conjunction with the Company's unaudited interim condensed consolidated financial statements and the accompanying notes for the three and nine months ended September 30, 2020 and 2019, and the audited financial statements for the twelve months ended December 31, 2019 and 2018 together with the notes thereto. The interim financial statements have been prepared in accordance with International Accounting Standards 34, Interim Financial Reporting, as issued by the IASB. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All amounts in the annual financial statements and this discussion are expressed in United States dollars, unless otherwise stated. The results for the periods presented are not necessarily indicative of the results that may be expected for any future period. Information contained herein is presented as at November 25, 2020 unless otherwise indicated.

For the purposes of preparing this MD&A, management, in conjunction with the Board of Directors, considers the materiality of information. Information is considered material if: (i) such information results in, or would reasonably be expected to result in, a significant change in the market price or value of XSF's securities; (ii) there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision; (iii) it would significantly alter the total mix of information available to investors. Management, in conjunction with the Board of Directors, evaluates materiality with reference to all relevant circumstances, including potential market sensitivity.

This discussion contains "forward-looking information" and may also contain statements that may constitute "forward-looking statements", collectively "forward-looking information", within the meaning of applicable Canadian securities legislation. Such forward-looking information is not representative of historical facts or information or current condition, but instead represent the beliefs and expectations regarding future events about the business and the industry and markets in which XSF operates, as well as plans or objectives of management, many of which, by their nature, are inherently uncertain. Generally, such forward-looking information can be identified by the use of terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or may contain statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "will continue", "will occur" or "will be achieved".

Management considers the assumptions on which forward-looking information is based to be reasonable at the time the statements were made. Accordingly, actual results could differ materially from those expressed or implied within forward-looking information.

### **GOING CONCERN ASSUMPTION**

The financial statements have been prepared on a going concern basis, which assume that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. As at September 30, 2020 and December 31, 2019, the Company had working capital of \$348,839 and \$1,802,038, respectively, and an accumulated deficit of \$(17,913,334) and \$(13,586,621), respectively. The Company's ability to continue as a going concern is dependent upon its

ability to attain profitable operations and generate funds therefrom, and to continue to obtain equity investment and borrowings sufficient to meet current and future obligations and/or restructure the existing debt and payables. 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 it can generate sufficient revenue from its operations to cover its expenses. While the Company has been successful in obtaining equity and debt funding for operating and capital requirements, there can be no assurance that the Company will be able to obtain additional funds on reasonable terms, if at all.

## **OVERVIEW OF THE COMPANY**

### **Company Background**

XSF, 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".

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 XS (formerly known as Xtraction Services Holdings Corp.) and continued with the business of XSI.

### **Description of Business**

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. In addition, the Company provides a full range of consulting services including equipment selection and procurement, through its network of Preferred Vendor partnerships with original equipment manufacturers and equipment distributors.

The Company predominantly generates equipment sales and leases through its employee sales force, who focus on equipment vendors and direct equipment users. XSF distinguishes itself from traditional equipment leasing companies in that it:

- offers equipment-specific leasing, sale-leasebacks, and purchasing solutions;
- contracts are primarily generated through its relationships with industry vendors that provide XSF services at the point of sale, and direct relationships; and
- provides analytical and support services, equipment procurement, and testing protocols beyond the equipment manufacturers whose products it is leasing

XSF provides customers with the option of leasing equipment in consideration for monthly lease payments (pursuant to lease agreements).

## **Recent Developments and Outlook**

### *Revenue Activity*

XSF continues to assess numerous leasing opportunities and intends to focus on pursuing those opportunities that align with its growth objectives, primarily in the US. Target leasing opportunities will primarily consist of leases to businesses underpinned by recurring, predictable revenues, sound balance sheets and an experienced management team. While the Company recognizes the challenging market dynamics of the Cannabis sector, XSF remains well-positioned to execute its business plan due to the fact that many Cannabis businesses require mission-critical equipment to operate and grow, but lack sufficient access to new capital or are burdened with expensive sources of financing.

In January 2020, the Company entered into a new revenue leasing agreement with Lehua Group LLC, USA (“Lehua”), a multi-state, licensed cannabis processor specializing in THC-infused beverages. Per the terms of the agreement, the lease has a term of 36 months with expected total monthly rentals and fees of approximately \$166,000. Additionally, Lehua has the option to repurchase the leased equipment at the end of month 12 for approximately \$53,000 and an end of lease term purchase option for approximately \$11,000.

In May, June, and August 2020, the Company entered into new leasing arrangements with PharmaCann Inc., (“PharmaCann”), a vertically-integrated cannabis company operating cultivation, manufacturing, distribution and retail locations in multi-states in the USA. Per the terms of the agreements the leases have terms of 48 months with expected monthly rentals and fees of approximately \$4,400,000. Additionally, PharmaCann has end of lease term purchase options for approximately \$170,000.

In August and September 2020, the Company entered into new leasing arrangements with multiple new customers. Per the terms of the agreements the leases have terms ranging between 36 and 48 months with expected monthly rentals and fees of approximately \$1,000,000. Additionally, the leases have end of term purchase options for approximately \$22,000.

### *Share Swap*

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) 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. On completion of the share swap, KushCo became a 19.9% shareholder of the Company.

### *Servicing Equipment and Spare Parts Inventory Divestitures*

During the nine months ended September 30, 2020, the Company sold excess servicing equipment and spare parts inventory to both third party buyers and Khrysos. The total of these transactions resulted in the Company reducing the net book value of servicing equipment and inventory by approximately \$672,000, receiving gross proceeds of approximately \$522,000 and recognizing losses of approximately \$150,000.

### *Acquisition*

In July 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 \$96,237 plus transaction costs of \$13,651.

## **Components of Our Results of Operations**

### *Revenue*

The Company derives the majority of its revenue from sale, leasing and sale-leaseback of extraction, processing, manufacturing, testing, etc. equipment (“servicing equipment”) used in the supply chain for cannabis and hemp operators. The Company’s products and services include: (i) the sale or lease of equipment and processes.

### *Cost of Sales and Gross Profit*

Gross profit is calculated as revenue less cost of sales. Cost of sales represents those costs directly attributable to the generation of our revenue, and primarily includes equipment costs for the purchase and leasing of servicing equipment, personnel costs, including salaries and benefits, supplies, maintenance and repairs. Cost of sales also includes non-cash items such as depreciation of the Company’s servicing equipment.

### *Operating Expenses*

Operating expenses consist of administrative, selling and marketing costs. Administrative expenses primarily represent contractor costs, personnel costs, including salaries, benefits, incentive-based non-cash compensation, management fees and other professional service costs, including legal and accounting, to support Company operations. Selling costs primarily represent marketing activities, commissions, trade shows, contractor costs and personnel costs, including a portion of salaries, benefits and marketing activities related to customer acquisition.

### *Other (Income) Expense*

Other (income) expense consists of (i) financing interest expense on notes payable and convertible debentures, (ii) non-cash interest expense for debt issuance costs and debt discounts related to the issuance of our convertible debentures, (iii) gains and losses on the sale of servicing equipment and property, plant and equipment, (iv) mark-to-market changes in the fair value of embedded derivatives within the convertible debentures and (v) mark-to-market changes in the fair value of the Company’s investment in KushCo.

### *Income Taxes (Recovery)*

The Company is subject to income taxes in the jurisdictions in which it operates and, consequently, income tax expense is a function of the allocation of taxable income by jurisdiction and the various activities that impact the timing of taxable events.

## RESULTS OF OPERATIONS

The following table sets forth selected financial information for the periods indicated that was derived from our audited financial statements and the respective accompanying notes prepared in accordance with IFRS.

	Three months ended September 30,		Nine months ended September 30,	
	2020	2019	2020	2019
Revenue	\$ 3,858,329	\$ 663,468	\$ 5,451,489	\$ 1,635,493
Cost of sales	\$ 3,782,276	\$ 718,631	\$ 5,297,665	\$ 1,903,742
Gross profit (loss)	\$ 76,053	\$ (55,163)	\$ 153,824	\$ (268,249)
Operating expenses	\$ 364,034	\$ 625,509	\$ 1,652,669	\$ 3,096,867
Other expense (income)	\$ 531,945	\$ (2,486,616)	\$ 2,827,868	\$ 1,707,121
Income tax expense	\$ -	\$ -	\$ -	\$ 975
Net (loss) income	\$ (819,926)	\$ 1,805,944	\$ (4,326,713)	\$ (5,073,212)
(Loss) income per share - basic	\$ (0.02)	\$ 0.05	\$ (0.08)	\$ (0.15)
(Loss) income per share - diluted	\$ (0.02)	\$ 0.04	\$ (0.08)	\$ (0.15)
Weighted average shares outstanding - basic	54,589,706	36,295,096	52,563,488	33,974,504
Weighted average shares outstanding - diluted	54,589,706	49,984,444	52,563,488	33,974,504
	<b>September 30,</b>	<b>December 31,</b>		
	<b>2020</b>	<b>2019</b>		
Total assets	\$ 6,139,732	\$ 4,474,606		
Total liabilities	\$ 5,225,845	\$ 3,549,613		

### Three Months Ended September 30, 2020 as compared to the Three Months Ended September 30, 2019

#### Revenue

Revenues for the three months ended September 30, 2020 were \$3,858,329 compared with \$663,468 for the three months ended September 30, 2019. The increase of \$3,194,861 for the three months ended September 30, 2020 as compared to the same period in 2019 was primarily attributable to the recognition of approximately \$3,060,000 of revenue associated with nine new financing leases between five customers entered into in 2020, and an increase of approximately \$223,000 of equipment sales in 2020 compared to 2019. The above increases are partially offset by approximately \$111,000 decrease in revenue recognized from royalty sales and operating leases from 2019 to 2020.

#### Cost of Sales and Gross Profit (Loss)

Cost of sales for the three months ended September 30, 2020 were \$3,782,276 compared with \$718,361 for the three months ended September 30, 2019. The increase of \$3,063,915 for the three months ended September 30, 2020 as compared to the same period in 2019 was attributable to an increase of approximately \$2,814,000 of equipment costs associated with financing leases entered into in the three months ended September 30, 2020, and an increase of approximately \$480,000 from the write-off of servicing equipment associated with equipment sales in the quarter. The above increases are partially offset by decreases totaling approximately \$202,000 related to reduced (i) servicing equipment purchases, (ii) depreciation and amortization expense and (iii) compensation and related expenses for personnel providing services to customers.

Gross profit (loss) for the three months ended September 30, 2020 was a profit of \$76,053 compared to a loss of \$(55,163) for the three months ended September 30, 2019. The Company anticipates further gross margin improvement due to the curtailment of excess equipment sales and new leasing activity.

### *Operating Expenses*

Operating expenses for the three months ended September 30, 2020 were \$364,034 compared with \$625,509 for the three months ended September 30, 2019. The following table presents the components of operating expenses:

	<b>Three months ended</b>	
	<b>September 30,</b>	
	<b>2020</b>	<b>2019</b>
<b>Administrative expenses:</b>		
Personnel and contractor costs	\$ 51,171	\$ 100,021
Professional fees	160,272	234,185
Incentive compensation	28,829	64,553
Occupancy expenses	(1,857)	9,068
Management fee	-	86,000
Other	62,220	49,293
<b>Total administrative expenses</b>	<b>300,635</b>	<b>543,120</b>
<b>Selling and marketing expenses:</b>		
Personnel and contractor costs	\$ 647	\$ 47,122
Marketing and trade shows	5,591	31,704
Professional fees	43,209	3,250
Other	13,952	313
<b>Total selling and marketing expenses</b>	<b>63,399</b>	<b>82,389</b>
	<b>\$ 364,034</b>	<b>\$ 625,509</b>

Administrative expenses for the three months ended September 30, 2020 were \$300,635 compared with \$543,120 for the three months ended September 30, 2019. The decrease of \$242,485 in the three months ended September 30, 2020, as compared to the same period in 2019 was primarily attributable to the decrease in professional fees of approximately \$171,000 related to legal, audit, tax and internal accounting costs from 2019 to 2020, including costs associated with preparing for the reverse acquisition, subsequent receipts debenture financing and the Company to be publicly traded. The professional fees decrease of \$171,000 from 2019 to 2020 is partially offset by approximately \$96,000 of non-cash costs associated with the Company's purchase of a lenders license in July 2020. To lesser degree the decrease is attributable to the elimination of the management fee in the third quarter of 2020 charged by a related party for day-to-day executive management and support to the Company, and to the reduction in the use of third-party contactors and employees.

Selling and marketing expenses for the three months ended September 30, 2020 were \$63,399 compared with \$82,389 for the three months ended September 30, 2019. The decrease of \$18,990 in the three months ended September 30, 2020, as compared to the same period in 2019 was primarily attributable to a reduction in employee and marketing costs.

### *Other Expense (Income)*

Other expenses for the three months ended September 30, 2020 were \$531,945 compared with \$(2,486,616) for the three months ended September 30, 2019. The increase in other expense of \$3,018,561 for the three months ended September 30, 2020 as compared to the same period in 2019 was primarily attributable to approximately \$4,027,000 increase in the non-cash changes in fair value, resulting from a 2019 gain in fair value changes of approximately \$3,706,000 related to the derivative liabilities and the Company's change in functional currency, and a 2020 loss of approximately \$321,000 related to the Company's unrealized loss in the KushCo investment. The above increase was partially offset by reductions of (i) approximately \$516,000 of non-cash accretion expense associated with debt issuance costs, and debt discounts on our term loans and convertible debt, (ii) approximately \$59,000 of interest expense on our term loans and convertible debt, (iii) approximately \$81,000 of losses on the sale of servicing equipment and property, plant and equipment and (iv) approximately \$363,000 of non-cash listing expense for the excess of purchase price paid over nets assets acquired for the Caracara reverse acquisition.

#### *Income Tax (Recovery) Expense*

Income taxes for the three months ended September 30, 2020 and 2019 were \$Nil.

#### *Net (Loss) Income*

The Company's net (loss) income for the three months ended September 30, 2020 was \$(819,926) compared to \$1,805,944 for the three months ended September 30, 2019. The increase in net loss of \$(2,625,870) for the three months ended September 30, 2020 as compared to the same period in 2019 is primarily attributable to the one-time non-cash gain recognized in 2019 related to the derivative liabilities and the Company's change in functional currency.

### **Nine Months Ended September 30, 2020 as compared to the Nine Months Ended September 30, 2019**

#### *Revenue*

Revenues for the nine months ended September 30, 2020 were \$5,451,489 compared with \$1,635,493 for the nine months ended September 30, 2019. The increase of \$3,815,996 for the nine months ended September 30, 2020 as compared to the same period in 2019 was attributable to the recognition of approximately \$4,347,000 of revenue associated with nine new financing leases between five customers entered into in 2020 and approximately \$104,000 of revenue recognized from one operating lease. These increases were partially offset by approximately \$667,000 decrease in revenue recognized from equipment sales and royalty sales from 2019 to 2020.

#### *Cost of Sales and Gross Profit (Loss)*

Cost of sales for the nine months ended September 30, 2020 were \$5,297,665 compared with \$1,903,742 for the nine months ended September 30, 2019. The increase of \$3,393,923 for the nine months ended September 30, 2020 as compared to the same period in 2019 was attributable an increase of approximately \$3,964,000 of equipment costs associated with financing leases entered into in the first nine months of 2020, and an increase of approximately \$634,000 from the write-off of servicing equipment associated with equipment sales. The above increases are partially offset by a decrease of approximately \$684,000 in equipment purchases made in 2019 related to the direct sale of equipment to a single customer, and decreases of approximately \$413,000 related to depreciation and amortization expense and compensation and related expenses for personnel providing services to customers.

Gross profit (loss) for the nine months ended September 30, 2020 was a profit of \$153,824 compared to a loss of \$(268,249) for the nine months ended September 30, 2019. The Company anticipates further gross margin improvement due to the curtailment of excess equipment sales and new leasing activity.

### *Operating Expenses*

Operating expenses for the nine months ended September 30, 2020 were \$1,652,669 compared with \$3,096,867 for the nine months ended September 30, 2019. The following table presents the components of operating expenses:

	<b>Nine months ended</b>	
	<b>September 30,</b>	
	<b>2020</b>	<b>2019</b>
<b>Administrative expenses:</b>		
Personnel and contractor costs	\$ 115,509	\$ 282,809
Professional fees	440,817	1,651,695
Incentive compensation	314,331	463,983
Occupancy expenses	23,834	46,057
Management fee	146,200	260,400
Other	273,156	223,887
Total administrative expenses	<u>1,313,847</u>	<u>2,928,831</u>
<b>Selling and marketing expenses:</b>		
Personnel and contractor costs	\$ 60,392	\$ 67,287
Marketing and trade shows	79,093	50,066
Professional fees	71,076	49,083
Other	128,261	1,600
Total selling and marketing expenses	<u>338,822</u>	<u>168,036</u>
	<u>\$ 1,652,669</u>	<u>\$ 3,096,867</u>

Administrative expenses for the nine months ended September 30, 2020 were \$1,313,847 compared with \$2,928,831 for the nine months ended September 30, 2019. The decrease of \$1,614,984 in the nine months ended September 30, 2020, as compared to the same period in 2019 was primarily attributable to the decrease in professional fees of approximately \$468,000 related to legal, audit, tax and internal accounting costs from 2019, including costs associated with preparing for the reverse acquisition, subsequent receipts debenture financing and the Company to be publicly traded. The Company also incurred approximately \$743,000 of non-cash professional fees related to issuance of stock and warrants to advisors and brokers in the nine months ended September 30, 2019. To a lesser degree the decrease is attributable to reduction in the use of third-party contactors and employees, reductions in the 2020 second and third quarter management fee charged from a related party for day-to-day executive management and support to the Company and a reduction in non-cash incentive compensation related to increased expense recognized in 2019 associated with cancelled stock options that accelerated vested.

Selling and marketing expenses for the nine months ended September 30, 2020 were \$338,822 compared with \$168,036 for the nine months ended September 30, 2019. The increase of \$170,786 in the nine months ended September 30, 2020, as compared to the same period in 2019 was primarily attributable to the recognition of \$171,000 of non-cash marketing costs and commissions related to the issuance of stock to third party service providers.



### *Other Expense*

Other expenses for the nine months ended September 30, 2020 were \$2,827,868 compared with \$1,707,121 for the nine months ended September 30, 2019. The increase in other expense of \$1,120,747 for the nine months ended September 30, 2020 as compared to the same period in 2019 was attributable to approximately \$3,108,000 increase in the non-cash changes in fair value, resulting from a 2019 gain in fair value changes of approximately \$889,000 related to the derivative liabilities and the Company's change in functional currency, and a 2020 loss of approximately \$2,219,000 related to the Company's unrealized loss in the KushCo investment. The above increase was partially offset by reductions of (i) approximately \$1,277,000 of non-cash accretion expense associated with debt issuance costs, and debt discounts on our term loans and convertible debt, (ii) approximately \$236,000 of interest expense on our term loans and convertible debt, (iii) approximately \$102,000 of losses on the sale of servicing equipment and property, plant and equipment and (iv) approximately \$363,000 of non-cash listing expense for the excess of purchase price paid over nets assets acquired for the Caracara reverse acquisition.

### *Income Tax (Recovery) Expense*

Income taxes for the nine months ended September 30, 2020 were \$Nil compared with income tax of \$975 for the nine months ended September 30, 2019.

### *Net Loss(Income)*

The Company's loss for the nine months ended September 30, 2020 was \$(4,326,713) compared to a loss of \$(5,073,212) for the nine months ended September 30, 2019. The Company anticipates further improvement in losses throughout 2020 due to the curtailment of excess equipment sales, significant cost reduction initiatives, the absence of costs related to the reverse acquisition and new leasing activity.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **Overview**

The Company's liquidity needs are primarily to finance growth initiatives including equipment acquisition, leasing activities, debt service and for general corporate purposes. The Company's primary source of liquidity to date has been funds generated by private financing via convertible debentures and term loans. The Company has been generating revenue from operations since the third quarter of 2018. The Company's ability to fund its operations, make planned capital expenditures, satisfy scheduled debt payments and repay or refinance indebtedness depends on the Company's future operating performance and cash flows. These cash flows are subject to prevailing economic conditions and financial, business and other factors, some of which are beyond the Company's control (see "*Financial Instruments and Financial Risk Management*").

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 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, although the Company has not experienced any material impact on its operations to date, the Company is unable to determine if it will have a future material impact to its operations or ability to raise funds.

As of September 30, 2020, the Company had \$717,012 of cash, working capital (current assets minus current liabilities) of \$348,839 and an accumulated deficit of \$(17,913,334) compared with \$2,487,293 of cash, working capital of \$1,802,038 and an accumulated deficit of \$(13,586,621) as of December 31, 2019. The decrease in working capital by \$(1,453,199) was primarily attributable to the purchase of servicing equipment and increase in trade payables and accrued equipment purchases related to new financing leases as well as the ongoing funding of operations. These decreases are partially offset by the value of the KushCo shares received and recognized as an investment in 2020. The increase in accumulated deficit \$(4,326,713) was primarily attributable to the funding of operations and non-cash charges related to the unrealized loss on the fair value change of the KushCo investment, amortization of debt issuance costs and discounts and non-cash compensation.

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.

### Cash Flows

The following table sets forth the primary sources and uses of cash for the nine months ended September 30, 2020 and 2019:

	<b>Nine months ended September 30,</b>	
	<b>2020</b>	<b>2019</b>
Cash flows (used in) operating activities	\$ (2,081,223)	\$ (1,572,683)
Cash flows provided by investing activities	\$ 270,336	\$ 964,210
Cash flows provided by financing activities	\$ 55,762	\$ 5,045,414

#### *Cash Flow from Operating Activities*

Net cash used in operating activities for the nine months ended September 30, 2020 was \$(2,081,223) primarily due to a (i) loss for the period of \$(4,326,713), (ii) the addition of servicing equipment for finance leases of \$(2,824,431), and (iii) an increase in working capital components of \$(645,195). The above decreases were offset in part by (i) non-cash adjustments of \$2,914,313 including unrealized loss on mark-to-market fair value change of investments, accretion of debt issuance costs and discounts, depreciation and non-cash incentive compensation, and (ii) proceeds of \$2,800,803 received from financing receivables.

Net cash used in operating activities for the nine months ended September 30, 2019 was \$(1,572,683) primarily due to a loss for the period of \$(5,073,212), offset in part by non-cash adjustments of \$2,450,408 including a change in fair value of the embedded derivative liabilities, accretion of debt issuance costs and discounts, depreciation, amortization, non-cash compensation and incentive compensation, and a decrease in working capital components of \$1,012,621.

#### *Cash Flow from Investing Activities*

Net cash provided by investing activities for the nine months ended September 30, 2020 of \$270,336 was attributable to \$522,205 of proceeds received from the sale of servicing equipment, offset by \$(251,869) of servicing equipment and property, plant and equipment purchases.

Net cash provided by investing activities for the nine months ended September 30, 2019 of \$964,210 was attributable due to \$313,180 of proceeds from the sale of servicing equipment and property, plant and

equipment and \$698,858 of cash acquired as part of the reverse acquisition with Caracara, offset in part by \$(48,028) of servicing equipment and property, plant and equipment purchases.

#### *Cash Flow from Financing Activities*

Net cash provided by investing activities for the nine months ended September 30, 2020 was \$55,762 and was attributable to proceeds received from a third party lender under the U.S. government’s Paycheck Protection Program (“PPP”) via the Coronavirus Aid, Relief, and Economic Security (“CARES”) Act loan borrowings.

Net cash provided by financing activities for the nine months ended September 30, 2019 was \$5,045,214 and consisted primarily of proceeds from loans and borrowings, specifically Sub Receipt debentures of \$4,472,085 and term loans of \$1,100,000, offset in part by payment of debt issuance and deferred financing costs and repayments of loans and borrowings.

### **CONTRACTUAL OBLIGATIONS**

In the normal course of business, the Company may be subject to contractual obligations to make future payments in relation to contracts or other financial commitments. As at September 30, 2020, the Company is not aware of any legal or financial contractual obligations or financial commitments outside of its loans and borrowings and related party management services agreement.

### **OFF-BALANCE SHEET ARRANGEMENTS AND PROPOSED TRANSACTIONS**

The Company has no material undisclosed off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on its results of operations, financial condition, revenues or expenses, liquidity, capital expenditures or capital resources that are material to investors.

### **RELATED PARTY TRANSACTIONS**

Related parties include officers and employees of the Company that are investors, debt holders and the Company’s primary provider of servicing equipment.

#### *Key Management and 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:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2020</b>	<b>2019</b>	<b>2020</b>	<b>2019</b>
Salaries, contractor costs, management fees and benefits	\$ 51,171	\$ 138,435	\$ 270,897	\$ 378,199
Incentive compensation (non-cash)	18,889	9,751	56,897	324,969
	<u>\$ 70,060</u>	<u>\$ 148,186</u>	<u>\$ 327,794</u>	<u>\$ 703,168</u>

#### *Related Party Loans and Borrowings*

As of September 30, 2020 and December 31, 2019, the Company had loans and borrowings, and related interest due to related parties of \$618,000 and \$600,000, respectively. The following table presents the Company's loans and borrowings, and related interest, from related parties:

	<u>September 30,</u> <u>2020</u>	<u>December 31,</u> <u>2019</u>
Archytas:		
Term loans	\$ 600,000	\$ 600,000
Accrued interest	18,000	-
	<u>\$ 618,000</u>	<u>\$ 600,000</u>

#### *Related Party Transactions and Amounts Due to Related Parties*

The following table presents expenses incurred on behalf of the Company by Archytas and assets purchased from Khrysos:

Amounts due to related parties at January 1, 2019	\$	118,654
Interest expense		218,957
Management fee		260,400
Operating expenses		86,614
Prepaid equipment purchases		286,083
Conversion of accrued interest to common stock		(15,713)
Less payments to related parties		(3,000)
Amounts due to related parties at September 30, 2019	<u>\$</u>	<u>951,995</u>
Amounts due to related parties at January 1, 2020	\$	-
Interest expense		66,000
Management fee		146,200
Less payments to related parties		(174,133)
Amounts due to related parties at September 30, 2020	<u>\$</u>	<u>38,067</u>

#### *Related Party Management Services Agreement*

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 addition, two officers and directors of the Company are partners of Archytas. 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 exchange for the issuance of stock options. In June 2020 the management services agreement was amended to reduce the monthly rate to \$nil for July, August, and September 2020. The agreement cannot be terminated until Archytas holds less than 5% of the fully diluted capital stock of the Company. As at September 30, 2020, Archytas held 19.8% of outstanding voting shares of the Company.

#### *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.

## **CHANGES IN OR ADOPTION OF ACCOUNTING POLICIES**

### **New standards adopted**

#### *IAS 1 – Presentation of Financial Statements (“IAS 1”) and IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors (“IAS 8”)*

In October 2018, IAS 1 – Presentation of Financial Statements (“IAS 1”) and IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors (“IAS 8”) were amended 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 interpretation is effective for annual periods beginning January 1, 2020. The 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.

#### *IFRS 16, Business Combinations*

In October 2018, IFRS 3 – Business Combinations (“IFRS 3”) was amended 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 interpretation is effective for annual periods beginning January 1, 2020. 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.

### **New standards and interpretations to be adopted in future periods**

There are no new IFRS standards or interpretations expected to go into effect subsequent to the report date that would have a material impact on the Company’s financial statements whether or not the policy is adopted early.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the Company’s financial statements in conformity with IFRS requires management 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 estimates.

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 interim 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 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.

#### *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.

### *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.

### *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*

#### 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 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.

#### *Definition of a Business*

Determination of whether a set of assets acquired, and liabilities assumed constitute a business under IFRS 3 requires the Company to make certain judgments, taking into account all facts and circumstances.

## **FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT**

The Company categorizes its financial assets and liabilities measured and reported at fair value in the financial statements on a recurring basis based upon the level of judgments associated with the inputs used to measure their fair value. Hierarchical levels, which are directly related to the amount of subjectivity associated with the inputs used to determine the fair value of financial assets and liabilities, are as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; and
- Level 3: Inputs for the asset or liability that are not based on observable market data.

Each major category of financial assets and liabilities measured at fair value on a recurring basis is categorized based upon the lowest level of significant input to the valuations. The fair value hierarchy also requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

### **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 September 30, 2020.

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 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 September 30, 2020, the Company had current assets of \$2,667,248 and current liabilities of \$2,987,456. All current liabilities are due within one year.

At September 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 under the U.S. government's PPP and \$4,326,685 are due in 2024, as follows:

	Less than 6 months	6 months to 1 years	1 to 3 years	Over 3 years
Trade and other payables	\$ 698,973	\$ -	\$ -	\$ -
Accrued expenses	964,369	-	-	-
Loans and borrowings	600,000	-	55,762	4,326,685
	<u>\$ 2,263,342</u>	<u>\$ -</u>	<u>\$ 55,762</u>	<u>\$ 4,326,685</u>
Commitments	-	-	-	-
Balance at September 30, 2020	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

### Market Risk

#### *Currency Risk*

The Company has determined its functional currency to be the Canadian 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 not entered into any agreements or purchased any instruments to hedge possible currency risks at this time. 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 debts have fixed rates of interest and therefore expose the Company to a limited interest rate fair value risk.

### **Disclosure Controls and Procedures**

The Company's management, with the participation of its President and CEO and CFO, have evaluated the effectiveness of the Company's disclosure controls and procedures. Based upon the results of that evaluation, the certifying officers have concluded that, as of the end of the year covered by this report, the disclosure controls and procedures effectively provide reasonable assurance that information required to be disclosed, in reports the Company is required to file or submit under Canadian securities laws, was recorded, processed, summarized and reported within the appropriate time periods specified by those laws. The Company's certifying officers, being the President and CEO and the CFO have evaluated the effectiveness of the Company's disclosure controls and procedures. The certifying officers also concluded that material information was accumulated and communicated to management of the Company, including the President and CEO and the CFO, as appropriate to allow timely decisions regarding disclosure.

### **Internal Controls over Financial Reporting**

The Company's President and CEO, and the CFO are responsible for establishing and maintaining adequate internal control over financial reporting. Under the supervision of the President and CEO and the CFO, the Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the consolidated financial statements for external purposes, in accordance with IFRS. The Company's internal control over financial reporting includes policies that:

- pertain to the maintenance of records that accurately and fairly reflect, in reasonable detail, the transactions and dispositions of assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit the preparation of the consolidated financial statements in accordance with IFRS and that the Company's receipts and disbursements are made only in accordance with authorizations of management and the Company's Directors; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the Company's consolidated financial statements.

The Company's management believes that its policies and procedures provide the best controls achievable under the constraints described above, subject to the limitations below.

### **Limitation of Controls and Procedures**

The Company's management including the President and CEO and the CFO believe that any disclosure controls and procedures or internal control over financial reporting, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. The inherent limitations include the realities that judgements in decision-making can be faulty, and that breakdowns can occur because of simple error

or mistake. Controls can be circumvented by the individual acts of some persons, by collusion of two or more individuals or by unauthorized override of the control. The design of any control system is also based in part upon certain assumptions about the likelihood of future events, and therefore there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

### **Accounting Responsibilities, Procedures and Policies**

The Board of Directors, which among other things is responsible for the consolidated financial statements of the Company, delegates to management the responsibility for the preparation of the consolidated financial statements. Responsibility for their review rests with the Audit Committee. Each year the shareholders appoint independent auditors to audit and report directly to them on the consolidated financial statements.

The Audit Committee is appointed by the Board of Directors and all of its members are non-management directors. The Audit Committee meets periodically with management and the external auditors to discuss internal controls, auditing matters and financial reporting issues, and to confirm that all administrative duties and responsibilities are properly discharged. The Audit Committee also reviews the consolidated financial statements and MD&A and considers the engagement or reappointment of external auditors. The Audit Committee reports its findings to the Board of Directors for its consideration when approving the consolidated financial statements for issuance to the shareholders. The external auditors have full and free access to the Audit Committee.

### **CAUTIONARY NOTE REGARDING FORWARD-LOOKING INFORMATION**

This MD&A contains certain “forward-looking information” as defined in applicable securities laws. These statements relate to future events or the Company’s future performance. All statements other than statements of historical fact are forward-looking in nature. The forward-looking information in this MD&A speak only as of the date of this MD&A or as of the date specified in such statements.

### **SUBSEQUENT EVENTS**

#### *Line of credit*

In November 2020, the Company closed a \$2,000,000 senior secured revolving credit facility, with an FDIC insured bank, which has a term of two years, expiring in November 2022. Loans made under the revolving facility will bear interest at an annual rate equal to the greater of (i) 8.0% per annum or (ii) the Wall Street Journal Prime plus 4.0% and may be prepaid with no penalty at any time. The Company intends to use such loan proceeds, together with cash on hand, to fund additional equipment leases with new and existing customers.

#### *New leases*

In October 2020, the Company announced it had entered into lease agreement with Skymint Brands (formerly known as Green Peak Innovations), Michigan’s leading vertically integrated cannabis operator. Skymint Brands was approved for an equipment lease facility of up to \$5,000,000 for new equipment, to be deployed in multiple tranches on a pro-rata basis and based on 48-month terms.

In November 2020, the Company announced that it had entered into a lease agreement with a large scale, vertically integrated publicly traded company with operations in Nevada and Massachusetts. The customer was approved for an equipment lease facility of up to \$5,000,000, which can be drawn upon in multiple tranches as needed, with 48-month terms.