SHARC INTERNATIONAL SYSTEMS INC.
Consolidated Financial Statements

For the year ended December 31, 2018

(Expressed in Canadian dollars)

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
Sharc International Systems Inc.

Opinion

We have audited the accompanying consolidated financial statements of Sharc International Systems Inc. (the "Company"), which comprise the consolidated statements of financial position as at December 31, 2018 and 2017 and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity (deficiency) and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

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

Material Uncertainty Related to Going Concern

We draw attention to Note 1 of the consolidated financial statements, which indicates that as at December 31, 2018, the Company has accumulated a deficit of $18,889,188 and a working capital deficit of $989,868. As stated in Note 1, these events and conditions indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Other Information

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is David Harris.

"DAVIDSON & COMPANY LLP"

Vancouver, Canada

Chartered Professional Accountants

April 30, 2019

Sharc International Systems Inc.
Consolidated Statements of Financial Position
(Expressed in Canadian dollars)

	Note	December 31, 2018 $	December 31, 2017 $
ASSETS			
Current			
Cash		1,899,657	526,036
Receivables	5	1,244,773	350,215
Prepaid expenses		100,877	81,483
Inventory	6	330,482	528,838
Loans receivable	7	—	74,197
Total current assets		**3,575,789**	**1,560,769**
Equity investments	8	945	—
Restricted cash	9	50,000	50,000
Deposits		9,999	9,999
Property and equipment	10	2,241,792	83,718
Total assets		**5,878,525**	**1,704,486**
LIABILITIES AND SHAREHOLDERS' DEFICIENCY			
Current liabilities			
Accounts payable and accrued liabilities	11	3,687,352	791,192
Loans payable	12	872,100	17,604
Deferred revenue	13	3,933	200,168
Warranty provisions	14	2,272	14,926
Total current liabilities		**4,565,657**	**1,023,890**
Loans payable	12	1,553,386	30,313
Warranty provisions	14	13,757	4,000
Convertible debentures	15	2,038,381	1,877,661
		8,171,181	**2,935,864**
SHAREHOLDERS' DEFICIENCY			
Share capital	16	13,201,868	9,255,241
Subscriptions received	16	—	309,000
Reserves	16	3,360,162	2,594,075
Currency translation reserve		(90,540)	(10,715)
Convertible debentures – equity component	15	125,042	125,042
Deficit		(18,889,188)	(13,504,021)
Total shareholders' equity (deficiency)		**(2,292,656)**	**(1,231,378)**
Total liabilities and shareholders' deficiency		**5,878,525**	**1,704,486**

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

Nature of Operations and Going Concern [Note 1]
Commitments and Contingencies [Note 17]
Subsequent Events [Note 23]

Approved on behalf of the Board:

/s/ Lynn Mueller
Director

/s/ Mark McCooey
Director

Sharc International Systems Inc.

Consolidated Statements of Loss and Comprehensive Loss

(Expressed in Canadian dollars)

	Note	Year Ended December 31, 2018 $	Year Ended December 31, 2017 $
Revenue		2,136,398	268,810
Cost of Sales		(2,435,305)	(207,486)
Gross Margin		**(298,907)**	**61,324**
Expenses			
Accounting and legal		195,256	234,075
Advertising and promotion		466,506	356,353
Consulting	11	933,485	848,496
Depreciation	10	53,037	249,505
Foreign exchange		(57,261)	(11,197)
Insurance		38,117	23,221
Office and miscellaneous		296,184	402,456
Regulatory and filing fees		51,247	30,633
Rent	11	173,090	130,831
Repairs and maintenance		—	127,821
Research and development		218,927	121,967
Share-based payments	11,16	436,452	630,083
Telephone and utilities		77,018	40,063
Travel		235,990	126,766
Wages and benefits	11	1,072,184	1,171,534
Warranty expense		8,003	13,798
		(4,198,235)	**(4,496,405)**
Government grants and assistance		—	88,201
Loss from equity investment	8	(16,412)	—
Interest and financing expense	12,15	(1,383,738)	(266,661)
Gain (loss) on debt settlement	16	816	(7,000)
Loss before income taxes		**(5,896,476)**	**(4,620,541)**
Deferred tax recovery	22	—	**99,000**
Loss for the year		**(5,896,476)**	**(4,521,541)**
Other comprehensive loss			
Foreign currency translation		(79,825)	(47,649)
Net loss and comprehensive loss		**(5,976,301)**	**(4,569,190)**
Basic and diluted loss per common share		**(0.17)**	**(0.16)**
Weighted average number of common shares outstanding		**34,790,471**	**27,906,176**

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

Sharc International Systems Inc.

Consolidated Statements of Changes in Shareholders' Equity (Deficiency)

(Expressed in Canadian dollars)

	Common Shares		Subscription Received	Reserves	Currency translation reserve	Convertible debenture	Deficit	Total
	Number	$	$	$	$	$	$	$
Balance, December 31, 2016	**26,379,302**	**7,876,677**	**–**	**2,183,696**	**36,934**	**–**	**(9,780,690)**	**316,617**
Common shares issued	1,450,528	1,523,054	–	–	–	–	–	**1,523,054**
Residual value of warrants granted	–	(431,730)	–	431,730	–	–	–	**–**
Share issue costs	–	(174,960)	–	52,580	–	–	–	**(122,380)**
Shares issued for debt	100,000	112,000	–	–	–	–	–	**112,000**
Shares issued for services	50,000	42,438	–	–	–	–	–	**42,438**
Warrants exercised	303,714	148,820	–	–	–	–	–	**148,820**
Stock options exercised	135,714	78,750	–	–	–	–	–	**78,750**
Fair value of stock options exercised	–	80,192	–	(80,192)	–	–	–	**–**
Issuance of convertible debt	–	–	–	160,857	–	125,042	–	**285,899**
Warrants issued for loan extension	–	–	–	13,531	–	–	–	**13,531**
Share-based compensation	–	–	–	630,083	–	–	–	**630,083**
Reversal of forfeited options	–	–	–	(798,210)	–	–	798,210	**–**
Subscriptions received	–	–	309,000	–	–	–	–	**309,000**
Currency translation adjustment	–	–	–	–	(47,649)	–	–	**(47,649)**
Net loss for the year	–	–	–	–	–	–	(4,521,541)	**(4,521,541)**
Balance, December 31, 2017	**28,419,258**	**9,255,241**	**309,000**	**2,594,075**	**(10,715)**	**125,042**	**(13,504,021)**	**(1,231,378)**
Common shares issued	9,777,745	3,911,098	(192,000)	–	–	–	–	**3,719,098**
Share issue costs	–	(243,110)	–	85,112	–	–	–	**(157,998)**
Stock option exercised	500,000	196,000	–	–	–	–	–	**196,000**
Fair value of stock options exercised	–	75,455	–	(75,455)	–	–	–	**–**
Subscriptions refunded	–	–	(117,000)	–	–	–	–	**(117,000)**
Shares for debt	23,173	7,184	–	–	–	–	–	**7,184**
Warrants issued for loan	–	–	–	831,287	–	–	–	**831,287**
Share-based payments	–	–	–	436,452	–	–	–	**436,452**
Reversal of expired options	–	–	–	(511,309)	–	–	511,309	**–**
Currency translation adjustment	–	–	–	–	(79,825)	–	–	**(79,825)**
Net loss for the year	–	–	–	–	–	–	(5,896,476)	**(5,896,476)**
Balance, Decmeber 31, 2018	**38,720,176**	**13,201,868**	**–**	**3,360,162**	**(90,540)**	**125,042**	**(18,889,188)**	**(2,292,656)**

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

Sharc International Systems Inc.
Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

	Note	Year Ended December 31, 2018 $	Year Ended December 31, 2017 $
OPERATING ACTIVITIES			
Net loss for the year		(5,896,476)	(4,521,541)
Add items not affecting cash:			
Depreciation	10	53,037	249,505
Unrealized foreign exchange		(70,580)	(43,543)
Share-based payments	16[d]	436,452	630,083
Warrants issued for finance expense	12	831,287	—
Accrued interest expense	12,15	536,748	267,609
Shares issued for services	16[b]	—	42,438
(Gain) Loss on debt settlement	16[b]	(816)	7,000
Deferred tax recovery		—	(99,000)
Loss from equity investment	8	16,412	—
Changes in non-cash working capital items:			
Receivables		(884,543)	(80,133)
Prepaid expenses		(19,394)	(19,543)
Inventory		202,361	(342,570)
Deposits		—	(8,674)
Accounts payable and accrued liabilities		1,213,533	235,700
Deferred revenue		(196,235)	179,768
Warranty provisions		(2,897)	(151,770)
Cash used in operating activities		**(3,781,111)**	**(3,654,671)**
INVESTING ACTIVITIES			
Purchase of property and equipment	10	(3,162,550)	(19,733)
Restricted cash		—	(50,000)
Purchase of 50% of Bandwidth Energy Limited	8	(17,357)	—
Cash used in investing activity		**(3,179,907)**	**(69,733)**
FINANCING ACTIVITIES			
Proceeds from loans payable	12	3,900,921	80,000
Repayment of loans payable	12	(1,619,523)	(324,330)
Repayment of loans receivable		74,197	1,045
Repayment of convertible debenture		(294,950)	—
Proceeds on exercise of stock options	16[b]	196,000	78,750
Proceeds on exercise of warrants		—	148,820
Proceeds on private placement, net of costs	16[b]	3,561,100	1,400,674
Proceeds on convertible debentures, net of costs	15	—	2,185,990
Proceeds from government grants	17	2,643,350	—
Subscriptions received		—	309,000
Subscriptions refunded		(117,000)	—
Cash provided by financing activities		**8,344,095**	**3,879,949**
Increase (decrease) in cash		**1,364,162**	**155,545**
Impact of exchange rate changes on cash		9,455	(2,939)
Cash, beginning of the year		526,036	373,430
Cash, end of the year		**1,899,657**	**526,036**

Supplemental disclosure with respect to cash flow (Note 21)

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

1. NATURE OF OPERATIONS AND GOING CONCERN

Sharc International Systems Inc. (the "**Company**" or "**SHARC**") was incorporated under the *Business Corporations Act* (British Columbia) on February 4, 2011. The Company's shares are listed on the Canadian Securities Exchange (the "**CSE**") under the trading symbol "**SHRC**". The Company is engaged in providing wastewater heat exchange expertise and products that service commercial, industrial, public utilities and residential development projects objectives of reducing their carbon footprint while saving on energy costs. The Company's registered and records office is located at 1443 Spitfire Place, Port Coquitlam, British Columbia, Canada, V3C 6L4.

These consolidated financial statements (the "**Financial Statements**") have been prepared under the assumption that the Company will continue as a going concern. The going concern basis of presentation assumes that the Company will be able to meet its obligations and continue its operations for the foreseeable future and be able to realize its assets and discharge its liabilities and commitments in the normal course of business. Realization values may be substantially different from the carrying values as shown, and these Financial Statements do not give effect to adjustments that would be necessary to the carrying values and classifications of assets and liabilities should the Company be unable to continue as a going concern.

The Company has incurred losses and negative operating cash flows since its inception. As of December 31, 2018, the Company has accumulated a deficit of $18,889,188 (December 31, 2017 - $13,504,021) and working capital deficit of $989,868 (December 31, 2017 – working capital of $536,879). The Company has not generated positive cash flows from operations and additional financings will be required to maintain operations for the near term. These material uncertainties may cast significant doubt upon the Company's ability to continue as a going concern.

The Company will continue to pursue opportunities to raise additional capital through equity markets and/or debt to fund its operating activities; however, there is no assurance of the success or sufficiency of these initiatives. The Company's ability to continue as a going concern is dependent upon it securing the necessary working capital to eventually generate positive cash flows either from operations or additional financing. These Financial Statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and statement of financial position that would be necessary if the going concern assumption were inappropriate, and these adjustments could be material.

2. BASIS OF PRESENTATION

[a] Statement of compliance

These Financial Statements have been prepared in accordance with International Financial Reporting Standards ("**IFRS**") as issued by the International Accounting Standards Board ("**IASB**") and interpretations issued by the International Financial Reporting Interpretations Committee ("**IFRIC**"). These Financial Statements were approved by the Company's Board of Directors on April 30, 2019.

[b] Basis of measurement and consolidation

These Financial Statements have been prepared on a historical cost basis, except for certain financial assets and financial liabilities measured at fair value.

These Financial Statements include the accounts of the Company's subsidiaries:

Company	Location	December 31, 2018 Ownership %	December 31, 2017 Ownership %
Sharc Energy Systems Inc. ("**SES**")	Canada	100	100
Sharc Energy Ltd (formerly IWWS (UK) Ltd. ("**Sharc UK**")	United Kingdom	100	100
Sharc Highlands Ltd. ("**Highlands**")	United Kingdom	100	—
Green Sharc Ltd. (1)	United Kingdom	100	100
Sharc Energy Services (UK) Ltd. (1)	United Kingdom	100	100
Sharc Energy Systems Australasia Pty Ltd. ("**Sharc Australasia")** (1)	Australia	80	—
2336882 Ontario Inc. (1)	Canada	100	100

(1)The subsidiary was inactive at period end.

All significant intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

[c] Presentation currency

These Financial Statements are presented in Canadian dollars.

2. BASIS OF PRESENTATION (CONTINUED)

[d] Significant accounting estimates and judgments

The preparation of these Financial Statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the Financial Statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. These Financial Statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the Financial Statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and future periods if the revision affects both current and future periods. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The Company reviews its estimates and underlying assumptions on an ongoing basis.

Critical Judgments

The following are critical judgments that management has made in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the Financial Statements:

i. Research costs are recognized as an expense when incurred but development costs may be capitalized as intangible assets if certain conditions are met as described in IAS 38, *Intangible Assets*. Management has determined that development costs do not meet the conditions for capitalization under IAS 38 and all research and development costs have been expensed.

ii. Management is required to assess the functional currency of the Company. The determination of functional currency often requires significant judgment where the primary economic environment in which they operate may not be clear. This can have a significant impact on the consolidated results of the Company based on the foreign currency translation method.

iii. The determination of categories of financial assets and financial liabilities has been identified as an accounting policy which involves judgments or assessments made by management.

iv. Management is required to determine whether or not the going concern assumption is appropriate for the Company at the end of each reporting period. Considerations taken into account include available information about the future including the availability of financing and revenue projection, as well as current working capital balance and future commitments of the Company.

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

2. BASIS OF PRESENTATION (CONTINUED)

[d] Significant accounting estimates and judgments (continued)

Estimation Uncertainty

The following are key assumptions concerning the future and other key sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year:

i. Provisions for income taxes are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period. However, it is possible that at some future date an additional liability could result from audits by taxation authorities. Where the final outcome of these tax-related matters is different from the amounts that were originally recorded, such differences will affect the tax provisions in the period in which such determination is made.

ii. The fair value of accrued liabilities at the time of initial recognition is made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors.

iii. Warranty provisions are recognized for the future obligations to provide services for the repairs and maintenance of products sold to its customers. The Company assesses its warranty provision based on experience. Actual costs incurred may differ from those amounts estimated.

iv. The Company estimates the net realizable values of inventories, taking into account the most reliable evidence available at each reporting date. The future realization of these inventories may be affected by future technology or other market drive changes that may reduce future selling prices.

v. The Company has service agreements with regards to some of its product sales which requires management to make judgments regarding the timing and allocation of revenue. Specifically, installation is generally not assumed to have standalone value and is often recognized on the same basis as the remainder of the services fees. However, the Company defers the recognition of revenue associated with fees for services agreements or warranty costs that are built in to the original sales price and recognizes the assosciated revenue evenly over the term of the service or warranty is provided.

vi. Revenue on development of heat supply infrastructure projects, predominantly based out of the UK, require the Company to make estimates of the percentage of completion of the project in order to determine the amount of revenue to recognize. Management uses costs and third party evidence to determine estimated progress of development as of the period end dates.

3. SIGNIFICANT ACCOUNTING POLICIES

Foreign exchange

The functional currency is the currency of the primary economic environment in which the entity operates and has been determined for each entity within the Company. The functional currency of the Company and SES is the Canadian dollar and the functional currency of Sharc UK and Highlands is the British Pound. The functional currency determinations were conducted through an analysis of the consideration factors identified in IAS 21, The Effects of Changes in Foreign Exchange Rates.

Transactions in currencies other than the Canadian dollar are recorded at exchange rates prevailing on the dates of the transactions. At the end of each reporting period, the monetary assets and liabilities of the Company that are denominated in foreign currencies are translated at the rate of exchange at the statement of financial position date while non-monetary assets and liabilities are translated at historical rates. Revenues and expenses are translated at the exchange rates approximating those in effect on the date of the transactions. Exchange gains and losses arising on translation are reflected in profit or loss for the year.

Where applicable, the functional currency is translated into the presentation currency using the period end rates for assets and liabilities while the operations and cash flows are translated using average rates of exchange. Exchange adjustments arising when net assets and profit or loss are translated into the presentation currency are taken into a separate component of equity and reported in other comprehensive income or loss.

Equipment

Equipment is recorded at cost and amortized at the following rates.

Equipment	20% declining balance per annum
Furniture and fixtures	20% declining balance per annum
Computer hardware	55% declining balance per annum
Computer software	100% declining balance per annum
Leasehold improvements	5 year straight line
Demonstration units	1 year straight line

Equipment that is withdrawn from use or has no reasonable prospect of being recovered through use or sale, are regularly identified and written off. The assets' residual values, depreciation methods and useful lives are reviewed, and adjusted if appropriate, at each reporting date.

Subsequent expenditure relating to an item of property, plant and equipment is capitalized when it is probable that future economic benefits from the use of the assets will be increased. All other subsequent expenditure is recognized as repairs and maintenance.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Impairment

At the end of each reporting period, the Company's assets are reviewed to determine whether there is any indication that those assets may be impaired. If such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. The recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in profit or loss for the period. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but to an amount that does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

Inventory

Materials and supplies, work-in-progress and finished goods are measured at the lower of cost, determined on a weighted average basis, and net realizable value.

The cost of materials and supplies is comprised of the purchase price, applicable taxes and other costs incurred in bringing inventory to their present location and condition. The cost of finished goods includes cost of materials and cost of conversion. The cost of conversion includes costs directly related to the units of production, such as direct labour, and fixed and variable production overheads, based on normal operating capacity.

The net realizable value of inventory is generally considered to be the selling price in the ordinary course of business less the estimated costs of completion and estimated costs to make the sale.

The amount of any impairment of inventories to net realizable value and all losses of inventories is recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any impairment of inventories, arising from an increase in net realizable value, is recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue recognition

Revenue from all product sales of the Company is recognized when products are shipped to customers and ownership is transferred to customers, when the price is fixed or determinable and when the ultimate collection is reasonably assured. Customer prepayments are recorded as deferred revenue and revenue is not recognized until the shipment of goods occurs. Shipping and handling costs related to product sales are included in cost of sales.

Revenue from the rendering of services performed by the Company is recognized when the following conditions are met: amount of the revenue can be measured reliably; it is probable that economic benefits associated with the transaction will flow to the entity; the stage of completion of the transaction at the end of the reporting period can be measured reliably; and the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

The Company may sell its heating and ventilation unit and services on a stand-alone basis or as a multiple-element transaction with separately identifiable components, also known as a bundled transaction. Where the Company enters into an agreement involving a bundled transaction, the Company records each of the separate components at their relative stand-alone selling price and recognizes the revenue on an appropriate basis for each of the separate components. A delivered element is considered a separate unit of accounting if it has value to the customer on a stand-alone basis. The Company determines the value of each of the components sold based on the selling price when they are sold separately. When the stand alone value cannot be determined based on when it was sold separately, the Company determines a value that most reasonably reflects the selling price that might be achieved in a stand-alone transaction.

Government grants

Government grants are recognized where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognized as a deduction against the related expense over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, it reduces the carrying amount of the asset. Government assistance received relating to expenses of future periods is deferred and deducted against the related expenditures as incurred.

Grants received for employees have been credited against the related expense, grants related to specific projects have been credits against the build-up of costs (ie. inventory) and grants received to assist in the development of the Company have been recorded as other income.

Warranty provision

The Company provides product warranties on certain products pursuant to the manufacturing contract, and makes provision for the anticipated cost of these warranties through cost of sales; this provision is reviewed periodically to assess its adequacy in the light of actual warranty costs incurred.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments

The Company adopted all of the requirements of IFRS 9 – Financial Instruments ("IFRS 9") as of January 1, 2018. IFRS 9 replaces IAS 39 – Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 utilizes a revised model for recognition and measurement of financial instruments and a single, forward-looking "expected loss" impairment model. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9, so the Company's accounting policy with respect to financial liabilities is unchanged. As a result of the adoption of IFRS 9, management has changed its accounting policy for financial assets retrospectively, for assets that continued to be recognized at the date of initial application. The change did not impact the carrying value of any financial assets or financial liabilities on the transition date.

The following is the Company's new accounting policy for financial instruments under IFRS 9:

Classification

The Company classifies its financial instruments in the following categories: at fair value through profit and loss ("FVTPL"), at fair value through other comprehensive income (loss) ("FVTOCI"), or at amortized cost. The Company determines the classification of financial assets at initial recognition. The classification of debt instruments is driven by the Company's business model for managing the financial assets and their contractual cash flow characteristics. Equity instruments that are held for trading are classified as FVTPL. For other equity instruments, on the day of acquisition the Company can make an irrevocable election (on an instrument-by-instrument basis) to designate them as at FVTOCI. Financial liabilities are measured at amortized cost, unless they are required to be measured at FVTPL (such as instruments held for trading or derivatives) or the Company has opted to measure them at FVTPL.

The Company completed a detailed assessment of its financial assets and liabilities as at January 1, 2018. The following table shows the original classification under IAS 39 and the new classification under IFRS 9:

Financial assets/liabilities	Original Classification IAS 39	New Classification IFRS 9
Cash	FVTPL	FVTPL
Restricted cash	FVTPL	FVTPL
Receivables	Loans and receivables	Amortized cost
Loans receivable	Loans and receivables	Amortized cost
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Loans payable	Other financial liabilities	Amortized cost
Convertible debentures	Other financial liabilities	Amortized cost

The Company did not restate prior periods and determined that the adoption of IFRS 9 resulted in no impact to the opening accumulated deficit on January 1, 2018.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Financial instruments (continued)

Measurement

Financial assets and liabilities at amortized cost

Financial assets and liabilities at amortized cost are initially recognized at fair value plus or minus transaction costs, respectively, and subsequently carried at amortized cost less any impairment.

Financial assets and liabilities at FVTPL

Financial assets and liabilities carried at FVTPL are initially recorded at fair value and transaction costs are expensed in profit or loss. Realized and unrealized gains and losses arising from changes in the fair value of the financial assets and liabilities held at FVTPL are included in profit or loss in the period in which they arise.

Impairment of financial assets at amortized cost

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

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

Derecognition

Financial assets

The Company derecognizes financial assets only when the contractual rights to cash flows from the financial assets expire, or when it transfers the financial assets and substantially all of the associated risks and rewards of ownership to another entity. Gains and losses on derecognition are generally recognized in profit or loss.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income taxes

Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax is recorded using the statement of financial position liability method, providing for temporary differences, between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes; the initial recognition of assets or liabilities that affect neither accounting or taxable loss; and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the statement of financial position date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized.

Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend. Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Loss per share

The Company presents basic loss per share for its common shares, calculated by dividing the loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted loss per share is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed by assuming that outstanding options, warrants and similar instruments were exercised and that the proceeds from such exercises were used to acquire common stock at the average market price during the reporting period. Diluted loss per share does not adjust the loss attributable to common shareholders or the weighted average number of common shares outstanding when the effect is anti-dilutive.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Investments in associated companies

Associated companies over which the Company has significant influence are accounted for using the equity basis of accounting, whereby the investment is initially recorded at cost, adjusted to recognize the Company's share of earnings or losses and reduced by dividends received. The Company assesses its equity investments for impairment if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the equity investment and that the event or events has an impact on the estimated future cash flow of the investment that can be reliably estimated.

Objective evidence of impairment of equity investment includes:

- Significant financial difficulty of the associated companies;
- Becoming probable that the associated companies will enter bankruptcy or other financial reorganization; or
- National or local economic conditions that correlate with defaults of the associated companies.

Warrants issued in equity financing transactions

The Company engages in equity financing transactions to obtain the funds necessary to continue operations. These equity financing transactions may involve issuance of common shares or units. Each unit comprises a certain number of common shares and warrants. Depending on the terms and conditions, the warrants are exercisable into additional common shares at a price prior to the expiry as stipulated by the transaction. Warrants that are part of units are valued using the residual method and included in share capital with the common shares that were concurrently issued. Warrants that are issued as payment for agency fee or other transaction costs are accounted for as share-based payments.

4. RECENT ACCOUNTING PRONOUNCEMENTS

New Standards Recently Adopted

The following is an overview of new accounting standards that the Company adopted effective January 1, 2018:

- **IFRS 9** *Financial Instruments* - This standard provides added guidance on the classification and measurement of financial liabilities.

- **IFRS 15** *Revenue from Contracts with Customers* - This standard covers principles for reporting about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The core principle in IFRS 15 is that a company should recognize revenue to depict the transfer of promised goods or services to the customer in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. To recognize revenue, a company would apply the following steps:

    1. Identify the contract(s) with the customer
    2. Identify the performance obligations in the contract
    3. Determine the transaction price
    4. Allocate the transaction price
    5. Recognize revenue when a performance obligation is satisfied

The adoption of the above standards did not have a material impact on the Financial Statements.

New Standards Not Yet Effective

The following is an overview of a new accounting standard that the Company will be required to adopt this year.

- **IFRS 16** *Leases* - This standard specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting substantially unchanged from its predecessor, IAS 17. This standard is effective January 1, 2019 and the Company will use the modified retrospective method of recognition. Under this method, financial information will not be restated and will continue to be reported under the accounting standards in effect for those periods. The Company will recognize lease obligations related to its lease commitments for its vehicles and office lease. It will be measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as at January 1, 2019. The associated right of use asset will be measured at the lease obligation amount, less prepaid lease payments, resulting in no adjustment to the opening balance of retained earnings.

  As at January 1, 2019, the Company expects to recognize approximately $107,657 in right-of-use assets and an incremental lease obligations.

5. RECEIVABLES

	As at December 31, 2018 $	As at December 31, 2017 $
GST Recoverable (Canada)	107,407	113,684
VAT and government assistance receivable (UK)	577,283	88,550
Holdback receivables	—	60,165
Other receivables	215,009	13,279
Trade receivables	345,074	74,537
Total	**1,244,773**	**350,215**

6. INVENTORY

	As at December 31, 2018 $	As at December 31, 2017 $
Materials and supplies	9,536	260,593
Work-in-progress	320,946	268,245
Total	**330,482**	**528,838**

7. LOANS RECEIVABLE

During the year ended December 31, 2015 the Company advanced $80,000 to the CEO of the Company. During the year ended December 31, 2016, $40,000 was repaid. The advance bore interest at a rate of 3% per annum. As at December 31, 2018 the outstanding balance was $Nil (December 31, 2017 - $42,788) as the loan was repaid. In addition, there was a non-interest bearing advance of $Nil (December 31, 2017 - $27,702) to the CEO that was repaid.

8. EQUITY INVESTMENTS

During the year ended December 31, 2015, the Company acquired a 40% interest in SHARC Caledonia Ltd ("**Caledonia**") for £4,000 ($7,817). As the Company exerts significant influence over Caledonia but does not control it, the investment is accounted for as an equity investment.

The Company's unrecognized share of the loss for the year ended December 31, 2018 was $79,850 for a balance at December 31, 2018 of $294,348 (December 31, 2017 - $214,498).

As at December 31, 2018, 2017 and 2016, the equity investment was $Nil.

8. EQUITY INVESTMENT

The table below discloses selected financial information for Caledonia on a 100% basis:

	As at December 31, 2018 $	As at December 31, 2017 $
Current assets	130,089	79,043
Non-current assets	1,154,372	1,221,276
Current liabilities	(112,250)	(110,445)
Non-current liabilities	(1,715,538)	(1,509,863)
Revenue	142,977	90,234
Total comprehensive loss	(199,626)	(274,779)

During the year ended December 31, 2018, the Company entered into a joint arrangement and holds a 50% interest in Bandwidth Energy Limited ("**Bandwidth**") for £10,000 ($17,357). As the Company holds joint control of the arrangement but the legal form of the arrangement and the contractual terms of the arrangement does not give or specify that the parties have rights to the assets, and obligations for the liabilities and therefore, the investment is treated as a joint venture and accounted for as an equity investment. The Company's share of the loss for the year ended December 31, 2018 was $9,487. As of December 31, 2018, the equity investment in Bandwidth was calculated as the following:

	As at December 31, 2018 $	As at December 31, 2017 $
Cost	17,357	—
Net loss attributable to equity investment	(16,412)	—
Contributions	—	—
Withdrawals	—	—
Equity Investment	945	—

The table below discloses selected financial information for Bandwidth on a 100% basis:

	As at December 31, 2018 $	As at December 31, 2017 $
Current assets	412,889	—
Non-current assets	818,109	—
Current liabilities	(365,980)	—
Non-current liabilities	(863,231)	—
Revenue	—	—
Total comprehensive income	32,824	—

9. RESTRICTED CASH

The restricted cash balance is comprised of a guaranteed investment certificate and security deposit held as collateral for the Company's corporate credit cards.

10. PROPERTY AND EQUIPMENT

	Equipment, furniture and fixtures $	Demo units $	Computer hardware $	Leasehold improvements $	Building under construction $	Total $
Cost:						
Balance, December 31, 2016	**46,080**	**—**	**27,926**	**19,025**	**—**	**93,031**
Addition	19,733	271,614	—	—	—	291,347
Balance, December 31, 2017	**65,813**	**271,614**	**27,926**	**19,025**	**—**	**384,378**
Addition	—	31,799	—	—	4,822,662	4,854,461
Government grant (Note 17)	—	—	—	—	(2,643,350)	(2,643,350)
Balance, December 31, 2018	**65,813**	**303,413**	**27,926**	**19,025**	**2,179,312**	**2,595,489**
Accumulated depreciation:						
Balance, December 31, 2016	**19,346**	**—**	**22,531**	**9,278**	**—**	**51,155**
Depreciation	7,133	235,600	2,967	3,805	—	249,505
Balance, December 31, 2017	**26,479**	**235,600**	**25,498**	**13,083**	**—**	**300,660**
Depreciation	7,907	39,989	1,336	3,805	—	53,037
Balance, December 31, 2018	**34,386**	**275,589**	**26,834**	**16,888**	**—**	**353,697**
Net book value:						
As of December 31, 2017	39,334	36,014	2,428	5,942	—	83,718
As of December 31, 2018	**31,427**	**27,824**	**1,092**	**2,137**	**2,179,312**	**2,241,792**

Building under construction relates to the Clyde Gateway project. Depreciation will begin when the project is completed and available for its intended use.

11. RELATED PARTY DISCLOSURE

[a] Transactions with related parties

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly. Key management personnel include officers and directors.

The Company incurred the following charges with key management personnel:

	Year Ended December 31, 2018 $	Year Ended December 31, 2017 $
Consulting fees [i]	94,516	111,000
Wages and benefits [ii]	392,898	371,400
Share-based payments [iii]	186,974	196,143
Inventory/cost of sales/research and development [iv]	32,202	98,862
	706,590	**789,076**

[i] The Company paid consulting fees to companies controlled by the current and former Chief Financial Officer, Chief Operating Officer and a Director of Sharc UK.

[ii] The Company paid wages and and benefits to the Chief Executive Officer and Director, a Director, the Chief Operating Officer and Senior Vice President of Finance.

[iii] Share-based payments was recognized in connection with the vesting of options granted to directors and officers of the Company.

[iv] The Company paid consulting fees to companies controlled by the Chief Operating Officer and a Director of Sharc UK that were capitalized to inventory costs and expensed to cost of sales or research and development expense .

Other transactions with related parties included rent of $Nil (2017 - $11,671) due to a company controlled by a director of a subsidiary.

Included in accounts payable is $252,025 (December 31, 2017 – $205,587) due to related parties.

During the year ended December 31, 2018, the Company entered into an installation agreement with Bandwidth whereby the Company sold a SHARC unit with associated installation services to Bandwidth. In relation to the sale, the Company recognized $1,513,030 of revenue during the year ended December 31, 2018. The associated costs of the project were $2,038,793 which are included in cost of sales. As the project resulted in a loss, the total revenue and cost of sale of the project have been recognized. At December 31, 2018, included in receivables is $292,858 due from Bandwidth.

12. LOANS PAYABLE

[i] During the year ended December 31, 2015 Sharc UK received a loan of $102,035 (£50,000) from an unrelated company. The loan accrues interest at a rate of 12.5% per annum and is payable on April 17, 2020. The loan must be repaid in monthly payments of £1,125 with the first payment required on June 17, 2015. An arrangement fee of £1,000 was paid prior to the loan being advanced. The loan is guaranteed by the CEO of Sharc UK. During the year ended December 31, 2018, the Company made payments totaling $23,354 (£13,500), of which $4,799 (£2,774) related to interest and $18,555 (£10,726), related to principal. The balance of the loan as at December 31, 2018 is $30,565 (£17,527).

[ii] In February 2017, the Company received a loan of $80,000 from the former CFO of the Company. The loan bore interest at a rate of 35% per month and was repayable on demand. The loan was repaid in March 2017.

[iii] In November 2016, the Company received a loan of $200,000. The loan was guaranteed by the CEO of the Company. The loan bore interest at a rate of 2% per month and was repayable within 60 days. On January 25, 2017, the Company received a loan extension to March 26, 2017. In consideration, the interest rate on the loan increased to 2.5% per month and the Company issued 28,571 share purchase warrants exercisable at $1.40 for a period of two years from the date of issuance. The fair value of the share purchase warrants was $13,531 estimated by using the Black-Scholes valuation model with the following assumptions: expected dividend yield of 0%, expected volatility of 99.66% which is based on historical volatility, risk-free rate of return of 0.76% and an expected maturity of 2 years. The loan was repaid in March 2017.

[iv] In February 2018, the Company received a $150,000 loan from a third-party lender. The loan was unsecured, bore interest at 12%. The loan was repaid in May 2018 for $154,500.

[v] In March 2018, the Company received a $60,000 loan from a company controlled by the Chief Financial Officer. The loan was unsecured, non-interest bearing and was repaid in May 2018.

[vi] In March 2018, Highlands received a £1,000,000 loan facility from a third party lender. This facility is to be used finance eligible costs incurred in connection with the Clyde Gateway Project. The loan is guaranteed by Sharc UK, bears interest at 3.5%, and is repayable in monthly payments £7,148.83 (or pro-rata depending on how much is drawn down) for 180 consecutive payments beginning 4 months from initial draw down. As of December 31, 2018, the facility had $930,556 (£533,606) drawn. Subsequent to year end, the remaining $813,345 (£466,394) on the facility was drawn and monthly pro-rata payments began in March 2019.

[vii] In June 2018, Highlands received a £450,000 loan facility from a third party lender. This facility is to be used to pay costs incurred in connection with the Clyde Gateway Project. The loan provides the lender a bond and floating charge on Highlands, bears interest at 4.73% and interest is capitalized and added to the term loan to be repaid on June 25, 2024 or at such other times and in such amounts as the the Company and the lender may agree. As of December 31, 2018, the facility had $610,365 (£350,000) drawn. Subsequent to year end, the remaining $174,390 (£100,000) on the facility was drawn.

12. LOANS PAYABLE (CONTINUED)

[viii] In November 2018, the Company received a $150,000 loan from a third-party lender. The loan is guaranteed by the CEO, bears interest at 12% and was repayable on January 13, 2019. Subsequent to year end, the loan repayment date was extended for 270 days to September 13, 2019.

[ix] In November 2018, the Company received aggregate loan proceeds of $1,300,000 from third-party lenders. Of the $1,300,000, 1, $600,000 was guaranteed by the CEO and the remaining $700,000 was unsecured. The full $1,300,000 bears interest at 18% and is subject to a finance fee of 5% of the amount advanced. The third-party lenders received an aggregate of 3,714,286 common share purchase warrants exercisable at $0.35 for a period of three years, expiring November 22, 2021. The fair value of the share purchase warrants was $831,287 estimated by using the Black-Scholes valuation model with the following assumptions: expected dividend yield of 0%, expected volatility of 102.93% which is based on historical volatility, risk-free rate of return of 2.2% and an expected maturity of 3 years. The warrants have been recorded as a financing expenses. The loan was repaid on December 19, 2019.

[x] In December 2018, the Company received a $490,000 loan from a third-party lender. The loan is guaranteed by the CEO, bears interest at 6% and was repayable on March 13, 2019. In the event of a default on repayment, the interest rate rises to 9%. Subsequent to year end, $140,000 of the loan plus accrued interest was repaid by March 13, 2019 with the balance remaining outstanding.

[xi] In December 2018, the Company received a $210,000 loan from a third-party lender. The loan was guaranteed by the CEO, bore interest at 6% and was repayable on March 13, 2019. In the event of a default on repayment, the interest rate rises to 9%. Subsequent to year end, the loan plus accrued interest was repaid by March 13, 2019.

	Year ended December 31, 2018	Year ended December 31, 2017
	$	$
Balance, beginning of year	**47,917**	**267,402**
Proceeds from loans	3,900,921	80,000
Repayment of loans	(1,619,523)	(324,330)
Interest expense	94,968	23,575
Foreign exchange	1,203	1,270
Balance, end of year	**2,425,486**	**47,917**
Less: non-current portion	(1,553,386)	(30,313)
	872,100	**17,604**

13. DEFERRED REVENUE

Deferred revenue relates to on-going projects and service agreements at period end. Revenue will be recognized on a completion and sale of the projects and over the length of term for the service agreements.

14. WARRANTY PROVISIONS

	Year ended December 31, 2018	Year ended December 31, 2017
	$	$
Balance, beginning of year	**18,926**	**169,370**
Warranty provisions recognized	18,052	13,798
Warranty provisions derecognized	(10,049)	—
Warranty expenses incurred	(10,900)	(164,242)
Balance, end of year	**16,029**	**18,926**
Less: non-current portion	(13,757)	(4,000)
	2,272	**14,926**

15. CONVERTIBLE DEBENTURES

On May 30, 2017 and June 29, 2017, the Company issued two tranches of senior unsecured convertible debenture units with total principal amounts of $1,320,000 and $1,023,000, respectively. The debentures mature on May 30, 2020 and June 29, 2020, respectively, and bear interest at an annual rate of 12% due semi-annually. The debentures are convertible, in whole or in part, at the option of the holder at any time prior to the maturity date into common shares of the Company at a conversion price of $1.05 per common share.

Each debenture unit consisted of one $1,000 principal amount senior unsecured convertible debenture and 714 share purchase warrants, each exercisable into one common share of the Company at $1.05 per share three years from issuance.

The Company may abridge the exercise period of the warrants at any time after the date that is four months after the closing date, by providing written notice to the warrant holders within 30 days, in the event that the volume weighted average closing price of the Company's common shares is greater than $2.10 per common share for twenty consecutive trading days. The warrants will, unless exercised, expire on the 30th day after the Company provides such written notice to the warrant holders.

Total finders' fees of $157,010 in cash and 110,900 finders' warrants were incurred on the issuances. Each finders' warrant is exercisable into one common share of the Company at $1.40 per share two years from issuance. The fair value of $35,815 was assigned to the 110,900 finders' warrants using the Black-Scholes valuation model with the following weighted average assumptions: expected dividend yield of 0%, expected volatility of 102.68% which is based on historical volatility, risk-free rate of return of 0.85% and an expected maturity of 2 years.

The convertible debentures are compound financial instruments with the equity component being the residual value after accounting for the debt component. The Company valued the debt component of the debentures by calculating the present value of the principal and interest payments, discounted at a rate of 20%, being management’s best estimate of the rate that a non-convertible debenture with similar terms would bear. The equity component consists of the warrants and the equity conversion feature. The values attributed to each was based on the relative fair value approach.

15. CONVERTIBLE DEBENTURES

On initial recognition, the liability components were $1,962,798 ($1,801,419 net of transaction costs), the warrants were $190,101 ($125,042 net of transaction costs and tax effect) and the residual equity components were $190,101 ($125,042 net of transaction costs and tax effect).

Accretion charges, included in interest and financing expense on the statement of loss and comprehensive loss, attributable to the debentures for the year ended December 31, 2018 was $441,880, of which $281,660 (2017 - $231,768, of which $155,526) relates to accrued interest.

16. SHARE CAPITAL

[a] Authorized Share Capital

The authorized share capital consisted of unlimited number of common shares. The common shares do not have a par value. All issued shares are fully paid.

[b] Common shares

[i] On December 23, 2016, the Company closed a non-brokered private placement pursuant to which the Company issued 650,095 common share at a price of $1.05 per share for total gross proceeds of $682,600. In connection to this financing, the Company paid finder's fees and expenses of $49,788.

On April 7, 2017**,** the Company amended the terms of the placement to be a brokered placement which consisted of a unit at a price of $1.05 per unit. As a result, investors in the December 23, 2016 closing were issued a warrant on the same terms as the brokered placement (see Note 16 [b][v]).

[ii] On January 11, 2017, the Company issued 100,000 common shares to settle outstanding debt of $105,000. The fair value of $112,000 was assigned to the common shares based on the common share price on the date of issuance. As a result, the Company recognized a loss on debt settlement of $7,000 on the consolidated statement of loss and comprehensive loss.

[iii] On January 16, 2017, the Company issued 25,000 common shares for services. The valuation was based on the fair value of the shares issued.

16. SHARE CAPITAL (CONTINUED)

[b] Common shares (continued)

[iv] On February 27, 2017, the Company closed the first tranche of a brokered private placement pursuant to which the Company issued 759,957 units at a price of $1.05 per unit for aggregate gross proceeds of $797,955. Each unit consisted of one common share and one common share purchase warrant. Each warrant is exercisable at a price of $1.40 until February 27, 2019.The value of $79,795 was assigned to the 759,957 warrants using the residual value method.

In connection with the placement, the Company paid finders' fees and expenses of $91,097 and issued 56,997 finders' warrants. Each warrant is exercisable at a price of $1.05 until February 27, 2019. The fair value of $28,866 was assigned to the 56,997 finders' warrants as estimated by using the Black-Scholes valuation model with the following assumptions: expected dividend yield of 0%, expected volatility of 108.30% which is based on historical volatility, risk-free rate of return of 0.76% and an expected maturity of 2 years.

[v] On April 7, 2017, the Company completed the final tranche of a brokered private placement pursuant to which the Company issued 690,571 additional units at a price of $1.05 per unit for aggregate gross proceeds of $725,100. Each unit consists of one common share and one common share purchase warrant of the Company. Each warrant entitles the holder to purchase one common share until February 27, 2019 at an exercise price of $1.40 per share. The value of $181,275 was assigned to the 690,591 warrants using the residual method.

In connection with the final tranche of the placement, the Company paid finders' fees of $31,283 and issued 29,793 finders' warrants. Each finders' warrant entitles the holder to purchase one common share until February 27, 2019 at an exercise price of $1.05 per share

In conjunction with the closing, the Company amended the terms of the non-brokered private placement completed on December 23, 2016 to offer each participant in the non-brokered placement one warrant for each common share purchased on the same terms as the brokered placement. Accordingly, the Company issued a total of 650,095 warrants to purchasers from the non-brokered placement. The Company also issued an additional 36,464 finders' warrants. Each finders' warrant entitles the holder to purchase one common share until December 23, 2018 at an exercise price of $1.05 per share.

The value of $181,275 was assigned to the 1,340,666 warrants using the residual method.

The fair value of $23,714 was assigned to the 66,257 finders' warrants as estimated by using the Black-Scholes valuation model with the following weighted average assumptions: expected dividend yield of 0%, expected volatility of 107.34%-113.03% which is based on historical volatility, risk-free rate of return of 0.76% and an expected maturity of 1.71-1.89 years.

[vi] On August 3, 2017, the Company issued 25,000 common shares for services. The valuation was based on the fair value of the shares issued.

16. SHARE CAPITAL (CONTINUED)

[b] Common shares (continued)

[vii] On May 11, 2018, the Company closed the first tranche of a non-brokered private placement raising gross proceeds of $2,332,598 from the issuance and sale of 5,831,495 units at a price of $0.40 per unit. $309,000 of subscriptions were received prior to December 31, 2017. $192,000 was included in this tranche. The remaining $117,000 was refunded at the request of subscribers. Each unit consists of 1 common share and 1 share purchase warrant. Each warrant entitles the holder to acquire one common share at an exercise price of $0.60 for a period of 24 months from the closing date of the private placement. In the event that the Company's common shares trade at a closing price on the CSE of greater than $1.00 per share for a period of 10 consecutive trading days at any time after the closing date, the Company may accelerate the expiry date of the common share purchase warrants by giving notice to the holders thereof and in such case the warrants will expire on the 30th day after the date hereafter.

In connection with the private placement, the Company paid finder's fees of $64,238 and issued 133,000 finder's warrants. Each warrant has the same terms as the share purchase warrants issued under the private placement. The fair value of $30,840 was assigned to the 133,000 finders' warrants as estimated by using the Black-Scholes valuation model with the following assumptions: expected dividend yield of 0%, expected volatility of 109.70% which is based on historical volatility, risk-free rate of return of 1.93% and an expected maturity of 2 years.

[viii] On June 7, 2018, the Company closed the second tranche of a non-brokered private placement raising gross proceeds of $1,578,500 from the issuance and sale of 3,946,250 units at a price of $0.40 per unit. Each unit consists of 1 common share and 1 share purchase warrant. Each warrant entitles the holder to acquire one common share at an exercise price of $0.60 for a period of 24 months from the closing date of the private placement. In the event that the Company's common shares trade at a closing price on the CSE of greater than $1.00 per share for a period of 10 consecutive trading days at any time after the closing date, the Company may accelerate the expiry date of the common share purchase warrants by giving notice to the holders thereof and in such case the warrants will expire on the 30th day after the date hereafter.

In connection with the private placement, the Company paid finder's fees of $93,760 and issued 234,400 finder's warrants. Each warrant has the same terms as the share purchase warrants issued under the private placement. The fair value of $54,272 was assigned to the 234,400 finders' warrants as estimated by using the Black-Scholes valuation model with the following assumptions: expected dividend yield of 0%, expected volatility of 107.85% which is based on historical volatility, risk-free rate of return of 1.90% and an expected maturity of 2 years.

[ix] On December 19, 2018 the Company issued 23,173 common shares to settle outstanding debt of $8,000. The fair value of $7,184 was assigned to the common shares based on the common share price on the date of issuance. As a result, the Company recognized a gain on debt settlement of $816 on the consolidated statement of loss and comprehensive loss.

[x] During the year ended December 31, 2018, the Company issued 500,000 common shares pursuant to the exercise of stock options for aggregate gross proceeds of $196,000. The fair value of the options of $75,455 was transferred from reserves to share capital.

16. SHARE CAPITAL (CONTINUED)

[c] Common share purchase warrants

Common share purchase warrant transactions and the number of common share purchase warrants outstanding are summarized below:

	Number	Weighted Average Exercise Price $
Balance, December 31, 2016	**494,286**	**0.61**
Issued	4,036,919	1.24
Exercised	(303,714)	(0.67)
Balance, December 31, 2017	**4,227,491**	**1.22**
Issued	13,859,431	0.53
Expired	(877,131)	(1.25)
Balance, December 31, 2018	**17,209,791**	**0.67**

Date of Expiry	Exercise Price $	Number of Warrants Outstanding
February 27, 2019	1.40	1,450,528
February 27, 2019	1.05	86,790
May 30, 2020	1.05	942,857
May 30, 2019	1.40	66,000
June 6, 2019	1.40	28,571
June 29, 2020	1.05	730,714
June 29, 2019	1.40	44,900
May 11, 2020	0.60	5,964,495
June 7, 2020	0.60	4,180,650
November 22, 2021	0.35	3,714,286
Balance, December 31, 2018	**0.67**	**17,209,791**

[d] Stock options

During the year ended December 31, 2018 and 2017, the Company recorded share-based payments of $436,452 and $630,083, respectively. During the year ended December 31, 2018, the Company recorded a reversal of reserves of expired and forfeited options of $511,309 (2017 - $798,210). The fair values of share options granted during the year ended December 31, 2018 and 2017 are estimated using the Black-Scholes option pricing model with the following weighted-average assumptions:

	2018	2017
Risk-free interest rate	2.10%	1.51%
Estimated annualized volatility	104.44%	92.44%
Expected life	2.17 year	1 year
Expected dividend yield	0%	0%
Exercise price	$0.38	$0.47
Fair value per option	$0.2142	$0.1522
Share price	$0.38	$0.44

16. SHARE CAPITAL (CONTINUED)

[e] Stock options (continued)

Stock option transactions and the number of stock options outstanding are summarized below:

	Number	Weighted Average Exercise Price $
Balance, December 31, 2016	**1,738,572**	**1.07**
Issued	2,500,000	0.52
Exercised	(135,714)	0.58
Cancelled	(1,460,000)	1.05
Balance, December 31, 2017	**2,642,858**	**0.58**
Issued	3,239,000	0.38
Exercised	(500,000)	(0.39)
Expiry	(2,200,000)	(0.52)
Balance, December 31, 2018	**3,181,858**	**0.45**

Date of Expiry	Exercise Price $	Number of Options Outstanding	Number of Options Exercisable
October, 27, 2020	1.47	142,858	142,858
July 12, 2021	1.05	100,000	100,000
September 4, 2021	0.47	400,000	100,000
October 1, 2021	0.40	1,489,000	496,333
Deember 18, 2019	0.28	800,000	800,000
March 13, 2019	0.46	250,000	250,000
Balance, December 31, 2018	**$0.45**	**3,181,858**	**1,889,191**

As of December 31, 2018, the weighted average remaining life for outstanding options was 2.05 years (December 31, 2017 – 0.92 years).

17. COMMITMENTS AND CONTINGENCIES

[a] Operating lease

The Company entered into a lease agreement commencing March 1, 2017 for a one-and-a-half year term at an annual rate of $77,753 with the option to renew the lease for an additional 2-year term. In the event of failure to reach an agreement on base rent prior to commencement of the renewed term, the Company will provide ninety days' notice to vacate the property plus 3 months' rent at a rate of 110% of the base rate. The Company is operating on a month to month basis as it negotiates with the landlord for the next lease.

[b] Government Grants from the Energy Deployment Division of the Scottish Government

During the year ended December 31, 2018, in connection with two wastewater heat recovery demonstration projects Sharc UK received $43,911 (year ended December 31, 2017 - $295,590), in aggregate $339,501 in government grants from the Energy Deployment Division of the Scottish government. The funds received to date have been offset against the related expenses associated with the project. Per the underlying funding agreements, the parties jointly forecasted the expected revenue that would be generated from the projects for the first five years after completion. Under the terms of the grant, should the projects actual revenue exceed 10% or more of the forecasted revenue, the Scottish government reserves the right to require the Company to repay part of the grant.

[c] Low Carbon Infrastructure Transition Programme ("LCITP") Grant for Clyde Gateway

The Company has received grant funding of £1,684,188 for 50% of eligible capital costs associated with the Clyde Gateway Project. As of December 31, 2018, $2,643,350 (Note 10) (£1,515,769) has been received. Per the underlying funding agreements, the parties jointly forecasted the expected revenue that would be generated from the projects for the first five years after completion. Under the terms of the grant, should the projects actual revenue exceed 10% or more of the forecasted revenue, the Scottish government reserves the right to require the Company to repay part of the grant.

18. SEGMENTED INFORMATION

The Company has a single operating segment, the sales and marketing of sewage heat recovery systems. Substantially all of the Company's operations, assets, and employees are in Canada and the United Kingdom.

Geographic information as at December 31, 2018 is as follows:

	Canada	United Kingdom	Total
Asset			
Inventory	$ 315,882	$ 14,600	$ 330,482
Property and equipment	104,947	2,136,845	2,241,792
	$ 420,829	**$ 2,151,445**	**$ 2,572,274**

18. SEGMENTED INFORMATION (CONTINUED)

Geographic information as at December 31, 2017 is as follows:

	Canada	United Kingdom	Total
Asset			
Inventory	$ 327,911	$ 200,927	$ 528,838
Equipment	65,771	17,947	83,718
	$ 393,682	**$ 218,874**	**$ 612,556**

Geographic information for the year ended December 31, 2018 is as follows:

	Canada	United Kingdom	Total
Revenues	$ 530,864	$ 1,605,534	$ 2,136,398
Cost of sales	(285,141)	(2,150,164)	(2,435,305)
Gross margin	**$ 245,723**	**$ (544,630)**	**$ (298,907)**
Loss for the year	**$ (4,428,540)**	**$ (1,467,936)**	**$ (5,896,476)**

Geographic information for the year ended December 31, 2017 is as follows:

	Canada	United Kingdom	Total
Revenues	$ 227,717	$ 41,093	$ 268,810
Cost of sales	(168,325)	(39,161)	(207,486)
Gross margin	**$ 59,392**	**$ 1,932**	**$ 61,324**
Loss for the year	**$ (3,708,945)**	**$ (812,596)**	**$ (4,521,541)**

19. CAPITAL MANAGEMENT

The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern in order to support the development of its business and maintain the necessary corporate and administration functions to facilitate these activities. The capital of the Company consists of items included in shareholders' equity.

The Company manages and adjusts its capital structure when changes to the risk characteristics of the underlying assets or changes in economic conditions occur. To maintain or adjust the capital structure, the Company may attempt to raise new funds.

There were no changes to the Company's approach to capital management during the year. The Company is not subject to externally imposed capital requirements.

20. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair value

IFRS 13 establishes a fair value hierarchy for financial instruments measured at fair value that reflects the significance of inputs used in making fair value measurements as follows:

Level 1 – quoted prices in active markets for identical assets or liabilities;
Level 2 – inputs other than quoted prices included in Level 1 that are observable for the asset or liabilities, either directly (i.e. as prices) or indirectly (i.e. from derived prices); and
Level 3 – inputs for the asset or liability that are not based upon observable market data.

The fair value of cash is based on Level 1 inputs. The fair value of the Company's receivables, loans receivable, accounts payable and accrued liabilities, loans payable and convertible debentures approximate their carrying values due to the short-term to maturity. The fair value of long-term liabilities are initially recorded at fair value and subsequently carried at amortized cost using rates comparable to market interest rates.

[a] Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company's cash and receivables are exposed to credit risk. The Company reduces its credit risk on cash by placing these instruments with institutions of high credit worthiness. Receivables are primarily from sales or loans. The Company believes these parties to be of sound creditworthiness, and to date, all receivables have been settled in accordance with agreed upon terms and conditions. As at December 31, 2018 and December 31, 2017, the Company is exposed to credit risk arising from receivables and loans receivable.

[b] Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company manages liquidity risk by maintaining sufficient cash balances to enable settlement of transactions on the due date. The Company addresses its liquidity through debt financing. While the Company has been successful in securing financings in the past, there is no assurance that it will be able to do so in the future.

20. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (CONTINUED)

[c] Market risk (continued)

[i] 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. As at December 31, 2018, the Company is not exposed to any significant interest rate risk.

[ii] Currency risk

Foreign exchange risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. As at December 31, 2018 the Company has exposure to the British pound that is subject to fluctuations as a result of exchange rate variations to the extent that transactions are made and balances are held in this currency. The Company has not hedged its exposure to currency fluctuations. The sensitivity of the Company's net loss to changes in the exchange rate between the Canadian dollar and the British pound resulting from a 10% change in the British pound exchange rate relative to the Canadian dollar would change the Company's net loss by approximately $6,527 (December 31, 2017 - $5,000)

21. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

The following is the non-cash operating, investing and financing activities:

	Year Ended December 31, 2018 $	Year Ended December 31, 2017 $
Finders' warrants issued as share issuance costs	85,112	52,580
Fair value of stock options exercised	75,455	80,192
Accrued interest on debt in accounts payable and accrued liabilities	141,735	155,526
Additions to property and equipment in accounts payable and accrued liabilities	1,688,741	—
Shares issued for debt	7,184	—
Reversal of share-based payment	511,309	798,210
Residual value of warrants granted	—	431,730
Issuance of warrants for loans payable	—	60,165
Inventory reclassified to equipment	—	13,279
Issuance of convertible debt – brokers' warrants	—	74,537
Issuance of convertible debt – equity component	—	174,572
Issuance of convertible debt – warrant component	—	174,542

22. INCOME TAXES

A reconciliation of income taxes (recovery) at statutory rates with the reported taxes is as follows:

	Year ended December 31, 2018	Year ended December 31, 2017
Loss before income taxes	$ (5,896,476)	$ (4,620,541)
Expected income tax (recovery)	$ (1,592,000)	$ (1,201,000)
Changes in statutory rates, foreign tax, foreign exchange rates and other	78,000	64,000
Permanent differences	373,000	79,000
Share issue costs	(43,000)	(32,000)
Adjustment to prior year provision versus statutory returns	(2,000)	(35,000)
Change in unrecognized deductible temporary difference	1,186,000	956,000
Total deferred tax recovery	$ -	$ (99,000)

In September 2017, the British Columbia (BC) Government proposed changes to the general corporate income tax rate to increase the rate from 11% to 12% effective January 1, 2018 onwards. This change in tax rate was substantively enacted on October 26, 2017. The relevant deferred tax balances have been remeasured to reflect the increase in the Company's combined federal and provincial (BC) general corporate income tax rate from 26% to 27%.

The significant components of the Company's deductible temporary differences, unused tax credits and unused tax losses that have not been recognized on the statement of financial position are as follows:

	2018	Expiry dates	2017	Expiry dates
Mineral property costs	$ 534,000	No expiry	$ 534,000	No expiry
Share issue costs	270,000	2039-2042	203,000	2038-2041
Equipment	419,000	No expiry	65,000	No expiry
Non-capital losses:	15,048,000		10,682,000	
Canada	10,917,000	2030-2038	7,965,000	2030-2037
United Kingdom	4,131,000	No expiry	2,717,000	No expiry

23. SUBSEQUENT EVENTS

[a] Subsequent to December 31, 2018, the Company had 250,000 stock options expire unexercised (Note 16 [e]).

[b] Subsequent to December 31, 2018, the Company had 1,537,318 common share purchase warrants expire unexercised (Note 16 [c]).

[c] On March 8, 2019, the Company closed the sale of 810 convertible debenture units ("Units") for gross proceeds of $810,000. Each unit consists of i) $1,000 principal amount of 8.0% unsecured convertible debentures (the "Debentures") and ii) 1,563 warrants (each a "Warrant").

The Debentures bear interest at 8% per annum and mature three years following the date of issuance. The Debentures are unsecured and rank pari passu in right of payment of principal and interest with all of the existing and future unsecured indebtedness of the Company.

The Debentures (including any accrued and unpaid interest) are convertible at the option of the holder into common shares of the Company at a conversion price of $0.32 per common share. If after the first anniversary of the date of issuance the closing price of the common shares on the CSE is $0.64 or greater for 20 consecutive trading days, the Company may, at its option, convert the Debentures (including any accrued and unpaid interest) into common shares at the conversion price by disseminating a press release, in which case the Debentures shall be converted into common shares on the second business day after dissemination of such press release.

Each Warrant is exercisable to acquire one common share at an exercise price of $0.40 per share for a period of three years following the date of issuance.

The Company paid the Agent a cash fee of $48,600 and issued 49 compensation warrants to the Agent and other selling dealer group members ("**Compensation Warrants").** Each Compensation Warrant entitles the holder thereof to purchase one Unit of the Company at an exercise price of $1,000 for a period of three years following the date of issuance. The Units issuable upon exercise of the Compensation Warrants are on the same terms as the Units sold under the Offering.

[d] In April 2019, the Company received a $150,000 loan from a third-party lender. The loan is guaranteed by the CEO, bears interest at 12% and matures three months from receipt.