

# *Supreme.*

**THE SUPREME CANNABIS COMPANY, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL RESULTS**

FOR THE THREE AND SIX MONTHS ENDED DECEMBER 31, 2018

Date: February 12, 2019

# THE SUPREME CANNABIS COMPANY, INC.

## Management's Discussion and Analysis

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The following Management's Discussion and Analysis ("**MD&A**") should be read in conjunction with The Supreme Cannabis Company, Inc. (the "**Company**" or "**Supreme**") condensed interim consolidated financial statements and notes for the three and six months ended December 31, 2018 (the "**Financial Statements**"). The Financial Statements, together with this MD&A are intended to provide investors with a reasonable basis for assessing the financial performance of Supreme as well as forward-looking statements relating to future performance. The financial statements are prepared in accordance with International Financial Reporting Standards ("**IFRS**"). All amounts are in Canadian dollars unless otherwise noted.

This MD&A contains disclosures up to February 12, 2019.

## Forward-Looking Statements

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This MD&A contains certain information that may constitute "forward-looking information" and "forward-looking statements" (collectively, "**forward-looking statements**") which are based upon the Company's current internal expectations, estimates, projections, assumptions and beliefs. Such statements can, in some cases, be identified by the use of forward-looking terminology such as "expect," "likely", "may," "will," "should," "intend," "anticipate," "potential," "proposed," "estimate" and other similar words, including negative and grammatical variations thereof, or statements that certain events or conditions "may" or "will" happen, or by discussions of strategy. Forward-looking statements include estimates, plans, expectations, opinions, forecasts, projections, targets, guidance, or other statements that are not statements of fact. The forward-looking statements included in this MD&A are made only as of the date of this MD&A. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to:

- performance of the Company's business and operations;
- intention and plans to grow the business and operations of the Company;
- licensing risks and expectations with respect to renewal and/or extension of the Company's licenses;
- regulatory risks and any commentary with respect to the legalization of medical or recreational cannabis;
- change in laws, regulations and guidelines;
- expectations with respect to the cannabis market and market risks;
- expansion and production capacity of the Company's facility and the timing related thereto;
- risks inherent in an agricultural business;
- history of net losses; and
- competition.

Certain of the forward-looking statements and forward-looking information and other information contained herein concerning the cannabis industry and the general expectations of Supreme concerning the cannabis industry and concerning Supreme are based on estimates prepared by Supreme using data from publicly available governmental sources as well as from market research and industry analysis and on assumptions based on data and knowledge of this industry which Supreme believes to be reasonable. While Supreme is not aware of any misstatement regarding any industry or government data presented herein, the cannabis industry involves risks and uncertainties that are subject to change based on various factors and the Company has not independently verified such third-party information.

Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement. In particular, but without limiting the foregoing, disclosure in this MD&A under "*Overview of Supreme's Cannabis Business & Corporate Strategy*" as well as statements regarding the Company's objectives, plans and goals, including future operating results and economic performance may refer to or involve forward-looking statements.

## **Forward-Looking Statements (continued)**

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A number of factors could cause actual events, performance or results to differ materially from what is projected in the forward-looking statements. See below under “Risks and Uncertainties” for further details. The purpose of forward-looking statements is to provide the reader with a description of management’s expectations, and such forward-looking statements may not be appropriate for any other purpose. You should not place undue reliance on forward-looking statements contained in this MD&A. Supreme undertakes no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable law.

## **Overview of Supreme’s Cannabis Business & Corporate Strategy**

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Supreme is a federally incorporated Canadian company with its common shares publicly traded on the Toronto Stock Exchange (“**TSX**”) under the symbol “**FIRE**”, Over-the-Counter (“**OTCQX**”) under the symbol “**SPRWF**”, and on the Frankfurt Stock Exchange (“**FRA**”) under the symbol “**53S1**”.

Supreme is a diversified cannabis company based in Canada and a producer and distributor of consumer-focused proprietary cannabis plant products globally. Supreme’s mission is to make a positive impact on people and the planet by continuing to grow better cannabis businesses.

### ***Strategy for Launch of the Canadian Cannabis Market***

Early on, Supreme’s strategic priority was to establish a distinctive competitive advantage in the Canadian cannabis market through its wholly-owned and federally incorporated subsidiary, 7ACRES. 7ACRES is a Licensed Producer (as such term is defined under the *Access to Cannabis for Medical Purposes Regulations* (“**ACMPR**”)), licensed as at March 11, 2016, operating a 440,000 sq. ft. cultivation facility located in Kincardine, Ontario (the “**Facility**”). The Facility combines the best aspects of indoor and greenhouse cultivation to execute on 7ACRES’ mission to grow premium cannabis on a commercial scale.

Through 7ACRES, Supreme grows cannabis flower with unique qualities and utilizes proprietary growing methodology resulting in a “ladder of benefits” for consumers: genetics selected to maximize aroma and visual appeal; cultivation methodologies that prioritize quality over yield; and post-harvest drying and curing practices designed with the intention to maximize consumer enjoyment.

Supreme believes the premium product segment represents an opportunity to compete on quality and earn premium pricing versus competing in the lower cost and lower quality product segment of the market. Supreme believes high-quality cannabis is an essential product for the success of the legal recreational cannabis market and is necessary to combat competition from the illicit market and low-cost producers. Supreme believes that focusing on the premium product segment and cultivation at scale allows for the establishment of a valued brand, revenue growth, and development of intellectual property and proprietary value with respect to strictly regulated cannabis production – which can be applied to other markets and product segments.

Prior to October 17, 2018, Supreme’s cannabis sales were restricted to the legal medical cannabis market. These cannabis sales were and continue to be completed via Business to Business (“**B2B**”) transactions with legal and licensed Canadian retailers, which is currently restricted to only Licensed Producers in Canada. The B2B model was designed to allow 7ACRES to grow its revenue through high-value bulk sales while maintaining its focus on cultivation, without the expense of patient acquisition and retention or retail order fulfillment and logistics. Following the launch of the legal adult-use recreational market on October 17, 2018, sales are transacted with provincial distributors and retailers, and provincially-approved private retailers across the country. The B2B model has prepared 7ACRES for the B2B sales model in the recreational market. See “Regulatory Background” for more information.

To support product distribution, Supreme has built a regulated sales and marketing team that includes professionals from the alcohol beverage, tobacco and cannabis industries. Supreme’s sales and marketing efforts with respect to the 7ACRES brand include a commitment to a quality consumer experience, collaborative demand planning with retail partners and investments in on-going corporate social responsibility and trade education.

Supreme’s focus on premium quality cannabis flower cultivation and brand positioning has resulted in 7ACRES establishing recreational distribution in eight provinces and being placed exclusively in the premium brand category in provinces that group cannabis products by quality. As of the date hereof, 7ACRES premium flower is available for legal adult-use customers in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick, Nova Scotia and Prince Edward Island.

## **Overview of Supreme's Cannabis Business & Corporate Strategy (continued)**

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### ***Strategy for the International Medical Cannabis Market and Other Canadian Product Segments***

Recognizing the opportunities presented by new product categories and the burgeoning global medical market, Supreme's strategic focus following the successful execution of the 7ACRES launch is to continue investing in other product and geographical segments. This may include strategic partnerships or developing additional productive assets and new brands for the Canadian adult-use market and existing medical markets in Canada and internationally. In particular, Supreme will continue identifying opportunities that provide distinct proprietary advantages.

Supreme made its first international investment during the year ended June 30, 2018, in Medigrow Lesotho (PTY) Limited ("**Medigrow**"), a licensed producer of cannabis in the Kingdom of Lesotho. On October 17, 2017, the Ministry of Health in Lesotho issued a license for prohibited drug operators to Medigrow pursuant to Section 12 of the Drugs of Abuse Act. The licence allows the following activities in respect of cannabis and cannabis resin: (i) cultivation; (ii) manufacture; (iii) supply or distribution; (iv) storage; and (v) export, import and transit within, into and out of Lesotho for medicinal purposes or scientific use and any other lawful use. Although Medigrow is producing extracted cannabis oils, it does not currently generate revenue and the establishment of distribution channels is required in order for Medigrow to generate revenue.

Supreme anticipates Medigrow becoming a leading supplier of Good Manufacturing Practice ("**GMP**") Certified medical cannabis oil produced in Lesotho. Pursuant to its investment in Medigrow, Supreme and Medigrow formed a strategic alliance providing Supreme with long-term access to Medigrow's cannabis oil for distribution into legal international markets. Supreme believes the cannabis oil produced by Medigrow will be globally cost competitive and will be a key component of Supreme's future international medical cannabis strategy. The cannabis oil will be produced by Medigrow in Lesotho. Subject to all government and international regulatory approvals, the oil will be exported to international medical cannabis markets. Supreme does not have any plans to sell the cannabis oil in Lesotho.

In addition to MediGrow, Supreme entered into an exclusive consulting agreement with Khalifa Kush Enterprises Canada ULC ("**KKE**") to develop and launch a lineup of premium cannabis products. Supreme will become the exclusive producer of KKE branded products in Canada, and subject to certain approvals, international markets (other than the United States). Supreme and KKE will work to develop and commercialize a product lineup that is expected to include pre-rolls, extracts, capsules, and cannabis oils to be sold by the Company under the brand, "KKE" or "KK".

In addition to Canada and Lesotho, Supreme regularly considers opportunities in emerging cannabis markets, only where medical and/or recreational cannabis is federally legal.

Supreme does not, directly or indirectly, have any business operations in jurisdictions where cannabis is not federally legal, such as the United States of America.

### **About 7ACRES, the Facility and 7ACRES Unique Cultivation Methodology**

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7ACRES is a Canadian Licensed Producer (now, under the Cannabis Act, a licensed cultivator, licensed processor and an entity licensed to sell medical cannabis), focused on cultivating premium dried cannabis flowers on a commercial scale. 7ACRES is a leading Canadian B2B Licensed Producer, a cannabis business model it pioneered in 2016. Currently, 7ACRES operates 120,000 sq. ft. of flowering room capacity which is expected to have an average output of approximately 17,500 kilograms of dried cannabis per annum. The Company does not have any Canadian operations independent of 7ACRES.

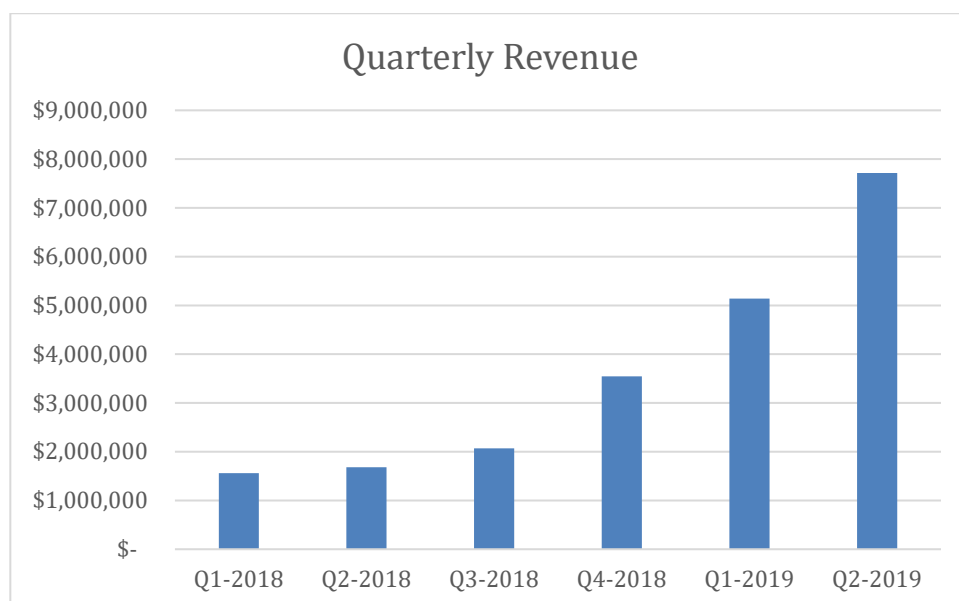
The 7ACRES Facility is located in Kincardine, Ontario. It is expected that the Facility, once complete, will span more than 440,000 sq. ft. Management expects the Facility will be able to produce 50,000 kilograms of premium dried cannabis per year once it is able to operate at full capacity. The Facility has been developed to produce premium dried cannabis, at scale.

Management believes the Facility is unique in Canada for combining what management believes to be the best aspects of indoor and greenhouse cannabis cultivation. The Facility is intended to combine the science, standardization and quality of indoor cultivation with the benefits of full-spectrum sunlight. The Company expects that all flowering rooms at the Facility will be completed by March 2019 and the entire Facility (including staff offices, lunch rooms and other non-cultivation areas) is expected to be completed by the middle of calendar 2019.

## Highlights for the three and six months ended December 31, 2018

### **Supreme achieves sixth straight quarter of record revenue growth**

During the three months ended December 31, 2018, Supreme achieved \$7,718,351 of revenue representing a 50% and 359% increase from the three months ended September 30, 2018 and the three months ended December 31, 2017, respectively. The record revenue achieved during the three months ended December 31, 2018 is due to increased production at the 7ACRES Facility, the strong demand for the Company's premium dry cannabis flower and robust wholesale and adult use market pricing.



### **Supreme signs international partnership agreement with Khalifa Kush Enterprises**

On December 6, 2018 the Company entered into an exclusive consulting agreement with KKE to develop and launch a lineup of premium cannabis products.

KKE will provide cannabis related consulting services to the Company who will be the exclusive producer of KKE branded products in Canada and, subject to certain approvals, international markets (other than the United States). This will include a strain to be developed by the parties in Canada based on KKE's flagship "Khalifa Kush" strain. Supreme and KKE will work to develop and commercialize a product lineup that is expected to include pre-rolls, extracts, capsules, and cannabis oils to be sold by the Company under the brand, "KKE" or "KK".

The initial term of the agreement is five years and may be extended by Supreme for an additional five years, subject to certain conditions and the issuance of a number of common shares of Supreme to be determined at the time of the renewal. As partial consideration, KKE received 5,745,000 common shares along with a cash payment of CDN \$1,000,000. In addition, KKE will receive annual royalty payments paid over the course of the agreement, calculated based on the sale of products developed pursuant to the agreement.

### **Supreme acquires Bayfield Strategy, Inc.**

On November 30, 2018 the Company acquired Bayfield Strategy, Inc. ("**Bayfield**"), a leading communications and stakeholder relations firm. Bayfield's CEO, founder and shareholder, Mr. Riyaz Lalani, was appointed to the position of Chief Corporate Officer ("**CCO**") of the Company. Bayfield's other employees entered into employment agreements with Supreme and assumed a variety of roles in corporate operations and stakeholder relations.

## **Highlights for the three and six months ended December 31, 2018 (continued)**

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### ***Supreme acquires Bayfield Strategy, Inc. (continued)***

Over the last two decades, Mr. Lalani has advised public companies, boards of directors, private equity funds and hedge funds across North America. Prior to founding Bayfield, Mr. Lalani was the Chief Operating Officer of a leading shareholder services firm in Canada. Beforehand he was the head of research for an international asset manager in New York and Toronto, focused on investments in biotechnology, life sciences, resources, and a variety of other industry sectors. Mr. Lalani will contribute a unique and diverse experience set that encompasses capital allocation, strategic communications, and operational execution.

Supreme issued 1,075,269 common shares to Bayfield's shareholders in exchange for all of the issued and outstanding shares of Bayfield. Portion of the share consideration is considered compensation due to claw back requirement tied to continuous employment of Bayfield employees with the Company.

### ***Bought deal offering***

On October 19, 2018, the Company closed a bought deal offering for gross proceeds of \$100 million, including the exercise, in full, of the underwriters' over-allotment option (the "**Offering**"), comprised of 6.0% senior unsecured convertible debentures (the "**Debentures**") of the Company at the issue price of \$1,000 per Debenture, with a syndicate of underwriters, co-led by GMP Securities L.P. and BMO Capital Markets, including Cormark Securities Inc., Eight Capital, Beacon Securities Limited and P.I. Financial Corp.

The Debentures have a maturity date that is 36 months from the closing date of the Offering (the "**Maturity Date**") and bear interest from the date of closing at 6.0% per annum, payable semi-annually on June 30 and December 31 of each year. The Debentures are convertible, at the option of the holder, into common shares at any time prior to the close of business on the last business day immediately preceding the Maturity Date at a conversion price of \$2.45 per common share (the "**Conversion Price**"), subject to adjustment in certain circumstances. The Company may force the conversion of the principal amount of the then outstanding Debentures at the Conversion Price on not less than 30 days' notice should the daily volume weighted average trading price of the common shares be greater than \$3.43 for any 10 consecutive trading days. The Debentures are listed for trading on the TSX under the symbol "**FIRE.DB**".

### ***Settlement of debt***

On November 6, 2018, Supreme completed the conversion of an aggregate principal amount of \$4,840,000 and accrued interest outstanding of 8% unsecured convertible debentures due November 2019 to 3,261,622 common shares of the Company reducing its debt load.

### ***Subsequent Events***

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#### ***7ACRES completes construction of additional flowering rooms and receives Health Canada cultivation approval***

In January 2019, 7ACRES obtained Health Canada approval for 30,000 sq ft of flowering rooms, bringing the total flowering room capacity at 7ACRES to approximately 120,000 sq ft. The additional cultivation capacity, assuming a current yield, increases 7ACRES' annual production potential to 17,500 kilograms.

As of December 31, 2018, 7ACRES had completed the construction of 19 flowering rooms, out of the total of 25 flowering rooms planned, once the Facility is complete. The remaining flowering rooms are expected to be completed in March 2019. This flowering room expansion continues to increase the Company's capacity and improves the Company's ability to meet the demand of cannabis enthusiasts in the recreational cannabis market in Canada.

#### ***Approval to list on the Toronto Stock Exchange***

On January 9, 2019 the Company received conditional approval from the TSX to graduate from the TSX Venture Exchange ("**TSXV**") and list its common shares on the TSX. On February 4, 2019, Supreme's common shares were delisted from the TSXV and commenced trading on the TSX under the symbol "**FIRE**". The Company's 6.0% senior unsecured convertible debentures due 2021 were also delisted from the TSXV and commenced trading on the TSX under the symbol "**FIRE.DB**".

## **Results of Operations for the three and six months ended December 31, 2018 and 2017**

During the three and six months ended December 31, 2018, the Company reported a net comprehensive loss of \$1,550,638 (December 31, 2017: \$2,034,615) and \$6,936,097 (December 31, 2017: \$4,213,761), respectively.

The net comprehensive loss for the three and six months ended December 31, 2018 increased as compared to the prior period, primarily as a result of increases in production costs, operating expenses and other expenses offset by an increase in revenues, the net impact from gains on fair value of biological assets and deferred tax recovery. The increase in revenue, production costs, net fair value gains on biological assets and operating expenses are as a result of the expanded production at the Facility and increased employee head count. Other expenses increased as a result of additional borrowing costs related to convertible debentures issued in October 2018, loss on disposal of assets as a result of repurposing of various areas at the Facility and unrealized losses on investments from the Company's investment in BlissCo Cannabis Corp.

The net comprehensive loss for the three months ended December 31, 2018 decreased as compared to the prior period, primarily as a result of the factors discussed above and deferred tax recovery.

### **Revenue**

During the three and six months ended December 31, 2018 the Company generated revenues of \$7,718,351 (December 31, 2017: \$1,680,641) and \$12,858,263 (December 31, 2017: \$3,240,639), respectively. The increase in revenue of 359% and 297%, respectively is due to the launch of the Canadian adult use market, the increased capacity of the 7ACRES' Facility and an increase in the average price of premium cannabis flower by 15% and 22% as compared to the three and six months ended December 31, 2017, respectively.

### **Production costs**

Production costs consist of direct and overhead costs attributable to cannabis production activities during the biological transformation process up to the point of harvest incurred in the period, as well as direct and overhead costs attributable to post-harvest cannabis processing activities that have been initially capitalized to inventory and subsequently expensed to production costs as cannabis inventory is sold.

Production costs related to cannabis production activities during the biological transformation process up to the point of harvest consist of direct and overhead allocation for wages and benefits, facilities, materials, supplies and facility amortization expense for production, sanitation, record keeping, quality assurance, utilities, security and facility maintenance activities. These costs are expensed to production costs in the period they are incurred.

Production costs related to cannabis processing activities after harvest consist of direct and overhead allocation for wages and benefits, facilities, materials, supplies and facility amortization expense for drying, trimming, packaging, sanitation, record keeping, quality assurance, utilities, security and facility maintenance activities. These costs are initially capitalized to inventory in the period incurred and subsequently expensed to production costs as cannabis is sold.

Production costs for the three and six months ended December 31, 2018 and 2017 includes the following direct and overhead costs:

### **Production costs incurred during the pre-harvest biological transformation process:**

|  | <b>Six months<br/>ended December<br/>31, 2018</b> | Six months<br>December 31,<br>2017 | <b>Three months<br/>ended<br/>December 31,<br/>2018</b> | Three months<br>ended December<br>31, 2017 |
|--|---|------------------------------------|---|--|
| Wages and benefits expense                 | \$ 2,451,769                                      | \$ 1,202,521                       | \$ 1,388,198  | \$ 651,770                                 |
| Facilities, materials and supplies expense | 1,552,829   | 1,047,035                          | 1,013,738   | 691,177                                    |
| Amortization expense                       | 752,798   | 271,223                            | 388,978   | 155,261                                    |
|  | <b>\$ 4,757,396</b>                               | <b>\$ 2,520,779</b>                | <b>\$ 2,790,914</b>                                     | <b>\$ 1,498,208</b>                        |

**Results of Operations for the three and six months ended December 31, 2018 and 2017 (continued)**

**Production costs (continued)**

**Post-harvest production costs incurred related to cannabis inventory sold:**

|  | <b>Six months<br/>ended December<br/>31, 2018</b> | Six months<br>December 31,<br>2017 | <b>Three months<br/>ended<br/>December 31,<br/>2018</b> | Three months<br>ended December<br>31, 2017 |
|--|---|------------------------------------|---|--|
| Wages and benefits expense                 | \$ 1,634,573                                      | \$ 33,092                          | \$ 1,032,836  | \$ 33,092                                  |
| Facilities, materials and supplies expense | 415,272   | 12,864                             | 181,360   | 12,864                                     |
| Amortization expense                       | 104,438   | 4,006                              | 31,587  | 4,006                                      |
|  | <b>\$ 2,154,283</b>                               | <b>\$ 49,962</b>                   | <b>\$ 1,245,783</b>                                     | <b>\$ 49,962</b>                           |

Production costs related to cannabis production activities during the biological transformation process increased by \$2,236,617 during the six months ended December 31, 2018, as compared to prior year. This is due to a substantial increase in the footprint and output of the Company's Facility and consequently an increase in personnel, facility costs and amortization expenses that have been incurred.

As discussed below in the *Realized fair value changes on inventory sold or impaired* section, production costs related to cannabis processing activities were expensed to the statement of profit and loss as the costs were incurred prior to June 30, 2017. This is due to the previous accounting policy of expensing inventory processing costs as the Company did not have a license to sell cannabis. As a result, production costs would have been higher by approximately \$312,070 for the six months ended December 31, 2017 if the current policy to capitalize post-harvest processing cost would have been in place. A portion of the cannabis sold during the three and six months ended December 31, 2017 was harvested and processed prior to June 28, 2017, the date the Company, through 7ACRES, was granted permission to sell.

IFRS allows for the use of alternative methods when recording actual costs incurred during the biological transformation process. As described above, the Company has elected to expense cost incurred during the biological transformation process when the costs are incurred. Alternatively, IFRS allows for actual costs incurred during the biological transformation process to be capitalized when incurred and expensed when the related inventory is sold. For greater comparability the Company has presented both methods. The alternatives presented below are both IFRS compliant and use the retrospective approach, except as described above:

| <b>For the six months ending December 31, 2018</b>        | <b>Results of the<br/>Company's current<br/>IFRS compliant<br/>method</b> | <b>Results when capitalizing<br/>costs during the<br/>biological transformation<br/>process</b> |
|---|---|---|
| Production Costs  | \$ 6,911,679  | \$ 4,530,536  |
| Gain on fair value changes of biological assets           | (15,315,563)  | (8,403,884)   |
| Realized fair value changes on inventory sold or impaired | 10,039,198  | 5,508,662   |
| <b>Total</b>  | <b>\$ 1,635,314</b>   | <b>\$ 1,635,314</b>   |

| <b>For the six months ending December 31, 2017</b>        | <b>Results of the<br/>Company's current<br/>IFRS compliant<br/>method</b> | <b>Results when capitalizing<br/>costs during the<br/>biological transformation<br/>process</b> |
|---|---|---|
| Production Costs  | \$ 2,570,741  | \$ 805,239  |
| Gain on fair value changes of biological assets           | (3,005,055)   | (434,314)   |
| Realized fair value changes on inventory sold or impaired | 941,281   | 136,042   |
| <b>Total</b>  | <b>\$ 506,967</b>   | <b>\$ 506,967</b>   |



## **Results of Operations for the three and six months ended December 31, 2018 and 2017 (continued)**

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### ***Changes in fair value of biological assets***

In accordance with IFRS, the Company is required to record its biological assets at fair value less cost to sell. At each reporting period, each harvest is adjusted to full fair value less costs to sell based on the actual yield in grams for completed harvests and estimated yield for harvests in progress. Costs incurred during the biological transformation process are expensed in the period the costs are incurred. Cannabis which has been harvested is transferred to inventory at the full fair value less costs to sell.

Additional costs incurred after harvest related to processing and other finishing costs are capitalized to inventory until such time that the cannabis is ready for sale and recorded as finished inventory.

During the three and six months ended December 31, 2018, the Company recognized a gain of \$10,138,817 (December 31, 2017: \$1,706,358) and \$15,315,563 (December 31, 2017: \$3,005,055), respectively related to the fair value adjustments of biological assets.

The biological assets as at December 31, 2018, of \$5,454,963 (June 30, 2018: \$3,283,233) are comprised of 14,714 (June 30, 2018: 8,364) cannabis plants that are estimated to be 63% (June 30, 2018: 65%) complete to harvest. Once harvested, the produced cannabis is transferred to inventory. During the six months ended December 31, 2018, the Company transferred approximately 1,816 kilograms (December 31, 2017: 502 Kilograms) of cannabis to inventory.

### ***Realized fair value changes on inventory sold or impaired***

Realized fair value changes on inventory sold or impaired is the fair value less cost to sell recognized during the biological transformation process related to cannabis sold during the period and impairment charges related to cannabis inventory.

During the three and six months ended December 31, 2018, the Company recognized realized fair value changes on inventory sold or impaired of \$6,080,780 (December 31, 2017: \$941,281) and \$10,039,198 (December 31, 2017: \$941,281), respectively as a result of cannabis sold during the period and impairment charges.

During the six months ended December 31, 2017, a portion of cannabis sold was not recognized as inventory when harvested as a result of the Company's previous accounting policy to expense costs related to cannabis inventory and not recognize the related biological assets as the Company did not have permission to sell cannabis.

Under the current policy, which was implemented by the Company after obtaining permission to sell cannabis, the Company would have recognized approximately \$2,157,162 of additional realized fair value changes on inventory sold or impaired and capitalized production costs related to revenue generated during the six months ended December 31, 2017.

During the six months ended December 31, 2018, net effect of changes in fair value of biological assets and inventory include: \$5,276,365 of net unrealized changes in fair value due to biological transformation charges that have been added to biological assets and inventory, and \$10,039,198 of realized fair value increments on inventory sold or impaired.

### ***Profits before operating expenses and other charges***

During the three and six months ended December 31, 2018 the Company generated profits before operating expenses and other charges of \$7,739,691 (December 31, 2017: \$897,548) and \$11,222,949 (December 31, 2017: \$2,733,672), respectively. The increase in profits before operating expenses and other charges for the three and six months ended December 31, 2018 as compared to prior year is a result of the Company generating higher revenues of \$7,718,351 (December 31, 2017: \$1,680,641) and \$12,858,263 (December 31, 2017: \$3,240,639), respectively. Additionally, during the three and six months ended December 31, 2018 the Company recognized a net impact of \$4,058,037 (December 31, 2017: \$765,077) and \$5,276,365 (December 31, 2017: \$2,063,774), respectively due to non-cash changes in fair value of biological assets, offset by production costs of \$4,036,697 (December 31, 2017: \$1,548,170) and \$6,911,679 (December 31, 2017: \$2,570,741) respectively.

## **Results of Operations for the three and six months ended December 31, 2018 and 2017 (continued)**

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### **Operating expenses**

During the three and six months ended December 31, 2018, total operating expenses increased to \$10,890,569 (December 31, 2017: \$2,084,170) and \$16,828,806 (December 31, 2017: \$6,140,457), respectively. The operating expenses contributing to the overall movement for the period are due to the following:

- For the three and six months ended December 31, 2018, the Company's total wages and benefits expense increased to \$4,074,236 (December 31, 2017: \$948,241) and \$5,922,299 (December 31, 2017: \$1,666,663), respectively. The total increase in wages and benefits expense for the three and six months ended December 31, 2018, are due primarily to the additions to the management team, increase in variable management compensation and the increased staffing requirements at 7ACRES.
- For the three and six months ended December 31, 2018, the Company's total rent and facilities expense increased to \$885,480 (December 31, 2017: \$194,297) and \$1,348,742 (December 31, 2017: \$331,073), respectively. The total increase in rent and facilities expense for the three and six months ended December 31, 2018, is due to the increase in the number of employees requiring more office space and the expansion of the Company's Facility requiring more utilities, security and other related occupancy costs.
- For the three and six months ended December 31, 2018, the Company's total professional fees expense increased to \$1,067,365 (December 31, 2017: \$319,728) and \$1,335,582 (December 31, 2017: \$350,923) respectively. Professional fees expense increased for the three and six months ended December 31, 2018 as compared to prior period due to higher legal, regulatory fees, and enterprise resource planning integration costs, in the current period.
- For the three and six months ended December 31, 2018, the Company's total sales, marketing and business development expense increased to \$1,496,545 (December 31, 2017: \$293,496) and \$2,352,761 (December 31, 2017: \$415,666), respectively. The marketing expense increased due to sales, marketing and business development related travel expenses and additional brand development expenses and the launch of the 7ACRES brand for the legalization of recreational cannabis in Canada.
- For the three and six months ended December 31, 2018, the Company's total general and administrative expense increased to \$668,704 (December 31, 2017: \$254,964) and \$1,152,323 (December 31, 2017: \$478,839), respectively. The general and administrative expense increased due to the additional information technology, training and other general expenses as a result of the increased number of employees and the expansion of the Facility.
- For the three and six months ended December 31, 2018, the Company's share-based payments expense amounted to \$1,889,922 (December 31, 2017: \$nil) and \$3,659,030 (December 31, 2017: \$2,803,385), respectively. Share based payments were made in correspondence with the Employee Stock Option Plan ("ESOP") and represent incentives to employees and directors for the positive achievements over the past fiscal year and the strengthening of the management team. The ESOP grants are used by management to obtain and retain key executives, employees and consultants. The increase in share-based payment expense for this period is due to an increase in the total amount of incentive options vested during the period.

### **Construction of the 7ACRES Facility**

For the three and six months ended December 31, 2018, the Company's total capitalized expenditure related to the Facility increased to \$25,729,966 (December 31, 2017: \$13,632,677) and \$45,379,638 (December 31, 2017: \$22,661,333), respectively. In addition, for the three and six months ended December 31, 2018, the Company capitalized borrowing costs of \$1,115,985 (December 31, 2017: \$1,550,774) and \$2,772,643 (December 31, 2017: \$3,047,065), respectively, directly attributable to the construction of the Facility. The increase in aggregate capitalized expenditure related to the Facility is a result of accelerated construction efforts aimed at the rapid expansion of the Facility including the newly licensed growing rooms.

During the period, the Company completed a bought deal offering of convertible debentures, through which it raised gross proceeds of \$100,000,000. Use of proceeds from the bought deal offering were used as follows:

## Results of Operations for the three and six months ended December 31, 2018 and 2017 (continued)

### Construction of the 7ACRES Facility (continued)

| Use of proceeds <sup>(1)</sup>                      | Amount raised   | Amount used during six months ending December 31, 2018 |
|---|-----------------|--|
| Construction and development of the 7ACRES facility | \$20M - \$26.4M | \$ 6,721,461   |
| Construction and development of Lot 16              | \$40M - \$60M   | \$ -   |
| General working capital and corporate purposes      | \$0 - \$26.4M   | \$ -   |
| <b>Total</b>  | <b>\$86.4M</b>  | <b>\$ 6,721,461</b>                                    |

(1) Before over-allotment option, as defined in the short form prospectus offering dated October 11, 2018.

### Selected Annual Information

|                                    | June 30, 2018<br>(Audited) | June 30, 2017<br>(Audited) | June 30, 2016<br>(Audited) |
|------------------------------------|----------------------------|----------------------------|----------------------------|
| Revenue                            | \$ 8,854,714               | \$ -                       | \$ -                       |
| Net loss before taxes              | (6,600,087)                | (18,332,089)               | (4,386,787)                |
| Net loss after taxes               | (7,347,130)                | (15,267,175)               | (4,386,787)                |
| Net comprehensive loss after taxes | (7,347,130)                | (14,422,540)               | (4,386,787)                |
| Basic and diluted loss per share   | (0.03)                     | (0.09)                     | (0.05)                     |
| Total assets                       | 199,784,069                | 95,903,338                 | 24,284,266                 |
| Total long-term liabilities        | 31,721,913                 | 31,705,456                 | 536,700                    |
| Dividends declared per share       | -                          | -                          | -                          |

During the years ended June 30, 2016 and 2017, the Company did not generate revenues as its license to sell cannabis was granted on June 28, 2017. The increase in net loss after tax from the year ended June 30, 2016 to June 30, 2017 is mainly due to an increase in share-based payments and other operating expenses offset by deferred tax recovery. During the year ended June 30, 2018, the Company generated its first revenue from the cultivation and sale of cannabis. The decrease in net comprehensive loss from the year ended June 30, 2017 to June 30, 2018 is mainly due to the Company generating revenues, increase in fair value gains on biological assets, increase in unrealized gains on investments, decrease in operating expenses offset by increase in production costs, the recognition of losses due to disposal of assets, higher finance costs and deferred tax.

Total assets increased each year ended June 30, 2016, 2017 and 2018. The increase in net assets is mainly due to the increase in investments made to property, plant and equipment related to the Facility, equity investments and an increase in biological assets and inventory as the Company increased the cultivation capacity of cannabis at its Facility.

The increase in long term liabilities from the year ended June 30, 2016 to June 30, 2017 is due to the issuance of convertible debentures in December 2016. Since June 30, 2017, the Company settled the convertible debentures issued in December 2016 and issued additional convertible debentures in November 2017 that were partially outstanding as at June 30, 2018, but fully settled in October 2018.

The weighted average number of common shares, basic and diluted, outstanding for the six months ended December 31, 2018 is 270,235,520 (December 31, 2017: 198,297,674).

## Selected Financial Information – Quarterly Highlights

The following table sets out selected quarterly information for the last 8 completed fiscal quarters of the Company:

|   | 31-Dec-18     | 30-Sep-18     | 30-Jun-18    | 31-Mar-18     | 31-Dec-17     | 30-Sep-17     | 30-Jun-17    | 31-Mar-17      |
|---|---------------|---------------|--------------|---------------|---------------|---------------|--------------|----------------|
| Net Sales / Revenue                         | \$ 7,718,351  | \$ 5,139,912  | \$ 3,545,043 | \$ 2,069,032  | \$ 1,680,641  | \$ 1,559,998  | Nil          | Nil            |
| Net Income (Loss) after tax                 | \$(1,550,638) | \$(5,385,459) | \$ 234,361   | \$(3,367,730) | \$(2,034,615) | \$(2,179,146) | \$ 3,817,113 | \$ (3,777,437) |
| Basic and diluted Earnings (Loss) per share | \$ (0.01)     | \$ (0.02)     | \$ 0.00      | \$ (0.01)     | \$ (0.01)     | \$ (0.01)     | \$ 0.04      | \$ (0.03)      |

The quarterly variation in operating results has been discussed above in *Results of Operations for the three and six months ended December 31, 2018 and 2017*. The Company's results of operations are not exposed to seasonal variations.

## Liquidity

As at December 31, 2018, the Company has working capital surplus of \$94,002,241 (June 30, 2018: \$50,599,141).

Cash used in operating activities during the three and six months ended December 31, 2018 is \$7,247,680 (December 31, 2017: \$1,704,878) and \$11,181,170 (December 31, 2017: cash inflow of \$1,636,884), respectively. The cash outflows from operating activities mainly relates to non-cash expenses and gains of \$1,158,266, cash outflows from working capital changes of \$3,086,807 and a loss for the period of \$6,936,097.

Cash used in investing activities during the three and six months ended December 31, 2018 is \$28,725,226 (December 31, 2017: \$18,117,609) and \$53,718,553 (December 31, 2017: \$28,078,481), respectively. The increase in cash used for investing activities is mainly related to investments made to the Facility to increase capacity, develop proprietary designs and increase ultimate efficiency.

Cash provided from financing activities during the three and six months ended December 31, 2018 is \$96,742,213 (December 31, 2017: \$45,483,709) and \$100,969,685 (December 31, 2017: \$46,324,272), respectively. The cash inflows from financing activities are due to warrant and option exercises and the issuance of convertible debentures.

The Company's contractual obligations for the next five fiscal years ending June 30, and thereafter are summarized as follows:

|                 | Operating leases    | KKE Minimum Royalty Payments | Convertible debentures |
|-----------------|---------------------|------------------------------|------------------------|
| 2019            | \$ 248,864          | \$ 1,000,000                 | \$ 3,000,000           |
| 2020            | 429,728             | 1,500,000                    | 6,000,000              |
| 2021            | 429,728             | 2,000,000                    | 6,000,000              |
| 2022            | 429,728             | 2,500,000                    | 101,800,000            |
| 2023 and beyond | 2,743,648           | 3,000,000                    | -                      |
|                 | <b>\$ 4,281,696</b> | <b>\$ 10,000,000</b>         | <b>\$ 116,800,000</b>  |

## Capital Resources and Liquidity Risk

The Company constantly monitors and manages its capital resources to assess the liquidity necessary to fund operations and capacity expansion. As at December 31, 2018 the Company had a cash balance of \$91,965,959 and current liabilities of \$25,879,588. The Company's current resources are sufficient to settle its current liabilities. Management believes the current resources available will be sufficient for the completion of the Facility. All of the Company's liabilities are due within 12 months except for the convertible debt and KKE royalty fees. The Company believes, that after the substantial completion of the Facility, positive operating cash flows will be generated. Should additional capital requirements or the replacement of debt be necessary, the Company expects it could satisfy these requirements through capital raises, debt restructurings, or asset sales. However, the outcome of these matters cannot be predicted with certainty at this time.

## **Related Party Transactions**

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As at December 31, 2018, there were no material transactions with related parties except for wages and stock option compensation as described in the Financial Statements.

## **Regulatory Background**

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On November 27, 2017, the House of Commons passed Bill C-45 (the proposed *Cannabis Act*) and on June 21, 2018, the Government of Canada announced that Bill C-45 received Royal Assent. The *Cannabis Act* and the Cannabis Regulations (defined below) came into force on October 17, 2018.

Prior to the *Cannabis Act* coming into force, only the sales of medical cannabis was legal in Canada. The medical cannabis regime was regulated federally pursuant to the *Controlled Drugs and Substances Act* (“**CDSA**”) and its associated ACMPR. The ACMPR regulated the production, sale and distribution of cannabis and cannabis oil extracts for medical purposes in Canada. The ACMPR provided for three possible options for Canadian residents who have been authorized by their health care practitioner to access cannabis for medical purposes:

- (a) access quality-controlled cannabis by registering with a Licensed Producer;
- (b) register with Health Canada to produce a limited amount of cannabis for their own medical purposes (starting materials (including marijuana seeds and plants) must be purchased from a Licensed Producer); or
- (c) they can designate someone else who is registered with Health Canada to produce cannabis on their behalf (starting materials (such as marijuana seeds and plants) must be purchased from a Licensed Producer).

On July 11, 2018, the regulations issued pursuant to the *Cannabis Act* (the “**Cannabis Regulations**”) were released by the government which, among other things, set forth the following:

1. Licences, Permits and Authorizations;
2. Security Clearances;
3. Cannabis Tracking System;
4. Cannabis Products;
5. Packaging and Labelling;
6. Cannabis for Medical Purposes; and
7. Drugs Containing Cannabis.

As noted, on October 17, 2018, the Cannabis Regulations came into force. At the same time, among other things, the CDSA was amended to remove cannabis from being regulated under the CDSA and the Industrial Hemp Regulations and the ACMPR under the CDSA were repealed (new Industrial Hemp Regulations under the Cannabis Act, introduced at the same time as the Cannabis Regulations, also came into force on October 17, 2018).

### **Licenses, Permits and Authorizations**

The Cannabis Regulations provide that all licences issued under the *Cannabis Act* would be valid for a period of no more than five years and that no licensed activity could be conducted in a dwelling-house. The Cannabis Regulations also permit both outdoor and indoor cultivation of cannabis. The implications of the new regulations allowing outdoor cultivation is not yet known, but such a development could be significant as it may reduce start-up capital required for new entrants in the cannabis industry. It may also ultimately lower prices as capital expenditure requirements related to growing outside are typically much lower than those associated with indoor growing.

Generally, the *Cannabis Act* provides that licences issued under the ACMPR that are in force immediately before the *Cannabis Act* coming into force are to be deemed to be licences issued under the corresponding provisions of the *Cannabis Act* and any such licences will continue in force until it is revoked or expires. For example, a licence for production and sale of dried cannabis flower, cannabis resin, cannabis seeds, cannabis plants and cannabis oil under the ACMPR will be deemed to be licences for cultivation, processing and sale for medical purposes under the *Cannabis Act*, provided that the licence holder meets certain requirements.

## **Regulatory Background (continued)**

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### ***Licenses, Permits and Authorizations (continued)***

Similarly, the *Cannabis Act* generally provides that licences pertaining to cannabis or its derivatives issued under the *Narcotic Control Regulations* that are in force immediately before the *Cannabis Act* comes into force are deemed to be licences issued under the corresponding provisions of the *Cannabis Act* and any such licences will continue in force until it is revoked or expires. For example, a licence issued under the *Narcotic Control Regulations* authorizing cultivation of cannabis for scientific purposes shall be a research licence under the *Cannabis Act*.

### ***Security Clearances***

The ACMPR required certain individuals to hold security clearances. For a corporation, this includes officers and directors of the corporation. The Cannabis Regulations broaden the scope of individuals required to hold security clearances, including all individuals occupying key positions, individuals, such as shareholders, that have direct control over a licence holder, and the officers and directors of any corporation having direct control over a licence holder (e.g., officers and directors of a parent corporation). The Cannabis Regulations provided a three-month grace period for licence holders to identify those individuals that required security clearances and to apply for such security clearances (i.e., until January 17, 2019). Security clearances issued under the ACMPR are considered to be security clearances for the purposes of the *Cannabis Act* and Cannabis Regulations.

### ***Cannabis Tracking System***

Under the *Cannabis Act*, the Minister of Health would be authorized to establish and maintain a national cannabis tracking system. The purpose of this system would be to track cannabis throughout the supply chain to help prevent diversion of cannabis into, and out of, the illicit market. The Cannabis Regulations provide the Minister of Health with the authority to make a ministerial order that would require certain persons named in such order to report specific information about their authorized activities with cannabis, in the form and manner specified by the Minister. The Minister of Health has introduced the Cannabis Tracking and Licensing System (“**CTLS**”). Licence holders are required to use the CTLS to submit monthly reports to the Minister of Health, among other things.

### ***Cannabis Products***

The Cannabis Regulations permit the sale to the public of dried cannabis, cannabis oil, fresh cannabis, cannabis plants, and cannabis seeds. The sale of edible cannabis products, topical cannabis products and concentrates (such as hashish, wax and vaping products) are currently prohibited but are expected to be permitted within one year following the *Cannabis Act* coming into force. On December 21, 2018, the Regulations Amending the Cannabis Regulations (New Classes of Cannabis) were published in Part 1 of the Canada Gazette for comment. The comment period closes on February 20, 2019. At the same time, an order amending Schedules 3 and 4 of the Cannabis Act were also published in Part 1 of the Canada Gazette. Collectively, these proposed amendments allow for the sale of edible cannabis products, topical cannabis products and concentrates, including the regulatory requirements and restrictions related to such products. After the comment period closes, it is expected that the final regulations will publish and come into force by October 17, 2019 at the latest.

The Cannabis Regulations acknowledge that a range of product forms should be enabled to help the legal industry displace the illegal market. Additional product forms that are mentioned under the Cannabis Regulations include vaporization cartridges manufactured with dried cannabis. Specific details related to these new products are to be set out in a subsequent regulatory proposal.

### ***Packaging and Labelling***

The Cannabis Regulations require plain packaging for cannabis products, including strict requirements for logos, colours and branding. The Cannabis Regulations further require mandatory health warnings, standardized cannabis symbol and specific product information. Cannabis package labels must include specific information, such as: (i) product source information, including the class of cannabis and the name, phone number and email of the cultivator; (ii) a mandatory health warning, rotating between Health Canada’s list of standard health warnings; (iii) the Health Canada standardized cannabis symbol; and (iv) information specifying THC and CBD content. The Cannabis Regulations provide a six-month transitional period to allow licensed holders to sell cannabis products labelled in accordance with the ACMPR.

## **Regulatory Background (continued)**

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### **Packaging and Labelling (continued)**

These requirements are intended to promote informed consumer choice and allow for the safe handling and transportation of cannabis, while also reducing the appeal of cannabis to youth and promoting safe consumption.

### **Advertising**

The *Cannabis Act* introduces restrictions regarding the promotion of cannabis products. Subject to a few exceptions, all promotions of cannabis products are prohibited unless authorized by the *Cannabis Act*.

### **Cannabis for Medical Purposes**

On October 17, 2018, the medical cannabis regime moved under the Cannabis Act and the Cannabis Regulations. The medical cannabis regulatory framework under the Cannabis Act and the Cannabis Regulations remains substantively the same as it existed under the CDSA and ACMPR, with adjustments to create consistency with rules for non-medical use, improve patient access, and reduce the risk of abuse within the medical access system (see Part 14 of the Cannabis Regulations entitled "Access to Cannabis for Medical Purposes"). The sale of medical cannabis remains federally regulated and in each case, sales can only be made by an entity that holds a licence to sell under the Cannabis Regulations (i.e., a licence for sale for medical purposes) to patients that have a medical document and have registered with the licensed entity. Note, a licence to sell is not required to sell between federally licensed entities, such as between licensed cultivators, or to wholesalers or retailers in the recreational market (discussed below). Just as with the medical cannabis regime under the ACMPRs, under the Cannabis Regulations, customers (patients) will need to obtain a medical document (i.e., prescription) from their doctor and then register as a client with a cannabis company that has a licence to sell (the registration is only good for up to a year). Then the client can order from the cannabis company online or via telephone and the cannabis will be shipped directly to the client (max. 150 grams per month). Individuals that have obtained a registration from Health Canada to produce their own cannabis for medical purposes may also register with an entity Licensed to Sell and obtain cannabis or supplies from the cannabis company.

### **Provincial Regulatory Framework**

While the *Cannabis Act* provides for the regulation of the commercial production of cannabis for recreational purposes and related matters by the federal government, the *Cannabis Act* proposes that the provinces and territories of Canada will have authority to regulate other aspects of recreational cannabis (similar to what is currently the case for liquor and tobacco products), such as sale and distribution, minimum age requirements, places where cannabis can be consumed, and a range of other matters. The Company plans to distribute cannabis in each of the provinces and territories of Canada.

To date, the governments of every Canadian province and territory have, to varying degrees, announced proposed regulatory regimes for the distribution and sale of cannabis for recreational purposes within those jurisdictions. Each of these Canadian jurisdictions has established a minimum age of 19 years old, except for Quebec and Alberta, where the minimum age will be 18. See "*Risk Factors – Change in laws, Regulations and Guidelines*".

There are essentially three general frameworks that the provinces and territories have proposed: (i) private cannabis retailers licensed by the province; (ii) government run retail stores; or (iii) a combination of both frameworks (e.g., privately licensed bricks and mortar retail stores, while online retail stores are operated by the applicable provincial government). Regardless of the framework, the recreational cannabis market will ultimately be supplied by federally licensed cultivators and processors. In many cases, the provinces that are proposing to have privately licensed retailers will have a government run wholesaler. Such privately licensed retail stores will be required to obtain their cannabis products from the wholesalers, while the wholesalers, in turn, acquire the cannabis products from the federally licensed cultivators and processors.

**Ontario:** On September 8, 2017, the Ontario government announced its proposed retail and distribution model of legalized recreational cannabis to be modelled on the current Liquor Control Board of Ontario ("**LCBO**") framework. On December 12, 2017, the Ontario government passed the *Cannabis Act, 2017* (Ontario), which will regulate the lawful use, sale and distribution of cannabis for adult use in connection with the federal government's proposed legalization. The *Cannabis Act, 2017* (Ontario) proposes to, among other things:

## **Regulatory Background (continued)**

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### **Provincial Regulatory Framework (continued)**

- create a new provincial retailer, overseen by the LCBO, to manage the distribution of recreational cannabis through stand-alone stores and an LCBO-controlled online order and distribution service, which together, will comprise the only channels through which consumers in Ontario will be able to legally purchase recreational cannabis;
- set a minimum age of 19 to use, buy, possess and cultivate cannabis in Ontario; and
- ban the use of cannabis in public places, workplaces and motor vehicles in Ontario, as is the case with alcohol.

Other details of Ontario's approach will be set out in regulations to the *Cannabis Act, 2017* (Ontario).

On August 13, 2018, the Ontario government announced a new regulated private retail model for recreational cannabis in Ontario, which emphasizes three public policy objectives: to implement safe, legal system for cannabis that will protect consumers, to undermine the illegal market and to protect public safety. The Ontario government announced that it will consult with various government agencies, community groups and industry stakeholders in order to structure a private retail model for the recreational cannabis market by April 2019. Until then, a government run online store (the "**Ontario Cannabis Store**") will be the sole source of lawful adult use recreational cannabis in Ontario as of October 17, 2018.

On September 27, 2018, the Ontario government introduced Bill 36 to amend the *Cannabis Act, 2017* (which will be renamed as the *Cannabis Control Act, 2017*) and to introduce the *Cannabis Licence Act, 2017* and related amendments to other acts, including the *Ontario Cannabis Retail Corporation Act, 2017*, the *Liquor Control Act, Smoke-Free Ontario Act, 2017* and the *Highway Traffic Act*. Bill 36 received royal assent on October 17, 2018 and many of the amendments came into force on that date.

Ontario's new legislation provides for privately licensed retail cannabis stores. The legislation establishes the Alcohol and Gaming Commission of Ontario ("**AGCO**") as the provincial regulator authorized to grant cannabis retail store licences. The Ontario Cannabis Store, which will be operated by an agency (the "**Ontario Cannabis Retail Corporation**") that will report directly to Ontario's Minister of Finance, is Ontario's only online retailer and cannabis wholesaler. The Ontario Cannabis Retail Corporation (i.e., the Ontario Cannabis Store) is the exclusive wholesaler and distributor to private retail stores.

The new legislation gave municipalities the flexibility to opt-out of having cannabis retail stores in their communities before January 22, 2019.

It is expected that the private retail stores will not be licensed and operating until April 2019. Until that time, the recreational cannabis market in Ontario will only be available through the Ontario Cannabis Store's online sales. Note, though originally there was not to be a cap on the number of private retail stores servicing the recreational cannabis market, on December 13, 2018, the Government of Ontario announced that a temporary cap of 25 retail stores will initially be imposed. Therefore, it is expected that only 25 private retail stores will be operational by April 2019.

**Manitoba:** The Government of Manitoba has announced a "hybrid model" for cannabis distribution when cannabis for recreational purposes is legalized. The supply of cannabis in the Province of Manitoba will be secured and tracked by the Manitoba Liquor and Lotteries Corp.; however, licensed private retail stores will be permitted to sell recreational cannabis.

**Alberta:** The Government of Alberta has announced a cannabis framework providing for the purchase of cannabis products from private retailers that will receive their products from a government-regulated distributor, similar to the distribution system currently in place for alcohol in the province. Only licensed retail outlets will be permitted to sell cannabis with online sales run by the Alberta Gaming and Liquor Commission.

**New Brunswick:** Similar to the approach originally taken by Ontario, the Province of New Brunswick announced that it will set up a network of tightly-controlled, stand-alone stores through the New Brunswick Liquor Corporation.

**Quebec:** On July 19, 2018 the Government of Quebec passed its cannabis law, Bill 157. Bill 157 sets the legal age for cannabis consumption in the province at 18 years and all recreational marijuana will be managed and sold by Société québécoise du cannabis outlets and will be available for sale online, the entire process controlled by the Société des alcools du Québec.



## Regulatory Background (continued)

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### Provincial Regulatory Framework (continued)

**Newfoundland and Labrador:** In May 2018, the Government of Newfoundland and Labrador introduced legislation relating to the legalization of cannabis including the *Cannabis Control Act* (the “**CCA**”) whereby recreational cannabis will be sold through licensed private stores, with its crown-owned liquor corporation, the Newfoundland and Labrador Liquor Corp. (the “**NLC**”), overseeing the distribution to private sellers who may sell to consumers. Pursuant to the CCA, the NLC will control the possession, sale and delivery of cannabis, and set prices. It will also be the initial online retailer, although licenses may later be issued to private interests. The Government of Newfoundland and Labrador has issued a request for proposals for private retailers.

**Yukon:** Similarly, the Government of Yukon has released the *Cannabis Control and Regulation Act* which limits the initial distribution and sale of recreational cannabis to government outlets and government-run online stores, and allows for the later licensing of private retailers.

**Northwest Territories:** The Government of the Northwest Territories has also announced its proposed approach for the distribution and sale of recreational cannabis which relies on the N.W.T. Liquor Commission to control the importation and distribution of cannabis, whether through retail outlets or by mail order service run by the liquor commission. Communities in the Northwest Territories will be able to hold a plebiscite to prohibit cannabis, similar to the options currently available to restrict alcohol.

**British Columbia:** The Government of British Columbia’s *Cannabis Control and Licensing Act* (the “**CCLA**”) received royal assent on May 31, 2018. The CCLA stipulates that recreational cannabis will be sold in that province through both public and privately operated stores, with the provincial Liquor Distribution Branch handling wholesale distribution.

**Saskatchewan:** The Government of Saskatchewan announced that recreational cannabis will be sold by private retailers. The Saskatchewan Liquor and Gaming Authority will issue approximately 60 retail permits to private stores located in roughly 40 municipalities and First Nation communities across the province, with municipalities having the option of opting out of having a cannabis store if they choose.

**Nova Scotia:** In Nova Scotia, Bill 108, *Cannabis Control Act* received royal assent on April 18, 2018, and establishes the licensing system for the retail sale of non-medical cannabis. The Nova Scotia Liquor Corporation will be responsible for the regulation of cannabis in the province, and recreational cannabis will only be sold publicly through government-operated storefronts and online sales.

**Nunavut:** In Nunavut, Bill 7, *Cannabis Act* (“**Nunavut Cannabis Act**”) received royal assent on June 13, 2018. The Nunavut Cannabis Act provides for the regulation of non-medical cannabis in the province of Nunavut, and establishes the licensing system for the retail sale of non-medical cannabis. Under the Nunavut Cannabis Act, a person can submit an application for a licence to operate a cannabis store, remote sales store or cannabis lounge. Licences may not be issued to minors, employees or agents of the Liquor and Cannabis Commission (Nunavut), or a person who does not meet the conditions prescribed by regulation for applicants. Nunavut will allow for the sale of cannabis through both public and private retail and online.

**Prince Edward Island:** In Prince Edward Island, Bill 29, An Act to Respond to the Legalization of Cannabis received royal assent on June 12, 2018. Similar to Nova Scotia, Prince Edward Island will require cannabis be sold publicly, through government stores and online.

There is no guarantee that the provincial and territorial frameworks supporting the legalization of cannabis for recreational use in Canada will be implemented on the terms outlined above or at all.

## Risks and Uncertainties

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### Overview

Commercial cannabis production is a new industry in Canada and relies on, among other things, obtaining and maintaining regulatory approvals. As a result, there is a high degree of risk associated with the Company’s business. There is a significant risk that the expenditures made by the Company in developing its cannabis business, specifically the 7ACRES business, will not result in profitable operations.

## **Risks and Uncertainties (continued)**

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There are a number of risk factors that could cause future results to differ materially from those described herein. The following sets out the principal risks faced by the Company. Additional risks and uncertainties, including those that the Company does not know about or that it currently deems immaterial, could also adversely affect the Company's business and results of operations.

**Key Personnel Risks.** The Company's efforts are dependent to a large degree on the skills and experience of certain of its key personnel, including the executive team and the board of directors. The Company does not maintain "key man" insurance policies on these individuals. Should the availability of these persons' skills and experience be in any way reduced or curtailed, due to departure or other reasons, this could have a material adverse outcome on the Company and its securities.

**Low Quality Cannabis Risk.** Supreme currently operates in an early stage market which has a small representation of Canadian cannabis consumers. Should the Company be unable to grow a quality product demanded by the consumers, this could have a material impact on the Company's revenues and average price per gram.

**Licensing Risk.** 7ACRES business is dependent on maintaining its Cultivation Licence, Processing Licence and Licence to Sell (Medical Cannabis) (as defined in the Cannabis Regulations). Although 7ACRES was successful in obtaining the status of a License Producer and seller, there is no guarantee that 7ACRES will retain such status as licensing is beyond the control of Supreme and/or 7ACRES and the sole discretion lies with Health Canada. The Company's current License is valid until March 2020, and licenses may only be granted for a maximum of 3 years thereby requiring frequent and continuing approval by Health Canada. Supreme and 7ACRES must strictly adhere to the regulations and applicable law in order to maintain the License and to secure necessary renewals. There can be no guarantee that Health Canada will extend or renew the License. Failure to comply with the requirements of the License or any failure to maintain its License would have a material adverse impact on the business, financial condition and operating results of the Company.

**Regulatory Risks.** Supreme operates in a new industry which is highly regulated and is in a market which is very competitive and evolving rapidly. Sometimes new risks emerge and management may not be able to predict all of them, or be able to predict how they may cause actual results to be different from those contained in any forward-looking statements. 7ACRES ability to grow, store and sell cannabis in Canada is dependent on the License from Health Canada and the need to maintain the License in good standing. Failure to comply with the requirements of the License or any failure to maintain this License would have a material adverse impact on the business, financial condition and operating results of Supreme.

Supreme will incur ongoing costs and obligations related to regulatory compliance. Failure to comply with regulations may result in additional costs for corrective measures, penalties or in restrictions of our operations. In addition, changes in regulations, more vigorous enforcement thereof or other unanticipated events could require extensive changes to Supreme's operations, increased compliance costs or give rise to material liabilities, which could have a material adverse effect on the business, results of operations and financial condition of the Company.

The industry is subject to extensive controls and regulations, which may significantly affect the financial condition of market participants. The marketability of any product may be affected by numerous factors that are beyond Supreme's control and which cannot be predicted, such as changes to government regulations, including those relating to taxes and other government levies which may be imposed. Changes in government levies, including taxes, could reduce Supreme's earnings and could make future capital investments or Supreme's operations uneconomic. The industry is also subject to numerous legal challenges which may significantly affect the financial condition of market participants and which cannot be reliably predicted.

Supreme's business as a Licensed Cultivator and Licensed Processor under the Cannabis Act represents a new industry and new market derived from the ACMPR and its regulated regime. In addition to being subject to general business risks and to risks inherent in the nature of an early stage business, a business involving an agricultural product and a regulated consumer product, Supreme will need to continue to build brand awareness in the industry and market through significant investments in its strategy, its production capacity, quality assurance, and compliance with regulations. These activities may not promote the Supreme brand and products as effectively as intended. This new market and industry into which management is entering will have competitive conditions, consumer tastes, patient requirements and unique circumstances, and spending patterns that may differ from existing markets.

## **Risks and Uncertainties (continued)**

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**Change in Laws, Regulations and Guidelines.** Supreme's operations are subject to a variety of laws, regulations and guidelines relating to the manufacture, management, transportation, storage, sale and disposal of cannabis as well as laws and regulations relating to health and safety, privacy, the conduct of operations and the protection of the environment. While to the knowledge of Supreme's management, Supreme is currently in compliance with all such laws, regulations and guidelines, changes to such laws, regulations and guidelines due to matters beyond the control of Supreme may have an adverse effect on Supreme's operations and the financial condition of Supreme. See "Regulatory Background" above.

**Market Risks.** Supreme's securities trade on public markets and the trading value thereof is determined by the evaluations, perceptions and sentiments of both individual investors and the investment community taken as a whole. Such evaluations, perceptions and sentiments are subject to change, both in short-term and long-term horizons. An adverse change in investor evaluations, perceptions and sentiments could have a material adverse outcome on the Company and its securities.

**Commodity Price Risks.** Cannabis is a developing market and likely subject to volatile and possibly declining prices year over year as a result of increased competition. Because cannabis is a newly commercialized and regulated industry, historical price data is either not available or not predictive of future price levels. There may be downward pressure on the average price for cannabis and Supreme has arranged its proposed business accordingly. However, there can be no assurance that price volatility will be favorable to Supreme or in line with expectations. Pricing will depend on general factors including, but not limited to, the number of licenses granted by Health Canada and the supply such licensees are able to generate and the number of cannabis consumers and demand for recreational or medical cannabis. An adverse change in the cannabis prices, or in investors' beliefs about trends in those prices, could have a material adverse outcome on the Company and its securities.

**Financing Risks.** Entering the regulated cannabis marketplace requires a substantial outlay of capital. There can be no assurance that the capital markets will remain favorable in the future, and/or that the Company will be able to raise the financing needed to continue its business at favorable terms, or at all. Restrictions on the Company's ability to raise financing could have a material adverse outcome on the Company and its securities.

**Expansion of Facility.** Expansion of the Facility is subject to Health Canada regulatory approvals. The delay or denial of such approvals may have a material adverse impact on the business and may result in Supreme not meeting anticipated or future demand when it arises.

**Reliance on a Single Location.** Supreme's current and future production is expected to take place at the Facility in Kincardine, Ontario. Adverse changes or developments affecting the Facility could have a material adverse effect on Supreme's ability to continue producing cannabis, its financial condition and prospects.

**Risks Inherent in an Agriculture Business.** Supreme's business involves the growing of medical cannabis, which is an agricultural product. As such, the business is subject to the risks inherent in the agricultural business, such as pests, plant diseases, crop failure and similar agricultural risks. Although Supreme grows its products indoors under climate controlled conditions, and carefully monitors the growing conditions with trained personnel, there can be no assurance that natural elements will not have a material adverse effect on the volume, quality and consistency of its products.

**Brand Perception.** Supreme is targeting making 7ACRES a premium cannabis producer that is recognized as such by retailers and consumers. Any negative changes to 7ACRES' brand as a quality cannabis producer could have a material adverse effect on Supreme's sales, profitability and financial condition.

**Share Price Volatility and Price Fluctuations.** In recent years, the securities markets in Canada have experienced a high level of price and volume volatility, and the market prices of securities of many corporations have experienced wide fluctuations which have not necessarily been related to the operating performance, underlying asset values or prospects of such companies. Such volatility has been particularly evident with regards to the share price of the cannabis companies that are public issuers in Canada.

**Competition.** On October 19, 2015, the Liberal Party of Canada (the "**Liberal Party**") obtained a majority government in Canada and legalized recreational cannabis on October 17, 2018 pursuant to the Cannabis Act. The introduction of a recreational model for cannabis production and distribution may impact the cannabis market.

## **Risks and Uncertainties (continued)**

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### **Competition (continued):**

The impact of this potential development may be negative for the Company and could result in increased levels of competition in its existing medical market and/or the entry of new competitors in the overall cannabis market in which the Company operates.

There is potential that Supreme will face intense competition from other companies, some of which can be expected to have more financial resources, industry, manufacturing and marketing experience than Supreme. Additionally, there is potential that the industry will undergo consolidation, creating larger companies that may have increased geographic scope and other economies of scale. Increased competition by larger, better-financed competitors with geographic or other structural advantages could materially and adversely affect the business, financial condition and results of operations of Supreme.

The government has only issued to date a limited number of licenses, under the ACMPR prior to October 17, 2018 and now the Cannabis Act, to produce and sell cannabis. There are, however, several hundred applicants for licenses. The number of licenses granted could have an impact on the operations of the Company. Due to the early stage of the industry in which the Company operates, the Company expects to face additional competition from new entrants. According to Health Canada there were 150 Licensed Producers as of February 8, 2019. If the number of users of recreation or medical cannabis in Canada increases, the demand for products will increase and the Company expects that competition will become more intense as current and future competitors begin to offer an increasing number of diversified products. To remain competitive, the Company will require a continued level of investment in research and development, marketing, sales and client support. The Company may not have sufficient resources to maintain research and development, marketing, sales and client support efforts on a competitive basis which could materially and adversely affect the business, financial condition and results of operations of the Company.

**Intellectual Property.** The ownership and protection of trademarks, patents, trade secrets and intellectual property rights are significant aspects of the Company's future success. Unauthorized parties may attempt to replicate or otherwise obtain and use the Company's products and technology. Policing the unauthorized use of the Company's current or future trademarks, patents, trade secrets or intellectual property rights could be difficult, expensive, time-consuming and unpredictable, as may be enforcing these rights against unauthorized use by others.

In addition, other parties may claim that the Company's products infringe on their proprietary and perhaps patent protected rights. Such claims, whether or not meritorious, may result in the expenditure of significant financial and managerial resources, legal fees, injunctions, temporary restraining orders and/or require the payment of damages. As well, the Company may need to obtain licenses from third parties who allege that the Company has infringed on their lawful rights. Such licenses, however, may not be available on terms acceptable to the Company or at all. In addition, the Company may not be able to obtain or utilize on terms that are favorable to it, or at all, licenses or other rights with respect to intellectual property that it does not own.

**Environmental and Other Regulatory Requirements.** The current or future operations of the Company, including development activities and production within the Facility, may require permits from various governmental authorities and such operations are and may be subject to laws and regulations governing disposal, growing, storage, transportation, record keeping, sales and similar activities. Companies engaged in the cannabis business need to comply with numerous laws, regulations and permits. There can be no assurance that the Company will be able to obtain or maintain all approvals and permits that may be required to develop or operate the Facility on terms which enable operations to be conducted at economically justifiable costs.

Environmental regulations mandate, among other things, the maintenance of air and water quality standards and land reclamation. Such regulations also set forth limitations on the generation, transportation, storage and disposal of solid and hazardous waste. Environmental legislation is evolving in a manner which may require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations.

## **Risks and Uncertainties (continued)**

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### **Environmental and Other Regulatory Requirements (Continued):**

Failure to comply with applicable laws, regulations, and permitting requirements may result in enforcement actions thereunder, potentially including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. Parties engaged in cannabis operations may be required to compensate those suffering loss or damage by reason of such activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

**Product Liability.** As a distributor of products designed to be ingested by humans, Supreme faces an inherent risk of exposure to product liability claims, regulatory action and litigation if its products are alleged to have caused significant loss or injury. In addition, the sale of Supreme's products involves the risk of injury to consumers due to tampering by unauthorized third parties or product contamination. Previously unknown adverse reactions resulting from human consumption of Supreme's products alone or in combination with other medications or substances could occur.

Supreme may be subject to various product liability claims, including, among others, that Supreme's products caused injury or illness, include inadequate instructions for use or include inadequate warnings concerning possible side effects or interactions with other substances. A product liability claim or regulatory action against Supreme could result in increased costs, could adversely affect Supreme's reputation with its clients and consumers generally, and could have a material adverse effect on our results of operations and financial condition of Supreme.

**Product Recalls.** Manufacturers and distributors of products are sometimes subject to the recall or return of their products for a variety of reasons, including product defects, such as contamination, unintended harmful side effects or interactions with other substances, packaging safety and inadequate or inaccurate labelling disclosure. If any of Supreme's products are recalled due to an alleged product defect or for any other reason, Supreme could be required to incur the unexpected expense of the recall and any legal proceedings that might arise in connection with the recall. Supreme may lose a significant amount of sales and may not be able to replace those sales at an acceptable margin or at all.

**Results of Future Clinical Research.** Research regarding the medical benefits, viability, safety, efficacy, dosing and social acceptance of cannabis or isolated cannabinoids (such as CBD and THC) remains in early stages. There have been relatively few clinical trials on the benefits of cannabis or isolated cannabinoids (such as CBD and THC). Future research studies and clinical trials may reach negative conclusions regarding the medical benefits, viability, safety, efficacy, dosing, social acceptance or other facts and perceptions related to cannabis, which could have a material adverse effect on the demand for the Company's products with the potential to lead to a material adverse effect on the Company's business, financial condition and results of operations.

**Litigation.** The Company may become party to litigation from time to time in the ordinary course of business, which could adversely affect its business. Should any litigation in which the Company becomes involved be determined against the Company, such a decision could adversely affect the Company's ability to continue operating and the value of its securities and could use significant resources. Even if the Company is involved in litigation and wins, litigation can redirect significant Company resources, including the time and attention of management and available working capital. Litigation may also create a negative perception of the Company's brand.

**Uncertain tax burden.** Tax regimes, including excise taxes and sales taxes, can disproportionately affect the price of our products, or disproportionately affect the relative price of our products versus other cannabis products. Because our products are targeted at the premium cannabis market, tax regimes based on sales price can place us at a competitive disadvantage in certain price-sensitive markets. As a result, our volume and profitability may be adversely affected in these markets.

**History of Net Losses; Accumulated Deficit; Revenue from Operations.** The Company has incurred net losses to date and the Company may continue to incur losses. There is no certainty that the Company will continue to produce revenue or operate profitably in the future. There is also no certainty that the Company will provide a return on investment in the future.

## **Risks and Uncertainties (continued)**

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**Breaches of security.** Given the nature of the Company's product and the concentration of inventory in its facilities, despite meeting or exceeding Health Canada's security requirements, there remains a risk of shrinkage as well as theft. A security breach at one of the Company's facilities could expose the Company to additional liability and to potentially costly litigation, increase expenses relating to the resolution and future prevention of these breaches and may deter potential cannabis consumers from choosing the Company's products.

**Uninsurable risks.** The Company may become subject to liability for pollution, fire and explosion, against which it cannot insure or against which it may elect not to insure. Such events could result in substantial damage to property and personal injury. The payment of any such liabilities may have a material, adverse effect on the Company's financial position.

**Financial Performance of Subsidiary.** Supreme is a holding company that conducts its business through 7ACRES which generates substantially all revenues. As a result, the Company's financial performance and ability to meet financial obligations is dependent on the operating results and revenues of 7ACRES, and the distribution of those earnings to Supreme. In the event of a liquidation or bankruptcy of 7ACRES, lenders and trade creditors will generally be entitled to payment of their claims from the assets of 7ACRES before any assets are made available for distribution to Supreme.

**Expansion into Foreign Jurisdictions.** The Company's expansion into jurisdictions outside of Canada is subject to risks. In addition, in jurisdictions outside of Canada, there can be no assurance that any market for the Company's products will develop. The Company may face new or unexpected risks or significantly increase its exposure to one or more existing risk factors, including economic instability, changes in laws and regulations, and the effects of competition. These factors may limit the Company's ability to successfully expand its operations into such jurisdictions and may have a material adverse effect on the Company's business, financial condition and results of operations.

**U.S. Border Officials Could Deny Entry into the U.S. to Employees of, or Investors in, Companies with Cannabis Operations in the United States and Canada.** Since cannabis remains illegal under U.S. federal law, those employed at or investing in legal and licensed Canadian cannabis companies could face detention, denial of entry or lifetime bans from the U.S. for their business associations with U.S. cannabis businesses. Entry happens at the sole discretion of the U.S. Customs and Border Protection officers on duty, and these officers have wide latitude to ask questions to determine the admissibility of a foreign national. The Government of Canada has started warning travelers on its website that previous use of cannabis, or any substance prohibited by U.S. federal laws, could mean denial of entry to the U.S. In addition, business or financial involvement in the legal cannabis industry in Canada or in the United States could also be reason enough for U.S. border guards to deny entry. On September 21, 2018, U.S. Customs and Border Protection released a statement outlining its current position with respect to enforcement of the laws of the United States. It stated that Canada's legalization of cannabis will not change U.S. Customs and Border Protection enforcement of United States laws regarding controlled substances and because cannabis continues to be a controlled substance under United States law, working in or facilitating the proliferation of the legal marijuana industry in U.S. states where it is deemed legal or Canada may affect admissibility to the U.S. As a result, U.S. Customs and Border Protection has affirmed that, a Canadian citizen working in or facilitating the proliferation of the legal marijuana industry in Canada, coming to the U.S. for reasons unrelated to the marijuana industry, will generally be admissible to the U.S. However, if a traveler is found to be coming to the U.S. for reason related to the marijuana industry, they may be deemed inadmissible.

**The Company's Operations in Emerging Markets are Subject to Political and Other Risks Associated with Operating in a Foreign Jurisdiction.** The Company has operations in various emerging markets and may have operations in additional emerging markets in the future. Such operations expose the Company to the socioeconomic conditions as well as the laws governing the cannabis industry in such countries. Inherent risks with conducting foreign operations include, but are not limited to: high rates of inflation; extreme fluctuations in currency exchange rates, military repression; war or civil war; social and labour unrest; organized crime; hostage taking; terrorism; violent crime; expropriation and nationalization; renegotiation or nullification of existing licenses, approvals, permits and contracts; changes in taxation policies; restrictions on foreign exchange and repatriation; and changing political norms, banking and currency controls and governmental regulations that favour or require the Company to award contracts in, employ citizens of, or purchase supplies from, the jurisdiction.

## Risks and Uncertainties (continued)

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Governments in certain foreign jurisdictions intervene in their economies, sometimes frequently, and occasionally make significant changes in policies and regulations. Changes, if any, in marijuana industry or investment policies or shifts in political attitude in the countries in which the Company operates may adversely affect the Company's operations or profitability. Operations may be affected in varying degrees by government regulations with respect to, but not limited to, restrictions on production, price controls, export controls, currency remittance, importation of product and supplies, income and other taxes, royalties, the repatriation of profits, expropriation of property, foreign investment, maintenance of concessions, licenses, approvals and permits, environmental matters, land use, land claims of local people, water use and workplace safety. Failure to comply strictly with applicable laws, regulations and local practices could result in loss, reduction or expropriation of licenses, or the imposition of additional local or foreign parties as joint venture partners with carried or other interests.

The Company continues to monitor developments and policies in the emerging markets in which it operates and assess the impact thereof to its operations; however such developments cannot be accurately predicted and could have an adverse effect on the Company's operations or profitability.

**Corruption and Fraud in Certain Emerging Markets Relating to Ownership of Real Property May Adversely Affect the Company's Business.** There are uncertainties, corruption and fraud relating to title ownership of real property in certain emerging markets in which the Company operates or may operate. Property disputes over title ownership are frequent in emerging markets, and, as a result, there is a risk that errors, fraud or challenges could adversely affect the Company's ability to operate in such jurisdictions.

**The Company Relies on International Advisors and Consultants in Order to Keep Abreast of Material Legal, Regulatory and Government Developments that Impact its Business and Operations in the Jurisdictions in which it Operates.** The legal and regulatory requirements in the foreign countries in which the Company operates with respect to the cultivation and sale of cannabis, banking systems and controls, as well as local business culture and practices are different from those in Canada. The Company's officers and directors must rely, to a great extent, on local legal counsel and consultants in order to keep abreast of material legal, regulatory and governmental developments as they pertain to and affect the Company's business operations, and to assist with governmental relations. The Company must rely, to some extent, on those members of management and the board of directors who have previous experience working and conducting business in these countries, if any, in order to enhance its understanding of and appreciation for the local business culture and practices. The Company also relies on the advice of local experts and professionals in connection with current and new regulations that develop in respect of the cultivation and sale of cannabis as well as in respect of banking, financing, labour, litigation and tax matters in these jurisdictions. Any developments or changes in such legal, regulatory or governmental requirements or in local business practices are beyond its control. The impact of any such changes may adversely affect the Company's business.

**The Company's Operations may be Impaired as a Result of Restrictions on the Acquisition or Use of Properties by Foreign Investors or Local Companies under Foreign Control.** Non-resident individuals and non-domiciled foreign legal entities may be subject to restrictions on the acquisition or lease of properties in certain emerging markets. Limitations also apply to legal entities domiciled in such countries which are controlled by foreign investors, such as the entities through which the Company operates in certain countries. Accordingly, the Company's current and future operations may be impaired as a result of such restrictions on the acquisition or use of property, and the Company's ownership or access rights in respect of any property it owns or leases in such jurisdictions may be subject to legal challenges, all of which could result in a material adverse effect on the Company's business, results of operations, financial condition and cash flows.

## Financial Instruments & Other Instruments

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The Company's financial instruments consist of cash, receivables, investments, accounts payable and accrued liabilities and convertible debt. The fair values of cash, receivables, accounts payable and accrued liabilities approximate their carrying values due to the relatively short-term to maturity. The Company classifies its cash as fair value through profit and loss ("FVTPL"), receivables and other short and long-term liabilities as amortized cost, investments as fair value through other comprehensive income ("FVOCI") or FVTPL, and accounts payable, accrued liabilities and convertible debt as amortized cost. The fair value of cash is based on Level 1 inputs of the IFRS fair value hierarchy.

## **Financial Instruments & Other Instruments (continued)**

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The FVTPL investment in common shares is considered Level 1 categorization in the IFRS fair value hierarchy as a quoted price if an active market exists. The FVTPL investment in common share purchase warrants that are not traded on active markets is considered Level 2 categorization in the IFRS fair value hierarchy as fair value is determined by observable inputs such as volatility, discount rates and the underlying stock price for the common shares.

The FVOCI investments are considered Level 3 categorization in the IFRS fair value hierarchy, as it is a security without a quoted value. If Level 2 inputs are available, such as implied valuations from follow-on financing rounds, third party sale negotiations, or market-based approaches, fair value is considered determinable.

For the three and six months ended December 31, 2018, the Company has recognized an unrealized loss from investments of \$1,909,620 (December 31, 2017: \$nil) and \$2,401,410 (December 31, 2017: \$nil), respectively, due to the changes in fair value. The unrealized gain was determined using Level 1 and Level 2 inputs. Some of the Company's investments are not traded on active markets which may negatively impact the liquidity of these investments.

## **Off-Balance Sheet Arrangements**

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The Company has no off-balance sheet arrangements that would potentially affect current or future operations or the financial condition of the Company.

## **Critical Accounting Estimates**

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The preparation of these Financial Statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts 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.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment to the amounts recognized in the Financial Statements are listed below:

i) **Business Combination:**

Determination of fair value of assets acquired, liabilities assumed and the fair value of total purchase consideration, including contingent consideration, requires the use of various estimates made by management.

ii) **Biological Assets:**

Determination of the fair values of the biological assets requires the Company to make various estimates and assumptions. The fair value of biological assets is considered a Level 3 categorization in the IFRS fair value hierarchy. The significant estimates and inputs used to assess the fair value of biological assets include the following assumptions as at December 31, 2018:

(a) **Selling prices** – selling prices are based on the Company's actual historical average selling price per gram for the preceding nine months. Estimated selling prices average \$6.43 for cannabis flower and \$2.39 for cannabis trim.

(b) **Post-harvest costs** – the costs are based on actual processing costs incurred by drying, trimming, testing and packaging activities incurred in the period, including overhead allocations for these activities. Estimated post-harvest processing costs average \$0.88 per gram.

(c) **The stage of plant growth** – the stage of plant growth is estimated by the number of days into the growing stage as compared to the estimated growing time for a full harvest. The estimated stage of growth of the cannabis plants as at December 31, 2018 averages 63%.



## Critical Accounting Estimates (continued)

ii) Biological Assets (continued):

(d) Expected yield – the expected yield per plant is based on the Company's actual historical average yield per plant. Expected yield per plant is 40.44 grams of cannabis trim and 87.03 grams of cannabis flower.

iii) Property, Plant and Equipment:

Initial recognition of costs – The Company uses estimates to determine certain costs that are directly attributable to self-constructed assets. These estimates primarily include certain internal and external direct labor, overhead, and interest costs associated with the acquisition, construction, development, or betterment of its Facility.

Useful lives of property, plant and equipment – Components of an item of Property, Plant and Equipment may have different useful lives. The Company makes significant estimates when determining depreciation rates and asset useful lives, which require considering company specific factors, such as past experience and expected use, and industry trends. The Company monitors and reviews residual values, depreciation rates, and asset useful lives at least once a year and changes them if they are different from previous estimates.

iv) Intangible Assets and Goodwill:

The Company uses estimates in determining the useful life and residual values of its definite life intangible assets. The definite life intangible assets that are not under development and are ready for use, are amortized on a straight-line basis, based on the estimated useful lives as described in the table below:

| Asset Class                    | Basis         | Estimated useful life      |
|--------------------------------|---------------|----------------------------|
| Assets under development       | Not amortized | N/A                        |
| Database & System Technologies | Straight-line | 3-5 years                  |
| Product License                | Straight-line | Expected term of agreement |

For indefinite life intangible assets, the Company uses estimates in determining the recoverable amount of those intangible assets and long-lived assets. The determination of the recoverable amount for impairment testing requires the use of significant estimates, such as future cash flows and discount rates.

Future cash flows are based on the Company's estimates and expected future operating results of the cash generating unit ("CGU") after considering economic conditions impacting the CGU. The following inputs have been used to determine the recoverability of intangible assets and long-lived assets:

- (a) Discount rate of 20%
- (b) Average selling price per gram of approximately \$6.30
- (c) Average quantity sold per year ranging from approximately 15,000 Kilograms to 50,000 Kilograms
- (d) Average cost of production and operating expenses of approximately 60% of revenue

v) Investments

The Company uses the Black-Scholes pricing model to estimate the value of its investment in BlissCo warrants. The following estimates were used as inputs into the model as at December 31, 2018:

|                           | 2018       |
|---------------------------|------------|
| Share price               | \$ 0.28    |
| Expected dividend yield   | 0.00%      |
| Stock price volatility    | 84.00%     |
| Expected life of warrants | 1.12 years |
| Forfeiture rate           | -          |
| Risk free rate            | 1.860%     |

## Critical Accounting Estimates (continued)

v) Investments (continued):

The Company uses the discounted cash flows valuation method to estimate the value of its FVOCI investments considered a Level 3 categorization on the IFRS fair value hierarchy. The significant unobservable input into the valuation models of these investments is the discount rate, which has been estimated to be between 20%-25%. Changes in discount rates will result in changes in the fair values of these investments.

vi) Convertible Debentures:

Market rate of interest – The market rate of interest used to assess the fair value of the liability component of the convertible debenture instrument is estimated by assessing market conditions and other internal and external factors. The market rate of interest used to calculate the fair value of the debt component is 18.31%.

vii) Share Based Compensation:

Significant estimates are used to determine the fair value of stock options, estimates include the assumptions and inputs used in applying the Black-Scholes option pricing model

|                          | <b>2018</b>     |
|--------------------------|-----------------|
| Share price              | \$ 1.47 - 2.02  |
| Expected dividend yield  | 0.00%           |
| Stock price volatility   | 78.66% - 84.70% |
| Expected life of options | 5 Years         |
| Forfeiture rate          | -               |
| Risk free rate           | 2.21% - 2.41%   |

viii) Income Taxes:

Provisions for taxes are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period. However, it is possible that at some future date an additional liability could result from audits by taxing authorities. Where the final outcome of these tax-related matters is different from the amounts that were initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

ix) Financial Instruments:

Financial instruments measured at fair value are classified into one of the levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

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 Company has not recorded gains or losses on investments as a result of level 3 inputs in the current quarter.

## New Accounting Standards and Interpretations Effective July 1, 2018

The Company adopted the following new accounting standards effective July 1, 2018.

i) IFRS 9 – Financial Instruments (“IFRS 9”)

Effective July 1, 2018, the Company adopted IFRS 9. In July 2014, the IASB issued the final publication of the IFRS 9 standard, which supersedes IAS 39 – Financial Instruments: recognition and measurement (“IAS 39”). IFRS 9 includes revised guidance on the classification and measurement of financial instruments and new guidance for measuring impairment on financial assets. The Company has made a policy choice to adopt IFRS 9 on a retrospective basis where the cumulative impact of adoption will be recognized in retained earnings as of July 1, 2018; thus, prior period comparatives will not be restated.

Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. IFRS 9 contains three primary measurement categories for financial assets: measured at amortized cost, FVOCI, and FVTPL. Under IFRS 9, the Company has irrevocably elected to present subsequent changes in the fair value of equity investments that are not held-for-trading in other comprehensive income (“OCI”).

For these equity investments, any subsequent changes in fair value or impairment on the instrument will be recorded in OCI, and cumulative gains or losses in OCI will not be reclassified into net income on disposal. Any subsequent changes in fair value or impairment on equity investments that are held-for-trading will continue to be realized in net income.

Under IFRS 9, the loss allowance for trade receivables must be calculated using the expected lifetime credit loss and recorded at the time of initial recognition. A portion of the Company’s trade receivables required a loss allowance of \$36,506 which has been written off. The Company did not record any loss allowance as at December 31, 2018 as all the trade receivable balance are expected to be collected on time and there is limited history of lifetime credit loss. There is no significant effect on the carrying value of the Company’s other financial instruments under IFRS 9 related to this new requirement.

Below is a summary showing the classification and measurement bases of the Company’s financial instruments as at July 1, 2018 as a result of adopting IFRS 9 (along with a comparison to IAS39).

| Financial Instrument                     | IAS 39                               | IFRS 9         |
|--|--------------------------------------|----------------|
| <b>Financial Assets</b>                  |                                      |                |
| Cash                                     | FVTPL                                | FVTPL          |
| Accounts Receivable                      | Loans and receivables                | Amortized cost |
| Investments:                             |                                      |                |
| BlissCo shares                           | Held-for-trading (FVTPL)             | FVTPL          |
| BlissCo warrants                         | Held-for-trading (FVTPL)             | FVTPL          |
| Trellis Solutions Inc.                   | Available-for-sale (Note 1)          | FVOCI (Note 2) |
| MediGrow                                 | Available-for-sale (Note 1)          | FVOCI (Note 2) |
| <b>Financial Liabilities</b>             |                                      |                |
| Accounts Payable and Accrued Liabilities | Other financial liabilities          | Amortized cost |
| Convertible Debentures                   | Other financial liabilities (Note 3) | Amortized cost |

**Note 1:** Subsequently measured at fair value with changes recognized in other comprehensive income. The net change subsequent to initial recognition, in the case of investments, is reclassified into net income upon disposal of the investment or when the investment becomes impaired.

## **New Accounting Standards and Interpretations Effective July 1, 2018 (continued)**

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### i) IFRS 9 – Financial Instruments (“**IFRS 9**”) (continued)

**Note 2:** Subsequently measured at fair value with changes recognized in OCI. The net change subsequent to initial recognition, in the case of investments, is not reclassified into net income upon disposal of the investment or when the investment becomes impaired.

**Note 3:** Subsequently measured at amortized cost using the effective interest rate.

### ii) IFRS 15 – Revenue from contracts with customers

Effective July 1, 2018, the Company adopted IFRS 15. IFRS 15 supersedes previous accounting standards for revenue, including IAS 18, Revenue.

IFRS 15 introduced a single model for recognizing revenue from contracts with customers. This standard applies to all contracts with customers, with only some exceptions, including certain contracts accounted for under other IFRSs.

The standard requires revenue to be recognized in a manner that depicts the transfer of promised goods or services to a customer and at an amount that reflects the consideration expected to be received in exchange for transferring those goods or services. This is achieved by applying the following five steps:

1. identify the contract with a customer;
2. identify the performance obligations in the contract;
3. determine the transaction price;
4. allocate the transaction price to the performance obligations in the contract; and
5. recognize revenue when (or as) the entity satisfies a performance obligation.

Revenue, net of excise tax, from the direct business to business sale of cannabis to legal and licensed Canadian retailers for a fixed price is recognized when the Company transfers control of the good to the customer. The Company has elected to adopt IFRS 15 on a cumulative effective basis, with no restatement of the comparative period. The Company assessed the impact of adopting IFRS 15 retrospectively and determined that no retroactive adjustments were necessary.

## **New Accounting Standards and Interpretations Not Yet Effective**

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### IFRS 16 – Leases (“**IFRS 16**”)

In 2016, the IASB issued IFRS 16 replacing International Accounting Standards (“**IAS 17**”), Leases, and related interpretations. The standard introduces a single on-balance sheet recognition and measurement model for lessees, eliminating the distinction between operating and finance leases. Lessors continue to classify leases as finance and operating leases. IFRS 16 becomes effective for annual periods beginning on or after January 1, 2019 and is to be applied retrospectively. Early adoption is permitted if IFRS 15 has been adopted. The Company is currently assessing the impact of the new standard on its consolidated financial statements and will adopt IFRS 16 starting July 1, 2019.

## **Other MD&A Requirements**

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As specified by National Instrument 51-102, the Company advises readers of this MD&A that important additional information about the Company, including the Company’s annual information form, is available on the SEDAR website – [www.sedar.com](http://www.sedar.com).

The Company’s Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting for the Company.

## Outstanding Share Data

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The authorized capital of the Company consists of an unlimited number of common shares without par value, 10,000,000 Class "A" preference shares with a par value of \$10 each and 10,000,000 Class "B" preference shares with a par value of \$50 each. The Company had 290,274,566 common shares issued and outstanding as at February 12, 2019.

The following table sets out the number of stock options granted and outstanding as at February 12, 2019.

| Exercise price | Number of options | Expiry date        |
|----------------|-------------------|--------------------|
| \$0.41         | 250,000           | October 14, 2019   |
| \$0.50         | 905,000           | January 10, 2021   |
| \$0.75         | 800,000           | April 25, 2021     |
| \$0.75         | 3,572,483         | August 29, 2021    |
| \$1.45         | 2,920,000         | September 25, 2022 |
| \$2.00         | 6,500,000         | December 15, 2026  |
| \$3.05         | 500,000           | January 5, 2023    |
| \$2.05         | 200,000           | March 5, 2023      |
| \$1.80         | 300,000           | May 15, 2023       |
| \$1.70         | 400,000           | June 25, 2023      |
| \$1.80         | 6,940,000         | March 29, 2028     |
| \$1.50         | 375,000           | August 23, 2023    |
| \$2.05         | 200,000           | October 17, 2023   |
| \$1.50         | 75,000            | January 2, 2024    |
| <b>Total</b>   | <b>23,937,483</b> |                    |

The following table sets out the number of share purchase warrants issued and outstanding as at February 12, 2019.

| Exercise price | Number of Warrants | Expiry date       |
|----------------|--------------------|-------------------|
| \$0.50         | 7,807,057          | June 20, 2019     |
| \$0.32         | 4,724,366          | April 23, 2020    |
| \$0.50         | 832,093            | July 15, 2019     |
| \$0.50         | 15,944,499         | August 30, 2019   |
| \$1.70         | 18,456,327         | December 13, 2019 |
| \$1.80         | 12,433,925         | November 14, 2020 |
| <b>Total</b>   | <b>60,198,267</b>  |                   |