

XPHYTO THERAPEUTICS CORP.

Condensed Consolidated Interim Financial Statements

For the three and six months ended June 30, 2020 and 2019

NOTICE TO READER

Under National Instrument 51-102, Part 4, paragraph 4.3(3)(a), if an auditor has not performed a review of interim financial statements, they must be accompanied by a notice indicating that the interim financial statements have not been reviewed by an auditor.

The accompanying unaudited condensed consolidated interim financial statements of XPhyto Therapeutics Corp. have been prepared by and are the responsibility of the Company's management and approved by the Board of Directors of the Company.

The Company's independent auditor has not performed a review of these unaudited condensed consolidated interim financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

XPHYTO THERAPEUTICS CORP.
Condensed Consolidated Interim Statements of Financial Position
(Unaudited)
(Expressed in Canadian dollars)

	Note	June 30, 2020	December 31, 2019
Assets			
Current assets			
Cash		\$ 642,167	\$ 295,014
Amounts receivable		608,000	292,858
Prepaid expenses		310,908	126,255
		1,561,075	714,127
Non-current assets			
Equipment	4	1,077,370	1,089,182
Intangible assets	5	360,335	386,873
Right-of-use asset	6	4,511,998	4,830,846
Goodwill	5	1,715,478	1,634,859
Total assets		\$ 9,226,256	\$ 8,655,887
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	7	\$ 748,256	\$ 772,064
Lease liability	6	140,642	131,434
Convertible debt	8	229,688	477,485
		1,118,586	1,380,983
Non-current liabilities			
Lease liability	6	804,117	788,280
Convertible debt	8	208,069	-
Deferred tax liability		173,258	163,000
Total liabilities		2,304,030	2,332,263
Equity			
Shareholders' equity			
Share capital	9	19,350,326	12,249,855
Share-based payments reserve		2,844,113	2,576,147
Equity component of convertible debt	8	39,697	43,230
Accumulated other comprehensive loss		98,264	(11,811)
Accumulated deficit		(15,410,174)	(8,533,797)
Total shareholders' equity		6,922,226	6,323,624
Total liabilities and shareholders' equity		\$ 9,226,256	\$ 8,655,887

Approved by the Directors on August 28, 2020

Hugh Rogers (signed)

Wolfgang Probst (signed)

Nature and continuance of operations (Note 1)
 Commitments (Note 14)
 Subsequent events (Note 17)

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

XPHYTO THERAPEUTICS CORP.
Condensed Consolidated Interim Statements of Loss and Comprehensive Loss
(Unaudited)
(Expressed in Canadian dollars)

	Six Months Ended June 30		Three Months Ended June 30	
	2020	2019	2020	2019
Revenues	\$ 183,702	\$ -	\$ (76,813)	\$ -
Operating Expenses				
Depreciation and amortization (Note 4, 5, and 6)	473,789	441,999	250,139	233,650
Professional fees	195,895	191,742	108,799	106,694
Consulting fees (Note 11)	821,508	119,383	411,350	102,680
Salaries and benefits (Note 11)	785,790	463,733	409,191	233,351
Share-based compensation (Note 10)	960,845	129,111	74,497	70,267
Regulatory fees	38,957	16,348	27,221	10,382
Marketing and advertising	2,928,735	-	1,417,775	-
Office and miscellaneous	268,021	115,078	169,000	67,586
Travel and related	24,294	51,844	12,218	42,950
Rent	64,607	52,679	30,482	7,018
Research and lab fees	701,863	70,000	570,948	14,000
Foreign exchange (gain)	82,390	15,775	(64,771)	(57,274)
Operating Loss	(7,162,992)	(1,667,692)	(3,493,662)	(830,304)
Finance costs (Note 6 and 8)	196,543	78,719	100,353	39,322
Deferred tax recovery (Note 8)	(78,451)	-	-	-
Loss for the period	\$ (7,281,084)	\$ (1,746,411)	\$ (3,594,015)	\$ (869,626)
Cumulative translation adjustment	110,075	-	(46,212)	-
Comprehensive loss for the period	\$ (7,171,009)	\$ (1,746,411)	\$ (3,640,227)	\$ (869,626)
Loss Per Share – Basic and Diluted	\$ (0.13)	\$ (0.04)	\$ (0.06)	\$ (0.02)
Weighted Average Number of Common Shares Outstanding	53,940,319	42,099,486	56,033,761	44,535,873

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

XPHYTO THERAPEUTICS CORP.
Condensed Consolidated Interim Statements of Cash Flows
(Unaudited)
(Expressed in Canadian dollars)

	Six Months Ended June 30	
	2020	2019
Operating Activities		
Loss for the period	\$ (7,281,084)	\$ (1,746,411)
Adjustments for:		
Depreciation and amortization	473,789	441,999
Share-based compensation	960,845	129,911
Non-cash marketing and advertising costs	355,935	-
Non-cash consulting fees	339,000	20,000
Finance costs	196,543	78,719
Foreign exchange	38,411	-
Deferred tax recovery	(78,451)	-
Changes in non-cash working capital items		
Amounts receivable	(315,142)	71,464
Prepaid expenses	(184,653)	(8,570)
Accounts payable and accrued liabilities	(23,808)	(231,434)
Cash Used in Operating Activities	(5,518,615)	(1,336,109)
Investing Activities		
Intangible asset	-	(5,258)
Equipment additions	(71,194)	(39,968)
Cash Used in Investing Activities	(71,194)	(45,226)
Financing Activities		
Proceeds from issuance of shares	-	811,282
Share issue costs	-	(76,440)
Proceeds from issuance of convertible debenture, net of cash costs	1,869,706	-
Proceeds from special warrants	-	448,000
Proceeds from exercise of warrants	3,671,251	-
Proceeds from exercise of options	542,000	-
Convertible debenture payments	(80,090)	-
Repayment of lease liabilities	(67,201)	(30,084)
Cash Provided by Financing Activities	5,935,666	1,152,758
Effect of exchange rate on cash	1,296	-
Change in cash for the period	347,153	(228,577)
Cash and cash equivalents, beginning of period	295,014	2,365,597
Cash and cash equivalents, end of period	\$ 642,167	\$ 2,137,020

Supplemental disclosure with respect to cash flows (Note 15)

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

XPHYTO THERAPEUTICS CORP.
Condensed Consolidated Interim Statements of Changes in Shareholders' Equity
(Unaudited)
(Expressed in Canadian dollars)

	Number of Common Shares	Share Capital	Special Warrants	Reserves	Equity component of convertible debt	Accumulated other comprehensive loss	Accumulated Deficit	Total Shareholder's equity
Balance, January 1, 2019	39,464,000	\$ 6,590,003	\$1,778,200	\$ 259,207	\$ -	\$ -	\$ (865,085)	\$ 7,762,325
Share issuances, financings	2,028,205	811,282	-	-	-	-	-	811,282
Issue costs	-	(76,440)	-	-	-	-	-	(76,440)
Finders warrants	-	(31,581)	-	31,581	-	-	-	-
Shares issued per consultant agreement	50,000	20,000	-	-	-	-	-	20,000
Share based compensation	-	-	-	129,111	-	-	-	129,111
Special warrant financing	-	-	448,000	-	-	-	-	448,000
Special warrant conversion	5,565,500	2,226,200	(2,226,200)	-	-	-	-	-
Loss for the period	-	-	-	-	-	-	(1,746,411)	(1,746,411)
Balance, June 30, 2019	47,107,705	\$9,539,464	\$ -	\$419,899	\$ -	\$ -	\$(2,611,496)	\$7,347,867
Balance, January 1, 2020	50,175,269	\$ 12,249,855	\$ -	\$ 2,576,147	\$43,230	\$ (11,811)	\$(8,533,797)	\$6,323,624
Issuance of shares on conversion of convertible debt	1,943,532	1,690,484	-	-	(83,969)	-	-	1,606,515
Warrants issued per a supply agreement	-	-	-	355,935	-	-	-	355,935
Shares issued per a consultant agreement	120,000	180,000	-	-	-	-	-	180,000
Shares issued per a development, technology purchase and licence agreement	50,000	159,000	-	-	-	-	-	159,000
Share based compensation	-	-	-	960,845	-	-	-	960,845
Issuance of convertible debt	-	-	-	213,629	80,436	-	-	294,065
Issuance of shares on exercise of warrants	5,301,344	4,328,760	-	(657,509)	-	-	-	3,671,251
Issuance of shares on exercise of options	420,000	742,227	-	(200,227)	-	-	-	542,000
Forfeited options	-	-	-	(404,707)	-	-	404,707	-
Cumulative translation adjustment	-	-	-	-	-	110,075	-	110,075
Loss for the period	-	-	-	-	-	-	(7,281,084)	(7,281,084)
Balance, June 30, 2020	58,010,145	\$ 19,350,326	\$ -	\$2,844,113	\$ 39,697	\$ 98,264	\$(15,410,474)	\$ 6,922,226

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

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
(Expressed in Canadian dollars)
For the six months ended June 30, 2020 and 2019

1. NATURE AND CONTINUANCE OF OPERATIONS

XPhyto Therapeutics Corp. (the “Company” or “XPhyto”) was incorporated under the Business Corporations Act (British Columbia) on December 12, 2017. The principal business of the Company is to focus on strategic assets and investments in the field of rapid pathogen screening systems and next generation drug delivery, as well as medical cannabis opportunities focused on emerging European markets. The Company’s shares are trading on the Canadian Securities Exchange (“CSE”).

The Company’s head office is located at Suite 270 – 1820 Fir Street, Vancouver, British Columbia, Canada, V6J 3B1. The Company’s registered and records office is 1500 – 1055 West Georgia Street, Vancouver, British Columbia, Canada, V6E 4N7.

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) on a going concern basis.

To date, the Company has incurred losses and further losses are anticipated as the Company further develops its business. The continuing operations of the Company are dependent upon its ability to generate profitable operations in the future, and to continue to secure additional financing. There can be no assurance that the Company will be successful in its efforts to raise additional financing or if financing is available or that it will be on terms that are acceptable to the Company. The Company has working capital of \$442,489 at June 30, 2020 and incurred a comprehensive loss of \$7,171,009 for the period then ended. The Company anticipates it will need further funding to maintain its operations and activities for the next 12 months. These material uncertainties may cast significant doubt on the Company’s ability to continue as a going concern. These consolidated financial statements do not include any adjustments related to the recoverability of assets and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

2. BASIS OF PRESENTATION

a) Statement of compliance to International Financial Reporting Standards

These unaudited condensed consolidated interim financial statements have been prepared in accordance with International Accounting Standard (“IAS”) 34, “Interim Financial Reporting”, and IFRS as issued by the International Accounting Standards Board (“IASB”). These condensed consolidated interim financial statements should be read in conjunction with the Company’s audited financial statements as at and for the year ended December 31, 2019, as some disclosures from the annual financial statements have been condensed or omitted.

These condensed consolidated interim financial statements were prepared using accounting policies consistent with those in the audited financial statements as at and for the year ended December 31, 2019.

These condensed consolidated interim financial statements were authorized by the Company’s Directors on August 28, 2020.

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
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2. BASIS OF PRESENTATION (cont'd)

b) Basis of Consolidation

The following entities have been consolidated within these condensed consolidated interim financial statements:

Entity	Registered	Holding
XPhyto Therapeutics Corp.	British Columbia, Canada	Parent company
XPhyto Laboratories Inc.	Alberta, Canada	100% owned
Bunker Pflanzenextrakte GmbH	Germany	100% owned
Bunker Biopharma GmbH	Germany	100% owned
Vektor Pharma TF GmbH	Germany	100% owned
SCUR-Alpha 1108 GmbH	Germany	100% owned

The subsidiaries are controlled by the Company. Control exists when the Company is exposed, or has rights, to the variable returns from its involvement with the investee and can affect those returns through its power over the investee.

The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Intercompany balances and transactions, and any unrealized income and expenses arising from intercompany transactions, are eliminated in preparing the consolidated financial statements.

c) Basis of measurement

These condensed consolidated interim financial statements of the Company have been prepared on an accrual basis and are based on historical costs except for financial instruments measured at fair value. The financial statements are presented in Canadian dollars.

d) Use of estimates and judgments

The preparation of the condensed consolidated interim financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of revision and further periods if the review affects both current and future periods.

Key sources of estimation uncertainty

The significant assumptions about the future and other major sources of estimation uncertainty as at the end of the reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of the Company's assets and liabilities are as follows:

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Notes to the Condensed Consolidated Interim Financial Statements
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2. BASIS OF PRESENTATION (cont'd)

i) Share-based compensation

The inputs used in calculating the fair value for share-based compensation included in profit or loss. The share-based compensation expense is estimated using the Black-Scholes option pricing model as measured on the grant date to estimate the fair value of stock options. This model involves the input of highly subjective assumptions, including the expected price volatility of the Company's common shares, the expected life of the options, and the estimated forfeiture rate.

ii) Deferred tax assets

Deferred tax assets, including those arising from un-utilized tax losses, require management to assess the likelihood that the Company will generate sufficient taxable earnings in future periods in order to utilize recognized deferred tax assets. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows. In addition, future changes in tax laws could limit the ability of the Company to obtain tax deductions in future periods. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted.

iii) Valuation of right-of-use asset and lease liabilities

The application of IFRS 16 requires the Company to make judgments that affect the valuation of the right-of-use assets and the valuation of lease liabilities. These include: determining agreements in the scope of IFRS 16, determining the contract term and determining the interest rate used for the discounting of cash flows.

The lease term determined by the Company is comprised of the non-cancellable period of lease agreements, periods covered by an option to extend the lease if the Company is reasonably certain to exercise that option and periods covered by an option to terminate the lease if the Company is reasonably certain not to exercise that options.

The present value of the lease payment is determined using a discount rate representing the rate of its loan payable observed in the period when the lease agreement commences or is modified.

iv) Economic recoverability and probability of future economic benefits of intangible assets and amortization

Management has determined that capitalized intangible asset costs may have future economic benefits and may be economically recoverable. Management uses several criteria in its assessments of economic recoverability and probability of future economic benefits including anticipated cash flows and estimated economic life.

The amortization expense related to intangible assets is determined using estimates relating to the useful life of the intangible asset.

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
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2. BASIS OF PRESENTATION (cont'd)

Significant judgments in applying accounting policies

The critical judgments that the Company's management has made in the process of applying the Company's accounting policies, apart from those involving estimations, that have the most significant effect on the amounts recognized in the Company's consolidated financial statements are as follows:

i) Business combinations

The determination of whether a set of assets acquired, and liabilities assumed constitute a business may require the Company to make certain judgments, taking into account all facts and circumstances. A business is presumed to be an integrated set of activities and assets capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or economic benefits. The transaction with Bunker Pflanzenextrakte GmbH was determined to constitute an acquisition of assets. The transaction with Vektor Pharma TF GmbH was determined to constitute a business acquisition.

ii) Determination of functional currency

The Company determines the functional currency through an analysis of several indicators such as expenses and cash flow, financing activities, retention of operating cash flows, and frequency of transactions within the reporting entity.

3. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies applied by the Company in these condensed interim consolidated financial statements are the same as those applied by the Company in its consolidated financial statements for the year ended December 31, 2019.

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
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4. EQUIPMENT

	Office equipment & Fixtures	Computer hardware	Testing, Lab equipment & machines	Total
Cost				
Balance at January 1, 2019	\$ 4,626	\$ 5,628	\$ -	\$ 10,254
Additions	2,510	14,848	866,104	883,462
Additions from acquisition	46,851	-	262,776	309,627
Cumulative translation adjustment	(264)	(19)	(2,592)	(2,875)
Balance at December 31, 2019	53,723	20,457	1,126,288	1,200,468
Additions	11,823	6,262	53,109	71,194
Cumulative translation adjustment	2,383	168	24,085	26,636
Balance at June 30, 2020	\$ 67,929	\$ 26,887	\$ 1,203,482	\$ 1,298,298
Accumulated Depreciation				
Balance at January 1, 2019	\$ 27	\$ 714	\$ -	\$ 741
Depreciation	3,172	4,711	103,183	111,066
Cumulative translation adjustment	(33)	(11)	(477)	(521)
Balance at December 31, 2019	3,166	5,414	102,706	111,286
Depreciation	4,020	4,174	97,798	105,992
Cumulative translation adjustment	157	47	3,446	3,650
Balance, June 30, 2020	\$ 7,343	\$ 9,635	\$ 203,950	\$ 220,928
Carrying amounts				
As at January 1, 2019	\$ 4,599	\$ 4,914	\$ -	\$ 9,513
As at December 31, 2019	\$ 50,557	\$ 15,043	\$ 1,023,582	\$ 1,089,182
As at June 30, 2020	\$ 60,586	\$ 17,252	\$ 999,532	\$ 1,077,370

5. INTANGIBLE ASSETS

On August 20, 2018, the Company signed an Exclusive Dealing Agreement with Dr. Raimar Loebenberg ("Loebenberg") with respect to commercial operations under the license issued pursuant to the Canadian Controlled Drugs and Substance Act held by Loebenberg and Loebenberg's cannabis related research and associated intellectual property. The agreement grants the Company an exclusive right to benefit from the exercise of Loebenberg's rights under the license. The exclusivity period commences on the closing date of the agreement and expires on the earlier of (i) termination of the agreement, and (ii) the date that the last shares are released from escrow.

As part of the Vektor business acquisition, the Company acquired several narcotic licences and permits pursuant to EU GMP certification and other governing regulations.

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
(Expressed in Canadian dollars)
For the six months ended June 30, 2020 and 2019

5. INTANGIBLE ASSETS (cont'd)

	Right-to- use License	Web Design & Software	Licenses & Permits	Total
Cost				
Balance at January 1, 2019	\$ 717,759	\$ 4,811	-	\$ 722,570
Additions	-	21,031	-	21,031
Additions from acquisition	-	772	389,000	389,772
Cumulative translation adjustment	-	(4)	(2,111)	(2,115)
Write-down	(717,758)	-	-	(717,758)
Balance at December 31, 2019	1	26,610	386,889	413,500
Additions	-	-	-	-
Cumulative translation adjustment	-	38	19,078	19,116
Balance at June 30, 2020	\$ 1	\$ 26,648	\$ 405,967	\$ 432,616
Accumulated Depreciation				
Balance at January 1, 2019	\$ 68,358	\$ 1,109	\$ -	\$ 69,467
Amortization	205,076	3,228	22,692	230,996
Cumulative translation adjustment	-	(11)	(391)	(402)
Write-down	(273,434)	-	-	(273,434)
Balance at December 31, 2019	-	4,326	22,301	26,627
Amortization	-	4,592	38,900	43,492
Cumulative translation adjustment	-	36	2,126	2,162
Balance, June 30, 2020	\$ -	\$ 8,954	\$ 63,327	\$ 72,281
Carrying amounts				
As at January 1, 2019	\$ 649,401	\$ 3,702	-	\$ 653,103
As at December 31, 2019	\$ 1	\$ 22,284	\$ 364,588	\$ 386,873
As at June 30, 2020	\$ 1	\$ 17,694	\$ 342,640	\$ 360,335

The net change in goodwill is as follows:

As at December 31, 2019	\$ 1,634,859
Cumulative translation adjustment	80,619
As at June 30, 2020	\$ 1,715,478

During the year ended December 31, 2019, the Company performed an impairment assessment on the right-to-use license and determined the license is impaired. Accordingly, the Company recorded an impairment charge of \$444,324.

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
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6. RIGHT OF USE ASSET AND LEASE LIABILITY

The Company and its wholly owned subsidiaries have various property rental lease agreements in place ranging from 3 to 10 years in length of term. Right-of-use assets consist of corporate office spaces, the Bunker facility and lab and operational space for Vektor.

	June 30, 2020	December 31, 2019
Right-of-Use Asset		
Opening balance	\$ 4,830,846	\$ 5,256,408
Additions from acquisitions	-	125,514
Additions	-	52,677
Depreciation	(324,305)	(603,219)
Cumulative translation adjustment	5,457	(534)
	<u>\$ 4,511,998</u>	<u>\$ 4,830,846</u>
Lease Liability		
Opening balance	\$ 919,714	\$ 781,986
Additions from acquisitions	-	127,729
Additions	-	52,677
Payments	(67,201)	(88,995)
Accrued interest	46,855	82,177
Cumulative translation adjustment	5,682	(574)
Foreign exchange adjustment	39,709	(35,286)
	<u>\$ 944,759</u>	<u>\$ 919,714</u>
Current portion	\$ 140,642	\$ 131,434
Non-current portion	\$ 804,117	\$ 788,280

Using the June 30, 2020 period end exchange rate, the estimated annual commitment over the term of the leases is as follows:

2020	\$ 68,629
2021	\$ 144,355
2022	\$ 159,221
2023	\$ 232,386
2024	\$ 197,280
2025 and beyond	\$ 561,360

The following is a summary of the maturities for the Company's lease liabilities as at June 30, 2020.

	Up to 1 year (\$)	1 year to 2 years (\$)	More than 2 years (\$)
Lease liabilities	140,642	151,788	1,070,800
TOTAL:	140,642	151,788	1,070,800

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
(Unaudited)
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For the six months ended June 30, 2020 and 2019

7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	June 30, 2020	December 31, 2019
Trades payables	\$ 390,059	\$ 257,707
Accrued liabilities	358,197	514,357
	\$ 748,256	\$ 772,064

8. CONVERTIBLE DEBT

On September 13, 2019, the Company issued two (2) unsecured convertible debentures in accordance with the Vektor acquisition and equipment purchase agreement.

The principal amount of the first debenture of \$293,532 matures six (6) months after issuance and accrues interest at 2.5% per annum payable in cash on the maturity date. The principal amount of the second debenture of \$220,149 matures twelve (12) months after issuance and accrues interest at 2.5% per annum payable in cash on the maturity date. The first debenture was converted by the holder on March 13, 2020.

The principal amounts of the debentures are convertible into Payment Units, at a conversion price of \$1.00 per Payment Unit, at the option of the holder, at any time prior to the maturity date. Each Payment Unit consists of one common share and one common share purchase warrant. The common shares will be subject to three-year escrow. The warrants are exercisable into one common share of the Company at an exercise price of \$1.00 per share for a period of three years from closing.

The debentures are compound instruments and the proceeds are required to be bifurcated to record the fair value of the separate debt and equity components. The fair value of the debt was determined using a discounted cash flow model using an estimated market interest rate for equivalent debt of 16%. The initial fair value of the debt was calculated to be \$470,542 with the residual portion of \$43,230 allocated to equity.

On January 22, 2020, the Company signed a three-year definitive supply, import and distribution agreement (the "Agreement") with PharmaCielo Ltd. ("PharmaCielo"). Pursuant to the Agreement, the Company closed a subscription receipt whereby PharmaCielo agreed to purchase \$500,000 of convertible debentures units of the Company. The convertible debentures were issued on January 31, 2020 as part of the non-brokered private placement described below. The Company also issued PharmaCielo an additional 500,000 share purchase warrants exercisable by the holder into common shares of the Company at a price of \$2.00 per common share for a period of two years. The warrants which were expensed as marketing and advertising costs had a fair value of \$355,935 estimated using the Black-Scholes option pricing model with a volatility of 95.00%, risk-free interest rate of 1.43%, dividend rate of 0% and expected life of 2 years.

On January 31, 2020, the Company closed the sale of 2,000 convertible debenture units for gross proceeds of \$2,000,000 pursuant to a non-brokered private placement. Each debenture unit consists of: (i) \$1,000 principal amount of 8.0% unsecured convertible debenture and (ii) 1,000 common share purchase warrants. The debentures bear interest at 8.0% per annum, calculated and payable semi-annually and mature two years following the date of issuance. The debentures are convertible at the option of the holder into common shares of the Company at a conversion price of \$1.00 per common share. Conversion of the debentures may be forced in part or in whole at the option of the Company if the 15-day volume weighted average price of the common shares on the CSE exceeds \$2.50 per share.

XPHYTO THERAPEUTICS CORP.
Notes to the Condensed Consolidated Interim Financial Statements
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(Expressed in Canadian dollars)
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8. CONVERTIBLE DEBT (cont'd)

Each warrant is exercisable to acquire one common share at an exercise price of \$1.50 per share until January 31, 2022. In connection with the offering, the Company paid a cash fee of \$120,000 and issued 120,000 finder warrants to Canaccord Genuity Corp. Each finder warrant entitles the holder thereof to purchase one common share at an exercise price of \$1.00 per share until January 31, 2022. The finders' warrants had a fair value of \$118,037 estimated using the Black-Scholes option pricing model with a volatility of 95%, risk-free interest rate of 1.55%, dividend rate of 0% and expected life of 2 years.

The debentures are compound instruments and the proceeds are required to be bifurcated to record the fair value of the separate debt and equity components. The fair value of the debt was determined using a discounted cash flow model using an estimated market interest rate for equivalent debt of 16%. The initial fair value of the debt was calculated to be \$1,709,444 with the residual portion of \$290,556 allocated to both equity (\$132,769) and the warrants (\$157,787). Transaction costs totalled \$248,331 of which \$212,255 were allocated to the liability component and offset the carrying value and are amortized using the effective interest method as finance costs over the expected life of the debentures. Transaction costs of \$16,485 were charged to the equity component and \$19,592 were charged to the warrant component. In addition, the resulting deferred tax amount of \$78,451 has been charged to the both the equity (\$35,848) and warrant components (\$42,603).

Debentures with a principal amount of \$1,650,000 were converted by the holders on June 3, 2020 with the debt having a fair value of \$1,312,984 at the date of conversion.

	June 30, 2020	December 31, 2019
Opening balance	\$ 477,485	\$ -
Additions from Principal amounts	2,000,000	513,681
Less equity component of convertible debt	(290,556)	(43,230)
Less fair value of conversions	(1,606,515)	-
Less transaction costs	(212,255)	-
Less payments	(80,090)	(15,850)
Accrued interest	<u>149,688</u>	<u>22,884</u>
	\$ 437,757	\$477,485
Current portion	\$ 229,688	\$477,485
Non-current portion	\$ 208,069	\$ -

9. SHARE CAPITAL

a) Common Shares

Authorized

The authorized capital stock of the Company is an unlimited number of common shares without par value.

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9. SHARE CAPITAL (cont'd)

Issued

On March 13, 2020, the Company issued 120,000 common shares at a value of \$180,000 pursuant to a consultant agreement.

On March 13, 2020, the Company issued 293,532 common shares at a value of \$311,141 pursuant to a convertible debt conversion (Note 8).

On June 3, 2020, the Company issued 1,650,000 common shares at a value of \$1,312,984 pursuant to a convertible debt conversion (Note 8).

On June 3, 2020, the Company issued 50,000 common shares at a value of \$159,000 pursuant to a development, technology purchase and license agreement.

During the period ended June 30, 2020, the Company issued 420,000 common shares for proceeds of \$542,000 in connection with the exercise of 420,000 stock options. Upon exercise, \$220,227 was allocated from reserves to share capital.

During the period ended June 30, 2020, the Company issued 5,301,344 common shares for proceeds of \$3,671,251 in connection with the exercise of 5,301,344 share purchase warrants. Upon exercise, \$657,509 was allocated from reserves to share capital.

As at June 30, 2020, there are 9,621,048 common shares subject to escrow which includes 562,500 common shares issued to officers of the Company which will be released from escrow in tranches over 36 months from date of listing on the CSE.

b) Share Purchase Warrants

The following is a summary of changes in warrants from January 1, 2019 to June 30, 2020:

	Number of Warrants	Weighted Average Exercise Price
Balance at January 1, 2019	15,156,800	\$ 0.61
Issued warrants	8,421,369	1.17
Exercised warrants	<u>(1,760,500)</u>	0.57
Balance at December 31, 2019	21,817,669	0.83
Issued warrants	2,913,532	1.51
Exercised warrants	<u>(5,301,344)</u>	0.69
Balance at June 30, 2020	19,429,857	\$ 1.03

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9. SHARE CAPITAL (cont'd)

As at June 30, 2020, the Company had outstanding warrants as follows:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
7,615,000	\$ 0.70	July 31, 2021
539,668	\$ 0.125	July 31, 2021
1,206,000	\$ 0.70	July 31, 2021
120	\$ 0.125	July 31, 2021
37,500	\$ 0.70	July 31, 2021
289,000	\$ 0.70	July 31, 2021
21,600	\$ 0.125	July 31, 2021
136,612	\$ 0.40	July 31, 2021
89,600	\$ 0.40	July 31, 2021
457,500	\$ 1.20	July 31, 2021
36,600	\$ 0.40	July 31, 2021
625,000	\$ 1.20	July 31, 2021
35,420	\$ 0.40	July 31, 2021
765,705	\$ 1.20	July 31, 2021
4,191,000	\$ 1.20	July 31, 2021
420,000	\$ 1.20	July 31, 2021
120,000	\$ 1.00	January 31, 2022
2,000,000	\$ 1.50	January 31, 2022
500,000	\$ 2.00	January 31, 2022
50,000	\$ 1.00	September 13, 2022
293,532	\$ 1.00	March 13, 2023
19,429,857		

10. SHARE-BASED COMPENSATION

The Company held its shareholder meeting on December 10, 2018 where the shareholders approved adoption of the Stock Option Plan in accordance with the policies of the CSE. The directors are authorized to grant stock options to directors, officers, consultants or employees. Options granted under the plan will have the term, exercise price and vesting determined by the directors.

During the year ended December 31, 2019, 2,600,000 stock options were issued to certain officers and consultants of the Company exercisable for a period ranging from one year to five years at a price ranging from \$0.50 to \$1.25 per common share.

During the period ended June 30, 2020, 1,200,000 stock options were issued to certain consultants of the Company exercisable for a period ranging from six months to two years at a price ranging from \$1.70 to \$2.50 per common share. 200,000 stock options with an exercise price of \$1.25 were forfeited. 500,000 stock options with an exercise price of \$1.70 were forfeited.

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10. SHARE-BASED COMPENSATION (cont'd)

Share option transactions from January 1, 2019 to June 30, 2020 are as follows:

	Number of options	Weighted Average Exercise Price
Balance at January 1, 2019	1,000,000	\$ 0.50
Issued options	<u>2,600,000</u>	1.22
Balance at December 31, 2019	3,600,000	1.02
Issued options	1,200,000	1.91
Forfeited options	(700,000)	1.57
Exercised options	<u>(420,000)</u>	1.29
Balance at June 30, 2020	3,680,000	\$ 1.17
Exercisable at June 30, 2020	3,070,000	\$ 1.22

As at June 30, 2020, the following stock options were outstanding and exercisable:

Number Outstanding	Number Exercisable	Exercise Price	Expiry Date
300,000	300,000	1.25	August 7, 2020
500,000	500,000	2.00	February 13, 2021
30,000	30,000	2.10	February 19, 2021
100,000	100,000	0.50	April 11, 2021
400,000	400,000	1.25	August 7, 2021
100,000	100,000	2.10	February 19, 2022
50,000	50,000	2.50	March 25, 2022
1,000,000	750,000	0.50	December 20, 2023
<u>1,200,000</u>	<u>840,000</u>	1.25	August 7, 2024
3,680,000	3,070,000		

The Company recorded share-based compensation of \$960,845, during the period ended June 30, 2020 (June 30, 2019 – \$129,111). The fair value of the options granted during the period ended June 30, 2020 was \$789,211 (June 30, 2019 - \$13,914) or \$0.66 (June 30, 2019 - \$0.14) per option. All option grants were valued using the Black-Scholes Option Pricing Model with the following assumptions:

	<u>2020</u>
Volatility	95.00%
Risk-free interest rate	0.66% - 1.55%
Expected life of option	0.5 years to 5 years
Dividend yield	<u>0%</u>

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11. RELATED PARTY TRANSACTIONS

Key management personnel are the persons responsible for planning, directing, and controlling the activities of the Company and include both executive and non-executive directors, and entities controlled by such persons. The Company considers its directors, Chief Executive Officer and Chief Financial Officer of the Company, Managing Director of Vektor and Managing Director and Chief Financial Officer of Bunker to be key management personnel.

The following is a summary of the Company's key management compensation:

	June 30, 2020	June 30, 2019
Consulting fees	\$ 30,000	\$ 30,000
Salaries and benefits	391,933	345,732
Share-based compensation	32,204	115,199

As at June 30, 2020, \$5,250 (December 31, 2019 - \$ 13,582) remained unpaid and has been included in accounts payable and accrued liabilities.

Included in amounts receivable at June 30, 2020 is \$151,147 (December 31, 2019 - \$88,349) owing from the former Managing Director of Bunker for funds previously advanced.

The Company issued an unsecured convertible debenture in the amount of \$220,149 to the Managing Director of Vektor for the purchase of certain equipment (Note 8).

12. MANAGEMENT OF CAPITAL

The Company's objectives when managing capital are to safeguard its ability to continue as a going concern in order to pursue the development of its business and to maintain a flexible capital structure, which optimizes the costs of capital at an acceptable risk. The Company considers its capital for this purpose to be its shareholders' equity.

The Company's primary source of capital is through the issuance of equity. The Company manages and adjusts its capital structure when changes in economic conditions occur. To maintain or adjust the capital structure, the Company may seek additional funding. The Company may require additional capital resources to meet its administrative overhead expenses in the long term. The Company believes it will be able to raise capital as required in the long term but recognizes there will be risks involved that may be beyond its control. There are no external restrictions on the management of capital. There have been no changes to the management of capital during the current fiscal period.

13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Fair Value

Cash is carried at fair value using level 1 fair value measurement. The carrying value of amounts receivables, and accounts payable and accrued liabilities and convertible debt approximate their fair value because of the short-term nature of these instruments. The carrying value of lease liability approximates fair value as there has not been any significant changes in interest rates since initial recognition.

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13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd)

The Company records certain of its financial instruments at fair value using various techniques. These include estimates of fair values based on prevailing market prices (bid and ask prices, as appropriate) for instruments with similar characteristics and risk profiles or internal and external valuation models, such as discounted cash flow analyses, using, to the extent possible, observable market-based inputs.

The financial instruments have been characterized on a fair value hierarchy based on whether the inputs to those valuation techniques are observable (inputs reflect market data obtained from independent sources) or unobservable (inputs reflect the Company's market assumptions).

The three levels of fair value estimation are:

Level 1 – quoted prices in active markets for identical instruments.

Level 2 – quoted prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The Company has exposures to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives. The type of risk exposure and the way in which such exposure is managed is provided as follows:

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company's maximum exposure to credit risk at June 30, 2020 under its financial instruments is approximately \$1.2 million.

Most of the Company's cash is held with a major financial institution in Canada and management believes the exposure to credit risk with respect to such institutions is not significant. The Company actively monitors its amounts receivable and believes the exposure to credit risk is insignificant.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company currently has no debt subject to variable interest rates. Accordingly, the Company has limited exposure to interest rate movements.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations associated with financial liabilities. The Company has a planning and budgeting process in place by which it projects the funds required to support its operations.

Management and the Board of Directors are actively involved in the review, planning, and approval of significant expenditures and commitments.

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13. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (cont'd)

Foreign exchange rate risk

The Company operates in Canada and Germany and is therefore exposed to foreign exchange risk arising from transactions denominated in a foreign currency. The operating results and the financial position of the Company are reported in Canadian dollars. The fluctuations of the operating currencies in relation to the Canadian dollar will, consequently, have an impact upon the reporting results of the Company, and may also affect the value of the Company's assets and liabilities. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks at this time.

The Company is exposed to foreign currency risk through the following financial assets and liabilities held in the following Canadian dollar equivalents:

June 30, 2020	Euro	Total
Cash	\$ 362,917	\$ 362,917
Amounts receivable	607,068	607,068
Total financial assets	969,985	969,985
Less: accounts payable and accrued liabilities	(579,119)	(579,119)
Less: Lease liability	(904,250)	(904,250)

At June 30, 2020, a 10% appreciation (depreciation) in the value of the Euro against the Canadian dollar, with all other variables held constant, would result in approximately a \$51,000 decrease (increase) in the Company's net loss for the year.

14. COMMITMENTS

On December 7, 2018, the Company and the UoA executed an exclusive five-year product manufacturing agreement pursuant to which the Faculty of Pharmacy and Pharmaceutical Sciences agreed to manufacture cannabis-based extracts and isolates. The Company is responsible to provide any necessary equipment for the manufacture of the extracts and isolates and will pay UoA an annual fee estimated at \$140,000.

Effective January 2019, the Company entered into a 3-year fixed term employment agreement with the Chief Financial Officer of Bunker and Director of the Company at an annual salary of EUR 120,000. Should the employment relationship be terminated with due notice by the Company during the fixed term period of employment, the individual shall be entitled to receive a severance payment in the amount of the gross salary which would have otherwise have been accrued between the effective period of the notice and December 31, 2021.

In August 2019, the Company entered into a 2-year consultancy agreement. As consideration the Company will pay USD \$20,000 per month to the consultant in addition to stock based compensation in the form of stock options and common shares to vest and be issued, respectively, over a two year period: 1) 600,000 stock options, each of which is exercisable into one common share of the Company for a period of five years at an exercise price of \$1.25 per share, of which 120,000 will vest immediately and 120,000 will vest every six months thereafter; and 2) 700,000 common shares of the Company, of which 220,000 will be issued immediately and 120,000 will be issued every six months thereafter.

In September 2019, the Company entered into a 3-year Managing Director agreement. The agreement provides for an annual salary of EUR 162,000 paid in equal monthly installments.

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14. COMMITMENTS (cont'd)

In April 2020, the Company signed a development, technology purchase and license agreement with 3a-Diagnostics GmbH ("3a") for the development and commercialization of an oral screening test for the detection of infectious diseases. The Company has committed to fund EUR 250,000 in stages through to October 2020 and up to an additional EUR 1,073,000 based on certain development milestones. The Company will also issue 50,000 common shares on signing (issued), 200,000 common shares based on certain development milestones and 250,000 common shares upon achieving EUR 25,000,000 in gross sales within 24 months. 3a will retain 5% royalty on net sales of related products sold by the Company.

15. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Significant non-cash transactions for the period ended June 30, 2020 consisted of:

- 1) The issuance of 293,532 common shares with a fair value of \$311,141 pursuant to a convertible debt conversion.
- 2) The issuance of 120,000 common shares with a fair value of \$180,000 pursuant to a consulting agreement.
- 3) The issuance of 50,000 common shares with a fair value of \$159,000 pursuant to a development, technology purchase and license agreement.
- 4) The issuance of 500,000 warrants with a fair value of \$355,935 pursuant to a supply agreement.
- 5) The issuance of 120,000 finder warrants with a fair value of \$118,037 relating to the issuance of convertible debt.
- 6) The issuance of 1,650,000 common shares with a fair value of \$1,312,984 pursuant to a convertible debt conversion.

Significant non-cash transactions for the period ended June 30, 2019 consisted of:

- 1) The issuance of 190,600 finder warrants with a fair value of \$31,581 relating to the issuance of shares.
- 2) The issuance of 50,000 common shares valued at \$20,000 pursuant to a consultancy agreement.
- 3) Deposits totaling \$413,358 have been reclassified to equipment.
- 4) The issuance of 5,565,500 common shares and 5,565,500 share purchase warrants on conversion of the Special Warrants.

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16. SEGMENTED INFORMATION

The Company has one operating segment. Information on geographical area is as follows:

	June 30, 2020	June 30, 2019
Revenues		
Germany	\$ 183,702	\$ -
Non-current assets		
Canada	\$ 564,194	\$ 1,086,550
Germany	7,103,853	7,515,686
	\$ 7,668,047	\$ 8,602,236

17. SUBSEQUENT EVENTS

Subsequent events to June 30, 2020 are as follows:

- 1) The Company issued 1,133,800 common shares for proceeds of \$1,173,225 in connection with the exercise of 1,133,800 share purchase warrants.
- 2) The Company issued 630,000 common shares for proceeds of \$1,188,000 in connection with the exercise of 630,000 stock options.
- 3) The Company issued 250,000 common shares pursuant to a convertible debt conversion.
- 4) The Company issued 120,000 common shares valued at \$363,600 pursuant to a consulting agreement.
- 5) 650,000 stock options were issued to certain consultants of the Company exercisable for a period of one year at a price ranging from \$2.50 to \$3.00 per common share.