

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS FOR THE QUARTERS ENDED MARCH 31, 2021 AND 2020

This management's discussion and analysis ("MD&A") of the financial condition and results of operations of the Company is for the quarters ended March 31, 2021 and 2020. It is supplemental to, and should be read in conjunction with, the Company's consolidated financial statements and the accompanying notes for the year ended December 31, 2020. All amounts in this MD&A are expressed in thousands of United States dollars (" \$" or "US\$"), unless otherwise indicated.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements. In some cases, you can identify these statements by forward-looking words such as "may", "will", "would", "could", "should", "believes", "estimates", "projects", "potential", "expects", "plans", "intends", "anticipates", "targeted", "continues", "forecasts", "designed", "goal", or the negative of those words or other similar or comparable words. Any statements contained in this Quarterly Report on Form 10-Q that are not statements of historical facts may be deemed to be forward-looking statements. We have based these forward-looking statements largely on our current expectations and projections about future events and financial trends that we believe may affect our business, financial condition, results of operations and future growth prospects. The forward-looking statements contained herein are based on certain key expectations and assumptions, including, but not limited to, with respect to expectations and assumptions concerning receipt and/or maintenance of required licenses and third party consents and the success of our operations, are based on estimates prepared by us using data from publicly available governmental sources, as well as from market research and industry analysis, and on assumptions based on data and knowledge of this industry that we believe to be reasonable. These forward-looking statements are not guarantees of future performance or development and involve known and unknown risks, uncertainties and other factors that are in some cases beyond our control. As a result, any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be inaccurate. Factors that may cause actual results to differ materially from current expectations include, among other things, those listed under "Risk Factors" in our registration statement on Form 10, as amended May 7, 2021 (the "Form 10"). Except as required by law, we assume no obligation to update or revise these forward-looking statements for any reason, even if new information becomes available after the date of this Quarterly Report on Form 10-Q. You should, however, review the factors and risks we describe in the reports we will file from time to time with the SEC after the date of this Quarterly Report on Form 10-Q.

OVERVIEW OF THE COMPANY

We are a California-based cannabis company with vertically integrated operations including large scale cultivation, extraction, processing, manufacturing, branding, packaging and wholesale distribution to retail dispensaries. We manufacture and distribute proprietary and third-party brands throughout the State of California, the largest cannabis market in the world. We also provide manufacturing, extraction and distribution services to third-party cannabis and cannabis branding companies. We operate a 225,000 square foot greenhouse cultivation facility in Monterey County, a 15,000 square foot manufacturing and laboratory facility in Salinas, California, a separate 20,000 square foot distribution facility in Salinas, California and a warehouse depot and distribution vehicles in Los Angeles, California.

Our product offerings include flower, vape pens, oils, extracts, chocolate edibles, mints, gummies, beverages, tinctures and pre-rolls. We sell our products under owned and third-party brands. Brands we own include the following Lowell Herb Co. and Lowell Smokes (premium packaged flower, pre-roll, concentrates, and vape products); Cypress Reserve (a premium flower brand); Flavor Extracts (crumble and terp sugar products); Kaizen (premium brand cannabis concentrates); House Weed (a value driven flower and concentrates offering delivering a flavorful and potent experience); Moon (a range of high-potency, high-quality and high-value edibles); Altai (hand-crafted and award-winning edibles); Humble Flower (a premium brand offering cannabis-infused topical creams, balms and oils); Original Pot Company (baked edibles); CannaStripe (gummy edibles); and Acme Elixirs (high quality, lab-tested vaporizing pens). We also exclusively manufacture and distribute third party brands in California and provide third party extraction processing and distribution services and bulk extraction concentrates and flower to licensed manufacturers and distributors.

We conduct cannabis cultivation operations located in Monterey County, California. We currently operate a cultivation facility which includes four greenhouses totaling approximately 225,000 square feet sited on 10 acres located on Zabala Road. Farming cannabis at this scale enables us to curate specialized strains and maintain greater control over the quantity and quality of cannabis available for our products, preserving the consistency of our flower and cannabis feedstocks for our extraction laboratory and product manufacturing operations. We maintain a strict quality control process which facilitates a predictable output yield of pesticide-free products.

Our manufacturing facility is located in Salinas, California and houses our edible product operations and extraction and distillation operations. The edible product operations utilize internally produced cannabis oil, which can also be supplied from multiple external sources. Our manufacturing operations produce a wide variety of cannabis-infused products in our 15,000 square foot manufacturing facility in Salinas. Our products include chocolate confections, beverages, baked goods, hard and soft non-chocolate confections, and topical lotions and balms. Lowell Farms utilizes modern commercial production equipment and employs food grade manufacturing protocols, including industry-leading standard operating procedures designed so that its products meet stringent quality standards. We have implemented updated compliance, packaging and labeling standards to meet the requirements of the California Medical and Adult-Use Cannabis Regulation and Safety Act with the advent of adult use legalization in California.

We also operate an automated flower packaging line and a pre-roll assembly line for making finished goods in those respective categories with feedstock grown by the Lowell Farms cultivation operations acquired in the Lowell Acquisitions described under "Recent Developments" below.

Our business is conducted by the following subsidiaries of the Company:

- Indus Holding Company is the owner of our principal brand intellectual property (other than the Lowell Herb Co. and Lowell Smokes brands) and an intermediate holding company for our operating entities.
- Cypress Manufacturing Company conducts the majority of our cannabis operations, including cultivation, extraction, manufacturing and distribution, and holds all manufacturing and distribution licenses.
- Cypress Holding Company owns the majority of our equipment and is a lessee for facility and equipment leases.
- Wellness Innovation Group Incorporated provides sales, marketing, administrative and managerial services to our other operating entities.
- Indus LF LLC is the owner of the brands, product portfolio and assets acquired in the Lowell Acquisition. Licensed activities acquired by Indus LF LLC in the Lowell Acquisition are being transitioned to Cypress Manufacturing Company.

The Company's corporate office and principal place of business is located at 19 Quail Run Circle, Salinas, California. As of March 31, 2021, we had 223 full-time employees and 2 part-time employees, all of which are located in California. Additionally, Lowell Farms utilizes contract employees in security, cultivation, packaging and warehousing activities. The use of contract employees enables Lowell Farms to manage variable staffing needs and in the case of cultivation and security personnel, access to experienced, qualified and readily available human resources.

Reverse Takeover

On November 13, 2018, Indus Holding entered into a business combination agreement with the Company (then called Mezzotin Minerals Inc. ("Mezzotin")) whereby the parties agreed to combine their respective businesses, which would result in the reverse takeover of Mezzotin by the security holders of Indus Holding Company and Indus Holding Company became a subsidiary of the Company. Mezzotin 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, the Company changed its name from Mezzotin Minerals Inc. to Indus Holdings, Inc.

Recent Developments

Acquisition

On February 25, 2021, we acquired the Lowell Herb Co. and Lowell Smokes trademark brands, product portfolio and production assets from The Hacienda Group, a California limited liability company ("Hacienda"), and its subsidiaries. The acquisition is referred to in this Form 10-Q as the "Lowell Acquisition." The Lowell Acquisition expanded our product offerings by adding a highly regarded, mature line of premium branded cannabis pre-rolls, including infused pre-rolls, to our product portfolio under the Lowell Herb Co. and Lowell Smokes brands. The Lowell Acquisition also expanded our offerings of premium packaged flower, concentrates, and vape products. Upon the completion of the acquisition of certain regulatory assets in the Lowell Acquisition, we expect to acquire from Hacienda certain non-hydrocarbon extraction assets used for the production of oils, water hashish, bubble hashish and rosin. The acquisition was valued at approximately \$41 million, comprised of \$4.1 million in cash and the issuance of 22,643,678 Subordinate Voting Shares. In connection with this acquisition, the Company changed its corporate name to Lowell Farms Inc. effective March 1, 2021.

Reconciliations of Non-GAAP Financial and Performance Measures

The Company has provided certain supplemental non-GAAP financial measures in this MD&A. Where the Company has provided such non-GAAP financial measures, we have also provided a reconciliation below to the most comparable GAAP financial measure, see "Reconciliations of Non-GAAP Financial and Performance Measures" in this MD&A. These supplemental non-GAAP 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 GAAP financial measures presented herein.

In this MD&A, reference is made to adjusted EBITDA and working capital which are not measures of financial performance under GAAP. The Company calculates each as follows:

- EBITDA is net income (loss), excluding the effects of income taxes (recovery); net interest expense; depreciation and amortization; and adjusted EBITDA also includes non-cash fair value adjustments on investments; unrealized foreign currency gains/losses; share-based compensation expense; and other transactional and special expenses, such as acquisition costs and expenses related to the markup of acquired finished goods inventory, 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. We use adjusted EBITDA internally to understand, manage, make operating decisions related to cash flow generated from operations and evaluate our business. In addition, we use adjusted EBITDA to help plan and forecast future periods.
- 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. We use working capital internally to understand, manage, make operating decisions related to cash flow required to fund operational activity and evaluate our business cash flow needs. In addition, we use working capital to help plan and forecast future periods.

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

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

Periods Ended March 31,

(in thousands)

	Three Months	
	2021	2020
Net income/(loss) attributable to Lowell Farms, Inc.	\$ (6,719)	\$ (7,874)
Interest expense	831	850
Provision for income taxes	63	25
Depreciation in cost of goods sold	584	514
Depreciation and amortization in operating expenses	324	363
EBITDA	(4,917)	(6,122)
Investment and currency (gains)/ losses	(106)	(85)
Share-based compensation	289	1,612
Net effect of cost of goods on mark-up of acquired finished goods inventory	167	-
Adjusted EBITDA⁽¹⁾	\$ (4,569)	\$ (4,594)

(1) Non-GAAP measure

RESULTS OF OPERATIONS

Quarter Ended March 31, 2021 Compared to Quarter Ended March 31, 2020

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 brands 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.

Revenue by Category

Quarter Ended March 31,

(in thousands)

	2021	2020	2021 v 2020 % Change
Owned	\$ 9,667	\$ 5,207	86%
Agency	1,230	2,709	-55%
Distributed	129	1,526	-91%
Net revenue	<u>\$ 11,026</u>	<u>\$ 9,442</u>	<u>17%</u>

In the quarter ended March 31, 2021:

- Revenue increases compared to the same quarter in the prior year were driven by expanded cultivation capacity, resulting in flower and pre-roll brand sales increasing approximately 339%, which included over \$900 in acquired Lowell brand sales, and the expansion of owned brand product offerings resulting in concentrates brand and edible brand sales increasing 11% and 19%, respectively. Customer onboarding and targeted marketing initiatives also favorably impacted owned brand sales.
- Revenues in the quarter ended March 31, 2021 were adversely impacted by a strategic decision to focus only on agency and distributed brands that realize a higher per order sales level. As a result, the number of agency and distributed brands carried by the Company for the quarter ended March 31, 2021 declined by approximately 81%, compared to the same quarter in the prior year, and no new agency or distributed brands were onboarded in the quarter ended March 31, 2021.

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 only realize a higher per order sales level that will enable profitable growth. As a result, we expect agency and distributed brand sales to continue to decline from 2020 levels.

Cost of Sales, Gross Profit and Gross Margin

Cost of goods sold consist of 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 right of use asset depreciation, insurance, managerial salaries, utilities, and other expenses, such as employee training and product testing. 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. 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. We are focusing on executing smaller, more frequent production runs to lower inventory working capital, optimize efficiencies and expedite product getting to the market faster, while continuing to decrease third party manufacturing activities.

Quarter Ended March 31,

(in thousands)

	2021	2020
Net revenue	\$ 11,026	\$ 9,442
Cost of goods sold	\$ 12,503	\$ 11,171
Gross profit (loss)	\$ (1,477)	\$ (1,729)
Gross margin	(13.4)%	(18.3)%

Gross margin was (13.4)% and (18.3)% in the quarters ended March 31, 2021 and 2020, respectively. The improvement between periods in gross profit and gross margin is primarily due to efficiencies from the \$4.5 million, or 86% increase in owned brand revenue, reflecting increased cultivation output of flower and biomass which more than doubled in the current quarter compared to the same quarter in the prior year, on a similar cost base. Additionally, the \$2.9 million, or 68% reduction in revenue in the current quarter compared to the same quarter in the prior year, from lower margin agency and distributed brands had an unfavorable impact on gross profit of approximately \$0.3 million in the current quarter, while having a favorable impact on gross margin in the current quarter.

In the quarter ended March 31, 2021, as a result of the change in brand product mix, cost of goods sold increased 12% compared to the 17% increase in revenue resulting in the gross margin improvement over the same period last year. However, the Company continued to be adversely impacted from the plant stress resulting from the extreme temperatures experienced in the third quarter of 2020. As a result, cultivation yields did not return to levels realized prior to the stress event. The Company has purchased and developed new genetics and is beginning to see significantly improved yields in the second quarter of 2021. The Company anticipates significantly improved gross margin in the second and third quarters of 2021 as a result of the yield improvement from the new plant genetics

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 the general and administrative function to support the increasing complexity of the cannabis business.

Quarter Ended March 31,

(in thousands)

	2021	2020
Total operating expenses	\$ 4,225	\$ 5,380

Total operating expenses decreased \$1.2 million for the quarter ended March 31, 2021, compared to the same quarter in the prior year. Stock based compensation expense for the quarter ended March 31, 2021 decreased compared to the same quarter in the prior year by \$1.3 million as restricted stock unit grants associated with the reverse takeover fully vested at the end of the first quarter in 2020. Operating expenses declined as a percentage of sales from 57% in the first quarter of 2020 to 38% in the first quarter of 2021. 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.

Net Loss

Quarter Ended March 31,

(in thousands, except per share amounts)

	2021	2020
Net loss	\$ (6,719)	\$ (7,874)
Net loss per share:		
Basic and Diluted	\$ (0.13)	\$ (0.24)
Shares used in per share calculation:		
Basic and Diluted	53,592	32,988

Net loss declined \$1.2 million, or 15%, for the quarter ended March 31, 2021, compared to the same quarter in the prior year, as a result of the factors noted above.

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 March 31, 2021, the Company had \$13.6 million of cash and cash equivalents and \$22.4 million of working capital, compared to \$25.8 million of cash and cash equivalents and \$30.9 million of working capital as of December 31, 2020.

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:

- Accelerated cultivation facility renovations which are expected to result in an increase in flower and trim output by over two times in 2021, compared to the prior year,
- Installation of new automated environmental and irrigation equipment design to improve yields and optimize greenhouse environmental conditions,
- Developed new cultivation genetics focused on increasing yields and potency,
- Scaled back our investment in and support for non-core brands,
- Focus marketing and brand development activities on significantly growing the Lowell brands acquired in the first quarter, and
- As a result of the Lowell brand acquisition, restructured our organization and identified operating, selling and administrative expense cost efficiencies.

The Company realized margin improvement in the first quarter of 2021, compared to the same quarter in the prior year, as greenhouse renovations were substantially completed, low profit agency and distributed brands were eliminated and operational efficiencies improved. As noted above, the Company anticipates significant improvement in gross margin for the balance of the year, due in large part to yield improvements in cultivation.

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 quarters ended March 31, 2021 and 2020.

Quarter Ended March 31,

(in thousands)

			Change	
	2021	2020	\$	%
Net cash used in operating activities	\$ (9,271)	\$ (2,351)	\$ (6,920)	(294)%
Net cash used in investing activities	(2,962)	(1,284)	(1,678)	(131)%
Net cash provided by financing activities	54	2,879	(2,825)	98%
Change in cash and cash equivalents	<u>\$ (12,179)</u>	<u>\$ (756)</u>	<u>\$ (11,424)</u>	<u>1,511%</u>

Cash used in operating activities

Net cash used in operating activities was \$9.3 million for the quarter ended March 31, 2021, an increase of \$6.9 million or 294%, compared to the quarter ended March 31, 2020. The increase was primarily driven by inventory increasing \$0.7 million in the current quarter compared to a reduction of \$1.4 million in the first quarter of 2020, and accounts receivable increasing by \$2.5 million in the quarter ended March 31, 2021 due to higher sales levels, compared to a decrease of \$0.9 million in the first quarter of 2020.

Cash used in investing activities

Net cash used in investing activities was \$3.0 million for the quarter ended March 31, 2021, an increase of \$1.7 million compared to the same quarter of the prior year. Cash used in the Lowell brand acquisition was \$4.6 million, which was off-set by net proceeds received associated with the termination of the W Vapes acquisition agreement. See Note 2 in notes to the condensed consolidated financial statements. Capital expenditures of \$0.4 million in the current quarter, principally associated with greenhouse renovations, compared to \$1.2 million in capital expenditures in the same period last year. 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 processing of flower and biomass, which is expected to be completed around the end of the third quarter in 2021.

Cash provided by financing activities

Net cash provided by financing activities was \$0.1 million for the quarter ended March 31, 2021, compared to \$2.9 million in the same quarter of the prior year, primarily due to proceeds from note payable financing in the prior year.

We expect that our cash on hand and cash flows from operations will be adequate to meet our operational needs for the next 12 months. The Company intends to seek additional external financing to fund new business initiatives, including the construction or expansion of additional cultivation sites.

Working Capital and Cash on Hand

The following table presents the Company's cash on hand and working capital position as of March 31, 2021 and December 31, 2020.

(in thousands)			Change	
	March 2021	December 2020	\$	%
Working capital ⁽¹⁾	\$ 22,364	\$ 30,883	\$ (8,515)	(28)%
Cash on hand	\$ 13,572	\$ 25,751	\$ (12,180)	(47)%

(1) Non-GAAP measure - see Non-GAAP Financial Measures in this MD&A.

At December 31, 2020, we had \$25.8 million cash and \$30.9 million of working capital, compared to \$13.6 million of cash and \$22.4 million of working capital at March 31, 2021. The decrease in cash was primarily due to funding operational losses and cash used in the Lowell brand asset acquisition.

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

CHANGES IN OR ADOPTION OF ACCOUNTING PRONOUNCEMENTS

This MD&A should be read in conjunction with the audited financial statements of the Company for the year ended December 31, 2020. Also see Note 1 to this Form 10-Q for changes of adoption of accounting pronouncements.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Company's condensed 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.
- Identifiable assets acquired and liabilities assumed are recognized at the acquisition date fair values as defined by accounting standards related to fair value measurements.

- 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 and, 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 carry-forwards, 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.

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, 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 March 31, 2021 and December 31, 2020 is the carrying amount of cash and cash equivalents and accounts receivable. All cash and cash equivalents are placed with U.S. and 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.
- In addition to the commitments outlined in Note 15, the Company has the following contractual obligations at March 31, 2021:

	<u>Maturity: < 1 Year</u>	<u>Maturity: > 1 Year</u>
(in thousands)		
Accounts payable and Other accrued liabilities	<u>\$ 10,551</u>	<u>\$ -</u>

Market Risk

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

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 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 or in line with expectations. Pricing will depend on general factors including, but not limited to, the number of licenses granted by the local and state governments, the supply such licensees are able to generate, activity by unlicensed producers and sellers 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 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 are arguments that financial institutions cannot accept for deposit funds from businesses involved with the marijuana industry and legislative efforts to provide greater certainty to financial institutions have not been successful. Consequently, businesses involved in the marijuana 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 business of the Company, its subsidiaries and investee companies, and leaves their cash holdings vulnerable.

SELECTED FINANCIAL DATA

Quarter Ended March 31,

(in thousands, except per share amounts)

Consolidated Operations

	2021	2020
Net revenue	\$ 11,026	\$ 9,442
Gross loss	\$ (1,477)	\$ (1,729)
Operating loss	\$ (5,702)	\$ (7,109)
Loss before income taxes	\$ (6,656)	\$ (7,849)
Net loss	\$ (6,719)	\$ (7,874)
Net loss per share - basic and diluted	\$ (0.13)	\$ (0.24)
Weighted average shares outstanding - basic and diluted	\$ 53,592	\$ 32,988

Consolidated Financial Position

	March 31, 2021	December 31, 2020
Cash	\$ 13,572	\$ 25,751
Current assets	\$ 37,111	\$ 46,604
Property, plant and equipment, net	\$ 49,456	\$ 49,243
Total assets	\$ 124,452	\$ 97,416
Current liabilities	\$ 14,747	\$ 15,723
Working capital	\$ 22,364	\$ 30,883
Long-term notes payable including current portion	\$ 666	\$ 1,516
Capital lease obligations including current portion	\$ 38,803	\$ 38,834
Total stockholders' equity	\$ 59,903	\$ 31,156

Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

OUTSTANDING SHARE DATA

As of May 17, 2021, the Company had the following securities issued and outstanding:

	Number of Shares (on an as converted basis)
(in thousands)	
Issued and Outstanding	
Subordinate voting shares	84,415
Super voting shares	203
Reserved for Issuance	
Options	7,399
Restricted Stock Units	1,735
Warrants	15,244
Convertible debenture shares	77,629
Convertible debenture warrants	78,629

Item 3. Quantitative and Qualitative Disclosures about Market Risk

As a smaller reporting company, we are not required to provide the information requested by this Item.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, we conducted an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act). Based on the evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer concluded that, as of March 31, 2021, our disclosure controls and procedures were effective to ensure that the information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Control over Financial Reporting

Subsequent to the quarter ended March 31, 2021, our Form 10 became effective with the SEC. We are engaged in the process of the design and implementation of our internal control over financial reporting in a manner commensurate with the scale of our operations.