HILL INCORPORATED

(FORMERLY HILL STREET BEVERAGE COMPANY INC.)

UNAUDITED CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE-MONTH PERIOD ENDED SEPTEMBER 30, 2023 AND 2022

(Expressed in Canadian dollars)

**NOTICE TO READER**

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

The accompanying unaudited condensed interim consolidated financial statements have been prepared by and are the responsibility of management. The Company's independent auditor has not performed a review of these condensed interim consolidated financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

TORONTO, ON
November 28, 2023

**Hill Incorporated (Formerly Hill Street Beverage Company Inc.)**
**Condensed Interim Consolidated Statements of Financial Position**
(Expressed in Canadian Dollars)

| | Notes | September 30, 2023 | June 30, 2023 |
|---|---|---|---|
| | | $ | $ |
| **ASSETS** | | | |
| Current | | | |
| Cash and cash equivalents | | 713,690 | 1,195,415 |
| Accounts receivable | 5 | 296,632 | 515,955 |
| Inventory | 6 | 15,581 | 14,775 |
| Prepaid expenses | | 313,470 | - |
| Total current assets | | 1,339,373 | 1,726,145 |
| Intangible assets | 7 | 2,702,794 | 2,769,837 |
| **TOTAL ASSETS** | | 4,042,167 | 4,495,982 |
| **LIABILITIES** | | | |
| Current | | | |
| Accounts payable and accrued liabilities | 10 | 126,889 | 332,665 |
| Note payable – current | 8 | 78,739 | 107,947 |
| CEBA loan | 8 | 60,000 | 60,000 |
| | | 265,628 | 500,612 |
| Note payable – non-current | 8 | 2,440,388 | 2,361,199 |
| | | 2,706,016 | 2,861,811 |
| **SHAREHOLDERS' EQUITY** | | | |
| Share capital | 9 | 20,660,357 | 20,660,357 |
| Reserve | 9 | 5,334,505 | 5,304,587 |
| Deficit | | (24,658,711) | (24,330,773) |
| **TOTAL SHAREHOLDERS' EQUITY** | | 1,336,151 | 1,634,171 |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | | 4,042,167 | 4,495,982 |

Nature of operations and going concern (Note 1)
Subsequent events (None)

| | |
|---|---|
| "Jack Fraser" | "Craig Binkley" |
| Director | Director |

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

**Hill Incorporated (Formerly Hill Street Beverage Company Inc.)**
**Condensed Interim Consolidated Statements of Operations and Comprehensive Loss**
(Expressed in Canadian Dollars)

| For the Three-Month Period Ended | Notes | September 30, 2023 | September 30, 2022 |
|---|---|---|---|
| | | $ | $ |
| **Gross revenue** | 4 | 226,057 | 380,502 |
| **Chargebacks & listing fees** | 4 | - | (26,852) |
| **Net revenue** | | 226,057 | 353,650 |
| **Cost of sales** | | (5,027) | (113,097) |
| **Gross profit** | | 221,030 | 240,553 |
| | | | |
| **Expenses** | | | |
| Accretion expense | | - | 3,100 |
| Bad debts | 5 | - | 118,151 |
| Bank charges and interest | | (1,016) | 3,229 |
| Consulting fees | | 20,240 | 22,163 |
| Depreciation | 6 | 67,043 | 80,498 |
| Filing and transfer agent fees | | 7,484 | 6,028 |
| Insurance | | 61,055 | 59,390 |
| Interest on promissory note | 8 | 62,236 | 54,229 |
| Management fees | 10 | 21,073 | 36,236 |
| Marketing | | (11,795) | 19,976 |
| Office and miscellaneous | | 33,131 | 70,145 |
| Professional fees | | 6,570 | 60,403 |
| Stock-based compensation | 9/10 | 29,918 | 36,732 |
| Travel and meal allowance | | 4,502 | 10,097 |
| Wages and salaries | 10 | 246,933 | 250,917 |
| Selling and delivery | | 5,695 | 75,123 |
| | | 553,069 | 906,417 |
| | | | |
| Loss before other income (expenses) | | (332,039) | (665,864) |
| | | | |
| **Other income (expenses)** | | | |
| Foreign exchange gain | | 5,073 | 18,296 |
| Other (expenses) income | | (972) | 1,697 |
| | | 4,101 | 19,993 |
| | | | |
| **Net loss and comprehensive loss** | | (327,938) | (645,871) |
| **Basic and diluted loss per common share** | | (0.10) | (0.22) |
| **Weighted average number of common shares outstanding** | | 3,244,403 | 2,989,785 |

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

**Hill Incorporated (Formerly Hill Street Beverage Company Inc.)**
**Condensed Interim Consolidated Statements of Changes in Shareholders' Equity**
(Expressed in Canadian Dollars)

| | Common Shares | | | | |
|---|---|---|---|---|---|
| | Shares | Share Capital | Reserve | Deficit | Total |
| | | $ | $ | $ | $ |
| **As at June 30, 2022** | 2,972,538 | 20,095,633 | 4,884,242 | (22,223,571) | 2,756,304 |
| Exercise of RSUs (Note 9) | 22,666 | 68,000 | (68,000) | - | - |
| Stock-based compensation | - | - | 36,732 | - | 36,732 |
| Net loss for the period | - | - | - | (645,871) | (645,871) |
| **As at September 30, 2022** | 2,995,204 | 20,163,633 | 4,852,974 | (22,869,442) | 2,147,165 |
| | | | | | |
| **As at June 30, 2023** | 3,244,403 | 20,660,357 | 5,304,587 | (24,330,773) | 1,634,171 |
| Stock-based compensation | - | - | 29,918 | - | 29,918 |
| Net loss for the period | - | - | - | (327,938) | (327,938) |
| **As at September 30, 2023** | 3,244,403 | 20,660,357 | 5,334,505 | (24,658,711) | 1,336,151 |

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

**Hill Incorporated (Formerly Hill Street Beverage Company Inc.)**
**Condensed Interim Consolidated Statements of Cash Flows**
(Expressed in Canadian Dollars)

| For the Three-Month Period Ended | September 30, 2023 | September 30, 2022 |
|---|---|---|
| | $ | $ |
| **OPERATING ACTIVITIES** | | |
| Net loss for the period | (327,938) | (645,871) |
| Items not affecting cash: | | |
| Bad debt | - | 118,151 |
| Depreciation | 67,043 | 80,498 |
| Stock-based compensation | 29,918 | 36,732 |
| Accretion expense | - | 3,100 |
| Accrued interest | 62,236 | 56,038 |
| | (168,741) | (351,352) |
| Changes in non-cash working capital items: | | |
| Accounts receivable | 219,323 | 597,267 |
| Subscription receivables | - | 6,150 |
| Inventory | (806) | 7,949 |
| Prepaid expenses | (313,470) | (515,715) |
| Accounts payable and accrued liabilities | (205,776) | (167,556) |
| Cash used in operating activities | (469,470) | (423,257) |
| **INVESTING ACTIVITIES** | | |
| Purchase of property and equipment | - | (6,037) |
| Cash used in investing activities | - | (6,037) |
| **FINANCING ACTIVITIES** | | |
| Lease payments | - | (5,544) |
| Repayment of loans | (12,255) | - |
| Cash used in financing activities | (12,255) | (5,544) |
| **CHANGE IN CASH AND CASH EQUIVALENTS** | (481,725) | (434,838) |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR** | 1,195,415 | 1,153,195 |
| **CASH AND CASH EQUIVALENTS, END OF PERIOD** | 713,690 | 718,357 |

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

## 1. NATURE OF OPERATIONS AND GOING CONCERN

Hill Incorporated, formerly Hill Street Beverage Company Inc., and before that, Avanco Capital Corp. (the "**Company**") was incorporated on April 6, 2016 in British Columbia under the Business Corporations Act (British Columbia) and was continued to Ontario under the Business Corporations Act (Ontario) on November 30, 2018. The Company commenced trading on the TSX Venture Exchange (the "**TSX V**") under the symbol "AAA.P" on March 24, 2017. The Company is engaged in the sale of alcohol-free beverages. The Company sells its products to distributors who in turn, sell the products in retail stores and online in Canada and the United States. The Company is also engaged in biodelivery technology licensing.

The Company changed its name from Avanco Capital Corp. to Hill Street Beverage Company Inc., on July 24, 2018 in conjunction with a reverse takeover transaction (the "**RTO**"). The Company resumed trading on the TSXV at the opening of the market on July 24, 2018 under the new symbol "BEER". The Company subsequently changed to its current stock ticker symbol of "HILL" on March 2, 2022. In addition to trading on the TSXV (located in Canada), the Company also commenced trading on the OTCQB Venture Market (located in the United States), on February 21, 2023, under the symbol "HSEEF". On May 30, 2023, the Company changed its name from Hill Street Beverage Company Inc., to Hill Incorporated.

The Company's registered address and the records are held at 222 Bay Street, Suite 3000, Toronto, Ontario, M5K 1E7.

On May 30, 2023, the Company implemented the consolidation of its common shares (Note 9) based on 1 post-consolidation common share for each 75 pre-consolidation common shares. All common shares and per share amounts have been retroactively restated to reflect the consolidation.

These condensed interim consolidated financial statements are prepared on a going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future and that management does not intend to liquidate the entity, or has no realistic alternative but to do so. As at September 30, 2023, the Company had not yet achieved profitable operations, had a net loss of $327,938 (September 30, 2022: $645,871), accumulated deficit of $24,658,711 (June 30, 2022: $24,330,773), and expects to incur further losses in the foreseeable future, all of which indicate the existence of a material uncertainty that may cast significant doubt upon the Company's ability to continue as a going concern. Realization values may be substantially different from carrying values as shown and these condensed interim consolidated financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern. Such adjustments could be material.

The Company's ability to continue its operations and to realize assets at their carrying values is dependent upon its ability to obtain necessary financing and generate operational profit to meet its ongoing levels of corporate overhead and discharge its liabilities as they come due. The success of the Company's endeavors cannot be predicted at this time. There is no assurance that it will be able to obtain adequate financing in the future or that such financing will be on terms advantageous to the Company.

## 2. BASIS OF PREPARATION

Statement of Compliance

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and IAS 34 – Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC"). As such, these condensed interim financial statements do not contain all the disclosures required by IFRS for annual financial statements and should be read in conjunction with the Company's audited annual consolidated financial statements for the years ended June 30, 2023 and 2022 (the "Annual Financial Statements").

These condensed interim consolidated financial statements for the three-month period ended September 30, 2023 were approved and authorized for issuance by the Board of Directors on November 28, 2023.

Basis of Presentation

The condensed interim consolidated financial statements have been prepared on a historical cost basis except for certain financial assets that are measured at fair value. All dollar amounts presented are in Canadian dollars unless otherwise specified.

Basis of Consolidation

These condensed interim consolidated financial statements incorporate the financial statements of the Company and its wholly owned subsidiaries, Hill Street Marketing Inc. and Hill Avenue Cannabis Inc., companies incorporated in Ontario; and Hill Avenue Marketing US Inc., a company incorporated in Delaware. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are included in the consolidated financial statements from the date control is obtained until the date control ceases.

All intercompany transactions and balances have been eliminated on consolidation.

## 2. BASIS OF PREPARATION (continued)

Use of Estimates and Judgments

The preparation of these consolidated financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported expenses during the year. Actual results could differ from these estimates.

In particular, information about significant areas of estimation uncertainty and judgment considered by management in preparing the financial statements includes:

*Critical Accounting Estimates and Judgements*

- Calculation of the net book value of property and equipment and intangible assets require management to make estimates of the useful economic life of the assets, residual value at the end of the asset's useful economic life, method of depreciation and whether impairment in value has occurred. Residual values of the assets, estimated useful lives and depreciation methodologies are reviewed annually with prospective application of any changes, if deemed appropriate. Changes to estimates could be caused by a variety of factors, including changes to the useful life of the assets. A change in any of the estimates would result in a change in the amount of depreciation and, as a result, a charge to net income recorded in the period in which the change occurs, with a similar change in the carrying value of the asset on the consolidated statement of financial position.

- When valuing options and warrants, estimates are required to be made by management when determining the inputs to the Black-Scholes option pricing model including the expected plan lives, underlying share price volatility and forfeiture rates. Volatility is estimated by considering the Company's own historical share price volatility, as well as peer companies historic share price volatility over similar periods to the expected life of the awards under consideration. Changes in these assumptions will impact the calculation of fair value and the amount of compensation expense recognized in the consolidated statements of loss and comprehensive loss.

- When determining the discount rate used to estimate the fair value of the CEBA loan, the Company considers market conditions and other internal and external factors. The Company estimates its credit rating and benchmarks the discount rate to certain fixed income indices.

- When valuing restricted share units subject to market based vesting terms, similar to other stock-based compensation, management uses judgment to determine the inputs to the Barrier option pricing model including the expected life, and underlying share price volatility. Volatility is estimated by considering the Company's own historical share price volatility. Management is also required to apply judgment in assessing the timing and success rate for which non-market based vesting terms will be achieved. Changes in these assumptions will impact the calculation of fair value and the amount of compensation expense recognized in the consolidated statements of loss and comprehensive loss.

**2. BASIS OF PREPARATION (continued)**

Use of Estimates and Judgments (continued)

- When the Company enters into leases as a lessee and where the interest rate implicit in a lease cannot be readily determined, the Company determines its incremental borrowing rate in order to measure its lease liability. The incremental borrowing rate is the rate of interest that a lessee would have to pay to borrow over a similar term, and with similar security, the funds necessary to obtain an asset of a similar value to the right-of-use ("ROU") asset in a similar economic environment. In estimating its incremental borrowing rate, the Company considers the term of the lease, the nature of the leased asset, and its level of indebtedness with reference to market risk-free interest rates.

- The recoverable amount of property and equipment and intangible asset is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted. If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss, or any reversal of a previously recognized impairment loss, is recognized immediately in profit or loss.

- The Company performs impairment testing at the end of each reporting period for accounts receivable in accordance with IFRS 9. The ECL model requires considerable judgment, including consideration of how changes in economic factors affect ECLs, which are determined on a probability-weighted basis. IFRS 9 outlines a three-stage approach to recognizing ECLs which is intended to reflect the increase in credit risks of a financial instrument based on 1) 12-month expected credit losses or 2) lifetime expected credit losses. The Company measures provision for ECLs at an amount equal to lifetime ECLs. The Company applies the simplified approach to determine ECLs on trade receivables by using a provision matrix based on historical credit loss experiences. The historical results were used to calculate the run rates of default which were then applied over the expected life of the trade receivables, adjusted for forward looking estimate.

- The assessment of the Company's ability to continue as a going concern involves judgement regarding future funding available for its operations and working capital requirements as discussed in Note 1.

- Upon reclassification of non-current assets as held for sale, assets are required to be measured at the lower of their carrying value and fair value, less costs to sell. Accordingly, estimates are required to be made by management in assessing the fair market value of the assets held for sale, less the expected costs to complete the sale based on the current available market data. If actual market conditions are more or less favorable than previously projected, this can materially affect the fair value estimate.

(Expressed in Canadian Dollars)

## 2. BASIS OF PREPARATION (continued)

Use of Estimates and Judgments (continued)

- Provisions are recognized when the Company has a present obligation, legal or constructive as a result of a previous event, if it is probable that the Company will be required to settle the obligation and a reliable estimate can be made of the obligation. The amount recognized is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligations. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate of the expected future cash flows.

## 3. NEW STANDARDS ADOPTED

During the three-month period ended September 30, 2023, no new standards were adopted.

## 4. NET REVENUE

| For the Three-Month Period Ended | | September 30, 2023 | September 30, 2022 |
|---|---|---|---|
| Non-alcoholic beverage sales | $ | 9,226 | 187,581 |
| DehydraTECH Licensing income | | 202,285 | 174,835 |
| Other income | | 14,546 | 18,086 |
| Chargebacks | | - | (26,852) |
| | $ | 226,057 | 353,650 |

Other income consists of commissions.

## 5. ACCOUNTS RECEIVABLE

Accounts receivable consist of the following:

| As at | | September 30, 2023 | June 30, 2023 |
|---|---|---|---|
| Trade receivables | $ | 282,976 | 515,815 |
| GST receivables | | 13,656 | 140 |
| | $ | 296,632 | 515,955 |

Bad debt expenses of $nil (September 30, 2022: $118,151) is the result of specific customer amounts owing being deemed uncollectible.  This amount is recorded on the condensed interim consolidated statements of operations and comprehensive loss.

(Expressed in Canadian Dollars)

## 6. INVENTORY

| As at | | September 30, 2023 | June 30, 2023 |
|---|---|---|---|
| Finished goods | $ | 15,581 | 14,775 |
| | $ | 15,581 | 14,775 |

The cost of inventory recognized as an expense and included in cost of sales during the three-month period ended September 30, 2023 was $5,027 (September 30, 2022: $113,097).

## 7. INTANGIBLE ASSETS

| | | | | |
|---|---|---|---|---|
| **Cost** | $ | $ | $ | $ |
| Balance at June 30, 2022 | 3,816,492 | 69,104 | 12,113 | 3,897,709 |
| Impairment | (264,049) | (69,104) | (12,113) | (345,266) |
| Balance at June 30, 2023 and September 30, 2023 | 3,552,443 | - | - | 3,552,443 |
| **Accumulated depreciation** | | | | |
| Balance at June 30, 2022 | 560,485 | 29,152 | - | 589,637 |
| Depreciation for the year | 297,154 | 3,886 | - | 301,040 |
| Impairment | (75,033) | (33,038) | - | (108,071) |
| Balance at June 30, 2023 | 782,606 | - | - | 782,606 |
| Depreciation for the period | 67,043 | - | - | 67,043 |
| Balance at September 30, 2023 | 849,649 | - | - | 849,649 |
| Carrying amount at June 30, 2023 | 2,769,837 | - | - | 2,769,837 |
| **Carrying amount at September 30, 2023** | 2,702,794 | - | - | 2,702,794 |

## 7. INTANGIBLE ASSETS (continued)

(i) On July 30, 2018, the Company entered into a semi-exclusive licensing agreement with Lexaria Canpharm ULC ("**Canpharm**") for the use of its DehydraTECH technology to produce a line of cannabis-infused alcohol-free beverages for Canadian distribution, following regulatory approval. In connection with the licensing agreement, the Company has capitalized a total of $209,250.

On December 9, 2020, the Company entered into an intellectual property license agreement with Lexaria Hemp Corp. ("**Lexaria Hemp License**") to expand the Company's DehydraTECH license with Lexaria Hemp Corp. to make products containing CBD on a global basis for ten years. This agreement supersedes and replaces in its entirety the prior agreement dated July 30, 2018.

**7. INTANGIBLE ASSETS (continued)**

(ii) On December 9, 2020, the Company also entered into an asset purchase agreement with Lexaria Canpharm ULC to acquire exclusive rights in perpetuity to use Lexaria's non-pharmaceutical THC-related DehydraTECH property assets and license agreement assets (the "**Canpharm Licenses**") in exchange for aggregate consideration of $3,590,928 (the "**Lexaria Asset Acquisition**"). Additional transaction costs totaling $38,655 were incurred in connection with the completion of the asset purchase agreement. The transaction was accounted for as an asset acquisition.

Aggregate consideration included an upfront cash payment of $350,000 on closing (paid), $2,000,000 payable in the form of a promissory note bearing 10% interest per annum (note 9), a total of 80,418 common shares valued at $753,920 issued on closing and $1,000,000 of consideration payable to be settled in the form of common shares, payable in two equal tranches 8 months and 16 months from the date of closing. The fair value of the consideration payable on the date of closing of the acquisition amounted to $487,008, determined using a Monte Carlo Simulation.

During the year ended June 30, 2022, the consideration payable was settled through the issuance of 156,863 shares with a total fair value of $676,916, with a gain on fair value of consideration payable totaling $69,308 recognized in the consolidated statements of operations and comprehensive loss.

The intangible assets acquired included a license and sublicenses. The value of each was proportionately allocated based on their fair value, determined to be $3,607,242. The license is being amortized over the useful life of the patents it gives the right to which are 20 years. The sublicenses are being amortized over their remaining useful life which is between 4 and 9 years.

During the year ended June 30, 2023, the Company deemed one of its DehydraTECH sublicensing agreements to be impaired due to the inability to collect future revenues on the sublicensing agreement, recognizing a loss on impairment of intangible assets totaling $189,016 in the consolidated statements of operations and comprehensive loss. The recoverable amount of the sublicensing agreement was determined by reference to its value-in-use, determined to be $nil as of June 30, 2023 and September 30 2023, with the impairment loss recognized being equal to the carrying value of the sublicensing agreement.

(Expressed in Canadian Dollars)

## 7. INTANGIBLE ASSETS (continued)

(iii) The Company has capitalized a total of $69,104 of costs associated with acquiring a Standard Processor License under the Cannabis Act (Canada), and a Standard Processing License application under Health Canada. These licenses fees are being amortized over their useful life of 5 years. During the year ended June 30, 2023, the Standard Processing Licenses were deemed to be impaired due to the decision to shut down the planned cannabis products research and development facility in Mississauga, Canada. Accordingly, the Company recognized a loss on impairment of intangible assets totaling $36,066 in the consolidated statements of operations and comprehensive loss. The recoverable amount of the Standard Processing Licenses was determined by reference to their value-in-use, determined to be $nil as of June 30, 2023 and September 30, 2023, with the impairment loss recognized being equal to the carrying value of the Standard Processing Licenses.

(iv) The Company has capitalized a total of $12,113 for various trademarks. The full amount of $12,113 was deemed to be impaired and recognized as a loss on impairment of intangible assets in the consolidated statements of operations and comprehensive loss during the year ended June 30, 2023. The recoverable amount of the trademarks was determined by reference to their value-in-use, determined to be $nil as of June 30, 2023 and September 30, 2023, with the impairment loss recognized being equal to the carrying value of the trademarks.

## 8. NOTE PAYABLE AND CEBA LOAN

The Company has/had the following loans payable as at September 30, 2023 and June 30, 2023:

| **As at** | **September 30, 2023** | **June 30, 2023** |
|---|---|---|
| | $ | $ |
| CEBA loan | 60,000 | 60,000 |
| Promissory note | 2,519,127 | 2,469,146 |
| Total loans payable | 2,579,127 | 2,529,146 |

<u>Canada Emergency Business Account</u>

| | **CEBA loan** |
|---|---|
| **Balance at June 30, 2022** | **$53,623** |
| Accretion Expense | $6,377 |
| **Balance at June 30, 2023 and September 30, 2023** | **$60,000** |

**8. NOTE PAYABLE AND CEBA LOAN (continued)**

The Company received a loan in the aggregate amount of $60,000 pursuant to the Canada Emergency Business Account ("**CEBA**"). The CEBA provides zero-interest, partially forgivable loans of up to $60,000 to small businesses that have experienced diminished revenues due to COVID-19 but face ongoing non-deferrable costs, such as rent, utilities, insurance, taxes and employment costs. If the balance of the loan is repaid on or before December 31, 2022, 25% on the first $40,000, plus 50% percent on the additional $20,000 will be forgiven. The loan bears no interest until December 31, 2022, at which point if unpaid, it will convert to a three-year term loan bearing interest at 5% per annum. On recognition, the initial $40,000 and additional $20,000 were recognized at their respective fair values totaling $22,061 and $13,459, and the subsequently measured at amortized cost, using an effective interest rate of 23%. During the three-month period ended September 30, 2023, $nil (September 30, 2022: $3,100) of interest expense related to the CEBA loan was recognized and included in accretion expense in the condensed interim consolidated statements of operations and comprehensive loss.

On February 15, 2022, the repayment terms for the CEBA loan were amended such that, provided that $40,000 of the CEBA loan's outstanding balance is repaid on or before December 31, 2023, the remaining $20,000 in outstanding balance will be forgiven. The outstanding balance of the CEBA loan that is not repaid by December 31, 2023 becomes immediately repayable in 24 consecutive monthly installments beginning January 1, 2024 until fully repaid at December 31, 2025.

Note payable

On December 9, 2020, in consideration of the value received in connection with the Lexaria Asset Acquisition, the Company agreed to pay the principal sum of $2,000,000 in the form of a promissory note. On initial recognition, the principal amount shall bear interest at the rate of 10% per annum and shall accrue and be calculated quarterly-annually. The principal amount and any accrued interest shall be repayable by the Company in quarterly installments in an amount equal to 5% of the gross sales realized from cannabis infused product sold by the Company or its licenses utilizing the acquired technology until such time that the promissory note is repaid in full. This promissory note and any accrued interest may be prepaid by the Company at any time in its sole and absolute discretion without penalty. On December 9, 2021, the principal balance on the promissory note was amended to $2,180,082, comprising the original principal balance of $2,000,000 and $180,082 of accrued and unpaid interest. Under the amended terms of the promissory note, interest shall now be compounded and calculated annually. During the three-month period ended September 30, 2023, the Company recognized interest expenses totaling $62,236 (September 30, 2022: $54,229) in the condensed interim consolidated statements of operations and comprehensive loss. During the three-month period ended September 30, 2023, total principal repayment was $12,255 (September 30, 2022: $nil).

As of September 30, 2023, the repayments of the note payable are variable in nature, with the upcoming 12-months of payments of principal and interest estimated to be $78,739 based on the projected licensing revenues.

## 9. SHARE CAPITAL

a) Authorized

Unlimited number of common shares with no par value.

b) Issued and outstanding

At September 30, 2023 and June 30, 2023, the issued and outstanding share capital is/was comprised of 3,244,403 common shares.

On May 30, 2023, the Company consolidated its issued share capital on a ratio of 75 pre-consolidation common shares to 1 post-consolidation common share (the "Share Consolidation"). The current and comparative references to the common shares, weighted average number of common shares, loss per share, stock options and warrants have been restated to give effect to this Share Consolidation. The share consolidation was approved by the shareholders on May 2, 2023.

***No shares were issued during the three-month period ended September 30, 2023.***

***During the year ended June 30, 2023, the Company issued the following shares:***

On July 22, 2022, 22,666 of the RSUs previously granted and which had vested were redeemed by an employee and executive for common shares of the Company. The fair value of RSUs redeemed of $68,000 was reclassified to share capital from reserves.

On November 18, 2022, 6,666 of the RSUs previously granted and which had vested, were redeemed by an employee for common shares of the Company. The fair value of RSUs redeemed of $12,500 was reclassified to share capital from reserves.

On December 22, 2022, the Company issued 233,333 units at a price of $3.00 per unit for gross proceeds of $700,000 (the "December 2022 Private Placement"). Each unit consisted of one common share and one common share purchase warrant, with each whole warrant exercisable into one common share of the Company at an exercise price of $3.75 per share, exercisable for a period of 24 months from the date of issuance. Should the closing price at which the common shares trade on the TSX V (or any such other exchange as such shares may be listed) exceed $6.00 for 10 consecutive trading days at any time following the date of issuance, the Company may accelerate the warrant expiry such that the warrants shall expire on the date which is 60 business days from the date the Company gives notices. The warrants were assigned a value of $256,034, determined by reference to their proportionate fair value using a Black-Scholes Option Pricing Model. In connection to the private placement, the Company paid $5,225 in cash for share issuance costs.

The fair value of the warrants was determined using the Black-Scholes pricing model using the following assumptions: share price of $1.50; a volatility of 149.61%; risk-free interest rate of 3.82%; expected life of 2 years; and a dividend rate of 0%.

(Expressed in Canadian Dollars)

## 9. SHARE CAPITAL (continued)

b) Issued and outstanding (continued)

On March 7, 2023, the Company issued 9,200 common shares upon the exercise of warrants by a director. The exercise price of such warrant exercise was valued at $34,500, but the Company waived the receipt of the exercise price in lieu of the Company's payment of the equal amount of board compensation owing to such director. The shares issued were valued at $45,483, representing the sum of the board compensation owing to the director of $34,500 and the transfer of previously recognized warrants reserve of $10,983.

c) Stock options

The continuity of options for the period ended September 30, 2023 and the year ended June 30, 2023 is summarized below:

| | Number of options | Weighted average exercise price | |
|---|---|---|---|
| Balance, June 30, 2022 | 183,249 | $ | 5.89 |
| Granted | 93,333 | | 3.75 |
| Expired / Forfeited | (32,287) | | (5.77) |
| **Balance, June 30, 2023** | **244,295** | **$** | **5.09** |
| Expired / Forfeited | (57,716) | | (5.50) |
| **Balance, September 30, 2023** | **186,579** | **$** | **4.96** |

The following table summarizes the options outstanding and exercisable at September 30, 2023:

| **Expiry** | | **Exercise Price** | **Options Outstanding** | **Options Exercisable** |
|---|---|---|---|---|
| May 23, 2024 | $ | 5.625 | 2,866 | 2,866 |
| May 1, 2025 | $ | 3.75 | 7,334 | 7,334 |
| March 1, 2026 | $ | 7.125 | 22,666 | 22,666 |
| April 30, 2026 | $ | 6.75 | 50,380 | 50,380 |
| March 28, 2027 | $ | 3.00 | 10,000 | 10,000 |
| April 27, 2028 | $ | 3.75 | 93,333 | 93,333 |
| Total | $ | 5.09 | 186,579 | 186,579 |

As of September 30, 2023, the weighted average remaining contractual life of all options outstanding was 3.54 years.

(Expressed in Canadian Dollars)

**9. SHARE CAPITAL (continued)**

c) Stock options (continued)

***No stock options were granted during the three-month period ended September 30, 2023.***

***During the year ended June 30, 2023, the Company granted the following stock options:***

On April 27, 2023, 93,333 options were granted to certain directors of the Company at an exercise price of $3.75 per share, expiring on April 27, 2028. All such stock options vested on June 30, 2023 and the fair value of the options at grant date was $84,100.

On August 30, 2022, the expected life of 14,666 fully vested options held by a former officer of the Company, previously granted on May 1, 2020, were reduced to one year from the date of employment termination, being August 30, 2023.

On August 30, 2022, the expected life of 13,334 fully vested options held by a former officer of the Company, previously granted on March 1, 2021, were reduced to one year from the date of employment termination, being August 30,2023, and a total of 6,666 of unvested options were forfeited during the year ended June 30, 2023. Previously recorded stock-based compensation of $20,118 related to the forfeited options was reversed during the period ended September 30, 2023.

All options are recorded at fair value using the Black-Scholes option pricing model. Volatility is based on peer companies and the historical trading prices of the Company's shares. Pursuant to the vesting schedule of options granted during the three-month period ended September 30, 2023 share-based compensation of $nil (September 30, 2022: deficiency of ($17,706)) was recognized in the condensed interim consolidated statements of operations and comprehensive loss.

The following weighted average assumptions were used in the option pricing models of stock options granted during the period ended September 30, 2023 and the year ended June 30, 2023:

| | **September 30, 2023** | **June 30, 2023** |
|---|---:|---:|
| Share price | $ Nil | $1.125 |
| Risk-free interest rate | Nil | 2.92% |
| Expected life | Nil | 5 years |
| Expected volatility | Nil | 138% |
| Expected dividends | Nil | Nil |

(Expressed in Canadian Dollars)

**9. SHARE CAPITAL (continued)**

d) Warrants

The continuity of warrants for the period ended September 30, 2023 and the year ended June 30, 2023 is summarized below:

| | Number of warrants | Weighted average exercise price |
|---|---|---|
| **Balance, June 30, 2022** | **794,926** | **$ 8.68** |
| Granted (Note 9(b)) | 233,333 | 3.75 |
| Exercised (Note 9(b)) | (9,200) | (9.75) |
| Expired | (218,413) | (9.74) |
| **Balance, June 30, 2023 and September 30, 2023** | **800,646** | **$ 6.94** |

The following table summarizes the warrants outstanding at September 30, 2023:

| Expiry | | Exercise Price | Warrants Outstanding |
|---|---|---|---|
| April 9, 2024 | $ | 8.25 | 567,313 |
| December 22, 2024 | $ | 3.75 | 233,333 |
| Total | | | 800,646 |

As of September 30, 2023, the weighted average remaining contractual life of all warrants outstanding was 0.73 years.

On November 18, 2022, the Company received approval from the TSX V to modify the exercise price and extend the expiry date of 150,012 warrants, at the discretion of the Board of Directors. These warrants, previously set to expire on November 18, 2022, had an extended expiry date of March 17, 2023. The exercise price has also been reduced from $9.75 to $3.75. On March 9, 2023, 9,200 of these warrants were exercised.

For details on warrants granted, refer to Note 9(b).

(Expressed in Canadian Dollars)

**9. SHARE CAPITAL (continued)**

d) Warrants

The following weighted-average assumptions used in the option-pricing model of warrants issued during the period ended September 30, 2023 and the year ended June 30, 2023:

| | **September 30, 2023** | **June 30, 2023** |
|---|---:|---:|
| Share price | $Nil | $1.50 |
| Risk-free interest rate | Nil | 3.82% |
| Expected life | Nil | 2 years |
| Expected volatility | Nil | 149.61% |
| Expected dividends | Nil | Nil |

e) Restricted share unit plan

The Company has adopted a restricted share unit plan (the "**RSU Plan**"), which provides that the Board of Directors of the Company may, from time to time, grant to directors, officers, employees and consultants of the Company, non-transferable RSUs. The expiry date for each restricted share unit shall be set by the Board of Directors at the time of issue. A vesting schedule may be imposed at the discretion of the Board of Directors at the time of issue. The number of shares that may be reserved for issuance shall not exceed 20% of the total number of issued and outstanding shares of the Company.

***No RSUs were granted during the three-month period ended September 30, 2023.***

***During the year ended June 30, 2023, the Company granted the following RSUs:***

On July 1, 2022, the Company granted 6,666 RSUs to an employee of the Company. Each RSU entitles the holder to receive one common share of the Company upon the vesting of such RSU. The RSUs vested immediately. The fair value of these RSUs was determined to be $12,500 by reference to the fair value of the Company's common shares on the date of grant and will be recognized immediately as an expense.

On October 12, 2022, the Company granted 13,333 RSUs to an officer of the Company. The RSUs vested on October 12, 2023. The fair value of these RSUs was determined to be $40,000 by reference to the fair value of the Company's common shares on the date of grant and will be recognized as an expense over the vesting period.

On April 27, 2023, the Company granted 13,343 RSUs to a director of the Company. The RSUs vested on June 30, 2023. The fair value of these RSUs was determined to be $15,011 by reference to the fair value of the Company's common shares on the date of grant and will be recognized as an expense over the vesting period.

(Expressed in Canadian Dollars)

## 9. SHARE CAPITAL (continued)

e) Restricted share unit plan (continued)

Pursuant to the vesting schedule of RSUs granted during the three-month period ended September 30, 2023 share-based compensation of $29,918 (September 30, 2022: $54,438) was recognized in the condensed interim consolidated statements of operations and comprehensive loss.

The continuity of RSUs for the period ended September 30, 2023 and the year ended June 30, 2023 are summarized below:

| | Number of RSUs |
|---|---|
| Balance as at June 30, 2022 | 155,614 |
| Granted | 33,342 |
| Redeemed into common shares | (29,332) |
| **Balance as at June 30, 2023 and September 30, 2023** | **159,624** |

As at September 30, 2023, a total of 48,910 RSUs have vested and are exercisable.

## 10. RELATED PARTY TRANSACTIONS

The Company considers its executive officers and directors to be key management personnel. The Company incurred the following amounts to related parties during the respective periods for key management personnel compensation:

| During the Three-Month Period Ended September 30, | $ 2023 | $ 2022 |
|---|---|---|
| Total salaries, benefits and management fees | 188,442 | 158,375 |
| Stock-based compensation | 29,918 | 45,599 |
| Total salaries and other short-term benefits | 218,360 | 203,974 |

Included in accounts payable and accrued liabilities as at September 30, 2023 is $40,270 (June 30, 2023: $76,236) payable to Directors and Officers of the Company for management wages, including vacation payable. The amount is non-interest bearing and unsecured.

## 11. FINANCIAL INSTRUMENTS

Financial instruments are initially recognized at fair value on the consolidated statements of financial position. Subsequent measurement of financial instruments is based on their classification. Financial assets and liabilities classified at fair value through profit or loss ("**FVTPL**") are measured at fair value with changes in those fair values recognized in the consolidated statements of operations and comprehensive loss. Financial assets and liabilities classified at amortized cost are measured at amortized cost using the effective interest method.

The following table summarizes the classification and measurement for each financial instrument:

| Financial instrument | Category | Measurement |
|---|---|---|
| Cash and cash equivalents | FVTPL | FVTPL |
| Accounts receivable | Loans and receivables | Amortized cost |
| Accounts payable and accrued liabilities | Other liabilities | Amortized cost |
| CEBA Loan | Other liabilities | Amortized cost |
| Note payable | Other liabilities | Amortized cost |

<u>Financial assets</u>

The Company classifies its financial assets into the following categories, depending on the purpose for which the asset was acquired. Management determines the classification of its financial assets at initial recognition. Financial assets are derecognized when the contractual rights to cash flows from the financial asset receipt or when the contractual rights to those assets are transferred.

*Amortized cost*

Financial assets measured at amortized cost are financial assets held within a business model whose objective is to collect contractual cash flows, with the cash flows representing solely payments of principal and interest. These assets are initially recognized at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, these financial assets are measured at amortized cost using the effective interest method, less any impairment losses.

*FVTPL*

Financial instruments are classified as FVTPL when they are held for trading. A financial instrument is held for trading if it was acquired for the purpose of sale in the near term. Financial instruments classified as FVTPL are measured at fair value, with any changes in fair value recognized in net loss.

**11. FINANCIAL INSTRUMENTS (continued)**

Financial liabilities

Management determines the classification of its financial liabilities at initial recognition.

*Amortized cost*

Financial liabilities are classified as measured at amortized cost unless they fall into one of the following categories: financial liabilities at FVTPL, financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition, financial guarantee contracts, commitments to provide a loan at a below-market interest rate, or contingent consideration recognized by an acquirer in a business combination.

Financial liabilities are classified as current liabilities if payment is due within one year or less. If not, there are presented as non-current liabilities.

*Financial liabilities recorded FVTPL*

Financial liabilities are classified as FVTPL if they fall into one of the five exemptions detailed above.

Transaction costs

Transaction costs associated with financial instruments, carried at FVTPL, are expensed as incurred, while transaction costs associated with all other financial instruments are included in the initial carrying amount of the asset or the liability.

Subsequent measurement

Instruments classified as FVTPL are measured at fair value with unrealized gains and losses recognized in profit or loss. Instruments classified as amortized cost are measured at amortized cost using the effective interest rate method. Instruments classified as FVTOCI are measured at fair value with unrealized gains and losses recognized in other comprehensive income.

Derecognition

The Company derecognizes financial liabilities only when its obligations under the financial liabilities are discharged, cancelled, or expired. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable, including any non-cash assets transferred or liabilities assumed, is recognized in profit or loss.

## 11. FINANCIAL INSTRUMENTS (continued)

Expected credit loss impairment model

The Company assumes that the credit risk on a financial asset has increased significantly if it is more than 30 days past due. The Company considers a financial asset to be in default when the borrower is unlikely to pay its credit obligations to the Company in full or when the financial asset is more than 90 days past due.

The carrying amount of a financial asset is written off (either partially or in full) to the extent that there is no realistic prospect of recovery. This is generally the case when the Company determines that the debtor does not have assets or sources of income that could generate sufficient cash flows to repay the amounts subject to the write-off.

During the three-month period ended September 30, 2023, the Company recognized $nil (September 30, 2022 - $118,151) of bad debts in the condensed interim consolidated statements of operations and comprehensive loss.

Financial instruments held at fair value

The fair value hierarchy that prioritizes the inputs used to measure fair value is as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and

Level 3 - Inputs that are not based on observable market data.

The fair value of cash and cash equivalents is determined based on Level 1 inputs which consist of quoted prices in active markets for identical assets.

The fair value of the Company’s accounts receivable, accounts payable and accrued liabilities, CEBA loan and note payable approximate their carrying values due to their short-term nature and their subjectivity to interest rates that are similar to the market interest rates of a similar item with similar security.

(Expressed in Canadian Dollars)

## 12. FINANCIAL RISK EXPOSURE AND RISK MANAGEMENT

The Company's financial instruments are exposed to a number of risks that are summarized below:

Credit Risk

Credit risk is the risk of potential loss to the Company if the counterparty to a financial instrument fails to meet its contractual obligations. The Company is exposed to credit risk from its cash and cash equivalents, accounts receivable, due from related parties, and subscription receivables. The risk exposure is limited to their carrying amounts reflected on the consolidated statements of financial position. The risk for cash and cash equivalents is mitigated by holding most of these instruments with highly rated Canadian financial institutions. The carrying value of these financial assets represents the Company's maximum exposure to credit risk. As at September 30, 2023, the Company had $296,632 (June 30, 2023 - $515,955) financial assets that may be subject to credit risk defaults.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its obligations with respect to financial liabilities as they fall due. The Company's financial liabilities consist of its accounts payable and accrued liabilities, CEBA loan and note payable. The Company manages its liquidity risk through the management of its capital structure as described in Note 13. The Company's accounts payable and accrued liabilities have contractual maturities of 30 days or are due on demand, do not generally bear interest and are subject to normal trade terms. As at September 30, 2023, the Company held $265,628 (June 30, 2023 - $500,612) in current liabilities.

The composition and maturity of the Company's financial liabilities was as follow:

| | | Total | 1 year | 2-3 years | 4-5 years | Over 5 years |
|---|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | $ | 126,889 | 126,889 | - | - | - |
| CEBA loan | | 60,000 | 60,000 | - | - | - |
| Note payable | | 2,519,127 | 78,739 | 284,339 | 409,209 | 1,746,840 |
| | $ | 2,706,016 | 265,628 | 284,339 | 409,209 | 1,746,840 |

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, investment fluctuations, and equity prices. Market conditions will cause fluctuations in the fair values of financial assets classified as fair value through profit or loss, and cause fluctuations in the fair value of future cash flows for assets or liabilities measured at fair value. As at September 30, 2023, the Company holds $2,519,127 (June 30, 2023 - $2,469,146) of interest-bearing debt, however there is no cash flow interest rate risk because the interest rate is fixed at 10%.

## 12. FINANCIAL RISK EXPOSURE AND RISK MANAGEMENT (continued)

Foreign exchange risk

Foreign exchange risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in the foreign currency exchange rates. Revenue and expenses are mostly denominated in Canadian dollar, US dollar or Euro. A significant change in the currency exchange rates between the Canadian dollar, US dollar and Euro could have an effect on the Company's results of operations, financial position or cash flows. The Company has not hedged its exposure to currency fluctuations.

As at September 30, 2023, a plus or minus 5% change in foreign exchange rates would affect the consolidated statements of operations and comprehensive loss by $45,433 (September 30, 2022 - $21,788).

Interest rate risk

The Company's policy is to invest excess cash in guaranteed investment certificates ("**GIC**") at fixed or floating rates of interest and cash equivalents are to be maintained in floating rates of interest in order to maintain liquidity, while achieving a satisfactory return for shareholders. As at September 30, 2023, the Company held $nil in redeemable GICs accruing interest at 3.75% (June 30, 2023 – $300,243). Fluctuations in interest rates impact the value of cash and cash equivalents. The Company manages risk by monitoring changes in interest rates in comparison to prevailing market rates.

## 13. CAPITAL MANAGEMENT

The Company considers capital to consist of note payable and shareholders' equity. The Company's primary objectives in capital management are to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and to maintain sufficient funds to finance its business development and meet its obligations as they come due. The Company is in the early stages of operations and is currently developing a capital structure which will support expanded activity. The Company monitors economic conditions and the risks related to the underlying assets and business opportunities. The Company does not presently utilize any quantitative measures to monitor its capital and is not subject to externally imposed capital requirements.

## 14. SEGMENTED REPORTING

The Company operates primary in two business segments, the sale of beverages and DehydraTECH licensing. Revenues from external customers are derived from customers located as follows:

| **During the Three-Month Period Ended September 30,** | | **2023** | **2022** |
|---|---|---|---|
| Canada | $ | 23,772 | 178,815 |
| United States | | 202,285 | 174,835 |
| Other | | - | - |
| | $ | 226,057 | 353,650 |

(Expressed in Canadian Dollars)

## 14. SEGMENTED REPORTING (continued)

During the three-month period ended September 30, 2023, one of the Company's customers accounted for 72% of net revenue and customer accounted for 17% of net revenue (September 30, 2022: 44% and 29%, respectively).

Disaggregation of non-current assets by geographic area:

| As at | | September 30, 2023 | June 30, 2023 |
|---|---|---|---|
| Canada | $ | 2,702,794 | 2,769,837 |
| United States | | - | - |
| Other | | - | - |
| | $ | 2,702,794 | 2,769,837 |

Reportable business segment information is as follows:

| | September 30, 2023 | | September 30, 2022 | |
|---|---|---|---|---|
| | Beverages | Licensing | Beverages | Licensing |
| | $ | $ | $ | $ |
| Revenue | (23,772) | (202,285) | (178,815) | (174,835) |
| Interest and accretion | - | 62,236 | 3,100 | 56,038 |
| Depreciation | - | 67,043 | 580 | 79,918 |
| Total assets | 1,295,471 | 2,746,696 | 1,866,496 | 3,568,244 |
| Total liabilities | (186,889) | (2,519,127) | (877,555) | (2,410,020) |