

# **Cronos Group Inc. (formerly PharmaCan Capital Corp.)**

## **Management's Discussion & Analysis**

For the Three and Six Month Periods Ended  
June 30, 2017 and June 30, 2016

## Introduction

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This Management Discussion and Analysis ("MD&A") provides relevant information on the interim condensed results of operations and financial condition of Cronos Group Inc. (formerly PharmaCan Capital Corp.) (the "Company") for the three and six month periods ended June 30, 2017 and June 30, 2016. This MD&A should be read in conjunction with the interim condensed financial statements for the six month periods ended June 30, 2017 in addition to the audited consolidated financial statements for the year ended December 31, 2016.

This discussion contains forward looking information that is qualified by reference to, and should be read in conjunction with the Caution Regarding Forward Looking Statements below.

This MD&A provides information that the management of the Company believes is important to assess and understand the results of operations and financial condition of the Company. Our objective is to present readers with a view of the Company from management's perspective by interpreting the material trends and activities that affect the operating results, liquidity and financial position of the Company. All monetary amounts herein are expressed in Canadian dollars unless otherwise specified.

This MD&A is current as of August 28, 2017.

The Company's audited interim condensed financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

Additional information relating to the Company can be found on the SEDAR website at [www.sedar.com](http://www.sedar.com).

## Caution Regarding Forward-Looking Statements

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Certain information in this MD&A contains or incorporates comments that constitute "forward-looking" statements within the meaning of applicable securities legislation. Forward-looking statements are not historical facts and involve 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 statements. Such factors include, but are not limited to, the factors discussed in the section entitled "**Risk and Uncertainties**".

Generally, these forward-looking statements can be identified by the use of forward-looking terminology such as "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "continue", "anticipates" or "does not anticipate", or "believes" or variation of such words and phrases or state that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved". All forward looking statements are based on our beliefs and assumptions based on information available at the time the assumption was made. While the Company considers its assumptions to be reasonable and appropriate based on the current information available, there is a risk that they may not be accurate.

All forward-looking information is provided as of the date of this MD&A. There can be no assurance that forward-looking statements 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 statements. The Company does not undertake to update any forward-looking statements except as required by applicable securities laws.

## **Business of the Company**

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### Company Overview

Cronos Group Inc. (formerly PharmaCan Capital Corp.) was incorporated under the Business Corporations Act (Ontario) on August 21, 2012 as 2339498 Ontario Inc., changed its name on October 18, 2012 to Searchtech Ventures Inc. and was classified as a Capital Pool Company as defined pursuant to Policy 2.4 of the TSX Venture Exchange. During the year ended December 31, 2014, the shareholders of Hortican Inc. ("Hortican") completed a reverse takeover of PharmaCan Capital Corp. (formerly Searchtech Ventures Inc.). For purposes of accounting for the Transaction, Hortican is considered the acquirer, and thus, the interim condensed financial statements are a continuation of the financial statements of Hortican. These interim condensed financial statements include the accounts of Cronos Group Inc. (formerly PharmaCan Capital Corp.) and its wholly owned subsidiaries, Hortican Inc., In the Zone Produce Ltd. ("In the Zone"), and Peace Naturals Project Inc. ("Peace"). The Company began rebranding itself as Cronos Group Inc. on October 6, 2016. The Company finalized its name change to Cronos Group Inc. on February 27, 2017.

The Company's business has grown into two segments. The first segment is the business of investing in companies either licensed, or actively seeking a license, to produce medical marijuana pursuant to the Access to Cannabis for Medical Purposes Regulations, ("ACMPR"), which replaced the Marijuana for Medical Purposes Regulations ("MMPR"). The second segment is the operation and continued development of entities which are already licensed under the ACMPR.

### Access to Cannabis for Medical Purposes Regulations

The ACMPR was developed in response to the February 2016 Federal Court of Canada decision in *Allard v. Canada*, which ruled that restricting individuals to obtaining marijuana only from licensed producers violated individual protected rights. The new regulations enable an individual to produce their own marijuana for personal use, or designate someone to produce it for them. The ACMPR adopts the concept, authorized activities, and application requirements for producer's licenses under the MMPR. In addition, the ACMPR enables the production and sale of starting materials, including marijuana seeds and plants.

Health Canada estimates that within a decade, the medical marijuana marketplace will grow to at least 400,000 registered patients, generating annual sales of approximately \$1.3 billion. As of August 28, 2017, fifty-six producer's licenses have been issued by Health Canada.

The Government of Canada has introduced Bill C-45, the Cannabis Act, providing for the legalization of recreational cannabis in Canada. The draft Cannabis Act does not amend or repeal the ACMPR. The Cannabis Act is draft legislation and there can be no assurance that it will be enacted in its current form or at all.

## Investments

As at June 30, 2017, the Company has invested in and made loans to:

- (a) *Whistler Medical Marijuana Corporation* (“*Whistler*”) (\$4,058,154 book equity and 17,200,000 estimated fair value). Whistler is a corporation incorporated under the laws of British Columbia, and is a licensed producer and seller of medical marijuana with operations in Whistler, British Columbia. The Company has invested an additional \$1,075,800 in WMMC during the six month period ended June 30, 2017 in order to maintain its 21.5% equity position. Based on the most recent equity financing, which was done at a post money valuation of \$80,000,000, management believes the market value of its equity position is approximately \$17,200,000.
- (b) *Canopy Growth Corp.* (“*Canopy*”) (\$235,099 equity). Canopy is a corporation incorporated under the laws of Canada, and is the parent company of licensed producers and sellers of medical marijuana. Canopy’s common shares are listed on the TSX, under the trading symbol “WEED”. During the six months ended June 30, 2017, the Company sold some of its shares of Canopy for proceeds of \$87,653. The remaining shares of Canopy are held in escrow and may be released upon certain conditions related to Vert Medical.
- (c) *Evergreen Medicinal Supply Inc.* (“*Evergreen*”) (\$300,000 equity, and \$314,089 loan receivable). Evergreen is a corporation incorporated under the laws of British Columbia, with facility and operations in Victoria, British Columbia. During the six months ended June 30, 2017, the Company filed a claim in the Supreme Court of British Columbia against Evergreen and its directors, seeking, among other things, declarations that the Company holds equity of Evergreen and that the agreement between the parties in respect of its equity is a valid and binding contract.
- (d) *AbCann Global Corporation* (“*AbCann*”) (\$3,184,548 equity and \$1,201,104 in warrants). AbCann is a privately-held corporation incorporated under the laws of Ontario which has obtained a license for cultivation and sale of medical cannabis from Health Canada. AbCann entered into a reverse takeover during the three months ended June 30, 2017 and are listed on the TSX-V under the trading symbol “ABCN”. The Company subscribed for additional shares of AbCann of \$1,016,000 during the period. Furthermore, the Company sold some of its shares of AbCann for proceeds of \$1,682,548.
- (e) *The Hydropothecary Corporation* (“*Hydropothecary*”) (\$726,003 equity). Hydropothecary is a publicly traded corporation incorporated under the laws of Canada which has obtained licenses for the cultivation and sale of medical cannabis and the production and sale of fresh marijuana and cannabis oil from Health Canada. During the six months ended June 30, 2017, BFK Capital Corp. acquired all of the outstanding shares of Hydropothecary Corporation, and began trading as Hydropothecary Corporation on the TSX-V, under the trading symbol “THCX”. As a result of this transaction, Hydropothecary Corporation executed a 6:1 stock split.

## Acquisition of Peace

On September 6, 2016, the Company acquired all issued and outstanding shares of Peace Naturals Project Inc., a company headquartered in Stayner, Ontario and incorporated under the laws of Canada. Peace is a licensed producer and seller of medical cannabis from its facility in Ontario. Consideration for the acquisition included \$6,247,543 in cash and \$2,590,367 to be paid at a future date. As the Company previously held shares of Peace, the acquisition is considered a step acquisition and resulted in a loss due to fair value re-measurement. The preliminary purchase price allocation for this acquisition is shown below:

<b>Fair value of consideration transferred:</b>	
Cash	\$ 6,247,543
Liability	2,590,367
	<b>8,837,910</b>
<b>Fair value of previously held interest:</b>	
Fair value of interest held immediately before acquisition	3,314,960
Loss due to fair value re-measurement	(346,970)
	<b>2,967,990</b>
	<b>\$ 11,805,900</b>
<b>Fair value of net assets acquired:</b>	
Cash	109,443
Accounts receivable	50,647
Prepaid and deposits	29,000
Loans receivable	16,167
Inventory	1,194,417
Biological assets	865,452
Property and equipment	10,281,935
Other intangible assets	9,595,824
Goodwill	1,400,000
Accounts payable	(2,876,239)
Loans payable	(7,460,836)
Deferred tax liability	(1,400,000)
	<b>\$ 11,805,900</b>

Due to the complexities in identifying certain intangible assets, such as licenses and intellectual property, and assigning fair values, the Company has yet to finalize its assessment of the purchase price allocation. The allocation of the consideration paid will be adjusted once a valuation of certain intangible assets has been finalized. Management expects to complete the assessment by the end of Q3 2017.

During the six months ended June 30, 2017, approximately 50% of the liability has been repaid by the Company, resulting in a remaining balance of \$1,291,496.

## Overall Performance

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The Company's efforts have been focused on operating In the Zone and Peace and establishing international distribution channels, and optimizing production. In the Zone continued production in 2017.

During the six months ended June 30, 2017, In the Zone obtained a license to sell medicinal marijuana from Health Canada. Product produced at In the Zone is sold to Peace at arms-length terms in bulk form and then packaged and sold to patients by Peace. During the six months ended June 30, 2017 In the Zone Produce sold 26 kilograms of medical marijuana to Peace.

During the six month period ended June 30, 2017, the Company incurred approximately \$5,529,355 (six month period ended June 30, 2016 - \$69,613) of capital expenditures. Of which, during the three month period ended June 30, 2017, the Company incurred approximately \$3,493,762 (three month period ended June 30, 2016 - \$9,996) of capital expenditures. The majority of these expenditures related to improvements and construction on the production facility used in the production of medical marijuana at Peace.

### **The Company has undertaken significant improvements to the existing facilities at Peace:**

- The original facility ("B1") has been retrofitted to increase production capacity. A new two-tier hydroponic methodology will be employed using LED lighting. The Company expects to resume growing late in Q3F17 or early in Q4F17.
- The Company completed its new extraction laboratory in B1, including a state-of-the-art supercritical and subcritical CO<sub>2</sub> and commercial oil production methodology ("New Oil Program") approved in late Q3F17. The Company has a Health Canada inspection scheduled for mid-September after which it expects to significantly ramp up oil production and sales. In anticipation of the New Oil Program, the Company has saved a significant amount of extract grade inventory, which it expects to convert to oil and sell to patients in Q4F17.
- The planned renovations and improvements to the first 15,000 square foot purpose built production facility ("B2") have been completed. B2 is now fully operational and harvests have been completed in all flower rooms.
- Substantial renovations and improvements to the second 15,000 square foot purpose built production facility ("B3") have been completed and there are ongoing improvements being made. The Company completed its first harvest in B3 in August 2017 and expects B3 to be fully operational during Q3F17.

### **The Company began construction on 315,000 square feet of new production facilities:**

- The Company is building a 28,000 square foot hybrid greenhouse (the "Greenhouse"). The Greenhouse will provide low-cost flower for extraction in a 1,200 square foot pharmaceutical-grade extraction lab that will be connected to the Greenhouse. Construction of the Greenhouse is progressing well and the Company expects the Greenhouse to be operational in Q4F17.
- The Company is also building a 286,000 square foot facility ("B4"). In addition to large scale cultivation of premium dried flower, B4 will include: (a) designated areas for proprietary genetic breeding, (b) pharmaceutical laboratory for cannabinoid and terpene extraction, identification, and formulation, (c) R&D space for analyzing metabolite enhancement and new lighting technologies, (d) tissue culture laboratory, (e) industrial-grade kitchen and (f) processing infrastructure capable of supporting output from other Cronos facilities. Construction is progressing well and the superstructure is expected to be completed in November 2017. Production from B4 is expected to be fully operational in Q3F18.

## Update on Indigenous Roots:

- On December 06, 2016, the Company launched a joint venture ("Indigenous Roots") led by Phil Fontaine, former National Chief of the Assembly of First Nations. Indigenous Roots is a medical cannabis company that will work cooperatively with Canadian First Nations towards building and operating licensed facilities and providing medical cannabis to First Nations. Cronos owns a 49.9% stake in Indigenous Roots.
- The Company believes that Indigenous Roots will provide the Company with optionality for non-traditional distribution channels, incremental production capacity without dilution, and a strong brand for its portfolio.
- Indigenous Roots has commanded significant interest, having met with over 100 indigenous communities/leaders across Canada. Indigenous Roots is in the process of finalizing its capital raise. Once completed, Indigenous Roots will commence construction of a 30,000 square foot production facility at In the Zone.

During the six month period ended June 30, 2017, the Company issued 7,705,000 common shares in a bought deal offering, at \$2.25 per share.

During the three month period ended June 30, 2017, the Company repaid substantially all of its debt obligation, consisting of the \$4,000,000 mortgage payable obtained from the acquisition of Peace.

## Results of Operations

### Select Financial Information

The following table provides a summary of the interim condensed results of the Company for the three and six month periods ended June 30, 2017, and the comparative periods ended June 30, 2016 and 2015:

Statements of Operations and Comprehensive Income	Three months ended June 30, 2017	Three months ended June 30, 2016	Three months ended June 30, 2015
Product sales	\$ 643,701	\$ -	\$ -
Gain on revaluation of biological assets	1,297,023	40,468	-
Inventory expensed to cost of sales	644,429	-	-
Production costs	175,121	64,053	46,965
Investment income (loss)	1,643,613	(1,314,166)	(81,952)
Expenses	2,612,908	560,748	427,882
Net income (loss)	174,879	(1,842,499)	(556,799)
Gain on revaluation of other investments	11,820	-	-
Total comprehensive income (loss)	186,699	(1,842,499)	(556,799)
Weighted average number of outstanding shares, basic	132,647,546	43,168,381	34,848,698
Weighted average number of outstanding shares, diluted	167,787,028	43,168,381	34,848,698
Basic and diluted income (loss) per share	\$ 0.00	\$ (0.04)	\$ (0.02)

<b>Statements of Operations and Comprehensive Income</b>	<b>Six months ended June 30, 2017</b>	<b>Six months ended June 30, 2016</b>	<b>Six months ended June 30, 2015</b>
Product sales	\$ 1,157,457	\$ -	\$ -
Gain on revaluation of biological assets	3,109,990	40,468	-
Inventory expensed to cost of sales	1,700,545	-	-
Production costs	410,356	98,459	95,681
Investment income (loss)	1,692,931	(1,328,980)	(253,376)
Expenses	4,541,035	1,043,658	965,287
Net loss	(669,558)	(2,332,629)	(1,314,344)
Gain on revaluation of other investments	694,340	-	-
Total comprehensive income (loss)	24,782	(2,332,629)	(1,314,344)
Weighted average number of outstanding shares, basic and diluted	128,824,503	43,168,381	34,827,233
Basic and diluted loss per share	\$ (0.01)	\$ (0.05)	\$ (0.04)

The net loss decreased and became net income during the three months ended June 30, 2017 compared to the three month period ended June 30, 2016 due to the sale of other investments during the period, as well as the generation of revenue through product sales. Similarly, the net loss decreased during the six months ended June 30, 2017 compared to the six month period ended June 30, 2016.

#### Revenues

Peace and In the Zone have a license to produce and sell medicinal marijuana. The Company earned \$643,701 in revenue from product sales made by Peace during the three month period ended June 30, 2017, and \$1,157,457 in revenue during the six month period ended June 30, 2017.

#### Cost of sales

The operations of In the Zone and Peace caused an increase in production costs of \$111,068 when comparing the three month periods ended June 30, 2017 and June 30, 2016. Product costs increased by \$311,897 comparing the six month periods ended June 30, 2017 and June 30, 2016. Furthermore, the product sales made by Peace resulted in \$362,678 of inventory expensed to cost of sales during the three month period ended June 30, 2017 which includes a cost of \$106,856 associated with a goodwill loyalty credit granted to all patients, as well as a write-down in inventory to net realizable value of \$281,751. The Company reported a gain on the revaluation of biological assets of \$1,297,023 during the three month period ended June 30, 2017, and \$3,109,990 during the six month period ended June 30, 2017, representing an increase in the fair value of the medicinal marijuana plants of both Peace and In the Zone.

#### Investment income (loss)

During the three months ended June 30, 2017, the Company earned \$313,390 in income from its equity investment, Whistler, in which the Company owns 21.5%, as Whistler continued to generate income from its operations. The income is further increased due to the revaluation of AbCann Global Corporation shares and share warrants during the period.



### Expenses

Salaries and benefits have increased from Q2 2016 to Q2 2017, which included an increase in stock-based compensation due to vesting of options previously issued. Salaries and benefits only relate to the investing segment of the business. Salaries and benefits associated with the operational segment of the business are included in Production costs. Production costs represent costs incurred on inventory sold during the period, which have increased during Q2 2017, as Peace sold products in Q2 2017. Inventory expensed to cost of sales includes the transfer of net realizable value from inventory to cost of sales for products sold, in addition to production costs capitalized to inventory and subsequently written down as biological assets are transferred to inventory at fair value less costs to sell. Interest expense during the period includes interest on Peace's \$4,000,000 mortgage, which was repaid during the quarter.

### Other comprehensive income

Other comprehensive income has increased from Q2 2016 to Q2 2017 due to the increase in fair value of the investments in AbCann Global Corporation. This gain is offset by the decrease in fair value of Hydroponthecary and Canopy. As these investments are accounted for as available-for-sale investments, the gains are recorded in other comprehensive income.

The following table provides a summary of the interim condensed financial position of the Company as at June 30, 2017, as at December 31, 2016 and as at December 31, 2015:

<b>Statements of Financial Position</b>	<b>As at June 30, 2017</b>	<b>As at December 31, 2016</b>	<b>As at December 31, 2015</b>
Total assets	\$ 55,098,523	\$ 42,900,596	\$ 14,723,846
Total liabilities	4,110,588	9,222,967	3,021,991
Working capital (deficiency)	10,496,268	320,621	(1,101,906)
Share capital	51,566,126	33,590,324	14,799,821
Accumulated deficit	6,885,127	6,215,569	5,025,498
Accumulated other comprehensive income	\$ 1,587,374	\$ 1,584,490	\$ Nil

### Total assets

Total assets increased from December 31, 2016 to June 30, 2017 primarily due to capital asset additions made in Peace, the increase in fair value of the biological assets, as well as the Company's equity raises. The operations of Peace and In the Zone resulted in biological assets of \$2,784,791, and inventory of \$2,713,241 as at June 30, 2017. Peace has been operating in its current facility and is in the process of building another facility, resulting in the addition of \$5,529,355 in property, plant, and equipment.

### Total liabilities

Total liabilities decreased from December 31, 2016 to June 30, 2017 due to the partial repayment of the purchase price liability which arose from the acquisition of Peace during 2016, as well as the full repayment of the mortgage payable of \$4,000,000.

### Share capital

Share capital increased from December 31, 2016 to June 30, 2017, as a result of the bought deal offering in March 2017, resulting in the issuance of 7,705,000 common shares, increasing share capital by \$17,336,250. In addition, there were various stock options and warrants exercised during the six month period ended June 30, 2017, increasing share capital by \$689,042 and \$1,272,152 respectively.

### Accumulated deficit

Accumulated deficit continues to increase as the Company generated a net loss during the six month period ended June 30, 2017. However, the accumulated deficit has decreased when comparing June 30, 2017 to March 31, 2017, as a net income was generated during the second quarter. There were no dividends declared or paid in the period, and no other transactions with shareholders impacting accumulated deficit.

### Accumulated other comprehensive income

This balance includes the fair value increases and decreases in the investment in Canopy, AbCann, and Hydropothecary based on their publicly traded share prices at June 30, 2017, which is included in other comprehensive income since the investments are classified as available-for-sale.

### Discussion of Operations

#### In The Zone

During the three month ended June 30, 2017, In the Zone continued production of medicinal marijuana. There were minimal improvements to the facility, as most efforts during the period were focused on production, yielding biological assets valued at \$183,690 and inventory of \$152,888. During the six months ended June 30, 2017, the Company obtained a license to sell medicinal marijuana from Health Canada and sold 26 kilograms of medical marijuana to Peace valued at \$196,950.

#### Peace Naturals Project Inc.

During the three months ended June 30, 2017, Peace continued to make improvements on its production facilities. Peace continued to produce and sell medicinal marijuana, and generated product sales of \$643,701 during the period.

The Company has also been focused on patient acquisition and commencing outreach programs with educational and access centers, hosting community based patient supply groups, and onboarding new clients at an accelerated rate. Peace has registered over 4,750 patients since being granted its license in 2013.

The upgraded production infrastructure and improved cultivation methods at Peace have already resulted in significant yield increases. As a result, the production capacity for existing facilities is expected to increase to approximately 5,000 kilos per year. Additionally, the Company has significantly upgraded its extraction infrastructure, acquiring a customized CO2 extraction system capable of efficiently producing upwards of 6,000 liters of finished cannabis oil annually. The Company expects material increases to both extract production and sales in the coming quarters. As part of the global strategy, management has focused on developing and solidifying the Company's international distribution channels. Peace Naturals is now distributing cannabis through 1,000 pharmacies in Germany.

During the three months ended June 30, 2017, Peace was notified by Health Canada that upon testing a random cannabis leaf sample, trace levels of Piperonyl Butoxide (PBO) were discovered at 0.78 parts per million (ppm). PBO is an organic compound known as a synergist. Peace's root cause analysis concluded that this was the result of cross-contamination from a sanitation protocol that is no longer practiced at Peace. The sanitation protocol has not been practiced since new management implemented

an improved production methodology after taking control of Peace. The source of the PBO was a PMRA approved product that was used to sanitize empty rooms between harvests. Out of an abundance of caution, Peace assessed which lots were impacted, notified patients, and voluntarily recalled any products that were even potentially implicated. As a goodwill gesture, Peace offered all patients a loyalty discount. During the three months ended June 30, 2017 no recalled product was returned to Peace and goodwill credits were issued in the amount of \$106,856 included as part of cost of goods sold.

Peace is subject to three ongoing claims for damage as disclosed in the notes of the interim condensed financial statements. The Company believes that all three allegations contained in the statement of claims are without merit and plans to vigorously defend itself; accordingly, no provision for loss has been recognized. As the date of the MD&A no further actions or updates have occurred.

### Summary of Quarterly Results

	<b>Q2 Three month period ended June 30, 2017</b>	<b>Q1 Three month period ended March 31, 2017</b>	<b>Q4 Three month period ended December 31, 2016</b>	<b>Q3 Three month period ended September 30, 2016</b>
Net income (loss)	\$ 174,879	\$ (844,437)	\$ 1,370,165	\$ (227,607)
Total comprehensive income (loss)	\$ 186,699	\$ (161,917)	\$ 2,736,740	\$ (9,692)
Basic earnings (loss) per share	\$ 0.00	\$ (0.01)	\$ 0.01	\$ (0.00)
Diluted earnings (loss) per share	\$ 0.00	\$ (0.01)	\$ 0.01	\$ (0.00)

	<b>Q2 Three month period ended June 30, 2016</b>	<b>Q1 Three month period ended March 31, 2016</b>	<b>Q4 Three month period ended December 31, 2015</b>	<b>Q3 Three month period ended September 30, 2015</b>
Net income (loss)	\$ (1,842,499)	\$ (490,130)	\$ 2,193,844	\$ (493,334)
Basic earnings (loss) per share	\$ (0.04)	\$ (0.01)	\$ 0.06	\$ (0.01)
Diluted earnings (loss) per share	\$ (0.04)	\$ (0.01)	\$ 0.05	\$ (0.01)

Through quarters two and three of fiscal 2015, the net loss and basic and diluted loss per share remained relatively consistent. There were significant changes in Q4F15, specifically related to the reclassification of Peace from equity-accounted to available-for-sale, which resulted in a gain of \$4,590,321. Further, there was various impairment losses recognized in Q4F15, \$1,448,292 on Evergreen and Vert. Diluted earnings per share in Q4F15 was calculated using a weighted average number of shares of 43,694,412. In quarters two and three of 2015, the weighted average number of shares for basic and diluted loss per share remained consistent, because the Company was in a net

loss position, and therefore all instruments were anti-dilutive. In Q4F15, the Company was in a net income position, and as a result, there were dilutive instruments included in the calculation.

In Q1F16, the net loss returned to the consistent position as the three first quarters of 2015, as there were no significant changes in the quarter. In Q2F16, the loss increased due to the revaluation of Peace, resulting in a \$1,325,984 loss recognized. In Q3F16, the Company was in a loss position, but the loss is significantly less than in previous quarters due to the reversal of impairment losses of \$725,150, the gain on revaluation of biological assets of \$392,405, and product sales of \$123,647 generated through the acquisition of Peace. In Q4F16, the quarterly income was due to the product sales of \$430,556 generated during the quarter as well as the large gain on revaluation of biological assets.

In Q1F17, the return to net loss position is due to expenses incurred as the Company is working on its next investment opportunity and increase in salaries as the Company continues to grow. This is offset by the gain on revaluation of other investments which is recorded as other comprehensive income.

In Q2F17, the quarterly income is due to the gain on the sale of shares of AbCann Global Corporation, as well as gains due to other investments. Furthermore, the Company continues to generate product sales through its subsidiary Peace, contributing to the positive net income.

## **Liquidity**

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The Company may seek to raise additional funds so that it may fund its expansion of operations, which represent the Company's working capital requirements, and fund new investment opportunities. The amount and timing of raising additional funds will depend on variables such as, the state of the capital markets, investor interest in medical cannabis companies, and investment opportunities available.

During the six month period ended June 30, 2017, the Company raised \$17,336,250 in cash through its bought deal offering.

Based on the current investee group, the Company estimates that its annual expenses are expected to be approximately \$8.2 million (or \$680,000 per month), the major components of which include production costs (\$2,500,000 per year or \$208,000 per month), payroll (\$3,725,000 per year or \$310,000 per month), professional fees (approximately \$1,000,000 per year or \$83,000 per month), and general and administrative costs (\$1,000,000 per year or \$83,000 per month).

As part of the acquisition of Peace Naturals the Company will make a final payment of the purchase price to former Peace shareholders in the amount of \$1,291,496 on September 5, 2017.

The Company divested a portion of its equity interest in Canopy during the six months ended June 30, 2017 for proceeds of \$87,653. The Company also divested a portion of its equity interest in AbCann Global Corporation during the three months ended June 30, 2017 for proceeds of \$1,682,548.

On August 24, 2017 the Company announced that it has entered into a commitment letter for \$40 million in debt financing with Romspen Investment Corporation to fund the continued construction of its 315,000 sq. ft. expansion previously announced on May 23, 2017.

The Company must continue to ramp up operations in Peace and In the Zone to generate positive cash from operations, and raise additional debt and/or equity financing or divest non-core investment assets to fund operations including production expansion and investment opportunities.

## **Capital Resources**

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The Company manages its capital with the objective of maximizing shareholder value and ensuring that it has appropriate resources to foster the growth and development of the business.

As of the date of this MD&A, the Company's authorized share capital is an unlimited number of common shares of which 135,931,619<sup>1</sup> are issued and outstanding. The Company also has 11,902,098 stock options<sup>2</sup>, and 39,842,586 warrants outstanding<sup>3</sup>.

During the three months ended June 30, 2017, Evergreen received a cultivation license under the ACMPR. As a result, the Company completed its subscription for a second tranche of shares of Evergreen for \$100,000 and exercised its option to acquire an additional 5% of the equity of Evergreen for \$500,000, for a total additional investment of \$600,000. However, Evergreen, through its counsel, has indicated that the Company is not entitled to any interest in Evergreen and has rejected the payment. The Company filed a statement of claim in the Supreme Court of British Columbia and Evergreen has filed a statement of defence. The Company intends to vigorously pursue the enforcement of its rights to acquire equity in Evergreen.

Subsequent to the period end, the Company entered into a commitment letter for \$40 million in debt financing. The loan is secured for a first mortgage on the real estate of each of Peace and In the Zone. In the Zone, Hortican and the Company are also guarantors of the loan. The loan bears interest at a rate of 12% per annum, and has a 2 year term with a one-year extension option, and is repayable on one-month's notice.

## **Transactions between Related Parties**

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The Company paid \$105,768 (2016 - \$91,058 expense) in salaries and benefits owing to key management during the three months ended June 30, 2017. In addition, there was \$59,786 in professional fees paid during the three months ended June 30, 2017 (2016 - \$21,650). Further, the vesting of options resulted in share-based compensation of \$160,645 during the three months ended June 30, 2017 (2016 - \$Nil). Key management is compensated for providing planning, directing and controlling activities to the Company.

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<sup>1</sup> Subsequent to June 30, 2017, the Company issued 83,333 shares upon the exercise of stock options, and issued 2,705,960 shares upon the exercise of warrants. As a result of the agreement with ITZ's founders as described in Note 15(a)(i) of the interim condensed financial statements for the year ended December 31, 2015, 426,780 shares were effectively repurchased for cancellation during Q3 2015. An aggregate of 170,712 of the shares are held in escrow as of the date of this MD&A and will be cancelled immediately upon release from escrow.

<sup>2</sup> Subsequent to June 30, 2017, 83,333 options were exercised at an exercise price of \$0.50.

<sup>3</sup> Subsequent to June 30, 2017, 2,300,000 warrants were exercised at an exercise price of \$0.245, 157,894 warrants at an exercise price of \$0.31, and 248,066 warrants at an exercise price of \$0.08.

## Additional Disclosure for Venture Issuers without Significant Revenue

### Administrative Expenses

Statements of Operations and Comprehensive Income	Three months ended June 30, 2017	Three months ended June 30, 2016	Six months ended June 30, 2017	Six months ended June 30, 2016
Salary and benefits	\$ 1,264,954	\$ 260,044	\$ 1,928,799	\$ 324,796
Advertising and promotion	62,378	8,653	101,583	10,735
Consulting fees	118,379	26,911	371,294	73,569
Professional fees	671,963	133,580	1,088,951	321,810
Office expenses	259,097	20,982	455,455	71,949
Interest expense	(13,400)	37,001	142,147	84,247
Travel	21,230	9,728	23,949	29,540
Other	228,307	63,849	428,857	127,012
	<b>\$ 2,612,908</b>	<b>\$ 560,748</b>	<b>\$ 4,541,035</b>	<b>\$ 1,043,658</b>

The increase in salary and benefits between June 30, 2016 and June 30, 2017 in the amount of \$1,004,910 is mainly due to the vesting of issued options during 2016 and 2017, as well as compensation for additional employees due to the acquisition of Peace during 2016.

The increase in professional fees and consulting fees in the amount \$ 629,851 is due to additional legal fees associated with the Company's investments, litigation, and the negotiation of the Company's Canadian and international production and distribution joint ventures.

The year over year increase in advertising and promotion in the amount of \$53,725 is due to management's decision to incur such costs to increase sales in Peace.

The decrease in interest expense in 2017 relates primarily to the amortization of the fair value increment associated with the \$4,000,000 mortgage payable as part of the acquisition of Peace, which was acquired by the Company at fair value when the acquisition took place in Q3 2016. The amortization reduced interest expense during the period.

The increase in other expenses in the amount of \$164,459 is primarily related to increased depreciation expense due to the depreciation of additional property, plant, and equipment purchases by Peace during the period.

## **New Accounting Pronouncements**

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The International Accounting Standards Board has not issued any new standards, amendments to standards, or interpretations that impact the Company during the three months ended June 30, 2017. The Company's evaluations of previously issued new standards, amendments to standards, and interpretations are consistent with those disclosed in note 3 of the Company's interim condensed financial statements. New accounting pronouncements not yet mandatorily effective have not been applied in preparing these interim condensed financial statements.

## **Estimates and critical judgments by management**

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The preparation of these interim condensed financial statements in conformity with International Financial Reporting Standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the interim condensed financial statements and the reported amounts of revenues and expenses during the current year. These estimates are reviewed periodically and adjustments are made to income as appropriate in the year they become known. Items for which actual results may differ materially from these estimates are described in the following section.

### Warrants and options

In calculating the value of the warrants and options, management is required to make various assumptions and estimates which are susceptible to uncertainty, including the volatility of the share price, expected dividend yield and expected risk-free interest rate.

### Useful lives of property, plant and equipment

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

### Biological assets and inventory

Biological assets, consisting of cannabis plants, are measured at fair value less cost to sell up to the point of harvest. Determination of the fair values of the biological assets requires the Company to make assumptions about how market participants assign fair values to these assets. These assumptions primarily relate to the level of effort required to bring the cannabis up to the point of harvest, sales price, risk and expected future yields for the cannabis plant.

Inventory of finished goods is transferred from biological assets at fair value less costs to sell at the point of harvest, which becomes the deemed cost. Inventory is subsequently measured at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business less estimated costs of completion and estimated variable costs to sell.

### Impairment of cash-generating units and goodwill

The impairment test for cash-generating units ("CGUs") to which goodwill is allocated is based on the value in use of the CGU, determined in accordance with the expected cash flow approach. The calculation is based primarily on assumptions used to estimate future cash flows, the cash flow growth rate and the discount rate used.

### Impairment of long-lived assets

The impairment test for long-lived assets, including plant, property, and equipment and intangible assets, are reviewed for impairment at each statement of financial position date or whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds its recoverable amount. The recoverable amount of the asset or CGU is determined based on the higher of its fair value less cost to sell and its value in use. If the carrying amount of an asset exceeds its recoverable amount, an impairment charge is recognized immediately in profit or loss by the amount by which the carrying amount of the asset exceeds the recoverable amount. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimate of recoverable amount, and the carrying amount that would have been recorded had no impairment loss been recognized previously.

### Fair value of financial assets available for sale

Financial assets available for sale consist of privately and publicly held investments. Determination of the fair values of privately held investments requires the Company to make various assumptions about the future prospects of the Investees, the economic, legal, and political environment in which the Investees operate, and the ability of the Investees to obtain financing to support their operations. As a result, any value estimated may not be realized or realizable, and the values may differ from values that would be realized if a ready market existed. The determination of fair value of the Company's privately held investments is subject to inherent limitations. Financial information for private companies may not be available, or may be unreliable. Use of the valuation approach described below involves uncertainties and management judgments, and any value estimated from these techniques may not be realized or realizable.

### Income taxes

Income taxes and tax exposures recognized in the interim condensed financial statements reflect management's best estimate of the outcome based on facts known at the reporting date. When the Company anticipates a future income tax payment based on its estimates, it recognizes a liability. The difference between the expected amount and the final tax outcome has an impact on current and deferred taxes when the Company becomes aware of this difference.

In addition, when the Company incurs losses that cannot be associated with current or past profits, it assesses the probability of taxable profits being available in the future based on its budgeted forecasts. These forecasts are adjusted to take account of certain non-taxable income and expenses and specific rules on the use of unused credits and tax losses. When the forecasts indicate the sufficient future taxable income will be available to deduct the temporary differences, a deferred tax asset is recognized for all deductible temporary differences.



## **Risks and Uncertainties**

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Any investment in the securities of the Company is speculative, due to the nature of its business and its general stage of development. These risk factors could materially affect the Company's future operating results and could cause actual events to differ materially from those described in forward looking statements relating to the Company. In addition to the usual risks associated with investment in a business, investors should carefully consider the following risk factors as well as the risk factors set out in the amended and restated annual information form of the Company dated February 10, 2017:

### *Strategic Risks*

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#### (a) Management of Growth

Any expansion of the Company's business may place a significant strain on its financial, operational and managerial resources. There can be no assurance that the Company will be able to implement and subsequently improve its operations and financial systems successfully and in a timely manner in order to manage any growth it experiences. There can be no assurances that the Company will be able to manage growth successfully. Any inability of the Company to manage growth successfully could have a material adverse effect on the Company's business, financial condition and operational results.

The Company has invested in a number of companies (the "Investees") that are all currently in early development stages. The Company's growth strategy contemplates outfitting Investee facilities with additional production resources. There is a risk that these additional resources will not be achieved on time, on budget, or at all, as they can be adversely affected by a variety of factors.

#### (b) Competition

There is potential that the Company and the Company Investees will face intense competition from other companies, some of which can be expected to have longer operating histories and more financial resources and manufacturing and marketing experience than the Investees or the Company.

### *Industry Risks*

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#### (c) Risks Inherent in an Agricultural Business

The business of the Company Investees involves the growing of medical cannabis, an agricultural product. As such, the business is subject to the risks inherent in the agricultural industry.

#### (d) Political Risks

A change in government could result in meaningful changes to the regulatory regime under which the Company operates, which could negatively impact its operations. The Government of Canada has introduced Bill C-45, the Cannabis Act, providing for the legalization of recreational cannabis. There is no assurance that the legalization of recreation cannabis in Canada, whether via the Cannabis Act or by any other means, will occur as anticipated or at all.

#### (e) Vulnerability to Rising Energy Costs

The Company Investees' medical cannabis growing operations consume considerable energy, making the Company vulnerable to rising energy costs.

(f) Transportation Disruptions and Costs

Due to the perishable and premium nature of the Company Investee products, fast and efficient courier services will be necessary to distribute product. Any prolonged disruption of this courier service could have an adverse effect on the financial condition and results of operations of the Company Investees.

(g) Product Liability

As a manufacturer and distributor of products designed to be ingested by humans, the Company Investees face an inherent risk of exposure to product liability claims, regulatory action and litigation if its products are alleged to have caused significant loss or injury.

(h) Product Recalls

Manufacturers and distributors of products are sometimes subject to the recall or return of their products for a variety of reasons, including product defects, such as contamination, unintended harmful side effects or interactions with other substances, packaging safety and inadequate or inaccurate labeling disclosure with adverse impact on the Company Investees and the Company.

(i) Unfavourable Publicity or Consumer Perception

The Company believes the medical cannabis industry is highly dependent upon consumer perception regarding the safety, efficacy and quality of the medical cannabis produced. Consumer perception of the Company Investees' products can be significantly influenced by scientific research or findings, regulatory investigations, litigation, media attention and other publicity regarding the consumption of medical cannabis products. There can be no assurance that future scientific research, findings, regulatory proceedings, litigation, media attention or other research findings or publicity will be favourable to the medical cannabis market or any particular product, or consistent with earlier publicity.

*Operational Risks*

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(j) Limited Operating History

The Company began carrying on business in 2013 and the Investees are also newly operational. They are therefore subject to many of the risks common to early-stage enterprises.

(k) Reliance on Key Inputs

The Company Investees' businesses are dependent on a number of key inputs and their related costs including raw materials and supplies related to its growing operations, access to skilled labour, equipment, parts, and components, as well as electricity, water and other local utilities.

(l) Compliance with Regulations of ACMPR and Health Canada

The activities of the Company Investees are subject to regulation by governmental authorities, particularly Health Canada. Achievement of the Company's business objectives are contingent, in part, upon Investee compliance with stringent regulatory requirements enacted by these governmental authorities and obtaining all regulatory approvals. Under the ACMPR, any entity applying for a license from Health Canada would need to be an indoor facility equipped with physical barriers which prevent unauthorized entry in to the facility and further physical barriers to all growing areas are required. The

cost of security measures will be considerable and the readiness of each facility will factor into any the Company investment decision. Failure to comply with the requirements of the license or any failure to maintain this license could have a material adverse impact on the business, financial condition and operating results of the Company. The framework of the Canadian recreational cannabis market will be significantly influenced by provincial legislation governing, among other things, cannabis distribution and sale. Such legislation, if enacted, could result in different provincial regulatory and market environments, compliance costs and competitive factors.

#### (m) Environmental and Employee Health and Safety Regulations

The Company Investees' operations are subject to environmental and safety laws and regulations concerning, among other things, emissions and discharges to water, air and land, the handling and disposal of hazardous and non-hazardous materials and wastes, and employee health and safety.

#### (n) Reliance on Management

Both the success of the Company and the success of the Company Investees are dependent upon the ability, expertise, judgment, discretion and good faith of their respective senior management. Certain of the directors and officers of the Company are also directors and officers of other companies, and conflicts of interest may arise between their duties as officers and directors of the Company and as officers and directors of such other companies.

#### (o) Operating Risk and Insurance Coverage

The Company has insurance to protect its assets, operations and employees. While the Company believes its insurance coverage addresses all material risks to which it is exposed and is adequate and customary in its current state of operations, such insurance is subject to coverage limits and exclusions and may not be available for the risks and hazards to which the Company is exposed.

### *Financial Risks*

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#### (p) No History of Profits

There is no assurance that the Company will earn profits in the future, or that profitability will be sustained. The success of the Company ultimately depends upon its ability to generate significant revenues to finance operations and its ability to secure additional funding. There is no assurance that future revenues will be sufficient to generate the funds required to continue operations without external funding. If the Company does not have sufficient capital to fund its operations, it may be required to forego certain business opportunities.

#### (q) Future Capital Requirements

The Company may require additional financing in order to grow and expand its operations. Additional financing could include the incurrence of debt and the issuance of additional equity securities, which could result in substantial dilution to existing shareholders. It is possible that required future financing will not be available, or if available, will not be available on favourable terms. If adequate funds are not available, or are not available on acceptable terms, the Company may not be able to take advantage of opportunities or otherwise respond to competitive pressures and remain in business. There can be

no assurances that the Company will be able to raise additional capital if its capital resources are exhausted.

(r) Market Risks

The market price of the Company's shares may be subject to wide fluctuations in response to various factors. There can be no assurance that an active and liquid market for the Company's shares will develop or be maintained and an investor may find it difficult to resell any securities of the Company.

(s) Dividends

The Company has no dividend record to date, and does not anticipate paying any dividends on the common shares in the foreseeable future.