# AUXLY CANNABIS GROUP INC.

## CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
## FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2019 AND 2018

**Dated August 15, 2019**

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

# AUXLY CANNABIS GROUP INC.

**Condensed Consolidated Interim Statements of Financial Position**
Expressed in thousands of Canadian Dollars
Unaudited

| | | June 30 2019 | | December 31 2018 *(Restated, Measurement Period Adjustment - see note 10)* |
|---|---|---|---|---|
| **Assets** | | | | |
| **Current assets** | | | | |
| Cash and cash equivalents (Note 4) | **$** | **119,127** | $ | 211,707 |
| Short-term investments | | **349** | | 3,349 |
| Note receivable (Note 5) | | **14,301** | | 2,946 |
| Biological assets (Note 6) | | **1,532** | | 2,158 |
| Inventory (Note 7) | | **15,569** | | 2,215 |
| Research contract costs | | **1,587** | | 1,843 |
| Debt obligation receivable in product equivalents (Note 14) | | **4,566** | | 14,912 |
| Prepaid expenses | | **4,183** | | 8,092 |
| Other receivables | | **6,330** | | 6,147 |
| | | **167,544** | | 253,369 |
| **Non-current assets** | | | | |
| Prepaid expenses | | **10,120** | | - |
| Long-term investments (Note 12) | | **27,492** | | 27,223 |
| Investment in joint venture (Note 13) | | **70,069** | | 29,158 |
| Property, plant and equipment (Note 8) | | **44,604** | | 28,726 |
| Intangible assets (Note 9) | | **86,008** | | 88,422 |
| Goodwill (Note 11) | | **34,051** | | 33,920 |
| | | **272,344** | | 207,449 |
| **Total assets** | **$** | **439,888** | $ | 460,818 |
| **Liabilities** | | | | |
| **Current liabilities** | | | | |
| Accounts payable and accrued liabilities | **$** | **17,991** | $ | 20,330 |
| Interest payable | | **3,085** | | 2,756 |
| Lease liability (Note 15) | | **1,656** | | - |
| Convertible debenture (Note 16) | | **95,906** | | - |
| Deferred revenue | | **3,757** | | 3,984 |
| | | **122,395** | | 27,070 |
| **Non-current liabilities** | | | | |
| Convertible debenture (Note 16) | | **-** | | 93,563 |
| Long-term loans | | **731** | | 588 |
| Lease liability (Note 15) | | **2,939** | | - |
| Deferred tax liability | | **15,958** | | 18,445 |
| | | **19,628** | | 112,596 |
| **Total liabilities** | | **142,023** | | 139,666 |
| **Equity** | | | | |
| Share capital (Note 17) | | **361,036** | | 350,647 |
| Shares to be issued (Note 17) | | **-** | | 9,523 |
| Reserves (Note 17) | | **61,186** | | 55,567 |
| Accumulated other comprehensive income | | **(12,558)** | | (10,873) |
| Deficit | | **(114,327)** | | (86,729) |
| Total equity attributable to shareholders of the Company | | **295,337** | | 318,135 |
| Total equity attributable to non-controlling interest | | **2,528** | | 3,017 |
| **Total equity** | | **297,865** | | 321,152 |
| **Total liabilities and equity** | **$** | **439,888** | $ | 460,818 |

Commitments and Operating Segments are found in Notes 21 and 24, respectively
The accompanying notes are an integral part of these condensed consolidated interim financial statements

The condensed consolidated interim financial statements were approved by the Board of Directors on August 15, 2019 and were signed on its behalf by:

| | |
|---|---|
| *(s) Chuck Rifici* | *(s) Genevieve Young* |
| Chuck Rifici | Genevieve Young |

## Condensed Consolidated Interim Statements of Loss and Comprehensive Loss

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

| | Three months Ended June 30 2019 | Three months Ended June 30 2018 | Six months Ended June 30 2019 | Six months Ended June 30 2018 |
|---|---|---|---|---|
| **Revenues** | | | | |
| Research contracts and other | **$ 2,318** | $ - | **$ 2,843** | - |
| Revenue from sales of cannabis products | **444** | - | **736** | - |
| **Total Revenues** | **2,762** | - | **3,579** | **-** |
| **Costs of sales** | | | | |
| Research contracts and other | **2,090** | - | **2,372** | - |
| Costs of finished cannabis inventory sold | **228** | - | **376** | - |
| **Gross profit excluding fair value items** | **444** | - | **831** | **-** |
| Realized fair value change on inventory | **(1)** | - | **(195)** | - |
| Unrealized fair value loss on biological transformation (Note 6) | **(155)** | - | **(537)** | - |
| **Gross profit** | **288** | - | **99** | - |
| **Other incomes** | | | | |
| Fair value gain / (loss) for financial instruments accounted under FVTPL (Note 12,14) | **(1,812)** | 282 | **(430)** | 900 |
| Interest income | **2,019** | 994 | **2,979** | 1,409 |
| **Total other incomes** | **207** | 1,276 | **2,549** | 2,309 |
| **Expenses** | | | | |
| Selling, general, and administrative expenses (Note 22) | **11,325** | 10,504 | **22,293** | 18,235 |
| Depreciation and amortization (Note 8, 9) | **1,437** | 113 | **2,475** | 190 |
| Interest expense (Note 23) | **1,897** | 2,756 | **5,431** | 4,961 |
| Impairment of intangible assets (Note 9) | **-** | - | **1,800** | - |
| (Gain) / loss on settlement of financial assets and liabilities | **250** | - | **(125)** | 4,191 |
| Share of loss on investment in joint venture (Note 13) | **372** | - | **552** | - |
| Foreign exchange (gain) / loss | **869** | (38) | **940** | (49) |
| **Total expenses** | **16,150** | 13,335 | **33,366** | 27,528 |
| **Net loss before income tax** | **(15,655)** | (12,059) | **(30,718)** | (25,219) |
| Income tax recovery / (expense) | **1,464** | (104) | **2,723** | 2,534 |
| **Net loss** | **$ (14,191)** | $ (12,163) | **$ (27,995)** | $ (22,685) |
| **Net loss attributable to shareholders of the Company** | **$ (13,987)** | $ (11,878) | **$ (27,598)** | $ (22,400) |
| **Net loss attributable to non-controlling interest** | **(204)** | $ (285) | **$ (397)** | $ (285) |
| **Other comprehensive loss** | | | | |
| Fair value change on fair value through other comprehensive income investments - not subsequently reclassified to profit or loss (net of tax) (Note 12) | **(9,536)** | (2,928) | **(1,408)** | (1,931) |
| Currency translation adjustment - subsequently reclassified to profit or loss | **(150)** | 875 | **(369)** | 875 |
| **Total comprehensive loss** | **$ (23,877)** | $ (14,216) | **$ (29,772)** | $ (23,741) |
| **Total comprehensive loss attributable to shareholders of the Company** | **$ (23,593)** | $ (14,808) | **$ (29,283)** | $ (24,331) |
| **Total comprehensive income / (loss) attributable to non-controlling interest** | **(284)** | $ 590 | **$ (489)** | $ 590 |
| **Net loss per common share** | | | | |
| Basic and diluted | **$ (0.02)** | $ (0.03) | **$ (0.05)** | $ (0.05) |
| **Weighted average number of shares outstanding** | | | | |
| Basic and diluted | **592,208,342** | 466,768,801 | **589,730,772** | 416,214,533 |

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

## Condensed Consolidated Interim Statements of Cash Flows
Expressed in thousands of Canadian Dollars
Unaudited

| | | **Three months Ended June 30 2019** | | Three months Ended June 30 2018 | | **Six months Ended June 30 2019** | | Six months Ended June 30 2018 |
|---|---|---|---|---|---|---|---|---|
| **Operating activities** | | | | | | | | |
| **Net loss for the period** | **$** | **(14,191)** | $ | (12,163) | **$** | **(27,995)** | $ | (22,685) |
| Items not affecting cash: | | | | | | | | |
| Unrealized fair value loss on biological transformation (Note 6) | | **155** | | - | | **537** | | - |
| Depreciation and amortization (Note 8, 9) | | **1,437** | | 113 | | **2,475** | | 190 |
| Share-based compensation (Note 17) | | **2,672** | | 2,742 | | **5,714** | | 5,561 |
| Interest income | | **(1,295)** | | - | | **(1,295)** | | - |
| Interest expense (Note 23) | | **1,611** | | 1,180 | | **4,685** | | 2,167 |
| Share of loss on investment in joint venture (Note 13) | | **372** | | - | | **552** | | - |
| Fair value gain / (loss) for financial instruments accounted under FVTPL (Note 12,14) | | **1,812** | | (282) | | **430** | | (900) |
| Income tax recovery / (expense) | | **(1,464)** | | 104 | | **(2,723)** | | (2,533) |
| Impairment of intangible assets (Note 9) | | **-** | | - | | **1,800** | | - |
| (Gain) / loss on settlement of financial assets and liabilities | | **250** | | - | | **(125)** | | 4,191 |
| Changes in non-cash working capital items: | | | | | | | | |
| Other receivables | | **1,048** | | (601) | | **(183)** | | (781) |
| Prepaid expenses | | **(8,308)** | | (333) | | **(6,458)** | | (809) |
| Interest payable | | **1,372** | | 1,492 | | **329** | | 2,032 |
| Biological assets (Note 6) | | **227** | | - | | **89** | | - |
| Inventory (Note 7) | | **(9,737)** | | (357) | | **(13,354)** | | (357) |
| Research contract costs | | **795** | | - | | **256** | | - |
| Accounts payable and accrued liabilities | | **5,013** | | (1,267) | | **(4,376)** | | (2,636) |
| Deferred revenue | | **(1,217)** | | - | | **(227)** | | - |
| **Net cash used in operating activities** | **$** | **(19,448)** | $ | (9,372) | **$** | **(39,869)** | $ | (16,560) |
| | | | | | | | | |
| **Investing activities** | | | | | | | | |
| Issuance of notes receivable (Note 5) | **$** | **(7,164)** | $ | (901) | **$** | **(12,374)** | $ | (1,535) |
| Proceeds from repayment of promissory notes | | **-** | | - | | **400** | | - |
| Investment of debt obligation receivable in product equivalents (Note 14) | | **-** | | - | | **-** | | (7,000) |
| Proceeds from debt obligation receivable in product equivalents (Note 14) | | **323** | | - | | **9,514** | | - |
| Investment in short-term investments | | **-** | | - | | **-** | | - |
| Investment in long-term investments (Note 12) | | **(1,500)** | | (396) | | **(1,500)** | | (3,502) |
| Investment in intangible assets | | **-** | | (4,963) | | **-** | | (4,963) |
| Proceeds from sale of long-term investments (Note 12) | | **1,545** | | - | | **1,620** | | - |
| Proceeds from short-term investments | | **3,000** | | - | | **3,000** | | - |
| Investment in joint venture (Note 13) | | **(16,863)** | | (3,441) | | **(41,463)** | | (3,441) |
| Purchase of capital assets (Note 8) | | **(5,649)** | | (3,488) | | **(12,104)** | | (4,084) |
| Net cash used for business combinations (Note 10) | | **-** | | 1,390 | | **-** | | 1,390 |
| **Net cash used in investing activities** | **$** | **(26,308)** | $ | (11,799) | **$** | **(52,907)** | $ | (23,135) |
| | | | | | | | | |
| **Financing activities** | | | | | | | | |
| Proceeds from share, special warrant and unit issuances | **$** | **-** | $ | 109,359 | **$** | **-** | $ | 109,359 |
| Net proceeds from convertible debentures (Note 16) | | **-** | | 129 | | **-** | | 100,000 |
| Repayment of convertible debentures | | **(140)** | | - | | **(140)** | | - |
| Proceeds from share options exercised (Note 17) | | **-** | | 25 | | **-** | | 550 |
| Proceeds from warrants exercised (Note 17) | | **-** | | 2,999 | | **336** | | 90,620 |
| Proceeds from broker warrant units exercised (Note 17) | | **-** | | (1) | | **-** | | 3,419 |
| Proceeds / (Repayment) on long-term debt | | **-** | | (1,904) | | | | (1,904) |
| **Net cash from financing activities** | **$** | **(140)** | $ | 110,607 | **$** | **196** | $ | 302,044 |
| | | | | | | | | |
| **Net (decrease)/increase in cash and cash equivalents** | **$** | **(45,896)** | $ | 89,436 | **$** | **(92,580)** | $ | 262,349 |
| Cash position, beginning of period | **$** | **165,023** | $ | 206,367 | **$** | **211,707** | $ | 33,454 |
| **Cash position, end of period (Note 4)** | **$** | **119,127** | $ | 295,803 | **$** | **119,127** | $ | 295,803 |

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

# AUXLY CANNABIS GROUP INC.

## Condensed Consolidated Interim Statements of Changes in Equity

Expressed in thousands of Canadian Dollars

Unaudited

| | Attributable to the shareholders of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share Capital | | Reserves | | | | | | | |
| | Number of Shares | Share Capital | Shares to Be Issued | Warrants | Contributed Surplus | Convertible Debenture | Deficit | Accumulated Other Comprehensive Income | Non-Controlling Interests | Total Equity |
| **Balance December 31, 2018** | **573,532,247** | **$ 350,647** | **$ 9,523** | **$ 33,618** | **$ 17,873** | **$ 4,076** | **$ (86,729)** | **$ (10,873)** | **$ 3,017** | **$ 321,152** |
| Shares issued for acquisition of Inverell | 1,927,343 | 9,523 | (9,523) | - | - | - | - | - | - | - |
| Contingent shares on acquisition of Robinsons released from escrow (Note 17) | 2,013,421 | - | - | - | - | - | - | - | - | - |
| Shares issued on exercise of warrants (Note 17) | 14,387,301 | 336 | - | - | - | - | - | - | - | 336 |
| Fair value transfer on exercise of warrants (Note 17) | - | 92 | - | (92) | - | - | - | - | - | - |
| Expiry of warrants (Note 17) | - | - | - | (3,063) | 3,063 | - | - | - | - | - |
| Shares issued to settle financial liabiliites | 450,000 | 387 | - | - | - | - | - | - | - | 387 |
| Shares issued on conversion of convertible debt (Note 16) | 32,258 | 51 | - | - | - | (3) | - | - | - | 48 |
| Share-based payments (Note 17) | - | - | - | - | 5,714 | - | - | - | - | 5,714 |
| Net Loss | - | - | - | - | - | - | (27,598) | - | (397) | (27,995) |
| Changes in fair value of long-term investments | - | - | - | - | - | - | - | (1,408) | - | (1,408) |
| Currency translation adjustment | - | - | - | - | - | - | - | (277) | (92) | (369) |
| **Balance June 30, 2019** | **592,342,570** | **$ 361,036** | **$ -** | **$ 30,463** | **$ 26,650** | **$ 4,073** | **$ (114,327)** | **$ (12,558)** | **$ 2,528** | **$ 297,865** |

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

## AUXLY CANNABIS GROUP INC.

**Condensed Consolidated Interim Statements of Changes in Equity**
Expressed in thousands of Canadian Dollars
Unaudited

| | Attributable to the shareholders of the Company | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Share Capital | | Reserves | | | | | | | |
| | Number of Shares | Share Capital | Shares to Be Issued | Warrants | Contributed Surplus | Convertible Debenture | Deficit | Accumulated Other Comprehensive Income | Non-Controlling Interests | Total Equity |
| **Balance December 31, 2017** | 263,452,946 | $ 60,813 | $ - | $ 12,002 | $ 4,870 | $ 1,334 | $ (19,741) | $ 3,515 | $ - | $ 62,793 |
| Equity component of convertible debentures issued on private placement January 2018 | - | - | - | 3,195 | - | 6,765 | - | - | - | 9,960 |
| Units issued on private placement May 2018 | 82,225,000 | 90,459 | - | 18,900 | - | - | - | - | - | 109,359 |
| Shares issued on acquisition of Robinsons | 5,369,126 | 9,889 | - | - | - | - | - | - | - | 9,889 |
| Shares and warrants issued on acquisition of Dosecann | 14,863,550 | 33,783 | - | 5,481 | - | - | - | - | - | 39,264 |
| Shares to be issued for acquisition of Inverell | - | - | 10,156 | - | - | - | - | - | - | 10,156 |
| Shares issued for Data Licensing Agreement | 359,211 | 528 | - | - | - | - | - | - | - | 528 |
| Shares issued to Province | 303,030 | 436 | - | - | - | - | - | - | - | 436 |
| Investment in Joint Venture | 1,250,000 | 3,980 | - | 6,497 | - | - | - | - | - | 10,477 |
| Shares issued on exercise of warrants | 141,272,969 | 90,620 | - | - | - | - | - | - | - | 90,620 |
| Fair value transfer on exercise of warrants | - | 14,742 | - | (14,742) | - | - | - | - | - | - |
| Shares and warrants issued on exercise of broker warrant units | 3,419,549 | 1,858 | - | 3,061 | (1,499) | - | - | - | - | 3,420 |
| Cancellation of warrants | - | - | - | (237) | 237 | - | - | - | - | - |
| Units issued on Investment in Inner Spirit Holdings Inc. | 674,418 | 1,275 | - | 704 | - | - | - | - | - | 1,979 |
| Shares issued for debt settlement | 3,018,109 | 6,881 | - | - | - | - | - | - | - | 6,881 |
| Shares issued on conversion of convertible debt | 21,975,482 | 20,122 | - | - | - | (1,403) | - | - | - | 18,719 |
| Share-based payments | - | - | - | - | 5,561 | - | - | - | - | 5,561 |
| Shares issued on exercise of stock options | 550,000 | 550 | - | - | - | - | - | - | - | 550 |
| Fair value transfer on exercise of stock options | - | 378 | - | - | (378) | - | - | - | - | - |
| Deferred income tax | - | - | - | - | - | (2,193) | - | 312 | - | (1,881) |
| Non-controlling interest arising from acquisitions | - | - | - | - | - | - | - | - | 3,170 | 3,170 |
| Net loss | - | - | - | - | - | - | (22,400) | - | (285) | (22,685) |
| Changes in fair value of long-term investments | - | - | - | - | - | - | - | (2,243) | - | (2,243) |
| Currency translation adjustments | - | - | - | - | - | - | - | - | 875 | 875 |
| **Balance June 30, 2018** | 538,733,390 | $ 336,314 | $ 10,156 | $ 34,861 | $ 8,791 | $ 4,503 | $ (42,141) | $ 1,584 | $ 3,760 | $ 357,828 |

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

## 1. Nature of operations and going concern

Auxly Cannabis Group Inc. ("Auxly", "we", "our", or the "Company") is a publicly traded company 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 an international cannabis company dedicated to bringing innovative, effective, and high-quality cannabis products to the medical, wellness and adult-use markets. Auxly's experienced team of industry first-movers and enterprising visionaries have secured a diversified supply of raw cannabis, strong clinical, scientific and operating capabilities and leading research and development infrastructure in order to create trusted products and brands in an expanding global market.

## 2. Basis of preparation

**Statement of compliance**

These condensed consolidated interim financial statements for the six months ended June 30, 2019 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), including International Accounting Standard ("IAS") 34, Interim Financial Reporting. The same accounting policies and methods of computation were followed in the preparation of these condensed consolidated interim financial statements as were followed in the preparation of the annual consolidated financial statements for the year ended December 31, 2018 prepared in accordance with IFRS as issued by the IASB.

Certain comparative figures have been reclassified to conform to the current period's presentation. See Note 10 for more information.

The condensed consolidated interim financial statements do not include all the information and disclosures required in the annual consolidated financial statements. Accordingly, these condensed consolidated interim financial statements for the six months ended June 30, 2019 should be read together with the annual consolidated financial statements for the year ended December 31, 2018, which are available on SEDAR at www.sedar.com.

The preparation of condensed consolidated interim financial statements in accordance with IAS 34 requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the financial statements are consistent with those disclosed in the notes to the annual consolidated financial statements for the year ended December 31, 2018. These condensed consolidated interim financial statements were authorized for issue by the Board of the Directors on August 15, 2019.

## 3. Significant accounting policies

**Subsidiaries**

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. The table below lists the Company’s subsidiaries that are consolidated in these financial statements and the ownership interest held by non-controlling interests, as at June 30, 2019.

| Subsidiaries | Equity interests |
|---|---|
| Dosecann Inc. | 100% |
| KGK Science Inc. | 100% |
| Kolab Project Inc. | 100% |
| Robinson’s Cannabis Inc. | 100% |
| Inverell S.A. | 80% |

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. Unrealized losses are eliminated to the extent of the gains, but only to the extent that there is no evidence of impairment.

**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.

**IFRS 16 – Leases**
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 line with IFRS 16 ‘Leases’.

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.

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.

## 3. Significant accounting policies (continued)

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;
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;
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;
iii. periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

**Impact of transition to IFRS 16**

Effective January 1, 2019, the Company has adopted IFRS 16 using the modified retrospective approach, with recognition of a right of use asset equal to the lease liability adjusted for prepaid or accrued lease payments immediately before the date of initial application.

In applying the modified retrospective approach, the Company has taken advantage of the following practical expedients:

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

## 3. Significant accounting policies (continued)

a) A single discount rate has been applied to portfolios of leases with reasonably similar characteristics;
b) Leases with a remaining term of twelve months or less from the date of application have been accounted for as short-term leases even though the initial term from lease commencement have been more than twelve months.
c) The company maintained the lease assessments made under IAS 17 and IFRIC 4 for existing contracts. Therefore, the definition of a lease under IFRS 16 was applied only to contracts entered or changed after January 1, 2019.
d) The Company recognized a right-of-use asset on the date of the application at an amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognised in the statement of financial position immediately before the date of initial application.

The aggregate lease liability recognised in the statement of financial position at January 1, 2019 can be reconciled as follows:

| | |
|---|---|
| Operating lease commitment as at December 31, 2018 | $6,401 |
| Effect of discounting those leases commitments | 1,253 |
| | 5,148 |

The weighted-average incremental borrowing rate used to measure lease liabilities at the date of initial application was 12%. A corresponding right-of-use asset of $5,148 has been recognised in the condensed consolidated interim statement of financial position as at January 1, 2019 and has been classified as property and equipment.

## 4. Restricted Cash

Auxly has committed to pay for Sunens Farms Inc. ("Sunens") equipment purchases of $21,855. Auxly has provided the vendor a Letter of Credit for the full amount of cash to be used for the equipment purchases. Further, Auxly has restricted the cash until December 31, 2019 as collateral in order to facilitate the issuance of the Letter of Credit. As at June 30, 2019, $21,314 remains as restricted cash included in cash and cash equivalents.

## 5. Notes receivable

| | June 30, 2019 | December 31, 2018 |
|---|---|---|
| Curative principal value | $ 13,458 | $ 3,086 |
| Nature Crisp principal value | 2,002 | - |
| Other loans principal value | 135 | 535 |
| Less: Allowance for credit losses and discounting using effective interest rate | (1,294) | (675) |
| **Total notes receivable** | **$ 14,301** | **$ 2,946** |

On May 15, 2019, Auxly entered into a Supply Agreement with Curative Cannabis Inc. ("Curative") and was issued 25 common shares of Curative as additional consideration for committing to fund Curative's facility up to $18,000. $151 was allocated to the common shares of Curative Cannabis based on the market prices of comparable companies and was recorded as a long-term investment. $1,144 was allocated to the supply agreement based on a discounted cash flow model of the cost savings and

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

## 5. Notes receivable (continued)

recorded as an intangible asset. $1,295 was recognized as interest income on the condensed consolidated interim statement of loss and comprehensive loss.

As at June 30, 2019, the Company had a principal note receivable balance of $13,458 due from Curative. The note has a maturity date of August 27, 2019, and interest is accrued on the outstanding value of the principal at 10% per annum. The expected credit loss reserve used to value the note was 10%. The carrying value of the note at June 30, 2019 is $12,164 and the note is secured against all assets of Curative. The value of the security approximates the value of the note receivable.

On February 11, 2019, the Company issued a note receivable with a principal value of USD $1,500 due from Nature Crisp. The note has a maturity date of July 31, 2020, and interest is accrued on the outstanding value of the principal at 1% per annum. The note is secured by an interest in the debtor's property and assets. The effective interest rate used to value the note was 15%, including an expected credit loss reserve of 5%. As at June 30, 2019, the carrying amount of the note is $2,002.

## 6. Biological assets

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

| | 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 | (537) | - | (537) |
| Capitalized production costs | 566 | 1,794 | 2,360 |
| Transferred to inventory upon harvest | (195) | (2,170) | (2,365) |
| Biological Asset Write-off | - | (92) | (92) |
| Currency Translation Adjustment | - | 8 | 8 |
| **Balance at June 30, 2019** | **$ 179** | **$ 1,353** | **$ 1,532** |

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; | Level 3 input |
| (b) Attrition rate; | Level 3 input |
| (c) Average yield per plant; | Level 3 input |
| (d) Standard cost per gram to compete production | Level 3 input |
| (c) Cumulative stage of completion in production process | Level 3 input |

As at June 30, 2019 the cannabis plants were on average 41% complete through their 14-week growing cycle while Hemp was substantially available to harvest.

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

## 6. Biological assets (continued)

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 & assumptions | Range of inputs | Sensitivity | Effect on Biological Asset Balance |
|---|---|---|---|
| Selling price per gram | $1.50 - $14.00 dollars | Increase/decrease $1.00/gram | Increase/decrease $27 |
| Average yield per plant | 86 grams | Increase/decrease 10% | Increase/decrease $18 |
| Post-harvest cost per gram | $2.25 dollar/gram | Increase/decrease $0.50/gram | Decrease/increase $25 |

## 7. Inventory

The following is a breakdown of inventory at June 30, 2019:

| | Acquired through business combination | Capitalized costs | Fair Value Transferred from Biological Assets | Currency Translation Adjustment | Carrying Value |
|---|---|---|---|---|---|
| Dried Cannabis | | | | | |
| Work-in-process | $ - | $ 3,002 | $ (190) | $ - | $ 2,812 |
| Finished goods | - | 236 | 51 | - | 287 |
| Dried Hemp | | | | | |
| Work-in-process | 607 | 4,990 | - | (20) | 5,577 |
| Cannabis Oil | | | | | |
| Work-in-process | - | 5,984 | - | - | 5,984 |
| Finished goods | - | 206 | - | - | 206 |
| Merchandise Products | - | 92 | - | - | 92 |
| Packaging, Hardware, Consumables and Ingredients | - | 611 | - | - | 611 |
| **Balance at June 30, 2019** | **$ 607** | **$ 15,121** | **$ (139)** | **$ (20)** | **$ 15,569** |

As of June 30, 2019, the Company recognized $15,569 (December 31, 2018-$2,215) of inventory on the condensed consolidated interim statements of financial position, including $(139) (December 31, 2018- $523) non-cash expense relating to the fair value less cost to sell transferred to inventory upon harvest. The Company wrote off $213 of dried cannabis inventory due to the costs capitalized exceeding the net realizable value of the inventory. The impairment loss has been included in the cost of goods sold in the condensed consolidated interim statement 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 | Building | 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 | 741 | 432 | 2,877 | 1,807 | 3,964 | 2,112 | 171 | **12,104** |
| **June 30, 2019** | **$ 2,595** | **$ 1,445** | **$ 5,566** | **$ 6,168** | **$ 22,787** | **$ 2,787** | **$ 5,319** | **$ 46,667** |
| **Accumulated Depreciation:** | | | | | | | | |
| **December 31, 2018** | $ 161 | $ 68 | $ 140 | $ 343 | $ - | $ - | $ - | **$ 712** |
| Depreciation | 245 | 154 | 309 | 121 | - | - | 522 | **1,351** |
| **June 30, 2019** | **$ 406** | **$ 222** | **$ 449** | **$ 464** | **$ -** | **$ -** | **$ 522** | **$ 2,063** |
| **Adjustments** | | | | | | | | |
| Currency Translation | $ 4 | $ 4 | $ 8 | $ 7 | $ - | $ - | $ - | **$ 23** |
| **Carrying amounts** | | | | | | | | |
| **December 31, 2018** | **$ 1,697** | **$ 949** | **$ 2,557** | **$ 4,025** | **$ 18,823** | **$ 675** | **$ -** | **$ 28,726** |
| **June 30, 2019** | **$ 2,189** | **$ 1,223** | **$ 5,117** | **$ 5,704** | **$ 22,787** | **$ 2,787** | **$ 4,797** | **$ 44,604** |

| | Computers and Office Furniture | Leasehold Improvement | Equipment | Building | Construction in Progress | Land | Right of Use Assets | Total |
|---|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | | |
| **December 31, 2017** | $ 144 | $ 55 | $ 149 | $ 2,655 | $ 504 | $ - | $ - | **$ 3,507** |
| Additions from acquisitions | 226 | 312 | 782 | 1,157 | 5,265 | 212 | - | **7,954** |
| Additions | 1,484 | 646 | 1,758 | 549 | 13,054 | 463 | - | **17,954** |
| **December 31, 2018** | **$ 1,854** | **$ 1,013** | **$ 2,689** | **$ 4,361** | **$ 18,823** | **$ 675** | **$ -** | **$ 29,415** |
| **Accumulated Depreciation:** | | | | | | | | |
| **December 31, 2017** | $ 5 | $ 2 | $ 7 | $ 18 | $ - | $ - | $ - | **$ 32** |
| Depreciation | 156 | 66 | 133 | 325 | - | - | - | **680** |
| **December 31, 2018** | **$ 161** | **$ 68** | **$ 140** | **$ 343** | **$ -** | **$ -** | **$ -** | **$ 712** |
| **Adjustments** | | | | | | | | |
| Currency Translation | $ 4 | $ 4 | $ 8 | $ 7 | $ - | $ - | $ - | **$ 23** |
| **Carrying amounts** | | | | | | | | |
| **December 31, 2017** | **$ 139** | **$ 53** | **$ 142** | **$ 2,637** | **$ 504** | **$ -** | **$ -** | **$ 3,475** |
| **December 31, 2018** | **$ 1,697** | **$ 949** | **$ 2,557** | **$ 4,025** | **$ 18,823** | **$ 675** | **$ -** | **$ 28,726** |

Construction in progress includes $751 (2018 - $nil) of capitalized borrowing costs at an annualized capitalization rate of 10%.

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

## 9. Intangible assets

| | Cultivation Interests | Canadian Cultivation Licenses | Processing Licenses | International Cultivation Licenses | Distribution Agreements | Others | Total |
|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | |
| **December 31, 2018** | | | | | | | |
| *(Restated - see note 10)* | $ 11,142 | $ 27,152 | $ 31,100 | $ 14,206 | $ 829 | $ 4,240 | **$ 88,669** |
| Additions | 1,597 | - | - | - | - | - | **1,597** |
| Dispositions | - | - | - | - | - | (603) | **(603)** |
| Impairment | (1,800) | - | - | - | - | - | **(1,800)** |
| **June 30, 2019** | **$ 10,939** | **$ 27,152** | **$ 31,100** | **$ 14,206** | **$ 829** | **$ 3,637** | **$ 87,863** |
| **Accumulated Amortization:** | | | | | | | |
| **December 31, 2018** | $ - | $ - | $ - | $ - | $ - | $ 1,446 | **$ 1,446** |
| Dispositions | - | - | - | - | - | (151) | **$ (151)** |
| Amortization | 458 | - | - | - | 28 | 681 | **1,167** |
| **June 30, 2019** | **$ 458** | **$ -** | **$ -** | **$ -** | **$ 28** | **$ 1,976** | **$ 2,462** |
| **Adjustments** | | | | | | | |
| Currency Translation (2018) | $ - | $ - | $ - | $ 1,199 | $ - | $ - | **$ 1,199** |
| Currency Translation (2019) | $ - | $ - | $ - | $ 607 | $ - | $ - | **$ 607** |
| **Carrying amounts** | | | | | | | |
| **December 31, 2018** | **$ 11,142** | **$ 27,152** | **$ 31,100** | **$ 15,405** | **$ 829** | **$ 2,794** | **$ 88,422** |
| **June 30, 2019** | **$ 10,481** | **$ 27,152** | **$ 31,100** | **$ 14,813** | **$ 801** | **$ 1,661** | **$ 86,008** |

| | Cultivation Interests | Canadian Cultivation Licenses | Processing Licenses | International Cultivation Licenses | Distribution Agreements | Others | Total |
|---|---|---|---|---|---|---|---|
| **Cost:** | | | | | | | |
| **December 31, 2017** | $ 10,800 | $ 16,963 | $ - | $ - | $ - | $ 1,442 | **$ 29,205** |
| Additions | 9,142 | - | - | - | 829 | 522 | **10,493** |
| Additions from acquisitions (*Restated - see note 10)* | - | 10,189 | 31,100 | 14,206 | - | 2,276 | **57,771** |
| Impairment | (8,800) | - | - | - | - | - | **(8,800)** |
| **December 31, 2018** | **$ 11,142** | **$ 27,152** | **$ 31,100** | **$ 14,206** | **$ 829** | **$ 4,240** | **$ 88,669** |
| **Accumulated Amortization:** | | | | | | | |
| **December 31, 2017** | $ - | $ - | $ - | $ - | $ - | $ - | **$ -** |
| Amortization | - | - | - | - | - | 1,446 | **1,446** |
| **December 31, 2018** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ 1,446** | **$ 1,446** |
| **Adjustments** | | | | | | | |
| Currency Translation (2018) | $ - | $ - | $ - | $ 1,199 | $ - | $ - | **$ 1,199** |
| **Carrying amounts** | | | | | | | |
| **December 31, 2017** | **$ 10,800** | **$ 16,963** | **$ -** | **$ -** | **$ -** | **$ 1,442** | **$ 29,205** |
| **December 31, 2018** | **$ 11,142** | **$ 27,152** | **$ 31,100** | **$ 15,405** | **$ 829** | **$ 2,794** | **$ 88,422** |

### a) Cultivation interests

On February 7, 2019, the Company terminated the definitive agreement with FV Pharma Inc. ("FV") on the basis of contractual breaches relating to, among other things, FV's management and staffing obligations of the JV Facility, resulting in an impairment loss of $1,800.

On January 8, 2019, the Company and Green Relief Inc. ("Green Relief") mutually agreed to terminate their interim agreement, and Green Relief agreed to pay the Company a termination fee of $1,500 through the issuance of 496,689 common shares of Green Relief and the execution of an offtake

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

## 9. Intangible assets (continued)

cultivation agreement. The value of $1,047 was allocated to the common shares of Green Relief and recorded as a long-term investment. The residual value of $453 was allocated to the cultivation agreement and recorded as an intangible asset. A gain of $1,047 was recorded in the statement of profit and loss on the termination of the interim agreement.

## 10. Business combinations

The purchase price allocation for Dosecann has been finalized during the period ended March 31, 2019. All net assets acquired, and consideration paid have been included at their respective fair values with no changes in the preliminary purchase price allocation.

The purchase price allocation for KGK Sciences Inc. has been finalized during the period ended June 30, 2019. All net assets acquired, and consideration paid have been included at their respective fair values. The Company has restated the comparative figures in the consolidated statement of financial position based on the measurement period adjustments. The following tables summarize the effects of the change described above on the line items of the consolidated statement of financial position for the year ended December 31, 2018:

| For the year ended December 31, 2018 | As previously reported | Adjustment | As restated |
|---|---|---|---|
| Intellectual property | 89,327 | (905) | 88,422 |
| Goodwill | 33,015 | 905 | 33,920 |

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

## 10. Business combinations (continued)

The purchase price allocations of business combinations that were preliminary as at December 31, 2018 have been included in the table below:

| | 2018 | |
|---|---|---|
| | **Dosecann Inc.** | **KGK Science Inc.** *(restated)* |
| Cash and cash equivalents | $ 4,062 | $ 445 |
| Other receivables | 748 | 817 |
| Accounts receivable | - | 693 |
| Prepaid Expenses | - | 68 |
| Inventory and biological assets | - | - |
| Research contract costs | - | 1,348 |
| Property, plant and equipment | 5,007 | 445 |
| Licenses and licenses in progress | 31,100 | - |
| Non-competition agreements | - | - |
| Intellectual property | - | 1,123 |
| Goodwill | 10,112 | 11,821 |
| Accounts payable and accrued liabilities | (2,479) | (1,189) |
| Long-term loans | - | - |
| Deferred revenue | - | (2,950) |
| Deferred tax liabilities | (9,468) | - |
| Non-controlling interests | - | - |
| Net assets acquired | $ 39,082 | $ 12,621 |
| | | |
| Consideration paid in shares | $ 33,783 | $ 4,092 |
| Consideration paid in warrants | 5,109 | - |
| Consideration paid in cash | 190 | 5,288 |
| Fair value of future make-whole payment | - | 1,082 |
| Assumed loans | - | 2,159 |
| | $ 39,082 | $ 12,621 |
| | | |
| Consideration paid in cash | $ (190) | $ (7,447) |
| Less: Cash and cash equivalents acquired | 4,062 | 445 |
| Net cash (outflow) / inflow | $ 3,872 | $ (7,002) |

## 10. Business combinations (continued)

### a) Dosecann Inc.

On May 15, 2018, the Company purchased 100% of the issued and outstanding shares of Dosecann Inc. ("Dosecann"). The transaction was accounted for as a business combination. The shareholders of Dosecann received aggregate consideration from the Company as follows:

i. 5,253,955 common shares on closing of the acquisition;
ii. 5,701,248 warrants of the Company on closing of the acquisition;
iii. 9,609,594 common shares subject to lock-up agreements restricting their ability to transfer shares until a date that is up to 18 months following the closing date; and
iv. 9,630,947 common shares issued in escrow payable as follows:
   a. 3,021,474 shares payable 120 days after closing date;
   b. 3,399,158 shares payable upon Dosecann receiving its dealer license approval by Health Canada; the dealers license was issued during the year and the shares released from escrow;
   c. 1,888,421 shares payable upon Dosecann's receipt of good manufacturing practice certification; and
   d. 1,321,894 shares payable upon Dosecann's first commercial sale of a cannabis product.

The contingent consideration of shares (b, c, d above) has been classified as equity. Management assessed the probability of the issuance of the contingent shares to be highly probable.

The shares subject to lock-up agreements are discounted to present value based on the lock-up periods. The discount rates range from 21.6% to 32.6% depending on the lock-up period, calculating using the put-option pricing models.

The total fair value of the consideration is $39,082.

Dosecann includes a facility purpose-built for the research, development, extraction, formulation, filling and packaging of cannabis-based products and is located in Charlottetown, Prince Edward Island. Dosecann will develop a range of value-added cannabis-based products for the Company which will ultimately be sold to medical cannabis patients and adult-use cannabis markets, anticipated to be in conjunction with Q4 2019 Health Canada regulations.

Goodwill arose in the acquisition of Dosecann, primarily due to the assembled work force of Dosecann. These benefits were not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets. Goodwill of $10,112 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.

### b) KGK Science Inc.

On August 29, 2018, the Company purchased all the issued and outstanding shares of KGK Science Inc. ("KGK"). The transaction was accounted for as a business combination. The shareholders of KGK received aggregate consideration from the Company as follows:

i. 4,132,231 common shares of the Company on closing of the acquisition;
ii. $5,288 in cash on closing of the acquisition;

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

## 10. Business combinations (continued)

iii. $2,159 in a cash payment on closing to repay long term loans of KGK;

iv. $1,082 as a future make-whole payment, depending on the share price of the Company six months following the transaction date; and

v. Additional payment of 30% of the purchase price received for the sale of the KGK patents, if the patents are sold by August 29, 2019 or a bona-fide cash offer received. Management has assessed that there is a low probability that the patents will be sold, and the fair value is a nominal amount.

The total fair value of the consideration is $12,621.

The fair value of the make-whole payment is $1,082 based on the following assumptions: Strike price - $1.21, Share price – $1.13, Annualized volatility – 78.18%; Risk-free interest rate – 2.23%. If the market value of the Company's shares is less than $1.21 on February 28, 2019, Auxly shall make a payment to KGK shareholders that is equal to the difference between the market price of the Auxly shares on the final day of the Hold-up Period and $1.21 per share, up to a maximum total payment of $0.64 per share. On March 4, 2019, the Company completed the make-whole payment of $1,776.

KGK is a leading health and wellness focused private contract research organization based in London, Ontario, and the Company expects to leverage KGK's expertise and research abilities to further the Company's product development efforts through collaboration with the Company's wholly owned subsidiary, Dosecann.

Goodwill of $11,821 arose in the acquisition of KGK primarily due to the assembled work force of KGK. These benefits were not recognized separately from goodwill because they do not meet the recognition criteria for identifiable assets. None of the goodwill arising on this acquisition is expected to be deductible for tax purposes.

## 11. Goodwill

| | | |
|---|---|---|
| As at December 31, 2018 *(Restated - see note 10)* | $ | 33,920 |
| Currency Translation Adjustment | | 131 |
| **As at June 30, 2019** | **$** | **34,051** |

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

## 12. Long-term investments

| Entity | Note | Instrument | Classification | Balance at December 31, 2018 | Additions | FV Change | Disposals | Balance at June 30, 2019 |
|---|---|---|---|---|---|---|---|---|
| VIVO Cannabis | | Shares | FVTOCI | $ 4,733 | $ - | $ (1,306) | $ (1,527) | $ 1,900 |
| CannTx Life Sciences | | Shares | FVTOCI | 971 | - | 60 | - | 1,031 |
| Inner Spirit Holdings | | Shares | FVTOCI | 3,448 | - | 1,870 | - | 5,318 |
| Inner Spirit Holdings | | Warrants | FVTPL | 248 | - | 55 | - | 303 |
| Lotus Ventures Inc. | | Shares | FVTOCI | 1,198 | - | (143) | (32) | 1,023 |
| Lotus Ventures Inc. | | Warrants | FVTPL | 48 | - | (24) | - | 24 |
| Province Brands | | Shares | FVTOCI | 166 | - | 10 | - | 176 |
| Cannabis OneFive Inc. | | Shares | FVTOCI | 110 | - | 7 | - | 117 |
| Cannabis OneFive Inc. | | Warrants | FVTPL | 12 | - | (1) | - | 11 |
| Delta 9 Cannabis | | Shares | FVTOCI | 7,209 | - | (945) | - | 6,264 |
| FSD Pharma | | Shares | FVTOCI | 2,138 | - | (938) | - | 1,200 |
| Good Leaf | | Shares | FVTOCI | 384 | - | 24 | - | 408 |
| Good Leaf | | Warrants | FVTPL | 278 | - | - | - | 278 |
| Ascent Industries Corp. | | Shares | FVTOCI | 711 | - | (289) | (74) | 348 |
| Green Relief Inc. | 9 (a) | Shares | FVTOCI | - | 1,047 | 453 | | 1,500 |
| Curative Cannabis Inc. | 5 | Shares | FVTOCI | - | 151 | - | - | 151 |
| Inner Spirit Holdings | | Convertible Debt | FVTPL | - | 1,500 | 756 | - | 2,256 |
| ICC International Cannabis Corp. | | Convertible Debt | FVTPL | 5,569 | - | (385) | - | 5,184 |
| **Total** | | | | **$ 27,223** | **$ 2,698** | **$ (796)** | **$ (1,633)** | **$ 27,492** |

## 13. Investment in Joint Ventures

On June 15, 2018, the Company signed a definitive joint venture agreement with Peter Quiring to develop, construct and operate a fully-automated, state-of-the-art, purpose-built greenhouse for cannabis cultivation in Leamington, Ontario. The joint arrangement is structured through a separate legal entity, Sunens, and has been classified as a joint venture per IFRS 11.

There was a $552 equity loss recorded for the six months ended June 30, 2019 (2018 - $Nil). At June 30, 2019, the joint venture reported a net loss of $1,082, and the material assets in the joint venture were land and buildings valued at $4,020 and supplier and construction deposits of $52,019.

On February 15, 2019, the Company and Sunens cancelled the issuance of 19,025,807 Class B non-voting shares and reclassified the $19,026 investment as a convertible promissory note convertible into Class B non-voting shares, accounted for as fair value through profit and loss.

The Company made additional investments in the joint venture throughout the six months ended June 30, 2019 of $41,463 through a secured loan to the joint venture, bearing of 1% per annum and convertible into Class B shares of the Sunens.

The net investment in the joint venture is $70,069 as at June 30, 2019, which is made up of an equity balance of $9,580 of the Company's 51% of the voting shares and $60,489 of convertible promissory notes. The Company has joint control as decisions about operating activities require unanimous consent.

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

## 14. Debt obligation receivable in product equivalents

### a) Beleave Inc.

The Company previously advanced $5,000 to Beleave Inc. and the instrument was deemed to be a fair value through profit or loss debt investment per IFRS 9 guidance. The fair value of the promissory note was estimated to be $4,566 at June 30, 2019 (2018 - $6,700) and a fair value loss of $1,141 was recorded on the condensed consolidated interim statement of loss and comprehensive loss for the six months ended June 30, 2019 (2018 – gain of $352). As at June 30, 2019, $1,214 was received as repayment on the note, with $595 received as at December 31, 2018.

### b) Sundial Growers Inc.

On March 1, 2018, the Company announced that it had entered into a definitive agreement with Sundial Growers Inc. ("Sundial") whereby the Company advanced $7,000 to Sundial by way of a promissory note. The note was subject to an interest rate of 24% per annum, with a minimum guaranteed interest of $840. The Company extended the loan for an additional six months and as a result, the amount due on maturity increased to $8,780.

The instrument was deemed to be a fair value through profit or loss debt investment per IFRS 9 guidance. On February 22, 2019, $8,895 was received to fully settle the promissory note that included an extension charge of $115. A fair value gain of $310 was recorded on the condensed consolidated interim statement of loss and comprehensive loss for the six months ended June 30, 2019 (2018 - $666).

## 15. Lease liability

| | | June 30, 2019 |
|---|---|---|
| **Maturity analysis - contractual undiscounted cash flows** | | |
| Less than one year | $ | 1,532 |
| One to five years | | 4,453 |
| More than five years | | 139 |
| **Total undiscounted lease obligations** | **$** | **6,124** |
| **Discounted lease obligations included in the condensed interim statement of financial position** | **$** | **4,595** |
| Current portion | | 1,656 |
| Non-current portion | | 2,939 |

## 16. Convertible debenture

### 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 consists of a $1 principal amount of senior unsecured convertible debentures and 322 share purchase warrants.

The debentures bear interest at 6% per annum, payable semi-annually and mature within 24 months on January 17, 2020. The principal amount of the debentures will be convertible into common shares of the Company at a price of $1.55 per share, at the option of the holder. The debenture was recorded at its fair value of $90,040, discounted at a market interest rate of 12% and is net of debt issue costs.

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

## 16. Convertible debenture (continued)

The accretion expense calculated using the effective interest method for the six months ended June 30, 2019 was $2,522 (2018 - $2,083). The effective interest rate used was 11.6% and the coupon rate on the debt is 6.0%. Interest expense for the six months ended June 30, 2019 for convertible debentures was $2,975 (2018 – $2,674).

| | | Convertible debenture |
|---|---|---|
| **BALANCE AT DECEMBER 31, 2017** | $ | - |
| Face value of debt upon issuance | | 100,000 |
| Less: Allocation to warrants and conversion feature | | (9,832) |
| Less: Debt issue costs | | (128) |
| Fair value of debt on initial recognition | | 90,040 |
| Accretion expense during the period | | 4,550 |
| Less: Units converted during the period | | (1,158) |
| **BALANCE AT DECEMBER 31, 2018** | $ | 93,432 |
| Accretion expense during the period | | 2,522 |
| Less: Units converted during the period | | (48) |
| **BALANCE AT JUNE 30, 2019** | $ | 95,906 |

## 17. Share capital

### a) Authorized

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

### b) Issued and outstanding

At June 30, 2019, there were 592,342,570 issued and fully paid common shares and 14,329,505 shares held in escrow related to the contingent considerations in acquisitions and investments (June 30, 2018 had 538,733,390 issued and fully paid common shares, and 27,657,788 held in escrow).

During the six months ended June 30, 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, and 2,013,421 common shares to the previous shareholders of Robinsons on completion of contingent milestones.

### c) Stock options

The Company has a stock award plan to provide incentives to directors, employees and consultants of the Company. The total number of options awarded is limited to 10% of the issued and outstanding shares, or 60,667,207 as at June 30, 2019.

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

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

## 17. Share capital (continued)

| | 2019 | 2018 |
|---|---|---|
| Risk-Free Annual Interest Rate | 1.53% - 1.92% | 1.72% - 2.52% |
| Expected Annual Dividend Yield | 0% | 0% |
| Expected Annualized Volatility | 92.37% - 94.86% | 93.17% - 108.60% |
| Expected Life of Options | 5 - 10 years | 5 - 10 years |
| Forfeiture rate | 0% | 0% |

The expected annualized volatility was estimated based on the Company's historical stock returns.

During the six months ended June 30, 2019 and 2018, 6,590,000 and 11,003,468 options were granted, respectively.

The following table summarizes information about stock options outstanding as at June 30, 2019.

| Options Granted | Number of options granted | Number of options exercised | Number of options modified | Number of options expired or forfeited | Ending balance | Average exercise price ($) | Average remaining life (years) |
|---|---|---|---|---|---|---|---|
| Jan 1, 2019 | 41,052,053 | - | (1,492,500) | (1,290,000) | 38,269,553 | 0.855 | 6.81 |
| 2019 Q1 | 1,440,000 | - | - | (50,000) | 1,390,000 | 0.858 | 5.07 |
| 2019 Q2 | 5,150,000 | - | - | (10,000) | 5,140,000 | 0.934 | 5.05 |
| **Jun 30, 2019** | **47,642,053** | **-** | **(1,492,500)** | **(1,350,000)** | **44,799,553** | **0.869** | **6.55** |

| Options Granted | Number of options granted | Number of options exercised | Number of options modified | Number of options expired or forfeited | Ending balance | Average exercise price ($) | Average remaining life (years) |
|---|---|---|---|---|---|---|---|
| Jan 1, 2018 | 19,861,085 | (775,000) | - | (5,000) | 19,081,085 | 0.356 | 4.97 |
| 2018 Q1 | 6,300,000 | - | (2,590,000) | (257,500) | 3,452,500 | 1.952 | 9.16 |
| 2018 Q2 | 4,703,468 | - | - | (572,500) | 4,130,968 | 1.271 | 9.47 |
| 2018 Q3 | 6,080,000 | - | - | - | 6,080,000 | 1.220 | 9.74 |
| 2018 Q4 | 8,307,500 | - | - | - | 8,307,500 | 1.240 | 9.07 |
| **Dec 31, 2018** | **45,252,053** | **(775,000)** | **(2,590,000)** | **(835,000)** | **41,052,053** | **0.889** | **7.31** |

Options issued to consultants prior to January 1, 2019 were measured based on the fair value of the equity instrument granted as the fair value of services could not be reliably measured.

As at June 30, 2019, stock options outstanding have a weighted average remaining life of 6.55 years. The total fair value of stock options granted during the six months ended June 30, 2019 was $3,952 (2018 – $16,100).

For the six months ended June 30, 2019, $5,714 of share-based payments were recorded on the statements of loss and comprehensive loss relating to the vesting of the Company's stock options (2018 - $5,561).

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 June 30, 2019:

| Warrants Granted | Number of warrants issued | Number of warrants exercised | Warrant expiries | Ending balance | Average exercise price ($) | Average remaining life (years) |
|---|---|---|---|---|---|---|
| Jan 1, 2019 | 103,735,321 | (14,387,301) | (3,419,500) | 85,928,520 | 1.795 | 1.13 |
| 2019 Q1 | - | - | - | - | - | - |
| 2019 Q2 | - | - | - | - | - | - |
| **Jun 30, 2019** | **103,735,321** | **(14,387,301)** | **(3,419,500)** | **85,928,520** | **1.795** | **1.13** |

| Warrants Granted | Number of warrants issued | Number of warrants exercised | Warrant expiries | Ending balance | Average exercise price ($) | Average remaining life (years) |
|---|---|---|---|---|---|---|
| Jan 1, 2018 | 160,647,124 | (145,101,635) | (1,158,188) | 14,387,301 | 0.023 | 0.18 |
| 2018 Q1 | 36,869,549 | (49) | - | 36,869,500 | 1.797 | 0.99 |
| 2018 Q2 | 56,183,748 | (3,805,228) | - | 52,378,520 | 1.775 | 1.99 |
| 2018 Q3 | 100,000 | - | - | 100,000 | 1.310 | 1.73 |
| **Dec 31, 2018** | **253,800,421** | **(148,906,912)** | **(1,158,188)** | **103,735,321** | **1.539** | **1.39** |

The weighted average exercise price of warrants outstanding during the six months ended June 30, 2019 was $1.795, with a weighted average remaining life of 1.13 years. Cash proceeds from warrants exercised during the six months ended June 30, 2019 was $336.

### e) Earnings per share

The calculation of basic and diluted earnings / (loss) per share is based on the earnings / (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.

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

## 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, executive officers and the President. 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:

| | **Three months Ended June 30 2019** | Three months Ended June 30 2018 | **Six months Ended June 30 2019** | Six months Ended June 30 2018 |
|---|---|---|---|---|
| Short-term benefits | **$ 533** | $ 411 | **$ 1,066** | $ 821 |
| Long-term benefits | **1,013** | 820 | **1,957** | 1,141 |
| | **$ 1,546** | $ 1,231 | **$ 3,023** | $ 1,962 |

### Other related party transactions

Nesta Holding Co. Ltd., a company owned and controlled by the CEO of the Company, provides travel and accommodation services to the Company. For the six months ended June 30, 2019, the Company incurred $31 (2018 - $32) in general expenses.

## 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 condensed consolidated interim 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.

| **Level 3 Investments** | |
|---|---|
| Opening balance, January 1, 2019 | $ 41,138 |
| Additions | 44,160 |
| Repayment | (9,514) |
| Transfers | - |
| Change in Unrealized Gain / (Loss) - FVTPL | (460) |
| Change in Unrealized Gain / (Loss) - FVTOCI | 554 |
| **Ending Balance - June 30, 2019** | **$ 75,878** |

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

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

| Instrument | Valuation Technique | Significant unobservable inputs | Inter-relationship between key unobservable inputs and fair value measurement |
|---|---|---|---|
| Debt obligation receivable in product equivalent - Beleave Inc. | Discounted cash flows: The valuation model considers the present value of the net cash flows expected to be generated by the investment. | - Risk adjusted discount rate: 20%<br>- Default risk percentage: 5% - 20%<br>- Selling price per gram of cannabis | - If the estimated discount rate was lower (higher) by 1%, the fair value would increase (decrease) by $26<br>- if the estimated default risk percentage was higher (lower) by 1%, the fair value would increase (decrease) by $62<br>- If the price per gram of Cannabis increases (decreases) by 1%, the fair value increase (decrease) would be $46 |
| Convertible promissory note 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 $605. |
| 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 $8. |
| Investment in KBB Convertible debt | Monte Carlo Simulation | - volatility: 104%<br>- discount rate: 19.8% | - If the volatility was lower (higher) by 10%, the fair value would increase (decrease) by $167 ($163)<br>- If the estimated discount rate was lower (higher) by 2%, the fair value would increase (decrease) by $153 ($161) |

| As at June 30, 2019 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Short-term Investments | $ 349 | $ - | $ - | $ 349 |
| Public Company Shares | 16,053 | - | - | 16,053 |
| Company Warrants | - | 616 | - | 616 |
| Convertible Debentures | - | - | 7,440 | 7,440 |
| Debt Obligations Receivable in Product Equivalents | - | - | 4,566 | 4,566 |
| Convertible promissory note in Joint Venture | - | - | 60,489 | 60,489 |
| Private Company Shares | - | - | 3,383 | 3,383 |
| | $ 16,402 | $ 616 | $ 75,878 | $ 92,896 |

### 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, debt obligation receivable in product equivalent, accounts payable and accrued liabilities, convertible debenture and long-term loans and interest payable on convertible debt. As at June 30, 2019, the carrying value of cash and cash equivalents is carried at fair value. Notes receivable and accounts payable and accrued liabilities, interest payable on convertible debenture approximate their fair value due to their short-term nature. The carrying value of notes receivable, convertible debentures, and long-term loans 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 FVTOCI and FVTPL. For such investments classified as at FVTOCI and FVTPL, the impact of a 10% increase in the share price would have increased equity by $2,992 before tax. An equal change in the opposite direction would have decreased equity by $2,992 before tax.

The company is exposed to price risk of medical cannabis, which arises from the investment in Debt obligation receivable in product equivalent. The table in note (a) summarizes the impact of price changes.

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

### 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, other receivables, notes receivable, and debt obligation receivable in product equivalent.

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.

### 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 1% increase (decrease) in the exchange rate would increase (decrease) net income by $60 (60).

## 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

As at June 30, 2019, Auxly has entered into certain agreements which commit the Company to future funding following a mutually agreed upon event or events. Commitments have not been described where agreements are insufficiently advanced, unlikely to progress further or amounts are indeterminable.

Auxly has funding commitments related to construction as follows:

- Total funding of approximately $98,500 to Sunens towards construction of the fully automated state-of-the-art, purpose-built greenhouse facility in Leamington, Ontario. Total costs of construction are approximately $150,000, with the remainder to be funded through debt. As at June 30, 2019, Auxly has provided approximately $60,489 towards the construction costs, and has provided a Letter of Credit for $21,383 to be used for equipment purchases. The Company anticipates that the construction will be substantially complete by December 2019;
- funding of approximately $18,000 to Curative towards construction of a cannabis cultivation facility with an estimated total cost of $17,800, including $2,230 for the provision of power to the site. As at June 30, 2019, Auxly has funded approximately $13,458 of the total towards the construction costs. The Company anticipates that the construction will be substantially complete by December 2019;
- funding of $7,000 to CannTx related to a phase II expansion of the Facility, subject to the completion of satisfactory due diligence and the parties agreeing to a construction budget and timeline for the phase II expansion.

Auxly has commitments in respect of leases relating to office spaces, equipment and land which will require payments within one year, but not included in the lease liability on the condensed consolidated interim statement of financial position for the six months ended June 30, 2019, amounting to $280.

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:

| | Three months | | Six months | |
|---|---|---|---|---|
| | **Ended June 30 2019** | Ended June 30 2018 | **Ended June 30 2019** | Ended June 30 2018 |
| Wages and salaries | **$ 4,163** | $ 1,809 | **$ 8,268** | $ 2,981 |
| Office and administrative | **1,542** | 1,447 | **3,227** | 2,430 |
| Professional fees | **1,821** | 2,048 | **2,865** | 2,671 |
| Business development | **1,060** | 2,458 | **2,071** | 4,592 |
| Share-based compensation (Note 17) | **2,672** | 2,742 | **5,714** | 5,561 |
| Selling expenses | **67** | - | **148** | - |
| | **$ 11,325** | $ 10,504 | **$ 22,293** | $ 18,235 |

## 23. Interest and accretion expenses

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

| | Three months | | Six months | |
|---|---|---|---|---|
| | **Ended June 30 2019** | Ended June 30 2018 | **Ended June 30 2019** | Ended June 30 2018 |
| Cash interest expense on lease liabilities | **$ 74** | $ - | **$ 196** | $ - |
| Other cash interest expense | **212** | 1,576 | **550** | 2,794 |
| Non-cash interest expense | **991** | - | **2,975** | - |
| Accretion expense on convertible debt | **1,281** | 1,180 | **2,522** | 2,167 |
| Accretion expense on long-term loans | **76** | - | **143** | - |
| Accretion expense on long-term notes receivables | **(737)** | - | **(955)** | - |
| | **$ 1,897** | $ 2,756 | **$ 5,431** | $ 4,961 |

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

## 24. Operating segments

Management has determined the operating and geographic segments. The Executive Leadership Team evaluates and makes decisions on operating performance by segment. The Company has one reportable operating segment and two geographic segments.

***Geographic Information***

All the Company's revenue is from the Canadian operations. For the Company's geographically segmented non-current assets, the Company has allocated them based on the location of assets, as follows:

| | June 30, 2019 | | December 31, 2018 | |
|---|---|---|---|---|
| **Long-term assets** | **Canada** | **Uruguay** | **Canada** | **Uruguay** |
| Long-term investments | $ 27,492 | $ - | $ 27,223 | $ - |
| Investment in joint venture | 70,069 | - | 29,158 | - |
| Property, plant, and equipment | 39,156 | 5,448 | 26,033 | 2,693 |
| Intangible assets *(Restated - see note 10)* | 71,195 | 14,813 | 72,859 | 15,563 |
| Goodwill *(Restated - see note 10)* | 30,393 | 3,658 | 30,393 | 3,527 |
| **Total** | **$ 238,305** | **$ 23,919** | **$ 185,666** | **$ 21,783** |

## 25. Subsequent events

a) On July 25, Auxly announced that Imperial Brands PLC ("Imperial Brands") will invest approximately $123,000 by way of a debenture, convertible into 19.9% ownership of Auxly.

Upon completion, Auxly will obtain rights to Imperial Brands' vaping technology and intellectual property for cannabis use globally, be granted access to Imperial Brands' vapor innovation business, and become Imperial Brands' exclusive partner for the future development, manufacture, commercialization, sale and distribution of cannabis products of any kind anywhere in the world.

Further, Imperial Brands will designate one director nominee and one non-voting observer to Auxly's Board of Directors.

b) On August 14, the Company announced that Sunens has entered into a term sheet for a syndicated credit facility with the Bank of Montreal as Lead Underwriter, to receive up to $84,000 of secured debt financing over a three-year term towards the construction of the Sunens' cultivation facility.

The credit facility consists of a $33,000 revolving loan, a $38,500 term loan, and a $12,500 leasing facility, which will be used to fund phase one of the Sunens greenhouse facility in Leamington, Ontario.