Auxly

AUXLY CANNABIS GROUP INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE THREE AND TWELVE MONTHS ENDED DECEMBER 31, 2022

Dated March 30, 2023

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MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("**MD&A**") was prepared as of March 30, 2023 unless otherwise indicated. This MD&A reviews the operating results, financial position and liquidity of Auxly Cannabis Group Inc. ("**Auxly**", "**we**", "**our**", or the "**Company**"). All amounts are stated in millions of Canadian dollars unless otherwise noted, except common shares ("**Shares**"), options, warrants, and per Share amounts. This MD&A should be read in conjunction with the consolidated financial statements and accompanying notes thereto for the year ended December 31, 2022.

This MD&A may contain forward-looking information that is based on the Company's expectations, estimates and projections regarding its business and the economic environment in which it operates. Forward-looking information contained herein is made as of the date of this MD&A and is not a guarantee of future performance and involves risks and uncertainties that are difficult to control or predict. Readers should refer to the "*Forward Looking Statements*" section in this MD&A. This MD&A references certain financial measures, including non-GAAP measures and readers should refer to the "*Non-GAAP Measures*" section in this MD&A.

DESCRIPTION OF BUSINESS

Our Business

We are a leading Canadian consumer packaged goods company in the cannabis products market, headquartered in Toronto, Canada. Our focus is on developing, manufacturing and distributing branded cannabis products that delight our consumers.

Our vision is to be a leader in branded cannabis products that deliver on our consumer promise of quality, safety and efficacy.

Canadian Market

On October 17, 2018, the Cannabis Act came into force, initially permitting the recreational sale of certain classes of cannabis products, including dried cannabis, fresh cannabis, cannabis plants, cannabis seeds, and cannabis oil (collectively referred to as "**Cannabis 1.0 Products**"). On October 17, 2019, edible cannabis, cannabis extracts and cannabis topicals were added to the authorized classes of cannabis (collectively referred to as "**Cannabis 2.0 Products**", and together with Cannabis 1.0 Products, collectively referred to as "**Cannabis Products**") and such Cannabis 2.0 Products were first available for sale on December 16, 2019. Since 2019, Health Canada undertook a consultation, established a Scientific Advisory Committee, and has been engaged in discussions regarding the possible legalization of Cannabis Health Products, which would permit the making of health claims in respect of cannabis products without the required oversight of a practitioner, such as a doctor, but such products are not currently permitted.

Canadian Strategy and Capabilities

Brand Portfolio and Product Offering

We have created a portfolio of brands designed for a broad market of cannabis consumers, with differentiation in price points across targeted consumer segments.

Our Brands

PARCEL
Parcel delivers on its promise – high quality cannabis for less. No bells, no whistles, just really good cannabis grown by really good people.

BACK FORTY
Take a Trip. Explore the Back Forty. Back Forty is all about embracing simplicity, getting back to basics and not taking life too seriously. Back Forty's mission is to bring to consumers a simple, uncomplicated cannabis product that already feels familiar.

FORAY
Foray is a versatile, modern, and inviting cannabis brand, designed for the curious. Foray is an accessible entry point for anybody—at any stage of their cannabis journey. Designed for the curious, Foray is an approachable brand that aims to both celebrate and guide one's foray into cannabis, ultimately inviting them to see cannabis differently.

DOSECANN
We believe in the natural potential of cannabis. Backed by science and advanced research and development, Dosecann products are driving today's innovation and establishing tomorrow's standards. Cannabis down to a science.

KOLAB PROJECT
Offering a refined collection of high quality cannabis products and design-focused, purposeful goods. We connect consumers with a carefully selected group of collaborators in order to create experiences that are inspired by the ever-evolving world we live in.

Based upon consumer insights, Auxly has developed a broad portfolio of Cannabis Products to meet the evolving needs and preferences of Canadian cannabis consumers. Our initial focus was on the development of Cannabis 2.0 Products and we were one of the first cannabis companies to distribute and sell Cannabis 2.0 Products across Canada following their legalization.

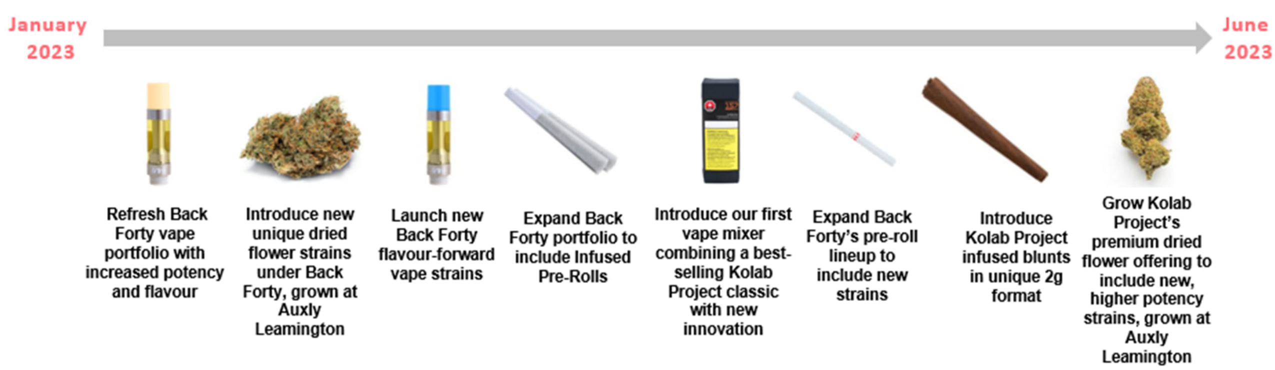
We were the top-selling licensed producer of Cannabis 2.0 Products nationally for the past three years. We have continued to introduce a variety of Cannabis Products to the market throughout 2022, ranking among the top 10 licensed producers in Canada by total recreational retail sales as reported by Headset Canadian Insights Data ("Headset")[1].

Our Cannabis Products available during the fourth quarter of 2022 are described below by brand and product format:

Products Available by Brand

KOLAB PROJECT	Dosecann	BACK FORTY	Foray	Parcel
510 Vape Cartridges All-in-one Vape Pens Dried Flower Pre-rolled Cannabis Infused Pre-rolls Concentrates Chocolates Soft Chews	Cannabis Oil Drops Capsules Topicals	510 Vape Cartridges Dried Flower Milled Flower Pre-rolled Cannabis Infused Pre-rolls Chocolates Soft Chews	510 Vape Cartridges All-in-one Vape Pens Chocolates Soft Chews	Dried Flower Milled Flower

Our Cannabis Products have been well received by consumers. We plan to further strengthen our brand recognition by using consumer insights to drive innovation as we continue to introduce new Cannabis Products to the Canadian market, with an emphasis on expanding our dried flower, vape and pre-roll offerings. The Company's upcoming product offerings are presented below:



[1] Data provided by Headset as at March 8, 2023

Distribution

Given the current provincial legislative framework in Canada, we have pursued a multifaceted strategy to gain access to Canadian consumers. This includes supply arrangements with provincial control boards and retailers, including our partnership with Medical Cannabis by Shoppers Drug Mart Inc., and strong relationships with major Canadian retailers. Prior to the fourth quarter of 2022, Auxly's sales were supported by an externally managed sales team, but the Company now conducts its sales through an internal sales team.

We have secured listings and sold our Cannabis Products in all provinces except Quebec. We have obtained the necessary pre-authorization to enter into public contracts in Quebec and continue to explore listings for certain products that comply with Quebec's regulatory requirements. In the fourth quarter of 2022, the Company began its first wholesale bulk sales of dried cannabis intended for sale in the Quebec market.

Cannabis Operations: Cultivation, Product R&D and Manufacturing

Auxly Charlottetown

In May 2018, we acquired our subsidiary Auxly Charlottetown Inc. ("**Auxly Charlottetown**"), and its purpose-built, GMP-compliant cannabis processing facility located in Charlottetown, Prince Edward Island. The Company conducts its primary extraction, product development, manufacturing and R&D activities for its Cannabis Products in-house at the Auxly Charlottetown facility. Auxly Charlottetown holds licences for processing, analytical testing and research under the Cannabis Act. The full perimeter of the 52,000 square foot facility is currently licensed under the Cannabis Regulations for the production, storage and sale of Cannabis Products.

Product development is led by Auxly Charlottetown's team, who have experience in the pharmaceutical, food, scientific research and product development fields. As the Company's manufacturing hub, this facility provides the Company with the ability to be responsive to changing industry regulation and evolving consumer preferences. Auxly Charlottetown is authorized to conduct broad in-house analytical and sensory testing, incorporating consumer input and feedback on attributes such as flavour, aroma, texture or mouthfeel, to better evaluate later-stage product formulations. In December 2022, the Company also obtained a research licence to conduct sensory testing at its head office in Toronto.

For the year ending December 31, 2022, expenditures of approximately $1.1 million were made towards automation initiatives at the Auxly Charlottetown facility. The Company anticipates that expenditures of approximately $Nil-0.5 million will be made towards the purchase of automation equipment, the expansion of throughput capabilities and security enhancements at the facility in 2023.

Auxly Ottawa

In October 2017, we acquired our subsidiary Auxly Ottawa Inc. ("**Auxly Ottawa**") and its facility located in Carleton Place, Ontario. Auxly Ottawa holds licences for cultivation and processing under the Cannabis Act. In 2020, we ceased cultivation at the facility and shifted focus to the manufacturing, processing and distribution of pre-roll and dried flower Cannabis Products. Auxly Ottawa processes and packages certain of the Company's Cannabis 1.0 Products, including Kolab Project 950 Series dried flower and pre-rolls, Back Forty 40s pre-rolls, and Back Forty and Parcel dried and milled flower.

Over the past two years, the Company undertook new capital projects to increase pre-roll production volumes and output from the Auxly Ottawa facility through the purchase, installation and commissioning of automated manufacturing and packaging equipment and minor associated building alterations. Supply chain issues resulted in significant delays in receipt of both the manufacturing equipment and the technical support required to complete commissioning for full scale production. The pre-roll packaging automation equipment is operational and the Company expects to see continued increases in production in Q1 2023, however, the Company continues to work closely with the manufacturer to commission the equipment as it is currently operating below specification. For the year ending December 31, 2022, expenditures of approximately $2.5 million were made towards dried flower and pre-roll automation initiatives. We expect to incur expenditures of approximately $2.5-3.5 million towards capital projects focused on pre-roll cannabis filling machinery and dried flower and pre-roll packaging automation throughout 2023.

Auxly Leamington

We simplified our cultivation supply chain through the acquisition of 100% of Auxly Leamington Inc. ("**Auxly Leamington**") on November 22, 2021. Auxly Leamington provides the Company with a secure and cost-efficient source of dried cannabis, milled flower and extraction materials. Prior to the acquisition of Auxly Leamington, the Company was dependent on third party wholesale purchases. Auxly also began its first wholesale bulk cannabis sales from the Auxly Leamington facility starting in the fourth quarter of 2022 and intends to continue to increase its wholesale bulk cannabis sales throughout 2023.

Auxly Leamington is comprised of a 1.1 million square foot automated greenhouse in Leamington, Ontario, which holds licences for cultivation and processing under the Cannabis Act, authorizing the cultivation, processing, storage and sale of Cannabis Products. Auxly Leamington utilizes a perpetual harvest methodology resulting in a continuous supply of cannabis and flexibility to adjust production capacity to demand as required. On October 26, 2022, Auxly Leamington received approval under the Cannabis Act for an additional cannabis storage area, resulting in a 12,156 square foot expansion of its licensed perimeter. Auxly Leamington intends to use this environmentally controlled expansion to increase its storage and manufacturing capabilities. The total area of the licensed perimeter at Auxly Leamington for cultivation, processing and storage stands at 876,270 square feet. Auxly Leamington is producing award-winning cannabis strains, including popular Back Forty strains; innovative and unique strains under Kolab Project; and high-quality value strains under the newly launched brand Parcel all of which are sold to and used by the Company in its full suite of Cannabis Products across all Auxly brands. In addition, Auxly Leamington possesses an extensive genetic library and continues to evaluate all opportunities to acquire new cultivars suited for Auxly's portfolio of Cannabis Products. For the year ended December 31, 2022, expenditures of approximately $4.0 million were made towards capacity expansion, equipment and post-harvest automation. We expect to incur expenditures at the Leamington facility of approximately $2.0-3.0 million towards capital projects throughout 2023 to increase staff housing, implement alternate post-harvest drying methods and purchase equipment to support higher output from the facility.

Funding for the initial project budget was provided by the Company in the form of an equity contribution and a subordinated promissory note totaling approximately $98.5 million provided prior to 2020, and a $84 million secured credit facility underwritten by a syndicate of lenders led by the Bank of Montreal ("**BMO**"). The Company's contribution along with the credit facility comprised the required expenditures for the initial budgeted construction of the facility. Concurrently with the Auxly Leamington acquisition, the Company and Auxly Leamington amended and restated the secured credit facility with BMO and the same syndicate of lenders thereby remedying the defaults noted by BMO on April 16, 2021. Under the amended and restated secured credit agreement ("**ARCA**"), Auxly made a $15 million cash payment towards the outstanding principal balance of the credit facility and the maturity date of the credit facility was extended to September 30, 2023. The obligations of Auxly Leamington under the credit facility also continue to be supported by an unsecured $33 million limited resource guarantee provided by the Company.

Auxly Leamington informed the syndicate of lenders that it did not wish to exercise its option to extend the maturity date for an additional year by making a further principal repayment of $5 million by December 31, 2022. As at December 31, 2022 Auxly Leamington was in compliance with its covenants under the credit facility, including all financial covenants. Upon filing this MD&A and the corresponding financial statements, the Company will breach a reporting covenant under the ARCA due to the inclusion of the going concern qualifications herein. The Company has received a waiver from the syndicate of lenders for such breach.

Auxly Annapolis and Auxly Annapolis OG

On February 7, 2022, Auxly announced that it had ceased operations at the Auxly Annapolis Inc. ("**Auxly Annapolis**") and Auxly Annapolis OG Inc. ("**Auxly Annapolis OG**") facilities and its intention to divest of these non-core assets and apply the proceeds from any such sale to support its ongoing operations. On July 5, 2022, Auxly announced that it had closed the sale of the Auxly Annapolis indoor facility to a private purchaser for total proceeds of $6 million. On August 10, 2022, Auxly announced that it had closed the sale of the Auxly Annapolis OG outdoor facility to a private purchaser for total proceeds of $4.1 million.

Strategic Partner

Imperial Brands

Through our strategic partnership with Imperial Brands PLC ("**Imperial Brands**"), Auxly was granted global licenses to Imperial Brands vaping technology for cannabis uses, and access to its vapour innovation business, Nerudia, and Imperial Brands will use Auxly as its exclusive partner for the future development, manufacture, commercialization, sale and distribution of cannabis products of any kind anywhere in the world. Auxly has elected to its Board of Directors one out of six director nominees and one non-voting observer, each designated by Imperial Brands. Auxly will continue to leverage the expertise of these Imperial Brands representatives to improve its corporate and product stewardship governance practices. On November 1, 2021, Murray McGowan, Chief Strategy and Development Officer for Imperial Brands, was appointed to Auxly's Board of Directors as Imperial Brands' director nominee. Mr. McGowan replaced the previous Imperial Brands' nominee Conrad Tate. Mr. Tate left Imperial Brands in October 2021, but, at the request of the Company, agreed to remain on the Board of Directors as an independent director.

International Operations

Presently the Company does not have any active international operations. In the third quarter of 2020, the Company ceased all activities at its subsidiary Inverell S.A. ("**Inverell**") in Uruguay due to the slower than anticipated pace of cannabis-specific regulatory development in Latin America. Auxly is continuing to monitor the progress of other jurisdictions towards recreational and medical cannabis legalization, including the United States and Europe.

OUTLOOK

In 2022, we committed to building on our success as a Canadian market leader. We planned on driving organic growth through continued innovation, increasing brand traction, and strengthening distribution, while prioritizing operational efficiencies and profitability. Our high-level objectives for 2022 were:

- Improve revenue and Gross Profit Margin to achieve positive Adjusted EBITDA
    - Our key priority in 2022 was to achieve Adjusted EBITDA profitability by continuing to grow top line revenue while enhancing Gross Profit Margins through leveraging the increasing flower output from our Auxly Leamington facility, focused and differentiated brand and product offerings, increased depth and breadth of distribution, and cost optimization through investments in automation to increase production capabilities and efficiency and continuous improvement initiatives.
- Win with consumers and increase brand traction
    - We continue to be deeply committed to understanding our targeted consumers and to developing products and brands that help them live happier lives. Driven by deep consumer insights, we will continue to evolve our brand portfolio to earn and maintain the trust and loyalty of our customers and consumers and be the choice of consumers in-store. We will service the evolving preferences of our consumers by bringing new and innovative branded products to market and ensuring that our consumers can access those products broadly and reliably.

Looking back on the year, the Canadian cannabis industry continued to face challenges posed by increasing competition and fragmentation, oversupply of cannabis, high taxation, restrictive regulations, a robust illicit market and severe price compression, which were further exacerbated by inflation, global conflict, negative macroeconomic impacts from the COVID-19 pandemic, global supply chain disruptions, and constrained capital markets.

In light of these challenges, we adapted our approach, and at the end of the third quarter, streamlined our product assortment to run off certain low-margin or low-demand SKUs and increased our focus on the dried flower, pre-roll and vape product categories. Concurrently, we reduced costs throughout the organization, and internalized our sales team providing us with a sales team that focuses exclusively on our brands and products when communicating with our retail partners. While we did not meet all of our objectives for 2022, we are pleased with the progress made during the year and, in particular, with the impact that our actions taken at the end of the third quarter have had on our business. We have seen improvements in our margins, our fourth quarter sales (even with fewer SKUs), especially in the key dried flower and pre-roll categories, and material improvements in our Adjusted EBITDA resulting from significant reductions in our supporting cost structure.

As a backdrop to the year ahead, we have been working hard on updating and expanding our dried flower and pre-roll product portfolio utilizing Auxly Leamington's competitive advantage of high-quality, large-scale and low-cost cultivation. Starting in 2023, we have increased our listed flower SKUs by 60% and pre-roll SKUs by 50% as compared to September 30, 2022. We are entering 2023 with improved earnings performance, increased focus on key product formats, lowered costs and increased efficiency, which we expect will yield positive results. With these actions in mind, our goals for the coming year are broadly defined below:

- Increase net revenues by 15%, with a focus on key product categories, enhanced by strategic expansion of our product portfolio, while supporting strong retail distribution through our internal sales team.
- Continue to leverage Auxly Leamington's large-scale, low-cost cultivation facility and the Company's manufacturing automation to increase blended Cost of Finished Cannabis Inventory Sold Margin to an average of 35-40%.
- Vigorously manage SG&A as a percentage of net revenues to keep it below 40%, further building upon savings realized in Q4 2022.
- Prudently manage the Company's balance sheet and streamline assets where possible.

We believe we have an achievable plan built upon proven demand for our products, outstanding employees, top-tier assets and an underlying desire to continue to put our consumers first by delivering safe, effective, high-quality products that address their evolving needs and preferences and help them live happier lives.

RECENT DEVELOPMENTS: Fourth Quarter 2022 To Date

Auxly Closes $3.36 Million Private Placement

On February 15, 2023, the Company closed a private placement for 96,000,000 Shares at a price of $0.035 per Share and 96,000,000 warrants, with each warrant entitling the investors to purchase one Share at an exercise price of $0.045 per Share at any time up until February 15, 2028, resulting in total gross proceeds of approximately $3.36 million, before deducting any applicable fees or expenses.

On February 10, 2023 as part of the $3.36 million private placement, the Company announced that it intends to amend the terms of 27,381,500 Share purchase warrants (the "**Bought Deal Warrants**") which were issued pursuant to a bought deal financing completed on June 14, 2021. The Bought Deal Warrants currently have an exercise price of $0.38 per Share and expire on June 14, 2024. The purpose of the proposed amendments is to (i) reduce the exercise price of the Bought Deal Warrants from $0.38 to $0.045 per Share, and (ii) extend the expiry date of the Bought Deal Warrants from June 14, 2024 to June 14, 2026 (the "**Bought Deal Warrant Amendments**"). The Bought Deal Warrant Amendments are subject to the completion of formal documentation and the Company receiving all necessary approvals, including any required approvals from the holders of the Bought Deal Warrants under the terms of the indenture governing the Bought Deal Warrants. As of the date hereof, the Bought Deal Warrant Amendments have not yet become effective.

FINANCIAL HIGHLIGHTS AND KEY PERFORMANCE INDICATORS

For the years ended December 31: (000's)	**2022**	2021	2020	Change 2022	Change 2021
Total net revenues	**94,472**	83,829	46,719	10,643	37,110
Net income/(loss)*	**(130,293)**	(33,739)	(85,426)	(96,554)	51,687
Net income/(loss) from continuing operations*	**(130,293)**	(45,895)	(83,889)	(84,398)	37,994
Adjusted EBITDA**	**(16,878)**	(21,672)	(28,523)	4,794	6,851
Weighted average shares outstanding	**889,871,187**	783,379,798	631,528,750	106,491,389	151,851,048

As at December 31: (000's)	**2022**	2021	2020	Change 2022	Change 2021
Cash and equivalents	**$ 14,636**	$ 14,754	$ 20,657	$ (118)	$ (5,903)
Total assets	**$ 331,820**	$ 450,422	$ 378,963	$ (118,602)	$ 71,459
Debt***	**$ 174,475**	$ 168,809	$ 114,825	$ 5,666	$ 53,984

*Attributable to shareholders of the Company
**Adjusted EBITDA is a Non-IFRS financial measure. Refer to the Non-GAAP Measures section in this MD&A for definitions
***Debt is a supplementary financial measure. Refer to the Non-GAAP Measures section in this MD&A for definitions

Financial Year 2022 vs 2021

For the year ended December 31, 2022, net revenues were $94.5 million, an increase of approximately $10.6 million or 13% over the same period of 2021. Sales increased primarily as a result of a continuous shift in sales towards Cannabis 1.0 Products which account for approximately 70% of retail sales and wholesale bulk dried flower sales during the fourth quarter, supported by overall industry sales growth.

Net losses attributable to shareholders from continuing operations of $130.3 million increased by $96.6 million over the same period in 2021, primarily due to the impairment of goodwill and other assets of $45 million as reported in the third quarter, losses of $25.7 million associated with the sale of the Auxly Annapolis facilities, greater equity-based compensation, increased depreciation and amortization, and interest expense associated with the addition of Auxly Leamington.

Adjusted EBITDA was negative $16.9 million for the year, an improvement of $4.8 million when compared to negative $21.7 million during the same period of 2021. Adjusted EBITDA for the twelve months ended December 31, 2022 improved primarily as a result of net improvements in revenues and cost of finished cannabis inventory sold, partially offset by higher SG&A on an annual basis, with significant net improvement in the fourth quarter of 2022.

For the year ended December 31, 2022, the average number of Shares outstanding increased to 889.9 million Shares, an increase of 106.5 million Shares or 14% over 2021 primarily as a result of the full year impact of Shares issued in 2021 as well as Shares issued under the Company's at-the-market equity program ("**ATM Program**") and in relation to the amendment of unsecured convertible debentures in the second quarter of 2022.

Cash and equivalents were $14.6 million on December 31, 2022, a decrease of $0.1 million from December 31, 2021. The change in cash was associated with net proceeds from financing activities and the sale of non-core assets, partially offset by capital expenditures, negative cash from operating activities, and payments made towards lease liabilities and debt instruments.

Financial Year 2021 vs 2020

For the year ended December 31, 2021, net revenues were $83.8 million, an increase of approximately $37.1 million over the same period of 2020. Sales for the year improved primarily due to increases in Auxly's adult recreational retail sales and expansion into Cannabis 1.0 Products.

Net losses attributable to shareholders of $33.7 million improved by $51.7 million from a loss of $85.4 million for the year ended December 31, 2020, primarily due to improved gross profits, total other income including a net gain from discontinued operations, a gain from the amendments to the debentures held by Imperial Brands and income tax recoveries, partially offset by additional depreciation, amortization and interest expense.

Adjusted EBITDA of negative $21.7 million improved by approximately $6.9 million from negative $28.5 million primarily as a result of increased gross profits partially offset by increased selling, general and administrative expenses during the year.

For the year ended December 31, 2021, the average number of Shares outstanding increased to 783.4 million Shares, an increase of 151.9 million Shares or 24% over 2020 primarily as a result of equity offerings completed in 2021 including Shares issued under the Company's ATM Program.

Cash and equivalents were $14.8 million on December 31, 2021, a decrease of $5.9 million from December 31, 2020. The net cash decrease was due to negative cash from operating activities, investing activities and the acquisition of Auxly Leamington that was partially offset by proceeds from financing activities which include the equity offerings completed in 2021. Debt increased in 2021 primarily as a result of the acquisition of Auxly Leamington.

RESULTS OF OPERATIONS

For the Year ended December 31: (000's)		2022		2021
CONTINUING OPERATIONS				
Revenues				
Revenue from sales of cannabis products	**$**	**138,885**	$	120,824
Excise taxes		**(44,413)**		(36,995)
Total net revenues		**94,472**		83,829
Costs of sales				
Costs of finished cannabis inventory sold		**70,262**		62,754
Biological asset impairment		**704**		-
Inventory (gain)/impairment		**10,732**		3,264
Gross profit/(loss) excluding fair value items		**12,774**		17,811
Unrealized fair value gain/(loss) on biological transformation		**28,518**		2,384
Realized fair value gain/(loss) on inventory		**(24,780)**		(905)
Gross profit		**16,512**		19,290
Expenses				
Selling, general, and administrative expenses		**46,649**		44,288
Equity-based compensation		**4,023**		1,433
Depreciation and amortization		**14,816**		12,507
Interest expense		**21,578**		17,668
Total expenses		**87,066**		75,896
Other income/(loss)				
Fair value gain/(loss) for financial instruments accounted under FVTPL		**-**		6
Interest and other income		**337**		1,591
Impairment of assets		**(67,180)**		(11,426)
Gain/(loss) on settlement of assets and liabilities and other expenses		**(2,231)**		20,289
Gain on disposal of assets held for sale		**2,150**		-
Gain/(loss) on disposal of subsidiary		**-**		1,355
Share of gain/(loss) on investment in joint venture		**-**		(4,661)
Foreign exchange gain/(loss)		**923**		(788)
Total other income/(loss)		**(66,001)**		6,366
Net loss before income tax		**(136,555)**		(50,240)
Income tax recovery		**6,262**		4,330
Net loss from continuing operations	**$**	**(130,293)**	$	(45,910)
Net income/(loss) from discontinued operations		**-**		12,156
Net income/(loss)	**$**	**(130,293)**	$	(33,754)
Net income/(loss) attributable to shareholders of the Company	**$**	**(130,293)**	$	(33,739)
Net loss attributable to non-controlling interest		**-**		(15)
Adjusted EBITDA	**$**	**(16,878)**	$	(21,672)
From continuing operations	**$**	**(0.15)**	$	(0.06)
From discontinued operations		**-**		0.02
Net income/(loss) per common share (basic and diluted)	**$**	**(0.15)**	$	(0.04)
Weighted average shares outstanding (basic and diluted)		**889,871,187**		783,379,798

Net Revenues

For the year ended December 31, 2022, net revenues were $94.5 million as compared to $83.8 million during the same period in 2021. Revenues for 2022 were comprised of approximately 42% in sales of dried flower and pre-roll Cannabis Products, with the remainder from oils and Cannabis 2.0 Product sales. Net revenues included wholesale bulk flower sales of approximately $3.2 million in the fourth quarter, contributing towards the Company's overall shift to increased sales of Cannabis 1.0 Products, which represented approximately 48% of net revenues during the quarter. For the third year, Auxly continued its leadership in national sales of Cannabis 2.0 Products, while increasing its share of market for Cannabis 1.0 Products over the year from 2.5% to 3.7%[1].

Consistent with prior periods, as the Company does not participate in the Quebec market, approximately 85% of cannabis sales in 2022 originated from sales to British Columbia, Alberta and Ontario.

Gross Profit

Auxly realized a gross profit of $16.5 million in 2022, a decrease of $2.8 million as compared to 2021, which includes the impacts of non-cash impairments and fair value adjustments. The Gross Profit Margin for 2022 was 17% versus 23% in 2021. Excluding non-cash amounts, the Cost of Finished Cannabis Inventory Sold Margin improved to 26% versus 25% in 2021, while increasing from 23% in the first quarter of 2022 to 30% in the fourth quarter as a result of a higher proportion of Cannabis 1.0 Products sold by the Company utilizing low-cost cannabis cultivated at Auxly Leamington, and the streamlining of Cannabis 2.0 SKUs and operating costs.

Following the acquisition of Auxly Leamington in November 2021, the Company recognizes gross profit or loss from Auxly Leamington as part of the costs of finished cannabis inventory sold only as product is sold to the Company's customers after being further processed by Auxly Ottawa or Auxly Charlottetown. Realized and unrealized fair value gains and losses reflect accounting treatments associated with Auxly Leamington cultivation and sales. Prior to the acquisition of Auxly Leamington, the net operating results of Auxly Leamington were recorded in other income and expenses on an equity basis in proportion to the Company's ownership in the joint venture.

Biological and inventory impairments during the year were $11.4 million as compared to $3.3 million in 2021, primarily as a result of charges related to the closure of the Auxly Annapolis facilities of $5.0 million in the first quarter of 2022, certain third-party product write-offs, and as a result of SKU rationalization and run-off, and product not meeting quality specifications.

Total Expenses

Selling, general and administrative expenses ("**SG&A**") are comprised of wages and benefits, office and administrative, professional fees, business development, and selling expenses. SG&A expenses were $46.7 million during 2022, a $2.4M or 5% increase over 2021, which includes the full year impact of the addition of Auxly Leamington expenditures.

Wages and benefits were $18.7 million for the year, as compared to $17.8 million for the same period of 2021. The net increase is primarily due to the addition of Auxly Leamington, partially offset by reductions associated with the closure and sale of the Auxly Annapolis and Auxly Annapolis OG facilities and measures taken after the third quarter to reduce overhead in the rest of the organization.

Office and administrative expenses were $11.6 million for the year, decreasing by $2.0 million compared to the same period in 2021. The decreased expenditures primarily relate to higher product cost absorption, reduced waste and the timing and cost associated with product innovation, partially offset by the inclusion of Auxly Leamington.

Auxly's professional fees were $2.9 million for 2022, the same as the prior year. Professional fees incurred primarily related to accounting fees, regulatory matters, reporting issuer fees, and legal fees associated with certain corporate activities.

Business development expenses were $0.3 million for the year ended December 31, 2022, consistent with the same period in 2021. These expenses have been nominal during the year due to the COVID-19 pandemic and primarily relate to acquisition, business development and travel related expenses.

Selling expenses were $13.1 million for 2022, an increase of $3.5 million over 2021, as a result of cannabis sales activities comprised of brokerage fees, Health Canada fees related to higher revenues, and increased marketing initiatives for Cannabis Products.

Equity-based compensation for the year ended December 31, 2022, was $4.0 million, an increase of $2.6 million over 2021, primarily reflecting the impact of restricted share units ("**RSU**") granted in June 2022, in respect of services provided by employees in 2021. The RSU charge is primarily determined by the number of units granted, vesting periods and forfeiture assumptions, and the Share price at the time of grant. Equity-based compensation includes expenses related to options which are primarily determined as a function of the number of grants, the weighted average aging of the grants and the share price at the time of grant.

Depreciation and amortization expenses were $14.8 million for the year representing an increase of $2.3 million over 2021, primarily related to additional capital expenditures and the inclusion of Auxly Leamington in 2022.

Interest expenses were $21.6 million in 2022 as compared to $17.7 million during the prior year. The increase in expense is primarily a result of the inclusion of Auxly Leamington and the impact of rising interest rates where such obligations are subject to variable charges. Interest expense includes accretion on the convertible debentures and interest paid in kind on the $123 million Imperial Brands Debenture. Interest payable in cash was approximately $6.7 million for the year.

Total Other Incomes and Losses

Total other incomes and losses for the year were a net loss of $66.0 million primarily due to the third quarter impairment of goodwill and other assets of $45 million, comprised of $24.8 million towards goodwill, $13.2 million towards intangible assets, $2.2 million towards other receivables, and $4.8 million of impairment losses towards long-term assets, including property, plant and equipment. In addition, during the first quarter of 2022, an impairment of long-term assets of $12.9 million and intangible assets and goodwill of $10.8 million related to the closure of the Auxly Annapolis and Auxly Annapolis OG facilities, respectively, where the carrying value exceeds the fair value less cost to sell.

In 2022, foreign exchange gains were $0.9 million as compared to a loss of $0.8 million in 2021. Auxly is exposed to foreign exchange fluctuations from the U.S. dollar to CAD dollar exchange rate primarily related to inventory, capital purchases and Inverell net assets.

Net Income and Loss

Net losses attributable to shareholders of the Company for the year ended December 31, 2022 were $130.3 million, net of income tax recoveries of $6.3 million, representing a net loss of $0.15 per share on a basic and diluted basis. The change in net loss in 2022 as compared to 2021 was primarily driven by changes in total other incomes and losses in 2022 as compared to net gains recorded in 2021.

Adjusted EBITDA

Adjusted EBITDA during the year ended December 31, 2022 was negative $16.9 million, an improvement of $4.8 million over the same period of 2021, primarily as a result of improvements realized during the fourth quarter of 2022.

Discontinued Operations

On May 27, 2021, the Company announced that it had reached an agreement to sell KGK to Myconic Capital Corp. (now Wellbeing Digital Sciences Inc.) ("**Wellbeing**"), and on June 2, 2021, completed the sale of KGK to Wellbeing. As a result of the sale, results from operations and cash flows from KGK have been presented as discontinued operations, as applicable, on a retrospective basis.

SUMMARY OF QUARTERLY RESULTS

The following table summarizes comparative quarterly results for the last eight quarters.

(000's)	**Q4/22**	Q3/22	Q2/22	Q1/22	Q4/21	Q3/21	Q2/21	Q1/21
CONTINUING OPERATIONS								
Total net revenues	**24,681**	19,830	27,335	22,626	29,318	24,493	20,852	9,166
Net losses*	**(16,056)**	(60,102)	(14,289)	(39,846)	(18,376)	(13,527)	(3,676)	(10,316)
Adjusted EBITDA**	**(783)**	(5,776)	(3,995)	(6,324)	(6,043)	(6,099)	(2,989)	(6,540)
Average shares outstanding (000's)	**905,819**	901,521	888,267	847,604	829,480	825,613	762,653	714,041
Per share: Basic & diluted loss	**(0.02)**	(0.07)	(0.02)	(0.05)	(0.02)	(0.02)	(0.00)	(0.01)

*attributable to shareholders of the Company and excludes discontinued operations.

**Adjusted EBITDA is a Non-IFRS financial measure. Refer to the Non-GAAP Measures section in this MD&A for definitions.

The Company commenced cannabis sales to the Canadian adult recreational market with the legalization of Cannabis 2.0 Products in the fourth quarter of 2019. Since that date, the Company has become a leader in Cannabis 2.0 Products and has continued to introduce new products including Cannabis 1.0 Products to increase total net revenues. To date, net revenues have been seasonally low during the first quarter as a result of retail sales trends which impact the Company's provincial customers' purchasing practices. The Company's expansion into the larger dried flower and pre-roll product categories has contributed to the increasing sales trend. Sales during the third quarter of 2022 were negatively impacted by reduced orders from two of our largest customers Ontario and British Columbia, as they worked through their respective data security and labour issues, and a one-week closure of Auxly Charlottetown due to hurricane Fiona.

Net losses from continuing operations have fluctuated over the eight quarters primarily as a result of other losses which include impairment charges, fair value adjustments and losses on settlement of assets and liabilities. Results for Q2 2021 improved primarily as a result of increased income tax recoveries and recognition of a gain from the Imperial Brands Debenture amendments, partially offset by total other losses. The first quarter of 2022 reflects the impact of losses associated with the closure of the Auxly Annapolis and Auxly Annapolis OG facilities, while the third quarter of 2022 reflects charges of $45 million related to the impairment of goodwill and other assets.

Adjusted EBITDA has fluctuated with changes in total net revenues, changes to product mix with an increase of dried flower and pre-roll Cannabis Products which presently have lower Gross Profit Margins, and the timing of SG&A expenditures, in particular selling expenses. Improvements in the fourth quarter of 2022 reflect the impact of lower cultivation costs, improved overall margins and reductions in SG&A during the period, resulting in the strongest quarter in the Company's history.

The increases in average outstanding Shares reflect financing activities (issuance and exchange of Shares, exercise of warrants, options and conversion of convertible debentures).

FOURTH QUARTER RESULTS OF OPERATIONS

For the three months ended December 31: (000's)		**2022**		2021
CONTINUING OPERATIONS				
Revenues				
Revenue from sales of cannabis products	**$**	**36,455**	$	43,304
Excise taxes		**(11,774)**		(13,986)
Total net revenues		**24,681**		29,318
Costs of sales				
Costs of finished cannabis inventory sold		**17,245**		23,374
Inventory (gain)/impairment		**2,062**		2,194
Gross profit/(loss) excluding fair value items		**5,374**		3,750
Unrealized fair value gain/(loss) on biological transformation		**2,814**		1,462
Realized fair value gain/(loss) on inventory		**(7,382)**		(904)
Gross profit		**806**		4,308
Expenses				
Selling, general, and administrative expenses		**9,515**		12,676
Equity-based compensation		**429**		212
Depreciation and amortization		**2,791**		5,678
Interest expense		**5,655**		4,348
Total expenses		**18,390**		22,914
Other income/(loss)				
Fair value gain/(loss) for financial instruments accounted under FVTPL		**-**		(408)
Interest and other income		**63**		308
Impairment of assets		**(676)**		-
Gain/(loss) on settlement of assets and liabilities and other expenses		**1,330**		(815)
Share of gain/(loss) on investment in joint venture		**-**		1,387
Foreign exchange gain/(loss)		**(301)**		(242)
Total other income/(loss)		**416**		230
Net loss before income tax		**(17,168)**		(18,376)
Income tax recovery		**1,112**		-
Net loss from continuing operations	**$**	**(16,056)**	$	(18,376)
Net income/(loss) from discontinued operations		**-**		-
Net income/(loss)	**$**	**(16,056)**	$	(18,376)
Net income/(loss) attributable to shareholders of the Company	**$**	**(16,056)**	$	(18,376)
Net loss attributable to non-controlling interest		**-**		-
Adjusted EBITDA	**$**	**(783)**	$	(6,043)
From continuing operations	**$**	**(0.02)**	$	(0.02)
From discontinued operations		**-**		-
Net income/(loss) per common share (basic and diluted)	**$**	**(0.02)**	$	(0.02)
Weighted average shares outstanding (basic and diluted)		**905,819,080**		829,479,680

Unless stated otherwise, the narrative in this section is in reference to the operating results for the fourth quarter of 2022 as compared to the same period in 2021.

Net Revenue

In the fourth quarter of 2022, the Company achieved a milestone by becoming the top licensed producer in the sale of Cannabis 2.0 Products for the third consecutive year, commenced limited wholesale bulk flower sales, and broadened its distribution of Cannabis 1.0 Products while curtailing the sale of certain unprofitable SKUs. Net revenues were $24.7 million, approximately $4.9 million greater than the third quarter of 2022, however $4.6 million lower than the fourth quarter of 2021. During the quarter, dried flower and pre-roll products comprised approximately 48% of net revenues while Cannabis 2.0 Products and oil sales contributed the remaining 52% of net revenues. During the fourth quarter of 2021, Cannabis 2.0 Products and oil sales comprised approximately 59% of net revenues.

Gross Profit

Auxly achieved a gross profit of $0.8 million in the fourth quarter of 2022, compared to a gross profit of $4.3 million for the fourth quarter of 2021. Gross Profit Margin was approximately 3% whereas Cost of Finished Cannabis Inventory Sold Margin was 30%. Gross profits were impacted by an increase in sales of Cannabis 1.0 Products which have an improved margin profile based on the favourable Auxly Leamington costs of production. Inventory impairments were $2.1 million, slightly lower than those of 2021, comprised of charges related to obsolescence of certain retired products and packaging, and reductions in the net realizable value of dried cannabis under the Company's product specifications. Unrealized fair value gains and losses on biological assets and realized fair value gains and losses on inventory in 2022 primarily relate to Auxly Leamington. Prior to the acquisition, Auxly Leamington was accounted for under the equity method.

Total Expenses

Selling, general and administrative expenses of $9.5 million during the fourth quarter of 2022 decreased by $3.2 million over the same period in 2021. The decrease in expenses included reductions in wages and salaries of $1.8 million related to streamlining operations and support staff for a more focused product portfolio and adjustments to compensation accruals, partially offset by the full quarter inclusion in 2022 of Auxly Leamington. Office and administrative expenditures of $3.1 million were $0.6 million lower than 2021 as a result of reductions of $0.3 million of Auxly Annapolis expenditures included in 2021, lower testing and R&D expenditures of $0.2 million, and a number of other savings, partially offset by increases associated with the full quarter of Auxly Leamington. Professional fees of $0.8 million and selling expenses of $2.5 million were each approximately $0.4 million lower than the same period in 2021, primarily as a result of lower acquisition related expenditures and the internalization of the sales team.

Depreciation and amortization expenses were $2.8 million, which was $2.9 million lower than the same period of 2021, as 2021 included adjustments for classification changes between property plant and equipment and right of use assets and related amortization periods.

Interest expenses were $5.7 million for the three months ended December 31, 2022, which reflects an increase of $1.3 million from 2021, primarily as a result of increased interest payments on variable rate debt and the full quarter inclusion of Auxly Leamington in 2022.

Total Other Incomes and Losses

For the quarter, net total other income was $0.4 million primarily comprised of $1.3 million in a gain on settlement of assets and liabilities and other expenses associated with the reversal of a claims provision partially offset by an impairment of remaining Inverell assets and foreign exchange losses.

Net Losses

Net losses improved by $2.3 million to $16.1 million in 2022 from a net loss of $18.4 million in 2021. The improvement in net losses is primarily the result of lower total expenses of $4.5 million and income tax recoveries, offset by lower gross profit.

Adjusted EBITDA

Adjusted EBITDA of negative $0.8 million in the fourth quarter of 2022 improved by approximately $5.3 million compared to the same period in 2021 primarily as a result of lower SG&A and improved Cost of Finished Cannabis Inventory Sold Margin.

TRANSACTIONS WITH RELATED PARTIES

Key management and director compensation

Auxly's key management personnel have authority and responsibility for overseeing, planning, directing and controlling the activities of the Company. Key management personnel include members of the Board of Directors and executive officers. Compensation of key management personnel may include short-term and long-term benefits, as applicable, including salaries, bonuses, equity-based awards or post-employment benefits. Compensation provided to current and key management is as follows:

For the years ended December 31:				
		2022		2021
Short-term benefits	**$**	**2,083**	$	2,149
Long-term benefits		**2,656**		337
Total	**$**	**4,739**	$	2,486

LIQUIDITY AND CAPITAL RESOURCES

For the years ended December 31: (000's)		**2022**		2021
Cash provided/(used) in continuing operating activities	**$**	**(2,481)**	$	(49,077)
Net change in investments		**10,371**		17,707
Net capital expenditures		**(9,192)**		(378)
Cash provided/(used) in continuing investing activities		**1,179**		17,329
Net cash provided/(used) from continuing financing activities		**1,184**		26,726
Net cash provided/(used) from discontinued operations		**-**		(881)
Cash position, at the beginning of the period		**14,754**		20,657
Cash position, end of period	**$**	**14,636**	$	14,754

Auxly’s objectives when managing its liquidity and capital resources are to safeguard its ability to continue as a going concern and to maintain a flexible capital structure which optimizes the cost of capital within a framework of acceptable risk. Auxly considers its capital structure to include debt and shareholders’ equity.

Auxly manages its capital structure by preparing rolling cash flow forecasts, monitoring the condition and value of assets available for use as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements.

Auxly is dependent on expected business growth, changes in the business environment and capital markets as its source of operating capital and may issue additional Shares or debt, acquire or dispose of assets to maintain or adjust its capital structure.

During the year ended December 31, 2022, Auxly used $2.5 million in operating activities from continuing operations, including the positive impact of $20.0 million from changes in working capital. Net investing activities from continuing operations for the period ended December 31, 2022, were a source of $1.2 million primarily related to the sale of non-core assets, partially offset by capital expenditures at Auxly Leamington. Net financing activities from continuing operations were $1.2 million for the year ended December 31, 2022, reflecting proceeds from the Company's ATM Program partially offset by repayment of the unsecured convertible debentures, lease and other payments.

Going concern uncertainty

The Company's financial statements were prepared on a going concern basis. The going concern basis assumes that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities and commitments in the normal course of business. The financial statements do not include any adjustments to the amounts and classification of assets and liabilities that would be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

On December 31, 2022, the Company had total cash and cash equivalents of $14.6 million, negative working capital of $2.8 million, and negative cash flow from operating activities of $2.5 million for the twelve months ended December 31, 2022. The Company currently will have insufficient cash to fund its operations for the next 12 months if the Company's sales do not improve or if they decline; if the Company's margins do not improve or if they decline; if the Company's SG&A increases or does not decrease; and/or the Auxly Leamington credit facility of $48.2 million matures on September 30, 2023, without extension or refinancing. Whether, and when, the Company can attain profitability and positive cash flows from operations is subject to material uncertainty that may cast significant doubt upon the Company's ability to continue as a going concern.

In assessing whether the going concern assumption was appropriate, management took into account all relevant information available about the future including, but not limited to, all relevant information available about the twelve-month period following December 31, 2022. To address its financing requirements, the Company will seek financing through debt and equity financings (which may include use of its ATM Program and/or rights offerings to existing shareholders) and non-core asset sales. The Company will also seek to improve its sales and cash flows by prioritizing certain products and projects with a greater expected return and reducing operating costs by streamlining its operations and support functions. While the Company has been successful in obtaining financing to date, and believes it will be able to obtain sufficient funds in the future and ultimately achieve profitability and positive cash flows from operations, the Company's ability to raise capital may be adversely impacted by: market conditions that have resulted in a lack of normally available financing in the cannabis industry; the Company's ongoing litigation matters; increased competition and price compression across the industry; the industry's inability to quickly eliminate Canada's large illicit cannabis market, and overall negative investor sentiment in light of inflation, global conflict and negative macroeconomic impacts from the COVID-19 pandemic. Accordingly, there can be no assurance that the Company will achieve profitability, or secure financing on terms favourable to the Company or at all.

Auxly's business is subject to risks and uncertainties that could significantly impair Auxly's ability to raise funds or to generate profits sufficient to meet future obligations, operational, or development needs. See "*Risk Factors*" in this MD&A for information on the risks and uncertainties that could have a negative effect on Auxly's liquidity.

OUTSTANDING SHARE DATA

Auxly's authorized share capital consists of an unlimited number of Shares. The following table quantifies the number of issued and outstanding Shares and exercisable securities.

	March 30, 2023	December 31, 2022	December 31, 2021
Issued Shares	1,009,008,498	913,008,498	850,732,172
Escrowed shares	6,994,190	6,994,190	6,994,190
Outstanding shares	1,002,014,308	906,014,308	843,737,982
Exercisable securities			
Warrants	218,510,533	122,510,533	122,542,280
Convertible debentures	196,914,452	205,844,409	188,089,377
Options	24,423,306	24,773,639	28,920,509
Restricted share units	62,088,353	62,088,353	-

Shares outstanding as at December 31, 2022 increased by approximately 62.3 million to 913.0 million primarily as a result of the issuance of equity under the ATM Program and in respect of amendments to the unsecured convertible debentures which also resulted in a change to the outstanding convertible debentures net of payments. The number of options declined by 4.1 million to 24.8 million as at December 31, 2022 due to plan forfeitures. Restricted share units were granted to eligible employees in June 2022 in respect of services provided to the Company in 2021. In February 2023 the Company closed a private placement for 96,000,000 Shares and 96,000,000 warrants, and also repaid $1.232 million of the principal amount of convertible debentures owing under the amended standby financing agreement as a result of raising additional capital.

NON-GAAP MEASURES

The audited consolidated financial statements of Auxly are prepared in accordance with IFRS. Auxly's basis of presentation and significant accounting policies are summarized in detail in notes 2 and 3 of the annual consolidated financial statements for the year ended December 31, 2022.

This MD&A makes reference to certain financial measures, including non-GAAP measures that are historical, non-IFRS measures that are forward-looking, and supplementary financial measures. Management uses these financial measures for the purpose of comparison to prior periods and the development of future projections and earnings growth prospects. This information is also used by management to measure the profitability of ongoing operations and in analyzing our business performance and trends. These measures are not recognized measures under IFRS, do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of our results of operations from management's perspective. Accordingly, they should not be considered in isolation nor as a substitute for analysis of our financial information reported under IFRS. We use the following non-GAAP financial measures: "EBITDA", "Adjusted EBITDA," and the supplementary financial measures of "Cost of Finished Cannabis Inventory Sold Margin", "Gross Profit Margin", and "Debt."

Financial Measures

EBITDA and Adjusted EBITDA

These are non-GAAP measures used in the cannabis industry and by the Company to assess operating performance removing the impacts and volatility of non-cash adjustments. The definition may differ by issuer. EBITDA and Adjusted EBITDA used by the Company are reconciled with net loss from continuing operations of the Company, an IFRS measure, in the section "Results of Operations" in this MD&A. The calculation of Adjusted EBITDA is comprised of the net loss from continuing operations of the Company added or subtracted as applicable as provided in the detailed reconciliation found in this MD&A. There are a number of individual financial statement adjustments however, they are inclusive of, interest expense and income, income taxes, depreciation and amortizations, fair value gains or losses, impairments or settlements, foreign exchange, changes in the share of joint venture investments, share based compensation, gains or losses on the sale or disposal of assets and any other unusual items. The Adjusted EBITDA reconciliation is as follows:

(000's)	**Q4/22**	Q3/22	Q2/22	Q1/22	Q4/21	Q3/21	Q2/21	Q1/21
Net loss from continuing operations	**$ (16,056)**	$ (60,102)	$ (14,289)	$ (39,846)	$ (18,376)	$ (13,527)	$ (3,685)	$ (10,322)
Interest expense	**5,655**	5,507	5,336	5,080	4,348	3,932	4,787	4,601
Interest income	**(63)**	(105)	(84)	(85)	(308)	(436)	(431)	(416)
Income tax recovery	**(1,112)**	(2,110)	(85)	(2,955)	-	-	(4,291)	(39)
Depreciation and amortization included in cost of sales	**1,296**	681	2,180	1,211	689	386	326	141
Depreciation and amortization included in expenses	**2,791**	3,525	3,900	4,600	5,678	2,223	2,174	2,432
EBITDA	**(7,489)**	(52,604)	(3,042)	(31,995)	(7,969)	(7,422)	(1,120)	(3,603)
Impairment of biological assets	**-**	-	-	704	-	-	-	-
Impairment of inventory	**2,062**	2,014	1,778	4,878	2,194	716	124	230
Unrealized fair value loss / (gain) on biological transformation	**(2,814)**	(7,496)	(11,735)	(6,473)	(1,462)	(352)	(315)	(255)
Realized fair value loss / (gain) on inventory	**7,382**	8,175	6,898	2,325	904	1	1	(1)
Restructuring related costs	**-**	193	-	-	-	-	-	-
Equity-based compensation	**429**	475	2,916	203	212	55	960	206
Fair value loss / (gain) for financial instruments accounted under FVTPL	**-**	-	-	-	408	(223)	(75)	(116)
Impairment of assets	**676**	42,831	-	23,673	-	60	11,366	-
(Gain) / loss on settlement of assets, liabilities and disposals	**(1,330)**	1,574	(163)	-	815	(1,396)	(16,995)	(4,068)
Share of loss on investment in joint venture	**-**	-	-	-	(1,387)	3,095	2,494	459
Foreign exchange loss / (gain)	**301**	(938)	(647)	361	242	(633)	571	608
Adjusted EBITDA	**$ (783)**	$ (5,776)	$ (3,995)	$ (6,324)	$ (6,043)	$ (6,099)	$ (2,989)	$ (6,540)

Supplementary Financial Measures

Cost of Finished Cannabis Inventory Sold Margin

"Cost of Finished Cannabis Inventory Sold Margin" is a supplementary financial measure and is defined as Cost of Finished Cannabis Inventory Sold divided by net revenues.

Gross Profit Margin

"Gross Profit Margin" is defined as gross profit divided by net revenues. Gross Profit Margin is a supplementary financial measure.

Debt

"Debt" is defined as current and long-term debt and is a supplementary financial measure. It is a useful measure in managing our capital structure and financing requirements.

COMMITMENTS AND OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2022, the Company has entered into certain agreements which commit the Company to future funding following a mutually agreed upon event or events. Commitments have not been described where agreements are insufficiently advanced, unlikely to progress further or amounts are indeterminable**.**

The Company has funding commitments as follows:

As part of the debt financing provided by a syndicate led by BMO towards the construction of the Auxly Leamington purpose-built greenhouse facility, the Company has guaranteed payments up to $33 million in the event of default;

Payments of $1.0 million USD in 2023 to Capsugel, as part of a multi-year licensing arrangement with Lonza;

Payments of an aggregate of €1.664 million in 2022 for cannabis equipment to expand the Company's pre-roll and dried flower capabilities;

Annual payment of $0.1 million for minimum annual volume requirement with Union Gas, with agreement ending August 1, 2029; and

Annual payment of approximately $0.1 million until 2024 for guaranteed minimum purchase of bulk carbon dioxide with Air Liquide.

The Company has commitments in respect of long-term debt obligations and leases relating to office spaces, equipment and land which will require payments as follows:

	2023	2024	2025	2026	Thereafter	Total
Lease obligations	$ 5,068	$ 3,119	$ 2,749	$ 2,728	$ 10,004	**$ 23,668**
Loans payable obligations	50,291	8,132	738	-	-	**59,161**
Promissory note obligations	4,977	500	-	-	-	**5,477**
Convertible debenture obligations	773	155,233	-	-	-	**156,006**
Total	**$ 61,109**	**$ 166,984**	**$ 3,487**	**$ 2,728**	**$ 10,004**	**$ 244,312**

Long-term debt obligations include principal and interest on the Imperial Brands Debenture maturing on September 25, 2024. Pursuant to the amendments to the Debenture, interest payable may also be converted to Shares or capitalized and paid at maturity.

Concurrently with the acquisition of Auxly Leamington, Auxly Leamington and Fresh Energy Inc. agreed to complete the transfer of (or part of) a load facility located at 525 County Rd. 14, Mersea RD 9 PH 5 (the "**Transfer**") for which Auxly Leamington shall pay Fresh Energy consideration of:

- an unsecured promissory note in the principal amount of $3,000 payable in monthly instalments of $100 for 30 months and;
- contingent consideration payable of $500 upon the completion of effecting such Transfer, included in the consideration paid for the acquisition of Auxly Leamington.

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The Company entered into a brokerage agreement with Kindred Partners Inc. ("**Kindred**") to act as the Company's strategic sales agent in September 2019. In October 2022, the brokerage agreement with Kindred was terminated. In January 2023, Kindred commenced arbitration against the Company for an aggregate claim of $3,442. The Company has filed its defence and counterclaim against Kindred. As at December 31, 2022, the Company recorded a provision of $1,235 related to this claim.

The Company and its subsidiaries are involved in litigation matters arising out of the ordinary course and conduct of its business. Although such matters cannot be predicted with certainty, management does not consider the Company's exposure to litigation to be material to the consolidated financial statements.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements requires management to make judgments, 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.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only; or in the period of the change and future periods, if the change affects both.

Areas requiring estimates and judgements are as follows:

Business combinations

In a business combination, substantially all identifiable assets, liabilities and contingent liabilities acquired are recorded at the date of acquisition at their respective fair values. One of the most significant areas of judgment and estimation relates to the determination of the fair value of these assets and liabilities, including the fair value of contingent consideration, if applicable. If any intangible assets are identified, depending on the type of intangible asset and the complexity of determining its fair value, an independent external valuation expert may develop the fair value, using appropriate valuation techniques, which are generally based on a forecast of the total expected future net cash flows. These valuations are linked closely to the assumptions made by management regarding the future performance of the assets concerned and any changes in the discount rate applied. In certain circumstances where estimates have been made, the Company may obtain third-party valuations of certain assets, which could result in further refinement of the fair-value allocation of certain purchase prices and accounting adjustments.

Impairment of goodwill and intangible assets

The carrying value of goodwill and intangibles is reviewed annually for impairment or more frequently when there are indicators that impairment may have occurred. The Company's impairment tests for goodwill and intangible assets are based on the comparison of the carrying amount of the CGU and the recoverable amount, which is the greater of value in use calculations that use a discounted cash flow model and estimated fair value less cost of disposal. The determination of the Company's CGUs are based on management's judgement.

If the recoverable amount of the CGU is greater than the carrying amount, the difference is written off as impairment loss. The impairment loss is first allocated to goodwill and the remainder is allocated to other assets of the CGU subject to the limitation that the carrying amount of an asset should not be reduced below the highest of fair value less cost of disposal, value in use or zero.

The value-in-use calculations employ the following key assumptions: future cash flows, growth projections including economic risk assumptions and estimates of achieving key operating metrics. The cash flows are derived from the Company's budget for the future and do not include restructuring activities that the Company is not yet committed to or significant future investments that will enhance the asset base of the CGU being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash inflows and the growth rate used for extrapolation purposes. The estimated fair value less cost of disposal is based on assessment of comparable company multiples and precedent transactions.

Biological assets and inventory

In calculating the value of the biological assets and inventory, management is required 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, average or expected selling prices and list prices, expected yields for the cannabis plants, and oil conversion factors. In calculating final inventory values, management compares the inventory cost to estimated net realizable value. Further information on estimates used in determining the fair value of biological assets is contained in note 6.

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

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

Share-based compensation

In calculating the equity-based compensation expense, key estimates such as the rate of forfeiture of options and RSUs granted, the expected life of the option and RSU, the volatility of the Company's stock price and the risk-free interest rate are used.

Fair value measurements

Certain of the Company's assets and liabilities are measured at fair value. In estimating the fair value of Level 2 investments, the Company uses key inputs including the share price of underlying securities, annualized volatility, the risk-free interest rate, the dividend yield, and the expected life of the security. In estimating the fair value of Level 3 investments, the Company uses market-observable data to the extent it is available.

Inputs when using Black-Scholes valuation model

The estimates used in determining the stock option and warrant fair values, utilizes estimates made by management in determining the appropriate input variables in the Black-Scholes valuation model. Inputs subject to estimates include volatility, forfeiture rates, estimated lives and market rates.

Discount rates

The discount rates used to calculate the purchase price allocation, impairment analysis, net present value of notes receivable, the convertible debentures and the notes payable are based on management's best estimates of an approximate industry peer group weighted average cost of capital and management's best estimate of the Company's risk levels.

Changes in the general economic environment could result in significant changes to this estimate.

Convertible instruments

Convertible debentures 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 debentures in the future, is initially measured at its fair value and subsequently measured at amortized cost. The residual amount is accounted for as an equity instrument at issuance.

The identification of convertible debenture components is based on interpretations of the substance of the contractual arrangement and therefore requires judgment from management. The separation of the components affects the initial recognition of the convertible debenture at issuance and the subsequent recognition of interest on the liability component. The determination of the fair value of the liability is also based on a number of assumptions, including contractual future cash flows, discount rates and the presence of any derivative financial instruments.

DISCLOSURE AND INTERNAL CONTROLS AND PROCEDURES

Internal controls over financial reporting (ICFR) and disclosure controls and procedures (DCP) are designed to provide reasonable assurance that material information required to be publicly disclosed is gathered and reported on a timely basis so that appropriate decisions can be made regarding public disclosure.

Auxly's certifying officers have designed, and assessed the design of, ICFR to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financials for external purposes in accordance with IFRS using the criteria set forth in the Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("**COSO**"). In addition, the Company's certifying officers and its disclosure committee have designed, and assessed the design of, a system of DCP to provide reasonable assurance that (i) material information relating to Auxly, including its consolidated subsidiaries, is made known to them and others; and (ii) information required to be disclosed by Auxly in its annual filings, interim filings and other reports filed or submitted by Auxly under securities legislation is recorded, processed, summarized and reporting within the time periods specified.

The Company has used the Internal Control – Integrated Framework (2013) from COSO in order to assess the effectiveness of the Company's internal control over financial reporting. There are no material weaknesses relating to the design of either ICFR or DCP at December 31, 2022. There have been no changes to our ICFR during the quarter and the year ended December 31, 2022, that has materially affected, or is reasonably likely to materially affect Auxly's ICFR.

Management does recognize that any controls and procedures no matter how well designed and operated, can only provide reasonable assurance and not absolute assurance of achieving the desired control objectives. In the unforeseen event that lapses in the disclosure or internal controls and procedures occur and/or mistakes happen, Auxly intends to take whatever steps are necessary to minimize the consequences thereof.

CHANGES IN ACCOUNTING POLICIES

Adoption of new accounting pronouncements

Amendments to IAS 1, Presentation of Financial Statements: Classification of Liabilities as Current or Non-current

In January 2020, the IASB issued amendments to clarify the requirements for classifying liabilities as current or non-current. The amendments specify that the conditions that exist at the end of a reporting period are those which will be used to determine if a right to defer settlement of a liability exists. The amendments also clarify the situations that are considered a settlement of a liability. The amendments are effective January 1, 2022. Effective January 1, 2022, the Company adopted the Amendments to IAS 1 with no impact to the Company's consolidated financial statements.

Amendments to IFRS 9, Financial Instruments

As part of its 2018-2020 annual improvements to the IFRS standards process, the IASB issued an amendment to IFRS 9. The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment. The amendment is effective for annual reporting periods beginning on or after January 1, 2022. Effective January 1, 2022, the Company adopted the Amendments to IFRS 9 with no impact to the Company's consolidated financial statements.

Amendments to IAS 37, Onerous Contracts and the Cost of Fulfilling a Contract

The amendment specifies that the "cost of fulfilling" a contract comprises the "costs that relate directly to the contract." Costs that relate directly to a contract can either be incremental costs of fulfilling that contract or an allocation of other costs that relate directly to fulfilling contracts. The amendment is effective for annual periods beginning on or after January 1, 2022. Effective January 1, 2022, the Company adopted the Amendments to IAS 37 with no impact to the Company's consolidated financial statements.

Future changes in accounting standards

Amendments to IAS 8, Definition of Accounting Estimates

In February 2021, IASB issued amendments to IAS 8 to replace the definition of a change in accounting estimates with a definition of accounting estimates. Under the new definition, accounting estimates are "monetary amounts in financial statements that are subject to measurement uncertainty." The amendment provides clarification to help entities to distinguish between accounting policies and accounting estimates. The amendments are effective for annual reporting periods beginning on or after January 1, 2023. The Company expects no material impact on its consolidated financial statements.

Amendments to IAS 12, Deferred Tax related to Assets and Liabilities arising from a Single Transaction

In May 2021, IASB issued amendments to IAS 12 to narrow the scope of the initial recognition exemption so that it does not apply to transactions that give rise to equal and offset temporary differences. As a result, companies will need to recognize a deferred tax asset and deferred tax liability for temporary differences arising on initial recognition of transactions such as leases and decommissioning obligations. The amendments are effective for annual reporting periods beginning on or after January 1, 2023 and are to be applied retrospectively. The Company expects no material impact on its consolidated financial statements.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Auxly's financial instruments include cash and cash equivalents, restricted cash, short-term investments, accounts receivable, other receivables, deposits, long-term investments, accounts payable and accrued liabilities, promissory notes, loans payable and convertible debentures. Cash and cash equivalents and short-term investments are exposed to credit risk and Auxly reduces its credit risks by placing these instruments with institutions of high credit worthiness. Other receivables relate to outstanding loans and Auxly mitigates the credit risk by entering into agreements and reviewing its exposure to credit risk on a regular basis. Auxly is exposed to liquidity risk with respect to its trade and other payables and Auxly manages liquidity risk by maintaining sufficient cash balances for settlement of financial liabilities on their due dates.

RISK FACTORS

Auxly's business and structure are subject to a number of risks and uncertainties which could cause future results to differ materially from those described herein, including without limitation, the risk factors discussed in Auxly's Annual Information Form dated March 30, 2023, which risk factors are incorporated by reference into this document and should be reviewed by all readers. These documents as well as additional information regarding Auxly can be found on SEDAR at www.sedar.com.

FORWARD LOOKING STATEMENTS

This MD&A and the documents incorporated by reference herein contain certain statements which contain "forward-looking information" within the meaning of Canadian securities legislation (each a "forward-looking statement"). No assurance can be given that the expectations in any forward-looking statement will prove to be correct and, as such, the forward-looking statements included in this MD&A should not be unduly relied upon. Forward-looking information is by its nature prospective and requires Auxly to make certain assumptions and is subject to inherent risks and uncertainties. All statements, other than statements of historical fact included in this MD&A, including information that address activities, events or developments that the Company expects or anticipates will or may occur in the future, are forward-looking statements. The use of any of the words "anticipates", "plans", "contemplates", "continues", "estimates", "expects", "intends", "proposes", "might", "may", "will", "shall", "projects", "should", "could", "would", "believe", "predict", "forecast", "pursue", "potential", "capable", "budget" and similar expressions are intended to identify forward-looking statements. Forward-looking statements in this MD&A may include, but is not limited to, statements pertaining to:

- the ability of the Company to continue as a going concern;
- future liquidity and financial position;
- the Company's growth strategy, targets for future growth and projections of the results of such growth;
- the competitive and business strategies of the Company;
- the intention to grow the business, operations and existing and potential activities of the Company;
- the sufficiency of the Company's resources to fund continued operations;
- the Company's expectations regarding its future sales;
- the Company's response to the COVID-19 pandemic;
- the impact of the COVID-19 pandemic on the Company's current and future operations;
- the success, and integration of operations, of the entities the Company acquires and the Company's collaborations;
- any ongoing construction, expansions, consolidations, improvements, commissioning of the Company's facilities, equipment or assets, including those of Auxly Charlottetown, Auxly Leamington and Auxly Ottawa, and the timing thereof;
- inventory and production capacity, including discussions of anticipated yields or plans or potential for expansion of capacity at existing facilities;
- the market for the Company's current and proposed product offerings, as well as the Company's ability to capture and maintain market share;
- the distribution methods expected to be used by the Company to deliver its products;
- the benefits and applications of the Company's current and proposed product offering and expected sales mix thereof;
- development of brands, product diversification and future corporate development;
- the competitive landscape in which the Company operates and the Company's market expertise;
- expectations regarding the Company's ability to raise additional financing to further the Company's investment in the business;
- the applicable legislation, regulations and licensing, and any amendments thereof, related to the cultivation, production, processing, distribution and sale of cannabis products by the Company's subsidiaries and other business interests;
- the ability of the Company to use consumer insights to drive innovation; continuously innovate new cannabis products; and introduce innovative cannabis products to the market;
- the ability of the Company, its subsidiaries and its cultivation partners to cultivate, produce, process, distribute or sell cannabis and cannabis products;
- the ability of the Company to increase its wholesale bulk cannabis sales;

- expectations regarding the Company’s licences, including in respect of the grant and maintenance of licences under the Cannabis Act, the Cannabis Regulations and the Industrial Hemp Regulations enacted pursuant to the Cannabis Act, and the permitted activities thereunder;
- the fluctuations in the price of Shares and the market for the Shares;
- the expectation and timing of future revenues and of positive Adjusted EBITDA;
- expectations regarding the Company’s expansion of sales, operations and investment into foreign jurisdictions;
- the anticipated benefits of the Company’s acquisition of Auxly Leamington;
- the performance of the Company’s business and operations;
- the ability of the Company to generate cash flow from operations and from financing activities; and
- the Company’s competitive position.

The forward-looking statements in this MD&A are based on information currently available and what management believes are reasonable assumptions. Forward-looking statements speak only to such assumptions as of the date of this MD&A. In addition, this MD&A may contain forward-looking statements attributed to third party industry sources, the accuracy of which has not been verified by Auxly. The purpose of forward-looking information is to provide the reader with a description of management's expectations, and such forward-looking information may not be appropriate for any other purpose.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors, that may cause the actual results, performance or achievements of the Company to be materially different from those expressed or implied by the forward-looking statements. A number of factors could cause actual results to differ materially from a conclusion, forecast or projection contained in the forward-looking statements in this MD&A including, but not limited to, whether:

- the Company will be able to continue as a going concern, will have sufficient working capital and be able to secure adequate financing required in the future on acceptable terms to develop its business and continue operations;
- current and future management will abide by the business objectives and strategies outlined herein;
- the Company will retain and supplement its Board of Directors and management, or otherwise engage consultants and advisors, having knowledge of the industries in which Auxly participates;
- the Company will be able to continue to attract, develop, motivate and retain highly qualified and skilled employees;
- no adverse changes will be made to the regulatory framework governing cannabis, taxes and all other applicable matters in the jurisdictions in which the Company conducts business and any other jurisdiction in which the Company may conduct business in the future;
- the Company will be able to generate cash flow from operations, including, where applicable, the cultivation, production, processing, distribution and sale of Cannabis Products;

- the Company will be able to execute on its business strategy;
- the Company will be able to maintain and/or grow its market share;
- the Company's subsidiaries will be able to meet the governmental and regulatory requirements necessary to maintain their licences;
- general economic, financial market, regulatory and political conditions in which Auxly operates will remain the same;
- the Company will be able to compete in the cannabis industry;
- there are not materially more closures or lockdowns related to the COVID-19 pandemic;
- the Company will be able to manage anticipated and unanticipated costs;
- the Company will be able to successfully integrate Auxly Leamington's operations with its own; and whether the expected benefits of the acquisition materialize in the manner expected, or at all;
- Auxly Leamington will generate sufficient cash flow to satisfy its payment obligations under the amended and restated credit facility; and whether Auxly Leamington will remain in compliance with its operating covenants under the amended and restated credit facility;
- Auxly will be able to maintain effective internal controls over financial reporting and disclosure, controls and procedures;
- there will not be material price compression in the cannabis industry;
- the Company will be able to continue to achieve its target SG&A expenses;
- the Company will be able to increase revenues and achieve positive Adjusted EBITDA;
- the Company will be able to continue to further expand production capacity and introduce new products and product formats;
- the Company will be able to increase its wholesale bulk cannabis sales;
- the Company will be able to successfully launch and commercialize new brands, create new products and product formats and enter into new markets; and
- there is acceptance and demand for current and future Company products by consumers and provincial purchasers;

Although management believes that the expectations represented in such forward-looking statements are reasonable, there is no assurance that such expectations will prove to have been correct. Auxly cannot guarantee future results, performance or achievements.

Readers are further cautioned that the preparation of financial statements in accordance with IFRS requires management to make certain judgments and estimates that affect the reported amount of assets, liabilities, revenues and expenses. These estimates may impact the financial performance of Auxly when further information becomes available.