LOTUS
VENTURES INC.

FINANCIAL STATEMENTS

(UNAUDITED)

For the six months ended February 29, 2020

(Expressed in Canadian Dollars)

NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM FINANCIAL STATEMENTS

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor. The following condensed interim financial statements of Lotus Ventures Inc. are unaudited. They have been prepared by management and approved by the Audit Committee and Board of Directors of the Company. The Company's independent auditors have not performed a review of these condensed interim financial statements.

LOTUS VENTURES INC.
STATEMENTS OF FINANCIAL POSITION
Unaudited – prepared by management
(Expressed in Canadian Dollars)

	February 29, 2020	August 31, 2019
ASSETS		
Current		
Cash and cash equivalents	$ 4,025	$ 110,748
Accounts receivable	318,552	-
GST receivable	-	87,472
Other receivables	22,032	22,032
Biological assets (Note 4)	458,601	490,000
Inventory (Note 5)	1,309,245	-
Prepaid expenses	231,343	246,543
	2,343,798	956,795
Non-current		
Restricted cash (Note 6)	434	98,458
Property, plant and equipment (Note 6)	14,197,432	14,538,643
	14,197,866	14,637,101
Total assets	$ 16,541,664	$ 15,593,896
LIABILITIES		
Current		
Accounts payable and accrued liabilities	$ 652,584	$ 954,100
GST payable	43,035	-
Deferred revenue (Note 7)	1,059,370	1,333,333
Loans payable (Note 10)	861,742	242,436
Total liabilities	2,616,731	2,529,869
SHAREHOLDERS' EQUITY		
Share capital (Note 8)	$ 16,956,365	$ 16,600,490
Reserves	4,141,610	4,140,245
Deficit	(7,173,042)	(7,676,708)
	13,924,933	13,064,027
	$ 16,541,664	$ 15,593,896

Note 13 Subsequent Event

The accompanying notes form an integral part of these financial statements.

Approved and authorized by the Board on May 4, 2020.

"Dale McClanaghan" Director *"Carl Correia"* Director
Dale McClanaghan Carl Correia

LOTUS VENTURES INC.
STATEMENTS OF COMPREHENSIVE LOSS
Unaudited – prepared by management
(Expressed in Canadian Dollars)

	Three months ended February 29, 2020	Three months ended February 28, 2019	Six months ended February 29, 2020	Six months ended February 28, 2019
Revenue	**$ 1,071,252**	$ -	**$ 1,071,252**	$ -
Cost of sales*	**(329,348)**	-	**(329,348)**	-
Gross margin before fair value changes	**741,904**	-	**741,904**	-
Changes in fair value of biological assets less realized portion relating to inventory sold**	**(675,061)**	-	**634,939**	-
Gross margin	**66,843**	-	**1,376,843**	-
General and administrative expenses				
Advertising and promotion	**23,374**	83,734	**47,921**	109,826
Amortization	**184,778**	3,833	**369,556**	7,665
Bank fees and interest (Note 10)	**24,977**	235	**25,601**	1,343
Consulting (Note 9)	**71,882**	441,036	**122,161**	771,928
Insurance	**19,123**	1,690	**38,246**	1,690
Listing, filing and transfer fees	**7,216**	10,131	**10,907**	13,853
Office and miscellaneous	**29,303**	4,311	**45,754**	20,280
Professional fees	**36,000**	36,969	**44,500**	65,807
Rent	**-**	10,446	**-**	15,859
Share-based compensation (Note 8)	**-**	-	**162,240**	396,110
Travel	**6,078**	19,046	**6,291**	46,334
	(402,731)	(611,431)	**(873,177)**	(1,450,695)
Net income (loss) and comprehensive income (loss)	**$ (335,888)**	$ (611,431)	**$ 503,666**	$ (1,450,695)
Basic and diluted income (loss) per share	**$ (0.00)**	$ (0.01)	**$ 0.01**	$ (0.02)
Weighted average number of shares outstanding	**85,049,799**	72,474,329	**84,867,656**	84,865,609

*Comprised only of costs incurred exclusive of the effects of any fair value adjustments.
**A composite figure comprising unrealized income related to recording biological assets at fair value net of these same amounts, related to the cost of those assets, recognized as an expense upon sale.

The accompanying notes form an integral part of these financial statements.

LOTUS VENTURES INC.
STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
Unaudited – prepared by management
(Expressed in Canadian Dollars)

	Common shares					
	Number of Shares	Amount	Subscription receivables	Reserves	Deficit	Total
Balance, August 31, 2019	**84,074,799**	**$ 16,600,490**	**$ -**	**$ 4,140,245**	**$ (7,676,708)**	**$ 13,064,027**
Options exercised	975,000	355,875	-	(160,875)	-	195,000
Share-based compensation	-	-	-	162,240	-	162,240
Net income	-	-	-	-	503,666	503,666
Balance, February 29, 2020	**85,049,799**	**$ 16,956,365**	**$ -**	**$ 4,141,610**	**$ (7,173,042)**	**$ 13,924,933**
Balance, August 31, 2018	**57,423,931**	**$ 10,702,975**	**$ (10,000)**	**$ 1,694,390**	**$ (4,764,218)**	**$ 7,623,147**
Shares issued for cash – private placement	15,015,868	5,481,667	-	-	-	5,481,667
Share issue costs	-	(210,250)	-	-	-	(210,250)
Share subscription received	-	-	10,000	-	-	10,000
Warrants exercised	150,000	32,500	-	-	-	32,500
Options exercised	500,000	125,000	-	-	-	125,000
Fair value of options exercised	-	93,250	-	(93,250)	-	-
Share-based compensation	-	-	-	396,110	-	396,110
Net loss	-	-	-	-	(1,450,695)	(1,450,695)
Balance, February 28, 2019	**73,089,799**	**$ 16,225,142**	**$ -**	**$ 1,997,250**	**$ (6,214,913)**	**$ 12,007,479**

The accompanying notes form an integral part of these financial statements.

LOTUS VENTURES INC.
STATEMENTS OF CASH FLOWS
Unaudited – prepared by management
(Expressed in Canadian Dollars)

	Three months ended February 29, 2020	Three months ended February 28, 2019	Six months ended February 29, 2020	Six months ended February 28, 2019
Operating activities				
Net income (loss) for the period	**$ (335,888)**	$ (611,431)	**$ 503,666**	$ (1,450,695)
Items not affected by cash:				
Amortization	**184,778**	3,833	**369,556**	7,665
Share-based compensation	**-**	-	**162,240**	396,110
Changes in fair value of biological assets	**675,061**	-	**(634,939)**	-
Changes in non-cash working capital items:				
Accounts receivable	**(318,552)**	(15,500)	**(318,552)**	(15,500)
GST receivable (payable)	**60,341**	391,288	**130,507**	172,913
Biological assets	**(292,390)**	-	**(566,538)**	-
Subscription receivable	**-**	-	**-**	10,000
Inventory	**(19,245)**	-	**(84,245)**	-
Prepaid expenses	**10,362**	(47,114)	**15,200**	(36,573)
Accounts payable and accrued liabilities	**5,499**	(616,229)	**(18,849)**	(1,587,224)
Interest payable	**16,261**	-	**24,272**	-
Due to (from) related party	**-**	-	**(7,525)**	-
	(13,773)	(895,153)	**(425,207)**	(2,503,304)
Financing activities				
Cash received for shares issued	**-**	-	**-**	5,481,667
Deferred revenue	**(273,963)**	-	**(273,963)**	1,333,333
Share issue costs	**-**	-	**-**	(210,250)
Options exercised	**-**	125,000	**195,000**	125,000
Warrants exercised	**-**	12,500	**-**	32,500
Proceeds from loans	**303,045**	-	**595,034**	-
	29,082	137,500	**516,071**	6,762,250
Investing activities				
Expenditures on property, plant and equipment	**(81,520)**	(1,907,713)	**(197,587)**	(5,384,414)
	(81,520)	(1,907,713)	**(197,587)**	(5,384,414)
Increase (decrease) in cash	**(66,211)**	(2,665,366)	**(106,723)**	(1,125,468)
Cash, beginning of the period	**70,236**	3,281,751	**110,748**	1,741,853
Cash, end of the period	**$ 4,025**	$ 616,385	**$ 4,025**	$ 616,385

Note 12 Supplemental Non-cash Disclosures

The accompanying notes form an integral part of these financial statements.

Note 1 <u>Nature and Continuance of Operations</u>

The public company predecessor to Lotus Ventures Inc. (the ‘Company’) was incorporated under the Business Corporations Act (B.C.) on May 12, 2010 as Strachan Resources Ltd. (‘Strachan’). Strachan’s common shares were previously listed for trading on the TSX Venture Exchange (‘Venture’), and it was classified as a Capital Pool Company pursuant to Venture Policy 2.4 until the completion of the 2014 amalgamation agreement (the ‘Transaction”) described below. Effective December 8, 2014, the Company’s common shares were listed for trading on the Canadian Securities Exchange (‘CSE’).

In March 2019 the Company received Health Canada certification as a Licensed Producer of cannabis products. During the fourth quarter of the current fiscal year the Company commenced cultivation activity at its production facility, which since 2018 it has been constructing near Armstrong, BC.

These financial statements have been prepared on the going concern basis, which assumes the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. There are certain adverse conditions and events that may cast doubt on the validity of this assumption. The Company has incurred losses since inception, at February 29, 2020 had a net working capital deficiency of $272,933, and only during the most recent quarter the Company began to realize its first revenues from active business operations. These factors are indicative of the existence of a material uncertainty that may cast significant doubt about the Company’s ability to continue as a going concern. The Company’s ability to continue its operations and to realize its assets at their carrying values is dependent upon developing profitable operations on a commercial basis, and/or obtaining financing and continued support from its shareholders and creditors on terms which are acceptable to it. These financial statements do not give effect to any adjustments which would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities in other than the normal course of business and at amounts different from those reflected in the accompanying financial statements.

Note 2 <u>Basis of Preparation</u>

Statement of Compliance

These financial statements are prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”), applicable to the presentation of interim financial statements, including IAS 34, Interim Financial Reporting. These condensed interim financial statements should be read in conjunction with the Company’s audited financial statements as at and for the year ended August 31, 2019, which have been prepared in accordance with IFRS as issued by the IASB.

Basis of Measurement

These financial statements have been prepared on a historical costs basis except for financial instruments classified as financial instruments at fair value through profit or loss, which are stated at their fair value. In addition, these financial statements have been prepared using the accrual basis of accounting.

Note 2 Basis of Preparation – (cont'd)

Basis of Measurement – (cont'd)

These financial statements are presented in Canadian dollars, which is also the Company's functional currency.

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 the reported expenses during the period. Actual results could differ from these estimates.

Note 3 Significant Accounting Policies

Financial instruments

Effective September 1, 2018, the Company adopted IFRS 9 using the modified retrospective approach. IFRS 9 did not impact the Company's classification and measurement of financial assets and liabilities. The standard did not have an impact on the carrying amounts of the Company's financial instruments at the transition date. IFRS 9 uses a single approach to determine whether a financial asset is classified and measured at amortized cost or fair value. The classification and measurement of financial assets is based on the Company's business models for managing its financial assets and whether the contractual cash flows represent solely payments for principle and interest.

Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward in IFRS 9.

Cash and cash equivalents

Cash in the statement of financial position comprises cash at banks and on hand. Cash equivalents is comprised of highly liquid investments held at major financial institutions, having maturity dates of three months or less from the date of purchase, which are readily convertible into known amounts of cash. There were no cash equivalents at August 31, 2019.

Intangible assets

Intangible assets are recognized when they become identifiable, which is to say when they arise from contractual or other rights, or when they are separable, or capable of being sold, transferred, licensed, rented or exchanged. They are initially recorded at cost, subject to the reliability of measurement, and are carried as assets to the extent that it is probable that the future economic benefits applicable to such costs will flow to the Company.

Biological assets

Biological assets are valued in accordance with IAS 41 and are presented at their fair value less costs to sell up to the point of harvest, which becomes the basis for the cost of finished goods inventory after harvest. The Company's biological assets consist of cannabis plants, and because there is no actively traded commodity market for plants or dried product, the valuation of these biological assets is obtained using valuation techniques where the inputs are based upon unobservable market data. These inputs are Level 3 on the fair value hierarchy, and are subject to

Note 3 Significant Accounting Policies – (cont'd)

Biological assets – (cont'd)

volatility in market prices and several uncontrollable factors, which could significantly affect the fair value of biological assets in future periods.

The Company initially records cannabis plants at cost, which includes elements of seedling purchases, direct labour, power and all other direct costs. The number of weeks in the production cycle is between 14 and 16 weeks from propagation to harvest. The fair value of biological assets under cultivation is then determined using a valuation model to estimate expected harvest yield per plant applied to the estimated price per gram less processing and selling costs. The delta between this valuation and the actual costs incurred in respect to it is recognized in income as an unrealized gain on changes in fair value of biological assets.

The wholesale selling price is between $3.00 and $5.50 per gram.

The harvest yield is between 80 and 115 grams per plant.

The selling price used in the valuation of biological assets is based on the average selling price of all cannabis products and can vary based on strain. Expected yield is also subject to a variety of factors including psychoactive strength and length of the growth cycle.

Inventory

The Company values inventories at the lower of cost and net realizable value. Inventories of harvested cannabis are transferred from biological assets at their fair value at harvest, which becomes the initial deemed cost. Any subsequent post-harvest costs are capitalized to inventory to the extent that aggregate cost remains less than net realizable value. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. The cost of inventories is determined using the weighted average cost basis.

Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage, or declining market prices. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is apparent evidence of an increase in selling price then the amount of the write down previously recorded is reversed. Storage costs, indirect administrative overhead, and certain other selling costs related to inventories are expensed in the period incurred.

Property, plant and equipment

Property, plant and equipment are carried at cost, less accumulated amortization and accumulated impairment losses. Cost comprises the fair value of consideration given to acquire an asset and includes the direct expenditures associated with bringing the asset to the location and condition necessary for putting it into use along with the future cost of dismantling and removing the asset.
When parts of an item of fixed assets have different useful lives, they are accounted for as separate items (major components) of fixed assets.

Note 3 **Significant Accounting Policies – (cont'd)**

Property, plant and equipment– (cont'd)

The Company uses the following amortization rates for its property, plant and equipment:

Computer software and equipment	55%	Declining balance
Buildings	6%	Declining balance
Equipment	5 years	Straight line

Certain of the Company's property, plant and equipment have not yet been put into use and as a result useful lives have not yet been determined and no amortization has been recorded to date on this property, plant and equipment.

Costs of assets in the course of construction are capitalized as construction in progress. On completion, the cost of construction is transferred to the appropriate category of property and equipment and amortization commences when the asset is available for its intended use.

An asset's residual value, useful life and amortization method are reviewed at each financial year-end and adjusted if appropriate. When parts of an item of equipment have different useful lives, they are accounted for as separate items (major components) of equipment.

Gain and losses on disposal of an item of equipment are determined by comparing the proceeds from disposal with the carrying amount of the equipment and are recognized in profit or loss.

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 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. To the extent that the Company does not consider it is probable that a future tax asset will be recovered, it provides a valuation allowance against that excess.

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.

Note 3 Significant Accounting Policies – (cont'd)

Share capital

Common shares are classified as equity. Transaction costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

The Company has adopted a residual value method with respect to the measurement of shares and warrants issued as private placement units. The residual value method first allocates value to the more easily measurable component based on fair value and then the residual value, if any, to the less easily measurable component.

The fair value of the common shares issued in the private placements is considered to be the more easily measurable component and the common share are valued at their fair value, as determined by the closing quoted bid price on the announcement date. The balance, if any, is allocated to the attached warrants. Any fair value attributed to the warrants is recorded as reserves.

Share-based compensation

Employees (including directors and senior executives) of the Company may receive a portion of their remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

In situations where equity instruments are issued for goods or services, the share-based compensation is measured at the fair value of the goods and services received. Where the consideration cannot be specifically identified, they are measured at the fair value of the share-based compensation.

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which they are granted.

The costs of equity-settled transactions are recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense is recognized for equity-settled transactions at each reporting date until the vesting date reflects the Company's best estimate of the number of equity instruments that will ultimately vest.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied provided that all other performance and/or service conditions are satisfied.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based compensation arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

(Expressed in Canadian Dollars)

Note 3 **Significant Accounting Policies – (cont'd)**

Income (loss) per share

The Company presents basic and diluted income (loss) per share data for its common shares, calculated by dividing the loss attributed to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted income (loss) per share does not adjust the income (loss) attributed to common shareholders or the weighted average number of common shares outstanding when the effect is anti-dilutive.

Related party transactions

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

Revenue Recognition

Revenue is recognized at the fair value of consideration received or receivable. Revenue from the sale of goods is recognized when all the following conditions have been satisfied:

- the Company has transferred to the buyer the significant risks and rewards of ownership of the goods;
- the Company retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the Company; and
- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Payments received from customers in advance of meeting all of the recognition criteria are recorded as deferred revenue and subsequently recognized as those criteria are met.

Note 4 **Biological assets**

	2020	2019
Balance, September 1, 2019	$ 490,000	$ -
Production costs capitalized	519,286	-
Changes in fair value less costs to sell due to biological transformation	1,845,240	-
Transferred to inventory upon harvest	(2,395,925)	-
Balance, February 29, 2020	$ 458,601	$ -

Included in production costs capitalized is $7,876 of amortization related to growing equipment.

(Expressed in Canadian Dollars)

Note 4 Biological assets – (cont'd)

The Company's biological assets consist of medical cannabis plants. The significant assumptions used to determine the fair value of the medical plants include:

- Expected yield by strain of plant;
- Wastage of plants;
- Duration of the production cycle;
- Percentage of costs incurred to date compared to the total costs expected to be incurred;
- Percentage of costs incurred for each stage of plant growth; and
- Market value less selling costs.

The Company's estimates are, by their nature, subject to change and differences from anticipated yield will be reflected in the gain or loss on biological assets in future periods.

On average, the production cycle is 117 days. As at February 29, 2020, the Company had approximately 4,500 plants that were biological assets (2019 – nil). It is estimated that these biological assets will yield approximately 340,000 grams of cannabis once fully matured and harvested (2019 – nil).

As of February 29, 2020, a change of 10% or less in the estimated yield per plant, growth cycle and selling price of dry cannabis would not result in a significant variance in the fair value of biological assets.

Note 5 Inventory

As at February 29, 2020, the Company's inventory consisted of approximately 319,000 grams of dried cannabis awaiting release for sale (2019 – Nil). The cost of inventory is recognized as a separate asset upon harvest and subsequently included in cost of sales when sold. For the six month period ended February 29, 2020, the amount of inventory recognized in cost of sales was approximately 283,000 grams (2019 - nil).

Note 6 Property, plant and equipment

	Land	**Buildings**	**Software**	**Equipment**	**Construction in Progress**	**Total**
	$	**$**	**$**	**$**	**$**	**$**
Cost						
As at August 31, 2019	1,026,557	12,353,890	73,752	799,765	744,216	14,998,180
Additions during the period	-	-	-	-	47,303	47,303
As at February 29, 2020	1,026,557	12,353,890	73,752	799,765	791,519	15,045,483
Accumulated Amortization						
As at August 31, 2019	-	383,756	35,822	39,959	-	459,537
Additions during the period	-	359,104	10,430	18,980	-	388,514
As at February 29, 2020	-	742,860	46,252	58,939	-	848,051
Net Book Value						
As at August 31, 2019	1,026,557	11,970,134	37,930	759,806	744,216	14,538,643
As at February 29, 2020	**1,026,557**	**11,611,030**	**27,500**	**740,826**	**791,519**	**14,197,432**

Note 6 <u>Property, plant and equipment</u> – (cont'd)

On June 4, 2018, the Company exercised an option that it held to purchase a 23-acre property located near Armstrong, BC by completing payment of an aggregate of $1,100,000 plus transaction costs of $21,057. Included within the acquisition costs was an aggregate of $225,000 allocated to certain pre-existing buildings based on estimates of their current fair values.

To August 31, 2017 the Company had capitalized certain pre-construction related costs incurred in anticipation of its current project advancing, including $35,000 paid to the project manager. However, consistent with previous periods the annual lease payments continued to be expensed on the basis that they are not directly related to the actual construction process. Upon exercise of this option, the historical costs applicable to it and certain other options related to the development of the cannabis production assets were also reclassified within property, plant and equipment.

Effective September 1, 2017 the Company entered into a construction management services contract whereby the Company committed to pay an aggregate additional fee of $876,875, exclusive of the $35,000 noted above, in equal installments over a 12-month period (paid). Additional reimbursable costs incurred by the project manager are subject to a 10% surcharge.

The Company is entitled to, and has, withheld 10% of all costs incurred, subject to certain completion requirements, and at February 29, 2020, owes $31,961 in connection with these holdbacks (included within accounts payable and accrued liabilities). The amount is also represented by an offsetting balance of restricted cash.

Note 7 <u>Commitments</u>

<u>Cannabis Wheaton Streaming Agreement</u>

On January 5, 2017, the Company entered into a binding interim agreement with Cannabis Wheaton Income Corp. now Auxly Cannabis Group Inc. ("XLY"), pursuant to which XLY agreed to subscribe for $5 million in common shares of the Company (the "Initial Subscription"). The Initial Subscription is conditional upon, (i) completion of XLY's satisfactory due diligence review of the Company; (ii) the parties mutually agreeing to the Company's construction budget, design and timeline to build the facility; and (iii) the Company receiving confirmation from Health Canada requesting a pre-licensing inspection of the facility.

Upon completion of the Initial Subscription, XLY shall receive the greater of (i) access to and control of 10,000 square feet of the initial production area, or (ii) 50% of the actual cultivation yield generated, together with certain ancillary rights, including access to and use of the Company's related infrastructure at the facility, for a period of 10 years.

On September 12, 2018, XLY completed the Initial Subscription for gross proceeds of $4,000,000. The financing was comprised of an equity component of 3,755,868 common shares issued at $0.71 per share, for proceeds of $2,666,667 (see note 7). The remaining $1,333,333 of proceeds was recorded as deferred revenue, the future recognition of which by the Company is subject to the exercise, by XLY, of certain call options in respect to the Company's future cannabis production. The amount is expected to be recognized as income if and as XLY exercises its call options to acquire up to 50% of the Company's production yield at various prices, based on the discount, if any, of the call prices to current equivalent market values.

Note 7 Commitments – (cont'd)

4th Gen Duwyn Farms Inc. Licensing Agreement

On December 14, 2017, the Company announced that it has entered into a Licensing Agreement (the "Agreement") with 4th Gen Duwyn Farms Inc. ("DFI") to license the Company's intellectual property ("IP"), including its proprietary facility design, to a newly formed company owned by the Company and DFI ("DMFI"). Under the agreement, Lotus will provide DFI access to its IP including building design, standard operating procedures, training and license application support in return for DFI selling 100% of the production from the facility to Lotus for a period of 15 years at a discount to wholesale pricing.

Note 8 Share Capital

a) Authorized

The authorized share capital of the Company consists of an unlimited number of common shares without any special rights or restrictions.

During the six months ended February 29, 2020, the Company completed the following share issuances:

- On October 4, 2019, 975,000 options expiring November 3, 2020 were exercised at $0.20 per share for gross proceeds of $195,000.

During the six months ended February 28, 2019, the Company completed the following share issuances:

- On September 12, 2018, the Company issued 3,755,868 common shares at $0.71 per share in connection with the XLY agreement. See note 5.

- On September 13, 2018, 100,000 share purchase warrants exercisable at $0.25 were exercised for proceeds of $20,000.

- In October 2018, the Company completed a private placement of 11,260,000 units ("Units") at a price of $0.25 per Unit for gross proceeds of $2,815,000. Each Unit consists of one common share and one share purchase warrant ("Warrant"). Each Warrant entitles the holder to purchase one additional common share of the Company at a price of $0.30 per share for a period of five years from closing.

  In relation to this private placement, the Company paid cash finders fees of $210,250.

- On January 24, 2019, 50,000 share purchase warrants exercisable at $0.25 were exercised for proceeds of $12,500.

- On February 26, 2019, 500,000 options exercisable at $0.25 were exercised for proceeds of $125,000.

(Expressed in Canadian Dollars)

Note 8 Share Capital – (cont'd)

b) Share purchase options

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

During the six months ended February 29, 2020, the Company granted the following options:

- On October 31, 2019, the Company granted 975,000 share purchase options exercisable for ten years at a price of $0.30 per share.

During the six months ended February 28, 2018, the Company granted the following options:

- On October 4, 2018, the Company granted 1,100,000 share purchase options exercisable for ten years at a price of $0.30 per share.

  The fair value of these share purchase options was estimated using the Black-Scholes Option Pricing Model based on the following weighted average assumptions:

Risk-free interest rate (%)	2.55
Expected life (years)	10
Expected volatility (%)	134.1699
Expected dividend yield (%)	-

On February 26, 2019, 500,000 options expiring December 14, 2019 were exercised at $0.25 per share. The fair value of the options was $93,250 and was reallocated from reserves to share capital.

During the period ended February 29, 2020, share-based compensation expense was $162,240 (2019 - $396,110).

(Expressed in Canadian Dollars)

Note 8 Share Capital – (cont'd)

b) Share purchase options – (cont'd)

Details of granted, exercised, and outstanding stock options are as follows:

	Six Months Ended February 29, 2020		Year Ended August 31, 2019	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
		$		$
Balance at the beginning of the period	8,460,000	0.29	5,590,000	0.33
Granted	975,000	0.20	3,620,000	0.23
Cancelled/forfeited	-	-	(250,000)	0.50
Exercised	(975,000)	0.20	(500,000)	0.25
Outstanding, end of the period	8,460,000	0.29	8,460,000	0.29

As at February 29, 2020, the weighted-average contractual remaining life of the options was 8.07 years (August 31, 2019 – 7.04 years).

c) Share purchase warrants

Details of outstanding share purchase warrants are as follows:

	Six Months Ended February 29, 2020		Year Ended August 31, 2019	
	Number of Warrants	Weighted Average Exercise Price	Number of Warrants	Weighted Average Exercise Price
		$		$
Balance at the beginning of the period	40,900,764	0.40	20,505,764	0.52
Issued	-	-	20,745,000	0.28
Exercised	-	-	(350,000)	0.22
Outstanding, end of the period (1)	40,900,764	0.40	40,900,764	0.40

As at February 29, 2020, the weighted-average contractual remaining life of the share purchase warrants was 2.92 years (August 31, 2019 – 3.42 years).

During the year ended August 31, 2019, the Company extended the exercise period of 1,000,000 warrants exercisable for one share at $0.20 per share from December 29, 2017 to December 29, 2020.

(Expressed in Canadian Dollars)

Note 9 Related Party Transactions

	February 29, 2020	February 28, 2019
Compensation:		
Consulting fees	$ 50,000	$ 196,500
Share-based payments	81,120	252,070
	$ 131,120	$ 448,570

During the six months ended February 29, 2020, the Company incurred management consulting fees of $nil (2019 – $42,000) to a private company controlled by the Company's President and CEO. As at February 29, 2020, $nil (August 31, 2019 - $7,525) was payable to this private company for the unpaid portion of these fees.

During the six months ended February 29, 2020, the Company incurred management consulting fees of $50,000 (2019 - $58,500) and paid a bonus of $nil (2019 - $96,000) to the Company's COO.

During the six months ended February 29, 2020, the Company recorded share-based compensation expense of $$81,120 pursuant to 487,500 stock options issued to directors and officers of the Company. During the six months ended February 28, 2019, the Company recorded share-based compensation expense of $141,470 pursuant to 430,000 stock options issued to directors and officers of the Company. See Note 8.

Refer also to Notes 10.

Note 10 Loans Payable

On July 12, 2019, $190,000 was advanced from a party related to the Company's CEO. The promissory note is repayable, in whole or in part, upon written notice provided by the lender and bears interest at a rate of 8.95% compounded annually. An additional $315,034 was advanced by this party during the period ended February 29, 2020 under the same terms as the original promissory note.

On August 15, 2019, $50,000 was advanced to the Company from an unrelated party. The promissory note is repayable, in whole or in part, upon written notice provided by the lender and bears interest at a rate of 8.95% compounded annually. An additional $70,000 was advanced by this party during the period ended February 29, 2020 under the same terms as the original promissory note.

During the period ended February 29, 2020, an aggregate of $210,000 was advanced to the Company from other directors. These promissory notes are repayable, in whole or in part, upon written notice provided by the lenders and bear interest at a rate of 9.00% compounded annually.

(Expressed in Canadian Dollars)

Note 11 Capital Management

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern and to maintain a flexible capital structure which optimizes the cost of capital within a framework of acceptable risk. In the management of capital, the Company includes the components of shareholders' equity, as well as cash and cash equivalents. There are

no external restrictions on the use of the Company's capital other than as provided in Policy 2.4 Capital Pool Companies of the TSX Venture Exchange.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust its capital structure, the Company may issue new shares, issue new debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents

The Company's financial instruments are exposed to the following risks:

Credit Risk

The Company's primary exposure to credit risk is the risk of illiquidity of cash amounting to $4,025 at February 29, 2020. As the Company's policy is to limit cash holdings to instruments issued by major Canadian banks, or investments of equivalent or better quality, the credit risk is considered by management to be negligible.

Fair Value of Financial Instruments

The fair value of the Company's financial assets approximates the carrying amount. Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- 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 that are not based on observable market data.

The fair value classification of the Company's financial instruments as at February 29, 2020 is as follows:

		February 29, 2020	
	Fair value level	Fair value through profit or loss	Loans and receivables at amortized cost
Financial assets			
Cash	1	$ 4,025	$ -
Accounts receivable		-	318,552
		$ 4,025	$ 318,552

(Expressed in Canadian Dollars)

Note 11 Capital Management – (cont'd)

The fair value classification of the Company's financial instruments as at August 31, 2019 is as follows:

		As at August 31, 2019	
	Fair value level	Fair value through profit or loss	Loans and receivables at amortized cost
Financial assets			
Cash	1	$ 110,748	$ -
		$ 110,748	$ -

During the six months ended February 29, 2020 and the year ended August 31, 2019, there were no transfers between level 1, level 2 and level 3 classified assets.

Note 12 Supplemental Non-cash Disclosures

The Company incurred $563,486 in property, plant and equipment acquisition costs which were included in accounts payable and accrued liabilities as at February 29, 2020 (August 31, 2019 - $755,667).