

DIXIE BRANDS INC. AND SUBSIDIARIES

**CONDENSED CONSOLIDATED INTERIM FINANCIAL
STATEMENTS FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2019 AND 2018
(UNAUDITED)**

(Expressed in United States Dollars)

NOTICE TO READER

Under National Instrument 51-102, Part 4, subsection 4.3 (3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by the auditor.

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

The Company's independent auditor has not performed a review of these interim condensed consolidated financial statements in accordance with standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

DIXIE BRANDS INC. AND SUBSIDIARIES

Index to Condensed Consolidated Interim Financial Statements

	Page
CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS:	
Condensed Consolidated Statements of Financial Position	2
Condensed Consolidated Statements of Operations	3
Condensed Consolidated Statements of Changes in Shareholders' Equity (Deficit)	4
Condensed Consolidated Statements of Cash Flows	5
Notes to Condensed Consolidated Financial Statements	6-25

DIXIE BRANDS INC. AND SUBSIDIARIES

Condensed Consolidated Interim Statements of Operations

For the Three and Nine Months Ended September 30, 2019 and 2018 (unaudited)

		<u>September 30, 2019</u>	<u>December 31, 2018</u>
ASSETS			
Cash		\$ 892,312	\$ 18,361,113
Accounts Receivable, net		2,985,702	2,266,733
Deferred Contract Costs		506,013	-
Inventories	<i>Note 4</i>	2,221,572	950,938
Prepaid Expenses		925,908	411,295
Total Current Assets		7,531,507	21,990,079
Related Party Advances and Notes Receivable, net	<i>Note 10</i>	849,399	1,274,444
Advances to Affiliates, net		455,417	-
Property and Equipment, net	<i>Note 5</i>	649,446	959,374
Intangible Assets, net	<i>Note 6</i>	483,405	675,275
TOTAL ASSETS		\$ 9,969,174	\$ 24,899,172
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)			
LIABILITIES			
Accounts Payable		\$ 2,830,007	\$ 1,099,298
Accrued Payroll		444,939	276,426
Other Accrued Liabilities		2,320,560	2,574,699
Deferred Closing Costs	<i>Note 3</i>	4,758,844	-
Prepaid License Fees	<i>Note 10</i>	750,000	4,000,000
Notes Payable, Current Portion	<i>Note 7</i>	1,000,000	775,000
Total Current Liabilities		12,104,350	8,725,423
Derivative Liabilities	<i>Note 8</i>	70,000	238,100
Total Liabilities		12,174,350	8,963,523
STOCKHOLDERS' EQUITY (DEFICIT)			
Share Capital		41,561,241	40,226,961
Contributed Surplus		7,416,937	8,506,705
Common Shares to be Issued		-	250,000
Accumulated Deficit		(49,590,610)	(31,310,910)
Non-Controlling Interest	<i>Note 11</i>	(1,592,744)	(1,737,107)
Total Stockholders' Equity (Deficit)		(2,205,176)	15,935,649
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		\$ 9,969,174	\$ 24,899,172

Nature of Operations and Going Concern (Note 1)

Commitments and Contingencies (Note 16)

Approved on behalf of the Board on November 26, 2019

"Charles Smith" (Signed)

Director

"Devin Binford" (Signed)

Director

DIXIE BRANDS INC. AND SUBSIDIARIES

Condensed Consolidated Interim Statements of Operations

For the Three and Nine Months Ended September 30, 2019 and 2018 (unaudited)

		Three months ended September 30,		Nine months ended September 30,	
		2019	2018	2019	2018
Revenues	<i>Note 13</i>	\$ 3,121,211	\$ 2,435,398	\$ 8,334,696	\$ 4,205,169
Cost of Goods Sold		<u>1,777,168</u>	<u>1,397,230</u>	<u>4,890,222</u>	<u>2,269,015</u>
Gross Profit		<u>1,344,043</u>	<u>1,038,168</u>	<u>3,444,474</u>	<u>1,936,154</u>
Expenses:					
General and Administrative	<i>Note 14</i>	3,744,921	1,245,410	15,365,606	4,128,693
Sales and Marketing		1,597,021	263,883	5,018,155	456,865
Depreciation and Amortization		<u>303,086</u>	<u>68,396</u>	<u>468,149</u>	<u>166,936</u>
Total Expenses		<u>5,645,028</u>	<u>1,577,689</u>	<u>20,851,910</u>	<u>4,752,494</u>
Loss From Operations		<u>(4,300,985)</u>	<u>(539,521)</u>	<u>(17,407,436)</u>	<u>(2,816,340)</u>
Other Expense:					
Interest Expense		448,453	(20,936)	1,201,730	564,240
Change in Fair Value of Derivative Liabilities	<i>Note 8</i>	(61,700)	-	(168,100)	(498,232)
Loss on Debt Conversion		-	2,186,614	-	2,186,614
Other		<u>334,427</u>	<u>(218,722)</u>	<u>174,410</u>	<u>(203,420)</u>
Total Other Expense		<u>721,180</u>	<u>1,946,956</u>	<u>1,208,040</u>	<u>2,049,202</u>
Net Loss Before Non-Controlling Interest		<u>(5,022,165)</u>	<u>(2,486,477)</u>	<u>(18,615,476)</u>	<u>(4,865,542)</u>
Non Controlling Interest		<u>(106,358)</u>	<u>(81,592)</u>	<u>(335,776)</u>	<u>(169,304)</u>
Net Loss Attributable to the Company		<u>\$ (4,915,807)</u>	<u>\$ (2,404,885)</u>	<u>\$ (18,279,700)</u>	<u>\$ (4,696,238)</u>
Earnings (Loss) Per Share - Basic and Diluted	<i>Note 12</i>	<u>\$ (0.04)</u>	<u>\$ (0.05)</u>	<u>\$ (0.15)</u>	<u>\$ (0.11)</u>
Attributable to Dixie Brands Inc		\$ (0.04)	\$ (0.05)	\$ (0.15)	\$ (0.11)
Attributable to Non-Controlling Interest		\$ (0.00)	\$ (0.00)	\$ (0.00)	\$ (0.00)
Weighted-Average Shares Outstanding - Basic and Diluted	<i>Note 12</i>	<u>126,196,426</u>	<u>46,687,223</u>	<u>125,650,694</u>	<u>45,398,608</u>

DIXIE BRANDS INC. AND SUBSIDIARIES

Condensed Consolidated Interim Statements of Changes in Shareholders' Equity (Deficit)

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

	Atributable to the shareholders of the Company								Non- Controlling Interest	TOTAL SHAREHOLDERS' EQUITY
	Share Capital				Preferred Shares #	Preferred Shares \$	Contributed Surplus	Accumulated Deficit		
	Common Shares #	Common Shares \$	Shares to be issued #	Shares to be issued \$						
BALANCE AS OF DECEMBER 31, 2017	43,685,463	\$ 8,959,408					\$ 34,280	\$ (10,727,852)	\$ (478,369)	\$ (2,212,533)
Adjustments Related to the Adoption of IFRS 9 <i>Note 15</i>								\$ (290,000)		\$ (290,000)
Net Loss								\$ (4,696,238)	\$ (169,304)	\$ (4,865,542)
Series B Issuance					1,090,247	\$ 4,000,000				\$ 4,000,000
Issuance of Warrants							\$ 400,569			\$ 400,569
Incentive Share Compensation	138,767	\$ 51,194					\$ -			\$ 51,194
Stock Award	1,116,710	\$ 137,800								\$ 137,800
Insuance to Shareholders of Academy - Common	339,838	\$ 300,000	283,202	\$ 250,000			\$ -			\$ 550,000
DBFN Convertible Debt	3,085,870	\$ 2,059,199					\$ 850,945		\$ (313,445)	\$ 2,596,699
Contributory Surplus							\$ 20,558,577			\$ 20,558,577
BALANCE AS OF SEPTEMBER 30, 2018	48,366,648	\$ 11,507,601	283,202	\$ 250,000	1,090,247	\$ 4,000,000	\$ 21,844,371	\$ (15,714,090)	\$ (961,118)	\$ 20,926,764
Net Loss								\$ (15,596,820)	\$ (775,989)	\$ (16,372,809)
Contributory Surplus							\$ (20,558,577)			\$ (20,558,577)
Series B Conversion	33,986,742	\$ 4,000,000			(1,090,247)	\$ (4,000,000)				\$ -
Series C Issuance	25,905,175	\$ 14,378,457					\$ 5,255,030			\$ 19,633,487
Academy Common Shares on Reverse Take-Over	6,640,300	\$ 6,640,301					\$ 94,456			\$ 6,734,757
Exercise of ACA Stock Options	75,000	\$ 70,842					\$ (70,842)			\$ -
Cancellation of Common Shares	(474,075)	\$ (550,000)					\$ -			\$ (550,000)
Exercise of Warrants	6,205,505	\$ 1,232,638					\$ (406,194)			\$ 826,444
Incentive Share Compensation	2,534,848	\$ 1,523,097					\$ -			\$ 1,523,097
Convertible Debt - Debt Discount	1,613,130	\$ 1,424,025					\$ (14,319)			\$ 1,409,706
Stock Option							\$ 2,362,780			\$ 2,362,780
BALANCE AS OF DECEMBER 31, 2018	124,853,273	\$ 40,226,961	283,202	\$ 250,000	-	\$ -	\$ 8,506,705	\$ (31,310,910)	\$ (1,737,107)	\$ 15,935,649
Net Loss								\$ (18,279,700)	\$ (335,776)	\$ (18,615,476)
Exercise of ACA Stock Options	25,000	\$ 23,614					\$ (23,614)			\$ -
Exercise of Elben Capital Stock Options	150,000	\$ 133,733					\$ (40,733)			\$ 93,000
Exercise of Stock Options	400,000	\$ 356,621					\$ (108,621)			\$ 248,000
Stock Award	781,250	\$ 570,313					\$ -			\$ 570,313
Stock Option							\$ 7,049,940			\$ 7,049,940
Therabis change in NCI							\$ (480,139)		\$ 480,139	\$ -
Purchase of Therabis							\$ (7,486,602)			\$ (7,486,602)
Shares to be issued Issued	283,202	\$ 250,000	(283,202)	\$ (250,000)			\$ -			\$ -
BALANCE AS OF SEPTEMBER 30, 2019	126,492,725	\$ 41,561,241	-	\$ -	-	\$ -	\$ 7,416,937	\$ (49,590,610)	\$ (1,592,744)	\$ (2,205,176)

DIXIE BRANDS INC. AND SUBSIDIARIES
Condensed Consolidated Interim Statements of Cash Flows
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

	Nine months ended September 30,	
	2019	2018
OPERATING ACTIVITIES		
Net Loss	\$ (18,615,476)	\$ (4,865,542)
Adjustments to Reconcile Net Loss to Net Cash Used in Operating Activities:		
Depreciation and Amortization	660,019	300,515
Amortization of Debt Discount	-	152,595
Change in Fair Value of Derivative Liabilities	(168,100)	(498,232)
Incentive Share-Based Payment	570,313	77,439
Warrants	-	371,931
Loss on Debt Conversion	-	2,186,614
Stock Incentive Expense	7,049,940	-
Change in Credit Loss Reserve on Advances and Related Party Advances	300,474	(10,000)
Loss on Disposal of Property and Equipment	63,825	30,656
Changes in:		
Accounts Receivable	(718,969)	(2,317,528)
Deferred Contract Costs	(506,013)	-
Lease Receivable	-	15,328
Inventories	(1,270,634)	28,636
Prepaid Expenses	(514,613)	(178,513)
Accounts Payable	1,730,709	135,146
Accrued Payroll	168,513	129,473
Prepaid License Fees	(3,250,000)	4,000,000
Other Accrued Liabilities	(2,940,741)	(578,187)
Deferred Closing Costs	4,758,844	-
NET CASH USED IN OPERATING ACTIVITIES	(12,681,909)	(1,019,669)
INVESTING ACTIVITIES		
Purchases of Property and Equipment	(200,796)	(431,061)
Purchase of Intangibles	-	(297,491)
Additions to Related Party Advances and Notes Receivable	(265,234)	(407,349)
Payments Received on Notes Receivable	440,407	452,000
Advances to Affiliates	(506,019)	-
Investment in Affiliate	(4,800,000)	-
NET CASH USED IN INVESTING ACTIVITIES	(5,331,642)	(683,901)
FINANCING ACTIVITIES		
Contribution	-	4,000,000
Purchase of Treasury Stock	-	(186,000)
Proceeds from exercise of stock options	341,000	-
Proceeds from Issuance of Notes Payable	1,000,000	250,000
Payments on Notes Payable	(775,000)	(3,145,000)
Contributory Surplus	-	19,352,510
Payments on Equipment Lease	-	(27,796)
CASH FROM FINANCING ACTIVITIES	566,000	20,243,714
NET (DECREASE) INCREASE IN CASH	(17,447,551)	18,540,144
CASH, BEGINNING OF PERIOD	18,361,113	43,852
CASH, END OF PERIOD	\$ 913,562	\$ 18,583,996
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Paid for Interest	\$ 102,173	\$ 602,648
Cash Paid for Taxes	\$ -	\$ -
SUPPLEMENTAL NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Effect of adoption of IFRS 9	\$ -	\$ 290,000

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

1. NATURE OF OPERATIONS AND GOING CONCERN

Dixie Brands Inc. (“DBI” or the “Company”), formerly known as Academy Explorations Limited (“Academy”), was incorporated under the Business Corporations Act (British Columbia) on July 20, 1970. The Company’s Subordinate Voting Shares (“SVS”) are listed on the Canadian Securities Exchange under the symbol “DIXI.U”, the Frankfurt stock exchange under “0QV” and the OTCQX Best Market under “DXBRF”. The head office and principal address of the Company is 4990 Oakland Street, Denver, Colorado 80239. The Company’s registered and records office address is 3400 One First Canadian Place, Toronto, Ontario M5X 1B4. The Company operates through its wholly-owned subsidiary, Dixie Brands (USA), Inc, a Delaware corporation (“OpCo”). DBI has six other subsidiaries: (i) Therabis, LLC (“Therabis”) (85% ownership); (ii) Aceso Wellness, LLC (“Aceso”) (100% ownership); (iii) DB Finance, LLC (“DBFN”) (92% ownership); (iv) DB Products Nevada, LLC (“DBPN”) (70% ownership); (v) DB Michigan, LLC (“DBMI”) (100% ownership) and (vi) DBAT Logistics, LLC (“DBAT”) (100% ownership).

Dixie Brands, Inc., a Delaware corporation (“USA Inc.”), and Academy entered into a definitive agreement (the “Amalgamation Agreement”) by and among Academy, Dixie Brands Acquisition, Inc. (“Amalco”), and USA Inc. in respect of the Amalgamation (as defined below). Pursuant to the Amalgamation Agreement, on November 27, 2018, Academy agreed to acquire all the issued and outstanding common stock in the capital of USA Inc. in exchange for SVS of Academy by way of a “three-cornered” amalgamation (the “Amalgamation”).

The Amalgamation resulted in USA Inc. merging with AmalCo and becoming OpCo and OpCo becoming a wholly-owned subsidiary of DBI.

References herein to the “Company” prior to November 27, 2018 means the USA Inc.

DBI owns the intellectual property, product branding, formulations, proprietary ingredients, consulting expertise, and preparation methods related to a variety of cannabis infused products, referenced herein as the “Dixie Product Line”. DBI has relationships with entities in Colorado, California, Nevada, Oklahoma, Maryland and Michigan who are locally licensed to manufacture cannabis products, including the Dixie Product Line. DBI designs and distributes packaging, ingredients, and non-cannabis consumer goods.

Going Concern

These condensed consolidated interim financial statements have been prepared with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. The Company had net losses in the three and nine months ended September 30, 2019 of \$4,915,807 and \$18,279,700, respectively and \$2,404,885 and \$4,696,238, for the three and nine months ended September 30, 2018, respectively. Current liabilities exceeded current assets by \$4,572,843 at September 30, 2019 and current assets exceeded current liabilities by \$13,264,656 at December 31, 2018. The Company's ability to continue in the normal course of operations is dependent on its ability to increase revenues among its product lines, reduce expenses and raise additional debt or equity financing. There are no assurances that the Company will be successful in achieving these goals. The existence of these material uncertainties cast significant doubt on the Company’s ability to continue as going concern. These condensed consolidated interim 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 operations.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Preparation

These unaudited condensed consolidated interim financial statements (“interim financial statements”) have been prepared in accordance with IAS 34 Interim Financial Reporting and should be read in conjunction with the Company’s last annual financial statements as at and for the year ended December 31, 2018 (“last annual financial statements”). They do not include all of the information required for a complete set of IFRS financial statements. However, selected explanatory notes are included to explain events and transactions that are significant to an understanding of the changes in the Company’s financial position and performance since the last annual financial statements.

These interim financial statements were approved and authorized for issue by the Board of Directors of the Company on November 26, 2019.

Basis of Measurement

These interim financial statements have been prepared on a historical cost basis except for derivative financial instruments, which have been measured at fair value.

Functional Currency

The Company and its affiliates’ functional currency, as determined by management, is the United States (“U.S.”) dollar. These condensed consolidated interim financial statements are presented in U.S. dollars.

Fair Value Measurements

Certain of the Company’s assets and liabilities are measured at fair value. In estimating fair value, the Company uses market-observable data to the extent it is available.

Basis of Consolidation

Subsidiaries are entities over which the Company has control. The Company controls an entity when the Company is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

Subsidiaries are fully consolidated from the date on which control is acquired by the Company and they are deconsolidated from the date that control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company using consistent accounting policies. All inter-company balances, revenues and expenses and earnings and losses resulting from inter-company transactions are eliminated on consolidation.

Non-controlling interest in the net assets of consolidated subsidiaries are a separate component of the Company’s equity. Non-controlling interests consist of the non-controlling interests on the date of the original acquisition plus the non-controlling interests’ share of changes in equity since the date of acquisition. Changes in the Company’s interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

The accompanying consolidated financial statements include the accounts of the following entities: DBI, Aceso, Therabis, DBFN, DBPN, USA Inc, DBMI and DBAT.

Significant Accounting Judgments Estimates and Assumptions

The preparation of the Company's condensed consolidated interim financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, revenue and expenses. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the review affects both current and future periods.

Significant judgments, estimates and assumptions that have the most significant effect on the amounts recognized in the condensed consolidated interim financial statements are described below.

Estimated Credit Loss Provision

The Company performs impairment testing for accounts receivable in accordance with IFRS 9. The Expected Credit Loss ("ECL") model requires considerable judgement, including consideration of how changes in economic factors affect ECLs, which are determined on a probability-weighted basis. IFRS 9 outlines a three-stage approach to recognize ECLs which is intended to reflect the increase in credit risks of a financial instrument based on 1) 12-month expected credit losses or 2) lifetime expected credit losses. The Company measures provision for ECLs at an amount equal to lifetime ECLs.

Estimated Useful Lives and Depreciation of Property and Equipment

Depreciation of property and equipment is 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 take into account factors such as economic and market conditions and the useful lives of assets.

Estimated Useful Lives and Amortization of Intangible Assets

Amortization of intangible assets is recorded on a straight-line basis over their estimated useful lives, which do not exceed the contractual period, if any. Intangible assets that have indefinite useful lives are not subject to amortization and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired.

Derivative Liabilities

The Company uses the fair-value method of accounting for derivative liabilities and such liabilities are re-measured at each reporting date with changes in fair value recorded in the period incurred. The fair value is estimated using a Monte Carlo simulation model. Critical estimates and assumptions used in the model are discussed in Note 8.

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

Taxes

Provisions for taxes are made using the best estimate of the amount expected to be paid based on a qualitative assessment of all relevant factors. The Company reviews the adequacy of these provisions at the end of the reporting period. It is possible, however, that at some future date, an additional liability could result from audits by taxing authorities. If the final outcome of these tax related matters is different from the amounts that are initially recorded, such differences will affect the tax provisions in the period in which such determination is made.

IRC Section 280E

As the Company derives revenue from third parties in the cannabis industry and taking into account the potential impact of ongoing US tax cases that interpret the application of IRC Section 280E, the Company may be subject to the limits of IRC Section 280E under which the Company is only allowed to deduct expenses directly related to the cost of producing the products or cost of production. This results in permanent differences between ordinary and necessary business expenses deemed unallowable under IRC Section 280E. The Company does not believe it is subject to the 280E. However, similar to all ancillary companies in the cannabis sector, there is a general risk that the regulators may consider application of Section 280E.

Non-controlling Interest

Non-controlling interest represents equity interests owned by parties that are not shareholders of the ultimate parent. Non-controlling interest is initially measured either at fair value or at the noncontrolling interest's proportionate share of the recognized amounts of the acquiree's identifiable net assets. The choice of measurement is made on a transaction-by-transaction basis. The share of net assets attributable to non-controlling interests is presented as a component of equity. Their share of net income or loss is recognized directly in equity. Changes in the parent company's ownership interest that do not result in a loss of control are accounted for as equity transactions.

Adoption of New Accounting Standards

The following accounting standard came into effect commencing in the Company's 2019 first quarter:

The Company adopted IFRS 16 Leases on January 1, 2019, which introduces a new approach to lease accounting. The Company adopted the standard using the modified retrospective approach, which does not require restatement of prior period financial information, as it recognizes the cumulative impact on the opening balance sheet and applies the standard prospectively. Accordingly, the comparative information in these condensed consolidated interim financial statements is not restated.

At the inception of a contract, the Company assesses whether the contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. This policy has been applied to contracts entered into, or modified, on or after January 1, 2019.

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

Effective January 1, 2019, the IFRS 16 transition date, the Company elected to use the following practical expedients under the modified retrospective transition approach:

- Leases with lease terms of less than twelve months (“short-term leases”) and leases of low-value assets (less than \$5,000) (“low-value leases”) that have been identified at transition, were not recognized in the consolidated statement of financial position;
- Right-of-use assets on transition were measured at the amount equal to the lease liabilities at transition, adjusted by the amount of any prepaid or accrued lease payments;
- For certain leases having associated initial direct costs, the Company, at initial measurement on transition, excluded these direct costs from the measurement of the right-of-use assets; and
- Any provision for onerous lease contracts previously recognized at the date of adoption of IFRS 16, has been applied to the associated right-of-use asset recognized upon transition.

Where the Company is a lessee, a right-of-use asset representing the right to use the underlying asset with a corresponding lease liability is recognized when the leased asset becomes available for use by the Company. The right-of-use asset is recognized at cost and is depreciated on a straight-line basis over the shorter of the estimated useful life of the asset and the lease term on a straight-line basis. The cost of the right-of-use asset is based on the following:

- the amount of initial recognition of related lease liability;
- adjusted by any lease payments made on or before inception of the lease;
- increased by any initial direct costs incurred; and
- decreased by lease incentives received and any costs to dismantle the leased asset.

The lease term includes consideration of an option to extend or terminate if the Company is reasonably certain to exercise that option. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

Lease liabilities are initially recognized at the present value of the lease payments. The lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company’s incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate. In the situation where the implicit interest rate in the lease is not readily determined, the Company uses judgement to estimate the incremental borrowing rate for discounting the lease payments. The Company’s incremental borrowing rate generally reflects the interest rate that the Company would have to pay to borrow a similar amount at a similar term and with a similar security. The Company estimates the lease term by considering the facts and circumstances that create an economic incentive to exercise an extension or termination option. Certain qualitative and quantitative assumptions are used when evaluating these incentives.

Subsequent to recognition, lease liabilities are measured at amortized cost using the effective interest rate method. Lease liabilities are remeasured when there is a change in future lease payments arising mainly from a change in an index or rate, if there is a change in the Company’s estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, renewal or termination option. The payments related to short-term leases or low-value leases are recognized and included within selling, general and administrative costs over the lease term in the condensed consolidated interim statement of operations.

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

The Company's condensed consolidated interim financial statements were not impacted by the adoption of IFRS 16 Leases in relation to lessor accounting. Lessors will continue with the dual classification model for recognized leases with the resultant accounting remaining unchanged from IAS 17 Leases.

The Company's condensed consolidated interim financial statements were not materially impacted by the adoption of IFRS 16 Leases in relation to lessee accounting.

3. SIGNIFICANT TRANSACTIONS

On April 4, 2019, the Company entered into a Manufacturing License Agreement with Globus Holdings, whereby Dixie Brands' portfolio of products will be manufactured, sold and distributed across the state of Oklahoma. As of September 30, 2019, the agreement with Globus Holding has been terminated. An agreement has been reached with a new partner in fourth quarter (Note 18).

On March 12, 2019 the Company amended the initial agreement with Auxly to exclude the exclusive rights in Mexico and paid \$375,000 for those rights.

On March 12, 2019, the Company signed a joint venture agreement with Khiron Life Sciences Corp. ("Khiron"), a vertically integrated cannabis leader with core operations in Latin America. With the execution of this agreement, a new company called Dixie Khiron JV Corp. has been established with 50% owned by each of the Company and Khiron. The purpose of the joint venture is to manufacture and distribute products in the Latin American market. Both parties are paying costs on behalf of the joint venture, Dixie's payments related to activities is \$144,247 for the nine months ended September 30, 2019.

On March 5, 2019, the Company entered into a Packaging and Supply Agreement with Choice Labs, whereby Dixie Brands' portfolio of products will be manufactured, sold and distributed across the state of Michigan. The companies had a selection of products available for sale in Michigan provisioning centers by late March 2019.

On February 19, 2019, the Company repaid \$3,250,000 of the \$4,000,000 of prepaid license fees to Auxly as a result of "elixirs", "mints" and "chocolates" not being permitted under the Cannabis Act in Canada by December 31, 2018.

On January 29, 2019, the Company's subordinate voting shares were listed and traded on the Frankfurt Stock Exchange under the trading symbol 0QV. Operated by Deutsche Börse AG, the Frankfurt Stock Exchange (known in Germany as Frankfurter Wertpapierbörse or FWB®) is one of the world's largest trading centers for securities, and the largest of Germany's seven stock exchanges. This listing will facilitate the process of trading in Dixie shares by investors in Europe and internationally.

On January 2, 2019, the Company purchased an additional 25% of its subsidiary Therabis, LLC, or 25,000 units, for a total purchase price of \$7,422,827, plus expenses not to exceed \$63,774. The initial closing payment was in the amount of \$3,922,827 with a deferred closing payment in the amount of \$3,500,000. The deferred closing cost has not been paid as of September 30, 2019 and on April 4, 2019 began to accrue interest at 3% per month for January through March 31, 2019 and at 4.167% per month April 1, 2019 through September 30, 2019, with an interest payable balance of \$1,190,070 as of September 30, 2019. With this purchase, Dixie Brands holds an 85% ownership in Therabis, LLC. In addition, to the initial closing payment, the outstanding balance of the Promissory Notes of \$877,173, of which principal totals \$775,000 and interest totals \$102,173 was paid.

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

4. INVENTORIES

Inventories consist of the following:

	September 30, 2019	December 31, 2018
Raw Materials:		
Materials	\$ 707,169	\$ 255,850
Ingredients	305,496	460,391
Total Raw Materials	1,012,665	716,241
Finished Goods	1,248,907	234,697
Less: Reserve on Inventory	(40,000)	-
Total Inventories	<u>\$ 2,221,572</u>	<u>\$ 950,938</u>

5. PROPERTY AND EQUIPMENT

Property, plant and equipment consist of the following:

	<u>Furniture and Fixtures</u>	<u>Equipment</u>	<u>Computer Equipment</u>	<u>Leasehold Improvements</u>	<u>Leased Equipment</u>	<u>Total</u>
Cost:						
December 31, 2018	\$ 174,934	\$ 445,367	\$ 107,143	\$ 508,378	\$ 404,633	\$ 1,640,455
Additions	-	139,516	10,700	-	50,580	200,796
Reclassification	-	(20,865)	-	-	20,865	-
Disposals	-	-	53,200	-	-	53,200
September 30, 2019	<u>174,934</u>	<u>564,018</u>	<u>64,643</u>	<u>508,378</u>	<u>476,078</u>	<u>1,788,051</u>
Accumulated Depreciations:						
December 31, 2018	92,897	184,064	49,696	226,225	128,199	681,081
Depreciation	47,314	62,164	20,973	282,153	55,545	468,149
Disposals	-	-	10,625	-	-	10,625
September 30, 2019	<u>\$ 140,211</u>	<u>\$ 246,228</u>	<u>\$ 60,044</u>	<u>\$ 508,378</u>	<u>\$ 183,744</u>	<u>\$ 1,138,605</u>
Net Book Value:						
December 31, 2018	\$ 82,037	\$ 261,303	\$ 57,447	\$ 282,153	\$ 276,434	\$ 959,374
September 30, 2019	\$ 34,723	\$ 317,790	\$ 4,599	\$ -	\$ 292,334	\$ 649,446

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

6. INTANGIBLE ASSETS

Intangible assets consist of the following:

	Balance at January 1, 2018	Purchases	Disposals	Amortization Expense	Balance at December 31, 2018
Formula	\$ 37,500	\$ -	\$ (28,500)	\$ 9,000	\$ -
License Agreement	568,570	297,491	-	190,786	675,275
Total Intangible Assets	<u>\$ 606,070</u>	<u>\$ 297,491</u>	<u>\$ (28,500)</u>	<u>\$ 199,786</u>	<u>\$ 675,275</u>
	Balance at December 31, 2018	Purchases	Disposals	Amortization Expense	Balance at September 30, 2019
Formula	\$ -	\$ -	\$ -	\$ -	\$ -
License Agreement	675,275	-	-	191,870	483,405
Total Intangible Assets	<u>\$ 675,275</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 191,870</u>	<u>\$ 483,405</u>

7. NOTES PAYABLE

Notes payable consist of the following:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
Unsecured promissory note dated September 8, 2017, which matured on July 13, 2018; payment in full was due on the maturity date of note, interest at rate of 8% per annum, paid quarterly. Payment in full was paid on January 2, 2019 which included principal, interest, and penalties. See Note 3.	\$ -	\$ 250,000
Unsecured promissory note dated September 8, 2017, which matured on July 13, 2018; payment in full was due on the maturity date of note, interest at rate of 8% per annum, paid at maturity date. Payment in full was paid on January 2, 2019 which included principal, interest, and penalties. See Note 3.	-	275,000
Unsecured promissory note dated May 14, 2018, with a maturity of May 14, 2019; payment in full was due on maturity date of note, interest at rate of 12% per annum, paid quarterly. Payment in full was paid on January 2, 2019 which included principal, interest, and penalties. See Note 3.	-	250,000
Unsecured promissory note dated August 28, 2019, with a maturity of October 27, 2019; payment in full is due on maturity date of note, interest at rate of 12% per annum, to be paid along with principal on maturity date. The note is personally guaranteed by shares of an officer of the Company.	1,000,000	-
Total Notes Payable	1,000,000	775,000
Less: Current Portion of Notes Payable	<u>1,000,000</u>	<u>775,000</u>
Notes Payable, Net of Current Portion	<u>\$ -</u>	<u>\$ -</u>

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

8. DERIVATIVE LIABILITIES

During the year ended December 31, 2018, the Company entered into a manufacturing agreement with one of its customers, Cypress Manufacturing Company (“Cypress”). Included in this manufacturing agreement, Cypress will be granted stock options (“Incentive Options Award”) by the Company to purchase voting common stock as an incentive for meeting mutually agreed upon revenue targets, pursuant to the Company’s Employee Stock Option Plan. Since the number of options to be granted is unknown, the instrument did not meet the “fixed for fixed” criteria under IAS 32 - Financial Instruments: Presentation (“IAS 32”). As such, the conversion option was classified as a derivative liability and accounted for at fair value through profit and loss (“FVTPL”). Key assumptions used in the valuation include an expected term of two years from the inception date. The fair value of the conversion option (“derivative liability”) was valued at \$282,400 on inception date (August 1, 2018), \$238,100 on December 31, 2018, and revalued to \$70,000 on September 30, 2019 using Monte Carlo simulations, with the following assumptions:

	Inception	December 31, 2018	September 30, 2019
Risk-free Rate	2.60%	2.59%	1.67%
Expected Dividend Yield	0%	0%	0%
Expected Term (in years)	1.5	1.08	0.5
Volatility	70%	74%	110%

The total change in the fair value of the derivative liabilities for the nine months ending September 30, 2019 is \$168,100. Total change for all the derivative liabilities for the nine months ended September 30, 2019 is \$498,232.

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

9. SHAREHOLDERS' EQUITY

Stock Options

A summary of the status of the stock options outstanding follows:

	Stock Options #	Weighted average exercise price \$
Balance, as at December 31, 2017	-	-
Issued (1)	15,362,265	0.66
Exercised (2)	(75,000)	(0.08)
Balance, as at December 31, 2018	15,287,265	0.66
Issued (3)	5,200,000	0.67
Exercised (4)	(575,000)	(0.54)
Terminated (5)	(200,000)	0.62
Balance, as at June 30, 2019	19,712,265	0.68

- (1) Each stock option entitles the holder to purchase one common share.
Included in 15,362,265 stock options, 100,000 Academy stock options are exercisable at C\$0.08
- (2) 75,000 Academy stock options were exercised on December 14, 2018.
- (3) Each stock option entitles the holder to purchase one common share.
Included in 5,200,000 stock options, 3,300,000 were issued to employees that are exercisable at a weighted average exercise price of \$0.68, 1,900,000 were issued to third party consultants that are exercisable at \$0.65. Options are valued using the Black-Scholes model with the expected life of the options, the risk-free rate and volatility from the date of the contract for the options.
- (4) 25,000 Academy stock options were exercised on January 24, 2019. 150,000 Elben Capital stock options were exercised on May 30, 2019. 400,000 stock options were exercised on August 16, 2019.
- (5) 200,000 of stock options issued to third party consultant that were exercisable at \$0.62.
These options ceased to be exercisable due to termination of the contract for services.

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

Share Purchase Warrants

Each whole warrant entitles the holder to purchase one common share of the Company. A summary of the status of the warrants outstanding as follows:

	Warrants classified as equity #	Weighted average exercise price \$
Balance, as at December 31, 2017	2,243,966	1.42
Issued	31,350,438	1.42
Exercised	(6,205,505)	(1.42)
Cancelled	(965,712)	(1.42)
Balance, as at December 31, 2018	26,423,187	1.42
Balance, as at September 30, 2019	26,423,187	1.42

Non-Participating Voting Shares

Before the reverse takeover (RTO), the Company issued 500,000 Non-Participating Voting Shares to management. These Non-Participating Shares have no economic value or rights to dividends. They were first issued in the form of management options, exercisable at \$20 per share and were later automatically exercised to shares upon the RTO. Each Non-Participating Voting share entitles the holder to one hundred votes and each Subordinated Voting Share entitles the holder to one vote, voting together as a single class.

10. RELATED PARTY TRANSACTIONS

Transactions with related parties are entered into in the normal course of business and are measured at the amount established and agreed to by the parties.

Left Bank LLC d/b/a Dixie Elixirs & Edibles (“Left Bank”)

One Director of the Company, Vincent ‘Tripp’ Keber III, is the sole owner of Left Bank.

The Company purchased intellectual properties (Note 6) from Left Bank in 2015 for \$1,000,000.

The Company leases the facility for DBI from Left Bank under a sub-lease agreement that expired in November 2018. Currently the Company leases the building under a month to month agreement. Annual rent is not to exceed \$214,462. Total rent expense paid to Left Bank for the nine months ended September 30, 2019 and 2018 is \$160,579 and \$139,938, respectively. Left Bank holds inventory on behalf of the Company at the facility for a total amount of \$86,807 at September 30, 2019 and \$111,253 at December 31, 2018.

In addition to the above arrangements between the Company and Left Bank, DBI incurred shared expenses with Left Bank for accounting services provided by DBI accounting team and consultants for \$90,000 and \$94,500, respectively, for the nine months ended September 30, 2019 and 2018. The Company also incurred

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

various other shared expenses with Left Bank for \$183,560 and \$69,760 for the nine months ended September 30, 2019 and 2018, respectively.

In addition to the above arrangements between the Company and Left Bank, Left Bank incurred shared expenses with DBI for facility maintenance and research and development services provided by Left Bank employees for \$290,177 and \$0, respectively, for the nine months ended September 30, 2019 and 2018.

Purchases and sales between Left Bank and DBI are recorded in accounts payable or accounts receivable. The nine months ended September 30, 2019 the Company earned \$5,293,920 of packaging revenue. DBI also incurred \$3,064,406 of cost of goods sold reimbursements. During the nine months ended September 30, 2018, the Company earned \$1,946,060 of packaging revenue and \$126,523 of raw materials and ingredients resale revenue.

At September 30, 2019 and December 31, 2018, the Company had \$3,611,891 and \$2,793,198, respectively of accounts receivable from Left Bank.

Silver State Wellness

Silver State Wellness owns 30% of DBPN. In October 2016, DBPN issued \$675,000 under a note receivable bearing interest at 12% from Silver State Wellness. DBPN had non-interest-bearing advances receivable from Silver State Wellness for \$656,887 as at September 30, 2019 and December 31, 2018.

DBPN has equity contributions receivable of \$228,263 as at September 30, 2019 and December 31, 2018 from Silver State Wellness. At September 30, 2019 and December 31, 2018, the Company had \$485,138 and \$1,107,741, respectively of accounts receivable from Silver State Wellness including \$21,520 of affiliate packaging revenue and \$441 of materials and ingredients resale revenue. The Company also incurred \$100,720 of COGS reimbursement due to Silver State Wellness based on the licensing agreement.

DBI has \$10,006 worth of accounts receivable from Silver State Wellness as at September 30, 2019 and December 31, 2018.

Rose Capital Fund

Rose Capital Fund owned 25% of Therabis as of December 31, 2018. On January 2, 2019 DBI purchased Rose Capital Fund's 25% share of Therabis (Note 3).

Auxly

Two former Directors of the Company, Michael Lickver and Hugo Alves, are officers of Auxly. During the previous year the Company entered into a licensing agreement with Auxly and received a prepayment of \$4,000,000. During the nine months ended September 30, 2019, \$3,250,000 had been returned to Auxly (Note 3).

The Company amended the initial agreement with Auxly to exclude the exclusive rights in Mexico and paid \$375,000 for those rights.

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

Related party advances and notes receivable:

Related party advances and notes receivable consist of the following:

	September 30, 2019	December 31, 2018
Left Bank	\$ 1,580,713	\$ 1,755,886
Silver State Wellness	<u>1,331,887</u>	<u>1,331,887</u>
Total Related Party Notes Receivable	2,912,600	3,087,773
Related Party Advances	97,155	97,155
Less: Fair Value Adjustments on Notes Receivable	429,919	429,919
Less: Allowance on Related Party Advances	<u>1,730,437</u>	<u>1,480,565</u>
Total Related Party Advances and Notes Receivable	<u>\$ 849,399</u>	<u>\$ 1,274,444</u>

DBI holds two notes receivable from Left Bank. The first note for \$633,333 and the second note is for \$947,380. During the prior year, both notes receivables were extended to June 2022. The notes accrue interest at 2% per annum and are payable at maturity in June 2022. Interest on these notes is not significant as at September 30, 2019 and December 31, 2018.

Compensation of key management personnel:

The Company's key management personnel have the authority and responsibility for planning, directing and controlling the activities of the Company and consists of the Company's executive management team and management directors.

	September 30, 2019	September 30, 2018
Management Compensation	\$ 429,375	\$ 125,000
Stock Incentives	<u>1,915,034</u>	<u>66,800</u>
	<u>\$ 2,344,409</u>	<u>\$ 191,800</u>

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

11. NON-CONTROLLING INTEREST

The following table summarizes the comprehensive income attributable to the non-controlling shareholders for the year.

Net Assets of NCI, January 1, 2018	\$ (478,369)
Net Income Attributable to NCI	(945,293)
Adjustment to NCI due to DBFN Debt Conversion	<u>(313,445)</u>
Net Assets of NCI, December 31, 2018	(1,737,107)
Net Income Attributable to NCI	(335,776)
Adjustment to NCI due to Acquisition of Therabis Equity	<u>480,139</u>
Net Assets of NCI, September 30, 2019	<u>\$ (1,592,744)</u>

12. EARNINGS (LOSS) PER SHARE

The following is a reconciliation for the calculation of basic and diluted earnings (loss) per share for the periods ended September 30, 2019 and 2018.

	Nine months ended September 30,	
	2019	2018
Net Loss	\$ (18,615,476)	\$ (4,865,542)
Weighted-Average Number of Shares and Units Outstanding	<u>125,650,694</u>	<u>45,398,608</u>
Earnings (Loss) Per Share - Basic and Diluted	<u>\$ (0.15)</u>	<u>\$ (0.11)</u>
Attributable to Dixie Brands Inc	\$ (0.15)	\$ (0.11)
Attributable to Non-Controlling Interest	\$ (0.00)	\$ (0.00)

13. REVENUE

Revenue by service line:

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Revenues				
Licensing Revenue	2,892,895	1,754,961	7,366,037	2,678,042
Finished Goods	295,304	166,136	673,805	548,300
Materials and Ingredients	(86,192)	428,081	212,738	697,604
Other	<u>19,204</u>	<u>86,220</u>	<u>82,116</u>	<u>281,223</u>
	3,121,211	2,435,398	8,334,696	4,205,169

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

14. GENERAL AND ADMINISTRATIVE EXPENSES

For the nine months ended September 30, 2019 and 2018, general and administrative expenses consisted of the following:

	September 30, 2019	September 30, 2018
Stock Incentives / Share-Based Compensation	\$ 6,616,169	\$ 77,439
Salaries and Benefits	3,561,405	1,539,157
Professional Fees	3,388,092	972,183
Legal	567,708	365,061
Other General and Administrative	442,031	111,814
Travel and Entertainment	421,900	79,611
Rent	220,405	180,628
Insurance	201,096	85,293
Lobbying Expense	57,040	117,088
Office Expense	54,662	276,769
Employee Benefits	45,109	104,954
Bad Debts (Recovery)	(210,011)	218,696
	<u>\$ 15,365,606</u>	<u>\$ 4,128,693</u>

15. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The Company has adopted IFRS 9 - Financial Instruments (“IFRS 9”), which replaced IAS 39 - Financial Instruments: Recognition and Measurement. The revised guidance changed the classification and measurement of financial assets and liabilities. Under IFRS 9, financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows.

Expected credit losses for trade receivables are based on the payment profiles of sales for the last 12 months, before September 30, 2019, as well as the corresponding historical credit losses during that period. The historical rates are adjusted to reflect current and forward-looking cash flow projections of the customers which is the primary factor used to estimate the collectability of the amounts outstanding.

The following is a breakdown of the exposure to ECLs for trade receivables as of September 30, 2019:

	Trade receivables past due				
	0-30 days	31-60 Days	61-90 Days	91+ Days	Total
Expected credit loss rate	10%	16%	19%	51%	
Gross Carrying Amount	1,293,731	419,275	320,958	2,449,878	4,483,843
Lifetime expected credit loss	122,918	66,123	61,745	1,247,355	1,498,141

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

As of September 30, 2019, \$1,331,887 in SSW notes receivables (\$675,000 in principal), non-interest-bearing advances (\$656,887 in principal) (the “SSW loans”) and equity contributions receivable (\$230,763 in principal) have matured but remain unpaid. As a result, the Company assessed the credit risk of the SSW loans as having been significantly deteriorated. Therefore, the Company evaluated the SSW loans as a Stage 3 credit impaired financial asset and have estimated the lifetime expected credit loss on the SSW loans to be 100%. An expected credit loss provision of \$1,562,650 has been taken on the SSW loans as of September 30, 2019.

As of September 30, 2019, there are no maturing notes receivables due from Left Bank (the “Left Bank loans”). The Company has not identified any significant increases in the credit risk of the Left Bank loans. Therefore, the Company has evaluated the Left Bank loans as a Stage 1 financial asset and have estimated the twelve-month expected credit loss on the loan to be 10%. An expected credit loss provision of \$167,787 has been taken on the Left Bank loans as of September 30, 2019.

As of September 30, 2019, there are no maturing notes receivables due from other advances. The Company has not identified any significant increases in the credit risk of the advances. Therefore, the Company has evaluated the other advances as a Stage 1 financial asset and have estimated the twelve-month expected credit loss on the loan to be 10%. An expected credit loss provision of \$50,602 has been taken on the other loans as of September 30, 2019.

IFRS 9 contains three primary measurement categories for financial assets: measured at amortized cost, FVTPL and fair value through other comprehensive income. The Company’s financial assets are measured at amortized cost or FVTPL.

The Company determines classification of financial assets at initial recognition. The Company’s accounting policy in respect to its financial instruments is as follows:

(i) Financial assets are classified and measured at FVTPL unless they meet the following criteria for amortized cost:

- The Company plans to hold the financial assets in order to collect contractual cash flows; and
- Payments received on the financial assets are solely payments of principal and interest on the principal amount outstanding.

(ii) Financial liabilities - non-derivative financial liabilities are measured at amortized cost unless they have been designated as FVTPL. Derivative liabilities are initially measured at FVTPL, with subsequent changes in fair market value recognized in the Consolidated Statements of Operations.

(iii) Compound financial instruments - the component parts of compound instruments issued by the Company are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangement. At the date of issue, the fair value of the liability is measured separately using an estimated market rate for a similar liability without an equity component and the residual is allocated to the conversion option. The liability component is subsequently recognized on an amortized cost basis using the effective interest method until extinguished upon conversion or at the instrument’s maturity date. The equity component is recognized and included in equity and is not subsequently re-measured. In addition, the conversion option classified as equity will remain in equity until the conversion option is exercised, in which case, the balance recognized in equity will be transferred to share capital. Transaction costs are divided between the liability and equity components in proportion to their values.

DIXIE BRANDS INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Interim Financial Statements

For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

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

- Level 1 quoted prices (unadjusted) that are in active markets for identical assets or liabilities
- Level 2 inputs that are observable for the asset or liability, either directly (prices) for similar assets or liabilities in active markets or indirectly (derived from prices) for identical assets or liabilities in markets with insufficient volume or infrequent transactions
- Level 3 inputs for assets or liabilities that are not based upon observable market data

The Company classifies its financial instruments as follows:

Financial Instrument	Classification	Fair Value Hierarchy
Cash	Amortized cost	N/A
Accounts receivables	Amortized cost	N/A
Accounts payable and accrued payroll and other liabilities	Amortized cost	N/A
Promissory notes receivable	Amortized cost	N/A
Derivative liabilities	FVTPL	Level 3
Notes payable	Amortized cost	N/A

A summary of activity for level 3 derivative liabilities for the nine months ending September 30, 2019 and for the year ending December 31, 2018:

	<u>Conversion Features</u>
Balance as of January 1, 2018	\$ 498,232
Change in Fair Value	<u>(260,132)</u>
Balance as of December 31, 2018	238,100
Change in Fair Value	<u>168,100</u>
Balance as of September 30, 2019	<u>\$ 70,000</u>

There are no material reclassifications between fair value levels during the nine months ended September 30, 2019 or the year ended December 31, 2018.

16. COMMITMENTS AND CONTINGENCIES

The Company may, from time to time, be subject to various administrative, regulatory, and other legal proceedings arising in the ordinary course of business. Contingent liabilities associated with legal proceedings are recorded when a liability is probable, and the contingent liability amount can be reasonably estimated.

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

The Company's operations are subject to a variety of local and state regulations. Failure to comply with one or more of those regulations could result in fines, restrictions on its operations, or losses of permits that could result in the Company ceasing operations. While management of the Company believes that the Company is in compliance with applicable local and state regulation as at September 30, 2019, medical and adult use cannabis regulations continue to evolve and are subject to differing interpretations. As a result, the Company may be subject to regulatory fines, penalties, or restrictions in the future.

17. FINANCIAL RISK MANAGEMENT

Market risk

Strategic and operational risks arise if the Company fails to carry out business operations and/or to raise sufficient equity and/ or debt financing. These strategic opportunities or threats arise from a range of factors that might include changing economic and political circumstances and regulatory approvals and competitor actions. The risk is mitigated by consideration of other potential development opportunities and challenges which management may undertake.

Credit risk

The Company's exposure to non-payment or non-performance by our counterparties is a credit risk. The maximum credit exposure as at September 30, 2019 is the carrying amount of cash, accounts receivable and other receivables and promissory notes receivable. The Company has a significant outstanding balance in accounts receivable over 90 days as of September 30, 2019. The Company mitigates its credit risk on its other receivables and promissory notes receivable through its review of the counterparties and business review. The Company considers a variety of factors when determining interest rates for notes receivable, including the creditworthiness of the counterparty, market interest rates prevailing at the note's origination and duration and terms of the note. Notes that are overdue are assessed for impairment.

Liquidity risk

The Company's ability to generate cash to fund operations, fund planned growth and development activities is contingent on its ability to increase revenues amongst its various product lines in combination with its ability to raise capital through various funding partners and reduce expenditures. The Company expects to increase revenues in its various CBD product lines through new distribution partners, expanding ecommerce sales and developing new sales channels. The Company also expects to increase licensing revenue from affiliate sales of medicated products by expanding into new states and creating organic growth in current operating states. The Company expects to reduce expenses by effectively managing headcount and focusing effort on ensuring cost effective spending. Any negative cash flows will be managed by funding provided by a funding partner. The inability to increase revenue, obtain funding or reduce expenses according to management's plans could result in liquidity risk.

Asset forfeiture risk

Because the cannabis industry remains illegal under U.S. federal law, any property owned by participants that conduct business with affiliates in the cannabis industry, which either are used in the course of conducting such business, or are the proceeds of such business, could be subject to seizure by law enforcement and subsequent civil asset forfeiture. Even if the owner of the property are never charged with a crime, the property in question could still be seized and subject to an administrative proceeding by which,

DIXIE BRANDS INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Interim Financial Statements
For the Nine Months Ended September 30, 2019 and 2018 (unaudited)

with minimal due process, it could be subject to forfeiture.

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 cannabis 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 cannabis industry. Consequently, businesses involved in the cannabis 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 ordinary businesses.

Interest rate risk

Interest rate risk is the risk that the fair value or the future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates.

Capital structure risk management

The Company considers its capital structure to include debt financing, contributed capital, accumulated deficit, non-controlling interests and any other component of stockholders' equity. The Company's objectives when managing its capital are to safeguard its ability to continue as a going concern, to meet its capital expenditures for its continued operations, and to maintain a flexible capital structure which optimizes the cost of capital within a framework of acceptable risk. The Company manages its capital structure and adjusts it as appropriate given changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust its capital structure, the Company may issue new units, issue new debt, or acquire or dispose of assets. The Company is not subject to externally imposed capital requirements. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There have been no changes to the Company's capital management approach during the period ended September 30, 2019.

18. SUBSEQUENT EVENTS

On November 18, 2019, the Company formed a wholly owned subsidiary DB Oklahoma, LLC ("DBOK"). On November 18, 2019, DBOK entered into a manufacturing and licensing agreement for medical marijuana products in Oklahoma. Revenue is expected to begin in first quarter of 2020.

On November 14, 2019, the Company finalized the supply agreement with Herbal Enterprises LLC, an affiliate of the AriZona™ brand. A collection of THC-infused branded products are expected to be launched in 2020.

Dixie executed three promissory notes ("Loans") totaling \$1,500,000, each for \$500,000 on October 30, 2019, November 11, 2019 and November 25, 2019. The Loans are interest bearing at 10% and principal and interest will be due one year from the date of the note. The financing is non-dilutive, unsecured loan with a strategic unrelated party. This loan is contemplated to be the initial component of a strategic financing initiative between the parties.