



California Nanotechnologies Corp.
Condensed consolidated financial statements
For the interim period May 31, 2018
(in United States Dollars)

Contents

Notice to Reader	2
Condensed consolidated financial statements	
Statements of Financial Position	3
Statements of Income and Comprehensive Income	4
Statements of Changes in Equity	5
Statements of Cash Flows	6
Notes to Condensed consolidated financial statements	7 - 23

UNAUDITED INTERIM FINANCIAL STATEMENTS

In accordance with National Instrument 51-102 released by the Canada Securities Administrators, the Company discloses that its auditors have not reviewed the unaudited financial statements for the period ended May 31, 2018.

NOTICE TO THE READER OF THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

The financial statements of California Nanotechnologies Corp. and the accompanying interim condensed consolidated statements of financial position as at May 31, 2018 and the interim consolidated statements of income, comprehensive income, changes in equity and cash flows for the nine month period ended are the responsibility of the Company's management.

These condensed consolidated financial statements have not been reviewed on behalf of the shareholders by the independent external auditors of the Company, MNP LLP.

The condensed consolidated interim financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB").

signed "Roger Dent"

Roger Dent
Director
July 24, 2018

signed "Sebastien Goulet"

Sebastien Goulet
Director
July 24, 2018

California Nanotechnologies Corp.
Consolidated Statements of Financial Position
United States Dollars

As at	Note	May 31, 2018	February 28, 2018
ASSETS			
Current assets			
Cash		\$ 29,291	\$ 36,192
Accounts receivable		42,433	50,126
Inventory	4	37,692	39,084
Prepaid expenses and deposits		15,003	19,920
Total current assets		124,419	145,322
Equipment	6	686,759	712,504
Intangible assets	7	35,557	38,890
Loan receivable		2,500	-
Other assets		8,615	8,615
Total assets		\$ 857,850	\$ 905,331
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Accounts payable and accrued liabilities		\$ 148,982	\$ 169,216
Income taxes payable		3,200	800
Interest payable		19,249	13,963
Finance lease obligation – current portion	9	917	897
Bank indebtedness	8	349,902	349,825
Advances from related parties	3	1,045,522	1,045,522
Share purchase warrants	11(b)	-	11
Total current liabilities		1,567,772	1,580,234
Bank indebtedness		426,103	450,175
Finance lease obligation – long-term	9	573	810
Total liabilities		1,994,448	2,031,219
Shareholders' deficit			
Share capital	11	2,902,277	2,902,277
Contributed surplus	13	284,895	280,961
Deficit		(4,323,770)	(4,309,126)
Total shareholders' deficit		(1,136,598)	(1,125,888)
Total liabilities and shareholders' deficit		\$ 857,850	\$ 905,331
Going concern	2		

“signed” Roger Dent
Director

“signed” Sebastien Goulet
Director

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

California Nanotechnologies Corp.
Condensed Consolidated Statements of Income and Comprehensive Income
United States Dollars
(Unaudited – prepared by management)

For the three month period ended May 31	Note	2018	2017
Revenue		\$ 182,549	\$ 116,723
Cost of goods sold		82,928	27,156
Gross margin		99,621	89,567
Expenses			
Advertising and promotion		4,543	9,556
Depreciation and amortization - equipment and intangible assets	6, 7	31,356	5,775
Consulting		963	9,909
Office		7,577	3,185
Professional fees		11,660	8,295
Repairs and maintenance		170	2,180
Research and development		132	10,000
Salaries, wages and benefits		19,803	64,186
Supplies		13,735	11,263
Travel and entertainment		3,106	1,138
Share-based compensation	11(c)	3,934	11,191
		96,979	136,678
Income (loss) from operations		2,642	(47,111)
Other income (expense)			
Foreign exchange gain (loss)		(62)	913
Interest expense		(16,435)	(7,537)
Unrealized gain on share purchase warrants	11(b)	11	66,536
(Loss) income before income taxes		(13,844)	12,801
Provision for income taxes		800	800
Net (loss) income and comprehensive (loss) income		\$ (14,644)	\$ 12,001
(Loss) earnings per share – basic	12	\$nil	\$nil
- diluted	12	nil	nil
Weighted average shares outstanding - basic	12	31,430,296	31,368,378
- diluted	12	31,430,296	31,368,378

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

California Nanotechnologies Corp.
Consolidated Statements of Changes in Equity
United States Dollars
(Unaudited – prepared by management)

	Note	Share capital	Contributed surplus	Deficit	Total
Balance at February 28, 2018		\$ 2,902,277	\$ 280,961	\$ (4,309,126)	\$ (1,125,888)
Share-based compensation	11(c)	-	3,934	-	3,934
Net loss and comprehensive loss		-	-	(14,644)	(14,644)
Balance at May 31, 2018		\$ 2,902,277	\$ 284,895	\$ (4,323,770)	\$ (1,136,598)

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

California Nanotechnologies Corp.
Consolidated Statements of Cash Flows
United States Dollars
(Unaudited – prepared by management)

For the three month period ended May 31	Note	2018	2017
Cash provided by (used for) the following activities			
Operating activities			
Net income (loss) and comprehensive income (loss)		\$ (14,644)	\$ 12,001
Depreciation and amortization - equipment and intangible assets	6, 7	31,356	5,775
Unrealized gain on share purchase warrants	11(b)	(11)	(66,536)
Share-based compensation	11(c)	3,934	11,191
		<u>20,635</u>	<u>(37,569)</u>
Changes in working capital accounts			
Accounts receivable		7,693	1,356
Inventory		1,392	-
Prepaid expenses and deposits		2,417	(9,436)
Income taxes payable		800	-
Accounts payable and accrued liabilities		(18,634)	(13,172)
Interest payable		5,286	3,516
Net cash (used) provided by operating activities		19,589	(55,305)
Financing activities			
Repayment of finance lease obligation		(217)	(199)
Repayment of bank indebtedness		(23,995)	-
Advances from bank indebtedness		-	60,000
Net cash (used) provided by financing activities		(24,212)	59,801
Investing activities			
Purchase of equipment		(2,278)	-
Net cash used by investing activities		(2,278)	-
(Decrease) increase in cash resources		(6,901)	4,496
Cash, beginning of period		36,192	18,257
Cash, end of period		\$ 29,291	\$ 22,753

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

1. Incorporation and operations

Veritek Technologies Inc. was incorporated under the laws of the Province of Alberta on May 19, 2002. On February 1, 2007, the Company changed its name to California Nanotechnologies Corp. (the “Company”) in connection with the reverse takeover with California Nanotechnologies Inc. The condensed consolidated financial statements of the Company for the period ended May 31, 2018 include the accounts of the Company and its wholly-owned subsidiaries. Its head office, research and development, and production operations are located at 17220 Edwards Road, Cerritos, California, U.S.A, 90703. A corporate, registered office is located at 900 - 517 - 10th Avenue S.W., Calgary, Alberta T2R 0A8. Since the date of the reverse takeover, the Company has been devoted to the development of nanocrystalline materials through grain size reduction. The advantages of these materials include improved strength and ductility. The Company's target markets are Aerospace, Defense, Automotive, Medical and Sports and Recreation. Since the most significant portion of the Company's operations is located in the United States and its functional currency is denominated in United States dollars, these condensed consolidated financial statements are presented in United States dollars. The Company is listed for trading on the TSX Venture Exchange under the symbol CNO and in the United States on the OTCQB under the symbol CANOF. These condensed consolidated financial statements were authorized for issue in accordance with a resolution by the Board of Directors on July 24, 2018.

2. Going concern

These condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to meet its liabilities as they become due.

The Company has a net (loss) income and comprehensive (loss) income for the period of \$(14,644) (2017 – \$12,001). In addition, the Company has an accumulated deficit of \$4,323,770 (2017 - \$4,249,811). These conditions indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern.

The Company's ability to continue as a going concern is dependent upon its ability to attain profitable operations and generate funds there from, and to continue to obtain equity investment and borrowings sufficient to meet current and future obligations and/or restructure the existing debt and payables. These condensed consolidated financial statements do not reflect the adjustments or reclassification of assets and liabilities which would be necessary if the Company were unable to continue its operations.

3. Significant accounting policies

These condensed consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and the International Financial Reporting Interpretations Committee (“IFRIC”) in effect at March 1, 2018. The principal accounting policies are set out below.

Any standards and interpretations that have been issued but are not yet effective, and that are available for early application, have not been applied by the Company in these condensed consolidated financial statements. The impact of these standards and interpretations on the Company is still to be assessed.

The preparation of condensed consolidated financial statements requires management to make estimates and judgments that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The condensed consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

3. Significant accounting policies – continued

(a) Consolidation

The Company has consolidated the assets, liabilities, revenues and expenses of the subsidiaries after the elimination of intercompany transactions and balances. These condensed consolidated financial statements include the accounts of the Company, and its wholly owned subsidiaries, California Nanotechnologies Inc. and White Roof Solutions, Inc.

(b) Basis of measurement

These condensed consolidated financial statements have been prepared on a going concern basis, using the historical cost convention except for share-based compensation and financial assets classified as fair value through profit or loss or available-for-sale which are measured at fair value. In addition, they have been prepared on an accrual basis of accounting except for cash flow information.

(c) Inventory

Inventories are carried at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method. The cost of finished goods and work-in-progress comprises raw materials, direct labour, and other direct costs (based on normal operating capacity) but excludes borrowing costs.

(d) Revenue recognition

Revenue is recognized when obligations under the terms of a contract with our customer have been satisfied; generally this occurs with the transfer of our parts or services. Revenue and related cost is measured and the amount of consideration we expect to receive in exchange for the transfer of goods or providing services can be reasonably assured.

The Company recognizes revenue and profits from services on the percentage of completion basis, and accordingly costs are expensed as incurred and revenue is recognized only to the extent of contract costs incurred that will be recoverable. Expected losses are recognized immediately when it is probable that total contract costs will exceed total contract revenue.

(e) Cash includes balances with banks. Any cheques issued in excess of cash are covered with the Company's overdraft protection in the amount of \$30,000 within three months of their issuance.

(f) Business combinations

The Company uses the acquisition method of accounting to account for business combinations. The consideration transferred is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Company. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date.

(g) Equipment

Equipment is carried at historical cost less accumulated depreciation. Depreciation is provided using the straight-line method and is calculated over the estimated useful life of the assets, which has been estimated as seven years for nanotechnology equipment and three years for roof coating equipment. Borrowing costs are capitalized that are directly attributable to the construction of equipment are capitalized. The Company reviews the criteria for capitalization and the useful life of its equipment on an on-going basis considering changes in circumstances.

3. Significant accounting policies – continued

(g) Equipment- continued

When the cost of a part of an item of equipment is significant in relation to the total cost of an item and the items have different useful lives, they are accounted for as separate items (significant components) of equipment. The costs of day-to-day servicing of equipment are recognized in direct operating expenses. Gains or losses on disposal of an item of equipment is determined by comparing the proceeds from disposal with the carrying amount of equipment, and are recognized net within net income in the consolidated statements of income and comprehensive income. Depreciation methods, useful lives and residual values are reviewed at the end of each reporting period and adjusted if appropriate.

(h) Leased assets

Leases in terms of which the Company assumes substantially all of the risks and rewards of ownership are classified as finance leases and are capitalized at the commencement of the lease term at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset. Other leases are operating leases and are not recognized on the Company's consolidated statement of financial position.

(i) Intangible assets

Intangible assets are comprised of customer relationships, trade secrets, use of operating rights and contract intangibles. Intangible assets are recorded at cost less any accumulated amortization and/or impairment losses. Intangible assets are amortized on a straight-line basis over their estimated useful life of 15 years and are assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization method and period of an intangible asset is reviewed at least annually.

Patents are recorded at cost and are amortized on a straight-line basis over a period of ten years based on management's analysis of the market and competition. Patents represent accumulated costs and are not intended to reflect present or future values. The recoverability of these amounts is dependent upon future profitable operations.

(j) Impairment of non-financial assets

The Company assesses, at the end of each reporting period, whether there is an indication that an asset group may be impaired. If any indication of impairment exists, the Company estimates the recoverable amount of the asset group. External triggering events include, for example, changes in customer or industry dynamics, other technologies and economic declines. Internal triggering events for impairment include lower profitability or planned restructuring. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets, cash generating units ("CGU").

If the carrying amount of the asset, or its respective CGU, exceeds its estimated recoverable amount, the difference is recognized as an impairment charge. The Company's corporate assets, which do not generate separate cash inflows, are allocated to the CGUs on a reasonable basis for impairment testing purposes.

The Company's impairment tests compare the carrying amount of the asset or CGU to its recoverable amount. The recoverable amount is the higher of fair value less costs of disposal ("FVLCD") and value in use ("VIU"). FVLCD is the amount obtainable from the sale of an asset or CGU in an arm's length transaction of similar assets or observable market prices, less the costs of disposal. The determination of VIU requires the estimation and discounting of cash flows which involves key assumptions that consider all information available on the respective testing date. Management uses its judgment, considering past and actual performance as well as expected developments in the respective markets and in the overall macro-economic environment and economic trends to model and discount future cash flows.

3. Significant accounting policies – continued

(k) Provisions

Provisions cover risks resulting from legal disputes and proceedings. In order to determine the amount of the provisions, the facts related to each case, the size of the claim, awards in similar cases, the expected timing of such possible awards, insurance coverage and deductibles and independent expert advice are considered along with assumptions regarding the probability of a successful claim and the range of possible awards. The actual costs can deviate from these estimates.

A provision is recognized in the condensed consolidated financial statements when the Company has a material obligation, whether existing or potential, as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the obligation is determined to be material, then the estimated amount of the provision is determined by discounting the expected future cash outflows. At May 31, 2018 and February 29, 2018 there were no provisions recognized in the condensed consolidated financial statements.

(l) Income taxes

Income tax expense for the period consists of current and deferred tax. Deferred tax is recognized in the consolidated statement of income and comprehensive income, except to the extent that it relates to a business combination or items recognized in other comprehensive income (“OCI”) or directly in equity.

Taxable income differs from income as reported in the condensed consolidated statements of loss and comprehensive loss. As a result, current tax is the expected tax due on taxable loss less adjustments to prior periods using tax rates enacted, or substantively enacted as at the reporting date in jurisdictions where the Company operates.

In general, deferred taxes are recognized based on temporary differences arising between the tax value of assets and liabilities and their carrying amounts in the condensed consolidated financial statements. Deferred tax liabilities are not recognized and are not accounted for if they arise from the initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable income. Deferred taxes are calculated on the basis of the tax laws enacted or substantively enacted as at the reporting date and apply to when the related deferred tax asset is realized or the deferred tax liability is settled.

Current and deferred tax assets and liabilities are offset when there is a legally enforceable right to settle on a net basis and when such assets and liabilities relate to income taxes imposed by the same taxation authority.

(m) Foreign exchange

These condensed consolidated financial statements have been presented in United States (U.S.) dollars, the functional currency of the Company's operations. Monetary assets and liabilities denominated in foreign currencies are translated into U.S. dollars at the foreign exchange rate in effect at the statement of financial position date. Revenue and expense transactions in foreign currencies are translated to the appropriate functional currency at the foreign exchange rate on the date of the transaction with all consequential exchange differences recognized in net loss and comprehensive loss.

Non-monetary assets that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transactions. All resulting exchange differences from translation of the functional currency into a different reporting currency are recognized as a separate component of OCI.

3. Significant accounting policies – continued

(n) Share-based compensation plan

The Company provides equity-settled share-based payments in the form of a share option plan to its employees, officers, directors and consultants. The Company accounts for these share options using the fair value method of accounting for share-based compensation. Under this method, the associated compensation expense is charged to net income and comprehensive income with a corresponding increase to contributed surplus less an estimated forfeiture rate over each vesting period (tranches) of the options granted. The forfeiture rate is based on past experience of actual forfeitures. Each tranche is treated as a separate share option grant, and subsequently valued at the start of each tranche's vesting period.

Share-based compensation transactions with non-employees are measured at the fair value of the goods or services recovered. However, if the fair value cannot be estimated reliably, the share-based compensation transaction is measured at the fair value of the equity instruments granted at the date the non-employee provides the goods or services.

(o) Per share amounts

Basic income per share is calculated using the weighted average number of shares outstanding during the period. The Company follows the treasury stock method for the computation of diluted per share amounts. This method assumes the proceeds from the exercise of dilutive options and warrants are used to purchase common shares at the weighted average market price during the period.

(p) Research and development expenses

Expenses related to research and development activities that do not meet generally accepted criteria for deferral are expensed as incurred, net of related tax credits and government grants. Development expenses that meet generally accepted criteria for deferral, in accordance with the IAS 38, "Intangible Assets", are capitalized, net of related tax credits and government grants, and are amortized against net income and comprehensive income over the estimated benefit period. The Company assesses, at the end of each reporting period, whether there is an indication the assets may be impaired. If any indication of impairment exists, the Company estimates the recovery amount of the assets. Research and development expenses are mainly comprised of salaries and related expenses, material costs as well as fees paid to third party consultants.

(q) Financial instruments

All financial instruments are required to be measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as "fair value through profit or loss", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities" as defined by the standard.

Financial assets and financial liabilities at "fair value through profit or loss" are measured at fair value with changes in fair value recognized in net income and comprehensive income. Financial assets classified as "available-for-sale" are measured at fair value, with changes in fair value recognized in OCL. Transaction costs related to financial assets and liabilities recorded at fair value are included in net income and comprehensive income when incurred. Financial assets classified as "held-to-maturity", "loans and receivables" and financial liabilities classified as "other financial liabilities" are initially recorded at fair value plus transaction costs and are subsequently measured at amortized cost using the effective interest method of amortization.

3. Significant accounting policies – continued

(q) Financial instruments - continued

Cash and share purchase warrants are designated as "fair value through profit or loss". Accounts receivable are designated as "loans and receivables". Accounts payable and accrued liabilities, bank indebtedness, and advances from related parties are designated as "other liabilities".

Financial instruments measured at fair value on the consolidated statement of financial position require classification into one of the following levels of the fair value hierarchy:

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

The fair value hierarchy level at which a fair value measurement is categorized is determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety.

A financial asset, except for those classified as "fair value through profit or loss," is assessed at each reporting date to determine whether it is impaired based on objective evidence indicating that one or more events have had a negative effect on the estimated future cash flows of that asset. An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the net present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics. All impairment losses are recognized in net income and comprehensive income. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

(r) Significant accounting estimates and judgments

The preparation of condensed consolidated financial statements in conformity with IFRS requires management to make estimates and judgments that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities at the reporting date. On an ongoing basis, management evaluates its judgments and estimates in relation to revenue, expenses, assets and liabilities. Management uses historical experience and various other factors it believes to be reasonable under the given circumstances as the basis for its judgments and estimates. Actual outcomes may differ from these estimates under different assumptions and conditions.

The following are the most significant accounting judgments and estimates made by the Company in applying accounting policies:

Judgments

Determining CGU's

For the purpose of assessing impairment of tangible and intangible assets, assets are grouped at the lowest level of separately identified cash inflows which make up the CGU. Determination of what constitutes a CGU is subject to management judgment. The asset composition of a CGU can directly impact the recoverability of assets included within the CGU. In assessing the recoverability of tangible and intangible assets, each CGU's carrying value is compared to the greater of its FVLCD and VIU.

3. Significant accounting policies – continued

(r) Significant accounting estimates and judgments - continued

Deferred taxes

Uncertainties exist with respect to the interpretation of complex tax regulations and the amount and timing of future taxable income. Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable earnings will be available against which the losses can be utilized. Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable earnings together with future tax planning strategies.

Estimates

Valuation of loans and receivables

Loans and receivables are reviewed on a regular basis to estimate recoverability of balances. Loans and receivables are stated after evaluation as to their collectability and an appropriate allowance for doubtful accounts is provided where considered necessary.

Inventory

Inventories are carried at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and any applicable variable selling expenses.

Share-based compensation and share purchase warrants

The Corporation uses an option pricing model to determine the fair value of share-based compensation and share purchase warrants. Inputs to the model are subject to various estimates about volatility, interest rates, dividend yields, forfeiture rates and expected life of the units issued. Fair value inputs are subject to market factors as well as internal estimates. The Company considers historic trends together with any new information to determine the best estimate of fair value at the date of grant.

Depreciation and amortization

The condensed consolidated financial statements include estimates of the useful economic life of equipment and intangible assets. Due to varying assumptions required to be made with regards to future recoverability of these assets, the depreciation and amortization recorded by management is based on their best estimate in this regard and may be significantly different from those determined based on future operational results.

(s) New accounting policies

In May 2014, the IASB issued IFRS 15 “Revenue from Contracts with Customers”, which replaces International Accounting Standard (“IAS”) 18 “Revenue”, IAS 11 “Construction Contracts”, and related interpretations. The standard is required to be adopted either retrospectively or using a modified transition approach for fiscal years beginning on or after January 1, 2018, with earlier adoption permitted.

The Company adopted IFRS 15 on March 1, 2018 using the retrospective with cumulative effect method. Under the standard, the Company is required to provide additional disclosure of disaggregated revenue by major product type. There were no changes to reported net earnings or retained earnings as a result of adopting IFRS 15.

3. Significant accounting policies – continued

(s) New accounting policies - continued

In July 2014, the IASB completed the final elements of IFRS 9 “Financial Instruments”. The standard supersedes earlier versions of IFRS 9 and completes the IASB’s project to replace IAS 39 “Financial Instruments: Recognition and Measurement”. IFRS 9, as amended, includes a principle-based approach for classification and measurement of financial assets, a single ‘expected loss’ impairment model and a substantially reformed approach to hedge accounting.

The Company retrospectively adopted the amendment to IFRS 9 on March 1, 2018 and elected to apply the limited exemption in IFRS 9 relating to transition for impairment. Accordingly, provisions for impairment have not been restated in the comparative periods. Adoption of the amendment did not have a significant impact on the Company’s previous accounting for impairment of financial assets.

Effective March 1, 2018, the Company’s accounting policy for impairment of financial assets is as follows:

At each reporting date, on a forward looking basis, the Company assesses the expected credit losses associated with its debt instruments carried at amortized cost. For trade accounts receivable, the Company applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognized from initial recognition of the receivables. Credit risk is assessed based on the number of days the receivable has been outstanding and an internal credit assessment of the customer. Credit risk for longer-term receivables is assessed based on an internal credit assessment and where available, an external credit rating of the counterparty.

(t) Recent accounting pronouncements

In January 2016, the IASB issued IFRS 16 “Leases”, which replaces IAS 17 “Leases”. For lessees applying IFRS 16, a single recognition and measurement model for leases would apply, with required recognition of assets and liabilities for most leases. The standard will come into effect for annual periods beginning on or after January 1, 2019, with earlier adoption permitted if the entity is also applying IFRS 15 “Revenue from Contracts with Customers”. IFRS 16 will be applied by the Company on March 1, 2019 and the Company is currently evaluating the impact of the standard on its condensed consolidated financial statements.

4. Inventory

The major components of inventory are classified as follows:

	March 31, 2018	February 28, 2018
Raw materials	\$ 27,951	\$ 27,951
Finished goods	9,741	11,133
	\$ 37,692	\$ 39,084

The cost of finished goods inventories recognized as expense and included in cost of goods sold was \$1,392 (2017 - \$nil). There were no recurring inventory write-downs included in cost of goods sold.

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

5. Related party transactions

Advances from related parties are from a related entity that owns 18% of the Company's shares. The advances bear interest at 2% per annum and is due upon demand. There are no set terms for repayment and the loan is secured by all the assets of the Company. Interest was paid in the amount of \$nil (2017 - \$3,727) on the advances with accrued interest in the amount of \$163,453 (February 28, 2018 - \$158,167). This related entity also engaged with the Company for revenue of \$1,239 (2017 - \$3,283) and incurred expenses of \$9,717 (2017 - \$19,493). The transactions are considered to be in the normal course of operations and are initially recognized at their fair value.

	May 31, 2018	February 28, 2018
Advances from related parties	\$ 1,045,522	\$ 1,045,522

Significant subsidiaries:

The table below provides information relative to California Nanotechnologies Corp.'s significant subsidiaries, including the entity's name, its jurisdiction of incorporation/formation, the percentage of securities directly or indirectly owned by California Nanotechnologies Corp., and the market areas served, if applicable.

Company (Jurisdiction of Incorporation/ Formation	Percentage of ownership by California Nanotechnologies Corp.	Overview	Market Area
California Nanotechnologies Inc. (California, USA)	100%	Wholly-owned subsidiary of California Nanotechnologies Corp. which was formed and incorporated on February 4, 2005. It is the head office which conducts research and development, and materials processing.	USA
White Roof Solutions Inc. (California, USA)	100%	Wholly-owned subsidiary of California Nanotechnologies Inc. which was formed and incorporated on May 21, 2012. It conducts sales and the application of white solar reflective roof coatings.	USA

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

6. Equipment

	Nanotechnology equipment	Roof coating equipment	Totals
Cost			
At February 28, 2017	\$ 961,940	\$ 8,520	\$ 970,460
Additions	714,850	-	714,850
At February 28, 2018	\$ 1,676,790	\$ 8,520	\$ 1,685,310
Additions	2,278	-	2,278
At May 31, 2018	\$ 1,679,068	\$ 8,520	\$ 1,687,588
Accumulated depreciation			
At February 28, 2017	\$ 913,485	\$ 8,520	\$ 22,005
Depreciation	50,801	-	50,801
At February 28, 2018	\$ 964,286	\$ 8,520	\$ 972,806
Depreciation	28,023	-	28,023
At May 31, 2018	\$ 992,309	\$ 8,520	\$ 1,000,829
Net book value			
At February 28, 2018	\$ 712,504	-	\$ 712,504
At May 31, 2018	\$ 686,759	-	\$ 686,759

Nanotechnology equipment includes equipment with a cost of \$4,084 (February 28, 2018 - \$4,084) and a net book value of \$2,090 (February 28, 2018 - \$2,236) under finance lease obligation (See note 9).

7. Intangible assets

	Trade secrets	Use of operating rights	Customer list	Customer contract	Total
Cost					
At February 28, 2017, February 28, 2018, and May 31, 2018	\$ 100,000	\$ 50,000	\$ 27,000	\$ 23,000	\$ 200,000
Accumulated amortization					
At February 28, 2017	\$ 73,891	\$ 36,943	\$ 19,950	\$ 16,992	\$ 147,776
Amortization	6,666	3,334	1,800	1,534	13,334
At February 28, 2018	\$ 80,557	\$ 40,277	\$ 21,750	\$ 18,526	\$ 161,110
Amortization	1,666	834	450	383	3,333
At May 31, 2018	\$ 82,223	\$ 41,111	\$ 22,200	\$ 18,909	\$ 164,443
Net book value					
At February 28, 2018	\$ 19,443	\$ 9,723	\$ 5,250	\$ 4,474	\$ 38,890
At May 31, 2018	\$ 17,777	\$ 8,889	\$ 4,800	\$ 4,091	\$ 35,557

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

8. Credit facilities

	May 31, 2018	February 28, 2018
Effective September 2016, the Company established a new long-term primary credit facility (the "Credit Agreement") with total credit facilities of up to \$250,000, comprised of a commercial advance line in the amount of \$250,000, bearing interest at the prime rate plus one-half of one percent (0.50%) maturing on September 30, 2018. The Credit Agreement is secured by all the accounts, inventory, equipment, and general intangibles of the Company and guaranteed by a related party.	\$ 250,000	\$ 250,000
Effective February 2017, the Company increased the long-term primary credit facility up to \$800,000, adding an equipment advance line in the amount of \$550,000, bearing interest at the prime rate plus one-half of one percent (0.50%) maturing on May 31, 2023.	526,005	550,000
Less: current portion	(349,902)	(349,825)
	\$ 426,103	\$ 450,175

Interest of \$10,774 (May 31, 2017 - \$2,249) related to the long-term credit facilities has been recorded as interest expense in the condensed consolidated statements of loss and comprehensive loss for the fiscal period ended May 31, 2018.

Future minimum payments related to the long-term credit facilities are as follows:

2018-9	\$	375,810
2019-20		125,810
2020-21		125,810
2021-22		125,810
Thereafter		94,357
		847,597
Less: interest		(71,592)
		776,005
Less: current portion		(349,902)
		\$ 426,103

9. Finance lease obligation

	May 31, 2018	February 28, 2018
Equipment under a finance lease payable in equal month installments of \$84 which includes implied interest of 8.7%. The lease matures on December 16, 2019 and is secured against the equipment under finance lease with a net book value of \$2,090 (2017 - \$2,236).	\$ 1,490	\$ 1,707
Less: current portion	(917)	(897)
	\$ 573	\$ 810

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

9. Finance lease obligation - continued

Interest of \$36 (May 31, 2017 - \$54) related to the finance lease has been recorded as interest expense in the consolidated statements of income and comprehensive income for the period ended May 31, 2018.

Future minimum lease payments related to obligations under finance lease are as follows:

2018-9	\$ 1,011
2019	<u>590</u>
	1,601
Less: implied interest	<u>(111)</u>
	1,490
Less: current portion	<u>(917)</u>
	<u>\$ 573</u>

10. Compensation of Key Management Personnel

The remuneration of key management personnel during the period was as follows:

	<u>May 31, 2018</u>	<u>May 31, 2017</u>
Remuneration including share-based payments	\$ 24,231	\$ 12,440

Key management personnel of the Company include the CEO and COO. For the fiscal period ended March 31, 2018, the Company did not pay the current Chief Executive Officer (2017 - \$nil). It is management's estimate that the fair value salary would approximate \$37,500. Due to the lack of independent evidence with respect to the fair value of these services, this transaction has been recorded at the carrying amount of \$nil.

11. Share capital

(a) Authorized:

Unlimited number of Class "A" Common shares, without nominal or par value.

(b) Issued:

	<u>Number</u>	<u>Amount</u>
Total issued and outstanding, February 28, 2017 and 2018, and May 31, 2018	31,430,296	\$ 2,902,277

On April 9, 2014, the Company completed a private placement of 5,290,296 units at \$0.135 Canadian Dollars ("CAD") per unit for total proceeds of \$714,190 CAD. Each unit was comprised of one common share and one-half of one common share purchase warrant exercisable at \$0.225 CAD per common share until April 9, 2015. The ascribed values of the warrants were determined using the Black-Scholes fair value pricing model based on a risk free rate of 1.06%, expected volatility of 167.9% and an expected life of one year.

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

11. Share capital - continued

Since April 9, 2014 various extensions of the warrants' expiration date have been approved by the TSV Venture Exchange with a current extension of the share purchase warrants to April 8, 2018, which have expired. As the exercise price of the share purchase warrants are fixed in Canadian dollars and the functional currency of the Company is the U.S. dollar, the warrants are considered a derivative, as a variable amount of cash in the Company's functional currency will be received on exercise. At May 31, 2018, the fair value of share purchase warrants issued and outstanding with Canadian dollar exercise prices was \$nil(February 28, 2018 - \$11). The share purchase warrants are re-measured at fair value at each statement of financial position date with the change in fair value recorded in net loss and comprehensive loss during the period of change. The fair value of share purchase warrants is reclassified to equity upon exercise.

Warrants

	Number	Amount
Total issued and outstanding, February 28, 2017	2,645,148	\$ 69,014
Unrealized gain on share purchase warrants	-	(69,003)
Total issued and outstanding, February 28, 2018	2,645,148	\$ 11
Unrealized gain on share purchase warrants	-	(11)
Total issued and outstanding, May 31, 2018	2,645,148	\$ -

(c) Options - Directors, Officers, Employees and Consultants

The Company has a stock option plan for directors, officers, employees and consultants. Stock options can be issued up to a maximum number of common shares equal to 10% of the issued and outstanding common shares of the Company. The exercise price of options granted is not less than the market price of the common shares traded and along with the vesting period, is determined by the Board of Directors. Options granted have a term of up to 5 years.

	Number of Options	Weighted Average price (CAD)
Balance, February 28, 2017	2,450,000	\$ 0.07
Granted	25,000	0.14
Expired	(25,000)	0.10
Forfeited	(175,000)	0.07
Balance, February 28, 2018 and May 31, 2018	2,275,000	\$ 0.07

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

11. Share capital - continued

During the period ended May 31, 2018, the Company recorded \$3,934 in share-based compensation expense (2017 - \$11,191). There were no options granted during the period was \$nil (2017 weighted average fair value - \$0.08), and was estimated using the Black Scholes option-pricing model with the following assumptions:

Risk free interest rate (%)	0.87-1.25
Expected term (years)	2-5
Expected volatility (%)	138-201
Dividend per share	-
Forfeiture rate (%)	11.81

The following tables summarize information about stock options outstanding at May 31, 2018:

Options Outstanding				Options Exercisable	
Exercise Price	Number of options	Weighted Average of Remaining Contractual Life (years)	Weighted Average Exercise Price (CAD)	Number of Options	Weighted Average Exercise Price (CAD)
\$ 0.05 - 0.12	2,275,000	2.1	\$ 0.07	1,299,992	\$ 0.07

The following tables summarize information about stock options outstanding at February 28, 2018:

Options Outstanding				Options Exercisable	
Exercise Price	Number of options	Weighted Average of Remaining Contractual Life (years)	Weighted Average Exercise Price (CAD)	Number of Options	Weighted Average Exercise Price (CAD)
\$ 0.05 - 0.12	2,275,000	2.3	\$ 0.07	1,299,992	\$ 0.07

12. Income per share

The basic income per common share is calculated by dividing net income and comprehensive income by the weighted-average number of common shares outstanding. The diluted income per common share is calculated using net income and comprehensive income divided by the weighted-average number of diluted common shares outstanding during the period.

13. Contributed surplus

	May 31, 2018	February 28, 2018
Balance, beginning of period	\$ 280,961	\$ 246,167
Share-based compensation (11(c))	3,934	34,794
Balance, end of period	\$ 284,895	\$ 280,961

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

14. Financial instruments

Financial instruments of the Company consist of cash, accounts receivable, share purchase warrants, accounts payable and accrued liabilities, finance lease obligation, bank indebtedness and advances from related parties.

	May 31, 2018		February 28, 2018	
	Carrying Value	Fair Value	Carrying Value	Fair Value
At fair value through profit or loss				
Cash	\$ 29,291	\$ 29,291	\$ 36,192	\$ 36,192
Share purchase warrants	-	-	11	11
Loans and receivables				
Accounts receivable	42,433	42,433	50,126	50,126
Other liabilities				
Accounts payable and accrued liabilities	148,982	148,982	166,816	166,816
Finance lease obligation	1,490	1,490	1,707	1,707
Bank indebtedness	776,005	776,005	800,000	800,000
Advances from related parties	1,045,522	1,045,522	1,045,522	1,045,522

The table below sets out fair value measurements using fair value hierarchy.

	Total	Level 1	Level 2	Level 3
Assets				
Cash	\$ 29,291	\$ 29,291	\$ -	\$ -

There have been no transfers during the period between Levels 1, 2 and 3.

The carrying values of accounts receivable, accounts payable and accrued liabilities, and bank indebtedness approximate their fair value due to their short-term nature.

The fair value of the Company's advances from related parties and finance lease obligation approximate their fair values due to the interest rates applied to these instruments, which approximate market interest rates.

As disclosed above, the Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to various risks. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical. The Company does not use off statement of financial position contracts to manage these risks.

Liquidity Risk

The Company defines liquidity risk as the financial risk that the Company will encounter difficulties meeting its obligations associated with financial liabilities. The Company's objective for managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. This risk is mitigated by managing the cash flow by controlling receivables and payables to vendors and related parties. At May 31, 2018, the Company had a working capital deficiency of \$1,443,353 (February 28, 2018 – \$1,434,912).

California Nanotechnologies Corp.
Notes to the Consolidated Financial Statements
United States Dollars
For the interim period ended May 31, 2018

14. Financial instruments - continued

Foreign currency risk

A portion of the Company's operations are located outside of the U.S. and, accordingly, the related financial assets and liabilities are subject to fluctuations in exchange rates.

The Company manages its exposure to foreign currency fluctuations by maintaining foreign currency bank accounts and receivables to offset foreign currency payables and planned expenditures. At May 31, 2018, the Company had the following balances denominated in Canadian dollars. The balances have been translated into U.S. currency in accordance with the Company's foreign exchange accounting policy.

	U.S. Dollar May 31, 2018	U.S. Dollar February 28, 2018
Cash/(bank overdraft)	\$ 196	\$ 1,581
Accounts payable and accrued liabilities	31,921	36,947

The Company operates with a U.S. dollar functional currency which gives rise to currency exchange rate risk on the Company's Canadian dollar denominated monetary assets and liabilities, such as Canadian dollar bank accounts and accounts payable, as follows:

	Impact on Net Income
U.S. Dollar Exchange Rate – 10% increase	\$ 3,172
U.S. Dollar Exchange Rate – 10% decrease	(3,172)

Credit risk

The Company manages credit risk by dealing with financially sound customers, based on an evaluation of the customer's financial condition. For the period ended May 31, 2018, the Company was engaged in contracts for products with three (May 31, 2017 – two) customers in excess of 10% of revenue, which accounted for \$122,351 (May 31, 2017 - \$73,235) or 67% (May 31, 2017 – 63%) of the Company's total revenue. The maximum exposure to credit risk is the carrying value of accounts receivable and cash. Four (2017 - one) customers had an outstanding balance in excess of 10% of accounts receivable, which accounted for \$34,230 (2017 - \$45,657) or 81% (2017 – 69%) of the Company's total accounts receivable balance. No allowance for doubtful accounts was recorded. The table below provides an analysis of our current and past due but not impaired accounts receivables.

	Total	Current	≤ 30 days	> 30 days ≤ 60 days	>60 days ≤ 90 days	> 90 days
May 31, 2018	\$ 42,433	\$ 38,056	\$ 313	\$ 4,059	\$ -	\$ 5
February 28, 2018	\$ 50,126	\$ 43,468	\$ 5,463	\$ -	\$ 1,195	\$ -

14. Capital disclosures

The Company manages its capital to maintain its ability to continue as a going concern and to provide returns to shareholders and benefits to other stakeholders. The capital structure of the Company consists of cash, and equity comprised of issued capital, contributed surplus and deficit.

The Company manages its capital structure and makes adjustments to it in light of economic conditions. The Company, upon approval from its Board of Directors, will balance its overall capital structure through new share issues or by undertaking other activities as deemed appropriate under the specific circumstances.

The Company is not subject to externally imposed capital requirements and the Company's overall strategy with respect to capital risk management remains unchanged from the period ended May 31, 2018.