calnano

# California Nanotechnologies Corp.

## Condensed Consolidated Financial Statements

For the interim three and six months ended August 31, 2019 and 2018

(in United States Dollars)

Contents

**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 condensed consolidated financial statements for the three and six months ended August 31, 2019.

**NOTICE TO THE READER OF THE CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

The interim financial statements of California Nanotechnologies Corp. and the accompanying interim condensed consolidated statements of financial position as at August 31, 2019 and the interim condensed consolidated statements of loss, comprehensive loss, changes in equity and cash flows for the three and six months ended August 31, 2019 and 2018 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 condensed consolidated interim financial statements in accordance with IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB").

| | |
|---|---|
| *signed "Eric Eyerman"* | *signed "Roger Dent"* |
| Eric Eyerman | Roger Dent |
| Director | Director |
| October 30, 2019 | October 30, 2019 |

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

| As at | Note | August 31, 2019 (unaudited) | February 28, 2019 (audited) |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets** | | | |
| Cash | | **$ 11,911** | $ 18,563 |
| Accounts receivable | **14** | **106,767** | 61,187 |
| Inventory | **4** | **30,732** | 30,732 |
| Prepaid expenses and other current assets | **4** | **5,008** | 8,094 |
| **Total current assets** | | **154,418** | 118,576 |
| Equipment | **6** | **562,893** | 620,299 |
| Intangible assets | **7** | **27,505** | 34,172 |
| **Total assets** | | **$ 744,816** | $ 773,047 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | | **$ 158,249** | $ 141,206 |
| Income taxes payable | | **800** | 3,200 |
| Interest payable | | **59,295** | 42,107 |
| Finance lease obligation – current portion | **9** | **331** | 731 |
| Bank indebtedness | **8** | **356,818** | 362,547 |
| Advances from related parties | **5** | **1,045,522** | 1,045,522 |
| **Total current liabilities** | | **1,621,015** | 1,595,313 |
| Bank indebtedness | **8** | **294,020** | 347,854 |
| **Total liabilities** | | **1,915,035** | 1,943,167 |
| **Shareholders' equity** | | | |
| Share capital | **11** | **2,902,277** | 2,902,277 |
| Contributed surplus | **13** | **300,916** | 295,896 |
| Deficit | | **(4,373,412)** | (4,368,293) |
| **Total shareholders' equity** | | **(1,170,219)** | (1,170,120) |
| **Total liabilities and shareholders' equity** | | **$ 744,816** | $ 773,047 |
| Going concern | **2** | | |

*"signed" Eric Eyerman*
**CEO**

*"signed" Roger Dent*
**Director**

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

| | Note | **For the six months ended August 31, 2019** | For the six months ended August 31, 2018 | **For the three months ended August 31, 2019** | For the three months ended August 31, 2018 |
|---|---|---|---|---|---|
| **Revenue** | | **$ 420,758** | $ 357,719 | **$ 290,715** | $ 175,170 |
| **Cost of goods sold** | | **151,534** | 134,112 | **79,055** | 51,184 |
| **Gross margin** | | **269,224** | 223,607 | **211,660** | 123,986 |
| **Expenses** | | | | | |
| Advertising and promotion | | **15,873** | 9,129 | **6,543** | 4,586 |
| Amortization and depreciation - equipment and intangible assets | **6,7** | **64,073** | 62,658 | **32,037** | 31,302 |
| Consulting | | **5,373** | 8,711 | **5,373** | 7,748 |
| Office | | **17,439** | 13,741 | **7,052** | 6,164 |
| Professional fees | | **16,661** | 23,174 | **8,263** | 11,514 |
| Repairs and maintenance | | **259** | 553 | **259** | 383 |
| Research | | **2,866** | 132 | **173** | - |
| Salaries, wages and benefits | | **88,313** | 69,687 | **51,559** | 49,884 |
| Supplies | | **16,577** | 29,174 | **8,828** | 15,439 |
| Travel and entertainment | | **5,402** | 3,510 | **2,975** | 404 |
| Share-based compensation | **13** | **5,020** | 7,875 | **2,270** | 3,941 |
| | | **237,856** | 228,344 | **125,332** | 131,365 |
| **Income (loss) from operations** | | **31,368** | (4,737) | **86,328** | (7,379) |
| Foreign exchange loss | | **(204)** | (119) | **(49)** | (57) |
| Interest expense | | **(38,683)** | (32,811) | **(20,796)** | (16,376) |
| Unrealized gain on share purchase warrants | | **-** | 11 | **-** | - |
| **(Loss) income before income taxes** | | **(7,519)** | (37,656) | **65,483** | (23,812) |
| **(Recovery) provision for income taxes** | | **(2,400)** | 800 | **-** | - |
| **Net (loss) income and comprehensive (loss) income** | | **$ (5,119)** | $ (38,456) | **$ 65,483** | $ (23,812) |
| **Loss per share - basic** | **12** | **$ (0.01)** | $ (0.01) | **$ -** | $ (0.01) |
| **- diluted** | **12** | **(0.01)** | (0.01) | **-** | (0.01) |
| **Weighted average shares outstanding - basic** | **11** | **31,430,296** | 31,430,296 | **31,430,296** | 31,430,296 |
| **- diluted** | | **31,430,296** | 31,430,296 | **31,430,296** | 31,430,296 |

# California Nanotechnologies Corp.
## Condensed 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 | 13 | - | 7,875 | - | 7,875 |
| Net loss and comprehensive loss | | - | - | (38,456) | (38,456) |
| Balance at August 31, 2018 | | $ 2,902,277 | $ 288,836 | $ (4,347,582) | $ (1,156,469) |

| | Note | Share capital | Contributed surplus | Deficit | Total |
|---|---|---|---|---|---|
| Balance at February 28, 2019 | | $ 2,902,277 | $ 295,896 | $ (4,368,293) | $ (1,170,120) |
| **Share-based compensation** | **13** | **-** | **5,020** | **-** | **5,020** |
| **Net loss and comprehensive loss** | | **-** | **-** | **(5,119)** | **(5,119)** |
| **Balance at August 31, 2019** | | **$ 2,902,277** | **$ 300,916** | **$ (4,373,412)** | **$ (1,170,219)** |

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

| | Note | For the six months ended August 31, 2019 | For the six months ended August 31, 2018 | For the three months ended August 31, 2019 | For the three months ended August 31, 2018 |
|---|---|---|---|---|---|
| **Cash provided by (used for) the following activities** | | | | | |
| **Operating activities** | | | | | |
| Net (loss) income | | **$ (5,119)** | $ (38,456) | **$ 65,483** | $ (23,812) |
| Amortization and depreciation - equipment and intangible assets | **6,7** | **64,073** | 62,658 | **32,037** | 31,302 |
| Unrealized gain on share purchase warrants | **11(b)** | **-** | (11) | **-** | - |
| Share-based compensation | **11(c)** | **5,020** | 7,875 | **2,270** | 3,941 |
| | | **63,974** | 32,066 | **99,790** | 11,431 |
| Changes in working capital accounts | | | | | |
| Accounts receivable | | **(45,580)** | 7,730 | **(59,251)** | 37 |
| Inventory | | **-** | 7,193 | **-** | 5,801 |
| Prepaid expenses and other current assets | | **3,086** | 6,136 | **1,423** | 3,719 |
| Income taxes payable | | **-** | 800 | **-** | - |
| Accounts payable and accrued liabilities | | **14,643** | (22,911) | **4,882** | (4,277) |
| Interest payable | | **17,188** | 12,939 | **9,214** | 7,653 |
| **Net cash provided by operating activities** | | **53,311** | 43,953 | **56,058** | 24,364 |
| **Financing activities** | | | | | |
| Lease obligation | | **(400)** | (439) | **(222)** | (222) |
| Payments to related parties | | **-** | - | **(15,000)** | - |
| Payments to bank indebtedness | **8** | **(59,563)** | (40,194) | **(34,146)** | (16,199) |
| **Net cash used for financing activities** | | **(59,963)** | (40,633) | **(49,388)** | (16,421) |
| **Investing activities** | | | | | |
| Purchase of equipment | | **-** | (16,892) | **-** | (14,614) |
| **Net cash used for investing activities** | | **-** | (16,892) | **-** | (14,614) |
| **(Decrease) increase in cash resources** | | **(6,652)** | (13,572) | **6,670** | (6,671) |
| **Cash, beginning of period** | | **18,563** | 36,192 | **5,241** | 29,291 |
| **Cash, end of period** | | **$ 11,911** | $ 22,620 | **$ 11,911** | $ 22,620 |

## 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 three and six months ended August 31, 2019 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 October 30, 2019.

## 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 and comprehensive income loss for the six months of $5,119 (2018 – $38,456). In addition, the Company has an accumulated deficit of $4,373,412 (February 28, 2019 - $4,368,293). 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 that could be material.

## 3. Significant accounting policies

The significant accounting policies of the Company are the same as those applied in the Company's annual audited consolidated financial statements for the years ended February 28, 2019 and 2018 except as noted in note 3(a). These policies have been consistently applied to each of the periods presented, unless otherwise indicated.

These condensed consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") in effect at March 1, 2019. These condensed consolidated interim financial statements are unaudited and have been prepared in accordance with International Accounting Standards ("IAS") 34 "Interim Financial Reporting".

**3. Significant accounting policies – continued**

(a) New accounting policies

**IFRS 9 Financial Instruments ("IFRS 9")**

On March 1, 2018, the Company retrospectively adopted IFRS 9, as well as consequential amendments to IFRS 7 Financial Instruments: Disclosures using the modified retrospective approach. The standard supersedes earlier versions of IFRS 9 and completes the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. On the adoption date of March 1, 2018, IFRS 9 did not result in any adjustments to the opening consolidated statement of financial position.

The following table summarizes the classification categories for the Company's financial assets and liabilities by financial statement line item under the superseded IAS 39 standard and the newly adopted IFRS 9:

| | IAS 39 | IAS 9 |
|---|---|---|
| **Financial assets** | | |
| Cash | Held for trading | FVTPL |
| Accounts receivable | Loans and receivables | Amortized cost |
| **Financial liabilities** | | |
| Accounts payable and accrued liabilities | Other financial liabilities | Amortized cost |
| Interest payable | Other financial liabilities | Amortized cost |
| Bank indebtedness | Other financial liabilities | Amortized cost |
| Advances from related party | Other financial liabilities | Amortized cost |
| Share purchase warrants | FVTPL | FVTPL |

IFRS 9 also introduces a new model for the measurement of impairment of financial assets based on expected credit losses which replaces the incurred losses impairment model applied under IAS 39. There were no material adjustments to the carrying value of any of the Company's financial instruments following the adoption of IFRS 9.

**IFRS 15 Revenue from Contracts with Customers ("IFRS 15")**

On March 1, 2018 the Company adopted IFRS 15 using the modified retrospective approach. The adoption of IFRS 15 did not result in any changes in the timing or amount of revenue recognized for the Company's goods and services.

(b) 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 was applied by the Company on March 1, 2019 and the Company is currently quantifying the impact of the standard on its consolidated financial statements.

## 4. Inventory

The major components of inventory are classified as follows:

| | August 31, 2019 | February 28, 2019 |
|---|---|---|
| Raw materials | **$ 27,951** | $ 27,951 |
| Finished goods | **2,781** | 2,781 |
| | **$ 30,732** | $ 30,732 |

The cost of finished goods inventories recognized as expense and included in cost of goods sold was $12,912 (2018 - $7,577). There were no recurring inventory write-downs included in cost of goods sold.

## 5. Related party transactions

Advances from related party are from a related entity that owns 19.1% of the Company's shares. The advances bear interest at 2% per annum through December 31, 2018, 2.89% thereafter and are due upon demand. There are no set terms for repayment and the loan is secured by all the assets of the Company. Additional security for the loan has been provided by one of the founders and a current member of the board of directors of the Company. Interest was paid in the amount of $nil (2018 - $nil) on the advances with accrued interest in the amount of $196,700 (2018 – $163,453). This related entity guaranteed the Company's long-term primary credit facility and engaged with the Company for revenue of $nil (2018 – $11,739) and incurred expenses of $12,912 (2018 – $14,071). The transactions are considered to be in the normal course of operations.

| | August 31, 2019 | February 28, 2019 |
|---|---|---|
| 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 of the application of white solar reflective roof coatings. | USA |

## 6. Equipment

| | Nanotechnology equipment | Roof coating equipment | Totals |
|---|---|---|---|
| **Cost** | | | |
| At February 28, 2019 | 1,676,790 | 8,520 | 1,685,310 |
| Additions | 20,469 | - | 20,469 |
| At August 31, 2019 and August 31, 2019 | **$ 1,697,259** | **$ 8,520** | **$ 1,705,779** |
| **Accumulated depreciation** | | | |
| At February 28, 2018 | $ 964,286 | $ 8,520 | $ 972,806 |
| Depreciation | 112,674 | - | 112,674 |
| At February 28, 2019 | 1,076,960 | 8,520 | 1,085,480 |
| Depreciation | **57,406** | **-** | **57,406** |
| At August 31, 2019 | **1,134,366** | **8,520** | **1,142,886** |
| **Net book value** | | | |
| At February 28, 2019 | $ 620,299 | - | $ 620,299 |
| At August 31, 2019 | **$ 562,893** | **$ -** | **$ 562,893** |

Nanotechnology equipment includes equipment with a cost of $4,084 (February 28, 2019 - $4,084) and a net book value of $1,361 (February 28, 2019 - $1,653) under finance lease obligation (See note 9).

## 7. Intangible assets

| | Trade secrets | Use of operating rights | Customer list | Customer contract | Patent | Totals |
|---|---|---|---|---|---|---|
| **Cost** | | | | | | |
| At February 28, 2018 and 2019 and May 31, 2019 | **$ 100,000** | **$ 50,000** | **$ 27,000** | **$ 23,000** | **$ 8,615** | **$ 208,615** |
| **Accumulated amortization** | | | | | | |
| At February 28, 2018 | $ 80,557 | $ 40,277 | $ 21,750 | $ 18,526 | $ - | $ 161,110 |
| Amortization | 6,666 | 3,333 | 1,800 | 1,533 | - | 13,333 |
| At February 28, 2019 | $ 87,224 | $ 43,610 | $ 23,550 | $ 20,059 | $ - | $ 174,443 |
| Amortization | **3,333** | **1,667** | **900** | **767** | **-** | **6,667** |
| At May 31, 2019 | **$ 90,557** | **$ 45,277** | **$ 24,450** | **$ 20,826** | **$ -** | **$ 181,110** |
| **Net book value** | | | | | | |
| At February 28, 2019 | $ 12,776 | $ 6,390 | $ 3,450 | $ 2,941 | $ 8,615 | $ 34,172 |
| At May 31, 2019 | **$ 9,443** | **$ 4,723** | **$ 2,550** | **$ 2,174** | **$ 8,615** | **$ 27,505** |

## 8. Bank indebtedness

| | **August 31, 2019** | February 28, 2019 |
|---|---|---|
| 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 $250,000, bearing interest at the prime rate plus one-half of one percent (0.50%) maturing on January 31, 2020. The Credit Agreement is secured by all the accounts, inventory, equipment, and general intangibles of the Company and guaranteed by a related party (Note 5). | **$ 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 February 23, 2023, with monthly principal payments of $10,484 that commenced March 31, 2018 for a period of 60 months. | **400,838** | 460,401 |
| Less: current portion | **(356,818)** | (362,547) |
| | **$ 294,020** | $ 347,854 |

Interest of $22,680 (2018 - $21,398) related to the long-term credit facilities has been recorded as interest expense in the condensed consolidated statements of net loss and comprehensive loss for the six months ended August 31, 2019.

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

| | |
|---|---|
| 2019-20 | $ 376,810 |
| 2020-21 | 125,810 |
| 2021-22 | 125,810 |
| Thereafter | 63,341 |
| | 691,771 |
| Less: interest | (40,933) |
| | 650,838 |
| Less: current portion | (356,818) |
| | $ 294,020 |

## 9. Finance lease obligation

| | **August 31, 2019** | February 28, 2019 |
|---|---|---|
| Equipment under a finance lease payable in equal monthly installments of $84 which includes interest 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 $1,361 (February 28, 2019 - $1,653). | **$ 331** | $ 731 |
| Less: current portion | **(331)** | (731) |
| | **$ -** | $ - |

Interest of $26 (2018 - $67) related to the finance lease has been recorded as interest expense in the condensed consolidated statements of net loss and comprehensive loss for the six months ended August 31, 2019. No finance leases were present in the prior year.

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

| | |
|---|---|
| 2019-20 | $ 337 |
| Less: implied interest | (6) |
| | 331 |
| Less: current portion | (331) |
| | $ - |

## 10. Compensation of key management personnel

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

| | **August 31, 2019** | August 31, 2018 |
|---|---|---|
| Remuneration | **$ 47,270** | $ 48,077 |

Key management personnel of the Company include the CEO, COO and Directors. For the six months ended August 31, 2019, the Company did not pay the current Chief Executive Officer. It is management's estimate that the fair value salary would approximate $75,000. 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:

| | **Number** | **Amount** |
|---|---|---|
| Total issued and outstanding, February 28, 2018 and 2019, and May 31, 2019 | **31,430,296** | **$ 2,902,277** |

## 11. Share capital

(b) Issued - continued:

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.

Since April 9, 2014 various extensions of the warrants' expiration date have been approved by the TSV Venture Exchange with the final extension of the share purchase warrants to April 8, 2018. As the exercise price of the share purchase warrants are fixed in CAD 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, 2019, the fair value of share purchase warrants issued and outstanding with CAD exercise prices was $nil (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, 2018 | 2,645,148 | $ 69,014 |
| Unrealized gain on share purchase warrants | - | (11) |
| Expired, April 8, 2018 | **(2,645,148)** | **-** |
| Total issued and outstanding, February 28, 2019 and August 31, 2019 | - | $ - |

(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, 2018 | 2,275,000 | $ 0.07 |
| Granted | 1,235,000 | 0.05 |
| Expired | (600,000) | 0.05 |
| Forfeited | (500,000) | 0.07 |
| Balance, February 28, 2019 | 2,410,000 | $ 0.06 |
| Expired | **(100,000)** | **0.11** |
| Balance, August 31, 2019 | **2,310,000** | **$ 0.06** |

## 11. Share capital – continued

During the three and six months ended August 31, 2019, the Company recorded $5,020 in share-based compensation expense (August 31, 2018 - $7,875). The fair value of the options granted in the three and six months was estimated using the Black Scholes option-pricing model with the following assumptions:

| | |
|---|---|
| Risk free interest rate (%) | 0.99-1.98 |
| Expected term (years) | 2-5 |
| Expected volatility (%) | 138-201 |
| Dividend per share | - |
| Forfeiture rate (%) | 12.38 |

The following tables summarize information about stock options outstanding at August 31, 2019:

| **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 - 0.20** | **2,310,000** | **2.9** | **$ 0.06** | **1,144,991** | **$ 0.07** |

The following tables summarize information about stock options outstanding at February 28, 2019:

| 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 - 0.20 | 2,410,000 | 3.5 | $ 0.07 | 841,662 | $ 0.08 |

## 12. Loss per share

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

2,310,000 (August 31, 2018 – 2,275,000) options were excluded in calculating the weighted-average number of diluted common shares outstanding for the six months ended August 31, 2019 and 2018, because the Company was in a net loss position and therefore any exercise would be anti-dilutive.

## 13. Contributed surplus

| | **August 31, 2019** | February 28, 2019 |
|---|---|---|
| Balance, beginning of year | **$ 295,896** | $ 280,961 |
| Share-based compensation (11(c)) | **5,020** | 14,935 |
| Balance, end of period | **$ 300,916** | $ 295,896 |

## 14. Financial instruments

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

| | **August 31, 2019** | | February 28, 2019 | |
|---|---|---|---|---|
| | **Carrying Value** | **Fair Value** | Carrying Value | Fair Value |
| **At FVTPL** | | | | |
| Cash | **$ 11,911** | **$ 11,911** | $ 18,563 | $ 18,563 |
| **At amortized cost** | | | | |
| Accounts receivable | **106,767** | **106,767** | 61,187 | 61,187 |
| Accounts payable and accrued liabilities | **158,249** | **158,249** | 141,206 | 141,206 |
| Interest payable | **59,295** | **59,295** | 42,107 | 42,107 |
| Bank indebtedness | **650,838** | **650,838** | 710,401 | 710,401 |
| Advances from related party | **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 | $ 11,911 | $ 11,911 | - | - |

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

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

The fair value of the Company's long term portion of bank indebtedness and finance lease obligation approximate its fair values due to the interest rates applied to these instruments, which approximate market interest rates. The fair value of the Company's advances from related party approximate their fair values due to the amounts being due on demand.

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 make use of off statement of financial position contracts to manage these risks.

## 14. Financial instruments - continued

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 August 31, 2019, the Company had a working capital deficiency of $1,466,597 (2018 – $1,472,439) (Note 2).

The following table provides an analysis of the financial liabilities based on the remaining terms of the liabilities as at:

| **August 31, 2019** | **≤ 1 year** | **> 1 year ≤ 3 years** | **> 3 year ≤ 4 years** | **> 5 years** | **Total** |
|---|---|---|---|---|---|
| **Accounts payable and accrued liabilities** | **$ 158,249** | **$ -** | **$ -** | **$ -** | **$ 158,249** |
| **Finance lease obligation** | **331** | **-** | **-** | **-** | **331** |
| **Bank indebtedness** | **356,818** | **231,667** | **62,353** | **-** | **650,838** |
| **Total** | **$ 515,398** | **$ 231,667** | **$ 62,353** | **$ -** | **$ 809,418** |

| February 28, 2018 | ≤ 1 year | > 1 year ≤ 3 years | > 3 year ≤ 4 years | > 5 years | Total |
|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | $ 143,606 | $ - | $ - | $ - | $ 143,606 |
| Finance lease obligation | 731 | - | - | - | 731 |
| Bank indebtedness | 362,547 | 225,555 | 122,299 | - | 710,401 |
| Total | $ 506,884 | $ 225,555 | $ 122,299 | $ - | $ 854,738 |

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 believes its exposure to foreign currency risk to be minimal. At Augusty 31, 2019, the Company had the following balances denominated in CAD. The balances have been translated into United States currency in accordance with the Company's foreign exchange accounting policy.

| | **USD August 31, 2019** | USD February 28, 2019 |
|---|---|---|
| Cash | **$ 2,401** | $ 61 |
| Accounts Receivable | **1,302** | 2,930 |
| Accounts payable and accrued liabilities | **40,709** | 36,994 |

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 Loss** |
|---|---|
| U.S. Dollar Exchange Rate – 10% increase | **$ 3,701** |
| U.S. Dollar Exchange Rate – 10% decrease | **(3,701)** |

**14. Financial instruments - continued**

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 six months ended August 31, 2019, the Company was engaged in contracts for products with two (August 31, 2018 – three) customers in excess of 10% of revenue, which accounted for $236,072 (August 31, 2018 - $199,570) or 56% (August 31, 2018 – 56%) of the Company's total revenue. The maximum exposure to credit risk is the carrying value of accounts receivable and cash. Three (2018 - two) customers had an outstanding balance in excess of 10% of accounts receivable, which accounted for $89,495 (2018 - $24,585) or 84% (2018 – 58%) 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 |
|---|---|---|---|---|---|---|
| **August 31, 2019** | **$ 106,767** | **$ 72,274** | **$ 33,427** | **$ 1,606** | **$ -** | **$ -** |
| February 28, 2019 | $ 61,187 | $ 37,977 | $ 19,448 | $ 3,762 | $ - | $ - |

As at August 31, 2019, the average expected credit loss on the Company's accounts receivable was 0% and as a result the provision for expected credit losses is $nil.

Interest rate risk

The Company's revolving line of credit is subject to floating rates. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate as a result of changes in market rates. As at August 31, 2019, the increase or decrease in (loss) income before taxes for each 1% change in interest rates on floating rate debt amounts to approximately $6,508 (2018 - $7,598). The related disclosures regarding these debt instruments are included in Note 10 of these condensed consolidated interim financial statements.

**15. 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 year ended February 28, 2019.