

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

*This management discussion and analysis ("MD&A") of the financial condition and results of operations of Lowell Farms Inc. (the "Company", "we", "our", "us" or "Lowell"), formerly known as Mezzotin Minerals Inc., is for the years ended December 31, 2020 and 2019. It is supplemental to, and should be read in conjunction with, the Company's consolidated financial statements and the accompanying notes for the years ended December 31, 2020 and 2019. The Company's financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts in this MD&A are expressed in thousands of United States dollars ("\$" or "US\$"), unless otherwise indicated.*

*This MD&A has been prepared by reference to the MD&A disclosure requirements established under National Instrument 51-102 – Continuous Disclosure Obligations of the Canadian Securities Administrators.*

#### **Cautionary Note Regarding Forward-Looking Information**

This MD&A contains "forward-looking statements" and "forward-looking information" within the meaning of applicable securities laws (collectively referred to herein as "forward-looking statements"). Such forward-looking statements are not representative of historical facts or information or current condition, but instead represent only the Company's beliefs regarding future events, plans or objectives, many of which, by their nature, are inherently uncertain and outside of the Company's control. Often, but not always, forward-looking statements can be identified by the use of words such as "plans", "expects", "is expected", "budget", "scheduled", "estimates", "continues", "forecasts", "projects", "predicts", "intends", "anticipates" or "believes", or variations of, or the negatives of such words and phrases, or statements that certain actions, events or results "may", "could", "would", "should", "might" or "will" be taken, occur or be achieved. The forward-looking statements contained herein may include, but are not limited to, information with respect to the Company's expectations regarding:

- assumptions and expectations described in the Company's critical accounting estimates;
- the legislative framework regarding the licensing of cannabis and related activities;
- proposed and anticipated changes to applicable laws and regulations regarding the cannabis market, associated fees and taxes and the business impact on the Company;
- the availability and renewal of requisite licenses and permits on terms acceptable to the Company;
- the implementation of the Company's remaining construction plans in respect of its cultivation facility, including the timing thereof;
- anticipated future cultivation, manufacturing and extraction capacity and output resulting from the completion of construction at the Company's cultivation facility, and the resulting anticipated operational and financial benefits to the Company;
- expectations as to the development and distribution of the Company's brands and products and the distribution of third-party products;
- estimated future sales, estimated future operating costs and other prospective financial performance and the resulting effects on the Company's financial position;
- prospective operational performance;
- business prospects and objectives and near and long term strategies, including growth strategies;
- anticipated trends and challenges in the Company's business and the markets in which it operates;
- anticipated cash needs;
- the Company's ability to secure further equity or debt financing, including, but not limited to, raising funds in the capital markets and the resulting effects on the Company's financial position;

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- the Company's ability to achieve profitability;
- expectations for other economic, business, regulatory and/or competitive factors related to the Company or the cannabis industry generally, and other events or conditions that may occur in the future.

The forward-looking statements in this MD&A are not a guarantee of future performance and are based upon a number of estimates and assumptions of management at the date the statements are made including among other things assumptions about: development costs remaining consistent with budgets; production and distribution costs remaining consistent with budgets; ability to manage anticipated and unanticipated costs; favorable equity and debt capital markets; the ability to raise sufficient capital to advance and sustain the business of the Company, including by way of satisfying the terms under existing credit arrangements entered into by the Company; favorable operating and economic conditions; political and regulatory stability; obtaining and maintaining all required licenses and permits; receipt of governmental approvals and permits; sustained labor stability; stability in financial and capital goods markets; favorable production levels and costs from the Company's operations; the pricing of various cannabis products; the level of demand for cannabis products, including the Company's products; the availability of employees, third party service providers and other inputs for the Company's operations; and the Company's ability to conduct operations in a safe, efficient and effective manner. While the Company considers these assumptions to be reasonable, many of the assumptions are based on factors and events that are not within the control of the Company and there is no assurance they will prove to be correct.

The forward-looking statements in this MD&A are effective as of the date of this MD&A. Forward-looking statements are based on the reasonable assumptions, estimates, analysis and opinions of management made in light of its experience and its perception of trends, current conditions and expected developments, as well as other factors that management believes to be relevant and reasonable in the circumstances at the date that such statements are made, and are inherently subject to known and unknown risks, uncertainties and other factors that may be beyond the Company's ability to predict or control and that may cause the actual results, level of activity, performance or achievements of the Company to be materially different from those expressed or implied by such forward-looking statements, including, but not limited to, the factors included under the "Risk Factors" section of this MD&A and the factors detailed under the heading "Risk Factors" in the Company's annual information form dated November 9, 2020 (the "AIF"). Although the Company has attempted to identify important factors that could cause actions, events or results to differ materially from those described in the forward-looking statements, there may be other factors that cause actions, events, or results to differ from those anticipated, estimated or intended. Forward-looking statements contained herein are made as at the date of this MD&A. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on the forward-looking statements. The Company does not undertake to update any forward-looking statements except as required by applicable securities laws.

### **Non-IFRS Financial Measures**

*The Company has provided certain supplemental non-IFRS financial measures in this MD&A. Where the Company has provided such non-IFRS financial measures, we have also provided a reconciliation to the most comparable IFRS financial measure, see "Reconciliations of Non-IFRS Financial and Performance Measures" in this MD&A. These supplemental non-IFRS financial measures should not be considered superior to, as a substitute for or as an alternative to, and should only be considered in conjunction with, the IFRS financial measures presented herein.*

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*In this MD&A, reference is made to gross profit before fair value adjustments or adjusted gross profit (loss), adjusted gross margin, adjusted EBITDA, and working capital which are not measures of financial performance under IFRS. The Company calculates each as follows:*

- *Gross profit (loss) before fair value adjustments (adjusted gross profit) is equal to gross profit less the non-cash increase (plus the non-cash decrease) in the fair value adjustments on sale of inventory and on growth of biological assets, if any. Management believes this measure provides useful information as it removes fair value metrics tied to increasing stock levels (decreasing stock levels) required by IFRS.*
- *Adjusted gross margin is gross profit (loss) before fair value adjustments divided by net revenue. Management believes this measure provides useful information as it represents the gross profit (loss) based on the Company's cost to produce inventory sold and removes fair value metrics tied to increasing stock levels (decreasing stock levels) required by IFRS.*
- *Adjusted EBITDA is net income (loss), excluding the effects of income taxes (recovery); net interest expense; depreciation and amortization; non-cash fair value adjustments on investments; unrealized foreign currency gains/losses; non-cash fair value adjustments on sale of inventory and on growth of biological assets; share-based compensation expense; and other transactional and special expenses, such as acquisition costs and expenses related to our reverse takeover, which are inconsistent in amount and frequency and are not what we consider as typical of our continuing operations. Management believes this measure provides useful information as it is a commonly used measure in the capital markets and as it is a close proxy for repeatable cash generated by operations.*
- *Working capital is current assets less current liabilities. Management believes the calculation of working capital provides additional information to investors about the Company's liquidity.*

*These measures are not necessarily comparable to similarly titled measures used by other companies.*

### **COVID-19 Considerations**

In March 2020, the World Health Organization categorized coronavirus disease 2019 (“COVID-19”) as a pandemic. COVID-19 continues to spread throughout the U.S. and other countries across the world, and the duration and severity of its effects are currently unknown. The Company continues to implement and evaluate actions to strengthen its financial position and support the continuity of its business and operations in the face of this pandemic and other events.

The Company's priorities during the COVID-19 pandemic are protecting the health and safety of its employees and its customers, following the recommended actions of government and health authorities. In the future, the pandemic may cause reduced demand for the Company's products and services if, for example, the pandemic results in a recessionary economic environment or potential new restrictions on business operations or the movement of individuals. However, given the Company's operations have to date been deemed essential services in the State of California, the only State in which the Company currently conducts its business, the Company believes that there will continue to be strong demand for Indus products.

Operations of the Company are currently ongoing as the cultivation, processing and sale of cannabis products is currently considered an essential business in the State of California. The Company's ability to continue to operate

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without any significant negative operational impact from the COVID-19 pandemic will in part depend on the Company's ability to protect its employees, customers and supply chain and continued designation as "essential" in the State of California should there be an increased imposition of restrictions on business operations.

While during the year ended December 31, 2020, the Company's revenue, liquidity position and business operations were not significantly impacted by COVID-19 and the Company generally maintained the consistency of our operations, the uncertain nature of the spread of COVID-19 may impact its business operations for reasons including the potential quarantine of Lowell employees or those of its supply chain partners and a change in the designation of its business as "essential" in the State of California should there be an increased imposition of restrictions on business operations by the applicable regulatory authorities.

For additional information on risks related to the pandemic or other risks that could impact Indus' results, please refer to the factors included under the "Risk Factors" section of this MD&A and the factors detailed under the heading "Risk Factors" in the AIF.

*Neither the Canadian Securities Exchange nor its Regulation Service Provider has reviewed and does not accept responsibility for the adequacy or accuracy of the content of this MD&A.*

*This MD&A is prepared as of April 27, 2021.*

### 1. OVERVIEW OF THE COMPANY

Lowell is a California-based cannabis company with vertically integrated operations including large scale cultivation, extraction, processing, manufacturing, branding, packaging and wholesale distribution to licensed retail dispensaries statewide. Indus offers services supporting every step of the supply chain from seed to sale and an extensive portfolio of award-winning brands, including owned brands, such as Cypress Cannabis, House Weed, Kaizen Medicinals, Humble Flower, Acme, and Moon, and agency brands, such as Dixie, Dr. Raw and Kin Slips.

The Company was founded by Robert Weakley who has played a pioneering role in the emergence of the regulated cannabis market in California. Together with co-founder Mark Ainsworth and the Indus team, the vision for Indus was introduced to the industry in 2014 with the development of Altai as its first brand of edibles. The Company leverages technology, innovation, product quality and superior service levels to continuously develop its customer and partner networks of top-tier industry retailers and innovators. Our strategy focuses on four core pillars: the quality of our products, brand awareness, distribution capabilities, and utilization of existing capacity. Indus is backed by an experienced team that is deeply in tune and integrated with industry partners and the Company's customers. Together, we are building a new American Industry, creating products that emphasize consumer safety while advancing changing perceptions of cannabis use.

The Company operates a 225,000 square foot cultivation facility in Monterey County and a manufacturing and laboratory facility in Salinas, California for production of extracts, distillates and branded and packaged cannabis flower, concentrates and edible products. The Company also distributes proprietary and third-party brands throughout the State of California and maintains warehouses and distribution vehicles in Central and Southern California.

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In addition to owning cultivation, manufacturing and distribution cannabis licenses and operations, the Company also provides manufacturing, extraction and distribution services to third-party cannabis manufacturers and cannabis branding companies.

Lowell's operations are comprised of the following companies:

- Indus Holding Company, wholly owned by Indus Holdings, Inc.
- Cypress Holding Company, wholly owned by Indus Holding Company
- Cypress Manufacturing Company, wholly owned by Indus Holding Company
- Indus Nevada LLC, wholly owned by Indus Holding Company
- Wellness Innovation Group Incorporated wholly owned by Indus Holding Company

The Company's corporate office and principal place of business is located at 19 Quail Run Circle, Salinas, California. As of December 31, 2020, the Company had 327 fulltime-equivalent employees.

### Reverse Takeover

On November 13, 2018, Indus Holding Company (a wholly owned subsidiary of Indus Holdings, Inc.) and Mezzotin Minerals Inc. ("Mezzotin") entered into a combination agreement whereby the parties agreed to combine their respective businesses, which would result in the reverse takeover of Mezzotin by the security holders of Indus. Mezzotin Minerals was originally incorporated under the Business Corporations Act (Ontario) on October 27, 2005 as Zoolander Corporation. On September 10, 2013, Zoolander changed its name to Mezzotin Minerals Inc. On April 26, 2019 the reverse takeover transaction concluded. In connection with the agreement, Mezzotin changed its name from Mezzotin Minerals Inc. to Indus Holdings, Inc. (the "Company", "Pubco", or "Indus"). Effective at the close of markets on April 29, 2019, the common shares of the Company ("Existing Mezzotin Shares") were delisted from the NEX board of the TSX Venture Exchange, and the subordinate voting shares of the Company commenced trading on the Canadian Securities Exchange effective at market open on April 30, 2019, under the new symbol "INDS".

Indus Holding Company ("IHC"), a Delaware corporation, was formed in 2014. Lowell Farms Inc. became the indirect parent of IHC in connection with the reverse takeover transaction.

### Recent Developments

On February 25, 2021, the Company announced the acquisition of substantially all of the assets of the Lowell Herb Co. and Lowell Smokes trademark brands, product portfolio, and production assets from The Hacienda Group. Lowell Herb Co. is a leading California cannabis brand that manufactures and distributes distinctive and highly regarded premium packaged flower, pre-roll, concentrates, and vape products. The acquisition was valued at approximately \$39 million, comprised of \$4.1 million in cash and the issuance of 22,643,678 subordinate voting shares. The Hacienda Group has agreed to continue to produce Lowell products for an interim period for the account of the Company pending completion of the transfer of certain regulatory assets. In connection with this acquisition, the Company changed in its corporate name from Indus Holdings, Inc. to Lowell Farms Inc.

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### *Terminated Pending Acquisition*

On May 14, 2019, the Company entered into a definitive agreement to acquire the assets of W The Brand ("W Vapes"), a manufacturer and distributor in Nevada and Oregon of cannabis concentrates, cartridges and disposable pens, in a cash and stock transaction. Under the terms of the agreement, the purchase consideration to W Vapes shareholders consisted of \$10 million in cash and \$10 million in Subordinate Voting Shares (based on a deemed value of CDN\$15.65 per share). In November 2019, the definitive agreement was amended whereby the Company advanced \$2 million in non-recourse funds to the seller in exchange for release of \$10 million of cash held in escrow related to the acquisition and in December 2019, the Company purchased the Las Vegas, Nevada facility for \$4.1 million.

On July 17, 2020, the Company announced the termination of the definitive agreement with W Vapes and is no longer obligated to acquire the assets of W Vapes. The termination of the agreement coincided with an asset acquisition announcement between W Vapes and Planet 13 Holdings Inc., a vertically integrated provider of cannabis and cannabis-infused products in the State of Nevada ("Planet 13"). Additionally, the Company sold the Las Vegas facility to certain affiliates of Planet 13 for a cash payment of approximately \$500, and an additional cash payment of approximately \$2.8 million upon regulatory approval of the W Vapes and Planet 13 transaction, which was received in January 2021, and in the third quarter the Company finalized a note payable of \$843 to the owners of W Vapes, payable coinciding with the receipt of the \$2.8 million payment from the facility sale, which was paid in January 2021. As a result, the Company has reflected a \$4.4 million loss in its consolidated financial statements.

### *Acquisitions*

On April 18, 2019, the Company acquired all of the assets, global rights and business interests associated with the brand Humble Flower Co. for a purchase price of \$472 that will be paid as and if financial performance targets are met during the period beginning on April 19, 2019 and ending on April 18, 2023. The acquisition marks the Company's expansion into cannabis-infused topical creams, balms, and oils. Effective June 1, 2020 the asset purchase agreement was modified, eliminating payments associated with meeting financial performance targets in exchange for the issuance of 225,000 options to purchase Subordinate Voting Shares and a note payable of \$65 with payments commencing on January 1, 2021 for 24 months. Had the modifications been reflected as of the date of acquisition, net assets would have decreased \$308 at December 31, 2019 and net loss in 2019 would have been reduced by \$34.

On May 1, 2019, the Company acquired all of the assets, global rights and business interests of Kaizen Inc. for a purchase price of \$556 that will be paid as and if financial performance targets are met during the period beginning on May 1, 2019 and ending on April 30, 2023. Kaizen is a premium brand offering a full spectrum of cannabis concentrates. Effective July 15, 2020 the asset purchase agreement was modified, eliminating payments associated with meeting financial performance targets in exchange for the issuance of 225,000 options to purchase Subordinate Voting Shares and a note payable of \$200, with payments over two years. Had the modifications been reflected as of the date of acquisition, net assets would have decreased \$223 at December 31, 2019 and net loss in 2019 would have been reduced by \$21.

On June 12, 2019, the Company completed the acquisition of 70% of the outstanding capital stock of Shredibles LLC, a manufacturer of CBD infused health products. The Company transferred an aggregate consideration of \$240 comprised of 42.6 thousand Subordinate Voting Shares with an acquisition-date fair value of \$5.64 per share. The acquisition was a strategic investment that expanded the Company's brand portfolio into the CBD protein bar market and provided

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development opportunities for products with crossover offerings in CBD and THC versions. In February 2020, the Company determined that Shredibles was not a strategic fit for the Company at this time and reached an agreement with the Shredibles co-founders to nullify the investment and the investment consideration of 42.6 thousand Subordinate Voting Shares were returned to the Company. The termination has been reflected as being effective as of December 31, 2019 in the consolidated financial statements. The operations of Shredibles, and the termination of the agreement, did not have a material impact on the results of operations of the Company in 2019

On September 17, 2019, the Company announced that the OTC Markets Group, Inc. approved the trading of Indus Holdings, Inc. shares on the OTCQX® Best Market, the premium market tier of OTC Markets Group. Shares commenced trading at the opening of the market on September 17, 2019 under the symbol "INDXF," which was changed to "LOWLF" effective March 5, 2021.

In recognition of its ongoing commitment to Monterey County and its contributions to the Northern California economy, Indus was awarded Monterey County Business Council's 2019 Agriculture Award.

### Management Changes

Effective April 13, 2020, Mark Ainsworth, Co-Founder, has been appointed to the role of Interim Chief Executive Officer following Robert Weakley's resignation from the Company. Mark has been instrumental to Indus' vision and growth strategy since inception and will focus on successfully executing the company's strategic plans to get the Company to profitability. Robert Weakley remained on the Board of Directors, but did not stand for re-election at Indus' annual general meeting of shareholders held on October 22, 2020. Brian Shure was appointed Chief Financial Officer in November 2020 replacing Steve Neil who was appointed Chief Financial Officer following Tina Maloney's retirement in December 2019. Steve remains with the Company. In June 2020, Jenny Montenegro was appointed Chief Operating Officer and in January 2021, Kevin Lawrence was appointed Chief Revenue Officer.

### Operations and Regulatory Overview

In accordance with the Canadian Securities Administrators Staff Notice 51-352 (Revised) - *Issuers with U.S. Marijuana-Related Activities* ("**Staff Notice 51-352**"), below is a discussion of the federal and state-level U.S. regulatory regimes in those jurisdictions where Indus is currently involved, directly or through its subsidiaries in the cannabis industry. Indus is directly engaged in the manufacture, extraction, cultivation, package, sale or distribution of cannabis in the adult-use and/or medical industries in the State of California. **The Company derives all of its revenues from the cannabis industry in the State of California, which industry is illegal under U.S. federal law. The Company's cannabis-related activities are compliant with applicable State and local law, and the related licensing framework, and the Company is not aware of any non-compliance with applicable State and local law, and the related licensing framework, by any of the Company's clients to whom the Company renders services. Nonetheless, such activities remain illegal under U.S. federal law. The enforcement of relevant laws is a significant risk.**

The Company evaluates, monitors and reassesses this disclosure, and any related risks, on an ongoing basis in accordance with Staff Notice 51-352, and the same will be supplemented and amended to investors in public filings, including in the event of government policy changes or the introduction of new or amended guidance, laws or regulations regarding marijuana regulation. Any non-compliance, citations or notices of violation which may have an impact on the Company's licenses, business activities or operations will be promptly disclosed by the Company.

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### United States Federal Overview

The United States federal government regulates drugs through the Controlled Substances Act (the "CSA"), which places controlled substances, including cannabis, in one of five different schedules. Cannabis is classified as a Schedule I drug. As a Schedule I drug, the federal Drug Enforcement Agency ("DEA") considers marijuana to have a high potential for abuse; no currently accepted medical use in treatment in the United States; and a lack of accepted safety for use of the drug under medical supervision<sup>1</sup>. The classification of marijuana as a Schedule I drug is inconsistent with what the Company believes to be many valuable medical uses for marijuana accepted by physicians, researchers, patients, and others. As evidence of this, the U.S. Federal Drug Administration ("U.S. FDA"), on June 25, 2018, approved Epidiolex CBD oral solution with an active ingredient derived from the cannabis plant for the treatment of seizures associated with two rare and severe forms of epilepsy, Lennox-Gastaut syndrome and Dravet syndrome, in patients two years of age and older. This is the first U.S. FDA -approved drug that contains a purified drug substance derived from the cannabis plant. In this case, the substance is CBD, a chemical component of marijuana that does not contain the intoxication properties of THC, the primary psychoactive component of marijuana. The Company believes the CSA categorization as a Schedule I drug is not reflective of the medicinal properties of marijuana or the public perception thereof, and numerous studies show cannabis is not able to be abused in the same way as other Schedule I drugs, has medicinal properties, and can be safely administered<sup>2</sup>.

The federal position is also not necessarily consistent with democratic approval of marijuana at the State government level in the United States. Unlike in Canada, which has federal legislation uniformly governing the cultivation, distribution, sale and possession of marijuana under the *Cannabis Act* (Canada), marijuana is largely regulated at the State level in the United States. State laws regulating cannabis conflict with the CSA, which makes cannabis use and possession federally illegal. Although certain states and territories of the United States authorize medical or adult-use cannabis production and distribution by licensed or registered entities, under United States federal law, the possession, use, cultivation, and transfer of cannabis and any related drug paraphernalia is illegal, and any such acts are criminal acts. Although the Company's activities are compliant with applicable State and local laws, strict compliance with State and local laws with respect to cannabis may neither absolve the Company of liability under United States federal law nor provide a defense to federal criminal charges that may be brought against the Company. The Supremacy Clause of

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<sup>1</sup> 21 U.S.C. 812(b)(1).

<sup>2</sup> See Lachenmeier, DW & Rehm, J. (2015). Comparative risk assessment of alcohol, tobacco, cannabis and other illicit drugs using the margin of exposure approach. *Scientific Reports*, 5, 8126. doi: 10.1038/srep08126; Thomas, G & Davis, C. (2009). Cannabis, Tobacco and Alcohol Use in Canada: Comparing risks of harm and costs to society. *Visions Journal*, 5. Retrieved from [http://www.heretohelp.bc.ca/sites/default/files/visions\\_cannabis.pdf](http://www.heretohelp.bc.ca/sites/default/files/visions_cannabis.pdf); Jacobus et al. (2009). White matter integrity in adolescents with histories of marijuana use and binge drinking. *Neurotoxicology and Teratology*, 31, 349-355. <https://doi.org/10.1016/j.ntt.2009.07.006>; Could smoking pot cut risk of head, neck cancer? (2009 August 25). Retrieved from <https://www.reuters.com/article/us-smoking-pot/could-smoking-pot-cut-risk-of-head-neck-cancer-idUSTRES57O5DC20090825>; Watson, SJ, Benson JA Jr. & Joy, JE. (2000). Marijuana and medicine: assessing the science base: a summary of the 1999 Institute of Medicine report. *Arch Gen Psychiatry Review*, 57, 547-552. Retrieved from <https://www.ncbi.nlm.nih.gov/pubmed/10839332>; Hoaken, Peter N.S. & Stewart, Sherry H. (2003). Drugs of abuse and the elicitation of human aggressive behavior. *Addictive Behaviours*, 28, 1533-1554. Retrieved from <http://www.ukcia.org/research/AggressiveBehavior.pdf>; and Fals-Steward, W., Golden, J. & Schumacher, JA. (2003). Intimate partner violence and substance use: a longitudinal day-to-day examination. *Addictive Behaviors*, 28, 1555-1574. Retrieved from <https://www.ncbi.nlm.nih.gov/pubmed/14656545>.



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the United States Constitution establishes that the United States Constitution and federal laws made pursuant to it are paramount and, in case of conflict between federal and State law, federal law shall apply.

Nonetheless, as of the date of this MD&A, 36 States in the United States, the District of Columbia and four US Territories have legalized some form cannabis for medical use, while 17 states and the District of Columbia have legalized the adult use of cannabis for recreational purposes. As more and more states legalized medical and/or adult-use marijuana, the federal government attempted to provide clarity on the incongruity between federal prohibition under the CSA and these State-legal regulatory frameworks. Notwithstanding the foregoing, marijuana remains illegal under U.S. federal law, with marijuana listed as a Schedule I drug under the CSA. Until 2018, the federal government provided guidance to federal law enforcement agencies and banking institutions through a series of United States Department of Justice ("DOJ") memoranda. The most recent such memorandum was drafted by former Deputy Attorney General James Cole on August 29, 2013 (the "**Cole Memorandum**")<sup>3</sup>.

The Cole Memorandum offered guidance to federal enforcement agencies as to how to prioritize civil enforcement, criminal investigations and prosecutions regarding marijuana in all States, and instructed federal law enforcement agencies not to prosecute violations of federal drug laws related to cannabis where the activity is permitted and regulated under cannabis laws of the relevant state.

The Cole Memorandum put forth eight prosecution priorities:

1. Preventing the distribution of marijuana to minors;
2. Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs and cartels;
3. Preventing the diversion of marijuana from states where it is legal under State law in some form to other states;
4. Preventing the State-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
5. Preventing the violence and the use of firearms in the cultivation and distribution of marijuana;
6. Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
7. Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
8. Preventing marijuana possession or use on federal property.

The Cole Memorandum was seen by many State-legal marijuana companies as a safe harbor – albeit an imperfect one – for their licensed operations that were conducted in full compliance with all applicable State and local regulations.

On January 4, 2018, former United States Attorney General Jeff Sessions rescinded the Cole Memorandum by issuing a new memorandum to all United States Attorneys (the "**Sessions Memorandum**"). Rather than establish national enforcement priorities particular to marijuana-related crimes in jurisdictions where certain marijuana activity was legal under State law, the Sessions Memorandum instructs that "[i]n deciding which marijuana activities to prosecute... with the [DOJ's] finite resources, prosecutors should follow the well-established principles that govern all federal

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<sup>3</sup> See James M. Cole, *Memorandum for All United States Attorneys* (Aug. 29, 2013), available at <https://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf>

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prosecutions." Namely, these include the seriousness of the offense, history of criminal activity, deterrent effect of prosecution, the interests of victims, and other principles.

In the absence of a uniform federal policy, as had been established by the Cole Memorandum, numerous United States Attorneys with State-legal marijuana programs within their jurisdictions have announced enforcement priorities for their respective offices. For instance, Andrew Lelling, United States Attorney for the District of Massachusetts, stated that while his office would not immunize any businesses from federal prosecution, he anticipated focusing the office's marijuana enforcement efforts on: (1) overproduction; (2) targeted sales to minors; and (3) organized crime and interstate transportation of drug proceeds. Other United States attorneys provided less assurance, promising to enforce federal law, including the CSA in appropriate circumstances.

Former United States Attorney General Sessions resigned on November 7, 2018. He was replaced by William Barr on February 14, 2019. It is unclear what specific impact this development or any subsequent United States Attorney General appointments by future administrations will have on U.S. federal government enforcement policy. However, in a written response to questions from U.S. Senator Cory Booker made as a nominee, Attorney General Barr stated "I do not intend to go after parties who have complied with State law in reliance on the Cole Memorandum."<sup>4</sup> Nonetheless, there is no guarantee that State laws legalizing and regulating the sale and use of cannabis will not be repealed or overturned, or that local governmental authorities will not limit the applicability of State laws within their respective jurisdictions. Unless and until the United States Congress amends the CSA with respect to cannabis (and as to the timing or scope of any such potential amendments there can be no assurance), there is a risk that federal authorities may enforce current U.S. federal law.

The Company does not believe that it is able to determine if any prosecutorial effects will be undertaken by the rescission of the Cole Memorandum, or if Attorney General Barr or any subsequent United States Attorney General will reinstitute the Cole Memorandum or a similar guidance document for United States attorneys. The sheer size of the cannabis industry, in addition to participation by State and local governments and investors, suggests that a largescale enforcement operation would possibly create unwanted political backlash for the DOJ and the Trump and any future administration.

As an industry best practice, despite the recent rescission of the Cole Memorandum, the Company abides by the following standard operating policies and procedures to ensure compliance with the guidance provided by the Cole Memorandum:

1. ensure that its operations are compliant with all licensing requirements as established by the applicable State, county, municipality, town, township, borough, and other political/administrative divisions;
2. ensure that its cannabis related activities adhere to the scope of the licensing obtained (for example: in the States where cannabis is permitted only for adult-use, the products are only sold to individuals who meet the requisite age requirements);
3. implement policies and procedures to ensure that cannabis products are not distributed to minors;
4. implement policies and procedures to ensure that funds are not distributed to criminal enterprises, gangs or cartels;

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<sup>4</sup> *Questions for the Record William P. Barr Nominee to be United States Attorney General, available at <https://www.judiciary.senate.gov/imo/media/doc/Barr%20Responses%20to%20Booker%20QFRs1.pdf>.*

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5. implement an inventory tracking system and necessary procedures to ensure that such compliance system is effective in tracking inventory and preventing diversion of canna-bis or cannabis products into those States where cannabis is not permitted by State law, or across any State lines in general;
6. ensure that its State-authorized cannabis business activity is not used as a cover or pretense for trafficking of other illegal drugs, is engaged in any other illegal activity or any activities that are contrary to any applicable anti-money laundering statutes; and
7. ensure that its products comply with applicable regulations and contain necessary disclaimers about the contents of the products to prevent adverse public health consequences from cannabis use and prevent impaired driving.

In addition, the Company conducts background checks to ensure that the principals and management of its operating subsidiaries are of good character, have not been involved with other illegal drugs, engaged in illegal activity or activities involving violence, or use of firearms in cultivation, manufacturing or distribution of cannabis. The Company will also conduct ongoing reviews of the activities of its cannabis businesses, the premises on which they operate and the policies and procedures that are related to possession of cannabis or cannabis products outside of the licensed premises, including the cases where such possession is permitted by regulation. See "*Risk Factors*" section of this MD&A.

Although the Cole Memorandum has been rescinded, one legislative safeguard for the medical marijuana industry remains in place: Congress has passed a so-called "rider" provision in the FY 2015, 2016, 2017, 2018, 2019 and 2020 Consolidated Appropriations Acts to prevent the federal government from using congressionally appropriated funds to enforce federal marijuana laws against regulated medical marijuana actors operating in compliance with State and local law. The rider is known as the "Rohrabacher- Farr" Amendment after its original lead sponsors (it is also sometimes referred to as the "Rohrabacher- Blumenauer" or "Joyce-Leahy" Amendment, but it is referred to in this MD&A as the "**Rohrabacher-Farr Amendment**"). Most recently, the Rohrabacher-Farr Amendment was included in the Consolidated Appropriations Act of 2019, which was signed by President Trump on February 14, 2019 and funds the departments of the federal government through the fiscal year ending September 30, 2019. In signing the Act, President Trump issued a signing statement noting that the Act "provides that the DOJ may not use any funds to prevent implementation of medical marijuana laws by various States and territories," and further stating "I will treat this provision consistent with the President's constitutional responsibility to faithfully execute the laws of the United States." While the signing statement can fairly be read to mean that the executive branch intends to enforce the CSA and other federal laws prohibiting the sale and possession of medical marijuana, the president did issue a similar signing statement in 2017 and no major federal enforcement actions followed. On September 27, 2019 the Rohrabacher-Farr Amendment was temporarily renewed through a stopgap spending bill and was similarly renewed again on November 21, 2019. The FY 2020 omnibus spending bill was ultimately passed on December 20, 2019, making the Rohrabacher-Farr Amendment effective through September 30, 2020. In signing the spending bill, President Trump again released a statement similar to the ones he made May 2017 and February 2019 regarding the Rohrabacher-Farr Amendment.

There is a growing consensus among marijuana businesses and numerous congressmen and congresswomen that guidance is not law and temporary legislative riders, such as the Rohrabacher-Farr Amendment, are an inappropriate way to protect lawful medical marijuana businesses. Numerous bills have been introduced in Congress in recent years to decriminalize aspects of State-legal marijuana trades. For fiscal year 2019, the strategy amongst the bipartisan Congressional Marijuana Working Group in Congress, has been to introduce numerous marijuana-related appropriations amendments in the Appropriations Committee in both the House and Senate, similar to the strategy employed in Fiscal 2018. The amendments included protections for marijuana-related businesses in States with medical

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and adult-use marijuana laws, as well as protections for financial institutions that provide banking services to State-legal marijuana businesses. The Company also has observed that each year more congressmen and congresswomen sign on and co-sponsor marijuana legalization bills. These include the CARERS Act, REFER Act and others. While there are different perspectives on the most effective route to end federal marijuana prohibition, Congressman Blumenauer and Senator Wyden have introduced the three-bill package, Path to Marijuana Reform, which would fix the so-called Internal Revenue Service 280E provision that provides tax burdens for marijuana businesses, eliminate civil asset forfeiture and federal criminal penalties for marijuana businesses complying with State law, reduce barriers to banking, de-schedule marijuana from the federal list of controlled substances, and tax and regulate marijuana.<sup>5</sup>

Senator Booker has also introduced the Marijuana Justice Act, which would de-schedule marijuana, and in 2018 Congresswoman Barbara Lee introduced the House companion. Colorado Republican Senator Cory Gardner has reportedly secured a probable assurance from President Trump that he would sign a bill to allow States to legalize and regulate marijuana without federal intervention<sup>6</sup>.

In light of all of this, it was anticipated that the federal government will eventually repeal the federal prohibition on cannabis and thereby leave the States to decide for themselves whether to permit regulated cannabis cultivation, production and sale, just as States are free today to decide policies governing the distribution of alcohol or tobacco. Given current political trends, however, the Company considers these developments unlikely in the near-term. For the time being, marijuana remains a Schedule I controlled substance at the federal level, and neither the Cole Memorandum nor its rescission nor the continued passage of the Rohrabacher-Farr Amendment has altered that fact. The federal government of the United States has always reserved the right to enforce federal law regarding the sale and disbursement of medical or adult-use marijuana, even if State law sanctions such sale and disbursement. If the United States federal government begins to enforce United States federal laws relating to cannabis in States where the sale and use of cannabis is currently legal, or if existing applicable State laws are repealed or curtailed, the Company's business, results of operations, financial condition and prospects could be materially adversely affected.

Additionally, under United States federal law, it may potentially be a violation of federal money laundering statutes for financial institutions to take any proceeds from the sale of any Schedule I controlled substance. Due to the CSA categorization of marijuana as a Schedule I drug, federal law makes it illegal for financial institutions that depend on the Federal Reserve's money transfer system to take any proceeds from marijuana sales as deposits. Banks and other financial institutions could be prosecuted and possibly convicted of money laundering for providing services to cannabis businesses under the Bank Secrecy Act. Therefore, under the Bank Secrecy Act, banks or other financial institutions that provide a cannabis business with a checking account, debit or credit card, small business loan, or any other service could be charged with money laundering or conspiracy. See "*Ability to Access Capital*" section of this MD&A and "*Risk Factors*" section of this MD&A.

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<sup>5</sup> Wyden, Blumenauer. (2017 March 30). Wyden, Blumenauer announce bipartisan path to marijuana reform. Retrieved from <https://blumenauer.house.gov/media-center/press-releases/wyden-blumenauer-announce-bipartisan-path-marijuana-reform>.

<sup>6</sup> Mark. K. Matthews, *Donald Trump would "probably" support legalizing Colorado's marijuana industry – through bid by Cory Gardner and Elizabeth Warren*, THE DENVER POST (June 8, 2018), available at <https://www.denverpost.com/2018/06/08/coloradamarijuana-industry-sanctioning-donald-trump/>.

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On September 26, 2019, the U.S. House of Representatives passed the Secure and Fair Enforcement Banking Act of 2019 (commonly known as the "**SAFE Banking Act**"), which aims to provide safe harbor and guidance to financial institutions that work with legal U.S. cannabis businesses. The SAFE Banking Act is currently being reviewed by the U.S. Senate Banking Committee. While the Senate is contemplating the SAFE Banking Act, the passage of which would permit commercial banks to offer services to cannabis companies that are in compliance with State law, if Congress fails to pass the SAFE Banking Act, the Company's inability, or limitations on the Company's ability, to open or maintain bank accounts, obtain other banking services and/or accept credit card and debit card payments may make it difficult for the Company to operate and conduct its business as planned or to operate efficiently. See "*Ability to Access Capital*" section of this MD&A and "*Risk Factors*" section of this MD&A.

While there has been no change in U.S. federal banking laws to accommodate businesses in the large and increasing number of U.S. States that have legalized medical and/or adult-use marijuana, in 2014, the Department of the Treasury Financial Crimes Enforcement Network ("**FinCEN**") issued guidance to prosecutors of money laundering and other financial crimes (the "**FinCEN Guidance**") and notified banks that it would not seek enforcement of money laundering laws against banks that service cannabis companies operating under State law, provided that strict due diligence and reporting standards are met. The FinCEN Guidance advised prosecutors not to focus their enforcement efforts on banks and other financial institutions that serve marijuana-related businesses so long as that business is legal in their State and none of the federal enforcement priorities referenced in the Cole Memorandum are being violated (such as keeping marijuana away from children and out of the hands of organized crime). The FinCEN Guidance also clarifies how financial institutions can provide services to marijuana-related businesses consistent with their Bank Secrecy Act obligations, including thorough customer due diligence, but makes it clear that they are doing so at their own risk. The customer due diligence steps include:

1. Verifying with the appropriate State authorities whether the business is duly licensed and registered;
2. Reviewing the license application (and related documentation) submitted by the business for obtaining a State license to operate its marijuana-related business;
3. Requesting from State licensing and enforcement authorities available information about the business and related parties;
4. Developing an understanding of the normal and expected activity for the business, including the types of products to be sold and the type of customers to be served (e.g., medical versus adult use customers);
5. Ongoing monitoring of publicly available sources for adverse information about the business and related parties;
6. Ongoing monitoring for suspicious activity, including for any of the red flags described in this guidance; and
7. Refreshing information obtained as part of customer due diligence on a periodic basis and commensurate with the risk.

With respect to information regarding State licensure obtained in connection with such customer due diligence, a financial institution may reasonably rely on the accuracy of information provided by State licensing authorities, where States make such information available.

Because most banks and other financial institutions are unwilling to provide any banking or financial services to marijuana businesses, these businesses can be forced into becoming "cash-only" businesses. While the FinCEN Guidance decreased some risk for banks and financial institutions considering serving the industry, in practice it has not increased banks' willingness to provide services to marijuana businesses, and most banks continue to decline to

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operate under the strict requirements provided under the FinCEN Guidance. This is because, as described above, the current law does not guarantee banks immunity from prosecution, and it also requires banks and other financial institutions to undertake time-consuming and costly due diligence on each marijuana business they accept as a customer.

The few State-chartered banks and/or credit unions that have agreed to work with marijuana businesses are limiting those accounts to small percentages of their total deposits to avoid creating a liquidity risk. Since, theoretically, the federal government could change the banking laws as it relates to marijuana businesses at any time and without notice, these credit unions must keep sufficient cash on hand to be able to return the full value of all deposits from marijuana businesses in a single day, while also keeping sufficient liquid capital on hand to serve their other customers. Those State-chartered banks and credit unions that do have customers in the marijuana industry charge marijuana businesses high fees to pass on the added cost of ensuring compliance with the FinCEN Guidance. Unlike the Cole Memorandum, however, the FinCEN Guidance from 2014 has not been rescinded.

The current Secretary of the U.S. Department of the Treasury, Stephen Mnuchin, has publicly stated that the Department was not informed of any plans to rescind the Cole Memorandum. Secretary Mnuchin stated that he does not have a desire to rescind the FinCEN Guidance.<sup>7</sup> As an industry best practice and consistent with its standard operating procedures, the Company adheres to all customer due diligence steps in the FinCEN Guidance.

In both Canada and the United States, transactions involving banks and other financial institutions are both difficult and unpredictable under the current legal and regulatory landscape. Legislative changes could help to reduce or eliminate these challenges for companies in the cannabis space and would improve the efficiency of both significant and minor financial transactions.

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

CBD is a product that often is derived from hemp, which contains only trace amounts of THC, the psychoactive substance found in marijuana. On December 20, 2018, President Trump signed the Agriculture Improvement Act of 2018 (popularly known as the "**2018 Farm Bill**") into law.<sup>8</sup> Until the 2018 Farm Bill became law, hemp and products derived from it, such as CBD, fell within the definition of "marijuana" under the CSA and the DEA classified hemp as a Schedule I controlled substance because hemp is part of the cannabis plant.<sup>9</sup>

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

<sup>8</sup> H.R.2 - 115th Congress (2017-2018): Agriculture Improvement Act of 2018, Congress.gov (2018), <https://www.congress.gov/bill/115th-congress/house-bill/2/text>.

<sup>9</sup> *See, e.g.*, 21 C.F.R. § 1308.35.

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The 2018 Farm Bill defines hemp as the plant *Cannabis sativa* L. and any part of the plant with a delta-9 THC concentration of not more than 0.3 percent by dry weight and removes hemp from the CSA. The 2018 Farm Bill also allows States to create regulatory programs allowing for the licensed cultivation of hemp and production of hemp-derived products. Hemp and products derived from it, such as CBD, may then be sold into commerce and transported across State lines provided that the hemp from which any product is derived was cultivated under a license issued by an authorized State program approved by the U.S. Department of Agriculture and otherwise meets the definition of hemp removed from the CSA. The introduction of hemp and products derived from it, such as CBD, in foods, beverages, and dietary supplements has not been approved by the U.S. FDA. The U.S. FDA expects to engage in rulemaking on this subject.

### State Level Overview and Compliance Summary

#### *California Regulatory Landscape*

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

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

In September 2015, the California legislature passed three bills collectively known as the “Medical Cannabis Regulation and Safety Act” (“**MCRSA**”). The MCRSA established a licensing and regulatory framework for medical marijuana businesses in California. The system created multiple license types for dispensaries, infused products manufacturers, cultivation facilities, testing laboratories, transportation companies, and distributors. Edible infused product manufacturers would require either volatile solvent or non-volatile solvent manufacturing licenses depending on their specific extraction methodology. Multiple agencies would oversee different aspects of the program and businesses would require a State license and local approval to operate. However, in November 2016, voters in California overwhelmingly passed Proposition 64, the “Adult Use of Marijuana Act” (“**AUMA**”) creating an adult-use marijuana program for adult-use 21 years of age or older. AUMA had some conflicting provisions with MCRSA, so in June 2017, the California State Legislature passed Senate Bill No. 94, known as Medicinal and Adult-Use Cannabis Regulation and Safety Act (“**MAUCRSA**”), which amalgamates MCRSA and AUMA to provide a set of regulations to govern medical and adult use licensing regime for cannabis businesses in the State of California.

Pursuant to MAUCRSA: (i) CalCannabis, a division of the California Department of Food and Agriculture, issues licenses to cannabis cultivators; (ii) the Manufactured Cannabis Safety Branch (the “**MCSB**”), a division of the California Department of Public Health, issues licenses to cannabis manufacturers; and (iii) the California Department of Consumer Affairs, via its agency the Bureau of Cannabis Control (BCC, issues licenses to cannabis distributors, testing laboratories, retailers, and micro-businesses. These agencies also oversee the various aspects of implementing and maintaining California’s cannabis landscape, including the statewide track and trace system. All three agencies released their emergency rulemakings at the end of 2017 and updated them with revisions in June 2018. The three agencies released their permanent rulemakings on January 16, 2019 which are now in effect. All three agencies began issuing temporary licenses in January 2018 and are currently evaluating annual license applications. The issuance of temporary

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licenses ended on December 31, 2018, though previously-issued temporary licenses remain valid until their expiration dates.

In order to legally operate a medical or adult-use cannabis business in California, the operator must have both local authorization and a State license. This requires license holders to operate in jurisdictions with marijuana licensing programs. Therefore, cities and counties in California (“**Local Jurisdictions**”) are allowed to determine the number of licenses they will issue to marijuana operators, or Local Jurisdictions can choose to outright ban marijuana in such Local Jurisdictions. California has not set a limit on the number of State licenses an entity may hold, unlike other States that have restricted how many cannabis licenses an entity may hold in total or for various types of cannabis activity. Although vertical integration across multiple license types is allowed under MAUCRSA, testing laboratory licensees may not hold any other licenses aside from a laboratory license. There are also no residency requirements for ownership under MAUCRSA. Indus conducts business only in Californian cities with other State cannabis licensees.

### *Licenses*

Lowell and its subsidiaries are licensed to operate Medical and Adult-Use Manufacturing, Nursery, Cultivation and Distribution facilities under applicable California and local jurisdictional law. Indus’ licenses permit it to possess, cultivate, process, dispense and wholesale medical and adult-use cannabis in the State of California pursuant to the terms of the various licenses issued by the BCC, California Department of Public Health and California Department of Food and Agriculture under the provision of the MAUCRSA and California Assembly Bill No. 133. The licenses are independently issued for each approved activity for use at the Indus facilities in California.

California State and local licenses are renewed annually. Each year, licensees are required to submit a renewal application per guidelines published by the BCC. While renewals are annual, there is no limit on the number of permitted annual renewals. In respect of the renewal process, provided that the requisite renewal fees are paid, the renewal application is submitted in a timely manner, and there are no material violations noted against the applicable license, Lowell would expect to receive the applicable renewed license in the ordinary course of business. While Indus’ compliance controls have been developed to mitigate the risk of any material violations of a license arising, there is no assurance that Indus’ licenses will be renewed in the future in a timely manner. Any unexpected delays or costs associated with the licensing renewal process could impede the ongoing or planned operations of Indus and have a material adverse effect on Indus’ business, financial condition, results of operations or prospects.

To obtain a State license, cannabis operators must first obtain local authorization, which is a prerequisite to obtaining State licensure. All three State regulatory agencies require confirmation from the applicable locality that an applicant is in compliance with local requirements and has either been granted authorization to, upon State licensure, continue previous cannabis activities or commence cannabis operations. One of the basic aspects of obtaining local authorization is compliance with all local zoning and land use requirements. Local governments are permitted to prohibit or otherwise regulate the types and number of cannabis businesses allowed in their locality. Some localities have limited the number of authorizations an entity may hold in total or for various types of cannabis activity. Others have tiered the authorization process, granting the initial rounds of local authorization to applicants that previously conducted cannabis activity pursuant to the CUA or those that meet the locality’s definition of social equity.



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### *California – Compliance Procedures*

Lowell utilizes MAX ERP, an integrated enterprise compliance platform, which integrates Indus' inventory management program and standard operating procedures with the software's compliance and quality features to facilitate compliance with State and local requirements. MAX ERP features include a compliance software solution that offers lot and batch control, recall management, document control and quality analysis. Additionally, Indus utilizes standard operating procedure building tools to facilitate the implementation and maintenance of compliant operations and tracks all required licensing maintenance criteria.

Lowell has developed a robust compliance program designed to ensure operational and regulatory requirements continue to be satisfied and has retained outside counsel to monitor its compliance with U.S. State law on an ongoing basis. Indus will continue to work closely with its legal counsel to develop and improve its internal compliance program and will defer to their legal opinions and risk mitigation guidance regarding California's complex regulatory framework. The internal compliance program requires continued monitoring by managers and executives of Indus to ensure all operations conform to and comply with required laws, regulations and legally compliant standard operating procedures.

### Service Providers

As a result of any adverse change to the approach in enforcement of United States cannabis laws, adverse regulatory or political change, additional scrutiny by regulatory authorities, adverse change in public perception in respect of the consumption of marijuana or otherwise, third party service providers to the Company could suspend or withdraw their services, which may have a material adverse effect on the Company's business, revenues, operating results, financial condition or prospects.

In addition to the above disclosure, please see "*Risk Factors - Risks Related to the Company's Business and Cannabis Industry - Service Providers*" in the Company's AIF.

### Ability to Access Capital

Given the current laws regarding cannabis at the federal law level in the United States, traditional bank financing is typically not available to United States cannabis companies. Specifically, the federal illegality of marijuana in the United States means that financial transactions involving proceeds generated by cannabis-related conduct can form the basis for prosecution under money laundering statutes, the unlicensed money transmitter statute and the Bank Secrecy Act. As a result, businesses involved in the cannabis industry often have difficulty finding a bank willing to accept their business. Banks who do accept deposits from cannabis-related businesses in the United States must do so in compliance with the Cole Memorandum and the FinCEN Guidance, both discussed above.

The Company has historically had access to equity and debt financing from the private markets in Canada and private markets in the United States and internationally and, subject to market conditions, may access the public markets in Canada and the United States in the future. While the Company is not able to obtain bank financing in the United States or financing from other U.S. federally regulated entities, subject to market conditions, it has the ability to access such equity and debt financing in Canada, the United States and internationally, both on a brokered and non-brokered basis.

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The Company's executive team and board of directors have extensive relationships with sources of private capital (such as funds, high net worth individuals and family offices), which has facilitated its ability to complete non-brokered financing transactions. There are increasing numbers of high net worth individuals, family offices, private equity and venture capital firms and other funds that have made meaningful investments in cannabis companies, including those with U.S. operations. Although there has been an increase in the amount of private financing available to cannabis companies over the last several years, there can be no assurance that additional financing will be available to the Company when needed or on terms which are acceptable.

The Company's inability to raise financing to fund operating or capital expenditures or acquisitions could limit its ability to operate or its growth and may have a material adverse effect upon the Company's business, financial condition, results of operations or prospects.

If additional funds are raised through further issuances of equity or convertible debt securities, existing shareholders of the Company could suffer significant dilution, and any new equity securities issued could have rights, preferences and privileges superior to those of existing shareholders. Any debt financing obtained in the future could involve restrictive covenants relating to capital raising activities and other financial and operational matters, which may make it more difficult for the Company to obtain additional capital and to pursue business opportunities, including potential acquisitions.

In addition to the above disclosure, please see "Risk Factors - Risks Related to the Company's Business and Cannabis Industry - The illegality of cannabis under U.S. Federal law restricts the Company's access to capital" and "Risk Factors - Risks Related to the Company's Business and Cannabis Industry - Anti-Money Laundering Laws and Regulations" in the Company's AIF.

### Reconciliations of Non-IFRS Financial and Performance Measures

The table below reconciles Net Loss to Adjusted EBITDA for the periods indicated.

Year Ended December 31,

(in thousands)

	2020	2019
Net loss attributable to Indus Holdings, Inc. (IFRS)	\$ (7,616)	\$ (50,752)
Interest expense	3,331	2,152
Provision (benefit) for income taxes	224	205
Depreciation in cost of goods sold	241	592
Depreciation and amortization in operating expenses	3,671	3,322
Investment and currency losses	(168)	2,091
Share-based compensation	2,200	3,385
Transaction and other special charges	4,201	2,341
Net effect of change in fair value of biological assets	(14,555)	638
<b>Adjusted EBITDA (non-IFRS)<sup>(1)</sup></b>	<b>\$ (8,472)</b>	<b>\$ (36,026)</b>

<sup>(1)</sup> Non-IFRS measure

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The table below reconciles Gross Profit (Loss) and Gross Margin to Adjusted Gross Profit (Loss) and Adjusted Gross Margin for the periods indicated.

### Year Ended December 31,

(in thousands)	2020	2019
Net revenue	\$ 42,618	\$ 37,045
Cost of goods sold	\$ 38,085	\$ 45,641
Net effect of change in fair value of biological assets	\$ (14,555)	\$ 638
Gross profit	\$ 19,088	\$ (9,234)
Adjusted gross profit (loss) <sup>(1)</sup>	\$ 4,533	\$ (8,596)
Adjusted gross margin <sup>(1)</sup>	10.6%	-23.2%

<sup>(1)</sup> Non-IFRS measure

## 2. SELECTED FINANCIAL DATA

The following table presents selected financial data derived from the consolidated financial statements of the Company as at and for the years ended December 31, 2020 and 2019. The selected consolidated financial information set out below may not be indicative of the Company's future performance.

### Year Ended December 31,

(in thousands, except per share amounts)	2020	2019
<b>Statement of Operations Data:</b>		
Net revenue	\$ 42,618	\$ 37,045
Cost of goods sold	\$ 38,085	\$ 45,641
Net effect of change in fair value of biological assets	\$ (14,555)	\$ 638
Gross profit (loss)	\$ 19,088	\$ (9,234)
Adjusted gross profit (loss) <sup>(1)</sup>	\$ 4,533	\$ (8,596)
Adjusted gross margin <sup>(1)</sup>	10.6%	-23.2%
Total operating expenses	\$ 20,602	\$ 37,165
Total other expense, net	\$ (5,878)	\$ (4,148)
Provision for income taxes	\$ 224	\$ 205
Net loss	\$ (7,616)	\$ (50,752)
<b>Per Share Data:</b>		
Net loss attributable to Indus Holdings, Inc. per share:		
Basic and Diluted	\$ (0.22)	\$ (1.62)
Shares used in per share calculation:		
Basic and Diluted	33,940	31,379
Adjusted EBITDA <sup>(1)</sup>	\$ (8,472)	\$ (36,026)

<sup>(1)</sup> Non-IFRS measure

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The following table presents selected financial data derived from the consolidated financial statements of the Company at December 31, 2020 and 2019.

(in thousands)	December 31,	
	2020	2019
<b>Balance Sheet Data:</b>		
Cash and cash equivalents	\$ 25,751	\$ 1,344
Working capital	\$ 45,851	\$ 10,004
Total assets	\$ 112,384	\$ 69,208
Long-term notes payable including current portion	\$ 1,516	\$ 506
Capital lease obligations including current portion	\$ 38,834	\$ 33,805
Total liabilities	\$ 66,260	\$ 44,848
Total stockholders' equity	\$ 46,124	\$ 24,360

### Year Ended December 31, 2020 Compared to the Year Ended December 31, 2019

#### *Revenue*

We derive our revenue from sales of extracts, distillates, branded and packaged cannabis flower, concentrates and edible products to retail dispensaries in the state of California. In addition, we distribute proprietary and third-party brands throughout the state of California. The Company recognizes revenue upon delivery of goods to customers since at this time performance obligations are satisfied.

The Company classifies its revenues into three major categories: Owned, Agency and Distributed brands.

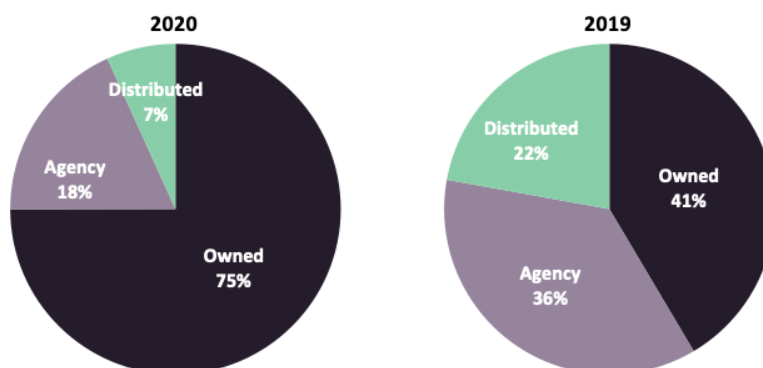
- Owned are the proprietary brands of the Company.
- Agency brands are third-party brands that the Company manufactures and/or sells utilizing our in-house sales team and distributes on behalf of the third-party.
- Distributed brands are brands in which the Company provides distribution services to retail dispensaries. Distributed brands also include third-party sourced bulk product sales.

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### Revenue by Category



Year Ended December 31, (in thousands)	2020	2019	2020 v 2019 % Change
Owned	\$ 31,955	\$ 15,366	108%
Agency	7,778	13,470	-42%
Distributed	2,885	8,209	-65%
Net revenue	<u>\$ 42,618</u>	<u>\$ 37,045</u>	<u>15%</u>

In the year ended December 31, 2020:

- Revenue increases compared to the prior year were driven by expanded cultivation capacity, resulting in flower brand sales increasing 167% over 2019 and expansion of owned brand product offerings resulting in concentrates brand sales increasing 154% over 2019 and edible brand sales increasing 103% over 2019. Customer onboarding and targeted marketing initiatives also favorably impacted owned brand sales.
- Revenues in 2020 were adversely impacted by a strategic decision to focus on agency and distributed brands that realize a higher per order sales level. As a result, the number of agency brands carried by the Company in 2020 declined by approximately 60% and no new agency brands were onboarded, and, the number of distributed brands carried by the Company declined by approximately 85%, and only two new distributed brands were onboarded in 2020.

Lowell expects to continue its focus on profitable sales growth in 2021 primarily through increased cultivation yields as a result of completing greenhouse renovations in 2020, including installation of environmental monitoring equipment designed to significantly reduce plant stress should the Company encounter severe temperature and atmospheric conditions as occurred at the end of the summer in 2020. Flower capacity in 2021 is expected to increase to over 40,000 pounds harvested, more than twice the harvest in 2020. The increased output will also increase internally sourced materials for distillation and concentrate products. Revenues are also expected to increase, although at a lesser pace, through improved penetration of edible products and selective new product introductions including pre-rolls, vapes and gummies. Our focus on agency and distributed brand sales will continue to be on those brands that realize a higher per order sales level that will enable profitable growth. As a result, we expect agency and distributed brand sales to decline from 2020 levels.

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### *Cost of Sales, Gross Profit and Gross Margin*

Cost of goods sold currently consist of the following categories:

- **Product Costs** – Includes all direct and indirect costs of production and distribution, and includes amounts paid for direct labor, raw materials, packaging, operating supplies, and allocated overhead, which includes allocations of rent, insurance, managerial salaries, utilities, and other expenses, such as employee training and product testing. Our focus in 2021 is on flower, pre-rolls and concentrates from our expanded cultivation operations, and on increased vertical integration utilizing greater internally sourced biomass for edible and vape products.
- **Agency brand manufacturing** - The Company manufactures products for certain brands that do not have the capability, licensing or capacity to manufacture their own products. The fees earned for these activities absorbs fixed overhead in manufacturing. In 2021, the Company is focusing on reducing agency brand manufacturing while executing smaller, more frequent production runs to lower inventory working capital, optimize efficiencies and expedite product getting to the market faster.
- **Net Effect of the Change in Fair Value of Biological Assets** – These fair value adjustments are part of the Company's cost of sales as required in accordance with IFRS standards relating to agriculture and biological assets. The fair value adjustment on sale of inventory represents the effect of the non-cash fair value adjustment on inventory sold in the period.

Management believes that the use of non-cash IFRS adjustments in calculating gross profit and gross margin can be confusing due to the potentially large value of non-cash fair value metrics required. Accordingly, management believes the use of gross profit (loss) before fair value adjustments and adjusted gross margin provides a better representation of performance by excluding non-cash fair value metrics required by IFRS.

<b>Year Ended December 31,</b>		
(in thousands)	<b>2020</b>	<b>2019</b>
Net revenue	\$ 42,618	\$ 37,045
Cost of goods sold	\$ 38,085	\$ 45,641
Net effect of change in fair value of biological assets	\$ (14,555)	\$ 638
Gross profit	\$ 19,088	\$ (9,234)
Adjusted gross profit (loss) <sup>(1)</sup>	\$ 4,533	\$ (8,596)
Adjusted gross margin <sup>(1)</sup>	10.6%	-23.2%

<sup>(1)</sup> Non-IFRS measure

Gross margin was 44.8% and 1.7% in the year ended December 31, 2020 and 2019, respectively. Excluding the net effect of change in fair value of biological assets, the corresponding gross margins were 10.6% and (23.2%) for the year ended December 31, 2020 and 2019, respectively. The increase between periods in gross profit and gross margin, as reported, is primarily due an increase in owned brand revenue reflecting increased cultivation output, and due to the favorable impact of the net effect of the change in fair value of biological assets. The favorable net effect of change in fair value of biological assets in 2021 is expected to reduce from the net change in 2020 as the number of operating grow rooms in 2021 will be the same as in the fourth quarter of 2020.

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

### Total Operating Expenses

Total operating expenses consist primarily of costs incurred at our corporate offices; personnel costs; selling, marketing, and other professional service costs including legal and accounting; and licensing costs. Sales and marketing expenses consist of selling costs to support our customer relationships, including investments in marketing and brand activities and corporate infrastructure required to support our ongoing business. We expect selling costs as a percentage of revenue to decrease as our business continues to grow, due to efficiencies associated with scaling the business and reduced focus on non-core brands. We expect to incur periodic acquisition and transaction costs related to expansion efforts and to continue to invest where appropriate in general and administrative functions to support the increasing complexity of the cannabis business.

#### Year Ended December 31,

(in thousands)

	2020	2019
Total operating expenses	\$ 20,602	\$ 37,165

Total operating expenses decreased \$16,563 for the year ended December 31, 2020 compared to the prior year. The decrease is primarily attributable to the reduction in general and administrative salaries and expenses through cost cutting initiatives and fully burdening distribution operations in cost of goods sold. Stock based compensation expense in 2020 decreased \$1,185 as restricted stock unit grants associated with the reverse takeover fully vested at the end of the first quarter in 2020. In addition, operating expenses in 2019 include \$2,251 of transaction costs related to the reverse takeover and acquisition-related costs. Operating expenses declined as a percentage of sales from 100% in 2019 to 48% in 2020. While operating expenses are expected to increase as owned brand marketing and infrastructure expenditures are incurred in support of revenue increases, operating expenses as a percentage of sales are expected to continue to decline.

### Total other income (expense), net

#### Year Ended December 31,

(in thousands)

	2020	2019
Total other income/(expense)	\$ (5,878)	\$ (4,148)

Other expense in 2020 included a loss of \$4,367 on the termination of the agreement to purchase the Nevada and Oregon operations of W Vapes and the sale of the Las Vegas facility while 2019 included \$2,250 in unrealized losses from investments. Interest expense increased \$1,179 in 2020 due to bridge financing and convertible debentures entered into in the current year.

### Net Loss

#### Year Ended December 31,

(in thousands)

	2020	2019
Net loss	\$ (7,616)	\$ (50,752)
Net loss per share:		
Basic and Diluted	\$ (0.22)	\$ (1.62)
Shares used in per share calculation:		
Basic and Diluted	33,940	31,379

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

Net loss reduced \$41,768, or 82%, in 2020 as a result of the factors noted above.

### Summary of Quarterly Results

The table below presents selected financial information for each of the eight most recently completed quarters, presented on an IFRS basis.

Three Months Ended	Net	Net	Net Income/(Loss) Per Share	
	Revenue	Income/(Loss)	Basic	Diluted
December 31, 2020	\$ 9,151	\$ (1,047)	\$ (0.03)	\$ (0.03)
September 30, 2020	\$ 14,131	\$ 2,391	\$ 8.57	\$ 0.02
June 30, 2020	\$ 9,894	\$ (4,835)	\$ (0.15)	\$ (0.15)
March 31, 2020	\$ 9,442	\$ (4,125)	\$ (0.13)	\$ (0.13)
December 31, 2019	\$ 10,803	\$ (18,338)	\$ (0.58)	\$ (0.58)
September 30, 2019	\$ 10,119	\$ (19,638)	\$ (0.61)	\$ (0.61)
June 30, 2019	\$ 9,689	\$ (7,841)	\$ (0.24)	\$ (0.24)
March 31, 2019	\$ 6,434	\$ (4,934)		

### 3. LIQUIDITY AND CAPITAL RESOURCES

Our primary need for liquidity is to fund the working capital requirements of our business, capital expenditures, general corporate purposes, and to a lesser extent debt service. Our primary source of liquidity is funds generated by financing activities. Our ability to fund our operations, to make planned capital expenditures, to make scheduled debt payments and to repay or refinance indebtedness depends on our future operating performance and cash flows, and ability to obtain equity or debt financing, which are subject to prevailing economic conditions, as well as financial, business and other factors, some of which are beyond our control. Cash generated from ongoing operations in 2020 were not sufficient to fund operations and, in particular, to fund the Company's cultivation capital expenditures in the short-term, and growth initiatives in the long-term. The Company raised additional funds from a \$16.1 million convertible debt financing which was initially funded in April 2020 and finalized in May 2020 and a \$25.0 million equity financing in December 2020.

As of December 31, 2020, the Company had \$25.8 million of cash and cash equivalents, and \$44.5 million of working capital, compared to \$1.3 million of cash and cash equivalents and \$10.0 million of working capital as of December 31, 2019.

The Company is focused on improving its balance sheet by improving accounts receivable collections, right-sizing inventories and increasing gross profits. We have taken a number of steps to improve our cash position and to continue to fund operations and capital expenditures including:

- Entered into a \$16.1 million senior secured convertible debenture and warrant purchase agreement in April 2020. The debentures bear interest at 5.5% per annum and will mature in October 2023. See Note 14 in the consolidated financial statements.



# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

- Accelerate cultivation facility renovations which are expected to result in an increase in flower and trim output by over two times in 2021, and over 4 times compared to 2019.
- Completed a 23 million subordinate voting share offering in December 2020 which generated \$25.0 million in net proceeds.
- Terminated the technology agreement with our e-commerce partner to reduce distribution expenses.
- Scaled back our investment in and support for non-core brands.
- Reduced accounts receivable in excess of \$2.3million in 2020.
- Restructured our organization and identified operating, selling and administrative expense cost reductions, which includes component cost reductions, reorganization of our sales and commission structure and realignment of our discount programs.

The Company realized considerable margin improvement in 2020 as greenhouse renovations were substantially completed, low profit agency and distributed brands were eliminated and operational efficiencies improved.

### Private Placement

In connection with the Company's Reverse Takeover, on April 2, 2019 Lowell completed a private placement offering (the "Private Placement"), in which 3,436 subscription receipts ("Subscription Receipts") were issued at a price of CDN\$15.65 per Subscription Receipt for gross proceeds of approximately US\$40 million. The gross proceeds of the Private Placement, less certain associated expenses, were deposited into escrow (the "Escrowed Proceeds") pending satisfaction of certain specified release conditions (the "Escrow Release Conditions"), all of which were satisfied immediately prior to the completion of the Transaction. As a result, the Escrowed Proceeds were released to FinanceCo prior to the closing of the Transaction, and each Subscription Receipt was automatically converted, for no additional consideration, into one common share of FinanceCo. Following satisfaction of the Escrow Release Conditions, in connection with the Transaction, the Company acquired all of the issued and outstanding FinanceCo shares pursuant to a three-cornered amalgamation, and the former holders thereof (including the former holders of FinanceCo Shares acquired upon conversion of the Subscription Receipts) each received one Subordinate Voting Share in exchange for each FinanceCo share held. The proceeds from the Private Placement were used for general corporate and working capital purposes.

### Cash Flows

The following table presents the Company's net cash inflows and outflows from the condensed interim consolidated financial statements of the Company for the years ended December 31, 2020 and 2019.

Year Ended December 31, (in thousands)			Change	
	2020	2019	\$	%
Net cash used in operating activities	\$ (7,752)	\$ (39,323)	\$ 31,571	80%
Net cash used in investing activities	(5,607)	(10,061)	4,454	44%
Net cash provided by financing activities	37,765	40,418	(2,653)	-7%
Change in cash, cash equivalents and restricted cash	<u>\$ 24,406</u>	<u>\$ (8,966)</u>	<u>\$ 33,372</u>	<u>372%</u>

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

### *Cash used in operating activities*

Net cash used in operating activities was \$7,752 for the year ended December 31, 2020, a decrease of \$31.6 million or 80%, compared to the year ended December 31, 2019. The reduction was primarily driven by the \$41.8 million reduction in net loss offset by a \$8.4 million larger increase in biological assets in the current year. Accounts receivable decreased by \$1.0 million in 2020 compared to an increase of \$6.2 million in 2019 reflecting significant collections focus in the current year. Inventory increased \$4.2 million in 2020 compared to a decline of \$3.5 million in 2019 reflecting significantly greater number of plants in cultivation as a result of the completion of greenhouse renovations in 2020 offset in part by a continuing focus on reducing inventory days on hand for manufactured product.

### *Cash used in investing activities*

Net cash used in investing activities was \$6,350 for the year ended December 31, 2020, a decrease of \$3.7 million, compared to the prior year. Capital expenditures of \$6.4 million, principally associated with greenhouse renovations, were comparable to \$10.0 million in capital expenditures in the same period last year. Capital expenditures in 2019 included a \$4.1 million purchase of a building in Nevada which was sold in 2020, and the Company received \$0.5 million of proceeds in the current year and an additional \$2.8 million in January 2021. Greenhouse renovations were substantially completed at the end of the third quarter in 2020. Remaining construction at the cultivation facility consists primarily of the construction of a head house for drying and processing of flower and biomass, which is expected to be completed around the end of the first quarter in 2021.

### *Cash provided by financing activities*

Net cash provided by financing activities was \$37,765 for the year ended December 31, 2020, compared to \$40,418 in the prior year. The inflow consisted primarily of \$15.2 million in net proceeds from the convertible debenture financing in the second quarter and \$25.0 million in net proceeds from the subordinate voting share offering in the fourth quarter. The inflow in 2019 was the result of the \$40 million Private Placement financing.

We expect that our cash on hand and cash flows from operations, will be adequate to meet our capital requirements and operational needs for the next 12 months.

### *Working Capital and Cash on Hand*

The following table presents the Company's cash on hand and working capital position as of December 31, 2020 and 2019.

(in thousands)	December 31,		Change	
	2020	2019	\$	%
Working capital <sup>(1)</sup>	\$ 45,851	\$ 10,004	\$ 35,847	358%
Cash on hand	\$ 25,751	\$ 1,344	\$ 24,407	1816%

<sup>(1)</sup> Non-IFRS measure - see Non-IFRS Financial Measures in this MD&A.

At December 31, 2020, we had \$25,751 of cash and \$44,482 of working capital, compared with \$1,344 of cash and \$10,004 of working capital at December 31, 2019. The increase in cash was primarily due to the convertible debenture financing and subordinate voting share offering, offset by capital expenditures and increases in inventories and biological assets.

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

The Company's working capital is expected to be significantly impacted by the growth in operations, increased cultivation output, and continuing margin improvement.

### Contractual Obligations

On May 14, 2019, the Company entered into a definitive agreement to acquire the assets of W The Brand ("W Vapes"), a multi-state manufacturer and distributor of cannabis concentrates, cartridges and disposable pens, in a cash and stock transaction comprised of \$10 million in cash and \$10 million in Subordinate Voting Shares based on a deemed value of CDN\$15.65 per share. On July 17, 2020, the Company announced the termination of the definitive agreement with W Vapes and is no longer obligated to acquire the assets of W Vapes. A \$2.8 million note receivable associated with the sale of the building in Nevada and a note payable of \$843 were outstanding at December 31, 2020 and subsequently collected and paid in January 2021.

The Company and its subsidiaries, in the normal course of business, have entered into lease agreements for corporate offices, a cultivation facility, a manufacturing facility, operating assets and distribution centers. As of December 31, 2020, maturities of these lease obligations were:

(in thousands)	December 31, 2020
1 - 3 years	\$ 14,138
4 - 5 Years	7,361
Greater than 5 years	17,335
<b>Total</b>	<b>\$ 38,834</b>

The Company is responsible for real estate taxes and common operating expenses incurred by the building or facility in which it leases space in addition to the future minimum rentals disclosed above.

The Company had the following additional obligations at December 31, 2020 and 2019:

(in thousands)	Maturity: < 1 Year		Maturity: > 1 Year	
	December 31,		December 31,	
	2020	2019	2020	2019
Accounts payable and				
Other accrued liabilities	\$ 10,996	\$ 9,060	\$ -	\$ -

### Off-Balance Sheet Arrangements

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

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

### 4. 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.

Lowell receives certain administrative, operational and consulting services through a Management Services Agreement with Edibles Management, LLC ("EM"). EM is a limited liability company owned by the co-founders of Indus and was formed to provide Indus with certain administrative functions comprising: cultivation, distribution, and production operations support; general administration; corporate development; human resources; finance and accounting; marketing; sales; legal and compliance. The agreement provides for the dollar-for-dollar reimbursement of expenses incurred by EM in performance of its services. Amounts paid to EM for the year ended December 31, 2020 and 2019 were \$11,385 and \$15,858, respectively. The Management services Agreement with EM was terminated as of December 31, 2020.

In April 2015, Lowell entered into a services agreement with Olympic Management Group ("OMG"), for advisory and technology support services, including the access and use of software licensed to OMG to perform certain data processing and enterprise resource planning (ERP) operational services. OMG is owned by one of the Company's co-founders. The agreement provides for the dollar-for-dollar reimbursement of expenses incurred by OMG in performance of its services. Amounts paid to OMG for the year ended December 31, 2020 and 2019 were \$5 and \$86, respectively.

### 5. CRITICAL ACCOUNTING ESTIMATES AND CHANGES IN ACCOUNTING POLICIES

The preparation of the Company's consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and 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 consolidated financial statements are described below.

- 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.
- Fair Value of Biological Assets and Inventory – In calculating the value of the biological assets and inventory, management is required to make a number of estimates, including estimating the stage of growth of the cannabis up to the point of harvest, harvesting costs, selling costs, sales price, expected yields for the cannabis plants. In calculating final inventory values, management is required to determine an estimate of spoiled or expired inventory and compare the inventory cost to estimated net realizable value.

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

- Fair Value of Investments in Private Entities – The Company uses discounted cash flow model to determine fair value of its investment in private entities. In estimating fair value, management is required to make certain assumptions and estimates such as discount rate, long term growth rate, estimated free cash flows.
- Share-Based Compensation – The Company uses the Black-Scholes option-pricing model to determine the fair value of stock options and warrants granted. In estimating fair value, management is required to make certain assumptions and estimates such as the expected life of units, volatility of the Company's future share price, risk free rates, future dividend yields and estimated forfeitures at the initial grant date. Changes in assumptions used to estimate fair value could result in materially different results.
- Deferred Tax Asset and Valuation Allowance – Deferred tax assets, including those arising from tax loss carryforwards, requires management to assess the likelihood that the Company will generate sufficient taxable earnings in future periods in order to utilize recognized deferred tax assets. Assumptions about the generation of future taxable profits depend on management's estimates of future cash flows. In addition, future changes in tax laws could limit the ability of the Company to obtain tax deductions in future periods. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted.
- Business Combinations – A business combination is defined as an acquisition of assets and liabilities that constitute a business. A business consists of inputs, including non-current assets and processes, including operational processes, that when applied to those inputs have the ability to create outputs that provide a return to the Company. Business combinations are accounted for using the acquisition method of accounting. The consideration of each acquisition is measured at the aggregate of the fair values of tangible and intangible assets obtained, liabilities and contingent liabilities incurred or assumed, and equity instruments issued by the Company at the date of acquisition. Key assumptions routinely utilized in allocation of purchase price to intangible assets include projected financial information such as revenue projections for companies acquired. As of the acquisition date, goodwill is measured as the excess of consideration given, generally measured at fair value, and the net of the acquisition date fair values of the identifiable assets acquired and the liabilities assumed.
- Goodwill – Goodwill represents the excess of the purchase price paid for the acquisition of an entity over the fair value of the net tangible and intangible assets acquired. Goodwill that has an indefinite useful life is not subject to amortization and is tested annually for impairment, or more frequently if events or changes in circumstances indicate that goodwill might be impaired. Any goodwill impairment loss is recognized in the consolidated statements of operations in the period in which the impairment is identified. Impairment losses on goodwill are not subsequently reversed.

The Company adopted IFRS 16 - *Leases* effective January 1, 2019 using the modified retrospective adoption method which allowed it to initially apply the new standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of accumulated deficit. In connection with the adoption of the new lease pronouncement, the Company recorded a charge to accumulated deficit of \$847.

Other than the implementation of IFRS 16, there have been no other changes in accounting policies.

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

### 6. FINANCIAL INSTRUMENTS AND FINANCIAL RISK

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities; current portion of long-term debt; and long-term debt. The carrying values of these financial instruments approximate their fair values.

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 has exposure to the following risks from its use of financial instruments and other risks to which it is exposed and assess the impact and likelihood of those risks. These risks include: market, credit, liquidity, price, asset forfeiture, banking and interest rate risk.

#### **Credit Risk**

Credit risk is the risk of a potential loss to the Company if a customer or third party to a financial instrument fails to meet its contractual obligations. The maximum credit exposure at December 31, 2020 and 2019 is the carrying amount of cash and cash equivalents and accounts receivable. All cash and cash equivalents are placed with U.S. or Canadian financial institutions.

The Company provides credit to its customers in the normal course of business and has established credit evaluation and monitoring processes to mitigate credit risk but has limited risk as a significant portion of its sales are transacted with cash.

#### **Liquidity Risk**

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

The Company is monitoring the impacts of COVID-19 closely, and although liquidity has not been materially affected by the COVID-19 outbreak to date, the ultimate severity of the outbreak and its impact on the economic environment is uncertain. Given the current uncertainty of the future economic environment, the Company has taken additional measures in monitoring and deploying its capital to minimize the negative impact on liquidity.

#### **Market Risk**

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

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.

### **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. The Company's interest-bearing loans and borrowings are all at fixed interest rates; therefore, the Company is not exposed to interest rate risk on these financial liabilities. The Company considers interest rate risk to be immaterial.

### **Price Risk**

Price risk is the risk of variability in fair value due to movements in equity or market prices. Cannabis is a developing market and likely subject to volatile and possibly declining prices year over year as a result of increased competition. Because adult-use cannabis is a newly commercialized and regulated industry in the state of California, historical price data is either not available or not predictive of future price levels. There may be downward pressure on the average price for cannabis. There can be no assurance that price volatility will be favorable to Indus or in line with expectations. Pricing will depend on general factors including, but not limited to, the number of licenses granted by the state and local governments, the supply such licensees are able to generate and consumer demand for cannabis. An adverse change in cannabis prices, or in investors' beliefs about trends in those prices, could have a material adverse outcome on the Company and its valuation.

### **Asset Forfeiture Risk**

Because the cannabis industry remains illegal under U.S. federal law, any property owned by participants in the cannabis industry which are either 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 were never charged with a crime, the property in question could still be seized and subject to an administrative proceeding by which, with minimal due process, it could be subject to forfeiture.

### **Banking Risk**

Notwithstanding that a majority of states have legalized medical and/or adult-use marijuana, there has been no change in U.S. federal banking laws related to the deposit and holding of funds derived from activities related to the marijuana industry. Given that U.S. federal law provides that the production and possession of cannabis is illegal, there is a strong argument that banks cannot accept for deposit funds from businesses involved with the 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 the businesses of the Company and its subsidiaries and leaves their cash holdings vulnerable.

## **7. RISK FACTORS**

There are a number of risk factors that could cause future results to differ materially from those described herein or implied by forward-looking statements, including without limitation, the following risk factors, which are discussed in

# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

greater detail under the heading "Risk Factors" in the AIF, which is available under the Company's profile on SEDAR at [www.sedar.com](http://www.sedar.com). The risks and uncertainties in the AIF and described below are not the only ones that the Company faces or may in face in the future. Such risk factors include, but are not limited to, risks related to: the fact that cannabis continues to be a controlled substance under the CSA; the enforcement of U.S. federal law and any other relevant law and an investor's contribution to and involvement in such activities may result in U.S. federal civil and/or criminal prosecution, including forfeiture of his, her or its entire investment; the Rohrabacher-Farr Amendment not being renewed; federal and state forfeiture laws; the illegality of cannabis under U.S. federal law restricts the Company's access to capital; anti-money laundering laws and regulation; restricted access to banking; heightened scrutiny by regulatory authorities; risks associated with travelling across borders; risk of regulatory or political change; the fact that the cannabis industry is a new industry and may not succeed; the Company's management team or other owners could be disqualified from ownership in the Company; public opinion and perception; general regulatory risks and risks related to licensure; California regulatory non-compliance; reclassification of cannabis in the United States; service providers; enforceability of contracts; lack of access to U.S. bankruptcy protections; environmental risk and regulation; COVID-19 risks; risks associated with the loss of foreign private issuer status; risks related to the Company's super voting shares; unpredictability caused by the Company's capital structure; the fact that the convertible debenture purchase agreement carries significant provisions and creditor control; the Company may not be able to refinance, extend or repay its indebtedness; limited operating history; reliance on management; additional financing may be required to fund the Company's continuing operations; lack of profitability of the Company; negative cash flow from operations; competition; future acquisitions or dispositions may present risks; risks inherent in an agricultural business; vulnerability to rising energy costs; product liability; product recalls; results of future clinical research being unfavourable; reliance on key inputs; dependence on suppliers and skilled labour; management of growth; product diversion; internal controls being inadequate; forecasting risks; risks presented by premises being leased; reliance on a single jurisdiction; probable lack of diversification; the fact that reliable data on the medical and adult-use marijuana industry is not available; litigation; intellectual property risks; competition from synthetic production and technological advances; constraints on marketing products; fraudulent or illegal activity by employees, contractors and consultants; information technology systems and cyber-attacks; security breaches; federal tax risks; California state and local taxes; high bonding and insurance coverage costs; global financial conditions; the fact that the Company is a holding company; increased costs as a result of being a public company; certain remedies and rights to indemnification may be limited; difficulty in enforcing judgments and effecting service of process on directors and officers; past performance not indicative of future results; financial projections may prove materially inaccurate or incorrect; market price volatility risks; sales by existing securityholders, including upon expiration of existing lock-up arrangements; limited market for securities and dilution and future sales of Indus securities.



# LOWELL FARMS INC. AND AFFILIATES

## MANAGEMENT'S DISCUSSION AND ANALYSIS

FOR THE YEARS ENDED DECEMBER 31, 2020 AND 2019

### 8. OUTSTANDING SHARE DATA

As of April 27, 2021, the Company had the following securities issued and outstanding:

(in thousands)	Number of Shares (on an as converted basis)
<b>Issued and Outstanding</b>	
Subordinate voting shares	83,346
Super voting shares	203
<b>Reserved for Issuance</b>	
Options	7,639
Restricted Stock Units	1,735
Warrants	15,602
Convertible debenture shares	78,629
Convertible debenture warrants	78,629

### 9. SUBSEQUENT EVENTS

On February 25, 2021, the Company announced the acquisition of substantially all of the assets of the Lowell Herb Co. and Lowell Smokes trademark brands, product portfolio, and production assets from The Hacienda Group. Lowell Herb Co. is a leading California cannabis brand that manufactures and distributes distinctive and highly regarded premium packaged flower, pre-roll, concentrates, and vape products. The acquisition was valued at approximately \$39 million, comprised of \$4.1 million in cash and the issuance of 22,643,678 subordinate voting shares. The Hacienda Group has agreed to continue to produce Lowell products for an interim period for the account of the Company pending completion of the transfer of certain regulatory assets. In connection with this acquisition, the Company changed its corporate name from Indus Holdings, Inc. to Lowell Farms Inc.

The Company has evaluated subsequent events through April 27, 2021, the date the financial statements were available to be issued.