AUXLY CANNABIS GROUP INC.

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

FOR THE THREE MONTHS ENDED MARCH 31, 2019

Dated May 24, 2019

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MANAGEMENT’S DISCUSSION AND ANALYSIS

This Management’s Discussion and Analysis (“MD&A”) was prepared as of May 24, 2019 unless otherwise indicated. This MD&A reviews the operating results, financial position and liquidity of Auxly Cannabis Group Inc. (“Auxly”, “we”, “our”, or the “Company”). All amounts are stated in millions of Canadian dollars unless otherwise noted, except common shares (“Shares”), options, and per Share amounts. This MD&A should be read in conjunction with the condensed consolidated interim financial statements and the notes thereto for the three months ended March 31, 2019.

This MD&A may contain forward-looking information that is based on the Company’s expectations, estimates and projections regarding its business and the economic environment in which it operates. Forward-looking information speaks only of the date it is provided, is not a guarantee of future performance and involves risks and uncertainties that are difficult to control or predict. Readers should refer to the “Forward Looking Statements” in this MD&A.

DESCRIPTION OF BUSINESS

Our Business

We are 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.

VISION AND STRATEGY

Our vision is to be a global cannabis leader focused on providing branded cannabis products backed by science and innovation.

Since our inception, we have worked closely with our partners to develop a secure, cost-efficient and diversified source of cannabis. To accelerate market participation in the medical and wellness cannabis market, and prior to the legalization and creation of the adult-use cannabis markets in Canada in October 2018, we invested in cultivation opportunities, more commonly referred to as “streaming” transactions, with the goal of supply diversification and efficient use of capital. These cultivation partners remain important to our predictable supply of diverse, cost efficient raw cannabis.

With our cultivation platform largely in place and in anticipation of the legalization of derivative adult-use products for October 2019 (namely, concentrates, edibles and topicals as contemplated by the *Cannabis Act* and its current and proposed accompanying regulations) (“Phase two”), we have been focused on product formulation and development at our wholly owned subsidiary, Dosecann Inc. (“Dosecann”). We were a first mover in 2018 with the acquisition of Dosecann. Its state-of-the-art processing facility and its highly-skilled team give us the ability to turn raw cannabis into a variety of derivative cannabis products under one roof. Further, our acquisition of KGK Science Inc. (“KGK”) provides additional scientific and clinical bench strength to Dosecann’s ability to develop and produce safe, effective and high-quality cannabis products.

We continue to develop strategic distribution channels to expand our exposure to new and existing markets, including health care providers, provincial boards and retailers, and our wholly-owned retail outlet with province-wide e-commerce capabilities in Saskatchewan.

We have also invested in hemp cultivation and extraction in Uruguay through our 80% ownership of Inverell S.A. (“Inverell”) and our 100% ownership of its sister company Zeratol S.A. and are constantly evaluating other international cultivation and distribution opportunities.

Cultivation

At March 31, 2019, we had multiple partners and subsidiaries in various stages of cannabis cultivation readiness. Each was expected to be, or in the process of completing, their facility build-outs with cultivation of cannabis in due course. In January 2019, we received our first shipments of cannabis from several partners with delivery and production expected to increase steadily throughout the year. A majority of cannabis received or produced to date will be held in inventory or processed further during the year in support of Dosecann’s product development and manufacturing activities, with the remainder intended for distribution as dried cannabis flower through Kolab Project Inc. (“Kolab”) to its registered patients.

Construction of the Sunens Farms Inc. (“Sunens”) fully-automated, purpose-built greenhouse for cannabis cultivation is underway in Leamington, Ontario. Completion of the first phase of the project is expected to deliver approximately 100,000 kgs of cannabis, commencing on or about the second quarter of 2020.

Product Development

We believe we are well on our way to creating world-class operations that will allow us to participate in the anticipated market for derivative cannabis products. Through the combined capabilities of Dosecann and KGK, we are developing and manufacturing value-added derivative cannabis products to position us to benefit from changing industry legislation. Following regulatory approval, Dosecann will supply derivative cannabis products for the medical, wellness and adult-use cannabis markets. We will also offer branded derivative cannabis products including several proprietary brands developed by Auxly as well as branded Dixie products through our in-licensing arrangement with Dixie Brands Inc. (“Dixie”).

Distribution

Given the current provincial legislative framework in Canada, we are pursuing a multifaceted strategy to gain access to Canadian consumers. This includes wholly-owned retail stores, retail joint ventures, in-store development and ownership, investment in independent retailers and supply agreements with provincial boards. In the medical sector, we have formed key relationships in the areas of health care providers and employee groups, and are able to sell to registered patients of Kolab.

International Operations

The Company, through Inverell, is a cultivation leader in Latin America. Our Uruguayan operations are led by the renowned Dr. Raul Urbina, the founder of Stevia One, which became one of the largest and lowest cost producers of stevia in the world. Inverell has approximately 190 hectares (approximately 20 million square feet) of hemp planted and which is currently being harvested with an intention to complete the sale of isolate by early 2020. We are currently evaluating our distribution strategy for our Uruguayan operations.

We are also focused on additional opportunities in the LATAM region, Europe, and North America through strategic partnerships, joint ventures and supply arrangements including leveraging our existing relationships.

OUTLOOK

In 2019, we expect to sell dry cannabis flower and participate in the market for Phase two cannabis products with an increasing part of our business dedicated to derivative cannabis product development, manufacturing and distribution. As dry cannabis flower is being used in the development of Phase two products, we expect that material revenue generation will coincide with the legalization and regulatory approvals for derivative cannabis products and our sale of such products to the market, presently anticipated to commence in late 2019. Over the long-term, we believe shareholders will benefit from the higher profitability and anticipated strong growth of the derivative cannabis product market.

Our priorities for 2019 and updates thereto are as follows:

1. Complete product R&D, formulation and manufacturing activities at the Dosecann facility in preparation for the legalization of derivative cannabis products:
    - Progress has been made in several areas including extraction of flower to cannabis resin and development of edible product formulations, with a full product suite to be completed during the third quarter of 2019
    - Successful production of oil in a bottle for sale in the second quarter of 2019;

2. Complete construction of all ongoing cultivation assets, while continuing to work with our joint venture partner Sunens' as it completes phase one of a state-of-the-art greenhouse facility in 2019, with expected supply of over 100,000 kg of cannabis in 2020:
    - The anticipated cost is $160.0 million of which $43.6 million has been paid as at March 31, 2019
    - Construction is anticipated to be fully completed by December 2019. We plan on receiving a cultivation licence shortly after the physical completion of the facility;

3. Continue to support the rollout of Kolab and Robinsons and build brand awareness:
    - On April 5, 2019, Robinsons received its cultivation and processing licenses in Nova Scotia
    - We have advanced the process for receipt of Kolab's oil sales approval and Robinsons flower sales approval by the third quarter of 2019
    - The Lloydminster store is nearing completion with an anticipated opening date in early Q3 2019;

4. Opportunistically expand our footprint in international markets to facilitate the sale of CBD, derived from our large-scale hemp cultivation operation in Uruguay:
    - Corporate development and public relation activities progressed in April 2019
    - Inverell was awarded a licence for scientific research and development of cannabis strains for registration during May 2019.

RECENT DEVELOPMENTS: 2019 YEAR TO DATE

Inverell

As previously announced on January 8, 2019, the Company closed the acquisition of Inverell S.A. and Zeratol S.A. in Uruguay.

During May 2019, Inverell was granted a licence for scientific research for the development of cannabis strains for registration by the Institute for Regulation and Control of Cannabis (“IRCCA”). The licence allows Inverell to engage in the research and development of novel non-psychoactive cannabis strains and register such genetics with the National Seed Institute of Uruguay (“INASE”). With the licence, Inverell will be able to implement its breeding methodology with the objective of improving the key characteristics of its cannabis genetics, including yield and cannabidiol (“CBD”) concentration and, once registered, use such improved genetics to increase the overall productivity and CBD output.

Green Relief

On January 8, 2019, the Company and Green Relief Inc. (“Green Relief”) mutually terminated their interim agreement. As consideration for the termination, the Company received 496,689 common shares of Green Relief, representing approximately 0.5% of Green Relief on a non-diluted basis; and entered into a cannabis sales framework agreement pursuant to which the Company is entitled to purchase up to 3,000,000 grams of dried cannabis from Green Relief at a purchase price of $1.50 per gram (subject to CPI adjustment) over a three year period commencing no later than Q3 2019.

Dosecann

On January 11, 2019, as part of the transition to the *Cannabis Act*, Dosecann received an Analytical Testing License to accompany their Processing License received in December 2018.

Kolab

On July 23, 2018, Kolab received its cannabis sales license from Health Canada. The sales license authorizes Kolab to sell dried cannabis to registered Canadian medical patients across the country as well as provincial and territorial purchasers. Kolab commenced sales of medical cannabis products in February 2019.

FSD Pharma

As previously announced on February 7, 2019, the Company terminated the definitive agreement with FV on the basis of contractual breaches relating to, among other things, FV’s management and staffing obligations of the JV Facility.

Sundial

On March 1, 2018, the Company entered into a definitive agreement with Sundial Growers Inc. (“Sundial”) whereby the Company advanced $7.0 million to Sundial by way of a promissory note for a period of 6 months. On February 22, 2019, $8.9 million was received to fully settle the Sundial promissory note.

KGK Science

On March 5, 2019 the Company completed the make-whole payment of $1.8 million and has therefore completed all of its obligations pursuant to the business combination. KGK has applied for a research and development licence under the *Cannabis Act*, which is under final review by Health Canada.

Lotus

On March 8, 2019, Lotus was granted cultivation and medical sales licenses pursuant to the *Cannabis Act*. These licenses give Lotus the ability to commence cannabis cultivation and certain cannabis sales. Lotus has commenced cultivation at its facility in British Columbia.

Dixie

In the first quarter of 2019, the Company received approximately $4.7 million of the initial $5.0 million back due to regulatory milestone events and the sale of Mexican access rights back to Dixie.

Robinsons

Robinsons received its cultivation and processing licenses on April 5, 2019.

Q1 HIGHLIGHTS

(000's)		**March 31, 2019**		March 31, 2018		Change	Percentage Change
Total revenues	**$**	**817**	$	-	$	817	N/A
Net losses*		**(13,611)**		(10,520)		(3,091)	23%
Cash and equivalents		**165,023**		206,367		(41,344)	-25%
Total assets		**455,903**		281,213		174,690	38%
Debt	**$**	**95,411**	$	91,068	$	4,343	5%
Average Shares outstanding		**587,246,553**		365,098,552		222,148,001	38%

*attributable to shareholders of the Company.

Q1 2019 was an important quarter for the Company as it made substantial progress towards its objectives for the year by: completing sales of cannabis products; adding value through the research and development of derivative cannabis products being developed through Dosecann; making progress towards obtaining sales licenses for all subsidiaries; making progress towards the development of a clinical study plan at KGK to support the safety, efficacy and quality of Dosecann products; and expanding the distribution channels through which the Company will bring its products to the medical, wellness and adult-use cannabis markets in Canada.

RESULTS OF OPERATIONS

(000's)		March 31 2019		March 31 2018
Revenues				
Research contracts and other	**$**	**525**		**-**
Revenue from sales of cannabis products		**292**		**-**
Total Revenues		**817**		**-**
Cost of sales				
Research contracts and other		**282**		**-**
Costs of finished cannabis inventory sold		**148**		**-**
Gross profit excluding fair value items		**387**		**-**
Realized fair value change on inventory		**(194)**		**-**
Unrealized fair value loss on biological transformation		**(382)**		**-**
Gross loss		**(189)**		-
Other incomes				
Fair value gain for financial instruments, under FVTPL		**1,382**		618
Interest income		**960**		415
Total other incomes		**2,342**		1,033
Expenses				
Selling, general, and administrative expenses		**10,968**		7,730
Depreciation and amortization		**1,038**		77
Interest expense		**3,534**		2,205
Impairment of intangible assets		**1,800**		-
(Gain) / loss on settlement of financial assets and liabilities		**(375)**		4,191
Share of loss on equity investment in joint venture		**180**		-
Foreign exchange (gain) / loss		**71**		(11)
Total expenses		**17,216**		14,192
Net loss before income tax		**(15,063)**		(13,159)
Income tax recovery		**1,259**		2,639
Net loss	**$**	**(13,804)**	$	(10,520)
Net loss attributable to shareholders of the Company	**$**	**(13,611)**	$	(10,520)
Net loss attributable to non-controlling interest	**$**	**(193)**	$	-
Net loss per common share (Basic and diluted)	**$**	**(0.02)**	$	(0.03)
Weighted average number of shares outstanding (basic and diluted)		**587,246,553**		365,098,552

Revenue

For the three months ended March 31, 2019, Auxly recognized $0.5 million of research revenues from the recently completed acquisition of KGK in the third quarter of 2018. KGK revenues are deferred and only recognized as performance criteria are met. KGK is a critical component in Auxly’s overall strategy to develop safe, effective and high-quality consumer cannabis products while continuing to conduct leading edge research for third party clients.

For the three months ended March 31, 2019, Auxly recognized $0.3 million of revenues from sales of dry cannabis products. Dry cannabis flower sales have been curtailed as a result of the company’s decision to use the dry flower to develop derivative cannabis products in anticipation of Phase two legalization.

Gross loss

Auxly realized a gross loss of $0.2 million during the three months ended March 31, 2019, comprised of KGK earned revenues less expenses of $0.2 million in support of third-party research contracts which can fluctuate significantly during the contract and related performance milestones and gross profit of $0.2 million on the sale of cannabis products. In addition, a $0.2 million fair value loss on inventory recognized on net realizable value and a $0.4 million unrealized fair value loss on biological asset transformation contributed to the overall gross loss.

Other incomes

Total other incomes of $2.3 million is comprised of a fair value gain of $1.3 million from changes in securities held and interest income of $1.0 million primarily earned on cash and cash equivalents held during the three months ended March 31, 2019.

Selling, general and administrative expenses

Selling, general and administrative expenses are comprised of wages and salaries, office and administrative, professional fees, business developments, share-based payments, and selling expenses. Share-based payments were reported separately prior to 2019.

Wages and benefits were $4.1 million during the three months ended March 31, 2019, an increase of $2.9 million over the same period of 2018, primarily due to workforce increases in 2018. The increases were to support expansionary activities as a direct result of workforces added on acquisition of four entities and the corporate office.

Office and administrative expenses were $1.7 million during the three months ended March 31, 2019 as compared to $1.0 million over the same period in 2018. The increase of $0.7 million is comprised of $1.0 million of rent, filing fees, IT expenses and other office and admin charges from subsidiaries acquired in 2018, net of a $0.1 million decrease in filing fees and a $0.2 million decrease in rent at the corporate office.

Professional fees were $1.0 million during the three months ended March 31, 2019 as compared to $0.6 million over the same period in 2018. The increase in professional fees are attributable to $0.3 million in legal fees related to investment opportunities and $0.1 million in recruiting fees to facilitate the Company’s growth.

Business development fees were $1.0 million during the three months ended March 31, 2019 as compared to $2.1 million over the same period in 2018. The overall reduction in expense is attributable to lower transaction activities during the first quarter of 2019.

Auxly recorded share-based expenses of $3.0 million during the three months ended March 31, 2019, an increase of $0.2 million over 2018. During the first quarter of 2019, 1,440,000 options were issued with vesting over a four-year period, resulting in an expense of $0.1 million with the remaining $2.9 million relating to the vesting of prior period options.

Other Expenses

Depreciation and amortization expenses of $1.0 million during the three months ended March 31, 2019 reflect the impact of approximately $0.6 million of intangible amortization primarily associated with acquisition related non-competition features and property, plant and equipment depreciation of $0.4 million related to equipment, buildings, and equipment.

Interest expenses of $3.5 million during the three months ended March 31, 2019 increased by $1.3 million primarily due to interest of 6% on the convertible debentures and the non-cash accretion of placement and other related fees being recognized over 24 months.

An impairment charge of $1.8 million related to the intangible value of the FSD streaming agreement was taken during the first quarter as a result of previously announced contract breaches. The Company is currently evaluating its next steps in this matter.

Net Losses

For the three months ended March 31, 2019, Auxly reported a net loss attributable to shareholders of $13.6 million with net loss of $0.02 per Share on a basic and diluted basis. This compares to a net loss of $10.5 million for the year three months ended March 31, 2018 with net loss of $0.03 per Share on a basic and diluted basis. The decrease in net income was primarily driven by an increase in expenses, compounded by non-cash expenses and losses during the period, partially offset by income tax recoveries of $1.3 million.

SUMMARY OF QUARTERLY RESULTS

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

(000's)	**Q1/19**	Q4/18	Q3/18	Q2/18	Q1/18	Q4/17	Q3/17	Q2/17
Total revenues	**$ 817**	$ 647	$ 100	$ -	$ -	$ -	$ -	$ -
Net losses*	**(13,611)**	(34,861)	(9,727)	(11,880)	(10,520)	(9,205)	(5,903)	(1,584)
Average shares outstanding (000's)	**587,247**	571,156	544,626	466,769	365,099	237,870	199,583	162,927
Per share								
Basic & diluted loss	**$ (0.02)**	$ (0.06)	$ (0.02)	$ (0.03)	$ (0.03)	$ (0.04)	$ (0.03)	$ (0.01)

*attributable to shareholders of the Company.

Auxly's current revenues are primarily as a result of the acquisition of KGK in Q3 2018. During the three months ended March 31, 2019 the Company completed its first sales of dried cannabis flower. Expenses have increased due to the build out of the business through acquisitions (employees, professional fees), additional employees in the corporate offices and share compensation expenses. Increases in average outstanding Shares reflect financing and acquisition related activities (issuance and exchange of Shares, exercise of warrants, options and conversion of convertible debentures).

TRANSACTIONS WITH RELATED PARTIES

Key management and director compensation

Auxly's key management personnel have authority and responsibility for overseeing, planning, directing and controlling the activities of the Company. Key management personnel include members of the Board of Directors, 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:

For the three months ended March 31 (000's)	2019	2018
Short-term benefits	**$533**	$410
Long-term benefits	**944**	321
	$1,477	$731

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 on a month to month basis. For the three months ended March 31, 2019, the Company incurred $10 thousand (2018 - $32 thousand) in general expenses.

LIQUIDITY AND CAPITAL RESOURCES

(000's)	March 31, 2019	March 31, 2018
Cash used in operating activities	**$ (18,645)**	$ (7,188)
Net change in investments	**(21,920)**	(10,740)
Net capital expenditures	**(6,455)**	(596)
Cash used in investing activities	**(28,375)**	(11,336)
Net cash from financing activities	**336**	191,437
Cash position, end of period	**$ 165,023**	$ 206,367

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

Auxly manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying asset and may issue additional Shares or debt, acquire or dispose of assets to maintain or adjust its capital structure.

Auxly is dependent on expected business growth, changes in the business environment and capital markets as its source of operating capital.

During the three months ended March 31, 2019, Auxly used $18.6 million in operating activities, primarily as a result of expenses associated with the build out of the business in preparation of sales in the adult-use derivative cannabis products cannabis market, estimated to occur in late 2019. Investing activities included capital expenditures of $6.5 million primarily related to construction in progress of cultivation locations and $21.9 million associated with net long-term business investments, joint ventures and debt obligations. These cash outflows were offset by financing activities of $0.3 million. At March 31, 2019, cash and equivalents are $165.0 million.

Auxly anticipates that it has liquidity and capital resources to meet short term obligations, however, will require additional funding to complete all projects and meet all commitments contemplated in 2019. Management has the ability to defer certain capital expenditures and commitments and is considering a variety of options to finance operations including secured financing, debt or equity offerings. As part of the financing considerations Auxly is evaluating which options will best optimize current interest rates, term length, security provided, covenants and impact on future business plans. Auxly believes it will have sufficient capital for the next 12 months upon successful completion of contemplated financing activities.

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

OUTSTANDING SHARE DATA

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

	May 24, 2019	March 31, 2019	March 31, 2018
Outstanding shares	606,672,075	606,672,075	430,731,089
Exercisable securities			
Warrants	85,928,520	85,928,520	67,939,360
Convertible Debentures	63,810,970	63,810,970	64,656,129
Options	44,562,053	41,847,053	25,636,085

Subsequent to March 31, 2019, Nil Shares were issued.

COMMITMENTS AND OFF-BALANCE SHEET ARRANGEMENTS

As at March 31, 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:

- funding of approximately $160.0 million to Sunens towards construction of the fully automated state-of-the-art, purpose-built greenhouse facility in Leamington, Ontario. As at March 31, 2019, Auxly has provided approximately $43.6 million towards the construction costs, and has provided a Letter of Credit for $21.9 million to be used for equipment purchases. The Company anticipates that the construction will be substantially complete by December 2019;

- funding of approximately $17.4 million to Curative Cannabis towards construction of a cannabis cultivation facility, including $2.2 million to Hydro One to provide required power to the site. As at March 31, 2019, Auxly has funded approximately $6.2 million of the total towards the construction costs. The Company anticipates that the construction will be substantially complete by December 2019;

- funding of $7.0 million 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 which have not been included in the lease liabilities for the three months ended March 31, 2019, amounting to $0.4 million.

CRITICAL ACCOUNTING ESTIMATES

Auxly makes estimates about the future that affect the reported amount of assets and liabilities. Estimates and judgments are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results may differ from these estimates and assumptions.

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

Areas requiring estimates and judgements are as follows:

Impairment assessment of indefinite life intangible assets, intangible assets not available for use and goodwill

The carrying value of goodwill, indefinite life intangible assets and intangible assets not yet in use are subject to annual impairment assessments. Auxly's impairment tests for goodwill and intangible assets are based on the greater of value in use calculations that use a discounted cash flow model over a five-year period and estimated fair value less cost to sell. 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 Auxly's budget for the future and do not include restructuring activities that Auxly has 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 to sell is based on assessment of comparable company multiples and precedent transactions.

Business Combinations

Judgment is used in determining whether an acquisition is a business combination or an asset acquisition. In determining the allocation of the purchase price in a business combination, including any acquisition-related contingent consideration, estimates including market based and appraisal values are used. The contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Contingent considerations have all been classified as equity which is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Auxly measures all the assets acquired and liabilities assumed at their acquisition-date fair values.

Valuation of the debt obligation receivable in product equivalents

In determining the valuation of the fair value of the debt obligation receivable in product equivalents, management estimates were used such as an appropriate discount rate, estimate of future selling prices and estimate of future production abilities.

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 are 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 Auxly's risk levels. Changes in the general economic environment could result in significant changes to this estimate.

Valuation of long-term investments in private companies

In determining the valuation of long-term investments in companies not publicly traded (IFRS 13 level 3 security), there are unobservable inputs used to measure fair value. Estimates were used for unobservable inputs using the best information available such as public company market comparables and recent public company transactions.

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 debentures 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 upon a number of assumptions, including contractual future cash flows, discount rates and the presence of any derivative financial instruments.

CHANGES IN ACCOUNTING POLICIES

IFRS 16 Leases was issued by the IASB in January 2016 and specifies the requirements to recognize, measure, present and disclose leases. IFRS 16 is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted. The standard consolidates the majority of lease contracts for lessees under one definition, based on the former finance lease classification. The Company implemented IFRS 16 as of January 1, 2019 using the modified retrospective approach. Under this approach, the Company will not restate its comparative figures but will recognize the cumulative effect of adopting IFRS 16 as an adjustment to opening retained earnings.

The Company elected to apply the practical expedient to grandfather the assessment of which transactions are leases and apply IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under *IAS 17 Leases* will not be reassessed for whether a lease exists.

As at January 1, 2019, a right-of-use asset of $5.1 million was recognized along with a corresponding lease liability of $5.1 million, and a change in retained earnings of $nil. The estimated lease liability is based on the present value of remaining lease payments as of January 1, 2019, discounted using the Company’s incremental borrowing rate as of this date.

FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Auxly’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. Cash and cash equivalents and short-term investments are exposed to credit risk and Auxly reduces its credit risks by placing these instruments with institutions of high credit worthiness. Note receivables and debt obligation receivable in product equivalent relates to outstanding loans and Auxly mitigates the credit risk by entering into agreements and reviewing its exposure to credit risk on a regular basis. Auxly is exposed to liquidity risk with respect to its trade and other payables and Auxly manages liquidity risk by maintaining sufficient cash balances for settlement of financial liabilities on their due dates.

RISK FACTORS

Auxly’s business and structure are subject to a number of risks and uncertainties which remain unchanged, as discussed in Auxly’s Annual Information Form dated May 24, 2018, and Auxly's Amended and Restated Short Form Base Shelf Prospectus, dated February 28, 2018. These documents as well as additional information regarding Auxly can be found on SEDAR at www.Sedar.com.

FORWARD LOOKING STATEMENTS

This MD&A and the documents incorporated by reference herein contain certain statements which contain "forward-looking information" within the meaning of Canadian securities legislation (each a "forward-looking statement"). No assurance can be given that the expectations in any forward-looking statement will prove to be correct and, as such, the forward-looking statements included in this MD&A should not be unduly relied upon. Forward-looking information is by its nature prospective and requires Auxly to make certain assumptions and is subject to inherent risks and uncertainties. All statements other than statements of historical fact are forward-looking statements. The use of any of the words "anticipate", "plan", "contemplate", "continue", "estimate", "expect", "intend", "propose", "might", "may", "will", "shall", "project", "should", "could", "would", "believe", "predict", "forecast", "pursue", "potential", "capable", "budget", "*pro forma*" and similar expressions are intended to identify forward-looking statements. Forward-looking statements include, among others, statements pertaining to:

- the dependence of Auxly's cash flow and financial performance on third parties;
- expectations regard the Company’s ability to raise additional financing to further the Company’s investment in the business;
- changes in laws, regulations and guidelines, including the advent of the adult-use cannabis and cannabis-derived products market and changes in the regulation of medical cannabis;
- the price of medical and adult-use cannabis or derivative cannabis products;
- the lack of control over operations of Auxly's cultivation partners;
- the fluctuations in the price of Shares and the market for the Shares;

- Auxly's ongoing investment strategy;
- the ability of Auxly's cultivation partners to produce medical and adult-use cannabis;
- the successful buildout of the current and proposed facilities of each of Auxly's cultivation partners;
- licensing risk;
- regulatory risk;
- future liquidity and financial position;
- the Company's growth strategy, targets for future growth and projections of the results of such growth;
- expectations regarding the Company's expansion of operations and investment into foreign jurisdictions, including Uruguay;
- the ability of the Company to generate cash flow from operations and from financing activities; and
- Auxly's competitive position.

The forward-looking statements in this MD&A are based on information currently available and what management believes are reasonable assumptions. Forward-looking statements speak only to such assumptions as of the date of this MD&A. In addition, this MD&A may contain forward-looking statements attributed to third party industry sources, the accuracy of which has not been verified by Auxly. The purpose of forward-looking information is to provide the reader with a description of management's expectations, and such forward-looking information may not be appropriate for any other purpose. Readers should not place undue reliance on forward-looking information contained in this MD&A. Auxly undertakes no obligation to update or revise any forward-looking information, whether as a result of new information, future events or otherwise, except as required by applicable law.

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

- current and future management will abide by the investment objectives and investment strategies of Auxly;
- Auxly will supplement its board of directors and management, or otherwise engage consultants and advisors, having knowledge of the industries in which Auxly invests;
- the Company will be able to secure adequate funding in the future on acceptable terms to expand its business;

- cultivation partners will be able to generate cash flow;
- general economic, financial market, regulatory and political conditions in which Auxly operates will remain the same;
- Auxly will be able to compete in the industry;
- Auxly will be able to manage anticipated and unanticipated costs;
- Auxly will be able to enter into additional cultivation agreements;
- Auxly will be able to maintain internal controls over financial reporting and disclosure, controls and procedures;
- cannabis prices will not decline materially;
- cultivation partners will be able to meet the requirements necessary to obtain and / or maintain their licenses under the *Cannabis Act*;
- Auxly will be able to successfully develop and commercialize derivative cannabis products; and
- cultivation partners will be able to successfully complete initial construction and / or expansion construction of their respective facilities pursuant to the terms and conditions of their respective agreements.

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

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