
DELTA 9 CANNABIS INC.

CONSOLIDATED INTERIM

FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

(EXPRESSED IN CANADIAN DOLLARS)

DELTA 9 CANNABIS INC.

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(UNAUDITED)

SEPTEMBER 30, 2019

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CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION

(UNAUDITED)

(CANADIAN DOLLARS)

As At

	September 30, 2019	December 31, 2018
A S S E T S		
CURRENT		
Cash	\$ 10,215,102	\$ 16,229,605
Trade and other receivables (Note 5)	4,654,672	1,972,676
Inventories (Note 6)	6,221,254	2,566,943
Biological assets (Note 7)	6,718,059	3,787,640
Prepayments and other current assets (Note 8)	838,914	1,765,920
Due from shareholders (Note 13)	<u>56,341</u>	<u>54,504</u>
	28,704,342	26,377,288
PROPERTY, PLANT AND EQUIPMENT (Note 9)	27,795,339	16,839,328
RIGHT-OF-USE ASSETS (Note 14)	8,994,575	
INVESTMENTS (Note 10)	<u>1,797,333</u>	<u>2,759,000</u>
	<u>\$ 67,291,589</u>	<u>\$ 45,975,616</u>
L I A B I L I T I E S		
CURRENT		
Accounts payable and accrued liabilities (Note 11)	\$ 2,991,710	\$ 5,105,461
Customer deposits (Note 12)	13,666	122,102
Due to shareholders (Note 13)	48,951	48,951
Current portion of loan from related parties (Note 13)	475,833	
Current portion of lease liabilities (Note 14)	6,654,168	
Current portion of borrowings (Note 15)	<u>1,182,870</u>	<u>478,098</u>
	11,367,198	5,754,612
LOAN FROM RELATED PARTIES (Note 14)	1,745,725	
LEASE LIABILITIES (Note 13)	1,925,003	
BORROWINGS (Note 15)	7,687,609	4,915,835
CONVERTIBLE DEBENTURES (Note 16)	<u>9,511,381</u>	<u>-</u>
	<u>32,236,916</u>	<u>10,670,447</u>
S H A R E H O L D E R S ' E Q U I T Y		
SHARE CAPITAL (Note 17)	55,378,690	53,156,044
WARRANTS (Note 17)	1,961,286	685,849
CONTRIBUTED SURPLUS	3,291,831	2,751,641
ACCUMULATED DEFICIT	(7,111,477)	(21,135,850)
ACCUMULATED OTHER COMPREHENSIVE LOSS	(18,396,000)	
NON-CONTROLLING INTEREST	<u>(69,657)</u>	<u>(152,515)</u>
TOTAL SHAREHOLDERS' EQUITY	<u>35,054,673</u>	<u>35,305,169</u>
	<u>\$ 67,291,589</u>	<u>\$ 45,975,616</u>

COMMITMENTS (Note 23)

Approved on behalf of the Board:

"John William Arbuthnot III"

Signed: Director

"John William Arbuthnot IV"

Signed: Director

CONSOLIDATED INTERIM STATEMENTS OF NET INCOME (LOSS) AND COMPREHENSIVE LOSS
(UNAUDITED)
(CANADIAN DOLLARS)
FOR THE THREE AND NINE MONTH PERIOD ENDED

	Three month ended September 30		Nine month ended September 30	
	2019	2018	2019	2018
REVENUE <i>(Note 19)</i>	\$ 6,662,137	\$ 1,251,213	\$ 21,180,476	\$ 2,299,066
COST OF SALES	<u>4,628,070</u>	<u>938,733</u>	<u>14,380,975</u>	<u>1,542,422</u>
GROSS PROFIT BEFORE UNREALIZED GAIN FROM CHANGES IN BIOLOGICAL ASSETS	2,034,067	312,480	6,799,501	756,644
Unrealized gain from changes in fair value of biological assets	4,345,570	1,218,257	12,784,746	1,640,228
Fair value of biological assets in inventory sold	<u>(2,956,707)</u>	<u>-</u>	<u>(8,402,781)</u>	<u>-</u>
GROSS PROFIT	<u>3,422,930</u>	<u>1,530,737</u>	<u>11,181,466</u>	<u>2,396,872</u>
EXPENSES				
General and administrative <i>(Note 20)</i>	2,681,388	2,757,452	9,209,091	6,194,671
Sales and marketing <i>(Note 20)</i>	1,151,158	300,138	3,444,897	689,116
Share based compensation <i>(Note 17)</i>	<u>215,456</u>	<u>671,606</u>	<u>1,208,371</u>	<u>1,814,394</u>
	<u>4,048,002</u>	<u>3,729,196</u>	<u>13,862,359</u>	<u>8,698,181</u>
LOSS FROM OPERATIONS	<u>(625,072)</u>	<u>(2,198,459)</u>	<u>(2,680,893)</u>	<u>(6,301,309)</u>
OTHER INCOME				
Finance income (expense) - net <i>(Note 21)</i>	(666,529)	(29,579)	(1,042,123)	(44,722)
Rental and other income	24,339	16,229	53,227	27,524
Gain on disposal of Westleaf project investment <i>(Note 10)</i>	<u>-</u>	<u>(183,500)</u>	<u>17,401,000</u>	<u>(183,500)</u>
	<u>(642,190)</u>	<u>(196,850)</u>	<u>16,412,104</u>	<u>(200,698)</u>
NET INCOME (LOSS)	<u>\$(1,267,262)</u>	<u>\$(2,395,309)</u>	<u>\$ 13,731,211</u>	<u>\$(6,502,007)</u>
Net income (loss) and comprehensive loss attributable to:				
Delta 9 Cannabis Inc.	(1,438,096)	(2,317,068)	14,024,373	(6,344,141)
Non-controlling interest <i>(Note 18)</i>	<u>170,834</u>	<u>(78,241)</u>	<u>(293,162)</u>	<u>(157,937)</u>
	<u>(1,267,262)</u>	<u>(2,395,309)</u>	<u>13,731,211</u>	<u>(6,502,078)</u>
Other comprehensive income (loss)				
Fair value change in Westleaf investment	<u>(1,708,000)</u>	<u>-</u>	<u>(18,396,000)</u>	<u>-</u>
Total comprehensive income (loss)	<u>(2,975,262)</u>	<u>(2,395,309)</u>	<u>(4,664,789)</u>	<u>(6,502,078)</u>
Delta 9 Cannabis Inc	(3,146,096)	(2,317,068)	(4,371,627)	(6,344,141)
Non-controlling interest	<u>170,834</u>	<u>(78,241)</u>	<u>(293,162)</u>	<u>(157,937)</u>
	<u>(2,975,262)</u>	<u>(2,395,309)</u>	<u>(4,664,789)</u>	<u>(6,502,078)</u>
Earnings (loss) per share - basic <i>(Note 22)</i>	<u>\$(0.02)</u>	<u>\$(0.03)</u>	<u>\$ 0.16</u>	<u>\$(0.08)</u>
Earnings (loss) per share - diluted <i>(Note 22)</i>	<u>\$(0.02)</u>	<u>\$(0.03)</u>	<u>\$ 0.15</u>	<u>\$(0.08)</u>

See accompanying notes to consolidated interim financial statement:

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
(UNAUDITED)
(CANADIAN DOLLARS)
FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30

	Number of shares	Share Capital	Warrants	Contributed Surplus	Accumulated Deficit	Accumulated Other Comprehensive Loss	Non- Controlling Interest	Total Equity
BALANCE, December 31, 2017	78,819,412	\$ 36,223,754	\$ 819,342	217,136	\$(12,650,277)	\$	\$(53,557)	\$ 24,556,398
Net loss and comprehensive loss					(6,344,141)		(157,937)	(6,502,078)
Exercise of agents' warrants	529,522	477,682	(133,493)					344,189
Exercise of employee stock options	283,475	263,012		(78,753)				184,259
Private placement bought deal - net of share issue costs	5,909,090	16,162,808						16,162,808
Share based compensation	-	-	-	1,814,394	-	-	-	1,814,394
BALANCE, September 30, 2018	<u>85,541,499</u>	<u>53,127,256</u>	<u>685,849</u>	<u>1,952,777</u>	<u>(18,994,418)</u>	<u>-</u>	<u>(211,494)</u>	<u>36,559,970</u>
BALANCE, December 31, 2018	85,571,993	53,156,044	685,849	2,751,641	(21,135,850)		(152,515)	35,305,169
Net income					14,024,373		(293,162)	13,731,211
Other comprehensive loss						(18,396,000)		(18,396,000)
Equity component of promissory note (Note 13)							376,020	376,020
Warrants relating to debentures (Note 16)			1,275,437					1,275,437
Exercise of employee stock options (Note 17)	2,391,485	2,222,646		(668,181)				1,554,465
Share based compensation (Note 17)	-	-	-	1,208,371	-	-	-	1,208,371
BALANCE, September 30, 2019	<u>87,963,478</u>	<u>\$ 55,378,690</u>	<u>\$ 1,961,286</u>	<u>3,291,831</u>	<u>\$(7,111,477)</u>	<u>\$(18,396,000)</u>	<u>\$(69,657)</u>	<u>\$ 35,054,673</u>

See accompanying notes to consolidated interim financial statements

CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS

(UNAUDITED)

(CANADIAN DOLLARS)

FOR THE NINE MONTH PERIOD ENDED SEPTEMBER 30

	September 30, 2019	September 30, 2018
CASH FLOW FROM		
<i>OPERATING ACTIVITIES</i>		
Net income (loss) for period	\$ 13,731,211	\$(6,502,078)
Items not affecting cash:		
Amortization of property, plant and equipment	2,362,244	341,078
Unrealized gain from changes in fair value of biological assets	(4,381,965)	(1,529,609)
Gain on disposal of Westleaf project investment (Note 10)	(17,401,000)	
Customer deposit forfeited	(122,102)	
Interest accrued on lease liabilities	185,445	
Interest accrued on promissory note	97,578	
Interest accrued on convertible debentures	407,172	
Share of loss from limited partnership		183,500
Share based compensation (Note 17)	<u>1,208,371</u>	<u>1,814,394</u>
	<u>(3,913,046)</u>	<u>(5,692,715)</u>
Trade and other receivables	(2,161,996)	(1,366,243)
Inventories	(2,202,765)	(2,025,275)
Prepayments and other current assets	508,181	(431,340)
Accounts payable and accrued liabilities	(2,113,761)	815,600
Customer deposits	<u>13,666</u>	<u>-</u>
Changes in non-cash working capital	<u>(5,956,675)</u>	<u>(3,007,258)</u>
	<u>(9,869,721)</u>	<u>(8,699,973)</u>
<i>INVESTING ACTIVITIES</i>		
Acquisition of property, plant and equipment	(12,769,889)	(5,278,399)
Investment in Vitreous Cannabis Inc. (Note 10)	<u>(33,333)</u>	<u>(3,000,000)</u>
	<u>(12,803,222)</u>	<u>(8,278,399)</u>
<i>FINANCING ACTIVITIES</i>		
Proceeds from share capital - net of share issue costs (Note 17)	1,034,465	16,691,256
Loan from related parties (Note 13)	2,500,000	
Proceeds from convertible debentures - net (Note 16)	10,379,646	
Proceeds from non-revolving masterline (Note 15)	3,834,080	
Repayment of lease liabilities (Note 14)	(730,381)	
Repayment of borrowings (Note 15)	(357,534)	
Repayment of amounts due to related parties	<u>(1,836)</u>	<u>(49,571)</u>
	<u>16,658,440</u>	<u>16,641,685</u>
NET DECREASE IN CASH	(6,014,503)	(336,687)
CASH, beginning of period	<u>16,229,605</u>	<u>23,548,451</u>
CASH, end of period	<u>\$ 10,215,102</u>	<u>\$ 23,211,764</u>
CASH COMPRISED OF		
Cash	\$ 9,565,102	\$ 23,211,764
Restricted cash (Note 4)	<u>650,000</u>	<u>-</u>
	<u>\$ 10,215,102</u>	<u>\$ 23,211,764</u>

See accompanying notes to consolidated interim financial statements

DELTA 9 CANNABIS INC.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

1. NATURE OF BUSINESS

Delta 9 Cannabis Inc. (the "Company") is a licensed Cannabis Producer regulated by Health Canada under The Cannabis Act. The Company is a publicly traded company on the TSX Exchange under the symbol DN. The Cannabis license is in the name of Delta 9 Bio-Tech Inc., a wholly owned subsidiary of the Company. On February 16, 2018, the Manitoba government had awarded a license to legally retail recreational cannabis in the province to a consortium consisting of the Company and Canopy Growth Corporation. Recreational cannabis was legalized on October 17, 2018.

On October 31, 2017, Delta 9 Bio-Tech Inc. completed a reverse acquisition transaction with SVT Capital Corp. ("SVT"). Upon completion of the transaction, SVT changed its name to Delta 9 Cannabis Inc.

The address of the registered office is Suite 2600, 1066 West Hastings Street, Vancouver, British Columbia, V6E 3X1.

On November 11, 2019 the Board of Directors authorized the Consolidated Interim Financial Statements for issue.

2. BASIS OF PRESENTATION

a) Statement of compliance

These consolidated interim financial statements have been prepared in accordance with International Financial Reporting Standard 34 Interim Financial Reporting ("IAS 34"). The consolidated interim financial statements should be read in conjunction with the annual financial statements of the Company for the year ended December 31, 2018, which have been prepared in accordance with International Financial Reporting Standards (IFRS), as issued by International Accounting Standards Board (IASB).

b) Basis of measurement

These consolidated interim financial statements have been prepared on a historical cost basis except for biological assets, long term investments, borrowings, loan from related parties, warrants and options which are measured at fair value, as explained in the accounting policies below.

Historical cost is the fair value of the consideration given in exchange for goods and services based on the fair value at the time of the transaction of the consideration given in exchange for assets.

c) Functional and presentation currency

These consolidated interim financial statements are presented in Canadian dollars, which is the Corporation's functional and presentation currency.

d) Basis of consolidation

These consolidated interim financial statements consolidate the accounts of the Company and its subsidiaries. Subsidiaries are all entities over which the Company has control. The Company controls an entity when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The Company has power over an entity where it has existing rights that give the current ability to direct the activities that most significantly affect the entity's returns (relevant activities). Power may be determined on the basis of voting rights or, in the case of structured entities, other contractual arrangements. The Company consolidates all subsidiaries from the date it obtains control and ceases consolidation when an entity is no longer controlled by it. All transactions and balances from subsidiaries have been eliminated upon consolidation.

These consolidated interim financial statements include the Company and its wholly owned subsidiary, Delta 9 Bio-Tech Inc. and the Company's interest in Delta 9 Lifestyle Cannabis Inc.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

2. BASIS OF PRESENTATION *(continued)*

In addition to Delta 9 Bio-Tech Inc. (and its subsidiary, Delta 9 Lifestyle Cannabis Clinic Inc.), the Company has one other subsidiary, 10007705 Manitoba Ltd. which was incorporated under The Corporations Act (Manitoba) on December 14, 2017. Delta 9 Bio-Tech Inc. owns 50% of the issued and outstanding shares of 10007705 Manitoba Ltd. The remaining 50% of the issued and outstanding shares are owned by Canopy Growth Corporation, an arm's length third party. The retail license was issued to 10007705 Manitoba Ltd. The retail license allows each of Delta 9 Bio-Tech Inc. and Canopy Growth Corporation to license individual retail store locations to sell recreational cannabis, which are independently owned, operated, and branded by subsidiaries of Delta 9 Bio-Tech Inc. and Canopy Growth Corporation, respectively. Delta 9 Lifestyle Cannabis Clinic Inc. was awarded its first four retail location licenses for stores in Winnipeg, Brandon and Thompson, Manitoba on September 17, 2018.

No financial transactions were incurred by 10007705 Manitoba Ltd. as of September 30, 2019.

3. SIGNIFICANT ACCOUNTING POLICIES**REVENUE RECOGNITION**

The Company's policy for the timing and amount of revenue to be recognized is based on the following 5-step process described in IFRS 15:

- Identifying the contract with a customer
- Identifying the performance obligations
- Determining the transaction price
- Allocating the transaction price to the performance obligations
- Recognizing revenue when or as performance obligation(s) are satisfied

Revenue from the sale of cannabis, related merchandise and devices and grow pods is recognized when the Company has transferred the significant risks and rewards of ownership to the customer, the amount of the revenue can be reliably measured and it is probable that the Company will receive the previously agreed upon payment. Significant risks and rewards are generally considered to be transferred when the product leaves the Company's premises. Revenue is recognized at the fair value of the consideration received or receivable. Interest and sundry income is recognized at the time the amount is earned, determinable and collectibility is reasonably assured.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, balances with banks net of bank overdrafts and term deposits having maturity of three months or less at acquisition, which are held for the purpose of meeting short-term cash commitments.

TRADE AND OTHER RECEIVABLES

Trade receivables are stated at the amounts billed to customers under normal trade, and are recognized initially at fair value and subsequently measured at amortized cost less an allowance for impairment.

Other receivables include amounts owed to the Company for share subscription and goods and services tax recoverable.

Trade and other receivables are classified as current assets if amounts are due within one year or less. If not, they are presented as non-current assets.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)**INVENTORIES*

Inventories of raw materials, merchandise and devices, grow pods, and finished goods are valued at the lower of cost and net realizable value. Harvested cannabis plants 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 to the extent that cost is less than net realizable value. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs to sell. Packaging, supplies and seeds are initially valued at cost.

BIOLOGICAL ASSETS

The Company's biological assets consist of cannabis clones, mother plants and flowering plants. All the biological assets are presented as current assets on the statement of financial position. The Company measures biological assets at fair value less cost to sell up to the point of harvest which becomes the basis for the cost of finished goods inventories after harvest. Gains or losses arising from changes in fair value less cost to sell are included in the results of operations of the related period.

PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets include short-term prepaid expenses and prepayments related to materials and other deposits required in the normal course of business, which are less than one year.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are measured at cost less accumulated amortization and impairment losses. Amortization is provided on a straight-line basis using the following rates:

Building	5%
Leasehold improvements	20%
Containers	10%
Production equipment	20%
Security equipment	20%
Computer equipment	55%
Computer software	33%
Office furniture and equipment	20%
Vehicles	30%

In the year of acquisition, amortization is taken at one-half of the straight line rate.

IMPAIRMENT OF LONG-LIVED ASSETS

Long lived assets, including property, plant and equipment and intangible assets are reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds the recoverable amount. For the purposes of impairment-testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash flows from continuing use that are largely independent of cash flows of other assets or groups of the assets (the cash generating unit, or CGU). The recoverable amount of an asset or a CGU is the higher of its fair value, less costs to sell, and its value in use. If the carrying amount of an asset exceeds its recoverable amount, an impairment charge is recognized immediately in profit or loss by the amount by which the carrying amount of the asset exceeds the recoverable amount. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimate of the recoverable amount, and the carrying amount that would have been recorded had no impairment loss been recognized previously.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)**TRADE AND OTHER PAYABLES*

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Other payables include amounts due to shareholders, corporate director's credit cards and goods and services tax payable. Trade and other payables are classified as current liabilities if payments are due within one year or less. If not, they are presented as non-current liabilities.

BORROWINGS

Borrowings are recognized initially at fair value, net of transaction costs incurred. Borrowings are subsequently carried at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in earnings over the period of the borrowings using the effective interest method.

Fees paid on the establishment of loan facilities are recognized as transaction costs of the loan to the extent that it is probable that some or all of the facility will be drawn down. If so, the fee is deferred until the draw-down occurs. To the extent there is no evidence that it is probable that some or all of the facility will be drawn down, the fee is capitalized as a pre-payment for liquidity services and amortized over the period of the facility to which it relates.

CONVERTIBLE INSTRUMENTS

Convertible instruments are compound financial instruments which are accounted for separately by their components, a financial liability and an equity instrument. The financial liability, which represents the obligation to pay coupon interest on the convertible instruments in the future is initially measured at its fair value of a similar liability that does not have an equity conversion option, and subsequently measured at amortized cost using the effective interest method. The residual amount is accounted for as an equity instrument at issuance. The equity component is not remeasured subsequent to initial recognition, except on conversion or expiry. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

LEASES

IFRS 16 Leases

Adjustments recognized on adoption of IFRS 16

On adoption of IFRS 16 by applying modified retrospective approach, the Company recognized lease liabilities in relation to leases that had previously been classified as "operating leases" under the principles of IAS 17 Leases. These lease liabilities were measured at the present value of the remaining lease payments and discounted using entity-specific incremental borrowing rate. The incremental borrowing rate applied was the interest rate on a loan obtained closer to the year ended December 31, 2018, from a commercial bank for the purchase of a building. The weighted average incremental borrowing rate applied by the Company upon transition was 4.95%.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

The associated right-of-use assets for leases were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the balance sheet as at January 1, 2019.

The recognized right-of-use assets relate to properties.

The change in accounting policy affected the following items in the consolidated balance sheet on January 1, 2019:

- Right-of-use assets increased by \$7,946,695
- Prepayments decreased by \$31,069
- Lease liabilities increased by \$7,915,627

(i) Practical expedients applied

In applying IFRS 16 for the first time, the Company has used the following practical expedients permitted by the standard:

- The use of a single discount rate to a portfolio of leases with reasonably similar characteristics
- To account for each lease component of a contract and any associated non-lease components as a single lease component, where non-lease components are not significant when compared with the lease components of a contract
- The use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease

(ii) The Company's leasing activities and how these are accounted for

The Company leases various properties for its offices, manufacturing facility and retail stores to sell recreational cannabis. Rental contracts are typically made for fixed periods, but might have extension options. Lease terms are negotiated on an individual basis and contain a wide range of different terms and conditions. The lease agreements do not impose any covenants, but leased assets cannot be used as security for borrowing purposes.

Leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Company.

Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of fixed payments (including in-substance fixed payments), less any lease incentives receivable. The lease payments are discounted using the Company's incremental borrowing rate.

The Company recognizes a right-of-use asset and a lease liability at the commencement of the lease. The right-of-use asset is initially measured based on the present value of lease payments, plus initial direct costs and the cost of obligations to refurbish the asset, adjusted for any lease payments made at or before the commencement date less any incentives received.

Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. In case of a future purchase option, the right-of-use asset is depreciated over the asset's useful life.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

The Company has elected not to recognize right-of-use assets and liabilities for leases where the total lease term is less than or equal to 12 months, or for leases of low-value assets. Payments associated with short-term leases and leases of low-value assets are recognized on a straight-line basis as an expense in profit or loss. Presently, there are no short term or low value leases in effect.

Income from operating leases is recognized on a straight-line basis over the term of the lease.

Impact of adoption of IFRS 16 on net income and comprehensive income for the nine month period ended September 30, 2019:

- Rent expense decreased by \$731,290
- Amortization on right-of-use assets increased by \$548,390
- Interest on lease liabilities increased by \$185,444
- Net income and comprehensive income decreased by \$2,544

SHARE-BASED COMPENSATION

The Company has a stock option plan for directors, officers, employees, and consultants. Grants are subject to a service condition by the option holder.

All option grants are initially measured at fair value at the grant date using the Black-Scholes option pricing model. The fair value of the options is amortized over the vesting period and is included in operating expenses with a corresponding increase in contributed surplus, net of an estimated forfeiture credit. Management reassesses the estimated forfeiture credit at each reporting period. Where the terms and conditions of the initial option grant are modified before they vest, the options are remeasured at fair value at the modification date and any increase in fair value is charged to earnings.

When options are exercised, common shares are issued from treasury and the proceeds are credited to share capital in the Consolidated Statements of Financial Position.

WARRANTS

The Company uses the residual value approach in respect of unit offerings whereby the amount assigned to the warrant is the excess of the unit price over the trading price of the Company's shares at the date of issuance, if any, to a maximum fair value of the warrant determined by using the Black-Scholes option pricing model.

INCOME TAXES

The Company uses the liability method to account for income taxes. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities for accounting purposes and their respective tax bases. Deferred income tax assets and liabilities are measured using tax rates that have been enacted or substantively enacted applied to taxable income in the years in which temporary differences are expected to be reversed or settled. The effect on deferred income tax assets and liabilities of a change in statutory tax rates is recognized in profit or loss in the year of change. Deferred income tax assets are recorded when their recoverability is considered probable and are reviewed at the end of each reporting period.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)**FINANCIAL INSTRUMENTS*

Financial instruments consist of financial assets and liabilities and are initially measured at fair value, and are recognized in the consolidated statements of financial position when the Company has become party to the contractual provisions of the instruments. The accounting policies for financial instruments are described below and the composition of the Company's financial instruments and related risks are disclosed in Notes 25 and 26.

1) Financial Assets

The Company classifies each financial asset into one of following categories depending on the purpose for which the asset was acquired. The classification of its instruments is driven by the Company's business model for managing the financial assets and their contractual cash flow characteristics.

a) At Fair Value Through Profit or Loss ("FVTPL").

Assets in this category are derivatives, equity instruments which the Company has not irrevocably elected, at initial recognition, to classify at FVTOCI, or other assets classified as held-for-trading (i.e. acquired or incurred principally for the purpose of selling or repurchasing in the near term) or designated as FVTPL upon initial recognition subject to meeting certain conditions. After initial recognition, such assets are measured at fair value with changes therein being recognized in profit or loss. The Company has cash and cash equivalents which are classified as FVTPL.

b) At fair value through other comprehensive income ("FVTOCI")

Equity instruments that are not held-for-trading can be irrevocably designated to have their change in fair value recognized through other comprehensive income instead of through profit or loss. This election can be made on individual instruments and is not required to be made for the entire class of instruments. Attributable transaction costs are included in the carrying value of the instruments. Financial assets at fair value through other comprehensive income are initially measured at fair value and changes therein are recognized in other comprehensive income. The Company has investment in equity instruments of Westleaf Inc. and Vitreous Cannabis Inc. which are classified as FVTOCI.

c) Amortized Cost

Assets in this category are initially recognized at fair value plus or minus transaction costs, respectively, and subsequently carried at amortized cost less impairment. The Company has accounts receivable and amounts due from related parties which are classified as financial assets at amortized cost.

2) Financial Liabilities

The Company classifies each financial liability into one of following categories depending on the purpose for which the liability was incurred.

a) At FVTPL

Financial liabilities in this category are derivatives or liabilities classified as held-for-trading or designated as FVTPL, upon initial recognition subject to meeting certain conditions. After initial recognition, such liabilities are measured at fair value with changes in fair value being recognized in profit or loss. The Company has no financial liabilities at FVTPL.

(b) Other Financial Liabilities

Liabilities in this category are non-derivative financial liabilities that are not classified as FVTPL. After initial recognition, such liabilities are measured at amortized cost using the effective interest rate method. The Company has accounts payable and accrued liabilities, customer deposits, lease liabilities, loan from related parties, borrowings, convertible debentures and due to related parties which are classified as other financial liabilities.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

3. SIGNIFICANT ACCOUNTING POLICIES *(continued)*

3) Transaction Costs

For FVTPL financial assets and liabilities, transaction costs on initial recognition, and thereafter, are included directly in profit or loss. For other categories of financial assets and liabilities, transaction costs are capitalized and included in the calculation of the effective interest rate i.e. amortized through profit or loss over the terms of the related instrument.

4) Impairment of Financial Assets

The Company recognizes a loss allowance for expected credit losses on financial assets that are measured at amortized cost. At each reporting date, the Company measures the loss allowance for the financial asset at an amount equal to the lifetime expected credit losses if the credit risk on the financial asset has increased significantly since initial recognition. If at the reporting date, the credit risk on financial asset has not increased significantly since initial recognition, the Company measures the loss allowance for the financial asset at an amount equal to twelve month expected credit losses. The Company recognizes in the statements of net income (loss), as an impairment gain or loss, the amount of expected credit losses (or reversal) that is required to adjust the loss allowance at the reporting date to the amount that is required to be recognized.

5) Fair value measurement

Fair value is defined as the price to sell an asset or transfer a liability (i.e. the "exit price") in an orderly transaction between market participants. Management uses a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data. The fair value hierarchy is broken down into the following three levels:

Level 1: Fair value based on unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2: Fair value based on quoted prices in active markets for similar assets or liabilities, quoted prices for identical assets or liabilities in inactive markets, or for which significant inputs are observable (e.g. interest rates, yield curves, etc.) or can be corroborated by observable market data.

Level 3: Fair value based on inputs that are unobservable and reflecting significant management judgments about assumptions that market participants might use.

The fair value hierarchy requires the use of observable market inputs whenever such inputs exist. A financial instrument is classified to the lowest level of the hierarchy for which a significant input has been considered in measuring fair value.

Cash and cash equivalents are classified as Level 2 financial instruments.

CRITICAL ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

1) Biological Assets and Inventory

Determination of the fair value of biological assets requires the Company to make a number of estimates, including estimating the stage of growth of the cannabis up to the point of harvest, harvesting costs, selling costs, sales prices, wastage and expected yields of the cannabis plant. In determining final inventory values, the Company estimates spoiled or expired inventory in determining net realizable value.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019
3. SIGNIFICANT ACCOUNTING POLICIES (continued)

The Company's estimates are, by their nature, subject to change and differences from the anticipated yield will be reflected in the gain or loss on biological assets in future periods.

2) Estimated Useful Lives of Property, Plant and Equipment

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

3) Share Based Compensation

The fair value of share-based compensation expenses are estimated using the Black-Scholes option pricing model and relies on a number of estimated inputs, such as the expected life of the option, the volatility of the underlying share price, the risk free rate of return and the estimated rate of forfeiture of options granted. Changes in the underlying estimated inputs may result in materially different results.

4) Warrants

In calculating the fair value of warrants, management relies on estimated inputs, such as the volatility of the Company's stock price and the risk-free rate of return.

4. RESTRICTED CASH

	September 30, 2019	December 31, 2018
Assignment of deposit instrument with Canadian Western Bank against bank borrowings	\$ 500,000	\$ 500,000
Security deposits as required by the Province of Manitoba through the Liquor Gaming and Cannabis Authority (LGCA)	<u>150,000</u>	<u>150,000</u>
	<u>\$ 650,000</u>	<u>\$ 650,000</u>

5. TRADE AND OTHER RECEIVABLES

	September 30, 2019	December 31, 2018
Trade and other	\$ 2,746,627	\$ 920,217
Due from shareholders	573,553	118,553
Goods and services tax receivable	<u>1,334,492</u>	<u>933,906</u>
	<u>\$ 4,654,672</u>	<u>\$ 1,972,676</u>

The following table provides details on the age of trade receivables:

	September 30, 2019	December 31, 2018
0 - 30 days	\$ 1,446,207	\$ 774,970
31 - 60 days	3,862	98,327
61 - 90 days	302,437	
Greater than 90 days	<u>994,121</u>	<u>46,920</u>
	<u>\$ 2,746,627</u>	<u>\$ 920,217</u>

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019
6. INVENTORIES

	September 30, 2019	December 31, 2018
Raw materials	\$ 226,759	\$ 165,825
Packaging materials	194,872	181,999
Finished goods	4,009,664	1,835,824
Merchandise and devices	640,228	383,295
Grow pods for resale	<u>1,149,731</u>	<u>-</u>
	<u>\$ 6,221,254</u>	<u>\$ 2,566,943</u>

The amount of inventories recognized as an expense was \$12,469,290 (\$4,922,224 - December 31, 2018)

7. BIOLOGICAL ASSETS

Biological assets consist of cannabis plants.

	September 30, 2019	December 31, 2018
Biological assets, beginning of period/year	\$ 3,787,640	\$ 125,943
Net increase in fair value less cost to sell due to biological transformation	12,784,746	4,330,749
Transferred to inventory upon harvest	<u>(9,854,327)</u>	<u>(669,052)</u>
Biological assets, end of period/year	<u>\$ 6,718,059</u>	<u>\$ 3,787,640</u>

Biological assets are valued in accordance with IAS 41 and are presented at their fair values less costs to sell up to the point of harvest. The Company's biological assets are primarily cannabis clones, mother plants and flowering plants, and because there is no actively traded commodity market for plants or dried product, the valuation of these biological assets is obtained using valuation techniques where the inputs are based upon unobservable market data (Level 3).

The significant assumptions used in determining the fair value of biological assets include:

- Average selling price less cost to sell of \$7.86 per gram
- Estimated yield of 30 grams per cannabis flowering plant
- Average selling price pro-rated based on the stage of growth of the biological assets at the reporting period, less wastage
- Selling costs are estimated based on the salaries paid to marketing and inventory personnel

8. PREPAYMENTS AND OTHER CURRENT ASSETS

	September 30, 2019	December 31, 2018
Advertising and promotion	\$ 13,024	\$ 15,835
Deposit for purchase of production supplies	421,996	732,229
Deposit for purchase of building		350,000
Excise tax deposit - Canada Revenue Agency	208,000	208,000
Prepaid rent	90,127	157,580
Insurance	80,797	258,123
Other	<u>24,970</u>	<u>44,153</u>
	<u>\$ 838,914</u>	<u>\$ 1,765,920</u>

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019
9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment relate to the infrastructure for cannabis growing production and operations. A cost continuity of the accounts for the nine month period ended September 30, 2019 is as follows:

	Balance at January 1, 2019	Additions/ Transfers	Disposals/ Transfers	Balance at September 30, 2019
Land	\$ 647,650	\$	\$	\$ 647,650
Building	5,725,000	1,447,525		7,172,525
Leasehold improvements	767,900	2,657,217	(1,448,037)	1,977,080
Containers	4,889,508	4,109,014		8,998,522
Production equipment	3,160,777	4,419,476	(268,044)	7,312,209
Security equipment	453,020	459,393		912,413
Computer equipment	196,036	56,504		252,540
Computer software	80,172			80,172
Office furniture and equipment	213,005	197,204		410,209
Vehicles		16,195		16,195
Construction in progress	<u>1,844,486</u>	<u>7,605,040</u>	<u>(6,618,431)</u>	<u>2,831,095</u>
	<u>\$ 17,977,554</u>	<u>\$20,967,568</u>	<u>\$ (8,334,512)</u>	<u>\$ 30,610,610</u>

The accumulated amortization continuity for property, plant and equipment for the nine month period ended September 30, 2019 is as follows:

	Balance at January 1, 2019	Additions	Disposals/ Transfers	Balance at September 30, 2019
Building	\$ 143,125	\$ 244,068	\$	\$ 387,193
Leasehold improvements	121,903	123,023	(99,937)	144,989
Containers	247,124	477,109		724,233
Production equipment	437,361	726,007	(36,905)	1,126,463
Security equipment	72,613	93,414		166,027
Computer equipment	78,238	85,453		163,691
Computer software	13,228	19,976		33,204
Office furniture and equipment	24,634	43,449		68,083
Vehicles	<u>-</u>	<u>1,388</u>	<u>-</u>	<u>1,388</u>
	<u>1,138,226</u>	<u>1,813,887</u>	<u>(136,842)</u>	<u>2,815,271</u>
Net book value	<u>\$ 16,839,328</u>			<u>\$ 27,795,339</u>

10. INVESTMENTS

	September 30, 2019	December 31, 2018
Westleaf Inc.	\$ 1,764,000	\$ 2,759,000
Vitreous Cannabis Inc.	<u>33,333</u>	<u>-</u>
	<u>\$ 1,797,333</u>	<u>\$ 2,759,000</u>

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

10. INVESTMENTS (continued)

Westleaf Inc.

The Company entered into a limited partnership agreement with Westleaf Cannabis Inc. ("Westleaf") on April 18, 2018 to create a strategic partnership for the joint development of a large-scale cannabis production facility located in Southern Alberta (the "Westleaf Project"). Pursuant to the terms of the agreement, the Company and Westleaf Cannabis will each own a 50% equity interest in the Westleaf Project, which will include the retrofit of an existing building that is intended to be equipped to produce approximately 4,000 kilograms of dried cannabis flower per annum and include an extraction lab for the production of cannabis oil and derivative products.

The Company and Westleaf Cannabis had each advanced \$3,000,000 for their 50% equity interest in the Westleaf Project. Certain cannabis genetics products will be provided to the Westleaf Project by the Company. Westleaf Cultivation Management II Inc., a wholly owned subsidiary of Westleaf Cannabis, will act as manager of the Westleaf Project.

As at December 31, 2018, the Company's investment was adjusted by \$241,000 being its share of loss from the limited partnership.

During the first quarter of 2019, the Company sold its 50% interest in the limited partnership to Westleaf Inc. Under the agreement for sale, Westleaf Inc. issued an aggregate of 5,600,000 common shares in the capital of Westleaf in consideration for the acquisition of Delta 9's 50% interest in the limited partnership. The purchase price was based on the closing price of the Westleaf Inc. shares on the TSX Venture Exchange of \$3.60 per Westleaf Inc. share on January 31, 2019. On closing, the Company entered into a voluntary escrow agreement that in addition to the four month restricted period required by law, restricts the transfer of the Westleaf Inc. shares issuable under the agreement as to: (i) 1,000,000 Westleaf Inc. shares for a four month period following closing; and (ii) 4,600,000 Westleaf Inc. shares for an eight month hold period following closing. The transaction was completed on January 31, 2019 and a gain on disposal in the limited partnership was recorded in Consolidated Statement of Net Income and Comprehensive Income..

Vitreous Cannabis Inc.

During the period, the Company has made an initial strategic investment by subscribing to 333,333 Class A common shares of Vitreous Cannabis Inc. for gross proceeds of \$33,333. Vitreous will develop a cannabis cultivation facility in Ontario once they obtain a license from Health Canada under the Cannabis Act. Vitreous is also pursuing options to raise further equity.

The investment was valued based on the fair value of the consideration paid.

The Company has elected to measure investment in equity instruments of Westleaf Inc. and Vitreous Cannabis Inc. at FVTOCI on initial recognition as the investments are not held-for-trading, instead long-term and strategic in nature, and net changes in fair value are more suited to be presented in other comprehensive income.

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	September 30, 2019	December 31, 2018
Trade payables	\$ 1,482,967	\$ 4,767,676
Accrued liabilities	506,027	247,842
Excise tax payable	372,295	41,006
Social responsibility fee	615,425	
Government remittances payable	14,995	48,937
	<u>\$ 2,991,709</u>	<u>\$ 5,105,461</u>

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES *(continued)*

Effective October 17, 2018, Canada Revenue Agency ("CRA") began levying an excise tax on the sale of medical and consumer cannabis products. The Company becomes liable for these excise duties when cannabis products are delivered to the customer.

The excise tax payable is the higher of (i) a flat-rate duty which is imposed when a cannabis product is packaged, and (ii) an advalorem duty that is imposed when a cannabis product is delivered to the customer. Where the excise tax has been billed to customers, the Company has reflected the excise tax as part of revenue in accordance with IFRS 15. Net revenue as presented on the Consolidated Statements of Net Income and Comprehensive Income, represents revenue from the sale of goods less applicable excise taxes. Given that the excise tax payable/paid to CRA cannot be reclaimed and is not always billed to customers, the Company recognizes that the excise tax is an operating cost that affects gross margin to the extent that it is not recovered from its customers.

Effective January 1, 2019, Manitoba government began collecting a social responsibility levy at 6% on all retail cannabis sales.

12. CUSTOMER DEPOSITS

	September 30, 2019	December 31, 2018
Customer deposits	\$ <u>13,666</u>	\$ <u>122,102</u>

13. DUE FROM/TO RELATED PARTIES AND SHAREHOLDERS

Related entities have advanced funds to the Company through various loans, some of which were secured by a promissory note and other amounts which were unsecured with no specified terms of repayment. These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

Unsecured advances/loans from (to) related entities

1) During the period, the Chairman and Chief Executive Officer of the Company were using their personal credit cards to pay expenses of the Company. As of September 30, 2019 \$56,341 was advanced to prepay expenditures subsequent to the balance sheet date.

2) On April 1, 2017, a unanimous shareholders' agreement was signed by the shareholders of Delta 9 Lifestyle Cannabis Clinic Inc. It was agreed that the initial fixturing of the leased premises by the Clinic shall be financed by shareholder loans amounting to \$51,000 (received in July 2017) from Delta 9 Bio-Tech Inc. and \$49,000 from 7217804 Manitoba Ltd. These loans are unsecured, non-interest bearing and with no specific date of repayment. As of September 30, 2019, \$48,951 was outstanding to 7217804 Manitoba Ltd.

On September 30, 2018, a loan amounting to \$3,000,000, secured by a promissory note, was provided by Delta 9 Bio-Tech Inc. to Delta 9 Lifestyle Cannabis Clinic Inc. to finance its ongoing business operations. The loan carried interest at a rate of 5.95% per annum, compounded and accrued monthly, repayable upon demand. During the current period, the loan was converted into a new loan of \$3,060,000 at an interest rate of 3% per annum for the first six months and will increase to 6% thereafter. An additional amount of \$440,000 was provided by Delta 9 Bio-Tech Inc. to Delta 9 Lifestyle Cannabis Clinic Inc. during the third quarter of current year on the same terms and conditions.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

13. DUE FROM/TO RELATED PARTIES AND SHAREHOLDERS *(continued)*

During the current period, the minority shareholder in Delta 9 Lifestyle Cannabis Clinic Inc. also provided a loan, secured by a promissory note, amounting to \$2,500,000 to Delta 9 Lifestyle Cannabis Clinic Inc. The loan carries interest at a rate of 3% per annum for the first six months and will increase to 6% thereafter, compounded and accrued monthly.

The repayment terms on the above loans are as follows:

1) The holders of the above promissory notes shall not make demand for repayment of any amount of the principal sum until June 30, 2019.

2) From July 1, 2019 to December 31, 2019, the holders may make demand for, and Delta 9 Lifestyle Cannabis Clinic Inc. shall pay such amount of the principal sum and in such frequency as may be unanimously determined by the shareholders of Delta 9 Lifestyle Cannabis Clinic Inc.

3) From January 1, 2020 until repayment in full of the Principal Sum, the holders may make demand for and Delta 9 Lifestyle Cannabis Clinic Inc. shall pay such amount of the principal sum and in such frequency as may be unanimously determined by the shareholders of Delta 9 Lifestyle Cannabis Clinic Inc. However, if the shareholders of Delta 9 Lifestyle Cannabis Clinic Inc. have not unanimously determined the terms of repayment of the principal sum in full by January 1, 2020, the principal sum shall be repayable in equal monthly instalments over a period of sixty months commencing February 1, 2020.

The holders of promissory note may at their sole discretion elect to partially or fully convert the loan to Delta 9 Lifestyle Cannabis Clinic Inc's equity at a conversion rate of \$60,000 per common share. Such conversion may take place any time during the period commencing on the date that is six months from the date of the promissory note to the date that is ninety days prior to the maturity date of the promissory note.

In accordance with IFRS, the promissory note held by the minority shareholder in Delta 9 Lifestyle Cannabis Clinic Inc. was recorded at its fair value of \$2,123,980, discounted at a market interest rate of 10.50%. The estimated fair value of the equity component of the promissory note was recorded as part of non-controlling interest in Delta 9 Lifestyle Cannabis Clinic Inc's equity, which amounted to \$376,020. As of September 30, 2019, the carrying value of the promissory note, including accrued interest, was \$2,221,558.

The fair value on initial recognition of other promissory note held by Delta 9 Bio-Tech Inc., was \$2,979,968, resulting in residual equity component of \$520,032. As of September 30, 2019, the carrying value of the promissory note, including accrued interest, was \$3,103,073. The transactions and balances relating to this promissory note were eliminated on consolidation.

Lease Agreement with 6599362 Canada Ltd.

On March 19, 2018, the Company entered into a letter of intent and a lease agreement for an expansion facility with 6599362 Manitoba Ltd. (a company in which a director of the Company owns a 20% interest). Pursuant to the terms and conditions of the letter of intent, it is anticipated that the Company or its nominee(s) will purchase from 6599362 Manitoba Ltd. certain expansion properties consisting of three warehouse buildings having a total floor area of approximately 100,000 square feet and the approximately 40 acres of additional land located adjacent to its current production facility. Pending completion of the purchase and sale of these properties, the Company has entered into the lease agreement in respect of the expansion facility with 6599362 Manitoba Ltd. at a basic rent of \$6.60 per square foot per year (\$350,875 per year) and additional rent of \$4,440 per month. During the period, a temporary additional space was leased for a monthly rent of \$12,546. The Company is in the process of negotiating to acquire the property and until that time continues to make lease payments as per its lease agreement on a monthly basis.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

13. DUE FROM/TO RELATED PARTIES AND SHAREHOLDERS *(continued)*Lease Agreements with 3981496 MB Inc.

The Company has leased properties from 3981496 MB Inc. (a company owned by the owner of a minority shareholder corporation in Delta 9 Lifestyle Cannabis Clinic Inc.) The monthly rent for such properties is \$13,000.

Key management compensation

Key management personnel are those persons having the authority and responsibility for planning, directing, and controlling activities of the Company. The key management personnel of the Company is the executive management team and the Board of Directors.

For the nine month period ended September 30, 2019, a total compensation of \$549,732 was paid to the key management personnel. Further, share based compensation of \$462,019 was recorded in these consolidated interim financial statements for the board members and \$264,116 was recorded for key management personnel. Furthermore, the independent directors were paid a total fee of \$107,446 for attending board meetings and assisting and advising on Company's governance and reviewing and approving financial statements.

14. LEASE LIABILITIES

Note 3 explains the changes and new accounting policy introduced on January 1, 2019, resulting from the adoption of new accounting standard IFRS 16 Leases.

a) Amounts recognized in the balance sheet

The lease liability recorded on January 1, 2019 was \$7,915,627, including purchase option price for a property.

The right-of-use assets at January 1, 2019 by underlying class of asset comprise the following:

	January 1, 2019
Properties	<u>\$ 7,946,695</u>

The lease liability at September 30, 2019 and January 1, 2019 is as follows:

	September 30, 2019	January 1, 2019
Current	\$ 6,654,168	\$ 790,660
Non-current	<u>1,925,003</u>	<u>7,124,967</u>
	<u>\$ 8,579,171</u>	<u>\$ 7,915,627</u>

Previous disclosures of operating lease commitments were limited to the non cancellable operating leases. Reconciliation of lease commitment disclosed on December 31, 2018, and lease liability recorded on January 1, 2019 is as follows:

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

14. LEASE LIABILITIES *(continued)*

	January 1, 2019
Disclosed undiscounted future minimum lease payments under operating leases at December 31, 2018	\$ 2,954,972
Impact of discounting	(141,437)
Lease not yet commenced	(1,112,635)
Exercise price of a purchase option	6,250,000
Changes in underlying assumptions	(35,273)
Total lease liability	<u>\$ 7,915,627</u>

There was no net impact on retained earnings upon implementation of IFRS 16 on January 1, 2019.

The maturity analysis of the lease liability at September 30, 2019, is as follows:

	September 30, 2019
Less than one year	\$ 6,654,168
Between one and three years	930,760
Between three and five years	638,713
Between five and ten years	<u>355,530</u>
	<u>\$ 8,579,171</u>

b) Amounts recognized in the statement of net income and comprehensive income

The right-of-use assets at September 30, 2019 and the depreciation charge for the nine month period then ended are shown below by the underlying class of asset:

	September 30, 2019 Carrying Value	Depreciation charge - January to September 2019
Properties	<u>\$ 8,994,575</u>	<u>\$ 548,357</u>

During the nine month period ended September 30, 2019, two new leases for retail stores were commenced in the months of April and September 2019. The Company has used the incremental borrowing rate of 4.95% for the lease commenced in April, which was used on application of IFRS 16 at January 1, 2019, as it was still considered relevant. For the lease commenced in September, the incremental borrowing rate of 5.99% was used as the Company has recently obtained a long term loan from a bank on this rate. The present value of lease obligations of \$1,506,033 was recorded at the commencement of the lease with the corresponding right-of-use asset. Prepayments of \$37,756 were transferred to the right-of-use asset.

The lease liability at September 30, 2019 was \$8,579,171. The corresponding interest expense for the nine month period ended September 30, 2019, amounted to \$185,444. The portion of the lease payments recognized as a reduction of the lease liabilities and as a cash outflow from financing activities for the nine month period ended September 30, 2019 amounted to \$730,381. An amount of \$909 was recorded in other operating expenses for variable lease payments.

An amount of \$53,227 was recorded as sub-letting income on right-of-use assets.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

15. BORROWINGS

	September 30, 2019	December 31, 2018
Demand revolving loan for purchase of production facility - beginning balance	\$ 4,425,000	\$ 4,475,000
Non-revolving loan for purchase of equipment - beginning balance	968,933	1,000,000
Proceeds from non-revolving equipment masterline	<u>3,834,080</u>	<u>-</u>
	9,228,013	5,475,000
Less: Repayments made	357,534	81,067
Less: Current portion of borrowings	<u>1,182,870</u>	<u>478,098</u>
	<u>\$ 7,687,609</u>	<u>\$ 4,915,835</u>

On October 5, 2018, Delta 9 Bio-Tech Inc. (the "Borrower") entered into loan agreement with Canadian Western Bank (the "Bank"). The terms of the agreement were amended on August 1, 2019. Under the amended terms agreed to between the Borrower and the Bank, there will be seven separate loan segments, each of which is allocated for a different purpose, and each with its own terms. All amounts outstanding under all segments shall be repaid on demand. Unless demanded, the Bank will accept payment as mentioned below under each loan segment. Prepayment is permitted without charges with the exception of fixed rate option loans.

1) A demand operating loan of \$4,000,000 to be used to finance day-to-day operations. Interest will float at a rate of 1.00% per annum above the Bank's prime lending rate. The loan is repayable on demand. No amount was used as of September 30, 2019.

2) A demand revolving loan of \$4,500,000 which is intended to assist in financing the purchase of the Company's current production facility. Interest will initially float at 1% above prime. The loan is repayable in blended monthly principal and interest payments over 180 months. The drawdown of loan was made on October 9, 2018 to acquire Company's current production facility. The current applicable variable interest rate is 4.95% per annum.

As the variable interest rate was negotiated at arm's length (prime + 1%) and the loan is secured by a first line on the Company's assets, the financing cost reflects the market rate. However, factoring in the loan fees, the effective interest rate on the loan is 5.08%. The carrying value of the loan is calculated based on this effective rate.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

15. BORROWINGS *(continued)*

3) A demand non-revolving loan of \$4,275,000 to assist in the purchase of land and buildings. Interest will float at a rate of 1.00% per annum above prime. The loan is repayable in blended monthly principal and interest payments over 180 months. No amount was used as of September 30, 2019.

4) A non-revolving credit facility of \$1,000,000 for the purchase or lease of equipment required for the operation of the Company's business. Interest will float at a rate of 1.75% above prime. The loan is repayable in blended monthly principal and interest payments over 60 months. The drawdown of loan was made on October 9, 2018 to acquire containers. The current applicable fixed interest rate for five years is 6.02% per annum.

As the fixed interest rate was negotiated at arm's length and the loan is secured by a first line on the Company's assets, the financing cost reflects market rate and therefore the estimated fair value of this loan fairly approximates its carrying value.

5) A business visa facility of \$50,000 to provide a corporate expense account.

6) A letter of credit masterline of \$500,000 for the issue of letters of credit for the benefit of Province of Manitoba in connection with the opening of the retail stores for the sale of cannabis.

7) A non-revolving equipment masterline of \$4,000,000 to assist in financing the equipment capital expenditures. Interest will float at a rate of 1.70% above prime. The loan is repayable in blended monthly principal and interest payments over 60 months. The drawdown of loan was made on September 9, 2019 and September 16, 2019 for a total of \$3,834,080. The current applicable fixed interest rate for five years is 5.99% per annum.

As the fixed interest rate was negotiated at arm's length and the loan is secured by a first line on the Company's assets, the financing cost reflects market rate and therefore the estimated fair value of this loan fairly approximates its carrying value.

The loans are secured by:

(a) A general security agreement providing a first security interest in all present and future property to be registered in all appropriate jurisdictions over Delta 9 Bio-Tech Inc., Delta 9 Cannabis Inc. and Delta 9 Lifestyle Cannabis Clinic Inc. The agreement shall exclude cannabis products and other inventory that the Bank is not allowed to possess at law under the current legislative and regulatory scheme.

(b) General assignment of accounts receivable by the Borrower to be registered in all appropriate jurisdictions.

(c) Demand collateral mortgage in the principal amount of \$6,500,000 and conveying a first fixed charge over property to be held for all indebtedness of the Borrower.

(d) Full liability guarantee from the Company and Delta 9 Lifestyle Cannabis Clinic Inc. in favour of the Bank guaranteeing all indebtedness of the Borrower to the Bank.

(e) Assignment of bank deposit instrument in the amount of \$500,000 to be registered at the Personal Property Registry.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

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16. CONVERTIBLE DEBENTURES

	Convertible debentures debt	Convertible debentures warrants	Total
Issued - gross amount	\$ 10,608,815	\$ 1,191,185	\$ 11,800,000
Issued - broker warrants		253,193	253,193
Debenture issuance cost allocation	(1,504,606)	(168,941)	(1,673,547)
Accretion	<u>407,172</u>	<u>-</u>	<u>407,172</u>
	<u>\$ 9,511,381</u>	<u>\$ 1,275,437</u>	<u>\$ 10,786,818</u>

On July 17, 2019, the Company closed on a financing for 11,800 convertible debenture units at a price of \$1,000 dollars per unit for aggregate gross proceeds to the Company of \$11.8 million. Issuance costs including brokers fee and warrants totalled \$1.7 million for net proceeds of \$10.1 million. Each unit consists of one 8.5% unsecured convertible debenture (each a "Convertible Debenture") of the Company (each a "Warrant"). The convertible debentures will mature and be repayable on July 17, 2022. Interest is computed on the basis of a 360-day year composed of twelve 30-day months. Interest accrues at the rate of 8.5% per annum payable in arrears on the last business day of June and December of each year commencing December 31, 2019. The December 31, 2019 interest payment will represent accrued interest for the period from July 17, 2019 to December 31, 2019. Each debenture will be convertible into common shares in the capital of the Company at the option of the holder at any time prior to the earlier of: (i) the close of business on the maturity date; or (ii) if called for redemption, the business day immediately preceding the date specified by the Company for redemption of debentures, at a conversion price of \$1.21 per common share, being a conversion rate of approximately 826 common shares per \$1,000 principal amount of debentures, subject to adjustment in certain events. Each warrant will be exercisable to acquire one common share for a period of thirty-six months at an exercise price of \$1.33 per warrant, provided that if, at any time prior to the expiry date, the daily volume weighted average trading price of the common shares on the TSX Exchange, is greater than \$2.33 for 20 consecutive trading days, the Company may, within 10 business days of the occurrence of such event, deliver a notice to the holders of the warrants accelerating the expiry date to the date that is 30 days following the date of such notice. Any unexercised warrants shall automatically expire at the end of the accelerated exercise period. The warrants are trading on the TSX Exchange.

The fair value of the liability component at the time of issue of \$10.6 million was calculated using the discounted cash flows assuming a market interest rate of 12%, which was the rate estimated for the convertible debentures without the equity conversion feature or the warrants.

The fair value of the warrants component and brokers' warrants at the time of issue was estimated with a Black-Scholes valuation model as follows:

Exercise price	\$1.33
Share price	\$1.02
Risk free interest rate	1.48%
Expected life	3 years
Volatility	65%
Dividend yield	Nil

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

16. CONVERTIBLE DEBENTURES *(continued)*

Volatility was estimated by using the historical volatility of other companies that the Company considers comparable that have similar trading and volatility history. The expected life in years represents the period of time that warrants granted are expected to be outstanding. The risk-free rate is based on Canada government bonds with a remaining term equal to the expected life of the warrants.

The fair value of the warrants using the assumptions above was determined to be \$3.6 million, however, the discounted value of the liability component was determined to be \$10.6 million, therefore, the remaining amount of \$1.2 million represented the fair value of the warrants. Consequently, no amount was allocated to the convertible debenture's equity component.

The issuance costs include brokers' fee of \$826,000, 682,276 brokers' warrants (exercise price of \$1.21) with a value of \$253,193 as well as legal and other related costs.

17. SHARE CAPITAL

Authorized:

The authorized share capital of the Company consists of an unlimited number of common shares without par value.

	September 30, 2019	December 31, 2018
Issued share capital		
87,963,478 (December 31, 2018 - 85,571,993) Common Shares	\$ <u>55,378,690</u>	\$ <u>53,156,044</u>

The increase of \$2,222,646 in the value of common shares during the nine month period ended September 30, 2019 is represented by the following:

Cash subscription - net of share issue costs	\$ 1,034,465
Receivable from shareholders	520,000
Transfer from warrants and contributed surplus	<u>668,181</u>
	\$ <u>2,222,646</u>

Surplus Escrow Agreement

On October 31, 2017, the effective date of closing of the reverse acquisition transaction, the Company entered into a Surplus Security Escrow Agreement pursuant to TSXV Policy 5.4 Escrow, Vendor Consideration and Resale Restrictions. Approximately 57% of the Common Shares issued and outstanding on October 31, 2017 were initially subject to the Surplus Security Escrow Agreement. 11,139,292 shares were released before the period end, and 25,991,679 shares remained subject to the Surplus Security Escrow Agreement as at September 30, 2019.

Warrants

This represents 560,000 agent's warrants in connection with a brokered private placement of \$5,200,000, pursuant to reverse acquisition transaction between SVT and Delta 9 Bio-Tech Inc. Each warrant entitles the holder to acquire one share at the issue price of \$0.65 until October 31, 2019. As of September 30, 2019, 529,522 warrants were exercised.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

17. SHARE CAPITAL (continued)

On December 28, 2017, the Company completed a bought deal financing of 8,521,500 units which included an over-allotment of 1,111,500 units for aggregate gross proceeds of \$23,008,050 at an offering price of \$2.70 per unit. Each unit consisted of one common share of the Company and one common share purchase warrant. Each warrant is exercisable to acquire one common share at an exercise price of \$3.25 per warrant for a period of thirty months from the date of closing of the offering. The warrants are trading on TSX Exchange. No warrants were exercised as of September 30, 2019. The gross proceeds from the transaction were considered to be the fair value of shares at the time of issuance, therefore, no amount was allocated to the warrants.

596,505 agent's warrants were issued in connection with bought deal financing. Each warrant entitles the holder to acquire one share at the issue price of \$2.70 until December 28, 2019. No warrants were exercised as of September 30, 2019.

The following table provides a summary of warrants activity for the nine month period ended September 30, 2019:

	Number of warrants	Weighted Average Exercise Price
Outstanding, beginning of period	9,148,483	\$ 3.21
Issued	10,429,076	1.32
Exercised		
Outstanding, end of period	19,577,559	\$ 2.20

Option plan

On May 2, 2017, the Board of Directors approved the 2017 Stock Option Plan ("2017 Plan") to retain and attract directors, officers and key employees. This replaces and terminates the former option plan, which had no outstanding options.

On October 31, 2017, the effective date of closing of the reverse acquisition transaction, the Board of Directors approved the grant of 5,116,258 stock options to directors, officers, employees, and consultants, exercisable at \$0.65 each. The first vesting date for options was April 30, 2018. As of September 30, 2019, 1,600,000 options were exercised by the chairman and chief executive of the Company, 300,000 options were exercised by directors of the Company, 493,133 options were exercised by key management and 312,321 by the employees and consultants, and 426,675 stock options were forfeited due to certain employees who left the service of the Company prior to respective vesting dates. On March 29, 2019, the Board of Directors approved accelerating the vesting dates for this grant falling due on April 30 and October 31, 2019 to March 31, 2019. Based on this acceleration, an amount of \$200,845 was recorded in share based compensation on these stock options, for the three month period ended March 31, 2019.

On January 22, February 20 and September 12, 2018 the Board of Directors approved further grants of 671,700, 376,500 and 3,000,000 stock options respectively, to directors, officers, employees, and consultants, exercisable at \$2.77, \$2.30 and \$1.79 respectively, subject to the following vesting provision:

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

17. SHARE CAPITAL *(continued)*

Stock options granted on January 22, 2018:

- One third immediately on grant date;
- One third on July 22, 2018; and
- One third on January 22, 2019.

Stock options granted on February 20, 2018:

- One third on June 20, 2018;
- One third on October 20, 2018; and
- One third on February 20, 2019.

Stock options granted on September 12, 2018:

- 25% on March 12, 2019;
- 25% on September 12, 2019;
- 25% on March 12, 2020; and
- 25% on September 12, 2020.

485,219 stock options were forfeited due to certain employees who left the service of the Company prior to respective vesting dates. No options were exercised as of September 30, 2019.

An amount of \$1,007,526 was recorded in share based compensation on these stock options, for the nine month period ended September 30, 2019.

The following table provides a summary of stock option activity for the nine month period ended September 30, 2019:

	Number of options	Weighted Average Exercise Price
Outstanding, beginning of period	8,409,014	\$ 1.29
Granted		
Exercised	2,391,485	\$ 0.65
Forfeited	470,419	\$ 1.96
Outstanding, end of period	5,547,110	\$ 1.51

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

17. SHARE CAPITAL *(continued)*

The following table provides a summary of stock options outstanding as of September 30, 2019:

Grant date	Expiry date	Number of options outstanding	Exercise price
October 31, 2017	October 31, 2022	1,984,129	\$ 0.65
January 22, 2018	January 22, 2023	533,700	\$ 2.77
February 20, 2018	February 20, 2023	343,500	\$ 2.30
September 12, 2018	September 12, 2023	<u>2,685,781</u>	\$ 1.79
		<u>5,547,110</u>	

All options granted during 2017 and 2018 will expire five years from the grant date.

18. NON-CONTROLLING INTEREST

At September 30, 2019, the non-controlling interest represented a 49% interest in Delta 9 Lifestyle Cannabis Clinic Inc.

19. REVENUE

	September 30, 2019	September 30, 2018
Revenue from sale of cannabis:		
Wholesale	\$ 8,086,797	\$ 765,929
Retail	10,316,114	
Medicinal	250,746	632,290
Business to business	2,433,111	758,064
Merchandise and devices	497,956	34,545
Other	<u>140,723</u>	<u>108,238</u>
	21,725,447	2,299,066
Excise taxes	(544,971)	-
Net Revenue	<u>\$ 21,180,476</u>	<u>\$ 2,299,066</u>

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

20. EXPENSES

The Company presents its Consolidated Statements of Net Income and Comprehensive Income on a functional basis in which expenditures are aggregated to the function to which they relate. The Company has identified the major functions as general and administrative and sales and marketing.

Three month period ended September 30, 2019	General and administrative	Sales and marketing	Total
Amortization	\$ 738,573	\$ 210,146	\$ 948,719
Insurance	31,099	16,191	47,290
Legal, professional, consulting and investor relations	230,249	33,207	263,456
Other operating expenses	312,070	244,989	557,059
Personnel expenditures	1,082,133	596,474	1,678,607
Utilities	25,879	5,665	31,544
Site renovation	18,947		18,947
Supplies and materials	<u>242,438</u>	<u>44,486</u>	<u>286,924</u>
	<u>\$ 2,681,388</u>	<u>\$ 1,151,158</u>	<u>\$ 3,832,546</u>

Three month period ended September 30, 2018	General and administrative	Sales and marketing	Total
Amortization	\$ 193,400	\$	\$ 193,400
Insurance	27,840		27,840
Legal, professional, consulting and investor relations	830,170		830,170
Other operating expenditures	80,001	194,251	274,252
Personnel expenditures	853,409	105,887	959,296
Rent and utilities	292,520		292,520
Site renovation	364,987		364,987
Supplies and materials	<u>115,125</u>	<u>-</u>	<u>115,125</u>
	<u>\$ 2,757,452</u>	<u>\$ 300,138</u>	<u>\$ 3,057,590</u>

Nine month period ended September 30, 2019	General and administrative	Sales and marketing	Total
Amortization	\$ 1,867,581	\$ 494,663	\$ 2,362,244
Insurance	229,763	40,337	270,100
Legal, professional, consulting and investor relations	1,089,560	178,439	1,267,999
Other operating expenses	928,565	861,743	1,790,308
Personnel expenditures	3,211,504	1,698,176	4,909,680
Utilities	211,756	18,373	230,129
Research and development	250,000		250,000
Site renovation	43,755		43,755
Supplies and materials	<u>1,376,607</u>	<u>153,166</u>	<u>1,529,773</u>
	<u>\$ 9,209,091</u>	<u>\$ 3,444,897</u>	<u>\$ 12,653,988</u>

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

SEPTEMBER 30, 2019

20. EXPENSES (continued)

Nine month period ended September 30, 2018

	General and administrative	Sales and marketing	Total
Amortization	\$ 341,078	\$	\$ 341,078
Insurance	81,586		81,586
Legal, professional, consulting and investor relations	1,813,180		1,813,180
Other operating expenditures	340,246	411,374	751,620
Personnel expenditures	1,785,291	277,742	2,063,033
Rent and utilities	1,013,993		1,013,993
Site renovation	605,896		605,896
Supplies and materials	<u>213,401</u>	<u>-</u>	<u>213,401</u>
	<u>6,194,671</u>	<u>\$ 689,116</u>	<u>\$ 6,883,787</u>

21. FINANCE INCOME (EXPENSE)

	September 30, 2019	September 30, 2018
Interest revenue	\$ 21,841	\$ 3,480
Interest expense:		
Interest and bank charges	(88,315)	(23,202)
Interest on loans	(383,032)	(25,000)
Interest on leases	(185,444)	
Interest on debentures	<u>(407,173)</u>	<u>-</u>
	<u>\$(1,042,123)</u>	<u>\$(44,722)</u>

22. EARNINGS PER SHARE

Basic earnings per share

Basic EPS is calculated by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the period.

	September 30, 2019	September 30, 2018
Net income attributable to common shareholders	\$ 14,024,373	\$(6,344,141)
Weighted average number of common shares	<u>87,075,168</u>	<u>79,831,547</u>
Basic earnings (loss) per share	<u>\$ 0.16</u>	<u>\$(0.08)</u>

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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22. EARNINGS PER SHARE *(continued)*Diluted earnings per share

Diluted EPS was calculated by dividing the applicable net income by the weighted average number of common shares outstanding, adjusted for the effects of all dilutive potential common shares, which comprise warrants and share options issued. However, the calculation of diluted earnings per share excludes the effects of various conversions and exercise of options or warrants that would be anti-dilutive.

	September 30, 2019	September 30, 2018
Adjusted net income attributable to common shareholders	\$ 14,431,546	\$(6,344,141)
Weighted average number of common shares	87,075,168	79,831,547
In the money stock options outstanding	976,563	
In the money warrants outstanding	52,313	
Number of shares on conversion of debentures	<u>9,746,800</u>	<u>-</u>
Weighted average number of common shares for diluted EPS	<u>97,850,844</u>	<u>79,831,547</u>
Diluted earnings (loss) per share	\$ <u>0.15</u>	\$(<u>0.08</u>)

23. COMMITMENTS

On June 27, 2018 the Company entered into a supply agreement with Manitoba Liquor & Lotteries Company (MBLL) to supply the Province of Manitoba with a minimum of 2,300,000 grams of recreational dried cannabis products over the one-year term of the agreement. Under the supply agreement, MBLL supplies Manitoba retailers with a range of Delta 9 products ranging from Delta 9's lower-end "House Blend" to a selection of Delta 9's premium cannabis products.

The Company entered into a definitive agreement with Auxly Cannabis Group Inc. whereby Auxly has the right to purchase a fixed amount of dried cannabis and cannabis trim from the Company for a period of 10 years. Effective January 1, 2019 and until January 1, 2029, Auxly will have the right to purchase 1,000 kilograms of dried cannabis per annum as well as 100 kilograms of cannabis trim. In addition, effective July 1, 2020 and until July 1, 2030, Auxly will have the right to purchase an additional 4,000 kilograms per annum as well as 400 kilograms of cannabis trim.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

24. INCOME TAXES

There are no current income taxes payable for the period ended September 30, 2019. The deferred income tax recovery for the period ended September 30, 2019 and for the year ended December 31, 2018 consists of the following:

	September 30, 2019	December 31, 2018
Net income (loss) before income taxes	\$ 13,731,211	\$ (8,584,531)
Statutory rates:	<u>27%</u>	<u>27%</u>
Income tax recovery based on statutory rate	3,707,427	2,317,823
Deferred income tax not recognized	<u>(3,707,427)</u>	<u>(2,317,823)</u>
Income tax expense per financial statements	\$ <u>-</u>	\$ <u>-</u>

As at September 30, 2019, the Company has \$17,745,678 of non-capital losses that expire as follows:

2032	\$ 587
2033	73,021
2034	643,155
2035	1,004,283
2036	1,305,720
2037	4,657,473
2038	<u>10,061,439</u>
	<u>\$ 17,745,678</u>

Deferred tax assets are not recognized in these consolidated financial statements because the Company is in its start-up phase and realization of these deferred tax assets is contingent on future profits.

25. FINANCIAL INSTRUMENTS

As at September 30, 2019, the Company's financial instruments consist of cash and cash equivalents totaling \$10,215,102 trade and other receivables totaling \$4,654,672, net amount due from related parties totaling \$7,390, accounts payable and accrued liabilities totaling \$2,991,709, customer deposits totaling \$13,666, loan from related parties totaling \$2,221,558, lease liability totaling \$8,579,171, bank borrowings totaling \$8,870,479 and convertible debentures totalling \$9,511,381.

As at September 30, 2019, there were no significant differences between the carrying values of these items and their estimated fair values.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS
(UNAUDITED)**26. FINANCIAL RISK AND CAPITAL MANAGEMENT**

In the normal course of business, the Company is exposed to a variety of financial risk: market risk, credit risk, and liquidity risk.

Financial Risk Factors*Market Risk*

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises two types of risk: currency risk and interest rate risk.

1. Currency risk is the risk to the Company's earnings that arise from fluctuations of foreign exchange rates. The Company is not exposed to foreign currency exchange risk as it has no financial instruments denominated in a foreign currency.

2. Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Borrowings issued at variable interest rates expose Company to cash flow interest rate risk. The remaining outstanding demand revolving loan is subject to variable interest rate. In 2019 the Company has not entered interest rate swap to mitigate this cash flow interest rate risk.

An increase of 1% in the floating interest rate with all other variables held constant, would result in an insignificant increase to interest expense for the year.

Price Risk

Other price risk relates to the possibility that the fair value of future cash flows from financial instruments will change due to market fluctuations (other than due to currency or interest rate movements). The shares of Westleaf Inc. are listed on the Toronto Venture Exchange, and are recognized in these financial statements at \$0.315 per share. Management concluded that no further impairment is required on this investment at September 30, 2019.

Credit Risk

Credit risk arises from deposits with banks, short-term investments and outstanding receivables. For trade receivables, the Company does not hold any collateral as security but mitigates this risk by dealing only with what management believes to be financially sound counterparties and accordingly does not anticipate significant loss from non-performance. The exposure on trade receivables is minimal since 63% of the amount due is from a provincial government and a government agency. There is no material exposure to credit risk on cash and cash equivalents as cash balances are held by highly reputable, large financial institutions.

Liquidity Risk

The Company's liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company controls liquidity risk by management of working capital, cash flows and the issuance of share capital. The following table analyses the Company's financial liabilities, including commitments, based on the remaining period at the balance sheet date to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

NOTES TO CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

26. FINANCIAL RISK AND CAPITAL MANAGEMENT *(continued)*

Payment due:	Total	Within 1 year	1 - 3 years	3 - 5 years
Trade payables and other payables	\$ 2,991,709	\$ 2,991,709	\$	\$
Loan from related parties	2,221,558	475,833	1,197,500	548,225
Lease liabilities	8,579,171	6,654,168	930,760	638,713
Convertible debentures	9,511,381	958,422	8,552,959	
Borrowings	<u>8,870,479</u>	<u>1,182,870</u>	<u>2,518,305</u>	<u>2,469,301</u>
Total contractual obligations	<u>\$ 32,174,298</u>	<u>\$ 12,263,002</u>	<u>\$ 13,199,524</u>	<u>\$ 3,656,239</u>

At September 30, 2019, the Company's unrestricted financial assets of \$14,227,164 were sufficient to meet all contractual obligations due within the next twelve months.

Capital Management

The Company's key objectives when managing capital are to maintain a strong capital base in order to:

- maintain investor, creditor and market confidence
- advance the Company's corporate strategies to generate attractive risk-adjusted return over the long-term for the shareholders
- sustain the Company's operations and growth through all cycles; and
- ensure compliance with the covenants of any applicable credit facility and other financing facilities.

Management monitors the Company's capital and capital structure on an ongoing basis to ensure it is sufficient to achieve the Company's short-term and long-term objectives.

27. SEGMENTED INFORMATION

The Company operates in one segment, the production, distribution and sale of medical and recreational cannabis and related merchandise and devices. All property, plant and equipment are located in Canada. All revenues were principally generated in Canada. The chief operating decision maker (the Company's chief executive officer) evaluates the Company's operating performance and allocates resources based on information provided at a consolidated level.

28. NON-CASH TRANSACTIONS IN CASH FLOW STATEMENT

Following are the non-cash transactions in the statement of cash flows for the nine month period ended September 30, 2019:

- Prepayments of \$418,825 transferred to right-of-use assets on application of IFRS 16.
- Fair value of biological assets in finished goods inventory increased by \$1,451,545.

29. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the current period's presentation.

- Net finance income is now presented in other income on the statements of net income (loss) and comprehensive loss as compared to interest expense which was previously included in general and administrative expenses.