# HEMPSANA HOLDINGS LTD.

MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED DECEMBER 31, 2021

REPORT DATE: April 22, 2022

This Management Discussion and Analysis (the "MDA") provides relevant information on the operations and financial condition of Hempsana Holdings Ltd. (the "Company" or "Hempsana") for the years ended December 31, 2021 and 2020 and should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the years ended December 31, 2021 and 2020.

This MDA makes reference to the Company's activities prior to its July 12, 2021 Reverse Take Over Transaction ("RTO Transaction") with Stralak Resources Inc. ("Stralak"). In those cases, references to the "Company" refers to the Company's predecessor operating entity, Hempsana Inc.

All monetary amounts in this MDA and in the financial statements are expressed in Canadian dollars, unless otherwise stated. Financial results are being reported in accordance with International Financial Reporting Standards ("IFRS").

The Company's certifying officers, based on their knowledge, having exercised reasonable diligence, are also responsible to ensure that these filings do not contain any untrue statement of material fact or omits to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which is it was made, with respect to the period covered by these filings, and these financial statements together with other financial information included in these filings, The Board of Directors' approves the financial statements and MDA and ensures that management has discharged its financial responsibilities.

Additional information regarding the Company is available on SEDAR at www.sedar.com, and the Company's website www.hempsana.ca.

**FORWARD-LOOKING STATEMENTS**

This MDA contains forward-looking statements and forward-looking information (collectively, "forward-looking statements") within the meaning of applicable Canadian legislation. These statements relate to future events or the future activities or performance of the Company. All statements, other than statements of historical fact, are forward-looking statements. Forward-looking statements are typically identified by words such as: believe, expect, anticipate, intend, estimate, postulate, plans and similar expressions, or which by their nature refer to future events. These forward-looking statements include, but are not limited to, statements concerning:

- the Company's strategies and objectives general business and economic conditions; and

- the Company's ability to meet its financial obligations as they come due, and to be able to raise the necessary funds to continue operations

Although the Company believes that such statements are reasonable, it can give no assurance that such expectations will prove to be correct. Inherent in forward looking statements are risks and uncertainties beyond the Company's ability to predict or control, including, but not limited to, risks related to the Company's inability to raise the necessary capital to be able to continue in business and to implement its business strategies and the Company's inability to obtain any necessary permits, consents or authorizations required for its activities. Please refer to the listing statement of Hempsana Holdings Ltd. dated July 12, 2021 for further risks related to the Company.

Should one or more of these risks or uncertainties materialize, or should assumptions underlying the forward-looking statements prove incorrect, actual results, performance, or achievement may vary materially from those expressed or implied by the forward-looking information contained in MDA. These risk factors should be carefully considered, and readers are cautioned not to place undue reliance on forward-looking statements, which speaks only as of the date of this MDA. The Company does not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect events or circumstances that occur after the date of this MDA or to reflect the occurrence of unanticipated events, except as may be required under applicable securities laws.

## COMPANY OVERVIEW

Hempsana Inc. was incorporated under the laws of Canada on October 15, 2018. Stralak was incorporated on January 31, 1980 under the laws of the Province of British Columbia. On June 25, 2021, Stralak was renamed to Hempsana Holdings Ltd. Following the reverse takeover transaction, Hempsana Inc., is now a wholly-owned subsidiary of Hempsana Holdings Ltd.

The Company specializes in cannabis derivatives and is focused on extraction and purification, and end-product manufacturing. The Company earns revenues from three sources: the production and selling of various cannabis derivatives, including distillates and isolates, through wholesale channels in Canada; third party processing services ("Tolling Services"); and, white-label contracting manufacturing for cannabis brands and other licensed producers.

The Company amended their cannabis license that allows the Company to supply and sell finished cannabis products directly to provincial distributors and other authorized Canadian retail supply channels. The amended sales license is expected to open up new growth opportunities with partners and expand its sales channels both in the wholesale and consumer retail segment of the market. These include provincial distribution agreements for international brands and for additional contract manufacturing opportunities with partners interested in leveraging the Company's state of the art facilities and its amended sales license.

The Company operates an extraction facility located in Goderich, Ontario, Canada (the "Goderich Facility"). All of the Company's production activities, including product development, certain end-product manufacturing, and packaging and distribution, are conducted at the Goderich Facility.

The Goderich Facility is strategically located in an industrial area within a larger agricultural county, and its operations have the support of local government. The location provides the Company with excellent access to biomass raw materials and skilled workers. The Company purchased the building shell of the Goderich Facility and an acre of property in November 2018. The building was constructed as an 8,000 sq. ft. stand-alone facility that includes office space, manufacturing space, and a farm-gate retail sales area. The laboratory within the facility is engineered with ISO-8 standard clean rooms which are European Goods Manufacturing Practices and Good Production Practices compliant.

The Company's head office is located at 3080 Yonge Street, Suite 6060, Toronto, Ontario, Canada, M4N 3N1. The registered address is located at 148 Cranbrooke Avenue, Toronto, Ontario, Canada, M5M 1M5.

## RECENT DEVELOPMENTS

### First Year of Production Operations

2021 marked the first year of production and commercial operations for the Company. The focus for 2021 involved setting-up our production facilities, conducting R&D, building a production and management team and completing the RTO Transaction. As a newer player with limited resources in a competitive industry, the Company needed to find ways to operate economically. This includes leveraging our production assets to provide third parties Tolling and white-label contract manufacturing services. The Company has also negotiated revenue sharing agreement with suppliers of biomass. These agreements allow the Company to acquire biomass raw material without the need to expend cash in exchange for sharing a proportion of the resulting end revenue with the biomass supplier.

### Private Placements

In March 2021 the Company successfully closed a private placement for gross proceeds of $3,186,914, of which $735,767 was received in advance and recorded in equity as shares to be issued as at December 31, 2020. In connection with the private placement, the Company issued 4,249,218 units comprised of one common share of the Company and one purchase warrant. Each purchase warrant entitles its holder to acquire one common share of the Company at an exercise price of $1.50 any time up to 18 months from the distribution date.

In July 2021, the Company successfully closed a private placement for gross proceeds of $310,800. In connection with the private placement, the Company issued 296,000 units comprised of one common share of the Company and one-half purchase warrant, for a total of 148,000 warrants. The Company intends to use the net proceeds from the private placements for general operational and working capital purposes. Each purchase warrant entitles its holder to acquire one common share of the Company at an exercise price of $1.50 any time up to 24 months from the distribution date.

### Shares for Debt Issuance

On March 19, 2021 the Company issued 1,068,992 common shares for the aggregate amount of $801,745 to settle amounts owing to multiple vendors and related parties.

### Business Combination

On July 12, 2021, Stralak and Hempsana Inc. closed the RTO Transaction, which was completed by way of a three-cornered amalgamation (the “Amalgamation”).

Pursuant to the terms of the Amalgamation, Hempsana Inc. amalgamated with a wholly owned subsidiary of the Company, and the Company acquired all the issued and outstanding common shares of Hempsana Inc. in exchange for its common shares (“HHL Shares”) on the basis of one HHL Share for each Hempsana Inc. Share issued and outstanding, as a result of which Hempsana Inc. has now become a wholly owned subsidiary of the Company. The Amalgamation also provides that all outstanding warrants and options to purchase Hempsana Inc. Shares remain outstanding and now entitle the holders thereof to acquire equivalent securities of HHL in lieu of Hempsana Inc. on the same terms and conditions. The continuing company trading symbol is (CSE: HMPS).

Hempsana Inc. also issued 164,037 Hempsana Inc. Shares to certain finders at a deemed price of $1.05 per share in connection with the RTO Transaction. Upon completion of the RTO Transaction, the convertible debentures automatically converted into 297,619 shares of the Company at a 20% discount of the issue price of $1.05, for a total contributed capital of $250,000.

Upon closing of the RTO Transaction, the Company has 24,129,323 Common Shares issued and outstanding, as shown in the table below:

| | **Number outstanding** | **Percentage** |
|---|---|---|
| Hempsana Inc. – opening | 22,167,667 | |
| Hempsana – adjusted | 22,629,323 | 93.8% |
| Issued for consideration to Stralak | 1,500,000 | 6.2% |
| Hempsana Holdings Ltd. – ending | 24,129,323 | 100% |

**White-Label Contract Manufacturing Agreements**

The Company signed a number of white-label contract manufacturing agreements in it first year of production operations.

On August 12, 2021, the Company signed a white labelling agreement with Lune Rise Farms Inc. for extraction services and turn-key solution to manufacture finished consumer products. The agreement includes the full spectrum extraction of cannabinoid oil from four high quality craft strains that bring out unique terpene and cannabinoid profiles coveted by many consumers. Under the terms of the agreement, the cannabinoid oil will be used for numerous finished products, including the manufacture of a premium vape product which includes four SKUs for sales into the consumer market. The products will be manufactured and packaged for resale as a premium THC and a balanced THC and CBD retail product branded by Lune Rise Farms.

On November 25, 2021, the Company entered into a custom manufacturing agreement with Cream of the Crop Therapeutics ("Cream of the Crop"), to launch their Terpene Rich™ formulated product. Under the terms of the agreement, Hempsana has agreed to exclusively manufacture Cream of the Crop's Terpene Rich™ Relief Cream. Hempsana will be responsible for providing high quality cannabis extracts, filling, packaging, and manufacturing services.

**Amended Cannabis License**

On September 23, 2021, the Company had received approval from Health Canada to amend its cannabis license to authorize the activity of sale of cannabis extracts, beverages, edibles, and topical products. The amended license will allow the Company to supply and sell finished cannabis products directly to provincial distributors and other authorized Canadian retail supply channels. The amended sales license is expected to open up new growth opportunities with partners. These include provincial distribution agreements for international brands and for additional contract manufacturing opportunities with partners interested in leveraging the Company's state of the art facilities and its amended sales license.

## SELECTED ANNUAL AND THREE MONTHS INFORMATION

The following selected financial data have been prepared in accordance with IFRS unless otherwise noted and should be read in conjunction with the Company's audited consolidated financial statements. The following tables provide selected consolidated financial data for the periods indicated.

| **Financial Year Ended** | **December 31, 2021** | December 31, 2020 | December 31, 2019 |
|---|---|---|---|
| Sales | **$ 114,715** | $ - | $ - |
| Cost of sales | **66,281** | - | - |
| Net loss | **(4,238,470)** | (1,653,851) | (1,018,853) |
| Loss per share – basic and diluted | **(0.19)** | (0.10) | (0.07) |
| Gross profit | **48,434** | - | - |
| Gross profit % | **42.2%** | - | - |

| As at | December 31, 2021 | December 31, 2020 | December 31, 2019 |
|---|---|---|---|
| Cash | **$ 46,189** | $ 80,516 | $ 44,771 |
| Inventory | **118,108** | - | - |
| Other working capital | **329,454** | 303,906 | 452,820 |
| Total assets | **4,017,975** | 3,740,490 | 3,389,282 |
| Total non-current liabilities | **534,751** | 555,379 | 659,542 |

| Three months ended | December 31, 2021 | December 31, 2020 |
|---|---|---|
| Sales | **$ 84,351** | $ - |
| Cost of sales | **65,970** | - |
| Net loss | **(417,309)** | (812,646) |
| Loss per share - basic and diluted | **(0.02)** | (0.05) |

| | For the three months ended | | For the year ended | |
|---|---|---|---|---|
| Operating expenses | December 31, 2021 | December 31, 2020 | December 31, 2021 | December 31, 2020 |
| Auto expenses | **6,152** | 28,490 | **33,214** | 38,377 |
| Conference fees | **880** | 18,036 | **2,163** | 18,036 |
| Consulting fees | **60,489** | 173,373 | **237,612** | 174,993 |
| Depreciation and amortization | **43,901** | 48,322 | **205,739** | 151,283 |
| Facility Supplies | **(12,323)** | 33,542 | **45,629** | 33,862 |
| License Fees | **5,750** | 9,412 | **28,208** | 15,403 |
| Insurance | **20,962** | 11,038 | **49,250** | 32,165 |
| Investor Relations and Marketing | **1,420** | 66,518 | **313,647** | 75,688 |
| Legal and professional fees | **42,726** | 50,935 | **322,227** | 61,065 |
| Listing expenses | **-** | - | **1,949,739** | - |
| Management fees | **137,442** | 132,869 | **436,800** | 531,482 |
| Office expenses | **19,302** | 42,263 | **110,251** | 44,834 |
| Other operating expenses | **9,881** | 16,043 | **66,751** | 18,006 |
| Other selling, general and administrative expenses | **8,419** | 10,070 | **20,498** | 10,698 |
| Share-based payments | **-** | 46,496 | **32,345** | 307,853 |
| Utilities | **2,534** | 13,516 | **20,593** | 26,630 |
| Wages | **60,459** | 95,635 | **301,697** | 95,635 |
| Total operating expenses | **407,994** | 796,558 | **4,176,363** | 1,636,010 |

## Financial Results of Operations

### *Year ended December 31, 2021 compared to the year ended December 31, 2020*

The Company had $114,715 in revenues for the year ended December 31, 2021, and no revenues for the year ended December 31, 2020. Net loss for the year ended December 31, 2021 was higher by $2,584,619 and mostly due to $1,949,739 in listing expenses directly related to the RTO Transaction previously mentioned. Of the $1,949,739 listing expenses, $202,500 was paid in cash, and the remaining amounts were settled in equity. Legal and professional fees and investor relations marketing fees were significantly higher as they were directly related to the RTO Transaction.

Commercial production activity began December 2020, resulting in higher consulting fees, wages, facility supplies, other operating and office expenses, and depreciation and amortization expense for the year ended December 31, 2021 compared with the prior period.

The Company's gross profit margin was 42.2% in 2021. In order to minimize the use of cash, the Company sourced its biomass raw materials from partners using a revenue sharing arrangement. Under these arrangements, the Company does not need to pay for the biomass, but instead shares a percentage of the resulting revenues from the end products. The amount the Company shares with these partners are included in costs of sales. While these arrangements allow us to grow with less working capital, it potentially negatively impacts our gross margins compared to directly buying biomass raw materials.

Share-based payments expense decreased significantly as all the options granted in 2019 have fully vested in the year ended December 31, 2021. No stock options have been granted in the years ended December 31, 2020 and 2021.

***Year ended December 31, 2020 compared to the year ended December 31, 2019***

The Company had no revenues for the years ended December 31, 2020 and 2019. In May 2020, Hempsana received a Health Canada Standard Processing License. In December 2020, Hempsana began commercial production of CBD crude and distillate at its Goderich Facility for sales contracts and tolling contracts in-hand. Net loss for the year ended December 31, 2020 was $634,998 higher than the net loss for the year ended December 31, 2019 due to increased operational activity. Commercial production began late in 2020, resulting in higher consulting fees, wages, share-based payments, and depreciation and amortization expense for the year ended December 31, 2020 compared with the prior period.

***Three months ended December 31, 2021 compared to three months ended December 31, 2020***

The Company had no revenue for the three months ended December 31, 2020. Net loss for the three months ended December 31, 2021 was $395,337 lower compared to the three months ended December 31, 2020 mostly due to lower consulting fees, facility supplies, marketing fees, share-based compensation expenses and wages compared to the last three months of 2021. The Company had higher consulting fees in 2020 to prepare for the RTO Transaction. In 2021, facilities supplies expenses were adjusted into cost of sales for the inventory sold.

## QUARTERLY RESULTS

The following table presents certain unaudited financial information for each of the eight quarters up to and including the quarter ended December 31, 2021. The information has been derived from our unaudited quarterly consolidated financial statements.

| | For the three months ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **December 31, 2021** | **September 30, 2021** | **June 30, 2021** | **March 31, 2021** | **December 31, 2020** | **September 30, 2020** | **June 30, 2020** | **March 31, 2020** |
| Revenue | $ 84,351 | $ 30,364 | $ - | $ - | $ - | $ - | $ - | $ - |
| Net loss | (417,309) | (2,460,126) | (614,539) | (746,496) | (812,646) | (302,453) | (268,337) | (270,415) |
| Loss per share - basic and diluted | (0.02) | (0.11) | (0.03) | (0.04) | (0.05) | (0.02) | (0.02) | (0.02) |

## LIQUIDITY AND CAPITAL RESOURCES

As at December 31, 2021, the Company had a working capital deficit of $1,000,514 (December 31, 2020 - $2,068,701) and has incurred losses since inception. The Company has started generating revenues from its principal operations; however, the Company has been generating cash flows primarily from financing activities for the years ended December 31, 2021 and 2020. These conditions indicate a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent on its ability to generate positive cash flows from operations, complete additional financings, and/or extend or modify its loan payable.

On October 18, 2019, the Company entered into a private loan with a related party for $850,000 which bears interest at the rate of 12% per annum, calculated monthly. The private loan matures on November 1, 2024 and can be repaid before maturity without penalty and is secured by the Company's land and building.

The private loan is recorded at amortized cost, which was initially measured at fair value less transaction costs. Loan issuance costs were capitalized when incurred and are being amortized over the term of the loan using the effective interest rate method. The private loan is repayable in monthly installments, with a combined principal and interest payment of $18,908 per month.

On October 1, 2021, a Director and related party of the Company agreed to finance the Company's private loan payments for three months. The total commitment is $56,723 and would cover the loan payments for October, November and December 2021. This Director is related to the holder of the existing private loan. Prior to this additional financing, the Company had owed him $196,363 which comprised of the $189,108 previous loan payments he had made on the Company's behalf, as well as purchases for various equipment and services. As part of this additional financing, the Company restructured the entire amount owing as a new Promissory Note which bears a 10.0% interest rate. Half of the total amount owing must be repaid on August 25, 2022 and the remaining half is due by August 25, 2023. The Company can repay the Promissory Note early without penalty and it is secured by a second mortgage on the Company's Goderich property. As at December 31, 2021, the principal value of the promissory note was $266,685 (December 31, 2020 - $nil) and the fair value of the loan was $259,235 (December 31, 2020 - $nil).

In response to COVID-19, many governments around the world have provided various subsidy programs to assist companies during the pandemic. The Company participated in the Canada Emergency Business Account ("CEBA") program in Canada, which was announced in March 2021. CEBA provides interest-free loans up to $60,000 to small businesses. On April 28, 2020, the Company received a $40,000 interest-free government loan from the CEBA program. The interest-free benefit has been recorded in the statement of comprehensive income as other income. The loan bears no interest until December 31, 2022, and $10,000 loan forgiveness will be granted if repaid before this date. As at December 31, 2021, the principal value of the government loan was $40,000 (December 31, 2020 - $40,000) and the fair value of the loan was $33,445 (December 31, 2020 - $31,503).

On January 21, 2021 the Company issued convertible debentures for the aggregate amount of $250,000 to settle amounts owing to a vendor. The convertible debentures were non-interest bearing and were secured against certain equipment owned by the Company. The convertible debentures were to be automatically converted into shares of the Company upon the completion of certain events by the Company, including raising additional financing at specific thresholds. The conversion price was equal to the price that is a 20% discount to the additional financing raised. If these events did not occur by the maturity date of July 20, 2022, the Company would issue an additional 10% of convertible debentures in lieu of interest. At the measurement date, the Company assessed that these events are highly probable to occur.

The Company accounted for the convertible debentures as hybrid contracts where the initial carrying value of the host debt was the residual amount after separating the embedded derivatives. The host debt was carried at amortized cost and the embedded derivatives were accounted for as financial liabilities measured at fair value through profit or loss.

As the convertible debentures did not have a fixed conversion price, it did not meet the fixed-for-fixed criteria, therefore the fair value of the conversion feature was classified as a derivative liability. The residual debt host portion was accreted using an effective interest rate ("EIR") of 17.83%. Accretion expense has been included in interest expense line in the statements of loss and comprehensive loss.
On July 12, 2021, the convertible debentures were converted into equity.

## CASH FLOWS

The following tables and discussion show the significant cash transactions impacting the cash flows of the Company for the years ended December 31, 2021 and 2020.

| **Financial Year Ended** | **December 31, 2021** | December 31, 2020 |
|---|---|---|
| Cash flows used in operating activities | **$ (2,292,429)** | $ (346,579) |
| Cash flows used in investing activities | **(255,785)** | (245,167) |
| Cash flows from financing activities | **2,513,887** | 627,491 |
| Net (decrease)/increase in cash | **(34,327)** | 35,745 |
| Cash, beginning of year | **80,516** | 44,771 |
| Cash, end of year | **$ 46,189** | $ 80,516 |

Cash flows used in operating activities during the year ended December 31, 2021 were $1,945,850 higher than December 31, 2020 primarily due to higher net losses during the year ended December 21, 2021, offset by 1,747,239 of the listing expenses of the previously mentioned RTO Transaction being settled with equity.

Cash flows used in investing activities during the year ended December 31, 2021 were $10,618 higher than December 31, 2020 mostly due to increases to intangible assets offset by less machinery and equipment being purchased in the year December 31, 2021 compared to the year ended December 31, 2020.

Cash flows from financing activities during the year ended December 31, 2021 were $1,886,396 higher than December 31, 2020 due to the Company closing two private placements for $2,761,947 in the year ended December 31, 2021.

## SHARE CAPITAL

(a) As of the date of the MDA the Company has 24,129,323 issued and outstanding common shares. The authorized share capital is unlimited no par value common shares.
(b) As at the date of the MDA the Company has 1,655,345 incentive stock options outstanding.
(c) As at the date of the MDA the Company has 4,397,218 outstanding share purchase warrants.

## RELATED PARTY TRANSACTIONS

Several 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.

The following related parties transacted with the Company during the years ended December 31, 2021 and 2020:

(a) 12813521 CANADA INC
(b) 2822477 Ontario Inc.
(c) rk3 Global Services Incorporated
(d) The CFO Center Limited
(e) Eurofins Experchem Laboratories Inc.

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 for year ended December 31, 2021** | Transactions for year ended December 31, 2020 | **Balances outstanding December 31, 2021** | Balances Outstanding December 31, 2020 |
|---|---|---|---|---|
| 12813521 CANADA INC | **$ 100,000** | $ 150,000 | **$ 49,800** | $ 300,000 |
| 2822477 Ontario Inc. | **100,000** | 150,000 | **49,800** | 300,000 |
| rk3 Global Services Incorporated | **187,500** | 201,700 | **112,500** | 347,750 |
| The CFO Center Limited | **104,525** | - | **77,405** | - |
| Eurofins Experchem Laboratories Inc. | **38,617** | 10,072 | **13,181** | - |
| | **$ 530,642** | $ 511,772 | **$ 302,686** | $ 947,750 |

All related party balances, except for the previously discussed Promissory Note, are unsecured and are non-interest bearing.

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

**(a)** Management fees
- Includes the management consulting services charged to the Company by the Directors, Sohil Mana and Randy Ko, and by shareholder, Woo Kim.

**(b)** Consulting fees
- Includes the services of Eurofins, of which Director, Sohil Mana is President.
- Includes the consulting services of The CFO Centre, in which David Chan, CFO, serves as an independent contractor.

**Key management personnel**

Key management personnel include those persons having authority and responsibility for planning, directing and controlling the activities of the Company as a whole.

The remuneration of key management for the years ended December 31, 2021 and December 31, 2020 are as follows:

| | **December 31, 2021 $** | December 31, 2020 $ |
|---|---|---|
| Share-based payments | **16,173** | 92,234 |
| Wages and salaries | **-** | 44,315 |
| | **16,173** | 136,549 |

Share-based payments includes options granted as bonus to Director Randy Ko as incentive to service the company for 2 years from grant date.

Wages and salaries include salaries paid to Director, Randy Ko, Sohil Mana and shareholder, Woo Kim. In 2021, all of the compensation to management was through Management and Consulting fees.

## OFF BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

## CAPITAL MANAGEMENT

The Company defines capital as the aggregate of its shareholders' equity and debt. 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 and will make adjustments 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 year ended December 31, 2021. The Company is not subject to externally imposed capital requirements.

## FINANCIAL INSTRUMENTS AND FINANCIAL RISKS

***Financial instruments***

The Company's financial instruments consist of cash, deposits, other receivables, accounts payable and accrued liabilities, and private loan, which are all carried at amortized cost.

The carrying value of cash, deposits, other receivables, and accounts payable and accrued liabilities approximate their fair value because of the short-term nature of these instruments. The private loan value approximates its fair value due to the market rates of interest charged.

***Financial risks***

The Company's financial instruments are exposed to certain financial risks, including credit risk and liquidity risk.

**(a) Credit risk**

The Company is exposed to credit risk by holding cash in financial institutions. This risk is minimized by holding the funds in Canadian banks and credit unions or with Canadian governments. The Company has minimal receivable exposure, and its various refundable credits are due from Canadian governments.

**(b) Liquidity risk**

Liquidity risk is the risk that the Company is unable to meet its financial obligations as they come due. The Company does not yet generate revenues from its principal operations and has been generating cash flows primarily from financing activities for the years ended December 31, 2021 and 2020.

Considering the available liquidity as at December 31, 2021, the expected burn rate from operations and future commitments, the Company's exposure to liquidity risk as at December 31, 2021 is considered high. The Company expects to address this risk by raising funds through external financing as needed until revenues are sufficient to cover the operating requirements of the business.

The undiscounted cash flow requirements for financial liabilities as at December 31, 2021 are as follows:

| | Carrying value | Total | Less than 1 year | 1-3 years |
|---|---|---|---|---|
| Accounts payable | $ 893,206 | $ 893,206 | $ 893,206 | $ - |
| Accounts payable to related parties | 302,686 | 302,686 | 302,686 | - |
| Long term debt | 833,124 | 855,015 | 338,373 | 516,642 |
| Interest on long-term debt | - | - | 57,617 | 48,105 |
| Total | $ 2,029,016 | $ 2,050,907 | $ 1,591,882 | $ 564,747 |

**(c) Other risks**

In March 2020, the World Health Organization declared coronavirus COVID-19 ("COVID-19") a global pandemic which has resulted in governments worldwide enacting emergency measures to combat the spread of the virus. These measures, which include the implementation of travel bans, self-imposing quarantine period and social distancing, have caused material disruption to businesses globally resulting in an economic slowdown. Global equity markets have experienced significant volatility and weakness. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. While the impact of COVID-19 on the Company has not been significant to date, the duration and longer-term impact of the COVID-19 outbreak is unknown currently, as is the efficacy of the government and central bank interventions. It is not possible to reliably estimate the length and severity of these developments and the impact on the financial results and condition of the Company in future periods.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at each reporting date and the reported amounts of income and expenses during each reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.

The information about significant areas of estimation uncertainty considered by management in preparing these financial statements is as follows:

*Property, Plant and Equipment*

The estimated useful lives of property, plant and equipment are reviewed by management and adjusted if necessary. To estimate property, plant and equipment's useful life, management must use its past experience with the same or similar assets and use professional judgement in its determination of useful life.

*Going concern*

The assessment of the Company's ability to continue as a going concern as discussed in note 1 involves judgment regarding future funding available for its operations and working capital requirements.

*Inventory*

Inventory is carried at the lower of cost or net realizable value. The determination of net realizable value involves significant management judgement and estimates, including the estimation of future selling prices and potential obsolescence.

*Share-based payments*

The fair value of all share-based payments granted are determined using the Black-Scholes option pricing model which incorporates assumptions regarding risk-free interest rates, dividend yield, expected volatility, estimated forfeitures, and the expected life of the options. The Company has a significant number of options outstanding and expects to continue to make grants.

*Deferred taxes*

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the deductible temporary difference or tax loss carry-forwards can be utilized. The recognition of temporary differences and tax loss carry-forwards is based on the Company's estimates of future taxable profits in different tax jurisdictions against which the temporary differences and loss carry-forwards may be utilized.

Deferred tax liabilities are recognized when there are taxable temporary differences that will reverse and result in a future outflow of funds to a taxation authority. The Company records a provision for the amount that is expected to be settled, which requires judgment as to the ultimate outcome. Deferred tax liabilities could be impacted by changes in the Company's judgment of the likelihood of a future outflow and estimates of the expected settlement amount, timing of reversals, and the tax laws in the jurisdictions in which the Company operates.

*Valuation of embedded derivatives of financial instruments*

The convertible debentures were accounted for as hybrid contracts where the initial carrying value of the host debt was the residual amount after separating the embedded derivatives. The host debt was carried at amortized cost and the embedded derivatives were accounted for as financial liabilities measured at fair value through profit and loss. The fair value of the liability at the time of issuance is calculated as the discounted cash flows for the convertible debenture using the effective interest rate. The fair value of the host debt by the discounted cash flow approach could be impacted by the Company's assumptions and estimates used in the calculation.

## RISK FACTORS

Many factors could cause the Company's actual results, performance and achievements to differ materially from those expressed or implied by the forward-looking statements and forward-looking information, including without limitation, the following factors, which are discussed in greater detail under the section 17 "Risk Factors" in the Company's Listing Statement dated July 12, 2021 available at www.sedar.com, which risk factors are incorporated by reference into this document, and should be reviewed in detail by all readers:

- Regulatory risks, Regulatory Approvals, Permits, and Licenses
- Changes in Laws, Regulations and Guideline
- The Canadian Cannabis Market and Risks Related to the Cannabis Industries
- Unfavourable Publicity or Consumer Perception
- Successful Development of Brands, Products and Services
- Product Liability
- Product Recalls
- Competition
- Client Acquisition and Retention
- Changing Consumer Preferences
- Restrictions on Sales Activities
- Transportation Risks
- Market Unpredictability
- Business in A New Industry
- Potential Fraudulent or Illegal Activity
- Success of Quality Control Systems
- Effectiveness and Efficiency of Advertising and Promotional Expenditures
- Risks Related to the Operations of the Resulting Issuer Generally and Related to the Company's Facilities
- Environmental Risk and Regulation
- Successfully Promoting the Company's Brand
- Price of Raw Materials and Ability to Secure Biomass
- Price of Cannabis Derived End Products

- Limited Operating History
- The Company May Not Develop its Product and Service Offerings in a Manner that Enables it to be Profitable and Meet its Customers' Requirements
- The Company Growth Strategy may not be Successful
- Revenue may be Lower than Forecasted and Expenses may be Greater than Forecasted
- Fluctuations in the Company's operating results will be significant relative to its revenues
- Volatile Stock Price
- Energy Costs and Inflation
- Shelf Life Inventory
- Reliance on Management
- Potential Conflicts of Interest
- Insurance and Uninsured Risks
- Dependence on Suppliers and Skilled Labour
- Difficulty to Forecast
- Ability to Raise Additional Financing as Needed
- Management of Growth
- Internal Controls
- Stock Trading Liquidity
- Negative Cash Flow
- Dilution
- Potential Litigation
- Inability to Protect Intellectual Property Rights
- Reliance on Information Technology Systems and Cyberattacks
- Dividend Policy