

XS Financial Inc.

Condensed Consolidated Financial Statements

For the three months ended March 31, 2022 and 2021

(Unaudited)

(Expressed in United States Dollars)

XS Financial Inc.

Table of Contents

	Page(s)
Condensed consolidated statements of loss and comprehensive loss – For the three months ended March 31, 2022 and 2021	3
Condensed Consolidated Statements of Financial Position at March 31, 2022 and December 31, 2021 (audited)	4
Condensed Consolidated Statements of Changes in Equity – For the three months ended March 31, 2022 and 2021	5
Condensed Consolidated Statements of Cash Flows – For the three months ended March 31, 2022 and 2021	6
Notes to Condensed Consolidated Financial Statements	7–31

NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited condensed interim consolidated financial statements of the Company have been prepared by and are the responsibility of the Company's management.

The Company's independent auditor has not performed a review of these condensed interim consolidated financial statements, in accordance with standards established by CPA Canada for a review of interim financial statements by an entity's auditor.

XS Financial Inc.
Unaudited condensed consolidated statements of loss and comprehensive loss
For the three months ended March 31, 2022 and 2021
(Expressed in United States dollars)

	<u>Note</u>	Three months ended	
		March 31,	
		<u>2022</u>	<u>2021</u>
Revenue	5	\$ 1,288,633	\$ 416,172
Operating expenses			
Administrative expenses	6	1,002,306	702,596
Sales and marketing expenses	6	63,654	74,060
Gain (loss) from operations		222,673	(360,484)
Financing expense, net	14	1,129,343	159,166
Accretion expense	14	798,563	78,347
Unrealized loss (gain) in fair value change of investments	7	35,951	(169,954)
Change in fair value of derivative liabilities	14,15	328,877	-
Other income		(324,250)	(24,886)
Net loss		<u>\$ (1,745,811)</u>	<u>\$ (403,157)</u>
Other comprehensive loss			
Unrealized loss on foreign currency translation		(322,657)	(76,566)
Comprehensive loss		<u>\$ (2,068,468)</u>	<u>\$ (479,723)</u>
Loss per share - basic and diluted		<u>\$ (0.02)</u>	<u>\$ (0.01)</u>
Weighted average shares outstanding:			
Basic and diluted		<u>103,885,041</u>	<u>70,307,170</u>

Approved on behalf of the Board:

Gary Herman, Director

Stephen Christoffersen, Director

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

XS Financial Inc.
Unaudited condensed consolidated statements of financial position
As of March 31, 2022 and December 31, 2021
(Expressed in United States dollars)

	Note	March 31, 2022	(Audited) December 31, 2021
Assets			
<i>Current assets</i>			
Cash		\$ 14,273,082	\$ 17,119,026
Investments	7	49,821	85,772
Trade receivables, net	8	256,910	-
Financing receivables, short-term	9	11,447,185	9,484,979
Prepaid and other current assets	10	117,004	115,097
<i>Total current assets</i>		<u>26,144,002</u>	<u>26,804,874</u>
<i>Non-current assets</i>			
Servicing and property equipment	11	26,142	27,386
Financing receivables, long-term	9	27,695,396	25,474,255
<i>Total non-current assets</i>		<u>27,721,538</u>	<u>25,501,641</u>
Total assets		<u>\$ 53,865,540</u>	<u>\$ 52,306,515</u>
Shareholders' equity and liabilities			
<i>Current liabilities</i>			
Loans and borrowings, short-term	14	\$ 1,360,147	\$ 1,287,143
Trade and other payables	12	2,347,471	1,422,453
Accrued expenses	13	4,267,855	2,966,802
Warrant derivative liabilities	15	1,458,108	1,805,665
<i>Total current liabilities</i>		<u>9,433,581</u>	<u>7,482,063</u>
<i>Non-current liabilities</i>			
Loans and borrowings, long-term	14	34,868,939	34,334,201
Embedded derivative liabilities	14	1,749,156	1,072,722
<i>Total non-current liabilities</i>		<u>36,618,095</u>	<u>35,406,923</u>
Total liabilities		46,051,676	42,888,986
<i>Shareholders' equity</i>			
Share capital	16	20,766,334	20,766,334
Reserves		9,137,155	8,672,317
Conversion feature - debentures		930,697	930,697
Accumulated other comprehensive loss		350,853	673,545
Accumulated deficit		(23,371,175)	(21,625,364)
<i>Total shareholders' equity</i>		<u>7,813,864</u>	<u>9,417,529</u>
Total shareholders' equity and liabilities		<u>\$ 53,865,540</u>	<u>\$ 52,306,515</u>

Nature of operations and background information (Note 1)
Contingencies (Notes 14 and 20)
Subsequent events (Note 23)

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

XS Financial Inc.

Unaudited condensed consolidated statements of changes in equity

For the three months ended March 31, 2022 and 2021

(Expressed in United States dollars)

	Note	Number of Common Shares	Number of Proportionate Common Shares	Share Capital	Reserves	Conversion feature for debentures	Accumulated other comprehensive loss	Accumulated deficit	Total
Balance at January 1, 2021		32,337,724	23,107	\$ 14,688,043	\$ 3,589,233	\$ 939,534	\$ (42,789)	\$ (18,639,943)	\$ 534,078
Issuance of common shares to consultants and related parties	16	1,988,891	-	490,006	-	-	-	-	490,006
Common shares, proportionate voting shares and warrants issued in connection with private placement, net of issuance costs of \$1,464,866	15,16	40,709,731	5,251	5,529,194	4,385,379	-	-	-	9,914,573
Share-based incentive compensation	18	-	-	-	124,911	-	-	-	124,911
Net loss and comprehensive loss		-	-	-	-	-	(76,566)	(403,157)	(479,723)
Balance at March 31, 2021		<u>75,036,346</u>	<u>28,358</u>	<u>\$ 20,707,243</u>	<u>\$ 8,099,523</u>	<u>\$ 939,534</u>	<u>\$ (119,355)</u>	<u>\$ (19,043,100)</u>	<u>\$ 10,583,845</u>
Balance at January 1, 2022		75,526,443	28,358	\$ 20,766,334	\$ 8,672,317	\$ 930,697	\$ 673,510	\$ (21,625,364)	\$ 9,417,494
Share-based incentive compensation	18	-	-	-	464,838	-	-	-	464,838
Net loss and comprehensive loss		-	-	-	-	-	(322,657)	(1,745,811)	(2,068,468)
Balance at March 31, 2022		<u>75,526,443</u>	<u>28,358</u>	<u>\$ 20,766,334</u>	<u>\$ 9,137,155</u>	<u>\$ 930,697</u>	<u>\$ 350,853</u>	<u>\$ (23,371,175)</u>	<u>\$ 7,813,864</u>

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

XS Financial Inc.
Unaudited condensed consolidated statements of cash flows
For the three months ended March 31, 2022 and 2021
(Expressed in United States dollars)

	Note	Three months ended	
		March 31,	
		2022	2021
Cash flows from operating activities			
Net loss for the year		\$ (1,745,811)	\$ (403,157)
Adjustments to reconcile loss to net cash flows:			
Depreciation and amortization	11	4,077	4,563
Unrealized loss (gain) on investment	7	35,951	(169,954)
Change in fair value of derivative liabilities	14,15	328,877	-
Incentive compensation expense	18	464,838	124,911
Common shares issued for services	15	-	169,001
Interest expense paid in kind	14	168,086	-
Finance and accretion expense	14	798,563	78,347
		54,581	(196,289)
Change in working capital items:			
Trade and other receivables	8	(256,910)	-
Financing receivables	9	(4,183,347)	(2,737,767)
Prepaid and other current assets	10	(1,907)	10,260
Trade and other payables	12	925,018	290,254
Accrued expenses	13	1,301,019	(243,589)
Net cash flows used in operating activities		(2,161,546)	(2,877,131)
Cash flows from investing activities			
Purchases of servicing and property equipment	11	(2,834)	-
Net cash flows used in investing activities		(2,834)	-
Cash flows from financing activities			
Proceeds from issuance of private placement, net of issuance costs	16	-	9,914,574
Proceeds from loans and borrowings	14	-	2,250,000
Repayment of loans and borrowings	14	(358,907)	(2,025,243)
Net cash flows provided by (used in) financing activities		(358,907)	10,139,331
Effect of exchange rate changes on cash		(322,657)	(76,566)
Net increase (decrease) in cash		(2,845,944)	7,185,634
Cash at beginning of the the year		17,119,026	545,990
Cash at end of the year		\$ 14,273,082	\$ 7,731,624
Supplemental disclosure of cash flow information:			
Cash paid for interest		\$ 1,065,383	\$ 142,788
Non-cash investing and financing activities			
Private placement issuance costs - warrants issued	15,16	-	442,508
Issuance of units in connection with the payment of a finance fee related to the private placement	16	-	341,659

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

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(1) Nature of operations and background information

XS Financial Inc. ("XSF", or "the Company"), which changed its name from Xtraction Services Holdings Corp. on June 26, 2020 and formerly known as Caracara Silver Inc. ("Caracara") was incorporated under the laws of the Province of British Columbia on December 3, 2009 and is listed on the Canadian Securities Exchange ("CSE") under the symbol "XSF".

XSF, inclusive of its wholly-owned subsidiary Xtraction Services, Inc ("XSI"), is a specialty finance company that provides equipment leasing solutions in the United States to owner/operators of cannabis and hemp companies including cultivators, oil processors, manufacturers, testing laboratories, among others and operates in one business segment in one geographic area. Its registered office is located at 301 - 1665 Ellis Street, Kelowna, British Columbia, V1Y 2B3 and its operations address is 1901 Avenue of The Stars, Suite 120, Los Angeles, California 90067, USA.

On July 13, 2020, the Company purchased CA Licensed Lenders LLC ("CFL"), whereby the only asset was a California lenders license.

On July 7, 2021, the Company established XSF SPC, LLC ("XSF SPC"), a Delaware limited liability company wholly owned by XSF, and utilized as a special purpose vehicle for the purpose of funding new leases under a \$15,000,000 credit facility entered into in September of 2021 (Note 14).

The accompanying condensed consolidated financial statements have been approved by the Company's board of directors and are authorized for issuance as of May 24, 2022.

(2) Basis of presentation

Statement of compliance

These condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and International Accounting Standards and Interpretations (collectively IFRSs) as issued by the International Accounting Standards Board (IASB).

Basis of consolidation

Subsidiaries are entities over which the Company has control, where control is defined to exist when the Company is exposed to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Subsidiaries are consolidated from the date control is transferred to the Company and are de-consolidated from the date control ceases.

The condensed consolidated financial statements incorporate the financial statements of the Company and its wholly owned subsidiaries, Xtraction Services, Inc. incorporated in Delaware, United States, CA Licensed Lenders LLC incorporated in California, United States, XSF SPC,

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

LLC incorporated in Delaware, United States and CSI Princessa Inc. incorporated in Ontario, Canada. The results of subsidiaries acquired or disposed of during the year are included in the condensed consolidated financial statements of loss and comprehensive loss from the effective date of acquisition up to the effective date of disposal, as appropriate.

All intercompany transactions, balances, income and expenses are eliminated upon consolidation.

Functional and presentation currency

The condensed consolidated financial statements of the Company are presented in U.S. dollars (USD). The functional currency of the Company and CSI Princessa Inc., its Canadian subsidiary, is the Canadian dollar. The functional currency of Xtraction Services, Inc., CA Licensed Lenders LLC and XSF SPC, LLC is the U.S. dollar.

Basis of measurement

The condensed consolidated financial statements have been prepared on the going concern and historical cost bases, except for derivative financial instruments and hybrid financial liabilities designated at fair value through net income or loss, which have been measured at fair value. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services. In addition, these condensed consolidated financial statements have been prepared using the accrual basis of accounting except for cash flow information.

Use of estimates and judgement

The preparation of financial statements in compliance with adopted IFRS requires the use of certain critical accounting estimates. It also requires the management of the Company to exercise judgment in applying the Company's accounting policies. The areas where significant judgments and estimates have been made in preparing the condensed consolidated financial statements and their effect are disclosed in Note 4 below.

(3) Significant accounting policies

The Company has applied the same accounting policies and methods of computation in its interim condensed consolidated financial statements as in its 2021 and 2020 annual consolidated financial statements. The Company had no additional new standards adopted that resulted in changes to the Company's accounting policies for the three months ended March 31, 2022.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

Fair value of financial instruments

The following fair value hierarchy table presents information about each major category of the Company's financial assets and liabilities measured at fair value on a recurring basis:

	<u>Fair Value Measurement at Reporting Date Using</u>			<u>Total</u>
	<u>Quoted Prices in Active Markets for Identical Assets (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>	
As of March 31, 2022:				
Assets:				
Investments (Note 7)	\$ 49,821	\$ -	\$ -	\$ 49,821
Liabilities:				
Warrant derivative liabilities (Note 15)	\$ -	\$ -	\$ 1,458,108	\$ 1,458,108
Embedded derivative liabilities (Note 14)	\$ -	\$ -	\$ 1,749,156	\$ 1,749,156
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,207,264</u>	<u>\$ 3,207,264</u>
As of December 31, 2021:				
Assets:				
Investments (Note 7)	\$ 85,772	\$ -	\$ -	\$ 85,772
Liabilities:				
Warrant derivative liabilities (Note 15)	\$ -	\$ -	\$ 1,805,665	\$ 1,805,665
Embedded derivative liabilities (Note 14)	\$ -	\$ -	\$ 1,072,722	\$ 1,072,722
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 2,878,387</u>	<u>\$ 2,878,387</u>

The estimated fair value of the warrant derivative and embedded derivative liabilities would increase or decrease if the expected volatility and conversion price was higher or lower.

The following table shows a reconciliation from January 1, 2022 through March 31, 2022 for Level 3 fair values:

	<u>Warrant derivative liabilities</u>	<u>Embedded derivative liabilities</u>	<u>Total</u>
Balance at January 1, 2022	\$ 1,805,665	\$ 1,072,722	\$ 2,878,387
Net change in fair value (unrealized)	(347,557)	676,434	328,877
Balance at March 31, 2022	<u>\$ 1,458,108</u>	<u>\$ 1,749,156</u>	<u>\$ 3,207,264</u>

Transfers between levels are considered to occur on the date that the fair valuation methodology changes. There were no transfers between levels during the current or comparative periods.

(4) Critical accounting estimates and judgements

In the application of the Company's accounting policies, which are described in Note 3 above, the Company's management are required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these assumptions.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

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 revision affects both current and future periods. Significant judgments, estimates and assumptions that have the most significant effect on the amounts recognized in the condensed consolidated financial statements are described below.

Depreciation of Servicing Equipment and Property and Equipment and Estimate of Useful Lives

Depreciation of servicing and property and equipment is dependent upon estimates of useful lives. The Company estimates the useful lives of these assets based on the period over which the assets are expected to be available for use. The estimated useful lives are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the relevant assets.

Long-Lived Assets and Impairment

Long-lived assets, such as servicing equipment and property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, the Company estimates its recoverable amount. An impairment loss is recognized to the extent the carrying value exceeds its recoverable amount. Fair value is determined using various valuation techniques, including discounted cash flow models, quoted market values, and third-party independent appraisals, as considered necessary.

Share-based Incentive Compensation

The Company determines costs for share-based payments using market-based valuation techniques. The fair value of the market-based and performance-based share awards are determined at the date of grant using generally accepted valuation techniques. Assumptions are made and judgment used in applying valuation techniques. These assumptions and judgments include estimating the future volatility of the stock price, expected dividend yield, future employee turnover rates and future employee stock option exercise behaviors and corporate performance. Such judgments and assumptions are inherently uncertain. Changes in these assumptions affect the fair value estimates. The assumptions and models used for estimating fair value for share-based payment transactions is disclosed in Note 18. The expected volatility assumptions for the Company's option and warrant grants are based on both the Company's and comparable companies volatility.

Derivative Liabilities

Derivative liabilities are initially recognized at fair value on the date entered into and are subsequently remeasured to their fair value at the end of each reporting period. Changes in the fair value of any derivative instrument are recognized immediately as a component of other expense (income) in the condensed consolidated statements of loss and comprehensive loss. The fair value of the derivative liabilities are subject to measurement uncertainty due to the assumptions made for the inputs in the valuation models. See Notes 14 and 15.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

Compound Financial Instruments

The initial recognition of the compound financial instruments requires that the liability component and the conversion feature are recognized separately. Judgement is required to determine whether the conversion feature meets the definition of equity or a derivative liability. The fair values at initial recognition is subject to measurement uncertainty. See Note 14.

Functional Currency Determination

The functional currency for the Company and its subsidiaries is the currency of the primary economic environment in which the entity operates.

Determination of functional currency is conducted through an analysis of the consideration factors identified in IAS 21. The Effects of Changes in Foreign Exchange Rates may involve certain judgments to determine the primary economic environment. The Company reconsiders the functional currency of its entities if there is a change in events and conditions which determine the primary economic environment. Significant changes to those underlying factors could cause a change to the functional currency.

Determination of Discount Rates

Determination of the discount rate for term loans and convertible debentures is based on comparison to similar interest-bearing debt instruments of a group of comparative companies.

Determination of Financing Lease or Operating Lease

In making the determination of whether an arrangement should be accounted for as a financing lease or an operating lease, the Company makes certain assumptions including, the interest implicit in the lease and the residual value of the equipment at the end of the lease.

Expected Credit Losses

See Note 9.

Definition of a Business

Determination of whether a set of assets acquired, and liabilities assumed constitute a business under IFRS 3 requires the Company to make certain judgments, taking into account all facts and circumstances.

Contingencies

See Note 14 and 20.

Income, Value Added, Withholding and Other Taxes

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

The Company is subject to income, value added, withholding and other taxes. Significant judgment is required in determining the Company's provisions for taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Company recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. The determination of the Company's income, value added, withholding and other tax liabilities requires interpretation of complex laws and regulations. The Company is also subject to tax regulations as they relate to flow-through financing arrangements. The Company's interpretation of taxation law as applied to transactions and activities may not coincide with the interpretation of the tax authorities. All tax related filings are subject to government audit and potential reassessment subsequent to the financial statement reporting period. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the tax related accruals and deferred income tax provisions in the period in which such determination is made.

(5) Revenue

The following table presents a disaggregation of revenue by source and timing of revenue recognition:

	Three months ended	
	March 31,	
	2022	2021
Revenue source:		
Financing income on financing leases (Note 9)	\$ 1,283,633	\$ 406,172
Other revenue	5,000	10,000
	<u>\$ 1,288,633</u>	<u>\$ 416,172</u>

Revenue concentration

All of the Company's revenue is derived from customers in the United States with three customers representing 35%, 30%, and 21% for the three months ended March 31, 2022 and 39%, 22% and 21% of the Company's recognized revenue for the three months ended March 31, 2021.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(6) Expenses by nature

The following tables presents an analysis of expense by nature:

	Three months ended	
	March 31,	
	2022	2021
Administrative expenses:		
Compensation and benefits	\$ 270,057	\$ 19,359
Incentive compensation	464,838	124,911
Contractors and outside services	75,324	131,576
Management fee	-	86,001
Professional fees	57,223	239,254
Travel, meals and entertainment	5,723	3,597
Insurance	58,434	57,188
Depreciation expense	4,077	4,563
Other expenses	66,630	36,147
	<u>1,002,306</u>	<u>\$ 702,596</u>
Sales and marketing expenses:		
Compensation and benefits	\$ 52,271	\$ 27,835
Contractors and outside services	-	16,700
Advertising and marketing	11,291	28,998
Other expenses	92	527
	<u>\$ 63,654</u>	<u>\$ 74,060</u>

(7) Investments

In January 2020, the Company entered into a strategic partnership and cooperation agreement with KushCo Holdings Co. Inc. (“KushCo”), a CDN publicly listed company, whereby the Company issued 10,600.3 proportionate voting shares at a share price of approximately \$309CAD (\$236) for total consideration of \$3,273,100 in exchange for 1,653,081 shares of KushCo valued at the fair value of the KushCo shares at the time of receipt based on the quoted market price on the date of the transaction. In August 2021, KushCo merged with Greenlane Holdings, Inc. (“Greenlane”), a NASDAQ publicly listed company. The Company received 0.3016 shares of Greenlane common stock for each share of KushCo common stock owned, and Greenlane became the holders of the Company’s 10,600.3 proportionate voting shares.

The Company recorded the shares received from Greenlane (formerly KushCo) as investments on the consolidated statement of financial position. Investments are classified at FVTPL. At March 31, 2022 the remaining investment in Greenlane (formerly KushCo) was re-valued at \$49,821. The Company recorded an unrealized change in fair value, resulting in a loss of \$35,951 and a gain of \$(169,954) in the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2022 and 2021, respectively.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(8) Trade receivables

The carrying value of trade receivables as of March 31, 2022 and December 31, 2021 was \$256,910 and \$nil, respectively.

Trade receivables are measured at amortized cost net of allowance for uncollectible amounts. The Company determines its expected credit loss based on a number of factors, including length of time an account is past due, the customer's previous loss history, and the ability of the customer to pay its obligation to the Company. The Company writes off receivables when they become uncollectible. Expected credit losses are included in general and administration expenses within the condensed consolidated statements of loss and comprehensive loss.

(9) Financing receivables

The following table presents financing receivables:

	March 31, 2022	December 31, 2021
Financing receivables, short-term	\$ 11,447,185	\$ 9,484,979
Financing receivables, long-term	27,695,396	25,474,255
	<u>\$ 39,142,581</u>	<u>\$ 34,959,234</u>

The Company has entered into lease arrangements as a lessor that are considered to be finance leases. All of the risks and rewards of ownership of the service equipment assets underlying the finance leases are substantially transferred to the lessee.

The following table presents a maturity analysis of lease receivables, including the undiscounted lease payments to be received as at March 31, 2022:

2022	\$ 12,037,474
2023	15,772,921
2024	13,953,164
2025	5,571,634
2026	560,171
Total undiscounted lease payments receivable	47,895,364
Unearned finance income	(8,752,783)
Net investment in lease	<u>\$ 39,142,581</u>

Allowance for credit losses

The Company measures loss allowances based on an expected credit loss ("ECL") impairment model for all financial instruments except those measured at FVTPL. Application of the model depends on the following credit stages of the financial assets:

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

- (i) Stage 1 - for new leases recognized and for existing leases that have not experienced a significant increase in credit risk since initial recognition, a loss allowance is recognized equal to the credit losses expected to result from defaults occurring in the next 12 months;
- (ii) Stage 2 - for those leases that have experienced a significant increase in credit risk since initial recognition, a loss allowance is recognized equal to the credit losses expected over the remaining life of the lease; and
- (iii) Stage 3 - for leases that are considered to be credit-impaired, a loss allowance equal to full life time ECLs is recognized.

Thus, the evaluation of the allowance for credit losses is performed on a lease by lease basis. Definitions of default have been selected to eliminate the judgement that may otherwise be necessary, given the diversity within the finance receivable portfolio, the lack of individual drivers of changes in credit risk across assets and over time, and the resulting inability to assess which specific assets will be rectified. For the purposes of measuring ECL, a default is defined as leases and loans that have missed one payment and are not subsequently rectified within 60 days.

The Company is entitled to repossess financed equipment if the borrower defaults on their lease obligations. Any amounts recovered from the sale of repossessed equipment are credited to the allowance for credit losses when received.

The process of estimating ECLs uses the following inputs and assumptions to reflect information about past events, current conditions and forecasts of future conditions that are not already captured in the inputs:

- Recoveries of amounts previously written off in the last 12 months, as an estimate of recoveries for the next 12 months;
- An estimate of the effects of natural disasters and economic shocks that have occurred on credit losses in the next 12 months;
- The stage of the business cycle for the industry, which considers: the competitive environment, GDP growth, prevailing interest rates and expectations of future rates, fiscal policy and inflation rates; and
- Current delinquency trends of non-accrual and greater than 30 days delinquency rates.

Determining the inputs listed and ECLs requires significant estimation uncertainty. The estimation and application of forward-looking information requires significant judgement.

As of March 31, 2022, there are no finance receivables past due or impaired and the Company has not recognized and loss allowance for expected credit losses on financing receivables.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(10) Prepaid and other current assets

The following table presents prepaid and other current assets:

	March 31, 2022	December 31, 2021
Prepaid insurance	\$ 31,362	\$ 42,369
Prepaid software costs	50,000	-
Vendor receivable	10,000	37,462
Canada tax receivable	11,979	16,550
Other	13,663	18,716
	<u>\$ 117,004</u>	<u>\$ 115,097</u>

(11) Servicing, property and equipment

The following table below presents the change in carrying value of the Company's servicing property and equipment from January 1, 2022, through March 31, 2022:

	<u>Computers</u>	<u>Machinery and equipment</u>	<u>Servicing equipment</u>	<u>Total</u>
Cost:				
Balance at January 1, 2022	\$ 13,621	\$ 3,490	\$ 64,825	\$ 81,936
Additions	2,833	-	-	2,833
Balance at March 31, 2022	<u>\$ 16,454</u>	<u>\$ 3,490</u>	<u>\$ 64,825</u>	<u>\$ 84,769</u>
Accumulated Depreciation:				
Balance at January 1, 2022	\$ (11,023)	\$ (2,385)	\$ (41,142)	\$ (54,550)
Depreciation	(650)	(174)	(3,253)	(4,077)
Balance at March 31, 2022	<u>\$ (11,673)</u>	<u>\$ (2,559)</u>	<u>\$ (44,395)</u>	<u>\$ (58,627)</u>
Net book value:				
Balance at December 31, 2021	\$ 2,598	\$ 1,105	\$ 23,683	\$ 27,386
Balance at March 31, 2022	\$ 4,781	\$ 931	\$ 20,430	\$ 26,142

All of the servicing and property and equipment is located in the United States.

Depreciation expense related to servicing, property and equipment is included in administrative expenses within the condensed consolidated statements of loss and comprehensive loss.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(12) Trade and other payables

The following table presents trade and other payables:

	March 31, 2022	December 31, 2021
Trade payables	\$ 2,346,088	\$ 1,418,595
Other payables	1,383	3,858
	<u>\$ 2,347,471</u>	<u>\$ 1,422,453</u>

Trade payables primarily comprise equipment purchases satisfying financing agreements with the Company's customers.

(13) Accrued expenses

The following table presents accrued expenses:

	March 31, 2022	December 31, 2021
Accrued servicing equipment purchases	\$ 3,897,552	\$ 2,630,511
Accrued professional fees	75,000	82,850
Accrued compensation, commissions, benefits and related taxes	165,674	-
Accrued sales tax	50,655	11,777
Unearned revenue	78,974	17,500
	<u>\$ 4,267,855</u>	<u>\$ 2,966,802</u>

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(14) Loans and borrowings

The following table presents loans and borrowings outstanding:

Description	Maturity date	Interest rate	March 31, 2022	December 31, 2021
Line of credits:				
Line of credit	November, 2022	8.0%	\$ -	\$ -
Credit facility	September, 2023	11.75%	-	-
Term loans:				
Syndication notes	April, 2024 - July, 2025	12.0%	4,760,713	5,119,620
Convertible debentures:				
Broker debentures	March, 2024	10.0%	218,869	218,869
Sub Receipt debentures	September, 2024	10.0%	4,059,242	4,059,242
Convertible notes	October, 2023	9.5%	<u>33,785,335</u>	<u>33,617,249</u>
			42,824,159	43,014,980
Less:				
Unamortized discounts, debt issuance costs, financing costs and prepaid offering costs ⁽¹⁾			<u>(6,595,073)</u>	<u>(7,393,636)</u>
			<u>\$ 36,229,086</u>	<u>\$ 35,621,344</u>
Non-current			<u>\$ 34,868,939</u>	<u>\$ 34,334,201</u>
Current			<u>\$ 1,360,147</u>	<u>\$ 1,287,143</u>

Note to the table:

- (1) The carrying value of the broker debentures, and Sub Receipt debentures issued in 2019 were adjusted using a discount rate of 25% to reflect the prevailing borrowing rates associated with debt acquired by companies with a similar credit risk profile as the Company. The carrying value of the convertible notes issued in 2021 are netted against discounts related to the recognition of derivative liabilities and cash issuance costs. The debt discounts are accreted over the life of the respective debt instruments using the effective interest method.

The following table below shows the change in carrying value of the Company's loans and borrowings From January 1, 2022, through March 31, 2022:

	Line of credits	Term loans	Convertible debentures	Debt discounts, issuance costs and deferred financing costs	Total
Balance at January 1, 2021	\$ -	\$ 5,119,620	\$ 37,895,360	\$ (7,393,636) ⁽¹⁾	\$ 35,621,344
Repayments	-	(358,907)	-	-	(358,907)
Issuance of additional convertible notes as payment for PIK Interest	-	-	168,086	-	168,086
Amortization and accretion of debt discounts, financing costs and debt issuance costs	-	-	-	798,563	798,563
Balance at March 31, 2022	<u>\$ -</u>	<u>\$ 4,760,713</u>	<u>\$ 38,063,446</u>	<u>\$ (6,595,073)</u>	<u>\$ 36,229,086</u>

Note to the table:

- (1) Represents (i) debt discounts on loan borrowing proceeds and convertible debt issuances, and debt issuance costs netted against the gross proceeds of the Sub Receipt debenture issuance in 2019, (ii) debt discounts of \$3,927,168 on the convertible notes issuance in 2021 of which \$1,960,393 is allocated to embedded derivative liabilities, and \$1,966,775 is allocated to warrant derivative

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

liabilities, (iii) \$2,071,827 of debt issuance costs netted against the gross proceeds of the convertible notes and (iv) deferred financing costs related to the Company's line of credit borrowings.

Convertible debentures

In October 2021, the Company completed a private placement of unsecured convertible debenture notes ("convertible notes") in the aggregate principal amount of \$43,500,000, of which \$33,500,000 million was funded at closing with an additional \$10,000,000 available on a delayed draw on the same terms until June 30, 2022. The convertible notes mature two years following the closing date of the offering subject to a one-year extension at the option of the Company upon providing at least 30 days prior notice and issuing additional convertible notes to the holders on a pro-rata basis in an aggregate principal amount equal to 1% of the aggregate principal amount of the convertible notes outstanding as of the date of the extension notice. Additionally, as part of the transaction, one purchaser was entitled to a seat on the Company's board of directors.

The principal amount outstanding under the convertible notes may be converted by the holders at any time prior to the third business day prior to maturity into Shares at a conversion price equal to the lesser of: (i) CAD\$0.35 per Share; or (ii)(a) the last offering price per security (the "Qualified Offering Price") in one or more prospectus offerings of Shares completed by the Company within 12 months of the closing of the Offering to raise aggregate gross proceeds of at least US\$5,000,000 (a "Qualified Offering") if the date of conversion is prior to the commencement of marketing of such Qualified Offering; or (b) 125% of the Qualified Offering Price if the date of conversion is after the commencement of marketing of such Qualified Offering, all in accordance with the terms and conditions of the notes.

Interest on the convertible notes accrue at the rate of (i) 9.50% per annum, of which 7.50% shall be payable in cash and the remaining 2.00% shall be payable in kind by the issuance of additional convertible notes ("PIK Interest") and (ii) in the event of the Shares commence trading on a market tier of the Nasdaq Stock Market LLC (a "NASDAQ Listing"), interest shall accrue at a rate of 8.00% per annum, of which 6.00% shall be payable in cash, and the remaining 2.00% shall be payable as PIK Interest.

In the event of a change of control of the Company, XSF shall be required to redeem the convertible notes at a repurchase price equal to the greater of (i) 101% of the principal amount thereof, plus accrued and unpaid interest; and (ii) the product of (x) the number of Shares issuable upon conversion of the convertible notes to be redeemed and (y) the "transaction price" of such change of control, payable in the same form and amount as would be payable on the underlying Shares, all in accordance with the terms and conditions of the notes.

The Company also issued an aggregate of 16,750,000 share purchase warrants being one warrant for each US\$2.00 principal amount of convertible notes (Note 15). The warrants to be received have an exercise price of a \$0.45CAD (\$0.36) and have a three-year term.

The principal amount of the convertible notes was estimated at a fair value of \$31,539,607 at issuance with the difference of \$1,960,393 reflected as an embedded derivative liability for the conversion feature and offset against the convertible notes carrying value as a discount. The discount will be amortized to interest expense over the life of the convertible notes under the

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

effective interest rate method. Additionally, the Company incurred debt issuance costs, netted against the gross proceeds of the issuance, of \$2,071,826 in connection with the issuance of the convertible notes. The debt issuance costs were recorded as a discount on the convertible notes carrying value and are being amortized to interest expense over the life of the convertible notes under the effective interest rate method.

In March and April 2019, the Company issued \$294,000CAD (\$218,869) of convertible debentures to investment advisors and brokers for services rendered in raising debt subscriptions ("broker debentures"). The broker debentures mature after 5 years and bear interest at a rate of 10% per annum payable in cash in equal quarterly installments. The broker debentures convert into common shares and warrants at a conversion price of \$1.10CAD (\$0.82) at the holders' option prior to maturity or upon a change of control. The warrants to be received have an exercise price of a \$1.50CAD (\$1.12) and have a five-year term. Upon a change in control, the Company is required to purchase the broker debentures at a price of 105% of the principal balance plus accrued, unpaid interest. The Company has accounted for the fair value of the convertible debt at issuance of \$218,869 as debt issuance costs, within the consolidated statements of financial position and is being amortized to interest expense over the term of the Sub Receipt debentures under the effective interest rate method within the condensed consolidated statements of loss and comprehensive loss. The debt discount of \$160,499 is being amortized to interest expense over the term of the broker debentures under the effective interest rate method within the condensed consolidated statements of loss and comprehensive loss. As of September 11, 2019, with the completion of the reverse acquisition, the broker debentures were re-issued through the legal parent entity and the underlying functional currency change triggered a reclassification of the debenture liability to equity. The fair value of the debenture liability as at September 11, 2019 immediately prior to the reclassification was \$145,989.

In March and April 2019, the Company completed a private placement of 5,882 subscription receipts for aggregate gross proceeds of approximately \$5,882,000CAD (\$4,500,000) and closing costs of approximately \$560,000 CAD (\$426,000). The subscription receipts were held in escrow, until satisfaction of the escrow release conditions, at which time each subscription receipt would be convertible into one 10% unsecured convertible debenture of the Company in the principal amount of \$1,000CAD ("Sub Receipt debenture"). On September 11, 2019, the escrow conditions were met, and the Company issued \$5,882,000CAD (\$4,472,085) of convertible debentures ("Sub Receipt debentures") to various investors. The Sub Receipt debentures mature after 5 years and bear interest at a rate of 10% per annum payable in cash in equal quarterly installments. The Sub Receipt debentures convert into common shares and warrants at a conversion price of \$1.10CAD (\$0.82) at the holders' option prior to maturity or upon a change of control. The warrants to be received have an exercise price of a \$1.50CAD (\$1.12) and have a five-year term. Upon a change in control the Company is required to purchase the Sub Receipt debentures at a price of 105% of the principal balance plus accrued, unpaid interest.

The principal amount of the debenture was estimated at its fair value of \$2,630,804 based on a discount rate of 25%. The Company incurred debt issuance costs, netted against the gross proceeds of the issuance, of \$1,398,268CAD (\$1,060,821) in connection with the issuance of the Sub Receipt debentures, of which \$821,332CAD (\$623,112) was allocated to the debenture liability. The debt issuance costs were recorded as a discount on the Sub Receipt debentures carrying value and are being amortized to interest expense over the life of the sub receipts

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

convertible debentures under the effective interest rate method. The residual value of the debenture of \$1,841,281 was allocated to the conversion feature and recorded as a component of equity, net of issuance costs of \$437,709 and deferred tax impact of \$384,000.

The Company incurred interest expense related to the convertible debentures of \$909,606, of which \$168,086 is non-cash PIK interest, and \$111,922 for the three months ended March 31, 2022 and 2021, respectively, within the condensed consolidated statements of loss and comprehensive loss.

Line of credits

In September 2021, the Company entered into a secured term loan credit facility (“credit facility”), with a maximum borrowing base of \$15,000,000 and required monthly interest payments with all unpaid principal and interest due in September 2023. The maturity date of September 2023 can be extended automatically for successive 12-month periods upon mutual agreement by both the Company and the lender. The credit facility bears interest at an annual rate equal to the Wall Street Journal Prime plus 8.5% with a prime rate floor of no less than 3.25%. The credit facility is subject to monthly financial covenants such as maintaining a minimum tangible net worth, EBITDA and default rates such as defined in the agreement. Additionally, the Company is subject to borrowing requirements whereby the minimum outstanding balance of the credit facility must equal or exceed \$2,500,000 90 days after the effective date of the credit facility agreement, and \$7,500,000 one year after the effective date of the credit facility agreement and thereafter during the remaining term of the credit facility agreement. The Company was in compliance with its financial covenants as of March 31, 2022.

Under the credit facility, the Company sells financing arrangements (“finance receivables”) to XSF SPC, LLC (“SPC”), a wholly-owned limited liability company of XSF. In turn, SPC grants, without recourse, a senior undivided interest in the financed receivables and the underlying equipment to the lender in exchange for cash while maintaining a subordinated undivided interest, in the form of over-collateralization, in the leased receivables. The Company has agreed to continue servicing the receivables for SPC at market rates; accordingly, no servicing asset or liability has been recorded. Although SPC is a wholly-owned consolidated subsidiary of the Company, SPC is legally separate from the Company and its subsidiaries. Upon and after the sale or contribution of the lease receivables to SPC, such lease receivables are legally assets of SPC, and as such are not available to creditors of other subsidiaries or the parent company.

The Company is subject to certain fees under the credit facility including an origination fee equal to the greater of \$25,000 or 1% of the Company’s first borrowing and 1% of each loan borrowing thereafter with a minimum fee of \$75,000 in the first year of the credit facility. Additionally, the Company is subject to an anniversary fee due equal to the greater of \$37,500 or 0.50% of the outstanding credit facility balance on each anniversary of the credit facility agreement. As of December 31, 2021, the Company has incurred fees and other financing costs of \$231,029 related to credit facility. The fees and financing costs were recorded net of the credit facility carrying value and are being amortized to interest expense over the life of the credit facility under the effective interest rate method. The Company incurred interest expense related to the credit facility of \$73,437, within the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2022.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

In November 2020, the Company entered into a senior secured revolving credit facility (“line of credit”), with a maximum borrowing base of \$2,000,000 and required monthly interest payments with all principal and unpaid interest payments due in November 2022. In July 2021, the Company increased the maximum borrowing base to \$4,000,000. The line of credit bears interest at an annual rate equal to the greater of (i) 8.0% per annum or (ii) the Wall Street Journal Prime plus 4.0% and may be prepaid with no penalty at any time. The line of credit is subject to monthly financial covenants such as maintaining a maximum total leverage ratio and tangible net worth, such as defined in the agreement. The Company was in compliance with its financial covenants as of March 31, 2022. The line of credit is secured by substantially all of the assets of the Company. The Company incurred financing costs of \$22,321 related to the increase in the line of credit borrowing base. The financing costs were recorded net of the line of credit carrying value and are being amortized to interest expense over the life of the line of credit under the effective interest rate method. The Company incurred interest expense related to the line of credit of \$nil and \$42,710, within the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2022 and 2021, respectively.

Term loans

In February 2021, the Company launched its syndication platform by way of entering into promissory note agreements (“syndication notes”) with third-party lenders totaling \$5,765,000 with maturity dates ranging from April 2024 to July 2025. The syndication notes bear interest at rates between 10.25% and 12% per annum, payable monthly. Each syndication note is secured by the lease payment streams and the underlying equipment of certain finance leases the Company has entered into with customers. The Company incurred interest expense related to the syndication notes of \$146,300 and \$3,333 within the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2022 and 2021, respectively.

Summary of financing expense, net

The following table below details financing expense, net:

	Three months ended	
	March 31,	
	2022	2021
Financing expense:		
Convertible debentures	\$ 909,606	\$ 111,922
Term loans	146,300	3,333
Line of credits	73,437	42,710
Other	-	1,201
	<u>\$ 1,129,343</u>	<u>\$ 159,166</u>

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

Embedded derivative liabilities

The conversion feature of the convertible notes was considered an embedded derivative liability as the conversion price is not fixed. The Company performed a Binomial Lattice Model analysis that probability weighted various expected conversion prices, resulting in a fair value of \$1,960,393 determined at issuance, and accounted for the embedded derivative liabilities as a long-term liability within the statements of financial position. At March 31, 2022 the embedded derivative liabilities were re-valued at \$1,749,156 with the change in fair value of \$676,434 reflected in the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2022.

The fair value of the embedded derivative liabilities was determined using a Binomial Lattice Model with the following assumptions as of March 31, 2022:

Expected dividend yield		-
Expected volatility		100.0%
Risk-free interest rate		2.0%
Expected term		1.6 years
Conversion / share price	\$	Various

(15) Warrants

The Company had no warrant activity from January 1, 2022, through March 31, 2022.

Warrant issuances

In October 2021, in connection with the private placement of unsecured convertible notes (Note 14), the Company issued 16,750,000 of common share warrants. The warrants have a term of three years and an exercise price of \$0.45CAD (\$0.36) per share. The warrants had a value of \$0.15CAD (\$0.13) on the date of issue based on the allocation of the total carrying value of the convertible notes using the Black-Scholes option pricing model. The Company recorded \$2,395,079CAD (\$1,966,775) as a derivative liability as the exercise price is not fixed with an offset reflected as a discount to carrying value of the convertible notes within the consolidated statements of financial position. At March 31, 2022, the warrant derivative liabilities were re-valued using the Black-Scholes option pricing model at \$1,822,350CAD (\$1,458,108) with a change in fair value of \$428,177CAD (\$347,557) reflected in the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2022.

The grant date fair value of the warrants was determined using the Black-Scholes option pricing model with the following assumptions during the three months ended March 31, 2022:

Expected dividend yield		-
Expected volatility		155.1%
Risk-free interest rate		2.3%
Expected term		2.6 years
Conversion / share price	\$	0.36

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

In March 2021, the Company issued 40,709,731 common share warrants, of which 1,450,000 of the warrants were satisfaction for a corporate financing fee, and 5,251 proportionate voting share warrants related to a private placement equity issuance (Note 16). The warrants have a term of two years and exercise prices of \$0.45CAD (\$0.36) per share for the common share warrants and \$450CAD (\$360) per share for the proportionate voting share warrants. The non-corporate financing fee warrants had a value of \$5,377,706CAD (\$4,267,007) on the date of issue using the Black-Scholes option pricing model and were recorded as a component of equity within the consolidated statements of financial position. The corporate financing fee warrants had a value of \$175,194CAD (\$137,595) on the date of issue using the Black-Scholes option pricing model and were recorded as a component of equity as non-cash equity issuance costs within the consolidated statements of financial position.

In connection with the private placement the Company issued an additional 2,353,400 common share warrants to brokers and agents for services rendered in the private placement equity issuance. The warrants entitle the holder to acquire one unit at a price of \$0.30CAD (\$0.24) for a period of two years from the date of issuance. Each unit consists of one common share and one warrant. The warrants to be received have an exercise price of a \$0.45CAD (\$0.36) and have a two-year term. The warrants had a value of \$561,809CAD (\$442,508) on the date of issue using the Black-Scholes option pricing model and were recorded as a component of equity as non-cash equity issuance costs within the consolidated statements of financial position.

The following table presents warrants outstanding at March 31, 2022:

<u>Expiration date</u>	<u>Term (years)</u>	<u>Number of warrants outstanding</u>	<u>Number of warrants exercisable</u>	<u>Exercise price US \$</u>	<u>Exercise price CAD \$</u>
Common share warrants:					
3-Mar-23	2	40,709,731	40,709,731	\$ 0.36	\$ 0.45
3-Mar-23	2	2,353,400	2,353,400	\$ 0.36	\$ 0.45
12-Apr-24	5	500,000	500,000	\$ 0.82	\$ 1.10
11-Sep-24	5	374,308	374,308	\$ 0.82	\$ 1.10
11-Sep-24	5	5,452,134	5,452,134	\$ 1.12	\$ 1.50
11-Sep-24	5	363,636	363,636	\$ 1.13	\$ 1.50
11-Sep-24	5	50,000	50,000	\$ 1.14	\$ 1.50
11-Sep-24	5	22,727	22,727	\$ 1.16	\$ 1.50
11-Sep-24	5	25,454	25,454	\$ 1.05	\$ 1.50
11-Sep-24	5	31,818	31,818	\$ 1.20	\$ 1.50
1-Oct-24	3	16,750,000	16,750,000	\$ 0.36	\$ 0.45
Proportionate voting share warrants:					
3-Mar-23	2	5,251	5,251	\$ 355.55	\$ 450.00
Total		<u>66,638,459</u>	<u>66,638,459</u>		

The weighted average remaining term for outstanding warrants is 1.5 years, and the weighted average exercise price is \$0.47CAD (\$0.37) as at March 31, 2022.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(16) Share capital

As at March 31, 2022 and December 31, 2021, the Company has an unlimited number of authorized common and proportionate voting shares with no par value. Proportionate voting shares can be converted into common shares at the option of the holders at a ratio of 1,000 to 1 upon approval of the Company's Resulting Issuer Board and satisfaction of the condition that greater than 40% of common and proportionate shareholders are US residents. On all voting matters, common shareholders are entitled to one vote and proportionate voting shareholders are entitled to 1,000 votes per proportionate voting share. Generally, in all other matters the proportionate voting shareholders have the same rights as the common shareholders and will be treated as if they were one class of shares. At March 31, 2022 and December 31, 2021, the Company had 75,526,443 issued and outstanding common shares and 28,358 issued and outstanding proportionate voting shares, respectively.

Share issuances

In March and June 2021, the Company issued 1,988,891 common shares at share prices ranging between \$0.30CAD (\$0.24) and \$0.37CAD (\$0.30), based on the value of the services provided, to consultants and a related party (Archytas) (Note 20), as consideration for services performed. The Company recorded \$404,563CAD (\$321,005) for 1,348,542 of the common shares issued as a reduction to accrued expenses for previously accrued bonuses, within the condensed consolidated statements of financial position, and \$211,639CAD (\$169,001) for the remaining 640,349 of common shares issued as general and administrative expense, within the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2021.

In February and March 2021, the Company received gross proceeds of \$13,353,219CAD (\$10,595,270), including \$1,575,300 CAD (\$1,249,940) from a related party Archytas (Note 20), net of cash issuance costs of \$914,667CAD (\$720,141), from the issuance of 39,259,731 units at a price \$0.30CAD (\$0.24) and 5,251 proportionate voting units at a price \$300CAD (\$238). Each unit consists of one common share and one warrant. The warrants to be received have an exercise price of a \$0.45CAD (\$0.36) and \$450CAD (\$360) for the units and proportionate voting units, respectively, and have a two-year term (Note 15). The Company recorded \$7,975,513CAD (\$6,328,263) of the unit value as share capital with the residual value of \$5,377,706CAD (\$4,267,007) allocated to warrants (Note 15) and recorded as a component of equity within the consolidated statements of financial position.

In connection with the private placement the Company issued an additional 2,353,400 warrants to brokers and agents which entitled the holder to acquire one unit at a price of \$0.30CAD (\$0.24) for a period of two years from the date of issuance (Note 15), and an aggregate of 1,450,000 units in satisfaction of a corporate finance fee. Each unit consists of one common share and one warrant. The warrants to be received have an exercise price of a \$0.45CAD (\$0.36) and have a two-year term. The corporate financing fee common shares had a value of \$259,824CAD (\$204,064) on the date of issue using the Black-Scholes option pricing model and were recorded as a component of equity as non-cash equity issuance costs within the consolidated statements of financial position.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

(17) Income taxes

The Company recognized a deferred income tax provision of \$Nil for both the three months ended March 31, 2022 and 2021.

Income tax expense is recognized based on management's estimate of the weighted average effective annual income tax rate expected for the full financial year. The estimated average annual tax rate was 26.5%, for the three months ended March 31, 2022 and 2021.

(18) Share-based compensation

In September 2019, the Company established the Omnibus Incentive Plan ("Incentive Plan") which replaced and governs all options under the Company's previously issued 2018 Stock Option Plan. The Omnibus plan was revised in August 2021. The Incentive Plan provides for the granting of up to 15% of outstanding shares and is not to exceed a maximum of 75,000,000 share-based equity incentive compensation awards such as stock options and restricted stock awards to directors, officers, employees, contractors, and advisors, as determined by the Company's board of directors.

In January 2022, the Company granted a total of 14,917,080 options to employees, directors and consultants of the Company with an exercise price of \$0.18CAD (\$0.14). The options have terms of five years, with vesting terms either immediately or over three years. A total of 10,813,040 stock options were granted to directors and officers.

In February 2022 the Company and a related party mutually cancelled 50,000 options, and the Company and an unrelated party mutually cancelled 427,500 options.

The per-share grant date weighted average fair value of stock options was estimated at \$0.11 on the date of grant for the three months ended March 31, 2022, using the Black-Scholes option pricing model with the following weighted average assumptions:

Expected dividend yield	-
Expected volatility	159.6%
Risk-free interest rate	1.6%
Expected term	3.5 years
Share price	\$ 0.14

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

The following table summarizes stock option activity under the Option Plan from January 1, 2022 through March 31, 2022:

	Number of shares	Weighted average exercise price per share	Weighted average re remaining contractual term (years)
Outstanding at January 1, 2022	17,883,548	\$ 0.21	4.5
Granted	14,917,080	\$ 0.14	
Cancelled / forfeited	<u>(477,500)</u>	\$ 0.60	
Outstanding at March 31, 2022	<u>32,323,128</u>	\$ 0.17	4.5
Exercisable and vested at March 31, 2022	<u>12,546,238</u>	\$ 0.20	4.2

As of March 31, 2022, there was approximately \$2,372,000 of unrecognized compensation expense related to unvested stock options, which is expected to be recognized over a weighted average period of 2.3 years.

The Company recorded compensation expense for stock options of \$464,838 and \$124,911 for the three months ended March 31, 2022, and 2021, respectively.

The following table summarizes the stock options outstanding as at March 31, 2022:

Expiry Date	Exercise Price US \$	Exercise Price CAD \$	Weighted Average		
			Remaining Contractual Life (years)	Number of Options Outstanding	Number of Options Vested
July 2028	\$ 0.60	\$ 0.78	6.30	539,194	539,194
November 2024	\$ 0.26	\$ 0.34	2.65	1,730,000	1,730,000
April 2025	\$ 0.16	\$ 0.22	3.06	1,471,449	1,471,449
December 2025	\$ 0.18	\$ 0.23	3.71	16,565	16,565
March 2026	\$ 0.26	\$ 0.33	3.99	1,880,180	1,114,555
April 2026	\$ 0.27	\$ 0.33	4.07	360,000	360,000
June 2026	\$ 0.25	\$ 0.30	4.20	148,660	148,660
September 2026	\$ 0.16	\$ 0.20	4.44	11,260,000	2,815,000
January 2027	\$ 0.14	\$ 0.18	4.83	14,917,080	4,350,815
	<u>\$ 0.17</u>	<u>\$ 0.22</u>	<u>4.46</u>	<u>32,323,128</u>	<u>12,546,238</u>

(19) Retirement plan

The Company sponsors a defined contribution 401(k) retirement plan (“401(k) Plan”) that allows eligible employees to contribute a portion of their compensation through payroll deductions. The retirement plan is a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. Under the 401(k) Plan, participating U.S. employees may defer a portion of their pre-tax earnings, up to the U.S. Internal Revenue Service annual contribution limit (\$20,500 for calendar

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

year 2022). Participants are eligible to receive a matching contribution from the Company of 100% of the first 4% of contributions.

(20) Related party transactions

The following presents balances and transactions between the Company and other related parties as of March 31, 2022, and for the three months ended March 31, 2022 and 2021, respectively.

Key management personnel

Key employees include executive management with the authority and responsibility for planning, directing and controlling the activities of the Company. The following table presents compensation and benefit expenses of key employees:

	Three months ended	
	March 31,	
	2022	2021
Salaries, contractor costs, management fees and benefits	\$ 153,723	\$ 176,437
Incentive compensation (non-cash)	230,283	35,226
	<u>\$ 384,006</u>	<u>\$ 211,663</u>

See also Notes 16 and 18.

Related party transactions and amounts due to related parties

The following table presents expenses incurred and paid on behalf of the Company from related parties for the three months ended March 31, 2022 and 2021:

	Archytas
Amounts due to related parties at January 1, 2021	\$ 256,486
Management fee	86,001
Less payment through issuance of common shares	(341,001)
Less payments to related parties	(1,486)
Amounts due to related parties at March 31, 2021	<u>\$ -</u>
Amounts due to related parties at January 1, 2022	\$ -
Operating expenses	4,061
Less payments to related parties	(4,061)
Amounts due to related parties at March 31, 2022	<u>\$ -</u>

In March 2021, the Company received gross proceeds of \$1,249,940 from Archytas related to the issuance of 5.251 proportionate voting shares to Archytas (Note 16).

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

Effective January 2019, the Company entered into a management services agreement with Archytas at a monthly rate of \$28,667 and a term of five years, with one-year automatic renewals, whereby Archytas will provide day-to-day executive management and support to the Company. Archytas is a shareholder of the Company, having been involved in the initial formation of XSI. In March 2021, the Company authorized the issuance of 1,432,535 common shares to Archytas as payment for a 2020 management fee bonus and the 2021 first quarter management fee (Note 16). The Company recorded \$255,000 as a reduction to accrued expenses for previously accrued bonuses, within the condensed consolidated statements of financial position, and \$86,001 as management fee expense, within the condensed consolidated statements of loss and comprehensive loss for the three months ended March 31, 2021.

In July 2021, the Company and Archytas mutually agreed to terminate the management services agreement and the Company entered into employment agreements with the Company's CEO, COO and VP of Corporate Development all of whom previously provided services to the Company under the management services agreement. The Company is party to certain management contracts. These contracts may require payments upon the occurrence of termination on change in control of the Company, as defined by each officer's respective consulting agreement. As a triggering event has not taken place, the contingent payments have not been reflected in these condensed consolidated financial statements.

Related party loans and borrowings

In August and November 2021, the Company entered into syndication term loans (Note 14) with certain officers and directors of the Company with borrowings totaling \$550,000 and repayments totaling \$70,435 resulting in a balance outstanding of \$479,565 as of March 31, 2022. The Company had a balance outstanding of \$513,439 as of December 31, 2021.

(21) Financial instrument risk exposures

Financial risk management

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board mitigates these risks by assessing, monitoring and approving the Company's risk management processes:

Credit risk

Credit risk is the risk of a potential loss to the Company if a customer or third party to a financial instrument fails to meet its contractual obligations. The maximum credit exposure is the carrying amount of cash, trade and other receivables and financing receivables. The Company does not have significant credit risk with respect to customers as all payments are direct debited from customer accounts and all customers go through initial and periodic qualitative and quantitative credit analysis to evaluate and mitigate credit risk. All cash is placed with recognized U.S. and Canadian financial institutions. The Company provides credit to its customers in the normal course of business and has established credit evaluation and monitoring processes to mitigate credit risk. The Company has not recognized any loss allowance for expected credit losses on the trade and financing receivables as of March 31, 2022. See also Note 9.

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

The Company is entitled to repossess financed equipment if the lessee defaults on their contract in order to minimize any credit losses.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations associated with financial liabilities. The Company manages liquidity risk through the management of its capital structure. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to settle obligations and liabilities when due.

At March 31, 2022, the Company had current assets of \$26,144,002 and current liabilities of \$9,433,581. All current liabilities are classified as due within one year.

At March 31, 2022, the Company also has the following obligations due:

	<u>Less than 6 months</u>	<u>6 months to 1 years</u>	<u>1 to 3 years</u>	<u>Over 3 years</u>
Trade and other payables	\$ 2,347,471	\$ -	\$ -	\$ -
Accrued expenses	4,267,855	-	-	-
Amounts due to related parties	-	-	-	-
Loans and borrowings ⁽¹⁾	749,882	794,774	41,279,503	-
Balance at March 31, 2022	<u>\$ 7,365,208</u>	<u>\$ 794,774</u>	<u>\$ 41,279,503</u>	<u>\$ -</u>

Note to the table:

(1) Represents undiscounted loans and borrowings.

Market risk

Currency risk

The Company has determined its functional currency to be the Canadian dollar and U.S. dollar. The operating results and financial position of the Company are reported in U.S. dollars. The Company has minimal financial transactions denominated in currencies other than the Canadian and U.S. dollar. The Company has no hedging agreements in place with respect to foreign exchange rates. The following table presents financial instruments in CAD currency subject to currency risk:

	<u>March 31, 2022</u>	<u>December 31, 2021</u>
Tax receivable	\$ 14,981	\$ 20,920
Trade payable	\$ 48,746	\$ 47,021
Loans and borrowings ⁽¹⁾	\$ 5,633,000	\$ 5,633,000

Note to the table:

(1) Represents broker debentures and sub receipt convertible debentures (Note 14).

XS Financial Inc.

Notes to the Condensed Consolidated Financial Statements

Three Months Ended March 31, 2022, and 2021

(Expressed in United States Dollars)

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's line of credit is subject to fluctuations in interest rates and therefore exposes the Company to interest rate fair value risk. The remainder of the Company's financial debt and lease receivables have fixed rates of interest resulting in limited interest rate fair value risk for the Company.

Price risk

Price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices, other than those arising from interest rate risk or foreign currency risk. The Company is exposed to equity price risk associated with changes in the market value of its investments. The Company closely monitors equity prices to determine the appropriate course of action to be taken. A 10% change in the quoted market of investments would result in a change of approximately \$5,000 in the condensed consolidated statements of loss and comprehensive loss for the nine months ended March 31, 2022.

Coronavirus

In March 2020, the World Health Organization declared the outbreak of a novel coronavirus (COVID-19) as a pandemic, which continues to spread throughout Canada and the United States. The spread of COVID-19 has caused significant volatility in Canadian, U.S. and international markets. There is significant uncertainty around the breadth and duration of business disruptions related to COVID-19, as well as its impact on the Canadian, U.S. and international economies and, although the Company has not experienced any material impact on its operations to date, the Company is unable to determine if it will have a future material impact to its operations or ability to raise funds.

(22) Business segments

The Company has one reportable business segment, which is engaged in the business of providing leasing solutions to owners/operators of cannabis and hemp companies including cultivators, oil processors, manufacturers, and testing laboratories, among others.

(23) Subsequent events

Lease Originations

In the months of April and May 2022, the Company completed 14 lease transactions with publicly-traded and private cannabis companies including Columbia Care Inc. ("Columbia Care"), Ayr Wellness Inc., ("Ayr Wellness"), PharmaCann, Inc. ("PharmaCann"), and CLS Holdings USA, Inc ("CLS"). During this period, the Company originated over \$16.8 million of leases.