

**INNER SPIRIT
HOLDINGS**



Inner Spirit Holdings Ltd.

Interim Condensed Consolidated Financial Statements
(Unaudited)

For the three months ended March 31, 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 | March 31, 2019 | December 31, 2018 |
|---|---------|----------------------|----------------------|
| ASSETS | | | |
| Current | | | |
| Cash | | \$ 2,049,841 | \$ 2,175,588 |
| Short-term deposit | | - | 1,200,000 |
| Accounts receivable | | 984,813 | 578,842 |
| Marketable securities | 4(i,ii) | 186,335 | 1,262,928 |
| Prepaid investment subscription | 4(iii) | 149,710 | 149,710 |
| Prepaid expenses and deposits | | 233,308 | 208,344 |
| Inventory | 5 | 2,516,131 | 2,622,152 |
| Total current assets | | 6,120,138 | 8,197,564 |
| Non-current | | | |
| Property and equipment | 6 | 1,792,216 | 1,349,216 |
| Note receivable | | 416,667 | - |
| Right of use assets | | 10,496,728 | - |
| Lease deposits | | 989,800 | 1,126,639 |
| Marketable securities | | 36,534 | 62,257 |
| Store permits | | 3,216,019 | 713,993 |
| Total assets | | \$ 23,068,102 | \$ 11,449,669 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | | |
| Current | | | |
| Accounts payable and accrued liabilities | | \$ 1,090,583 | \$ 1,294,261 |
| Short term note payable | | 1,750,000 | - |
| Current portion of lease liabilities | | 1,680,227 | - |
| Deferred revenue | 4(i) | 330,677 | 303,121 |
| Franchise fee deposits | 9 | 15,000 | 53,750 |
| Unredeemed gift card liability | | 167,443 | 183,531 |
| Payable to related party | | 208,508 | 208,779 |
| Total current liabilities | | 5,242,438 | 2,043,442 |
| Non-current | | | |
| Franchise fee deposits | 9 | 1,773,850 | 1,788,850 |
| Lease liabilities | | 9,234,916 | - |
| Deferred revenue | 4(i) | 919,265 | 1,001,934 |
| Total liabilities | | 17,170,469 | 4,834,226 |
| Shareholders' equity | | | |
| Share capital | 11(b) | 18,483,660 | 16,971,660 |
| Contributed surplus | | 725,137 | 725,137 |
| Warrants | 11(e) | 1,948,801 | 1,948,801 |
| Deficit | | (15,201,040) | (12,984,037) |
| Total Shareholders' equity of parent | | 5,956,558 | 6,661,561 |
| Non-controlling interest | | (58,925) | (46,118) |
| Total Shareholders' equity | | 5,897,633 | 6,615,443 |
| Total liabilities and shareholders' equity | | \$ 23,068,102 | \$ 11,449,669 |

Nature of Operations and Going Concern (Note 1)

Commitments (Note 10)

Subsequent Events (Note 15)

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

**Interim Condensed Consolidated Statements of Loss and Comprehensive Loss
(Unaudited)**

(Expressed in Canadian Dollars)

For the Three Months Ended March 31, 2019 and 2018

| | | Three months ended March 31 | |
|--|---------|--------------------------------|-----------------------|
| | Note | 2019 | 2018 |
| Revenue | | | |
| Retail revenue | | \$ 787,856 | \$ 931,825 |
| Royalties | | 116,618 | 35,112 |
| Advertising | | 26,067 | 8,778 |
| Millwork | | 201,889 | 34,456 |
| Franchise fee | | 43,750 | - |
| Supply and other revenue | | 76,915 | - |
| Total revenue | | 1,253,095 | 1,010,171 |
| Cost of goods sold | 5 | 582,818 | 521,393 |
| Gross profit | | 670,277 | 488,778 |
| Operating expenses | | | |
| General and administrative | | 933,930 | 329,804 |
| Salaries, wages, and benefits | | 780,852 | 544,937 |
| Occupancy costs | | 194,023 | 208,878 |
| Depreciation and amortization | 6 | 79,447 | 71,512 |
| Right of use asset depreciation | | 488,329 | - |
| Sales and marketing | | 85,974 | 96,411 |
| Total operating expenses | | 2,562,555 | 1,251,542 |
| Operating loss before other expenses | | (1,892,278) | (762,764) |
| Share-based compensation | | - | 151,635 |
| Loss (gain) on marketable securities | 4(i,ii) | (72,539) | 479,928 |
| Interest expense | | 185,156 | 10,913 |
| Royalty expense | | - | 5,040 |
| Loss before income taxes | | \$ (2,004,895) | \$ (1,410,280) |
| Recovery of deferred taxes | | - | - |
| Net loss and comprehensive loss | | \$ (2,004,895) | \$ (1,410,280) |
| Total net loss and comprehensive loss attributed to | | | |
| Common shareholders | | 2,017,702 | (1,410,280) |
| Non-controlling interest | | (12,807) | - |
| Attributed net loss and comprehensive loss | | 2,004,895 | (1,410,280) |
| Net loss per share - Basic and diluted | | \$ 0.01 | \$ (0.01) |
| Weighted average shares outstanding | | | |
| - Basic and diluted | | 137,469,525 | 96,032,613 |

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 Three Months Ended March 31, 2019 and 2018

| | Note | Share Capital | | Share Subscriptions | Contributed Surplus | Warrants | Deficit | Total |
|---------------------------------|-----------|---------------|--------------|---------------------|---------------------|-------------|-----------------|--------------|
| | | Number | Amount | | | | | |
| Balance, December 31, 2017 | | 65,946,105 | \$ - | \$ 3,420,871 | \$ 1,149,556 | \$ - | \$ (1,335,182) | \$ 3,235,245 |
| Share subscriptions | 11b | 11,495,560 | | 1,149,556 | (1,149,556) | - | - | - |
| Private placements | 11b | 24,617,159 | | 2,461,727 | - | - | - | 2,461,727 |
| Investment by Auxly | 4(i), 11b | 15,000,000 | | 1,650,000 | - | - | - | 1,650,000 |
| Share issuance costs | | - | | (16,030) | - | - | - | (16,030) |
| Share-based compensation | | - | | - | - | 151,635 | - | 151,635 |
| Net loss and comprehensive loss | | - | | - | - | - | (1,410,280) | (1,410,280) |
| Balance, March 31, 2018 | | 117,058,824 | \$ - | \$ 8,666,124 | \$ - | \$ 151,635 | \$ (2,745,462) | \$ 6,072,297 |
| Balance, December 31, 2018 | | 186,179,524 | \$16,971,660 | \$ - | \$ 725,137 | \$1,948,801 | \$ (12,984,037) | \$ 6,661,561 |
| Franchisee acquisitions | 11b(xv) | 7,075,472 | 1,500,000 | - | - | - | - | 1,500,000 |
| Exercise of options | 11b(xvi) | 120,000 | 12,000 | - | - | - | - | 12,000 |
| IFRS 16 Adjustment | | | | | | | (271,033) | (271,033) |
| Net loss and comprehensive loss | | | | | | | (2,004,895) | (2,004,895) |
| Non controlling interest | | - | - | - | - | - | 58,925 | 58,925 |
| Balance, March 31, 2019 | | 193,374,996 | \$18,483,660 | \$ - | \$ 725,137 | \$1,948,801 | \$ (15,201,040) | \$ 5,956,558 |

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 Three Months Ended March 31, 2019 and 2018

| | | March 31 | |
|---|-------------|-----------------------|-----------------------|
| | Note | 2019 | 2018 |
| Cash provided by (used in) the following activities: | | | |
| Operating | | | |
| Net loss for the period | | \$ (2,004,895) | \$ (1,410,280) |
| Items not affecting cash | | | |
| Amortization and depreciation | 6 | 79,447 | 71,512 |
| Depreciation of right-of-use asset | | 488,329 | - |
| Share-based compensation | | - | 151,635 |
| Loss (gain) on marketable securities | 4(i,ii) | (72,539) | 479,928 |
| Changes in non cash working capital balances: | | | |
| Change in accounts receivable | | (405,971) | 64,088 |
| Change in prepaids and deposits | | (24,964) | (12,702) |
| Change in inventory | | 106,021 | (350,880) |
| Change in accounts payable and accrued liabilities | | (203,678) | (105,690) |
| Change in short term note payable | | 1,750,000 | - |
| Change in short term lease liability | | 1,680,227 | - |
| Change in unredeemed gift card liability | | (16,088) | 18,016 |
| Change in restricted cash | | - | (60,020) |
| Change in lease deposits | | 136,839 | (147,118) |
| Change in store permits | | (2,502,026) | - |
| Change in deferred revenue | | 82,669 | - |
| Change in franchise fee deposits | 9 | (38,750) | 126,000 |
| Cash flow used in operating activities | | (945,379) | (1,175,511) |
| Financing | | | |
| Principal portion of lease payments | | (306,654) | - |
| Issuance of share capital, net of issuance costs | 11 | 1,512,000 | 1,795,697 |
| Payable to shareholder | | (271) | (593,141) |
| Cash flow provided by financing activities | | 1,205,075 | 1,202,556 |
| Investing | | | |
| Acquisition of property and equipment | 6 | (442,364) | (96,909) |
| Acquisition of franchise store permits | | (1,143,079) | - |
| Cash flow provided by (used in) financing activities | | (1,585,443) | (96,909) |
| Change in cash | | (1,325,747) | (69,864) |
| Cash, beginning of period | | 3,375,588 | 953,055 |
| Cash, end of period | | \$ 2,049,841 | \$ 883,191 |

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

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. ("204AB") 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 sale and ongoing support of franchise retail cannabis stores across Canada. Spirit Leaf Corporate Inc. and Spirit Leaf Macleod Inc.'s primary business is the sale of cannabis accessories and the planned sale of cannabis products, through corporate stores. Watch It!'s primary business is the ongoing support of retail watch store franchises and the sale of watches and accessories through retail outlets across Canada and website sales.

The Company's registered office is located at Suite 1600 Dome Tower, 333 7th Avenue S.W., Calgary, AB, 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 period ended March 31, 2019, the Company had negative cash flows from operating activities, incurred a net loss of \$2,004,895 (2018 - \$1,410,280) and, as of that date, the Company has an accumulated deficit of \$15,201,040 (December 31, 2018 - \$12,984,037). The Company will require additional financing in order to conduct its planned business operations, meet its ongoing levels of corporate overhead and discharge its liabilities and commitments as they come due, all of which may cast significant doubt about the Company's ability to continue as a going concern.

Management's view is that the success of the Company is dependent upon financing its capital requirements and 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.

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 May 30, 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.

2. BASIS OF PRESENTATION (CONTINUED)

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 subsidiary are included in the Financial Statements of the Company from the date that control commences until the date that control ceases.

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 related to 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 ("ECL"). 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.

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.

2. BASIS OF PRESENTATION (CONTINUED)

Significant accounting judgments and estimates (continued)

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 requires 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. 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.

3.SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 our 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.

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 March 31, 2019 was \$185,186. The expense relating to variable lease payments not included in the measurement of lease obligations was \$125,650. This consists of variable lease payments for operating costs, property taxes, and insurance. Expenses relating to short-term leases were \$68,373 and expenses relating to leases of low value assets were not material. Total cash outflow for leases was \$491,720, including \$306,654 of principal payments on lease obligations.

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 three-month period ended March 31, 2019:

| | Three months ended March 31, 2019 |
|---|--|
| | \$ |
| Right-of-use assets, beginning of period | 10,302,721 |
| Net additions | 628,959 |
| Right-of-use assets depreciation | (434,953) |
| Right-of-use assets, end of period | 10,496,728 |

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, we assess 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.

3.SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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 we are reasonably certain to exercise the option; and
- Periods covered by options to terminate the lease, where we are reasonably certain not to exercise the option.

If the Company expects to obtain ownership of the leased asset at the end of the lease, we depreciate the right of-use asset over the underlying asset's estimated useful life. The right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

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 condensed interim consolidated 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; and (iii) issuing to the Company 1,250,000 share purchase warrants, each share purchase warrant entitling the Company to purchase a common share in the capital of Auxly at an exercise price of \$2.53 for a period of two (2) years and 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 provided 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. Also, as part of the agreement, the Company will allocate 50% of its distribution locations' floor space for Auxly products.

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4. MARKETABLE SECURITIES (CONTINUED)

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 March 31, 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 gives Auxly the commercial right to supply the Company with up to 50% of its cannabis and cannabis inputs and profit sharing 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 on the condensed consolidated statement of financial position and \$55,113 has been recognized as revenue on the condensed consolidated income statement.

During the period ended March 31, 2019, the Company sold 674,418 shares of Auxly for gross proceeds of \$536,899. As at March 31, 2019, the Auxly warrants were marked down to fair market value based on the closing Auxly share price 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%.

| | Auxly Shares | Auxly Warrants | Total |
|--|---------------------|-----------------------|------------------|
| Fair market value, February 6, 2018 | \$ 1,267,906 | \$ 1,187,149 | \$ 2,455,055 |
| Unrealized loss | (654,186) | (1,050,503) | (1,704,689) |
| Fair Market Value, December 31, 2018 | 613,720 | 136,646 | 750,366 |
| Current portion, December 31, 2018 | 613,720 | 109,317 | 723,037 |
| Dispositions | (536,899) | - | (536,899) |
| Realized loss | (76,821) | - | (76,821) |
| Unrealized loss | - | (58,724) | (58,724) |
| Fair Market Value, March 31, 2019 | - | 77,922 | 77,922 |
| Current portion | \$ - | \$ 77,922 | \$ 77,922 |

- 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 \$1,125,000 in cash and 1,250,000 Newstrike common shares issued at closing at a price of \$0.90. Newstrike also issued 1,125,000 warrants to purchase Newstrike common shares at an exercise price of \$0.99, with a term of 24 months and 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 ("Units") at a price of \$0.15 per Unit. Each 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.

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4. MARKETABLE SECURITIES (CONTINUED)

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 March 31, 2019, the Company sold 1,250,000 shares of Newstrike for gross proceeds of \$637,956. As at March 31, 2019, Newstrike shares were marked down to fair market value based on the closing Newstrike share price on that date. The Newstrike 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%, (b) stock price volatility of 91% and the closing Newstrike stock price.

| | Newstrike Shares | Newstrike Warrants | Total |
|--|-----------------------------|-------------------------------|-------------------|
| Fair market value, July 31, 2018 | \$ 637,500 | \$ 325,458 | \$ 962,958 |
| Unrealized loss | (150,000) | (238,139) | (388,139) |
| Fair Market Value, December 31, 2018 | 487,500 | 87,319 | 574,819 |
| Current portion, December 31, 2018 | 487,500 | \$ 52,319 | \$ 539,819 |
| Dispositions | (637,956) | - | (637,956) |
| Realized gain | 150,456 | - | 150,456 |
| Unrealized gain | - | 57,628 | 57,628 |
| Fair Market Value, March 31, 2019 | - | 144,947 | 109,947 |
| Current portion | \$ - | \$ 108,413 | \$ 108,413 |

- 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 to the period ended March 31, 2019, the shares in Hightimes were received by the Company.

5. INVENTORY

| As at December 31, | March 31, 2019 | December 31, 2018 |
|-------------------------|-----------------------|--------------------|
| Watch it! merchandise | \$940,712 | \$939,916 |
| Spirit Leaf merchandise | 300,930 | 265,196 |
| Millwork | 1,274,489 | 1,417,040 |
| | \$2,516,131 | \$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 \$nil (December 31, 2018 - \$86,834).

Inventory costs included in cost of sales:

| | 3 months ended March 31, 2019 | Year ended December 31, 2018 |
|----------------------------------|--|---|
| Expensed inventories Watch it! | \$378,785 | \$499,270 |
| Expensed inventories Spirit Leaf | 20,105 | 22,123 |
| Expensed inventories millwork | 183,928 | - |
| | \$582,818 | \$521,393 |

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6. PROPERTY AND EQUIPMENT

| Cost | Computer Equipment | Furniture and Fixtures | Vehicle | Leasehold Investments | Total |
|------------------------------------|-------------------------------|-----------------------------------|-------------------|----------------------------------|---------------------|
| December 31, 2018 | \$ 59,293 | \$ 489,343 | \$ 27,557 | \$ 921,343 | \$ 1,497,536 |
| Additions | - | 59,176 | 27,557 | 451,383 | 538,116 |
| March 31, 2019 | \$ 59,293 | \$ 548,519 | \$ 27,557 | \$ 1,372,726 | \$ 2,035,652 |
| Accumulated depreciation | | | | | |
| December 31, 2018 | \$ (20,084) | \$ (49,635) | \$ (4,134) | \$ (74,467) | \$ (148,320) |
| Depreciation for the period | (5,469) | (22,867) | (1,757) | (49,354) | (79,447) |
| March 31, 2019 | \$ (25,553) | \$ (72,502) | \$ (5,891) | \$ (111,933) | \$ (226,291) |
| Net book value | | | | | |
| December 31, 2018 | \$ 39,209 | \$ 439,708 | \$ 23,423 | \$ 846,876 | \$ 1,349,216 |
| March 31, 2019 | \$ 33,740 | \$ 476,017 | \$ 21,666 | \$ 1,260,793 | \$ 1,792,216 |

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 | - | - | - | 2,502,026 | 2,502,026 |
| March 31, 2019 | \$ 2,078,018 | \$ 500,000 | \$ 530,000 | \$ 3,216,019 | \$ 6,324,037 |
| Accumulated amortization | | | | | |
| December 31, 2018 | \$ (2,078,018) | \$ (500,000) | \$ (530,000) | \$ - | \$ (3,083,018) |
| Amortization for the period | - | - | - | - | - |
| March 31, 2019 | \$ (2,078,018) | \$ (500,000) | \$ (530,000) | \$ - | \$ (3,083,018) |
| Net book value | | | | | |
| December 31, 2018 | \$ - | \$ - | \$ - | \$ - | \$ - |
| March 31, 2019 | \$ - | \$ - | \$ - | \$ 3,216,019 | \$ 3,216,019 |

During 2018, management assessed whether indicators of impairment existed and concluded indicators of impairment existed on the Watch It! CGU's, 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! CGU's.

The recoverable amount of the Watch it! CGU's 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 CGU's 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.

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 are as follows:

| | 3 months ended March 31, 2019 | Year ended December 31, 2018 |
|------------------------|--|---------------------------------|
| Short-term benefits | \$ 66,000 | \$ 364,100 |
| Long-term benefits (*) | - | 61,171 |
| | \$ 66,000 | \$ 425,271 |

(*) 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 March 31, 2019, there was \$nil (December 31, 2018 - \$100,000) of outstanding payables to related parties, that is included in accounts payable and accrued liabilities.

During the year ended December 31, 2018, the Company paid rent for office space to a company related by virtue of a common officer and director, in the amount of \$43,796 (period from March 16 to December 31, 2017 - \$30,565). Subsequent to year end, the Company entered into a new lease agreement effective March 1, 2019 for a term of 5 years, for \$30,000 per year for the first 3 years, and \$32,070 per year for the last 2 years. The yearly rent was based on a fair value assessment completed by an independent appraiser.

As at March 31, 2019, payable to related party was a non-interest-bearing, unsecured, due on demand loan of \$208,508 (December 31, 2018- \$208,779) for costs incurred for Spirit Leaf Macleod.

9. FRANCHISE FEE DEPOSITS

The Company has a franchise model associated with its cannabis 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 franchisee was required to pay 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.

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 remaining \$15,000 initial deposit is non-refundable, unless a lease is not signed by the Landlord and the Franchisee and delivered to the Company by June 30, 2019. At the option of the Company they may terminate the lease agreement and any refundable initial fee less amounts payable to the Company shall be 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.

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9. FRANCHISE FEE DEPOSITS (CONTINUED)

As at March 31 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 \$15,000 (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 | 37,500 | (10,000) | (37,500) | (5,000) | (15,000) |
| Recognized revenue | - | 10,000 | (10,000) | (38,750) | (38,750) |
| Payments received | (27,500) | 13,750 | 13,750 | - | - |
| March 31, 2019 | \$ 350,250 | 707,350 | \$ 863,750 | \$ (132,500) | 1,788,850 |
| Current portion | - | 15,000 | - | - | 15,000 |
| Long term portion | \$ - | 692,350 | \$ 863,750 | \$ - | 1,773,850 |

As at March 31, 2019, there was an aggregate of \$350,250 (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.

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 March 31, 2019, the minimum annual lease payments for corporately operated locations are expected to be as follows:

| | Watch It! | Spirit Leaf |
|------------|------------|--------------|
| 2019 | \$ 390,675 | \$ 1,806,223 |
| 2020 | \$ 412,589 | \$ 1,745,956 |
| 2021 | \$ 137,654 | \$ 1,754,360 |
| 2022 | \$ 16,981 | \$ 1,778,885 |
| 2023 | \$ - | \$ 1,691,489 |
| Thereafter | \$ - | \$ 3,627,659 |

As at March 31, 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.

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10. COMMITMENTS (CONTINUED)

| | | Watch It! | Spirit Leaf |
|------------|----|-----------|--------------|
| 2019 | \$ | 414,918 | \$ 1,494,766 |
| 2020 | \$ | 514,109 | \$ 1,548,413 |
| 2021 | \$ | 477,703 | \$ 1,567,510 |
| 2022 | \$ | 439,640 | \$ 1,576,067 |
| 2023 | \$ | 319,740 | \$ 1,530,311 |
| Thereafter | \$ | 583,980 | \$ 1,198,442 |

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) | 120,000 | 12,000 |
| Share issuance costs | | - | (1) |
| Balance, March 31, 2019 | | 193,374,996 | \$ 18,483,659 |

- 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 pursuant to the termination of the Royalty Agreement.
- iii. On February 6, 2018, the Company issued 15,000,000 Common shares to Auxly at a price of \$0.10 per share as part of 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.

11. SHARE CAPITAL (CONTINUED)

- 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 consists of one common share and one-half common share purchase warrant exercisable at \$0.30 per share until June 22, 2020, which was valued at \$237,227 (Note 11(e)).
- 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 consists of one common share and one-half 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 initial public offering ("IPO") raising \$3,750,000 through the issuance of 25,000,000 units, at a price of \$0.15 per unit. Each unit consists of one common share in the capital of the Company and one-half of one common share purchase 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 as part of their investment agreement (Note 4(ii)). Each unit consists 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 and 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 consists 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 two of the Spirit Leaf 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 of Inner Spirit at a price of \$0.20 per share for gross proceeds of \$2,250,000 pursuant to an investment agreement with Tilray, Inc.
- xiii. During the year ended December 31, 2018, a total of 250,000 shares were issued based on warrant exercises at a price of \$0.10 per share. 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 based on option exercises at a price of \$0.10 per share. 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 which total consideration payable for the locations was \$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, as well as \$250,000 in cash and a \$250,000 promissory note due one year after the closing of the acquisition.
- xvi. During the period ended March 31, 2019, a total of 120,000 shares were issued based on option exercises at a price of \$0.10 per share.
- xvii. On January 14, 2019, the Company entered into an exclusivity agreement with a third-party to enter into a retail agreement (the "Retail Agreement") in exchange for 5,000,000 Inner Spirit common shares to be issued to the third-party at a price of \$0.20 per share and a signing bonus. On February 6, 2019, the Retail Agreement was entered into whereby the Company will supply the use of Spirit Leaf's intellectual property and provide a sublease in exchange for a monthly fee based on a percentage of monthly gross sales earned by the third-party.

11. SHARE CAPITAL (CONTINUED)

(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% - 6 months following the listing date;
- 15% - 12 months following listing date;
- 15% - 18 months following the listing date;
- 15% - 24 months following the listing date;
- 15%- 30 months following the listing date; and,
- 15% -36 months following the listing date.

As at March 31, 2019, 9,535,963 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 March 31, 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 |
| Exercised during period | 11b(xvi) | (120,000) | \$ 0.10 |
| Forfeited during period | | (550,000) | \$ 0.10 |
| Balance, March 31, 2019 | | 13,915,000 | \$ 0.14 |
| Exercisable, end of period | | 3,191,250 | \$ 0.14 |

- 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)

(d) Options (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) Share-based compensation recognized on the issuance of the above options during the period ended March 31, 2019 was \$nil (December 31, 2018 - \$730,169)

| Options Outstanding | Weighted Average Exercise Price | Weighted Average Remaining Term (Years) | Options Exercisable | Weighted Average Exercise Price |
|----------------------------|--|--|----------------------------|--|
| 8,375,000 | \$0.10 | 3.92 | 1,816,250 | \$0.10 |
| 5,540,000 | \$0.20 | 4.70 | 1,375,000 | \$0.20 |
| 13,915,000 | | | 3,191,250 | |

Subsequent to March 31, 2019, 95,000 options were exercised at a price of \$0.10 per share.

(e) Warrants

During the year ended December 31, 2018, the Company issued warrants for consulting services, security for leases, investments, and the initial public offering. 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 \$113,694.

| | 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 | 2.13 |
| Sugarbud investment | 11b(vi) | 3,750,000 | 237,227 | 0.30 | 1.23 |
| Auxly investment | 11b(vii) | 661,765 | 41,864 | 0.30 | 1.23 |
| IPO warrants | 11b(viii) | 12,500,000 | 775,680 | 0.30 | 1.34 |
| Agents options | | 2,500,000 | 213,334 | 0.15 | 1.34 |
| Auxly investment | 11b(x) | 3,529,412 | 218,602 | 0.30 | 1.34 |
| Newstrike investment | 11b(ix) | 7,500,000 | 465,408 | 0.30 | 1.34 |
| Cancellation of franchise agreement | | 360,500 | 79,144 | 0.28 | 1.41 |
| Investor relation warrants | | 100,000 | 6,020 | 0.30 | 1.31 |
| 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 |
| Exercisable, end of year | | 32,101,677 | | 0.30 | 1.57 |
| Balance, March 31, 2019 | | 32,901,677 | 1,948,801 | 0.29 | 1.38 |
| Exercisable, end of period | | 32,101,677 | | 0.30 | 1.32 |

Inner Spirit Holdings Ltd.
Notes to the Interim Condensed Consolidated Financial Statements
(Unaudited)
For the Three Months Ended March 31, 2019 and 2018

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 cannabis accessories through retail outlets, and the sale and ongoing support of franchise retail cannabis stores; (ii) Watch It! Consolidated Ltd., which has the primary business of the ongoing support of retail watch store franchises and the sale of watches and accessories through retail outlets and website sales; and (iii) Inner Spirit, a division for its corporate administration. All of the Company's assets are located in Canada.

| Quarter ended March 31, 2019 | Watch It! (\$) | Spirit Leaf (\$) | Inner Spirit (\$) | NCI (\$) | Total (\$) |
|---|---------------------------|-----------------------------|------------------------------|---------------------|-----------------------|
| Revenue | | | | | |
| Retail revenue | 779,778 | 8,078 | - | - | 787,856 |
| Royalties | 22,979 | 93,639 | - | - | 116,618 |
| Advertising | 7,339 | 18,728 | - | - | 26,067 |
| Millwork | - | 201,889 | - | - | 201,889 |
| Franchise fees | - | 43,750 | - | - | 43,750 |
| Supply and other revenue | 3,216 | 69,673 | 4,026 | - | 76,915 |
| | 813,312 | 435,757 | 4,026 | - | 1,253,095 |
| Cost of goods sold | 378,785 | 204,033 | - | - | 582,818 |
| Gross profit | 434,527 | 231,724 | 4,026 | - | 670,277 |
| General and administrative | 61,582 | 724,017 | 146,285 | 2,046 | 933,930 |
| Salaries, wages, and benefits | 344,638 | 436,214 | - | - | 780,852 |
| Occupancy costs | 84,564 | 109,395 | - | 64 | 194,023 |
| Depreciation and amortization | 101,353 | 455,634 | 92 | 10,697 | 567,776 |
| Sales and marketing | 1,727 | 25,806 | 58,441 | - | 85,974 |
| Total operating expenses | 593,864 | 1,751,066 | 204,818 | 12,807 | 2,562,555 |
| Operating loss before other expenses | (159,337) | (1,519,342) | (200,792) | (12,807) | (1,892,278) |
| Unrealized loss (gain) on marketable securities | - | - | (72,539) | - | (72,539) |
| Interest | 42,235 | 142,921 | - | - | 185,156 |
| Net loss and comprehensive loss | (201,572) | (1,662,263) | (128,253) | (12,807) | (2,004,895) |
| Total assets | 3,353,326 | 17,489,433 | 2,225,343 | - | 23,068,102 |
| Total liabilities | 2,775,671 | 11,350,952 | 3,043,846 | - | 17,170,469 |

Inner Spirit Holdings Ltd.
Notes to the Interim Condensed Consolidated Financial Statements
(Unaudited)
For the Three Months Ended March 31, 2019 and 2018

12. SEGMENTED INFORMATION (CONTINUED)

| Quarter ended March 31, 2018 | Watch It! (\$) | Spirit Leaf (\$) | Inner Spirit (\$) | NCI (\$) | Total (\$) |
|--|---------------------------|-----------------------------|------------------------------|---------------------|-----------------------|
| Revenue | | | | | |
| Retail revenue | 931,825 | - | - | - | 931,825 |
| Royalties | 35,112 | - | - | - | 35,112 |
| Advertising | 8,778 | - | - | - | 8,778 |
| Miscellaneous revenue | 5,059 | 29,397 | - | - | 34,456 |
| | 980,774 | 29,397 | - | - | 1,010,171 |
| Cost of goods sold | 499,270 | 22,123 | - | - | 521,393 |
| Gross profit | 481,504 | 7,274 | - | - | 488,778 |
| General and administrative | 52,576 | 126,917 | 150,311 | - | 329,804 |
| Salaries, wages, and benefits | 345,457 | 199,480 | - | - | 544,937 |
| Occupancy costs | 195,804 | 10,074 | 3,000 | - | 208,878 |
| Depreciation | 55,287 | 1,414 | 2,311 | - | 59,012 |
| Amortization | 12,500 | - | - | - | 12,500 |
| Sales and marketing | 2,143 | 38,819 | 55,449 | - | 96,411 |
| Total operating expenses | 663,767 | 376,704 | 211,071 | - | 1,251,542 |
| Operating loss before other expenses | 182,263 | 369,430 | 211,071 | - | 762,764 |
| Share-based compensation | - | - | 151,635 | - | 151,635 |
| Unrealized loss on marketable securities | - | - | 479,928 | - | 479,928 |
| Interest | 10,913 | - | - | - | 10,913 |
| Royalties | 5,040 | - | - | - | 5,040 |
| Net loss and comprehensive loss | 198,216 | 369,430 | 842,634 | - | 1,410,280 |
| Total assets | 5,241,927 | 439,716 | 2,660,381 | - | 8,342,024 |
| Total liabilities | 444,347 | 1,912,551 | 62,829 | - | 2,419,727 |

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 March 31, 2019, is \$5,956,558 (December 31, 2018 - \$6,661,561).

14. FINANCIAL INSTRUMENTS AND RISK FACTORS

Fair values

At March 31, 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. The fair value of the payable to shareholder and royalty debt are estimated using a discount cashflow valuation technique.

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 March 31, 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 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 franchise for millwork, which are considered reputable companies.

| As at December 31, | March 31, 2019 | December 31, 2018 |
|----------------------|----------------|-------------------|
| Current | \$ 538,155 | \$ 46,770 |
| 31 – 60 days | 13,653 | 83,905 |
| 61 – 90 days | 189 | 25,970 |
| Greater than 90 days | 432,816 | 422,197 |
| Accounts receivable | \$ 984,813 | \$ 578,842 |

For the three months-ended March 31, 2019, the total revenue included in accounts receivable is \$60,254 (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.

14. FINANCIAL INSTRUMENTS AND RISK FACTORS (CONTINUED)

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 March 31, 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 provided refundable franchise fee deposits, 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 March 31, | Maturity | | 2019 |
|---|---------------|----|-----------|
| Accounts payables and accrued liabilities | Within 1 year | \$ | 1,090,583 |
| Advances from related party | Within 1 year | | 208,508 |
| Refundable franchise fee deposits | Within 1 year | | 15,000 |
| | | \$ | 1,314,091 |

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 in the share price would have increased equity by \$168,250 net tax. An equal change in the opposite direction would have decreased equity by \$168,250 net tax.

15. SUBSEQUENT EVENTS

- i. On May 24, 2019, the Company closed an offering of debenture units of the Company (the "Debenture Units") for aggregate gross proceeds of \$9,270,000. Each Debenture Unit consisted of (i) one 12% senior secured convertible debenture of the Company in the principal amount of \$1,000, with interest payable semi-annually in arrears on June 30 and December 31 of each year commencing June 30, 2020, and maturing on June 30, 2022, and (ii) 2,000 common share purchase warrants of the Company, each entitling the holder thereof to purchase one common share in the capital of the Company at an exercise price of \$0.25 until November 24, 2020.