Adastra Labs Holdings Ltd. (formerly Arrowstar Resources Ltd.)

MANAGEMENT DISCUSSION AND ANALYSIS

Six Months Ended June 30, 2020

Adastra Labs Holdings Ltd. (formerly Arrowstar Resources Ltd.)
MANAGEMENT DISCUSSION AND ANALYSIS ("MD&A")
Effective August 31, 2020

The following management discussion and analysis ("MD&A") of the financial condition and results of operations of Adastra Labs Holdings Ltd. ("Adastra" or the "Company") constitutes management's review of the factors that affected the Company's financial and operating performance for the three and six months period ended June 30, 2020 and 2019. This MD&A has been prepared in compliance with the requirements of National Instrument 51-102 – Continuous Disclosure Obligation. This MD&A should be read in conjunction with Adastra's audited financial statements and related notes for the period ended December 31, 2019 and the period from incorporation June 18, 2018 to April 30, 2019, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All monetary amounts in the MD&A are expressed in Canadian dollars, except per share amounts or as otherwise indicated.

Additional information regarding the Company is available on SEDR at www.sedar.com, and the Company's website www.adastralabs.ca. The date of this MD&A is August 31, 2020.

FORWARD-LOOKING STATEMENTS

This MD&A includes forward-looking statements that are based upon current expectations, which involve risks and uncertainties associated with our business and the environment in which the business operates. Any statements contained herein that are not statements of historical fact may be deemed to be forward looking statements, including those identified by the expressions "considers", "plans", "expects" or "does not expect", "is expected", "budget", "scheduled", "estimates", "forecasts", "intends", "anticipates" or "does not anticipate", or "believes", or variations of such words and phrases or statements that certain actions, events or results "may", "could", "would", "might" or "will be taken", "occur" or "be achieved", or the negative of these terms or comparable terminology. In this document, certain forward-looking statements are identified by words including "may", "future", "expected", "will", "intends", and "estimates". By their very nature forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause the 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. The Company provides 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.

DESCRIPTION OF THE BUSINESS

Adastra Labs Holdings Ltd. (formerly Arrowstar Resources Ltd.) (the "Company" or "Arrowstar") was incorporated under the laws of the province of British Columbia on October 14, 1987. The Company changed its name to Adastra Labs Holdings Ltd., on December 19, 2019. The Company is an extraction and processing solutions company. The Company's mission is to develop and deploy large-scale cannabis and hemp extraction technologies and provide turn-key processing solutions to help licensed standard and micro-cultivators maximize the value of every harvest. The Company is listed on the Canadian Securities Exchange ("CSE") under the symbol "XTRX". The Company's registered and records office is 5451 275th Street, Langley City, British Columbia, V4W 3X8.

Health Canada issued an Analytical Testing License on the Company's facility to Chemia Analytics Inc., ("Chemia"). Chemia is a wholly owned subsidiary of the Company.

On December 20, 2019, Arrowstar acquired all of the issued and outstanding common shares of Adastra Labs Holdings (2019) Ltd. ("Adastra") a private British Columbia cannabis extraction and processing solutions company incorporated on June 18, 2018. The acquisition was completed by entering into a share exchange agreement whereby the parties completed a business combination by way of a transaction that constituted a reverse takeover ("RTO") of the Company by Adastra (the "Transaction"). The Transaction was accounted for as an RTO of Arrowstar by Adastra for accounting purposes, with Adastra being identified as the accounting acquirer, and accordingly, these financial statements are a continuation of Adastra. The net assets of Arrowstar at the date of the RTO are deemed to have been acquired by Adastra. This MD&A includes the results of operations of Arrowstar since December 20, 2019. The comparative figures are those of Adastra prior to the RTO. At the time of the transaction the Company changed its financial year end from April 30 to December 31.

In March 2020, the World Health Organization declared coronavirus COVID-19 a global pandemic. This contagious disease outbreak, which has continued to spread, and any related adverse public health developments, has adversely affected workforces, economies, and financial markets globally, potentially leading to an economic downturn. The extent of the impact on COVID-19 on the Company's operational and financial performance will depend on various developments, including the duration and magnitude of the outbreak, and the impact on customers, employees and vendors, all of which are uncertain and cannot be predicted at this point.

On March 16, 2020, Health Canada issued a Standard Processing License on the Company's facility to Adastra Labs Inc., ("Labs"). Labs is a wholly owned subsidiary of the Company.

REVERSE ACUISITION

On December 20, 2019, Arrowstar and Adastra completed the Transaction which constituted a reverse acquisition.

The Transaction resulted in the shareholders of Adastra obtaining control of the combined entity by obtaining control of the voting rights, governance and management decision making processes, and the resulting power to govern the financial and operating policies of the combined entity.

The transaction constitutes an RTO of Arrowstar by Adastra and has been accounted for as a reverse acquisition transaction in accordance with the guidance provided in IFRS 2, Share-based payments. As Arrowstar did not qualify as a business according to the definition in IFRS 3, the RTO does not constitute a business combination; rather it is treated as an issuance of common shares by Adastra for the net assets of Arrowstar and Arrowstars public listing, with Adastra as the continuing entity. Accordingly, no goodwill was recorded with respect to the transaction as it does not constitute a business.

For accounting purposes, Adastra was treated as an accounting parent company (legal subsidiary) and Arrowstar has been treated as the accounting subsidiary (legal parent) in the financial statements and MD&A. As Adastra was deemed to be the acquirer for accounting purposes, its assets, liabilities and operations since incorporation are included in these financial statements at their historical carrying values. Arrowstar's results of operations have been included from December 20, 2019.

	December 20, 2019
Net assets (liabilities) of Arrowstar acquired:	**$**
Cash	111,496
Receivables	10,802
Other assets	7,504
Accounts payable	(356,384)
Net liabilities acquired	**(226,582)**
Consideration paid in RTO of Arrowstar:	**$**
Common shares (fair value 21,656,034 common shares at $0.05 per share)	1,082,802
Total consideration paid	**1,082,802**
Listing expense	**1,309,384**

The Transaction was measured at the fair value of the shares that Adastra would have had to issue to the shareholders of Arrowstar, to give the shareholders of Arrowstar the same percentage equity interest in the combined entity that results from the reverse acquisition had it taken the legal form of Adastra acquiring Arrowstar.

OVERALL PERFORMANCE

As of June 30, 2020, the Company had a mortgage payable liability and was in a negative working capital position. The Company's focus for the period ended June 30, 2020, included the raise of debt and equity capital, the expansion of its centralized processing facility in Langley, BC. The Company received their Analytical Testing License on October 19, 2019 and received their Standard Processing License on March 16, 2020.

Operations and Facility

As of the date of this MD&A, the Company will focus on the generation of revenue through two primary activities, being wholesale activities and tolling services related to the production of cannabis extracts and related cannabis products.

At the Company's 13,000 sq. ft. Langley, British Columbia facility which has completed commissioning and commenced operations as of April 23, 2020, it currently operates supercritical CO_2 primary extraction line for crude cannabis/hemp oil production, wiped film short path distillation line for production of high grade cannabis distillate, formulation and filling line for tincture bottles and vaporizer products, and packaging for finished packaged goods.

Wholesale Bulk Extracts Production

During the period ended June 30, 2020, the Company commenced processing their own inventory of dried cannabis through primary supercritical CO_2 extraction lines and secondary distillation lines and will sell the resulting bulk cannabis concentrates to licensed clients. The Company has procured all of its bulk shipments of dried cannabis for its wholesale production lines from various licensed cultivators under the Cannabis Act. During the six months ended June 30, 2020, the Company recognized revenue of $428,355 from processing services.

On May 5, 2020, the Company received its initial purchase order for bulk distillate from CannMart Inc., a majority-owned subsidiary of Namaste Technologies Inc.

SELECTED ANNUAL INFORMATION

For the periods ended:

	December 31, 2019 $	April 30, 2019 $
Expenses	(1,128,382)	(849,614)
Loss and comprehensive loss	(2,657,957)	(903,989)
Weighted average number of common shares outstanding - basic and diluted	82,487,647	13,265,014
Loss and comprehensive loss per share - basic and diluted	(0.03)	(0.07)

With respect to loss and comprehensive loss per share, financial instruments are anti-dilutive.

For the periods ended:

	December 31, 2019 $	April 30, 2019 $
Total assets	11,351,010	6,254,518
Working capital deficiency	471,084	145,048
Total liabilities	6,266,088	749,833
Non-current liabilities	2,955,511	-
Shareholders' equity	5,084,922	4,614,000
Deficit	(3,561,946)	(903,989)

For the period ended December 31, 2019, the Company raised additional equity capital which contributed to greater cash and current assets, it increased equipment purchases which drove an increase in total assets, and it incurred greater expenses overall which contributed to the increase in loss and comprehensive loss.

RESULTS OF OPERATIONS

The variations from quarter to quarter since incorporation as shown below are largely attributable to increased expenses correlating with increases in operating activity.

The Company's expenses with respect to office, professional fees and consulting, and wages and salaries have increased as the Company expands its development efforts relating to the build out of its centralized processing facility, and has engaged in further marketing activity in relation to the general development, promotion, and expansion of its business during the period ended June 30, 2020, relative to the comparative period June 30, 2019. More specifically:

- Advertising and promotion increased by approximately $261,000 due to increased efforts and significant marketing campaigns to create investor and customer awareness as a newly listed entity;
- Office expenses increased by approximately $127,000 to $239,481 as general and administrative items such as office supplies and products all increased. Additionally, small tools and equipment $65,000 as the Company's prepared the facility for operations and computer and internet expenses of approximately $29,000 were incurred for website subscription costs.
- Professional fees and consulting increased by approximately $109,000 to $395,901 primarily due to greater legal fees related to the Company's public listing, and other general corporate matters which increased as a result of becoming a reporting issuer. Additionally, the Company engaged with consultants to perform various professional services namely the provision of consulting relating to its centralized processing facility and the Company's custom-built extraction facility and equipment commissioning;
- Wages and salaries decreased by approximately $1,000 to $198,987. The Company hired additional staffing at its facility and head office in various departments to facilitate growth efforts; operating expenditures were offset by the allocated production staff to cost of sales; and
- Share-based payments of $2,537,300 is a non-cash expense. This represents the fair value of 7,570,000 using the Black-Scholes option pricing model.
- Revenues increase to $428,355 from processing of cannabis biomass for third party licensed producers.

SUMMARY OF QUARTERLY RESULTS

The following table shows results from the previous quarters since incorporation on June 18, 2018:

Period Ending	Revenue $	Loss and comprehensive loss $	Basic and Diluted Loss Per Share $
June 30, 2020	428,355	(467,584)	(0.00)
March 31, 2020	-	(3,343,034)	(0.03)
December 31, 2019	-	(1,785,818)	(0.02)
October 31, 2019	-	(333,290)	(0.00)
July 31, 2019	-	(538,849)	(0.01)
April 30, 2019	-	(203,506)	(0.07)
January 31, 2019	-	(206,277)	-
October 31, 2018	-	(138,044)	-

The Company's loss and comprehensive loss for the period ended June 30, 2020, was $467,584. The incurred amount was offset by revenues of $428,355 which represent the Company's first quarter of production revenue. The Company incurred $206,704 in advertising and promotion during the three months ended June 30, 2020 which represent the Company's increase to their investor awareness campaign.

The Company's loss and comprehensive loss for the period ended December 31, 2019, was $1,785,818. The incurred amount is due in large part to the increased activity and related expenditures above specific to the Company's efforts to expand the business, build its facility, and obtain a public listing. Approx. $1,300,000 represented the excess of the non-cash consideration paid over the net assets of Arrowstar.

The Company's loss and comprehensive loss for the period from incorporation on June 18, 2018 to April 30, 2019, is $903,989. The incurred amount is due in large part to the increased activity and related expenditures specific to the Company's efforts to expand the business, build its facility, and obtain a public listing.

LIQUIDITY AND CAPITAL RESOURCES

The Company's objectives when managing its liquidity and capital structure are to support further advancement of the Company's business objectives and existing service offerings, as well as to ensure that the Company is able to meet its financial obligations as they come due.

Cash and working capital

As of June 30, 2020 the Company had working capital deficiency of $4,652,252 and requires additional financing to meet its business objectives.

Cash flow activity

The decrease in cash and increase in working capital deficiency as of June 30, 2020 was primarily the result of an approximate $153,000 increase in cash flows from financing activities driven by the Company's interest and borrowing costs associated with the mortgage payable and subscriptions received in advance of the private placement. Cash used in operating activities and increase in cash used in investing activities of approximately, $998,854 and $590,231 which primarily consists of the acquisition of property plant and equipment.

Capital resource management

The Company defines capital as the components of shareholders' equity. The Company's objectives when managing capital are to support further advancement of the Company's business objectives, as well as to ensure that the Company is able to meet its financial obligations as they come due.

The Company manages its capital structure to maximize its financial flexibility making adjustments to it in response to changes in economic conditions and the risk characteristics of the underlying assets and business opportunities. The Company relies on the expertise of the Company's management to sustain the future development of the business. 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 were no changes in the Company's approach to capital management during the period ended June 30, 2020. The Company is not subject to externally imposed capital requirements.

SHARE CAPITAL INFORMATION

Authorized

Unlimited number of common shares with no par value.

Issued and Outstanding

As of June 30, 2020 the total issued and outstanding share capital consists of 110,056,904 common shares.

As of the date of the MD&A, the total issued and outstanding share capital consists of 129,968,085 common shares.

Transactions for the issue of share capital during the three months ended June 30, 2020:

On January 17, 2020, the Company issued 569,802 units from a conversion notice for $250,000 of principal and $6,411 accrued interest of the convertible debentures. Each unit consisting of one (1) common share of the Company and one (1) underlying share purchase warrant exercisable at $0.75 for two years from the date of conversion notice January 17, 2022. The warrants were given a value of $nil using the residual value method.

On January 27, 2020, the Company issued 800,280 units from a conversion notice for $350,000 of principal and $10,126 accrued interest of the convertible debentures. Each unit consisting of one (1) common share of the Company and one (1) underlying share purchase warrant exercisable at $0.75 for two years from the date of

Transactions for the issue of share capital during the three months ended June 30, 2019:

On June 20, 2018, the Company issued 1 common share for $1 on incorporation, the Company cancelled the incorporation share on February 7, 2019;

On February 7, 2019, the Company closed a private placement for the issuance of 26,000,000 common shares at a price of $0.005 per share for gross proceeds of $130,000;

On February 28, 2019, the Company closed a private placement for the issuance of 21,750,000 common shares at a price of $0.02 per share for gross proceeds of $435,000;

On March 7, 2019, the Company closed a private placement for the issuance of 21,053,333 common shares at a price of $0.075 per share for gross proceeds of $1,579,000;

On March 31, 2019, the Company closed a private placement for the issuance of 8,203,333 common shares at a price of $0.15 per share for gross proceeds of $1,230,500; and

On April 30, 2019, the Company closed a private placement for the issuance of 4,131,667 common shares at a price of $0.30 per share for gross proceeds of $1,239,500.

Escrowed shares

The Company entered into an Escrow Agreement in connection with closing the RTO on December 20, 2019, in relation to certain of its common shares which were placed in escrow. Pursuant to the Escrow Agreement the escrowed common shares are subject to a timed release schedule whereby a 10% portion of the escrow shares will be released beginning on listing date, and 15% every six months thereafter until January 6, 2023.

As of June 30, 2020, 23,400,000 common shares were held in escrow (December 31, 2019 – 26,000,000).

Stock options

As of the date of this MD&A, the Company has 7,570,000 stock options outstanding.

During the periods ended December 31, 2019 and April 30, 2019, there were no options granted or outstanding.

A summary of the status of the Company's options as of June 30, 2020 and December 31, 2019 and changes during the periods then ended is as follows:

	Period ended June 30, 2020		Period ended December 31, 2019	
	Options #	Weighted average exercise price $	Options #	Weighted average exercise price $
Options outstanding, beginning of period	-	-	-	-
Granted	7,570,000	0.45	-	-
Options outstanding, end of period	**7,570,000**	**0.45**	-	-

As of June 30, 2020, the Company has stock options outstanding and exercisable as follows:

Options outstanding #	Options exercisable #	Exercise Price $	Expiry date	Weighted average remaining life (years)
7,570,000	7,570,000	0.45	January 30, 2025	4.84
7,570,000	**7,570,000**			4.84

Warrants

As of the date of this MD&A, the Company has 25,114,078 warrants outstanding.

A summary of the status of the Company's warrants as of June 30, 2020 and December 31, 2019 and changes during the periods then ended is as follows:

	Period ended June 30, 2020		Period ended December 31, 2019	
	Warrants #	Weighted average exercise price $	Warrants #	Weighted average exercise price $
Warrants outstanding, beginning of period	7,411,655	0.73	-	-
Replaced on RTO	-	-	1,519,200	0.92
Issued - attached to units	1,370,082	0.75	5,892,455	0.60
Expired	(1,519,200)	9.00	-	-
Warrants outstanding, end of period	**7,262,537**	**0.63**	7,411,655	0.73

As of June 30, 2020, the Company had warrants outstanding and exercisable as follows:

Warrants outstanding #	Warrants exercisable #	Exercise Price $	Expiry date	Weighted average remaining life (years)
5,892,455	5,892,455	0.60	December 2, 2022	2.47
569,802	569,802	0.75	January 17, 2022	1.55
800,280	800,280	0.75	January 27, 2022	1.58
7,262,537	**7,262,537**			2.30

OFF-BALANCE SHEET ARRANGEMENTS

The Company has not engaged in any off-balance sheet arrangements such as obligations under guarantee contracts, a retained or contingent interest in assets transferred to an unconsolidated entity, any obligation under derivative instrument or any obligation under a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the Company or engages in leasing or hedging services with the Company.

PROPOSED TRANSACTIONS

There are currently no significant proposed transactions except as otherwise disclosed in this MD&A. Confidentiality agreements and non-binding agreements may be entered into from time to time, with independent entities to allow for discussions of the potential acquisition and/or development of potential business relationships.

MORTGAGE PAYABLE

a) On January 7, 2019, the Company entered into a mortgage for $2,446,000 (the “First Mortgage”) which bore interest at the rate of 8.25% per annum, calculated monthly. The First Mortgage matured on February 1, 2020 and was renewed as discussed below.

The First Mortgage payable was recorded at amortized cost and bore an effective interest rate of 10.44%.

The carrying value of the First Mortgage at December 31, 2019 was $2,437,175. Included in mortgage payable on initial recognition were the related mortgage transaction costs of $50,755 which were amortized over the term of the First Mortgage using the effective interest rate method.

The Company maintained minimum interest only payments of $16,816 per month in connection with the First Mortgage. Total interest expense of the First Mortgage during the period ended June 30, 2020 was $33,632 (2019 - $109,015).

b) On February 1, 2020, the Company renewed the First Mortgage of $2,446,000 (the “Second Mortgage”) which bears interest at the rate of 8.00% per annum, calculated monthly. The Second Mortgage matures on February 1, 2021 and can be repaid before maturity without penalty and is secured by the mortgage property and building improvements.

The Second Mortgage payable was recorded at amortized cost and bares an effective interest rate of 8.79% as at June 30, 2020.

The carrying value of the Second Mortgage payable at June 30, 2020 was $2,433,592. Included in mortgage payable (on initial recognition) were the related mortgage transaction costs of $18,345 which are being amortized over the term of the Second Mortgage using the effective interest rate method.

The Company maintains minimum interest only payments of $16,307 per month. As at June 30, 2020 the total non-discounted remaining scheduled payments related to the mortgage including interest payments, total $2,576,453. Total interest expense during the period ended June 30, 2020 was $48,920 (2019 - $nil).

CONVERTIBLE DEBENTURE

On October 31, 2019, the Company closed a 7,060,000 convertible debenture unit offering at a price of $0.45 per debenture unit for gross proceeds $3,177,000. Each debenture consists of a 12% secured convertible debenture with a maturity of two years from the date of issuance. If the holder converts their debenture unit they are entitled to one common share and one share purchase warrant exercisable at $0.75 per share exercisable two years from the date of the convertible debenture closing October 31, 2021 at the holders discretion.

If the closing price of the Common Shares of the Company is higher than $1.00 for any 10 consecutive trading days the expiry date of the Warrants may be accelerated to the 30th day after the date of a news release announcing such acceleration. The debentures will be secured to the facility subordinate to the mortgage currently on the facility.

As the debentures are convertible into units, the liability and equity components are presented separately on the condensed interim consolidated statement of financial position. The initial carrying amount of the financial liability was determined by discounting the stream of future payments of interest and principal at a market interest rate of 16% totaling $2,878,539. Using the residual method, the carrying amount of the conversion feature is the difference between the principal amount and the initial carrying value of the financial liability. The equity component is recorded in debenture reserves on the consolidated statement of financial position totaling $298,461. The debentures, net of the equity component are accreted using the effective interest method over the term of the debentures, such that the carrying amount of the financial liability will equal the principal balance at maturity.

During the six months ended June 30, 2020, the Company settled $616,537 of the debentures through the issuance of 1,370,083 units. The Company reversed $56,366 from debenture reserves in connection with the settlement.

The Company recorded interest expense of $158,700 and accretion expense of $43,637 related to the convertible debenture during the period ended June 30, 2020 (2019 - $nil). The carrying value of the convertible debenture at June 30, 2020 was $2,597,676 (December 31, 2019 - $2,955,511) an the carrying value of debenture reserves was $242,095 (December 31, 2019 - $298,461)

TRANSACTIONS WITH RELATED PARTIES

A number of key management personnel and Directors hold positions in other entities that result in them having control or significant influence over the financial or operating policies of these entities. There were no loans to key management personnel or Directors, or entities over which they have control or significant influence during the periods ended June 30, 2020 or December 31, 2019.

During the period ended June 30, 2020, 3,400,000 (2019 – nil) options were granted to Officers and Directors having a fair value on grant of $1,139,612 (2019 – nil).

The following related parties transacted with the Company or Company controlled entities during the periods:

(a) Andrew Hale is a Director and the Company's President and CEO.

(b) Blaine Bailey is a Director and Chairman of the Company's Audit Committee. He controls Promaid Services Ltd. ("Promaid.") which provides the Company with financial services.

(c) Stephen Brohman is the Company's CFO. He is a principal of Donaldson Brohman Martin CPA Inc. ("DBM CPA") a firm in which he has significant influence. DBM CPA provides the Company with accounting and tax services.

(d) George Routhier is a Company Director. He is the owner of Pipedreemz Inc. ("Pipedreemz"), which provides advisory services to the Company.

The aggregate value of transactions and outstanding balances with key management personnel and Directors and entities over which they have control or significant influence were as follows:

	Transactions Six months ended June 30, 2020 $	Transactions Six months ended June 30, 2019 $	**Balances outstanding June 30, 2020 $**	Balances outstanding December 31, 2019 $
DBM CPA	72,000	33,566	12,600	-
Andrew Hale	90,049	90,086	-	-
Pipedreemz	2,500	15,700	-	-
	164,549	139,352	**12,600**	-

All related party balances are unsecured and are due within thirty days without interest.

The transactions with the key management personnel and Directors are included in operating expenses as follows:

(a) Consulting fees

- Includes the advisory services of Director, George Routhier, charged to the Company by Pipedreemz.

(b) Professional fees

- Includes the accounting and tax services of the Company's CFO, Stephen Brohman, charged to the Company by DBM CPA.

(g) Wages and salaries

Includes charges by Andrew Hale for salaries paid to Officer.

<u>RISKS AND UNCERTAINTIES</u>

The Company operates in rapidly changing environment that involves risks and uncertainties and as a result management expectation may not be realized for a number of reasons. An investment in the Company common shares is speculative and involves a high degree of risk and uncertainty. The current regulatory uncertainty poses additional risks and uncertainties which may materially affect management's expectations.

Regulatory Risks

The operations of the Company will be subject to various laws governing the production and distribution of cannabis oil, taxes, labour standards and occupational health, toxic substances, land use, water use, and other matters.

The Cannabis Act is a new regime and as such, revisions to the regime could be implemented which could have an impact on operations.

Furthermore, although the operations of each of the Company are currently carried out in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail the ability to produce cannabis oil and related products. Amendments to current laws and regulations governing the distribution, transportation and/or production of cannabis oil or related products, or more stringent implementation thereof could have a substantial adverse impact.

Ongoing Need for Financing

The Company's ability to continue operations will be largely reliant on its continued attractiveness to equity investors. The Company is expected to incur operating losses as it continues to expend funds to develop its business operations. Even if its financial resources are sufficient to fund its current operations, there is no guarantee that the Company will be able to achieve its business objectives. The continued development of Adastra will require substantial additional financing. The failure to raise such capital could result in the delay or indefinite postponement of current business objectives or the going out of business. The primary source of funding available to the Company will consist of equity financing. There can be no assurance that additional capital or other types of financing will be available if needed or that, if available, the terms of such financing will be favorable. In addition, from time to time, the Company may enter into transactions to acquire assets or the shares of other corporations. These transactions may be financed wholly or partially with debt, which may temporarily increase the Company's debt levels above industry standards.

Competition

The marijuana production industry is competitive in all of its phases. The Company will face strong competition from other companies in connection with such matters. Many of these companies have greater financial resources, operational experience and technical capabilities than Adastra. As a result of this competition, the Company may be unable to maintain its operations or develop them as currently proposed, on terms it considers acceptable or at all. Consequently, the revenues, operations and financial condition of the Company could be materially adversely affected.

Because of early stage of the industry in which Adastra operates, the Company may face additional competition from new entrants. If the number of users of marijuana in Canada increases, the demand for products will increase and expects that competition will become more intense, as current and future competitors begin to offer an increasing number of diversified products. To remain competitive, the Company will require a continued high level of investment in research and development, marketing, sales and client support. The Company may not have sufficient resources to maintain research and development, marketing, sales and client support efforts on a competitive basis which could materially and adversely affect the business, financial condition and results of operations.

COVID-19 Pandemic

COVID19 outbreak continues to rapidly evolve and is causing business disruptions across the entire global economy and society. We have taken various measures to prioritize the health and safety of our employees, customers and partners, including: restricted work travel and site access; improved safety & hygiene; and the requirement of nonessential staff members to work remotely. As a manufacturer of consumable and medicinal products, our practice is always to operate to global pharma-quality standards to the best of our abilities with strict hygiene practices and mandated personal protective equipment. The extent of the impact on COVID-19 on the Company's operational and financial performance will depend on various developments, including the duration and magnitude of the outbreak, and the impact on customers, employees and vendors, all of which are uncertain and cannot be predicted at this point.

FINANCIAL RISK MANAGEMENT

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations.

The Company's cash is held with a Canadian chartered bank and accordingly, the Company's exposure to credit risk is considered insignificant. The Company's exposure to its trade receivables equates to their carrying value. The Company's receivables represent refunds due from the Government of Canada and the exposure to credit risk on these amounts are considered to be limited.

Liquidity risk

The Company manages liquidity risk by maintaining an adequate level of cash to meet its ongoing obligations. The Company has been successful in raising equity financing in the past; however, there is no assurance that it will be able to do so in the future. As of June 30, 2020, the Company had working capital deficiency of $4,652,252, and requires additional financing to meet its business objectives.

Market risk

Market risk is the risk that the fair value or future cash flows from a financial instrument will fluctuate because of changes in market prices or prevailing conditions. Market risk comprises three types of risk: currency risk, interest rate risk, and price risk as follows:

(i) Currency risk

Currency risk is the risk of change in profit or loss that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company has insignificant exposure to currency risk as it does not have assets or liabilities denominated in foreign currencies. The Company occasionally incurs equipment purchases denominated in the United States dollar.

(ii) Interest rate risk

The Company is not exposed to interest rate risk because it does not have any assets or liabilities subject to variable rates of interest, except for cash held in interest-bearing accounts which poses an insignificant risk exposure.

(iii) Price risk

Equity price risk is defined as the potential adverse impact on the Company's results of operations and the ability to obtain financing, due to movements in individual equity prices or general movements in the level of the stock market. The Company closely monitors individual equity movements and the stock market to determine the appropriate course of action to be taken by the Company. Fluctuations in value may be significant.

CRITICAL ACCOUNTING ESTIMATES AND FINANCIAL INSTRUMENTS

The Company prepares its financial statements in conformity with IFRS. Adastra lists its significant accounting policies and its financial instruments in Notes 2 and 14 respectively, to its annual audited financial statements for the period ended December 31, 2019.

SUBSEQUENT EVENT

(a) Subsequent to June 30, 2020, the Company received conversion notices for 6,226,339 units on conversion of $2,577,000 of principal and $224,853 of accrued interest of the convertible debenture. Each unit consists of one common share of the Company and one share purchase warrant exercisable at $0.75 for two years from the date of conversion. No value was attributed to the warrant component of the units issued.

(b) On July 13, 2020, the Company completed a non-brokered private placement of units (“Units”) issuing of 11,648,001 Units at a price of $0.30 per unit for gross proceeds of $3,494,400. Each unit consists one common share and one common share purchase warrant with each warrant exercisable into one common share at an exercise price of $0.50 until July 13, 2022.

In conjunction with the financing, finders’ fees of $21,600 in cash were paid and 72,000 compensation options (each a "Compensation Option") were granted. Each Compensation Option will entitle the holder to purchase one Unit on the same terms as the offering for a period of 24 months from the date of issuance. Each underlying common share purchase warrant (a "Compensation Option Warrant") will be subject to the same terms as the Warrants. If the Warrants are accelerated prior to the exercise of the Compensation Option, each Compensation Option Warrant will expire 30 days after the date of exercise of the Compensation Option.

Additionally, the company settled outstanding indebtedness of $543,175 through the issuance of 1,941,840 common shares of the corporation at a deemed price of $0.28 per common share. The common shares issued in connection with the debt settlement are subject to a hold period that expires four months and one day from the date of issuance.

(c) On August 5, 2020, the Company issued 95,000 common shares related to the exercise of 95,000 warrants at an exercise price of $0.60 per share.

(d) On August 11, 2020, the Company granted 4,850,000 stock options with exercise price of $0.78 to certain directors, officers, employees and consultants. The options expire five years from the date of grant and vest immediately.

APPROVAL

The directors of the Company have approved the disclosures in this MD&A