# AUXLY CANNABIS GROUP INC.

## CONSOLIDATED FINANCIAL STATEMENTS

### FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

**Dated April 23, 2021**

# Independent auditor's report

To the Shareholders of
**Auxly Cannabis Group Inc.**

### Opinion

We have audited the consolidated financial statements of **Auxly Cannabis Group Inc.** and its subsidiaries [the "Group"], which comprise the consolidated statements of financial position as at December 31, 2020 and 2019 the consolidated statements of loss and comprehensive loss, consolidated statements of cash flows and consolidated statements of changes in equity for the years then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2020 and 2019, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ["IFRS"].

### Basis for opinion

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

### Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

| Key audit matter | How our audit addressed the key audit matter |
| --- | --- |
| ***Valuation of goodwill and indefinite life intangible assets*** | |
| As at December 31, 2020, goodwill and indefinite life intangible assets related to the Cannabis cash generating unit ["CGU"] were $23.6 million and $58.3 million, respectively. Management assesses at least annually, or at any time if an indicator of impairment exists, whether there has been an impairment loss in the carrying value of these assets. The Company performs their annual impairment test as of December 31 and estimates the recoverable amount of the CGU to which goodwill and indefinite life intangible assets have been allocated using a discounted cash flow model. The Company discloses significant judgments, estimates and assumptions and the result of their analysis in respect of impairment in note 9 to the consolidated financial statements.<br><br>Auditing management's annual goodwill and indefinite life intangible assets impairment test was complex, given the degree of judgment and subjectivity in evaluating management's estimates and assumptions in determining the recoverable amount of the Cannabis CGU. Significant assumptions included revenue growth rates, earnings margins and the discount rate, which are affected by expectations about future market and economic conditions. | To test the estimated recoverable amount of the Cannabis CGU, our audit procedures included, among others:<br>• We evaluated the historical accuracy of management's estimates on revenue growth rates and earnings margins by comparing management's past projections to actual performance;<br>• We compared management's estimated revenue growth rates and earnings margins to current industry, market, historical performance and economic trends;<br>• With the assistance of our valuation specialists, we assessed the Company's impairment model, valuation methodology, and certain significant assumptions, including the discount rate, and compared the aggregate recoverable amount of the CGU to the Company's market capitalization;<br>• With the assistance of our valuation specialists, we assessed the selection and application of the discount rate by comparing the risk-free rate and risk premiums to comparable market data;<br>• With the assistance of our valuation specialists, we performed a sensitivity analysis on significant assumptions, including revenue growth rates, earnings margins and the discount rate, to evaluate changes in the recoverable amount of the CGU that would result from changes in the assumptions; and<br>• We assessed the adequacy of the Company's disclosures included in note 9 of the accompanying consolidated financial statements in relation to this matter. |

| Key audit matter | How our audit addressed the key audit matter |
|---|---|
| ***Valuation of cannabis inventory*** | |
| As at December 31, 2020, the Group held inventory of $43.8 million. The Company discloses its accounting policies with relation to inventory in note 3, and the significant components of inventory in note 7 to the consolidated financial statements.<br><br>Auditing management's inventory costing is complex due to the nature of the process to calculate the ongoing cost of inventory and the use of complex models [the "model"] used to calculate ongoing cost of inventory. There are a variety of inputs and source data used within the model that increase the extent of audit effort, including suitable portions of related production overheads, based on normal operating capacity and expenditures directly related to the manufacturing process. | To test the valuation of cannabis inventory, our audit procedures included, among others:<br>• We evaluated the incorporation of the source data into the models, and on a sample basis tested the formulas used and the computational accuracy;<br>• We tested management's calculation of production costs and allocation of indirect costs by assessing the appropriateness of the allocation method, assessing the appropriateness of utilization and normal operating capacity, and recalculating the allocations;<br>• We tested the production quantities used in the model by physically observing and verifying inventory quantities on a sample basis; and<br>• We assessed the adequacy of the Company's disclosures included in note 7 of the accompanying consolidated financial statements in relation to this matter. |

**Other information**

Management is responsible for the other information. The other information comprises of Management's Discussion and Analysis.

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

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

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

**Responsibilities of management and those charged with governance for the consolidated financial statements**

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

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

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

**Auditor's responsibilities for the audit of the consolidated financial statements**

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

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

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

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

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

The engagement partner on the audit resulting in this independent auditor's report is Kwan-Ho Song.

Ernst & Young LLP

Chartered Professional Accountants
Licensed Public Accountants

Toronto, Canada
April 23, 2021

# AUXLY CANNABIS GROUP INC.

## Consolidated Statements of Financial Position

Expressed in thousands of Canadian Dollars

| As at | December 31, 2020 | December 31, 2019 Restated * |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents (Note 4) | **$ 21,214** | $ 44,134 |
| Short-term investments | **286** | 306 |
| Accounts receivables (Note 5) | **10,684** | 1,712 |
| Note receivable | **-** | 135 |
| Biological assets (Note 6) | **419** | 230 |
| Inventory (Note 7) | **43,797** | 26,827 |
| Research contract costs | **2,931** | 1,538 |
| Prepaid expenses | **873** | 2,957 |
| Deposits (Note 13) | **7,444** | - |
| Other receivables | **2,785** | 13,759 |
| | **90,433** | 91,598 |
| **Non-current assets** | | |
| Property, plant and equipment, net (Note 8) | **95,354** | 85,178 |
| Intangible assets, net (Note 9) | **74,259** | 77,424 |
| Goodwill (Note 9) | **28,595** | 28,595 |
| Long-term investments (Note 11) | **5,026** | 16,239 |
| Investment in joint venture (Note 12) | **82,079** | 96,499 |
| Long-term deposits (Note 13) | **1,781** | 15,649 |
| | **287,094** | 319,584 |
| Assets held for sale (Note 27) | **1,436** | - |
| **Total assets** | **$ 378,963** | $ 411,182 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | **$ 27,241** | $ 20,235 |
| Interest payable | **6,563** | 1,384 |
| Lease liability (Note 14) | **1,473** | 1,243 |
| Convertible debenture (Note 15) | **-** | 2,705 |
| Short-term debt (Note 16) | **3,276** | - |
| Deferred revenue | **5,659** | 4,332 |
| | **44,212** | 29,899 |
| **Non-current liabilities** | | |
| Lease liability (Note 14) | **9,410** | 4,893 |
| Convertible debenture (Note 15) | **110,525** | 90,882 |
| Deferred tax liability (Note 24) | **21,463** | 21,752 |
| Other non-current liabilities | **1,024** | 1,851 |
| | **142,422** | 119,378 |
| Liabilities held for sale (Note 27) | **800** | - |
| **Total liabilities** | **187,434** | 149,277 |
| **Equity** | | |
| Share capital (Note 17) | **394,574** | 384,431 |
| Reserves (Note 17) | **98,047** | 89,844 |
| Accumulated other comprehensive loss | **(21,952)** | (20,718) |
| Deficit | **(274,729)** | (189,303) |
| Total equity attributable to shareholders of the Company | **195,940** | 264,254 |
| Total equity attributable to non-controlling interest | **(4,411)** | (2,349) |
| **Total equity** | **191,529** | 261,905 |
| **Total liabilities and equity** | **$ 378,963** | $ 411,182 |

* Restated Measurement Period Adjustment (Note 10)

Commitments and Contingencies (Note 21)

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

The consolidated financial statements were approved by the Board of Directors on April 23, 2021 and were signed on its behalf by:

*(s) Genevieve Young*

Genevieve Young

## Consolidated Statements of Loss and Comprehensive Loss

Expressed in thousands of Canadian Dollars, except share and per share amounts

| | | Year ended December 31 2020 | | Year ended December 31 2019 |
|---|---|---|---|---|
| **Revenue** | | | | |
| Revenue from sales of cannabis products | **$** | **57,182** | $ | 2,287 |
| Research contracts and other | | **4,147** | | 6,262 |
| Excise taxes | | **(10,533)** | | (197) |
| **Total net revenue** | | **50,796** | | 8,352 |
| **Costs of sales** | | | | |
| Costs of finished cannabis inventory sold | | **33,858** | | 2,162 |
| Research contracts and other | | **2,750** | | 5,743 |
| Inventory impairment (Note 7) | | **3,393** | | 3,244 |
| **Gross profit excluding fair value items** | | **10,795** | | (2,797) |
| Unrealized fair value gain / (loss) on biological transformation (Note 6) | | **537** | | (761) |
| Realized fair value loss on inventory | | **(193)** | | (153) |
| **Gross profit / (loss)** | | **11,139** | | (3,711) |
| **Expenses** | | | | |
| Selling, general, and administrative expenses (Note 22) | | **48,855** | | 50,291 |
| Depreciation and amortization (Notes 8, 9) | | **9,384** | | 8,574 |
| Interest expense (Note 23) | | **13,043** | | 12,121 |
| **Total expenses** | | **71,282** | | 70,986 |
| **Other income / (loss)** | | | | |
| Fair value loss for financial instruments accounted under FVTPL (Note 11) | | **(4,408)** | | (6,482) |
| Interest and other income | | **477** | | 3,612 |
| Impairment of long-term assets (Note 8) | | **(6,146)** | | (5,283) |
| Impairment of intangible assets and goodwill | | **-** | | (29,631) |
| Loss on settlement of assets and liabilities and other expenses | | **(10,048)** | | (3,550) |
| Share of loss on investment in joint venture (Note 12) | | **(7,407)** | | (2,081) |
| Foreign exchange loss | | **(437)** | | (1,484) |
| **Total other losses** | | **(27,969)** | | (44,899) |
| **Net loss before income tax** | | **(88,112)** | | (119,596) |
| Income tax recovery (Note 24) | | **681** | | 10,978 |
| **Net loss** | **$** | **(87,431)** | $ | (108,618) |
| **Net loss attributable to shareholders of the Company** | **$** | **(85,426)** | $ | (102,574) |
| **Net loss attributable to non-controlling interest** | **$** | **(2,005)** | $ | (6,044) |
| **Other comprehensive loss** | | | | |
| Fair value loss on fair value through other comprehensive income investments - not subsequently reclassified to profit or loss (Note 11) | | **(1,004)** | | (9,704) |
| Currency translation adjustment - subsequently reclassified to profit or loss | | **(287)** | | (187) |
| **Total comprehensive loss** | **$** | **(88,722)** | $ | (118,509) |
| **Total comprehensive loss attributable to shareholders of the Company** | **$** | **(86,646)** | $ | (112,419) |
| **Total comprehensive loss attributable to non-controlling interest** | **$** | **(2,076)** | $ | (6,090) |
| **Net loss per common share** | | | | |
| Basic and diluted | **$** | **(0.14)** | $ | (0.17) |
| **Weighted average number of shares outstanding** | | | | |
| Basic and diluted | | **631,528,750** | | 596,409,703 |

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

## Consolidated Statements of Cash Flows
Expressed in thousands of Canadian Dollars

| | | Year ended December 31 2020 | | Year ended December 31 2019 |
|---|---|---|---|---|
| **Operating activities** | | | | |
| **Net loss for the period** | **$** | **(87,431)** | $ | (108,618) |
| Items not affecting cash: | | | | |
| Inventory impairment (Note 7) | | **3,393** | | 3,244 |
| Realized fair value loss on inventory | | **193** | | 153 |
| Unrealized fair value gain / (loss) on biological transformation (Note 6) | | **(537)** | | 761 |
| Depreciation and amortization (Notes 8, 9) | | **9,384** | | 8,574 |
| Share-based compensation (Note 22) | | **4,349** | | 12,552 |
| Interest expense (Note 23) | | **8,354** | | 6,370 |
| Share of loss on investment in joint venture (Note 12) | | **7,407** | | 2,081 |
| Unrealized foreign exchange loss | | **290** | | 1,303 |
| Fair value loss for financial instruments accounted under FVTPL (Note 11) | | **4,408** | | 6,482 |
| Income tax recovery (Note 24) | | **(681)** | | (10,978) |
| Impairment of long-term assets (Note 8) | | **6,146** | | 5,283 |
| Impairment of intangible assets and goodwill | | **-** | | 29,631 |
| Loss on settlement of assets and liabilities and other expenses | | **10,198** | | 2,182 |
| Assets held for sale (Note 27) | | **(3)** | | - |
| **Cash used in operating activities before net working capital adjustments** | | **(34,530)** | | (40,980) |
| Net change in non-cash working capital (Note 25) | | **1,402** | | (38,139) |
| **Cash used in operating activities** | **$** | **(33,128)** | $ | (79,119) |
| **Investing activities** | | | | |
| Issuance of notes receivable | **$** | **-** | $ | (16,700) |
| Proceeds from repayment of promissory notes | | **-** | | 400 |
| Payment on long-term deposits | | **-** | | (15,649) |
| Proceeds from debt obligation receivable in product equivalents | | **-** | | 9,514 |
| Investment in long-term investments | | **-** | | (1,500) |
| Proceeds from sale of long-term investments (Note 11) | | **6,015** | | 2,742 |
| Proceeds from short-term investments | | **-** | | 3,043 |
| Investment in joint venture | | **-** | | (79,482) |
| Proceeds from sale of assets (Note 8) | | **184** | | - |
| Purchase of capital assets (Note 8) | | **(20,729)** | | (37,802) |
| Net cash from business combinations (Note 10) | | **-** | | 616 |
| **Cash used in investing activities** | **$** | **(14,530)** | $ | (134,818) |
| **Financing activities** | | | | |
| Proceeds from share, special warrant and unit issuances | **$** | **-** | $ | 5,207 |
| Net proceeds from convertible debenture (Note 15) | | **10,664** | | 120,961 |
| Net proceeds from private placement December 2020 (Note 17) | | **12,719** | | - |
| Repayment of convertible debenture (Note 15) | | **(2,705)** | | (80,140) |
| Proceeds from warrants exercised | | **-** | | 336 |
| Proceeds from options exercised (Note 17) | | **190** | | - |
| Proceeds on short-term borrowings | | **3,276** | | - |
| Repayment on long-term debt | | **(950)** | | - |
| Proceeds from new lessor of Dosecann property (Note 14) | | **5,010** | | - |
| Payment on lease liabilities | | **(3,466)** | | - |
| **Cash provided by financing activities** | **$** | **24,738** | $ | 46,364 |
| **Decrease in cash and cash equivalents** | **$** | **(22,920)** | $ | (167,573) |
| Cash position, beginning of period | **$** | **44,134** | $ | 211,707 |
| **Cash and cash equivalents, end of period (Note 4)** | **$** | **21,214** | $ | 44,134 |

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

## Consolidated Statements of Changes in Equity
Expressed in thousands of Canadian Dollars

| | | Year ended December 31 2020 | | Year ended December 31 2019 |
|---|---|---|---|---|
| **Share capital** | | | | |
| Balance - beginning of period | $ | 384,431 | $ | 350,647 |
| Shares issued on exercise of warrants | | - | | 336 |
| Shares issued on exercise of convertible debentures | | - | | 51 |
| Shares issued on settlement of convertible debt | | - | | 14,931 |
| Shares issued on exercise of options | | 190 | | - |
| Shares issued on settlement of liabilities | | - | | 387 |
| Shares issued to Imperial for top-up rights | | - | | 5,207 |
| Shares issued on acquisition of Inverell | | - | | 9,523 |
| Shares issued on private placement December 2020 (Note 17) | | 9,865 | | - |
| Shares issued as employee awards | | - | | 3,257 |
| Fair value transfer on exercise of warrants | | - | | 92 |
| Fair value transfer on exercise of options | | 88 | | - |
| **Share capital - end of period** | $ | 394,574 | $ | 384,431 |
| **Reserves** | | | | |
| **Convertible debentures** | | | | |
| Balance - beginning of period | $ | 29,150 | $ | 4,076 |
| Equity component of convertible debentures | | 602 | | 25,077 |
| Fair value transfer to shares upon conversion | | - | | (3) |
| **Convertible debentures - end of period** | $ | 29,752 | $ | 29,150 |
| **Warrants** | | | | |
| Balance - beginning of period | $ | 30,463 | $ | 33,618 |
| Equity component of convertible debentures | | 485 | | - |
| Warrants issued on private placement December 2020 (Note 17) | | 2,855 | | - |
| Expiry of warrants | | - | | (3,063) |
| Fair value transfer to shares upon conversion | | - | | (92) |
| **Warrants - end of period** | $ | 33,803 | $ | 30,463 |
| **Contributed surplus** | | | | |
| Balance - beginning of period | $ | 30,231 | $ | 17,873 |
| Expiry of warrants | | - | | 3,063 |
| Employee share options: | | | | |
| Share based compensation | | 4,349 | | 9,295 |
| Fair value transfer of exercise of options | | (88) | | - |
| **Contributed surplus - end of period** | $ | 34,492 | $ | 30,231 |
| **Reserves - end of period** | $ | 98,047 | $ | 89,844 |
| **Accumulated other comprehensive loss** | | | | |
| Balance - beginning of period | $ | (20,718) | $ | (10,873) |
| Fair value changes in long-term investments (Note 11) | | (1,004) | | (9,704) |
| Currency translation adjustment | | (230) | | (141) |
| **Accumulated other comprehensive loss - end of period** | $ | (21,952) | $ | (20,718) |
| **Deficit** | | | | |
| **Attributable to the company** | | | | |
| Balance - beginning of period | $ | (189,303) | $ | (86,729) |
| Net loss attributable to the company | | (85,426) | | (102,574) |
| Ending deficit attributable to the company | | (274,729) | | (189,303) |
| **Attributable to non-controlling interests** | | | | |
| Balance - beginning of period | $ | (2,349) | $ | 3,017 |
| Currency translation adjustment | | (57) | | (46) |
| Net loss attributable to non-controlling interests | | (2,005) | | (5,320) |
| Ending deficit attributable to non-controllable interests | | (4,411) | | (2,349) |
| **Deficit - end of period** | $ | (279,140) | $ | (191,652) |
| **Shareholders' equity - end of period** | $ | 191,529 | $ | 261,905 |

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

## 1. Nature of operations

Auxly Cannabis Group Inc. ("Auxly", "we", "our", or the "Company") is a publicly traded company listed on the Toronto Stock Exchange ("TSX") (as of April 20, 2021, and prior to that date was listed on the TSX Venture Exchange) under the symbol "XLY", and was incorporated in British Columbia, Canada. The principal business address is 777 Richmond Street West, Toronto, Ontario.

**Description of the Company**

Auxly is a Canadian consumer packaged goods company in the cannabis products market, headquartered in Toronto, Canada. The Company's focus is on developing, manufacturing and distributing branded cannabis products that delight wellness and recreational consumers.

## 2. Basis of preparation

**Statement of compliance**

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements were approved by the Board of Directors and authorized for issue by the Board of Directors on April 23, 2021.

**Basis of measurement**

The policies set out were consistently applied to all the periods presented unless otherwise noted below. The preparation of consolidated financial statements in accordance with International Accounting Standards ("IAS") 1, *Presentation of Financial Statements* ("IAS 1"), requires the use of certain critical accounting estimates. It also requires management to exercise judgement in applying the Company's accounting policies. Certain comparative figures have been reclassified to conform with the consolidated financial statement presentation adopted for the current period ended December 31, 2020.

These consolidated financial statements have been prepared in Canadian dollars on a historical cost basis except for biological assets, long-term investments, certain long-term liabilities and derivatives, which are measured at fair value. Historical cost is generally based upon the fair value of the consideration given in exchange for assets. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether the price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.

## 2. Basis of preparation (continued)

### Basis of consolidation

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly and indirectly, to govern the financial and operating policies of an entity and be exposed to the variable returns from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

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

### Assessment of impact from COVID-19 pandemic

On March 11, 2020, the World Health Organization recognized the outbreak of COVID-19 as a global pandemic resulting in continued and uncertain economic and business impact on a global scale. As a result, the Company has reviewed its estimates, judgments and assumptions used in the preparation of its consolidated financial statements, including with respect to the determination of whether indicators of impairment exist for its tangible and intangible assets, including goodwill and the credit risk of its counterparties.

Due to social distancing measures put in place in order to reduce the transmission of COVID-19, KGK Science Inc. ("KGK") was initially unable to commence new clinical trials with participants that make up a significant portion of its business, but has since shifted to a virtual process allowing it to facilitate new clinical trials.

As of December 31, 2020, the Company has determined that no significant revisions to estimates, judgments or assumptions were required for the Cannabis related operating segments; however, the continuing uncertainty associated with the COVID-19 pandemic may require changes in future periods. The Company will continue to closely monitor the impact of the COVID-19 pandemic, including any such changes to estimates, judgments or assumptions could have a material impact on the Company's financial position and results of operations.

For more information, refer to note 9.

## 2. Basis of preparation (continued)

### Subsidiaries

These consolidated financial statements are comprised of the financial results of the Company and its subsidiaries, which are the entities over which Auxly has control. Control exists when the Company has the power, directly and indirectly, to govern the financial and operating policies of an entity and be exposed to the variable returns from its activities. Non-controlling interests in the equity of Auxly's subsidiaries are shown separately in equity in the consolidated statements of financial position. The consolidated financial statements of the Company include:

| Subsidiaries | Equity interests |
|---|---|
| Dosecann LD Inc. | 100% |
| KGK Science Inc. | 100% |
| Kolab Project Inc. | 100% |
| Robinson's Cannabis Inc. | 100% |
| Robinson's Outdoor Grow Inc. | 100% |
| 2368523 Ontario Ltd. d/b/a Curative Cannabis | 96% |
| Inverell S.A. | 80% |

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

### Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The Company measures goodwill as the fair value of the consideration transferred, including the recognized amount of any non-controlling interest in the acquired business, less the net recognized amount of the identifiable assets and liabilities assumed, all measured as of the acquisition date. Any excess of the fair value of the net assets acquired over the assumed consideration paid is a gain on business acquisition and is recognized as a gain in the consolidated statements of loss and comprehensive loss. The Company elects on a transaction-by-transaction basis whether to measure non-controlling interest at its fair value or at its proportionate share of the recognized amount of the identifiable net assets, at the acquisition dates.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Company incurs in connection with a business combination are expensed as incurred.

### Joint ventures

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

Joint venture arrangements that involve the creation of a separate entity in which each party has an interest are referred to as jointly-controlled entities. The Company accounts for its interests in a joint venture using the equity method.

## 3. Significant accounting policies

### a) Functional currency

The consolidated financial statements are presented in Canadian dollars, which is also the Company's functional currency. Each entity within the consolidated financial statements determines its own functional currency and items included in the consolidated financial statements of each entity are remeasured using the functional currency. The functional currency of all subsidiaries is the Canadian dollar, except for Inverell S.A. ("Inverell") which has a U.S. Dollar functional currency.

Within each entity, transactions in currencies other than the functional currency are recorded at the rates of exchange prevailing on dates of transactions. At the end of each reporting period, monetary assets and liabilities denominated in foreign currencies are translated to the functional currency at the exchange rate at that date. Foreign exchange differences arising on translation are recognized in the consolidated statements of loss and comprehensive loss. Non-monetary assets and liabilities that are measured at historical cost are translated using the exchange rate at the date of the transaction.

The consolidated financial statements of subsidiaries for which the functional currency is not the Canadian dollar are translated into Canadian dollars using the exchange rate in effect at the end of the reporting period for assets and liabilities and the average exchange rates for the period for revenue, expenses and cash flows. Foreign exchange differences arising on translation are recognized in other comprehensive loss and in accumulated other comprehensive loss in shareholders' equity.

### b) Biological assets

The Company's biological assets consist of cannabis plants which are valued at fair value less cost to sell. The fair value was determined using the income approach.

Production costs include all direct and indirect costs relating to biological transformation, which are capitalized to biological assets as they were incurred on the consolidated statements loss and comprehensive loss.

## 3. Significant accounting policies (continued)

The direct and indirect costs include the following:

- Direct materials consumed in the growing process such as soil, chemicals, fertilizers and other supplies
- Direct labour for individuals who work in the cultivation department
- Indirect labour for other personnel's time spent related to the cultivation process
- Indirect materials consumed related to the cultivation process
- Utility related to the cultivation process
- Depreciation and maintenance of production equipment
- Quality assurance on the plants

The Company measures and adjusts the biological assets to the 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.

Unrealized gains or losses arising from the changes in fair value less cost to sell during the period are included as a separate line in the gross profit calculation on the consolidated statements of loss and comprehensive loss.

### c) Inventory

Inventories of purchased finished goods and packing materials are initially valued at cost and subsequently at the lower of cost and net realizable value. Inventories of harvested medical cannabis are transferred from biological assets at their fair value less costs to sell at harvest which becomes the initial cost. Inventories of harvested hemp are transferred from biological assets at their carrying amount upon harvest which becomes the initial cost. Any subsequent post-harvest costs, either direct or indirect, are capitalized to inventory to the extent that the 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 necessary to make the sale. Cost is determined using the average cost basis. Products for resale and supplies and consumables are valued at lower of cost and net realizable value on the consolidated statements of financial position. The Company reviews inventory for obsolete, redundant and slow-moving goods and any such inventory are written-down to net realizable value.

The post-harvest direct and indirect costs include the following:

- Direct materials such as packages, labels and bottles
- Direct labour for individuals who work in the processing department
- Indirect labour for other personnel's time spent related to the production process
- Indirect materials consumed related to the production process
- Utility related to the post-harvest process
- Depreciation and maintenance on dried cannabis processing and packaging equipment
- Quality assurance for the final product

The post-harvest costs capitalized in finished cannabis products and costs of other resale products are subsequently recorded in cost of goods sold on the consolidated statements of loss and comprehensive loss when they are sold. The realized initial costs upon sales, transferred from biological assets measured at fair value less costs to sell at harvest are presented as a separate line in the gross profit calculation on the consolidated statements of loss and comprehensive loss.

## 3. Significant accounting policies (continued)

### d) Property, plant and equipment

Property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Gains and losses on disposal are determined by comparing the proceeds from disposal and the carrying amount of the asset and are recognized in the consolidated statements of loss and comprehensive loss.

Depreciation is calculated using the straight-line method over the useful life of each asset as follows:

| | |
|---|---|
| • Land and assets not available for use | Not depreciated |
| • Computer equipment | 3 - 5 years |
| • Office furniture | 5 - 10 years |
| • Leasehold improvements | Over term of the lease |
| • Right of use assets | Over term of the lease |
| • Equipment | 5 - 10 years |
| • Buildings | 20 years |

Depreciation methods, useful lives, and estimated residual values are reviewed at the end of each financial year.

**Borrowing costs**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognized in profit or loss in the period which they are incurred.

### e) Finite-lived and indefinite-lived intangible assets

Finite-lived intangible assets are recorded at cost less accumulated amortization and accumulated impairment losses. Amortization is provided on a straight-line basis from when the asset is available for use, over the following terms:

| | |
|---|---|
| • Cultivation interests | Over the term of the agreement |
| • Canadian cultivation licenses | Indefinite life |
| • Processing licenses | Indefinite life |
| • International cultivation licenses | Indefinite life |
| • Distribution agreements | 15 years |

Others:

| | |
|---|---|
| • Patient referral agreements | 3 years |
| • Contractual rights agreements | 5 years |
| • Patents | 17 years |
| • Non-competition agreements | Over the term of the agreement |
| • Other licenses | Over the term of the agreement |

## 3. Significant accounting policies (continued)

The estimated useful life and amortization method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite useful lives are comprised of acquired product rights which are carried at cost less accumulated impairment losses.

Intangible assets with finite useful lives are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Indefinite life intangible assets are reviewed for impairment annually or at any time if an indicator of impairment exists.

### f) Impairment of long-lived assets

Long-lived assets, including property, plant and equipment and intangible assets are reviewed for impairment at each reporting date or whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds its recoverable amount. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of 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 of disposal, 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 equal to the amount by which the carrying amount 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 recoverable amount, and the carrying amount that would have been recorded had no impairment loss been recognized previously.

### g) Goodwill

Goodwill represents the excess of the price paid for the acquisition of an entity over the fair value of the net identifiable tangible and intangible assets and liabilities acquired. Goodwill is allocated to the CGU or CGUs to which it relates. Goodwill is measured at historical cost and is evaluated for impairment annually in the fourth quarter or more often if events or circumstances indicate there may be an impairment. Impairment is determined for goodwill by assessing if the carrying value of CGUs, including goodwill, exceeds its recoverable amount determined as the greater of the estimated fair value less costs of disposal and the value in use. Impairment losses recognized in respect of the CGUs are first allocated to the carrying value of goodwill and any excess is allocated to the carrying amount of assets in the CGUs. Any goodwill impairment is recorded in income in the period in which the impairment is identified. Impairment losses on goodwill are not subsequently reversed.

### h) Leased assets

The Company is a party to lease contracts for, among others: a) office space; b) machinery and equipment; and c) land. Leases are recognized, measured and presented in accordance with **IFRS 16**, *Leases* (“IFRS 16”).

The Company implemented a single accounting model, requiring lessees to recognize assets and liabilities for all leases excluding exceptions listed in the standard. The Company elected to apply exemptions for short term leases and for leases for which the underlying asset is of low value. The Company has also elected to apply the practical expedient to not separate non-lease components from lease components, and instead account for each lease component and any associated non-lease components as a single lease component.

## 3. Significant accounting policies (continued)

At inception of a contract, the Company assesses whether a contract is, or contains a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. The commencement date is the date on which a lessor makes an underlying asset available for use by a lessee.

The right-of-use assets are initially measured at cost, which comprises:

i. the amount of the initial measurement of the lease liability;
ii. any lease payments made at or before the commencement date, less any lease incentives; and
iii. any initial direct costs incurred by the lessee.

After the commencement date, the right-of-use assets are measured at cost less any accumulated depreciation and any accumulated impairment losses and adjusted for any re-measurement of the lease liability. Depreciation is calculated using the straight-line method over the estimated useful life on the same basis as owned assets, or where shorter, over the term of the respective lease. If the lease transfers ownership of the underlying asset to the Company by the end of the lease term or if the cost of the right-of-use asset reflects that the Company will exercise a purchase option, the Company depreciates the right of-use asset from the commencement date to the end of the useful life of the underlying asset.

The lease liability is initially measured at the present value of the lease payments that are not paid at that date, which comprises:

i. fixed payments, less any lease incentives receivable;
ii. variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
iii. amounts expected to be payable by the lessee under residual value guarantees;
iv. the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
v. payments of penalties for terminating the lease, if the lease term reflects the lessee exercising an option to terminate the lease.

The lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate. The lease liability is subsequently measured at amortized cost using the effective interest method. The lease term determined by the Company comprises:

i. non-cancellable period of lease contracts;
ii. periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option; and
iii. periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

## 3. Significant accounting policies (continued)

### i) Financial instruments

Financial assets and financial liabilities, including derivatives, are recognized on the consolidated statements of financial position when the Company becomes a party to the financial instrument or derivative contract.

***Classification***

The Company classifies its financial assets and financial liabilities in the following measurement categories: i) those to be measured subsequently at fair value through profit or loss ("FVTPL"); ii) those to be measured subsequently at fair value through other comprehensive income ("FVOCI"); and iii) those to be measured at amortized cost. The classification of financial assets depends on the business model for managing the financial assets and the contractual terms of the cash flows. Financial liabilities are classified as those to be measured at amortized cost unless they are designated as those to be measured subsequently at FVTPL (irrevocable election at the time of recognition). For assets and liabilities measured at fair value, gains and losses are either recorded in profit or loss or other comprehensive income.

The Company reclassifies financial assets when and only when its business model for managing those assets changes. Financial liabilities are not reclassified.

***Amortized cost***

This category includes financial assets that are held within a business model with the objective to hold the financial assets in order to collect contractual cash flows that meet the solely payments of principal and interest ("SPPI") criterion. Financial asset classified in this category are measured at amortized cost using the effective interest method.

***Fair value through profit or loss***

This category includes derivative instruments as well as quoted equity instruments which the Company has not irrevocably elected, at initial recognition or transition, to classify at FVOCI. This category would also include debt instruments whose cash flow characteristics fail the SPPI criterion or are not held within a business model whose objective is either to collect contractual cash flows, or to both collect contractual cash flows and sell. Financial assets in this category are recorded at fair value with changes recognized in profit or loss.

***Financial assets at fair value through other comprehensive income***

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.

***Measurement***

All financial instruments are required to be measured at fair value on initial recognition, plus, in the case of a financial asset or financial liability not at FVTPL, transaction costs that are directly attributable to the acquisition or issuance of the financial asset or financial liability. Transaction costs of financial

## 3. Significant accounting policies (continued)

assets and financial liabilities carried at FVTPL are expensed in profit or loss. Financial assets and financial liabilities with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payments of principal and interest.

Financial assets that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortized cost at the end of the subsequent accounting periods. All other financial assets including equity investments are measured at their fair values at the end of subsequent accounting periods, with any changes taken through profit and loss or other comprehensive income (irrevocable election at the time of recognition). For financial liabilities measured subsequently at FVTPL, changes in fair value due to credit risk are recorded in other comprehensive income.

***Summary of the Company's classification and measurements of financial assets and liabilities***

| | **IFRS 9** | |
|---|---|---|
| | **Classification** | **Measurement** |
| Cash and cash equivalents | FVTPL | Fair value |
| Short-term investments | FVTPL | Fair value |
| Other receivables | Amortized cost | Amortized cost |
| Note receivable | Amortized cost | Amortized cost |
| Long-term investments | FVOCI and FVTPL | Fair value |
| Accounts payable and accrued liabilities | Amortized cost | Amortized cost |
| Convertible debenture | Amortized cost | Amortized cost |
| Long-term loans payable | Amortized cost | Amortized cost |
| Interest payable on convertible debenture | Amortized cost | Amortized cost |

### j) Compound financial instruments

Compound financial instruments issued by the Company comprises convertible debentures that can be converted into common shares of the Company. The liability component of a compound financial instrument is recognized initially at the fair value of a similar liability that does not have an equity

## 3. Significant accounting policies (continued)

conversion option. The equity component is recognized initially as the difference between the fair value of the computed financial instrument as whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of a compound financial instrument is measured at amortized cost using the effective interest method. The equity component of a compound financial instrument is not re-measured subsequent to initial recognition. On conversion or upon expiration, the carrying value of the equity portion is transferred to common shares or contributed surplus.

**k) Revenue recognition**

***Revenue from contracts with customers***
Revenue is measured based on the consideration specified in a contract with a customer and excludes amounts collected on behalf of third parties. The Company recognizes revenue when it transfers control over a product or service to a customer.

The Company follows the five-step model in the Standard to recognize revenue

1) Identify the contract with a customer
2) Identify the performance obligations in the contract
3) Determine the transaction price
4) Allocate the transaction price to performance obligations in the contract
5) Recognize revenue when the Company satisfies a performance obligation

Revenue from the sale of cannabis to customers is recognized when the Company transfers control of the good to the customer. This evaluation was made on the basis of whether the business obtains control of the product before transferring to the end consumer. Control of the product transfers at a point in time either upon shipment to or receipt by the customer, depending on the contractual terms. The Company recognizes revenue in an amount that reflects the consideration that the Company expects to receive taking into account any variation that may result from rights of return.

Revenue is also generated from providing research services for customers who are conducting human clinical trials. Billing or payments received from customers in advance of revenue recognition are recorded as deferred revenue on the consolidated statements of financial position, and costs incurred for fulfilling the contract are recorded as research contract cost on the consolidated statements of financial position.

<u>Costs to obtain or fulfil contracts with customers</u>

The Company capitalizes the incremental costs incurred to obtain the contracts and direct costs incurred to fulfil the contracts and records them as research contract costs on the consolidated statements of financial position. Incremental costs are those costs the Company incurs to obtain a contract with a customer that would not have been incurred if the contract had not been obtained.

Expenditures that do not meet the above criteria are expensed when incurred.

## 3. Significant accounting policies (continued)

The Company amortizes the research contract costs on a systematic basis that is consistent with the transfer of research services and periodically compares the carrying amount to the remaining amount of consideration that Company expects to receive in exchange for the services to which the asset relates less the costs that relate directly to provide the services that have not been recognized as expenses (the recoverable amount). If the carrying amount of the asset is greater than the recoverable amount, an impairment loss will be recorded.

### l) Income taxes

Income tax comprises current and deferred tax. Income tax is recognized in the consolidated statements of loss and comprehensive loss except to the extent that it relates to items recognized directly in shareholders' equity, in which case the income tax is also recognized directly in shareholders' equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted at the end of the reporting period, and any adjustments to tax payable in respect of previous years.

In general, deferred tax is recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined on a non-discounted basis using the tax rates and laws that have been enacted or substantively enacted at the statements of financial position dates and are expected to apply when the deferred tax asset or liability is settled. Deferred tax assets are recognized to the extent that it is probable the assets can be recovered.

Deferred income tax assets and liabilities are presented as non-current.

### m) Share capital and share-based compensation

The Company has a stock option plan for directors, officers and employees. Each tranche of an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over each tranche's vesting period, based on the number of awards expected to vest, with the offset credited to contributed surplus. When options are exercised, the amount received is credited to share capital and the fair value attributed to these options is transferred from contributed surplus to share capital. The impact of a revision of the original estimate is recognized in profit or loss such that the cumulative expense reflects the revised estimate.

Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity. Contributed surplus includes amounts in connection with conversion options embedded in compound financial instruments, stock-based compensation and the value of expired options and warrants. Deficit includes all current and in period income and losses.

### n) Earnings (loss) per share

The Company presents basic and diluted loss per share data for its common shares. Basic loss per share is calculated by dividing the profit or loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted loss per share is determined by adjusting the loss attributable to common shareholders and the weighted average number of common shares outstanding, adjusted for the effects of all dilutive potential common shares, which comprise convertible debentures, warrants and share options issued.

## 3. Significant accounting policies (continued)

For the periods presented, all options, conversion features and warrants were anti-dilutive.

**o) Business combinations**

The Company has applied the acquisition method in accounting for business combinations.

The Company measures goodwill as the difference between the fair value of the consideration transferred, including the recognized amount of any non-controlling interest in the acquiree, and the net recognized amount (generally fair value) of the identifiable assets acquired and liabilities assumed, all measured as of the acquisition date.

Consideration transferred includes the fair value of the assets transferred (including cash), liabilities incurred by the Company on behalf of the acquiree, and equity interests issued by the Company. Consideration transferred also includes the fair value of any contingent consideration.

The contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as a liability is remeasured at subsequent reporting dates in accordance with **IFRS 9***, Financial Instruments*, with the corresponding gain or loss being recognized in profit or loss.

Transaction costs that the Company incurs in connection with a business combination, such as finders' fees, legal fees, due diligence fees, and other professional and consulting fees, are expensed in the period as incurred.

**p) Use of estimates and judgments**

The preparation of 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.

***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.

## 3. Significant accounting policies (continued)

***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.

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.

***Control, joint control or level of influence***

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

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

## 3. Significant accounting policies (continued)

***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.

### q) Adoption of new accounting standards

***Amendments to IFRS 3, Business Combinations ("IFRS 3") – Definition of a Business***

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 to help entities determine whether an acquired set of activities and assets is a business or not. The amendments clarify the minimum requirements for a business, removed the assessment of whether market participants are capable of replacing any missing elements, added guidance to help entities assess whether an acquired process is substantive, narrowed the definitions of a business and of outputs, and introduced an optional fair value concentration test. Effective January 1, 2020, the Company adopted the amendments to IFRS 3, with no material impact on its consolidated financial statements.

## 3. Significant accounting policies (continued)

***Amendments to IAS 1, Presentation of Financial Statements ("IAS 1"); and IAS 8, Accounting policies, changes in accounting estimates and errors ("IAS 8") – Definition of Material***

In October 2018, the IASB issued amendments to IAS 1 and IAS 8 to align the definition of "material" across the standards and to clarify certain aspects of the definition. The new definition states that, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Effective January 1, 2020, the Company adopted the amendments to IAS 1 and IAS 8, with no material impact on its consolidated financial statements.

**r) Future accounting pronouncements**

The Company monitors the potential changes proposed by the IASB and analyses the effect that changes in the standards may have on operations.

***Amendment to IAS 1***

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, with early adoption permitted. The amendments are to be applied retrospectively. The Company does not intend to early adopt these amendments and is currently assessing the impact of these amendment on its consolidated financial statements.

***Amendments to IFRS 9***

As part of its 2018-2020 annual improvements to IFRS standards process, the IASB issued 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 with earlier adoption permitted. The Company is still assessing the impact of adopting these amendments on its consolidated financial statements.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 4. Restricted cash

Auxly has restricted cash as collateral in order to facilitate an issuance of a letter of credit. As at December 31, 2020, Auxly has provided Union Gas a letter of credit in the amount of $557 (2019 - $557) on behalf of Sunens Farms Inc. ("Sunens") in order to supply power to the facility. In 2019, the Company had restricted cash of $3,480 related to the repayment of the maturing 2018 convertible debentures in January 2020.

## 5. Accounts receivables

Accounts receivables for cannabis sales are paid by most provinces in less than 60 days, with some provinces paying 60 - 70 days from receipt of goods. Research contract accounts receivables can extend beyond 120 days; however, have a historically high collection rate.

| | As at December 31, 2020 | As at December 31, 2019 |
|---|---|---|
| Less than 30 days past billing date | $ 5,784 | $ 1,681 |
| 31 to 60 days past billing date | 3,885 | 217 |
| 61 to 90 days past billing date | 1,033 | 3 |
| Over 120 days past billing date | 427 | 48 |
| | **$ 11,129** | **$ 1,949** |
| Sales provision | (445) | (237) |
| | **$ 10,684** | **$ 1,712** |

## 6. Biological assets

The continuity of the Company's biological assets is as follows:

| | Cannabis | Hemp | Total |
|---|---|---|---|
| **Balance at December 31, 2019** | **$ 230** | **$ -** | **$ 230** |
| Changes in fair value less cost to sell due to biological transformation | 537 | - | 537 |
| Capitalized production costs | 2,225 | 777 | 3,002 |
| Transferred to inventory upon harvest | (2,573) | - | (2,573) |
| Biological asset write-off | - | (777) | (777) |
| **Balance at December 31, 2020** | **$ 419** | **$ -** | **$ 419** |

| | Cannabis | Hemp | Total |
|---|---|---|---|
| **Balance at December 31, 2018** | **$ 345** | **$ 1,813** | **$ 2,158** |
| Changes in fair value less cost to sell due to biological transformation | (761) | - | (761) |
| Capitalized production costs | 1,494 | 3,420 | 4,914 |
| Transferred to inventory upon harvest | (848) | (2,800) | (3,648) |
| Biological asset write-off | - | (2,383) | (2,383) |
| Currency translation adjustment | - | (50) | (50) |
| **Balance at December 31, 2019** | **$ 230** | **$ -** | **$ 230** |

The fair value of biological assets is categorized within Level 3 on the fair value hierarchy. The inputs and assumptions used in determining the fair value of biological assets include:

(a) Selling price per gram;
(b) Attrition rate;
(c) Average yield per plant;
(d) Standard cost per gram to complete production; and
(e) Cumulative stage of completion in production process.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 6. Biological assets (continued)

As at December 31, 2020, the cannabis plants were on average 42% complete through their estimated 14-week growing cycle.

Significant unobservable assumptions used in the valuation of biological assets, including the sensitivities on changes in these assumptions and their effect on the fair value of biological assets, are as follows:

| Significant inputs and assumptions | Inputs | Sensitivity | Effect on biological asset balance |
|---|---|---|---|
| Selling price per gram | $8.60 dollar | Increase / (decrease) $1.00/gram | Increase / (decrease) $88.9 |
| Average yield per plant | 70 grams | Increase / (decrease) 10% | Increase / (decrease) $50.6 |
| Post-harvest cost per gram | $0.92 dollar/gram | Increase / (decrease) $0.5/gram | Increase / (decrease) $95.2 |

## 7. Inventory

The following is a breakdown of inventory at December 31, 2020:

| | Capitalized costs | Fair value transferred from biological assets | Carrying value |
|---|---|---|---|
| Dried cannabis | | | |
| Work-in-process | $ 3,911 | $ (189) | $ 3,722 |
| Finished goods | 425 | 3 | 428 |
| Dried hemp | | | |
| Work-in-process | 6,367 | - | 6,367 |
| Cannabis oil | | | |
| Work-in-process | 14,060 | - | 14,060 |
| Finished goods | - | - | - |
| Generation 2 derivative products | | | |
| Work-in-process | 1,311 | - | 1,311 |
| Finished goods | 6,703 | - | 6,703 |
| Merchandise products | 28 | - | 28 |
| Packaging, hardware, consumables and ingredients | 11,178 | - | 11,178 |
| **Balance at December 31, 2020** | **$ 43,983** | **$ (186)** | **$ 43,797** |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 7. Inventory (Continued)

The following is a breakdown of inventory at December 31, 2019:

| | Capitalized costs | Fair value transferred from biological assets | Carrying value |
|---|---|---|---|
| Dried cannabis | | | |
| Work-in-process | $ 4,437 | $ 21 | $ 4,458 |
| Finished goods | 189 | 52 | 241 |
| Dried hemp | | | |
| Work-in-process | 233 | - | 233 |
| Cannabis oil | | | |
| Work-in-process | 14,290 | - | 14,290 |
| Finished goods | 1,387 | - | 1,387 |
| Generation 2 derivative products | | | |
| Work-in-process | 735 | - | 735 |
| Finished goods | 447 | - | 447 |
| Merchandise products | 54 | - | 54 |
| Packaging, hardware, consumables and ingredients | 4,982 | - | 4,982 |
| **Balance at December 31, 2019** | **$ 26,754** | **$ 73** | **$ 26,827** |

As of December 31, 2020, the Company recognized $43,797 (2019 - $26,827) of inventory on the consolidated statements of financial position, including $186 non-cash expense (2019 - $73 non-cash income) relating to the fair value less cost to sell transferred to inventory upon harvest.

The Company wrote off $1,157 (2019 - $1,851) of dried hemp inventory due to the costs capitalized exceeding the recoverable amount. The Company also impaired $2,236 (2019 - $1,393) cannabis inventory due to the costs capitalised exceeding the net realizable value of the inventory. The impairment loss has been included in the cost of goods sold in the consolidated statements of loss and comprehensive loss.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 8. Property, plant and equipment

| | Computers and office furniture | Leasehold improvement | Equipment | Buildings | Construction-in-progress | Land | Right of use assets | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | | |
| **December 31, 2019** | $ 4,249 | $ 1,272 | $ 10,704 | $ 24,755 | $ 36,475 | $ 5,218 | $ 7,102 | **$ 89,775** |
| Additions | 355 | 68 | 7,168 | 1,012 | 13,281 | 14 | 1,963 | **23,861** |
| Disposals | (59) | (1,104) | (42) | (30) | (113) | - | (245) | **(1,593)** |
| Transfers | (606) | 29,852 | 904 | 3,483 | (33,638) | 5 | - | **-** |
| Impairment of long-term assets | (777) | - | (1,081) | (3,557) | - | (428) | - | **(5,843)** |
| **December 31, 2020** | **$ 3,162** | **$ 30,088** | **$ 17,653** | **$ 25,663** | **$ 16,005** | **$ 4,809** | **$ 8,820** | **$ 106,200** |
| **Accumulated depreciation:** | | | | | | | | |
| **December 31, 2019** | $ 688 | $ 353 | $ 1,046 | $ 1,404 | $ - | $ - | $ 967 | **$ 4,458** |
| Depreciation | 726 | 591 | 1,563 | 1,682 | - | 25 | 2,260 | **6,847** |
| Disposals | (8) | (153) | (7) | (471) | - | - | (214) | **(853)** |
| Transfers | - | - | 11 | (11) | - | - | - | **-** |
| Impairment of long-term assets | (208) | - | (221) | (456) | - | - | - | **(885)** |
| **December 31, 2020** | **$ 1,198** | **$ 791** | **$ 2,392** | **$ 2,148** | **$ -** | **$ 25** | **$ 3,013** | **$ 9,567** |
| **Adjustments** | | | | | | | | |
| Currency translation | **$ 12** | **$ (19)** | **$ (42)** | **$ 69** | **$ -** | **$ (20)** | **$ 4** | **$ 4** |
| Reclassification to assets held for sale (Note 27) | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ (1,280)** | **$ (3)** | **$ (1,283)** |
| **Carrying amounts** | | | | | | | | |
| **December 31, 2020** | **$ 1,976** | **$ 29,278** | **$ 15,219** | **$ 23,584** | **$ 16,005** | **$ 3,484** | **$ 5,808** | **$ 95,354** |

| | Computers and office furniture | Leasehold improvement | Equipment | Buildings | Construction-in-progress | Land | Right of use assets | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | | |
| **December 31, 2018** | $ 1,854 | $ 1,013 | $ 2,689 | $ 4,361 | $ 18,823 | $ 675 | $ - | **$ 29,415** |
| Reclassification on transition to IFRS 16 | - | - | - | - | - | - | 5,148 | **5,148** |
| Additions from foreclosure | 5 | - | - | 148 | 16,598 | 844 | - | **17,595** |
| Additions | 2,507 | 937 | 6,876 | 3,131 | 20,652 | 3,699 | 1,954 | **39,756** |
| Transfers | - | (3) | 2,090 | 17,342 | (19,429) | - | - | **-** |
| Dispositions | - | - | - | - | (169) | - | - | **(169)** |
| Impairment of long-term assets | (117) | (675) | (951) | (227) | - | - | - | **(1,970)** |
| **December 31, 2019** | **$ 4,249** | **$ 1,272** | **$ 10,704** | **$ 24,755** | **$ 36,475** | **$ 5,218** | **$ 7,102** | **$ 89,775** |
| **Accumulated depreciation:** | | | | | | | | |
| **December 31, 2018** | $ 161 | $ 68 | $ 140 | $ 343 | $ - | $ - | $ - | **$ 712** |
| Depreciation | 538 | 360 | 980 | 1,072 | - | - | 967 | **3,917** |
| Impairment of long-term assets | (11) | (75) | (74) | (11) | - | - | - | **(171)** |
| **December 31, 2019** | **$ 688** | **$ 353** | **$ 1,046** | **$ 1,404** | **$ -** | **$ -** | **$ 967** | **$ 4,458** |
| **Adjustments** | | | | | | | | |
| Currency translation | **$ (9)** | **$ (19)** | **$ (72)** | **$ (31)** | **$ -** | **$ (8)** | **$ -** | **$ (139)** |
| **Carrying amounts** | | | | | | | | |
| **December 31, 2019** | **$ 3,552** | **$ 900** | **$ 9,586** | **$ 23,320** | **$ 36,475** | **$ 5,210** | **$ 6,135** | **$ 85,178** |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 8. Property, plant and equipment (continued)

On November 6, 2020, the Company completed the disposal of all or substantially all of the assets and liabilities relating to Kolab Project Inc.'s wholly-owned retail store in Lloydminster, Saskatchewan. The proceeds received for the assets and liabilities were $934, resulting in a gain of $473 recorded in the consolidated statements of loss and comprehensive loss. $750 of the purchase price was satisfied through the issuance of 1,282,270 common shares in the capital stock of the purchaser at a deemed price of $0.5849 per common share. The balance of the purchase price was paid in cash.

## 9. Intangible assets and goodwill

### *Intangible Assets*

| | Cultivation interests | Canadian cultivation licences | Processing licences | International cultivation licences | Distribution agreements | Others | Total |
|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | |
| **December 31, 2019** | $ 19,783 | $ 27,152 | $ 31,100 | $ - | $ 829 | $ 4,512 | **$ 83,376** |
| Additions | - | - | - | - | 21 | 398 | **419** |
| Disposals | - | - | - | - | - | (2,291) | **(2,291)** |
| **December 31, 2020** | **$ 19,783** | **$ 27,152** | **$ 31,100** | **$ -** | **$ 850** | **$ 2,619** | **$ 81,504** |
| **Accumulated amortization:** | | | | | | | |
| **December 31, 2019** | $ 3,260 | $ - | $ - | $ - | $ 55 | $ 2,637 | **$ 5,952** |
| Amortization | 2,626 | - | - | - | 64 | 921 | **3,611** |
| Disposals | - | - | - | - | - | (2,318) | **(2,318)** |
| **December 31, 2020** | **$ 5,886** | **$ -** | **$ -** | **$ -** | **$ 119** | **$ 1,240** | **$ 7,245** |
| **Carrying amounts:** | | | | | | | |
| **December 31, 2020** | **$ 13,897** | **$ 27,152** | **$ 31,100** | **$ -** | **$ 731** | **$ 1,379** | **$ 74,259** |

| | Cultivation interests | Canadian cultivation licences | Processing licences | International cultivation licences | Distribution agreements | Others | Total |
|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | |
| **December 31, 2018** | $ 11,142 | $ 27,152 | $ 31,100 | $ 14,206 | $ 829 | $ 4,240 | **$ 88,669** |
| Additions | 1,597 | - | - | - | - | 1,603 | **3,200** |
| Dispositions | - | - | - | - | - | (603) | **(603)** |
| Reclassification | 10,441 | - | - | - | - | - | **10,441** |
| Impairment | (3,397) | - | - | (14,936) | - | (728) | **(19,061)** |
| **December 31, 2019** | **$ 19,783** | **$ 27,152** | **$ 31,100** | **$ (730)** | **$ 829** | **$ 4,512** | **$ 82,646** |
| **Accumulated amortization:** | | | | | | | |
| **December 31, 2018** | $ - | $ - | $ - | $ - | $ - | $ 1,446 | **$ 1,446** |
| Dispositions | - | - | - | - | - | (151) | **$ (151)** |
| Amortization | 3,260 | - | - | - | 55 | 1,342 | **4,657** |
| **December 31, 2019** | **$ 3,260** | **$ -** | **$ -** | **$ -** | **$ 55** | **$ 2,637** | **$ 5,952** |
| **Adjustments** | | | | | | | |
| Currency translation | **$ -** | **$ -** | **$ -** | **$ 730** | **$ -** | **$ -** | **$ 730** |
| **Carrying amounts:** | | | | | | | |
| **December 31, 2019** | **$ 16,523** | **$ 27,152** | **$ 31,100** | **$ -** | **$ 774** | **$ 1,875** | **$ 77,424** |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 9. Intangible assets and goodwill (continued)

### a) Cultivation interests

The Company's cultivation interests represent its access to raw cannabis, including offtake agreements, joint ventures, and streaming partners. As of December 31, 2020, the carrying value of cultivation interests was $13,897, consisting of four partners, CannTx Life Sciences Inc. ("CannTx"), Lotus Cannabis Co., Delta 9 Cannabis Inc. ("Delta 9") and Sunens.

### b) Distribution agreements

The Company has formed a strategic alliance with Inner Spirit which includes certain supply and marketing rights subject to applicable provincial laws for each applicable jurisdiction in which Inner Spirit operates retail cannabis stores. The distribution agreement intangible asset represents the premium paid by the Company over and above the fair market value of the shares on the date of the initial agreement.

### c) Others

On September 25, 2019, the Company and Imperial Brands PLC ("Imperial Brands") entered into a collaborative partnership whereby the Company was granted global licences to Imperial Brands' vaping technology for cannabis use and access to its vapor innovation business. A value of $1,603 was attributed to this right based on the cash flow savings expected to be derived from the licences, compared to the market rate for royalties of similar technology. A discount rate of 30% was used.

***Goodwill***

*Annual Impairment of CGUs*

As at December 31, 2020, the Company performed its annual impairment test on the indefinite life intangible assets and goodwill.

| | | |
|---|---|---|
| Balance, January 1, 2019 | $ | 33,920 |
| Business Combination - Curative *(restated - see Note 10)* | | 4,457 |
| Deferred tax adjustment | | 614 |
| Impairment of Goodwill | | (10,570) |
| Currency Translation Adjustment | | 174 |
| Balance, December 31, 2019 | $ | 28,595 |
| **Balance, December 31, 2020** | **$** | **28,595** |

*Canadian Cannabis CGU*

The Company's Canadian Cannabis CGU represents its operations dedicated to the cultivation and sale of cannabis and cannabis 2.0 products within Canada. In assessing goodwill and indefinite-life intangible assets for impairment, the Company compared the aggregate recoverable amount of the assets included in the CGU to their respective carrying amounts.

The recoverable amount of the CGU was based on value in use, estimated using discounted cash flows. The fair value measurement was categorized as a Level 3 fair value based on the inputs in the valuation technique used.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 9. Intangible assets and goodwill (continued)

The carrying value of the Canadian Cannabis CGU goodwill as at December 31, 2020 was $23,642. The key assumptions used in the estimation of the recoverable amount are set below. The values assigned to the key assumptions represent management's assessment of the future trends in the industry and have been based on historical data from both external and internal resources.

| | |
|---|---|
| Pre-tax discount rate | 19.0% |
| Terminal growth rate | 3.0% |
| Earnings growth rate | 37.0% to 155.0% |

The estimated recoverable amount of the CGU exceeded its carrying amount and as such, there was no impairment recorded as at December 31, 2020.

*Sensitivity to changes in assumptions*

Management has performed an assessment to determine whether an impairment would have been recognized if there was a change in any of the key assumptions identified above. An increase of 50 basis points in the pre-tax discount rate, a decrease of 50 basis points in the terminal growth rate, or a decrease of 50 basis points in the earnings growth rate, each used in isolation to perform the goodwill impairment tests, would not have resulted in an impairment charge being recognized for the year ended December 31, 2020.

*Research CGU*

The Company's Research CGU represents its operations dedicated to providing research services for customers who are conducting human clinical trials. In assessing goodwill and indefinite-life intangible assets for impairment, the Company compared the aggregate recoverable amount of the assets included in the CGU to their respective carrying amounts.

The recoverable amount of the CGU was based on value in use, estimated using discounted cash flows. The fair value measurement was categorized as a Level 3 fair value based on the inputs in the valuation technique used.

The key assumptions used in the estimation of the recoverable amount are set below. The values assigned to the key assumptions represent management's assessment of the future trends in the industry and have been based on historical data from both external and internal resources.

| | |
|---|---|
| Pre-tax discount rate | 19.0% |
| Terminal growth rate | 2.0% |
| Earnings growth rate | 67.0% to 147.0% |

## 9. Intangible assets and goodwill (continued)

The estimated recoverable amount of the CGU exceeded its carrying amount and as such, there was no impairment recorded as at December 31, 2020. In the year ending December 31, 2019, management allocated $728 of impairment losses towards the patent intangible asset, with the remaining $6,868 impairment being allocated to the goodwill of the CGU.

*Sensitivity to changes in assumptions*

Management has performed an assessment to determine whether an impairment would have been recognized if there was a change in any of the key assumptions identified above.

An increase of 50 basis points in the pre-tax discount rate, a decrease of 50 basis points in the terminal growth rate, or a decrease of 50 basis points in the earnings growth rate, each used in isolation to perform the goodwill impairment tests, would not have resulted in a material change in the impairment charge being recognized for the year ended December 31, 2020.

*South American Cannabis CGU*

The Company's South American Cannabis CGU represents its operations dedicated to the cultivation and sale of cannabis products within South America. Management determined that a liquidation approach was most appropriate in determination of the recoverable amount of the CGU due to the curtailing of Inverell's operations. Management reviewed the carrying amounts of the CGU's assets at the impairment date and wrote them down to the recoverable amount. Management recognized impairments of $Nil (2019 - $14,936) on indefinite life license intangible asset, $6,146 (2019 - $5,283) on long-term assets including property, plant and equipment (note 8), and $Nil (2019 - $3,702) on goodwill.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 10. Business combinations

On May 15, 2019, Auxly entered into a Supply Agreement with 2368523 Ontario Inc. d/b/a Curative Cannabis ("Curative") and was issued 25 common shares of Curative, representing a 20% ownership, as additional consideration for committing to fund Curative's facility. The Company's construction funding was secured against the 76% share ownership of the Curative shareholders. On November 27, 2019, Auxly foreclosed on the shares of the Curative shareholders and took ownership of an additional 76% of Curative's shares, bringing total ownership up to 96%.

The note and interest receivable prior to the foreclosure was $18,995. The foreclosure resulted in a loss of $893 due to the fair value of Curative's net assets being insufficient to cover Auxly's obligation due from the company. The loss was recorded in the consolidated statements of loss and comprehensive loss in the year ended December 31, 2019. A non-controlling interest was recorded on foreclosure of $724.

Goodwill of $4,457 arose due to the recognition of a deferred tax liability on the date of the acquisition. None of the goodwill arising on this acquisition is expected to be deductible for tax purposes.

The purchase price allocation for Curative was finalized during the period ended March 31, 2020. All net assets acquired, and consideration paid were included at their respective fair values. The Company has restated the comparative figures in the consolidated statements of financial position for the year ended December 31, 2019 based on the measurement period adjustments.

The following table summarize the effects of the change described above on the line items of the consolidated statements of financial position for the year ended December 31, 2019:

| As at December 31, 2019 | As previously reported | Adjustment | As restated |
|---|---|---|---|
| Goodwill | 29,005 | (410) | 28,595 |
| Deferred tax liability | 22,162 | (410) | 21,752 |

The purchase price allocations of the business combination has been included in the table below:

| | 2019 Curative Cannabis *(restated)* |
|---|---|
| Cash and cash equivalents | $ 616 |
| Other receivables | 693 |
| Prepaid expenses | 9 |
| Property, plant and equipment | 17,595 |
| Goodwill | 4,457 |
| Accounts payable and accrued liabilities | (811) |
| Deferred tax liabilities | (4,457) |
| Non-controlling interests | (724) |
| Net assets acquired | $ 17,378 |
| | |
| Loan settled through foreclosure | $ 13,757 |
| Value of existing investments in acquisition | 3,621 |
| | $ 17,378 |
| | |
| Consideration paid in cash | $ - |
| Less: Cash and cash equivalents acquired | 616 |
| Net cash (outflow) / inflow | $ 616 |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 11. Long-term investments

Set out below is a comparison, by class, of the carrying amounts of the Company's financial instruments:

| Entity | Instrument | Classification | Balance at December 31, 2019 | FV Change | Purchases (Sales) | Balance at December 31, 2020 |
|---|---|---|---|---|---|---|
| VIVO Cannabis | Shares | FVOCI | $ 205 | $ 39 | $ (179) | $ 65 |
| CannTx Life Sciences | Shares | FVOCI | 523 | (324) | - | 199 |
| Inner Spirit Holdings | Shares | FVOCI | 2,983 | 353 | (545) | 2,791 |
| Inner Spirit Holdings | Warrants | FVTPL | 55 | (34) | (21) | - |
| Inner Spirit Holdings | Options | FVTPL | - | 37 | 56 | 93 |
| Lotus Ventures Inc. | Shares | FVOCI | 807 | (241) | (566) | - |
| Lotus Ventures Inc. | Warrants | FVTPL | 6 | (6) | - | - |
| Province Brands | Shares | FVOCI | 126 | 27 | - | 153 |
| Cannabis OneFive Inc. | Shares | FVOCI | 50 | 59 | - | 109 |
| Cannabis OneFive Inc. | Warrants | FVTPL | 1 | (1) | - | - |
| Delta 9 Cannabis | Shares | FVOCI | 4,136 | (1,178) | (2,304) | 654 |
| FSD Pharma | Shares | FVOCI | 266 | 248 | (514) | - |
| Good Leaf | Shares | FVOCI | 225 | 310 | - | 535 |
| Good Leaf | Warrants | FVTPL | 112 | 264 | - | 376 |
| Luff Enterprises Ltd. (Ascent) | Shares | FVOCI | 348 | (297) | - | 51 |
| Inner Spirit Holdings | Convertible Debt | FVTPL | 1,638 | 90 | (1,728) | - |
| ICC International Cannabis Corp. | Convertible Debt | FVTPL | 4,758 | (4,758) | - | - |
| **Total** | | | **$ 16,239** | **$ (5,412)** | **$ (5,801)** | **$ 5,026** |

| Entity | Instrument | Classification | Balance at December 31, 2018 | Additions | FV Change | Disposals | Balance at December 31, 2019 |
|---|---|---|---|---|---|---|---|
| VIVO Cannabis | Shares | FVOCI | $ 4,733 | $ - | $ (1,892) | $ (2,636) | $ 205 |
| CannTx Life Sciences | Shares | FVOCI | 971 | - | (448) | - | 523 |
| Inner Spirit Holdings | Shares | FVOCI | 3,448 | - | (465) | - | 2,983 |
| Inner Spirit Holdings | Warrants | FVTPL | 248 | - | (193) | - | 55 |
| Lotus Ventures Inc. | Shares | FVOCI | 1,198 | - | (359) | (32) | 807 |
| Lotus Ventures Inc. | Warrants | FVTPL | 48 | - | (42) | - | 6 |
| Province Brands | Shares | FVOCI | 166 | - | (40) | - | 126 |
| Cannabis OneFive Inc. | Shares | FVOCI | 110 | - | (60) | - | 50 |
| Cannabis OneFive Inc. | Warrants | FVTPL | 12 | - | (11) | - | 1 |
| Delta 9 Cannabis | Shares | FVOCI | 7,209 | - | (3,073) | - | 4,136 |
| FSD Pharma | Shares | FVOCI | 2,138 | - | (1,872) | - | 266 |
| Good Leaf | Shares | FVOCI | 384 | - | (159) | - | 225 |
| Good Leaf | Warrants | FVTPL | 278 | - | (166) | - | 112 |
| Ascent Industries Corp. | Shares | FVOCI | 711 | - | (289) | (74) | 348 |
| Green Relief Inc. | Shares | FVOCI | - | 1,047 | (1,047) | | - |
| Inner Spirit Holdings | Convertible Debt | FVTPL | - | 1,500 | 138 | - | 1,638 |
| ICC International Cannabis Corp. | Convertible Debt | FVTPL | 5,569 | - | (811) | - | 4,758 |
| **Total** | | | **$ 27,223** | **$ 2,547** | **$ (10,789)** | **$ (2,742)** | **$ 16,239** |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 11. Long-term investments (continued)

### Inner Spirit Holdings

For the year ended December 31, 2020, the Inner Spirit Holding warrants were cancelled in favour of an amended commercial rights agreement, resulting in a $21 disposal within long-term investments and a corresponding $21 addition in distribution intangible assets. Further, Inner Spirit Holdings issued options to the Company to purchase shares during the year ended December 31, 2020, valued at $56 when received. Auxly recorded an adjustment of $90 towards Inner Spirit Holdings convertible debentures on receipt of the scheduled June interest payment. In the year ended December 31, 2020, the Inner Spirit Holdings convertible debenture units were sold for net proceeds of $1,728 and a loss on sale of $482 was recorded in the consolidated statements of loss and comprehensive loss.

### ICC International Cannabis Corp.

On September 17, 2018, the Company subscribed for $5,000 of convertible debentures of ICC International Cannabis Corp ("ICC"). The debentures bear interest at 8% and have a maturity of September 17, 2021 and can be converted into units at the option of the Company, at a price of $0.53 per unit. Each unit consists of one common share of ICC and one common share purchase warrant, exercisable at a price of $1.06 per share for a period of three years. As at December 31, 2020, the fair value of the long-term investment has been revalued to $Nil. The loss on revaluation was recorded in the consolidated statements of loss and comprehensive loss.

## 12. Investment in joint venture

| | Class 1 common shares and Class V special shares | Class B special shares | Secured promissory notes | Total investment in joint venture |
|---|---|---|---|---|
| **Balance at January 1, 2019** | **$ (309)** | **$ 19,026** | **$ -** | **$ 18,717** |
| Class B special shares exchanged for convertible promissory notes | - | (19,026) | - | (19,026) |
| Convertible promissory notes converted into class B special shares | - | 50,000 | - | 50,000 |
| Convertible promissory notes exchanged for secured promissory notes | - | - | 29,479 | 29,479 |
| Investment in secured promissory notes | - | - | 19,014 | 19,014 |
| Expected credit loss | - | - | (693) | (693) |
| Loan guarantee contribution | 938 | - | - | 938 |
| Share of net loss of Sunens | (1,930) | - | - | (1,930) |
| **Balance at December 31, 2019** | **$ (1,301)** | **$ 50,000** | **$ 47,800** | **$ 96,499** |
| Expected credit loss | - | - | (993) | (993) |
| Loan guarantee contribution | 86 | - | - | 86 |
| Redemption of Class V special shares | 1,004 | - | - | 1,004 |
| Loss on debt modification | - | - | (8,668) | (8,668) |
| Realization of interest income | - | - | 1,558 | 1,558 |
| Share of net loss of Sunens | (7,407) | - | - | (7,407) |
| **Balance at December 31, 2020** | **$ (7,618)** | **$ 50,000** | **$ 39,697** | **$ 82,079** |

The Company has a joint venture agreement with Peter Quiring to operate a purpose-built greenhouse for cannabis cultivation in Leamington, Ontario. The joint arrangement is structured through a separate legal entity and has been classified as a joint venture per IFRS 11, *Joint Agreements*. The Company holds 45% voting shares in Sunens through 4,500,000 class 1 common shares.

## 12. Investment in joint venture (continued)

On February 15, 2019, 19,025,807 class B special shares were exchanged for investment in $19,026 convertible promissory notes of Sunens. The convertible promissory notes were convertible into class B special shares of Sunens at an exercise price of $1 per class B special shares and carried a coupon rate of 1%. The convertible promissory notes were accounted for at fair value through profit or loss. The Company acquired an additional $60,453 convertible promissory note of Sunens from February 15, 2019 to September 17, 2019.

On September 17, 2019, the Company converted $50,000 of the convertible promissory notes into 50,000,000 Class B special shares of Sunens and the remaining convertible promissory notes of $29,479 were exchanged for secured promissory notes bearing interest at a rate of 6% per annum, compounded monthly, and maturing on July 1, 2026. The secured promissory notes were then repayable in equal monthly installments of principal and accrued interest starting July 1, 2021. The Company acquired additional $19,014 of secured promissory notes from September 18, 2019 to December 31, 2019 resulting in total investment in secured promissory notes of $48,493. The secured promissory notes are secured against all assets of Sunens, subordinated to the Bank of Montreal ("BMO") loan. Class B special shares are measured at fair value through other comprehensive income and secured promissory notes are measured at amortized cost.

On September 23, 2019, as part of the debt financing provided by a syndicate led by BMO, the Company has guaranteed payments up to $33,000 in the event of default. The guarantee was valued at $938 based on a 3.5% probability of default and a discount rate of 12% and was recognized as an other non-current liability with debit being recorded as an equity contribution to Sunens. The guarantee liability is measured at amortized cost.

On November 2, 2020, the Company consented to the redemption by Sunens of the Class V preferred shares, which would reduce the Company's ownership of the joint venture from 51% to 45% and a gain on redemption was recorded for $1,004 in the consolidated statements of loss and comprehensive loss. The Company amended the secured promissory note it has with the joint venture so that all interest accrued to date has been waived and interest will not start to accrue until January 1, 2023. On such date, interest will accrue on the outstanding balance at that time and equal payments of the outstanding principal amount will be due. The maturity date of the secured promissory note is July 1, 2026. The amendment was treated as a debt modification under IFRS 9 and the Company has calculated a new amortized cost of $43,201, resulting in a loss of $8,668 recorded in the consolidated statement of loss and comprehensive loss. The amended secured promissory note is discounted at 6.0% and based on the modified payment stream under the post-modification note.

On April 16, 2021, Sunens received a notice of default from the lending syndicate led by BMO. Please refer to Note 28 – "Subsequent Events" for additional details.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 12. Investment in joint venture (continued)

The Company recorded a $7,407 (2019 - $1,930) equity loss for the year ended December 31, 2020. As at December 31, 2020, the joint venture's statements of financial position and statements of loss and comprehensive loss are as follows:

| | | Year ended December 31, 2020 | | Year ended December 31, 2019 |
|---|---|---|---|---|
| Revenues | | 9 | | - |
| Loss before interest, taxation, depreciation and amortization | $ | (10,904) | $ | (3,491) |
| Interest expense | | (1,685) | | (145) |
| Depreciation and amortization | | (2,125) | | (149) |
| **Net loss and total comprehensive loss** | **$** | **(14,714)** | **$** | **(3,785)** |

| | | As at December 31, 2020 | | As at December 31, 2019 |
|---|---|---|---|---|
| Current assets | | 7,843 | | 6,007 |
| Non-current assets | | 147,694 | | 112,979 |
| **Total assets** | **$** | **155,537** | **$** | **118,986** |
| Current liabilities | | 76,248 | | 4,151 |
| Non-current liabilities | | 48,494 | | 69,226 |
| **Total liabilities** | **$** | **124,742** | **$** | **73,377** |
| **Net assets** | **$** | **30,795** | **$** | **45,609** |

## 13. Deposits

| | | Sponsorship | | Capital Assets | | Inventory | | Other | | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| **Balance:** | | | | | | | | | | |
| Current portion | $ | - | $ | 5,433 | $ | 1,813 | $ | 198 | **$** | **7,444** |
| Non-current portion | | - | | - | | - | | 1,781 | | **1,781** |
| **December 31, 2020** | **$** | **-** | **$** | **5,433** | **$** | **1,813** | **$** | **1,978** | **$** | **9,225** |
| **Balance:** | | | | | | | | | | |
| Non-current portion | $ | 6,202 | $ | 5,743 | $ | 2,406 | $ | 1,298 | **$** | **15,649** |
| **December 31, 2019** | **$** | **6,202** | **$** | **5,743** | **$** | **2,406** | **$** | **1,298** | **$** | **15,649** |

In 2019, the Company sponsored the development of a hemp farming co-operative, consisting of six individual hemp licence holders. The Company made deposits of $6,202 towards the biomass and as of December 31, 2020, the Company received the biomass resulting in $nil deposits at the end of the year.

As at December 31, 2020, the Company has made deposits towards specialized equipment to be utilized for extraction and product formulation, vape cartridge purchases and raw material cannabis purchases and such deposits are categorized as "Other" in the table above.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 14. Lease liability

| | | As at December 31, 2020 | | As at December 31, 2019 |
|---|---|---|---|---|
| **Maturity analysis - contractual undiscounted cash flows** | | | | |
| Less than one year | $ | 1,892 | $ | 1,959 |
| Two years and beyond | | 13,098 | | 5,308 |
| **Total undiscounted lease obligations** | **$** | **14,990** | **$** | **7,267** |
| Current portion | $ | 1,473 | $ | 1,243 |
| Non-current portion | | 9,413 | | 4,893 |
| Reclassification to liabilities held for sale (Note 27) | | (3) | | - |
| **Discounted lease obligations included in the consolidated statements of financial position** | **$** | **10,883** | **$** | **6,136** |

The Company has lease contracts for various items of building, plant, machinery, vehicles and other equipment used in its operations. Leases of building generally have lease terms between 2 and 21 years, while production and other equipment generally have lease terms between 3 and 5 years.

On November 27, 2020, the Company entered into a new long-term lease for its Dosecann facility. Under the terms of the new lease, Dosecann has the option to purchase the real property for the amortized lease amount of $8,000 (plus 4% interest) at any time throughout the 21-year term. Prior to this new lease, Dosecann was in the process of purchasing the real property from the original landlord; however, a new purchaser (and now landlord) agreed to purchase the property and fulfill conditions precedent thereby allowing Dosecann to be refunded $2,000 and to save an additional $6,000 in capital expenditures, thereby effectively providing the Company with $8,000 in proceeds.

The lease was accounted for as a modification under IFRS 16. Using an incremental borrowing rate of 4.03%, the Company recognized a right-of-use asset of $2,872 and a corresponding lease liability of $7,973.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 15. Convertible debenture

The convertible debentures balance is comprised of the following:

| As at December 31, | | 2020 | | 2019 |
|---|---|---|---|---|
| January 17, 2018 Issuance | $ | - | $ | 2,705 |
| September 25, 2019 Issuance | | 100,887 | | 90,882 |
| Standby financing | | 9,638 | | - |
| **Total** | **$** | **110,525** | **$** | **93,587** |

**Convertible debenture standby financing**

On April 28, 2020, Auxly entered into an unsecured convertible debenture in the principal amount of up to $25,000. The full principal can be withdrawn in tranches, subject to certain restrictions that may limit the amount available to the Company. Funding of additional tranches are subject to mutual agreement between the Company and the lender and such funding is not guaranteed.

Each tranche has a maturity date of 24 months from the date of issue and will bear guaranteed interest from the date of issue at 7.5% per annum, payable semi-annually on June 30 and December 31 of each year. In addition, common share purchase warrants of the Company will be issued equal to 55% of the number of common shares into which the convertible debenture is convertible. The conversion price is based on the closing price of the common shares on the TSXV or such other stock exchange in Canada on which the common shares are principally traded (the "Exchange") on the trading date immediately prior to the closing date for such tranche. Each warrant will be exercisable to purchase one common share for a period of 24 months from the date of issuance at an exercise price equal to 120% of the applicable conversion price.

The Company may require the investor, at any point after four months and one day after the date of issuance of a convertible debenture, to convert:

a) up to 50% of the principal amount of such convertible debenture if for any five consecutive trading days the volume weighted average price (the "VWAP") of the common shares on the Exchange is greater than 112% of the conversion Price; or
b) up to 100% of the principal amount of such convertible debenture if for any five consecutive trading days the VWAP of the common shares on the Exchange is greater than 120% of the conversion price; and/or
c) 100% of the principal amount of such convertible debenture at any time by paying a mutually agreeable make-whole payment to the investor, plus in each case interest on the principal amount of such convertible debenture.

In connection with each tranche, the Company has agreed to indemnify (the "Indemnity") certain of its directors and officers for any and all losses not otherwise recoverable from the collateral provided by the investor for the common shares provided by such directors and officers to the investor pursuant to the terms of the agreement. The Indemnity has been approved by the independent directors of the Company.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 15. Convertible debenture (continued)

During the year ended December 31, 2020, Auxly closed five tranches of convertible debentures for total net proceeds of $10,664. Details of the five tranches are as follows:

| | | Tranche 1 | Tranche 2 | Tranche 3 | Tranche 4 | Tranche 5 |
|---|---|---|---|---|---|---|
| Date raised | | 28-Apr-20 | 20-May-20 | 08-Jun-20 | 26-Jun-20 | 08-Sep-20 |
| Maturity date | | 28-Apr-22 | 20-May-22 | 08-Jun-22 | 26-Jun-22 | 08-Sep-22 |
| Gross proceeds | $ | 1,250 | 2,000 | 3,000 | 3,000 | 2,000 |
| Conversion price | $ | 0.435 | 0.425 | 0.380 | 0.305 | 0.180 |
| Financing costs | $ | (98) | (144) | (126) | (128) | (90) |
| Net proceeds | $ | 1,152 | 1,856 | 2,874 | 2,872 | 1,910 |
| Discount rate | % | 16.0% | 16.0% | 16.0% | 16.0% | 16.0% |
| Fair value | $ | 988 | 1,593 | 2,479 | 2,477 | 1,648 |
| Residual value | $ | 164 | 263 | 395 | 395 | 262 |
| Warrants issued | # | 1,580,460 | 2,588,235 | 4,342,105 | 5,409,836 | 6,111,111 |
| Warrant exercise price | $ | 0.522 | 0.510 | 0.460 | 0.366 | 0.216 |
| Expiry date | | 28-Apr-22 | 20-May-22 | 08-Jun-22 | 26-Jun-22 | 08-Sep-22 |

The residual value of the gross proceeds was allocated to the conversion feature and warrants based on their relative fair values and net of issuance costs. The relative fair value of the conversion features and warrants were derived based on the following assumptions:

| | | Tranche 1 | Tranche 2 | Tranche 3 | Tranche 4 | Tranche 5 |
|---|---|---|---|---|---|---|
| Share price | $ | 0.44 | 0.43 | 0.37 | 0.30 | 0.17 |
| Annualized volatility | % | 84.45% | 85.47% | 85.44% | 84.04% | 81.09% |
| Risk-free interest rate | % | 0.32% | 0.30% | 0.32% | 0.29% | 0.27% |
| Dividend yield | % | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Expected life | | 2 years | 2 years | 2 years | 2 years | 2 years |

The accretion expense on the convertible debentures was calculated using the effective interest method for the year ended December 31, 2020. The following is a continuity of the convertible debenture financing as at December 31, 2020:

| | | Tranche 1 | Tranche 2 | Tranche 3 | Tranche 4 | Tranche 5 |
|---|---|---|---|---|---|---|
| **Balance, December 31, 2019** | $ | - | - | - | - | - |
| Face value of debt upon issuance | $ | 1,250 | 2,000 | 3,000 | 3,000 | 2,000 |
| Less: allocation to warrants | $ | (54) | (87) | (129) | (129) | (85) |
| Less: allocation to conversion feature | $ | (110) | (176) | (266) | (266) | (177) |
| Less: financing costs | $ | (98) | (144) | (126) | (128) | (90) |
| Fair value of debt on initial recognition | $ | 988 | 1,593 | 2,479 | 2,477 | 1,648 |
| Accretion expense during the period | $ | 77 | 85 | 127 | 117 | 47 |
| **Balance, December 31, 2020** | $ | **1,065** | **1,678** | **2,606** | **2,594** | **1,695** |
| Effective interest rate | % | 20.37% | 17.74% | 17.89% | 17.95% | 18.08% |
| Coupon rate | % | 7.50% | 7.50% | 7.50% | 7.50% | 7.50% |
| Interest expense (twelve-months) | $ | 64 | 92 | 127 | 117 | 47 |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 15. Convertible debenture (continued)

### September 25, 2019 Issuance

On September 25, 2019, the Company issued unsecured convertible debentures in the aggregate amount of $122,851 to Imperial Brands as part of a collaborative partnership. The debentures bear interest at 4.0% per annum, payable annually and mature within 36 months. The principal amount of the debentures will be convertible into common shares of the Company at a price of $0.81 per share, at the option of the holder. The debenture was recorded at its fair value of $88,444, discounted at a market interest rate of 16.0% and is net of debt issue costs.

The accretion expense calculated using the effective interest method for the year ended December 31, 2020 was $10,005 (2019 – $2,438). The effective interest rate used was 15.8% and the coupon rate on the debt is 4.0%. Interest expense for the year ended December 31, 2020 was $4,928 (2019 – $1,239). See Note 28 “Subsequent Events” regarding changes to the convertible debenture terms.

| | | Convertible debenture |
|---|---|---|
| **Balance, December 31, 2019** | **$** | **90,882** |
| Accretion expense during the period | | 10,005 |
| **Balance, December 31, 2020** | **$** | **100,887** |

### January 17, 2018 Issuance

On January 17, 2018, the Company completed a brokered private placement of unsecured convertible debentures units in the aggregate amount of $100,000. Each convertible debenture unit consisted of a $1 principal amount of senior unsecured convertible debentures and 322 share purchase warrants. The debentures bore interest at 6% per annum, payable semi-annually and mature within 24 months on January 17, 2020. On October 18, 2019, the Company received approval to amend the conversion price from $1.55 per share to $0.74 per share. Notice was provided to all debenture holders of the right to amend their conversion price and that the Company had the right to prepay holders that consented to the revised conversion price but failed to convert before October 28, 2019. The Company issued 20,352,467 common shares on October 29, 2019 and 1,249,993 common shares on November 6, 2019, for a total of 21,602,460 common shares issued on the conversion of $15,986 principal (discounted book value of $15,826, market value $14,931), repaid debentures with a total principal balance of $79,999 plus accrued interest of $1,893 during the year ended December 31, 2019, and the balance in the first month of 2020.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 16. Short term debt

On August 12, 2020, the Company and several of its subsidiaries entered into a receivables purchase facility with Trichome Financial Cannabis Private Credit LP ("Trichome") for an aggregate available amount of up to $8,000. Under this arrangement, several of Auxly's subsidiaries may finance accounts receivables from Canadian provincial distributors as well as other customers. Offering of accounts receivable for factoring will be at the discretion of the Company's relevant subsidiary and acceptance of any such accounts receivable for factoring will be at the discretion of Trichome. Obligations of the Company and its subsidiaries under this arrangement are secured by a first-ranking perfected security interest in cannabis-related accounts receivable and is guaranteed by the Company and several of its subsidiaries. The Company has retained late payment and credit risk, therefore continues to recognise the transferred assets in their entirety in its balance sheet. The amount repayable under the factoring agreement is presented as short-term debt. In December 2020, the Company and Trichome mutually agreed to lower the aggregate funding available under the facility to $6,000.

## 17. Share capital

The share capital of the Company is summarized below:

| Number of units | **December 31 2020** | December 31 2019 |
|---|---|---|
| Issued shares | **691,861,024** | 638,249,946 |
| Escrowed shares | **10,994,190** | 13,007,611 |
| Outstanding shares | **680,866,834** | 625,242,335 |
| Exercisable securities | | |
| Warrants | **56,021,747** | 85,928,520 |
| Convertible Debentures | **188,089,377** | 153,413,181 |
| Options | **40,890,608** | 45,649,553 |

### a) Authorized

The Company is authorized to issue an unlimited number of common shares.

### b) Issued and outstanding

At December 31, 2020, there were 691,861,024 (2019 – 638,249,946) issued and outstanding common shares and 10,994,190 (2019 - 13,007,611) shares held in escrow related to the contingent considerations in acquisitions and investments.

During the year ended December 31, 2019, the Company issued 1,927,343 common shares on closing the Inverell S.A. acquisition, 14,419,559 common shares on exercise of warrants and conversion of convertible debt, 450,000 common shares to settle a lawsuit, 2,013,421 common shares to the previous shareholders of Robinsons on completion of contingent milestones, 1,321,894 common shares to the previous shareholders of Dosecann on completion of contingent milestones, 21,602,460 common shares on the settlement of convertible debt (see note 15), 6,315,574 common shares to Imperial Brands on exercise of their top-up rights (see note 15), and 3,659,837 common shares to non-executive employees of the Company as compensation, as part of their employment agreements related to services performed in 2019. The fair value of the common shares issued for compensation is $3,257 and was recorded as share-based payments on the statement of loss and comprehensive loss.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 17. Share capital (continued)

In December 2020, the Company closed a private placement and distributed a total of 46,000,000 units for gross proceeds of $13,800. Each unit consists of one share and one-half of one warrant, with each warrant entitling the holder to purchase one additional share at $0.40 until December 2023. The Company recorded $9,900 for the issuance of shares and $2,900 for the issuance of warrants based on a relative fair value calculation. The fair value of these warrants for the relative fair value calculation was based on the following assumptions: Share price - $0.29, Annualized volatility – 94.27%; Risk-free interest rate – 0.31%; Dividend yield – 0%; and Expected life – 3 years.

During the year ending December 31, 2020, 7,611,078 common shares were issued on the exercise of 7,611,078 stock options for gross proceeds of $190.

### c) Stock options

The Company has a stock award plan to provide incentives to directors and employees of the Company. The total number of options awarded is limited to 10% of the issued and outstanding shares, or 69,186,102 as at December 31, 2020.

The fair value of stock options was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

| | Year ended December 31, 2020 | Year ended December 31, 2019 |
|---|---|---|
| Risk-free annual interest rate | 0.33% - 1.35% | 1.53% - 1.92% |
| Expected annual dividend yield | 0% | 0% |
| Expected annualized volatility | 66.32% - 92.64% | 92.37% - 94.86% |
| Expected life of options | 5 - 10 years | 5 - 10 years |

The expected annualized volatility was estimated based on the Company's historical stock returns. During the year ended December 31, 2020, the Company granted 6,680,692 options (2019 – 7,980,000 options) at an exercise price range of $0.31 to $1.00 per share, exercisable between five to ten years to employees, and officers.

The following table summarizes information about stock options outstanding as at December 31, 2020:

| | Number of options | Average exercise price ($) | Average remaining life (years) |
|---|---|---|---|
| **Opening Balance, December 31, 2018** | **41,052,053** | **0.846** | **6.50** |
| Options granted | 7,980,000 | 0.959 | 5.40 |
| Options forfeited | (3,382,500) | 1.385 | |
| **Closing Balance, December 31, 2019** | **45,649,553** | **0.865** | **6.09** |
| Options granted | 6,680,692 | 0.331 | 4.65 |
| Options exercised | (7,611,078) | 0.025 | |
| Options forfeited | (3,828,559) | 1.163 | |
| **Closing Balance, December 31, 2020** | **40,890,608** | **0.902** | **5.45** |

Total options exercisable at December 31, 2020 were 26,351,665 (2019 – 27,887,935) with a remaining average life of 5.68 years (2019 – 6.09 years). Options issued to consultants prior to January 1, 2020 were measured based on the fair value of the equity instrument granted as the fair value of services could not be reliably measured.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 17. Share capital (continued)

### d) Warrants

Each warrant entitles the holder to purchase one common share of the Company. The following table summarizes information about warrants outstanding as at December 31, 2020:

| | Number of warrants | Average exercise price ($) | Average remaining life (years) |
|---|---|---|---|
| **Closing Balance, December 31, 2018** | **103,735,321** | **1.539** | **1.39** |
| Warrants exercised | (14,387,301) | 0.023 | |
| Warrants expired | (3,419,500) | 1.500 | |
| **Closing Balance, December 31, 2019** | **85,928,520** | **1.795** | **0.63** |
| Warrants issued | 46,021,747 | 0.381 | 2.33 |
| Warrants expired | (75,928,520) | 1.824 | |
| **Closing Balance, December 31, 2020** | **56,021,747** | **0.593** | **2.35** |

### e) Earnings per share

The calculation of basic and diluted loss per share is based on the loss for the year divided by the weighted average number of shares in circulation during the period. In calculating the diluted loss per share, potentially dilutive shares such as options, convertible debt and warrants have not been included as they would have the effect of decreasing the loss per share and they would, therefore be antidilutive.

## 18. Related party balances and transactions

### Key management and director compensation

The Company'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, stock options or post-employment benefits. Compensation provided to current and key management are as follows:

| | **Year ended December 31, 2020** | Year ended December 31, 2019 |
|---|---|---|
| Short-term benefits | **$ 2,058** | $ 2,028 |
| Long-term benefits | **1,377** | 3,753 |
| **Total** | **$ 3,435** | $ 5,781 |

### Other related party transactions

Nesta Holding Co. Ltd., a company owned and controlled by the former Chairman of the Company's Board of Directors and former Chief Executive Officer, provides travel and accommodation services to the Company on a month to month basis. For the year ended December 31, 2020, the Company incurred $8 (2019 - $85) in general expenses.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 19. Financial instruments and risk management

The Company has exposure to the following risks from its use of financial instruments. The Board of Directors approves and monitors the risk management processes.

### a) Financial instrument classification and measurement

Financial instruments that are recorded at fair value on the consolidated statements of financial position are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements.

The fair value of hierarchy has the following levels:

- Level 1 – quoted prices in active markets for identical financial instruments.
- Level 2 – quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in the markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
- Level 3 – valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

| **Instrument** | **Valuation technique** | **Significant unobservable inputs** | **Inter-relationship between key unobservable inputs and fair value measurement** |
|---|---|---|---|
| Non-voting shares in joint venture | Asset-based approach | - Fair value of net assets | - If the fair value of the net assets decreased by 1%, the fair value would decrease by $500. |
| Investments in private companies | Market approach | - Investment index | - If the investment index fair value change increased (decreased) by 10%, the estimated fair value of the long-term investment would increase (decrease) by $100 ($100). |

The table below presents the carrying value of the Company's financial instruments:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Short-term investments | $ 286 | $ - | $ - | $ 286 |
| Public company shares | 3,561 | - | - | 3,561 |
| Company options and warrants | - | 469 | - | 469 |
| Non-voting shares in joint venture | - | - | 50,000 | 50,000 |
| Private company shares | - | - | 996 | 996 |
| **Balance, December 31, 2020** | **$ 3,847** | **$ 469** | **$ 50,996** | **$ 55,312** |

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Short-term investments | $ 306 | $ - | $ - | $ 306 |
| Public company shares | 8,745 | - | - | 8,745 |
| Company options and warrants | - | 174 | - | 174 |
| Convertible debenture | - | - | 6,396 | 6,396 |
| Non-voting shares in joint venture | - | - | 50,000 | 50,000 |
| Private company shares | - | - | 924 | 924 |
| **Balance, December 31, 2019** | **$ 9,051** | **$ 174** | **$ 57,320** | **$ 66,545** |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 19. Financial instruments and risk management (continued)

The table below presents the continuity schedule of the Company's Level 3 investments:

| Level 3 investments | | |
|---|---|---|
| Balance, January 1, 2019 | $ | 41,138 |
| Additions | | 33,631 |
| Repayment | | (9,514) |
| Change in unrealized loss - FVTPL | | (6,181) |
| Change in unrealized loss - FVOCI | | (1,754) |
| **Balance, January 1, 2020** | **$** | **57,320** |
| Change in unrealized loss - FVTPL | | (4,668) |
| Change in unrealized loss - FVOCI | | 72 |
| Net proceeds on sale of convertible debentures | | (1,728) |
| **Balance, December 31, 2020** | **$** | **50,996** |

### b) Fair values of financial assets and liabilities

The Company's financial instruments include cash and cash equivalents, short-term investments, note and other receivables, long-term investments, accounts payable and accrued liabilities, short-term debt, and convertible debentures. As at December 31, 2020, the carrying value of cash and cash equivalents and short-term investments are measured at fair value. Accounts receivable and accounts payable and accrued liabilities and short-term debt, approximate their fair value due to their short-term nature. The carrying value of notes receivable approximate their fair value due to their short-term nature and market rates for similar instruments.

### c) Market Risk

Market risk is the risk that changes in market prices will affect the Company's earnings or the value of its financial instruments. The objective of market risk management is to manage and control exposures within acceptable limits, while maximizing returns.

The Company is exposed to equity price risk, which arises from investments measured at FVOCI and FVTPL. For such investments classified as at FVOCI and FVTPL, the impact of a 10% increase in the share price would have increased equity by $100 before tax. An equal change in the opposite direction would have decreased equity by $100 before tax.

### d) Interest rate risk

Interest rate risk is the risk that changes in interest rates will impact the cash flows of the Company. As all the Company's financial debt are on fixed interest rates, the impact of a change in interest rates will not impact the Company's income or cash flows during the contract term.

### e) Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. The financial instruments that are exposed to such risk include cash and cash equivalents, accounts receivables, other receivables, and notes receivable.

Management has mitigated the risk by using tier 1 financial institutions for managing its cash, established communication channels with the counterparties of the receivables for ongoing monitoring of their financial performance. The Company mitigates credit risk on notes receivable by securing the notes and monitoring the financial performance of the partners.

## 19. Financial instruments and risk management (continued)

### f) Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations associated with its financial liabilities. The Company manages liquidity risk through the management of its capital structure.

The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to settle obligations and liabilities when due.

### g) Foreign exchange risk

The financial statements are presented in Canadian dollars, which is also the Company's functional currency. Each entity within the consolidated group determines its own functional currency.

The Company is exposed to certain currency risks in that the value of certain financial instruments will fluctuate due to changes in foreign exchange rates. Management has mitigated the risk by holding sufficient cash in US dollars. A 10% increase / (decrease) in the exchange rate would increase / (decrease) net income by $9 / ($9).

## 20. Capital management

The Company's objectives when managing capital 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. The Company considers its capital structure to include debt and shareholders' equity.

The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. The Company may issue new shares or debt, acquire or dispose of assets to maintain or adjust its capital structure.

The Company is dependent on expected business growth, changes in the business environment and capital markets as its source of operating capital. The Company is not subject to any externally imposed capital requirements. There were no changes to the Company's approach to capital management in the period.

## 21. Commitments and contingencies

### Commitments

On December 22, 2017, the Company entered into an agreement with its cultivation partner CannTx Life Sciences Inc. ("CannTx") to fund the construction of its cannabis production facility. The Company had a commitment to pay CannTx another $7,000 related to phase II expansion of the Facility, subject to the completion of satisfactory due diligence by the parties agreeing to a construction budget and timeline for the phase II expansion. On September 25, 2020, Auxly and CannTx amended the agreement to remove Auxly's obligation to fund CannTx's phase II expansion of the facility.

As at December 31, 2020, Auxly has entered into certain agreements that 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.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 21. Commitments and contingencies (continued)

Auxly has funding commitments as follows:

- As part of the $84,000 in debt financing provided by a syndicate led by BMO towards the construction of the Sunens purpose-built greenhouse facility in Leamington, Ontario, the Company has guaranteed payments to $33,000 in the event of default. In addition, both joint venture parties have agreed to fund any cost overruns on the construction of the facility and maintain combined cash and available credit balances of at least $15,000;
- Funding of $4,200 from January 1, 2021 to December 31, 2021 to Kindred Partners Inc. ("Kindred") for brokerage services, whereby Kindred will market the Company's portfolio of brands across Canada. Further, during the period 2022 to 2024, the Company has committed to a fixed/variable structure whereby the fixed amount will be $3,600 annually;
- Annual payments of $300 USD for five years to June 2025 to Natures Crops International for the global exclusivity rights to Ahiflower® seed oil for use in Cannabis 2.0 products;
- Payments of $375 USD in March and June in 2021, respectively, and a payment of $1,000 USD in 2022 to Capsugel Manufacturing, LLC, as part of a multi-year licensing arrangement with Lonza Group Ltd.; and
- Payments of an aggregate of €2,100 from January 1, 2021 to December 31, 2021 for cannabis equipment to expand the Company's pre-roll and dried flower capabilities.

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

| | 2021 | 2022 | 2023 | 2024 | Thereafter | Total |
|---|---|---|---|---|---|---|
| Lease obligations | $ 1,892 | $ 1,344 | $ 1,135 | $ 684 | $ 9,936 | **$ 14,991** |
| Long-term debt obligations | 5,758 | 138,107 | - | - | - | **143,865** |
| **Total** | **$ 7,650** | **$ 139,451** | **$ 1,135** | **$ 684** | **$ 9,936** | **$ 158,856** |

### Contingencies

On November 1, 2019, the Company entered into a commercial lease agreement with 346 Spadina Inc. and provided a security deposit of $602. In April 2020, the landlord terminated the lease and commenced a claim against the Company for breach of the lease agreement for an aggregate claim of $21,692. The Company has filed its defence and counterclaim, and strongly disputes the landlord's claims and the termination of the lease. As at December 31, 2020, the Company has recorded a provision of $1,350 relating to this claim.

The Company, its subsidiaries and joint ventures 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.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 22. Selling, general, and administrative expenses

The breakdown of the Company's selling, general, and administrative expenses is as follows:

| | **Year ended December 31, 2020** | Year ended December 31, 2019 |
|---|---|---|
| Wages and salaries | **$ 22,614** | $ 17,939 |
| Office and administrative | **11,766** | 7,982 |
| Professional fees | **3,153** | 6,741 |
| Business development | **1,364** | 4,803 |
| Share-based compensation (Note 17) | **4,349** | 12,552 |
| Selling expenses | **5,609** | 274 |
| **Total** | **$ 48,855** | $ 50,291 |

## 23. Interest and accretion expenses

The breakdown of the Company's interest and accretion expenses is as follows:

| | **Year ended December 31, 2020** | Year ended December 31, 2019 |
|---|---|---|
| Cash interest expense on lease liabilities | **$ 473** | $ 626 |
| Other interest expense | **4,216** | 5,125 |
| Non-cash interest expense | **8,354** | 6,370 |
| **Total** | **$ 13,043** | $ 12,121 |

## 24. Income taxes

The reconciliation of income tax computed at the statutory tax rates to income tax recovery as is follows:

| | **Year ended December 31, 2020** | Year ended December 31, 2019 |
|---|---|---|
| Loss before income tax | **$ (88,112)** | $ (119,596) |
| Combined federal and provincial tax rate | **26.50%** | 26.50% |
| Expected tax recovery | **(23,350)** | (31,693) |
| Non-deductible expenses | **784** | 4,366 |
| Tax rate differentials | **(1,020)** | (339) |
| Effect of change in tax rates | **(204)** | - |
| Changes in deferred tax assets not recognized | **23,132** | 16,040 |
| Other | **(23)** | 648 |
| **Income tax recovery** | **$ (681)** | $ (10,978) |

The Company operates in multiple jurisdictions with differing tax rates. The Company's effective tax rates are dependent on the jurisdiction to which income relates.

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 24. Income taxes (continued)

Deferred taxes are a result of temporary differences that arise due to the differences between the carrying amount of assets and liabilities and the tax values. The movements of the deferred income tax assets (liabilities) are comprised of the following:

| | Balance December 31, 2019 | Recovered through (charged to) statement of loss | Recovered through (charged to) equity | Balance December 31, 2020 |
|---|---|---|---|---|
| **Deferred tax assets** | | | | |
| Non-capital losses | $ 8,171 | 313 | - | $ 8,484 |
| Financing and share issuance costs | 2,058 | (712) | 155 | 1,501 |
| Total deferred tax assets | $ 10,229 | (399) | 155 | $ 9,985 |
| | | | | |
| **Deferred tax liabilities** | | | | |
| Convertible debentures and other debt | (8,769) | 3,138 | (547) | (6,178) |
| Intangible assets | (18,601) | 957 | - | (17,644) |
| Marketable securities | - | - | - | - |
| Property, plant and equipment | (4,611) | (3,015) | - | (7,626) |
| Total deferred tax liabilities | $ (31,981) | 1,080 | (547) | $ (31,448) |
| **Net deferred tax liabilities** | **$ (21,752)** | **681** | **(392)** | **$ (21,463)** |

Deferred tax assets have not been recognized with respect of the deductible temporary differences:

| | **Year ended December 31, 2020** | Year ended December 31, 2019 |
|---|---|---|
| Non-capital losses carried forward | **$ 107,973** | $ 72,299 |
| Deductible temporary differences | **75,842** | 45,960 |
| Total | **$ 183,815** | $ 118,259 |

The Company has an income tax loss carry forward balance of approximately $138,342 (2019 – $103,264) which are predominately from Canada and if unused, will expire between 2034 to 2041.

## 25. Changes in working capital

The following table reconciles the change in working capital during the comparative periods as presented in these consolidated financial statements of cash flows.

| | **Year ended December 31, 2020** | Year ended December 31, 2019 |
|---|---|---|
| Short term investments | **$ 20** | $ - |
| Accounts receivable | **(8,972)** | - |
| Other receivables | **8,470** | (8,904) |
| Prepaid expenses | **9,945** | (2,363) |
| Interest payable | **5,179** | (1,372) |
| Biological assets (Note 6) | **359** | (2,480) |
| Inventory (Note 7) | **(19,848)** | (24,395) |
| Research contract costs | **(1,147)** | 305 |
| Accounts payable and accrued liabilities | **6,069** | 722 |
| Deferred revenue | **1,327** | 348 |
| **Total** | **$ 1,402** | $ (38,139) |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 26. Operating segments

Management has determined the operating and geographic segments. The Executive Leadership Team evaluates and makes decisions on the operating performance by segment. The Company's business activities are conducted through three operating segments as follows:

*Canadian cannabis operations* - The Company's Canadian Cannabis operations are dedicated to the cultivation and sale of cannabis and cannabis 2.0 products within Canada, and include subsidiaries Dosecann LD Inc., Kolab Project Inc., Robinson's Cannabis Inc., Robinson's Outdoor Grow Inc., and Curative Cannabis.

*Research operations* - The Company's research operations provide research services for customers who are conducting human clinical trials, through KGK in Canada.

*South American cannabis operations* - The Company's South America Cannabis operations are dedicated to the cultivation of cannabis products within South America, from Inverell S.A.

All the Company's revenue is from the Canadian operations. For the Company's geographically segmented non-current assets, the Company has allocated $1,436 of assets held for sale and $800 of liabilities held for sale, under the South American Cannabis CGU. In the year ending December 31, 2020, the South American Cannabis CGU contained $1,283 of property, plant, and equipment. Refer to note 27 for more information.

## 27. Assets and liabilities held for sale

As of December 31, 2020, given the slower than anticipated pace of cannabis-specific regulatory development in Latin America, the Company chose to explore strategic alternatives for Inverell, the Company's 80% owned subsidiary located in Montevideo, Uruguay. The Company initiated an active program to locate a buyer for Inverell and will not continue with operations nor fund any further operational expenditures. At December 31, 2020, Inverell was classified as a disposal group held for sale. The associated assets and liabilities are consequently presented as held for sale in the consolidated financial statements.

The results of South American Cannabis CGU, which have been included in the loss for the year, were as follows:

| **Operating results from South American Cannabis CGU** | **As at December 31, 2020** | **As at December 31, 2019** |
|---|---|---|
| Revenue | $ - | $ - |
| General and administraton expenses | (2,451) | (3,458) |
| Other expenses | (198) | (973) |
| Impairment loss recognized on the remeasurement to fair value less costs to sell | (7,303) | (1,851) |
| **Net loss from South American Cannabis CGU, net of tax** | **$ (9,952)** | **$ (6,282)** |

Expressed in thousands of Canadian Dollars, except share and per share amounts

## 27. Assets and liabilities held for sale

The following assets and liabilities were reclassified as held for sale in relation to South American Cannabis CGU of December 31, 2020:

| | | **As at December 31, 2020** |
|---|---|---|
| Cash and cash equivalents | $ | 3 |
| Other receivables | | 127 |
| Prepaid expenses | | 23 |
| Property, plant and equipment (Note 8) | | 1,283 |
| **Total assets held for sale** | **$** | **1,436** |
| | | |
| Accounts payable and accrued liabilities | $ | 797 |
| Lease liability (Note 14) | | 3 |
| **Total liabilities held for sale** | **$** | **800** |

The net cash flows incurred by South American Cannabis CGU are, as follows:

| | | **Year ended December 31, 2020** | | Year ended December 31, 2019 |
|---|---|---|---|---|
| Operating | $ | (2,451) | $ | (3,458) |
| Investing | | - | | - |
| Financing | | - | | - |
| **Net cash outflow** | **$** | **(2,451)** | $ | (3,458) |

## 28. Subsequent events

a) Subsequent to December 31, 2020, 3,456,666 warrants with a strike price between $0.30 and $0.40 per unit were exercised.

b) On February 8, 2021, the Company closed a private placement in which it issued 54,395,000 units of the Company at a price of $0.37 per unit for gross proceeds of $20,126. Each unit consists of one share and one-half warrant, with each warrant entitling the holder to purchase one common share at an exercise price of $0.46 at any time up to 36 months from the closing of the offering.

c) On March 23, 2021, the Company established an at-the-market equity program (the "ATM Program") that allows the Company to issue and sell up to $30,000 of common shares from treasury to the public, from time to time, at the Company's discretion to provide flexibility should future additional financing be required. Any common shares sold through the ATM Program will be sold through the TSX Venture Exchange or any other marketplace on which common shares are listed, quoted, or otherwise traded, at the prevailing market price at the time of sale.

d) On April 16, 2021, the Company announced that it has received final approval from the TSX to graduate from the TSX Venture Exchange and list its common shares on the TSX. Auxly's common shares commenced trading on the TSX at market open on Tuesday, April 20, 2021 under its existing symbol "XLY". The Company' shares will continue to trade on the OTCQX market under the symbol "CBWTF." Shareholders will not be required to take any action in connection with the graduation and listing on the TSX.

## 28. Subsequent events (continued)

e) On April 16, 2021, Sunens received a notice of default from BMO in its capacity as lender, administrative agent and syndication agent under the credit facility with respect to Sunens' failure to satisfy recently established revenue milestones for the first quarter of 2021. Although the lenders have reserved their rights under the credit agreement, they advanced another $1 million pursuant to a borrowing request made pursuant to the credit facility and BMO has granted a one-month deferral of the equipment loan payment due in May 2021 in the amount of approximately $0.2 million which will be used to fund day-to-day operations. In addition, Sunens may require additional funding for working capital until production and revenue from sales reach expected levels. Discussions with the lenders with respect to a formal credit amendment and/or forbearance agreement are continuing in a collaborative and positive manner, although there can be no assurance that an agreement with the lenders will be reached. As part of such financing provided by the syndicate, the Company has guaranteed payments up to $33 million in the event of default.

f) On April 19, 2021, the Company announced an agreement with its strategic partner, Imperial Brands to amend certain provisions of its previously issued $123 million debenture (the “Debenture”) and investor rights agreement (the “Investor Rights Agreement”) dated September 25, 2019 (collectively, the “Amendments”).

   Pursuant to the Amendments, Imperial Brands and Auxly have agreed to extend the maturity date of the Debenture by 24 months from September 25, 2022 to September 25, 2024. The Amendments will also provide Imperial Brands with the right, on an annual basis, to convert any or all of the accrued and unpaid interest on the Debenture then outstanding into Common Shares (the “Interest Conversion Election”), at a conversion price equal to the five-day volume weighted average trading price of the Common Shares on the date that Interest Conversion Election is made. Auxly and Imperial Brands have also agreed that the interest rate under the Debenture, which currently accrues at a rate of 4% per annum and is payable annually, will remain unchanged but will be payable on maturity of the Debenture. The Debentures are convertible into Common Shares at a price of $0.81 per share at any time prior to the close of business on the business day immediately preceding maturity. Lastly, the Amendments provide for the re-instatement of certain approval rights of Imperial Brands under the Investor Rights Agreement.

   The implementation of the Amendments is subject to the satisfaction of a number of conditions, including, among other things, the approval of the TSX Venture Exchange, and minority shareholder approval of the Amendments in accordance with Multilateral Instrument 61-101 - *Protection of Minority Security Holders in Special Transactions*.