



TERRASCEND CORP.

Unaudited Condensed Interim Consolidated Financial Statements

**As of and for the three and nine months ended September 30, 2020 and 2019
(In Thousands of Canadian Dollars)**

TerrAscend Corp.

Unaudited Condensed Interim Consolidated Statements of Financial Position

(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

| | Notes | At September 30, 2020 | At December 31, 2019 |
|---|--------|-----------------------------|----------------------------|
| Assets | | | |
| Current Assets | | | |
| Cash and cash equivalents | | \$ 40,834 | \$ 11,900 |
| Restricted cash | 20 | 4,517 | — |
| Receivables, net of sales returns and allowances | 4, 14 | 10,229 | 7,623 |
| Share subscriptions receivable | | 1,003 | 31,772 |
| Note receivable | | — | 5,986 |
| Investments | | — | 465 |
| Biological assets | 6 | 15,766 | 5,484 |
| Inventory | 7 | 32,099 | 20,422 |
| Prepaid expenses and other assets | | 6,817 | 7,081 |
| | | 111,265 | 90,733 |
| Non-Current Assets | | | |
| Investment in associate | | 1,667 | 1,299 |
| Property, plant and equipment | 8 | 160,780 | 112,650 |
| Intangible assets and goodwill | 9 | 264,998 | 241,148 |
| Indemnification asset | 15 | 15,340 | 14,936 |
| Other assets | | 3,101 | — |
| | | 445,886 | 370,033 |
| Total Assets | | \$ 557,151 | \$ 460,766 |
| Liabilities and Shareholders' Equity | | | |
| Current Liabilities | | | |
| Accounts payable and accrued liabilities | | \$ 26,400 | \$ 25,002 |
| Deferred revenue | | 793 | 1,179 |
| Loans payable | 10 | 4,135 | 63,068 |
| Contingent consideration payable | 5 | 189,372 | 31,182 |
| Lease liability | 11 | 2,236 | 1,157 |
| Corporate income tax payable | 15 | 30,895 | 21,276 |
| Preferred share liability | 13, 21 | 101 | — |
| | | 253,932 | 142,864 |
| Non-Current Liabilities | | | |
| Loans payable | 10 | 71,124 | 6,298 |
| Contingent consideration payable | 5 | 10,258 | 175,848 |
| Lease liability | 11 | 30,430 | 19,572 |
| Warrant liability | 13, 21 | 45,356 | — |
| Convertible debentures | 12 | 5,098 | 13,874 |
| Deferred income tax liability | 15 | 33,212 | 26,981 |
| | | 195,478 | 242,573 |
| Total Liabilities | | \$ 449,410 | \$ 385,437 |
| Shareholders' Equity | | | |
| Share capital | 13 | 309,779 | 259,892 |
| Contributed surplus | 13 | 80,885 | 54,777 |
| Cumulative translation adjustment | | (5,542) | (1,992) |
| Deficit | | (284,636) | (245,998) |
| Non-controlling interest | | 7,255 | 8,650 |
| Total Shareholders' Equity | | 107,741 | 75,329 |
| Total Liabilities and Shareholders' Equity | | \$ 557,151 | \$ 460,766 |
| Total Number of Common and Proportionate Voting Shares Outstanding | 13 | 150,718,884 | 141,980,314 |

Subsequent events (note 23), Commitments and contingencies (note 22)

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

On behalf of the Board

"Jason Ackerman"

Chief Executive Officer

"Jason Wild"

Chairman of the Board

TerrAscend Corp.

Unaudited Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

| | | For the three months ended | | For the nine months ended | |
|---|------------|----------------------------|-----------------------|---------------------------|-----------------------|
| | Notes | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| Sales, gross | | \$ 54,018 | \$ 27,233 | \$ 142,081 | \$ 61,217 |
| Excise taxes | | (3,050) | (402) | (9,085) | (2,232) |
| Sales, net | 17 | 50,968 | 26,831 | 132,996 | 58,985 |
| Cost of sales | 7 | 20,880 | 22,031 | 60,898 | 51,169 |
| Gross profit before gain on fair value of biological assets | | 30,088 | 4,800 | 72,098 | 7,816 |
| Unrealized gain on changes in fair value of biological assets | 6 | 25,267 | 2,283 | 63,207 | 3,736 |
| Realized fair value amounts included in inventory sold | | (20,793) | (87) | (45,899) | (464) |
| Gross profit | | 34,562 | 6,996 | 89,406 | 11,088 |
| Operating expenses: | | | | | |
| General and administrative | 16 | 13,736 | 12,187 | 44,042 | 31,576 |
| Share-based payments | 13 | 4,164 | 7,227 | 10,420 | 11,593 |
| Amortization and depreciation | 8, 9 | 2,550 | 3,312 | 7,351 | 5,305 |
| Research and development | | 20 | 197 | 395 | 494 |
| Total operating expenses | | 20,470 | 22,923 | 62,208 | 48,968 |
| Income (loss) from operations | | 14,092 | (15,927) | 27,198 | (37,880) |
| Revaluation of contingent consideration | 5, 21 | 8,094 | — | 19,861 | — |
| Finance and other expenses | 10, 11, 12 | 3,301 | 2,099 | 9,748 | 4,168 |
| Transaction and restructuring costs | | 245 | 2,419 | 2,558 | 6,224 |
| Unrealized gain on note receivable | | — | (120) | — | (120) |
| Unrealized (gain) loss on investments | | (414) | 236 | (81) | 2,822 |
| Impairment of intangible assets | 9 | — | — | 1,002 | 58 |
| Net increase in fair value of warrant and derivative liabilities | 21 | 22,174 | — | 22,174 | — |
| Foreign exchange loss | | 36 | 32 | 139 | 134 |
| Loss before income taxes | | (19,344) | (20,593) | (28,203) | (51,166) |
| Current income tax expense (recovery) | 15 | 2,748 | (928) | 18,411 | (889) |
| Deferred income tax expense (recovery) | 15 | (4,542) | (2,344) | (1,575) | (3,130) |
| Net loss | | \$ (17,550) | \$ (17,321) | \$ (45,039) | \$ (47,147) |
| <i>Items that will be subsequently reclassified to profit or loss:</i> | | | | | |
| Currency translation adjustment | | 3,621 | (12) | 3,550 | 2,894 |
| Comprehensive loss | | \$ (21,171) | \$ (17,309) | \$ (48,589) | \$ (50,041) |
| Net loss attributable to: | | | | | |
| Shareholders of the Company | | (16,917) | (17,056) | (42,854) | (46,290) |
| Non-controlling interests | | (633) | (265) | (2,185) | (857) |
| Comprehensive loss attributable to: | | | | | |
| Shareholders of the Company | | (20,538) | (17,044) | (46,404) | (49,184) |
| Non-controlling interests | | (633) | (265) | (2,185) | (857) |
| Net loss per share, basic and diluted | | | | | |
| Net loss per share – basic and diluted | | \$ (0.11) | \$ (0.16) | \$ (0.29) | \$ (0.52) |
| Weighted average number of outstanding common and proportionate voting shares | | 149,492,681 | 107,404,738 | 148,335,223 | 89,651,942 |

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

TerrAscend Corp.

Unaudited Condensed Interim Consolidated Statements of Changes in Shareholders' Equity

(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

| For the nine months ended September 30, 2020 | Notes | Share capital | Contributed surplus | Cumulative translation adjustment | Deficit | Non-controlling Interest | Total |
|---|-------|---------------|---------------------|-----------------------------------|--------------|--------------------------|------------|
| Balance at January 1, 2020 | | \$ 259,892 | \$ 54,777 | \$ (1,992) | \$ (245,998) | \$ 8,650 | \$ 75,329 |
| Private placement net of share issuance costs | 13 | 40,357 | — | — | — | — | 40,357 |
| Shares issued - stock option and warrant exercise | 13 | 1,105 | (518) | — | — | — | 587 |
| Issuance of warrants | 13 | 3,534 | 19,878 | — | — | — | 23,412 |
| Options expired/forfeited | 13 | — | (4,216) | — | 4,216 | — | — |
| Share-based compensation expense | 13 | 4,891 | 10,964 | — | — | — | 15,855 |
| Capital contribution | | — | — | — | — | 790 | 790 |
| Net loss for the period | | — | — | — | (42,854) | (2,185) | (45,039) |
| Cumulative translation adjustment | | — | — | (3,550) | — | — | (3,550) |
| Balance at September 30, 2020 | | \$ 309,779 | \$ 80,885 | \$ (5,542) | \$ (284,636) | \$ 7,255 | \$ 107,741 |

| For the nine months ended September 30, 2019 | Notes | Share Capital | Contributed surplus | Cumulative translation adjustment | Deficit | Non-controlling Interest | Total |
|--|-------|---------------|---------------------|-----------------------------------|-------------|--------------------------|------------|
| Balance at January 1, 2019 | | \$ 64,883 | \$ 22,184 | \$ — | \$ (30,596) | \$ 1,431 | \$ 57,902 |
| Shares issued - warrant exercises | 13 | 46,880 | (13,700) | — | — | — | 33,180 |
| Shares issued - stock option exercises | 13 | 3,860 | (1,712) | — | — | — | 2,148 |
| Shares issued- Acquisition of Grandeur | 13 | 7,372 | — | — | — | — | 7,372 |
| Shares issued- Acquisition of Apothecarium | 13 | 42,042 | — | — | — | — | 42,042 |
| Shares issued- Acquisition of Ilera | 13 | 26,318 | — | — | — | — | 26,318 |
| Private placement net of share issuance costs | 13 | 67,177 | — | — | — | — | 67,177 |
| Issuance of proportionate voting warrants | | (29,557) | 29,557 | — | — | — | — |
| Warrants expired | | — | (2) | — | 2 | — | — |
| Options expired/forfeited | | — | (235) | — | 235 | — | — |
| Share-based compensation expense | 13 | — | 12,501 | — | — | — | 12,501 |
| Non-controlling interest on acquisition of Solace Rx | | — | — | — | — | 2,407 | 2,407 |
| Non-controlling interest on acquisition of Ilera | | — | — | — | — | 565 | 565 |
| Capital contributions | | — | — | — | — | 381 | 381 |
| Net loss for the period | | — | — | — | (46,290) | (857) | (47,147) |
| Cumulative translation adjustment | | — | — | (2,894) | — | 17 | (2,877) |
| Balance at September 30, 2019 | | \$ 228,975 | \$ 48,593 | \$ (2,894) | \$ (76,649) | \$ 3,944 | \$ 201,969 |

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

TerrAscend Corp.

Unaudited Condensed Interim Consolidated Statements of Cash Flow

(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

| | Notes | For the nine months ended September 30, 2020 | September 30, 2019 |
|--|-------|--|-----------------------|
| Operating activities | | | |
| Net loss | | \$ (45,039) | \$ (47,147) |
| Add (deduct) items not involving cash | | | |
| Unrealized gain on changes in fair value of biological assets | 6 | (63,207) | (3,736) |
| Realized fair value amounts included in inventory sold | | 45,899 | 464 |
| Non-cash write downs of inventory | 7 | 4,321 | 1,744 |
| Accretion and accrued interest | | 9,606 | 4,026 |
| Depreciation of property, plant and equipment | 8 | 5,934 | 1,401 |
| Amortization of intangible assets | 9 | 5,951 | 4,317 |
| Share-based payments | 13 | 10,964 | 12,113 |
| Current income tax expense (recovery) | 15 | 18,411 | (889) |
| Deferred income tax expense (recovery) | 15 | (1,575) | (3,130) |
| Net increase in fair value of warrant and derivative liabilities | 21 | 22,174 | — |
| Unrealized loss on investments | | (81) | 2,840 |
| Revaluation of contingent consideration | 5 | 19,861 | — |
| Impairment of intangible assets | 9 | 1,002 | 58 |
| Changes in working capital items | 19 | (16,394) | (16,230) |
| Income taxes paid | | (9,101) | (157) |
| Cash inflow (outflow) from operating activities | | 8,726 | (44,326) |
| Financing activities | | | |
| Proceeds from warrants exercised | 13 | 1,883 | 33,180 |
| Proceeds from options exercised | 13 | 620 | 2,148 |
| Proceeds from loan including interest accrued | 10 | 90,129 | 47,085 |
| Return of capital to non-controlling interests | | 790 | — |
| Loan principal and interest paid | 10 | (76,718) | (2,278) |
| Loan origination fee paid | | — | (770) |
| Proceeds from private placement, net of share issuance costs | 13 | 95,522 | 67,177 |
| Proceeds from mortgage | 10 | — | 6,500 |
| Principal payments on mortgage | 13 | — | (41) |
| Notes receivable issued | | — | (4,449) |
| Lease payments | 11 | (2,971) | (778) |
| Cash inflow from financing activities | | 109,255 | 147,774 |
| Investing activities | | | |
| Investment in property, plant and equipment | 8 | (39,950) | (23,599) |
| Investment in intangible assets | 9 | (1,482) | (1,720) |
| Principal and interest payments received on lease receivable | 11 | 178 | — |
| Investment in joint venture | | — | (818) |
| Deposits for business acquisition | 24 | (1,334) | — |
| Payments of contingent consideration | 5 | (40,705) | — |
| Cash portion of consideration paid in acquisition of Grander, net of cash acquired | 5 | — | (9,187) |
| Cash portion of consideration paid in acquisition of Apothecarium net of cash acquired | | — | (47,701) |
| Cash portion of consideration paid in acquisition of Illera, net of cash acquired | | — | (32,109) |
| Contributions by non-controlling interests | | — | 381 |
| Cash received on acquisition of State Flower | 5 | 971 | — |
| Cash outflow from investing activities | | (82,322) | (114,753) |
| Increase (decrease) in cash, cash equivalents and restricted cash during the period | | 35,659 | (11,305) |
| Net effects of foreign exchange | | (2,208) | (3,615) |
| Cash, cash equivalents and restricted cash, beginning of period | | 11,900 | 21,773 |
| Cash, cash equivalents and restricted cash, end of period | | \$ 45,351 | \$ 6,853 |

Supplemental cash flow information (note 19)

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

Notes to the Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

1. Nature of operations

TerrAscend Corp. (“TerrAscend” or the “Company”) was incorporated under the Ontario Business Corporations Act, on March 7, 2017. TerrAscend provides cannabis products, brands, and services to the global cannabinoid market. With operations in both Canada and the United States (“US”), TerrAscend participates in the medical and legal adult use market across Canada and in several US states where cannabis has been legalized for therapeutic or adult use. TerrAscend operates a number of synergistic businesses, including The Apothecarium, a cannabis dispensary with several retail locations in California; Arise Bioscience Inc., a manufacturer and distributor of hemp-derived products; Ilera Healthcare, Pennsylvania’s medical marijuana cultivator, processor and dispenser; Valhalla Confections, a manufacturer of cannabis-infused edibles and State Flower a California-based cannabis producer operating a licensed cultivation facility in San Francisco. TerrAscend holds a cultivation permit in the State of New Jersey and is pending final approval for a vertically integrated medical cannabis operation with the ability to operate up to 3 Alternative Treatment Centers.

The Company was listed on the Canadian Stock Exchange effective May 3, 2017, having the ticker symbol TER and effective October 22, 2018, the Company began trading on OTCQX under the ticker symbol TRSSF. The Company’s registered office is located at PO Box 43125, Mississauga, Ontario, L5C 1W2.

2. Basis of presentation

(a) Statement of compliance

These condensed interim consolidated financial statements for the nine months ended September 30, 2020 and September 30, 2019 of the Company have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting. The Company followed the same accounting policies and methods of application as those disclosed in the audited annual consolidated financial statements for the year ended December 31, 2019 prepared in accordance with International Financial Reporting Standards (“IFRS”). These condensed interim consolidated financial statements should be read in conjunction with the Company’s December 31, 2019 audited annual consolidated financial statements and were authorized for issue by the Board of Directors on November 19, 2020.

(b) Basis of measurement

These condensed interim consolidated financial statements have been prepared on the going concern basis which assumes that the Company will continue operations for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of business. In accordance with the going concern basis, these condensed interim consolidated financial statements have been prepared under the historical cost convention except for certain financial instruments that are measured at fair value and biological assets that are measured at fair value less costs to sell, as detailed in the Company’s accounting policies.

(c) Functional and presentation currency

The Company’s functional currency, as determined by management, is the Canadian dollar. Management has determined that the functional currency of its Canadian subsidiaries is the Canadian dollar and the functional currency of its US subsidiaries is the US dollar. These condensed interim consolidated financial statements are presented in Canadian dollars unless otherwise specified.

(d) Basis of consolidation

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

Notes to the Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

2. Basis of presentation (continued)

All intercompany balances and transactions were eliminated on consolidation.

(e) Use of significant estimates and judgments

The preparation of condensed interim consolidated financial statements requires the use of certain critical accounting estimates. It also requires management to exercise judgment in applying the Company's accounting policies. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The 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, 2019.

(f) COVID-19 Estimation Uncertainty

In March 2020, the World Health Organization declared the outbreak of COVID-19 a global pandemic. Government measures to limit the spread of COVID-19, including the closure of non-essential businesses, did not materially disrupt the Company's operations during period ended September 30, 2020. The production and sale of cannabis have been recognized as essential services across Canada and the United States and the Company has not experienced production delays or prolonged retail closures as a result.

Due to the rapid developments and uncertainty surrounding COVID-19, it is not possible to predict the impact that COVID-19 will have on our business, financial position, and operating results in the future. In addition, it is possible that estimates in the Company's financial statements will change in the near term as a result of COVID-19 and the effect of any such changes could be material, which could result in, among other things, impairment of long-lived assets including intangibles and goodwill. An impairment test has not been performed as of September 30, 2020 for the Company's goodwill and indefinite life intangibles. Management is closely monitoring the impact of the pandemic on all aspects of its business. At September 30, 2020, management has not observed any material impairments of our assets or a significant change in the fair value of assets due to the COVID-19 pandemic.

3. Significant accounting policies

The same accounting policies are applied in these unaudited condensed interim consolidated financial statements as those disclosed in the notes to the annual consolidated financial statements for the year ended December 31, 2019, except as described below.

Preferred Shares

In June 2020, the Company completed a Preferred Share Unit financing (note 13). The Preferred Shares are classified partly as financial liabilities on the Statements of Financial Position, since they do not meet the criteria in IAS 32, *Financial Instruments: Presentation for classification as equity*. The Preferred Shares have a price protection clause that could result in the conversion to a variable number of common shares (proportionate voting shares for US investors) before May 22, 2021. The price protection clause holds certain characteristics of a derivative akin to a debt instrument and therefore the Preferred Shares have been classified as part liability and part share capital in the consolidated financial statements of the Company. In addition, the terms of the Preferred Share Warrants result in the liability classification relating to the conversion of Preferred Share Warrants to Preferred Shares, which arises due to the conversion taking place at a fixed US dollar redemption rate, while the Company maintains a Canadian dollar functional currency. The Company records the preferred share derivative liability and preferred share warrant liability at its fair value at every reporting period with any gains or losses recorded in the statement of loss and comprehensive loss.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

3. Significant accounting policies (continued)

New standards, amendments and interpretations adopted

IFRS 3 – “Business Combinations (Amendment)”, the amendments clarify the definition of a business, permitting a simplified assessment to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. The amendments are effective for transactions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2020. Earlier application is permitted. The Company has adopted this standard effective January 1, 2020. There was no impact to the Company’s financial statements as a result of this adoption.

4. Receivables, net of sales returns and allowances

| | September 30, 2020 | December 31, 2019 |
|--|-----------------------|----------------------|
| Trade receivables | \$ 10,720 | \$ 7,994 |
| Sales tax receivables | 34 | 1,158 |
| Other receivables | 306 | 1,088 |
| Provision for sales returns and allowances | (831) | (2,617) |
| Receivables, net of sales returns and allowances | \$ 10,229 | \$ 7,623 |

Sales tax receivables represents input tax credits arising from sales tax levied on the supply of goods purchased or services received in Canada.

| | September 30, 2020 | December 31, 2019 |
|--|--------------------|-------------------|
| Trade receivables | \$ 10,720 | \$ 7,994 |
| Less: provision for sales returns and allowances | (831) | (2,617) |
| Total trade receivables, net | \$ 9,889 | \$ 5,377 |

Of which

| | | |
|--|-----------------|-----------------|
| Current | \$ 9,114 | \$ 6,506 |
| 31-90 days | 1,365 | 880 |
| Over 90 days | 241 | 608 |
| Less: provision for sales returns and allowances | (831) | (2,617) |
| Total trade receivables, net | \$ 9,889 | \$ 5,377 |

5. Acquisitions

Acquisition of ABI SF, LLC (“State Flower”)

On January 23, 2020, the Company, through a wholly owned subsidiary, WDB Holding CA, Inc. (“WDB CA”), acquired ABI SF LLC (“State Flower”), which operates a California cannabis cultivation facility and the State Flower brand.

As consideration, the Company converted its previously issued note receivable and accrued interest in the amount of \$3,985 (US\$3.03 million) into a 49.9% equity interest in State Flower. The Company also recorded contingent consideration payable of \$8,714 (US\$6.63 million), representing the expected consideration payable to acquire the remaining 50.1% of State Flower, which comprises 100% of its Class A common shares, subject to regulatory approval. The contingent consideration is based on a multiple of future revenue. Effective with the conversion, the Company controls the appointment of three out of five seats on the board of directors and controls strategic and financial operations of State Flower.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***5. Acquisitions (continued)**

On a standalone basis had the Company acquired the business on January 1, 2020, sales estimates would have been \$1,185 for the nine months ended September 30, 2020 and net loss estimates would have been \$2,085. Actual sales and net loss for the nine months ended September 30, 2020 are \$864 and \$2,081 respectively. The following table presents the preliminary fair values of assets acquired and liabilities assumed as of the January 23, 2020 acquisition date and an allocation of the consideration to net assets required:

| | \$ |
|--|---------------|
| Cash and cash equivalents | 971 |
| Receivables | 139 |
| Inventory | 568 |
| Prepaid expenses and deposits | 184 |
| Right-of-use asset | 3,558 |
| Property, plant and equipment | 1,596 |
| Intangible assets | 6,269 |
| Goodwill | 6,817 |
| Accounts payable and accrued liabilities | (499) |
| Lease liability | (3,558) |
| Deferred tax liability | (652) |
| Net assets acquired | 15,393 |
| <hr/> | |
| Consideration paid on conversion of note receivable | 3,985 |
| Contingent consideration payable | 8,714 |
| Line of credit advances at date of acquisition | 2,694 |
| Total consideration | 15,393 |
| <hr/> | |
| Cash and cash equivalents acquired, net cash inflow | 971 |

Goodwill was recognized for this acquisition because the purchase consideration included a control premium. In addition, the consideration paid reflected the benefit of expected sales growth and future market and product development. These benefits were not recognized separately from goodwill because they do not meet the recognition criteria for identifiable intangible assets.

The accounting for this acquisition has been provisionally determined at September 30, 2020. The fair value of net assets acquired, specifically with respect to inventory, intangible assets and goodwill, and total consideration have been determined provisionally and subject to adjustment. Upon completion of a comprehensive valuation and finalization of the purchase price allocation, the amounts above may be adjusted retrospectively to the acquisition date in future reporting periods.

Costs related to this transaction were \$56, including legal, accounting, due diligence, and other transaction-related expenses and were included in transaction and restructuring costs. As part of the transaction, the Company entered into a put/call arrangement with the non-controlling shareholders of the State Flower principals. As a result, the non-controlling interest in State Flower does not qualify for equity treatment under IAS 32, Financial Instruments: Presentation. Under the put/call arrangement, the non-controlling interest is redeemable by either party to the agreement after certain regulatory approvals are met. The Company has classified the non-controlling interest as a liability on the consolidated statements of financial position as other contingent consideration payable. The initial 50.1% non-controlling interest liability was recorded at a fair value of \$8,714 million. This amount was calculated as a multiple of estimated revenues for the one-year period beginning three months after the completion of the first harvest following the installation of additional growing equipment, which is expected to be completed in October 2020. Any fair value adjustments to the liability are recorded in the consolidated statements of loss. No profit or loss with respect to State Flower operations is allocated to the non-controlling interest.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***5. Acquisitions (continued)**Contingent consideration

Contingent consideration at September 30, 2020 and for the year ended December 31, 2019 are as follows:

| | Grander | Apothecarium | Ilera | Total |
|--|----------------|---------------------|------------------|------------------|
| Carrying amount, December 31, 2018 | \$ — | \$ — | \$ — | — |
| Contingent consideration recognized on acquisition | 776 | 4,051 | 144,312 | 149,139 |
| Revaluation of contingent consideration | (772) | — | 62,623 | 61,851 |
| Effects of movements in foreign exchange | (4) | (118) | (3,838) | (3,960) |
| Carrying amount, December 31, 2019 | \$ — | \$ 3,933 | \$ 203,097 | \$ 207,030 |
| Amount recognized on acquisition of State Flower | — | 8,714 | — | 8,714 |
| Payments of contingent consideration | — | — | (40,705) | (40,705) |
| Revaluation of contingent consideration | — | 1,435 | 18,426 | 19,861 |
| Effects of movements in foreign exchange | — | 215 | 4,515 | 4,730 |
| Carrying amount, September 30, 2020 | — | 14,297 | 185,333 | 199,630 |
| Less: current portion | — | (4,039) | (185,333) | (189,372) |
| Non-current contingent consideration | \$ — | \$ 10,258 | \$ — | \$ 10,258 |

Contingent consideration recorded relates to the Company's business acquisitions.

On December 27, 2019, the Company and the sellers of Ilera amended the terms of the transaction to reduce the amount deposited into escrow from \$16,237 (US\$12.5 million) to \$649 (US\$0.5 million), which is deferred until the final earnout payment is due on March 15, 2021. The Company also agreed to pay to the sellers of Ilera an additional amount equal to \$2,269 (US\$1.75 million), payable in five installments, due every three months beginning April 15, 2020.

During the nine months ended September 30, 2020, the Company made earnout payments to the sellers of Ilera in the amount of \$26,481 (US\$20.3 million) on January 15, 2020, as well as two scheduled installments from the additional amount totaling \$1,033 (US\$0.7 million). On September 4, 2020 the Company and the sellers of Ilera amended the Ilera Purchase Agreement to allow the Company to utilize cash flow generated by the Ilera business to prepay up to \$30 million (the "Pre-Payment Amount") towards the final earnout payment, of which \$13,191 (US\$10.0 million) was pre-paid to the sellers of Ilera on September 8, 2020. The amendment to the Ilera Purchase Agreement also allows the Company to defer up to an amount equal to the actual Pre-Prepayment Amount paid to the sellers of Ilera until June 30, 2021. The Company expects that the full earnout amount to the sellers of Ilera of US\$225.0 million will be paid by the due dates set out in the Ilera Purchase Agreement (as amended), of which US\$146.1 million, undiscounted, is outstanding as of September 30, 2020.

Note 21 *Financial Instruments and Risk Management* discloses valuation methods used when determining the fair value of the contingent consideration liability at September 30, 2020 and the change in fair value during the nine months ended September 30, 2020.

Contingent consideration recognized on the acquisition of State Flower is included under Apothecarium as management considers it to be a member of the Apothecarium group of entities.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***6. Biological assets**

The Company's biological assets consist of 56,901 cannabis plants at September 30, 2020. The reconciliation of biological assets is as follows:

| | September 30, 2020 | December 31, 2019 |
|---|-----------------------|----------------------|
| Opening amount | \$ 5,484 | \$ 545 |
| Increase in fair value due to biological transformation | 63,207 | 5,480 |
| Additions on business acquisitions | 80 | 3,547 |
| Capitalized costs | 12,699 | 3,797 |
| Transferred to inventories upon harvest | (65,482) | (7,884) |
| Effect of movements in foreign exchange | (221) | — |
| Fair value less costs to sell of cultivated plants | 15,767 | 5,485 |
| Cannabis seeds purchased (planted) | (1) | (1) |
| Ending balance | \$ 15,766 | \$ 5,484 |

The fair value measurements for biological assets are categorized as Level 3 in the fair value hierarchy based on the inputs to the selected valuation technique. The fair value was determined using an expected cash flow model which assumes the biological assets at the balance sheet date will grow to maturity, be harvested and converted into finished goods inventory, and sold in the retail recreational or medical cannabis market. The Company's method of accounting for biological assets attributes value accretion on a straight-line basis throughout the life of the biological asset from the vegetation stage to the point of harvest and assumes that the value of clones is nominal. The Company deducts a distribution margin of 10% along with the excise tax when estimating the fair value of biological assets.

The Company's estimates, by their nature, are subject to changes that could result from volatility of market prices, unanticipated regulatory changes, harvest yields, loss of crops, changes in estimates and other uncontrollable factors that could significantly affect the future fair value of biological assets.

Dry bud

The dry bud model utilizes the following significant assumptions:

| | Weighted Average September 30, 2020 | Weighted Average December 31, 2019 |
|---|--|---|
| Weighted average of expected loss of plants until harvest | 5% | 7% |
| Expected yields for cannabis plants (average grams per plant) | 45 grams | 38 grams |
| Expected number of growing weeks | 13 weeks | 13 weeks |
| Estimated selling price (per gram) | \$ 8.82 | \$ 8.51 |
| Post-harvest cost to complete and sell (per gram) | \$ 1.04 | \$ 2.36 |

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***6. Biological assets (continued)**Trim

The trim model utilizes the following significant assumptions:

| | Weighted Average September 30, 2020 | Weighted Average December 31, 2019 |
|---|--|---|
| Weighted average of expected loss of plants until harvest | 5% | 7% |
| Expected yields for cannabis plants (average grams per plant) | 58 grams | 71 grams |
| Expected number of growing weeks | 13 weeks | 13 weeks |
| Estimated selling price (per gram) | \$ 5.88 | \$ 2.42 |
| Post-harvest cost to complete and sell (per gram) | \$ 0.24 | \$ 0.14 |

These estimates are subject to volatility in market prices and a number of uncontrollable factors, which could significantly affect the fair value of biological assets in future periods.

The following table presents the effect of a 10% change on the fair valuation of biological assets at September 30, 2020 and December 31, 2019 which would be reported as part of the gross profit (loss) on the statement of loss and comprehensive loss.

| | 10% change at September 30, 2020 | 10% change at December 31, 2019 |
|---|---|--|
| Weighted average of expected loss of plants until harvest | \$ 29 | \$ 21 |
| Expected yields for cannabis plants (average grams per plant) | 1,484 | 480 |
| Expected number of growing weeks | 1,337 | 272 |
| Estimated selling price (per gram) | 1,625 | 700 |
| Post-harvest cost to complete and sell (per gram) | 453 | 220 |

7. Inventory

The Company's inventory of dry cannabis includes both purchased and internally produced inventory. The Company's inventory is comprised of the following items:

| | September 30, 2020 | December 31, 2019 |
|--------------------------|---------------------------|--------------------------|
| Raw materials | \$ 11,846 | \$ 9,911 |
| Finished goods | 8,095 | 5,628 |
| Work in process | 10,307 | 3,439 |
| Accessories | 65 | 265 |
| Supplies and consumables | 1,786 | 1,179 |
| | \$ 32,099 | \$ 20,422 |

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

7. Inventory (continued)

During the nine months ended September 30, 2020, management assessed that the net book value of inventory held at its Canadian facility relating to raw materials and Cannabis 1.0 products (finished goods) exceeded the net realizable value and thus recorded an impairment of \$1,772 (December 31, 2019 - \$9,184). The impairment was recorded in cost of sales. Management determined net realizable value as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. In addition, during the nine months ended September 30, 2020, management wrote off \$135 (December 31, 2019 - \$5,078) of inventory that it deemed unsaleable.

On March 31, 2020, the Company's subsidiary, TerrAscend Canada Inc., signed an amended agreement with MediPharm Labs Inc. ("MediPharm") whereby TerrAscend Canada Inc. agreed to purchase from MediPharm certain quantities of cannabis crude oil and/or distillate. During the nine months ended September 30, 2020, management recorded an impairment of \$2,414 of inventory that the Company purchased in the current period under the agreement for which the net book value exceeded the net realizable value. Inventory impairment and write-offs have been recorded in cost of goods sold.

At September 30, 2020, the fair value adjustment component included in inventory is \$9,668 (December 31, 2019 - \$3,057).

8. Property, plant and equipment

Property, plant and equipment for the nine months ended September 30, 2020 are as follows:

| | Assets in Land | Process | Buildings and Improvements | Machinery & Equipment | Office & Furniture Equipment | Right of Use Assets | Total |
|---|----------------------|---------------|-------------------------------|-----------------------------|---------------------------------------|---------------------------|----------------|
| | \$ | \$ | \$ | \$ | \$ | \$ | \$ |
| Cost | | | | | | | |
| Balance at December 31, 2019 | 4,706 | 29,098 | 49,008 | 10,946 | 3,344 | 20,084 | 117,186 |
| Additions | — | 15,973 | 12,544 | 11,279 | 1,206 | 8,197 | 49,199 |
| Additions on Acquisition of State Flower | — | 1,352 | 799 | — | 33 | 3,558 | 5,742 |
| Completion of construction | — | (31,632) | 31,434 | — | 198 | — | — |
| Disposals | — | — | — | (313) | (150) | (1,104) | (1,567) |
| Effects of movements in foreign exchange | 101 | 22 | 716 | 7 | 21 | 409 | 1,276 |
| Balance at September 30, 2020 | 4,807 | 14,813 | 94,501 | 21,919 | 4,652 | 31,144 | 171,836 |
| Accumulated Depreciation | | | | | | | |
| Balance at December 31, 2019 | — | — | 1,816 | 624 | 1,000 | 1,096 | 4,536 |
| Depreciation | — | — | 2,201 | 1,606 | 583 | 1,544 | 5,934 |
| Additions on Acquisition | — | — | 584 | — | 4 | — | 588 |
| Disposals | — | — | — | (79) | 37 | — | (42) |
| Effects of movements in foreign exchange | — | — | 4 | (9) | 10 | 35 | 40 |
| Balance at September 30, 2020 | — | — | 4,605 | 2,142 | 1,634 | 2,675 | 11,056 |
| Net book value at September 30, 2020 | 4,807 | 14,813 | 89,896 | 19,777 | 3,018 | 28,469 | 160,780 |
| Net book value at December 31, 2019 | 4,706 | 29,098 | 47,192 | 10,322 | 2,344 | 18,988 | 112,650 |

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

8. Property, plant and equipment (continued)

During the nine months ended September 30, 2020, borrowing costs were not capitalized because the assets in process did not meet the criteria of a qualifying asset. During the year ended December 31, 2019, the Company capitalized \$836 of borrowing costs in assets in process using a weighted average capitalization rate of 11.82%.

9. Intangible assets and goodwill

Intangible assets and goodwill for the nine months ended September 30, 2020 were as follows:

| | Software & Licenses \$ | Intellectual Property \$ | Brand Name \$ | Customer Relationships \$ | Non- Compete Agreements \$ | Goodwill \$ | Total \$ |
|---|------------------------------|--------------------------------|---------------------|---------------------------------|-------------------------------------|----------------|----------------|
| Cost | | | | | | | |
| Balance at December 31, 2019 | 2,435 | 107,272 | 32,238 | 5,844 | 1,753 | 95,805 | 245,347 |
| Additions | 800 | 10,464 | — | — | — | — | 11,264 |
| Additions on acquisition of State Flower | — | 4,127 | 1,774 | — | 368 | 6,817 | 13,086 |
| Impairment | — | (533) | — | (679) | — | — | (1,212) |
| Effects of movements in foreign exchange | 2 | 2,719 | 898 | 172 | 53 | 2,691 | 6,535 |
| Balance at September 30, 2020 | 3,237 | 124,049 | 34,910 | 5,337 | 2,174 | 105,313 | 275,020 |
| Accumulated Amortization | | | | | | | |
| Balance at December 31, 2019 | 425 | 1,989 | — | 1,201 | 584 | — | 4,199 |
| Amortization | 390 | 4,158 | — | 855 | 548 | — | 5,951 |
| Impairment | — | — | — | (210) | — | — | (210) |
| Effects of movements in foreign exchange | — | 49 | — | 22 | 11 | — | 82 |
| Balance at September 30, 2020 | 815 | 6,196 | — | 1,868 | 1,143 | — | 10,022 |
| Net book value at September 30, 2020 | | | | | | | |
| | 2,422 | 117,853 | 34,910 | 3,469 | 1,031 | 105,313 | 264,998 |
| Net book value at December 31, 2019 | 2,010 | 105,283 | 32,238 | 4,643 | 1,169 | 95,805 | 241,148 |

During the nine months ended September 30, 2020, the Company capitalized \$9,782 (US\$7.5 million) related to two success fees payable to an entity controlled by the minority shareholders of NJ. The first success fee payment of \$4,891 (US\$3.75 million) was due upon NJ being granted an Alternative Treatment Center (“ATC”) license in the state of New Jersey. The first success fee payment was settled in shares on March 25, 2020 at a fair value determined on the date NJ received the license. The second success fee payment of \$4,891 (US\$3.75 million) is due upon NJ making its first sale of medicinal marijuana to a patient in compliance with the New Jersey Compassionate Use Marijuana Act (Note 13), which management believes is probable to occur during fiscal 2020. The payments were capitalized as an intellectual property intangible asset as costs to obtain the ATC license. The useful life of the assets is based on the ATC license.

At the end of each reporting period, the Company assesses whether there were events or changes in circumstances that would indicate that a Cash Generating Unit (“CGU”) or group of CGUs were impaired. The Company considers external and internal factors, including overall financial performance and relevant entity-specific factors, as part of this assessment. With respect to the Company’s Florida CGU, the cessation of a distribution agreement was identified as an indicator of impairment, resulting in the agreement recorded in customer relationships to be written down to its recoverable value of \$nil. The Company’s Canada CGU recorded an impairment of \$533 of intellectual property related to packaging designs that were written down to its recoverable value of \$nil.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

9. Intangible assets and goodwill (continued)

For the nine months ended September 30, 2020, \$4,534 (September 30, 2019 – \$316) of amortization was expensed to cost of sales.

10. Loans payable

| | Credit facility | Loans | Loans from related parties | Canopy Rivers Loan | Canopy Growth Financing | Total |
|--|-----------------|-----------------|----------------------------|--------------------|-------------------------|------------------|
| Opening carrying amount | \$ 59,691 | \$ 6,428 | \$ 3,247 | \$ — | \$ — | \$ 69,366 |
| Loan principal net of transaction costs | — | 8,039 | 1,963 | — | 80,127 | 90,129 |
| Converted from convertible debt | — | — | — | 12,833 | — | 12,833 |
| Less: fair value of warrants | — | — | — | (3,781) | (26,844) | (30,625) |
| Interest accretion | 1,574 | 191 | — | 1,267 | 3,570 | 6,602 |
| Principal and interest paid | (64,718) | (6,549) | (5,452) | — | — | (76,719) |
| Effects of movements in foreign exchange | 3,453 | (22) | 242 | — | — | 3,673 |
| Ending carrying amount | \$ — | \$ 8,087 | \$ — | \$ 10,319 | \$ 56,853 | \$ 75,259 |
| Less: current portion | — | (599) | — | (792) | (2,744) | (4,135) |
| Non-current loans payable | \$ — | \$ 7,488 | \$ — | \$ 9,527 | \$ 54,109 | \$ 71,124 |

Credit Facility

On December 14, 2018, the Company entered into a \$97.4 million (US\$75 million) credit facility (the “Credit Facility”) with certain funds managed by JW Asset Management LLC, where Jason Wild, Chairman of the Board of TerrAscend, is the President and Chief Investment Officer. The Credit Facility bears interest at 8.75% per annum, with a \$970 (US\$0.75 million) origination fee payable on a quarterly basis. Any principal amount drawn is due in one year and interest is payable monthly. The Credit Facility was recorded at its fair value at inception and subsequently carried at amortized cost.

On December 2, 2019, the Company and JW Asset Management agreed to an amendment of the Credit Facility whereby upon maturity on March 15, 2020, the Company would be extended a Term Loan for all outstanding principal and interest still outstanding on the Credit Facility. As of December 2, 2019, the interest rate of the Credit Facility was amended to 12.5% per annum. The expected Term Loan bears an interest rate of 12.5% per annum, payable semi-annually and the maturity date is no later than March 15, 2022. On March 11, 2020, a portion of the proceeds received from Canopy Growth loan financing were used to fully pay off the outstanding principal and interest amounts under the Credit Facility with JW Asset Management.

Loan from Related Parties

During the year ended December 31, 2019, the Company received loan proceeds of \$3,247 (US\$2.5 million) from key management of the Company’s subsidiary, Ilera. In January 2020, the Company received additional loan proceeds of \$1,963 (US\$1.5 million). The loans bear interest at a rate of 12% per annum, payable monthly. The principal and interest were fully paid during the nine months ended September 30, 2020.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements

For the three and nine months ended September 30, 2020 and 2019

(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

10. Loans payable (continued)

Canopy Rivers Loan

On February 5, 2020, the Company and Canopy Rivers Corporation (“Canopy Rivers”), a related party of the Company, agreed to amend the terms of their previously issued convertible debentures with a face value of \$13,243 (US\$10 million). Pursuant to the amended terms, the first tranche of the convertible debentures were converted into a \$13,243 loan payable bearing interest at a rate of 6% per annum, payable annually, with a balance due date of October 2, 2024. The effective interest rate on the loan is 15.4%. The Company also issued Canopy Rivers 2,225,714 common share purchase warrants, exercisable at \$5.95 upon the occurrence of certain triggering events. The warrants were issued such that they can be exercised upon maturity of the loan payable in a cashless exercise by offsetting the principal value of the loan payable. The amendment was treated as a modification of the convertible debenture and as a result, no gains or losses were recorded for the transaction.

Canopy Growth Financing

On March 10, 2020, TerrAscend Canada Inc. entered into a loan financing agreement with Canopy Growth, a related party of the Company, in the amount of \$80,526 pursuant to a secured debenture. In connection with the funding of the loan, the Company has issued 17,808,975 common share purchase warrants to Canopy Growth.

The secured debenture bears interest at a rate of 6.10% per annum, with an effective interest rate of 11.9%, and matures on March 10, 2030. The debenture is secured by the assets of TerrAscend Canada, is not convertible and is not guaranteed by the Company. The warrants are comprised of 15,656,242 common share purchase warrants entitling Canopy Growth to acquire one common share of TerrAscend at an exercise price of \$5.14 per share, expiring on March 10, 2030, and 2,152,733 common share purchase warrants entitling Canopy Growth to acquire one common share of TerrAscend at an exercise price of \$3.74 per share, expiring on March 10, 2031.

All warrants will be exercisable following changes in U.S. federal laws permitting the cultivation, distribution, and possession of marijuana or to remove the regulation of such activities from the federal laws of the United States. The warrants were issued such that they can be exercised upon maturity of the loan payable in a cashless exercise by offsetting the principal value of the loan payable. The fair value of the debt was calculated using the effective interest rate method, with the residual value allocated to contributed surplus.

Of the total proceeds received from Canopy Growth, \$64,718 was used to fully pay off the outstanding principal and interest amounts under the Credit Facility with JW Asset Management and \$8,494 was restricted for use in Canadian operations and was held in a segregated bank account. The restricted cash held at September 30, 2020 is \$4,517 (Note 20).

Other Loans

On April 23, 2019, the Company completed a \$6,500 mortgage financing secured by its manufacturing facility in Mississauga, bearing interest of 5.5% and a balance due date of May 1, 2022. The mortgage payable was recorded at its fair value at inception and subsequently carried at amortized cost. The loan principal and interest were fully paid in June 2020. The Company recognized a loss on termination of mortgage payable in the amount of \$636 recorded in finance and other expenses in the statement of comprehensive loss. The Company has capitalized \$255 of transaction costs in loan payable.

On June 19, 2020, the Company completed a \$7,250 loan financing secured by its manufacturing facility in Mississauga, bearing interest of 8.25% and a balance due date of July 1, 2023. The mortgage payable was recorded at its fair value at inception and subsequently carried at amortized cost.

Total interest paid on all loan payables during the nine months ended September 30, 2020 was \$2,794 (September 30, 2019 – \$2,278).

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***11. Leases**

The Company's lease liabilities for the nine months ended September 30, 2020 are as follows:

| | September 30, 2020 | December 31, 2019 |
|--|-------------------------------|------------------------------|
| Opening lease liability | \$ 20,729 | \$ — |
| Effect of adoption of IFRS 16, January 1, 2019 | — | 234 |
| Additions on Grandeur asset acquisition | — | 169 |
| Additions on Apothecarium acquisition | — | 16,126 |
| Additions on Ilera acquisition | — | 1,971 |
| Additions on State Flower acquisition | 3,558 | — |
| Non-acquisition related additions | 8,349 | 2,901 |
| Lease payments | (2,971) | (1,382) |
| Interest expense | 2,514 | 1,259 |
| Effects of movements in foreign exchange | 487 | (549) |
| Ending lease liability | \$ 32,666 | \$ 20,729 |
| Less: current portion | (2,236) | (1,157) |
| Non-current lease liability | \$ 30,430 | \$ 19,572 |

Undiscounted lease obligations are as follows:

| | \$ |
|----------------------|---------------|
| Less than one year | 4,172 |
| One to five years | 17,115 |
| More than five years | 38,602 |
| Total | 59,889 |

12. Convertible debentures

On October 2, 2019, the Company completed the first tranche of a non-brokered private placement of convertible debentures and warrants. The Company issued 13,243 units, having a maturity date of five years from the date of issue and bearing interest at 6% per annum, compounded and payable annually, at face value of \$13,243. Each unit comprises one convertible debenture and 25.2 common share purchase warrants. The convertible debentures are convertible at the holders' option into common shares of the Company at a conversion price of \$5.95.

On November 16, 2019, the Company completed the second tranche of the non-brokered private placement noted above. The Company issued 4,763 convertible debentures under the same terms, at face value of \$4,763. On November 26, 2019, the Company completed the third tranche of the non-brokered private placement noted above. The Company issued 2,654 convertible debentures under the same terms, at face value of \$2,654. The fair value of the equity portion was calculated as the residual value after determining the fair value of the convertible debentures using the effective interest method. The fair value of the equity portion is allocated to the conversion option and warrants using the relative fair value method.

On February 5, 2020, the Company amended the terms of its previously announced \$13,243 (US\$10 million) convertible debenture issuance to Canopy Rivers. The carrying value of the debt was converted to a loan payable as of the amendment date (Note 10). The amendment resulted in a reallocation of the previously recorded conversion option to warrants reserve in contributed surplus and had no impact on the consolidated statement of loss.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***12. Convertible debentures (continued)**

| | September 30, 2020 | December 31, 2019 |
|---|-----------------------|-------------------|
| Opening carrying amount | \$ 13,874 | \$ — |
| Convertible debentures issued, net of transaction costs | — | 20,343 |
| Less: fair value of conversion option | — | (5,798) |
| Less: fair value of warrants | — | (863) |
| Converted loan payable | (9,052) | — |
| Interest accretion | 610 | 192 |
| Ending carrying amount | \$ 5,432 | \$ 13,874 |
| Less: current portion | (334) | — |
| Non-current convertible debt | 5,098 | 13,874 |

13. Share capital and contributed surplusAuthorized share capital

The authorized share capital of the Company consists of an unlimited number of common shares, unlisted proportionate voting shares, unlisted exchangeable shares and unlisted preferred shares.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***13. Share capital and contributed surplus (continued)**Outstanding share capital

| | Common Shares | Exchangeable Shares | Proportionate Voting Shares | Preferred Shares | Amount \$ |
|--|-------------------|------------------------|-----------------------------------|---------------------|----------------|
| Outstanding, December 31, 2018 | 41,147,636 | 38,890,571 | 35,022 | — | 64,883 |
| Shares issued – warrant exercises | 959,772 | — | 28,636 | — | 33,179 |
| Shares issued – stock option exercises | 1,101,562 | — | — | — | 2,620 |
| Shares issued – acquisition of Grander assets | 1,362,343 | — | — | — | 6,729 |
| Shares issued – acquisition of Apothecarium | — | — | 6,700 | — | 41,259 |
| Shares issued – acquisition of Ilera | — | — | 5,059 | — | 27,488 |
| Shares issued – private placement net of share issue costs | 21,992,009 | — | — | — | 97,110 |
| Issuance of convertible units | — | — | — | — | 614 |
| Warrants issued | — | — | — | — | (29,820) |
| Reallocation from warrants reserve | — | — | — | — | 13,701 |
| Reallocation from share-based payment reserve | — | — | — | — | 2,129 |
| Outstanding, December 31, 2019 | 66,563,322 | 38,890,571 | 75,417 | — | 259,892 |
| Shares issued – private placement net of share issue costs | 5,313,786 | — | — | 18,679 | 40,357 |
| Shares issued – stock option exercises | 470,002 | — | — | — | 620 |
| Shares issued – warrant exercises | 829,080 | — | — | — | 2,886 |
| Shares issued – compensation for services | 1,625,701 | — | — | — | 4,891 |
| Shares issued – conversion | (523,555) | — | 1,024 | (500) | — |
| Reallocation from share-based payment reserve | — | — | — | — | 1,133 |
| Outstanding, September 30, 2020 | 74,278,336 | 38,890,571 | 76,441 | 18,179 | 309,779 |

Private Placements

On December 30, 2019, the Company completed the first tranche of a private placement and issued 12,968,325 units at a price of \$2.45, each comprised of one common share and one common share purchase warrant, for total proceeds of \$31,772. The proceeds were collected in January 2020.

On January 10, 2020, the Company closed the second tranche of the non-brokered private placement announced on December 30, 2019, issuing 3,450,127 units at an issue price of \$2.45 per unit, resulting in proceeds of \$8,343, net of share issue costs of \$110. Each unit consists of one common share and one common share purchase warrant, exercisable into one common share prior to January 14, 2022 at an exercise price of \$3.25.

On January 27, 2020, the Company closed the third tranche of the non-brokered private placement announced on December 30, 2019, issuing 1,863,659 units at an issue price of \$2.45 per unit, resulting in proceeds of \$4,439, net of share issue costs of \$127. Each unit consists of one common share and one common share purchase warrant, exercisable into one common share prior to January 14, 2022 at an exercise price of \$3.25.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***13. Share capital and contributed surplus (continued)**

During the nine months ended September 30, 2020, the Company closed a non-brokered private placement, issuing 18,679 units at an issue price of US\$2,000 per unit, resulting in proceeds of \$52,005 (US\$37,358). Each unit consists of one non-voting Preferred Share and one Preferred Share Warrant. Each preferred share will be convertible to 1,000 common shares of the Company (or the economic equivalent in proportionate voting shares for U.S. investors) at the option of the holder, subject to customary anti-dilution provisions. If the Company completes a qualified financing for gross proceeds in excess of US\$30 million at a price that in the good faith determination of the Company's board of directors is less than the average price paid in the private placement, the Company's board of directors may increase the conversion ratio of the preferred shares to an amount that it considers equitable in the circumstances to provide equivalent value to participants in the private placement. This price protection will be in effect until May 22, 2021. Each warrant can be used to acquire one preferred share at an exercise price of US\$3,000, subject to customary anti-dilution provisions. Warrants have a term of 3 years and can be exercised cashless.

On issuance date the total proceeds were allocated as follows:

| Date of Issuance | Preferred Shares Units Issued | Preferred Shares Equity Component | Preferred Shares Liability | Preferred Shares Warrant Liability | Total Proceeds |
|-------------------------|--|--|---|---|---------------------------|
| 22-May-20 | 13,646 | \$ 20,672 | \$ 5,490 | \$ 12,087 | \$ 38,249 |
| 28-May-20 | 3,561 | 5,298 | 1,407 | 3,098 | 9,803 |
| 5-Jun-20 | 1,397 | 2,028 | 539 | 1,186 | 3,753 |
| 8-Jun-20 | 75 | 109 | 28 | 63 | 200 |
| Total | 18,679 | \$ 28,107 | \$ 7,464 | \$ 16,434 | \$ 52,005 |

The price protection derivative liability and warrant liability have been measured at fair value at issuance date and subsequently remeasured using a Monte Carlo simulation model and have been classified as Level 3 in the fair value hierarchy.

Note 21 *Financial Instruments and Risk Management* discloses changes in fair value of the preferred share derivative liability and warrant liability during the nine months ended September 30, 2020, as well as the key inputs and assumptions used in the Monte Carlo simulation model.

Transaction costs associated with the brokered preferred share issuance amounted to \$1,045 and have been allocated pro rata between the preferred share liability, preferred share warrant liability and share capital. Transaction costs allocated to the liability component was \$505 and immediately expensed and transaction costs related to the equity component was \$540 netted with share capital.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

13. Share capital and contributed surplus (continued)

Warrants reserve

The following is a summary of the outstanding warrants for Common Shares at September 30, 2020 and December 31, 2019.

| Number outstanding at September 30, 2020 | Number of Warrants Outstanding | Number of Warrants Exercisable | Issue Date | Expiry Date | Weighted Average Exercise Price \$ | Weighted Average Remaining Life (years) |
|---|---|---|-----------------------|------------------------|---|--|
| Issued in payment for services | 320,000 | 320,000 | 06/06/18 | 06/06/23 | 4.16 | 2.68 |
| Issued in payment for services | 70,000 | 70,000 | 08/09/18 | 08/09/23 | 4.25 | 2.86 |
| Issued in convertible debt | 333,723 | 333,723 | 10/02/19 | 10/02/24 | 6.49 | 4.01 |
| Issued in convertible debt | 120,027 | 120,027 | 11/06/19 | 11/06/24 | 6.49 | 4.10 |
| Issued in convertible debt | 66,880 | 66,880 | 11/26/19 | 11/26/24 | 6.49 | 4.16 |
| Issued during private placement | 12,639,245 | 12,639,245 | 12/30/19 | 01/14/22 | 3.25 | 1.29 |
| Issued during private placement | 3,200,127 | 3,200,127 | 01/10/20 | 01/14/22 | 3.25 | 1.29 |
| Issued during private placement | 1,863,659 | 1,863,659 | 01/27/20 | 01/14/22 | 3.25 | 1.29 |
| Issued in debt arrangement | 2,225,714 | — | 02/05/20 | 10/02/24 | 5.95 | 4.01 |
| Issued in debt arrangement | 15,656,242 | — | 03/11/20 | 03/10/30 | 5.14 | 9.45 |
| Issued in debt arrangement | 2,152,733 | — | 03/11/20 | 03/10/31 | 3.74 | 10.45 |
| | 38,648,350 | 18,613,661 | | | 4.25 | 5.31 |

| Number Outstanding at December 31, 2019 | Number of Warrants Outstanding | Number of Warrants Exercisable | Issue Date | Expiry Date | Weighted Average Exercise Price \$ | Weighted Average Remaining Life (years) |
|--|---|---|-----------------------|------------------------|---|--|
| Issued in payment for services | 320,000 | 160,000 | 06/06/18 | 06/06/23 | 4.16 | 3.43 |
| Issued in payment for services | 70,000 | 70,000 | 08/09/18 | 08/09/23 | 4.25 | 3.61 |
| Issued in convertible debt | 333,723 | 333,723 | 10/02/19 | 10/02/24 | 6.49 | 4.76 |
| Issued in convertible debt | 120,027 | 120,027 | 11/06/19 | 11/06/24 | 6.49 | 4.85 |
| Issued in convertible debt | 66,880 | 66,880 | 11/26/19 | 11/26/24 | 6.49 | 4.91 |
| Issued during private placement | 12,968,325 | 12,968,325 | 12/30/19 | 01/14/22 | 3.25 | 2.04 |
| | 13,878,955 | 13,718,955 | | | 3.40 | 2.18 |

The relative fair value of the warrants issued in connection with the Canopy Growth financing were determined using the residual value method and recorded as a reduction to contributed surplus.

The following is a summary of the outstanding warrants for Proportionate Voting Shares at September 30, 2020. These warrants are exercisable for 0.001 of a Proportionate Voting Share. The Proportionate Voting Shares are exchangeable into Common Shares on a basis of 1,000 Common Shares per Proportionate Voting Share.

| Number outstanding at September 30, 2020 | Number of Warrants Outstanding | Number of Warrants Exercisable | Issue Date | Expiry Date | Weighted Average Exercise Price \$ | Weighted Average Remaining Life (years) |
|---|---|---|-----------------------|------------------------|---|--|
| Issued as incentive compensation | 8,590,908 | 8,590,908 | 08/23/19 | 08/23/22 | 7.21 | 1.90 |
| | 8,590,908 | 8,590,908 | | | 7.21 | 1.90 |

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

13. Share capital and contributed surplus (continued)

The following is a summary of the outstanding warrants for Preferred Shares at September 30, 2020. These warrants are exercisable into 1 preferred share.

| Number outstanding at September 30, 2020 | Number of Warrants Outstanding | Number of Warrants Exercisable | Issue Date | Expiry Date | Weighted Average Exercise Price USD\$ | Weighted Average Remaining Life (years) |
|---|---|---|-----------------------|------------------------|--|--|
| Issued during private placement | 13,646 | 13,646 | 05/22/20 | 05/22/23 | 3,000 | 2.64 |
| Issued during private placement | 3,311 | 3,311 | 05/28/20 | 05/28/23 | 3,000 | 2.66 |
| Issued during private placement | 1,397 | 1,397 | 06/05/20 | 06/05/23 | 3,000 | 2.68 |
| Issued during private placement | 75 | 75 | 06/08/20 | 06/08/23 | 3,000 | 2.69 |
| | 18,429 | 18,429 | | | 3,000 | 2.65 |

Share-based payments

On March 25, 2020, the Company issued 1,625,701 common shares to Regulatory Consulting Group Inc., an entity controlled by the minority shareholders of NJ, pursuant to a success fee surrounding the granting of certain licenses in the state of New Jersey to NJ. The issuance of these shares resulted in the Company capitalizing licensing costs of \$4,890.

Restricted Share Units

The Company's Share Unit Plan effective November 19, 2019 (the "Share Unit Plan") provides for the granting of performance share units (PSUs) and restricted share units (RSUs) to directors, officers, employees, and consultants of the Company. The PSUs generally become vested upon attainment of established performance conditions, as well as service conditions. The RSUs generally become vested upon completion of continuous employment with the Company. During the nine months ended September 30, 2020, the Company granted 155,283 RSUs, which vested on the grant date and recognized the grant date fair value of \$474 as a share-based payment expense.

Stock Options

The Company's Stock Option Plan (the "Plan") provides for the granting of stock options to directors, officers, employees, and consultants of the Company. Share options are granted for a term not to exceed ten years at an exercise price which is the greater of the closing market price of the shares on the CSE on the trading day immediately preceding the date the options are granted and on the same day of the option grant, in accordance with CSE policy. The options are not transferrable. The Plan is administered by the Board of Directors, which determines individual eligibility under the Plan, number of shares reserved for optioning to each individual (not to exceed 5% of issued and outstanding shares to any one individual) and the vesting period. The maximum number of shares of the Company that are issuable pursuant to the Plan is limited to 10% of the issued and outstanding shares of the Company at the date of the grant of options.

The stock options outstanding noted below consist of service-based options granted to employees to purchase common stock, the majority of which vest over a one to three-year period and have a five to ten-year contractual term. These awards are subject to the risk of forfeiture until vested by virtue of continued employment or service to the Company.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

13. Share capital and contributed surplus (continued)

The fair value of the various stock options granted during the nine months ended September 30, 2020 were estimated using the Black-Scholes option pricing model with the following weighted average assumptions: Stock price volatility – 83% (September 30, 2019 – 93%); Risk-free interest rate – 0.35% (September 30, 2019 – 1.29% to 1.96%); Dividend yield – 0% (September 30, 2019 – 0%); Forfeiture rate – 26.1% (September 30, 2019 – 26.5%); and Expected lives – 4.78 years to 5.31 years (September 30, 2019 – 5 years). The expected volatility of the Company's equity instruments was estimated based on the historical volatility.

The following is a summary of the changes in the Company's options for the nine months ended September 30, 2020, and year ended December 31, 2019.

| | Number of Options | Weighted Average Remaining Life in Years | Weighted Average Exercise Price \$ | Number of options Exercisable |
|--|----------------------|--|---|-------------------------------------|
| Balance Outstanding at December 31, 2018 | 8,473,129 | 5.88 | 4.28 | 1,480,189 |
| Options Granted | 6,844,000 | N/A | 6.69 | N/A |
| Options Exercised | (1,117,936) | N/A | 2.45 | N/A |
| Options Forfeited/Cancelled | (3,706,178) | N/A | 5.71 | N/A |
| Balance Outstanding at December 31, 2019 | 10,493,015 | 4.04 | 5.53 | 2,443,578 |
| Options Granted | 11,869,050 | N/A | 3.39 | N/A |
| Options Exercised | (470,002) | N/A | 1.32 | N/A |
| Options Forfeited/Cancelled | (3,868,598) | N/A | 5.56 | N/A |
| Balance Outstanding at September 30, 2020 | 18,023,465 | 4.17 | 4.22 | 3,409,134 |

Contributed surplus

The Company's contributed surplus balances include the following:

| | Warrants reserve | Share-based payments reserve | Contributed surplus | Total |
|--|---------------------|------------------------------------|------------------------|---------------|
| Outstanding, December 31, 2018 | 14,335 | 7,849 | — | 22,184 |
| Share-based compensation expense | 587 | 12,236 | — | 12,823 |
| Warrant and stock option exercise | (13,701) | (2,129) | — | (15,830) |
| Private placement | 1,298 | — | — | 1,298 |
| Issuance of proportionate voting warrants | 29,820 | — | — | 29,820 |
| Issuance of convertible units | 863 | — | 4,005 | 4,868 |
| Warrants expired | (2) | — | — | (2) |
| Options expired/forfeited | — | (384) | — | (384) |
| Outstanding, December 31, 2019 | 33,200 | 17,572 | 4,005 | 54,777 |
| Share-based compensation expense | 121 | 10,843 | — | 10,964 |
| Warrant and stock option exercise | (33) | (485) | — | (518) |
| Issuance of warrants | 19,878 | — | — | 19,878 |
| Reallocation on Canopy Rivers convertible debt amendment | 3,781 | — | (3,781) | — |
| Options expired/forfeited | — | (4,216) | — | (4,216) |
| Outstanding, September 30, 2020 | 56,947 | 23,714 | 224 | 80,885 |

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

14. Related parties

- (a) Key management includes directors and officers of the Company. Total compensation, comprised of salaries and share-based payments, awarded to key management for the nine months ended September 30, 2020 and September 30, 2019 respectively were as follows:

| | September 30, 2020 | September 30, 2019 |
|----------------------|-----------------------|-----------------------|
| Salaries and wages | \$ 1,895 | \$ 982 |
| Share-based payments | 5,685 | 5,141 |
| Total | \$ 7,580 | \$ 6,123 |

- (b) During the nine months ended September 30, 2020, the Company had cannabis sales of \$nil (September 30, 2019 - \$7,116) to Canopy Growth and other income of \$11 (September 30, 2019 - \$6) related to patient referral fees. During the nine months ended September 30, 2020, the Company and Canopy Growth exchanged cannabis products resulting in a cost of goods sold impact of \$326. There are no amounts payable or receivable to or from Canopy Growth at September 30, 2020 or December 31, 2019.
- (c) On March 25, 2020, the Company issued 1,625,701 common shares to Regulatory Consulting Group Inc., an entity controlled by the minority shareholders of NJ, pursuant to a success fee surrounding the granting of certain licenses in the state of New Jersey to NJ (Note 9).
- (d) Refer to note 10 for discussion regarding related party loans balances.

15. Income taxes

The reconciliation of the combined Canadian and U.S. federal and provincial and state corporate income taxes, and to the Company's effective income tax expenses is as follows:

| | September 30, 2020 | September 30, 2019 |
|---|-----------------------|-----------------------|
| Loss before income tax | \$ (28,203) | \$ (51,166) |
| Statutory tax rate | 26.5% | 26.5% |
| Expected income tax recovery | (7,474) | (13,559) |
| Effect on income taxes of deductible & non-deductible adjustments | | |
| IRC 280E adjustment | 10,647 | 600 |
| Transaction costs and legal fees adjustment | 296 | — |
| IFRIC 23 uncertain tax position | (3,889) | 762 |
| Foreign income taxes at different statutory rate | 4,760 | (34) |
| Net increase in fair value of warrant and derivative liabilities | 5,876 | — |
| Loss on revaluation of contingent consideration | 5,263 | — |
| Share based compensation and non-deductible expenses | 2,636 | 3,072 |
| Changes in tax benefits not recognized | (1,268) | 4,964 |
| Other adjustments | (11) | 176 |
| Income tax expense (recovery) | \$ 16,836 | \$ (4,019) |

The Company's income tax expense (recovery) is allocated as follows:

| | | |
|--------------------------------------|------------------|-------------------|
| Current tax expense | \$ 18,411 | \$ (889) |
| Deferred tax expense (recovery) | (1,575) | (3,130) |
| Income tax expense (recovery) | \$ 16,836 | \$ (4,019) |

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

15. Income taxes (continued)

The Company's combined Canadian federal and provincial statutory rates are 26.5% (December 31, 2019 – 26.5%)

As many of the Company's U.S. subsidiaries operate in the cannabis industry and are subject to the limitations of IRC Section 280E explained below, the impact results in a permanent tax difference as a disallowed tax deduction. Therefore, the U.S. effective tax rate can be highly variable and may not necessarily correlate with pre-tax income or loss due to the material impact of Section 280E. The Company's provision for income taxes for the nine months ended September 30, 2020 was reduced by a \$3,283 recovery resulting from an expiration of the statute of limitations to assess tax.

The Company's current tax liability of \$30,895 as of September 30, 2020 (December 31, 2019 – \$21,276) includes a liability related to a tax matter arising from application of United States Internal Revenue Code ("IRC") Section 280E to the Apothecarium. Under Section 280E, all ordinary and necessary business deductions are disallowed if the taxpayer's trade or business is "trafficking" in a Schedule I or II Controlled Substance under the Controlled Substances Act. Cannabis remains a Schedule I controlled substance. While the Internal Revenue Service (the "IRS") accepted that the figures on the filed tax returns were substantiated and accurate, it nevertheless sought a complete disallowance of certain expenses under Section 280E for income tax returns for the fiscal years ended September 30, 2014 and September 30, 2015. Through deficiency notices, the IRS asserted that the Apothecarium is liable for a tax deficiency for each of these tax years as well as negligence penalties pursuant to IRC Section 6662(d). The Company disagreed with the IRS assertion and filed a petition with the US Tax Court contesting the IRS's findings and challenging its calculations regarding the disallowed deductions. While the Company cannot predict the outcome and timing of the case at this time, it has recorded a liability of \$16,745 related to the years covered by the tax deficiency notices and certain other years, at September 30, 2020 (December 31, 2019- \$19,261). On the acquisition of the Apothecarium, the seller set aside cash in an escrow account to be used on future tax indemnifications. As of September 30, 2020, an indemnification asset of \$15,340 has been recorded on the statement of financial position (December 31, 2019 – \$14,936).

16. General and administrative expenses

The Company's general and administrative expenses for the nine months ended September 30, 2020, and 2019 are as follows:

| | For the three months ended | | For the nine months ended | |
|---------------------|----------------------------|-----------------------|---------------------------|-----------------------|
| | September 30, 2020 | September 30, 2019 | September 30, 2020 | September 30, 2019 |
| Office and general | \$ 3,028 | \$ 2,180 | \$ 11,312 | \$ 6,583 |
| Professional fees | 2,150 | 877 | 5,627 | 4,980 |
| Occupancy costs | 685 | 728 | 2,257 | 937 |
| Salaries and wages | 6,954 | 7,111 | 22,321 | 15,340 |
| Sales and marketing | 919 | 1,291 | 2,525 | 3,736 |
| Total | \$ 13,736 | \$ 12,187 | \$ 44,042 | \$ 31,576 |

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***17. Revenue**

The Company's disaggregated revenue by source, primarily due to the Company's contracts with its external customers for the nine months ended September 30, 2020, and 2019 are as follows:

| | For the three months ended | | For the nine months ended | |
|-----------------------|-----------------------------------|----------------------|----------------------------------|----------------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2020 | 2019 | 2020 | 2019 |
| Branded manufacturing | \$ 34,004 | \$ 17,705 | \$ 94,089 | 47,281 |
| Retail | 16,964 | 9,126 | 38,907 | 11,704 |
| Total | \$ 50,968 | \$ 26,831 | \$ 132,996 | 58,985 |

18. Segment disclosure

The Company has one operating segment, being the cultivation and sale of cannabis, with subsidiaries located in Canada and the United States. The information about these geographical areas is presented below.

| | Canada | United States | Total |
|--|---------------|----------------------|--------------|
| At September 30, 2020 | | | |
| Current assets | \$ 28,715 | \$ 82,550 | \$ 111,265 |
| Non-current assets | 43,389 | 402,497 | 445,886 |
| Current liabilities | 12,149 | 241,783 | 253,932 |
| Non-current liabilities | 120,849 | 74,629 | 195,478 |
| For the nine months ended September 30, 2020 | | | |
| Sales, net | \$ 14,908 | \$ 118,088 | \$ 132,996 |
| Gross profit (loss) before gain on fair value of biological assets | (2,572) | 74,670 | 72,098 |
| Gross profit (loss) | (2,588) | 91,994 | 89,406 |
| Income (loss) from operations | (23,426) | 50,624 | 27,198 |
| Net income (loss) attributable to controlling interest | (43,730) | 876 | (42,854) |

For the nine months ended September 30, 2020 and 2019, the Company did not have any single customer that accounted for 10% or more of the Company's revenues.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***19. Supplemental cash flow information**

The changes in working capital items during the nine months ended September 30, 2020, and 2019 are as follows:

| | For the nine months ended | |
|--|---------------------------|--------------------|
| | September 30, 2020 | September 30, 2019 |
| Receivables | \$ (1,177) | \$ (9,634) |
| Inventory | (8,567) | (7,278) |
| Prepaid expenses and deposits | 408 | (5,061) |
| Deferred tax asset | — | 22 |
| Other asset | (1,789) | — |
| Accounts payable and accrued liabilities | (4,850) | 5,006 |
| Other liability | — | 352 |
| Deferred revenue | (419) | 363 |
| | \$ (16,394) | \$ (16,230) |

20. Capital management and restricted cash

The Company's objective in managing capital is to ensure a sufficient liquidity position to safeguard the Company's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders. In order to achieve this objective, the Company prepares a capital budget to manage its capital structure. The Company defines capital as borrowings, equity comprised of issued share capital, share-based payments, accumulated deficit, as well as funds borrowed from related parties.

Since inception, the Company has primarily financed its liquidity needs through the issuance of share capital and debentures. The equity issuances are outlined in note 13 and debt issuances are outlined in note 10. Under the terms of the Canopy Growth Financing agreement, \$4,517 of the proceeds received is restricted for use in Canadian operations and is held in a segregated bank account.

There have been no changes to the Company's objectives pertaining to capital management during the nine months ended September 30, 2020 or during the year ended December 31, 2019. The Company is not subject to externally imposed capital requirements.

21. Financial instruments and risk managementFinancial instrumentsFair value hierarchy

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance of inputs used in making the measurements. The hierarchy is summarized as follows:

Level 1 – quoted prices (unadjusted) in active markets for identical assets and liabilities

Level 2 – inputs that are observable for the asset or liability, either directly (prices) or indirectly (derived from prices) from observable market data

Level 3 – inputs for assets and liabilities not based upon observable market data

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

21. Financial instruments and risk management (continued)

The following table shows the carrying amounts and fair values of financial assets and financial liabilities, including their levels in the fair value hierarchy.

| | Measurement basis | | | Fair value hierarchy |
|--|------------------------------------|---|-----------------------------------|----------------------|
| | Financial assets at amortized cost | Financial liabilities at amortized cost | Fair value through profit or loss | Level 3 |
| Fair value of assets | | | | |
| Cash and cash equivalents | 40,834 | — | — | — |
| Restricted cash | 4,517 | — | — | — |
| Receivables, net of sales returns and allowances | 10,229 | — | — | — |
| Share subscription receivable | 1,003 | — | — | — |
| Lease receivable | 1,921 | — | — | — |
| Fair value of liabilities | | | | |
| Accounts payable and accrued liabilities | — | 26,400 | — | — |
| Corporate income tax payable | — | 30,895 | — | — |
| Loans payable | — | 75,259 | — | — |
| Lease liability | — | 32,666 | — | — |
| Convertible debentures | — | 5,098 | — | — |
| Preferred share liability | — | — | 101 | 101 |
| Warrant liability | — | — | 45,356 | 45,356 |
| Contingent consideration payable | — | — | 199,630 | 199,630 |

There have not been any transfers between the levels of fair value hierarchy during the nine months ended September 30, 2020

The carrying values of financial assets and liabilities measured at amortized cost approximate their fair values due to their short periods to maturity.

Fair Value of Warrant and Derivative Liabilities

The preferred share derivative liability and warrant liability have been remeasured to fair value at September 30, 2020 using a Monte Carlo simulation model, resulting in the \$7,364 decrease in the fair value of the preferred share derivative liability and the \$29,537 increase in the warrant liability, with net increase in fair value of warrant and derivative liabilities of \$22,173 loss, including effects of the foreign exchange of the USD denominated Preferred Shares and Preferred Share Warrants described in the Note 13 *Share Capital and Contributed Surplus*. The fair value of preferred share derivative liability decreased largely due to the increase in the Company's share price at September 30, 2020 making it less likely that the Company's next round of financing would be priced lower than the preferred share and warrant private placement and thus, making it less likely that the price protection feature would be invoked. The fair value of warrant liability increased largely due to increase in the Company's share price making preferred share warrants more valuable.

Key inputs and assumptions used in the Monte Carlo simulation valuation model, as compared with the original inputs and assumptions used at the private placement dates is summarized below:

Notes to the Unaudited Condensed Interim Consolidated Financial Statements*For the three and nine months ended September 30, 2020 and 2019**(Amounts expressed in thousands of Canadian dollars, except for per share amounts)***21. Financial instruments and risk management (continued)**

| | May 22, 2020 | September 30, 2020 |
|---|--------------|--------------------|
| Common stock price of TerrAscend Corp.* | \$2.10 | \$5.77 |
| Unit issue price | USD\$ 2000 | USD\$ 2000 |
| Warrant exercise price | USD\$ 3000 | USD\$ 3000 |
| Initial conversion ratio | 1,000 | 1,000 |
| Annual volatility | 76.8% | 71.3% |
| Annual risk-free rate | 0.2% | 0.2% |
| Expected term | 3 year | 2.6 year |
| Early qualified financing probability | 80.0% | 80.0% |
| Late qualified financing probability | 20.0% | 20.0% |

*May 22, 2020 fair value input was based on the weighted-average closing price for the Company's common stock, based on all issuance dates for the Units described in Note 13 *Share Capital and Contributed Surplus*.

Contingent Consideration Payable

Note 5 *Acquisitions* describes the nature of contingent consideration liabilities. The fair value of contingent consideration at September 30, 2020 was determined using a probability weighted model based on the likelihood of achieving certain revenue and EBITDA scenario outcomes. A discount rate range of 11.8% to 13.69% (December 31, 2019 – 11.8%) was utilized to determine the present value of the liabilities, resulting in a loss on revaluation of contingent consideration of \$19,861 for the nine months ended September 30, 2020.

The illustrative variance of the total contingent consideration at September 30, 2020 based on a range of discount rates is outlined in the following table:

| <u>Discount rate sensitivity</u> | <u>Implied value of contingent consideration</u> | | |
|----------------------------------|--|--------------|--------------|
| | <u>Apothecarium</u> | <u>Ilera</u> | <u>Total</u> |
| Increase 100 basis points | \$13,939 | \$184,586 | \$198,525 |
| Increase 50 basis points | 14,110 | 184,958 | 199,068 |
| Decrease 50 basis points | 14,483 | 185,710 | 200,193 |
| Decrease 100 basis points | 14,669 | 186,089 | 200,758 |

Financial risk factors

The financial risk factors significant to the Company's condensed interim financial statements are consistent with those disclosed in the notes to the annual consolidated financial statements for the year ended December 31, 2019.

Notes to the Unaudited Condensed Interim Consolidated Financial Statements
For the three and nine months ended September 30, 2020 and 2019
(Amounts expressed in thousands of Canadian dollars, except for per share amounts)

22. Commitments and contingencies

On October 15, 2018, the Company's wholly owned subsidiary TerrAscend Canada entered into a multi-year cultivation agreement (the "PharmHouse Agreement") with PharmHouse Inc. ("PharmHouse"), a joint venture between Canopy Rivers Inc. and 2615975 Ontario Inc., the operators of a leading North American greenhouse produce company ("261"). Under the terms of the PharmHouse Agreement, it was expected that PharmHouse would grow and supply cannabis to TerrAscend Canada from its existing 1.3 million square foot greenhouse located in Leamington, Ontario. Once fully licensed, the production of flower, trim and clones from up to 20% of the dedicated flowering space planted at the greenhouse was expected to be made available to TerrAscend Canada. To date, PharmHouse has not yet delivered product in accordance with the terms of the PharmHouse Agreement. On September 11, 2020, the Company and TerrAscend Canada were informed that a statement of claim was issued on August 31, 2020 in the Ontario Superior Court of Justice by 261 against Canopy Rivers Inc., Canopy Growth Corporation, the Company and TerrAscend Canada (the "261 Claim"). In the 261 Claim, 261 seeks damages from the defendants in the amount of \$500,000 and alleges certain causes of action, including bad faith, fraud, civil conspiracy, breach of the duty of honesty and good faith in contractual relations and breach of fiduciary duty. The 261 Claim, as against the Company and TerrAscend Canada, is completely baseless and without merit, and the Company will vigorously defend itself, if necessary, in the appropriate forum. On September 16, 2020, PharmHouse obtained an order from the Ontario Superior Court of Justice granting PharmHouse creditor protection under the Companies' Creditors Arrangement Act ("CCAA"). Pursuant to the CCAA order, the 261 Claim has been stayed. Notwithstanding the 261 Claim and the CCAA order, TerrAscend Canada continues to be engaged in good faith negotiations with PharmHouse regarding the terms of the PharmHouse Agreement.

On October 20, 2018, Investments International Inc. ("Investments") signed a lease agreement with the Company and its wholly owned subsidiaries, 2627685 Ontario Inc. and 2151924 Alberta Inc. On February 8, 2019, Investments filed a statement of claim under the Court of Alberta against the Company and its wholly owned subsidiaries, for breach of the lease agreement. The amount claimed is \$2,764 plus interest from and after the termination date of an unexecuted lease. The Company has paid initial lease deposits in addition to submitting a statement of defence. The Company does not expect the claim to have a material adverse impact on the Company and no amount has been accrued in the condensed interim consolidated statements of loss.

23. Subsequent events

On November 2, 2020, the Company announced the appointment of Ed Schutter to its Board of Directors.

On November 6, 2020, the Company announced the signing of a definitive agreement to acquire HMS Health, LLC and HMS Processing, LLC (collectively "HMS") from Curaleaf Holdings, Inc. HMS is a cultivator and processor of medical cannabis products in the state of Maryland. TerrAscend has agreed to acquire 100% of the equity of HMS from Curaleaf for a total consideration of \$27,500, comprised of \$25,000 in cash and a \$2,500 note which bears 5.0% annual interest, due April 2022. Upon closing in the first quarter of 2021, 100% of HMS' economics will be retained by TerrAscend through full ownership of HMS Health, LLC and a master services agreement with HMS Processing, LLC. The transfer of 100% equity of HMS Processing is expected to close in April 2022. The Company made an initial deposit of \$1,334 (\$1,000 USD) during September 2020.

On November 6, 2020, the Company made a payment to the sellers of Ilera in the amount of \$6,520 (US\$5,000), reducing the final amount due.