Nextleaf Solutions Ltd.

Condensed Interim Consolidated Financial Statements
For the three months ended
December 31, 2021

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, 2021 and December 31, 2020, 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, 2021 and September 30, 2021

	Note	**December 31, 2021 $**	September 30, 2021 $
Assets			
Current assets			
Cash		1,818,042	915,385
Receivables and prepayments	3,9	1,057,997	1,221,174
Inventory	4	1,799,972	1,824,066
		4,676,011	3,960,625
Non-current assets			
Deposits		83,043	57,751
Property and equipment	5	4,495,826	4,693,175
Intangible assets	6	391,192	481,204
		4,970,061	5,232,130
Total assets		**9,646,072**	9,192,755
Liabilities and shareholders' equity			
Current liabilities			
Accounts payable and accrued liabilities	9	2,420,280	2,476,946
Customer deposits		42,500	42,500
Lease liability - current	5	35,300	35,300
Convertible debenture	7	1,457,735	2,852,122
		3,955,815	5,406,868
Non-current liabilities			
Lease liability	5	310,234	318,634
Government loan	15	40,000	40,000
		350,234	358,634
Total liabilities		**4,306,049**	5,765,502
Shareholders' equity			
Share capital	8	25,084,645	22,341,574
Reserves	8	4,150,389	4,085,276
Deficit		(23,895,011)	(22,999,597)
Total shareholders' equity		**5,340,023**	3,427,253
Total liabilities and shareholders' equity		**9,646,072**	9,192,755
Nature of operations and going concern	1		
Other receivables and contingency	16		

Approved on behalf of the Board of Directors on February 28, 2022:

"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, 2021, and December 31, 2020

		Three months ended	
	Note	**December 31, 2021 $**	December 31, 2020 $
Revenue			
Cannabis concentrate sales		423,782	1,256,589
Product sales		725,565	-
		1,149,347	1,256,589
Cost of sales		**805,928**	1,197,000
Gross margin		**343,419**	59,589
Expenses			
Accretion/interest on convertible debenture	7	252,953	-
Administrative expenses		81,913	86,438
Amortization	6	90,012	87,252
Depreciation	5	3,340	3,340
Finance costs, net	5	8,778	6,761
Investor relations and marketing		228,123	118,424
Professional fees and consulting	9	258,155	184,712
Research and operational supplies		15,947	24,493
Share-based payments	8,9	-	51,554
Salaries and fees	9	346,572	341,870
		(1,285,793)	(904,844)
Government assistance	15	22,473	57,798
Loss provision on receivables	16	-	(124,053)
		22,473	(66,255)
Loss and comprehensive loss for the period		**(919,901)**	(911,510)
Loss per share			
Weighted average number of common shares outstanding:			
Basic #		**126,917,098**	120,809,447
Diluted #		**126,917,098**	120,809,447
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, 2021 and December 31, 2020

	Note	**December 31, 2021 $**	December 31, 2020 $
Operating activities			
Loss for the period		(919,901)	(911,510)
Adjustments for:			
Accretion/interest on convertible debenture		252,953	-
Amortization		90,012	87,252
Depreciation	5	150,943	226,341
Finance costs		8,778	6,761
Share-based payments		-	51,554
Shares issued for services		-	11,200
Loss provision on receivables		-	124,053
Non-cash working capital items:			
Receivables and prepayments		163,177	537,485
Inventory		71,771	184,809
Deposits		(25,292)	-
Accounts payable and accrued liabilities		50,894	(906,254)
		(156,665)	(588,309)
Investing activities			
Purchases of property and equipment		(108,831)	(84,247)
Payments for intangible assets		-	(2,732)
		(108,831)	(86,979)
Financing activities			
Lease payments	5	(17,178)	(16,278)
Repayment of convertible debenture	7	(1,647,340)	-
Issuance of units/common shares, net of share issue costs		2,832,671	-
		1,168,153	(16,278)
Change in cash		**902,657**	(691,566)
Cash, beginning of period		**915,385**	988,675
Cash, end of period		**1,818,042**	297,109
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, 2021 and December 31, 2020

	Common shares \#	Share capital $	Reserves $	Deficit $	Total $
September 30, 2020	120,505,726	20,958,363	4,012,754	(17,708,730)	7,262,387
Shares issued - services	65,882	11,200	-	-	11,200
Shares issued on settlement of 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
September 30, 2021	125,318,208	22,341,574	4,085,276	(22,999,597)	3,427,253
Shares issued - prospectus financing	15,844,208	3,168,842	-	-	3,168,842
Shares issued - corporate finance fee	500,000	-	-	-	-
Share issue costs - cash	-	(336,171)	-	-	(336,171)
Share issue costs - brokers' warrants	-	(89,600)	89,600	-	-
Re-allocated on expiry of warrants	-	-	(24,487)	24,487	-
Loss and comprehensive loss for the period	-	-	-	(919,901)	(919,901)
December 31, 2021	**141,662,416**	**25,084,645**	**4,150,389**	**(23,895,011)**	**5,340,023**

The accompanying notes are an integral part of these condensed interim 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 formulation, and delivery of cannabinoids. The Company has developed an intellectual property (“IP”) portfolio, which includes a number of issued and pending patents (Note 6). The Company commercializes its intellectual property portfolio through IP licensing, production (toll processing services, and bulk sales) of CBD and THC oils through its wholly-owned subsidiary, Nextleaf Labs Ltd. (“Labs”), and selling products through provincial distribution boards for the adult-use market under the brand “Glacial Gold”.

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. The Company has taken various measures to prioritize the health and safety of its employees, customers, and partners, including restricted work travel and site access; improved safety and hygiene; and the requirement of nonessential staff members to work remotely. As a manufacturer of bulk products which are utilized in the production of consumable and medicinal products, the Company maintains robust quality standards with strict hygiene practices and mandated personal protective equipment. The Company has received various Government subsidies to assist with operating costs during the pandemic. The Government continues to update its COVID-19 relief programs, which may qualify the Company for additional assistance. Through to December 31, 2021, the Company has qualified for and received a $40,000 loan from the Government of Canada and rent and accrued or received wage subsidies of $872,704 ($850,231 to September 30, 2021) (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, 2021, the Company had working capital of $720,196 (September 30, 2021 – working capital deficiency of $1,446,243). 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 consolidated financial statements for the year end September 30, 2021, 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 subsidiaries.

2. SIGNIFICANT ACCOUNTING POLICIES (continued)

Principles of consolidation

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

Nextleaf Innovations Ltd.	100%	Extraction solutions company
Nextleaf Labs Ltd.	100%	Licenced processor

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.

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 consolidated financial statements for the year ended September 30, 2022. Accordingly, these financial statements should be read in conjunction with the Company's most recent annual audited consolidated financial statements.

Comparative figures

Certain comparative figures within operating expenses on the statement of loss and comprehensive loss have been reclassified to conform to the current period's presentation. This includes (i) the reclassification of management fees within salaries and fees; (ii) the reclassification of directors' fees within professional fees and consulting; and (iii) the reclassification of foreign exchange loss (gain) within administrative expenses.

Standards not yet effective

Certain pronouncements have been issued by the IASB or IFRIC that are effective for accounting periods beginning on or after January 1, 2021. The Company has reviewed these updates and determined that none are applicable or consequential to the Company and have been excluded from discussion within these significant accounting policies. Additionally, the Company did not adopt any new accounting standards during the period.

(Expressed in Canadian Dollars)

3. RECEIVABLES AND PREPAYMENTS

Receivables and prepayments comprise the following:

	December 31, 2021 $	September 30, 2021 $
Accrued Government assistance (Note 15)	22,473	161,925
Prepaid expenses	55,455	160,729
Sales tax recoverable	164,453	8,241
Trade receivables	815,616	890,279
	1,057,997	1,221,174

4. INVENTORY

Inventory is comprised of the following:

	December 31, 2021 $	September 30, 2021 $
Production work in progress - distillate	41,841	60,530
Cannabis products	289,749	283,164
Supplies and hardware	173,708	127,630
Finished goods - distillate	1,294,674	1,352,742
	1,799,972	1,824,066

Inventory expensed to cost of sales during the three months ended December 31, 2021, totaled $767,453 (2020 - $619,559).

(Expressed in Canadian Dollars)

5. PROPERTY AND EQUIPMENT

	Extraction and manufacturing equipment $	Leasehold improvements $	Right-of-use asset $	Furniture and equipment $	Total $
Cost					
September 30, 2020	3,639,584	3,060,110	380,160	203,876	7,283,730
Additions	17,027	48,727	-	-	65,754
Disposal	(76,431)	-	-	-	(76,431)
September 30, 2021	3,580,180	3,108,837	380,160	203,876	7,273,053
Accumulated depreciation					
September 30, 2020	1,360,201	255,049	43,416	75,926	1,734,592
Depreciation (1)	451,718	370,339	43,416	25,590	891,063
Disposal	(45,777)	-	-	-	(45,777)
September 30, 2021	1,766,142	625,388	86,832	101,516	2,579,878
Cost					
September 30, 2021	3,580,180	3,108,837	380,160	203,876	7,273,053
Additions	1,271	-	-	-	1,271
December 31, 2021	**3,581,451**	**3,108,837**	**380,160**	**203,876**	**7,274,324**
Accumulated depreciation					
September 30, 2021	1,766,142	625,388	86,832	101,516	2,579,878
Depreciation (1)	90,920	91,728	10,854	5,118	198,620
December 31, 2021	**1,857,062**	**717,116**	**97,686**	**106,634**	**2,778,498**
Net book value					
September 30, 2021	1,814,038	2,483,449	293,328	102,360	4,693,175
December 31, 2021	**1,724,389**	**2,391,721**	**282,474**	**97,242**	**4,495,826**

(1) Depreciation for the three months ended December 31, 2021 and December 31, 2020, is allocated as follows:

	December 31, 2021 $	December 31, 2020 $
Cost of sales	147,603	223,001
Inventory	47,677	-
Operating expenses	3,340	3,340
	198,620	226,341

During the year ended September 30, 2021, the Company disposed of extraction equipment that had a net book value of $30,654 for net proceeds, after commissions paid, of $47,500 resulting in a gain on disposal of equipment of $16,846.

(Expressed in Canadian Dollars)

5. **PROPERTY AND EQUIPMENT** (continued)

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, 2021, the remaining term of the Company's facility lease was 6.50 years which includes the five-year extension option.

A reconciliation of the carrying amount of the lease liability as at December 31, 2021 and September 30, 2021 and changes during the period/year then ended is as follows:

	December 31, 2021 $	September 30, 2021 $
Beginning of period/year	353,934	382,925
Lease payments	(17,178)	(66,012)
Lease interest (finance costs)	8,778	37,021
End of period/year	**345,534**	353,934
Current portion of lease liability	**35,300**	35,300
Non-current portion of lease liability	**310,234**	318,634
	345,534	353,934
Maturity analysis - contractual undiscounted cash flows		
Less than one year	68,712	69,120
One to five years	289,045	290,138
Over five years	153,185	134,506
	510,942	493,764

Short-term leases are leases with a lease term of twelve months or less. As at December 31, 2021 and September 30, 2021, the Company did not have any low value leases or short-term leases.

(Expressed in Canadian Dollars)

6. INTANGIBLE ASSETS

A continuity of intangible assets is as follows:

	Nano emulsion technology $	Issued patents $	Licences $	Brand $	Total $
Cost					
September 30, 2020	626,000	37,124	270,325	-	933,449
Additions	-	3,228	-	110,000	113,228
September 30, 2021	626,000	40,352	270,325	110,000	1,046,677
Accumulated amortization					
September 30, 2020	207,523	2,963	5,978	-	216,464
Amortization	308,751	1,993	34,016	4,249	349,009
September 30, 2021	516,274	4,956	39,994	4,249	565,473
Cost					
September 30, 2021	626,000	40,352	270,325	110,000	1,046,677
December 31, 2021	**626,000**	**40,352**	**270,325**	**110,000**	**1,046,677**
Accumulated amortization					
September 30, 2021	516,274	4,956	39,994	4,249	565,473
Amortization	78,250	505	8,507	2,750	90,012
December 31, 2021	**594,524**	**5,461**	**48,501**	**6,999**	**655,485**
Net book value					
September 30, 2021	109,726	35,396	230,331	105,751	481,204
December 31, 2021	**31,476**	**34,891**	**221,824**	**103,001**	**391,192**

Brand acquisition – Glacial Gold

During the year ended September 30, 2021, the Company acquired all rights associated with a specialty concentrates and extracts brand, “Glacial Gold”. The Company acquired the brand by issuing 440,000 common shares at a fair value of $110,000.

(Expressed in Canadian Dollars)

7. CONVERTIBLE DEBENTURE

On March 31, 2021, the Company executed a Securities Purchase Agreement (the “SPA”) with a creditor (the “holder”) whereby the Company issued a senior secured convertible note (the “Note”) and warrants to the holder for gross proceeds of $3,000,000 (the “cash value”).

The principal value of the Note is $3,300,000 whereby $300,000 of which was initially recognized as a deferred financing charge (liability) and is credited against interest expense as the balance is amortized over the term of the Note. The Note is secured by a security interest subordinate to all existing and future property undertakings by the Company and by assignment of collateral by way of a General Security Agreement over the assets of the business.

The Note is convertible at any time and at the option of the holder into common shares of the Company at a conversion price of $0.288 per share until maturity on September 30, 2022 and bears interest at a rate of 5.0% per annum. Commencing on September 1, 2021, the Company will make fourteen (14) monthly cash repayments inclusive of principal and interest (“installments”) in the amount of $253,393 through to September 2022 until the principal value of $3,300,000 is repaid in full. The installments and coupon interest may be converted into common shares subject to certain conditions.

In connection with the SPA, the Company issued a total of 6,875,000 warrants to the holder, exercisable at a price of $0.288 with an expiration in 36 months on March 31, 2024. There was no value attributed to the warrants issued as the equity conversion feature of the instrument was measured to be insignificant. Consequently, there was no value to bifurcate and apply to the warrants.

The Note was valued initially by measuring the fair value of the liability component using an 18% discount rate, and by allocating the residual (using the residual value method) to the equity conversion feature. The equity conversion feature was determined to be nominal, and therefore was assessed as $nil.

Transaction costs of $238,932 were incurred in connection with the issuance of the Note comprising $30,000 in direct cash transaction costs, $148,932 in legal, filing, and advisory fees, and a $60,000 structuring fee was settled through the issuance of 250,000 common shares at a fair value of $0.24 each.

A reconciliation of the convertible debenture liability and deferred financing costs (liability) is as follows:

	Liability $	Deferred financing cost $	Total $
Balance, September 30, 2020	-	-	-
Proceeds on issuance of convertible debenture	3,000,000	-	3,000,000
Allocation of transaction costs	(238,932)	-	(238,932)
Original issue discount	(300,000)	300,000	-
Repayments	(253,393)	-	(253,393)
Accretion/interest (expense) income	444,355	(99,908)	344,447
Balance, September 30, 2021	2,652,030	200,092	2,852,122
Balance, September 30, 2021	2,652,030	200,092	2,852,122
Repayments	(1,647,340)	-	(1,647,340)
Accretion/interest (expense) income	302,907	(49,954)	252,953
Balance, December 31, 2021	**1,307,597**	**150,138**	**1,457,735**

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, 2021:

- On December 22, 2021, the Company completed a short-form prospectus financing consisting of the issuance of 15,844,208 units at a price of $0.20 per unit for gross proceeds of $3,168,842 ($2,832,671, net proceeds). Each unit consisted of one common share and one share purchase warrant, with each warrant being exercisable at a price of $0.275 until December 22, 2023. No value was allocated to the warrant component of the unit.

  An agents' cash commission totalling $183,835 was paid upon closing of the offering, plus agents' legal fees and expenses of $89,380, and other legal fees of $62,956. Additionally, the Company issued 849,504 brokers' warrants exercisable at $0.20 until December 22, 2023 at a fair value of $89,600, and issued 500,000 common shares at a fair value of $100,000 ($0.20 per share) as an agent's corporate finance fee (share issue cost) resulting in a net $nil impact to share capital.

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 consultants for settlement of previously rendered services included within accounts payable and accrued liabilities. The difference between the carrying value of the amounts settled within accounts payable and accrued liabilities and the fair value of the common shares issued of $13,676 was recognized as a loss on settlement of accounts payable.

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 500,000 common shares (September 30, 2021 – 500,000) held in escrow pursuant to the acquisition of Labs which occurred on July 29, 2020.

As at December 31, 2021, 5,117,655 common shares were held in escrow (September 30, 2021 – 5,367,655).

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, 2021, 244,444 common shares of the Company (September 30, 2021 – 244,444) have been issued to non-executive employees under the Plan.

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.

(Expressed in Canadian Dollars)

8. **SHAREHOLDERS' EQUITY** (continued)

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, 2021 and September 30, 2021 and changes during the period/year then ended is as follows:

	Period ended December 31, 2021		Year ended September 30, 2021	
	Options #	Weighted average exercise price $	Options #	Weighted average exercise price $
Options outstanding, beginning of period/year	16,164,287	0.35	14,439,287	0.36
Granted	-	-	2,230,000	0.31
Exercised	-	-	(145,000)	0.35
Cancelled	-	-	(360,000)	0.35
Options outstanding, end of period/year	**16,164,287**	**0.35**	16,164,287	0.35

As at December 31, 2021, 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	0.33
(1)	13,220,000	13,220,000	0.35	March 15, 2024	2.21
	150,000	150,000	0.50	July 8, 2024	2.52
	300,000	300,000	0.50	October 15, 2024	2.79
	150,000	150,000	0.50	October 16, 2024	2.79
	250,000	250,000	0.25	December 10, 2025	3.95
	630,000	630,000	0.35	January 13, 2026	4.04
	560,000	560,000	0.35	February 15, 2026	4.13
	790,000	790,000	0.275	August 4, 2026	4.59
	16,164,287	**16,164,287**	**0.35**		**2.49**

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

During the year ended September 30, 2021, the Company granted 2,230,000 stock options to non-executive employees, consultants, and non-executive independent directors of the Company. The options are exercisable between $0.25 and $0.35 each until December 10, 2025, January 13, 2026, February 15, 2026 and August 4, 2026. 1,300,000 stock options vested immediately, and the remainder have varying vesting terms.

During the year ended September 30, 2021, the Company cancelled 360,000 stock options held by consultants (formerly granted in 2019) each having an exercise price of $0.35. As a result, $94,486 representing the fair value of the stock options granted and vested was re-allocated from reserves and credited to deficit.

(Expressed in Canadian Dollars)

8. **SHAREHOLDERS' EQUITY** (continued)

The Company recorded the fair value of the stock options granted during the year ended September 30, 2021 using the Black-Scholes option pricing model. The fair value is particularly impacted by the Company's stock price volatility, determined using data for the period from the Company's public listing to the grant date when such period is less than the expected life of the stock options, otherwise the Company uses historical data for a period equal to the expected life of the stock options. The fair values were determined using the following weighted average assumptions:

	September 30, 2021
Risk-free interest rate	0.60%
Expected life of options (years)	5.00
Historical volatility	100%
Dividend rate	0%

Total share-based payment expense for the three months ended December 31, 2021 was $nil (2020 – $51,554).

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. Additionally, warrants may be issued as an incentive to complete convertible debenture financings which are fair valued using the Black-Scholes option pricing model and allocated to the equity component of the convertible debenture on a relative fair value basis with the equity conversion feature.

A summary of the Company's common share purchase warrants as at December 31, 2021 and September 30, 2021 and changes during the period/year then ended is as follows:

	Perod ended December 31, 2021		Year ended September 30, 2021	
	Warrants #	Weighted average exercise price $	Warrants #	Weighted average exercise price $
Warrants outstanding, beginning of period/year	18,525,795	0.41	36,116,850	0.63
Issued - attached to units	15,844,208	0.275	-	-
Issued - brokers' warrants	849,504	0.20	-	-
Issued - attached to convertible debenture	-	-	6,875,000	0.288
Issued - exercise incentive program	-	-	1,004,250	0.35
Exercised	-	-	(1,004,250)	0.265
Expired	(250,000)	-	(24,466,055)	0.55
Warrants outstanding, end of period/year	**34,969,507**	**0.34**	18,525,795	0.41

Upon expiry of warrants during the three months ended December 31, 2021, certain of the warrants were issued as compensatory warrants (professional and consulting fees) and had a fair value recognized within reserves upon original issuance. Accordingly, their original fair values of $24,487 was reversed from reserves and credited to share capital where the fair value was initially recognized.

(Expressed in Canadian Dollars)

8. SHAREHOLDERS' EQUITY (continued)

Warrants (continued)

The following table summarizes information about the warrants outstanding and exercisable at December 31, 2021:

	Warrants #	Weighted average exercise price $	Expiry Date	Weighted average remaining life (years)
	6,666,667	0.50	May 21, 2022	0.39
	66,933	0.30	May 21, 2022	0.39
	3,534,071	0.50	May 28, 2022	0.41
	128,874	0.30	May 28, 2022	0.41
(1)	1,004,250	0.35	July 15, 2022	0.54
	849,504	0.200	December 22, 2023	1.98
	15,844,208	0.275	December 22, 2023	1.98
	6,875,000	0.288	March 31, 2024	2.25
	34,969,507	**0.34**		**1.52**

(1) Warrants were issued pursuant to the warrant exercise incentive program.

Warrant exercise incentive program

During the year ended September 30, 2021, the Company completed a warrant exercise incentive program to relating to then outstanding share purchase warrants originally expiring on May 15, 2021 (modified to July 15, 2021) (the "Warrants"). As part of the program, the Company reduced the exercise price of the Warrants from $0.70 each to $0.265 each. Upon the exercise of each Warrant prior to July 15, 2021, the warrantholder received one additional share purchase warrant (the "incentive warrant") for each Warrant exercised. Each incentive warrant is exercisable at $0.35 each until July 15, 2022, subject to accelerated expiry terms. There was no expense recognized on modification of the Warrants during the year ended September 30, 2021 as there was no original fair value.

The warrant exercise incentive program concluded on July 15, 2021 with a total of 1,004,250 Warrants being exercised into 1,004,250 incentive warrants. The program resulted in proceeds to the Company of $266,126.

During the three months ended December 31, 2021, the Company issued 849,504 compensatory brokers' warrants which were fair valued using the Black-Scholes option pricing model. The fair value is particularly impacted by the Company's stock price volatility and was determined using the following weighted average assumptions:

	December 31, 2021
Risk-free interest rate	1.50%
Expected life of options (years)	2.00
Historical volatility	100%
Dividend rate	0%

(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, 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
September 30, 2021	3,989,946	95,330	4,085,276
Brokers' warrants issued	-	89,600	89,600
Warrants expired	-	(24,487)	(24,487)
December 31, 2021	**3,989,946**	**160,443**	**4,150,389**

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, 2021 and December 31, 2020 is as follows:

	December 31, 2021 **$**	December 31, 2020 $
Directors' fees (within professional fees and consulting)	11,000	15,450
Management fees (within salaries and fees)	108,000	110,400
	119,000	125,850

Related party balances

Related party balances as at December 31, 2021 and September 30, 2021 are as follows:

	December 31, 2021 **$**	September 30, 2021 $
Balances included in accounts payable and accrued liabilities:		
Directors' fees	93,000	85,540
Management fees	356,301	369,500

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 Government assistance (Note 3)	Amortized cost	Amortized cost
Trade receivables (Note 3)	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
Convertible debenture	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. The carrying values of the Company's accrued government assistance, trade receivables, deposits, accounts payable and accrued liabilities, and government loan all approximate their fair values due to their short-term nature. The carrying value of the Company's convertible debenture, and lease liability approximates fair value as it bears a rate of interest commensurate with market rates.

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, 2021, the Company's cannabis concentrate sales (sale of bulk distillate) and product sales were 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, 2021, credit risk for the Company arises from cash, receivables, and deposits. The carrying amount of these financial assets represents the maximum credit exposure as at December 31, 2021.

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, 2021, the Company's receivables are current, and management considers the credit risk to be low.

10. FINANCIAL INSTRUMENTS (continued)

Impairment of financial assets

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

- Trade receivables; 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 trade receivables, and deposits. 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, trade receivables, and deposits 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, 2021, the Company did not have any loss allowances. However, the Company has previously recognized historical loss provisions on trade receivables relating to a single debtor, and other receivables in relation to another debtor resulting in an accumulated historical loss provision of $775,333 (refer to Note 16 for details).

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, 2021, the Company had working capital of $720,196. Refer to going concern considerations disclosed in 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, 2021, 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 period by approximately $1,000 (2020 - $18,000).

(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, 2021 and December 31, 2020 as follows:

	December 31, 2021 $	December 31, 2020 $
Non-cash investing activities:		
Purchases of property and equipment in accounts payable and accrued liabilities	-	324,470
Non-cash financing activities:		
Shares issued in settlement of accounts payable	-	215,000

During the three months ended December 31, 2021 and December 31, 2020, 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, 2021. 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, 2021 and September 30, 2021 and changes during the period/year then ended is as follows:

	December 31, 2021 $	September 30, 2021 $
Balance, beginning of period/year	-	200,000
Loss provision - bad debt	-	(200,000)
Balance, end of period/year	**-**	-

15. GOVERNMENT ASSISTANCE

<u>Canada Emergency Wage Subsidy ("CEWS") and Canada Emergency Rent Subsidy ("CERS")</u>

During 2021 and 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 three months ended December 31, 2021, the Company accrued or received CEWS and CERS subsidies of $22,473 (2020 - $57,798).

<u>Canadian Emergency Business Account ("CEBA")</u>

In 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.

(Expressed in Canadian Dollars)

16. OTHER RECEIVABLES AND CONTINGENCY

As at December 31, 2021 and September 30, 2021, the Company was owed an aggregate $801,868 from an equipment supplier relating to amounts advanced by the Company as a promissory note ("loan") in previous years and amounts advanced as deposits for cannabis extraction equipment.

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 partially during the year ended September 30, 2020 and the remainder in full as at September 30, 2021. Of the total provision applied, $620,266 was recognized during the year ended September 30, 2021. As at December 31, 2021 and September 30, 2021, the carrying value of the amount owed from the equipment supplier was $nil after recognition of loss provisions for the balances in full.

On December 9, 2020, the Company issued the equipment supplier 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 January 6, 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.

To the date of these financial statements, the Company and the equipment supplier have not negotiated terms for the repayment to the Company of principal and interest on the loan, and the refund of equipment deposits. There have been no material developments in respect of this matter and the claims have not been contested in the courts.

A continuity of other receivables is as follows:

	December 31, 2021	September 30, 2021
	$	$
Balance, beginning of period/year	-	620,266
Accumulated loss provision - allowance on principal of loan	-	(400,000)
Accumulated loss provision - allowance on equipment deposit	-	(220,266)
Balance, end of period/year	**-**	**-**