CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

# Liberty Health Sciences Inc.
# (formerly, SecureCom Mobile Inc.)

FOR THE THREE MONTHS ENDED MAY 31, 2019 AND THREE MONTHS ENDED MAY 31, 2018

(in Canadian Dollars)

**NOTICE TO READER**

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

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

The Company's independent auditor has not performed a review of these condensed interim consolidated financial statements in accordance with standards established by the Canadian Institute of Chartered Professional Accountants.

# Liberty Health Sciences Inc.
# (formerly, SecureCom Mobile Inc.)
May 31, 2019

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# Liberty Health Sciences Inc.
# (formerly, SecureCom Mobile Inc.)

## Condensed Interim Consolidated Statements of Financial Position

(In Canadian dollars)

| | Note | As at May 31, 2019 | As at February 28, 2019 |
|---|---|---|---|
| **Assets** | | | |
| Current assets | | | |
| Cash and term deposits | | **$ 5,415,538** | $ 13,291,426 |
| Inventory | **4** | **15,850,826** | 15,143,740 |
| Biological assets | **5** | **3,955,015** | 1,089,990 |
| Other receivables | | **1,155,455** | 1,123,432 |
| Prepaid assets | | **611,971** | 862,090 |
| Total current assets | | **$ 26,988,805** | $ 31,510,678 |
| Deposits | | **569,369** | 480,004 |
| Investments | **7** | **3,399,040** | 3,366,521 |
| Investment in joint ventures | **8** | **320,826** | 240,193 |
| Capital assets | **9** | **75,649,537** | 56,282,086 |
| Intangible assets | **10** | **47,189,750** | 46,031,663 |
| Total assets | | **$ 154,117,327** | $ 137,911,145 |
| **Liabilities** | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities | | **$ 7,027,860** | $ 9,505,264 |
| Total current liabilities | | **7,027,860** | 9,505,264 |
| Convertible notes payable | **11** | **12,024,700** | 11,124,391 |
| Embedded derivative | **11** | **1,246,262** | 2,586,646 |
| Deferred tax liability | | **1,424,717** | 1,424,717 |
| Lease liability | **12** | **18,527,678** | - |
| Total liabilities | | **40,251,217** | 24,641,018 |
| **Shareholders' equity** | | | |
| Share capital | **13** | **145,242,352** | 145,242,352 |
| Warrant reserve | **14** | **9,355,242** | 9,355,242 |
| Contributed surplus | **15** | **10,254,806** | 8,962,134 |
| Accumulated other comprehensive income | | **3,540,759** | 371,522 |
| (Deficit) retained earnings | | **(54,529,050)** | (50,661,123) |
| Total shareholders' equity | | **113,866,110** | 113,270,127 |
| Total liabilities and shareholders' equity | | **$ 154,117,327** | $ 137,911,145 |

Nature of operations and going concern (Note 1)
Contingent Liability (Note 17)
Commitments (Note 18)

Approved on behalf of the Board:

"Victor Mancebo"
Signed: Interim CEO and Director

"Sheri Cholodofsky"
Signed: CFO

# Liberty Health Sciences Inc.
# (formerly, SecureCom Mobile Inc.)
## Condensed Interim Consolidated Statements of Loss and Comprehensive Loss
(In Canadian dollars)

| | Note | For the three months ended May 31, 2019 | For the three months ending May 31, 2018 |
|---|---|---|---|
| **Revenue, net of discounts** | | **$ 5,520,561** | $ 1,126,149 |
| **Cost of sales** | | | |
| Cost of goods sold, net | 4 | **3,311,468** | 716,342 |
| **Gross profit before biological asset adjustment** | | **2,209,093** | 409,807 |
| Realized fair value amounts included in the cost of inventory sold | | **(1,506,243)** | (183,865) |
| Unrealized gains resulting from fair value changes on growth of biological assets | 5 | **4,315,549** | 904,364 |
| **Gross profit** | | **5,018,399** | 1,130,306 |
| **Operating expenses** | | | |
| Professional fees | | **931,268** | 512,692 |
| Employee and staff costs | | **1,056,139** | 664,882 |
| Office and general | | **834,032** | 238,315 |
| Consulting fees | | **75,364** | 45,940 |
| Travel and entertainment | | **78,506** | 166,490 |
| Advertising and marketing | | **285,867** | 210,595 |
| Insurance | | **321,774** | 261,582 |
| Selling costs | | **1,344,472** | 347,806 |
| Facilities expenses and leases | | **217,058** | 414,075 |
| Royalty | | **300,186** | 34,234 |
| Depreciation | 9 | **647,945** | 36,436 |
| Amortization | 10 | **99,665** | 422,175 |
| Share-based compensation | 15 | **1,292,672** | 1,137,933 |
| Investor relations and filing fees | | **234,408** | 268,898 |
| Total operating expenses | | **7,719,356** | 4,762,053 |
| **Non-operating items** | | | |
| Other loss | | **54,985** | 48,217 |
| Change in fair value of investments | | **52,844** | (429,474) |
| Interest expense | | **956,327** | 281,350 |
| Loss on investment in joint ventures | 8 | **68,999** | - |
| Transaction costs | | **-** | 247,268 |
| Interest accretion | 11 | **592,391** | 281,033 |
| Change in fair value of embedded derivative | 11 | **(1,397,723)** | (1,577,173) |
| Foreign exchange loss (gain) | | **173,916** | (66,788) |
| Total other non-operating items | | **501,739** | (1,215,567) |
| **Net loss before tax** | | **(3,202,696)** | (2,416,180) |
| **Other comprehensive loss** | | | |
| Foreign currency translation adjustment | | **3,171,238** | 478,177 |
| Net comprehensive loss | | **$ (31,458)** | $ (1,938,003) |
| Weighted average number of shares – basic and diluted | | **345,290,635** | 309,191,754 |
| Net loss per share – basic and diluted | | **$ (0.01)** | $ (0.01) |

# Liberty Health Sciences Inc. (formerly, SecureCom Mobile Inc.)

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity
(In Canadian dollars)

| | Note | Number of common shares | Share capital | Warrant reserve | Contributed surplus | Accumulated other comprehensive income (loss) | (Deficit) retained earnings | Total shareholders' equity |
|---|---|---|---|---|---|---|---|---|
| Balance as at February 28, 2018 | | 303,358,348 | $ 113,321,501 | $ 5,002,063 | $ 2,456,669 | $ (2,449,730) | $ (28,367,308) | $ 89,963,195 |
| Bought deal – cash, net of issuance costs | 13 | 25,555,875 | 15,518,617 | 5,791,272 | - | - | - | 21,309,889 |
| Share-based compensation | 15 | - | - | - | 1,137,933 | - | - | 1,137,933 |
| Net comprehensive loss for the year | | - | - | - | - | 478,177 | (2,416,180) | (1,938,003) |
| Balance as at May 31, 2018 | | 328,914,223 | 128,840,118 | 10,793,335 | 3,594,602 | (1,971,553) | (30,783,488) | 110,473,014 |
| Share issuance – debt settlement | 13 | 10,092,583 | 9,386,102 | - | - | - | - | 9,386,102 |
| Exercise of warrants | 14 | 6,283,829 | 7,016,132 | (1,438,093) | - | - | - | 5,578,039 |
| Share-based compensation | 15 | - | - | - | 5,367,532 | - | - | 5,367,532 |
| Net comprehensive loss for the year | | - | - | - | - | 2,343,075 | (19,877,635) | (17,534,560) |
| Balance as at February 28, 2019 | | **345,290,635** | **$ 145,242,352** | **$ 9,355,242** | **$ 8,962,134** | **$ 371,522** | **$ (50,661,123)** | **$ 113,270,127** |
| Impact of change in accounting policy | 12 | **-** | **-** | **-** | **-** | **-** | **(665,231)** | **(665,231)** |
| Share-based compensation | 15 | **-** | **-** | **-** | **1,292,672** | **-** | **-** | **1,292,672** |
| Net comprehensive loss for the year | | - | **-** | **-** | **-** | **3,171,238** | **(3,202,696)** | **(31,458)** |
| **Balance as at May 31, 2019** | | **345,290,635** | **$ 145,242,352** | **$ 9,355,242** | **$ 10,254,806** | **$ 3,542,760** | **$ (54,529,050)** | **$ 113,866,110** |

# Liberty Health Sciences Inc.
# (formerly, SecureCom Mobile Inc.)
## Condensed Interim Consolidated Statements of Cash Flows
(In Canadian dollars)

| | Note | For the three months ended May 31, 2019 | For the three months ended May 31, 2018 |
|---|---|---|---|
| **Operating activities** | | | |
| Net loss | | $ (3,202,696) | $ (2,416,180) |
| Adjustments for: | | | |
| Depreciation | 9 | 1,690,081 | 213,208 |
| Amortization | 10 | 97,223 | 422,175 |
| Change in fair value of biological assets | 5 | (2,809,306) | (720,499) |
| Share-based compensation | 14 | 1,292,672 | 1,137,933 |
| Accretion expense | 11 | 592,391 | 281,033 |
| Interest expense | 11 | 956,327 | 281,350 |
| Change in fair value of embedded derivative | 11 | (1,340,384) | (1,577,173) |
| Change in fair value of investments | 7 | 52,844 | (429,474) |
| Disposal of assets | 9 | 77,847 | 149,735 |
| Loss on investment in joint ventures | 8 | 68,999 | - |
| **Changes in non-cash working capital** | | | |
| Inventory | 4 | (707,086) | (1,341,090) |
| Biological assets | 5 | (55,719) | 477,961 |
| Other current assets | | (32,023) | (297,851) |
| Prepaid expenses | | 250,119 | 179,085 |
| Deposits | | (89,365) | 1,967,118 |
| Accounts payable and accrued liabilities | | (2,477,404) | 358,259 |
| Deferred rent | | - | 42,204 |
| | | (5,635,480) | (1,272,206) |
| **Investing activities** | | | |
| Purchase of capital assets and intangible assets | 9,10 | (1,622,914) | (2,856,238) |
| Purchase and sale of investments, net | 7 | (142,427) | (1,000,000) |
| Issuance of promissory note | 6 | - | (2,948,792) |
| | | (1,765,341) | (6,805,030) |
| **Financing activities** | | | |
| Share capital issued for cash, net of issuance costs | 13 | - | 21,309,889 |
| Finance lease | | - | (19,657) |
| | | - | 21,290,232 |
| Effect of exchange rate changes | | (475,067) | (514,340) |
| Net decrease in cash and term deposits | | (7,875,888) | 12,698,656 |
| Cash and term deposits, beginning of year and period | | 13,291,426 | 26,145,379 |
| Cash and term deposits, end of year and period | | $ 5,415,538 | $ 38,844,035 |

## 1. Nature of operations and going concern

Liberty Health Sciences Inc. (the "Company") was incorporated under the Business Corporations Act (British Columbia) on November 9, 2011 as SecureCom Mobile Inc. ("SecureCom"). The head and registered office of the Company is located at 425-180 John Street, Toronto, ON M5T 1X5.

The Company's principal business activity is the production and distribution of medical cannabis through its wholly owned subsidiary DFMMJ Investments, LLC (d/b/a Liberty Health Sciences Florida Ltd.). The Company also has three joint ventures with the Schottenstein Group in the state of Ohio, USA.

On July 20, 2017, the Company completed a reverse takeover transaction, pursuant to which DFMMJ Investments Ltd. ("DFMMJ") amalgamated with a wholly owned subsidiary of the Company. The Company's common shares resumed trading on the Canadian Securities Exchange under the symbol "LHS" on July 26, 2017.

The Company has not generated any positive cash flow from operations and has incurred losses since inception. The Company incurred a net loss of $3,418,167 for the three months ended May 31, 2019 and as of that date had an accumulated deficit of $54,744,521 with negative cash flows from operations of $5,633,479. To date the Company's activities have been funded through financing activities. These factors indicate the existence of a material uncertainty that may cast significant doubt as to the Company's ability to continue as a going concern.

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the settlement of liabilities in the normal course of business. The consolidated financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that could result should the Company be unable to continue as a going concern.

These condensed interim consolidated financial statements were approved by the Company's Board of Directors on July 30, 2019.

## 2. Basis of presentation

(a) Statement of compliance

The policies applied in these condensed interim consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board and Interpretations of the IFRS Interpretations Committee.

(b) Basis of presentation

These condensed interim consolidated financial statements have been prepared on the going concern basis, under the historical cost basis except for certain financial instruments that are measured at fair value and biological assets that are measured at fair value less costs to sell, as detailed in the Company's accounting policies.

(c) Functional and presentation currency and change in functional currency

These condensed interim consolidated financial statements are presented in Canadian dollars, which is the Company's functional and presentation currency. Effective May 23, 2017, the functional currency of DFMMJ Investments, LLC, a wholly owned subsidiary, was changed from the Canadian dollar to the United States dollar. The change in functional currency was a result of the increased influence of the United States dollar on the economic environment in which DFMMJ Investments, LLC operates due to the acquisition of Chestnut Hill Tree Farm, LLC in fiscal 2018. The change in functional currency of the foreign operation has been adjusted prospectively from May 23, 2017.

(d) Basis of consolidation

The Company consolidates entities which it controls. Control exists when the Company has the power, directly and indirectly, to govern the financial and operating policies of an entity and be exposed to the variable returns from its activities. The financial statements of the wholly owned subsidiaries are included in the condensed interim consolidated financial statements from the date that control commences until the date that control ceases.

Intragroup balances, and any unrealized gains and losses or income and expenses arising from transactions with controlled entities are eliminated to the extent of the Company's interest in the entity.

The Company accounts for its investments in joint ventures using the equity method. The joint ventures are initially measured at cost and then adjusted for the Company's share in the profits and losses.

| Entity Name | Jurisdiction of incorporation | Method of Consolidation |
|---|---|---|
| Liberty Health Sciences USA Ltd. | British Columbia, Canada | Consolidation |
| DFMMJ Investments, LLC (d/b/a Liberty Health Sciences Florida Ltd.) | Florida, USA | Consolidation |
| 242 Cannabis, LLC | Florida, USA | Consolidation |
| Liberty Health Sciences Ohio LLC I (50.1% interest in Schottenstein Aphria I LLC JV) | Ohio, USA | Consolidation (Equity for JV) |
| Liberty Health Sciences Ohio LLC II (50.1% interest in Schottenstein Aphria II LLC JV) | Ohio, USA | Consolidation (Equity for JV) |
| Liberty Health Sciences Ohio LLC III (50.1% interest in Schottenstein Aphria III LLC JV) | Ohio, USA | Consolidation (Equity for JV) |

(e) Foreign currency translation

All figures presented in the condensed interim consolidated financial statements are reflected in Canadian dollars unless otherwise noted.

Foreign currency transactions are translated into Canadian dollars at exchange rates in effect on the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the statement of financial position date are translated to Canadian dollars at the foreign exchange rate applicable as at that date. Realized and unrealized exchange gains and losses are recognized through profit or loss.

The assets and liabilities of foreign operations are translated in Canadian dollars at year-end exchange rates. Income and expenses, and cash flows of foreign operations are translated into Canadian dollars using average exchange rates. Exchange differences resulting from translating foreign operations are recognised in other comprehensive loss and accumulated in equity.

Foreign exchange gains or losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely to occur in the foreseeable future and which in substance is considered to form part of the net investment in the foreign operation, are recognized in other comprehensive income in the translation reserve.

(f) Use of estimates and judgements

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and revenue and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Management has applied significant estimates and assumptions related to the following:

*Biological assets and Inventory*

Determination of the fair value of the biological assets requires the Company to make several estimates primarily related to the fair value at point of harvest, attrition rates, expected future yields from the cannabis plants and estimating plants at various phases of the growth cycle.

The valuation of biological assets at the point of harvest is the cost basis for all cannabis-based inventory and thus any critical estimates and judgements related to the valuation of biological assets are also applicable for inventory. The Company must also determine if the cost of any inventory exceeds its net realized value, such as cases where prices have decreased, or inventory has spoiled or has otherwise been damaged.

*Estimated useful lives, impairment considerations and amortization of capital and intangible assets*

Amortization of capital and intangible assets is dependent upon estimates of useful lives based on management's judgment.

Indefinite life intangible asset impairment testing requires management to make critical estimates in the impairment testing model. On an annual basis, the Company tests whether indefinite life intangible assets are impaired. Estimation is required with respect to determining the recoverable amount of indefinite life intangibles.

Impairment of definite long-lived assets is influenced by judgment in defining a cash generating unit (or "CGU") and determining the indicators of impairment, and estimates used to measure impairment losses.

*Share-based compensation and warrants*

The fair value of share-based compensation and warrants are estimated using the Black-Scholes option pricing model and rely on a number of estimates, such as the expected life of the option or warrant, the volatility of the underlying share price, the risk-free rate of return, and the estimated rate of forfeiture options granted.

*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 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.

*Expected credit losses*

The Company measures expected credit losses in accordance with IFRS 9 – Financial instruments. Under this approach, the Company estimates the lifetime expected credit losses of financial instruments. In the case of an expected credit loss, the Company creates an impairment.

*Derivative liabilities*

The Company uses the fair value method of accounting for derivative liabilities and such liabilities are re-measured at each reporting date with changes in fair value recorded in the period incurred. The fair value is estimated using a Black-Scholes model.

*Financial instruments*

The Company evaluates the fair value of investments at the end of each reporting period. In addition to investment-specific information, the Company considers general market trends, conditions and transactions. Financial information for private companies in which the Company has investments may not be available and, even if available, that information may be limited and/or unreliable. Use of the valuation approach described below may involve uncertainties and determinations based on the Company's judgment and any value estimated from these techniques may not be realized or realizable.

The fair value of investments may be adjusted if:

1. There has been a significant subsequent equity financing provided by outside investors at a valuation different than the current value of the investee company, in which case the fair value of the investment is set to the value at which that financing took place
2. There have been significant corporate, political or operating events affecting the investee company that, in management's opinion, have a material impact on the investee company's prospects and therefore its fair value
3. The investee company is placed into receivership or bankruptcy
4. Based on financial information received from the investee company, it is apparent to the Company that the investee company is unlikely to be able to continue as a going concern
5. The investee company makes important positive/negative management changes that the Company's management believes will have a positive/negative impact on the investee company's ability to achieve its objectives and build value for shareholders

*CGU Determination*

The Company determines its cash-generating units ("CGUs") in accordance with IAS 36 – Impairment of Assets, defined as the smallest group of assets that independently generate cash flow and whose cash flow is largely independent of the cash flows generated by other assets.

## 3. Significant accounting policies

The significant accounting policies used by the Company are as follows:

(a) Revenue, net of discounts

The IASB's new revenue recognition standard IFRS 15 - Revenue from Contracts with Customers ("IFRS 15") was adopted by the Company on March 1, 2018. The new standard replaces IAS 18 - Revenue and provides for a single model that applies to all contracts with customers with two types of recognition – at a point in time or over time. The Company has applied IFRS 15 retrospectively and determined that there is no change to the comparative periods or transitional adjustments required as a result of adoption. The Company's accounting policy for revenue recognition under IFRS 15 is as follows:

1. Identify the contract with a customer
2. Identify the performance obligation(s)
3. Determine the transaction price
4. Allocate the transaction price to the performance obligation(s)
5. Recognize revenue when/as performance obligation(s) are satisfied

The Company manufactures and sells cannabis and cannabis-derived products. Revenue from the sale of goods is recognized when the Company sells a product to a customer. Payment of the transaction is due immediately when the customer purchases the product and takes delivery either in store or at a predetermined delivery location dictated by the customer. Due to the nature of the products sold, it is the Company's policy to not accept returned items under most circumstances unless products are defective. As a result, it is highly probable that a significant reversal in the cumulative revenue recognized will not occur. The validity of this assumption is reassessed at each reporting date.

The Company has a loyalty rewards program that allows customers to earn reward credits to be used on future purchases. Loyalty reward credit issued as part of a sales transaction results in revenue being deferred until the loyalty reward is redeemed by the customer. The loyalty rewards are shown as reductions to revenue, net of discounts on the accompanying consolidated statements of loss and comprehensive loss.

(In Canadian dollars unless otherwise noted)

Upon adoption of IFRS 15, the company recognizes revenue from dispensary customers and delivery customers.

The following table represents the company's revenue disaggregated by source for the three months ending May 31, 2019 and the three months ending from May 31, 2018:

| | **Three months ended May 31, 2019** | Three months ended May 31, 2018 |
|---|---|---|
| Dispensary | **4,695,838** | 494,921 |
| Delivery | **824,723** | 631,228 |
| **Total revenue** | **5,520,561** | 1,126,149 |

(b) Cash and term deposits

Cash and term deposits are comprised of cash and highly liquid investments that are readily convertible into known amounts of cash with original maturities of three months or less.

(c) Inventory

Inventories of harvested cannabis are transferred from biological assets into inventory at their fair value at harvest less costs to sell, which is deemed to be their cost. Any subsequent post-harvest costs are capitalized to inventory as incurred, including labour related costs, consumables, materials, utilities, packaging supplies, facilities costs, quality and testing costs, and production related depreciation. Inventory is valued at the lower of cost and net realizable value. Net realizable value is determined as the estimated selling price in the ordinary course of business less estimated costs to sell. Supplies and consumables are valued at lower of costs and net realized value, which costs determined based on average cost basis.

(d) Biological assets

The Company's biological assets consist of medical cannabis plants. The Company capitalizes all direct and indirect costs as incurred related to the transformation of the biological assets between the point of initial recognition and the point of harvest, including labour related costs, grow consumables, materials, utilities, facilities costs including an allocation of overhead costs related to depreciation on production facility and equipment. The Company then measures the biological assets at fair value less costs to sell and costs to complete up to the point of harvest, which becomes the basis for the cost of internally produced work in progress and finished goods inventories after harvest. Unrealized gains or losses arising from changes in fair value less cost to sell are included in the results of operations of the related period. Costs to sell includes post harvest production costs and fulfilment costs.

(e) Capital assets

Capital assets are stated at cost, net of accumulated amortization and accumulated impairment losses, if any.

Amortization is not recognized until the asset is determined to be ready for use. Amortization is calculated using the following terms and methods:

| Asset type | Amortization method | Amortization term |
|---|---|---|
| Land | Not amortized | No term |
| Greenhouse infrastructure | Straight-line | 15 years |
| Vehicles | Straight-line | 5 years |
| Furniture & equipment | Straight-line | 5 years |
| Computers | Straight-line | 3 years |
| Leasehold improvements | Straight-line | Over lease term |
| Construction in progress | Not amortized | No term |

An item of equipment is derecognized upon disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in the consolidated statements of loss and comprehensive loss in the year the asset is derecognized.

The assets' residual values, useful lives and methods of amortization are reviewed at each financial year-end and adjusted prospectively if appropriate.

(f) Intangible assets

Intangible assets are comprised of software and purchased licenses and permits. All are recorded at cost less accumulated amortization. Amortization of software is recorded on a straight-line basis over the estimated useful life of 1 year. There is no amortization of the licenses and permits which have an indefinite life.

(g) Impairment of non-financial assets

Intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

For the purpose of testing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. An impairment loss is recognized for the amount, if any, by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less cost to sell and the value-in-use (being the present value of expected future cash flows of the asset or CGU). Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimate of recoverable amount and the carrying amount that would have been recorded had no impairment loss been previously recognized.

(h) Income taxes

Income tax expense consisting of current and deferred tax expense is recognized in the consolidated statements of loss and comprehensive loss. Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at year end, adjusted for amendments to tax payable with regards to previous years.

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

A deferred tax asset is recognized to the extent that it is probable that future taxable income will be available against which the asset can be utilized.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

(i) Earnings (loss) per share

Basic earnings (loss) per share is calculated using the weighted average number of common shares outstanding during the year. The dilutive effect on earnings per share is calculated presuming the exercise of outstanding options, warrants and similar instruments. It assumes that the proceeds of such exercise would be used to repurchase common shares at the average market price during the year. However, the calculation of diluted earnings per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive. As the company had a loss during the year, the effect of options and warrants would be anti-dilutive.

(j) Share-based compensation

The Company has a stock option plan in place. The Company measures equity settled share-based payments based on their fair value at the grant date and recognizes compensation expense over the vesting period based on the Company's estimate of equity instruments that will eventually vest. Fair value is measured using the Black-Scholes option pricing model. Expected forfeitures are estimated at the date of grant and subsequently adjusted if further information indicates actual forfeitures may vary from the original estimate. Any revisions are recognized in the consolidated statements of loss and comprehensive loss such that the cumulative expense reflects the revised estimate.

(k) Investment in joint arrangements

The Company has certain investments in joint arrangements. On recognition, the Company assesses whether an investment is jointly controlled through an evaluation of the management structure and agreements. If jointly controlled, the Company then determines whether the joint arrangement is a joint venture recognized as an equity investment, or a joint operation recognized on a consolidated basis. Parties to joint ventures have rights to the net profits of the arrangement, whereas parties to joint operations have rights to the assets and obligations for the liabilities of the arrangement. The Company's investments in joint arrangements have been determined to be joint ventures.

The Company exercises judgement in determining whether it has joint control relating to its investments in joint ventures. The Company has considered relevant activities of the joint ventures that are established by contractual agreement and requiring unanimous consent for strategic financial and operating decisions.

Under the equity method of accounting for joint ventures, the investments are initially recognized at cost and adjusted thereafter for the Company's share of the profits or losses of the joint venture. This adjustment is recognized in profit or loss.

(l) Investments and other financial assets

(i) Classification

Financial assets are classified into two categories based on measurement:

- amortized cost; and
- measurement at fair value either through other comprehensive income ("OCI") or through profit and loss.

This classification depends on the Company's business model for managing its financial assets and contractual terms of the cash flows.

For assets measured at fair value, gains and losses will either be recorded in profit or loss or OCI. For investments in equity instruments that are not held for trading, this will depend on whether the Company has made an irrevocable election at the time of initial recognition to account for the equity investment at fair value through other comprehensive income ("FVOCI").

(ii) Recognition and derecognition

Regular way purchases and sales of financial assets are recognised on their trade date, the date on which the Company commits to purchase or sell the asset. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership.

(iii) Measurement

At initial recognition, the group measures a financial asset at its fair value plus, in the case of a financial asset not at fair value through profit or loss ("FVTPL"), transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are expensed in profit or loss.

**Debt instruments**

Subsequent measurement of debt instruments depends on the Company's business model for managing the asset and the cash flow characteristics of the asset. There are three measurement categories into which the group classifies its debt instruments:

Amortised cost: Assets that are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest are measured at amortised cost. Interest income from these financial assets is included in finance income using the effective interest rate method. Any gain or loss arising on derecognition is recognised directly in profit or loss. Impairment losses are presented as separate line item in the statement of profit or loss.

FVOCI: Assets that are held for collection of contractual cash flows and for selling the financial assets, where the assets' cash flows represent solely payments of principal and interest, are measured at FVOCI. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains or losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss. Interest income from these financial assets is included in finance income using the effective interest rate method. Impairment expenses are presented as separate line item in the statement of profit or loss.

FVTPL: Assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. A gain or loss on a debt investment that is subsequently measured at FVTPL is recognised in profit or loss in the period in which it arises.

**Equity instruments**

The group subsequently measures all equity investments at fair value. Where the Company has elected to present fair value gains and losses on equity investments in OCI, there is no subsequent reclassification of fair value gains and losses to profit or loss following the derecognition of the investment.

Changes in the fair value of financial assets at FVTPL are recognised in other income/(losses) in the consolidated statement of loss. Impairment losses (and reversal of impairment losses) on equity investments measured at FVOCI are not reported separately from other changes in fair value.

(iv) Impairment

From March 1, 2018, the Company assesses on a forward-looking basis, the expected credit losses associated with its debt instruments carried at amortised cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk.

For financial assets carried at amortized cost, the Company recognizes loss allowances for expected credit losses ("ECLs"). ECLs are a probability-weighted estimate of credit losses. The Company applies a three-stage approach to measure ECLs. The Company measures loss allowance at an amount equal to twelve months of expected losses if the credit risk at the reporting date has not increased significantly since initial recognition (Stage 1) and at an amount equal to lifetime expected losses if there is a significant increase in credit risk since origination (Stage 2) and at an amount equal to lifetime expected losses which are credit impaired (Stage 3).

The Company considers a significant increase in credit risk to have occurred if contractual payments are more than 30 days past due and considers the financial assets carried at amortized cost to be in default if they are 90 days past due. A significant increase in credit risk or default may have also occurred if there are other qualitative factors (including forward looking information) to consider; such as borrower specific information (i.e. change in credit assessment). Such factors include consideration relating to whether the counterparty is experiencing significant financial difficulty, there is a breach of contract, concessions are granted to the counterparty that would not normally be granted, or it is probable the counterparty will enter bankruptcy or a financial reorganization.

Significant increases in credit risk are assessed based on changes in probability of default of a financial asset subsequent to initial recognition. The Company uses past due information to determine whether credit risk has increased significantly since initial recognition. Financial assets are considered to have experienced a significant increase in credit risk and are reclassified to Stage 2 if a contractual payment is more than 30 days past due as at the reporting date.

The Company defines default as the earlier of when a contractual payment is more than 90 days past due or when a loan becomes insolvent as a result of customer bankruptcy. Financial assets that have experienced a default event are credit impaired and are reclassified as Stage 3 loans.

The Company measures ECL by considering the risk of default over the contract period and incorporates forward-looking information into its measurement. ECLs are measured as the difference in the present value of the contractual cash flows that are due to the Company under the contract, and the cash flows that the Company expects to receive. The Company assesses all information available, including past due status and forward looking macro-economic factors in the measurement of the ECLs associated with its assets carried at amortized cost.

The maximum period considered when estimating ECLs is the maximum contractual period over which the Company is exposed to credit risk. The Company's promissory note receivable carried at amortized cost is in Stage 3 as at May 31, 2019, and the Company has recognized an ECL of $2,999,122. Refer to Note 8.

(m) Financial liabilities

Financial assets are classified into two categories based on measurement:

- amortized cost; and
- measurement at fair value through profit and loss.

Financial liabilities held for trading are measured at FVTPL and all other financial liabilities are measured at amortized cost unless the fair value option is applied.

Financial liability can be designated to be measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases, or the liability is part or a group of financial liabilities or financial assets and financial liabilities that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

Financial liabilities are derecognized when the obligation specified in the contract is either discharged or cancelled or expires. Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognised in profit or loss.

(n) Embedded derivatives

The Company has convertible note payables whereby balances can be converted into equity. Embedded derivatives are separated from the host contract and accounted for separately if certain criteria are met. Derivatives are initially measured at fair value; any directly attributable transaction costs are recognised in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value and changes therein are recognised in profit or loss.

(In Canadian dollars unless otherwise noted)

(o) Classification of financial instruments

| Balance Sheet Classification | Classification under IFRS 9 | Classification under IAS39 |
|---|---|---|
| Cash and term deposits | FVTPL | FVTPL |
| Investments | FVTPL | FVTPL |
| Other receivables | Amortized cost | N/A |
| Accounts payable and accrued liabilities | Amortized cost | Other financial liabilities |
| Convertible notes payable | Amortized cost | Other financial liabilities |
| Embedded derivative | FVTPL | FVTPL |

(p) Borrowing costs

The Company capitalizes borrowing costs directly attributable to the acquisition, construction, and production of assets into the cost of the assets.

Borrowing costs not directly attributable to an asset are included as expenses.

*New standards and interpretations adopted in the current period*

The Company implemented the following standards and interpretations for the period beginning on March 1, 2019:

IFRS 16 – In January 2016, the IASB issued IFRS 16 Leases, which replaced IAS 17 Leases. This standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than twelve months unless the underlying asset is of low value. As a lessee, the Company will be required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments.

Substantially all the Company's operating leases are real estate leases for dispensaries. As a lessee, the Company has now recognized right-of-use assets and lease liabilities primarily for its operating leases of real estate properties. The depreciation expense on right-of-use assets and interest expense on lease liabilities will replace rent expense, previously recognized on a straight-line basis.

For leases where the Company is the lessee, it had the option of adopting a fully retrospective approach or a modified retrospective approach on transition to IFRS 16. The Company has adopted the standard on March 1, 2019 using the modified retrospective approach. The modified retrospective approach applies the requirements of the standard retrospectively with the cumulative effects of initial application recorded in opening retained earnings as at March 1, 2019, and no restatement of the comparative period. Under the modified retrospective approach, the Company chose to measure all right-of-use assets retrospectively as if the standard had been applied since lease commencement dates.

IFRS 16 permits the use of exemptions and practical expedients. The Company applied the following recognition exemptions and practical expedients:

• grandfather lease definition for existing contracts at the date of initial application;

• exclude low-value and short-term leases from IFRS 16 lease accounting;

• use portfolio application for leases with similar characteristics, such as vehicle and equipment leases;

• apply a single discount rate to a portfolio of leases with reasonably similar characteristics at the date of initial application;

• exclude initial direct costs from the measurement of the right-of-use assets at the date of initial application; and

• use hindsight in determining lease term at the date of initial application.

(In Canadian dollars unless otherwise noted)

As a result of the initial application of IFRS 16 as at March 1, 2019, Management recognized $17,976,267 of right-of-use assets and $18,641,498 of lease liabilities on its consolidated statements of financial position, with the difference recorded in opening retained earnings.

## 4. Inventory

Finished goods inventory consists of concentrates and other products that are complete and available for sale (both internally generated inventory and third-party products purchased in the wholesale market). Work in process inventory consists of cannabis after harvest in the processing stage. Packaging and miscellaneous consists of consumables for use in the transformation of biological assets and other inventory used in production of finished goods. The Company's inventories are comprised of:

| | | **May 31, 2019** | | February 28, 2019 |
|---|---|---|---|---|
| Raw materials | | | | |
| Harvested cannabis | **$** | **1,287,258** | $ | 829,689 |
| Packaging and miscellaneous | | **1,219,911** | | 444,116 |
| Total raw materials | **$** | **2,507,169** | $ | 1,273,805 |
| Work-in-process | | **8,218,507** | | 12,691,530 |
| Finished goods | | **5,125,149** | | 1,178,405 |
| **Total inventories** | **$** | **15,850,826** | $ | 15,143,740 |

During the three months ended May 31, 2019, the Company recognized $3,508,336 (May 31, 2018 - $735,673) of inventory expensed to cost of goods sold.

## 5. Biological assets

Biological assets are comprised of:

| | | Amount |
|---|---|---|
| Balance as at February 28, 2018 | $ | 743,896 |
| Costs incurred until harvest | | 4,457,045 |
| Effect of changes in fair value of biological assets | | 7,927,258 |
| Transferred to inventory upon harvest | | (12,038,209) |
| Balance as at February 28, 2019 | $ | 1,089,990 |
| Costs incurred until harvest | | 992,486 |
| Effect of changes in fair value of biological assets | | 4,315,549 |
| Transferred to inventory upon harvest | | (2,443,010) |
| **Balance as at May 31, 2019** | **$** | **3,955,015** |

The Company values biological assets at the end of each reporting period at fair value less costs to sell. This is determined using a valuation model to estimate the expected harvest yield per plant applied to the estimated price per gram less cost to sell.

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 May 31, 2019 and February 28, 2019:

(a) Selling prices – selling prices are based on the Company's average selling price per gram for cannabis flower. Estimated selling prices average $8.22 for cannabis flower for the three months ended May 31, 2019.

(b) The stage of plant growth – represents the weighted average number of days out of the 110-day growing cycle that biological assets have reached as at the measurement date. The estimated stage of growth of cannabis plants as at May 31, 2019 averages 49%.

(In Canadian dollars unless otherwise noted)

(c) Post-harvest costs –calculated as the cost per gram of harvested cannabis to complete the sale of cannabis plants after harvest, consisting of the cost of direct and indirect materials and labor related to labelling and packaging.

(d) Yield by plant – represents the expected number of grams of finished cannabis inventory which are expected to be obtained from each harvested cannabis plant. The average dried weight yield of whole flower used is 26 grams per plant for the three months ended May 31, 2019.

(e) Attrition rate – the estimated attrition rate of cannabis plants as they move from one stage of growth to the next (from germination to vegetative to flowering) based on the Company's historical results. As plants mature at each stage, their attrition rate decreases;

These estimates are subject to volatility in market prices and several uncontrollable factors, which could significantly affect the fair value of biological assets in future periods. The following table presents the effect of 10% positive change and 10% negative change on the fair valuation of biological assets as at May 31, 2019 and February 28, 2019.

| Assumption | 10% change as at May 31, 2019 | 10% change as at February 28, 2019 |
|---|---|---|
| Estimated Selling Price | 470,753 | 280,172 |
| Expected number of stages of growth | 283,713 | 103,138 |
| Expected yields for cannabis plants | 283,713 | 111,966 |
| Weighted average of expected loss of plants until harvest | 5,581 | 14,020 |
| After harvest cost to complete and sell | 181,656 | 163,047 |

## 6. Promissory note

On March 27, 2018, the Company announced that it had agreed to acquire a 75% ownership interest in Massachusetts-based William Noyes Webster Foundation Inc. ("WNWF") for US$16 million, pursuant to a binding term sheet.

As part of the transaction, the Company agreed to lend US$2,277,411 ($2,948,792) to WNWF under a promissory note accruing 5% interest annually. The promissory note is payable to the Company either on the completion of closing and can be credited against the purchase price, or on March 27, 2019 if earlier than closing.

As at May 31, 2019, the Company classified this promissory note as Stage 3 under its ECL model and recognized a provision on the promissory note of $2,999,122. The promissory note is in default and the Company is in negotiations regarding the restructuring of this outstanding obligation.

## 7. Investments

In June 2018, the Company entered into a subscription agreement with Promedia Investments Inc. ("Promedia") for the purchase of 150,000 shares of Promedia for a total cost of US$150,000 ($196,390). The Company recognized a gain from the change in fair value of $5,370 during the three months ended May 31, 2019 from changes in foreign exchange. As such, the ending fair value for this investment is $202,905.

(In Canadian dollars unless otherwise noted)

In April 2018, the Company entered into a subscription agreement with Isodiol International Inc. ("Isodiol") for the purchase of 1,369,863 units of Isodiol for a total cost of $1,000,000. Each unit was comprised of one common share of Isodiol and one common share purchase warrant of Isodiol, exercisable at a price of $1.00 per warrant for a period of three years from the closing of the agreement. At July 23, 2018, Isodiol enacted a reverse stock split at a ratio of one post-consolidated common share to ten pre-consolidated common shares and modifying the strike price of the common share purchase warrants to $10.00.

On October 12, 2018, the Company sold 34,200 common shares of Isodiol for proceeds of $108,414, realizing a loss of $32,039.

On May 31, 2019, the Company determined the fair value of the common shares based on the market price of the common shares at May 31, 2019. The value of the shares is $130,538 at May 31, 2019. The Company determined the fair value of the warrants based on a Black-Scholes valuation model using the following assumptions: stock price of $1.27; expected life of 2.0 years; $nil dividends; 146% volatility; risk-free interest rate of 1.510%; and exercise price of $10.00. The value of the warrants at year-end is $45,272. The Company recognized an unrealized loss of $52,843 for the three months ended May 31, 2019 on its investments in Isodiol.

In November 2017, the Company entered into a subscription agreement with Green Tank Holdings Corp. for the purchase of 49,213 preferred shares, for a total cost of US$250,000 ($325,003). Green Tank undertook a 12:1 share split during the period. During the year, due to meeting certain commercial activity thresholds, the Company is entitled to receive an additional 281,640 shares at no cost. These shares were included as additional shares to be received amounting to $949,910. As such, the Company determined the fair value of its investment, based on the most recent financing ($2.56 USD per share), is US$2,232,767 ($2,940,331). The Company recognized a gain from the change in fair value of $2,611,106 resulting from the higher valuation in the recent financing round and the additional shares granted, and a gain of $9,077 during the year ended February 28, 2019.

For the three months ending May 31, 2019, the Company recognized an unrealized gain of $79,933 on the investments in Green Tank Holdings Corp. from changes in foreign exchange.

A reconciliation of the Company's investments is as follows:

| | | Amount |
|---|---|---|
| Balance as at February 28, 2018 | $ | 320,225 |
| Acquisitions of investments | | 1,196,390 |
| Additional shares to be received | | 949,910 |
| Disposal of investments | | (108,414) |
| Net unrealized changes in fair value | | 998,687 |
| Effect of foreign exchange | | 9,723 |
| Balance as at February 28, 2019 | $ | 3,366,521 |
| Net unrealized changes in fair value | | (52,844) |
| Effect of foreign exchange | | 85,363 |
| **Balance as at May 31, 2019** | **$** | **3,399,340** |

## 8. Investment in Joint Ventures

In October 2017, the Company entered into joint venture agreements with the Schottenstein Group and created, Schottenstein-Aphria I, LLC ("SAI"), Schottenstein-Aphria II, LLC ("SAII") and Schottenstein-Aphria III, LLC ("SAIII"), with the purpose of entering into cannabis operations in the state of Ohio, USA. The Company owns a 50.1% stake in SAI, SAII, and SAIII.

For the period ending May 31, 2019, the company contributed $142,427 to the joint venture. Also, during the period, the company recoded $68,899 as its proportionate share of the loss on the joint venture and $7,205 as foreign exchange. The net value of the investment at May 31, 2019 was $320,826.

(In Canadian dollars unless otherwise noted)

## 9. Capital assets

| | Land | Greenhouse infratstructure | Vehicles | Furniture and equipment | Leasehold improvements | Right-of-use assets | Construction in progress | Total capital assets |
|---|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | | |
| As at February 28, 2018 | $ 2,369,442 | $ 19,450,173 | $ 197,399 | $ 1,832,042 | $ 430,749 | $ - | $ 1,286,034 | $ 25,565,839 |
| Additions | - | 222,860 | 279,097 | 4,313,857 | 706,911 | - | 23,910,775 | 29,433,500 |
| Borrowing costs | - | - | - | - | - | - | 2,424,674 | 2,424,674 |
| Transfers | - | 1,604,571 | - | - | 2,970,503 | - | (4,575,074) | - |
| Disposals | - | - | - | (84,674) | - | - | (262,803) | (347,477) |
| Effect of foreign exchange | 66,593 | 768,043 | 9,084 | (164,558) | (5,324) | - | 184,509 | 858,347 |
| As at February 28, 2019 | $ 2,436,035 | $ 22,045,647 | $ 485,580 | $ 5,896,667 | $ 4,102,839 | $ - | $ 22,968,115 | $ 57,934,883 |
| Additions | - | - | - | 346,558 | - | 17,810,879 | 1,269,119 | 19,426,556 |
| Borrowing costs | - | - | - | - | - | - | - | - |
| Transfers | - | 21,056,591 | - | - | 1,744,157 | - | (22,800,748) | - |
| Disposals | - | - | - | - | - | - | (77,847) | (77,847) |
| Effect of foreign exchange | 66,224 | 809,656 | 13,201 | 163,519 | 127,732 | 165,388 | 423,729 | 1,769,448 |
| **As at May 31, 2019** | **$ 2,502,259** | **$ 43,911,894** | **$ 498,781** | **$ 6,406,745** | **$ 5,974,728** | **$ 17,976,267** | **$ 1,782,368** | **$ 79,053,040** |

| | Land | Greenhouse infratstructure | Vehicles | Furniture and equipment | Leasehold improvements | Right-of-use assets | Construction in progress | Total capital assets |
|---|---|---|---|---|---|---|---|---|
| **Accumulated depreciation** | | | | | | | | |
| As at February 28, 2018 | $ - | $ 84,963 | $ 12,867 | $ 180,891 | $ 1,314 | $ - | $ - | $ 280,035 |
| Additions | - | 155,565 | 80,482 | 842,559 | 334,142 | - | - | 1,412,748 |
| Disposals | - | - | - | - | (3,414) | - | - | (3,414) |
| Effect of foreign exchange | - | 2,703 | 514 | (43,477) | 3,688 | - | - | (36,572) |
| As at February 28, 2019 | $ - | $ 243,231 | $ 93,863 | $ 979,973 | $ 335,730 | $ - | $ - | $ 1,652,797 |
| Additions | - | 724,032 | 24,913 | 315,546 | 210,321 | 415,269 | - | 1,690,081 |
| Disposals | - | - | - | - | - | - | - | - |
| Effect of foreign exchange | - | 13,335 | 2,783 | 29,571 | 11,080 | 3,856 | - | 60,625 |
| **As at May 31, 2019** | **$ -** | **$ 980,599** | **$ 121,559** | **$ 1,325,090** | **$ 557,131** | **$ 419,125** | **$ -** | **$ 3,403,503** |

| | Land | Greenhouse infratstructure | Vehicles | Furniture and equipment | Leasehold improvements | Right-of-use assets | Construction in progress | Total capital assets |
|---|---|---|---|---|---|---|---|---|
| **Net book value** | | | | | | | | |
| As at February 28, 2019 | $ 2,436,035 | $ 21,802,416 | $ 391,717 | $ 4,916,694 | $ 3,767,109 | $ - | $ 22,968,115 | $ 56,282,086 |
| **As at May 31, 2019** | **$ 2,502,259** | **$ 42,931,295** | **$ 377,222** | **$ 5,081,655** | **$ 5,417,597** | **$ 17,557,142** | **$ 1,782,368** | **$ 75,649,537** |

(In Canadian dollars unless otherwise noted)

For the three months ended May 31, 2019 depreciation expense was $1,690,081 (2018 - $213,209) of which $1,042,136 is included in inventory and $647,945 is included in the consolidated statement of loss.

## 10. Intangible assets

| | Licenses | Software | Intellectual property | **Total intangible assets** |
|---|---|---|---|---|
| **Cost** | | | | |
| As at February 28, 2018 | $ 44,439,009 | $ 20,955 | $ 5,000,000 | **$ 49,459,964** |
| Additions | - | 361,597 | - | **361,597** |
| Write-off of intangible asset | - | - | (5,000,000) | **(5,000,000)** |
| Effect of foreign exchange | 1,257,112 | 2,050 | - | **1,259,162** |
| As at February 28, 2019 | $ 45,696,121 | $ 384,602 | $ - | **$ 46,080,723** |
| Additions | - | 7,237 | - | **7,237** |
| Effect of foreign exchange | 1,239,786 | 10,523 | - | **1,250,309** |
| **As at May 31, 2019** | **$ 46,935,906** | **$ 402,363** | **$ -** | **$ 47,338,269** |

| | Licenses | Software | Intellectual property | **Total intangible assets** |
|---|---|---|---|---|
| **Accumulated depreciation** | | | | |
| As at February 28, 2018 | $ - | $ 8,761 | $ 1,286,531 | **$ 1,295,292** |
| Additions | - | 46,431 | 1,250,000 | **1,296,431** |
| Write-off of intangible asset | - | - | (2,536,531) | **(2,536,531)** |
| Effect of foreign exchange | - | (6,132) | - | **(6,132)** |
| As at February 28, 2019 | $ **-** | $ 49,060 | $ - | $ **49,060** |
| Additions | - | 97,223 | - | **97,223** |
| Effect of foreign exchange | - | 2,236 | - | **2,236** |
| **As at May 31, 2019** | **$ -** | **$ 148,519** | **$ -** | **$ 148,519** |

| | Licenses | Software | Intellectual property | **Total intangible assets** |
|---|---|---|---|---|
| **Net book value** | | | | |
| As at February 28, 2019 | $ 45,696,121 | $ 335,542 | $ - | **$ 46,031,663** |
| **As at May 31, 2019** | **$ 46,936,906** | **$ 253,844** | **$ -** | **$ 47,189,750** |

In April 2017, the Company entered into a Know-How License Agreement with Aphria, a related party in fiscal 2018, in exchange for common shares of the Company. The Know-How relates to Aphria's expertise in growing, harvesting and producing cannabis as well as processing automation and other operational improvements. The Company valued the purchase price for this Know-How at $5,000,000, which the Company estimated to be its fair value, and recognized this asset under intellectual property in the above table. In October 2018, Aphria terminated the Know-How License Agreement and the Company wrote off the remaining balance of the remaining intangible asset of $2,463,469.

## 11. Convertible notes payable

In November 2017, the Company issued convertible secured debentures of US$12,000,000 ($15,465,600) (the "Notes"). The Notes bear interest of 12% per annum, payable semi-annually, and mature in November 2020. The notes are convertible into common shares of the Company at $2.00 per share. The Company has the right to convert the Notes into common shares if the Company's shares are listed at a minimum of $3.00 per share for ten consecutive trading days, on a volume weighted average basis.

The Notes are secured by a perfected first priority lien in all existing and future tangible and intangible assets of the Company, including accounts receivable, inventory, equipment, permits, subject only to customary permitted liens and provided that no security interest shall attach to any property or asset (tangible and intangible) which violates or creates a default under any contract to which the Company or any subsidiary is a party. The first priority security interest includes a general security agreement covering and a mortgage over the Company's Liberty 360 Innovation Campus property.

The Notes are denominated in United States dollars, while convertible in Canadian dollars. The conversion feature in a different currency requires a variable number of shares to settle the Notes and therefore is treated as an embedded derivative under IFRS. The fair value of the embedded derivative was $6,944,868 on the date of issuance and $1,246,262 as at May 31, 2019. On November 22, 2017, the Company recognized $262,236 in transaction costs relating to the issuance of the Notes. The costs were allocated in a pro-rata manner to the derivative component and the Notes, with the amount of $81,266 for the derivative component being included as part of the transaction costs in the consolidated statement of loss for the period ended February 28, 2018 and $180,970 being allocated to the debt. The value of the convertible notes payable was $12,024,700 as at May 31, 2019.

During the three months ended May 31, 2019, the embedded derivative decreased by $1,397,723, representing the change in fair value on the embedded derivative. The Company incurred interest expense of US$360,000 ($482,492) and US$360,000 ($462,444) for the year three months ended May 31, 2019 and three months ended May 31, 2018, respectively. The Company recorded accretion interest of $592,391 and foreign exchange gain of $174,574. The outstanding interest payable at May 31, 2019 was $324,648 (May 31, 2018 - $346,833).

| | | Amount |
|---|---|---|
| Balance as at February 28, 2018 | $ | 8,837,835 |
| Interest accretion | | 2,027,104 |
| Effect of foreign exchange | | 259,452 |
| Balance as at February 28, 2019 | $ | 11,124,391 |
| Interest accretion | | 592,391 |
| Effect of foreign exchange | | 307,918 |
| **Balance as at May 31, 2019** | **$** | **12,024,700** |

The fair value of the embedded derivative was determined using the Black Scholes valuation model using the following assumptions on May 31, 2019: stock price of $0.78; expected life of 1.48 years; $nil dividends; 94% volatility; risk-free interest rate of 1.51%; foreign exchange rate of 0.7393; and the exercise price of $2.00. In fiscal 2019: stock price of $1.08; expected life of 1.73 – 3 years; $nil dividends; 92% volatility; risk-free interest rate of 1.94%; foreign exchange rate of 0.7594; and the exercise price of $2.00.

## 12. Leases

The Company leases commercial properties across the State of Florida where it operates its dispensary and delivery operations. Lease terms are generally between 3 and 5 years. All the Company's leases include an option to renew the lease for an additional period usually matching the original term lease. At inception, the Company assesses whether it is reasonably certain to exercise the extension options, which is reassessed if there is a significant event or change in circumstances. Some of the Company's leases also include requirements to make payments in respect of common area maintenance, property taxes, insurance and non-refundable sales taxes, most of which is determined annually.

As at May 31, 2019, the Company recognized $18,527,678 in lease liabilities on its statement of financial position.

Amounts recognized in profit and loss associated with leases were as follows:

(In Canadian dollars unless otherwise noted)

| | | Amount |
|---|---|---|
| Interest on lease liabilities | $ | 473,851 |
| Expenses related to short-term leases | $ | 77,709 |
| Expenses related to low-value assets | $ | 680 |

## 13. Share capital

The Company is authorized to issue an unlimited number of common shares. As at May 31, 2019 the Company has issued 345,290,635 shares, of which 3,299,998 were held under escrow.

| | Number of shares | | Amount |
|---|---|---|---|
| Balance as at February 28, 2018 | 303,358,348 | $ | 113,321,501 |
| Share issuance – cash, net of issuance costs | 25,555,875 | | 15,518,617 |
| Share issuance – repayment of debt | 10,092,583 | | 9,386,102 |
| Share issuance – warrants exercised | 6,283,829 | | 7,016,132 |
| Balance as at February 28, 2019 | 345,290,635 | **$** | **145,242,352** |
| **Balance as at May 31, 2019** | **345,290,635** | **$** | **145,242,352** |

In July 2018, the Company issued 10,092,583 common shares from treasury at a price of $0.93 per share to settle US$6,000,000 of outstanding payments to Thermo Energy Systems Inc., a third-party vendor. Outstanding invoices to Thermo Energy Systems Inc. were in respect of ongoing retrofitting and construction services performed at the Company's Liberty 360 Innovation Campus. As a result of this settlement, the Company recognized a loss of $1,493,799 in the consolidated statements of loss and comprehensive loss.

In May 2018, the Company closed a bought deal offering, issuing 25,555,875 units of the Company at a price of $0.90 per unit, including 3,333,375 of over allotment units exercised by the underwriters. Each unit contained one common share and one common share purchase warrant with an exercise price of $1.10 for a period of two years from closing. 1,533,352 Broker Warrants were issued as part of the transaction, consisting of warrants exercisable at $0.90 for a period of two years from closing to acquire one common share and one common share purchase warrant with an exercise price of $1.10 for a period of two years from closing. Cash issuance costs of $1,690,459 were paid in respect of this offering and were allocated in a pro-rata manner between share capital ($1,261,803) and warrant reserve ($428,656).

## 14. Warrant reserve

| | Number of warrants | | Weighted average exercise price |
|---|---|---|---|
| Balance as at February 28, 2018 | 12,402,853 | $ | 1.72 |
| Issued during the year | 25,555,875 | | 1.10 |
| Exercised during the year | (6,283,829) | | 0.89 |
| Balance as at February 28, 2019 | 31,674,899 | **$** | **1.36** |
| **Balance as at May 31, 2019** | 31,674,899 | **$** | **1.36** |

| | Bought deal broker warrants | | Weighted average exercise price |
|---|---|---|---|
| Balance as at February 29, 2018 | 1,533,352 | | 0.90 |
| **Balance as at May 31, 2019** | 1,533,352 | **$** | **0.90** |

On May 10, 2018, the Company issued 25,555,875 common share purchase warrants as part of its bought deal offering (note 14). Each warrant is exercisable at $1.10 per share and expires two years from closing. The fair value of these warrants on the grant date was $5,832,266 using the Black-Sholes method.

(In Canadian dollars unless otherwise noted)

As part of the bought deal offering on May 10, 2018, 1,533,352 Broker Warrants to acquire one common share and one common share purchase warrant exercisable at $1.10 per share for a period of two years from closing were issued (note 14). Each Broker Warrant is exercisable at $0.90 per unit and expires two years from closing. The fair value of these warrants on the grant date was $519,357 and were allocated in a pro-rata manner between share capital and warrant reserve as a cost of issuance in the amounts of $387,662 and $131,695, respectively. As at May 31, 2019, these Broker Warrants remained outstanding.

The warrant details (excluding broker warrants) of the Company are as follows:

| Expiry date | | Exercise price | Number of warrants | Vested and exercisable |
|---|---|---|---|---|
| July 21, 2019 | $ | 0.62 | 192,307 | 192,307 |
| May 10, 2020 | $ | 1.10 | 22,074,931 | 22,074,931 |
| February 15, 2021 | $ | 2.07 | 9,407,661 | 9,407,661 |
| **Balance as at May 31, 2019** | | | **31,674,899** | **31,674,899** |

The weighted average remaining life of the outstanding warrants is 1.2 years as at May 31, 2019. The Company used the Black-Scholes valuation model to measure the initial value of granted warrants issued in May 2018 using the following assumptions: risk-free rate of 1.920% expected life of 2 years; $nil dividends; and 75% volatility based on comparable companies.

## 15. Contributed surplus

The Company adopted a stock option plan under which it is authorized to grant options to officers, directors, employees and consultants enabling them to acquire common shares of the Company. The maximum number of common shares reserved for issuance of stock options that may be granted under the plan is 10% of the issued and outstanding common shares of the Company from time to time. The options granted have a maximum term of five years and vest as determined by the Board of Directors.

The Company recognized a share-based compensation expense of $1,292,672 and $1,137,933 during the three months ended May 31, 2019 and three months ended May 31, 2018, respectively.

| | Number of options | | Weighted average exercise price |
|---|---|---|---|
| Balance as at February 28, 2018 | 9,999,832 | $ | 1.43 |
| Issued during the year | 2,830,000 | | 0.95 |
| Forfeited during the year | (1,065,000) | | 0.97 |
| Expired during the year | (239,832) | | 1.25 |
| **Balance as at February 28, 2019** | 11,525,000 | $ | 1.36 |
| Issued during the year | 1,850,000 | | 0.94 |
| Forfeited during the year | (106,673) | | 1.03 |
| Expired during the year | - | | |
| **Balance as at May 31, 2019** | 13,268,327 | **$** | **1.30** |

In May 2019 the company issued 950,000 compensation options at the exercise price of $0.79 to employees and officers of the Company. All options expire May 2024.

In March 2019, the Company issued 900,000 compensation options at the exercise price of $1.09 to an officer of the company. All options expire February 2024.

In January 2019, the Company issued 2,380,000 compensation options at the exercise price of $0.96 to employees and officers of the Company. All options expire January 2024 and vest over two years.

In July 2018, the Company issued 450,000 compensation options at the exercise price of $0.92 to employees and officers of the Company. All options expire July 2023 and vest over two years.

The option details of the Company are as follows:

(In Canadian dollars unless otherwise noted)

| Expiry date | | Exercise price | Number of options | Vested and exercisable |
|---|---|---|---|---|
| July 24, 2019 | $ | 1.00 | 200,000 | 200,000 |
| July 24, 2019 | $ | 1.50 | 200,000 | 200,000 |
| July 24, 2019 | $ | 2.00 | 200,000 | 200,000 |
| July 28, 2022 | $ | 0.62 | 1,500,000 | 1,466,666 |
| October 23, 2022 | $ | 1.07 | 328,328 | 295,824 |
| December 4, 2022 | $ | 1.62 | 7,233,333 | 7,216,666 |
| July 4, 2023 | $ | 0.92 | 383,333 | 249,999 |
| January 24, 2024 | $ | 0.96 | 1,373,333 | 993,331 |
| February 28, 2024 | $ | 1.09 | 900,000 | 300,000 |
| May 3, 2024 | $ | 0.79 | 950,000 | 316,666 |
| **Balance as at May 31, 2019** | | | **13,268,327** | **11,439,152** |

## 16. Related parties

Key management personnel are those persons that have the authority and responsibility for planning, directing and controlling the activities of the Company directly and indirectly. Key management personnel include the Company's directors and certain members of the senior management group. Amounts paid to key management personnel and related parties were as follows:

| | | **Three months ended May 31, 2019** | | Three months ended May 31, 2018 |
|---|---|---|---|---|
| Employee and staff costs | **$** | **193,155** | $ | 149,891 |
| Professional fees | | **23,583** | | 16,373 |
| Share-based compensation | | **516,684** | | 1,104,273 |
| Termination payments | | **-** | | - |
| Consulting fees | | **20,982** | | - |
| Interest on convertible note | | **76,500** | | - |
| **Total** | **$** | **830,904** | $ | 1,270,537 |

Employee and staff costs, professional fees, share-based compensation and termination payments were payments made in respect of employment agreements of directors and officers of the Company and family members related to them. Share-based compensation expense includes the impact of the accelerated vesting of stock options for certain directors and officers. Payments of interest on the Company's convertible note were made to certain directors and officers of the Company who were also noteholders during the fiscal year.

As at May 31, 2019, the Company had accounts receivable of $75,000 with a previous significant shareholder of the Company.

## 17. Financial risk management and financial instruments

*Financial instruments*

The Company's financial instruments consist of cash and term deposits, investments, other receivables, accounts payable and accrued liabilities, convertible notes payable and embedded derivative.

The carrying values of accounts payable and accrued liabilities approximate their fair values due to their short periods of maturity.

(In Canadian dollars unless otherwise noted)

*Fair value hierarchy*

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance of inputs used in making the measurements. Cash and term deposits are Level 1. The hierarchy is summarized as follows:

| | |
|---|---|
| Level 1 | quoted prices (unadjusted) in active markets for identical assets and liabilities |
| Level 2 | inputs that are observable for the asset or liability, either directly (prices) or indirectly (derived from prices) from observable market data |
| Level 3 | inputs for assets and liabilities not based upon observable market data |

| | Level 1 | Level 2 | Level 3 | **May 31, 2019** |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and term deposits | $ 5,415,538 | $ - | $ - | **$ 5,415,538** |
| Investments | 320,826 | - | 3,399,040 | **3,719,866** |
| **As at May 31, 2019** | **$ 5,736,364** | **$ -** | **$ 3,399,040** | **$ 9,135,404** |
| | | | | |
| **Financial liabilities** | | | | |
| Embedded derivative | $ - | $ 1,246,262 | $ - | **$ 1,246,262** |
| **As at May 31, 2019** | **$ -** | **$ 1,246,262** | **$ -** | **$ 1,246,262** |

| | Level 1 | Level 2 | Level 3 | **February 28, 2018** |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and term deposits | $ 13,291,426 | $ - | $ - | **$ 13,291,426** |
| Investments | 228,655 | - | 3,137,866 | **3,366,521** |
| **As at February 28, 2019** | **$ 13,520,081** | **$ -** | **$ 3,137,866** | **$ 16,657,947** |
| | | | | |
| **Financial liabilities** | | | | |
| Embedded derivative | $ - | $ 2,586,646 | $ - | **$ 2,586,646** |
| **As at February 28, 2019** | **$ -** | **$ 2,586,646** | **$ -** | **$ 2,586,646** |

The following table presents the changes in level 3 items for the quarter ended May 31, 2019:

| | Unlisted equity securities |
|---|---|
| Balance as at February 28, 2018 | $ 320,225 |
| Additions | 1,146,300 |
| Unrealized gain on fair value | 1,661,695 |
| Effect of foreign exchange | 9,646 |
| Balance as at February 28, 2019 | $ 3,137,866 |
| Additions | - |
| Effect of foreign exchange | 85,303 |
| **Balance as at May 31, 2019** | **$ 3,223,169** |

The Company's investments in unlisted equity securities are classified as Level 3 in the fair value hierarchy. Changes to the fair value of these securities are based on financings and other transactional data of the underlying companies. A 10% increase/decrease in the price per share of the Company's investments classified as Level 3 would increase/decrease the Company's change in fair value of investments by $339,904.

*Financial risk management*

The Company has exposure to the following risks:

(a) Business risk

The Company operates in the medical cannabis industry in the United States, which is largely regulated at the state level. Cannabis is categorized under the US federal Controlled Substances Act as a controlled substance and as such, violates federal law in the United States. At this time, the Company believes and has obtained legal advice that proceedings regarding cannabis violations are remote.

(b) Foreign exchange risk

The Company maintains cash and term deposits, a portion of its other receivables, a portion of its investments, and convertible notes payable in United States dollars, which totaled US$3,601,377, US$654,527, US$2,619,442, and US$12,000,000, respectively, as of May 31, 2019 (February 28, 2019 – US$2,189,165, US$622,504, US$2,430,556, US$12,000,000) respectively. As a result, the Company's operations are subject to variations from fluctuation in the foreign exchange rate. A 1% change in the foreign exchange rate may result in a gain/loss of approximately $78,174. The Company does not maintain any contract to hedge against any fluctuation on foreign exchange rate.

(c) Credit risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company has two types of financial assets that are subject to the ECL model which are its cash and term deposits, its other receivable and promissory note receivable. The maximum credit exposure at May 31, 2019 is the carrying amount of these items. The Company does not have significant credit risk with respect to customers. All cash is placed with locally established financial institutions. The company does have risk associated with the promissory note receivable. In accordance with this risk the company has recognized an impairment as of May 31, 2019 as shown in the financial statements.

(d) Liquidity risk

As at May 31, 2019, the Company's financial liabilities consist of accounts payable and accrued liabilities, which have contractual maturity dates within one year, and its convertible notes payable, which matures in November 2020. The Company manages its liquidity risk by reviewing its capital requirements on an ongoing basis.

(e) Capital management

The Company's objective when managing its capital are to safeguard its ability to continue as a going concern, to meet its capital expenditures for its continued operations, and to maintain a flexible capital structure which optimizes the cost of capital within a framework of acceptable risk. The Company will manage its capital structure and adjust it considering changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust its capital structure, the Company may issue new shares, issue new debt, or acquire or dispose of assets. The Company is not subject to externally imposed capital requirements. Management reviews its capital management approach on an ongoing basis.

## 18. Contingent Liabilities

The Company has been served a summons in a class action lawsuit against the Company and certain of its former officers. These claims relate to alleged violations of federal securities laws. At this time, one class action claim originating in the United States has been served on the Company. The Company intends to vigorously defend itself in this action.

The Company is also the defendant in other legal actions arising out of the ordinary course and conduct of its business.

As at May 31, 2019, the Company had not made any provision related to these contingencies.

(In Canadian dollars unless otherwise noted)

## 19. Commitments

Minimum lease payments required under the Company's non-cancelable leases are as follows:

| | | Amount |
|---|---|---|
| 2020 | $ | 2,769,905 |
| 2021 | | 2,922,531 |
| 2022 | | 3,009,287 |
| 2023 | | 2,963,085 |
| 2024 | | 2,787,024 |
| Thereafter | | 16,910,342 |
| **Total minimum lease payments** | **$** | **31,362,174** |

## 20. Reclassification of comparative figures

Certain prior year figures have been reclassified to conform with current year presentation.