



PATRIOT ONE TECHNOLOGIES INC.

Consolidated Financial Statements

Year ended July 31, 2019 and 2018

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
Patriot One Technologies Inc.

Opinion

We have audited the accompanying consolidated financial statements of Patriot One Technologies Inc. (the "Company"), which comprise the consolidated statements of financial position as at July 31, 2019 and 2018, and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at July 31, 2019 and 2018, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audits in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information obtained at the date of this auditor's report includes Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.



In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Erez Bahar.

“DAVIDSON & COMPANY LLP”

Vancouver, Canada

Chartered Professional Accountants

October 28, 2019

PATRIOT ONE TECHNOLOGIES INC.

Consolidated Statements of Financial Position as at July 31,

	<u>2019</u>	<u>2018</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 50,637,942	\$ 17,576,735
Short term investments	-	15,060,055
Receivables (Note 10)	1,509,583	482,898
Prepaid expenses and deposits	694,114	403,437
Inventory (Note 11)	987,562	204,165
	<hr/>	<hr/>
	53,829,201	33,727,290
Property, plant and equipment (Note 6)	1,620,488	564,662
Investment in joint venture (Note 7)	3,386,390	-
Intangible assets (Note 8)	7,915,175	-
Goodwill (Note 9)	2,588,614	-
	<hr/>	<hr/>
Total assets	\$ 69,339,868	\$ 34,291,952
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	\$ 1,930,104	\$ 757,824
	<hr/>	<hr/>
Shareholders' equity		
Share capital (Note 12)	96,243,400	49,232,014
Contributed surplus	8,925,171	4,628,954
Accumulated deficit	(37,758,807)	(20,326,840)
	<hr/>	<hr/>
	67,409,764	33,534,128
	<hr/>	<hr/>
Total liabilities and shareholders' equity	\$ 69,339,868	\$ 34,291,952
Reporting entity (Note 1)		
Basis of preparation (Note 2)		
Commitments (Note 18)		
Subsequent events (Note 20)		

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

Approved on behalf of the Board:

"Martin Cronin"

Director, Chief Executive Officer

"Scott Shepherd"

Director, Chairman of the Board

PATRIOT ONE TECHNOLOGIES INC.

Consolidated Statements of Loss and Comprehensive Loss for the years ended July 31,

	<u>2019</u>	<u>2018</u>
Expenses		
Advertising and marketing	\$ 1,788,717	\$ 1,024,121
Amortization (Note 8)	28,825	-
Business development	1,759,998	868,675
Conferences and trade shows	1,269,720	714,387
Depreciation (Note 6)	467,163	34,304
General and administration	1,888,951	833,393
Licensing	429,245	175,401
Personnel costs	2,838,672	1,940,015
Professional fees	1,263,672	427,621
Research and development	2,772,645	4,750,193
Share-based compensation (Note 12)	3,080,807	1,217,666
	<hr/> 17,588,415	<hr/> 11,985,776
Equity loss on joint venture (Note 7)	825,565	-
Interest income	(862,013)	-
	<hr/> 17,551,967	<hr/> 11,985,776
Loss before income taxes	17,551,967	11,985,776
Deferred tax recovery (Note 17)	(120,000)	-
	<hr/> 17,431,967	<hr/> 11,985,776
Loss and comprehensive loss for the year	\$ 17,431,967	\$ 11,985,776
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Weighted average number of shares	130,719,916	89,217,039
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Basic and diluted loss per share	\$ 0.13	\$ 0.13
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The accompanying notes form an integral part of these consolidated financial statements.

PATRIOT ONE TECHNOLOGIES INC.

Consolidated Statements of Changes in Shareholders' Equity

	Share Capital		Share Subscriptions	Contributed surplus	Accumulated deficit	Total
	Number of shares	Amount				
Balance - July 31, 2018	110,957,029	\$ 49,232,014	\$ -	\$ 4,628,954	\$ (20,326,840)	\$ 33,534,128
Shares issued on prospectus financings, net of share issue costs (Note 12)	18,400,000	40,465,727	-	1,582,233	-	42,047,960
Shares issued on the exercise of warrants	7,789,582	2,348,866	-	(177,599)	-	2,171,267
Shares issued on the exercise of stock options	1,216,970	809,536	-	(263,633)	-	545,903
Shares and options issued on acquisition of EhEye (Note 9)	1,636,356	3,387,257	-	74,409	-	3,461,666
Share-based compensation (Note 12)	-	-	-	3,080,807	-	3,080,807
Loss for the year	-	-	-	-	(17,431,967)	(17,431,967)
Balance - July 31, 2019	139,999,937	\$ 96,243,400	\$ -	\$ 8,925,171	\$ (37,758,807)	\$ 67,409,764
Balance - July 31, 2017	60,605,716	\$ 7,110,602	\$ 4,628,750	\$ 2,113,167	\$ (8,341,064)	\$ 5,511,455
Shares issued on prospectus financings, net of share issue costs (Note 12)	28,950,821	35,813,867	(4,628,750)	1,886,367	-	33,071,484
Shares issued on the exercise of warrants	20,538,992	5,774,506	-	(414,932)	-	5,359,574
Shares issued on the exercise of stock options	861,500	533,039	-	(173,314)	-	359,725
Share-based compensation (Note 12)	-	-	-	1,217,666	-	1,217,666
Loss for the year	-	-	-	-	(11,985,776)	(11,985,776)
Balance - July 31, 2018	110,957,029	\$ 49,232,014	\$ -	\$ 4,628,954	\$ (20,326,840)	\$ 33,534,128

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

PATRIOT ONE TECHNOLOGIES INC.

Consolidated Statements of Cash Flows for the years ended July 31,

	2019	2018
Cash flow (used in) operating activities		
Loss and comprehensive loss for the year	\$ (17,431,967)	\$ (11,985,776)
Adjustment for:		
Share-based compensation (Note 12)	3,080,807	1,217,666
Depreciation	467,163	34,304
Amortization	28,825	-
Deferred tax recovery	(120,000)	-
Loss recognized on Sotech investment	825,565	-
	(13,149,607)	(10,733,806)
Changes in non-cash operating working capital		
Receivables	(978,846)	(301,972)
Prepaid expenses and deposits	(290,677)	(335,991)
Inventory	(783,397)	(40,027)
Accounts payable and accrued liabilities	842,997	92,566
Cash used in operating activities	(14,359,530)	(11,319,230)
Cash flow (to) from investing activities		
Purchase of property, plant and equipment (Note 6)	(1,508,083)	(598,966)
Cash payments and funding of investment in associate (Note 7)	(4,211,955)	-
Acquisition of intangible distribution rights (Note 8)	(6,574,000)	-
Capitlized development costs (Note 8)	(120,000)	-
Cash acquired on the acquisition of EhEye (Note 9)	9,590	-
Redemption (Investment) of guaranteed cash investment securities	15,060,055	(15,060,055)
Cash used in investing activities	2,655,607	(15,659,021)
Cash flow from financing activities		
Proceeds on issue of share capital, net of share issue costs	44,765,130	39,370,082
Cash received from financing activities	44,765,130	39,370,082
Increase in cash and cash equivalents for the year	33,061,207	12,391,831
Cash and cash equivalents at beginning of year	17,576,735	5,184,904
Cash and cash equivalents at end of year	\$ 50,637,942	\$ 17,576,735
Cash and cash equivalents comprise:		
Cash	\$ 50,637,942	\$ 2,525,272
Cash equivalents	-	15,051,463
	\$ 50,637,942	\$ 17,576,735

SUPPLEMENTAL CASH FLOW INFORMATION (Note 14)

The accompanying notes form an integral part of these consolidated financial statements

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

1. Reporting entity

Patriot One Technologies Inc. (the "Company"), was incorporated under the Business Corporation Act of British Columbia. Its common shares are listed on the Toronto Stock Exchange under the trading symbol "PAT". The Company, through its wholly owned subsidiary Patriot One Detection Ltd. ("Patriot") and Patriot One (UK) Limited ("Patriot UK"), Patriot One Detection Technologies Inc ("Patriot US") and EhEye Inc. ("EhEye"). In addition, Patriot US acquired a 49% equity interest in Sotech Secure, LLC ("Sotech"), a newly formed entity (Note 7). The Company, through its subsidiaries is principally engaged in the development and commercialization of systems to detect concealed weapons.

The Company's registered office is located at 750-1095 West Pender Street, Vancouver, British Columbia, Canada, V6E 2M6 and its registered and records office is located at 400-725 Granville Street, Vancouver, British Columbia, Canada, V7Y 1G5.

2. Basis of preparation

(a) Statement of compliance

These consolidated financial statements, including the comparative period, have been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB") and Interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). These consolidated financial statements were approved for issuance by the Board of Directors on October 28, 2019.

(b) Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Patriot, Patriot UK, Patriot US and EhEye. Subsidiaries are entities controlled by the Company. Control exists when the Company has the power to directly or indirectly govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken in account in the assessment of whether control exists. Subsidiaries are consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date on which control ceases.

All significant intercompany balances and transactions have been eliminated on consolidation.

(c) Functional and presentation currency

The functional currency of the Company and its subsidiaries is the Canadian dollar and these consolidated financial statements are presented in Canadian dollars.

(d) Basis of measurement

These consolidated financial statements have been prepared on the historical cost basis except for financial instruments measured at fair value. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

3. Significant accounting policies

(a) Financial instruments

(i) Financial assets

On initial recognition, financial assets are recognized at fair value and are subsequently classified and measured at: (i) amortized cost; (ii) fair value through other comprehensive income ("FVOCI"); or (iii) fair value through profit or loss ("FVTPL"). The classification of financial assets is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. A financial asset is measured at fair value net of transaction costs that are directly attributable to its acquisition except for financial assets at FVTPL where transaction costs are expensed. All financial assets not classified and measured at amortized cost or FVOCI are measured at FVTPL. On initial recognition of an equity instrument that is not held for trading, the Company may irrevocably elect to present subsequent changes in the investment's fair value in other comprehensive.

The classification determines the method by which the financial assets are carried on the statement of financial position subsequent to inception and how changes in value are recorded. Cash and cash equivalent and receivables are measured at amortized cost with subsequent impairments recognized in profit or loss.

(ii) Impairment

An 'expected credit loss' impairment model applies which requires a loss allowance to be recognized based on expected credit losses. The estimated present value of future cash flows associated with the asset is determined and an impairment loss is recognized for the difference between this amount and the carrying amount as follows: the carrying amount of the asset is reduced to estimated present value of the future cash flows associated with the asset, discounted at the financial asset's original effective interest rate, either directly or through the use of an allowance account and the resulting loss is recognized in profit or loss for the period.

In a subsequent period, if the amount of the impairment loss related to financial assets measured at amortized cost decreases, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the financial asset at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

(iii) Financial liabilities

Financial liabilities are designated as either: (i) fair value through profit or loss; or (ii) amortized cost. All financial liabilities are classified and subsequently measured at amortized cost except for financial liabilities at FVTPL. The classification determines the method by which the financial liabilities are carried on the statement of financial position subsequent to inception and how changes in value are recorded. Accounts payable and accrued liabilities are classified and carried on the statement of financial position at amortized cost.

As at July 31, 2018, the Company does not have any derivative financial liabilities.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

3. Significant accounting policies (continued)

(b) Intangible assets

(i) Research and development costs

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognized in profit or loss when incurred.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company has the intention and sufficient resources to complete development and to use or sell the asset. The expenditure capitalized in respect of development activities includes the cost of materials, direct labor and overhead costs that are directly attributable to preparing the asset for its intended use, and capitalized borrowing costs. Other development expenditure is recognized in profit or loss as incurred.

In subsequent periods, capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

(ii) Subsequent expenditure

Subsequent expenditure is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure, including expenditure on internally generated goodwill and brands, is recognized in profit or loss as incurred.

(iii) Amortization

Amortization is a systematic allocation of the amortizable amount of an intangible asset over its useful life. The amortizable amount is the cost of the asset less its estimated residual value.

Amortization is recognized in profit or loss on a sales-based rate, other than intangible assets arising from a service concession arrangement that are amortized according to the unit of production method, over the estimated useful lives of the intangible assets from the date they are available for use, since these methods most closely reflect the expected pattern of consumption of the future economic benefits embodied in each asset. Where a sales-based rate could not be determined, the straight-line approach was used.

Internally generated intangible assets are not systematically amortized as long as they are not available for use (i.e. they are not yet on site or in working condition for their intended use). Accordingly, these intangible assets, such as development costs, are tested for impairment at least once a year, until such date as they are available for use.

The Company examines the useful life of an intangible asset that is not periodically amortized at least once a year in order to determine whether events and circumstances continue to support the decision that the intangible asset has an indefinite useful life.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

3. Significant accounting policies (continued)

(c) Business Combinations

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued plus any liabilities and contingent liabilities assumed. Assets acquired and liabilities assumed (including liabilities of the acquiree not previously recognized) in the business combination are measured initially at fair values at the date of acquisition, irrespective of the extent of any minority interest.

Goodwill is initially measured at cost being the excess of the purchase consideration of the business combination over the Company's share in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities. If the costs of the acquisition are less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the statement of loss and comprehensive loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Company's cash-generating units ("CGUs") that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

Where goodwill forms part of a CGU and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative fair values of the operation disposed of and the portion of the CGU retained.

(d) Investments accounted for using the equity method

Investments accounted for using the equity method include investments in associates or joint ventures, which are entities over which the Company exercises significant influence, and joint arrangements representing joint ventures.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but without control or joint control over those policies. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control. The Company accounts for its investments in associates and joint ventures using the equity method of accounting. Under the equity method, investments in associates and joint ventures are initially recognized in the consolidated statements of financial position at cost, and subsequently adjusted for the Company's share of the net income (loss), comprehensive income (loss) and distributions of the investee. The carrying value is assessed for impairment at each statement of financial position date.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

3. Significant accounting policies (continued)

(e) Government assistance

Government grants are recognized where there is reasonable assurance that the grant will be received and all attached conditions will be complied with. When the grant relates to an expense item, it is recognized as a deduction against the related expense over the period necessary to match the grant on a systematic basis to the costs that it is intended to compensate. Where the grant relates to an asset, it reduces the carrying amount of the asset. Government assistance received relating to expenses of future periods is deferred and deducted against the related expenditures as incurred.

(f) Inventory

Inventory is recorded at the lower of cost and net realizable value. Cost is determined using the weighted average cost method. Net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

All inventories are periodically reviewed for impairment due to slow-moving and obsolete inventory. The provisions for obsolete, slow-moving or defective inventories are recognized in profit or loss. Previous write-downs to net realizable value are reversed to the extent there is a subsequent increase in the net realizable value of the inventories.

(g) Loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the period. The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on earnings per share is calculated presuming the exercise of outstanding options, warrants and similar instruments. It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the period. However, the calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

Shares held in escrow, other than where their release is subject to the passage of time, are not included in the calculation of the weighted average number of common shares outstanding.

(h) Income taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss, except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income/loss.

Current income taxes are recognized for the estimated income taxes payable or receivable on taxable income or loss for the current period and any adjustment to income taxes payable in respect of previous periods. Current income taxes are determined using tax rates and tax laws that have been enacted or substantively enacted by the year-end date.

Income tax expense consists of current and deferred tax expense. Income tax expense is recognized in the statement of comprehensive loss.

Current tax expense is the expected tax payable on the taxable income for the period using tax rates enacted or substantively enacted at period-end, adjusted for amendments to tax payable with regard to previous years.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

3. Significant accounting policies (continued)

(h) Income taxes (continued)

Deferred tax assets and liabilities are recognized for deferred tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in profit or loss in the period that substantive enactment occurs.

A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reduced to the extent that it is no longer probable that the tax benefit will be realized.

(i) Cash and cash equivalents

Cash and cash equivalents consist of balances and investments in highly liquid short-term deposits, which may be converted into cash within 24 hours. Deposits with banks and short-term interest bearing investments with original term to maturity greater than three months but less than one year are presented as short-term investments.

(j) Capital Stock

Instruments issued by the Company are classified as equity only to the extent that they do not meet the definition of a financial liability or financial asset. The Company's common shares are classified as equity instruments. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

Proceeds from unit placements are allocated between shares and warrants using the residual value method which first allocates value to the more easily measurable component, common shares, as determined by the closing market price on the date of announcement. The balance is then allocated to the attached warrants.

(k) Share-based compensation

The Company may grant stock options of the Company to allow directors, officers, employees and consultants to acquire common shares of the Company. Stock options granted to directors, officers and employees are measured at their fair values determined on the date of grant using the Black-Scholes option pricing model and recognized as an expense over the vesting periods of the options. Options granted to consultants or other non-insiders are measured at the fair value of goods or services received from these parties, or at their Black-Scholes fair values if the fair value of the goods or services received cannot be measured. A corresponding increase is recorded to equity reserves for share-based compensation recorded.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

3. Significant accounting policies (continued)

(l) Property, plant and equipment

Property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Depreciation is calculated to write-off the cost of items of property, plant and equipment less the estimated residual value over the estimated useful lives of the assets on a declining balance basis and is recognized in profit or loss. The depreciation rates are as follows:

Furniture and fixtures	20%
Machinery and equipment	25%
Office equipment	55%
Office software	100%
Leasehold Improvement	Straight line over the term of the lease

Depreciation methods and useful lives are reviewed at each financial year-end and adjusted if appropriate.

Gains and losses on disposal of plant and equipment are determined by comparing the proceeds from disposal with the carrying amount of property, plant and equipment and are recognized net within other income in profit or loss.

(m) Significant accounting judgments, estimates and assumptions

The preparation of these financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amount of assets, liabilities and contingent liabilities at the date of the financial statements, and reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.

Significant areas requiring the use of management estimates include:

Share-based payments

The fair value of stock options granted is measured using Black-Scholes option pricing model. Measurement inputs include share price on measurement date, exercise price of the option, expected volatility, expected life of the options, expected dividends and risk-free interest rate. These estimates will impact the valuation of share-based payments which are recognized.

Deferred income tax assets & liabilities

The measurement of deferred income tax provision is subject to uncertainty associated with the timing of future events and changes in legislation, tax rates and interpretations by tax authorities. The estimation of taxes includes evaluating the recoverability of deferred tax assets based on an assessment of the Company's ability to utilize the underlying future tax deductions against future taxable income prior to expiry of those deductions. Management assesses whether it is probable that some or all of the deferred income tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income, which in turn is dependent upon the successful operations of the Company. To the extent that management's assessment of the Company's ability to utilize future tax deductions changes, the Company would be required to recognize more or fewer deferred tax assets, and deferred tax provisions or recoveries could be affected.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

3. Significant accounting policies (continued)

(m) Significant accounting judgments, estimates and assumptions (continued)

Treatment of development costs

Costs to develop products are capitalized to the extent that the criteria for recognition as intangible assets in IAS 38 *Intangible Assets* are met. Those criteria require that the product is technically and economically feasible, which management assessed based on the attributes of the development project, perceived user needs, industry trends and expected future economic conditions. Management considers these factors in aggregate and applies significant judgment to determine whether the product is feasible.

Inventories

Inventories are valued at the lower of cost and net realizable value. Cost of inventory includes cost of purchase (purchase price, import duties, transport, handling, and other costs directly attributable to the acquisition of inventories), and other costs incurred in bringing the inventories to their present location and condition. Net realizable value for inventories is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Provisions are made in profit or loss in the period for any difference between book value and net realizable value.

Business combinations

Judgment is used in determining whether an acquisition is a business combination or an asset acquisition. Judgment is also required to assess whether the amounts paid on achievement of milestones represents contingent consideration or compensation for post-acquisition services. Judgment is also required to assess whether contingent consideration should be classified as equity or a liability. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as a liability is remeasured at fair value at each reporting date and subsequent changes in the fair value of the contingent consideration are recognized in net income (loss).

Control, joint control or level of influence

When determining the appropriate basis of accounting for the Company's interests in affiliates, the Company makes judgments about the degree of influence that it exerts directly or through an arrangement over the investees' relevant activities. Information about these judgments is included in Note 7.

Estimated useful lives and depreciation and amortization of property, plant and equipment and intangible assets

Depreciation and amortization of property, plant and equipment and intangible assets are dependent upon estimates of useful lives, which are determined through the exercise of judgment. The assessment of any impairment of these assets is dependent upon estimates of recoverable amounts that take into account factors such as economic and market conditions and the useful lives of assets.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

4. New accounting standards and interpretations

(a) New accounting standards adopted during the year

IFRS 9 – Financial Instruments ("IFRS 9")

On August 1, 2018, the Company adopted IFRS 9 – Financial Instruments ("IFRS 9") which replaced IAS 39 – Financial Instruments: Recognition and Measurement. IFRS 9 provides a revised model for recognition and measurement of financial instruments and a single, forward-looking 'expected loss' impairment model. IFRS 9 also includes significant changes to hedge accounting. The standard is effective for annual periods beginning on or after January 1, 2018. The Company adopted the standard retrospectively. IFRS 9 did not impact the Company's classification and measurement of financial assets and liabilities.

IFRS 9 uses a single approach to determine whether a financial asset is classified and measured at amortized cost or fair value. The classification and measurement of financial assets is based on the Company's business models for managing its financial assets and whether the contractual cash flows represent solely payments for principal and interest. The change did not impact the carrying amounts of any of the Company's financial assets on the transition date. Prior periods were not restated and no material changes resulted from adopting this new standard.

The adoption of the new "expected credit loss" impairment model under IFRS 9, as opposed to an incurred credit loss model under IAS 39, had no impact on the carrying amounts of our financial assets on the transition date given the Company transacts exclusively with large international financial institutions and other organizations with strong credit ratings.

IFRS 15 – Revenue from Contracts with Customers ("IFRS 15")

In May 2014, the IASB issued IFRS 15 to replace IAS 18 – Revenue, which establishes a new single five-step control-based revenue recognition model for determining the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with a customer. The amended standard was adopted on August 1, 2018 and did not have an impact on the consolidated financial statements.

(b) New accounting standards issued but not yet in effect

The Company has reviewed new and revised accounting pronouncements that have been issued but are not yet effective. IFRS 16 specifies how an IFRS reporter will recognize, measure, present and disclose leases. The standard provides a single lease accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with the IFRS 16 approach to lessor accounting substantially unchanged from its predecessor policy IAS 17. The Company expects to record a right-of-use asset and corresponding lease liability, measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying assets or the site on which it is located, less any lease incentives received, of approximately \$1,750,000 on August 1, 2019, the first year of adoption of IFRS 16.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

5. License, assignment and option fees

On April 29, 2016, Patriot entered into an agreement with Bullrun Capital Inc. ("Bullrun") wherein Bullrun agreed to assign to Patriot its option (the "Option Agreement") to obtain from McMaster University ("McMaster") a worldwide exclusive license to use or cause to be used certain radar technology used to detect concealed weapons (the "License Agreement") invented, developed and/or acquired by McMaster. As consideration for the Option Agreement, Patriot paid Bullrun a fee of \$60,000 and granted Bullrun a 2% royalty (the "Bullrun Royalty") to be paid on net sales of all commercial products developed under the License Agreement between McMaster and the Company. This royalty payable to Bullrun would be in addition to any royalties to be paid to McMaster by the Company. The Company exercised its option and entered into the License Agreement with McMaster. In consideration for the License Agreement, the Company paid an up-front license fee of \$10,000 and issued 1,560,000 common shares with a fair value of \$78,000. In addition, the Company agreed to pay a royalty of 3.5% on net sales and from time to time, issue common shares of the Company to McMaster so that in the aggregate, shares held by McMaster represent 5% of the Company's issued and outstanding common shares calculated on a fully diluted basis. Such issuance shall continue until and including the date upon which a total of \$2,000,000 in cash shall be received by the Company in exchange for the Company's capital stock. Thereafter, no additional shares shall be due to McMaster. The Company had met this requirement and no additional shares will be issued to McMaster. In addition, the Company agreed to make minimum annual royalty payments of \$2,500 in the first and second year, \$5,000 in the third year and \$7,500 each year thereafter.

On October 26, 2016, Patriot entered into an amended agreement with Bullrun wherein both parties set out their mutual understandings and conclusively recorded the terms and conditions with respect to the Bullrun Royalty. In the amended agreement, Bullrun agreed to an equal division of the Bullrun Royalty between Bullrun and Rajni Singhera ("Singhera") to be paid on net sales of the licensed product in a calendar year, the amount of which is to be accrued and paid annually on March 31 of the following year. Payment of the Bullrun Royalty is subject to a minimum royalty threshold of \$100,000, the first payment of which is not payable until March 31, 2019 and then annually thereafter. In the case where the Company's Board of Directors determines that the payment of the Bullrun Royalty would impact the ongoing operations of the Company, the annual payment for that year will be satisfied by the issuance of notes payable to Bullrun and Singhera which notes will mature two years from the date of issue and accrue interest at the Bank of Canada prime rate plus 3% per annum.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

6. Property, plant and equipment

	Office Equipment	Office Software	Furniture & Fixtures	Machinery & Equipment	Leasehold Improvements	Total
Cost						
Balance at July 31, 2017	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Additions	183,841	58,808	178,959	177,358	-	598,966
Balance at July 31, 2018	183,841	58,808	178,959	177,358	-	598,966
Additions	293,150	90,717	240,414	744,109	139,693	1,508,083
Additions through acquisitions	14,906	-	-	-	-	14,906
Balance at July 31, 2019	\$ 491,897	\$ 149,525	\$ 419,373	\$ 921,467	\$ 139,693	\$ 2,121,955
Accumulated depreciation						
Balance at July 31, 2017	-	-	-	-	-	-
Depreciation and amortization	\$ 14,530	\$ 9,523	\$ 4,668	\$ 5,583	\$ -	\$ 34,304
Balance at July 31, 2018	14,530	9,523	4,668	5,583	-	34,304
Depreciation and amortization	189,271	92,146	74,834	97,579	13,333	467,163
Balance at July 31, 2019	\$ 203,801	\$ 101,669	\$ 79,502	\$ 103,162	\$ 13,333	\$ 501,467
Carrying amount as at July 31, 2019	\$ 288,096	\$ 47,856	\$ 339,871	\$ 818,305	\$ 126,360	\$ 1,620,488
Carrying amount as at July 31, 2018	\$ 169,311	\$ 49,285	\$ 174,291	\$ 171,775	\$ -	\$ 564,662

7. Investment in joint venture

Sotech Secure, LLC ("Sotech"), a Delaware Limited Liability company, was formed on January 18, 2019 pursuant to the Limited Liability Company Agreement (the "Sotech Agreement") between the Company and NanoBio Detection Systems LLC ("NanoBio"). Pursuant to the Sotech Agreement, NanoBio granted Sotech the worldwide rights to exploit certain technologies to detect chemical molecules for early detection of explosives, narcotics and other substances. As at July 31, 2019 the Company has paid US\$2,000,000 to NanoBio and a further contribution by the Company of US\$1,000,000 will be made upon receipt by Sotech of US\$1,000,000 in non-debt working capital from a third party, which is not yet due. The Company has also agreed to provide initial on demand funding line of credit of a minimum of US\$1,800,000 to Sotech which may be drawn upon receipt of supporting documentation and written notice, following unanimous consent of the board of managers of Sotech, including the Company's representative thereon. As at July 31, 2019, the Company has funded US\$1,204,516 (CAD\$1,583,697) to Sotech. As at July 31, 2019, the Company has a 49% interest in Sotech, however the Sotech Agreement granted NanoBio the option to increase its interest in Sotech by an additional 19% at any time prior to January 18, 2020 by payment to Patriot of an amount equal to the total of the funding by the Company as of the time of the option exercise. The Company's investment in Sotech, which is classified as a joint venture, is accounted for using the equity method.

As at July 31, 2019 the carrying value of the investment in Sotech is comprised of:

Initial capital contributions	\$ 2,629,600
Reduction in ownership interest on option exercise	(1,342)
Funding advances on demand line of credit	1,583,697
Share of net loss from continuing operations	(825,565)
Carrying value at July 31, 2019	\$ 3,386,390

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

7. Investment in joint venture (continued)

The following table summarizes the financial information of Sotech in its own financial statements:

Current assets held by Sotech	\$ 275,882
Non-current assets held by Sotech	5,256,800
Current liabilities held by Sotech	(210,146)
Non-current liabilities held by Sotech	(1,721,258)
Net Assets (100%)	\$ 3,601,278
The Company's share of net assets (49%)	\$ 1,764,626
Personel and overhead expenses	\$ 806,801
Licensing fees	878,026
Loss and comprehensive loss (100%)	\$ 1,684,827
The Company's share of loss and comprehensive loss (49%)	\$ 825,565

8. Intangible assets

Quasar Licensing Agreement

The Company entered into a licensing agreement with Quasar Federal Systems, Inc. ("Quasar") receiving a perpetual, worldwide, exclusive, fully paid-up, transferable and irrevocable license (with a right of sublicense) to use Quasar's intellectual property in exchange for aggregate cash consideration of \$6,574,000 (US\$5,000,000). The Quasar license includes access to patented sensor technology and patent pending magnetic detection and security screening technology. The Company also has the right to engage Quasar's development team to assist with future modifications to the technology, as well as manufacturing and implementation engineering. The license was recognized as an intangible asset and is amortized over its estimated useful life.

Intellectual Property Acquired and Capitalized Development Expenditures

The Company has determined the fair value of the intellectual property acquired in connection with the acquisition of Eh Eye outlined in Note 9 to be \$1,250,000. In addition, the Company has determined \$120,000 of directly attributable development expenditures meet the criteria for capitalization. The Company will begin amortizing when it is available for use. As at July 31, 2019, the carrying values are as follows:

	Cost Base	Accumulated Amortization	Net Book Value
Licensed Distribution Rights	\$ 6,574,000	\$ (28,825)	\$ 6,545,175
Intellectual Property	1,370,000	-	1,370,000
	\$ 7,944,000	\$ (28,825)	\$ 7,915,175

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

9. Acquisition of EhEye

Effective January 8, 2019, the Company acquired 100% of the issued and outstanding shares of EhEye, a private company located in Saint John, New Brunswick, Canada. EhEye has developed video threat recognition software that automates the detection of weapons, disturbances and suspicious behaviours through existing camera infrastructure. The Company determined that EhEye's video threat recognition software will compliment its covert weapon detection system. Pursuant to the share purchase agreement, the Company issued 1,636,363 shares at a fair value of \$3,387,257. In addition, the Company granted 277,775 stock options (the "Replacement Options") to directors, officers and employees of EhEye to replace existing options in EhEye. The fair value of the Replacement Options was \$448,160, of which \$74,409 was allocated to the purchase consideration and the balance of \$373,751 was recorded as share-based compensation over the vesting terms of the stock options. The fair value of the shares attributed to the acquisition consideration was estimated based on the market price of the Company's common shares on January 8, 2019 of \$2.02 per share. The business combination has been accounted for using the acquisition method with the results of operations consolidated with those of the Company effective January 8, 2019.

The fair value of the Replacement Options was calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

Expected life	3.4 years
Expected volatility in market price of shares	100%
Expected dividend rate	0%
Risk-free interest rate	1.89%
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Weighted average fair value per warrant granted	\$ 1.6134

The consideration paid and the preliminary allocation of the consideration to the fair values of the assets acquired and liabilities assumed in the acquisition at January 8, 2019 are as follows:

Consideration	
Shares issued	\$ 3,387,257
Fair value of stock options granted	74,409
Total consideration	\$ 3,461,666
<hr/>	
Net assets acquired	
Cash	\$ 9,590
Accounts receivable	47,839
Property, plant and equipment	14,906
Intellectual Property	1,250,000
Accounts payable and accrued liabilities	(329,283)
Deferred income tax liability	(120,000)
Goodwill	2,588,614
Total	\$ 3,461,666

Amongst other things, the goodwill recognized reflects future cash flows, growth in sales to existing and new customers through cross selling opportunities and expected growth in the underlying markets in which the Company operates.

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

10. Raytheon Canada Ltd. Canadian Industrial & Technological Benefits ("ITB") Program Funding

The Company has entered into an agreement with Raytheon Canada Ltd. ("Raytheon") wherein Raytheon will fund Patriot with \$3,000,000 non-dilutive cash financing for further development of Patriot's concealed weapons detection technology (the "Project"). The Project has been approved as a qualifying project under the Government of Canada's ITB program, administered by Innovation Science and Economic Development Canada Pursuant to the terms of the agreement, Patriot will be eligible to claim milestone funding of \$500,000, \$1,000,000 and \$1,500,000 due on or before December 31, 2018, December 31, 2019, and December 31, 2020, respectively, provided at least double the applicable milestone value has been spent by Patriot on qualifying expenditures. The first milestone funding amount of \$500,000, relating to qualifying expenditures for the annual period ending December 31, 2018 was accrued and paid in early 2019. Additionally, having incurred qualifying expenditures from January 1, 2019 through July 31, 2019, Patriot has accrued a receivable of \$640,000 as at July 31, 2019. This reflects a portion of the second milestone funding of \$1,000,000 for the annual period ending December 31, 2019. Patriot has recorded total research and development costs net of the \$1,140,000 total non-dilutive funding for the year ended July 31, 2019.

11. Inventory

As at July 31, 2019, the Company held inventory of \$987,562 (2018 - \$204,165). The Company's inventory consists primarily of hardware components that will be used in its security product offerings. No inventory was written down, sold or pledged as security for liabilities during the year.

12. Share capital

Authorized, Issued and Outstanding

The authorized share capital of the Company consists of an unlimited number of common shares with no par value.

Issued and outstanding

The issued and outstanding share capital for the years ended July 31, is as follows:

	2019		2018	
	Number of shares	Amount	Number of shares	Amount
Balance at beginning of year	110,957,029	\$ 49,232,014	60,605,716	\$ 7,110,602
Shares issued for cash, net of share issue costs	18,400,000	40,465,727	28,865,000	35,753,792
Shares issued for the acquisition of EhEye (Note 9)	1,636,356	3,387,257	-	-
Shares issued on the exercise of warrants	7,789,582	2,348,866	20,538,992	5,774,506
Shares issued on the exercise of stock options	1,216,970	809,536	861,500	533,039
Shares issued for agency fees	-	-	32,250	22,575
Shares issued for corporate finance fees	-	-	53,571	37,500
Balance at end of year	139,999,937	\$ 96,243,400	110,957,029	\$ 49,232,014

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements

For the years ended July 31, 2019 and 2018

12. Share capital (continued)

On November 21, 2018, the Company issued 18,400,000 units (the "Units") for gross proceeds of \$46,000,000 pursuant to a bought deal equity financing. Each Unit consisted of one common share and one common share purchase warrant ("Warrants"). These 18,400,000 Warrants allow the holders to acquire an additional common share at \$3.25 per share until November 21, 2020. The Company paid cash commissions of \$3,680,000 and \$272,040 for other share issue costs. The Company issued 1,288,000 broker warrants exercisable at \$2.50 per share until November 21, 2020. The fair value of these broker warrants was \$1,582,233, which along with the other costs of this financing was deducted from the value of the common shares. The fair value of the broker warrants was calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

Expected life	2 years
Expected volatility in market price of shares	100%
Expected dividend rate	0%
Risk-free interest rate	2.23%
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Weighted average fair value per warrant granted	\$ 1.2284

On February 22, 2018, the Company issued 12,650,000 units (the "Units") for gross proceeds of \$25,300,000 pursuant to a bought deal equity financing. Each Unit consisted of one common share and one half of a common share purchase warrant (each whole common share purchase warrant, a "Warrant"). These 6,325,000 Warrants allow the holders to acquire an additional common share at \$2.40 per share until February 16, 2021. The Company paid the agents a cash commission of \$1,771,000 and \$97,120 for legal costs of the agents.

The Company issued 885,500 broker warrants exercisable at \$2.00 per share until February 16, 2020. The fair value of these broker warrants was \$1,124,076, which along with the other costs of this financing was deducted from the value of the common shares. The fair value of the broker warrants was calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

Expected life	2 years
Expected volatility in market price of shares	100%
Expected dividend rate	0%
Risk-free interest rate	1.82%
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Weighted average fair value per warrant granted	\$ 1.2694

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

12. Share capital (continued)

On October 31, 2017, the Company issued 9,602,500 units (the "Units") for gross proceeds of \$11,523,000 pursuant to a bought deal equity financing. Each Unit consisted of one common share and one half of a common share purchase warrant (each whole common share purchase warrant, a "Warrant"). These 4,801,250 Warrants allow the holders to acquire an additional common share at \$1.70 per share until October 31, 2020. The Company paid the agents a cash commission of \$806,610 and \$84,143 for legal costs of the agents.

The Company issued 672,175 broker warrants exercisable at \$1.20 per share until October 31, 2019. The fair value of these broker warrants was \$568,239, which along with the other costs of this financing was deducted from the value of the common shares. The fair value of the broker warrants was calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

Expected life	2 years
Expected volatility in market price of shares	100%
Expected dividend rate	0%
Risk-free interest rate	1.39%
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Weighted average fair value per warrant granted	\$ 0.8454

On August 29, 2017, the Company issued 6,612,500 units (the "Units") for gross proceeds of \$4,628,750 pursuant to a brokered private placement. Each unit consisted of one common share and one half of a common share purchase warrant (each whole common share purchase warrant, a "Warrant"). These 3,306,250 Warrants allow the holders to acquire an additional common share at \$1.25 per share until July 13, 2020. The Company paid the agents a cash commission of \$301,438, a corporate finance fee of \$37,500 and \$65,500 for legal costs of the agents. In addition, the Company issued 32,250 common shares valued at \$22,575 as an agency fee and 53,571 common shares valued at \$37,500 as a corporate finance fee.

The company incurred additional costs of \$648,280 with respect to shares issued during the year ended July 31, 2018 of which \$579,299 were included in deferred financing costs at July 31, 2017.

The Company issued 462,875 broker warrants exercisable at \$1.00 per common share until July 13, 2020 and 16,125 agency fee warrants exercisable at \$1.25 per common share until July 12, 2020. The fair value of the broker warrants was \$188,036 and the fair value of the agency fee warrants was \$6,016, which along with the other costs of this financing have deducted from the value of the common shares. The fair value of the broker warrants was calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

	Broker warrants	Agency fee warrants
Expected life	3 years	3 years
Expected volatility in market price of shares	100%	100%
Expected dividend rate	0%	0%
Risk-free interest rate	0.87%	0.87%
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Weighted average fair value per warrant granted	\$ 0.4062	\$ 0.3731

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

12. Share capital (continued)

Warrants

Warrant activity for the years ended July 31, is as follows:

	2019		2018	
	Number of warrants	Weighted average exercise price	Number of warrants	Weighted average exercise price
Balance at beginning of the year	24,095,014	\$ 1.35	28,164,831	\$ 0.26
Issued	19,688,000	3.20	16,469,175	1.85
Exercised	(7,789,582)	0.28	(20,538,992)	0.26
Expired	(30,000)	0.25	-	-
Balance at end of the year	35,963,432	\$ 2.60	24,095,014	\$ 1.35

As at July 31, 2019, outstanding warrants are as follows:

Number of warrants outstanding	Weighted average exercise price	Expiry date	Weighted average life remaining (months)
672,175	\$ 1.20	October 31, 2019	3.0
885,500	\$ 2.00	February 16, 2020	6.5
3,278,200	\$ 1.25	July 13, 2020	11.5
168,507	\$ 1.00	July 13, 2020	11.5
4,796,150	\$ 1.70	October 31, 2020	15.0
150,000	\$ 1.00	November 18, 2020	15.5
1,288,000	\$ 2.50	November 21, 2020	15.5
18,400,000	\$ 3.25	November 21, 2020	15.5
6,324,900	\$ 2.40	February 16, 2021	18.5
35,963,432	\$ 2.60		15.3

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

12. Share capital (continued)

Stock options

The Company offers an incentive stock option plan that provides for the granting of options up to 10% of its issued and outstanding common shares to directors, officers, employees and consultants. The exercise price of each option is equal to the quoted market price of the Company's common shares on the trading day immediately preceding the date of grant and the maximum term is five years. Vesting terms, if any, are set at the discretion of the Board.

The stock option activity for the years ended July 31 is as follow:

	<u>2019</u>		<u>2018</u>	
	<u>Number</u>	<u>Weighted</u>	<u>Number</u>	<u>Weighted</u>
	<u>of options</u>	<u>average</u>	<u>of options</u>	<u>average</u>
		<u>exercise</u>		<u>exercise</u>
		<u>price</u>		<u>price</u>
Balance at beginning of the year	6,030,000	\$ 0.62	5,356,500	\$ 0.41
Granted	2,992,775	1.92	1,535,000	1.32
Exercised	(1,216,970)	0.45	(861,500)	0.42
Cancelled / Expired	(391,252)	1.33	-	-
Balance at end of the year	7,414,553	\$ 1.15	6,030,000	\$ 0.62

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

12. Share capital (continued)

Stock options (continued)

Details of the outstanding stock options as at July 31, 2019 are as follows:

Number of stock options outstanding	Weighted average exercise price	Expiry date	Weighted average life remaining (months)	Number of stock options exercisable	Weighted average exercise price
50,000	\$ 1.00	September 15, 2020	13.5	50,000	\$ 1.00
200,000	\$ 1.44	December 14, 2020	16.5	200,000	\$ 1.44
150,000	\$ 1.71	February 22, 2021	18.1	150,000	\$ 1.71
345,000	\$ 1.30	June 22, 2021	22.5	301,667	\$ 1.30
250,000	\$ 1.35	July 10, 2021	23.5	250,000	\$ 1.35
250,000	\$ 0.30	August 1, 2021	24.0	250,000	\$ 0.30
850,000	\$ 0.185	October 3, 2021	26.0	850,000	\$ 0.185
965,000	\$ 0.30	October 3, 2021	26.0	965,000	\$ 0.30
133,333	\$ 0.70	December 15, 2021	28.5	49,992	\$ 0.70
1,114,000	\$ 0.65	May 18, 2022	33.5	1,114,000	\$ 0.65
250,000	\$ 2.00	May 29, 2022	34.0	62,500	\$ 2.00
22,222	\$ 0.70	June 20, 2022	34.5	5,552	\$ 0.70
33,332	\$ 0.70	August 9, 2022	36.5	6,246	\$ 0.70
125,000	\$ 0.65	September 5, 2022	37.0	125,000	\$ 0.65
66,666	\$ 0.70	September 14, 2022	37.5	12,495	\$ 0.70
75,000	\$ 1.47	November 1, 2022	39.0	75,000	\$ 1.47
150,000	\$ 1.82	March 22, 2023	43.5	93,750	\$ 1.82
75,000	\$ 1.61	April 4, 2023	44.0	75,000	\$ 1.61
50,000	\$ 1.62	August 27, 2023	49.0	50,000	\$ 1.62
555,000	\$ 2.48	October 15, 2023	50.5	555,000	\$ 2.48
370,000	\$ 2.01	December 11, 2023	52.5	161,666	\$ 2.01
75,000	\$ 1.80	June 18, 2024	58.5	18,750	\$ 1.80
1,200,000	\$ 1.81	July 3, 2024	59.0	675,000	\$ 1.81
60,000	\$ 1.83	July 25, 2024	60.0	15,000	\$ 1.83
7,414,553	\$ 1.15		37.0	6,111,618	\$ 1.03

During the year ended July 31, 2019, the Company recognized share-based compensation related to stock options of \$3,080,807 (2018 - \$1,217,666). The compensation expense was based on the fair value of each stock option on the date of the grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	<u>2019</u>	<u>2018</u>
Expected life	4.3 years	3.8 years
Expected volatility in market price of shares	100.0%	100.0%
Expected dividend rate	0%	0%
Risk-free interest rate	1.78%	1.86%
Weighted average fair value per option granted	\$ 1.457	\$ 0.897

PATRIOT ONE TECHNOLOGIES INC.

Notes to Consolidated Financial Statements
For the years ended July 31, 2019 and 2018

12. Share Capital (continued)

Loss per share

Stock options and warrants are not included in the determination of fully diluted loss per share for the years ended July 31, 2019 and 2018 as these instruments are anti-dilutive.

Escrow securities

Pursuant to a TSX-V Form 5D Escrow Agreement among the Company, TSX Trust Company and certain securityholders of the Company, a total of 10,248,001 shares, 1,023,000 share purchase warrants, and 2,100,000 incentive stock options of the Company (collectively the "Escrowed Securities") were to be held in escrow. The Escrowed Securities are to be released at 10% on the date of the Transaction and an additional 15% every six months thereafter with the final tranche being released on November 10, 2019. As at July 31, 2019, 1,675,651 common shares and 165,000 stock options of the Company are being held in escrow.

13. Related party transactions

Key management personnel include persons having the authority and responsibility for planning, directing and controlling the activities of the Company as a whole. The Company has determined that key management personnel consist of executive and non-executive members of the Board of Directors and corporate officers. Key management compensation incurred with officers and directors of the Company or to companies controlled by officers and directors of the Company during the year ended July 31, 2019 was \$933,131 (2018 - \$965,338). In addition, share-based compensation expense relating to officers and directors for the year ended July 31, 2019 was \$136,950 (2018 - \$271,725).

As at July 31, 2019 accounts payable and accrued liabilities includes \$33,571 (2018 - \$Nil) due to officers and directors of the Company or to companies controlled by directors and officers of the Company.

14. Supplemental Cash Flow Information

Non-cash activities during the year ended July 31, 2019 were conducted by the Company as follows:

Fair value of 1,288,000 warrants issued for broker fees	\$1,582,233
Fair value of shares issued on acquisition of EhEye	\$3,387,257
Fair value of replacement options granted	\$ 74,409
Transfer of contributed surplus on exercise of broker warrants	\$ 177,599
Transfer of contributed surplus on exercise of stock options	\$ 263,633

Non-cash activities during the year ended July 31, 2018 were conducted by the Company as follows:

Fair value of 53,371 common shares issued as corporate finance fee	\$ 37,500
Fair value of 32,250 common shares issued for agency fee	\$ 22,575
Fair value of 672,175 warrants issued for broker fees	\$ 568,239
Fair value of 462,875 warrants issued for broker fees	\$ 188,036
Fair value of 16,125 warrants issued for agency fee	\$ 6,015
Fair value of 885,500 warrants issued for broker fees	\$1,124,076
Transfer of contributed surplus on exercise of broker warrants	\$ 414,932
Transfer of contributed surplus on exercise of stock options	\$ 173,314
Transfer of deferred acquisition costs to share capital	\$ 579,299

No cash was paid towards taxes or interest during the periods ending July 31, 2019 or July 31, 2018.

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15. Financial Instruments and Risk Management

As at July 31, 2019, the Company's financial instruments comprise cash and cash equivalents, short term investments, receivables and accounts payable and accrued liabilities. The fair values of receivables and accounts payable and accrued liabilities approximate their carrying values due to their short-term maturity. Fair values of financial instruments are classified in a fair value hierarchy based on the inputs used to determine fair values. The levels of the fair value hierarchy are 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 (i.e. as prices) or indirectly (i.e. derived from prices); and

Level 3 – Inputs that are not based on observable market data (unobservable inputs).

As at July 31, 2019, the fair value of cash and cash equivalents held by the Company was based on Level 1 of the fair value hierarchy.

Risks to the Company's financial instruments and their potential impact on the Company's financial instruments are summarized below:

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company ensures there is sufficient capital in order to meet short-term business requirements, after taking into account cash flows from operations and the Company's holdings of cash. The Company believes that these sources are sufficient to cover the likely short-term cash requirements, but that further funding or net income from operating activities will be required to meet long-term requirements. As at July 31, 2019, the Company had cash and cash equivalents of \$50,637,942 to settle current liabilities of \$1,930,104. All of the Company's financial liabilities have contractual maturities of 30 days or are due on demand and subject to normal trade terms.

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The Company's credit risk is primarily attributable to its cash and amounts receivable. The Company limits exposure to credit risk by maintaining its cash with large financial institutions. The Company does not have cash that is invested in asset backed commercial paper. The Company's accounts receivable consists of sales tax refundable from the Canada Revenue Agency and accounts receivable under the ITB program and are not subject to significant credit risk.

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15. Financial Instruments and Risk Management (continued)

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates, foreign exchange rates, and equity prices.

i. Interest rate risk

Interest rate risk arises from changes in market rates of interest that could adversely affect the Company. The Company currently has no interest-bearing financial instruments other than cash, so its exposure to interest rate risk is insignificant.

ii. Foreign currency risk

Foreign currency risk is the risk that is related to the fluctuation of foreign exchange rates. Substantially all of the Company's assets, liabilities and operations are denominated in Canadian dollars. As at July 31, 2019 and 2018, the Company did not have any material monetary assets or liabilities denominated in a foreign currency and consequently is not exposed to significant foreign currency risk.

iii. Price risk

The Company is exposed to price risk with respect to equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. The Company closely monitors individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company.

16. Capital Management

The Company defines its capital as its shareholders' equity. It manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the research, development and commercialization of its systems to detect concealed weapons utilizing radar technologies. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business. The Company is not generating revenue and is dependent upon external financing to fund activities. In order to carry out planned research and development and pay for administrative costs, the Company will spend its existing working capital and will attempt to raise additional funds as needed.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

The Company's capital management objectives, policies and processes have not been changed over the period presented. The Company is not subject to any externally imposed capital requirements.

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Notes to Consolidated Financial Statements
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17. Income Taxes

The reconciliation of the combined federal and provincial income tax rate to the income tax expenses presented in the consolidated statement of operations and comprehensive loss is as follows:

	2019	2018
Loss for the year before income taxes	\$ (17,551,967)	\$ (11,985,776)
<u>Combined Canadian federal and provincial statutory rate</u>	<u>27.0%</u>	<u>27.0%</u>
Income tax expense (recovery) at statutory rate	(4,739,000)	(3,236,000)
Reconciliation of effective rate		
Change in statutory, foreign tax, foreign exchange rates and other	318,000	(92,000)
Permanent differences	845,000	341,000
Share issue costs	(1,067,000)	(998,000)
Adjustment to prior year provision versus statutory tax return	79,000	108,000
Changes in unrecognized deductible temporary timing differences and other items	4,444,000	3,877,000
<u>Deferred tax recovery</u>	<u>\$ (120,000)</u>	<u>\$ -</u>

The significant components of the Company's temporary differences, unused tax credits and unused tax losses that have not been included on the consolidated statement of financial position are as follows:

	2019		2018	
	Amount	Expiry	Amount	Expiry
Non-Capital losses - Canada	\$ 29,159,000	2029 - 2039	\$ 17,930,000	2029 - 2039
Non-Capital losses - United States	1,822,000	indefinite	-	indefinite
Non-Capital losses - United Kingdom	2,104,000	indefinite	456,000	indefinite
Share issue costs	5,523,000	2040 - 2043	3,164,000	2039 - 2042
	<u>\$ 38,608,000</u>		<u>\$ 21,550,000</u>	

18. Commitments

Operating lease commitments

The Company is committed to various operating leases for office premises with remaining terms up to January 2024. For the fiscal years ended July 31, the future minimum lease payments under these operating leases are as follows:

2020	\$ 663,315
2021	526,677
2022	401,722
2023	345,286
2024	168,249
	<u>\$ 2,105,249</u>

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19. Segmented Information

The Company currently operates in one business segment, being the research, development and commercialization of threat detection and counter-terrorism solutions.

Details on a geographical basis for total non-current assets are as follows:

	<u>Canada</u>	<u>United States</u>	<u>United Kingdom</u>	<u>Total</u>
As at July 31, 2019				
Property, plant and equipment	\$ 1,481,866	\$ 56,034	\$ 82,588	\$ 1,620,488
Intangible assets	1,370,000	6,545,175	-	7,915,175
Investment in Joint Venture	-	3,386,390	-	3,386,390
Goodwill	2,588,614	-	-	2,588,614
	<u>\$ 5,440,480</u>	<u>\$ 9,987,599</u>	<u>\$ 82,588</u>	<u>\$ 15,510,667</u>
As at July 31, 2018				
Property, plant and equipment	\$ 521,000	\$ -	\$ 43,662	564,662
Intangible assets	-	-	-	-
Goodwill	-	-	-	-
	<u>\$ 521,000</u>	<u>\$ -</u>	<u>\$ 43,662</u>	<u>\$ 564,662</u>

20. Subsequent events

Subsequent to July 31, 2019, the Company:

- granted stock options to allow the holders to acquire 75,000 common shares at \$1.78 per share, 70,000 common shares at \$1.81 and 50,000 common shares at \$1.43 per share. Each of these options was granted for a term of five years;
- granted stock options to allow the holder to acquire 200,000 common shares at \$1.80 per share for a term of four years;
- issued 11,108 common shares for cash of \$7,776 on the exercise of stock options and issued 34,818 common shares for cash of \$34,818 on the exercise of warrants;
- had warrants to purchase 15,000 common shares at \$0.30 per share expire unexercised; and
- acquired 100% of the issued and outstanding shares of Xtract Technologies Inc. ("Xtract"), a private company incorporated in British Columbia. Xtract develops and commercializes artificial intelligence, machine learning, deep neural network and predictive solutions utilizing its proprietary technology for public institutions and private enterprises. The purchase price included a cash payment of \$6,000,000 and the issuance of 9,422,956 common shares ("Consideration Shares") at a fair value of \$16,867,091. Subject to certain exceptions based on the business of the Company or the performance of the Company's common share price, the Consideration Shares will be subject to escrow restrictions and released on a quarterly basis over the next twelve consecutive fiscal quarters of the Company.