KONTROL ENERGY CORP.

CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2020
(UNAUDITED)
(Prepared in Canadian dollars)

KONTROL ENERGY CORP.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
(UNAUDITED)
AS AT
(in Canadian dollars)

	Notes	September 30 2020	December 31 2019
Assets			
Cash		**$3,065,995**	$644,313
Accounts receivable	5	**2,876,744**	3,260,052
Unbilled revenue		**282,004**	176,185
Finished inventory		**157,560**	176,751
Prepaid expenses		**207,426**	132,442
Current assets		**6,589,729**	4,389,743
Long-term accounts receivable	5	**331,198**	331,198
Property and equipment	6	**538,109**	505,618
Right-of-use assets	7	**797,195**	857,718
Goodwill	8	**5,543,632**	4,642,566
Intangible assets	8	**8,017,591**	6,995,418
Long-term investment	9	**1**	1
Non-current assets		**15,227,726**	13,332,519
Total assets		**$21,817,455**	$17,722,262
Liabilities			
Operating line	10	**$47,881**	$402,893
Accounts payable and accrued liabilities		**2,154,343**	2,935,722
Deferred revenue		**152,423**	179,049
Due to shareholders	11	**36,500**	36,500
Holdbacks	12	**982,500**	982,500
Debentures	13	**6,545,014**	5,491,000
Current portion of debt financing		**333,333**	-
Term loan	14	**45,800**	179,663
Current portion of lease liabilities	7	**244,993**	222,070
Current liabilities		**10,542,787**	10,429,397
Vendor take back	12	**750,000**	-
Debentures	13	**-**	204,608
Convertible debentures	16	**2,178,717**	903,108
Debt financing	15	**2,493,223**	2,788,961
Lease liabilities	7	**594,050**	662,230
Deferred income taxes		**1,069,749**	1,069,749
Non-current liabilities		**7,085,739**	5,628,656
Total liabilities		**17,628,526**	16,058,053
Equity			
Common shares	17	**11,653,759**	7,357,838
Equity portion of convertible debentures	16	**28,332**	138,941
Contributed surplus		**778,792**	858,648
Warrant reserve		**23,444**	298,276
Deficit		**(8,295,398)**	(6,989,494)
Total equity		**4,188,929**	1,664,209
Total liabilities and equity		**$21,817,455**	$17,722,262

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

KONTROL ENERGY CORP.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS (UNAUDITED)
(in Canadian dollars)

		Three months ended		Nine months ended	
		September 30	September 30	September 30	September 30
	Notes	2020	2019	2020	2019
Revenues		**$3,012,386**	$3,266,270	**$8,047,477**	$10,856,816
Cost of sales		**1,410,556**	1,557,022	**3,731,827**	5,391,808
Gross profit		**1,601,830**	1,709,248	**4,315,650**	5,465,008
Advertising and promotion		**14,682**	31,998	**26,701**	132,324
Business fees and licenses		**58,068**	74,903	**178,071**	218,067
Consulting		**147,260**	133,733	**442,930**	448,052
Employee salaries and benefits		**1,075,022**	1,114,167	**2,938,465**	3,315,324
Insurance		**41,938**	40,827	**89,810**	86,951
Maintenance and repairs		**28,185**	27,863	**100,980**	89,239
Office and general		**25,311**	20,814	**70,701**	66,282
Other (income) expense		**(773,954)**	-	**(1,495,499)**	-
Professional fees		**24,743**	30,421	**115,245**	180,320
Rent and utilities		**78,726**	18,724	**217,393**	63,865
Supplies		**20,061**	20,990	**64,873**	66,996
Telecommunication		**23,826**	19,491	**62,944**	61,105
Travel		**15,724**	36,161	**46,795**	107,597
Amortization - intangibles	8	**146,476**	143,938	**408,826**	431,814
Depreciation - property & equip. and right-of-use	6 & 7	**90,815**	144,352	**289,669**	457,896
Share-based compensation		**227,274**	72,686	**455,386**	462,576
		1,244,157	1,931,068	**4,013,290**	6,188,408
Net income (loss) from operations		**357,673**	(221,820)	**302,360**	(723,400)
Amortization - financing fees		**300,868**	197,897	**791,522**	465,976
Finance expense		**250,346**	272,458	**816,742**	779,277
		551,214	470,355	**1,608,264**	1,245,253
Net loss and comprehensive loss for the period		**$(193,541)**	$(692,175)	**$(1,305,904)**	$(1,968,653)
Basic and diluted loss per share		**$(0.01)**	$(0.02)	**$(0.04)**	$(0.07)
Weighted average number of common shares outstanding		**31,062,951**	29,189,421	**30,195,269**	29,043,017

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

KONTROL ENERGY CORP.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (UNAUDITED)
AS AT
(In Canadian dollars)

	Number of Shares	Common Shares	Equity portion Convertible Debentures	Contributed Surplus	Warrant Reserve	Deficit	Total Equity
As at December 31, 2018	28,089,570	$ 6,465,051	-	$ 503,200	210,000	$ (4,299,635)	$ 2,878,616
Shares to debenture holders (Note 13)	222,581	163,864	-	-	-	-	163,864
Shares to acquire Dimax Controls assets	600,000	420,000	-	-	-	-	420,000
Stock options grant (Note 18)	-	-	-	288,173	-	-	288,173
Share based compensation	290,672	174,403	-	-	-	-	174,403
Repurchase of common shares	(30,500)	(20,295)	-	-	-	-	(20,295)
Convertible debenture issue	-	-	138,941	-	-	-	138,941
Net loss	-	-	-	-	-	(1,968,653)	(1,968,653)
As at September 30, 2019	29,172,323	$ 7,203,023	$ 138,941	$ 791,373	$ 210,000	$ (6,268,288)	$ 2,075,049

	Number of Shares	Common Shares	Equity portion Convertible Debentures	Contributed Surplus	Warrant Reserve	Deficit	Total Equity
As at December 31, 2019	29,443,523	$ 7,357,838	$ 138,941	$ 858,648	298,276	$ (6,989,494)	$ 1,664,209
Shares to debenture holders (Note 13)	11,000	6,536	-	-	-	-	6,536
Stock options grant (Note 18)	-	-	-	231,524	-	-	231,524
Stock options exercise (Note 18)	968,280	964,712	-	(311,380)	-	-	653,332
Share based compensation	345,624	223,862	-	-	-	-	223,862
Convertible debentures conversion/issue (Note 16)	1,082,500	866,000	(110,609)	-	-	-	755,391
Warrants exercise	1,813,023	1,702,131	-	-	(274,832)	-	1,427,299
Shares for debt and service	237,586	132,680	-	-	-	-	132,680
Shares to acquire New Found Air	727,272	400,000	-	-	-	-	400,000
Net loss	-	-	-	-	-	(1,305,904)	(1,305,904)
As at September 30, 2020	**34,628,808**	**$ 11,653,759**	**$ 28,332**	**$ 778,792**	**$ 23,444**	**$ (8,295,398)**	**$ 4,188,929**

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

KONTROL ENERGY CORP.
CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOW
(UNAUDITED)
(in Canadian dollars)

	Nine months ended September 30	Nine months ended September 30
	2020	2019
Operating activities		
Net loss	**$(1,305,904)**	$(1,968,653)
Non-cash items		
Amortization and depreciation	**1,490,017**	1,355,686
Share based compensation	**455,386**	462,576
Accretion of convertible debenture	**33,920**	-
Non-cash working capital items		
Accounts receivable	**885,588**	1,201,336
Unbilled revenue	**(105,820)**	(166,823)
Finished inventory	**19,191**	3,844
Prepaid expenses	**(73,196)**	(22,687)
Accounts payable and accrued liabilities	**(840,881)**	(682,595)
Deferred revenue	**(26,626)**	38,834
Cash flows from operating activities	**531,675**	221,518
Investing activities		
Additions to property and equipment	**(25,928)**	(43,156)
Additions to product development and IP	**(102,998)**	(282,420)
Cash paid in respect of asset purchase	**-**	(100,000)
Cash paid in respect of shares acquisition	**(1,550,000)**	-
Cash acquired from shares acquisition	**55,944**	
Cash flows used in investing activities	**(1,622,982)**	(425,576)
Financing activities		
Payment of operating line	**(355,012)**	(309,161)
Payment of holdbacks and vendor take back	**-**	(652,500)
Payment of due to shareholder	**-**	(5,500)
Payment of term loan	**(133,863)**	(120,823)
Proceeds from debenture, net	**177,405**	637,987
Payment of lease principal *(Lease interest payment of $46,350 incl. in operating activities)*	**(177,863)**	(305,711)
Proceeds from 2024 convertible debentures, net	**159,072**	1,038,332
Proceeds from 2023 convertible debentures, net	**1,825,148**	-
Payment of debt financing fees	**(39,085)**	(23,312)
Proceeds from options exercise	**653,332**	-
Proceeds from warrants exercise	**1,403,855**	-
Repurchase of common shares	**-**	(20,295)
Proceeds from share issuance, net	**-**	12,500
Cash flows from financing activities	**3,512,989**	251,517
Net increase in cash	**2,421,682**	47,459
Cash at beginning of period	**644,313**	1,022,061
Cash at end of period	**$3,065,995**	$1,069,520

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

1. NATURE OF OPERATIONS

Kontrol Energy Corp. ("Kontrol" or the "Company") is incorporated under the laws of the Province of British Columbia and its common shares are listed in the Canadian Securities Exchange ("CSE"). The Company is a provider of energy efficiency solutions to commercial energy consumers. Through a disciplined mergers and acquisition strategy, combined with a growing technology platform, Kontrol's market-based energy solutions are designed to reduce its customers overall cost of energy while providing a corresponding reduction in Green House Gas (GHG) emissions. Management of the Company considers there to be one operating segment being the provision of energy compliance and consulting services. All of the Company's operations are in Canada. The address of the Company's head office is 180 Jardin Drive, Unit 9, Vaughan, ON, L4K 1X8.

2. BASIS OF PREPARATION

Statement of Compliance

The Company's condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard ("IAS") 34 "Interim Financial Reporting".

These condensed interim consolidated financial statements should be read in conjunction with the Company's annual audited consolidated financial statements for the year ended December 31, 2019. The accounting policies and methods of computation followed in the preparation of these condensed interim consolidated financial statements are consistent with those used in the preparation of the most recent annual audited consolidated financial statements.

The condensed interim consolidated financial statements are presented in Canadian dollars which is the currency of the primary economic environment in which the Company operates in.

The condensed interim consolidated financial statements have been prepared on a historical cost basis, except where financial instruments have been designated as fair value through profit and loss.

Basis of Presentation

The condensed interim consolidated financial statements are presented in Canadian dollars which is the currency of the primary economic environment in which the Company operates in.

These condensed interim consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Details of the Company's subsidiaries are as follows:

On June 30, 2016 the Company acquired 100% of Kontrol Technologies Inc., a company incorporated in Ontario. This entity and its parent company's activities are designed for commercial building applications and include deep energy retrofits, distributed power generation, conservation solutions, and energy audits.

On February 10, 2017 the Company acquired 100% of ORTECH Consulting Inc. ("ORTECH"), a company incorporated in Ontario. ORTECH is an engineering consulting firm specializing in Green House Gas reporting, air quality testing, emission testing and renewable energy/power consulting.

On August 4, 2017 the Company acquired 100% of Efficiency Engineering Inc. ("EE Inc."), a company incorporated in Ontario. EE Inc. provides engineering services to industrial, municipal and commercial building owners across Canada.

On April 30, 2018, the Company acquired assets from MCW Dimax Ltd. The purchased assets are used to manage HVAC systems in real time through ongoing monitoring and analysis. The acquisition of MCW Dimax Ltd was determined to be an acquisition of a business under IFRS 3 Business combinations.

On September 20, 2018, the Company acquired 100% of CEM Specialties Inc. ("CEMSI"), a company incorporated in Ontario. CEMSI provides the Canadian and US market with value added solutions for continuous emissions and process monitoring applications.

On August 1, 2020, the Company acquired 100% of New Found Air HVAC Services Inc. ("NFA"), a company incorporated in Ontario. NFA provides building energy services that ensures the effective operation and service of essential heating, cooling, ventilation, and utility systems.

All of the Company's subsidiaries share similar business products and services, customers, and markets in which they operate.

Basis of Consolidation

The condensed interim consolidated financial statements incorporate the financial statements of the Company and its subsidiaries after intercompany balances and transactions have been eliminated. Subsidiaries are consolidated from the date that control is obtained and deconsolidated on the date control ceases. The acquisition method is used to account for the acquisition of a subsidiary from an unrelated party at the date that control is obtained, with the difference between the consideration transferred and the fair value of the subsidiary's net identifiable assets acquired recorded as goodwill. Business acquisition related costs are recognized in profit and loss as incurred.

3. SIGNIFICANT ACCOUNTING POLICIES

In addition to the accounting policies followed in the preparation of the most recent annual audited consolidated financial statements, Government Grants and Assistance was applicable in the preparation of these condensed interim consolidated financial statements.

Government Grants and Assistance

The benefits of tax incentives for scientific research and experimental development expenditures, funding for industrial research assistance program, and subsidy assistance through the Canada emergency wage subsidy are recognized in the year the qualifying claim is made providing there is reasonable assurance of recoverability. The grants and assistance are recorded based on management's estimates of amounts expected to be recovered and are subject to audit by taxation authorities.

Government grants and assistance are recognized where there is a reasonable assurance that the grants and assistance will be received, and conditions will be complied with. Government grants and assistance are recognized in other income over the periods in which the Company recognizes expenses which the grants and assistance are intended to compensate.

Significant accounting judgments and estimates

The preparation of these condensed interim consolidated financial statements requires management to make judgments and estimates and form assumptions that affect the reported amounts of assets and liabilities at the date of the condensed interim consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Such estimates primarily relate to unsettled transactions and events as at the date of the condensed interim consolidated financial statements. On an ongoing basis, management evaluates its judgments and estimates in relation to assets, liabilities, revenues, and expenses. Management uses various factors it believes to be reasonable under the given circumstances as the basis for its judgments and estimates. Actual outcomes differ from these estimates under different assumptions and conditions.

COVID-19

The global pandemic outbreak of COVID-19 has resulted in governments worldwide enacting emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, store closures, self-imposed quarantine periods and social distancing, may cause material disruption to businesses globally resulting in an economic slowdown. COVID-19 has cast uncertainty on the assumptions used by management in making its judgements and estimates. The full extent of the impact that COVID-19, including government and/or regulatory responses to the outbreak, will have on the Corporation is highly uncertain and difficult to predict at this time. Accordingly, there is a higher level of uncertainty with respect to management's judgements and estimates.

Application of new and revised International Financial Reporting Standards

IFRS 3 Business combinations

Amendments to IFRS 3, issued in October 2018, provide clarification on the definition of a business. The amendments permit a simplified assessment to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. The amendments are effective January 1, 2020 and adopted by the Company and there was no impact on the condensed interim financial statements.

IAS 1 Presentation of financial statements

Amendments to IAS 1, issued in October 2018, provide clarification on the definition of material and how it should be applied. The amendments also align the definition of material across International Financial Reporting Standards and other publications. The amendments are effective January 1, 2020 and adopted by the Company and there was no material impact on the condensed interim financial statements.

IAS 8 Accounting policies, changes in accounting estimates and errors

Amendments to IAS 8, issued in October 2018, provide clarification on the definition of material and how it should be applied. The amendments also align the definition of material across International Financial Reporting Standards and other publications. The amendments are effective January 1, 2020 and adopted by the Company and there was no material impact on the condensed interim financial statements.

4. BUSINESS ACQUISITION IN 2020

AQUISITION OF NEW FOUND AIR HVAC SERVICES INC.

On August 1, 2020, the Company acquired 100% of the issued and outstanding shares of New Found Air HVAC Services Inc. ("NFA"), a company incorporated in Ontario. NFA provides building energy services that ensures the effective operation and service of essential heating, cooling, ventilation, and utility systems. The acquisition was accounted for using the acquisition method for business combinations. The net assets are included at their fair value.

Net assets acquired	
Cash	$55,944
Accounts receivable	502,280
Prepaid expenses	1,789
Property and equipment	103,103
Customer relationships	1,211,000
Brand names	117,000
Goodwill*	901,066
Accounts payable	(192,182)
	$2,700,000

Consideration	
Cash	$1,550,000
Vendor take back**	750,000
Common shares	400,000
	$2,700,000

*The excess of consideration over the identifiable net assets is allocated to Goodwill.

**Vendor take back is subject to a performance claw back based on NFA achieving an average annual EBITDA of $850,000 per annum over a 3-year period.

Final working capital balances to be settled in Q4 2020 and the purchase price adjusted accordingly.

Goodwill reflects how the acquisition will impact the Company's ability to generate future profits in excess of existing profits due to the reputation of NFA and credibility it has established in the Canadian market for providing HVAC services. The consideration paid relate to combined synergies, related mainly to revenue growth. The goodwill is not deductible for income tax purposes. The goodwill has been allocated to the NFA CGU for the purposes of testing for impairment.

The useful life of the customer relationships is 12 years. Brand names have a useful life of 10 years.

5. ACCOUNTS RECEIVABLE

All amounts included in accounts receivable are collectible within a short-term period and the net carrying value reasonably approximates the fair value of the receivables. Long-term accounts receivable represents a contract completed during the prior year for which the customer was granted extended payment terms

Allowance for expected credit losses as at September 30, 2020 is $72,614 (December 31, 2019 - $80,822).

6. PROPERTY AND EQUIPMENT

Cost	**Office Equipment**	**Lab & Other Equipment**	**Computer Equipment**	**Vehicles**	**Computer Software**	**Leasehold Improvements**	**Total**
Balance at January 1, 2020	467,983	1,217,969	950,907	312,726	434,283	175,402	3,559,269
Acquisitions	-	-	-	167,235	-	-	167,235
Additions	-	8,326	1,199	10,943	8,054	-	28,522
Disposals	-	-	(3,011)	(45,522)	-	-	(48,533)
Balance at September 30, 2020	467,983	1,226,295	949,095	445,382	442,337	175,402	3,706,494
Accumulated depreciation							
Balance at January 1, 2020	418,131	1,000,598	799,079	278,453	420,760	136,630	3,053,652
Acquisitions	-	-	-	64,132	-	-	64,132
Disposals	-	-	(2,810)	(43,129)	-	-	(45,939)
Depreciation	7,408	31,303	30,966	12,193	7,978	6,692	96,540
Balance at September 30, 2020	425,539	1,031,901	827,235	311,649	428,738	143,322	3,168,385
Carrying value							
At September 30, 2020	$42,443	$194,394	$121,859	$133,733	$13,599	$32,080	$538,109
At December 31, 2019	$49,851	$217,371	$151,828	$34,273	$13,523	$38,772	$505,618

The Company recorded property and equipment as part of the acquisition of NFA (see Note 4).

7. RIGHT-OF-USE ASSETS AND LEASE LIABILITIES

Right-of-Use Assets

Cost	**Property**	**Vehicles**	**Total**
Balance at January 1, 2020	1,107,383	43,804	1,151,186
Additions	-	132,606	132,606
Disposals	-	-	-
Balance at September 30, 2020	1,107,383	176,409	1,283,792
Accumulated depreciation			
Balance at January 1, 2020	289,425	4,044	293,468
Disposals	-	-	-
Depreciation	182,138	10,991	193,129
Balance at September 30, 2020	471,562	15,034	486,597
Carrying value			
At September 30, 2020	$635,820	$161,375	$797,195
At December 31, 2019	$817,958	$39,760	$857,718

Opening balance at January 1, 2020	884,300
Additions	132,606
Disposals	-
Principal repayment	(177,863)
Closing balance at September 30, 2020	$839,043

Current	$244,993
Long-term	$594,050

Lease payments for the period ended September 30, 2020

Principal payments	177,863
Interest expense	46,350
Lease payments	$224,213

Contractual lease payments by fiscal year

2020	$303,941
2021	$284,807
2022	$295,299
2023	$206,310
2024	$58,934

8. GOODWILL AND INTANGIBLE ASSETS

Cost	Goodwill	Product Development	Brand Names	Customer Relationships	Intellectual Property	Patents	Total Intangible Assets
Balance at January 1, 2020	4,642,566	678,811	483,000	5,509,275	1,410,000	160,000	8,241,086
Acquisitions	901,066	-	117,000	1,211,000	-	-	1,328,000
Additions	0	84,360	-	-	18,638	-	102,998
Balance at Sept 30, 2020	5,543,632	763,171	600,000	6,720,275	1,428,638	160,000	9,672,084
Accumulated amortization							
Balance at January 1, 2020	-	-	96,333	806,946	189,945	152,443	1,245,668
Amortization	-	-	38,175	292,283	70,811	7,557	408,826
Balance at Sept 30, 2020	-	-	134,508	1,099,229	260,756	160,000	1,654,493
Carrying value							
At Sept 30, 2020	$5,543,632	$763,171	$465,492	$5,621,046	$1,167,882	-$0	$8,017,591
At December 31, 2019	$4,642,566	$678,811	$386,667	$4,702,329	$1,220,055	$7,557	$6,995,418

Product development costs relate to the development of the Company's next generation Energy Management System (SmartSuite). The Company recorded goodwill and intangible assets as part of the acquisitions of NFA (see Note 4).

9. LONG-TERM INVESTMENT

On October 5, 2015, a consulting agreement with Ghana Energy One ("project") was assigned to Kontrol Energy Group Inc., which entitles the Company to have a 4% interest in the project's future revenue. The project is approximately 157 Megawatts in total size and is to be in the Ashanti region of Ghana. The project is in the final stages of development and is anticipated to begin construction in 2020. The project will have a long-term Power Purchase Agreement (PPA) with the Government of Ghana for a period of 20 years. The balance $1 (2019: $1) is a nominal value to represent the investment. No equity or initial investment has been made other than consulting time provided by the Company's CEO.

10. OPERATING LINE

	September 30, 2020	December 31, 2019
Operating Line	$47,881	$402,893

Operating line facilities are with two financial institutions.

Facility I: Capacity of $400,000. Bank Prime rate plus 1.50% per annum. Drawdowns as required; repayment on demand. General security agreement issued on all assets of Efficiency Engineering Inc.

Facility II: Capacity of $500,000. Bank Prime rate plus 1.75% per annum. Drawdowns as required; repayment on demand. General security agreement issued on all assets of ORTECH Consulting Inc. The Company has provided a guarantee over ORTECH Consulting Inc.'s borrowing under this facility. Also see financial covenants noted in the Term Loan issued by the same financial institution (Note 14).

11. DUE TO SHAREHOLDERS

Due to shareholders is unsecured, non-interest bearing and due on demand.

12. HOLDBACKS PAYABLE

	September 30, 2020	December 31, 2019
Holdback relating to EE acquisition	400,000	400,000
Holdback relating to CEMSI acquisition	582,500	582,500
	$982,500	$982,500

Holdbacks payable are to secure any indemnifications of Vendors in connection with acquisitions. The holdback relating to the CEMSI acquisition was due December 20, 2019, however, the amount has not been repaid as at September 30, 2020. The holdback due dates relating the to EE acquisition were extended and parties are establishing a revised date.

VENDOR TAKE BACK

	September 30, 2020	December 31, 2019
VTB relating to NFA acquisition	$750,000	$-

The VTB shall mature on the third anniversary of the closing date and shall accrue interest at 3.50% compounded annually. The VTB is subject to a performance claw back based on NFA achieving an average annual EBITDA of $850,000 per annum over a 3-year period. This indebtedness is in the form of a promissory note with subordinated security.

13. DEBENTURES

	September 30, 2020	December 31, 2019
Debentures, at face value	6,632,750	6,412,750
Deferred financing cost and unamortized discount	(87,736)	(717,142)
	6,545,014	5,695,608
Less: Current portion	-	5,491,000
	$-	$204,608

2020 Debenture offering
The Debentures bear interest at a rate of 8% per annum, payable quarterly in arrears with a maturity date of October 31, 2019 that was extended to October 31, 2020. The Debentures are non-convertible and non-redeemable. The Debenture Offering was up to $5,300,000 of units at a price of $1,000 per unit, each unit to be comprised of one 8% unsecured non-convertible debenture and 100 common shares of the Company. During the 2019 fiscal year, a material amount of the debenture offering was extended to October 31, 2020. A new offering memorandum was issued, additional proceeds were raised, and subscriptions were processed for a one-year extension. Subscribers of the extension received 50 common shares of the Company per $1,000 extended.

Subsequent to the September 30, 2020 quarter end the Company received approval from debenture holders to extend the maturity date from October 31, 2020 to December 15, 2020. This extension to December 15, 2020 was completed in connection with the Company's previously announced non-brokered private placement for gross proceeds of $5,800,000, allowing existing holders of 2020 Debentures to exchange for debentures maturing on October 31, 2022. The 2022 Debentures will be comprised of one $1,000 8% unsecured debenture of the Company maturing on October 31, 2022 and 10 common shares. The total subscription amount for the 2022 Debentures will be recognized in the fourth quarter of 2020.

Securities offering
Proceeds of $1,229,000 were raised and the offering was closed in the first quarter of 2019. Each unit is at a price of $1,000 consisting of a $750 Debenture, $250 of common shares, and 150 common share purchase warrants ("Units"). The Debentures bear interest at a rate of 7% per annum, payable monthly and will mature on April 25, 2021. The Debentures are non-convertible and non-redeemable.

Commissions paid to registered securities dealers to effect sales of the offerings and professional fees relating to preparation of the offerings is recorded as a reduction of the Debenture amount and amortized over the term of the Debenture. The common shares included in the 2016 offering are fair valued at the time of each Debenture closing and recorded as a reduction of the Debenture amount and amortized over the term of the Debenture.

14. TERM LOAN

	September 30, 2020	December 31, 2019
Term loan	45,800	179,663
Less: Current portion	(45,800)	(179,663)
	$-	$-

A term loan of $500,000 was taken out in the fourth quarter of 2017. Interest is payable at Bank Prime rate plus 2.40%. The repayment term of the loan is 36 months, regardless of potential adjustments made to the interest rate. The blended principal and interest repayment plus mandatory repayment is linked to ORTECH Consulting Inc.'s cash flow. In addition, a general security agreement was issued on all assets of ORTECH Consulting Inc. The Company has provided a guarantee over ORTECH Consulting Inc.'s borrowing under this facility.

15. DEBT FINANCING

	September 30, 2020	December 31, 2019
Debt financing	3,000,000	3,000,000
Deferred financing cost	(173,444)	(211,039)
	2,826,556	2,788,961
Less: Current portion	333,333	-
	$2,493,223	$2,788,961

Term is 36 months with principal repayments commencing at month 19. Maturity date is October 30, 2022. Interest is payable at the 3-Month BA Equivalent Rate plus 8.0% and facility management fees. The debt is secured by general security agreements and guarantees. Fees recorded as a reduction of the debt and will be amortized over the term of the financing. CEMSI financial covenants under this debt financing include the following: (i) a ratio of EBITDA to servicing cost of not less than 1.8:1 to be calculated on a rolling four quarters basis for the fiscal quarter then ended and the immediately preceding three fiscal quarters. After 9 months, this ratio will increase to 1.9:1. After 18 months, this will increase to 2.1:1; and a ratio of funded debt to EBITDA of not greater than 4.9:1, calculated on a rolling four quarters basis for the fiscal quarter then ended and the immediately preceding three fiscal quarters for EBITDA and the fiscal quarter for funded debt. CEMSI shall maintain a minimum cash balance of $300,000.

ORTECH Consulting Inc.'s financial covenants include the following: (i) Debt service coverage ratio on a rolling four quarters basis for the fiscal quarter then ended and the immediately preceding three fiscal quarters of not less than 1.25:1; and (ii) a ratio of funded debt to EBITDA, calculated on a rolling four quarter basis for the fiscal quarter then ended and the immediately preceding three fiscal quarters of not greater than 3:1.

16. CONVERTIBLE DEBENTURES

	Liability Portion	Equity Portion	Total
December 31, 2019 (Aggregate of 2024 & 2023 offerings shown below)	$903,108	$138,941	$1,042,049
September 30, 2020 (Aggregate of 2024 & 2023 offerings shown below)	$2,178,717	$28,332	$2,207,049

2024 offering	Liability Portion	Equity Portion	Total
December 31, 2019	903,108	138,941	1,042,049
Issuance less conversions	(600,036)	(110,609)	(710,645)
Accretion	37,637	-	37,637
September 30, 2020	$340,709	$28,332	$369,041

During the third quarter of 2019, the Company completed a private placement offering unsecured Convertible Debentures of the Company, at a price of $1,000 per $1,000 principal amount Convertible Debenture. The Convertible Debentures are convertible into common shares of the Company at a conversion price of $0.80 per share. Gross proceeds of $1,114,000 and $175,000 were received in 2019 and the first quarter of 2020 respectively. Conversions to common shares totaled $866,000 during the third quarter of 2020.

The Convertible Debentures shall bear interest at a rate of 8.0% per annum from and including their date of issue until the earlier of their date of conversion and the maturity date, payable semi-annually in arrears in cash on December 31 and June 30 of each year. The first interest payment was on December 31, 2019 for the period from the Closing Date to December 31, 2019.

The Convertible Debentures may be converted in full or in part, at the holders' option into Common Shares, at any time prior to the maturity date. Holders converting their Convertible Debentures will receive a cash payment equal to accrued and unpaid interest thereon for the period from and including the date of the latest interest payment date to, and including, the date of conversion.

At any time after the date that is eighteen months following the Closing Date, the Company may force the conversion of the principal amount of the then outstanding Convertible Debentures at the Conversion Price on not less than 30 days' notice if the volume weighted average trading price of the Common Shares on the CSE for any 20 consecutive trading day period is greater than $1.25.

Any Convertible Debentures that have not been converted will mature on August 31, 2024.

The Company paid a cash commission to finders and brokers equal to 7.0% of the gross proceeds from the sale of the Convertible Debentures attributable to such finders or brokers. In addition, the Company agreed to grant to finders and brokers common share purchase warrants equal to the quotient obtained by dividing 6.0% of the gross proceeds attributable to such finders or brokers by $0.80. Each Compensation Warrant shall be exercisable to purchase one Common Share of the Company at a price of $0.80 for a period of 24 months from the Closing Date.

The Convertible Debentures are unsecured obligations of the Company and shall rank pari passu in right of payment of principal and interest with all other Convertible Debentures issued under the private placement and all previously existing and future unsecured indebtedness of the Company.

The liability portion of the Convertible Debentures was assigned a value based on the present value of the contractually determined stream of future cash flows discounted at 12%. The rate is estimated to be equivalent market interest rate that would apply to a similar liability which does not contain an equity conversion option. The difference between the principal amount of the Convertible Debentures and the discounted cash flows represents the fair value of the conversion feature and was recognized in Equity. The transaction costs directly attributable to the offering were allocated to the liability and equity portions of the Convertible Debentures.

Accretion of the liability portion and interest payable on the Convertible Debentures are included in finance expense in the Consolidated Statements of Loss and Comprehensive Loss.

2023 offering	Liability
December 31, 2019	-
Issuance of convertible debentures	1,965,350
Deferred financing cost	(127,342)
September 30, 2020	$1,838,008

As at September 30, 2020, the Company received gross proceeds of $1,965,350 in connection with a private placement offering of convertible debenture units, each unit comprised of one $1,000 8% unsecured debenture of the Company, convertible into Common Shares at the conversion price; and 1,000 warrants, with each warrant exercisable at the holders' option to purchase one Common Share until June 30, 2023, at a price (subject to adjustment from time to time) of $0.60 cents on or prior to June 30, 2022 and at a price of $0.70 cents after June 30, 2022 until or on June 30, 2023.

The convertible debentures bear interest at a rate of 8.0% per annum from and including their date of issue until the earlier of their date of conversion and June 30, 2023, payable semi-annually in arrears in cash on December 31 and June 30 of each year.

The convertible debentures may be converted in full or in part, at the holders' option into Common Shares, at any time prior to the maturity date, at a conversion price (subject to adjustment from time to time) of $0.50 on or prior to June 30, 2022 and at a price of $0.60 after June 30, 2022 until or on June 30, 2023. Holders converting their convertible debentures will receive a cash payment equal to accrued and unpaid interest thereon for the period from and including the date of the latest interest payment date to, and including, the date of conversion.

At any time after August 31, 2021, the Company may force the conversion of the principal amount of the then outstanding debentures at the then applicable conversion price on not less than 30 days' notice if the volume weighted average trading price of the Common Shares on the CSE for any 20 consecutive trading day period is greater than $0.70.

At any time after August 31, 2021, the Company may accelerate the expiry date of the then outstanding Warrants on not less than 30 days' notice if the volume weighted average trading price of the Common Shares on the CSE for any 20 consecutive trading day period is greater than $0.85.

Any Convertible Debentures that have not been converted will mature on June 30, 2023.

The Company may pay a cash commission to finders and brokers equal to 7.0% of the gross proceeds from the sale of the Units attributable to such finders or brokers. In addition, the Company may grant to finders and brokers common share purchase warrants equal to the quotient obtained by dividing 7.0% of the gross proceeds attributable to such finders or brokers by $0.60. Each Compensation Warrant shall be exercisable to purchase one Common Share of the Company at a price of $0.60 cents on or prior to June 30, 2022, and at a price of $0.70 cents after June 30, 2022 until or on June 30, 2023.

The Convertible Debentures are unsecured obligations of the Company and shall rank pari passu in right of payment of principal and interest with all other Convertible Debentures issued under the private placement and all previously existing and future unsecured indebtedness of the Company.

Due to the multiple conversion prices of the debentures and excise prices of the warrants, the conversion feature and the warrants both fail the “fixed-for-fixed” criteria for equity classification and as such, both elements have been classified as a derivative liability to be measured at FVTPL.

Deferred financing cost relates to transaction fees directly related to the issuance of the debentures, which are recorded as a reduction of the debt and will be amortized over the term of the financing.

17. COMMON STOCK

The Company is authorized to issue an unlimited number of common shares.

During the nine months ended September 30, 2020, 11,000 shares were issued to Debenture Unit holders. These common shares were valued at $6,536 (see Note 13).

During the nine months ended September 30, 2020, 345,624 performance shares were issued to employees and management.

During the nine months ended September 30, 2020, 237,586 shares were issued in connection with debt settlement and shares for service agreements.

During the nine months ended September 30, 2020, 968,280 shares were issued in connection with stock options exercise.

During the nine months ended September 30, 2020, 1,082,500 shares were issued in connection with convertible debentures conversion.

During the nine months ended September 30, 2020, 1,813,023 shares were issued in connection with warrants exercise.

On August 1, 2020, 727,272 shares were issued in connection with the acquisition of NFA. The shares will be released based on the terms of the escrow agreement.

18. STOCK OPTIONS

The Company has established a stock option plan for directors, employees, and consultants. Under the Company's stock option plan, the exercise price of each option is determined by the Board, subject to the Discounted Market Price policies of the CSE. The aggregate number of common shares issuable pursuant to options granted under the plan is 10% of the Company's issued common shares. The board of directors has the exclusive power over the granting of options and their vesting and cancellation provisions.

The following is a summary of the changes in the Company's stock option plan for the nine months ended September 30, 2020 and 2019:

Options Outstanding	September 30, 2020		September 30, 2019	
	Number	Weighted average exercise price	Number	Weighted average exercise price
Opening	2,873,040	$0.74	2,631,165	$0.75
Granted	207,500	$1.29	400,000	$0.80
Exercised	(968,280)	$0.70	-	-
Expired	-	-	(260,000)	$0.77
Forfeited	-	-	-	-
Closing	2,112,260	$0.81	2,771,165	$0.76

The fair value of stock options is determined using the Black-Scholes Model. Volatility is calculated by using the historical volatility of other companies that the Company considers comparable that have trading and volatility history prior to the Company becoming public. The expected life in years represents the time that the options granted are expected to be outstanding. The risk-free rate is based on zero coupon Canada government bonds with a remaining term equal to the expected life of the options. The following outlines the range of assumptions used for the options issued during the nine-months ended September 30, 2020 and 2019:

Black-Scholes assumptions	September 30, 2020	September 30, 2019
Exercise price	$0.60 - $2.15	$0.60 - $0.80
Risk-free interest rate	1.5%	1.0%
Expected life	5 years	2 years – 5 years
Expected volatility	46%	46%
Expected dividend yield	0%	0%
Weighted average grant date fair value per option	$0.49	$0.24

19. WARRANTS

As at September 30, 2020, the outstanding warrants may be exercised for 3,950,140 common shares (December 31, 2019 – 2,650,785).

During the nine months ended September 30, 2020, the Company issued 26,295 warrants relating to the Securities offering. (see Note 13).

During the nine months ended September 30, 2020, the Company issued 1,999,000 warrants to unitholders in connection with the 2023 Convertible Debentures offering (see Note 16).

During the nine months ended September 30, 2020, the Company issued 134,083 broker warrants in connection with the 2023 Convertible Debentures offering (see Note 16).

During the nine months ended September 30, 2020, the Company issued 950,000 advisory warrants.

During the nine months ended September 30, 2020, 1,810,023 warrants were exercised.

Warrants issued are recorded at their fair value which is determined using the Black-Scholes Model. Key inputs to the model include exercise price, grant-date fair value of the Company's shares, the risk-free rate of return and volatility (46%). The inputs are adjusted on each issuance based on the prevailing rates and prices on the grant date.

20. RELATED PARTY TRANSACTIONS

Related Party Balances

	September 30, 2020	December 31, 2019
Due to shareholders (see Note 11)	$36,500	$36,500

Key Management Compensation

The Company's key management personnel have the authority and responsibility for planning, directing and controlling the activities of the Company and consists of the Company's executive management team and management directors. The following is a summary of the related party transactions, including key management compensation for the nine months ended September 30, 2020 and 2019.

	September 30, 2020	September 30, 2019
Salaries, benefits and consulting	255,176	389,100
Share-based compensation	221,181	141,196
	$476,357	$530,296

21. FINANCIAL INSTRUMENTS

The Company's financial instruments are exposed to certain financial risks, including credit risk, liquidity risk, and market risk.

(a) Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily attributable to the liquidity of its cash and accounts receivable. The Company limits exposure to credit risk by maintaining its cash with large Canadian financial institutions. To mitigate credit risk with respect to accounts receivable the Company subjects all major customer accounts to its credit evaluation process. The Company's maximum exposure to credit risk as at September 30, 2020 is the carrying value of cash held with financial institutions and accounts receivable.

(b) 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 ensures there is sufficient capital to meet short-term business requirements after taking into account cash flow from operations, the Company's holdings of cash, and the available credit facilities. The Company manages liquidity risk through the management of its capital structure. Accounts payable and accrued liabilities are due within the current operating period.

(c) Interest rate risk

As at September 30, 2020, the Company's Operating Line, Term Loan, and Debt Financing are subject to varying rates with the financial institution's prime rate and are subject to cash flow risks. The Company monitors its exposure to interest rates and has not entered into any derivative contracts to mitigate this risk. Based on the outstanding credit facilities, a 1% increase in interest rates for the Company would increase year to date 2020 net loss before tax by approximately $25,050 (September 30, 2019 - $6,220).

(d) Fair Value

IFRS 7 establishes a fair value hierarchy that prioritizes the input to valuation techniques used to measure fair value as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities:
Level 2 – 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); and
Level 3 – inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As at September 30, 2020, the conversion feature and warrant liability relating to the 2023 debentures are recorded at level 3 of the fair value hierarchy. The Company had no financial instruments recorded at level 3 fair value at December 31, 2019.

As at September 30, 2020 and December 31, 2019, both the carrying and fair value amounts of all the Company's financial instruments are approximately equivalent.

(e) Foreign currency risk

Foreign currency risk arises because of fluctuations in exchange rates. CEMSI conducts a portion of its business activities in U.S. dollars. Management of foreign exchange currency exposure is governed by the Company's foreign exchange policy as approved by its Board. The objective of the policy is to minimize the earnings impact of foreign currency gains and losses associated with foreign exchange rate fluctuations.

The financial assets and liabilities that are denominated in foreign currencies will be affected by changes in the exchange rate between the Canadian dollar and the U.S. dollar. This primarily includes cash, accounts receivable, and accounts payables and accrued liabilities which are denominated in foreign currencies.

22. MANAGEMENT OF CAPITAL RISK

The Company considers items included in shareholders' equity as capital. The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern and to maintain a flexible capital structure which optimizes the costs of capital at an acceptable risk.

The Company manages the capital structure and makes adjustment to it considering changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets or adjust the amount of cash and cash equivalents.

To facilitate the management of its capital requirements, the Company prepares expenditure budgets that are updated as necessary depending on various factors, including successful capital deployment and general industry conditions.

To maximize the ongoing development efforts, the Company does not pay out dividends. The Company's investment policy is to invest its short-term excess cash in highly liquid short-term interest-bearing investments with maturities of 90 days or less from the original date of acquisition selected with regard to the expected timing of expenditures from continuing operations. The Company's approach to managing capital remains unchanged from the year ended December 31, 2019.

23. SUBSEQUENT EVENTS

Subsequent to the September 30, 2020 quarter end the Company received approval from 2020 Debenture holders (see Note 13) to extend the maturity date from October 31, 2020 to December 15, 2020. This extension to December 15, 2020 was completed in connection with the Company's previously announced non-brokered private placement for gross proceeds of $5,800,000, allowing existing holders of 2020 Debentures to exchange for debentures maturing on October

31, 2022. The 2022 Debentures will be comprised of one $1,000 8% unsecured debenture of the Company maturing on October 31, 2022 and 10 common shares. The total subscription amount for the 2022 Debentures will be recognized in the fourth quarter of 2020.