

Inner Spirit Holdings Ltd.

Interim Condensed Consolidated Financial Statements

(Unaudited)

For the three and nine months ended September 30, 2019 and 2018

(Expressed in Canadian Dollars)

NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL RESULTS

Pursuant to National Instrument 51-102, Part 4, subsection 4.3(3)(a) issued by the Canadian Securities Administrators, if an auditor has not performed a review of the interim condensed consolidated financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying interim condensed financial statements of the Company have been prepared in accordance with IFRS and are the responsibility of the Company's management. The interim condensed consolidated financial statements and related financial reporting matters have been reviewed and approved by the Audit Committee.

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

Inner Spirit Holdings Ltd.

Interim Condensed Consolidated Statements of Financial Position
(Unaudited)
(Expressed in Canadian Dollars)

	Note	September 30 2019 (Unaudited)	December 31 2018 (Audited)
ASSETS			
Current			
Cash		\$ 3,893,233	\$ 2,175,588
Short-term deposits		-	1,200,000
Accounts receivable		1,443,731	578,842
Marketable securities	4	962,274	1,262,928
Prepaid investment subscription		-	149,710
Prepaid expenses and deposits		249,698	208,344
Inventory	5	2,408,857	2,622,152
Total current assets		8,957,793	8,197,564
Non-current			
Property and equipment	6	2,894,787	1,349,216
Lease deposits		993,744	1,126,639
Marketable securities	4	-	62,257
Loan to franchise partners		661,667	-
Right of use assets		9,863,345	-
Investments		149,710	-
Store Permits	7	3,097,189	713,993
Franchise inducements		1,257,155	-
Total assets		\$ 27,875,390	\$ 11,449,669
LIABILITIES AND SHAREHOLDERS' DEFICIT			
Current			
Accounts payable and accrued liabilities		\$ 1,377,494	\$ 1,294,261
Short term note payable		250,000	-
Current portion of lease liabilities		1,698,991	-
Franchise fee deposits	9	181,250	53,750
Deferred Revenue	4	330,677	303,121
Payable to related party	8	291,172	208,779
Unredeemed gift card liability		164,939	183,531
Total current liabilities		4,294,523	2,043,442
Non-current			
Franchise fee deposits	9	997,600	1,788,850
Lease liabilities		8,552,388	-
Convertible debenture	15	7,540,415	-
Deferred revenue	4	753,927	1,001,934
Total liabilities		22,138,853	4,834,226
Shareholders' Equity			
Share capital	11	21,050,410	16,971,660
Contributed surplus	11	780,248	725,137
Warrants	11	3,533,664	1,948,801
Convertible debentures	15	1,038,238	-
Deficit		(20,549,561)	(12,984,037)
Total Shareholders' equity of parent		5,852,999	6,661,561
Non-controlling interest		(116,462)	(46,118)
Total Shareholders' equity		5,736,537	6,615,443
Total liabilities and shareholders' equity		\$ 27,875,390	\$ 11,449,669

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

Inner Spirit Holdings Ltd.

Interim Condensed Consolidated Statements of Loss and Comprehensive Loss
(Unaudited)
(Expressed in Canadian Dollars)
For the Three and Nine Months Ended September 30, 2019 and 2018

	Note	Three months ended September 30		Nine months ended September 30	
		2019	2018	2019	2018
Revenue					
Retail revenue		\$ 2,053,446	\$ 1,133,625	\$ 3,801,269	\$ 3,222,783
Royalties		400,776	38,637	776,074	116,233
Advertising		80,158	11,484	163,541	30,883
Millwork		751,304	-	1,254,791	-
Franchise fee		315,000	-	416,250	-
Supply and other revenue		390,956	361,033	608,691	410,027
Total revenue		3,991,640	1,544,779	7,020,616	3,779,926
Cost of goods sold	5	2,092,793	910,930	3,508,959	2,067,721
Gross profit		1,898,847	633,849	3,511,657	1,712,205
Operating expenses					
General and administrative		778,484	557,976	3,383,143	1,387,482
Salaries, wages, and benefits		1,103,412	647,969	2,769,210	1,835,343
Occupancy costs		344,293	332,426	1,042,634	814,025
Depreciation and amortization	6,7	150,657	109,813	341,595	259,711
Right of use asset depreciation		370,411	-	1,168,455	-
Sales and marketing		164,006	174,683	420,069	400,560
Total operating expenses		2,911,263	1,822,867	9,125,106	4,697,121
Operating loss before other expenses		(1,012,416)	(1,189,018)	(5,613,449)	(2,984,916)
Share-based compensation		-	28,949	55,111	292,323
Unrealized loss (gain) on marketable securities	4	970,656	(277,658)	689,128	939,805
Interest expense		507,251	296	947,143	11,220
Royalty expense		-	-	-	5,040
Loss before income taxes		\$ (2,490,323)	\$ (940,605)	\$ (7,304,831)	\$ (4,233,304)
Recovery of deferred taxes		-	-	-	-
Net loss and comprehensive loss		\$ (2,490,323)	\$ (940,605)	\$ (7,304,831)	\$ (4,233,304)
Total net loss and comprehensive loss attributed to					
Common shareholders		(2,443,712)	(940,605)	(7,234,487)	(4,233,304)
Non-controlling interest		(46,611)	-	(70,344)	-
Attributed net loss and comprehensive loss		(2,490,323)	(940,605)	(7,304,831)	(4,233,304)
Net loss per share - Basic and diluted					
		\$ (0.01)	\$ (0.01)	\$ (0.04)	\$ (0.03)
Weighted average shares outstanding					
- Basic and diluted		192,448,544	123,919,565	192,448,544	123,919,565

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

**Interim Condensed Consolidated Statements of Changes in Shareholders' Equity
(Unaudited)**

(Expressed in Canadian Dollars)

For the Nine Months Ended September 30, 2019 and 2018

	Note	Share Capital		Share Subscriptions	Contributed Surplus	Convertible Debentures	Warrants	Deficit	Total
		Number	Amount						
Balance, December 31, 2017		65,946,105	3,420,871	\$ 1,149,556	\$ -	\$ -	\$ -	\$ (1,335,182)	\$ 3,235,245
Debt conversion	11,12(b)	10,000,000	1,000,000	-	-	-	-	-	1,000,000
Private placements	12(b)	23,553,895	2,355,390	(1,149,556)	-	-	-	-	1,205,834
Initial public offering	12(b)	25,000,000	2,974,320	-	-	-	775,680	-	3,750,000
Corporate investments	12(b)	48,441,177	5,299,254	-	-	-	963,102	-	6,262,356
Acquisition of franchisee	12(b)	1,333,334	400,000	-	-	-	79,360	-	479,360
Exercise of warrants	12(b)	150,000	15000	-	-	-	-	-	15,000
Exercise of options	12(b)	60,000	6000	-	-	-	-	-	6,000
Service warrants	12(e)	-	-	-	-	-	75,500	-	75,500
Agent warrants		-	-	-	-	-	213,334	-	213,334
Share issuance costs	12	-	(813,562)	-	-	-	(183,652)	-	(997,214)
Share-based compensation	12(c)	-	-	-	292,323	-	-	-	292,323
Net loss and comprehensive loss		-	-	-	-	-	-	(4,233,304)	(4,233,304)
Balance, September 30, 2018		174,484,511	14,657,273	\$ -	\$ 292,323	\$ -	\$1,923,324	\$ (5,568,486)	\$11,304,434
Balance, December 31, 2018		186,179,524	\$16,971,660	\$ -	\$ 725,137	\$ -	\$1,948,801	\$(13,030,648)	\$ 6,614,950
Franchisee acquisitions	11b(xv)	7,075,472	1,500,000	-	-	-	-	-	1,500,000
Exercise of options	11b(xvi)	287,500	28,750	-	-	-	-	-	28,750
IFRS 16 Adjustment		-	-	-	-	-	-	(284,426)	(284,426)
Bonus	11b(xvii)	250,000	50,000	-	-	-	-	-	50,000
Franchise inducement	11b(xviii)	5,000,000	1,000,000	-	-	-	-	-	1,000,000
Tilray equity swap	11b(xix)	7,443,799	1,500,000	-	-	-	-	-	1,500,000
Share based compensation	11d(iii)	-	-	-	55,111	-	-	-	55,111
Debenture Issuance		-	-	-	-	1,038,238	1,584,863	-	2,623,101
Net loss and comprehensive loss		-	-	-	-	-	-	(7,304,831)	(7,304,831)
Non controlling interest		-	-	-	-	-	-	70,344	70,344
Balance, September 30, 2019		206,236,295	\$21,050,410	\$ -	\$ 780,248	\$ 1,038,238	\$3,533,664	\$(20,549,561)	\$ 5,852,999

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

Inner Spirit Holdings Ltd.

Interim Condensed Consolidated Statements of Cash Flows
(Unaudited)
(Expressed in Canadian Dollars)
For the Nine Months Ended September 30, 2019 and 2018

Nine months ended	Note	September 30	
		2019	2018
Cash provided by (used in) the following activities:			
Operating			
Net loss for the period	\$	(7,304,831)	\$ (4,233,304)
Items not affecting cash			
Amortization and depreciation	6,7	341,595	259,711
Depreciation of right-of-use asset		1,168,455	-
Share-based compensation	11	55,111	292,323
Unrealized loss (gain) on marketable securities	4	689,128	939,805
Changes in non cash working capital balances:			
Change in accounts receivable		(864,889)	(164,764)
Change in prepaids and deposits		(41,354)	4,594
Change in inventory	5	213,295	(2,187,104)
Change in accounts payable and accrued liabilities		83,233	1,255,222
Change in short term note payable		250,000	-
Accretion of lease liability		1,011,722	-
Change in unredeemed gift card liability		(18,592)	74,761
Change in lease deposits		132,895	(340,383)
Change in deferred revenue		(220,451)	-
Franchise fee deposits	9	(791,250)	716,000
Cash flow used in operating activities		(5,295,933)	(3,383,139)
Financing			
Principal portion of lease payments		(1,077,549)	-
Issuance of share capital, net of issuance costs	11	4,078,750	6,906,853
Issuance of convertible debentures	15	10,000,000	-
Payable to related party	8	(82,935)	(593,141)
Cash flow provided by financing activities		12,918,266	6,313,712
Investing			
Investment in Auxly		-	350,000
Investment in Newstrike		-	1,125,000
Investment in prepaid share subscription		-	(146,997)
Acquisition of property and equipment	6	(1,947,533)	(582,156)
Acquisition of Tilray shares	4	(1,500,000)	-
Franchise Inducement		(1,257,155)	-
Acquisition of store permits	7	(2,400,000)	-
Cash flow used in financing activities		(7,104,688)	745,847
Change in cash		517,645	3,676,420
Cash, beginning of period		3,375,588	953,055
Cash, end of period	\$	3,893,233	\$ 4,629,475

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

Inner Spirit Holdings Ltd.

Notes to the Interim Condensed Consolidated Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2019 and 2018

1. NATURE OF OPERATIONS AND GOING CONCERN

Inner Spirit Holdings Ltd., ("Inner Spirit" or the "Company") was incorporated under the Business Corporations Act (Alberta), on March 16, 2017. The Company was amalgamated under the Business Corporations Act (Alberta) on August 31, 2017 with 2043246 Alberta Ltd. to continue as Inner Spirit Holdings Ltd.

The Company has four subsidiaries, Spirit Leaf Inc., Spirit Leaf Corporate Inc., and Spirit Leaf Macleod Inc. (collectively, "Spirit Leaf") and Watch It! Consolidated Ltd. ("Watch It!"). Spirit Leaf Inc.'s primary business is the current operation, planned opening and ongoing support of franchise retail cannabis stores in Canadian jurisdictions where the private sale of recreational cannabis is permitted. Spirit Leaf Corporate Inc.'s primary business is the current operation and planned opening of wholly-owned corporate retail cannabis stores. Spirit Leaf Macleod Inc.'s primary business is the current operation of a corporate retail cannabis store. Watch It!'s primary business is the ongoing support of licensed retail watch stores and the sale of watches, sunglasses and related accessories through corporate retail outlets across Canada and through its websites.

The Company's registered office is located at Suite 1600 Dome Tower, 333 7th Avenue S.W., Calgary, Alberta, T2P 2Z1.

These consolidated financial statements ("Financial Statements") have been prepared on a going concern basis, which assumes that the Company will continue to operate for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business.

During the three months ended September 30, 2019, the Company had negative cash flows from operating activities, incurred a net loss of \$2,490,323 (2018 - \$940,605) and, as of that date, the Company has an accumulated deficit of \$20,549,561 (December 31, 2018 - \$12,984,037).

Management's view is that the success of the Company is dependent upon achieving profitable operations. The Company has been successful in completing an initial public offering and completing private placements from public investors and strategic partners, who continue to support the Company.

The Financial Statements do not reflect adjustments that would be necessary if the going concern basis was not appropriate. Consequently, adjustments could then be necessary to the carrying value of assets and liabilities, the reported expenses and their classifications. Such adjustments if required, could be material.

2. BASIS OF PRESENTATION

Statement of compliance

These Financial Statements have been prepared using the same accounting policies and methods as those used in the Company's audited consolidated financial statements for the year ended December 31, 2018.

Inner Spirit Holdings Ltd.
Notes to the Interim Condensed Consolidated Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2019 and 2018

2. BASIS OF PRESENTATION (CONTINUED)

These Financial Statements have been prepared in accordance with International Accounting Standards ("IAS") 34, "Interim Financial Reporting". These Financial Statements do not include all of the information required for full annual financial statements and should be read in conjunction with the audited financial statements and notes thereto in the Company's December 31, 2018 audited financial statements available on SEDAR at www.sedar.com.

These Financial Statements were approved and authorized by the Board of Directors on November 20, 2019.

Basis of measurement

The Financial Statements have been prepared on historical cost basis except for certain financial instruments and marketable securities which are measured at fair value as explained in the accounting policies.

Basis of consolidation

The Financial Statements include the ownership percentages of Inner Spirit's subsidiaries:

Entity Name	Ownership Percentage
Spirit Leaf Inc.	100%
Spirit Leaf Corporate Inc.	100%
Spirit Leaf Macleod Inc.	50.1%
Watch It! Consolidated Ltd.	100%

The Company has consolidated the assets, liabilities, revenues and expenses of the subsidiaries after the elimination of inter-company transactions and balances.

A subsidiary is an entity controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. This control is evidenced through, among other things, owning more than 50% of the voting rights or currently exercisable potential voting rights of a company's share capital. The financial statements of the subsidiaries are included in the Financial Statements of the Company from the date that control commences until the date that control ceases.

2. BASIS OF PRESENTATION (CONTINUED)

Non-controlling interest

Non-controlling interest represent equity interests in subsidiaries owned by outside parties. The share of net assets of subsidiaries attributable to non-controlling interests is presented as a component of shareholders' equity. Changes in the Company's ownership interest in subsidiaries that do not result in a loss of control are accounted for as equity transactions.

Non-controlling interest consists of the non-controlling interest at the date of the original acquisition plus the non-controlling interest share of changes in equity since the date of acquisition. The Company owns 50.1% of the common shares outstanding of its subsidiary, Spirit Leaf Macleod Inc. These consolidated Financial Statements include 100% of the assets and liabilities of Spirit Leaf Macleod Inc., and include a non-controlling interest representing 49.9% of Spirit Leaf Macleod Inc.'s assets and liabilities not owned by the Company.

Functional currency

These Financial Statements have been prepared in Canadian dollars, which is the Company's functional and presentation currency.

Significant accounting judgments and estimates

The preparation of these Financial Statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and revenue and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may 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 the revision and future periods if the review affects both current and future periods. Significant assumptions about the future that management has made that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the following:

2. BASIS OF PRESENTATION (CONTINUED)

Significant accounting judgments and estimates (continued)

Going concern

- Determining if the Company has the ability to continue as a going concern is dependent on its ability to achieve profitable operations. Certain judgments are made when determining if the Company will achieve profitable operations.

Expected credit losses

- The Company's accounts receivables are typically short-term in nature and the Company recognizes an amount equal to the lifetime expected credit losses ("ECLs"). The Company measures loss allowances based on historical experience and including forecasted economic conditions. The amount of ECLs is sensitive to changes in circumstances of forecast economic conditions.

Inventory

- Inventory is carried at the lower of cost and net realizable value; in estimating net realizable value, the Company makes estimates related to obsolescence, future selling prices, seasonality, customer behavior, and fluctuations in inventory levels.

Determining CGUs

- For the purpose of assessing impairment of non-financial assets, the Company must determine its cash-generating units ("CGUs"). Assets are grouped into CGUs at the lowest level of separately identified cash flows. The determination of a CGU is based on management's judgment and is an assessment of the smallest group of assets that generate cash inflows independently of other assets. Management has determined that each corporate store in Spirit Leaf and Watch it! is its own CGU.

Impairment testing of PP&E, goodwill, and indefinite life intangible assets

- PP&E, goodwill and indefinite life intangible assets are assessed for impairment at least annually, and whenever there is an indication that the asset may be impaired. The Company determines the fair value of its CGU groupings and indefinite life intangible assets using discounted cash flow models corroborated by other valuation techniques.

The process of determining these fair values requires the Company to make estimates and assumptions of a long-term nature regarding discount rates, projected revenues, margins, as applicable, derived from past experience, actual operating results and budgets. These estimates and assumptions may change in the future due to uncertain competitive and economic market conditions or changes in business strategies.

2. BASIS OF PRESENTATION (CONTINUED)

Significant accounting judgments and estimates (continued)

Depreciation

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

Amortization of intangible assets

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

Deferred tax assets

- Deferred tax assets, including those arising from tax loss carry-forwards, require management to assess the likelihood that the Company will generate sufficient taxable income 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.

Estimate on share-based compensation and warrants

- The Company issues warrants and stock options to directors, officers and other consultants. The Company employs the fair value method of accounting for stock options and warrants. The determination of the share-based compensation expense for stock options and warrants requires the use of judgment as to the appropriate valuation model and the inputs for the model require assumptions including the rate of forfeiture of options and warrants granted, the expected life of the option or warrant, the expected volatility of the Company's share price, the risk-free interest rate and expected dividends.

3. SIGNIFICANT ACCOUNTING POLICIES

Recently adopted accounting pronouncements

IFRS 9, Financial Instruments

IFRS 9 introduces new requirements for classifying and measuring financial instruments. The standard became effective for fiscal years beginning on or after January 1, 2018. IFRS 9 affects the classification and measurement of financial assets and financial liabilities and the recognition of expected credit losses.

Inner Spirit Holdings Ltd.
Notes to the Interim Condensed Consolidated Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2019 and 2018

3.SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company adopted IFRS 9 effective January 1, 2018 on a retrospective basis. The prior year comparative information has not been adjusted with respect to the adoption of IFRS 9's classification and measurement requirements as the adoption of IFRS 9 did not result in any material changes.

IFRS 9 replaces the 'incurred loss' model in IAS 39 with an 'expected credit loss' (ECL) model for calculating impairment. The new impairment model applies to financial assets measured at amortized cost. Under IFRS 9, credit losses are recognized earlier than under IAS 39. The Company applied the simplified approach to providing for expected credit losses prescribed by IFRS 9, which requires the use of the lifetime expected loss provision for all accounts receivable.

The following table summarizes the classification impacts of the adoption of IFRS 9:

Financial Instrument	Previous Classification under IAS 39	New Classification under IFRS 9
Cash	Loans and receivables	Amortized cost
Short-term deposits	Loans and receivables	Amortized cost
Accounts receivable	Loans and receivables	Amortized cost
Marketable securities	Held for Trading	FVTPL
Accounts payable and accrued liabilities	Other liabilities	Amortized cost
Refundable franchise fee deposits	Other liabilities	Amortized cost
Payable to shareholder	Other liabilities	Amortized cost
Royalty debt	Other liabilities	Amortized cost

There were no adjustments to the carrying amounts of financial instruments as a result of the measurement classification category changes from International Accounting Standard 39- Financial Instruments: Recognition and Measurement ("IAS 39") to IFRS 9.

IFRS 15, Revenue from contracts with customers

On May 28, 2014 the IASB issued IFRS 15. The standard replaces IAS 11, Construction Contracts, IAS 18, Revenue, and related interpretations. The standard is effective for annual periods beginning on or after January 1, 2018. The standard outlines a single comprehensive model for entities for revenue recognition arising from contracts with customers.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Company has completed its evaluation of the impact of IFRS 15 on its Financial Statements. The Company's practices of revenue recognition are unchanged upon adoption of this standard, therefore, the adoption of IFRS 15 did not result in a material impact to the Financial Statements. The Company has elected to apply the standard on a modified retrospective basis. Under this approach, the 2017 comparative period was not restated. There was no cumulative transitional adjustment to the opening retained earnings balance required.

IFRS 16, Leases

On January 13, 2016, the IASB published a new standard, IFRS 16, "Leases". The new standard brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. The standard is effective for annual periods beginning on or after January 1, 2019, with early application permitted but only if the entity is also applying IFRS 15, "Revenue from contracts with customers". Under the new standard, a lessee recognizes a right-of-use asset and a lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly. The liability accrues interest.

Effective January 1, 2019, the Company adopted IFRS 16, Leases ("IFRS 16"), which supersedes previous accounting standards for leases, including IAS 17, Leases ("IAS 17"), and IFRIC 4, Determining whether an arrangement contains a lease ("IFRIC 4"). IFRS 16 introduces a single lessee accounting model, unless the underlying asset is of low value, and requires a lessee to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

As a result of adopting IFRS 16, the Company has recognized a significant increase to both assets and liabilities on its Condensed Interim Consolidated Statements of Financial Position, as well as a decrease to operating expenses (for the removal of base rent expense for leases), an increase to depreciation (due to the depreciation of the right-of-use asset), and an increase to finance costs (due to accretion of the lease liability). Leasehold inducements, store closure costs and average rent adjustments (which were previously included in accounts payable and accrued liabilities) and onerous lease provisions are no longer recognized as separate liabilities and are included in the calculation of right-of-use assets under IFRS 16.

The Company adopted IFRS 16 using the modified retrospective method and has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The cumulative effect of initially applying the new standard is recognized as an adjustment to the opening deficit within the shareholders' equity balance as at January 1, 2019.

Inner Spirit Holdings Ltd.
Notes to the Interim Condensed Consolidated Financial Statements
(Unaudited)
For the Three and Nine Months Ended September 30, 2019 and 2018

3.SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Adjustments recognized on adoption of IFRS 16

On adoption of IFRS 16, the Company recognized lease assets and liabilities in relation to leases previously classified as 'operating leases' under the principles of IAS 17. These liabilities were measured at the present value of the remaining lease payments, discounted using the related incremental borrowing rate as of January 1, 2019. The weighted-average rate applied is 7%. The associated right-of-use assets were measured as if the standard has been applied since the commencement date, discounted using the incremental borrowing rates as of January 1, 2019 adjusted for the effects of provisions for onerous leases.

Interest expense on lease obligations for the period ended September 30, 2019 was \$122,350. The expense relating to variable lease payments not included in the measurement of lease obligations was \$372,753. This consists of variable lease payments for operating costs, property taxes, and insurance. Expenses relating to short-term leases were \$88,636 and expenses relating to leases of low value assets were not material.

A reconciliation of lease commitments as at January 1, 2019, outlining the effect of the transition to IFRS 16 is outlined below.

January 1, 2019

Operating lease commitments disclosed as at December 31, 2018	12,494,176
Discounted using the incremental borrowing rate at January 1, 2019	7%
Lease liability recognized as at January 1, 2019	10,493,094
Of which are:	
Current lease liabilities	1,518,596
Non-current lease liabilities	8,974,498

Below is a summary of the activity related to our right-of-use assets for the nine-month period ended September 30, 2019:

	Nine months ended September 30, 2019
Right-of-use assets, beginning of period	\$10,302,721
Net additions	729,079
Right-of-use assets depreciation	(1,168,455)
Right-of-use assets, end of period	\$9,863,345

3.SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Leasing activities

The Company leases properties such as various retail stores and offices. Lease contracts are typically made for fixed periods of 1 to 10 years but may have extension options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions.

Accounting policy

At the inception of a contract, the Company assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Company assesses whether:

- The contract involves the use of an identified asset;
- The Company has the right to obtain substantially all of the economic benefits from use of the identified asset throughout the period of use; and
- The Company has the right to direct the use of the asset.

Lessee accounting

Effective January 1, 2019, leases are recognized as a right-of-use asset and a corresponding lease liability at the date at which the leased asset is available for use. Each lease payment is allocated between the lease liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the lease liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

Lease payments included in the measurement of the lease liability include the net present value of the following:

- Fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- Variable lease payments that are based on an index or a rate;
- Amounts expected to be payable by the lessee under residual value guarantee;
- The exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- Payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used. The incremental borrowing rate is the rate that the lessee would have to pay to borrow at prevailing interest rates, market precedents and the Company's specific credit spread, on similar terms and security.

3.SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Right-of-use assets are initially measured at cost, comprising the following:

- The amount of the initial measurement of the lease liability;
- Any lease payments made at or before the commencement date less any lease incentives received;
- Any initial direct costs; and
- Restoration costs.

The right-of-use assets are typically depreciated on a straight-line basis over the lease term. The lease term consists of:

- The non-cancellable period of the lease;
- Periods covered by options to extend the lease, where the Company is reasonably certain to exercise the option; and
- Periods covered by options to terminate the lease, where the Company is reasonably certain not to exercise the option.

Use of Estimates and Judgments

Estimates

The Company estimates the incremental borrowing rate used to measure our lease liability for each lease contract. This includes estimation in determining the asset-specific security impact. There is also estimation uncertainty arising from certain leases containing variable lease terms that are linked to operational results or an index or rate.

Judgments

The Company estimates the lease term by considering the facts and circumstances that can create an economic incentive to exercise an extension option, or not exercise a termination option by assessing relevant factors such as store profitability. Extension options (or periods after termination options) are only included in the lease term if the lease is reasonably certain to be extended (or not terminated). Potential future cash outflows have not been included in the lease liability because it is not reasonably certain that the lease will be extended. The assessment of the lease term is reviewed if a significant event or a significant change in circumstances occurs, which affects this assessment and that is within the control of the lessee.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Practical expedients applied

In applying IFRS 16 for the first time, the Company has used the following practical expedients permitted by the standard:

- the Company has elected to use a single discount rate to a portfolio of leases with reasonably similar underlying characteristics;
- the Company has elected to exclude initial direct costs incurred in obtaining leases in the measurement of the right-of-use asset on transition;
- the Company has elected to use hindsight to determine the lease term where the lease contracts contain options to extend or terminate the lease;
- the Company has elected to rely on an onerous lease assessment as of December 31, 2018, as an alternative to performing an impairment review as at January 1, 2019; and
- the Company has elected not to account for leases for which the lease term ends within 12 months of January 1, 2019 as short-term leases or leases that meet the low-value exemption.

The Company has also elected not to reassess whether a contract is, or contains a lease at the date of initial application. Instead, for contracts entered into before the transition date, the Company relied on its assessment made applying IAS 17 and IFRIC 4.

Significant estimates and judgments

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense. Actual results may differ from those estimates. In preparing these Financial Statements, the significant judgments made by management in applying the Company's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the consolidated financial statements as at and for the year ended December 31, 2018, with the exception of the new significant estimates and judgments related to IFRS 16.

Future accounting pronouncements issued but not yet applied

At the date of authorization of these Financial Statements, certain new standards, amendments and interpretations to existing IFRS standards have been published but are not yet effective and have not been adopted early by the Company. Management anticipates that all of the pronouncements will be adopted in the Company's accounting policies for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments and interpretations that are expected to be relevant to the Company's Financial Statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on the Company's Financial Statements.

4. MARKETABLE SECURITIES

- i) On February 6, 2018, the Company issued 15,000,000 common shares at \$0.10 per share to Auxly Cannabis Group Inc., formerly Cannabis Wheaton Income Corp. ("Auxly"), in consideration for Auxly: (i) paying to the Company the sum of \$350,000; (ii) issuing to the Company 674,418 common shares in the capital of Auxly ("Auxly Shares"); and (iii) issuing to the Company 1,250,000 warrants ("Auxly Warrants") to purchase Auxly Shares at an exercise price of \$2.53 per share for a period of two (2) years, vesting on a performance-based schedule triggered by the opening of a pre-determined number of future Spirit Leaf locations. The agreement with Auxly also provides an anti-dilution right (the "Auxly Anti-Dilution Right"), allowing Auxly to maintain its ownership percentage in the Company's voting securities in the event that the Company issues equity securities in the capital of the Company until July 31, 2018. The Auxly Anti-Dilution Right ceased to be effective following the Company's initial public offering on July 31, 2018 (the "IPO"). Also, as part of the agreement between the Company and Auxly, the Company is required to allocate up to 50% of its franchise and corporate retail cannabis stores' floor space for Auxly cannabis products.

As at February 6, 2018, the Auxly Warrants were valued using the Black Scholes model, with the following assumptions, (a) risk free interest rate of 1.80%, and (b) stock price volatility of 110%.

The Company has allocated \$1,305,055 of the investment in the Company as deferred revenue, which represents the difference between the fair value of consideration received and the fair value of the Company's shares transferred to Auxly.

As at September 30, 2019, a portion of this deferred revenue has been recognized, since the Company entered into an Irrevocable Commercial Rights Agreement with Auxly on January 31, 2019. The agreement between the Company and Auxly gives Auxly the commercial right to supply the Company up to 50% of all of its cannabis and cannabis inputs, and provides for profit sharing between the parties up to January 8, 2023. Based on their agreement, the Company has determined to recognize the deferred revenue straight line over the agreement terms and has therefore recorded \$330,677 as a current liability (December 31, 2018 - \$303,121) on the condensed consolidated statement of financial position and \$220,451 (\$82,669 in Q3 2019) has been recognized as revenue on the condensed consolidated income statement. The remaining non-current liability is \$753,927 (December 31, 2018 - \$1,001,934).

As at September 30, 2019, the Auxly Warrants were marked down to fair market value based on the closing price of Auxly Shares on that date. The Auxly Warrants were marked down to fair market value based on the Black Scholes model using with the following assumptions, (a) risk free interest rate of 1.56%, and (b) stock price volatility of 93.50%.

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4. MARKETABLE SECURITIES (CONTINUED)

	Auxly Shares	Auxly Warrants	Total
Fair Market Value, December 31, 2018	\$ 613,720	\$ 136,646	\$ 750,366
Dispositions	(536,899)	-	(536,899)
Realized loss	(76,821)	-	(76,821)
Unrealized loss	-	(135,153)	(135,153)
Fair Market Value, September 30, 2019	-	1,493	1,493
Current portion	\$ -	\$ 1,493	\$ 1,493

- ii) On July 31, 2018 the Company closed its investment transaction with Newstrike Brands Ltd. ("Newstrike"), pursuant to which both Newstrike and the Company acquired equity interests in each other. Newstrike made an aggregate investment in the Company valued at \$2.25 million, comprised of: (a) \$1,125,000 in cash; (ii) 1,250,000 common shares in the capital of Newstrike ("Newstrike Shares"), issued at closing at a price of \$0.90; and (iii) 1,125,000 warrants ("Newstrike Warrants") to purchase Newstrike Shares at an exercise price of \$0.99 per share for a term of 24 months, vesting on a performance-based schedule triggered by the opening of a pre-determined number of future Spirit Leaf locations.

In consideration for Newstrike's investment in Inner Spirit, Inner Spirit issued Newstrike 15,000,000 units of the Company ("Newstrike Units") at a deemed price of \$0.15 per Newstrike Unit. Each Newstrike Unit was comprised of one common share of the Company and one-half of a common share purchase warrant, exercisable at \$0.30 per share for a period of two (2) years following the date of issuance. The Company recorded these equity instruments at the fair value of consideration received.

As at July 31, 2018, the Newstrike warrants were valued using the Black Scholes model, with the following assumptions, (a) risk free interest rate of 2.05%, and (b) stock price volatility of 139%.

During the period ended June 30, 2019, the Company sold 1,250,000 Newstrike Shares for gross proceeds of \$637,956. During the period ended June 30, 2019, Newstrike announced that it has obtained a final court order from the Ontario Superior Court of Justice approving the plan of arrangement under the *Business Corporations Act* (Ontario), in which HEXO Corp. ("HEXO") would acquire all of Newstrike's issued and outstanding common shares by way of plan of arrangement under the *Business Corporations Act* (Ontario) (the "Arrangement"). Pursuant to the Arrangement, holders of common shares of Newstrike received 0.06332 shares of HEXO for each common share of Newstrike held. Based on the conversion into HEXO warrants, Inner Spirit would hold 71,235 HEXO warrants with an exercise price of \$15.63 with similar vesting terms as the Newstrike Warrants.

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4. MARKETABLE SECURITIES (CONTINUED)

The Newstrike Warrants were marked down to fair market value based on the Black Scholes model with the following assumptions, (a) risk free interest rate of 1.56%, (b) stock price volatility of 91% and the closing Newstrike Share price.

	Newstrike Shares	Newstrike Warrants	Total
Fair Market Value, December 31, 2018	\$ 487,500	\$ 87,319	\$ 574,819
Dispositions	(637,956)	-	(637,956)
Realized gain	150,456	-	150,456
Unrealized loss	-	(55,644)	(55,644)
Fair Market Value, September 30, 2019	-	31,675	31,675
Current portion	\$ -	\$ 31,675	\$ 31,675

iii) During the year ended December 31, 2018, the Company made a prepaid subscription of US\$110,000 (\$149,710 Cdn.) in an investment in Hightimes Holding Corp. ("Hightimes"). Subsequent to the period ended September 30, 2019, the shares in Hightimes were received by the Company.

iv) On June 13, 2019 the Company closed its investment transaction with Tilray Inc. ("Tilray"), pursuant to which both Tilray and the Company acquired equity interests in each other. Tilray made an investment in the Company valued at \$1.5 million comprised of 28,361 common shares in the capital of Tilray ("Tilray Shares") issued at a closing price of US\$43.34 (CDN\$52.89).

In consideration for Tilray's investment in Inner Spirit, Inner Spirit issued Tilray 7,443,799 common shares of the Company at a deemed price of \$0.2015 per common share.

	Tilray Shares
Fair Market Value, December 31, 2018	\$ -
Acquisitions	\$ 1,500,000
Dispositions	-
Unrealized loss	(570,894)
Fair Market Value, September 30, 2019	929,106
Current portion	\$ 929,106

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5. INVENTORY

	September 30, 2019	December 31, 2018
Watch it! merchandise	\$782,812	\$939,916
Spirit Leaf merchandise	589,055	265,196
Millwork	1,036,990	1,417,040
	\$2,408,857	\$2,622,152

Included in cost of sales for the year ended are inventory write-downs for damaged inventory and inventory shrinkage in the amount of \$22,389 (December 31, 2018 - \$86,834).

Inventory costs included in cost of sales:

	3 months ended September 30, 2019	3 months ended September 30, 2018
Expensed inventories Watch it!	\$488,203	\$910,930
Expensed inventories Spirit Leaf	1,310,400	-
Expensed inventories millwork	294,190	-
	\$2,092,793	\$910,930

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6. PROPERTY AND EQUIPMENT

Cost	Computer Equipment	Furniture and Fixtures	Vehicle	Leasehold Improvements	Total
December 31, 2018	\$ 59,293	\$ 489,343	\$ 27,557	\$ 921,343	\$ 1,497,536
Additions (Dispositions)	53,833	460,462	27,005	1,329,062	1,870,362
September 30, 2019	\$ 113,126	\$ 949,805	\$ 54,562	\$ 2,250,405	\$ 3,367,898
Accumulated depreciation					
December 31, 2018	\$ (20,084)	\$ (49,635)	\$ (4,134)	\$ (74,467)	\$ (148,320)
Depreciation for the period	\$ (27,938)	\$ (97,452)	\$ (8,308)	\$ (191,093)	\$ (324,791)
September 30, 2019	\$ (48,022)	\$ (147,087)	\$ (12,442)	\$ (265,560)	\$ (473,111)
Net book value					
December 31, 2018	\$ 39,209	\$ 439,708	\$ 23,423	\$ 846,876	\$ 1,349,216
September 30, 2019	\$ 65,104	\$ 802,718	\$ 42,120	\$ 1,984,845	\$ 2,894,787

7. GOODWILL AND INTANGIBLE ASSETS

Cost	Goodwill	Franchise Agreement	Trademarks	Store Permits	Total
December 31, 2018	\$ 2,078,018	\$ 500,000	\$ 530,000	\$ 713,993	\$ 3,822,011
Acquired during the year	-	-	-	2,400,000	2,400,000
September 30, 2019	\$ 2,078,018	\$ 500,000	\$ 530,000	\$ 3,113,993	\$ 6,222,011
Accumulated amortization					
December 31, 2018	\$ (2,078,018)	\$ (500,000)	\$ (530,000)	\$ -	\$ (3,108,018)
Amortization for the period	-	-	-	(16,804)	(16,804)
September 30, 2019	\$ (2,078,018)	\$ (500,000)	\$ (530,000)	\$ (16,804)	\$ (3,124,822)
Net book value					
December 31, 2018	\$ -	\$ -	\$ -	\$ 713,993	\$ 713,993
September 30, 2019	\$ -	\$ -	\$ -	\$ 3,097,189	\$ 3,097,189

During 2018, management assessed whether indicators of impairment existed and concluded indicators of impairment existed on the Watch It! CGUs, as a result of continuing losses and therefore an impairment test was performed. As a result, the Company recorded a \$3,526,918 impairment charge allocated to property and equipment of \$493,900, intangible asset of \$955,000, and goodwill of \$2,078,018 relating to the Watch it! CGUs.

The recoverable amount of the Watch it! CGUs was determined based on an adjusted net asset method which is an acceptable method under the fair value less cost of disposal methodology ("FVLCD"). Due to the cash flow forecasts projecting continuing negative cash flows, there is no basis for which to prepare an income approach to calculate the recoverable amount of the CGUs under the value-in-use methodology. A change of 10% to the assumptions used would not result in a change to the amount of impairment recorded.

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8. RELATED PARTY TRANSACTIONS

Key management and director compensation

The Company's key management personnel have authority and responsibility for overseeing, planning, directing and controlling the activities of the Company. Key management personnel include members of the Board of Directors, and executive officers. Compensation of key management personnel may include short-term and long-term benefits. Short-term benefits include salaries and consulting fees. Long-term benefits include stock options. Compensation provided to current key management and directors are as follows:

	3 months ended		3 months ended
	September 30, 2019		September 30, 2018
Short-term benefits	\$ 67,830	\$	66,000
Long-term benefits (*)	-		-
	\$ 67,830	\$	66,000

(*) Consists of share-based payments as the fair value of options granted to key management personnel of the Company under the Company's stock option plan.

As at September 30, 2019, there was \$nil (December 31, 2018 - \$100,000) of outstanding payables to related parties, that is included in accounts payable and accrued liabilities. As at September 30, 2019, payable to related party was a non-interest-bearing, unsecured, due on demand loan of \$291,172 (December 31, 2018- \$208,779) for costs incurred for Spirit Leaf Macleod Inc.

During the three months ended September 30, 2019, the Company paid \$7,500 (September 30, 2018 -\$11,379) in rent for office space to a company related to the Company by virtue of a common executive officer and director. The yearly rent was based on a fair value assessment completed by an independent appraiser. In the same period the Company also paid or accrued legal fees of \$1,888 (2018 - \$nil) to a corporation controlled by a director. The Company also paid fees to a law firm of which a director is an associate.

9. FRANCHISE FEE DEPOSITS

The Company has a franchise model associated with its Spirit Leaf operations. The Company charges a franchise fee of \$25,000 for the first location and \$12,500 for each additional location. For franchise agreements entered into before June 30, 2018, the franchise fee was required to be paid as follows: (i) \$15,000 upon signing the franchise agreement (2017 - \$5,000 upon signing the agreement and \$10,000 by December 31, 2017) and (ii) \$10,000 by June 30, 2018. The franchisee was required to pay for each additional location as follows (i) \$8,750 upon signing the Franchise Agreement and (ii) \$3,750 by June 30, 2018. For Franchise Agreements entered into after June 30, 2018, the entire fee was due upon signing. For those franchisees that signed agreements in 2017, the franchisee was able to invest a portion of the franchise fee into common shares of the Company.

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9. FRANCHISE FEE DEPOSITS (CONTINUED)

Non-Refundable

Franchise Agreements dated before September 30, 2018 provided that \$5,000 of the franchise fee was non-refundable. Franchise Agreements dated after September 30, 2018 provide that \$10,000 of the franchise fee is non-refundable.

Refundable

The refundable portion of the franchise fees are deposited into a savings bank account, which is segregated from the Company's operating bank accounts. These are classified as long term as repayment is at the option of the Company.

As at September 30, 2019, this amount is accounted for as a non-current liability, except for the initial fees expected to be earned or refunded within the next 12 months of \$181,250 (December 31, 2018 - \$53,750).

	Receivable	Non- Refundable	Refundable	Earned	Total
December 31, 2018	\$ 340,250	693,600	\$ 897,500	\$ (88,750)	1,842,600
Terminated franchises	(206,250)	(25,000)	(141,250)	(62,500)	(435,000)
Terminated Ontario for Redislosures	-	(155,000)	(260,000)	-	(415,000)
Ontario Redislosures	440,000	-	-	-	440,000
New franchises sold	100,000				100,000
Store openings		220,000	(220,000)	(353,750)	(353,750)
Payments received	(395,000)	153,750	241,250	-	-
September 30, 2019	\$ 279,000	887,350	\$ 517,500	\$ (505,000)	1,178,850
Current portion					181,250
Long term portion					997,600

As at September 30, 2019, there was an aggregate of \$616,500 (December 31, 2018- \$340,250) owing on the last payment by the franchisees. As the Company has the unconditional right to payment it has been included in franchise fee deposits.

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10. COMMITMENTS

Leases

The Company leases several retail outlets under operating leases expiring between 2019 and 2028, some of which are subleased for the full amount of the lease payments and some of which are used for the operations of its corporate stores. The Company also guarantees leases for several franchised retail outlets. If the franchisees defaulted on the lease payments, the Company would be liable for these lease payments and the ongoing lease liability. All of the Company's leases for Spirit Leaf have a conditional termination clause that allows for the lease to be terminated with a pre-determined penalty in the event that the Company is not able to secure a permit to sell cannabis at any particular location.

The Company has entered into and provided a covenant for various non-cancellable operating lease agreements. These lease agreements expire between December 31, 2019 and May 31, 2028.

As at September 30, 2019, the minimum annual lease payments for corporately operated locations are expected to be as follows:

	Watch It!	Spirit Leaf
2019	\$ 130,225	\$ 684,291
2020	\$ 412,589	\$ 1,990,389
2021	\$ 137,654	\$ 1,964,883
2022	\$ 16,981	\$ 1,992,351
2023	\$ -	\$ 1,894,467
Thereafter	\$ -	\$ 4,026,701

As at September 30, 2019, the minimum annual lease payments for franchise operated locations where the Company or its subsidiaries either sub-leased, assigned or provided a covenant for its franchisees are expected to be as follows. Payments are made directly to the landlord and the lease payment would only revert to the Company if a franchisee defaulted on their obligations under the terms of the sub-lease or lease.

	Watch It!	Spirit Leaf
2019	\$ 138,306	\$ 571,392
2020	\$ 514,109	\$ 1,393,571
2021	\$ 477,703	\$ 1,426,434
2022	\$ 439,640	\$ 1,418,460
2023	\$ 319,740	\$ 1,407,886
Thereafter	\$ 583,980	\$ 1,078,597

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11. SHARE CAPITAL

(a) Authorized:

The Company is authorized to issue an unlimited number of common shares and preferred shares with no par value.

(b) Issued common shares:

	Note	Number	Amount
Balance, December 31, 2017		65,946,105	\$ 3,420,871
Private placements	11b(i,v)	23,553,895	2,355,390
Debt conversion	11b(ii)	10,000,000	1,000,000
Initial public offering	11b(viii)	25,000,000	2,974,320
Corporate investments	11b(iii,iv,vi,vii,ix,x,xii)	59,776,190	7,513,093
Franchisee acquisitions	11b (xi)	1,593,334	465,000
Warrant exercise	11b(xiii)	250,000	37,500
Option exercise	11b(xiv)	60,000	11,032
Share issuance costs			(805,546)
Balance, December 31, 2018		186,179,524	\$ 16,971,660
Franchisee acquisitions	11b (xv)	7,075,472	1,500,000
Option exercise	11b(xvi)	287,500	28,750
Shares issued for bonuses	11b(xvii)	250,000	50,000
Franchise inducement	11b(xviii)	5,000,000	1,000,000
Tilray investment	11b(xix)	7,443,799	1,500,000
Balance, September 30, 2019		206,236,295	\$ 21,050,410

- i. On January 18, 2018, and February 5, 2018, the Company completed a private placement by issuing 17,553,895 common shares at a price of \$0.10 per share for gross proceeds of \$1,755,390. Of these total proceeds, \$1,149,556 was received prior to year-end and was recorded as share subscriptions.
- ii. On January 18, 2018, the Company issued 10,000,000 common shares at a price of \$0.10 to Grenville Strategic Royalty Corp. in connection with the termination of a security convertible royalty purchase agreement between Grenville Strategic Royalty Corp. and Watch It!.
- iii. On February 6, 2018, the Company issued 15,000,000 common shares to Auxly at a price of \$0.10 per share pursuant to the investment agreement entered into with Auxly (Note 4(i)).
- iv. On February 6, 2018 and March 27, 2018, the Company issued a total of 2,558,824 common shares to Auxly at \$0.10 per share for cash consideration of \$255,882 pursuant to the Auxly Anti-Dilution Right (Note 4(i)).
- v. On March 27, 2018, the Company completed a private placement by issuing 6,000,000 common shares at a price of \$0.10 for gross proceeds of \$600,000.
- vi. On June 22, 2018, the Company issued 7,500,000 units at a price of \$0.15 per unit to Sugarbud Craft Growers Corp. for \$1,125,000 in cash. Each unit consisted of one common share and one-half of one common share purchase warrant exercisable at \$0.30 per share until June 22, 2020, which was valued at \$237,227 (Note 11(e)).

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11. SHARE CAPITAL (CONTINUED)

- vii. On June 22, 2018, pursuant to the exercise of the Auxly Anti-Dilution Right (Note 4(i)), the Company issued 1,323,529 units at a price of \$0.15 per unit for cash consideration of \$198,529. Each unit consisted of one common share and one-half of one common share purchase warrant exercisable at \$0.30 per share until June 22, 2020, which was valued at \$41,864 (Note 11(e)).
- viii. On July 31, 2018 the Company completed its IPO, issuing 25,000,000 units at a price of \$0.15 per unit for gross proceeds of \$3,750,000. Each unit consisted of one common share in the capital of the Company and one-half of one common share purchase warrant exercisable at \$0.30 per share until July 31, 2020, which was valued at \$775,680 (Note 11(e)).
- ix. On July 31, 2018 the Company issued Newstrike 15,000,000 units of the Company with a fair value of \$2,087,958 pursuant to their investment agreement (Note 4(ii)). Each unit consisted of one common share of the Company and one-half of a common share purchase warrant, exercisable at \$0.30 per share until July 31, 2020, which was valued at \$465,408 (Note 11(e)).
- x. On July 31, 2018, the Company issued 4,411,765 units in a private placement along with 2,647,059 units pursuant to the exercise of the Auxly Anti-Dilution right (Note 4(i)) at a price of \$0.15 per unit, for gross proceeds of \$1,058,823. Each unit consisted of one common share of the Company and one-half of a common share purchase warrant, exercisable at \$0.30 per share until July 31, 2020, which was valued at \$218,602 (Note 11(e)).
- xi. On September 24, 2018, and October 26, 2018 the Company, issued 1,333,334 and 160,000 common shares, at a price of \$0.30 and 0.25 per share, respectively for the purchase of the assets of two proposed retail cannabis stores. The Company also issued 100,000 common shares to its Jasper franchise partner to terminate their franchise agreement at a price of 0.25 per share.
- xii. On December 10, 2018 the Company issued 11,335,013 common shares at a price of \$0.20 per share for gross proceeds of \$2,250,000 pursuant to an investment agreement among the Company, Spirit Leaf Inc., Tilray, Inc. and High Park Holdings Ltd.
- xiii. During the year ended December 31, 2018, a total of 250,000 common shares were issued at a price of \$0.10 per share pursuant to warrant exercises. The fair value of these warrants of \$12,500 was transferred from contributed surplus to share capital.
- xiv. During the year ended December 31, 2018, a total of 60,000 shares were issued at a price of \$0.10 per share pursuant to option exercises. The fair value of these options of \$5,032 was transferred from contributed surplus to share capital.
- xv. During the period ended March 31, 2019, the Company purchased the assets of three proposed retail cannabis stores for total consideration of \$2,000,000, of which \$1,500,000 was paid through the issuance of 7,075,472 common shares of the Company at an issue price equal to \$0.212 per share, \$250,000 was paid in cash, and \$250,000 was paid through a promissory note due one year after the closing of the acquisition.
- xvi. During the period ended June 30, 2019, a total of 287,500 shares were issued at a price of \$0.10 per share pursuant to option exercises.
- xvii. During the period ended June 30, 2019 a total of 250,000 shares were issued at a price of \$0.20 per share.
- xviii. During the period ended June 30, 2019 a total of 5,000,000 shares were issued at a price of \$0.20 per share as an inducement for a business partnership in Kingston, Ontario.

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11. SHARE CAPITAL (CONTINUED)

xix. During the period ended June 30, 2019 a total of 7,443,799 shares were issued to Tilray Inc. pursuant to an investment agreement between the Company and Tilray

(c) Shares held in escrow

In conjunction with the Company's IPO, an aggregate of 38,143,853 common shares were deposited in escrow pursuant to applicable securities law, to be released as follows based on the following terms:

- 10% on the date the Company's securities are listed on a Canadian exchange;
- 15% on the date that is 6 months following the listing date;
- 15% on the date that is 12 months following listing date;
- 15% on the date that is 18 months following the listing date;
- 15% on the date that is 24 months following the listing date;
- 15% on the date that is 30 months following the listing date; and
- 15% on the date that is 36 months following the listing date.

As at September 30, 2019, 15,257,541 common shares had been released.

(d) Options

The board of directors of the Company may from time to time, in its discretion, grant to directors, officers, employees and consultants of the Company, non-transferable options to purchase common shares provided that the number of common shares reserved for issuance under all outstanding options will not exceed 10% of the issued and outstanding common shares.

As at September 30, 2019, the following options are outstanding.

		Number of Options	Weighted Average Exercise Price
Balance, December 31, 2017	Note	-	\$ -
Issued during year		14,725,000	\$ 0.14
Exercised during year	11b(xiv)	(60,000)	\$ 0.10
Forfeited during year		(80,000)	\$ 0.10
Balance, December 31, 2018		14,585,000	\$ 0.14
Exercisable, end of year		3,541,250	\$ 0.14
Issued during period	11d(iii)	400,000	\$ 0.20
Exercised during period	11b(xvi)	(335,000)	\$ 0.10
Forfeited during period		(600,000)	\$ 0.12
Balance, September 30, 2019		14,050,000	\$ 0.14
Exercisable, end of period		5,242,500	\$ 0.13

i) On February 28, 2018, the Company granted 9,125,000 options at a price of \$0.10 per share to directors, officers, employees, and consultants, pursuant to the Company's stock option plan. One fourth of the stock options vest immediately and the remaining stock options granted vest one fourth on each of the first, second, and third anniversary of the grant date. The forfeiture rates are based on historical data and managements estimates. The fair value of the options granted is estimated as at the grant date using the Black-Scholes option pricing model. The following assumptions were used in the Black Scholes model (a) risk free interest rate of 1.94%, (b) share price volatility of 123%, (c) forfeiture rate 0.88%, and (d) 5 years as expected life of options.

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11. SHARE CAPITAL (CONTINUED)

- ii) On December 10, 2018, the Company granted 5,600,000 options at a price of \$0.20 per share to directors, officers, employees, and consultants, pursuant to the Company's stock option plan. One fourth of the stock options vest immediately and the remaining stock options granted vest one fourth on each of the first, second, and third anniversary of the grant date. The forfeiture rates are based on historical data and managements estimates. The fair value of the options granted is estimated as at the grant date using the Black-Scholes option pricing model. The following assumptions were used in the Black Scholes model (a) risk free interest rate of 1.93%, (b) share price volatility of 109%, (c) forfeiture rate 0.88%, and (c) 5 years as expected life of options.
- iii) In June 2019, the Company granted 400,000 options at a price of \$0.20 per share to directors, officers, employees, and consultants, pursuant to the Company's stock option plan. One fourth of the stock options vest immediately and the remaining stock options granted vest one fourth on each of the first, second, and third anniversary of the grant date. The forfeiture rates are based on historical data and managements estimates. The fair value of the options granted is estimated as at the grant date using the Black-Scholes option pricing model. The following assumptions were used in the Black Scholes model (a) risk free interest rate of 1.50%, (b) share price volatility of 97%, (c) forfeiture rate 0.88%, and (c) 5 years as expected life of options.

Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Term (Years)	Options Exercisable	Weighted Average Exercise Price
8,140,000	\$0.10	3.67	3,757,500	\$0.10
5,510,000	\$0.20	4.45	1,385,000	\$0.20
280,000	\$0.20	4.93	70,000	\$0.20
120,000	\$0.20	4.99	30,000	\$0.20
14,050,000	\$0.14	4.01	5,242,500	\$0.13

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11. SHARE CAPITAL (CONTINUED)

(e) Warrants

During the period ended September 30, 2019, the Company issued warrants for consulting services, security for leases, investments, and pursuant to the IPO. The value of the warrants was calculated by using the Black Scholes Model. The following assumptions were used in the Black Scholes model (a) risk free interest rate of 1.77% to 2.18% (b) share price volatility of 76%-110%, and (c) 1.5-5 year expected life of warrants. Share-based compensation recognized on the warrants issued for service and investor relations is \$277,209.

	Notes	Number of Warrants	Amount (\$)	Weighted Average Exercise Price (\$)	Weighted Average Expiry Date (Years)
Balance, December 31, 2017		-	-	-	-
Issued for services		2,250,000	107,674	0.13	1.88
Sugarbud investment	11b(vi)	3,750,000	237,227	0.30	0.98
Auxly investment	11b(vii)	661,765	41,864	0.30	0.98
IPO warrants	11b(viii)	12,500,000	775,680	0.30	1.09
Agents broker warrants		2,500,000	213,334	0.15	1.09
Auxly investment	11b(x)	3,529,412	218,602	0.30	1.09
Newstrike investment	11b(ix)	7,500,000	465,408	0.30	1.09
Cancellation of franchise agreement		360,500	79,144	0.28	1.16
Investor relation warrants		100,000	6,020	0.30	1.06
Exercised	11b(xiii)	(250,000)	(12,500)	0.10	-
Warrant issue costs		-	(183,652)	-	-
Balance, December 31, 2018		32,901,677	1,948,801	0.29	1.63
Issued for services		2,292,800	163,515	0.25	1.41
Convertible debenture warrants		20,000,000	1,421,348	0.25	1.41
Balance, September 30, 2019		55,194,477	3,533,664	0.29	1.54
Exercisable, end of period		54,410,077		0.30	1.07

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12. SEGMENTED INFORMATION

The Company is a holding company that operates in three segments through its four subsidiaries: (i) Spirit Leaf Inc., Spirit Leaf Corporate Inc., and Spirit Leaf Macleod Inc., which have the primary business of the sale of cannabis and related accessories through corporate retail cannabis stores and the current operation, planned opening and ongoing support of franchise retail cannabis stores; (ii) Watch It! Consolidated Ltd., which has the primary business of the sale of watches, sunglasses and related accessories through corporate retail outlets in Canada and through its websites; (iii) Inner Spirit, a division for its corporate administration; and (iv) NCI – non-controlling interest which accounts for the portion of income (loss) attributable to the minority shareholders in Spirit Leaf Macleod. All of the Company's assets are located in Canada.

Nine months ended September 30, 2019	Watch It!	Spirit Leaf	Inner Spirit	NCI	Total
Revenue					
Retail revenue	\$ 2,628,907	\$ 1,116,804	\$ -	\$ 55,558	\$ 3,801,269
Royalties	51,829	724,245	-	-	776,074
Advertising	18,689	144,852	-	-	163,541
Millwork	-	1,254,791	-	-	1,254,791
Franchise Fees	-	416,250	-	-	416,250
Supply revenue and other	11,997	576,747	19,947	-	608,691
	2,711,422	4,233,689	19,947	55,558	7,020,616
Cost of goods sold	1,380,095	2,088,973	-	39,891	3,508,959
Gross profit	1,331,327	2,144,716	19,947	15,667	3,511,657
General and administrative	161,070	1,320,999	1,896,648	4,426	3,383,143
Salaries, wages, and benefits	980,399	1,763,278	-	25,533	2,769,210
Occupancy costs	372,029	657,777	-	12,828	1,042,634
Depreciation and amortization	145,874	1,323,480	238	40,458	1,510,050
Sales and marketing	8,901	196,741	213,757	670	420,069
Total operating expenses	1,668,273	5,262,275	2,110,643	83,915	9,125,106
Operating loss before other expenses	(336,946)	(3,117,559)	(2,090,696)	(68,248)	(5,613,449)
Share based compensation	-	-	55,111	-	55,111
Unrealized loss (gain) on marketable securities	-	-	689,128	-	689,128
Interest	174,732	285,567	486,844	-	947,143
Net loss and comprehensive loss	\$ (511,678)	\$ (3,403,126)	\$ (3,321,779)	\$ (68,248)	\$ (7,304,831)
Total assets	\$ 971,252	\$ 22,477,995	\$ 4,426,143	\$ -	\$ 27,875,390
Total liabilities	\$ 552,225	\$ 12,393,135	\$ 9,193,493	\$ -	\$ 22,138,853

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12. SEGMENTED INFORMATION (CONTINUED)

Nine months ended September 30, 2018	Watch It!	Spirit Leaf	Inner Spirit	Total
Revenue				
Retail revenue	\$ 3,222,783	\$ -	\$ -	\$ 3,222,783
Royalties	116,233	-	-	116,233
Advertising	30,883	-	-	30,883
Miscellaneous revenue	9,876	400,123	28	410,027
	3,379,775	400,123	28	3,779,926
Cost of goods sold				
	1,716,529	351,192	-	2,067,721
Gross profit				
	1,663,246	48,931	28	1,712,205
General and administrative	252,513	532,261	602,708	1,387,482
Salaries, wages, and benefits	1,074,759	552,622	207,962	1,835,343
Occupancy costs	644,658	169,367	-	814,025
Depreciation and amortization	211,343	48,076	292	259,711
Sales and marketing	54,444	256,018	90,098	400,560
Total operating expenses	2,237,717	1,558,344	901,060	4,697,121
Operating loss before other expenses				
	(574,471)	(1,509,413)	(901,032)	(2,984,916)
Share-based compensation	-	-	292,323	292,323
Unrealized loss on marketable securities	-	-	939,805	939,805
Interest	11,220	-	-	11,220
Royalties	5,040	-	-	5,040
Net loss and comprehensive loss				
	(590,731)	(1,509,413)	(2,133,160)	(4,233,304)
Total assets				
	\$ 5,110,730	\$ 3,963,552	\$ 6,657,536	\$ 15,731,818
Total liabilities				
	\$ 570,755	\$ 2,280,917	\$ 1,575,712	\$ 4,427,384

13. CAPITAL RISK MANAGEMENT

The Company's objectives when managing its capital are to safeguard its ability to continue as a going concern, to meet its capital expenditures for its continued operations, and to maintain a flexible capital structure which optimizes the cost of capital within a framework of acceptable risk. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust its capital structure, the Company may issue new shares, issue new debt, or acquire or dispose of assets. The Company is not subject to externally imposed capital requirements.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There have been no changes to the Company's capital management approach in the year. The Company considers its shareholders' equity as capital which, as at September 30, 2019, is \$5,852,999 (December 31, 2018 - \$6,661,561).

14. FINANCIAL INSTRUMENTS AND RISK FACTORS

Fair values

At September 30, 2019, the Company's financial instruments consist of cash, short-term deposits, accounts receivable, marketable securities, accounts payable and accrued liabilities, payable to shareholder, and royalty debt. The fair values of cash, short-term deposits, accounts receivable, and accounts payable and accrued liabilities approximate their carrying values due to the relatively short-term maturity of these instruments. Marketable securities have been marked to market.

Fair value hierarchy

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Marketable securities are classified as level 1, and the warrants included in marketable securities are classified as level 2. During the periods ended September 30, 2019 and 2018, there were no transfers of amounts between levels.

The Company has exposure to the following risks from its use of financial instruments:

- Credit risk;
- Liquidity risk; and,
- Market risk.

Credit risk

Credit risk is the risk of loss associated with the counterparty's inability to fulfil its payment obligations. Financial instruments that potentially subject the Company to concentrations of credit risks consist principally of cash, short term deposits and accounts receivable. All of the Company's cash includes petty cash, store cash floats, and cash held at a financial institution which is a Canadian Chartered Bank in which management believes that the risk of loss is minimal. The accounts receivable balances consist of an ongoing account held with PayPal, Spirit Leaf franchise fee deposits outstanding, royalty revenue receivable from the franchisees from the previous month, and receivable from franchisees for millwork, which are considered reputable companies.

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14. FINANCIAL INSTRUMENTS AND RISK FACTORS (CONTINUED)

	September 30, 2019	December 31, 2018
Current	\$ 775,428	\$ 46,770
31 – 60 days	256,764	83,905
61 – 90 days	127,403	25,970
Greater than 90 days	284,136	422,197
Accounts receivable	\$ 1,443,731	\$ 578,842

For the three months-ended September 30, 2019, the total revenue included in accounts receivable is \$90,010 (December 31, 2018- \$25,413).

The Company assessed the credit loss risk to be nominal. The maximum credit risk exposure associated with cash, short-term deposits and accounts receivable is the total carrying value.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company currently settles its financial obligations with cash. As at September 30, 2019, the Company's financial liabilities consist of accounts payable and accrued liabilities, which have contractual maturity dates within one year. As the Company has historically treated a portion of the franchise fee deposits as refundable, these deposits may become financial obligations at the discretion of the Company. The Company manages its liquidity risk by reviewing its capital requirements on an ongoing basis. There have been no changes in the Company's strategy with respect to credit/liquidity risk in the year. All financial liabilities are due within a year.

As at September 30,	Maturity	2019
Accounts payables and accrued liabilities	Within 1 year	\$ 1,377,494
Advances from related party	Within 1 year	291,172
Short term note payable	Within 1 year	250,000
Refundable franchise fee deposits	Within 1 year	181,250
		\$ 2,099,916

Market risk

Market risk is the risk that changes in market prices will affect the Company's earnings or the value of its financial instruments. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns. The Company is exposed to equity price risk, which arises from investments measured at fair value through profit or loss ("FVTPL"). For investments classified as FVTPL, the impact of a 10% increase or decrease in the share price would have a minimal impact on equity as the exercise price for the warrants is substantially higher than the current trading price.

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15. DEBENTURES

A \$10,000,000 convertible debt issuance was finalized in June 2019, with a 12% coupon rate per annum and a maturity date of June 30, 2022. The debentures were classified as a debenture with the conversion option component classified as an equity instrument. The carrying value of the debenture component as at June 30, 2019 was \$7,540,415. The equity conversion option was measured at \$2,623,100 (split between the \$1,038,238 equity component of the debentures and the warrant component) using the Black Scholes model and the following assumptions: stock price of \$0.185; expected life of 3 years; \$nil dividends; expected volatility of 98.29%; exercise price of \$0.25; and risk-free interest rate of 1.42%.