# MEDCOLCANNA ORGANICS INC.

## (FORMERLY INTEGRATED ENERGY STORAGE CORP.)

## CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

## September 30, 2019

**NOTICE OF NO AUDITORS' REVIEW OF INTERIM FINANCIAL STATEMENTS**

The accompanying unaudited condensed interim consolidated financial statements of Medcolcanna Organics Inc. have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these financial statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim financial statements by an entity's auditors.

**MEDCOLCANNA ORGANICS INC.**

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

| *(Unaudited, expressed in Canadian Dollars)* | **September 30, 2019** | December 31, 2018 |
|---|---|---|
| **Assets** | | |
| Current Assets | | |
| Cash and cash equivalents | **4,705,672** | 628,618 |
| Restricted cash (Note 10) | **-** | 3,178,260 |
| Accounts receivable | **75,016** | 18,000 |
| Due from related parties (Note 16) | **201,716** | 22,533 |
| Prepaids | **417,214** | 3,413 |
| Inventory | **34,904** | - |
| | **5,434,522** | 3,850,824 |
| Non-Current Assets | | |
| Property, plant and equipment (Note 7) | **1,025,070** | 50,384 |
| Right-of-use assets (Note 8) | **310,896** | - |
| Intangible assets (Note 9) | **1,338,860** | 148,868 |
| **Total Assets** | **8,109,348** | 4,050,076 |
| **Liabilities** | | |
| Current Liabilities | | |
| Accounts payable and accrued liabilities | **635,365** | 286,973 |
| Current portion of lease liabilities (Note 8) | **94,136** | - |
| | **729,501** | 286,973 |
| Non-Current Liabilities | | |
| Lease liabilities (Note 8) | **212,153** | - |
| **Total Liabilities** | **941,654** | 286,973 |
| **Shareholders' Equity** | | |
| Share capital (Note 10) | **11,051,181** | 1,102,584 |
| Subscription receipts (Note 10) | **-** | 3,093,786 |
| Purchase warrants (Note 11) | **1,334,987** | 79,729 |
| Compensation options (Note 12) | **189,039** | 26,770 |
| Contributed surplus (Note 13) | **695,101** | - |
| Deficit | **(6,144,535)** | (538,482) |
| Accumulated other comprehensive income (loss) | **41,921** | (1,284) |
| **Total Shareholders' Equity** | **7,167,694** | 3,763,103 |
| **Total Liabilities and Shareholders' Equity** | **8,109,348** | 4,050,076 |

*Related party transactions (Note 16)*

*Commitments (Note 17)*

*See accompanying notes to the condensed interim consolidated financial statements.*

**MEDCOLCANNA ORGANICS INC.**

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF LOSS AND COMPREHENSIVE LOSS

For the three and nine months ended September 30, 2019

and for the period from July 10, 2018 (Date of Incorporation) to September 30, 2018

| | For the three months ended | | For the nine months ended | |
|---|---|---|---|---|
| *(Unaudited, expressed in Canadian Dollars)* | **2019** | 2018 | **2019** | 2018 |
| **Revenue** | | | | |
| Exclusivity fee | **-** | 32,750 | **-** | 32,750 |
| **Expenses** | | | | |
| Pre-operating expenses | **276,512** | - | **404,297** | - |
| Professional fees | **227,728** | 132,347 | **843,090** | 132,347 |
| General and administrative | **67,211** | 642 | **339,990** | 642 |
| Salaries, wages, and benefits | **249,615** | 58,500 | **514,852** | 58,500 |
| Selling, marketing, and promotion | **5,337** | - | **5,337** | - |
| Listing expense (Note 6) | **-** | - | **2,232,149** | - |
| Transaction costs relating to the RTO (Note 6) | **-** | - | **202,874** | - |
| Depreciation and amortization (Note 7 and 8) | **44,179** | - | **98,819** | - |
| Business development | **16,448** | - | **59,347** | - |
| Research and development | **153,804** | - | **153,804** | - |
| Share-based compensation (Note 13) | **176,443** | - | **676,644** | - |
| Finance expense | **27,261** | 100 | **37,964** | 100 |
| Foreign exchange loss (gain) | **(21,008)** | (1,720) | **36,886** | (1,720) |
| | **1,223,530** | 189,869 | **5,606,053** | 189,869 |
| Loss before income taxes | **(1,223,530)** | (157,119) | **(5,606,053)** | (157,119) |
| Current and deferred income tax | **-** | - | **-** | - |
| **Net loss** | **(1,223,530)** | (157,119) | **(5,606,053)** | (157,119) |
| **Other Comprehensive Income** | | | | |
| Foreign currency translation adjustment | **22,890** | 282 | **43,205** | 282 |
| **Comprehensive loss** | **(1,200,640)** | (156,837) | **(5,562,848)** | (156,837) |
| Loss per share - basic and diluted (Note 14) | **(0.01)** | (0.01) | **(0.09)** | (0.01) |
| Weighted average number of shares outstanding | **85,649,427** | 13,446,658 | **65,194,880** | 13,446,658 |

*See accompanying notes to the condensed interim consolidated financial statements.*

## MEDCOLCANNA ORGANICS INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

| *(Unaudited, expressed in Canadian Dollars)* | **Common Shares** | **Share Capital** (Note 10) | **Purchase Warrants** (Note 11) | **Subscription Receipts** (Note 10) | **Compensation Options** (Note 12) | **Contributed Surplus** (Note 13) | **Deficit** | **AOCI[1]** | **Total** |
|---|---|---|---|---|---|---|---|---|---|
| Balance at incorporation (July 10, 2018) | 50,000 | - | - | - | - | - | - | - | - |
| Shares cancelled | (50,000) | - | | | | | | | - |
| Shares issued | 32,000,000 | 32,000 | | | | | | | 32,000 |
| Shares issued for September 2018 placement | 7,362,659 | 643,883 | | | | | | | 643,883 |
| Share issuance costs | | (10,347) | | | | | | | (10,347) |
| Warrants issued September 2018 placement | | | 18,758 | | | | | | 18,758 |
| Warrant issuance costs | | | (301) | | | | | | (301) |
| Shares issued for December 2018 placement | 2,000,000 | 438,276 | | | | | | | 438,276 |
| Share issuance costs | | (1,228) | | | | | | | (1,228) |
| Warrants issued for December 2018 placement | | | 61,724 | | | | | | 61,724 |
| Warrant issuance costs | | | (452) | | | | | | (452) |
| Subscription receipts issued | | | | 3,480,500 | | | | | 3,480,500 |
| Subscription issuance costs | | | | (356,160) | | | | | (356,160) |
| Compensation options issued | | | | (30,554) | 30,554 | | | | - |
| Net loss for the period | | | | | | | (538,482) | | (538,482) |
| Other comprehensive loss | | | | | | | | (1,284) | (1,284) |
| **Balance at December 31, 2018** | **41,362,659** | **1,102,584** | **79,729** | **3,093,786** | **30,554** | **-** | **(538,482)** | **(1,284)** | **3,766,887** |
| Shares issued for March 2019 placement | 400,000 | 36,000 | | | | | | | 36,000 |
| Share issuance costs | | (3,187) | | | | | | | (3,187) |
| Subscription receipts issued | | | | 4,266,200 | | | | | 4,266,200 |
| Subscription issuance costs | | | | (324,554) | | | | | (324,554) |
| Compensation options issued | | | | (134,805) | 134,805 | | | | - |
| Shares issued pursuant to the RTO Transaction | 12,899,968 | 2,708,993 | | | | | | | 2,708,993 |
| Warrants issued pursuant to the RTO Transaction | | | 405,450 | | | | | | 405,450 |
| Warrant issuance costs | | | (881) | | | | | | (881) |
| Compensation options issued pursuant to the RTO Transaction | | | | | 23,680 | | | | 23,680 |
| Shares issued for subscriptions | 30,986,800 | 6,770,990 | | (6,770,990) | | | | | - |
| Share issuance costs | | (739,509) | | 739,509 | | | | | - |
| Warrants issued for subscriptions | | | 975,710 | (975,710) | | | | | - |
| Warrant issuance costs | | | (106,564) | 106,564 | | | | | - |
| Shares issued for acquisition of ICP | 4,701,240 | 1,175,310 | | | | | | | 1,175,310 |
| Warrants expired | | | (18,457) | | | 18,457 | | | - |
| Share-based compensation | | | | | | 676,644 | | | 676,644 |
| Net loss for the period | | | | | | | (5,606,053) | | (5,606,053) |
| Other comprehensive income | | | | | | | | 43,205 | 43,205 |
| **Balance at September 30, 2019** | **90,350,667** | **11,051,181** | **1,334,987** | **-** | **189,039** | **695,101** | **(6,144,535)** | **41,921** | **7,167,694** |

*(1) Accumulated Other Comprehensive Income*

*See accompanying notes to the condensed interim consolidated financial statements.*

# MEDCOLCANNA ORGANICS INC.

CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

For the nine months ended September 30, 2019

and for the period from July 10, 2018 (Date of Incorporation) to September 30, 2018

| *(Unaudited, expressed in Canadian Dollars)* | **2019** | 2018 |
|---|---|---|
| **Operating activities** | | |
| Net loss | **(5,606,053)** | (157,119) |
| Adjustments for: | | |
| Listing expense | **2,232,149** | - |
| Depreciation and amortization | **98,819** | - |
| Accrued interest on leases | **1,086** | - |
| Share-based compensation | **676,644** | - |
| Unrealized foreign exchange loss (gain) | **11,486** | (710) |
| Change in non-cash working capital (Note 18) | **514,378** | 168,379 |
| **Cash used in operating activities** | **(2,071,491)** | 10,550 |
| | | |
| **Investing activities** | | |
| Expenditures on property, plant & equipment | **(1,079,980)** | - |
| Transaction costs on acquisition of ICP | **(14,682)** | - |
| Cash acquired from RTO Transaction | **208,604** | - |
| **Cash used in investing activities** | **(886,058)** | - |
| | | |
| **Financing activities** | | |
| Issue common shares, net of cash issuance costs | **6,212,134** | 665,536 |
| Issue warrants, net of cash issuance costs | **890,449** | 18,456 |
| Payment of promissory note | **-** | (65,785) |
| Principal portion of lease payments | **(75,571)** | - |
| Change in non-cash working capital (Note 18) | **18,000** | (50,000) |
| **Cash generated from financing activities** | **7,045,012** | 568,207 |
| | | |
| **Net increase in cash** | **4,087,463** | 578,757 |
| Effects of variation in the exchange rate on cash | **(10,409)** | 282 |
| Cash, beginning of period | **628,618** | - |
| **Cash, end of period** | **4,705,672** | 579,039 |
| | | |
| Cash interest paid | 34,142 | - |
| Cash interest received | 16,941 | - |

*See accompanying notes to the condensed interim consolidated financial statements.*

## 1. NATURE OF OPERATIONS

Medcolcanna Organics Inc. ("Medcolcanna" or "MCCN"), which formerly operated under the name Integrated Energy Storage Corp. ("IES"), was incorporated on May 31, 2010 in the province of Alberta under the Business Corporations Act (Alberta).

On May 17, 2019, the Company completed a transaction whereby IES acquired all of the outstanding shares of Medcolcanna (BVI), Inc. ("Medcolcanna BVI" or "MCCN BVI" or the "Private Company"), a private company incorporated under the laws of the British Virgin Islands. The transaction constituted a reverse asset acquisition in accordance with International Financial Reporting Standards ("IFRS"), whereby the shareholders of Medcolcanna BVI took control of IES (the "Reverse Takeover Transaction" or "RTO Transaction" or "RTO"). Pursuant to the RTO Transaction, IES changed its name to Medcolcanna Organics Inc. and was continued into the province of British Columbia under the Business Corporations Act (British Columbia). See Note 6 for further details.

Through the Private Company's wholly owned subsidiary, Medcolcanna S.A.S, ("MCCN SAS"), Medcolcanna Organics Inc. is a licensed producer and distributor of, both THC (tetrahydrocannabinol) and CBD (cannabidiol), medicinal cannabis and cannabis derived products. Medcolcanna is also involved in the cannabis vaping industry through its Switzerland subsidiary MCCN SA.

References within these financial statements to the "Company" for periods, dates and/or transactions prior to the RTO Transaction are in reference to the Private Company, as the corporate entity of interest pre-RTO Transaction. Alternatively, references within these financial statements to the "Company" for periods, dates and/or transactions subsequent to the RTO Transaction are in reference to Medcolcanna, as the corporate entity of interest post-RTO Transaction. The comparative periods reflected in these financial statements are those of the Private Company, as the financials are a continuance of MCCN BVI.

The Company's corporate office address is Suite 800, 400 – 5th Avenue SW, Calgary, AB, T2P 0L6. On May 23, 2019, the common shares of the Company were listed on the TSX Venture Exchange ("TSXV") under the symbol "MCCN".

## 2. BASIS OF PREPARATION

### Statement of compliance

The Company applies IFRS as issued by the International Accounting Standards Board ("IASB") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC"). These condensed interim consolidated financial statements have been prepared in accordance with International Accounting Standard 34 – Interim Financial Reporting.

The policies applied in these condensed interim consolidated financial statements are based on IFRSs issued and outstanding as of November 29, 2019, the date the Board of Directors approved these financial statements.

### Basis of measurement

The condensed interim consolidated financial statements have been prepared on a going concern basis, under the historical cost convention except for certain assets, liabilities, or equity instruments measured at fair value as explained in the Company's accounting policies below.

### Functional and presentation currency

The functional currency of MCCN is the Canadian dollar. The condensed interim consolidated financial statements and notes to the financial statements are expressed and presented in Canadian dollars unless otherwise stated.

Transactions in currencies other than the functional currency are translated into the functional currency using the exchange rates prevailing at the date of such transaction. At each reporting period, monetary assets and liabilities denominated in foreign currencies are translated to the functional currency using the exchange rate at the reporting date. Foreign exchange gains and losses are recognized in the statement of loss and comprehensive loss.

At the financial reporting date, the foreign subsidiaries assets and liabilities are translated at the reporting period exchange rate, while revenues, expenses and cash flows are translated at the average exchange rate for the period. Shareholders' equity is translated at the rate effective at the time of the transaction. The resulting translation adjustments are recognized in other comprehensive income (loss) ("OCI") and in accumulated OCI in shareholders' equity.

**Basis of consolidation**

The condensed interim consolidated financial statements include the accounts of the Company and its subsidiaries. Subsidiaries are entities controlled by the Company. Subsidiaries are included in the consolidated financial results of the Company from the effective date of acquisition up to the effective date of disposition or loss of control. As at September 30, 2019, Medcolcanna had the following subsidiaries:

| Subsidiaries | Country of incorporation | Ownership | Functional currency |
|---|---|---|---|
| Medcolcanna (BVI), Inc. | British Virgin Islands | 100% | Canadian Dollar (CAD) |
| Medcolcanna S.A.S | Colombia | 100% | Colombian Peso (COP) |
| Innovative CBD Products B.V. | Netherlands | 100% | Euro |
| MCCN SA | Switzerland | 100% | Swiss Franc (CHF) |

All intercompany balances and transactions are eliminated upon consolidation in preparing the financial statements.

## 3. SIGNIFICANT ACCOUNTING POLICIES

**Cash and cash equivalents**

Cash and cash equivalents are comprised of cash and highly liquid investments that are readily convertible into known amounts of cash with original maturities of three months or less.

**Property, Plant & Equipment ("PP&E")**

Property and equipment are stated at cost, net of accumulated depreciation and accumulated impairment losses, if any. An item of equipment is derecognized upon disposal or when no future economic benefits are expected from its use. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in the consolidated statement of loss and comprehensive loss in the period the asset is derecognized.

The assets' residual values, useful lives and methods of depreciation are reviewed at each financial period end and adjusted if appropriate. PP&E is depreciated through the consolidated statement of loss over the assets' estimated useful life. Assets under construction are not subject to depreciation as they are not ready for use.

PP&E is depreciated over their estimated useful lives using the following methods and rates:

| | Method | Estimated useful life |
|---|---|---|
| Agricultural facilities | Straight-line | 10 years |
| Laboratory equipment | Straight-line | 5 years |
| Office equipment | Straight-line | 5 years |
| Leasehold improvements | Straight-line | lease term |

**Intangible assets**

Intangible assets are recognized if it is probable that future economic benefits attributable to the asset will flow to the Company and their cost can be reasonably measured.

Intangible assets that are acquired by the Company, which have definite useful lives, are measured at cost less accumulated amortization and impairment losses. These intangible assets are comprised of license costs and costs related to the retention of the licenses. Finite life intangible assets are amortized through the consolidated statement of loss on a straight-line basis over their estimated useful lives.

For licenses, permits, and intellectual property that are classified as intangible assets with an indefinite life, no amortization is recognized. This would apply to intangible assets that do not expire or that are expected to continue indefinitely and, as such, there is no foreseeable limit to the period over which these assets are expected to generate future cash inflows to the Company.

**Impairment of non-financial assets**

The Company reviews and evaluates impairment of its non-financial assets subject to depreciation and amortization whenever events or changes in circumstances occur that indicates that the carrying amount of the asset will not be recovered from its use or sale. An impairment loss is recognized for the amount by which the carrying amount of the assets exceeds the higher of its fair value and value in use. Fair value is the amount that can be obtained from the sale of an asset in an open market. The value in use corresponds to the present value of the estimated future cash flows expected to be obtained from the continuing use of the asset and from its sale at the end of its useful life. Impairment losses recognized in previous years are reversed if there is a change in the estimates used from the last time an impairment loss was recognized.

Indefinite life intangible assets are tested for impairment at a minimum on an annual basis and whenever events or circumstances indicate that an impairment may have occurred.

**Financial instruments**

The company classifies and measures its financial instruments as follows:

- Cash and cash equivalents – classified as fair value through profit and loss ("FVTPL") and measured at fair value
- Accounts receivable – classified at amortized costs and measured at amortized cost
- Due from related party – classified at amortized costs and measured at amortized cost
- Accounts payable and accrued liabilities - classified at amortized costs and measured at amortized cost

The initial classification of a financial asset depends upon the Company's business model for managing its financial assets and the contractual terms of the cash flows. On initial recognition, the Company may irrevocably designate a financial asset that meets the amortized cost or fair value through other comprehensive income ("FVOCI") criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch.

Financial liabilities are classified as either financial liabilities at FVTPL or at amortized cost. Financial liabilities at FVTPL are stated at fair value, with changes being recognized through the consolidated statements of income and comprehensive income. Financial liabilities classified at amortized cost are initially measured at fair value, net of transaction costs, and are subsequently measured at amortized cost using the effective interest method. A financial liability is classified as measured at FVTPL if it is held-for-trading, a derivative, or designated as FVTPL on initial recognition.

All financial instruments are initially recognized at fair value. For financial assets and liabilities not classified as FVTPL, transaction costs directly attributable to the acquisition or issuance of the financial assets or financial liabilities are recognized with the asset or liability. Transaction costs of financial assets and liabilities carried at FVTPL are expensed in the statement of loss and comprehensive loss.

***Impairment of financial assets***
The Company recognizes loss allowances for Expected Credit Losses ("ECLs") on its financial assets measured at amortized cost. Due to the nature of its financial assets, the Company measures loss allowances at an amount equal to expected lifetime ECLs. Lifetime ECLs are the anticipated ECLs that result from all possible default events over the expected life of a financial asset. ECLs are a probability-weighted estimate of credit losses. Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Company expects to receive). ECLs are discounted at the effective interest rate of the related financial asset.

***Offsetting financial instruments***
Financial assets and liabilities are offset and the net amount reported in the consolidated statement of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously.

**Segment reporting**

According to IFRS 8, operating segments are identified based on the 'management approach'. This approach stipulates external segment reporting based on the Company's internal organizational and management structure and on internal financial reporting to the chief operating decision maker. Management of the Company is responsible for measuring and steering the business success of the segments and is considered the chief operating decision maker within the meaning of IFRS 8.

**Income taxes**

Income tax expense consists of current and deferred tax expense. Current and deferred tax are recognized in the statement of loss except to the extent that it relates to items recognized directly in equity or other comprehensive income (loss).

***Current tax***
Current tax is recognized and measured at the amount expected to be recovered from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period. Provisions are established where appropriate on the basis of amounts expected to be paid to the tax authorities.

***Deferred tax***
Deferred taxes are the taxes expected to be payable or recoverable on any temporary differences between the

carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable earnings. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized and the liability is settled. The effect of a change in the enacted or substantively enacted tax rates is recognized in the statement of loss.

Deferred tax assets are recognized to the extent future recovery is probable. At each reporting period end, deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

**Share capital and warrants**

Common shares and warrants are classified as equity on the financial statements. The share capital represents the amount received upon issuance of shares. Incremental costs directly attributable to the issuance of shares or warrants are recognized as a deduction from the proceeds in equity in the period in which the transaction occurs. Proceeds from unit placements are allocated between shares and warrants issued on a pro-rata basis of their value within the unit using the Black-Scholes option pricing model to determine the fair value of warrants issued.

**Share-based compensation**

Share-based compensation expense is determined based on the estimated fair value of shares on the grant date using the Black-Scholes option pricing model. Forfeitures are estimated at the grant date and are subsequently adjusted to reflect actual forfeitures. The expense is recognized over the vesting period, with a corresponding increase to contributed surplus. At the time the stock options are exercised, the issuance of common shares is recorded as an increase to shareholders' capital and a corresponding decrease to contributed surplus.

**Research and development**

Research costs are expensed as incurred. Development expenditures are capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development to use or sell the asset. Other development expenditures are recognized in the statement of loss.

**New standards adopted on January 1, 2019**

Certain new standards, interpretations, amendments and improvements to existing standards were issued by the IASB or IFRIC that are mandatory for accounting periods beginning on or after January 1, 2019 or later periods.

***IFRS 16 Leases ("IFRS 16")***

In January 2016, the IASB issued IFRS 16 "Leases", which provides guidance on accounting for leases. The new standard replaced IAS 17 "Leases" and related interpretations. IFRS 16 eliminates the distinction between operating leases and financing leases for lessees and generally requires balance sheet recognition for all leases. Certain short-term (less than 12 months) and low-value leases (as defined in the standard) are exempt from the requirements, and the Company continues to treat these leases as expenses.

The Company adopted IFRS 16 on January 1, 2019 using the modified retrospective approach with no impact to opening retained earnings at the date of adoption. The modified retrospective approach does not require restatement of prior period financial information as it recognizes the cumulative effect as an adjustment to opening retained earnings and applies the standard prospectively.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

On adoption, the Company elected to use the following practical expedients permitted under IFRS 16:

- Apply a single discount rate to a portfolio of leases with similar characteristics;
- Account for leases with a remaining term of less than twelve months as at January 1, 2019 as short-term leases; and
- Account for lease payments as an expense and not recognize a right-of-use asset if the leased asset is of a low dollar value (less than US$5,000).

On adoption of IFRS 16, the Company recognized a lease liability in relation to rural property that is used for the cannabis operations. The lease has been measured at the present value of the remaining lease payments, discounted using the Company's incremental borrowing rate as at January 1, 2019. The Company's incremental borrowing rate was estimated at approximately 15.0 percent. Total lease liabilities of $255,960 were recorded as at January 1, 2019. Refer to Note 17 for a reconciliation of lease liabilities recognized on January 1, 2019 to operating lease commitments disclosed at December 31, 2018.

The associated right-of-use asset was measured in an amount equal to the corresponding lease liability on the statement of financial position as at January 1, 2019. Refer to Note 8 and Note 17 for additional information regarding the right-of-use asset.

The impact on adoption was as follows:

| | Reported amount at December 31, 2018 | IFRS 16 Adjustment | Balance as at January 1, 2019 |
|---|---|---|---|
| **Assets** | | | |
| Right-of-use asset | - | 255,960 | 255,960 |
| **Liabilities** | | | |
| Lease liability | - | 255,960 | 255,960 |

Effective January 1, 2019, the Company adopted the following accounting policy:

The Company assesses whether a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

A lease liability is recognized at the commencement of the lease term at the present value of the lease payments. Lease liabilities include the net present value of fixed payments, variable lease payments that are based on an index or a rate, amounts expected to be paid by the lessee under residual value guarantees, the exercise price of purchase options if the lessee is reasonably certain to exercise that option, and payments of penalties for terminating the lease, less any lease incentives receivable. Payments are discounted using the implicit rate within the lease, when readily available, or the Company's incremental borrowing rate when the rate implicit is not known. The Company applies a single discount rate for a portfolio of leases with reasonably similar characteristics.

The lease liability is measured at amortized cost using the effective interest rate method. The liability is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the amount expected to be payable under a residual value guarantee, or if there is a change in the assessment of whether the Company will exercise a purchase, extension, or termination option that is within the Company's control.

Upon recognition of a lease liability at the lease commencement date, a corresponding right-of-use asset is recognized at the amount equal to the lease liability. Depreciation is recognized on the right-of-use asset on a straight-line basis, over the shorter of the estimated useful life of the asset or the lease term.

Leases with terms of less than twelve months and leases for which the underlying asset is of low value (US$5,000) are recognized as an expense in the financial statements on a straight-line basis over the lease term.

## 4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

The preparation of 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.

**Impairment**

Long-term, non-financial assets are tested for impairment when events or changes in circumstances indicate that the asset's carrying amount may exceed its recoverable amount. Indefinite life intangible assets are tested for impairment, at a minimum, on an annual basis regardless of whether or not events or circumstances exist indicating possibility of impairment. For the purpose of testing impairment, assets may be grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating unit or "CGU"). Professional judgement is used to assess and determine the Company's CGU groupings.

**Useful lives of PP&E and intangible assets**

Depreciation and amortization of PP&E and intangible assets are dependent upon estimates of useful lives, which are determined through the exercise of professional 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 the assets.

**Valuation of deferred tax assets**

The Company assesses the probability of taxable profits being available in the future based on its budget forecasts. These forecasts are adjusted to account for certain non-taxable income and expenses and specific rules on the use of unused credits and tax losses. When a forecast shows a net profit, the Company considers that the use of deferred income taxes is probable and recognizes the benefit. When management believes that the benefits will not be realized, the deferred income tax asset is not recognized.

**Warrants, compensation options and stock options**

All warrants, compensation options, and stock options issued by the Company are recorded at fair value using the Black-Scholes option-pricing model. In assessing the fair value of equity-based compensation and warrants, estimates have to be made regarding the expected volatility in share price, instrument life, dividend yield, risk-free rate, estimated life and estimated forfeitures at the initial grant date.

**Lease liabilities and right-of-use assets**

A lease liability and a corresponding right-of-use asset is recognized at the commencement date of a lease at the present value of the lease payments over the lease term. The Company uses the implicit rate within the lease, if readily available, or the incremental borrowing rate when the rate implicit is not known. The discount rate is based on judgements including economic environment, term, currency, and the underlying risk inherent to the asset. The carrying balance of the right-of-use asset, lease liability, and resulting interest expense and depreciation expense, may differ due to changes in the market conditions. The lease term is also subject to certain assumptions including, the Company's intent regarding extension and termination options of a lease.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

## 5. CORPORATE TRANSACTIONS

**Medcolcanna S.A.S.**

In July 2018, the Company acquired, from a related party (a Colombian company controlled by an officer of the Company), all of the issued and outstanding shares of Medcolcanna S.A.S. in exchange for a promissory note of $65,785 (US$50,000) to be paid within 2 months of the date of the sale agreement (the "Colombian Acquisition"). Furthermore, costs related to this transaction were comprised of success fees of $130,160 (US$100,000) owed to a third-party consultant of the Company. A promissory note was issued to the third-party consultant to be paid within 90 days of the issuance of the promissory note. As such, the total consideration paid was $195,945 (US$150,000).

The transaction was accounted for using the asset acquisition method of accounting. The fair values assigned to the net assets and liabilities and consideration paid are as follows:

| | |
|---|---|
| Licenses | 148,868 |
| Accounts receivable | 53,465 |
| Accounts payable and accrued liabilities | (6,388) |
| **Total consideration** | **195,945** |

The results of the Colombian Acquisition have been included in the accounts of the Company commencing July 24, 2018.

**Innovative CBD Products B.V.**

In July 2019, the Company acquired all the issued and outstanding shares of Innovative CBD Products B.V. ("ICP"). ICP is the owner of various medicinal cannabinoid formulations and related intellectual property with respect to the development of cannabis and cannabis by-products. In exchange for the shares of ICP, Medcolcanna issued 4,701,240 shares of the Company to the seller. At a deemed price of $0.25 per share, the share consideration paid equated to $1,175,310. Medcolcanna also incurred transaction costs relating to the acquisition of $14,682, which has been included as part of the consideration paid by Medcolcanna. The transaction was accounted for as an asset acquisition as ICP did not meet the definition of a "business" under IFRS guidelines. The total consideration of $1,189,992 has been allocated entirely to the formulations owned by ICP as this was its only asset, with no existing liabilities.

| **Consideration paid** | |
|---|---|
| 4,701,240 common shares issued | 1,175,310 |
| Transaction costs | 14,682 |
| **Total consideration (inclusive of transaction costs)** | **1,189,992** |
| **ICP net assets acquired** | |
| **Medicinal cannabinoid formulations** | **1,189,992** |

The Company has also granted a royalty to the seller of ICP of 10% of Medcolcanna's interest in products derived from the formulations that are subsequently produced, marketed, and sold. Additionally, should Medcolcanna license or sell any of the formulations to a third party, then the royalty entitles the seller of ICP to 10% of proceeds received by Medcolcanna for such license or sale. The royalty commenced in July 2019 and ends ten years thereafter.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

## 6. REVERSE TAKEOVER TRANSACTION

In May 2019, IES completed the transaction to acquire all of the issued and outstanding shares of MCCN BVI (41,762,659 shares) in consideration for shares of IES on a one-for-one basis. MCCN BVI also had 3,681,330 unit warrants, 1,000,000 private placement warrants, 1,859,208 compensation options, and 30,986,800 subscription unit receipts issued and outstanding. The warrants and compensation options were exchanged for an equal amount of purchase warrants and compensation options of Medcolcanna as outlined in Note 11 and Note 12. On completion of the RTO Transaction, MCCN BVI's 30,986,800 subscription receipts were converted into 30,986,800 shares and 15,493,400 purchase warrants of Medcolcanna (Note 10 and 11). Prior to the RTO Transaction, IES had issued 6,450,000 warrants to settle outstanding long-term financial liabilities and 267,656 compensation options as compensation for a private placement that occurred during the first quarter of 2019.

The Company (then being IES) did not meet the definition of a "business" under IFRS guidelines, thus causing the RTO Transaction to be treated as a reverse asset acquisition rather than a business combination, with IES' main attribute being its public listing. Under this premise, as consideration for 100% of the outstanding shares of IES, by way of reverse acquisition, the Private Company issued 12,899,968 shares to the shareholders of IES. These shares were assigned a fair value of $0.21 per share for total share consideration of $2,708,993. Additionally, as part of the RTO Transaction consideration, the 6,450,000 IES warrants were converted to 6,450,000 of Medcolcanna purchase warrants and were ascribed a total value of $404,569 net of issuance costs (Note 11). The 267,656 IES compensation options were converted to 267,656 compensation options of Medcolcanna and were ascribed a total value of $23,680 (Note 12). With the issuance of shares, purchase warrants, and compensation options, the total consideration paid on the RTO Transaction was $3,137,242.

The total consideration has been allocated first to the fair value of the net assets acquired with any excess to non-cash cost of the RTO Transaction as follows:

| | |
|---|---|
| **Consideration paid** | |
| 12,899,968 common shares issued | 2,708,993 |
| 6,450,000 warrants issued | 404,569 |
| 267,656 compensation options issued | 23,680 |
| **Total consideration** | **3,137,242** |
| | |
| **Net assets acquired of IES** | |
| Cash | 208,604 |
| Accounts receivable | 15,942 |
| Loan receivable | 730,000 |
| Accounts payable and accrued liabilities | (49,453) |
| **Total net assets acquired at fair value** | **905,093** |
| **Listing expense** | **2,232,149** |
| | |
| Transaction costs relating to the RTO Transaction | 202,874 |
| **Total cost of acquisition** | **2,435,023** |

(Unaudited and expressed in Canadian dollars unless otherwise stated)

## 7. PROPERTY, PLANT & EQUIPMENT ("PP&E")

The components of the Company's property, plant and equipment ("PP&E") assets are as follows:

| | Agricultural Facilities | Laboratory Equipment | Office Equipment | Leashold Improvements | Total |
|---|---|---|---|---|---|
| Balance at incorporation (July 10, 2018) | - | - | - | - | - |
| Capital additions | 49,986 | - | - | - | 49,986 |
| Foreign currency translation | 398 | - | - | - | 398 |
| Balance at December 31, 2018 | 50,384 | - | - | - | 50,384 |
| Capital additions | 729,181 | 95,852 | 200,320 | 54,627 | 1,079,980 |
| Foreign currency translation | (54,182) | (6,510) | (13,605) | (3,710) | (78,007) |
| **Balance at September 30, 2019** | **725,383** | **89,342** | **186,715** | **50,917** | **1,052,357** |
| **Accumulated depreciation** | | | | | |
| Balance at incorporation (July 10, 2018) | - | - | - | - | - |
| Depreciation | - | - | - | - | - |
| Foreign currency translation | - | - | - | - | - |
| Balance at December 31, 2018 | - | - | - | - | - |
| Depreciation | (17,233) | (4,815) | (5,191) | (2,036) | (29,275) |
| Foreign currency translation | 1,170 | 327 | 353 | 138 | 1,988 |
| **Balance at September 30, 2019** | **(16,063)** | **(4,488)** | **(4,838)** | **(1,898)** | **(27,287)** |
| **Net book value** | | | | | |
| As at December 31, 2018 | 50,384 | - | - | - | 50,384 |
| **Balance at September 30, 2019** | **709,320** | **84,854** | **181,877** | **49,019** | **1,025,070** |

## 8. RIGHT-OF-USE ASSET AND LEASE LIABILITIES

The Company recognized right-of-use assets and corresponding lease liabilities relating to a property lease agreement and commercial-use office leases in Colombia and Switzerland. Further details regarding the lease agreements have been disclosed in Note 17.

**Right-of-use assets**

| | Property | Office | Total |
|---|---|---|---|
| Balance at January 1, 2019 | 255,960 | - | 255,960 |
| Additions | - | 155,241 | 155,241 |
| Depreciation | (40,160) | (29,384) | (69,544) |
| Foreign currency translation | (20,319) | (10,442) | (30,761) |
| **Balance at September 30, 2019** | **195,481** | **115,415** | **310,896** |

(Unaudited and expressed in Canadian dollars unless otherwise stated)

**Lease liabilities**

| | Property | Office | Total |
|---|---|---|---|
| Balance at January 1, 2019 | 255,960 | - | 255,960 |
| Additions | - | 155,241 | 155,241 |
| Interest expense | 23,258 | 10,892 | 34,150 |
| Payments[(1)] | (55,391) | (53,244) | (108,635) |
| Foreign currency translation | (20,864) | (9,563) | (30,427) |
| **Balance at September 30, 2019** | **202,963** | **103,326** | **306,289** |

1) Payments in this lease liability continuity include both principal and interest portions of lease payments made.

**Current vs non-current lease liabilities**

The current and non-current portions of the lease liabilities are presented below:

| | Property | Office | Total |
|---|---|---|---|
| Current portion | 41,147 | 52,989 | 94,136 |
| Non-current portion | 161,816 | 50,337 | 212,153 |
| **Balance at September 30, 2019** | **202,963** | **103,326** | **306,289** |

## 9. INTANGIBLE ASSETS

In June 2018, Medcolcanna S.A.S. was granted a license to produce, manufacture, market and export cannabis derivatives and products using extracts in Colombia by the Ministry of Health. $148,868 of the balance in intangible assets recognized as of September 30, 2019 (December 31, 2018 - $148,868) is attributed to the fair value assessed to the license assets at the time of the Colombian Acquisition (Note 5), which is considered to have an indefinite life as there is no foreseeable limit to the period over which these assets are expected to generate future cash inflows to the Company.

In July 2019, Medcolcanna acquired ICP (Note 5). The consideration paid in relation to this acquisition of $1,189,992 was attributed entirely to various medicinal cannabinoid formulations and related intellectual property owned by ICP. The formulations are considered to have an indefinite life as there is no foreseeable limit to the period over which the assets are expected to generate future cash inflows to the Company.

No amortization is recognized on the indefinite life intangible assets. However, impairment tests are carried out on an annual basis, unless new facts and circumstances arise to suggest impairment indicators exist at a specific point in time.

## 10. SHARE CAPITAL

**Common shares**

At September 30, 2019, the Company was authorized to issue an unlimited number of common shares, with no par value, with holders of common shares entitled to one vote per share and to dividends, if declared. As of September 30, 2019, common shares issued and outstanding are as follows:

(Unaudited and expressed in Canadian dollars unless otherwise stated)

| | Common shares | Amount ($) |
|---|---|---|
| Balance at incorporation (July 10, 2018) | 50,000 | - |
| Shares cancelled | (50,000) | - |
| Shares issued under shareholders agreement(1) | 32,000,000 | 32,000 |
| Shares issued for subscription in September 2018(2) | 7,362,659 | 643,883 |
| Share issuance costs | | (10,347) |
| Shares issued for subscription in December 2018(3) | 2,000,000 | 438,276 |
| Share issuance costs | | (1,228) |
| **Balance at December 31, 2018** | **41,362,659** | **1,102,584** |
| Shares issued for subscription in March 2019(4) | 400,000 | 36,000 |
| Share issuance costs | | (3,187) |
| Share pursuant to the RTO Transaction (Note 6) | 12,899,968 | 2,708,993 |
| Fair value of units attributed to common shares(5) | 30,986,800 | 6,770,990 |
| Share issuance costs of units attributed to common shares | | (739,509) |
| Shares issued to acquire ICP (Note 5) | 4,701,240 | 1,175,310 |
| **Balance at September 30, 2019** | **90,350,667** | **11,051,181** |

1) In August 2018, the Company formalized the shareholders agreement wherein 32,000,000 common shares of the company were issued. 8,100,000 of these shares were issued for $0.001 per common share. The other 23,900,000 shares were issued to various founders for services rendered. The value of the shares issued for services have also been recorded at $0.001 per common share. In accordance with the shareholders agreement, the 50,000 common shares issued at the incorporation of the Company were cancelled.

2) In September 2018, the Company closed a non-brokered private placement raising gross proceeds of $662,639 through the issuance of 7,362,659 units at an issue price of $0.09 per unit. Each unit was comprised of one common share of the Company and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one common share of the Company at a price equal to $0.25 per share, until September 2019. The Company has allocated the total proceeds to share capital of $643,883 and warrants of $18,758. The warrant fair value was determined based on a Black-Scholes option pricing model (see Note 11). The issue costs totaling $10,648 were also allocated to share capital of $10,347 and warrants of $301. As at December 31, 2018, there were subscriptions receivable of $18,000 from this private placement. This $18,000 was subsequently received in January 2019.

3) In December 2018, the Company closed a non-brokered private placement raising gross proceeds of $500,000 through the issuance of 2,000,000 units at an issue price of $0.25 per unit. Each unit was comprised of one common share of the Company and one half a share purchase warrant. Each whole warrant entitles the holder to purchase one common share of the Company at a price equal to $0.40 per share, until December 2020. The Company has allocated the total proceeds of $500,000 to share capital of $438,276 and warrants of $61,724. The warrant fair value was determined based on a Black-Scholes option pricing model (see Note 11). The issue costs on the private placement totaling $1,680 were also allocated to share capital of $1,228 and warrants of $452.

4) In March 2019, Medcolcanna completed a non-brokered private placement of 400,000 common shares at a price of $0.09 per share for gross proceeds of $36,000. The issue costs totaling $3,187 were allocated to the share capital of $36,000 on this private placement.

5) Upon completion of the RTO Transaction, the subscription units issued by the Company were allocated to common shares and warrants based on the assessed fair value using the Black-Scholes valuation model. As at

(Unaudited and expressed in Canadian dollars unless otherwise stated)

the RTO date, the subscription receipts had a gross value of $7,746,700 (December 31, 2018 - $3,480,500) and a net value of $6,900,627 (December 31, 2018 - $3,093,786) after issuance costs. The $6,900,627 was held as restricted cash at the RTO date (December 31, 2018 - $3,178,260) and only became available for the Company to use at the completion of the RTO Transaction. As a result of the RTO, 30,986,800 shares were issued to unit holders for a total gross value of $6,770,990 and 15,493,400 warrants issued for a gross value of $975,710. Issuance costs of $739,509 were allocated to the shares, while $106,564 issuance costs were allocated to the warrants for a net value of $6,031,481 and $869,146 respectively.

## 11. PURCHASE WARRANTS

| | Purchase warrants | Amount ($) (net of issuance costs) |
|---|---|---|
| **Balance at December 31, 2017** | - | - |
| Warrants issued in September 2018 (1) | 3,681,330 | 18,457 |
| Warrants issued in December 2018 (2) | 1,000,000 | 61,272 |
| **Balance at December 31, 2018** | **4,681,330** | **79,729** |
| Warrants issued pursuant to RTO (3) | 6,450,000 | 404,569 |
| Warrants issued from subscription units (3) | 15,493,400 | 869,146 |
| Warrants expired (1) | (3,681,330) | (18,457) |
| **Balance at September 30, 2019** | **22,943,400** | **1,334,987** |

1) Pursuant to the September 2018 private placement, the Company issued 3,681,330 share purchase warrants. The warrants were exercisable immediately at a price of $0.25 per common share. These warrants expired in September 2019 and the value thereof of $18,457 was transferred to contributed surplus.

2) Pursuant to the December 2018 private placement, the Company issued 1,000,000 share purchase warrants. The warrants are exercisable immediately at a price of $0.40 per common share until December 2020.

3) In May 2019, Pursuant to the RTO Transaction, 6,450,000 settlement warrants in IES were converted to 6,450,000 purchase warrants in Medcolcanna. Additionally, the 30,986,800 subscription units were converted into 30,986,800 common shares and 15,493,400 purchase warrants. The warrants issued are exercisable immediately at a price of $0.40 per common share until May 2021.

The following table summarizes information about the warrants outstanding as at September 30, 2019:

| Exercise price ($) | Number of warrants outstanding | Weighted average term to expiry (years) | Number of warrants exercisable |
|---|---|---|---|
| 0.40 | 22,943,400 | 1.61 | 22,943,400 |

The purchase warrants were allocated a value using the Black-Scholes option pricing model to estimate the fair value with the following assumptions:

| | September 2018 Purchase Warrants | December 2018 Purchase Warrants | May 2019 Purchase Warrants |
|---|---|---|---|
| Risk-free interest rate | 2.18% | 1.90% | 1.64% |
| Expected dividend yield | 0% | 0% | 0% |
| Expected stock price volatility | 89.7% | 85.3% | 86.6% |
| Expected warrant life (years) | 1.0 | 2.0 | 2.0 |
| Fair value of warrants granted | $0.0051 | $0.0617 | $0.0630 |

(Unaudited and expressed in Canadian dollars unless otherwise stated)

## 12. COMPENSATION OPTIONS

Pursuant to the closing of subscription receipts (Note 10), compensation options were awarded to agents of the subscription offering accumulating to 6% of the number of subscription units sold pursuant to the agency agreement under the offering. As at December 31, 2018, 348,960 compensation options with a value of $30,554 were awarded. During the nine months ended September 30, 2019, a further 1,510,248 compensation options with a value of $134,805 were awarded and 267,656 IES compensation options with a value of $23,680 (Note 6) were converted to Medcolcanna compensation options for a total of 2,126,864 compensation options outstanding.

Each compensation option entitles the holder thereof to acquire one Unit (a "Compensation Option Unit") at the offering price of $0.25 for a period of 24 months following the date of issuance. Each compensation option unit is comprised of one common share and one-half of one warrant (each whole Warrant, a "Compensation Option Warrant"). Each compensation option warrant shall entitle the holder thereof to purchase one common share at a price of $0.40 for a period of 24 months following the closing of the RTO Transaction.

| | Compensation options | Amount ($) |
|---|---|---|
| **Balance at December 31, 2017** | - | - |
| Compensation options issued | 348,960 | 30,554 |
| **Balance at December 31, 2018** | **348,960** | **30,554** |
| Compensation options issued pursuant to the RTO | 267,656 | 23,680 |
| Compensation options issued | 1,510,248 | 134,805 |
| **Balance at September 30, 2019** | **2,126,864** | **189,039** |

The following table summarizes information about the Compensation Options outstanding as at September 30, 2019:

| Exercise price ($) | Number of compensation options outstanding | Weighted average term to expiry (years) | Number of compensation options exercisable |
|---|---|---|---|
| 0.40 | 2,126,864 | 1.34 | 2,126,864 |

The Compensation Option issued in 2018 and 2019 were each allocated a value using the Black-Scholes option pricing model to estimate the fair value with the following weighted average assumptions:

| | 2018 Compensation Options | 2019 Compensation Options |
|---|---|---|
| Risk-free interest rate | 1.90% | 1.63% |
| Expected dividend yield | 0% | 0% |
| Expected stock price volatility | 85.3% | 87.2% |
| Expected warrant life (years) | 2.0 | 2.0 |
| Fair value of warrants granted | $0.0880 | $0.0893 |

## 13. CONTRIBUTED SURPLUS

Pursuant to the RTO Transaction, Medcolcanna adopted the Incentive Stock Option Plan (the "Plan") dated May 16, 2019. Per the Plan, the Board will establish vesting and other terms and conditions for options at the time that they are granted. The plan provides that stock options may be granted up to a number equal to 10% of the Company's outstanding shares. The plan also indicates, subject to a minimum exercise price of $0.05 per common share, the exercise price per common share for an option shall not be less than the discounted market price for the Company's common shares at the grant date. Options can have up to a maximum term of 10 years.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

In May 2019, 7,400,000 options were granted with an exercise price of $0.40 per option. These options have 5-year term, expiring in May 2024. One-third of the options vested immediately on the grant date, one-third vests on the first anniversary of the grant date in May 2020, and one-third vests on the second anniversary of the grant date in May 2021.

In July 2019, 700,000 options were granted with an exercise price of $0.40 per option. These options have a 5-year term, expiring in July 2024. One-third of the options vested immediately on the grant date, one-third vests on the first anniversary of the grant date in July 2020, and one-third vests on the second anniversary of the grant date in July 2021.

The following table summarizes information about stock options issued and outstanding as at September 30, 2019:

| Exercise price ($) | Number of stock options outstanding | Weighted average term to expiry (years) | Number of compensation options exercisable |
|---|---|---|---|
| 0.40 | 8,100,000 | 4.66 | 2,700,000 |

The stock options issued were allocated a value using the Black-Scholes option pricing model to estimate the fair value with the following assumptions:

| | May 2019 | July 2019 |
|---|---|---|
| Risk-free interest rate | 1.62% | 1.51% |
| Estimated stock price | $0.28 | $0.18 |
| Forfeiture rate | 10% | 10% |
| Expected dividend yield | 0% | 0% |
| Expected stock price volatility | 89.05% | 87.47% |
| Expected option life | 5 years | 5 years |
| Fair value per stock option | $0.18 | $0.09 |

The value of the stock options vesting in the nine months ending September 30, 2019 equated to $676,644 in share-based compensation (September 30, 2018 – nil) and is included in contributed surplus.

## 14. BASIC AND DILUTED LOSS PER SHARE

For the three and nine months ended September 30, 2019 and 2018, there is no difference between the calculated basic loss per share and diluted loss per share amounts. For the period ended September 30, 2019, 22,943,400 purchase warrants, 2,126,864 compensation options and 8,100,000 stock options have been excluded from the calculation as they have an anti-dilutive effect on the loss per share.

## 15. FINANCIAL RISK MANAGEMENT AND FINANCIAL INSTRUMENTS

As of September 30, 2019, the Company's financial instruments consist of cash and cash equivalents, accounts receivable, due from related parties, accounts payable and accrued liabilities, and lease liabilities.

The Company characterizes its fair value measurements of financial instruments into a three-level hierarchy depending on the degree to which the inputs are observable, as follows:

- Level 1 - inputs are quoted prices in active markets for identical assets and liabilities;
- Level 2 - inputs other than quoted prices included within Level 1, that are observable for the assets or liabilities either directly or indirectly; and
- Level 3 - inputs are unobservable for the asset or liability

A financial instrument is classified to the lowest level hierarchy for which a significant input has been used in measuring fair value. The carrying amounts for cash and cash equivalents, accounts receivable, due from related parties, and accounts payable and accrued liabilities approximate their respective fair values due to the short-term maturities of those instruments. The carrying amount of lease liabilities approximates its fair value as it is present valued using the discount rate implicit within the lease or the Company's incremental borrowing rate.

**Financial risk management**

The Company's activities are exposed to a variety of financial risks in the normal course of business. The Company's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize the Company's capital costs by using suitable means of financing and to manage and control the Company's financial risks effectively.

The principal financial risks arising from financial instruments are liquidity risk, credit risk, and market risks.

**Liquidity risk**

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due and describes the Company's ability to access cash. As at September 30, 2019 the Company's financial liabilities consist of accounts payable and accrued liabilities and lease liabilities. The Company manages its liquidity risk by reviewing its capital requirements on an ongoing basis. Management regards liquidity risk to be low due to the Company's positive working capital position as at September 30, 2019.

**Credit risk**

Credit risk is the risk of loss associated with the counterparty's inability to fulfil its contractual obligations. Financial instruments subject to credit risk include cash and cash equivalents, accounts receivables, and amounts due from related parties. All of the Company's cash and cash equivalents are held at reputable financial institutions.

As of September 30, 2019, the Company's accounts receivable balance consists mainly of sales tax receivables that the Company expects to receive from the Government of Canada. As such credit risk is deemed to be low.

**Market Risk**

Market risk is the risk or uncertainty that changes in price, foreign exchange rates, and interest rates will affect the Company's net earnings and the value of financial instruments. Medcolcanna is exposed to two types of market risk, being foreign currency risk and interest rate risk as outlined below.

***Foreign Currency Risk***
Foreign currency risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign currency exchange rates. The Company's functional and reporting currency is the Canadian dollar, but is exposed to foreign currency risk with respect to the expenditures incurred by its Colombian, Swiss, and Netherland subsidiaries. As at September 30, 2019, the Company had not entered into any foreign currency derivatives to manage its exposure to currency fluctuations.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

***Interest rate risk***
Interest rate risk is the risk that future cash flows will fluctuate as a result of changes in prevailing market interest rates. The Company is exposed to interest rate risk only on cash and cash equivalents. Fluctuations of interest rates for the period ending September 30, 2019 would not have had a significant impact on these condensed interim consolidated financial statements.

## 16. RELATED PARTY TRANSACTIONS

During the periods ended December 31, 2018 and September 30, 2019, there were separate related party transactions as follows:

a) On account of the acquisition of Medcolcanna S.A.S. in July 2018, a promissory note of US$50,000 was issued to the selling party (a Colombian company controlled by an officer of the Company), which was subsequently paid in full in September 2018. The selling party with whom the transaction was paid in cash and to whom payment of US$50,000 on the issued promissory note was a related party to the Company.

b) During the periods ended December 31, 2018 and September 30, 2019, certain expenses were paid by members of management. Periodically advances are made to management in anticipation of expenses that they will be paying on behalf of the Company. From time to time, the amount may result in a net receivable position. As at September 30, 2019, a net receivable of $201,716 existed as a result of these transactions (December 31, 2018 - $22,533). This was presented on the statement of financial position as an asset.

c) During the three and nine months ended September 30, 2019, Medcolcanna paid an accounting consulting fee of $45,000 and $51,739 respectively (September 30, 2018 – nil) to a firm affiliated with an officer of the Company. Fees are based on services rendered at prevailing market rates. The amount has been recorded within professional fees expense included on the statement of loss.

## 17. COMMITMENTS

### a) Lease commitments

As at September 30, 2019, the Company had one property lease commitment and two office lease commitments outstanding which were recorded as lease liabilities on the financial statements.

| Commitments | 2019 | 2020 | 2021 | 2022 and thereafter | Total |
|---|---|---|---|---|---|
| Property Lease | 18,464 | 73,855 | 73,855 | 123,091 | 289,265 |
| Office Leases | 3,526 | 68,265 | 52,586 | - | 124,377 |
| **Total** | **21,990** | **142,120** | **126,441** | **123,091** | **413,642** |

***Property lease agreement***
In 2018, Medcolcanna S.A.S. entered into a lease agreement for rural property in Colombia for utilization of its cultivation operations. The monthly lease payment is for $15,000,000 COP (approximately $6,155 CAD based on the average foreign exchange rate for the nine months ended September 30, 2019) and adjusted annually according to the Consumer Price Index. Lease payments began in November 2018 and the Company will pay annually an additional amount equal to 1% of the profits obtained from the sale of the products made with the cannabis grown on the leased property. The lease ends in August 2023.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

***Office lease agreements***

During the nine months ended September 30, 2019, the Company entered into two new lease agreements for office space in Colombia and Switzerland. Per the terms of the Colombian agreement, the Company can pay a fixed fee of $11,000,000 COP monthly (approximately $4,513 CAD based on the average foreign exchange rate for the nine months ended September 30, 2019) or $66,000,000 COP ($27,080 CAD) in advance for six months' worth of rent. The lease began February 1, 2019 and ends January 31, 2022. Per the terms of the Swiss lease agreement, the Company pays a fixed 980 CHF monthly fee ($1,310 CAD based on the averaged foreign exchange rate for the nine months ended September 30, 2019). The lease commenced September 15, 2019 and ends March 15, 2021.

**b) Lease reconciliation**

The following table reconciles the Company's lease commitments disclosed as at December 31, 2018 with lease obligations recognized on the Company's statement of financial position at January 1, 2019.

| | |
|---|---|
| Total commitment as disclosed at December 31, 2018 (1) | 379,260 |
| Less: payments made in 2018 (1) | (12,642) |
| Impact of discount | (109,973) |
| Effect of foreign exchange rate changes (2) | (685) |
| **Lease liability recognized at January 1, 2019** | **255,960** |

1) Commitments disclosed in the December 31, 2018 year end financial statements relate to the property lease payments of $15,000,000 COP monthly for a five-year term beginning in November 2018. This amount translates to approximately $379,260 CAD. As the lease payments began in November 2018, $12,642 has been deducted from the total commitment, which approximates two months' worth of lease payments.

2) The impact of foreign exchange rate changes from December 31, 2018 to January 1, 2019 is approximately $685.

**c) Other Commitments**

During the period ended September 30, 2019, Medcolcanna entered into various agreements with different vendors relating to the construction and improvement of its agricultural facilities and irrigation systems. The total aggregate amount of the construction commitments arising from these agreements is $355,000. The construction work is expected to be completed and paid within the current year 2019.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

## 18. SUPPLEMENTAL CASHFLOW INFORMATION

| For the nine months ended September 30, 2019 and for the period from July 10, 2018 (Date of incorporation) to September 30, 2018 | 2019 | 2018 |
|---|---|---|
| Accounts receivable | (57,149) | 53,465 |
| Prepaids | (437,258) | (8,981) |
| Due from related parties | (101,905) | - |
| Inventory | (35,804) | - |
| Accounts payable and accrued liaibilities | 468,005 | 123,895 |
| Working capital adjustment for acquired receivables relating to the RTO Transaction | 745,942 | - |
| Working capital adjustment for acquired payables relating to the RTO Transaction | (49,453) | - |
| **Change in non-cash working capital** | **532,378** | **168,379** |
| | | |
| Relating to: | | |
| Operating activities | 514,378 | 168,379 |
| Financing activities | 18,000 | - |
| **Change in non-cash working capital** | **532,378** | **168,379** |

## 19. GEOGRAPHICAL SEGMENTED INFORMATION

The Company is engaged in the growth, cultivation, and development of medicinal cannabis and medicinal cannabis products through its Colombian and Netherlands subsidiary. The Company is also engaged in the cannabis vaping industry through its Switzerland subsidiary. Management has defined the operating segments of the Company based on geographical areas, identifying operations held in Colombia, Switzerland, and the Netherlands as separate reporting segments. The Corporate segment reflects balances and expenses related to all Company operations outside of Colombia, Switzerland, and the Netherlands which collectively represent the corporate operations of the Company.

(Unaudited and expressed in Canadian dollars unless otherwise stated)

The following tables show information regarding the Company's segments for the three and nine months ended September 30, 2019 and 2018.

| **For the three months ended September 30, 2019** | **Colombia** | **Switzerland** | **Netherlands** | **Corporate** | **Total** |
|---|---|---|---|---|---|
| **Expenses:** | | | | | |
| Pre-operating expenses | 275,159 | 1,353 | - | - | 276,512 |
| Professional fees | 48,463 | 3,129 | 39,622 | 136,514 | 227,728 |
| General and administrative | 33,128 | 1,564 | - | 32,519 | 67,211 |
| Salaries, wages, and benefits | 105,594 | 6,679 | - | 137,342 | 249,615 |
| Selling, marketing, and promotion | - | 5,337 | - | - | 5,337 |
| Depreciation and amortization | 43,621 | 558 | - | - | 44,179 |
| Business development | - | - | - | 16,448 | 16,448 |
| Research and development | - | - | 153,804 | - | 153,804 |
| Share-based compensation | - | - | - | 176,443 | 176,443 |
| Finance expense (income) | 26,227 | 654 | - | 380 | 27,261 |
| Foreign exchange loss (gain) | (82) | 347 | - | (21,273) | (21,008) |
| **Net Loss** | **532,110** | **19,621** | **193,426** | **478,373** | **1,223,530** |

| **For the nine months ended September 30, 2019** | **Colombia** | **Switzerland** | **Netherlands** | **Corporate** | **Total** |
|---|---|---|---|---|---|
| **Expenses:** | | | | | |
| Pre-operating expenses | 402,944 | 1,353 | - | - | 404,297 |
| Professional fees | 246,309 | 3,129 | 39,622 | 554,030 | 843,090 |
| General and administrative | 202,205 | 1,564 | - | 136,221 | 339,990 |
| Salaries, wages, and benefits | 229,279 | 6,679 | - | 278,894 | 514,852 |
| Selling, marketing, and promotion | - | 5,337 | - | - | 5,337 |
| Listing expense | - | - | - | 2,232,149 | 2,232,149 |
| Transaction costs relating to the RTO | - | - | - | 202,874 | 202,874 |
| Depreciation and amortization | 98,261 | 558 | - | - | 98,819 |
| Business development | - | - | - | 59,347 | 59,347 |
| Research and development | - | - | 153,804 | - | 153,804 |
| Share-based compensation | - | - | - | 676,644 | 676,644 |
| Finance expense (income) | 50,765 | 654 | - | (13,455) | 37,964 |
| Foreign exchange loss (gain) | (276) | 347 | - | 36,815 | 36,886 |
| **Net Loss** | **1,229,487** | **19,621** | **193,426** | **4,163,519** | **5,606,053** |
| | | | | | |
| **Assets at September 30, 2019** | **2,467,870** | **161,555** | **1,189,992** | **4,289,931** | **8,109,348** |
| **Liabilities at September 30, 2019** | **514,061** | **48,297** | **-** | **379,296** | **941,654** |

(Unaudited and expressed in Canadian dollars unless otherwise stated)

| For the period from July 10, 2018 (incorporation date) to September 30, 2018 | Colombia | Switzerland | Netherlands | Corporate | Total |
|---|---|---|---|---|---|
| **Revenue:** | | | | | |
| Exclusivity fee | - | - | - | 32,750 | 32,750 |
| **Total revenue** | **-** | **-** | **-** | **32,750** | **32,750** |
| **Expenses:** | | | | | |
| Professional fees | 69,085 | - | - | 63,262 | 132,347 |
| General and administrative | 642 | - | - | - | 642 |
| Salaries, wages, and benefits | - | - | - | 58,500 | 58,500 |
| Finance expense (income) | - | - | - | 100 | 100 |
| Foreign exchange loss (gain) | - | - | - | (1,720) | (1,720) |
| **Total expenses** | **69,727** | **-** | **-** | **120,142** | **189,869** |
| **Net Loss** | **69,727** | **-** | **-** | **87,392** | **157,119** |
| **Assets at December 31, 2018** | **225,198** | **-** | **-** | **3,824,878** | **4,050,076** |
| **Liabilities at December 31, 2018** | **54,816** | **-** | **-** | **232,157** | **286,973** |