



MANAGEMENT'S DISCUSSION AND ANALYSIS

DionyMed Brands Inc.

For the three and six months ended June 30, 2019

Dated as of August 29, 2019

This Management's Discussion and Analysis ("MD&A"), dated August 29, 2019 has been prepared with all information available up to and including August 29, 2019. This MD&A reports on the financial condition and results of operations of DionyMed Brands Inc. ("DionyMed Brands", "DYME" or the "Company") for the three and six months ended June 30, 2019. This MD&A should be read in conjunction with the Company's unaudited condensed interim consolidated financial statements and accompanying notes as at and for the three and six months ended June 30, 2019 the ("Financial Statements"), and the Company's audited consolidated financial statements and accompanying notes and MD&A for the fiscal period from March 1, 2018 to December 31, 2018. The Company prepares its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board.

The Company's financial statements and other disclosure documents, including the Company's Annual Information Form for the period ended December 31, 2018, dated May 30, 2019, are available on the System for Electronic Document Analysis and Retrieval ("SEDAR") under the Company's issuer profile at www.sedar.com and on the Company's website at www.dionymed.com. The subordinate voting shares ("Common Shares") of the Company are listed for trading on the Canadian Securities Exchange ("CSE") under the symbol "DYME", and on the OTCQB Venture Market under the symbol "DYMEF".

Unless otherwise indicated, all financial information in this MD&A is reported in United States dollars ("\$" or "US\$"), except per share amounts or as otherwise indicated. Certain totals, subtotals and percentages may not reconcile due to rounding. This MD&A was prepared with reference to National Instrument 51-102 – *Continuous Disclosure Obligations* of the Canadian Securities Administrators.

This MD&A contains certain "forward-looking statements" and certain "forward-looking information" as defined under applicable United States securities laws and Canadian securities laws. Please refer to the discussion of forward-looking statements and information set out under "Cautionary Note Regarding Forward-Looking Statements". As a result of many factors, the Company's actual results may differ materially from those anticipated in these forward-looking statements and information.

CAUTIONARY NOTE REGARDING CERTAIN MEASURES OF PERFORMANCE

This MD&A presents certain measures that are not recognized measures and do not have any standardized meaning under IFRS. This data may not be comparable to data presented by other entities. The Company presents adjusted earnings before interest, taxes, depreciation and amortization ("Adjusted EBITDA"). For a reconciliation of Adjusted EBITDA to the most directly comparable financial information presented in the Financial Statements prepared in accordance with IFRS, see "Adjusted EBITDA" in this MD&A. In addition, although based on contractual arrangements with certain customers the Company only recognizes the service fees of the product processed through its distribution network, the Company presents the value of products processed through the Company in the discussion of financial results in this MD&A.

The Company believes that Adjusted EBITDA and value of products processed are realistic indicators of operating performance and is useful in performing year-over-year comparisons. However, these non-IFRS financial measure should be viewed as a supplement to, and not a substitute for, the Company's results of operations reported under IFRS.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This MD&A contains certain "forward-looking information" and "forward-looking statements" within the meaning of applicable Canadian securities laws and United States securities laws, concerning the business, operations and financial performance and condition of the Company. Forward-looking information includes, but is not limited to, statements relating to:

- the Company's expectations regarding legislation, regulations and licensing related to the cannabis market and products;
- the future size of, or future growth rate of, any particular market or market segment;
- the ability to enter and participate in international market opportunities;
- the Company's expectations with respect to the Company's future financial and operating performance;
- the Company's expectations with respect to future performance, the Company's business plan, results and terms of strategic initiatives, and strategic agreements;
- future corporate development, including the items set out in the "Outlook" section;
- expectations with respect to future expenditures and capital activities; and
- statements about expected use of proceeds from fundraising activities.

Generally, this forward-looking information can be identified by the use of words such as “plans”, “expects”, “is expected”, “budget”, “scheduled”, “estimates”, “forecasts”, “intends”, “anticipates”, or “believes” or variations (including negative variations) of such words and phrases, or statements that certain actions, events, or results “may”, “could”, “would”, “might”, or “will” be “taken”, “occur” or “be achieved”. Forward-looking information is based on the reasonable assumptions, estimates, internal and external analysis, and opinions of management made in light of its experience and perception of trends, current conditions, and expected developments, as well as other factors that management believes to be relevant and reasonable at the date that such statements are made; including, but not limited to: the ability to complete the transaction with Pioneer Valley Extracts, LLC on favorable terms or at all, the ability to leverage the strategic partnership with Acres Cannabis in order to access the Nevada market, expansion of Direct-to -Consumer sales following the acquisition of MMAC, the ability to draw future commitments under the Inventory Finance Facility, the ability to make repayments under the Inventory Finance Facility, the ability to exercise the option to acquire Waterside on favorable terms or at all, the ability to acquire Virginia’s Kitchen, LLC dba Blue Kudu on favorable terms or at all, the completion of amendments to logistics and distribution services contracts on terms described herein or at all, the market for home delivery maintaining the same level of growth in California, the Company being able to obtain profits from Hometown Heart under the management services agreement, the revenue from Hometown Heart continuing on its current trajectory, Hometown Heart maintaining its market share in the cannabis industry in California, successfully growing its brand portfolio, the Chill platform continuing to grow, the Company maintaining its market share in the cannabis industry in which it operates, the Company’s expectations for initiatives in U.S. markets outside of those already within the Company’s platform, the Company’s expectations with respect to raising additional capital, improving its balance sheet and working capital, adding more high margin sales into its revenue mix and the Company’s ability to continue as a going concern. Forward-looking information involves known and unknown risks, uncertainties, assumptions and other factors that may cause actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking information. Such factors include, but are not limited to, the factors discussed in the section entitled “Risks Factors” herein and in the Canadian Securities Exchange Listing Statement in respect of the listing of the Company’s subordinate voting shares filed on the Company’s profile on SEDAR. Although the Company has attempted to identify important factors that could cause actions, events or results to differ materially from those described in the forward-looking information, there may be other factors that cause actions, events, or results to differ from those anticipated, estimated, or intended. There can be no assurance that forward-looking information will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on the forward-looking information. Forward-looking information contained herein is given as of the date of the MD&A. The Company does not undertake to update any forward-looking information, whether as a result of new information, future events or otherwise, except as required by applicable securities laws.



CANNABIS BRANDS AT SCALE

GENERAL

Overview and History

DionyMed Brands Inc. (“**DionyMed Brands**”) is a corporation existing under the *Business Corporations Act* (British Columbia). DionyMed Brands and its subsidiaries (“**DionyMed Group**” or “**DionyMed**” or the “**Company**”) operate a multi-state, cannabis brands, distribution and direct-to-consumer delivery platform. The Company is a vertically integrated operator of licensed cannabis branding, cultivation, manufacturing and distribution of cannabis products in the United States. DionyMed Brands is currently licensed to produce and sell medicinal and adult-use cannabis products under the laws of the State of California and Oregon.

DionyMed has two primary revenue streams: Distribution and Direct-to-Consumer. DionyMed generates Distribution revenue by selling a portfolio of wholly-owned and third-party brands to over 800 retail dispensaries in California, Oregon and Nevada. DionyMed generates Direct-to-Consumer revenue by selling products online and delivering directly to customers through its website Chill (www.orderchill.com), as well as provides fulfillment services on behalf of other partner websites. Chill includes both wholly-owned and third-party products.

The Company’s subordinate voting shares are listed under the symbol “DYME” on the Canadian Securities Exchange (“CSE”) and under the symbol “DYMEF” on the OTCQX, part of the OTC Markets Group.

DionyMed Brand’s subordinate voting shares are listed under the symbol “DYME” on the Canadian Securities Exchange (“CSE”) and under the symbol “DYMEF” on the OTCQB, part of the OTC Markets Group. DionyMed Brand’s registered head office is 2200, 885 West Georgia Street, Vancouver, British Columbia V6C 2G2 Canada.

As used herein, “DionyMed Group,” “we,” “our,” and similar terms include DionyMed Brands and its subsidiaries, unless the context indicates otherwise.

Q2 2019 Growth and Operational Highlights

Expansion of Sales Distribution Channels for Wholly-Owned and Third-Party Brands in California and Oregon

During the quarter ended June 30, 2019, the Company continued expanding its sales distribution channels in California and Oregon. In California, DionyMed delivered or sold products to 441 out of 624 active retail dispensaries. In Oregon, DionyMed delivered or sold products to 387 out of over 600 active retail dispensaries.

In addition, DionyMed continued to expand its third-party distribution platform with an exclusive distribution agreement with CBD Alive to expand the Company’s award-winning cannabis brand portfolio with one of California’s highest-quality, premium CBD product lines.

Grown exclusively in natural sunlight, using organic, sustainable farming practices in California, CBD Alive products are all based on full-spectrum oil and are available in varying ratios that appeal to multiple consumer segments for a variety of uses. The product line, with over 40 products, is available in drops, capsules, topicals and raw oil.

Termination of Hometown Heart’s Relationship with Eaze

On March 29, 2019, Hometown Heart, a licensed California delivery service managed by DionyMed, terminated its relationship with customer acquisition provider Eaze Technologies, Inc., formerly Eaze Solutions, Inc. (“**Eaze**”). Following a review of certain of Eaze’s business practices, the Company was unable to confirm that Eaze’s credit card payment processing methodology met regulatory compliance requirements.

On June 4, 2019 Herban Industries CA LLC (“Herban”), a wholly-owned subsidiary of DionyMed filed suit in the California Superior Court for the County of San Francisco against Eaze seeking an injunction to halt Eaze’s processing of credit and debit cards through its website and app.

Expansion of Chill

Since terminating the Eaze relationship, the Company is focusing its efforts on scaling its online delivery platform, Chill, through aggressive marketing and customer acquisition. Since the Company began to actively market Chill in early April 2019, the Company has increased gross sales to \$855,000 per month as of June 2019, representing an annual run-rate of \$10.3 million. Revenues generated through Chill are also currently generating improved contribution margins relative to revenues earned under the Eaze relationship. The Company expects to launch chill in Southern California in early 4Q 2019, which will more than double the addressable market. Equity Bought Deal Private Placement

On May 7, 2019, the Company closed a bought deal private placement financing with a syndicate of agents co-led by Canaccord Genuity Corp. and Cormark Securities Inc. for 3,822,055 units of the Company at a price of C\$2.75 per Unit (the “Issue Price”) for aggregate gross proceeds to the Company of \$7,148,824. Each unit was comprised of one subordinate voting share and one subordinate voting share purchase warrant exercisable into one subordinate voting share at price of C\$3.80 per share for a period of 36 months following the closing of the offering. The net proceeds from the Offering were used primarily towards the Company’s strategic growth initiatives and for general working capital purposes.

Investment Agreement with Alumina Partners

On June 5, 2019, the Company announced a capital commitment from Alumina Partners (Ontario) Ltd. (“Alumina”) for up to CAD\$32,000,000 on a private placement basis completed in tranches over a 24-month period. The issuance of subordinate voting shares and warrants in each tranche is referred to herein as a unit (each a “Unit” and collectively, the “Units”). Each Unit shall be comprised of one (1) subordinate voting share and one-half of one (1/2) warrant.

Following the initial subscription, the Company may request that Alumina subscribe for subsequent tranches a minimum of five trading days following the issuance of the previous tranche.

The purchase price for a Unit in each tranche will be a discount of 15% to 20% to the market price of the subordinate voting shares, or such lesser discount as dictated policies of the CSE. The market price of the subordinate voting shares for each tranche will be defined as the price per subordinate voting share formally protected and reserved by the Company’s filing of a CSE Form 9. Alumina is not required to close a tranche if the closing price of the subordinate voting shares on the CSE determined as of the close of trading on the trading day prior to the closing date is below the market price in the Form 9 corresponding to such tranche, subject to investor waiver.

At the closing of each tranche, the Company shall issue Alumina an amount of subordinate voting share purchase warrants equal to one-half of the subordinate voting shares subscribed for by Alumina in connection with that tranche. Each such warrant will permit Alumina to acquire one subordinate voting share for five years from the date of closing the tranche, subject to a four month hold period from the date the warrants are issued. The exercise price of each warrant for each tranche is set at a 50% premium to the market price for the corresponding tranche.

As of June 30, 2019, the Company had completed one tranche of 662,252 Units for gross proceeds of \$753,750.

Growth and Operational Highlights Subsequent to Q2 2019

Acquisition of 1.83 Acre California Cannabis Campus from MMAC

On July 24, 2019, the Company closed the acquisition of certain assets from MMAC including 1.83-acre Los Angeles cannabis campus, retail, distribution, manufacturing and cultivation licenses, and a dispensary attached to the property for the purchase price of \$13,067,000 in cash and \$6 million in the Company’s series A shares.

In conjunction with the close of the MMAC transaction, the Company entered into an agreement to sell the Los Angeles cannabis campus to Innovative Industrial Properties, Inc. (“IIPR”) for \$13 million and lease back the Los Angeles cannabis campus through a 15-year lease

with two optional 5-year extensions. IIPR is also providing the Company up to \$2 million of capital to make improvements at the property.

The Los Angeles cannabis campus provides DionyMed:

- A market leading, Southern California direct-to-consumer fulfillment center capable of supporting up to 600 cannabis delivery drivers
- A dispensary storefront, distribution facility and manufacturing hub
- Premium indoor cultivation
- All property, leaseholds, equipment and licenses

Amendment to Inventory Finance Facility Agreement

On January 17, 2019, the Company signed a definitive agreement (the “**Inventory Finance Facility Agreement**”) for a two-year, up to \$40 million senior secured credit facility from certain investors (the “**Inventory Finance Facility**”). The Inventory Finance Facility consists of a \$15 million term loan facility and a \$25 million asset-backed loan facility. Pursuant to an amendment to the Inventory Finance Facility Agreement dated as of January 16, 2019, in July 2019, the lenders under the Inventory Finance Facility provided an additional advance of \$2 million bringing the total principal balance outstanding to \$15 million. In consideration for the lenders agreeing to enter into the amendment, the Company issued: (i) 986,853 warrants to purchase subordinate voting shares of the Company to the Marin Finance Fund LP with an exercise price of CAD\$1.65 per subordinate voting share until June 28, 2022; (ii) 563,318 warrants to purchase subordinate voting shares to the current lenders at an exercise price of CAD\$1.80 per subordinate voting share until June 28, 2022.

Issuance of \$2 Million Secured Convertible Notes to Gotham Green Partners (“GGP”)

On August 1, 2019, the Company issued an aggregate of \$2,000,000 of Secured Convertible Notes (the “Notes”) to funds managed by GGP, an investor in the global cannabis industry. The Company intends to use the proceeds from the issuance of the Notes for general corporate purposes.

The Notes bear interest from the date of issuance at LIBOR + 12.5% per annum. During the first six months, interest may be paid-in-kind (“PIK”) at the Company’s option such that any amount of PIK interest will be added to the outstanding principal of the Notes.

The Notes (including all accrued interest thereon) is convertible at any time at the option of the holder, into subordinate voting shares at a price equal to CAD\$1.45.

The Company shall have the right prior to December 31, 2019 to make a one-time prepayment (“One-Time Prepayment Option”) at 125% of the outstanding principal amount of the Notes and if it does so, the holders shall forfeit their conversion right.

In connection with the issuance of the Notes, the Company issued to the lenders 1,671,151 warrants with an exercise price of CAD\$1.58, each of which is exercisable to purchase one subordinate voting share of the Company for a period of 36 months from the date of issuance. If the Company elects to exercise the One-Time Prepayment Option, then the warrant coverage shall be reduced by 50%.

In connection with issuing the Notes, the Company’s Inventory Finance Facility Agreement was also amended to reflect an increase in the interest rate from LIBOR (at a floor of 0%) + 8% to LIBOR (at a floor of 2.5%) + 10%, to be in line with the Notes

Second Tranche Draw from Alumina Partners (Ontario) Ltd. Capital Commitment

On July 29, 2019, the Company issued 425,000 Units to Alumina for gross proceeds of \$458,621 as part of the second tranche draw from Alumina Capital Commitment.

Expanded Brand Portfolio with Fruit Slabs and Woah Candy Co.

DionyMed announced an exclusive distribution agreement with California-based edibles brand, Fruit Slabs, to expand the Company’s cannabis brand portfolio in Central Valley and Northern California. Fruit Slabs, California’s preeminent health and wellness edibles, which are designed for health-conscious consumers, are all organic, gluten free, vegan, and Kosher.

DionyMed also announced an exclusive distribution agreement with Long Beach, California-based manufacturer, Woah Candy Co., to bring its cannabis-infused caramels and chocolate edibles to consumers throughout California. Woah Candy Co.'s products, which include Dark Chocolate Honey Caramels and its classic Honey Caramels, are slow cooked with only the finest and freshest ingredients. The brand's unique caramel formulation utilizes classic caramel cooking techniques combined with a cleaner ingredients list, free of corn syrup, gelatin, gluten and artificial preservatives, to suit California's health conscious consumer. The brand's Dark Chocolate Honey Caramels are enrobed in Belgian Dark Chocolate and hand packed in classic confectionary packaging.

Strategic Partnership with Nevada-Based Retailer Acres Cannabis

On January 10, 2019, the Company signed a strategic partnership agreement with Acres Cannabis ("Acres"), a vertically integrated cannabis retailer based in Las Vegas, Nevada. The partnership grants the Company's brands and services access to the Nevada market. The Company's infused products and edible brands will be manufactured in Acres' facilities and sold state-wide under a royalty fee arrangement with Acres. During the first quarter, the Company advanced \$125,000 royalty fee to Acres.

The Company started recognizing revenue in Nevada during the third quarter of 2019.

Pending Transactions

Waterside Warehousing

On March 15, 2019, the Company signed a definitive agreement with an irrevocable option to acquire Waterside Warehousing ("Waterside"), a premium manufacturer and indoor craft cultivator located in Oakland, California. The agreement provides the Company with an option to acquire Waterside for an additional \$5 million payment.

The Company agreed to provide \$1,000,000 in cash by way of a secured convertible preferred note carrying a 6% interest rate per annum paid quarterly. During the six months ended June 30, 2019, \$600,000 of the loan has been advanced to date and the balance is to be paid during the third quarter of 2019 (Note 8). The secured convertible preferred note matures on March 15, 2021. The loan is carried at amortized cost.

As of the date of this MD&A, the Company has not exercised its option to acquire Waterside.

Virginia's Kitchen, LLC dba Blue Kudu

On April 5, 2019, the Company signed a term sheet to acquire Virginia's Kitchen, LLC dba Blue Kudu, an award-winning edibles brand and wholesale platform based in Denver, Colorado. The total consideration for the deal is expected to be \$5,500,000, consisting of \$5,000,000 at close comprised of \$4,000,000 in cash and \$1,000,000 in the Company's subordinated voting shares and the remaining \$500,000 subject to Colorado law allowing the Company to acquire Blue Kudu's cannabis business licenses.

Completion of the acquisition is subject to several conditions, including, but not limited to, execution and delivery of definitive documentation mutually agreeable to the parties, the Company's completion of due diligence on Blue Kudu and regulatory approvals.

As of the date of this MD&A, this transaction has not yet closed.

Pioneer Valley Extracts, LLC

On February 14, 2019, the Company signed a binding term sheet, subject to satisfaction of certain customary conditions to close, to acquire Pioneer Valley Extracts, LLC, a manufacturer and emerging cannabis brand in Massachusetts.

At close, the total purchase price will be \$550,000 consisting of \$150,000 in cash and \$400,000 in subordinate voting shares priced at the 15-day volume-weighted average price at closing of the transaction.

As of the date of this MD&A, this transaction has not yet closed.

Strategic Framework

The Company's mission is to build safe, trusted cannabis brands for medical and recreational consumers worldwide.

The Company's standards for governance, compliance and ethics are set company-wide. The Company weighs business decisions with consideration as to how its efforts affect customers, employees, the environment, and both the communities where its employees live and where the Company operates. We intend to use business as a force for good, to share best practices, to be a catalyst for innovation, and to support the communities we serve while strengthening our brands.

The Company seeks to make access to cannabis safe, convenient and easy for both medical and recreational customers. The Company focuses on supporting communities and non-profits that can utilize the wellness aspects of its products (i.e. military veterans, medical foundations, university research, etc.). We believe this will ultimately have a positive impact on our customers, our employees, and our shareholders.

The Company delivers products directly to consumers through our own e-commerce site (orderchill.com), as well as through dispensary retail partners. In addition, we support other brands and retailers by providing distribution, logistics, manufacturing and technology services. We strive to offer our customers products at price points that meet their needs, ranging from value-priced offerings to luxury products, together with fast and reliable fulfillment and timely customer service.

The Company uses state and local operating teams for the purpose of determining how best to apply our guiding strategic principles. Local market expertise is used to identify and deliver against the most valuable growth opportunities. This model provides greater flexibility to meet the diverse needs of our customers, while allowing for the speed of execution required in the dynamic cannabis market.

The Company identifies and acts on consumer trends to support growth. The Company uses consumer insights and marketing to drive product development and innovation at scale and develop relationships with our customers through distribution and sales. Our supply capabilities enable us to manufacture and distribute our brands efficiently and effectively.

The Company plans to build and sustain recognizable cannabis brands that play a positive role in society, serving all our partners: cultivators, manufacturers, dispensaries, customers, employees and shareholders.

FINANCIAL INFORMATION

Selected Quarterly Financial Information

The following is selected financial data derived from the Financial Statements of the Company for the three and six months ended June 30, 2019, and the three and four months ended June 30, 2018.

| \$ 000's | For the three months ended June 30, 2019 | For the three months ended June 30, 2018 | For the six months ended June 30, 2019 | For the four months ended June 30, 2018 |
|--|---|---|---|--|
| Total gross revenue including value of products distributed¹ | 12,659 | 1,361 | 34,384 | 2,400 |
| Gross revenue as reported | 10,310 | 1,361 | 27,028 | 2,400 |
| Revenue, net of discounts as reported | 8,951 | 1,361 | 23,368 | 2,400 |
| Gross margin | 1,449 | 232 | 7,956 | 451 |
| Operating expenses | 13,178 | 3,268 | 26,192 | 4,492 |
| Adjusted EBITDA (non-IFRS) | (11,593) | (3,035) | (18,100) | (4,041) |
| Other expenses | 3,752 | 433 | 8,428 | 439 |
| (Loss) from operations | (15,481) | (3,469) | (26,664) | (4,480) |
| Fair value gains | 6,050 | - | 17,492 | - |
| Deferred tax recovery | 227 | 9 | 314 | 9 |
| Net (loss) | (9,067) | (3,460) | (8,722) | (4,471) |
| Total assets | 55,466 | 14,470 | 55,466 | 14,470 |
| Total liabilities | 62,150 | 17,774 | 62,150 | 17,774 |

¹ Based on contractual arrangements with these customers, the Company only recognizes the service fees of the product processed through its distribution network.

RESULTS OF OPERATIONS

Revenue

For the three and six months ended June 30, 2019, below is a summary of the breakdown of the Company's revenues.

| \$ 000's | For the three months ended June 30, 2019 | For the three months ended June 30, 2018 | For the six months ended June 30, 2019 | For the four months ended June 30, 2018 |
|---|--|--|---|--|
| Revenue stream | | | | |
| Gross reported distribution revenue | 8,357 | 1,361 | 14,303 | 2,400 |
| Value of logistics product delivered through the Company | 2,349 | - | 7,356 | - |
| Gross distribution revenue | 10,706 | 1,361 | 21,659 | 2,400 |
| Gross reported direct-to-consumer revenue | 1,953 | - | 12,725 | - |
| Total gross revenue of total product processed through the Company | 12,659 | 1,361 | 34,384 | 2,400 |
| Discounts | (1,028) | - | (1,096) | - |
| Taxes on sales of product | (331) | - | (2,564) | - |
| Net revenue of total product processed through the Company | 11,300 | 1,361 | 30,724 | 2,400 |
| Pro-forma revenue prior to acquisition of control ¹ | - | - | 434 | - |
| Total revenue, including pro-forma revenue | 11,300 | 1,361 | 31,158 | 2,400 |

¹ DionyMed closed the transaction with Cascade at the end of February 2019, after regulatory approval was received. If Cascade would have been included on the platform for the full quarter, an additional \$434,000 of distribution revenue would be added to the platform.

The Company has two primary revenue streams: i) Distribution - distributing product to dispensaries throughout California and Oregon and ii) Direct-to-Consumer – online retailing and delivering products directly to consumers in California.

Gross revenues for the three and six months ended June 30, 2019 are \$12.7 million and \$34.4 million compared to \$1.3 million and \$2.4 million respectively in the comparable period in 2018. The increase is the result of acquiring Rise Logistics, Winberry Farms and Hometown Heart, plus the continued expansion of the Company's existing operations.

Distribution Revenue

Distribution revenues are recognized by the Company resulting from servicing over 800 dispensaries (441 in California and 387 in Oregon). The Company distributes both its house brand products and third-party products. As the Company increases its house brand portfolio, the

ratio of house brand products to third-party products will increase. For the quarter ended June 30, 2019, house brand products made up 59% of gross revenue from Distribution channel.

Gross revenue of product processed through the Distribution channel for the quarter ended June 30, 2019 increased to \$10.7 million, up 687% compared to the quarter ended June 30, 2018 and consistent when compared to the quarter ended March 31, 2019. The increase in revenue versus the comparable quarter in 2018 is the result of adding Rise Logistics and Winberry Farms to the distribution network and increases in revenues from existing operations. The slight decline in revenues compared to the quarter ended March 31, 2019 is due to higher sales in March 2019 to various retail dispensaries in California and Oregon in anticipation of the week of 420.

Reported revenue of portfolio products and house brands increased to \$8.4 million for the quarter or 514% over the quarter ended June 30, 2018 and 41% over the quarter ended March 31, 2019. The increase in revenues compared to the quarter ended March 31, 2019 is a result of the Company's focus on increasing sales from the existing portfolio and house brands business and conversion of the logistics customers to portfolio customers.

The Company provides logistics and distribution services for certain customers. Based on contractual arrangements with these customers, the Company recognizes the service fees of the product distributed through its network. The total value of product processed through the Company for the quarter ended June 30, 2019 was \$2.3 million or 213% lower than the quarter ended March 31, 2019. There was no logistics business during the quarter ended June 30, 2018. The decline is due to the Company's focus on higher margin portfolio and house brands business and conversion of the logistics customers to portfolio customers.

The gross revenue from Distribution for the six months ended June 30, 2019 increased to \$21.7 million, up 802% compared to the same period in 2018. The increase in revenue versus the comparable period in 2018 is the result of adding both Rise Logistics and Winberry Farms to the platform and ramp-up in existing operations.

Direct-to-Consumer Revenue

The Company generates its Direct-to-Consumer revenues through its Master Services Agreement with Hometown Heart.

During the three and six months ended June 30, 2019, Hometown Heart generated total Direct-to-Consumer revenue of \$1.9 million and \$12.7 million respectively. Net revenue for the quarter ended June 30, 2019 was \$710,536 and for the six months ended June 30, 2019 the net revenue was \$9.2 million. There was no direct to consumer revenue during same periods in the prior year. During the quarter ended June 30, 2019, this revenue was generated by Hometown Heart fulfilling orders through the Company's Chill platform. Hometown Heart terminated its relationship with Eaze at the end of the first quarter of 2019. The Company is now utilizing and scaling the Chill platform (www.orderchill.com) to acquire and service customers. Since the Company began to actively market Chill in early April 2019, Chill revenues have steadily increased. Currently Chill is operating in San Francisco, Oakland, and in an additional 24 cities in the Bay Area.

Gross Margin

| \$ 000's | For the three months ended June 30, 2019 | For the three months ended June 30, 2018 | For the six months ended June 30, 2019 | For the four months ended June 30, 2018 |
|---|--|--|--|---|
| Net revenue of total product processed through the Company | 11,300 | 1,361 | 30,724 | 2,400 |
| Net distribution revenue | 10,589 | 1,361 | 21,512 | 2,400 |
| Net direct-to-consumer revenue | 711 | - | 9,212 | - |
| Net direct-to-consumer revenue, before discounts | 1,623 | - | 10,162 | - |
| Gross margin | 1,449 | 232 | 7,956 | 451 |
| Distribution | 1,691 | 232 | 3,866 | 451 |
| Direct-to-consumer | (242) | - | 4,090 | - |
| Direct-to-consumer, before discounts | 670 | - | 5,040 | - |
| Gross margin % | 12.8% | 17.0% | 25.9% | 18.8% |
| Distribution | 16.0% | 17.0% | 18.0% | 18.8% |
| Direct-to-consumer | (34.0%) | 0.0% | 44.4% | 0.0% |
| Direct-to-consumer, before discounts | 41.3% | 0.0% | 49.6% | 0.0% |

The Company typically sells its house brand products such as Winberry Farms, Aja, and Gardener's and Afterglow through its distribution network at a gross margin ranging from 25% to 35% and third-party portfolio brands such as CBD Alive, Fruit Slabs and Defonce ranging

from 15% to 20%. For the service fees earned for providing logistics and distribution services, the Company includes the total value of logistics product delivered when calculating and analyzing gross margin, which ranges from 5% to 12%. For bulk sales where the Company purchases cannabis flowers, trims and oil in bulk and wholesales to another distributor or manufacturer, the gross margin ranges from 10% to 25%. The Company continues to focus on increasing the mix of revenue towards its higher margin house and portfolio brands.

Gross margin for the three months ended June 30, 2019 totaled 12.8% of net revenue, compared to 17.0% for the same period in 2018. The decrease was mainly due to the negative gross margin from the direct-to-consumer revenue stream as a result of discounts offered to new customers to ramp-up the Chill platform. In addition, a higher mix of products with lower gross margin such as bulk sales and logistics revenue further contributed to the lower gross margin during the quarter. The Company is focusing on increasing the mix of revenue toward its higher margin house and portfolio brands.

Gross margin for the six months ended June 30, 2019 was 25.9%, compared to 18.8% for the same period in 2018. The increase was mainly due to a higher mix of house brands and the addition of direct-to-consumer sales primarily during the quarter ended March 31, 2019.

The Company believes it can achieve higher margins on product sales generated through its Chill platform. The Chill platform includes both house and third-party brands.

Operating Expenses

These operating expenses are outlined below:

| \$ 000's | For the three months ended June 30, 2019 | For the three months ended June 30, 2018 | For the six months ended June 30, 2019 | For the four months ended June 30, 2018 |
|---------------------------------|--|--|--|---|
| Wages and Salaries | 6,482 | 1,428 | 12,362 | 1,820 |
| Sales and Marketing Expense | 1,614 | 329 | 3,655 | 468 |
| Administrative and Other | 3,712 | 828 | 7,485 | 1,291 |
| Professional Fees | 670 | 487 | 1,661 | 710 |
| Impairment of Trade Receivables | 340 | - | 365 | - |
| Legal Fees | 361 | 196 | 663 | 203 |
| Total operating expenses | 13,178 | 3,268 | 26,192 | 4,492 |

Operating expenses were \$13.2 million for the quarter ended June 30, 2019, compared to \$3.3 million for the quarter ended June 30, 2018. The increase was mainly due to the ramp-up of the Company's existing operations, marketing of the Chill platform and higher regulatory and compliance costs as a public company. Operating expenses were \$26.2 million for the six months ended June 30, 2019, compared to \$4.5 million for the four months ended June 30, 2018. The increase was mainly due to the ramp-up of the Company's existing operations, marketing of the Chill platform and higher regulatory and compliance costs as a public company. The Company had approximately 500 employees at the end of the quarter ended June 30, 2019 compared to about 60 employees at the end of the quarter ended June 30, 2018.

Wages and salaries include all people related costs including management and administration, sales and marketing, and operations. Wages and salaries of \$6.5 million for the quarter ended June 30, 2019 were 354% over the quarter ended June 30, 2018 due to scaling of the business. At the end of the second quarter of 2019, the Company had 220 staff members plus 280 drivers to deliver product in the Direct-to-Consumer business. For the six months ended June 30, 2019, wages and salaries of \$12.4 million were 576% higher than the same period in the prior year due to scaling of the business.

Sales and marketing expenses include advertising for new products and brands, product and brand development, marketing for the Chill platform. Sales and marketing expenses for the three and six months ended June 30, 2019 were \$1.7 million and \$3.7 million compared to \$0.3 million and \$0.5 million respectively mainly due to scaling of business and marketing for the Company's Chill platform. Sales and marketing expenses of \$1.7 million for the quarter ended June 30, 2019 was 19% lower than the quarter ended March 31, 2019 due to Eaze promotions no longer being offered as the Company discontinued delivering products from the Eaze platform at the end of the first quarter of 2019, partially offset by increased marketing costs for the Chill platform. For the six months ended June 30, 2019, sales and marketing expenses include all the sales and marketing related to the Chill platform during the second quarter and the Eaze platform during the first quarter.

Professional fees include fees and expenses with respect to audit fees, general consulting and various contractors. Legal fees include fees and expenses for general legal expenses and litigation expenses. Professional fees and legal fees for the three and six months ended June 30, 2019 were \$670,000 and \$1.7 million respectively, which was higher than the comparable periods in 2018 due to the increased platform costs for the Company as a publicly traded entity and litigation costs incurred for the termination of the Eaze relationship.

The administrative and other costs are outlined below:

| \$ 000's | For the three months ended June 30, 2019 | For the three months ended June 30, 2018 | For the six months ended June 30, 2019 | For the four months ended June 30, 2018 |
|--|--|--|--|---|
| Rent expenses | 272 | 262 | 322 | 325 |
| Travel expenses | 89 | 354 | 440 | 428 |
| Write-down of inventory | 191 | - | 191 | 70 |
| Insurance | 481 | 50 | 938 | 63 |
| Business taxes, permits and licenses | 1,265 | 53 | 1,479 | 138 |
| Credit card processing fees | - | - | 1,447 | - |
| Other operating and administrative expenses | 1,414 | 109 | 2,668 | 267 |
| Total administrative and other expenses | 3,712 | 828 | 7,485 | 1,291 |

Administrative and other expenses include a variety of operational and administrative expenses. Some of the more significant items are discussed herein.

Upon adoption of IFRS 16 starting in 2019, rent expense only includes short-term or immaterial lease expenses for facilities, vehicle and equipment. Under the new accounting standard, for leases other than those considered short-term or immaterial, the net present value of future lease payments is recognized upon contract inception as a right-of-use asset and a corresponding lease liability; the right-of-use asset is amortized over the term of the lease, which is included in amortization and depreciation expense on the consolidated statement of income (loss) and comprehensive income (loss), while the lease liability is extinguished upon payment of rent. The net rent expense for the quarters ended June 30, 2019, and June 30, 2018 respectively was \$272,000 and \$262,000, and the actual cash cost was \$276,000 and \$262,000, respectively.

Travel expenses represent expenses incurred for internal management travels between various office and warehouse locations in the normal course of business. Travel costs for the quarter ended June 30, 2019 of \$89,000 decreased by \$265,000 compared to the quarter ended June 30, 2018 due to limited travel activities conducted by the Company's management team and cost control measures. Travel costs for the six months ended June 30, 2019 of \$440,000 increased by \$12,000 compared to the same period in 2018 due to higher travel costs of six months compared to only four months in the comparable period offset by limited travel activities conducted by the Company's management team in the current quarter and cost control measures.

Insurance expenses for the three months and six months ended June 30, 2019 were \$481,000 and \$938,000 respectively, compared to \$50,000 and \$63,000 for the respective periods in the prior year. The increase is due the increase level of business activity.

Business taxes, permits and licenses were \$1.2 million and \$ 1.5 million for the three and six months ended June 30, 2019. These expenses were higher than the prior year due to increased business activity and additional fees and penalties accrued for the period.

Other operating and administrative expenses were \$1.4 million and \$2.7 million for the three and six months ended June30, 2019. These expenses include the credit card fees incurred by Hometown Heart with the for the Eaze platform during the first quarter which were discontinued at the end of the first quarter. The remaining expenses include utilities, facility expenses and software and development costs. For the three and six months ended June 30, 2019, the expenses were higher than the same period in the prior year due to higher level of activity and growth of the business.

Adjusted EBITDA

Adjusted EBITDA is defined by the Company as earnings before interest, taxes, depreciation and amortization, less certain non-cash equity compensation expenses, impairments, one-time transaction fees and all other non-cash items. The Company considers adjusted EBITDA an important operational measure for the business.

The chart below reconciles non-IFRS Adjusted EBITDA to IFRS reported net income (loss) per the financial statements.

| \$ 000's | For the three months ended June 30, 2019 | For the three months ended June 30, 2018 | For the six months ended June 30, 2019 | For the four months ended June 30, 2018 |
|---|--|--|--|---|
| Net (loss) as stated | \$ (9,067) | \$ (3,460) | \$ (8,722) | \$ (4,471) |
| Exclude | | | | |
| Fair Value Adjustment on Debt Carried at Fair Value | (7,082) | - | (20,018) | - |
| Fair Value Adjustment on Financial Liabilities | 355 | - | 1,156 | - |
| Fair Value Loss on Foreign Exchange | 540 | - | 1,234 | - |
| Deferred Tax Recovery | (227) | (9) | (314) | (9) |
| (Loss) from Operations | (15,481) | (3,469) | (26,664) | (4,480) |
| Exclude | | | | |
| Realized Fair Value Amounts of Inventory Sold | 170 | - | 171 | - |
| Unrealized Fair Value (Gain) on Growth of Biological Assets | (34) | - | (34) | - |
| Add back | | | | |
| Interest Expense | 1,156 | 50 | 1,951 | 67 |
| Amortization and Depreciation Expense | 900 | 48 | 1,821 | 50 |
| Financing Costs | 695 | - | 1,608 | - |
| Share-Based Compensation | 485 | 194 | 1,098 | 215 |
| Impairment of Intangible Assets | - | - | 540 | - |
| Royalties Expense | 464 | 93 | 766 | 93 |
| Business Development Expense | 45 | - | 553 | - |
| Foreign Exchange Loss | 7 | 49 | 90 | 14 |
| Adjusted EBITDA¹ | \$ (11,593) | \$ (3,035) | \$ (18,100) | \$ (4,041) |

¹ Adjusted EBITDA, a non-IFRS measure, is earnings before interest, tax, depreciation and amortization, share-based compensation expense, fair value changes and other non-cash items, and further adjusted to remove acquisition-related costs.

The loss from operations totaled \$15.5 million and \$26.7 million for the three and six months ended June 30, 2019. The details of these losses are outlined in the different components above.

The change in unrealized gain on debt carried at fair value of \$7.1 million and \$20.0 million and the change in unrealized loss on foreign exchange of \$0.5 million and \$1.2 million for the three and six months ended June 30, 2019 are non-cash items arising as a result of share price fluctuations and the resulting impact on the value of the convertible debentures.

Adjusted EBITDA loss was \$11.6 million and \$18.1 million for the three and six months ended June 30, 2019, with the loss primarily resulting from platform costs to support the Company's growth activities, professional fees and legal expenses for being a public company and litigation with Eaze, and sales and marketing expenses related to the build out and launch of the Company's Chill platform.

SUMMARY OF QUARTERLY RESULTS

| | For the three months and one month ended | | | | |
|-----------------------------|--|----------------|-------------------|---------------|----------------|
| | June 30, 2019 | March 31, 2019 | December 31, 2018 | June 30, 2018 | March 31, 2018 |
| Revenue \$000's | 10,310 | 14,417 | 5,507 | 1,361 | 1,039 |
| Net income (loss) \$000's | (9,067) | 1,039 | (43,854) | (3,460) | (1,011) |
| Net income (loss) per share | (0.16) | 0.02 | (1.00) | (0.09) | (0.03) |

The Company changed its year end in December 2018 to December 31 from its previous year end of February 28, 2018; accordingly, continuity is lost when comparing results between 2018 and 2019.

Due to the change in year end, the quarter ended March 31, 2018 only included one month of results.

The large losses during the fourth quarter of 2018 are mainly the result of the increase in the subordinate voting share price and accordingly the loss on the fair value of the convertible debentures and the costs associated with the listing of the Company on the Canadian Securities Exchange.

OUTLOOK

DionyMed is enhancing its platform through the pursuit of both organic and inorganic growth opportunities. Since March 1, 2018, the Company has completed the following acquisitions or arrangements:

- i) Rise Logistics in June 2018, a technology driven logistics and distribution business in California;
- ii) Winberry Farms in August 2018, an award-winning vape cartridge brand;
- iii) Hometown Heart in December 2018, a Direct-to-Consumer delivery business (being consolidated from entering into the Master Services Agreement);
- iv) Cascade in February 2019, a distribution business in Oregon; and
- v) MMAC facility and Gourmet Green Room, Inc, a large industrial campus in the heart of Los Angeles fully licensed enabling DionyMed to expand into Southern California.

The Company is focused on improving its balance sheet by reducing operating costs and adding appropriate debt and equity as required.

The company continues to work on investing and scaling the direct to consumer business. Currently the company is servicing the 26 cities in the Bay Area. With the acquisition of the MMAC facility in Los Angeles, the Company will initiate direct to consumer delivery in Southern California.

LIQUIDITY, FINANCING ACTIVITIES, AND CAPITAL RESOURCES

As of June 30, 2019, the Company had negative working capital of \$7.7 million excluding the lease liabilities, financial liabilities, and the Inventory Finance Facility. The Company had total cash of \$1.6 million and total current liabilities of \$36.3 million. The Company is working on improving the working capital deficit by managing accounts payable and increasing cash position from debt or equity financing.

Issued share capital of DionyMed Brands as at the end of the second quarter ended June 30, 2019

In the second quarter of 2019, the Company issued 11,007,890 subordinate voting shares as a result of the issuance of shares for the bought deal financing, the issuance of shares for the private placement to Alumina, the conversion of Series F shares, the payment of consultant fees, repayment of the financial liabilities for the acquisition of Rise, the conversion of subordinate voting share debentures as well as the exercise of options and warrants. At the end of the second quarter of 2019, the Company had 31,203,179 subordinate voting shares issued and outstanding. In addition, the Company's Series A and Series F Convertible Preferred Shares are convertible to Subordinate voting shares and would add an additional 28,678,400 subordinate voting shares (Series A – 1,063,400 and Series F – 27,615,400) for a total 59,881,579 issuable subordinate voting shares.

The Company's current focus is to achieve stable growth in its current markets and expand into new markets. Initiatives in markets outside of those already within the Company's platform are expected in the near future. To help fund these initiatives, the Company expects to raise additional capital, both in the form of debt and new equity, during the next fiscal year.

The Company is an early-stage growth company. It is generating cash from sales and is deploying its capital reserves to acquire and develop assets capable of producing additional revenues and earnings over both the immediate and near term. Capital reserves are being utilized for customer acquisitions, for capital expenditures and improvements, product development and marketing, as well as initiatives in customer, supplier, investor, and industry relations.

Going Concern

These consolidated financial statements have been prepared on a going concern basis under the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of operations for the foreseeable future. The Company's ability to continue in the normal course of operations as a going concern is dependent on its ability to raise financing sufficient to maintain

operations and there are no assurances that the Company will be successful in achieving this goal. For the three and six months ended June 30, 2019 (three and four months ended June 30, 2018), the Company reported a net loss of \$9,067,449 and \$8,721,686 (2018 – \$3,460,256 and \$4,471,458); negative operating cash flows of \$10,035,418 and \$17,153,285 (2018 – \$2,936,573 and \$4,309,543); and, as of June 30, 2019 and December 31, 2018, an accumulated deficit amounting to \$66,658,720 (2018 – \$57,779,953) and a negative working capital of \$24,035,057 (2018 – \$11,077,500). These circumstances indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern and ultimately on the appropriateness of the use of accounting principles applicable to a going concern. These consolidated financial statements do not include adjustments to amounts and classifications of assets and liabilities that might be necessary should the Company be unable to continue as a going concern. Such adjustments could be material.

To date, the Company has been successful in gaining access to equity and debt financing from private and public markets, however there are no guarantees that additional financing will be available in the future.

Cash Flows

Cash Used in Operating Activities

Net cash used in operating activities was \$10.0 million and \$17.2 million for the three and six months ended June 30, 2019 higher than the same period in 2018 primarily due to increases in operating expenses as a result of investing in the corporate infrastructure.

Cash provided from working capital for the three months ended June 30, 2019 was \$3.1 million as a result of a decrease in accounts receivable of \$78,000, an increase in inventories of \$1.6 million, an increase in other current assets of \$0.4 million netted against an increase in accounts payable and accrued liabilities of \$3.7 million, and an increase in tax liabilities of \$1.3 million.

Cash provided from working capital for the six months ended June 30, 2019 was \$3.5 million as a result of an increase in accounts receivable of \$0.8 million, an increase in inventories of \$2.4 million, an increase in other current assets of \$0.6 million netted against an increase in accounts payable and accrued liabilities of \$4.3 million, and an increase in tax liabilities of \$3.0 million.

Cash Flow from Investing Activities

Net cash used in investing activities was \$1.6 million and \$2.8 million for the three and six months ended June 30, 2019 lower than the same period in 2018 primarily due to fewer funds used in acquisitions, offset by the increased capital expenditures.

Cash Flow from Financing Activities

Net cash provided from financing activities was \$7.7 million and \$12.7 million for the three and six months ended June 30, 2019 compared to \$7.8 million and \$9.3 million in the comparable period in 2018. The changes are due to the timing of various financing activities conducted by the Company.

As of June 30, 2019, the Company had approximately \$12.3 million in current assets, including \$1.6 million of cash and cash equivalents. As of June 30, 2019, total assets were \$55.5 million.

As at June 30, 2019, the Company had current liabilities of \$35.1 million and total liabilities of \$61.0 million which included the convertible debentures of \$9.2 million.

Contractual Obligations

The Company has contractual obligations to make the following payments:

| | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 | Thereafter | Total |
|---------------------------------|---------------------|---------------------|---------------------|---------------------|-------------------|---------------------|----------------------|
| USD-denominated | | | | | | | |
| Lease liabilities | \$ 2,124,761 | \$ 2,072,768 | \$ 1,730,344 | \$ 1,245,819 | \$ 801,291 | \$ 2,304,788 | \$ 10,279,771 |
| Consultants and advisors | 216,000 | 216,000 | 216,000 | - | - | - | 648,000 |
| Total USD-denominated | \$ 2,340,761 | \$ 2,288,768 | \$ 1,946,344 | \$ 1,245,819 | \$ 801,291 | \$ 2,304,788 | \$ 10,927,771 |
| CAD-denominated (in USD) | | | | | | | |
| Lease liabilities | \$ 97,553 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 97,553 |
| Total CAD-denominated | \$ 97,553 | \$ - | \$ - | \$ - | \$ - | \$ - | \$ 97,553 |

As part of acquisition of assets from Winberry Farms and the acquisition of Hometown Heart, the Company is obligated for certain earn-out payments with aggregate maximum value of up to \$16,000,000.

Off-Balance Sheet Arrangements

As of the date of this filing, the Company does not have any off-balance-sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations or financial condition of the Company, including, and without limitation, such considerations as liquidity and capital resources.

CRITICAL ACCOUNTING ESTIMATES

Critical Accounting Estimates and Judgments

The preparation of the condensed interim consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Significant judgments, estimates and assumptions that have the most significant effect on the amounts recognized in the condensed interim consolidated financial statements are described below:

Impairment of property and equipment and intangible assets and goodwill

Management is required to use judgment in determining the grouping of assets to identify their Cash Generating Units ("CGUs") for the purposes of testing for impairment. Judgment is further required to determine appropriate groupings of CGUs for the level at which goodwill and any other assets requiring testing for impairment are tested for impairment. For the purpose of goodwill impairment testing, CGUs are grouped at the lowest level at which goodwill and any other assets requiring testing for impairment are monitored for internal management purposes. In addition, judgment is used to determine whether a triggering event has occurred requiring an impairment test to be completed.

In determining the recoverable amount of a CGU or a group of CGUs, various estimates are used. The Company determines the recoverable amount by using estimates such as projected future revenues, earnings, and capital investment consistent with strategic plans presented to the Board of Directors. Discount rates are consistent with external industry information reflecting the risk associated with the specific cash flows.

Management assesses property and equipment, as well as in use intangible assets with finite lives for any indicators of impairment at least annually taking into account factors such as economic and market conditions, as well as the useful lives of assets. If there are one or more indicators of impairment, management will estimate the recoverable amounts to assess whether there is an impairment.

Impairment of internally generated assets not yet in use, intangible assets with indefinite lives, and goodwill are assessed for impairment at least annually. This assessment takes into account factors such as economic and market conditions as well as any changes in the expected use of the asset.

Recoverability of accounts receivable

Accounts receivable includes trade and other receivables that are collectable within the short-term.

These balances are presented net of allowances for non-recoverability. In establishing our allowances for non-recoverability balances, significant judgment is exercised by management in determining the amount of outstanding accounts receivable that is expected to be recovered from the debtors adopting the expected credit loss methodology.

Although the accounts receivable balances are derived from determination of contractual provisions and trade transactions, the recoverability of such amounts may ultimately differ due to the potential for a debtor to become financially impaired or insolvent or for a contractual dispute over contract language or terms. Consequently, reviews of accounts receivable balances are done on a regular basis to determine if there is a need to establish an allowance for non-recoverability, the amount of expected credit loss provision to make and recoverability of slow-moving accounts. In performing this review, the Company uses judgment in assessing the credit worthiness of debtors and the expected probability of settlement.

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

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

Warrants

The warrants are valued using the Black-Scholes Model. Key estimates such as the expected life of the warrants, the volatility of the Company's stock price and the risk-free interest rate are used.

Share-based compensation

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

Fair value measurements

The Company's convertible debentures are measured at fair value. In estimating fair value, the Company uses market-observable data to the extent it is available. In certain cases where Level 1 inputs are not available, the Company will engage third party qualified valuers to perform the valuation.

In a business combination, all identifiable assets, liabilities and contingent liabilities acquired are recorded at their fair values. One of the most significant estimates relates to the determination of the fair value of these assets and liabilities. Contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as a liability is remeasured at subsequent reporting dates, as appropriate, with the corresponding gain or loss being recognized in profit or loss. For any intangible asset identified, depending on the type of intangible asset and the complexity of determining its fair value, an independent valuation expert or management may develop the fair value, using appropriate valuation techniques, which are generally based on a forecast of the total expected future net cash flows. The evaluations are linked closely to the assumptions made by management regarding the future performance of the assets concerned and any changes in the discount rate applied.

Certain fair values may be estimated at the acquisition date pending confirmation or completion of the valuation process. Where provisional values are used in accounting for a business combination, they may be adjusted retrospectively in subsequent periods. However, the measurement period will last for a maximum of one year from the acquisition date.

Business combinations

Judgment is used in determining whether an acquisition is a business combination or an asset acquisition. Judgment is also required to assess whether the amounts paid on achievement of milestones represents contingent consideration or compensation for post-acquisition services. Judgment is also required to assess whether contingent consideration should be classified as equity or a liability. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as a liability is remeasured at subsequent reporting dates in accordance with IFRS 9, or IAS 37 Provisions, Contingent Liabilities and Contingent Assets, as appropriate, with the corresponding gain or loss being recognized in profit or loss.

Recognition of deferred income tax assets

Management continually evaluates the likelihood that its deferred tax assets could be realized. This requires management to assess whether it is probable that sufficient taxable income will exist in the future to utilize these losses within the carry-forward period. By its nature, its assessment requires significant judgment.

Determination of functional currency

An area of judgment that has a significant impact on the amounts recognized in these condensed interim consolidated financial statements is the determination of functional currency. The determination of the Company and its subsidiaries' functional currency often requires significant judgment where the primary economic environment in which they operate may not be clear. This can have a significant impact on the consolidated results of the Company based on the foreign currency translation methods used.

Going concern risk assessment

The assessment of the Company's ability to continue as a going concern, raising additional debt or equity financing, attaining commercial operations, generating sufficient revenue to achieve and sustain profitability for the ensuing year, and to fund planned research and development activities, involves significant judgment based on historical experience and other factors including expectation of future events that are believed to be reasonable under the circumstances.

Contingencies

Management uses judgment to assess the existence of contingencies. By their nature, contingencies will only be resolved when one or more future events occur or fail to occur. Management also uses judgment to assess the likelihood of the occurrence of one or more future events.

When contingencies exist, Management estimates the related financial impact to the Company based on the possible outcomes of one or more future events.

Changes in Accounting Policies

These condensed interim consolidated financial statements have been prepared following the same accounting policies used in preparation of the audited consolidated financial statements for the year ended December 31, 2018, except for the changes outlined below.

IFRS 16, Leases

Effective January 1, 2019, the Company adopted IFRS 16, which is based on a single lessee accounting model to determine how to recognize, measure, and present leases.

Upon entering a lease arrangement, the Company will determine whether the agreement transfers the right to control the use of an identified asset within the context of the agreement, in exchange for regular payments.

The Company has elected to use the Modified Retrospective Approach under IFRS 16. Under this approach, the Company may be required to record an opening balance adjustment for leases previously recognized under IAS 17, Leases ("IAS 17") and IFRIC 4, Determining Whether an Arrangement Contains a Lease ("IFRIC 4"). The Company has also elected to apply the practical expedient to

grandfather the assessment of which transactions are leases on the date of initial application, as previously identified under IAS 17 and IFRIC 4. Finally, on transition, the Company has elected to use the practical expedient to not include initial direct costs associated with the lease in calculating the opening right-of-use asset value.

The Company leases office space in Ontario, Oregon and California. The Company also leases cultivation, manufacturing, and distribution space in Oregon and California. In adopting IFRS 16, the Company has elected to use the short-term lease recognition exemption which is applied by class of assets. The Company has also elected to use the low dollar value practical expedient, which unlike the short-term recognition exemption, is applied on an asset-by-asset basis.

In using the Modified Retrospective approach, the Company has elected to record the right-of-use asset for any identified leases under IFRS 16 at the present value of their future lease payments on January 1, 2019. On initial transition the Company's incremental borrowing rate as of that date has been used as the discount rate in determining this value.

The Company's then-current incremental borrowing rate will continue to be used for any leases entered into after initial transition, unless the discount rate implicit in the lease is known, in which case it will be used to determine the present value of the future lease payments. The Company has also elected to use the following practical expedients in transitioning to IFRS 16:

- Discount rates: The Company will apply a single discount rate to a portfolio of leases with reasonably similar characteristics.
- Leases with a short remaining term: The Company will account for leases for which the lease term ends within 12 months of the date of initial application as short-term leases. This practical expedient is independent of the Company's accounting policy for the short-term lease recognition exemption.

Subsequent to initial recognition, the lease liability will be measured at amortized cost using the effective interest method. The liability can be remeasured throughout the term of the lease if any of the following would cause a significant change in the present value of the future lease payments:

- change in an index or discount rate;
- change in the Company's estimate of the amount expected to be payable under a residual value guarantee;
- changes in the Company's assessment of whether it will exercise a purchase, extension or termination option.

As for the right-of-use asset, it will subsequently be measured at its net book value. The deemed cost of the asset will be amortized over the shorter of its expected useful life and the term of the lease on a straight-line basis. The average amortization period of the leases as at June 30, 2019 is 4 years. These right-of-use assets will be included with property and equipment in line with the Company's accounting policy for assessment for impairment.

The impact of the adoption of IFRS 16 on January 1, 2019 is as follows:

| | January 1, 2019 |
|--|-----------------|
| Right-of-use asset | \$ 6,836,440 |
| Lease liability | (7,150,203) |
| Accumulated deficit | 157,081 |
| Extinguishment of accounts payable – Reversal of deferred rent liability as at December 31, 2018 | 156,682 |

IFRIC 23, Uncertainty over Income Tax Treatments

IFRIC 23 'Uncertainty over Income Tax Treatments' was issued by the IASB in June 2017 and specifies the interpretation to be applied to the determination of taxable profit, tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12. The Company has adopted IFRIC 23 on January 1, 2019 and had no significant impact.

Related Party Transactions

Related party transaction not described elsewhere in the condensed interim consolidated financial statements are included herein.

Key Management Personnel Compensation

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling activities of the entity, directly or indirectly. The key management personnel of the Company are the members of the Company's executive management team and Board of Directors. Compensation provided to key management is as follows:

| | April 1, 2019 to June 30, 2019 | April 1, 2018 to June 30, 2018 | January 1, 2019 to June 30, 2019 | March 1, 2018 to June 30, 2018 |
|--------------------------|-----------------------------------|-----------------------------------|-------------------------------------|-----------------------------------|
| Salaries and bonuses | \$ 475,000 | \$ 207,000 | \$ 937,500 | \$ 307,000 |
| Share-based compensation | 300,000 | 86,000 | 402,000 | 91,000 |
| Total | \$ 775,000 | \$ 293,000 | \$ 1,339,500 | \$ 398,000 |

Consulting Services from Daniel Fields

Daniel Fields, a shareholder of the Company, provided consulting services for the Company. During the three and six months ended June 30, 2019 (three and four months ended June 30, 2018), the Company incurred consulting fees of \$20,000 and \$80,000, respectively (2018 – \$60,000 and \$80,000, respectively) and chargeable expenses of \$29,000 and \$151,000, respectively (2018 – \$156,000 and \$159,000, respectively), included in Legal and Professional Fees on the condensed interim consolidated statements of income (loss) and comprehensive income (loss). As at June 30, 2019, \$46,000 (2018 – \$243,000) remained payable by the Company, which is included in Accounts Payable and Accrued Liabilities on the condensed interim consolidated statement of financial position. The contract with Daniel Fields was terminated at the end of June 2019.

Ambassador Technologies Inc Marketing Services

Ambassador Technologies Inc, over which the Company's Chief Executive Officer has significant influence, is a marketing agency company doing business in California as ByProxie. The entity is not consolidated with the Company because the Company is not entitled to its variable returns. Since August 2017, the Company engaged ByProxie to provide marketing services in California. During the three and six months ended June 30, 2019 (three and four months ended June 30, 2018), the Company incurred related expenses to ByProxie of \$315,000 and \$519,000, respectively (2018 – \$9,000 and \$14,000, respectively) for ByProxie services in addition to \$1,217,000 and \$1,532,000, respectively (2018 – \$68,000 and \$94,000, respectively) in reimbursements for payments made by ByProxie to third-party vendors, included in Sales and Marketing Expenses on the condensed interim consolidated statements of income (loss) and comprehensive income (loss). As at June 30, 2019, \$666,000 (2018 – \$16,000) remained payable by the Company, which is included in Accounts Payable and Accrued Liabilities on the condensed interim consolidated statements of financial position.

WestField Partners, LLC and WestField Aviation Partners, LLC

The Company's Chief Executive Officer has control over WestField Partners, LLC, a management services company, and WestField Aviation Partners, LLC, an aviation services company. WestField Partners, LLC and WestField Aviation Partners, LLC are not consolidated with the Company because the Company is not entitled to their variable returns. WestField Partners, LLC entered into a management services agreement with the Company to provide rent and employee services on March 1, 2016, and WestField Aviation Partners, LLC is engaged as needed. During the three and six months ended June 30, 2019 (three and four months ended June 30, 2018), the Company incurred management services expenses of \$30,000 and \$60,000, respectively (2018 – \$30,000 and \$40,000, respectively) which are included in Administrative and Other Expenses; rent and employee expenses of \$39,000 and \$82,000, respectively (2018 – \$nil and \$nil, respectively) which are included in Administrative and Other Expenses and aviation expenses of \$nil and \$167,000, respectively (2018 – \$165,000 and \$165,000, respectively) which are included in Business Development Expenses on the condensed interim consolidated statements of income (loss) and comprehensive income (loss). As at June 30, 2019, \$16,000 (2018 – \$44,000) remained payable by the Company, which is included in Accounts Payable and Accrued Liabilities on the condensed interim consolidated statements of financial position.

Share Based Compensation

The Company granted options to employees during the second quarter of 2019. Please refer to the Company's Note 15 of the Financial Statements for the period ended June 30, 2019 for further information on options granted.

Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, investments in convertible notes receivable, accounts payable and accrued liabilities, notes payable, Inventory Finance Facility, financial liabilities, royalty debt, and convertible debentures. Financial liabilities and convertible debentures are carried at fair value. The carrying value of cash, accounts receivable, accounts payable and accrued liabilities, and notes payable equates to their fair value due to their short-term nature.

Financial instruments recorded at fair value are classified using a fair value hierarchy that reflects the significance of the inputs to fair value measurements. The three levels of hierarchy are:

Level 1 — Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 — Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; and

Level 3 — Inputs for the asset or liability that are not based on observable market data.

There have been no transfers between fair value levels during the six months ended June 30, 2019.

The following tables summarize the Company's financial instruments:

| | Financial Instruments Measured at Fair Value | Financial Instruments Measured at Amortized Cost | Carrying Value | Fair Value |
|--|---|---|----------------|---------------|
| Financial Assets | | | | |
| Cash | - | 1,579,410 | \$ 1,579,410 | \$ 1,579,410 |
| Accounts Receivables | - | 4,356,527 | \$ 4,356,527 | \$ 4,356,527 |
| Investments | - | 600,000 | \$ 600,000 | \$ 600,000 |
| Financial Liabilities | | | | |
| Accounts Payable and Accrued Liabilities | - | 12,646,779 | \$ 12,646,779 | \$ 12,646,779 |
| Inventory Finance Facility | - | 7,770,306 | \$ 7,770,306 | \$ 7,206,000 |
| Financial Liabilities (Level 3) | 13,554,000 | - | \$ 13,554,000 | \$ 13,554,000 |
| Convertible Debentures (Level 3) | 9,150,301 | - | \$ 9,150,301 | \$ 9,150,301 |
| Royalty Debt | - | 2,272,912 | \$ 2,272,912 | \$ 2,702,447 |

Financial Risk Management

The Company is exposed in varying degrees to a variety of financial instrument related risks. The Board mitigates these risks by assessing, monitoring and approving the Company's risk management processes:

Banking Risk

Notwithstanding that a majority of states have legalized medical marijuana, there has been no change in U.S. federal banking laws related to the deposit and holding of funds derived from activities related to the marijuana industry. Given that U.S. federal law provides that the production and possession of cannabis is illegal, there is a strong argument that banks cannot accept for deposit funds from businesses involved with the marijuana industry.

Consequently, businesses involved in the marijuana industry often have difficulty accessing the U.S. banking system and traditional financing sources. The inability to open bank accounts with certain institutions may make it difficult to operate the businesses of the Company, its subsidiaries and investee companies, and leaves their cash holdings vulnerable. The Company has banking relationships in all jurisdictions in which it operates.

In addition, the Company maintains cash with various U.S. banks and credit unions with balances in excess of the Federal Deposit Insurance Corporation and National Credit Union Share Insurance Fund limits, respectively. The failure of a bank or credit union where the Company has significant deposits could result in a loss of a portion of such cash balances in excess of the insured limit, which could materially and adversely affect the Company's business, financial condition, results of operations and the market price of the Company's share capital.

Credit Risk

Credit risk arises from the risk that a customer or counterparty will fail to meet its obligations. The Company is exposed to credit risk from cash and equivalents, accounts receivable, and investments in convertible notes receivable.

The Company minimizes credit risk associated with its accounts receivable by performing credit evaluation, approval, and monitoring processes. The Company applies the IFRS 9 simplified model of recognizing lifetime expected credit losses for all accounts receivables as these items do not have a significant financing component. Accounts receivable is written off when there is no reasonable expectation of recovery.

The maximum credit risk exposure as at June 30, 2019 is \$6,535,937.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations associated with financial liabilities. The Company manages liquidity risk through the management of its capital structure. The Company's approach to managing liquidity is to ensure that it will have sufficient liquidity to settle obligations and liabilities.

In addition to the commitments outlined in Note 19, the Company has the following contractual obligations:

As at June 30, 2019

| | <u>< 1 year</u> | <u>1 to 3 years</u> | | <u>Total</u> |
|--|--------------------|---------------------|----|--------------|
| Accounts Payable and Accrued Liabilities | 12,646,779 | - | \$ | 12,646,779 |
| Inventory Finance Facility | 7,770,306 | - | \$ | 7,770,306 |
| Financial Liabilities | 7,421,000 | 6,133,000 | \$ | 13,554,000 |
| Convertible Debentures | - | 9,150,301 | \$ | 9,150,301 |
| Royalty Debt | - | 2,272,912 | \$ | 2,272,912 |

Market Risk

- Interest Rate Risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Cash and cash equivalents bear interest at market rates. The Company's financial debts have fixed rates of interest and therefore expose the Company to interest rate fair value risk.

As at June 30, 2019, if the interest rates had increased or decreased by 1%, with all other variables held constant, the net income (loss) of the Company could possibly have decreased or increased by approximately \$90,000.

- Currency Risk

As the Company's operations are located in Canada and the United States, the Company is subject to currency transaction and translation risks.

The Company holds cash in Canadian dollars and U.S. dollars. The Company raises capital in Canadian capital markets and thus is exposed to fluctuations in the Canadian dollar relative to the U.S. dollar, specifically in relation to USD denominated liabilities.

As at June 30, 2019, if the Canadian dollar had strengthened or weakened by 5% in relation to the U.S. Dollar, with all other variables held constant, the net income (loss) of the Company could possibly have decreased or increased by approximately \$530,000.

As at June 30, 2019, the Company had no hedging agreements in place with respect to foreign exchange rates, however management monitors the Canadian and U.S. currency markets closely and continuously assesses the need to enter into

currency hedging arrangements. The Company has not entered into any agreements or purchased any instruments to hedge possible currency risks at this time.

Capital Management

The Company's objectives when managing capital are to ensure that there are adequate capital resources to safeguard the Company's ability to continue as a going concern and maintain adequate levels of funding to support its ongoing operations and development such that it can continue to provide returns to shareholders and benefits for other stakeholders.

The Company's capital is composed of equity and debt. The Company's primary uses of capital are future acquisitions and funding growth of existing operations. The Company also uses capital to finance operating losses, capital expenditures, and increases in non-cash working capital. The Company currently funds these requirements from cash raised through financings and may need to raise additional funds to reach its goals. The Company's objectives when managing capital are to ensure that the Company will continue to have enough liquidity to fund operations from which it will obtain returns on investment.

The Company monitors its capital based on the adequacy of its cash resources to fund its business plan. In order to maximize flexibility to finance growth, the Company does not currently pay a dividend to holders of its common shares. The Company did not institute any changes to its capital management strategy during the period.

OUTSTANDING SHARE DATA

The Company had the following securities issued and outstanding as of August 28, 2019:

| Security | Number of Securities |
|---|-----------------------------|
| <i>Issued and Outstanding</i> | |
| Subordinate Voting Shares | 32,960,662 |
| Series A Multiple/Subordinate Voting Shares | 6,562,500 |
| Series F Multiple Voting Shares | 27,190,000 |
| | |
| Total Subordinate Voting Share issued and outstanding (on an as converted basis) | 66,713,162 |
| <i>Subordinate Voting Shares Reserved for Issuance</i> | |
| On exercise of Warrants | 25,901,760 |
| On exercise of Options | 8,867,327 |
| On conversion of Convertible Debentures | 4,739,320 |
| Total Subordinate Voting Shares Reserved for Issuance (on an as converted basis) | 39,508,407 |

RISK FACTORS AND UNCERTAINTIES

An investment in the securities of the Company is speculative and subject to risks and uncertainties. The occurrence of any one or more of these risks or uncertainties could have a material adverse effect on the value of any investment in the Company and the business, prospects, financial position, financial condition or operating results of the Company. Additional risks and uncertainties not presently known to the Company or that the Company currently deems immaterial may also impair the Company's business operations.

Investors should carefully consider all information contained in the Company's public disclosures, and in particular should give special consideration to the risk factors under the section titled "Risk Factors" in the Company's annual information form dated May 30, 2019, which may be accessed on the Company's SEDAR profile at www.sedar.com.

The risks and uncertainties described or incorporated by reference in this MD&A are not the only ones the Company may face. Additional risks and uncertainties that the Company is unaware of, or that the Company currently deems not to be material, may also become important factors that affect the Company. If any such risks actually occur, the Company's business, financial condition or results of

operations could be materially adversely affected, with the result that the trading price of the subordinate voting shares could decline and purchasers could lose all or part of their investment.

U.S. REGULATORY OVERVIEW

Issuers with U.S. Marijuana-Related Assets

Nature of Involvement

The Company, through its subsidiaries, is directly involved in the production, cultivation, distribution and sale of marijuana in the States of California and Oregon and is in the process of entering the Nevada, Colorado, Massachusetts, Michigan and other markets.

Financial Exposure to U.S. Cannabis-Related Activities

All the Company's operations are in the United States. Therefore, the Company's balance sheet and operating statement exposure to U.S. marijuana-related activities is 100%.

United States Regulatory Environment

Under U.S. federal law, marijuana is currently a Schedule I drug. The CSA has five different tiers or schedules. A Schedule I drug means the Department of Justice ("DOJ") and U.S. Food and Drug Administration ("FDA") consider it to have a high potential for abuse, no accepted medical treatment, and lack of accepted safety for the use of it even under medical supervision.

Support for legalization has steadily spread over the past decade. 33 states plus the District of Columbia, the Commonwealth of the Northern Mariana Islands, Puerto Rico, U.S. Virgin Islands and Guam have legalized medical marijuana and 11 states plus the District of Columbia and the Commonwealth of Northern Marina Islands who have legalized recreational marijuana. In response to the rising tide of legalization, the federal government sought to provide guidance to enforcement agencies and banking institutions with the introduction of the United States Department of Justice Memorandum drafted by former Deputy Attorney General James Michael Cole in 2013 (the "Cole Memo")¹ and the Department of the Treasury Financial Crimes Enforcement Network ("FinCEN") guidance in 2014.²

The Cole Memo offered guidance to federal enforcement agencies as to how to prioritize civil enforcement, criminal investigations and prosecutions regarding marijuana in all states. The memo put forth eight prosecution priorities:

1. Preventing the distribution of marijuana to minors;
2. Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels;
3. Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;
4. Preventing the state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
5. Preventing the violence and the use of firearms in the cultivation and distribution of marijuana;
6. Preventing the drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;

¹ U.S. Dept. of Justice. (2013). *Memorandum for all United States Attorneys re: Guidance Regarding Marijuana Enforcement*. Washington, DC: US Government Printing Office. Retrieved from <https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf>.

² Department of the Treasury Financial Crimes Enforcement Network. (2014). *Guidance re: BSA Expectations Regarding Marijuana-Related Businesses* (FIN-2014-G001). Retrieved from <https://www.fincen.gov/resources/statutes-regulations/guidance/bsa-expectations-regarding-marijuana-related-businesses>.

7. Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
8. Preventing marijuana possession or use on federal property.

In January 2018, former United States Attorney General, Jeff Sessions, rescinded the Cole Memo and thereby removed its guidance for enforcement agencies and the Department of Justice. The FinCEN memo was not rescinded by Treasury Secretary Steven Mnuchin and still remains in effect.

Due to the CSA categorization of marijuana as a Schedule I drug, U.S. federal law makes it illegal for financial institutions that depend on the Federal Reserve's money transfer system to take any proceeds from marijuana sales as deposits. Banks and other financial institutions could be prosecuted and possibly convicted of money laundering for providing services to cannabis businesses under the United States Currency and Foreign Transactions Reporting Act of 1970 (the "**Bank Secrecy Act**"). Under U.S. federal law, banks or other financial institutions that provide a cannabis business with a checking account, debit or credit card, small business loan, or any other service could be found guilty of money laundering or conspiracy.

While there has been no change in U.S. federal banking laws to account for the trend towards legalizing medical and recreational marijuana by U.S. states, the DOJ issued guidance advising prosecutors of money laundering and other financial crimes not to focus their enforcement efforts on banks and other financial institutions that serve marijuana-related businesses in compliance with the FinCEN memo, so long as that business is legal in their state and none of the federal enforcement priorities are being violated (such as keeping marijuana away from children and out of the hands of organized crime). Although the original FinCEN Memorandum is still in place, this supplementary DOJ guidance that accompanied the FinCEN Memorandum was rescinded when former Attorney General Sessions rescinded the Cole Memorandum. The FinCEN guidance also clarifies how financial institutions can provide services to marijuana-related businesses consistent with their Bank Secrecy Act obligations, including thorough customer due diligence, but makes it clear that they are doing so at their own risk. The customer due diligence steps include:

1. verifying with the appropriate state authorities whether the business is duly licensed and registered;
2. reviewing the license application (and related documentation) submitted by the business for obtaining a state license to operate its marijuana-related business;
3. requesting from state licensing and enforcement authorities available information about the business and related parties;
4. developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served (e.g., medical versus recreational customers);
5. ongoing monitoring of publicly available sources for adverse information about the business and related parties;
6. ongoing monitoring for suspicious activity, including for any of the red flags described in the FinCEN guidance; and
7. refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk. With respect to information regarding state licensure obtained in connection with such customer due diligence, a financial institution may reasonably rely on the accuracy of information provided by state licensing authorities, where states make such information available.

Due to the fear by financial institutions of being implicated in or prosecuted for money laundering, marijuana businesses are often unable to secure stabling banking relationships and forced into becoming "cash-only" businesses. As banks and other financial institutions in the U.S. are generally unwilling to risk a potential violation of federal law without guaranteed immunity from prosecution, most refuse to provide any kind of services to marijuana businesses. Recently, some banks that have been servicing marijuana businesses have been closing accounts operated by marijuana businesses and are now refusing to open accounts for new marijuana businesses for the reasons enumerated above.

The few credit unions that have agreed to work with marijuana businesses are limiting those accounts to no more than 5% of their total deposits to avoid creating a liquidity risk. Since the federal government could enforce its banking laws as they relate to marijuana businesses

at any time and without notice, these credit unions must keep sufficient cash on hand to be able to return the full value of all deposits from marijuana businesses in a single day, while also servicing the needs of their other customers.

The U.S. Treasury Department, headed by Steven Mnuchin, has publicly stated they were not informed of former Attorney General Sessions' desire to rescind the Cole Memo and do not have a desire to rescind the FinCEN guidance for financial institutions.³ Multiple legislators believe that Sessions' rescinding of the Cole Memo invites an opportunity for Congress to pass more definitive protections for marijuana businesses in states with legal marijuana programs during this Congress, but there is no guarantee that this will occur.⁴

Both Congress and marijuana-related businesses recognize that guidance is not law and thus have worked to continually renew the Rohrabacher Blumenauer Appropriations Amendment (originally the Rohrabacher Farr Amendment) since 2014. This amendment prevents the DOJ from using congressional funds to prosecute cannabis businesses in states that have medical marijuana laws and programs. In 2017, Senator Patrick Leahy (D-Vermont) introduced a similar amendment to H.R.1625 (a vehicle for the Consolidated Appropriations Act of 2018), preventing federal prosecutors from using federal funds to impede the implementation of medical cannabis laws enacted at the state level, subject to Congress restoring such funding ("**Leahy Amendment**"). The Leahy Amendment remained in effect through September 30, 2018, the end of the federal government's 2018 fiscal year, at which point Congress was to reauthorize its extension. As the government was not able to negotiate a budget at the end of the fiscal year, the government partially shut down at the end of 2018. On January 25, 2019, a three-week continuing resolution was enacted to reopen the government. In February congress passed, and the president signed, full appropriations for the remaining seven appropriations bills for the rest of fiscal year 2019. The Leahy Amendment was included in these most recent budget appropriations bills and will remain in effect through the end of the 2019 fiscal year. For the remainder of fiscal year 2019, the strategy amongst the Congressional Marijuana Working Group is to introduce numerous marijuana-related appropriations amendments in the Appropriations Committee in both the House and Senate, similar to the strategy employed in fiscal year 2018.⁵ The amendments will include protections for marijuana-related businesses in states with medical and adult use marijuana laws, as well as protections for financial institutions that provide banking services to state-legal marijuana businesses.⁶ However it should be noted that there is no assurance that such amendments will be passed into law.

³ Angell, Tom. (2018 February 6). Trump Treasury Secretary Wants Marijuana Money In Banks. Retrieved from <https://www.forbes.com/sites/tomangell/2018/02/06/trump-treasury-secretary-wants-marijuana-money-in-banks/#2848046a3a53>; see also Mnuchin: Treasury is reviewing cannabis policies. (2018 February 7). Retrieved from <http://www.scotsmanguide.com/News/2018/02/Mnuchin--Treasury-is-reviewing-cannabis-policies/>.

⁴ Jackson, Chereese. (2018 January 30). State-by-State Analysis of Sessions Move to Rescind Cole Memo. Retrieved from <http://guardianlv.com/2018/01/state-state-analysis-sessions-move-rescind-cole-memo/>; see also Velasquez, Josefa. (2018 January 23). NY Lawmarker Asks US Attorneys to Keep Hands Off State's Med Marijuana Programs. Retrieved from <https://www.law.com/newyorklawjournal/sites/newyorklawjournal/2018/01/22/ny-lawmaker-asks-us-attorneys-to-keep-hands-off-states-med-marijuana-programs/?slreturn=20180205182803>; see also "This is Outrageous": Politicians react to news that A.G. Sessions is rescinding Cole Memo. (January 4 2018). Retrieved from <https://www.thecannabist.co/2018/01/04/sessions-marijuana-cole-memo-politicians/95890/>.

⁵ Congress of the United States. (2018 January 12). Letter to The Honorable Paul Ryan, The Honorable Nancy Pelosi, Chairman Rodney P. Frelinghuysen and Ranking Member Nita Lowey. Retrieved from https://polis.house.gov/uploadedfiles/marijuana_appropriations_mcclintock-polis_language_1-12-18.pdf.

⁶ Congress of the United States. (2018 January 17). Letter to Director Kenneth Blanco of the Financial Crimes Enforcement Network of the Department of the Treasury. Retrieved from <https://dennyheck.house.gov/sites/dennyheck.house.gov/files/FINCEN%20MJ%20Guidance%20Letter%20FINAL.pdf>; see also United States Senate. (2018 January 11). Letter to Director Kenneth Blanco of the Financial Crimes Enforcement Network of the Department of the Treasury. Retrieved from <https://www.documentcloud.org/documents/4347431-368944892-Letter-Urging-FinCEN-to-Maintain.html#document/p1>; see also United States Senate. (2018 January 18). Letter to Director Kenneth Blanco of the Financial Crimes Enforcement Network of the Department of the Treasury. Retrieved from <https://www.documentcloud.org/documents/4356160-18-01-18-FinCEN-LTR-Cannabis-Banking.html>; see also Congress of the United States. (2018 January 25). Letter to The Honorable Donald Trump. Retrieved from

Since 2014, Congress has made immense strides in marijuana policy. The bipartisan Congressional Cannabis Caucus launched in 2017 and is headed by Representatives Dana Rohrabacher (CA-48), Earl Blumenauer (OR-03), Don Young (AK-At Large), and Jared Polis (CO-02). The group is “dedicated to developing policy reforms that bridge the gap between federal laws banning marijuana and the laws in an ever-growing number of states that have legalized it for medical or recreational purposes”⁷ Additionally, each year more Representatives and Senators sign on and co-sponsor marijuana legalization bills including the CARERS Act, REFER Act and others. While there are different perspectives on the most effective route to end federal marijuana prohibition, Congressman Blumenauer and Senator Wyden introduced the three-bill package, Path to Marijuana Reform which would have fixed the 280E provision, eliminated civil asset forfeiture and federal criminal penalties for businesses complying with state law, reduced barriers to banking, and would have de-scheduled, taxed and regulated marijuana in 2017.⁸ Senator Booker has also introduced the Marijuana Justice Act, which would de-schedule marijuana, and in 2018 Congresswoman Barbara Lee introduced the House companion. In 2018, Senator Gardner and Senator Warren introduced the STATES Act, ostensibly supported by President Trump, which would exempt state-legal marijuana activities from being violations of the Controlled Substances Act, but there is no guarantee that this will occur.⁹

Notwithstanding the foregoing, there is no guarantee that the current presidential administration will not change the stated policy of the previous administration regarding the low-priority enforcement of U.S. federal laws that conflict with state laws.

An additional challenge to marijuana-related businesses is that the provisions of the Internal Revenue Code, Section 280E, are being applied by the IRS to businesses operating in the medical and adult use marijuana industry. Section 280E of the Code prohibits marijuana businesses from deducting their ordinary and necessary business expenses, forcing them to pay higher effective federal tax rates than similar companies in other industries. The effective tax rate on a marijuana business depends on how large its ratio of non-deductible expenses is to its total revenues. Therefore, businesses in the legal cannabis industry may be less profitable than they would otherwise be.

The following sections describe the legal and regulatory landscape in the states in which the Company operates. While the Company’s operations are in full compliance with all applicable state laws, regulations and licensing requirements, for the reasons described above and the risks further described in below, there are significant risks associated with the business of the Company. Readers are strongly encouraged to carefully read all the risk factors contained in this AIF.

The following sections describe the legal and regulatory landscape in the states in which the Company operates. While the Company’s operations are in full compliance with all applicable state laws, regulations and licensing requirements, for the reasons described above and the risks further described in below, there are significant risks associated with the business of the Company. Readers are strongly encouraged to carefully read all the risk factors contained in this AIF.

Compliance with Applicable State Laws in the United States

California

California Regulatory Landscape

In 1996, California was the first state to legalize medical cannabis through Proposition 215, the Compassionate Use Act of 1996 (“CUA”). This legalized the use, possession and cultivation of medical cannabis by patients with a physician recommendation for treatment of cancer, anorexia, AIDS, chronic pain, spasticity, glaucoma, arthritis, migraine, or any other illness for which cannabis provides relief.

https://www.warren.senate.gov/files/documents/2018_01_25%20Letter%20to%20Trump%20on%20Sessions%20withdrawal%20of%20the%20Cole%20memo.pdf.

⁷ Huddleston, Tom Jr. (2017 February 17). Pro-Pot Lawmakers Launch a Congressional Cannabis Caucus. Retrieved from <http://fortune.com/2017/02/16/congress-cannabis-caucus/>.

⁸ Wyden, Blumenauer. (2017 March 30). Wyden, Blumenauer announce bipartisan path to marijuana reform. Retrieved from <https://blumenauer.house.gov/media-center/press-releases/wyden-blumenauer-announce-bipartisan-path-marijuana-reform>.

⁹ Seung Min Kim (April 13, 2018), "Trump, Gardner strike deal on legalized marijuana, ending standoff over Justice nominees", The Washington Post.

In 2003, Senate Bill 420 was signed into law establishing an optional identification card system for medical cannabis patients.

In September 2015, the California legislature passed three bills collectively known as the “Medical Cannabis Regulation and Safety Act” (“**MCRSA**”). The MCRSA established a licensing and regulatory framework for medical cannabis businesses in California. The system created multiple license types for cultivators, manufacturers, distributors, testing laboratories and dispensaries. Infused product manufacturers would require either volatile solvent or non-volatile solvent manufacturing licenses depending on their specific extraction methodology. Multiple agencies would oversee different aspects of the program and businesses would require a state license and local approval to operate. However, in November 2016, voters in California overwhelmingly passed Proposition 64, the “Adult Use of Marijuana Act” (“**AUMA**”) creating an adult-use cannabis program for adult-use 21 years of age or older. AUMA had some conflicting provisions with MCRSA, so in June 2017, the California State Legislature passed Senate Bill No. 94, known as Medicinal and Adult-Use Cannabis Regulation and Safety Act (“**MAUCRSA**”), which amalgamates MCRSA and AUMA to provide a set of regulations to govern medical and adult-use licensing regime for cannabis businesses in the State of California. The three agencies that regulate commercial cannabis activity at the state level are the California Department of Food and Agriculture (“**CDFA**”), the California Department of Public Health’s Manufactured Cannabis Safety Branch (“**MCSB**”) and the California Department of Consumer Affairs’ Bureau of Cannabis Control (“**BCC**”).

To legally operate a medical or adult-use cannabis business in California, the operator must have both a local and state license. This requires operators to operate in cities with cannabis licensing programs. Cities in California can determine the number of licenses they will issue to cannabis operators or can choose to outright ban cannabis businesses, though they cannot prohibit deliveries made by operators based in other cities.

MAUCRSA went into effect on January 1, 2018. The Company began receiving its medical and adult-use cannabis licenses on January 1, 2018 in Oakland, CA. The Company currently operates three distribution licenses, two manufacturing licenses, a cultivation license (pending provisional approval), and a storefront retailer license, as well as operates two non-retail storefront delivery licenses under a management services agreement.

In California, there are four U.S. Attorneys covering the Central, Eastern, Northern, and Southern regions of the state, respectively. Below is a brief summary of each U.S. Attorney’s enforcement priorities related to state-legal cannabis.

In the Central District, current U.S. Attorney Nicola T. Hanna is a former Assistant U.S. Attorney who has prosecuted cases involving money laundering, narcotics trafficking, as well as violent and economic crimes. Hanna has not yet taken a public stance on his office’s enforcement priorities related to state-legal cannabis, but in March 2019 oversaw the prosecution of an unlicensed cultivation operation in San Bernardino County, about which he stated: “In states that have decriminalized marijuana, we have seen an influx of foreign money used to establish grow operations, with much of the marijuana being destined for out-of-state consumers.”

The U.S. Attorney for the Eastern District, McGregor Scott, previously served in the same position from 2003 to 2009. During his first tenure in the role, Scott prosecuted several people in California’s medical cannabis industry, including one case in which two of the individuals prosecuted each received prison sentences of 20 years or more.¹⁰ After the rescission of the Cole Memo in January 2018, Scott’s office issued the following statement: “The cultivation, distribution and possession of cannabis has long been and remains a violation of federal law for all purposes. We will evaluate violations of those laws in accordance with our district’s federal law enforcement priorities and resources.” In May 2018, Scott stated that his cannabis enforcement priorities would be focused on illegal cultivation on federal land,

¹⁰ Branan, Brad. (2018 January 4). Sessions’ weed decision puts spotlight on new U.S. attorney for eastern California. Retrieved from <https://www.sacbee.com/news/state/california/california-weed/article193086764.html>.

cartels dealing in cannabis, and interstate trafficking.¹¹ Scott also said, “The reality of the situation is that there is so much black-market marijuana in California that we could go after just the black market and never get [to state-licensed operations].” He explained that this black market is made up of “people who have no intent of ever entering the legal system that has been created and California has attempted to establish.”

In the Northern District, U.S. Attorney Alex G. Tse was previously the First Assistant U.S. Attorney in the same district. Earlier in his career, Tse spent time working in the San Francisco City Attorney’s Office. Though the U.S. Attorney’s office in this district has previously targeted medical cannabis businesses,¹² Tse has not yet issued a public statement on the issue.

The U.S. Attorney for the Southern District, Robert S. Brewer, Jr., has been a litigator in private practice since 1982. Before that he served as a Deputy District Attorney in Los Angeles County from 1975 to 1977, and as an Assistant US Attorney in the Central District of California from 1977 to 1982 where he prosecuted a variety of cases including espionage, bank robbery, murder for hire and aircraft hijacking. Brewer’s views on medical marijuana have been raised as he previously underwent aggressive chemotherapy and radiation treatment to fight non-Hodgkin lymphoma in the late 1990s. He mentioned to the media that he would have considered using marijuana had it been available at that time.

Licenses

The Company and its subsidiaries are licensed to operate as Medical and Adult-Use Retailers, Manufacturers and Distributors under applicable California and local jurisdictional law. The Company’s licenses permit it to cultivate, possess, process, distribute, dispense and sell medical and adult-use cannabis in the State of California pursuant to the terms of the various licenses issued by the MCSB and BCC under the provisions of the MAUCRSA and California Assembly Bill No. 133. The Company obtained the rights to the entities that were ultimately licensed pursuant to several acquisitions in the form of stock and/or asset purchase agreements.

The licenses are independently issued for each approved activity for use at the Company facilities in California. Please see the table below for a list of the licenses issued to the Company in respect of its operations in California.

¹¹ Miller, Cheryl. (2018 May 29). McGregor Scott’s Pot Policies Track Obama-Era ‘Cole Memo.’ Retrieved from <https://www.law.com/therecorder/2018/05/29/mcgregor-scotts-pot-policies-track-obama-era-cole-memo/?sreturn=20180916155413>.

¹² Adlin, Ben. (2016 August 16). Federal Court Bars Justice Department From Prosecuting Medical Cannabis. Retrieved from <https://www.leafly.com/news/politics/federal-court-bars-justice-department-from-prosecuting-medical-ca>.

| Holding Entity | Permit/License | City | Expiration/Renewal Date (if applicable) (MM/DD/YY) | Description |
|--|---|-------------------|--|---|
| Herban Industries CA, LLC | C11-0000880-LIC | Oakland, CA | 7/21/20 | Adult-Use and Medicinal Type 11 Distributor License ⁽²⁾ |
| | C11-18-0000484-LIC | Santa Rosa, CA | 6/24/20 | Medicinal Type 11 Distributor License |
| | CDPH-10002509 | Oakland, CA | 04/17/20 | Adult-Use and Medicinal Type N (Infusion) Manufacturer License ⁽³⁾ |
| Hometown Heart | Provisional approved—waiting for issuance of license ⁽¹⁾ | San Francisco, CA | N/A | Adult-Use and Medicinal Type 9 Non-Storefront Retail |
| | C9-0000215-LIC | Oakland, CA | 7/22/20 | Adult-Use and Medicinal Type 9 Non-Storefront Retail |
| Herban CA 2 LLC | M10-18-0000293-TEMP | Los Angeles, CA | 9/2/19 | Adult and Medicinal Retailer |
| | CDPH-10002318 | Los Angeles, CA | 4/8/20 | Adult and Medicinal Manufacturing Type 6 Non-Volatile Solvent Extraction |
| | A11-18-0000146-TEMP | Los Angeles, CA | 9/22/19 | Adult-Use and Medicinal Type 11 Distributor License ⁽²⁾ |
| | Provisional pending—in final stages of review ⁽¹⁾ | Los Angeles, CA | N/A | Cultivation |
| Notes: | | | | |
| 1) The Company is currently following the state process to secure provisional or annual licenses to replace its temporary licenses. | | | | |
| 2) A Type 11 Distribution License allows the holder to package, label, inspect, coordinate testing on, store, and transport product, whereas a Type 13 License would only allow the holder to transport product. | | | | |
| 3) A Type N Manufacturing License allows for infusion but not extraction. | | | | |

California state and local licenses are renewed annually. Each year, licensees are required to submit a renewal application per the applicable licensing body's regulations. Additionally, in respect of the renewal process, provided that the requisite renewal fees are paid, the renewal application is submitted in a timely manner, and there are no material violations noted against the applicable license, the Company would expect to receive the applicable renewed license in the ordinary course of business. While the Company's compliance controls have been developed to mitigate the risk of any material violations of a license arising, there is no assurance that the Company's licenses will be renewed in the future in a timely manner. Any unexpected delays or costs associated with the licensing renewal process could impede the ongoing or planned operations of the Company and have a material adverse effect on the Company's business, financial condition, results of operations or prospects.

License and Regulations

The Adult-Use Retailer licenses permit the sale of cannabis and cannabis products to any individual age 21 years of age or older without a physician's recommendation. Under the terms of such licenses that it holds, the Company is permitted to sell adult-use cannabis and cannabis products provided that the customer presents a valid government-issued photo identification. The Company maintains an open and collaborative relationship with the BCC and city level cannabis regulators.

The Medicinal Retailer licenses permit the sale of medicinal cannabis and cannabis products for use by a medicinal cannabis patient in California 18 years or older who possesses a physician's recommendation. The Company maintains an open and collaborative relationship with the BCC and city level cannabis regulators.

The Adult-Use and Medicinal Distribution licenses permit cannabis-related distribution activity which means the procurement, sale, packaging, labeling, quality assurance review, testing coordination and transportation of cannabis and cannabis products between licensed entities. Distribution activity is permissible to and from the Company and certain non-Company licensees.

In the state of California, only cannabis that is grown in the state can be sold in the state. Although California's framework does not require that all retailers must also cultivate and process all of their own cannabis sold at retail (commonly referred to as a vertically integrated system), the Company is vertically integrated and has the capabilities to process and sell/dispense/deliver cannabis and cannabis products. The state also allows the Company to make wholesale purchase of cannabis from, or a distribution of cannabis and cannabis product to, another licensed entity within the state.

Reporting Requirements

The state of California has selected Franwell Inc.'s METRC solution ("METRC") as the state's track-and-trace ("T&T") system used to track commercial cannabis activity and movement across the distribution chain ("seed-to-sale"). The METRC system is in the process of being implemented state-wide but has not been released. When operational, the system will allow for other third-party system integration via application programming interfaces ("API"). The Company currently utilizes an electronic T&T system independent of METRC that will integrate with METRC via API. The Company's T&T system currently captures required data points for cultivation, distribution and retail as stipulated in BCC regulations. Certain processes remain manual, with proper control and oversight, in anticipation of METRC and greater integration of processes.

Storage and Security

To ensure the safety and security of cannabis business premises and to maintain adequate controls against the diversion, theft, and loss of cannabis or cannabis products, the Company is required to do the following:

- 1) maintain a fully operational security alarm system;
- 2) contract for security guard services;
- 3) maintain a video surveillance system that records continuously 24 hours a day;
- 4) ensure that the facility's outdoor premises have sufficient lighting;
- 5) not dispense from its premises outside of permissible hours of operation;
- 6) store cannabis and cannabis product only in designated areas per the premises diagram submitted to the state of California during the licensing process;
- 7) store all cannabis and cannabis products in a secured, locked room or a vault;
- 8) report to local law enforcement within 24 hours after being notified or becoming aware of the theft, diversion, or loss of cannabis; and
- 9) to ensure the safe transport of cannabis and cannabis products between licensed facilities, maintain a delivery manifest in any vehicle transporting cannabis and cannabis products. Only vehicles registered with the BCC, that meet BCC distribution requirements, are to be used to transport cannabis and cannabis products.

California Compliance Summary

As of the date hereof, the Company and its subsidiaries are in full compliance with California law. The Company maintains several layers of compliance and internal checks and balances in order to ensure ongoing compliance with California law.

Compliance Team: While the executive management and operational management team members are well versed on the most current cannabis regulations, we also leverage outside counsel and consultants as resources for the development of standard operating procedures and answer day-to-day questions as they come up.

Our primary counsel for California regulation and licensing is Ringgenberg Law, a respected Oakland cannabis firm founded by a former Boies Schiller & Flexner LLP partner. The Company also relies on Vicente Sederberg LLP, one of the best known cannabis firms in the industry. For the development of our contract with supply chain partners, we also worked closely with Hinman & Carmichael LLP, a leading law firm in beverage law for more than 25 years and for the past several years as a trusted firm for the cannabis industry as well.

For the development of operating procedures and ongoing day-to-day compliance questions, we primarily depended on our Director of Compliance, Andy Shelley. Mr. Shelley is a former Law Enforcement Officer, Crime Scene Investigator and Oregon State Marijuana Inspector. He was one of the first cannabis compliance inspectors hired by the state of Oregon and has personally inspected and licensed over 300 locations. Andy is also the owner of CannXperts, which oversees the compliance needs of approximately 25 other licensees in the state. The Director of Compliance is responsible for documenting all operating procedures and keeping them up to date, and is responsible for auditing each position in the Company to ensure these procedures are being followed and all documentation properly maintained. Additionally, he is responsible for evaluating each department for training opportunities, and scheduling and facilitating trainings as needed. The Company also worked closely for over a year with a compliance consultant, Lauren Fraser, the Executive Director for the Cannabis Distribution Association and a key stakeholder in California cannabis policy since May 2015. In January 2019, the Company hired Columbia Law School attorney Christopher Wimmer as Vice President of Legal & Compliance to provide internal legal and compliance support.

The Director of Compliance performs regular inspections at the licensed facilities in order to identify risks and to insure all employees and facilities are compliant with California laws and rules. Each location is subject to inspection by the state at any time, without warning. Therefore, surveillance equipment, security, product storage and products themselves must be compliant at all times. Inventories are routinely performed on all products to ensure quantities match those reported to the state's cannabis tracking system. Product labeling is also scrutinized to ensure that all products meet the strict packaging and labeling requirements for each state.

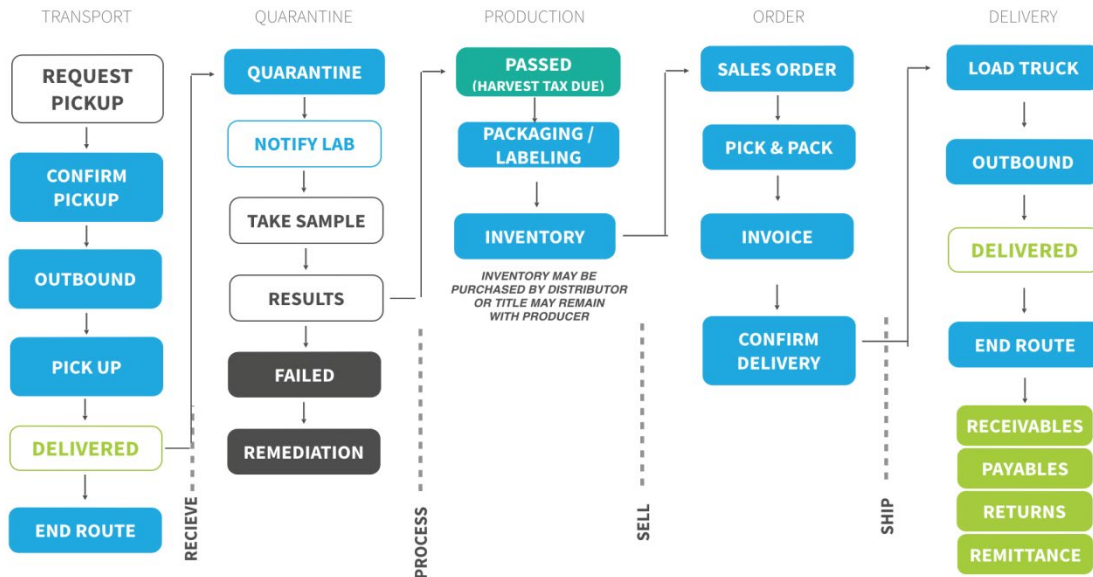
We maintain a Client Services Team with over six full-time personnel and growing. This team serves as the primary points of contact between licensed producer clients and the internal operational team. As that bridge, it is important that this team also be well versed on cannabis regulations. This team has direct access to our compliance officers for in-the-moment questions, maintains a database of responses to commonly asked questions, and receives regular compliance training.

Our Product Safety Manager is responsible for ensuring all product flowing through our distribution network undergoes mandatory state lab testing procedures before entering the commercial market. Additionally, a dedicated Track and Trace Administrator maintains a chain of custody on all products.

Our accounting team is responsible for, among several duties, ensuring cultivation and excise taxes are collected and remitted to the Department of Tax and Fee Administration and that all cannabis transactions are properly accounted for.

Compliance Technology Systems: Our custom developed technology platform tracks and maintains a database of every movement of product flowing into or out of our distribution network, and internally between facilities. The system safeguards the Company by limiting pick-ups and deliveries to only addresses of licensed facilities, pulling licensee data directly from the agencies' approved license databases. Our drivers, for example, can never be routed to a non-licensed premise as the system would recognize this as not matching an approved state licensed facility. Furthermore, the technology time-stamps each transaction and tracks the user who initiated the movement.

To illustrate the process flow, please find the illustration below:



Each step in the workflow diagram is accompanied by a series of physical processes and technology enabled procedures. Each vertical column represents a department or division within the organization’s warehouse and transportation operations.

Our law firm, Vicente Sederberg, has launched a compliance platform called Simplifya, which provides three core compliance functions: a) documented standard operating procedures up-to-date with latest state and local regulations, b) learning management system for initiating regular or ad hoc training for specific employees on specific regulation tests most relevant to their position, and c) document storage for all compliance documentation. The Company is in the process of onboarding this new tool, which will become the basis for our companywide compliance and quality management system of record. Maintaining this system will be the responsibility of the incoming Compliance Manager.

Nevada

Regulatory Landscape

Nevada has a medical marijuana program and passed adult-use legalization through the ballot box in November 2016. Previously, in 2000, Nevada voters passed a medical marijuana initiative allowing physicians to recommend cannabis for an inclusive set of qualifying conditions including chronic pain and created a limited non-commercial medical marijuana patient/caregiver system. Senate Bill 374, which was passed by the state legislature and signed by the Governor in 2013, expanded this program and established a for-profit regulated medical marijuana industry in Nevada.

The Nevada Division of Public and Behavioral Health licensed medical marijuana establishments up until July 1, 2017 when the state’s medical marijuana program merged with adult-use marijuana enforcement under the Nevada Department of Taxation. In 2014, Nevada accepted medical marijuana business applications and a few months later the Division approved 182 cultivation licenses, 118 licenses for the production of edibles and infused products, 17 independent testing laboratories, and 55 medical marijuana dispensary licenses. The number of dispensary licenses was then increased to 66 by legislative action in 2015. The application process is merit-based and competitive, and is currently closed. Residency is not required to own or invest in a Nevada medical cannabis business. In addition, vertical integration is neither required nor prohibited. Nevada’s medical law includes patient reciprocity, which permits medical patients from other states to purchase marijuana from Nevada dispensaries. Nevada also allows for dispensaries to deliver medical marijuana to patients.

After merging medical and adult-use marijuana regulation and enforcement, the single regulatory agency became the “Marijuana Enforcement Division of the Department of Taxation.” Under Nevada’s adult-use marijuana law, the Department of Taxation licenses marijuana cultivation facilities, product manufacturing facilities, distributors, retail stores and testing facilities. Retail marijuana licenses are issued within each county and unincorporated area proportionally based on the population of each jurisdiction. As of August 16, 2018 Nevada had 64 licenses yet to be allocated and conducted an application period for recreational licenses between October 30, 2018 and November 13, 2018. Currently, only medical marijuana establishments that hold a registration certificate(s) or ones that hold a provisional registration certificate(s) may apply. Any medical marijuana establishment that currently holds a retail marijuana license is not permitted to apply. In December 2018, the DOT issued 61 conditional adult-use dispensary permits. There are currently at least 24 licensed distributors that are medical marijuana establishments and at least six licensed distributors that are liquor distributors.

In the summer of 2017, the Department of Taxation began issuing “early start” recreational marijuana establishment licenses. These licenses expired at the end of 2017 but marijuana establishments holding both a retail marijuana store and dispensary license were allowed to sell their existing medical marijuana inventory as either medical or adult-use marijuana. In January 2018, the Nevada Department of Taxation approved permanent regulations to govern the industry. The adopted regulations included 66 new licenses and allowed for home delivery. Additionally, the new regulations included information on how the Department of Taxation will rank competing applications and break any ties. Included in the tiebreaking calculation will be, among other things, an applicant’s (including owners, officers, or board members): (1) prior business experience that is applicable to the marijuana establishment; and (2) amount of taxes paid or philanthropic involvement within the state.

Currently, The Department of Taxation has approved 126 Dispensaries, 121 Cultivation licenses, 84 Production licenses, and 10 laboratory licenses. Social use faculties are gaining some traction within the state, but are prohibited by statute until July 2021. Medical and adult-use marijuana incurs a 15% excise tax on the first wholesale sale (calculated on the fair market value) and adult-use cannabis incurs and additional 10% special retail marijuana sales tax in addition to any general state and local sales and use taxes.

Although Dayle Elieson, U.S. Attorney for the District of Nevada, has been relatively quiet on the issue of marijuana enforcement priorities,¹³ Nevada’s Governor, Brian Sandoval, stated in January 2018 that he would like to see Nevada’s U.S. Attorney take the same approach as Colorado’s U.S. Attorney by not enforcing federal laws against the legalized industry in the state.¹⁴ In February 2018, Nevada’s Attorney General Adam Laxalt stated, “I don’t really see a scenario where a U.S. Attorney is actually going to go down and shutdown recreational marijuana or legalized facilities that are recognized by the state.”¹⁵ Laxalt also added in regard to the ballot initiative to legalize recreational marijuana, “While I was opposed to the ballot initiative, I have done exactly what I promised... If voters want this, we’re going to do our job and support it.” Sandoval and Laxalt have each had meetings with Elieson.¹⁶ After his meeting, Sandoval would not disclose what was discussed but said, “There’s going to be a continuing dialogue with the U.S. Attorney’s office.” U.S. Senator Catherine Cortez Masto also met with Elieson, calling it a “positive conversation” in which Cortez Masto encouraged Elieson to “respect the spirit of the [Cole Memo].”¹⁷

¹³ Dehaven, James and Kane, Jenny. (2018 January 12). With pot shops’ fate in their hands, Nevada’s new U.S. Attorney remains mum on marijuana. Retrieved from <https://www.rgj.com/story/news/politics/2018/01/12/pot-shops-fate-her-hands-nevadas-new-u-s-attorney-remains-mum-marijuana/1029001001/>.

¹⁴ Marroquin, Art. (2018, January 8). Sandoval wants Nevada to follow Colorado plan on marijuana Retrieved from <https://www.reviewjournal.com/news/pot-news/sandoval-wants-nevada-to-follow-colorado-plan-on-marijuana/>.

¹⁵ Joecks, Victor. (2018 February 7). Laxalt talks education, Medicaid work requirements and what’s next for marijuana in Nevada. Retrieved from <https://www.reviewjournal.com/opinion/opinion-columns/victor-joecks/laxalt-talks-education-medicaid-work-requirements-and-whats-next-for-marijuana-in-nevada/>.

¹⁶ Rindels, Michelle. (2018 March 6). Sandoval, Laxalt meet with new U.S. attorney, but won’t say how conversations about marijuana went. Retrieved from <https://thenevadaindependent.com/article/sandoval-laxalt-meet-with-new-u-s-attorney-but-wont-say-how-conversations-about-marijuana-went>.

¹⁷ Sanchez, Humberto. (2018 March 22). Cortez Masto urged hands-off approach to marijuana with Nevada U.S. attorney in February. Retrieved from <https://thenevadaindependent.com/article/cortez-masto-urged-hands-off-approach-to-marijuana-with-nevada-u-s-attorney-in-february>.

Oregon

Oregon Regulatory Landscape

Oregon has both medical and adult-use marijuana programs. In 1998, Oregon voters passed a limited non-commercial patient/caregiver medical marijuana law with an inclusive set of qualifying conditions that include chronic pain. In 2013, the legislature passed, and governor signed, House Bill 3460 to create a regulatory structure for existing unlicensed medical marijuana businesses. However, the original regulations created by the Oregon Health Authority after the passage of House Bill 3460 were minimal and only regulated storefront dispensaries, leaving cultivators and infused-product manufacturers within the unregulated patient/caregiver system.

On June 30, 2015, Governor Kate Brown signed House Bill 3400 into law, which improved on the existing regulatory structure for medical marijuana businesses and created a licensing process for cultivators and processors. In November of 2014, Oregon voters passed Measure 91, “Control, Regulation, and Taxation of Marijuana and Industrial Hemp Act”, creating a regulatory system for individuals 21 years of age and older to purchase marijuana for personal use from licensed marijuana businesses.

The Oregon Health Authority licenses and regulates medical marijuana businesses and the OLCC licenses and regulates adult-use marijuana businesses. There are six distinct types of license types available for medical and adult-use businesses: cultivation, manufacturing (“processing”), wholesaling, dispensing, testing and research. Vertical integration between cultivation, processing, and sales is permissible, but not required, for both medical and adult-use.

The law does not impose a limit on the number of licenses and applications are currently being accepted for both medical and adult-use businesses on a rolling basis. Local governments may restrict the number of both medical or adult-use marijuana businesses. Laws passed during the 2016 legislative session removed the two-year residency requirement that existed within House Bill 3400.

On May 18, 2018, Billy J. Williams, U.S. Attorney for the District of Oregon, issued a memorandum outlining his office’s enforcement priorities related to marijuana.¹⁸ Williams listed the following primary enforcement priorities in the memorandum: (1) overproduction and interstate trafficking; (2) protecting Oregon’s children; (3) violence, firearms, or other public safety threats; (4) organized crime; and (5) protecting federal lands, natural resources, and Oregon’s environment. As to overproduction in particular, Williams stated, “there can be no doubt that there is significant overproduction of marijuana in Oregon[, and a]s a result, a thriving black market is exporting marijuana across the country, including to states that have not legalized marijuana under their state laws.” He also made clear that he “will not make broad proclamations of blanket immunity from prosecution to those who violate federal law,” but added that his “office’s resources are finite” and that they “must use appropriate discretion before prosecuting any federal case.” He went on to explain that his office will explore the use of civil law enforcement mechanisms, coordinate closely with partners in state, tribal, and local governments around the state, and “focus enforcement efforts on federal violations implicating one or more of the priority elements of this [memorandum].” Williams has told Oregon Governor Kate Brown’s senior policy advisor that he would like to see limits on licenses for marijuana producers and retailers.¹⁹

In June 1999, the White House Office of National Drug Control Policy created the Oregon-Idaho High Intensity Drug Trafficking Area program (“HIDTA”) to “facilitate, support and enhance collaborative drug control efforts among law enforcement agencies and community-based organizations; thus significantly reducing the impacts of illegal trafficking and use of drugs throughout Oregon and Idaho.”²⁰ In August 2018, HIDTA released a report entitled “An Initial Assessment of Cannabis in Oregon.” In response to this report’s findings, U.S. Attorney Williams issued the following statement:

¹⁸ The United States Attorney for the District of Oregon. (2018 May 18). Priorities in Enforcement of Federal Laws Involving Marijuana in the District of Oregon. Retrieved from [http://media.oregonlive.com/marijuana/other/2018/05/18/USAOR-Marijuana%20Enforcement%20Priorities-Final%20\(1\).pdf](http://media.oregonlive.com/marijuana/other/2018/05/18/USAOR-Marijuana%20Enforcement%20Priorities-Final%20(1).pdf).

¹⁹ Crombie, Noelle. (2018 May 18). Feds will target marijuana black market, overproduction in Oregon. Retrieved from https://www.oregonlive.com/marijuana/index.ssf/2018/05/black_market_overproduction_am.html.

²⁰ Oregon-Idaho High Intensity Drug Trafficking Area Program Overview. Retrieved from <http://oridhidta.org/>.

The recent HIDTA Insight Report on marijuana production, distribution, and consumption in Oregon confirms what we already know—it is out of control. The industry’s considerable and negative impacts on land use, water, and underage consumption must be addressed immediately. State officials should respond quickly and in a comprehensive manner to address the many concerns raised by this assessment. To date, we’ve seen insufficient progress from our state officials. We are alarmed by revelations from industry representatives, landowners, and law enforcement partners describing the insufficient and underfunded regulatory and enforcement structure governing both recreational and medical use. A weakly-regulated industry will continue to detract from the livability and health of communities throughout the state.

What is often lost in this discussion is the link between marijuana and serious, interstate criminal activity. Overproduction is rampant and the illegal transport of product out of state—a violation of both state and federal law—continues unchecked. My ask continues to be for transparency, responsible regulation, adequate funding, and a willingness to work together. It’s time for the state to wake up, slow down, and address these issues in a responsible and thoughtful manner.²¹

In late August 2018, federal prosecutors made six arrests related to marijuana allegedly being trafficked from Oregon to Florida, Texas, and Virginia.²² Those arrested were not affiliated with licensed recreational or medical programs in Oregon. In response to these arrests, Williams said, “These cases provide clear evidence of what I have repeatedly raised concerns over: Oregon’s marijuana industry is attracting organized criminal networks looking to capitalize on the state’s relaxed regulatory environment.”

Licenses

| Holding Entity | Permit/License | City | Expiration/Renewal Date (if applicable) (MM/DD/YY) | Description |
|---|-----------------------|----------------|---|-------------------------|
| Herban Industries OR LLC dba Winberry Farms | No.020 1011442A893 | Fall Creek, OR | 08/16/20 | Recreational Producer |
| | No. 060 1011452FFD4 | Eugene, OR | 01/17/20 | Recreational Wholesaler |

Regulatory Management and Reporting Requirements

The state of Oregon has selected Franwell Inc.’s METRC system as the state’s T&T system used to track commercial cannabis activity and movement across the distribution chain. The system allows for third-party system integrations via API. The Company currently utilizes an electronic T&T system independent of METRC that integrates with METRC via API. The Company’s T&T system currently captures required data points for cultivation, distribution and retail as stipulated in OLCC regulations. Certain processes remain manual, with proper control and oversight, in anticipation of greater integration of processes within METRC.

Storage, Security and Compliance

To ensure the safety and security of cannabis business premises and to maintain adequate controls against the diversion, theft, and loss of cannabis or cannabis products, the Company is required to do the following:

- 1) maintain a fully operational security alarm system;

²¹ The United States Attorney for the District of Oregon. (2018 August 2). U.S. Attorney Statement on Release of 2018 HIDTA Marijuana Insight Report. Retrieved from <https://www.justice.gov/usao-or/pr/us-attorney-statement-release-2018-hidta-marijuana-insight-report>.

²² Flaccus, Gillian. (2018 August 29). 6 arrests in pot trafficking case. Retrieved from <https://www.bendbulletin.com/localstate/6483494-151/6-arrests-in-pot-trafficking-case>.

- 2) contract for security guard services;
- 3) maintain a video surveillance system that records continuously 24 hours a day;
- 4) ensure that the facility's outdoor premises have sufficient lighting;
- 5) not dispense from its premises outside of permissible hours of operation;
- 6) store cannabis and cannabis product only in designated areas per the premises diagram submitted to the state of Oregon during the licensing process;
- 7) store all cannabis and cannabis products in a secured, locked room or a vault;
- 8) report to local law enforcement within 24 hours after being notified or becoming aware of the theft, diversion, or loss of cannabis; and
- 9) to ensure the safe transport of cannabis and cannabis products between licensed facilities, maintain a delivery manifest in any vehicle transporting cannabis and cannabis products.

Oregon Compliance Summary

As of the date hereof, the Company is in full compliance with Oregon law. The Company maintains several layers of compliance and internal checks and balances in order to ensure ongoing compliance with Oregon law.

Compliance Team: While the executive management and operational management team members are well versed on the most current cannabis regulations, we also leverage outside counsel and consultants as resources for the development of standard operating procedures and to answer day-to-day questions as they come up.

We have external regulatory counsel in the state of Oregon. For the development of our contract with supply chain partners, we also work closely with Hinman & Carmichael LLP, a leading law firm in beverage law for more than 25 years and for the past several years as a trusted firm for the cannabis industry as well.

For the development of operating procedures and ongoing day-to-day compliance questions, we primarily depended on our Director of Compliance, Andy Shelley. Mr. Shelley is a former Law Enforcement Officer, Crime Scene Investigator and Oregon State Marijuana Inspector. He was one of the first cannabis compliance inspectors hired by the state of Oregon and has personally inspected and licensed over 300 locations. Andy is also the owner of CannXperts, which oversees the compliance needs of approximately 25 other licensees in the state. The Director of Compliance is responsible for documenting all operating procedures and keeping them up to date, and is responsible for auditing each position in the Company to ensure these procedures are being followed and all documentation properly maintained. Additionally, he is responsible for evaluating each department for training opportunities, and scheduling and facilitating trainings as needed. The Company also worked closely for over a year with a compliance consultant, Lauren Fraser, the Executive Director for the Cannabis Distribution Association and a key stakeholder in cannabis policy since May 2015. In January 2019, the Company hired Columbia Law School attorney Christopher Wimmer as Vice President of Legal & Compliance to provide internal legal and compliance support.

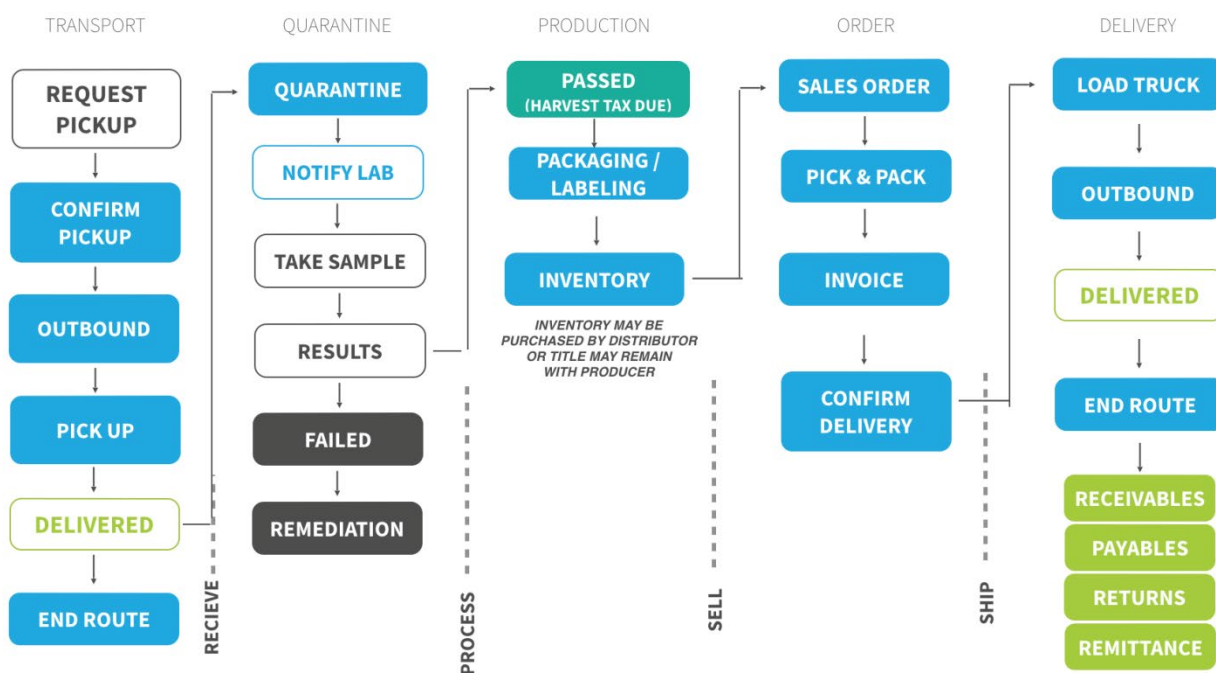
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We maintain a Client Services Team with over six full-time personnel and growing. This team serves as the primary points of contact between licensed producer clients and the internal operational team. As that bridge, it is important that this team also be well versed on cannabis regulations. This team has direct access to our compliance officers for in-the-moment questions, maintains a database of responses to commonly asked questions, and receives regular compliance training.

Our Product Safety Manager is responsible for ensuring all product flowing through our distribution network undergoes mandatory state lab testing procedures before entering the commercial market. Additionally, a dedicated Track and Trace Administrator maintains a chain of custody on all products.

Compliance Technology Systems and Inspection of Pick-Up and Delivery Facilities: Our custom developed technology platform tracks and maintains a database of every movement of product flowing into or out of our distribution network, and internally between facilities. The system safeguards the Company by limiting pick-ups and deliveries to only addresses of licensed facilities, pulling licensee data directly from the agencies’ approved license databases. Our drivers, for example, can never be routed to a non-licensed premise as the system would recognize this as not matching an approved state licensed facility. Furthermore, the technology time-stamps each transaction and tracks the user who initiated the movement.

To illustrate the process flow, please find the illustration below:



Each step in the workflow diagram is accompanied by a series of physical processes and technology enabled procedures. Each vertical column represents a department or division within the organization’s warehouse and transportation operations.

The Company’s external regulatory counsel has launched a compliance platform called Simplifya, which provides three core compliance functions: a) documented standard operating procedures up-to-date with latest state and local regulations, b) learning management system for initiating regular or ad hoc training for specific employees on specific regulation tests most relevant to their position, and c) document storage for all compliance documentation. The Company is in the process of on boarding this new tool, which will become the basis for our companywide compliance and quality management system of record. Maintaining this system will be the responsibility of the incoming Compliance Manager.

Massachusetts

Massachusetts Regulatory Landscape.

Massachusetts became the eighteenth state to legalize medical marijuana when voters passed a ballot measure in 2012. Adult-use (recreational) marijuana is legal in Massachusetts as of December 15, 2016, following the passage of a ballot initiative in November of that year. The Cannabis Control Commission (the "Commission"), a regulatory body created in 2016, oversees both the Medical Use of Marijuana Program and the Adult Use of Marijuana Program. Until December 23, 2018 the Department of Public Health was responsible for the Medical Use of Marijuana Program, but through statutory mandate the Commission assumed regulatory control of the medical program.

Under the Medical Use of Marijuana Program, a Registered Marijuana Dispensary ("RMD") is required to be vertically integrated, such that a single RMD license holder must cultivate, process, and dispense marijuana. For each RMD license, an RMD can carry out these three activities at up to two different locations. Some RMDs elect to do cultivation, processing, and retail operations all in one location. An RMD may also choose to have a retail dispensary in one location and grow marijuana at a remote cultivation location; in which case it may conduct the processing of the marijuana at either the retail dispensary location or the remote cultivation location. The remote cultivation location need not be in the same municipality or even the same county as the retail dispensary. RMDs may only wholesale purchase up to forty-five percent (45%), and may only wholesale sell up to forty-five percent (45%), of their annual inventory of marijuana and marijuana products from third-party RMDs (which percentage is calculated separately as to marijuana flower and marijuana infused products). RMDs with multiple licenses may designate a single cultivation and production facility to supply marijuana and marijuana products to their dispensary locations. Pursuant to the Commission's regulations, no executive, member, or entity owned or controlled by such executive or member, may directly or indirectly control more than three (3) RMDs (the "MA Control Limitation").

During the RMD application process, an RMD applicant must receive from the Commission a Provisional Certificate of Registration ("PCR"), a Final Certificate of Registration ("FCR"), and an Approval to Sell. The PCR is awarded by the Commission following the RMD applicant's successful completion of the first three stages of the RMD application process (Application of Intent, Management and Operations Profile, and Siting Profile). An RMD applicant receives an FCR following its successful completion of Architectural Review and a series of facility and operations-related inspections. Upon receipt of an FCR, an RMD is permitted to begin cultivation operations. Subsequent to receipt of an FCR, an RMD must successfully complete further inspections from the Commission in order to receive Approval to Sell, after which time the RMD may begin sales to registered, qualifying patients. As of February 12, 2019, Massachusetts had forty-nine (49) medical retail dispensaries open for sales to over 59,000 registered and active patients across the state.

Under the Adult Use of Marijuana Program, vertical integration is not required, and therefore multiple license-types exist. The Marijuana Cultivator, Marijuana Product Manufacturer, Marijuana Retailer licenses cover the three main operational license types (cultivation, processing, and retail sales). Licenses are also available for Independent Testing Laboratories, Research Laboratories, Transporters,²³ Craft Marijuana Cooperatives, and Microbusinesses. All license-types are described generally as Marijuana Establishments. No individual or entity can be a "controlling person" or have "decision-making authority" over more than three licenses in a particular class of license. Controlling Person is defined as an officer, board member, or other individual who has a financial or voting interest of 10% or greater in a Marijuana Establishment. Decision-making authority is defined as having (a) actual control of more than 50% of the voting equity of the power to appoint more than 50% of the directors, (b) contract rights to control, or (c) a right to veto significant events.

Marijuana Establishment applications are received and reviewed by the Commission on a rolling basis; however, applications submitted by Registered Marijuana Dispensaries that applied for and received "Priority" status, as well as applicants that successfully applied for status as Economic Empowerment Priority applicants, are reviewed prior to applications submitted by other applicants. The Marijuana

²³ There are two Transporter license types: Third-Party Transporter and Existing Licensee Transporter. Both licenses allow for the transportation of product between third-parties; the distinction between the two license-types is that the Existing Licensee Transporter License is what would be obtained by an entity that already holds another Marijuana Establishment license, whereas the Third-Party Transporter license would be held by an entity that only holds such license type. A Transporter license is not necessary for a Marijuana Establishment (such as a Marijuana Cultivator, Marijuana Product Manufacturer, or Marijuana Retailer) to transport product to or from its own facility.

Establishment application process includes, among other things, questions regarding site location, ownership, and control, as well as significant operational questions and background check submissions. Prior to submission of an application for a marijuana establishment license, an applicant must have completed a properly-noticed community outreach meeting in the municipality where the applicant is proposing its marijuana establishment operations, and the applicant must also enter into a host community agreement with that municipality.

Once a Marijuana Establishment application is submitted to the Commission, the Commission reviews the application before marking such application as complete. During that review, the Commission may issue Requests for Information, at which point an applicant must supplement the information previously provided. Once the application is marked complete by the Commission, the Commission must grant or deny a Provisional License not later than 90 days following notification to the applicant that the application was considered complete. The Commission makes determinations on Provisional Licenses for marijuana establishments in public hearings.

After a Provisional License is awarded, the licensee must begin registering agents and submit Architectural Review for the provisionally-licensed facility, which must be approved prior to facility build-out.²⁴ After build-out, the licensee must formally request an inspection, and presuming such inspection does not uncover additional items to be completed, the licensee will be scheduled for another public hearing before the Commission to receive a Final License. After receiving a Final License, the Licensee must successfully complete another series of inspections to receive approval to commence operations. The series of inspections between receiving a Final License and receiving Commence Operations from the Commission includes, among other things, ensuring appropriate packaging and labeling; registering with the Department of Revenue for tax purposes; and receiving/entering adult-use product into Metrc²⁵ and complying with all Metrc requirements. Once the licensee receives the commence operations designation from the Commission, the licensee may begin sales to other marijuana establishments or to consumers (as the license type dictates).

Colorado

Colorado Regulatory Landscape

Current State of Law in Colorado. Colorado has both medical and adult-use marijuana programs. In 2000, voters passed Amendment 20 to the Colorado Constitution, a medical marijuana law creating a patient/caregiver system that permits physicians to recommend cannabis for an inclusive set of qualifying conditions including chronic pain and allows cultivation of a limited number of plants by patients and caregivers for medical use. In 2010, Colorado became the first state in the country to establish a commercial state and local licensing and regulatory structure for medical marijuana centers, cultivators, and manufacturers. Colorado voters subsequently passed adult-use marijuana legalization by voter initiative in 2012 with Amendment 64 of the Colorado Constitution, and the first adult-use marijuana businesses opened in 2014. The laws governing medical and adult-use marijuana businesses are codified in C.R.S. §12-43.3-101 *et. seq.*, C.R.S. §12-43.4-101 *et. seq.*, and rules and regulations adopted thereto (the “**Colorado Regulations**”).

The Marijuana Enforcement Division, a subdivision of the Colorado Department of Revenue (the “**Colorado Regulators**”), regulates and licenses both medical and adult-use marijuana businesses in the state along with applicable local regulatory authorities. Separate medical and adult-use licenses are issued for: cultivation, product manufacturing and extraction, retail sales, off-storage premises facilities, transportation, and testing. In addition, the state issues occupational licenses for owners and employees of marijuana businesses. There are no limits on the number of licenses issued statewide, but localities can prohibit or otherwise regulate the number of establishments within their jurisdiction. Vertical integration is required for medical cultivation and dispensing businesses but is not required or prohibited for medical products manufacturers or any adult-use business types. The Colorado Regulators have a rolling non-competitive application process and business operations require both a state and local license.

²⁴ If the Marijuana Establishment facility is already substantially built-out, such as in the case of an RMD facility that is having an adult-use license applied to such facility, the architectural review process may be truncated or waived entirely.

²⁵ Metrc is the Commission required seed-to-sale tracking system for marijuana establishments. Licensees may also integrate a third-party seed-to-sale tracking software with Metrc as long as that third-party seed-to-sale tracking software is an approved vendor in Massachusetts by Metrc.

Compliance Program

The Company has placed a high priority on compliance. Compliance procedures are interwoven into all phases of Company operations to include revenue, employee onboarding, training and auditing. The Company's compliance program has been implemented in both California and Oregon, and will be similarly implemented in Massachusetts and Colorado once its operations commence in each state, respectively. In Nevada, under the Company's royalty agreement with Acres, Acres is responsible for ensuring the Company's products comply with state law. An ongoing review of compliance requirements takes place and has resulted in the following policies and procedures which are summarized below:

Operational, Employee Training and Onboarding

Two on site employees work directly with the Compliance Manager to ensure that compliance procedures are followed within the organization. The Compliance Manager has overall responsibility for local operations and works with the operations team to ensure that compliance procedures are correctly applied and implemented. The Product Safety Manager is assigned to screen all incoming products for state compliant labelling and warnings. The Safety Manager also monitors the laboratory testing requirements and ensures that all product transferred into the Company facility meets the applicable compliance testing and safety standards.

All employees are required to participate in periodic compliance reviews to maintain a current knowledge of the regulations they must follow. In addition, time is allotted for employee training during the Company all hands meetings, and employees are trained in regulations that pertain to their state. After the training, a review period occurs where employees may familiarize themselves with the regulations covered in the training. As a means of emphasizing the importance of compliance to employees, each is then required to sit for a short exam that requires them to cite the relevant regulation in their answers. The resultant score is used to determine which employees if any, need remedial education on the subject matter.

Additional training highlights the importance of proper conduct and the regulatory knowledge expected of every employee. Compliance, personal integrity and personal responsibility are stressed as a means of measuring each individual's performance.

Inspection of Downstream Retail Facilities

The controlling regulations in both Oregon and California require that the sale of cannabis products can only be between licensees except for a retailer who can sell direct to a consumer. However, California and Oregon approach how to maintain compliance with this rule differently. In Oregon, all sales and transfers are entered into the Marijuana Enforcement Tracking Reporting Compliance system ("METRC"). Each current and valid licensee is assigned an account on METRC. METRC is monitored by the Oregon Liquor Control Commission (OLCC), the state agency appointed to oversee cannabis compliance. When the OLCC revokes a license or when a license expires, the licensee's METRC account immediately becomes inactive. Once a licensee's account is inactive, the licensee can no longer conduct cannabis sales or transfers in the state.

Legislative Advocacy

The cannabis industry in the United States is complex. There are commonly 2 to 3 levels of regulatory oversight with some markets having more. It is important to understand how local county, state and even federal prohibition laws relate to each other to safely and compliantly conduct business in legal markets. The complexity of each market is highly dependent on local political support as well as state lawmakers' initiatives that are tied to federal lawmakers attempting to remove cannabis as a Schedule 1 drug. It is imperative that the Company leads the conversation at every possible level of regulatory oversight to enable safe and compliant expansion. Navigating this regulatory maze is a strategic and competitive advantage and places the Company in a leadership position. Having regulators consult with the Company leadership in new markets, allows for best business practices to be implemented and written into law, maximizing value creation.

The Company has deployed a team of seasoned professionals, enlisted from highly regulated industries with decades of experience, to engage the complex, highly regulated cannabis industry. This team is also comprised of current and past public officials that are well versed in public policy and regulatory demands. This team is responsible for relationships at all regulatory levels, providing appointed and elected officials access to the Company's thought leadership, especially during the adoption and creation of new and expanding laws. The Company sees the effort in creating and maintaining these relationships as an important business advantage.