Nextleaf Solutions Ltd.

Condensed Interim Consolidated Financial Statements

For the three months ended

December 31, 2020

Unaudited – Prepared by Management

(Expressed in Canadian Dollars)

NOTICE OF NO AUDITOR REVIEW OF CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

The accompanying unaudited condensed interim consolidated financial statements of Nextleaf Solutions Ltd. (“the Company”) for the three months ended December 31, 2020 and December 31, 2019, have been prepared by the management of the Company and approved by the Company’s Audit Committee and the Company’s Board of Directors.

Under National Instrument 51-102, Part 4, subsection 4.3 (3) (a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that an auditor has not reviewed the financial statements.

The accompanying unaudited condensed interim consolidated financial statements of the Company 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 CPA Canada for a review of the condensed interim financial statements by an entity’s auditor.

Nextleaf Solutions Ltd.

Condensed Interim Consolidated Statements of Financial Position

(Unaudited – Prepared by Management)
(Expressed in Canadian Dollars)

As at December 31, 2020 and September 30, 2020

	Note	**December 31, 2020 $**	September 30, 2020 $
Assets			
Current assets			
Cash		297,109	988,675
Receivables and prepayments	4,9	219,266	756,751
Inventory	5	756,978	941,787
		1,273,353	2,687,213
Non-current assets			
Deposits		7,155	7,155
Property and equipment	6	5,392,298	5,549,138
Intangible assets	7	632,465	716,985
Other receivables	16	496,213	620,266
Loans receivable	14	200,000	200,000
		6,728,131	7,093,544
Total assets		**8,001,484**	9,780,757
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable and accrued liabilities	9	959,445	2,095,445
Lease liability - current	6	30,629	28,991
		990,074	2,124,436
Non-current liabilities			
Lease liability	6	342,779	353,934
Government loan	15	40,000	40,000
		382,779	393,934
Total liabilities		**1,372,853**	2,518,370
Shareholders' equity			
Share capital	8	21,184,563	20,958,363
Reserves	8	4,064,308	4,012,754
Deficit		(18,620,240)	(17,708,730)
Total shareholders' equity		**6,628,631**	7,262,387
Total liabilities and shareholders' equity		**8,001,484**	9,780,757
Nature of operations and going concern	1		
Subsequent events	17		

Approved on behalf of the Board of Directors on March 1, 2021:

"Paul Pedersen" **Director** *"Charles Ackerman"* **Director**

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Nextleaf Solutions Ltd.

Condensed Interim Consolidated Statements of Loss and Comprehensive Loss
(Unaudited – Prepared by Management)
(Expressed in Canadian Dollars)

For the three months ended December 31,

	Note	$	$
Revenue			
Cannabis concentrate sales		1,256,589	-
Licensing	2	-	350,000
		1,256,589	350,000
Cost of sales - concentrate	2	**1,197,000**	-
Gross margin		**59,589**	350,000
Expenses			
Administrative expenses		79,837	146,015
Amortization	7	87,252	1,961
Depreciation	6	3,340	242,944
Directors' fees	9	15,450	17,500
Finance costs	6	6,761	4,915
Foreign exchange loss (gain)		6,601	(32,751)
Investor relations and advertising		118,424	193,982
Management fees	9	110,400	110,400
Professional fees and consulting		169,262	296,692
Research, extraction and lab supplies		24,493	-
Share-based payments	8,9	51,554	431,980
Wages and salaries		231,470	261,664
Loss from operating expenses		**(904,844)**	(1,675,302)
Government assistance	15	57,798	-
Interest income		-	4,840
Loss provision on other receivables	16	(124,053)	-
		(66,255)	4,840
Loss and comprehensive loss for the period		**(911,510)**	(1,320,462)
Loss per share			
Weighted average number of common shares outstanding:			
Basic #		**120,809,447**	108,123,044
Diluted #		**120,809,447**	108,123,044
Basic loss per share		**(0.01)**	(0.01)
Diluted loss per share		**(0.01)**	(0.01)

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Nextleaf Solutions Ltd.

Condensed Interim Consolidated Statements of Cash Flows

(Unaudited – Prepared by Management)

(Expressed in Canadian Dollars)

For the three months ended December 31,

	Note	**December 31, 2020 $**	December 31, 2019 $
Operating activities			
Loss for the period		(911,510)	(1,320,462)
Adjustments for:			
Amortization		87,252	1,961
Depreciation - cost of sales	6	223,001	-
Depreciation - operating expenses	6	3,340	242,944
Finance costs		6,761	4,915
Share-based payments		51,554	431,980
Shares issued for services		11,200	-
Interest income - accrued		-	(4,840)
Loss provision on other receivables		124,053	-
Non-cash working capital items:			
Receivables and prepayments		537,485	(380,564)
Inventory		184,809	-
Accounts payable and accrued liabilities		(906,254)	(15,131)
		(588,309)	(1,039,197)
Investing activities			
Purchases of property and equipment		(84,247)	(1,145,559)
Payments for intangible assets		(2,732)	(83,112)
		(86,979)	(1,228,671)
Financing activities			
Lease payments	6	(16,278)	(15,951)
		(16,278)	(15,951)
Decrease in cash		**(691,566)**	(2,283,819)
Cash, beginning of period		**988,675**	4,295,987
Cash, end of period		**297,109**	2,012,168
Supplemental cash flow information	11		

The accompanying notes are an integral part of these condensed interim consolidated financial statements.

Nextleaf Solutions Ltd.

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity

(Unaudited – Prepared by Management)

(Expressed in Canadian Dollars)

For the three months ended December 31, 2020 and December 31, 2019

	Common shares \#	Share capital $	Reserves $	Deficit $	Total $
September 30, 2019 (Restated - Note 2)	108,123,044	17,355,831	3,056,486	(11,727,869)	8,684,448
October 1, 2019, as previously reported (Restated - Note 2)	108,123,044	17,355,831	3,056,486	(11,727,869)	8,684,448
Impact of change in accounting policy - IFRS 16 (Note 2)	-	-	-	(27,245)	(27,245)
October 1, 2019, adjusted balance	108,123,044	17,355,831	3,056,486	(11,755,114)	8,657,203
Share-based payments	-	-	431,980	-	431,980
Loss and comprehensive loss for the period	-	-	-	(1,320,462)	(1,320,462)
December 31, 2019	108,123,044	17,355,831	3,488,466	(13,075,576)	7,768,721
September 30, 2020	120,505,726	20,958,363	4,012,754	(17,708,730)	7,262,387
Shares issued for services	65,882	11,200	-	-	11,200
Shares issued to settle accounts payable	1,264,706	215,000	-	-	215,000
Share-based payments	-	-	51,554	-	51,554
Loss and comprehensive loss for the period	-	-	-	(911,510)	(911,510)
December 31, 2020	**121,836,314**	**21,184,563**	**4,064,308**	**(18,620,240)**	**6,628,631**

The accompanying notes are an integral part of these consolidated financial statements.

1. NATURE OF OPERATIONS AND GOING CONCERN

Nextleaf Solutions Ltd. (“Nextleaf” or the “Company”) was incorporated under the laws of the province of British Columbia on December 8, 2016. The Company’s head office is located at #304 – 68 Water Street, Vancouver, British Columbia, V6B 1A4 and its registered and records office is located at #600 – 1090 West Georgia Street, Vancouver, British Columbia, V6E 3V7. The Company’s common shares trade on the Canadian Securities Exchange under the trading symbol “OILS”.

The Company is a Canadian cannabis extractor and processor, with a focus on developing intellectual property for the extraction, distillation, and formulation of cannabinoids. The Company has developed an intellectual property (“IP”) portfolio, which includes several issued and pending patents (Note 7). The Company commercializes its intellectual property portfolio through IP licensing, and production (toll processing services, and bulk sales) of CBD and THC oils through its wholly-owned subsidiary, Nextleaf Labs Ltd. (“Labs”).

In March 2020, the World Health Organization declared coronavirus COVID-19 a global pandemic. This contagious disease outbreak, which has continued to spread, and any related adverse public health developments, has adversely affected workforces, economies, and financial markets globally, potentially leading to an economic downturn. It is not possible for the Company to predict the duration or magnitude of the adverse results of the outbreak and its effects on the Company’s business or results of operations. There are travel restrictions and health and safety concerns that may delay the Company’s operational objectives. Operations depend on safeguarding all personnel during the outbreak, which may be prohibitive in certain aspects. Nonetheless, the Company has implemented prevention measures at its facilities. Various Government wage and loan subsidies are available to qualified companies to assist them with operating costs during the pandemic. The Government continues to update its COVID-19 relief programs, which may qualify the Company for additional assistance. As at December 31, 2020, the Company has qualified for and accrued or received a $40,000 loan from the Government of Canada, and wage subsidies of $438,857 (Note 15).

These condensed interim consolidated financial statements (the “financial statements”) are prepared on the basis that the Company will continue as a going concern, which assumes that the Company will be able to continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. These financial statements do not include any adjustments relating to the recoverability and classification of assets and liabilities that might be necessary should the Company be unable to continue in existence.

As at December 31, 2020, the Company had working capital of $283,279. The Company has been incurring losses and generating negative cash flows since inception. Although the Company has been successful in raising funds to date, there can be no assurance that adequate or sufficient funding will be available in the future or available under terms acceptable to the Company, or that the Company will generate sufficient revenue and positive cash flows from operations. The continuance of operations is dependent on the Company commercializing its patents, generating profitable and cash flow positive commercial operations, and continuing to obtain financing on acceptable terms. These conditions may cast significant doubt about the Company’s ability to continue as a going concern.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These financial statements have been prepared in conformity with International Accounting Standard (“IAS”) 34, Interim Financial Reporting, using the same accounting policies as detailed in the Company‘s annual audited financial statements for the year ended September 30, 2020, and do not include all the information required for full annual financial statements in accordance with International Financial Reporting Standards (“IFRS”), as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). It is suggested that these financial statements be read in conjunction with the annual audited financial statements.

These financial statements have been prepared on an historical cost basis, except for financial instruments measured at fair value. In addition, these financial statements have been prepared using the accrual basis of accounting, except for cash flow information. All amounts in these financial statements are presented in Canadian dollars, which is the functional currency of the Company and its subsidiary.

(Expressed in Canadian Dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Comparative figures

Certain comparative figures on the condensed interim statement of cash flows have been reclassified to conform to the current period's presentation.

Principles of consolidation

These financial statements include the accounts of the Company and its wholly-owned subsidiaries as follows:

Nextleaf Solutions Ltd.	100%	Legal parent company
Nextleaf Innovations Ltd.	100%	Extraction solutions company
Nextleaf Labs Ltd.	100%	Licenced processor (Note 3)

A subsidiary is an entity controlled by the Company and is included in these financial statements from the date that control commences until the date that control ceases. The accounting policies of a subsidiary are changed where necessary to align them with the policies adopted by the Company.

Revenue recognition

Revenue is comprised of (i) cannabis concentrate sales (toll processing services and sales of cannabis distillates and oil; and (ii) intellectual property licensing.

Cannabis concentrate sales revenue:

Cannabis concentrate sales revenue earned under fee for service agreements, is recognized at a point in time when the Company is considered to have satisfied its performance obligations. The performance obligations are considered satisfied once all of the following have been met: (i) the manufacturing process (services) are complete; (ii) regulatory quality assurance, and customer quality assurance specifications (acceptance of the finished goods) have been met; and (iii) when the transaction price can be reliably measured in instances of variable consideration or non-monetary consideration.

At times, the Company may enter into contracts with customers where payment for the services provided by the Company is in the form of retention of a certain portion of the finished goods. In such instances, the consideration amount is variable is determined based on fair market values for the same or similar goods. As fair market values are readily available for cannabis concentrate, the level of estimation uncertainty is limited.
Revenues are recorded net of discounts but inclusive of freight in the sale of goods. Once the customer has accepted the finished goods, the Company has no obligations for returns, refunds, warranties or similar obligations.

Licensing revenue:

Licensing revenue is a royalty arrangement (details below) whereby the Company recognizes revenue from the licensing of its intellectual property in the manufacture and sale of extraction hardware by a third party (the "Licencee"). The Company recognizes revenue as a percentage of the Licencee's revenue when the Licencee sells and delivers extraction hardware to its customers.

On December 16, 2019, the Company entered into a Licence and Distribution Royalty Agreement (the "Royalty Agreement") with a private British Columbia company (the "Licencee"). Pursuant to the Royalty Agreement, the Company granted the Licencee a non-exclusive Licence for the use of certain issued and pending patents (the "Licenced Patents") in exchange for a 20% royalty on the Licencee's gross revenue. The Royalty Agreement is for an undefined term. During the three months ended December 31, 2020, the Company had no licensing revenues (2019 - $350,000) in connection with the Royalty Agreement.

(Expressed in Canadian Dollars)

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventory and Cost of Sales

Inventory is valued at the lower of cost and net realizable value. Cost of cannabis biomass is comprised of initial third-party acquisition costs, plus analytical testing costs. Costs of extracted cannabis oil inventory are comprised of initial acquisition costs of the biomass and all direct and indirect processing costs including labour related costs, consumables, materials, packaging supplies, facility costs, analytical testing costs, and production related depreciation. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated cost of completion and the estimated costs necessary to make the sale. Packaging and supplies are initially valued at cost and subsequently at the lower of cost and net realizable value. When purchasing biomass, amounts due and payable by the Company prior to the receipt of inventory are accrued as inventory deposits.

Cost of sales represents costs related to manufacturing and distribution of the Company's products and services. Costs primarily include raw materials, direct labour, overhead (utilities and depreciation of production equipment and facilities), unallocated overhead from idle capacity, packaging, and shipping. The Company recognizes the cost of sales when the associated inventory is sold or written-off.

Significant accounting policies

The accounting policies, estimates and critical judgments, methods of computation and presentation applied in these financial statements are consistent with those of the most recent annual audited financial statements and are those the Company expects to adopt in its financial statements for the year ended September 30, 2021. Accordingly, these financial statements should be read in conjunction with the Company's most recent annual audited financial statements.

3. SHARE PURCHASE AGREEMENT

On July 29, 2020, the Company acquired all the issued and outstanding common shares of Nextleaf Labs Ltd. ("Labs") (Note 1). Labs was a private holding company formerly owned by an employee of the Company and incorporated in the province of British Columbia for the purpose of facilitating the Company's application process for a Standard Processing Licence. This Licence was issued to Labs by Health Canada on September 9, 2019. Additionally, Health Canada granted Labs a Cannabis Research Licence on January 22, 2020.

The acquisition of Labs was pursuant to a Share Purchase Agreement entered between the Company and Labs on October 11, 2019. On closing, the Company issued 1,000,000 common shares of the Company to the seller of Labs for total consideration of $285,000 ($0.285 per share). Labs' identifiable assets consisted of cash, receivables, and the Licenses. Consideration was allocated based on the relative fair values of the identifiable assets acquired.

The acquisition of Labs was accounted for as an asset acquisition in accordance with the guidance provided in IFRS 2, *Share-based Payments* as Labs did not qualify as a business according to the definition in IFRS 3, *Business Combinations* ("IFRS 3"). Accordingly, the acquisition did constitute a business combination; rather it was treated as an issuance of common shares by the Company for the net assets of Labs.

Assets of Labs acquired:	**July 29, 2020 $**
Cash	23,758
Receivables	982
Intangible assets	270,325
Net assets acquired	**295,065**

Consideration paid in acquisition of Labs:	**$**
Common shares (fair value of 1,000,000 common shares at $0.285 per share)	285,000
Transaction costs	10,065
Total consideration paid	**295,065**

(Expressed in Canadian Dollars)

4. RECEIVABLES AND PREPAYMENTS

Receivables and prepayments comprise the following:

	December 31, 2020	September 30, 2020
	$	$
Accrued receivables	99,534	175,055
CEWS receivable (Note 15)	-	68,160
Prepaid expenses	96,847	150,617
Sales tax recoverable	15,535	88,079
Trade receivables	7,350	274,840
	219,266	756,751

5. INVENTORY

Inventory is comprised of the following:

	December 31, 2020	September 30, 2020
	$	$
Raw materials	-	905,773
Production work in progress - distillate	93,128	36,014
Finished goods - distillate	663,850	-
	756,978	941,787

Inventory expensed to cost of sales during the three months ended December 31, 2020, totaled $619,559 (2020 - $nil).

(Expressed in Canadian Dollars)

6. PROPERTY AND EQUIPMENT

	Extraction equipment $	Leasehold improvements $	Right-of-use asset $	Furniture and equipment $	Mobile trailer $	Total $
Cost						
September 30, 2019	3,452,575	1,081,978	-	187,617	257,173	4,979,343
Adoption of IFRS 16	-	-	380,160	-	-	380,160
Additions	894,446	2,036,769	-	16,259	-	2,947,474
Transfer to equipment deposits	(707,437)	-	-	-	-	(707,437)
Disposals	-	(58,637)	-	-	(257,173)	(315,810)
September 30, 2020	3,639,584	3,060,110	380,160	203,876	-	7,283,730
Accumulated depreciation						
September 30, 2019	821,742	4,880	-	46,057	89,324	962,003
Depreciation (1)	538,459	250,556	43,416	29,869	33,570	895,870
Disposals	-	(387)	-	-	(122,894)	(123,281)
September 30, 2020	1,360,201	255,049	43,416	75,926	-	1,734,592
Cost						
September 30, 2020	3,639,584	3,060,110	380,160	203,876	-	7,283,730
Additions	-	69,501	-	-	-	69,501
December 31, 2020	**3,639,584**	**3,129,611**	**380,160**	**203,876**	**-**	**7,353,231**
Accumulated depreciation						
September 30, 2019	1,360,201	255,049	43,416	75,926	-	1,734,592
Depreciation (1)	117,309	91,781	10,854	6,397	-	226,341
December 31, 2020	**1,477,510**	**346,830**	**54,270**	**82,323**	**-**	**1,960,933**
Net book value						
September 30, 2020	2,279,383	2,805,061	336,744	127,950	-	5,549,138
December 31, 2020	**2,162,074**	**2,782,781**	**325,890**	**121,553**	**-**	**5,392,298**

Depreciation for the three months ended December 31, 2020 and December 31, 2019, is allocated as follows:

	December 31, 2020 $	December 31, 2019 $
Cost of sales	223,001	-
Operating expenses	3,340	242,944
	226,341	242,944

During the year ended September 30, 2020, the Company disposed of its mobile trailer for cash consideration of $108,240 ($81,000 USD). The mobile trailer had a net book value of $134,279 at the time of disposal and therefore a loss on disposal of equipment was recognized for $26,039. The cash proceeds were collected in full during the three months ended December 31, 2020, which was included in receivables (accrued receivables) as at September 30, 2020.

(Expressed in Canadian Dollars)

6. PROPERTY AND EQUIPMENT (continued)

A continuity of equipment deposits are as follows:

	December 31, 2020 $	September 30, 2020 $
Balance, beginning of period/year	-	338,148
Deposits paid	-	-
Deposits refunded (received)	-	(65,690)
Deposits refunded (receivable)	-	(66,815)
Expensed to administrative, net of credit memo	-	(17,791)
Termination of purchase agreement, net	-	266,930
Write-off of equipment deposits	-	(179,449)
Reclassified to other receivables (Note 18)	-	(275,333)
Balance, end of period/year	**-**	-

Right-of-use asset and Lease liability:

The Company has an agreement to lease its Licenced processing facility and corporate office lease in Coquitlam, BC. The Company has determined that its lease contract is a lease as defined under IFRS 16 – Leases (“IFRS 16”). In analyzing the identified contract, the Company applied the lessee accounting model pursuant to IFRS 16 and considered all the facts and circumstances surrounding the inception of the contract (but not future events that are not likely to occur). The lease liability was calculated with a discount rate of 10%. The lease is for the period from July 1, 2018 to June 30, 2023 with a five-year extension option through to June 30, 2028. The five-year extension option was included in the measurement of the right-of-use asset and lease liability on initial recognition.

As at December 31, 2020, the remaining term of the Company’s facility lease was 7.50 years (September 30, 2020 – 7.75 years) which includes the five-year extension option.

A reconciliation of the carrying amount of the lease liability as at December 31, 2020 and September 30, 2020 and changes during the period/year then ended is as follows:

	December 31, 2020 $	September 30, 2020 $
Beginning of period/year	382,925	407,405
Lease payments	(16,278)	(64,131)
Lease interest (finance costs)	6,761	39,651
End of period/year	**373,408**	382,925
Current portion of lease liability	**30,629**	28,991
Non-current portion of lease liability	**342,779**	353,934
	373,408	382,925
Maturity analysis - contractual undiscounted cash flows		
Less than one year	66,912	66,012
One to five years	286,045	284,544
Over five years	190,541	209,220
	543,498	559,776

Short-term leases are leases with a lease term of twelve months or less. As at December 31, 2020, the Company did not have any low value leases or short-term leases.

(Expressed in Canadian Dollars)

7. INTANGIBLE ASSETS

During the year ended September 30, 2020 (effective July 1, 2020), the Company adopted a voluntary change in accounting policy with respect to intangible assets and the recognition of application costs associated with patent filings as capitalized intangible assets. Previously, the Company capitalized costs relating to both the application and issuance of patents. The Company's new policy for intangible assets is to expense legal application costs and capitalize only those costs related to filing fees of patents as development costs (patents issued). This resulted in restated opening balances as at September 30, 2019 included below.

	Nano emulsion technology $	Issued patents $	Licences (Note 3) $	Total $
Cost				
September 30, 2019 (Restated - Note 2)	252,550	9,555	-	262,105
Additions	373,450	27,569	270,325	671,344
September 30, 2020	626,000	37,124	270,325	933,449
Accumulated amortization				
September 30, 2019	-	1,106	-	1,106
Amortization	207,523	1,857	5,978	215,358
September 30, 2020	207,523	2,963	5,978	216,464
Cost				
September 30, 2020	626,000	37,124	270,325	933,449
Additions	-	2,732	-	2,732
December 31, 2020	**626,000**	**39,856**	**270,325**	**936,181**
Accumulated amortization				
September 30, 2020	207,523	2,963	5,978	216,464
Amortization	78,250	498	8,504	87,252
December 31, 2020	**285,773**	**3,461**	**14,482**	**303,716**
Net book value				
September 30, 2020	418,477	34,161	264,347	716,985
December 31, 2020	**340,227**	**36,395**	**255,843**	**632,465**

Nano emulsion technology

On August 22, 2019, the Company entered into a Research Agreement with a private company (the "Researcher") for the research and development of water-soluble cannabinoid formulations ("nano emulsion technology") for the Company that can be sold by the Company to beverage producers to produce cannabinoid-infused water beverages. Pursuant to the Agreement, the Company acquired the intellectual property for total cash payments of $226,000 and the issuance of common shares with a fair value of $400,000.

Amortization on the nano emulsion technology commenced in February 2020 upon the Company making the final payment to acquire the formulations which is when the formulations became available for use by the Company.

Licences

During the year ended September 30, 2020, the Company acquired a Standard Processing Licence, and a Cannabis Research Licence through the acquisition of Labs (Note 3). The Licences are being amortized over the term of the facility lease.

8. SHAREHOLDERS' EQUITY

The authorized share capital of the Company consists of unlimited common shares without par value. All issued shares are fully paid.

Issued and Outstanding

Transactions for the issue of share capital during the three months ended December 31, 2020:

- In December 2020, the Company issued 418,823 common shares with an aggregate fair value of $71,200 ($0.17 per share) to two non-executive employees and a consultant as compensation for services rendered.
- In December 2020, the Company issued 911,765 common shares with an aggregate fair value of $155,000 ($0.17 per share) to two consultants for settlement of previously rendered services included within accounts payable and accrued liabilities.

Transactions for the issue of share capital during the three months ended December 31, 2019:

- There were no issuances of share capital during the three months ended December 31, 2019.

Escrowed shares

The Company has certain common shares held in escrow which are subject to a timed release schedule whereby a portion of the escrowed shares were released on March 14, 2019 and continue to be released every six months thereafter until March 14, 2022. Additionally, there are 750,000 common shares held in escrow pursuant to the acquisition of Labs which occurred on July 29, 2020.

As at December 31, 2020, 16,852,978 common shares were held in escrow (September 30, 2020 – 16,852,978).

Employee Equity Participation Plan

Effective April 1, 2020, the Company implemented an Employee Equity Participation Plan (the "Plan"). The Plan is fully voluntary and permits non-executive employees to receive common shares of the Company in lieu of a portion of an employee's cash compensation. As at December 31, 2020, 244,444 common shares of the Company (September 30, 2020 – 244,444) have been issued to non-executive employees under the Plan.

(Expressed in Canadian Dollars)

8. SHAREHOLDERS' EQUITY (continued)

Shareholder Rights Plan

On July 23, 2019, the Company adopted a Shareholder Rights Plan (the "Plan") whereby the Company issued one right (the "Right") for $nil consideration in respect of each outstanding common share of the Company to all holders of record on July 23, 2019. The term of the Plan is for three years, subject to re-approval by the shareholders of the Company at the 2022 Annual Meeting. The Rights become exercisable only if a person acquires 20% or more of the common shares of the Company without complying with the "Permitted Bid" provisions in the Plan, other prescribed exemptions, or without the approval of the Board of Directors. Should such an acquisition occur of the Company's common shares, rights holders can purchase common shares of the Company at half the prevailing market price as defined in the Plan at the time the rights become exercisable. Under the Plan, a permitted bid must be made to all shareholders for all shares of the Company and must be open for acceptance for a minimum of 105 days.

Stock options

The Company has adopted a stock option plan (the "Plan") which provides eligible Directors, Officers, employees and consultants with the opportunity to acquire common shares of the Company. The maximum number of common shares issuable under the Plan shall not exceed 20% of the number of common shares of the Company issued and outstanding as of each award date, inclusive of all common shares reserved for issuance pursuant to previously granted stock options. The stock options have a maximum term of five years form the date of grant, and vest over periods as determined by the Board of Directors. The exercise price of stock options granted under the Plan will be determined by the Board of Directors but may not be less than the closing market price of the Company's common shares on the date of grant.

A summary of the status of the Company's stock options as at December 31, 2020 and September 30, 2020 and changes during the period/year then ended is as follows:

	Period ended December 31, 2020		Year ended September 30, 2020	
	Options #	Weighted average exercise price $	Options #	Weighted average exercise price $
Options outstanding, beginning of period/year	14,439,287	0.35	13,989,287	0.35
Granted	250,000	0.25	450,000	0.50
Exercised	-	-	-	-
Options outstanding, end of period/year	**14,689,287**	**0.35**	14,439,287	0.35

As at December 31, 2020, the Company has stock options outstanding and exercisable as follows:

	Options outstanding #	Options exercisable #	Weighted average exercise price $	Expiry date	Weighted average remaining life (years)
	114,287	114,287	0.35	May 1, 2022	1.33
(1)	13,725,000	13,400,000	0.35	March 15, 2024	3.21
	150,000	150,000	0.50	July 8, 2024	3.52
	300,000	300,000	0.50	October 15, 2024	3.79
	150,000	150,000	0.50	October 16, 2024	3.79
	250,000	250,000	0.25	December 10, 2025	4.95
	14,689,287	**14,364,287**	**0.36**		**3.24**

(1) Includes 7,500,000 performance stock options held by Officers and Directors of the Company, all of which are exercisable.

(Expressed in Canadian Dollars)

8. SHAREHOLDERS' EQUITY (continued)

Stock options (continued)

During the three months ended December 31, 2020, the Company granted 250,000 stock options to consultants of the Company. The options are exercisable at $0.25 each for five years until December 10, 2025 and vested immediately.

The Company recorded the fair value of the stock options granted using the Black-Scholes option pricing model. The fair value is particularly impacted by the Company's stock price volatility. The fair values were determined using the following weighted average assumptions:

	December 31, 2020
Risk-free interest rate	0.30%
Expected life of options (years)	5.00
Expected volatility	100%
Dividend rate	0%

Total share-based payment expense for the three months ended December 31, 2020 was $51,554 (2019 – 431,980) which includes stock options that vested during the period then ended.

Warrants

As an incentive to complete private placements, the Company may issue units which include common shares and common share purchase warrants. Using the residual value method, the Company determines whether a value should be allocated to warrants attached to units sold in completed private placements. Finders' warrants may be issued as a private placement share issue cost and are valued using the Black-Scholes option pricing model.

A summary of the Company's common share purchase warrants as at December 31, 2020 and September 30, 2020 and changes during the period/year then ended is as follows:

	Period ended December 31, 2020		Year ended September 30, 2020	
	Warrants #	Weighted average exercise price $	Warrants #	Weighted average exercise price $
Warrants outstanding, beginning of period/year	36,116,850	0.69	25,470,305	0.69
Issued - attached to units	-	-	10,200,738	0.50
Issued - finders' warrants	-	-	195,807	0.30
Issued - services	-	-	250,000	0.40
Warrants outstanding, end of period/year	**36,116,850**	**0.63**	36,116,850	0.69

The following table summarizes information about the warrants outstanding at December 31, 2020:

Warrants #	Weighted average exercise price $	Expiry Date	Weighted average remaining life (years)
14,285,711	0.70	March 14, 2021	0.20
485,969	0.35	March 21, 2021	0.22
298,625	0.40	May 15, 2021	0.37
10,400,000	0.70	May 15, 2021	0.37
250,000	0.40	November 28, 2021	0.91
6,666,667	0.50	May 21, 2022	1.39
66,933	0.30	May 21, 2022	1.39
3,534,071	0.50	May 28, 2022	1.41
128,874	0.30	May 28, 2022	1.41
36,116,850	**0.63**		**0.60**

(Expressed in Canadian Dollars)

8. SHAREHOLDERS' EQUITY (continued)

Reserves

Reserves are comprised of the accumulated fair value of stock options recognized as share-based payments, and the fair value of finders' warrants issued on private placements and assumed on its public listing (RTO). Reserves are increased by the fair value of these items on vesting/issuance and are reduced by corresponding amounts when stock options or warrants expire or are exercised or cancelled.

	Stock options $	Warrants $	Total $
September 30, 2019	2,794,642	261,844	3,056,486
Finders' warrants issued	-	34,200	34,200
Warrants issued - debt settlement	-	24,500	24,500
Options vesting	897,568	-	897,568
September 30, 2020	3,692,210	320,544	4,012,754
September 30, 2020	3,692,210	320,544	4,012,754
Options vesting	51,554	-	51,554
December 31, 2020	**3,743,764**	**320,544**	**4,064,308**

9. RELATED PARTY TRANSACTIONS

Key management personnel include those persons having authority and responsibility for planning, directing and controlling the activities of the Company as a whole. The Company has determined that key management personnel consist of executive and non-executive members of the Company's Board of Directors and Corporate Officers, and companies controlled by them.

Key management personnel compensation

The remuneration of key management for the three months ended December 31, 2020 and December 31, 2019 is as follows:

	December 31, 2020 **$**	December 31, 2019 $
Directors' fees	15,450	17,500
Management fees	110,400	110,400
Share-based payments	-	288,369
	125,850	416,269

Related party balances

Related party balances as at December 31, 2020 and September 30, 2020 are as follows:

	December 31, 2020 **$**	September 30, 2020 $
Balances included in accounts payable and accrued liabilities:		
Management fees	242,351	206,251
Directors' fees	49,150	36,000
Balances included in receivables and prepayments:		
Prepaid management fees	26,900	38,900

(Expressed in Canadian Dollars)

10. FINANCIAL INSTRUMENTS

Fair value

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices that are observable for the assets or liability either directly or indirectly; and
- Level 3 - Inputs that are not based on observable market data.

Classification of financial instruments

Financial assets:	Classification:	Subsequent measurement:
Cash	FVTPL	Fair value
Accrued receivables	Amortized cost	Amortized cost
Trade receivables	Amortized cost	Amortized cost
Other receivables	Amortized cost	Amortized cost
Loans receivable	Amortized cost	Amortized cost
Deposits	Amortized cost	Amortized cost

Financial liabilities:	Classification:	Subsequent measurement:
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Lease liability	Other financial liabilities	Amortized cost
Government loan	Other financial liabilities	Amortized cost

The Company's financial instruments other than cash, approximate their fair values. Cash, under the fair value hierarchy is based on Level 1 quoted prices in active markets for identical assets or liabilities.

Economic dependence

Economic dependence risk is the risk of reliance upon a select number of customers which significantly impact the financial performance of the Company. During the three months ended December 31, 2020, the Company's cannabis concentrate sales (sale of bulk distillate) was generated from multiple customers.

Credit risk

Credit risk is the risk of financial loss to the Company if a counterparty to a financial instrument fails to meet its contractual obligations. As at December 31, 2020, credit risk for the Company arises from cash, accrued receivables, CEWS receivable, trade receivables, other receivables, loans receivable, and deposits. The carrying amount of these financial assets represents the maximum credit exposure as at December 31, 2020.

Cash is held with a Canadian chartered bank and accordingly, the Company's exposure to credit risk on cash is considered insignificant. As at December 31, 2020, the Company's trade receivable was due from one customer. Additionally, accrued receivables were due from two parties. The Company's trade receivables are current, and management considers the credit risk to be low.

Credit risk relating to other receivables is considered moderate since these balances are subject to collection action taken by the Company against the party that these amounts are due from. The Company has assessed the likelihood of collecting the amounts included in other receivables and has applied a loss provision to the balances resulting in the recognition of an additional loss provision during the three months ended December 31, 2020 of $124,053 (Year ended September 30, 2020 - $181,602) (Note 16). See additional details below ("Impairment of financial assets").

10. FINANCIAL INSTRUMENTS (continued)

Impairment of financial assets

The Company has the following financial assets that are subject to the expected credit loss model:

- Accrued receivables;
- Trade receivables;
- Other receivables;
- Loans receivable; and
- Deposits.

While cash is also subject to the impairment requirements of IFRS 9, the risk is insignificant.

The Company applies the IFRS 9 simplified approach to measure expected credit losses which uses a lifetime expected loss allowance for its accrued, trade, and other receivables, and deposit. The Company applies the general approach using practical expedients to loans receivable which involves recognition at each reporting date of a loss allowance based on a 12-month expected credit loss model without the requirement to re-assess whether any significant increases in credit risk have occurred at each reporting date.

To measure the expected credit losses, accrued receivables, trade receivables, deposit, and loans receivable are grouped by debtor, and each debtor's circumstances are reviewed. The expected loss amount, if any, is based on historical payment profiles, and the corresponding historical credit losses experienced within this period for the debtors.

As at December 31, 2020, the loss allowance was $nil for accrued receivables, trade receivables, and deposits. There has been no historical loss allowance recorded on these items. As described above, an accumulated loss provision of $279,120 is recognized as at December 31, 2020 (September 30, 2020 - $155,067) on other receivables (Note 16).

Amounts are written-off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, failure of a debtor to engage in a repayment plan with the Company (if applicable), and failure by the debtor to make contractual payments for a period of greater than 120 days past due, or shorter if specific circumstances suggest otherwise.

Impairment losses are presented as loss provisions within profit or loss. Subsequent recoveries of amounts previously written-off are credited against the same line item.

10. FINANCIAL INSTRUMENTS (continued)

Liquidity risk

The Company manages liquidity risk by maintaining an adequate level of cash to meet its ongoing obligations. The Company has been successful in raising equity financing in the past; however, there is no assurance that it will be able to do so in the future. As at December 31, 2020, the Company had working capital of $283,279, which is considered sufficient to fund future operations and obligations as they come due, and to allow the Company to meet business objectives for at least the next twelve months (Note 1).

Market risk

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

(i) Currency risk

Currency risk is the risk of change in profit or loss that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company is exposed to currency risk as it incurs transactions in the United States dollar.

As at December 31, 2020, the Company held cash, and accounts payable and accrued liabilities in United States dollars. A 10% change in the exchange rate between the United States dollar and the Canadian dollar, would have impacted loss and comprehensive loss for the three months ended December 31, 2020 by approximately $17,800 (2019 - $56,100).

(ii) Interest rate risk

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

(iii) Price risk

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

11. SUPPLEMENTAL CASH FLOW INFORMATION

The Company incurred non-cash investing and financing activities during the three months ended December 31, 2020 and December 31, 2019 as follows:

	December 31, 2020 $	December 31, 2019 $
Non-cash investing activities:		
Purchases of property and equipment in accounts payable and accrued liabilities	324,470	731,305
Recognition of right-of-use asset in property and equipment	-	188,316
Purchases of intangible assets included in accounts payable and accrued liabilities	-	20,221
Non-cash financing activities:		
Shares issued in settlement of accounts payable	215,000	-
Fair value of finders' warrants/units issued	-	-

During the three months ended December 31, 2020 and December 31, 2019, no amounts were paid for interest or income tax expenses.

(Expressed in Canadian Dollars)

12. CAPITAL RISK MANAGEMENT

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

The Company manages its capital structure to maximize its financial flexibility adjusting it in response to changes in economic conditions and the risk characteristics of the underlying assets and business opportunities. The Company relies on the expertise of the Company's management to sustain the future development of the business. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the three months ended December 31, 2020. The Company is not subject to externally imposed capital requirements.

13. SEGMENTED INFORMATION

The Company has a single reportable segment: the provision of goods, services, and intellectual property licensing to the cannabis industry in Canada. All the Company's revenues are generated in Canada, and its non-current assets are located in Canada.

14. LOANS RECEIVABLE

A summary of the Company's loans receivable as at December 31, 2020 and September 30, 2020 and changes during the period/year then ended is as follows:

	December 31, 2020 **$**	September 30, 2020 $
Balance, beginning of period/year	200,000	586,535
Advances	-	275,000
Interest accrual (interest income)	-	18,780
Loss on forgiveness of loan (Nextleaf Labs Ltd.) (Note 3)	-	(153,780)
Reclassification to Other receivables (Note 19)	-	(526,535)
Balance, end of period/year	**200,000**	200,000
Current portion	**-**	**-**
Non-current portion	**200,000**	**200,000**

Promissory note – Labs:

The Company had advanced $150,000 to the sole shareholder of Labs between the years ended September 30, 2020 and September 30, 2019 bearing interest at 5% per annum. The amounts were advanced by the shareholder to Labs and used as the initial working capital of Labs. Immediately preceding closing of the acquisition of Labs (Note 3), the aggregate principal and accrued interest of $153,780 was forgiven.

Loan receivable – Licencee (Note 16):

During the year ended September 30, 2020, the Company provided $200,000 as a working capital advance to the Licencee further described in Note 16 in connection with the underlying Royalty Agreement. The advance is non-interest bearing and must be repaid if the Royalty Agreement is terminated within five years of its effective date. As at September 30, 2020, the Company was owed $200,000 which is classified as non-current.

15. GOVERNMENT ASSISTANCE

During the three months ended December 31, 2020, the Company accrued or received $57,798 (2019 - $nil) in government assistance proceeds for the Canada Emergency Wage Subsidy ("CEWS").

Canada Emergency Wage Subsidy ("CEWS")

During the year ended September 30, 2020, the Company determined the impact on the Company's ability to generate revenue because of the COVID-19 pandemic, qualified the Company to apply for CEWS provided by the Government of Canada. During the year ended September 30, 2020, the Company accrued or received wages and salaries subsidies $381,059.

Canadian Emergency Business Account ("CEBA")

During the year ended September 30, 2020, the Company qualified for a government-guaranteed line of credit (government loan) of $40,000 which was interest-free until December 31, 2020. On January 1, 2021, the line of credit converted to a 2-year, 0% interest term loan to be repaid by December 31, 2022 at which time a 25% balance forgiveness ($10,000) will apply if the loan is repaid by such date.

The Company has the option to exercise a 3-year term extension on the loan by December 31, 2022, if the loan is not repaid by then. At which time, the remaining unpaid balance of the loan will bear interest at 5% interest per annum during the extension period and must be paid in full by December 31, 2025. Funds can be used to pay non-deferrable operating expenses including payroll.

16. OTHER RECEIVABLES

As at September 30, 2020, the Company was owed an aggregate $801,868 from an equipment supplier relating to amounts advanced by the Company as a promissory note ("loan") totaling $526,535 including principal and accrued interest and amounts advanced as deposits for cannabis extraction equipment totaling $275,333 (Note 6). Given the uncertainty surrounding repayment by the equipment supplier, the Company recognized a loss provision on the principal and interest of the loan, and the equipment deposit. The provision includes a 100% write-off of accrued interest on the loan, and an accumulated provision of $279,120 on the loan principal and the equipment deposit, as detailed in the table below.

As at December 31, 2020, the aggregate amount owed from the equipment supplier is $496,213 (September 30, 2020 - $620,266).

To the date of these financial statements, the Company and the equipment supplier are negotiating terms for the repayment to the Company of principal and interest on the loan, and the refund of equipment deposits.

On December 9, 2020, the Company issued the equipment suppler a Demand Notice requesting repayment of the equipment deposit and loan in full by December 17, 2020 (not paid). Accordingly, the Company commenced legal action on February 12, 2021 by way of issuing a Notice of Claim against the equipment supplier. On February 12, 2021, the equipment supplier issued a Statement of Defence and Counterclaim involving a third party. The Company does not believe that there is any substantive merit to any of the claims asserted against it and denies that any of the claims are supported by evidence.

(Expressed in Canadian Dollars)

16. OTHER RECEIVABLES (continued)

Other receivables comprise the following:

	December 31, 2020 **$**	September 30, 2020 $
Balance, beginning of period/year	620,266	-
Reclassification from loans receivable (Note 14)	-	526,535
Reclassification from equipment deposits (Note 6)	-	275,333
Loss provision - write-off of accrued interest on loan	-	(26,535)
Loss provision - allowance on principal of loan	(44,053)	(100,000)
Loss provision - allowance on equipment deposit	(80,000)	(55,067)
Balance, end of period/year	**496,213**	**620,266**

17. SUBSEQUENT EVENTS

(a) In January 2021, the Company granted 630,000 stock options to employees and consultants of the Company. The options are exercisable at $0.35 each until January 13, 2026 and vest fully on October 1, 2021. Additionally, the Company cancelled 360,000 stock options held by consultants (formerly granted in 2019) each having an exercise price of $0.35.

(b) In January 2021, the Company issued 145,000 common shares on the exercise of stock options by an employee and certain consultants of the Company at $0.35 each for proceeds of $50,750.

(c) In February 2021, the Company issued 383,428 common shares with an aggregate fair value of $109,277 ($0.285 per share) to two consultants as compensation for services rendered.

(d) In February 2021, the Company granted 560,000 stock options to employees of the Company. The options are exercisable at $0.35 each until February 16, 2026, of which 260,000 options vested immediately and 300,000 options vest on June 16, 2021.