

**HEXO®**

HEXO Corp  
**2021**  
**Annual Report**

A large, semi-transparent image of a cannabis plant with a prominent flower bud in the center, set against a dark blue background.

# MANAGEMENT'S DISCUSSION & ANALYSIS

For the years ended July 31, 2021 and 2020

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## Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended July 31, 2021

All dollar amounts in this MD&A are expressed in thousands of Canadian dollars, except for share and per share amounts, and where otherwise indicated. Amounts expressed in United States dollars ("USD") are expressed as USD\$.

# Introduction

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*This MD&A of the financial condition and results of operations of HEXO Corp and our subsidiaries (collectively, "we" or "us" or "our" or "Company" or "HEXO") is for the year ended July 31, 2021. HEXO is a publicly traded corporation, incorporated in Ontario, Canada. The common shares of HEXO trade under the symbol "HEXO" on both the Toronto Stock Exchange ("TSX") and the National Association of Securities Dealers Automated Quotations ("Nasdaq"). This MD&A is supplemental to, and should be read in conjunction with, our audited consolidated financial statements ("financial statements") for the year ended July 31, 2021. Our consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.*

*This MD&A has been prepared by reference to the MD&A disclosure requirements established under National Instrument 51-102, Continuous Disclosure Obligations, of the Canadian Securities Administrators. Additional information regarding the Company is available on our websites at [hexocorp.com/investors](http://hexocorp.com/investors) or through the SEDAR website at [sedar.com](http://sedar.com) or the EDGAR website at [www.sec.gov/edgar](http://www.sec.gov/edgar).*

*We do not, and do not intend to, engage in direct or indirect business with any business that derives revenue, directly or indirectly, from the sale of cannabis, cannabis products in any jurisdiction where the sale of cannabis is unlawful under applicable laws. HEXO does not currently engage in any unlawful U.S. marijuana-related activities as defined in Canadian Securities Administrators Staff Notice 51-352 (Revised) - Issuers with U.S. Marijuana-Related Activities and will only do so in the future to the extent fully legal under all applicable U.S. federal or state laws.*

*Management estimates that the working capital as at July 31, 2021 and forecasted cash flows may require additional capitalization in order to meet the Company's obligations through October 29, 2022. Please see Note 2 of the financial statements, and Liquidity and Capital Resources – Going concern section of this MD&A, for a more detailed discussion.*

*As at the date of this MD&A, the Company continues to assess the fair market value of the acquired net assets and working through the purchase price allocation of Redecan and 48North Cannabis Corp. ("48North"). The Company will account for both acquisitions under IFRS 3, using the acquisition method.*

*This MD&A is dated October 29, 2021.*

# Company Overview

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HEXO is a leading consumer-packaged goods (“CPG”) cannabis company with a top Canadian market share. We have a history of developing innovative award-winning products driven by our deep passion for manufacturing and bringing to market a diversified portfolio to our valued adult-use consumers and medical clients. We are keenly focused on delivering a complete range of experiences to our consumers who count on us for safe, reputable high quality cannabis products.

Headquartered in Gatineau, Quebec, with facilities across North America, we are constantly assessing our product development, cultivation, processing, marketing and sales practices to offer adult-use and medical cannabis products, extracts and derivatives in accordance with the Cannabis Act in Canada and globally pursuant to all applicable international regulations.

We manufacture and sell CBD Powered by HEXO® products in 17 states in the U.S. in partnership with Molson Coors and have taken HEXO international with our medical cannabis product offerings.

## M&A Activity

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On June 1, 2021, we completed the acquisition of Zenabis Global Inc. (“Zenabis”), and subsequent to year end, we completed the acquisition of Redecan and 48North Cannabis Corp.

Through our acquisition of Zenabis we have broadened our cultivation facilities with a state-of-the-art indoor grow facility in Atholville, NB. We have strengthened our relationship with provincial sales boards and expanded our market share. Redecan was Canada’s largest private licensed producer, with a strong brand following and market leading products. They are known for leading manufacturing, automation and packaging capabilities, resulting in some of the most consistent, efficiently produced products in the industry. Their highly efficient proprietary pre-roll technology has supported some of the highest gross margins in the industry. 48North is allowing us the potential to expand our product lines related to beauty, cosmetics and topicals.

Each of these acquisitions provides a unique strength to bolster our corporate strategy. As we integrate these companies into the HEXO family, we are focused on ensuring that we implement the strengths of each company across the organization, identify and resolve any weaknesses, and obtain synergistic value for the organization. We believe these acquisitions will increase our market share, accelerate our path to profitability and EPS, as well as providing accretive synergies.

Our new combined company has a top 2 market share in Canada, and holds the number one position in pre-rolls, oils, capsules, beverages and customer loyalty.

# Strategy and Outlook

Our strategy is to maintain our position as an industry leader in Canada and achieve similar success internationally, by delivering safe, high quality and innovative cannabis products to our consumers. We are focused on delivering long term shareholder value by leveraging our scale, expertise and capabilities, as well as managing our operating expenses to drive positive cash flow and earnings per share.



**OPERATIONAL EXCELLENCE**

Invest in people, processes, and systems to meet market demands, adapt to new opportunities and provide users with high-quality products at sustainable operating costs



**INNOVATION**

Continue to innovate and lead the market in identifying, developing and launching new cannabis products and formulations with improved technology that enhance the consumer experience through "Powered by HEXO"



**CONSUMER CENTRIC**

Using consumer insight to develop purposeful brands to support consumer needs across categories and price points

## Operational Excellence

In order to provide safe high-quality cannabis, with an efficient cost structure, we have invested considerable time designing and building out our operations. We are constantly reviewing our processes, practices and technology to ensure we are keeping our costs low and our yields high. We have been growing at our flagship Quebec greenhouses since 2014. Establishing our primary cultivation operations in Quebec has offered us access to renewable electricity at competitive rates, abundant water resources and a skilled workforce. Over the years, our facilities have grown from 7,000 sq. ft. to over 1 million sq. ft. Through our acquisitions, we have obtained a state-of-the-art indoor grow facility in Atholville, New Brunswick, as well as a premier outdoor grow site in Cayuga, Ontario, through the acquisition of Redecan on August 30, 2021.

We have also established our post-cultivation manufacturing Centre of Excellence in Belleville, Ontario for processing and packaging. The site is designed to not only meet our needs today but will allow us, and our partners, room to expand in the future. Through our acquisition of Redecan, we have acquired a state-of-the-art lean production facility with fully automated packaging lines and proprietary pre-roll technology. Through our integration process we are reviewing this technology and scaling it into our existing facilities.

We are investing in advanced manufacturing technologies and practices that compete directly with the technology at top CPG companies across all industries. We have focused on the supply chain from seed to sale to ensure that we are using the right people, technology, benchmark practices and services to consistently deliver fresh product to market. All with the lowest capital deployed per % of market share by a leading LP<sup>1</sup>.

<sup>1</sup> Total Capital deployed defined as total assets less cash plus accumulated deficit. Market share calculated as the trailing 6 months as at July 31, 2021 based on headcount data. Calculated using the most recently available public information.

## Innovation

We are known for our history of innovation. Whether it's creating new products (Canada's first sublingual mist), identifying market opportunities (Canada's first value brand offering), or using advanced technology to improve products (creating the number one selling cannabis infused beverage brand in Canada). Our focus on product development through research, innovation and technology continues to be one of our core strategic priorities.

We believe that by investing in platform technologies we can create the next generation of cannabis products. As a result of these technologies, we have one of the industry's top IP portfolios.<sup>2</sup> These products allow us to expand our market share and target new consumers who are not currently participating in the legal market.

Our recent acquisitions complement this strategy. We are expanding our product offerings and incorporating new technology into our production facilities to ensure we are bringing the best possible product portfolio to our consumers. Our cultivation facilities now include greenhouses, a state of the art indoor, and an outdoor grow facility.

Part of being an innovator is being able to see a problem and identify a solution. Trim is a byproduct of the harvesting process, it's the leaves and little bits that are removed when we harvest the flower. There's more of it than you would think, and there's cost associated with it. Prior to 2020 most of it was destroyed, written off or put into the vault (inventory). This led to write-downs of inventory, increased cost of sales, and decreased gross margins, but we saw its potential. We created a trim management initiative and thought of new ways that we could use this byproduct in our innovative products. Today, trim is the main ingredient in OS.HASH (#1 in Canada), OS pre-rolls, OS.KLIK, OS.SHAKE (#1 15g SKU in QC) and other advanced cannabis products. This helps us keep our costs low while continuing to supply award-winning products to our consumers. We believe that Keystone Isolation Technologies ("KIT") will allow us to do even more.

Building on our innovation platform, we have established KIT, a joint venture where we hold 60% of the ownership. This top tier extraction and isolation technology will allow us to supply quality cannabis and hemp extracts to our CPG partners to bring innovative products to market. We believe that the technology will allow us to scale up as required along with providing consistent high potency and purity for our distillates and isolates. We plan to leverage this technology through KIT's sister entity in the U.S. (see section "*HEXO USA*").

## Consumer Centric

Since our establishment in 2013, we have had the goal of becoming a leader in the Canadian cannabis industry. Today, as one of the Canadian market-share leaders, we are confident in our ability to shape the global cannabis industry by focusing on consumers, and that by succeeding in Canada, we are well positioned to become a major global player. We built a strong position in our initial jurisdiction, Quebec, where we maintain a top market share, and have expanded to all ten provinces in Canada. We are continuing to increase our sales across Canada and diversify our reach outside of Quebec, to increase our overall market share and have made significant gains in key markets such as Ontario and British Columbia. We made strategic acquisitions of Zenabis, and subsequent to year end, Redecan and 48 North to continue expanding our market share and build our diverse house of brands. We have focused on analyzing key consumer insights and developing brands that resonate with consumers across market segments, and represent innovation, quality and consistency.

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<sup>2</sup> Based upon a third-party report which compares the Company's published patent applications relative to its peers in the Canadian Cannabis market using the recently available public data.

# Canadian Cannabis Business

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# Truss Beverage Co.

Through Truss Beverage Co. (“Truss”), our business venture with Molson Coors Canada (“Molson Canada”) we have positioned ourselves to meet the cannabis beverage market in Canada head on. Truss is committed to developing and producing a range of cannabis beverages that focus on great taste, consistency and choice for consumers. We currently offer one of the largest portfolios of cannabis infused beverages and extract products in the Canadian market.

The average consumer’s appetite for smoke free alternatives to cannabis consumption<sup>3</sup> continues to grow with the introduction of legal Cannabis 2.0 products into Canada. The total Canadian cannabis beverage category grew 31%, while the total cannabis sector grew by 13%<sup>4</sup>. Although we only entered the Canadian market at the beginning of this fiscal year, Truss products have already had early success, most notably holding the top cannabis beverage market position in Canada with almost 50% of sales<sup>5</sup>. Truss products also hold the number one beverage brand position in Canada, with XMG<sup>6</sup>. We believe that the beverage brand portfolio offers a range of experiences from the high CBD found in Veryvell sparkling flavored water to XMG, which boasts 10mg of THC per beverage, and ideally positions Truss to meet consumer demand and maintain its position as an industry leader.

Truss’ CBD and THC products were developed with consumer input throughout the entire process of bringing the products to market. The current portfolio includes of the following five brands:



**Little Victory:** Vibrant, naturally flavoured sparkling beverages to toast to any of life’s little victories.

**House of Terpenes:** A range of terpene-forward sparkling tonics that celebrate the flavours of cannabis.

**Mollo:** Crisp with an easy drinking taste.

**Veryvell:** A complete line-up of products to support your self-care journey.

**XMG:** A range of high intensity flavoured beverages.

Truss beverages are produced and distributed from HEXO’s Belleville facility. Currently, the beverage related operations are conducted by HEXO (through the operations of HEXO Cannabis Infused Beverages or “HEXO CIB”) under HEXO’s licensing. Subsequent to year end, on October 1, 2021, Truss obtained its own processing license. We expect Truss to acquire the appropriate selling license from Health Canada during fiscal year 2022<sup>7</sup>, at which point sales and operations will transfer to Truss. Truss submitted their independent application to Health Canada on October 26, 2020.

<sup>3</sup> Per Deloitte’s “Seeding New Opportunities – Listening to Canada’s Cannabis Consumer” 2021 report.

<sup>4</sup> Per Source: Headset Total Canada Category Sales from May 1, 2021 to July 31, 2021 compared to February 1, 2020 to April 30, 2021.

<sup>5</sup> Per internal review of Headset sales data based on \$ sold Sales from May 1, 2021 to July 31, 2021.

<sup>6</sup> Per internal review of Headset sales data based on \$ sold Sales from May 1, 2021 to July 31, 2021.

<sup>7</sup> Due to the experienced delay in obtaining the Belleville facility’s sales license, in part, due to Health Canada and the COVID-19 pandemic related delays, the expected timing for Truss acquiring their independent license has been delayed. The Company expects to receive licensing within the 2022 fiscal year. The assumption of acquiring this licensing is derived through the Company’s internal expertise and historical experience in obtaining licensing from Health Canada.



HEXO and Molson Coors Beverage Company have created an additional Truss business venture, Truss CBD USA LLC, to explore opportunities for non-alcoholic, hemp-derived CBD beverages in the state of Colorado. See the section “*HEXO USA*” for additional information.

## HEXO Group of Facilities

The following provides information about HEXO’s facilities as of July 31, 2021 unless otherwise noted. The table does not reflect the facilities acquired through the Redecan and 48N acquisitions:

Location	Primary Purpose	Description
Gatineau, Quebec	Cultivation	<p>The Company’s Gatineau, Quebec facility is its main cultivation facility, featuring 1,292,000 sq. ft. of greenhouse cultivation space on a 143-acre campus. The greenhouse space is comprised of a 7,000 sq. ft. greenhouse, a 35,000 sq. ft. greenhouse completed in 2016, a 250,000 sq. ft. greenhouse completed in June 2018 and a 1 million sq. ft. greenhouse completed in December 2018, known as B9. Except as noted below, the facility is licensed by Health Canada (Standard Cultivation, Standard Processing, Sale for Medical Purposes, (the current license was amended effective April 7, 2020 and expires April 7, 2023), and Research (the previous license obtained October 25, 2019 was amended to include the Belleville and Vaughn facilities, with the result that the current license is effective August 27, 2020 and expires October 25, 2024)) and is fully operational.</p> <p>On January 15, 2021, the final phase of B9 received licensing, however, the space was not operational as at July 31, 2021. This zone was previously expected to become operational by the end of fiscal 2021, however the Company is undergoing further review of its cultivation requirements in light of the three recent acquisitions of licensed producers and redeploying capital as needed. As of the date of this MD&amp;A management estimates that the final fit ups will begin in late FY22 to be finalized in FY23.</p> <p>As at July 31, 2021 the Gatineau facility is operational and directly and/or indirectly generates sales for the Company, with the exception of the final phase of B9 as stated above. The approved remaining budget was increased to \$6,160 to online the asset to be utilized as intended by management.</p>

Atholville, New Brunswick	Cultivation	<p>The Company owns and operates the Atholville Facility, (obtained through the acquisition of Zenabis on June 1, 2021) a 380,000 sq. ft. indoor facility in Atholville, New Brunswick. The Atholville facility is fully licensed by Health Canada for Standard Cultivation, Standard Processing and Sale for Medical Purposes, (effective July 19, 2021 and expires July 19, 2025). In addition, a Research license has been granted (effective December 14, 2020 and expires December 10, 2025) to conduct activities at the facility) and is currently operating at a steady state of production. The facility received EU - GMP approval from its Malta based European partner, ZenPharm Ltd. for operations. This is Company's first significant indoor grow facility.</p>
Belleville, Ontario (HEXO and Truss)	Manufacturing	<p>HEXO's Belleville, Ontario facility is its centralized processing, manufacturing and distribution centre, featuring 932,190 sq. ft. of leased commercial space within a larger approximately 1.5 million sq. ft. industrial facility, with rights of first offer and first refusal to lease the remaining space in the facility. The facility acts as the Company's main production facility for processing, extraction and packaging, and the manufacturing of cannabis derivative products. Truss Beverage Co, the Company's venture with Molson Canada, is planned to operate at this facility once it obtains a separate license from Health Canada and it currently effectively operates under HEXO's license through HEXO CIB. The Company has subleased 183,600 sq. ft. to Truss, which Truss has then subleased back to HEXO CIB pending Truss' licensing. The facility is owned by Belleville Complex Inc., 25% of which is owned by the Company and the balance of which is owned by Olegna Holdings Inc. a company affiliated with a director of the Company, Vincent Chiara.</p> <p>The Belleville facility is licensed by Health Canada for Standard Processing and Sale for Medical Purposes (current license effective October 21, 2020 and expiring October 21, 2023). The facility also has a Cannabis Research license (effective August 27, 2020 and expires October 25, 2024). HEXO received an amendment to the license to authorize non-medical sale of additional cannabis product types, including derivative products on May 29, 2020.</p> <p>Accordingly, the facility is now operational manufacturing and selling activity.</p>
Belleville, Ontario (KIT)	Manufacturing	<p>KIT is expected to operate out of a separate area within the Belleville facility and provide the Company with high quality extraction technology to facilitate production transformation for certain of the Company's cannabis derivative products. KIT will effectively operate under the Company's license as described in section '<i>Belleville, Ontario (HEXO)</i>'. Previously management anticipated KIT to be operational by the end of the calendar year, however, due to additional construction required to zone the operations management now expects to have KIT commissioned and ready for testing before the end of Q2'22. Therefore, KIT remains non-operational as at July 31, 2021.</p> <p>As at July 31, 2021 the remaining capital budget for KIT remains in draft and is approximately \$14,400 of incremental spend to prepare the site and take KIT operational.</p>
Fort Collins, CO, USA	Manufacturing	<p>In June 2021, the Company finalized the acquisition an approximate 50,000 sq.ft. facility in the state of Colorado. The Company's first</p>

		international property allows for the necessary infrastructure to expand our joint venture with Molson Coors, Truss CBD USA and provide US CPG companies access to the Powered by HEXO® technology and products.
Stellarton, Nova Scotia	Manufacturing	The Company obtained the Stellarton Facility by way of the acquisition of Zenabis on June 1, 2021. The 255,000 sq. ft. indoor facility in Stellarton, Nova Scotia, is currently used as a packaging, processing and value-added cannabis product manufacturing facility. The facility is currently licensed by Health Canada for Standard Cultivation and Standard Processing (effective May 29, 2020 and expiring March 1, 2022). In addition, a Research license has been granted (effective December 14, 2020, and expiring December 10, 2025) to conduct activities at the site.
Brantford, Ontario	R&D	<p>HEXO's Brantford, Ontario facility is currently serving as a strain development site (with additional cultivation capability) facility, featuring 14,000 sq. ft. of indoor growing space on 1 acre of land. The facility was designed and engineered to permit pharmaceutical-quality management standards utilized by Canada's pharmaceutical manufacturers to be used in the production of cannabis in all acceptable forms. The facility is fully licensed by Health Canada (Standard Cultivation, Standard Processing and Sale for Medical Purposes (current license effective December 6, 2019 and expiring December 6, 2022)).</p> <p>Subsequent to July 31, 2021, management has decided to wind down operations at the R&amp;D facility and relocate this activity to the Masson campus.</p>
Vaughan, Ontario	R&D	HEXO's Vaughan, Ontario facility is its planned cannabis research laboratory for the development of edible products and related intellectual property, featuring 14,200 sq. ft. of leased commercial space. The facility includes a sensory testing area and a complete commercial kitchen. The facility received its Cannabis Research license on August 27, 2020, which is effective until October 25, 2024.
Ottawa, Ontario	Other	HEXO leases approximately 40,036 sq. ft. of office space in Ottawa, Ontario for its administrate and finance office space.
Montreal, Quebec	Other	HEXO's Montreal Quebec distribution facility is a warehouse and distribution centre, featuring 58,000 sq. ft. of leased commercial space. The facility serves as a warehouse and distribution centre for Quebec adult-use webstore orders for the SQDC, which are managed for the SQDC by HEXO and Metro Supply Chain Group Inc. It houses product from all the licensed producers who have contracts with the SQDC and serves as the sole distribution point for all direct-to-consumer shipments within the Province of Quebec for orders placed through the SQDC online webstore. This facility is fully operational and is regulated by the SQDC and does not require licensing by Health Canada.
Langley, British Columbia	Other	The Langley Facility was acquired by the Company via the acquisition of Zenabis on June 1, 2021. The facility was a leased 450,000 sq. ft. greenhouse in Langley, British Columbia retrofitted for cannabis production. The facility was licensed by Health Canada for Standard Cultivation and Standard Processing (effective December 13, 2019 and expires August 2, 2022). In addition, a Research license has been

		<p>granted (effective December 14, 2020 and expires December 10, 2025) to conduct activities at this site. In August 2021, the Company finalized the decision to close the facility as part of synergistic efforts to streamline operations and reorganize under the new group of entities.</p> <p>As of the date of this MD&amp;A, the Company has significantly completed ending its operations at the Langley Facility. The cessation of operations is in order to realize synergistic cost savings as intended on acquisition.</p>
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## HEXO USA

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We believe that the U.S. cannabis market represents a significant opportunity to create a global company. As such, we have taken some important first steps to begin entering this market.

- ✓ Established HEXO USA Inc. (“HEXO USA”) – a wholly owned US based entity to facilitate our expansion into the US hemp market. We have appointed a general manager for HEXO’s U.S operations whose role currently includes standing up and commissioning production facilities, overseeing operations, supply chain and logistics, and building the team.
- ✓ Established KIT USA – Sister entity of KIT, which will allow for in state, HEXO controlled cannabis extraction activity. In the future we aim to utilize this technology to offer our “Powered by HEXO” products to our future partners.
- ✓ Establish Truss CBD USA – We have created a second joint business venture, Truss CBD USA LLC (“Truss CBD USA”) with Molson Coors Beverage Company (“Molson Coors”). Established in Colorado, Truss CBD USA is majority owned by Molson Coors and operates as a stand-alone entity with its own board of directors, management team, resources and go-to-market strategy. All production for Truss CBD USA will be kept within Colorado state lines since it is one of a few states that has an established regulatory framework for hemp-derived CBD in food and beverages.

During the current fiscal year, Truss CBD USA was rolled out across select grocery markets within Colorado. Subsequent to year end, Truss CBD USA launched products in an additional 17 states. The operations of Truss CBD USA are currently non-material. Truss CBD USA and HEXO’s activities in relation to it will be conducted in accordance with all applicable laws.

- ✓ Purchased facility - On June 28, 2021, we announced the completion the acquisition of a 50,000 sq. ft. facility in Colorado to use for our U.S. expansion plans. The facility is zoned for production of a full range of cannabis products and offers a variety of operational capabilities. The site is located along primary shipping routes and will be retrofitted to support Powered by HEXO® initiatives across the country.

# Corporate Social & Environmental Responsibility

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At HEXO, our goal is to become one of the top three global cannabis products companies. We know that if we want to achieve our goal, we need to think about more than just our products and prices. We must also examine the way our operations impact the natural and social environment. We are monitoring and reporting on our greenhouse gas emissions, setting targets to reduce them, and offsetting our footprint. Our Corporate Social Responsibility Charter focuses on four priorities: People, Public, Products and Planet.

We recently entered into a partnership with Offsetters, a Vancouver-based organization that supports renewable energy and carbon projects across the world, and became carbon neutral in September 2021, as well as offsetting 100% of the Company's operational carbon emissions in addition to the personal emissions of our 1,200 employees<sup>8</sup>. At home in Canada, we are helping reduce old-growth tree harvesting by supporting the Great Bear Forest Carbon Project. This landmark project balances human well-being and ecological integrity through carbon finance and is the first carbon project in North America on traditional territory with unextinguished Aboriginal rights and title.

In addition to carbon emissions, we are also counteracting the use of plastic in our packaging. Working alongside our primary packaging supplier Dymapak, in conjunction with Plastic Bank, we have supported Plastic Bank's ethical recycling ecosystems in coastal communities which collect and reprocess ocean-bound plastics for re-introduction to the global manufacturing supply chain. In doing so, we have offset 71,000 kilograms of plastic – the total equivalent of over 3.55 million plastic bottles.

For us, this is just the beginning, and for HEXO, forward starts at neutral.



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<sup>8</sup> Estimated personal emissions based on the average Canadian's emissions from heating and powering their homes, driving and food consumption.

# COVID-19 Update

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During the year ended July 31, 2021, certain Canadian provinces, enacted province wide restrictions and protocols as a response to the rapid increase in COVID 19 cases, hospitalizations and new variants of the virus. Near the end of the year provinces loosened restrictions as vaccination rates increased and cases counts decreased. Subsequent to this loosening, some areas have reinstated restrictions as a result of an increase in case counts. COVID-19 remains an evolving situation that the Company continues to monitor closely for our employees, our customers, and our stakeholders.

The current impact of COVID-19 and the various provincial restrictions cannot be accurately quantified and may have materially impacted the Company's earnings. Due to the speed with which the COVID-19 situation is developing and the uncertainty of its magnitude, outcome and duration, it is not possible to estimate the future impact on our business, operations or financial results. Refer to the section "*Risk Factors*" section for further COVID-19 related risks to the business.

As of the date of this MD&A, the cannabis industry continues to be deemed an essential service to Canadians.

## Corporate Highlights and Events

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### FOURTH QUARTER OF FISCAL 2021



#### **Zenabis Acquisition**

Zenabis is a Canadian-licensed producer of medical and recreational cannabis. They have a cannabis import, export and processing joint venture, ZenPharm, operating out of Birżebbuġa, Malta. HEXO acquired all of the issued and outstanding shares of Zenabis, which was previously listed on the TSX, on June 1, 2021 by way of plan of arrangement. As of the date of this report, management's evaluation of the Zenabis operations and their integration is still in process. The directional strategy for each site and brand is being carefully assessed in order to maximize the proforma value of the combined entity.

#### **Establishment and Launch of At-the-Market Offering up to \$150 Million**

On May 11, 2021, HEXO established an at-the-market equity program (the "ATM Program") that allows us to issue and sell up to \$150 million (or its U.S. dollar equivalent) of common shares in the capital of the Company (the "Common Shares") from treasury to the public, at the Company's discretion. As at July 31, 2021, we had raised gross proceeds of \$46,987 through the issuance of 6,373,926 common shares.

## **Public Offering of USD\$360m Senior Secured Convertible Notes**

On May 27, 2021, we closed an offering of USD\$360 million aggregate principal amount of senior secured convertible notes (the “Notes”) directly to an institutional purchaser and certain of its affiliates or related funds (collectively, the “Purchaser”).

The Notes were sold at a purchase price of USD \$327.6 million or approximately 91.0% of their principal amount. The Notes will mature on May 1, 2023 (the “Maturity Date”). Subject to certain limitations, the Notes will be convertible into freely tradeable common shares of the Company at the option of the Purchaser and, subject to conditions and limitations, at the option of the Company. If not previously converted, all principal repayments of the Notes will be made at a price equal to 110% of the principal amount of the Notes being repaid. The Notes will not bear interest except upon the occurrence of an event of default. The Notes will be issued in registered form, without coupons, under a trust indenture dated May 27, 2021, between HEXO and GLAS Trust Company LLC as trustee (the “Trustee”), as supplemented and modified by resolutions of the board of directors of the Company.

Upon closing of the offering, 70% of the net proceeds have been placed into escrow with a third party. The escrow funds were released in conjunction with the closing of the acquisition of Redecan.

## **SUBSEQUENT TO JULY 31, 2021**

### **HEXO Transfers US Stock exchange Listing to the NASDAQ**

On August 13, 2021, the Company applied to transfer its U.S. stock exchange listing from the New York Stock Exchange to the Nasdaq. The transfer was completed on August 24, 2021, at which point the common shares of HEXO began trading as a Nasdaq-listed security with the shares continuing to trade under the symbol “HEXO”.

### **USD\$144.8M Underwritten Public Offering**

On August 24, 2020, the Company closed an underwritten public offering for total gross proceeds to the Company of US\$144,786. The Company sold 49,080,024 units of the Company at a price of US\$2.95 per Unit under this offering, including 1,622,396 units sold pursuant to the partial exercise of the underwriters’ over-allotment option.

Each unit is comprised of one common share of the Company and one half of one common share purchase warrant of the Company. Each full warrant is exercisable to acquire one common share of the Company for a period of 5 years following the closing date of the Offering at an exercise price of US\$3.45 per share, subject to adjustment in certain events.

The Company used the net proceeds from the Offering to satisfy a portion of the cash component of the purchase price payable to the Redecan shareholders on closing of the Redecan acquisition (see below) and for expenditures in relation to the Company’s U.S. expansion plans.

### **Acquisition of 48North Cannabis Corp.**

On September 1, 2021, HEXO completed the acquisition of 48North. HEXO acquired all issued and outstanding common shares of 48North at a conversion rate of one common share of 48North to 0.02366 of a HEXO common share. The total number of shares acquired and reissued were 5,352,005. Shares of 48North were de-listed from the TSX Venture Exchange on September 2, 2021.

### **Acquisition of Redecan**

On August 30, 2021, the Company completed its acquisition of all of the outstanding shares of the entities that carry on the business of Redecan, Canada’s largest privately-owned licensed producer. At closing, HEXO paid the selling shareholders of Redecan \$400,000 in cash and delivered 69,721,116 newly issued common shares of HEXO with an approximate value of \$214,043. Upon closing the acquisition of Redecan, Peter James Montour joined the HEXO board of directors. Will Montour will act as non-voting observer on the board of directors, until his election to the board in accordance with the investor rights agreement undertaken at acquisition.

### **Expansion of Global Leadership Team**

The Company appointed Valerie Malone as Chief Commercial Officer, effective September 6, 2021. Valerie brings more than 20 years of experience managing businesses across different verticals including consumer packaged goods, technology and electronics, durable goods and consulting to her role at HEXO. As HEXO's Chief Commercial Officer, Valerie will oversee the Marketing, Sales and Product Development groups with a focus on commercial strategy and development.

The Company also appointed Guillaume Jouët as Chief People & Culture Officer, effective September 8, 2021. Guillaume brings more than 20 years of experience as a senior international executive leading human resources, sustainability, public affairs and communications functions, to his role at HEXO. Recognized for successfully connecting growth and sustainability strategies, talent and organization development, innovation, and business opportunities, Guillaume has a proven record of driving engagement and performance. As HEXO's Chief People & Culture Officer, Guillaume will oversee the People & Culture group with a focus on developing and building an engaged workforce that supports the company's corporate goals.

### **Strategic Executive Change**

On October 18, 2021, Sébastien St-Louis, Co-Founder and Chief Executive Officer, departed the Company. Mr. St-Louis will remain on the Company's board of directors. HEXO also announced the resignation of the Company's Chief Operating Officer, Donald Courtney. He will remain as COO until a suitable replacement is identified.

On October 20, 2021, the Company appointed Scott Cooper as incoming President and Chief Executive Officer. The Company's Chairman, Dr. Michael Munzar will be acting in the capacity of the Chief Executive Officer until the Company's 2021 annual report is publicly filed, at which time, Mr. Cooper will effectively become the Company's President and Chief Executive Officer.



# FINANCIAL RESULTS

For the years ended July 31, 2021 and 2020

## Operational and Financial Highlights

### KEY FINANCIAL PERFORMANCE INDICATORS

Summary of results for the three months ended July 31, 2021, April 30, 2021 and July 31, 2020, and the years ended July 31, 2021, 2020 and 2019.

Income Statement Snapshot	For the three months ended			For the twelve months ended		
	July 31, 2021	April 30, 2021	July 31, 2020	July 31, 2021	July 31, 2020	July 31, 2019
Revenue from sale of goods	\$ 53,022	\$ 33,082	\$ 36,140	\$ 173,081	\$ 110,149	\$ 59,256
Excise taxes	(14,365)	(10,482)	(9,082)	(49,583)	(29,598)	(11,914)
Net revenue from sale of goods	38,657	22,600	27,058	123,498	80,551	47,342
Ancillary revenue	103	60	87	271	233	199
Total revenue	38,760	22,660	27,145	123,769	80,784	47,541
Gross profit before adjustments <sup>2</sup>	7,988	5,006	8,104	34,175	26,953	21,344
Gross profit/(loss) before fair value adjustments <sup>2</sup>	1,499	4,379	(36,012)	29,066	(46,421)	2,009
Gross profit/(loss) <sup>2</sup>	3,234	8,816	(34,690)	48,798	(57,975)	24,508
Operating expenses	(63,116)	(24,906)	(71,509)	(134,293)	(418,576)	(111,482)
Loss from operations	(59,882)	(16,090)	(106,199)	(85,495)	(476,551)	(86,974)
Other expenses and losses	(9,630)	(4,621)	(63,333)	(29,664)	(75,961)	(847)
Loss and comprehensive loss before tax	(69,512)	(20,711)	(169,532)	(115,159)	(552,512)	(87,821)
Current and deferred tax recovery	397	—	—	397	6,023	18,213
Other comprehensive income	1,156	3	—	1,152	—	—
Total Net loss and comprehensive loss	(67,959)	(20,708)	(169,532)	(113,610)	(546,489)	(69,608)

<sup>1</sup> The Company has adjusted the presentation of gross profit before fair value adjustments by removing inventory and biological asset write offs and impairment losses.

<sup>2</sup> See section 'Cost of Sales, Excise Taxes and Fair Value Adjustments' for reconciliation of gross profits

### Quarterly Financial Significant Items

- Total revenue growth of 71% quarter over quarter and 43% from the comparative quarter of fiscal 2020.
- 41% organic growth (exclusive of sales from acquisition) in total net sales during the period from Q3'21.
- \$6,800 of Zenabis contributed net sales for the post acquisition, two months ended July 31, 2021.
- Net adult-use revenue (exclusive of beverages) increased 28% quarter over quarter.
- Cannabis beverage net sales growth of 70% quarter over quarter and 161% from the prior fiscal year.
- Acquisition and transactions costs related to the M&A activity of Zenabis, 48North and Redecan were \$14,869 and \$17,174 in the three and twelve months ended July 31, 2021, respectively.
- The recognized deferred day 1 loss on the senior secured convertible note was \$9,229 in the three months ended July 31, 2021.
- The Company has issued a going concern note (Note 2) within the financial statements for the year ended July 31, 2021 (see section 'Going Concern'.)

## Summary of Results

### Revenue

The following table represents the Company disaggregated gross and net revenues by sale stream for past rolling five fiscal quarters.

For the three months ended	Units	Q4'21	Q3'21	Q2'21	Q1'21	Q4'20
<b>ADULT-USE (EXCLUDING BEVERAGES)</b>						
Adult-use cannabis gross revenue	\$	<b>38,511</b>	29,273	39,417	35,898	31,164
Adult-use excise taxes	\$	<b>(13,954)</b>	(10,122)	(12,513)	(11,554)	(8,589)
Adult-use cannabis net revenue	\$	<b>24,557</b>	19,151	26,904	24,344	22,575
Dried grams and gram equivalents sold (kg)	kg	<b>12,385</b>	8,645	10,450	11,241	7,661
<b>ADULT-USE (BEVERAGES)</b>						
Adult-use cannabis gross revenue	\$	<b>5,541</b>	3,330	3,648	3,302	2,386
Adult-use excise taxes	\$	<b>(348)</b>	(281)	(256)	(245)	(397)
Adult-use cannabis net revenue	\$	<b>5,193</b>	3,049	3,392	3,057	1,989
Dried grams and gram equivalents sold (kg)	kg	<b>5,934</b>	3,461	3,782	3,872	334
<b>DOMESTIC MEDICAL</b>						
Domestic medical cannabis gross revenue	\$	<b>261</b>	430	504	574	644
Domestic medical excise taxes	\$	<b>(63)</b>	(79)	(82)	(88)	(96)
Domestic medical net revenue	\$	<b>198</b>	351	422	486	548
Dried grams and gram equivalents sold (kg)	kg	<b>73</b>	79	78	83	90
<b>WHOLESALE</b>						
Wholesale cannabis gross revenue	\$	<b>1,899</b>	20	109	401	655
Wholesale non-cannabis gross revenue	\$	<b>—</b>	29	—	—	—
Wholesale cannabis excise taxes	\$	<b>—</b>	—	—	—	—
Wholesale cannabis net revenue	\$	<b>1,899</b>	49	109	401	655
Dried grams and gram equivalents sold (kg)	kg	<b>2,264</b>	4	91	160	258
<b>INTERNATIONAL</b>						
International cannabis gross revenue	\$	<b>6,810</b>	—	2,000	1,125	1,291
International cannabis excise taxes	\$	<b>—</b>	—	—	—	—
International cannabis net revenue	\$	<b>6,810</b>	—	2,000	1,125	1,291
Dried grams and gram equivalents sold (kg)	kg	<b>2,600</b>	—	800	450	493
<b>ANCILLARY REVENUE<sup>1</sup></b>	\$	<b>103</b>	60	53	55	87
<b>Total net revenue</b>	\$	<b>38,760</b>	22,660	32,880	29,468	27,145

<sup>1</sup> Revenue outside of the primary operations of the Company. These revenues are derived from a management agreement held by the Company with arms-length partners.

The following table represents the Company disaggregated gross revenues by sale stream for the past three fiscal years.

For the years ended	July 31, 2021	July 31, 2020	July 31, 2019
Retail (excluding beverage)	\$ <b>143,098</b>	\$ 101,713	\$ 53,590
Cannabis beverage retail	\$ <b>15,821</b>	\$ 2,851	\$ —
Medical	\$ <b>1,769</b>	\$ 3,299	\$ 5,288
Wholesale	\$ <b>2,458</b>	\$ 995	\$ 378
International	\$ <b>9,935</b>	\$ 1,291	\$ —
<b>Total gross revenue from the sale of goods</b>	<b>\$ 173,081</b>	<b>\$ 110,149</b>	<b>\$ 59,256</b>

### HEXO CIB (Cannabis Infused Beverages)

Sales from the Company's HEXO CIB revenue stream effectively represents the sales activity of the Company's joint business venture with Molson Canada, Truss LP. These sales began in the third quarter of the 2020 fiscal year. HEXO CIB was established in order to manufacture, produce and sell cannabis beverage products until Truss LP obtains its own separate license from Health

Canada. Subsequent to July 31, 2021, Truss LP obtained their Health Canada manufacturing license, effective October 1, 2021. As of the date of this MD&A, the Company is in the process of establishing a new agreement between HEXO and Truss LP which may result in the Company acting as an agent facilitating sales between Truss LP and our customers, and therefore HEXO would likely cease recording such sales on a gross basis.

HEXO CIB currently operates under the Company's cannabis licensing in compliance with Health Canada and the Cannabis Act's regulations. The Company has assessed that the CIB revenue stream remains to be presented on a gross basis as defined under IFRS 15 (see the Company's revenue recognition and presentation policy in the Company's annual financial statements for the year ended July 31, 2021). The Company will continue to operate HEXO CIB until Truss LP has obtained its independent licensing to sell cannabis products from Health Canada, at which point these operations will shift to Truss.

## ADULT-USE SALES

### Non-Beverage Adult-Use Sales

During the three months ended July 31, 2021, the Company's consolidated net adult-use revenue (exclusive of cannabis infused beverages) grew 28% quarter over quarter. The key drivers of the fourth quarter's growth as compared to the previous quarter were the following:

- Net adult-use sales contributed by the brands formerly of Zenabis (acquired June 1, 2021); Namaste and Re-Up amounted to \$3,968.
- The Company's net adult-use sales in the major market of Alberta grew 76% or \$1,658, led by Original Stash dried flower as the stock limitations of the third quarter were alleviated.
- Net adult-use sales in Ontario also saw significant growth in the quarter at 31% or \$1,549. This was on trend with the total growth in the Ontario marketplace which increased 32.5% in the quarter as COVID restrictions eased.
- Increased LP presence in Quebec, specifically in craft growers, as well as an inflow of new product offerings in the province lead to an 19% decline or (\$1,896) in the Company's provincial sales. Provincial market share remained in a top two position.

Adult-use net sales experienced organic growth (excluding the sales of Zenabis) of 9% from the fourth quarter of fiscal 2020. Key factors contributing to the net increase were the following:

- The newly launched brands within fiscal 2021; Bake Sale and Up! contributed net sales totalling \$5,233.
- Offsetting the above was the decline in the Company's premium brand HEXO Plus sales in Quebec due to additional competition.

Total organic adult-use net sales in the 2021 fiscal year grew by 31% from fiscal year 2020 due to the following:

- New brands launched in the fiscal year contributed sales totalling \$15,754;
- The Company's pre-roll line Original Stash Joints which launched in 2021 added sales of \$3,595; and
- New cannabis 2.0 innovative products such as Hash (introduced in late fiscal 2020) and Klik contributed new net revenue of \$9,621.

### Beverage Based Adult-Use Sales (see section 'HEXO CIB')

In the fourth quarter of fiscal 2021, the Company's cannabis infused beverage net sales increased to \$5,193, representing growth of 70% quarter over quarter. The growth was in part due to new product offerings amounting to \$570 and increased sales of the Company's high THC brand, XMG which contributed additional sales of \$1,310 from the previous quarter. Truss products retained a number one market share at 38% per OCS shared data during the three months ended April 30, 2021. Cannabis beverage sales as compared to the three months ended July 31, 2020, grew 161% due to a significantly larger and more diversified variety of offerings. As of July 31, 2021, the Company carried a total of 28 beverage product offerings, an increase of 3 and 25 from the prior quarter and the fourth quarter of fiscal 2020, respectively.

Quarter over quarter changes to beverage market share in the key Canadian provincial markets of Ontario, Quebec, Alberta and BC for the three months ended July 31, 2021 were as follows:

- Ontario market share increased to 40% from 38.5%. Total Ontario market sales grew 48% in the fourth quarter which helped drive the Company's beverage sales;
- BC market share increased to 51% from 43%;
- Alberta market share increased to 53% from 44%; and

- Quebec market share increased to 56% from 46%.

The Company recognized total beverage net revenues of \$14,691, representing growth of 507% from fiscal 2020. The experienced growth is a function of a full fiscal year of beverage sales in 2021 compared to just two quarters fiscal year 2020 as cannabis infused beverages were launched in the early Spring of 2020.

The Company notes that on October 1, 2021, Truss received their Health Canada manufacturing licensing. As of the date of this MD&A, the Company and Truss continue to work towards amending the TSSA between the entities and evaluate the potential for Truss to begin to recognize the CIB revenues with HEXO acting as the agent to facilitate these sales. This arrangement would effectively be in place until Truss receives their cannabis selling license which is expected in the latter half of fiscal 2022.

#### **INTERNATIONAL SALES**

In the fourth quarter of fiscal 2021 the Company realized \$6,810 of international medical sales in Israel. In the previous quarter the Company recognized no international medical cannabis sales due to revised prerequisite testing and an additional certification by the Israeli government which caused a delay in the Company's ability to export. During the period, the Company resumed its export activity with Israel and effectively doubled international medical sales in the current period due to the catch up from the previous quarter. The consolidated results of Zenabis provided an additional \$935 for the period of June 1, 2021 to July 31, 2021.

Currently, international medical sales arise from a 24-month purchase agreement established with an Israel based medical cannabis company in Q4'20 in which period the Company recognized \$1,291 of initial sales. These sales are also free of excise taxes as this burden belongs to the acquirer and ultimately the seller of the cannabis products and therefore by nature contribute a higher net revenue per gram sold.

#### **DOMESTIC MEDICAL SALES**

Domestic medical net revenue decreased 44% to \$198 from \$351 quarter over quarter. The decline is the result of reduced average prices of dry domestic medical grams sold by \$0.90 per gram as volumes sold fell by 6%. During the comparable periods of the three months ended July 31, 2020, net domestic medical sales decreased 64% from \$644 as a result of decreasing average medical product pricing to bring in line with the adult-use market.

Domestic net medical sales for the year ended July 31, 2021, fell 48% when compared to fiscal 2020 as a result of the above mentioned decrease in average medical pricing along with reduced volumes sold of 46%.

#### **WHOLESALE REVENUE**

Wholesale activity consists of transactions held between the Company and other licensed producers. These sales are generally large quantities at reduced prices per gram and gram equivalent which vary from sale to sale. These sales can include both cannabis and non-cannabis products and are also free of excise taxes as this burden belongs to the acquirer and ultimately the seller of the cannabis products and therefore possess a higher net revenue margin.

During the three months ended July 31, 2021 the Company recognized \$1,899 of wholesaling revenue. Wholesale revenues during the fourth quarter were driven by the acquisition of Zenabis, which accounted for significantly all of these revenues in the period, up from \$49 and \$655 in the previous fiscal quarter and the fourth quarter of fiscal 2020.

In the year ended July 31, 2021, the Company's wholesale revenue grew 147% from \$995 in fiscal year 2020 due to the above stated additional revenues derived from the acquisition of Zenabis.

#### **For the years ended July 31, 2020 vs. 2019**

The Company's total medical sales have steadily declined year over year since legalization in early fiscal 2019, upon which the Company realigned its focus and resources to the adult-use market.

Net sales of adult-use cannabis have increased significantly since 2019 due to the maturity and growth of the Canadian retail market. Sales in fiscal 2019 were limited to the initial wave of legalized products (dry flower and certain oils) as well as constrained by the slow roll out of retail brick and mortar cannabis outlets in key provinces.

The sale of cannabis infused beverages and the Company's international sales activity began in fiscal year 2020 and as such there were no sales in the fiscal year 2019.

#### **Cost of Sales, Excise Taxes and Fair Value Adjustments**

Cost of goods sold includes the direct and indirect costs of materials and labour related to inventory sold, and includes harvesting, processing, packaging, shipping costs, depreciation and applicable stock-based compensation and direct and indirect overhead.

Fair value adjustment on sale of inventory includes the fair value of biological assets included in the value of inventory transferred to cost of sales.

Fair value of biological assets represents the increase or decrease in fair value of plants during the growing process, less expected cost to complete and selling costs and includes certain management estimates.

The following table summarizes and reconciles the Company's gross profit line items per IFRS to the Company's selected non-IFRS measures gross profit before adjustments and gross profit before fair value adjustments. Refer to section 'Non-IFRS Measures' for definitions.

	For the three months ended			For the years ended	
	July 31, 2021	April 30, 2021	July 31, 2020	July 31, 2021	July 31, 2020
Net revenue	\$ 38,760	\$ 22,660	\$ 27,145	\$ 123,769	\$ 80,784
Cost of sales	(30,772)	(17,654)	(19,041)	(89,594)	(53,831)
<b>Gross profit before adjustments</b>	<b>7,988</b>	5,006	8,104	<b>34,175</b>	26,953
Write off of biological assets and destruction costs	—	—	—	—	(663)
Write off of inventory	(1,181)	(627)	(2,217)	(2,182)	(4,392)
Write (down)/up of inventory to net realizable value	(5,308)	—	(41,899)	(2,927)	(68,319)
<b>Gross (loss)/profit before fair value adjustments</b>	<b>1,499</b>	4,379	(36,012)	<b>29,066</b>	(46,421)
Realized fair value amounts on inventory sold	(14,148)	(6,426)	(6,656)	(31,767)	(40,910)
Unrealized gain on changes in fair value of biological assets	15,883	10,863	7,978	51,499	29,356
<b>Gross (loss)/profit</b>	<b>3,234</b>	8,816	(34,690)	<b>48,798</b>	(57,975)

#### EXCISE TAXES

Excise taxes are applicable to the adult-use and medical sales. Excise taxes are presented against the revenue generated by the sale of cannabis to derive the Company's net revenues on cannabis sales. Excise taxes for flower-based products are a function of fixed provincial and territorial rates based upon the gram equivalents sold as well as a variable ad valorem component which is dependent upon the selling price of the products. Excise taxes for distillate, oil-based products, such as the adult-use cannabis infused beverages are applied on the basis of a fixed amount per mg of THC, whereas CBD products are free of excise taxes.

Wholesale and International medical based sales are free of the excise tax burden.

Generally, increases to excise taxes are the result of increased adult-use sales when compared to fiscal 2020. As a percentage of adult-use gross sales in the period, excise taxes have increased to 36% from 35% of gross revenue, quarter over quarter and from 28% in Q4'20. This increase in the ratio is due to the declining average flower selling prices and an average decreased sales mix price due to increased market competition and competitive pricing strategies implemented in attempts to gain and hold market share.

#### COST OF SALES & GROSS MARGIN BEFORE ADJUSTMENTS

The following table illustrates the breakout of gross profit before adjustments (non-IFRS measure) by sales stream for the current the previous fiscal quarters.

For the three months ended	Adult-Use (excluding beverages)	Medical	International	Wholesale	Total non-beverage	Adult-use beverages	Company total
<b>July 31, 2021</b>	\$	\$	\$	\$	\$	\$	\$
Net revenue	24,557	198	6,810	1,899	33,464	5,193	38,657
Cost of sales	(21,652)	(116)	(2,383)	(3,125)	(27,276)	(3,496)	(30,772)
Gross profit before adjustments (\$)	2,905	82	4,427	(1,226)	6,188	1,697	7,885
Gross margin before adjustments (%)	12%	41%	65%	(65%)	18%	33%	20%
<b>April 30, 2021</b>	\$	\$	\$	\$	\$	\$	\$
Net revenue	19,151	351	—	49	19,551	3,049	22,600
Cost of sales	(13,860)	(128)	—	(48)	(14,036)	(3,618)	(17,654)
Gross profit before adjustments (\$)	5,291	223	—	1	5,515	(569)	4,946
Gross margin before adjustments (%)	28%	64%	Nil%	2%	28%	(19%)	22%
<b>July 31, 2020</b>	\$	\$	\$	\$	\$	\$	\$
Net revenue	22,575	548	1,291	655	25,069	1,989	27,058
Cost of sales	(13,663)	(119)	(642)	(222)	(14,646)	(4,395)	(19,041)
Gross profit before adjustments (\$)	8,912	429	649	433	10,423	(2,406)	8,017
Gross margin before adjustments (%)	39%	78%	50%	66%	42%	(121%)	30%

## International

The Company resumed its international sales during the period (see section 'Revenues – International Sales'). There is no excise tax burden applicable to International sales and the gross margin remains consistent with that of the first and second quarters of fiscal 2021. Previously, the Company realized no international sales during the three months ended April 30, 2021 due to new logistical requirements imposed by the Israel government, which were ultimately satisfied in the current period. As compared to the same period of fiscal 2020, the gross margin increased as the result of additional, onetime packaging costs required to be borne by the Company in Q4'20. As, previously disclosed, the Company's wholesale activity and the associated gross margins may vary from period to period as they are dependent upon the specific wholesale agreements with other licensed producers.

## Wholesale

Wholesale increased during the current quarter as the result of the Zenabis acquisition. However, the gross margin was negatively impacted by the applicable business combinations accounting, in which the fair market value adjustments associated to the existing inventory, were crystallized to the inventory's cost base at the acquisition date. When normalized for the impact of these crystallized fair value adjustments, gross margin improved to 21%. The negative impact to gross margin is transitory by nature as the acquired inventory is sold through.

### Adult-Use (excluding beverages)

The Company's total non-beverage gross margin declined to 18% from 28% in the previous quarter. Excise taxes as a percentage of sales increased 5% in the period which negatively impacted gross margin which was, in part, due to sales outside of the province of Quebec increasing (Quebec has a lower excise tax burden relative to other major provincial markets). Also, the average selling price decreased 10% as the result of more competitive market prices and there was an increased sales mix of the Company's lower margin, value brands.

Similar to what is disclosed above in 'Wholesales', the crystallization of fair value adjustments to the cost basis of inventory at the acquisition date of Zenabis extended to the Company's adult-use sales. When normalized for this, gross margins improve to 14% from the above stated 12%,

As compared to the fourth quarter of fiscal 2020, the gross margin decreased significantly as the average selling prices have fallen by 33% due to increasingly competitive market rates and the introduction of value brands such as Bake Sale.

## Cannabis Infused Beverages

The adult-use beverage gross margin increased significantly to 33% during the quarter, from its previous level of break even and below. These sales through the Company's CIB division (see section 'HEXO CIB') which began material activity in the fourth quarter of fiscal 2020, remain on the path of scaling to optimal production levels. As seen in the current period in which volume sold has increased 71% the previously unabsorbable overhead output levels have been reduced.

Total cost of sales for the Company in the year ended July 31, 2021 increased 66% when compared to the year ended July 30, 2020 as the result of an incremental gross sales increase of 54%, as well as those factors noted above.

## **IMPAIRMENTS AND WRITE OFFS**

During the three months ended July 31, 2021 the Company destroyed \$1,181 of unsellable, aged, dried cannabis inventory and \$5,308 in write downs to net realizable value ("NRV"). The NRV write downs were due to obsolete packaging and raw materials as well as aged finished goods which do not meet desired specifications.

The Company recorded \$5,109 of write offs and net write downs to NRV in the year ended July 31, 2021. In addition to the above, these net losses were due to the following:

- The Company destroyed \$2,182 of aged cannabis inventory; and incurred an additional \$4,529 of impairment related to excess and obsolete cannabis materials; and
- A reversal of impairment of \$1,602 was due to the Company realizing sales of previously written down adult-use dried flower product.

In the comparative period of the three months ended July 31, 2020 the Company incurred write downs on inventory to net realizable value of \$41,899 and write offs of \$2,217. These losses were due to the following;

- The Company impaired \$41,899 of inventory deemed to be in excess of external demand and internal utilization plans. The largest component of the impairment was \$29,540, related to outdated, older dry product, and is inclusive of \$15,649 of trim. The Company's more recently grown trim is to be utilized in the trim management plan. The Company also impaired \$5,503 of purchased cannabis oil related to an onerous supply agreement; and

- The Company switched to utilizing lower cost and more efficient pouches from traditional jars in the packaging process, resulting in a write off of \$2,217.

During the year ended July 31, 2020, the Company had write downs on inventory to NRV of \$68,319. In addition to the above, total impairment losses realized were due to the following:

- Write down of concentrated bulk purchase of \$1,422 due to an excess supply which reduced the value relative to the contractual obligation price.
- A reversal of impairment was recognized on previously written down cannabis trim of \$1,241 due to the Company's trim utilization plan in which trim previously primarily used for extraction is being utilized for other US value added products.
- Write down of a surplus of cannabis trim (trim was primarily used for extraction purposes) and milled products the amount of \$17,098 due to an excess of stock relative to the Company's short-term demand for cannabis distillate production;
- Write down of bulk purchased product of \$16,166 due, in part, to an oversupply in the market of bulk products with lower potencies as well as a relatively low value when compared to competing bulk goods with a higher potency in the current adult-use market;
- Write down of oil based finished goods of \$3,436 due a surplus of finished goods as oil-based products haven't captured the market share as originally estimated. Also contributing to the impairment is the decision made by certain provinces to return oil products with packaged dates greater than 3 to 4 months old;
- Write down of finished goods of \$1,186 which are required to be archived as at October 31, 2019 and possess a NRV of \$nil; and
- Write down in the amount of \$1,241 was recognized due to costs related to packaging reconfiguration

The continuing evolution of the cannabis industry and market conditions represent ongoing uncertainties that may affect the Company's future financial results and impairments. See "*Risk Factors*" for additional economic and inventory risks.

#### FAIR VALUE ADJUSTMENTS

The unrealized gain on changes in fair value of biological assets for the current period increased 46% from the previous quarter. The increase is the direct result of the additional \$9,041 in unrealized gains on the write up of biological assets acquired via the business combination of Zenabis. This is due to the realization of previous gains on biological assets at day one as mandated by IFRS 3. The Company's organic unrealized gain on changes in fair value of biological assets decreased by approximately \$4,000 or 37% quarter over quarter as the result of decreased average selling prices which adversely affected the value of its biological assets. Year over year, the Company's organic unrealized biological asset gains increased 45% due to higher average yields. This is the result of more efficient cultivation and a larger bud to trim ratio. This increase is netted against the Company's decreasing average weighted selling prices year over year.

The realized fair value adjustment on inventory sold for the three months ended July 31, 2021 increased 120% compared to the previous quarter and increased 113% for the comparable quarter of fiscal 2020. The increase is mainly attributable to an increase in grams sold as well as an approximate \$6,000 write-down of inventory; \$4,500 related to project commissioning, and \$1,500 for obsolete inventory. In addition, year over year realized fair value adjustment on inventory sold decreased in FY21 by approximately 22%. This reduction is driven by a decrease in inventory write-downs.

#### Operating Expenses

	For the three months ended			For the years ended		
	July 31, 2021	April 30, 2021	July 31, 2020	July 31, 2021	July 31, 2020	July 31, 2019
Selling, general and administration <sup>1</sup>	\$ 19,160	\$ 11,178	\$ 12,436	\$ 54,543	\$ 52,793	\$ 45,947
Marketing and promotion	3,665	2,452	2,375	10,348	12,474	31,191
Share-based compensation	827	2,715	4,373	11,731	25,790	28,008
Research and development	934	730	677	3,835	4,639	2,822
Depreciation of property, plant and equipment	1,728	1,612	1,179	6,097	6,072	1,747
Amortization of intangible assets	1,002	371	249	2,050	3,939	1,767
Restructuring costs	1,562	336	(79)	3,283	4,767	—
Impairment of property, plant and equipment	19,350	16	46,414	20,230	79,418	—
Impairment of intangible assets	—	—	2,000	—	108,189	—
Impairment of goodwill	—	—	—	—	111,877	—
Realization of onerous contract	—	—	1,763	—	4,763	—
Disposal of long-lived assets	—	—	122	1,294	3,855	—
Loss/(gain) on disposal of property, plant and equipment	19	(19)	—	64	—	—
Acquisition transaction costs	14,869	1,871	—	17,174	—	—
Health Canada Recovery Fee's <sup>1</sup>	—	3,644	—	3,644	—	—
<b>Total</b>	<b>63,116</b>	<b>24,906</b>	<b>71,509</b>	<b>134,293</b>	<b>418,576</b>	<b>111,482</b>

<sup>1</sup> The Company has adjusted the presentation of the Selling, General and Administrative expenses to breakdown the Health Canada Recovery Fee's for ease of user review and identification. This presentation differs from that of the Company's interim financial statement for the year ended July 31, 2021.

Operating expenses include general and administrative expenses, marketing and promotion, share-based compensation, research and development, and depreciation/amortization expenses. Marketing and promotion expenses include customer acquisition costs, customer experience costs, salaries for marketing, promotion and sales staff, and general corporate communications expenses. Selling, general and administrative expenses include salaries for administrative staff and executive salaries as well as general corporate expenditures including legal, insurance and professional fees.

#### **SELLING, GENERAL AND ADMINISTRATIVE**

During the three months ended July 31, 2021, the Company's selling, general and administrative expenses increased 54% compared to the fourth quarter of fiscal 2020. This increase is due to the following:

- Payroll related and other general expenses during the fourth quarter increased due to the addition of Zenabis operations during the two months post June 1, 2021 acquisition and the associated increased headcount.
- Audit and legal related professional fees have increased as the Company has increased in both complexity and size year over year, due to SEC filing status change and M&A activity.
- Facility related expenses have increased due to the operations of three new facilities which began upon acquisition of Zenabis June 1, 2021.
- The Company's commercial insurance expenses have also grown approximately 50% from Q4'20 due to increased size and scale of the consolidated operations of HEXO.

As previously noted the Health Canada Licensing fee was expensed in full during the previous fiscal quarter.

As a percentage of total gross revenues, SG&A expenses, have improved by 13% from 48% as compared to the fiscal year ended 2020.

Total SG&A expenses for the year end July 31, 2021 increased significantly from that of 2020 due to the general increase in size, scale and complexity of the Company and its operations. These include, increased uncapitalizable professional fees for US expansion, regulatory and financing events, increased professional service fees, additional insurance coverage, increased payroll related expenses and M&A activity. Included in SG&A in the three months ended July 31, 2021 is \$5,849 of additional payroll, professional, general and administrative expenses incurred due to the Zenabis operations.

#### **MARKETING AND PROMOTION**

Marketing and promotion expenses increased quarter over quarter and from the comparative period of fiscal 2020 because of increased market research, marketing of the relaunched Up brand, expansion of the Bake Sale brand and new marketing required for increased retail locations as provinces like Ontario have seen a significant increase in the number of retail stores in the past year.

Marketing and promotion expenses in the year ended July 31, 2021, decreased 17% as the result of decreased promotional contracts, advertising campaigns, and programs.

#### **RESEARCH AND DEVELOPMENT ("R&D")**

During the three months ended July 31, 2021 and compared to the same period of fiscal 2020, R&D expenses increased nominally as the result of increased payroll related expenses and additional materials and supplies expenses related to new product testing in the Company's Brantford facility which was converted to an R&D facility in early fiscal 2021, where future strain development takes place.

When compared to the twelve months ended fiscal year 2020, R&D decreased by 17% as a result of rightsizing of the R&D departments in fiscal 2020.

#### **SHARE-BASED COMPENSATION**

In the three months ended July 31, 2021, share-based compensation expenses decreased from the previous quarter because of the revalued cash-settlement based share liability which is revalued at each period end. The Company's share price decreased from \$8.23 on April 30, 2021 to \$4.95 on July 31, 2021 which resulted in a reduction to share-based expenses of \$1,284. The share-based compensation from traditional stock options remained consistent quarter over quarter.

When compared to the same period of fiscal 2020, share-based compensation decreased 81%, attributable to the vesting structuring of high value stock option grants issued in fiscal 2019 winding down towards less expensive vesting periods. Share-based expenses are weighted more significantly in the first twelve months after issuance due to their vesting structure, thus, critical vesting milestones have been reached. Subsequent grants in fiscal 2020 possess a lower call option burden to the Company due to lower market prices, and therefore lower contribution of expenses over time. During the year ended July 31, 2021, share-based compensation was reduced by 47% primarily due to the above.

#### **DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT**

For the three months ended July 31, 2021 and compared to the same period of fiscal 2020, depreciation of property, plant and equipment in operating expenses increased primarily due to the additional depreciation of the Zenabis property plant and equipment acquired.

Compared to the fiscal year ended 2020, depreciation of property, plant and equipment remained flat as the non-production related depreciable asset base remained consistent during the year.

#### **AMORTIZATION OF INTANGIBLE ASSETS**

During the three months ended July 31, 2021 the amortization of intangible assets increased due to the identified Cultivation License and Brands intangible assets recorded upon acquisition of Zenabis.

The amortization of intangible assets decreased from fiscal year 2020. The decrease in the period is due to the amortizable asset base of fiscal 2020 including \$113,888 of cultivation and license assets that were impaired by \$106,189. This resulted in \$3,939 of associated amortization expenses in fiscal 2020 compared to \$2,050 in 2021.

#### **RESTRUCTURING COSTS**

During the current fiscal year the Company underwent a restructuring of certain departments and functions within the organization. This began in the first quarter of fiscal 2021 in which \$525 of executive severance was realized, then followed by the reorganization of the Company human resources department in the second quarter amounting to \$860. The current periods restructuring was due to the severance incurred to restructure the former management of Zenabis and the associated severance payments. These restructuring efforts continue to rescale the Company's operations to the appropriate level in order to drive operating expenses lower.

During the comparative periods of the three and twelve months ended July 31, 2020 the Company was undergoing its initial restructuring efforts to rightsize the Company as previously disclosed in the Company's annual MD&A of fiscal 2020 in section '*Corporate Restructuring*.' These costs were primarily comprised of severance, consulting fees and other payroll related termination costs.

#### **IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT**

The Company incurred impairment losses on property, plant and equipment during the period. The impairments were due to redundant and obsolete cultivation and production equipment not required under the future operating plan.

During the comparative period in fiscal 2020, impairment losses amounted to \$46,414 and 79,418 for the three and twelve months ended respectively. These related to the impairment of the Niagara facility which was ultimately disposed of and certain idle assets under construction and in progress as they were not required under the Company's short term operational needs.

#### **ONEROUS CONTRACT**

The Company incurred no losses on onerous contracts during the three or twelve months ended July 31, 2021.

During the comparative periods twelve months ended July 31, 2020 the Company recognized onerous contract provisions of \$4,763 relating to a fixed price supply agreement for the supply of certain cannabis products to which the Company is currently liable to receive. The onerous portion of the supply agreement is the deemed excess contract price over the current market pricing. The supply agreement is currently the subject of legal proceedings (see section – '*Litigation*'). The costs and purchase obligations under the contract exceed the economic benefits expected to be received.

#### **DISPOSAL OF LONG-LIVED ASSETS**

During the periods of the three ended July 31, 2021, the Company did not dispose of any long-lived assets.

During the comparative periods of fiscal 2020, the Company disposed of certain equipment in the Niagara facility resulting in a loss of \$3,237.

#### **ACQUISITION AND TRANSACTION COSTS**

During the period, the Company began to realize expenses related to the then proposed acquisitions of 48North and Redecan (both of which were finalized after the period). During the period the Company began realizing expenses related to these proposed acquisitions including legal, due diligence, consulting, and other applicable costs. In addition to this, the Company continued to incur expenses relating to the acquisition of Zenabis which closed June 1, 2021. These costs represent uncapitalizable expenses per IFRS 3 – *Business Combinations*. In the previous quarter, the Company realized similar costs related to the Zenabis acquisition.

## Other Income and Losses

	For the three months ended			For the year ended		
	July 31, 2021	April 30, 2021	July 31, 2020	July 31, 2021	July 31, 2020	July 31, 2019
Interest and financing expenses	\$ (23,756)	\$ (3,296)	\$ (2,731)	\$ (32,124)	\$ (10,043)	\$ (469)
Interest income	544	349	662	1,601	1,902	5,187
Interest income (expense), net	(23,212)	(2,947)	(2,069)	(30,523)	(8,141)	4,718
Revaluation of financial instruments gain	7,304	(383)	(1,433)	(2,283)	6,533	(3,730)
Loss from investment in associate and joint ventures	(603)	(2,244)	(1,195)	(6,505)	(6,331)	(2,964)
Loss on inducement of convertible debentures	—	746	(54,283)	—	(54,283)	1,737
Fair value gain/(loss) on convertible debenture	514	—	(86)	1,260	(4,806)	—
Fair value loss on senior secured convertible note	(7,478)	544	(4,345)	(7,478)	(12,880)	(315)
Realized gain (loss) on investments	790	—	—	1,994	24	(215)
Foreign exchange gain/(loss)	12,944	(1,514)	(1,623)	9,108	1,392	(78)
Other income	252	1,177	2,369	4,763	2,531	—
Non-operating income (expense), net	13,723	(1,674)	(60,596)	859	67,820	(5,565)

### INTEREST AND FINANCING EXPENSES

During the three months ended July 31, 2021 interest and financing expenses significantly increased compared to the prior quarter and the same period of fiscal 2020. The increase was due to two events. The first being the acquisition of Zenabis on June 1, 2021 in which the acquired debt contributed approximately \$3,000 of interest and financing fees. Secondly, approximately \$18.8 million of broker, advisory and legal fees were incurred upon the offering of the senior secured convertible note (see section 'Capital Resources').

The increase in financing expenses for the year ended July 31, 2021 is attributable to those reasons as outlined above.

### REVALUATION OF FINANCIAL INSTRUMENTS

The Company revalued certain of its financial instruments on July 31, 2021, resulting in a gain in the current period due to the decrease to the Company's share price from April 30, 2021 which fell from \$8.26 to \$3.10. The unrealized losses in the previous quarter and the fourth quarter of fiscal 2020 were resultant of a lower volatility in the Company's share price. The applicable financial instruments are the Company's USD denominated warrants, which are classified as a liability and remeasured at each period end date.

Similarly, the revaluation gain of \$6,533 in the twelve months ended July 31, 2020 was due to the decrease in the Company's underlying market price year over year, resulting in a reduction of the outstanding warrant liability.

### SHARE OF LOSS FROM INVESTMENT IN ASSOCIATES AND JOINT VENTURES

The Company accounts for its interests in associates and joint venture under the equity method and as such recognizes the applicable portion of their financial results onto the consolidated statement of comprehensive loss.

Quarter over quarter, these losses were reduced significantly by the Company's share of rent recovery income through the BCI joint venture and reduced share of losses from Truss LP due to an increase in non-cannabis revenues and reduced operating expenses. Similarly, the decrease from the fourth quarter of fiscal 2020 due to the aforementioned.

When compared to the fiscal year ended 2020, the losses remained consistent.

### LOSSES ON CONVERTIBLE DEBENTURES AND REVALUATION GAIN ON CONVERTIBLE DEBENTURES

In the three months ended July 31, 2021, the company did not recognize any losses on convertible debenture receivable. In the previous quarter, the Company recognized a gain on revaluation of the \$19,500 convertible debenture receivable extended to Zenabis (the convertible debenture receivable is eliminated upon consolidation in the current period).

In the comparative period of fiscal 2020, an early inducement of \$29,860 aggregate principal amount of the Company's December 2019 convertible Debentures occurred. Offering under the early conversion was a reduction to the effective conversion ratio and one-half warrant per common share, resulting in the loss.

During fiscal year 2020 the Company, in two tranches, converted \$7,000 and \$3,000 debenture receivables to common shares which were immediately disposed of for realized losses of \$4,806.

### FAIR VALUE LOSS ON SENIOR SECURED CONVERTIBLE NOTE

During the period the Company issued a US\$360 million senior secured convertible note. On Day 1 the Company recorded an unrecognized loss of \$96,202 to be recognized straight line over the life of the note. The Day 1 loss is function of the premium paid to secure the necessary funding to enter in the definitive agreement to acquire Redecan. During the period the Company recognized

\$9,229 of the Day 1 loss. At July 31, 2021 the note was revalued to its fair market value and the Company recognized a net fair value gain of \$1,751.

#### UNREALIZED GAIN/(LOSSES) ON INVESTMENTS

The Company's level 1 investments in publicly held companies are marked-to-market at each period end date. During the three months and twelve months ended July 31, 2021 the Company's recorded gain on investments was due to the favorable increase in the underlying markets prices.

The losses in the comparative periods for the three and twelve months ended July 31, 2020, were principally due to the write off of two level 3 private investments which the Company obtained through a previous acquisition.

#### FOREIGN EXCHANGE GAIN/(LOSS)

Gains and losses are the outcome of favorable and unfavorable volatility in the CAD/USD FX rate period over period. As at July 31, 2021, the Company's USD holdings increased significantly due to proceeds of the May 2021 "At the Market Offering" held for the Redecan acquisition.

#### OTHER INCOME

During the three and twelve months ended July 31, 2021 the Company recognized recoveries on partnership as *Other Income* as the result of the Company's arrangement with Truss in which the Company recovers its net loss incurred due to the operations of HEXO CIB (see section *Cannabis Infused Beverage ("CIB")*). This activity remained consistent period over period.

#### Tax Recovery

In the year ended July 31, 2020, the Company realized a tax recovery of \$6,023 to offset the remaining differed tax liability generated through the acquisition of Newstrike in fiscal year 2019. There were no material tax recoveries or expenses during the three and twelve months ended July 31, 2021.

## Adjusted EBITDA

As defined under section '*Non-IFRS Measures*' Adjusted EBITDA is a non-GAAP financial measure that does not have any standardized meaning prescribed by IFRS and may not be comparable to similar measures presented by other companies. The Company calculates Adjusted EBITDA as total net loss, plus (minus) income taxes (recovery), plus (minus) finance expense (income), plus depreciation, plus amortization, plus (minus) investment (gains) losses, plus (minus) non-cash fair value adjustments on the sale of in inventory and biological assets, plus (minus) restructuring and acquisition costs as these are the associated costs for the severance and other payroll related expenses to restructure the Company in such a manner that they are not expected to be a part of the Company's continuous operations, plus (minus) certain non-cash items, as determined by management as follows:

	Q4'21	Q3'21	Q2'21	Q1'21	Q4'20
	\$	\$	\$	\$	\$
<b>Total net loss attributable to shareholders before tax</b>	<b>(69,512)</b>	<b>(20,708)</b>	<b>(20,839)</b>	<b>(4,197)</b>	<b>(169,532)</b>
Finance expense (income), net	23,211	2,947	2,472	1,895	2,069
Depreciation, included in cost of sales	2,308	1,502	2,385	2,406	1,254
Depreciation, included in operating expenses	1,728	1,612	1,679	1,078	1,179
Amortization, included in operating expenses	1,002	371	342	331	249
<b>Investment (gains) losses</b>					
Revaluation of financial instruments loss/(gain)	(7,304)	383	9,937	(733)	1,433
Share of loss from investment in joint venture	602	2,244	2,584	1,073	1,863
Loss/(gain) on convertible debentures	6,964	(746)	—	—	86
Unrealized loss/(gain) on investments	(788)	(544)	(1,248)	587	4,345
Realized loss/(gain) on investments	—	—	—	—	—
Foreign exchange loss/(gain)	(12,945)	1,514	1,862	461	1,623
Loss on inducement of convertible debentures	—	—	—	—	54,283
<b>Non-cash fair value adjustments</b>					
Realized fair value amounts on inventory sold	14,148	6,426	6,387	4,806	6,656
Unrealized gain on changes in fair value of biological assets	(15,883)	(10,863)	(13,657)	(11,096)	(7,978)
<b>Restructuring costs &amp; acquisition costs</b>					
Restructuring costs	1,562	336	860	525	(79)
Acquisition costs	14,869	1,871	436	—	—
<b>Other non-cash items</b>					

	Q4'21	Q3'21	Q2'21	Q1'21	Q4'20
Share-based compensation, included in operating expenses	\$ 827	\$ 2,715	\$ 5,259	\$ 2,930	\$ 4,373
Share-based compensation, included in cost of sales	333	251	402	596	511
Write-off of inventory	1,181	—	—	—	2,217
Write (up)/down of inventory to net realizable value	5,308	—	—	(1,543)	41,899
Impairment loss on right-use-assets	—	—	—	761	2,000
Gain on exit of lease	—	(88)	—	(419)	—
Impairment loss on property, plant and equipment	19,350	16	61	42	46,414
Recognition of onerous contract	—	—	—	—	1,763
Disposal of long-lived assets	19	(19)	1,280	78	122
<b>Adjusted EBITDA</b>	<b>(13,020)</b>	<b>(10,780)</b>	<b>202</b>	<b>(419)</b>	<b>(3,250)</b>

In the fourth quarter of fiscal 2021, the Company's Adjusted EBITDA decreased from the previous quarter due to the reduction of gross margin before fair value adjustments and increased operating expenses (see section 'Cost of Sales Before Adjustments' and 'Operating Expenses'). Gross margin was impacted by the crystallization of fair value adjustments on inventory at Zenabis to its cost base, thereby increasing the total COGS. Operating expenses also increased as the direct result of the acquisition of Zenabis (the Company continues working towards establishing synergist cost savings on its consolidated operating expenses). The reduction of adjusted EBITDA in Q3'21 was attributed decreased sales and gross margin quarter over quarter as well as a \$3,644 in period expense for Health Canada recovery fees. The Company reached Adjusted EBITDA positive in Q2'21 which was due to net revenue increase of 12%. During Q1'21, the Company's Adjusted EBITDA loss continued to improve as management works towards profitability of the Company. This improvement was driven by increased gross margin before fair value adjustments, as well as increased non-cash depreciation expensed through costs of sales due to the impact of produced inventory in periods with higher depreciation being sold. (See section *Revenue, Excise taxes and Cost of Sales*).

## Quarterly Results Summary

The following table presents certain unaudited financial information for each quarter of the past three fiscal years. Past performance is not a guarantee of future performance, and this information is not necessarily indicative of results for any future period.

	Q4 '21 July 31, 2021	Q3 '21 April 30, 2021	Q2 '21 January 31, 2021	Q1 '21 October 31, 2020
Net revenue	\$ 38,760	\$ 22,660	\$ 32,880	\$ 29,468
Total loss and comprehensive loss	(67,959)	(20,708)	(20,839)	(4,197)
Weighted average shares outstanding	142,018,176	122,397,731	122,022,069	120,849,754
Loss per share – basic	(0.48)	(0.17)	(0.17)	(0.04)
Loss per share – fully diluted	(0.48)	(0.17)	(0.17)	(0.04)
	Q4 '20 July 31, 2020	Q3 '20 April 30, 2020	Q2 '20 January 31, 2020	Q1 '20 October 31, 2019
Net revenue	\$ 27,145	\$ 22,132	\$ 17,007	\$ 14,499
Total loss and comprehensive loss	(169,532)	(18,837)	(298,167)	(60,016)
Weighted average shares outstanding	77,376,174	73,852,844	65,835,852	64,249,165
Loss per share – basic	(1.60)	(0.28)	(4.52)	(0.92)
Loss per share – fully diluted	(1.60)	(0.28)	(4.52)	(0.92)
	Q4 '19 July 31, 2019	Q3 '19 April 30, 2020	Q2 '19 January 31, 2020	Q1 '19 October 31, 2019
Net revenue	\$ 15,424	\$ 13,017	\$ 13,438	\$ 5,663
Total loss and comprehensive loss	(44,729)	(7,751)	(4,325)	(12,803)
Weighted average shares outstanding	62,396,681	52,503,466	49,580,750	48,508,345
Loss per share – basic	(0.80)	(0.20)	(0.10)	(0.32)
Loss per share – fully diluted	(0.80)	(0.20)	(0.10)	(0.32)

## Financial Position

The following table provides a summary of our condensed interim consolidated financial position at July 31<sup>st</sup> for past three fiscal years:

	July 31, 2021	July 31, 2020	July 31, 2019
Total assets	\$ 1,311,803	\$ 692,869	\$ 878,623
Total liabilities	579,538	136,193	89,911
Share capital	1,267,967	1,023,788	799,706
Share-based payment reserve	69,750	65,746	40,315
Warrants	124,112	95,617	60,433
Contributed Surplus	41,290	27,377	—
Non-controlling interest	1,987	3,379	1,000
Accumulated other comprehensive income and deficit	(772,841)	(659,231)	(112,742)

### Total Assets

#### FY 2021 vs. FY 2020

On July 31, 2021 the Company's total assets have increased by 89% from July 31, 2020. The following significant activities and events resulted in the net reduction of assets during the twelve months ended July 31, 2021:

- Total assets increased due to the business combination of Zenabis, inclusive of \$88,189 of Goodwill and \$34,314 of acquired intangible assets (brands and licenses).
- The Company's cash and cash equivalents fell \$116,711 (See section '*Liquidity and Capital Resources*')
- Restricted cash significantly increased due to \$385,474 of cash raised through the senior secured convertible note set aside for the Redecan acquisition and certain other contractual obligations.
- Since July 31, 2021, inventory has increased as the result of significantly increased from Zenabis acquisition and the increase in average yields of the Company's biological assets as well as greater bud to trim yields;
- Biological assets increased due to expected yields increased period over period due to entering a higher yielding, increased number of plants and weather favorable season to harvest;
- The acquired property, plant and equipment assets from Zenabis were \$129,074. Outside of these acquired assets, property, plant and equipment decreased as total depreciation and impairments losses exceeded the periods non business combination related additions. This is reflective of reduced construction in progress and capital projects as operations approach scale;
- The Company made a capital contribution of \$4,250 to Truss during the period, which was offset by the Company's share of losses in its joint venture and associates, resulting in a net decrease to the assets of \$1,627;

#### FY 2020 vs. FY 2019

Total assets decreased to \$692,869 as at July 31, 2020 from \$878,623 as at July 31, 2019. The following activities and events resulted in decreases to total assets during the year ended July 31, 2020:

- Goodwill was impaired to \$nil resulting in a decrease of total assets of \$111,877;
- An impairment of Niagara facilities cultivation and production licenses resulted in a reduction to intangible assets in the amount of \$108,189;
- Convertible debenture decreased to \$nil from \$13,354 from the comparative period as the Company has converted and disposed of the underlying securities during the period;
- Cumulative write downs of inventory to net realizable value were \$68,319 in the period, which contributed to the \$18,921 reduction to inventory year over year;
- Short term investments decreased by \$25,937, due to the liquidation of the Company's GICs;
- Raised cash through various financings was \$70,605;
- Property plant and equipment increased by \$30,158 due to continued leasehold improvements to the Belleville facility, capitalized right of use assets which contributed \$20,705 (new in fiscal 2020 due to adoption of IFRS 16) and the associated required additional production equipment required within the facility. The net additions to property, plant and equipment were impacted by impairments and disposals of \$75,833 and \$11,506, respectively; and
- The Company contributed capital of \$29,115 to Truss Beverage Co.

### Total Liabilities

Current liabilities on July 31, 2021 increased year over year due to the following:

- Accounts payable and accrued liabilities approximately doubled as the result of:
  - The additional payables obtained through the acquisition of Zenabis;

- Increased scale of operations at the Company's CIB division; and
- Accrued transaction and agent fees related to acquisitions.
- The current portion of the unsecured convertible debenture acquired on business combination was \$3,406;
- Current portions of loans and borrowings increased due to \$50,159 of debt acquired on the business combination of Zenabis; and
- Issuance of a senior secured convertible note increased by \$367,699 (see section '*Capital Resources*').

Long term liabilities increased year over year due to the following:

- Convertible debt accretion amounted to \$4,120; and
- The long-term lease liability increased significantly due to the acquisition of capital leases on the business combination of Zenabis.

#### ***FY 2020 vs. FY 2019***

Long term liabilities on July 31, 2020 increased to \$53,706 compared to \$6,969 as at July 31, 2019. The variance was driven by the following activities and events:

- An issuance of \$70,000 of unsecured convertible debentures in December 2019, which had a carrying value of \$28,969, representing the discounted value of the remaining outstanding debentures;
- The closing of two registered offerings for a combined USD\$45,000 which resulted to an increased warrant liability valued at \$3,450; and
- The adoption a new lease accounting standard (see section *IFRS 16 – Leases*) which resulted in the recognition of an assumed long-term lease liability in the amount of \$24,344.

#### **Share Capital**

During the year ended July 31, 2021, share capital increased \$244,179 primarily due to \$154,970 from the share issuance on the Zenabis acquisition, 29,540 on senior convertible debenture, 45,257 on the May 2021 "At the Market Offering" and \$9,932 on the exercise of warrants.

#### **Share-Based Payment Reserve**

During the year ended July 31, 2021 the Company's shares-based payment reserve increased on a net basis. The net increase is the result of total share-based compensation issued of \$13,150 and replacement stock options of \$7,282 on the Zenabis acquisition. This was offset by expired vested stock options of \$12,891 and exercised options and equity settled RSUs of \$3,537.

#### **Warrants Reserve**

During the year ended ended July 31, 2021, the warrant reserve was increased by \$32,354 due to the replacement warrants issued on the Zenabis acquisition, offset by \$3,859 on the exercise of 2,146,931 warrants.

#### **Contributed Surplus**

The Company's contributed surplus increased by \$13,913 during the year months ended July 31, 2021 due to the expired warrants and stock options as stated above.

## **Liquidity and Capital Resources**

#### **Liquidity**

Our objective when managing our liquidity and capital structure is to maintain sufficient cash to fund our working capital needs, capital project development and contractual obligations. During the period, the Company issued a US\$360,000 senior secured convertible note of which US\$253,000 may be redeemable in cash upon demand in fiscal 2022, if certain conditions are met or events occur (see section '*May 2021 Senior Secured Convertible Note*'). To date, all cash redemptions have been waived in place of equity issuances, however, there can no total assurance that this will continue to be the case over the next twelve months (see section '*Going Concern*').

<i>For the year ended</i>	<b>July 31, 2021</b>	<b>July 31, 2020</b>
Operating activities	\$ (43,068)	\$ (94,554)
Financing activities	377,972	248,203
Investing activities	(451,615)	(83,044)

#### **Operating Activities**

Net cash used in operating activities for the year ended July 31, 2021 decreased to \$43,068 from \$94,554 in the comparative period as a result following:

- Net revenue increase of \$42,985;
- The changes to items not affecting cash were \$71,263 (July 31, 2020 – \$508,484) and are composed primarily of:
  - Unrealized gain on changes in fair value of biological assets was \$51,499 (July 31, 2020- \$29,356)
  - Impairment's losses of property, plant and equipment and right of use assets were \$20,230 (July 31, 2020 – \$299,484 of impairments and write offs of property, plant and equipment, goodwill, intangibles and inventory);
  - Share-based compensation add back reduced to \$14,859 (July 31, 2020 –\$25,790)
- Changes to non-cash working capital of \$431 (July 31, 2020 – (\$56,549)) composed of:
  - Net decrease of inventories and biological assets carried of \$1,139 (July 31, 2020 – (\$71,999)); and
  - Decrease in cash collection of accounts receivable by \$14,203 (July 31, 2020 – collected cash of \$267).

## Financing Activities

Net cash generated from financing activities for the year ended July 31, 2021 increased from the comparative period due to the following events and transactions:

- Cash generated from issuance of the senior secured convertible note in May 2021 was \$395,511 (During fiscal 2020 the Company raised proceeds of \$70,000 through the issuance of convertible debt);
- Increased exercising activity of options and warrants lead to increased cash generation of \$3,611;
- Net proceeds from the May 2021 “At the Market Offering” were \$45,257 (During fiscal 2020 the Company raised \$196,843 in proceeds from the issuance of common shares across several public and private financings); and
- During the fiscal year, the Company repaid its term loan in full and other debt repayments increased cash outflows by \$34,915;

## Investing Activities

Cash used for investing activities increased significantly in the year ended July 31, 2021 from the year ended July 31, 2020 due to the following events and transactions:

- Restricted funds increased significantly, as the net proceeds raised through the senior secured convertible note were placed into escrow to help fund Company's acquisition of Redecan (closed August 30, 2021) and to settle certain acquired liabilities from the acquisition of Zenabis during the period;
- The Company issued a convertible debenture of \$19,500 during the period;
- Capital contributions to the Company's joint ventures and investments in associates decreased by 25,500 during the current period as operations continue to mature and scale; and
- The acquisition of property, plant and equipment was significantly reduced (approximately 75%) the Company's capital needs to fund core operations at the Masson campus and Belleville Centre of Excellence approach significant completion.

## Going Concern

For the year ended July 31, 2021, the Company reported an operating loss of \$85,495; cash outflows from operating activities of \$43,068 and an accumulated deficit of \$773,993. In addition, the Cash held in escrow were released subsequent to year end to finance the Redecan acquisition (Note 39).

Under the terms of the Senior Secured Convertible Note, the holder has the option to require monthly redemptions, which are settled in either cash or equity. In order to retain the right to settle the monthly redemptions in either cash or equity, the Company must maintain, for each of the 20 previous trading days, a daily volume weighted average price per common share on the Nasdaq Capital Market (“VWAP”) above US\$1.50, as well as meet certain other conditions. In the event that the Company's daily VWAP falls below US\$1.50, the Company must seek a waiver from the holder in order to settle each monthly redemption in equity (the “Equity Condition Waiver”). If the holder does not grant the waiver, the monthly redemption is required to be settled in cash. These monthly redemptions may result in significant cash outflows over the next twelve months (Note 19).

On October 22, 2021, the Company negotiated an amendment to the terms of the Senior Secured Convertible Note which resulted in reducing the daily VWAP attached to the equity waiver condition from US\$5.00 to US\$1.50. In addition, to date, when requested, the holder has granted the equity waiver and has permitted settlement of the monthly redemptions in equity. However, there can be no assurances that the daily VWAP will remain above US\$1.50 or, in situations where the daily VWAP falls below US\$1.50, that the holder will continue to grant equity waivers to permit settlement of the monthly redemptions in equity. The Company has maintained a positive relationship with the holder, with the holder having negotiated and agreed to two amendments favorable to the Company. While there exists a risk that significant cash outflows may be required over the next twelve months under the terms of the Senior Secured Convertible Note, the Company has been working with the Holder to renegotiate the terms of the Senior Secured Convertible Note.

The Company has sufficient funding for ongoing working capital requirements, however, current funds on hand, combined with operational cash flows, are not sufficient to also support funding potential cash requirements under the Senior Secured Convertible Note, investments required to continue to develop cultivation and distribution infrastructure, and the future growth plans of the Company. Management is exploring several options to secure the necessary financing, which could include the issuance of new public or private equity or debt instruments, supplemented with operating cash inflows from operations. Nevertheless, there is risk

that certain sources of additional future funding will not be available to the Company or will be available on terms which are acceptable to management. In the meantime, Management continues to monitor and manage its cash flow in relation to its strategic growth objectives and working capital requirements.

The financial statements and this MD&A do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary if the company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

## Capital Resources

On July 31, 2021, working capital totaled \$189,920. The exercise of all the in-the-money warrants and vested stock options of the Company issued and outstanding as of July 31, 2021, using the closing market price of the common shares on the Nasdaq of \$4.95 (as at July 30, 2021, the final trading day of the period), would result in an increase of cash of approximately \$97,962 and \$4,658, respectively.

Subsequent to July 31, 2021, the Company established and closed an underwritten public offering for total gross proceeds of USD\$144,786 (see section “*Other Corporate Highlights - Subsequent Events*”). The Company utilized a portion the net proceeds from the offering to fulfil the cash component of the purchase price payable on the Redecan acquisition August 30, 2021. The balance of the raised funds is intended to be used relation to the Company’s U.S. expansion plans.

The Company is continuously assessing its capital and operational expenditures to streamline the business and cut down operational losses each period on the path to generating earnings per share.

The following table provides information about the Company’s remaining funds from recent public offering and private placement and the actual use of proceeds from those financings compared to the intended use of proceeds from the offerings. The remaining cash related to financings raised for general corporate and working capital needs are prorated based timing of funds raised and the current periods cash flow.

Date	Type	Gross Proceeds	Initially Intended Use of Net Proceeds	Actual Use of Proceeds
May 21, 2020	Underwritten public offering	\$57,545	<p>The net proceeds generated from the financing amounted to \$54,493.</p> <p>The Company expects to use the net proceeds from the Offering for working capital and other general corporate purposes.</p>	<p>The Company has remained compliant with its stated intended use as at July 31, 2021 and management has not undertaken new direction over the intended use of these funds as at the reporting date.</p> <p>Due to the timing of the financing the Company utilizing raised funds for general purposes on a first in, first out basis, there is an estimated \$9,169 remaining at period end.</p>
July 16, 2020 to July 31, 2020	At-the-market public offering	\$34,551	<p>The net proceeds generated from the financing amounted to \$33,236.</p> <p>The Company expects to use the net proceeds from the ATM Program for general corporate purposes, which may include:</p> <ul style="list-style-type: none"> <li>(i) working capital;</li> <li>(ii) capital expenditures; and</li> <li>(iii) debt repayments.</li> </ul>	<p>The Company has remained compliant with its stated intended use as at July 31, 2021 and management has not undertaken new direction over the intended use of these funds as at the reporting date.</p> <p>The Company repaid its \$30,625 outstanding credit facility in full on April 30, 2021, along with \$56 in closing fees (which were applied against the financing proceeds).</p> <p>Due to the timing of the financing the Company utilizing raised funds for general purposes on a first in, first out basis, there is an estimated \$832 remaining at July 31, 2021.</p>
May 11, 2021	At-the-market public offering	\$46,987	<p>The net proceeds generated from the financing were approximately \$46,564.</p> <p>The Company expects to use the net proceeds from the ATM Program for:</p>	<p>The Company has remained compliant with its stated intended use as at July 31, 2021 and management has not undertaken new direction over the intended use of these funds as at the reporting date.</p> <p>The raised proceeds through to July 31, 2021 remained on hand and were</p>

			<ul style="list-style-type: none"> <li>(i) costs associated with the Company's U.S. expansion plans including the contemplated acquisition of a facility in the State of Colorado and its subsequent retrofitting and improvement;</li> <li>(ii) capital expenditures, including potential capital expenditures to make additional improvements to the production lines at the Company's Belleville, Ontario facility;</li> <li>(iii) potential future acquisitions;</li> <li>(iv) working capital, including replenishing existing cash resources and working capital which will be used to fund certain transaction and integration costs and minimum debt repayments related to the Company's proposed acquisition of Zenabis Global Inc. ("Zenabis"); and</li> <li>(v) repayment of additional debts owed by Zenabis following the completion of the Zenabis acquisition.</li> </ul>	subsequently utilized to acquire Redecan on August 30, 2021.
May 27, 2021	Senior Secured Convertible Note	USD\$327,600	<p>The approximate net proceeds before closing fees from the financing were USD\$327,600.</p> <p>The Company expected to use virtually all the funds to finalize the acquisition of Redecan.</p>	<p>Upon receipt, as agreed upon, USD\$229,320 of the funds were placed into escrow. The remaining amount was wired to the Company subject to a covenant to restrict \$80,000 of the funds for the acquisition of Redecan.</p> <p>The Company was in compliance with the stated use of funds and the required covenant at July 31, 2021.</p> <p>The Company ultimately complied with the stated intended use of the funds on September 1, 2021 upon the close of Redecan (see section '<i>HEXO Acquires Canadas Largest Private Cannabis Licensed Producer Redecan</i>').</p>

#### May 2020 Underwritten Public Offering

On May 21, 2020 the Company closed an underwritten public offering for total gross proceeds of \$57,545 through the issuance of 63,940,000 units at a price of \$0.90 per unit. Each unit contained one common share and one common share purchase warrant. Total issuance costs amounted to \$3,052.

#### June 2020 ATM Offering

On June 16, 2020 the Company established the ATM program allowing the Company to issue up to \$34,500 (or its U.S. dollar equivalent) of common shares to the public. The program closed on July 31, 2020 and a total of approximately \$34,551 (after foreign exchange gains were applied) was generated through the issuance of 32,942,479 common shares in the year ended July 31, 2020. On July 31, 2020 a receivable of \$883 remained for irrevocable sales which occurred prior to year-end and subsequently settled on August 5, 2020, at which time the remaining 979,500 shares were issued. Total issuance costs and broker fees amounted to \$1,288.

#### May 2021 ATM Offering

See section "*Establishment and Launch of At-the-Market Offering up to \$150 Million.*"

#### May 2021 Senior Secured Convertible Note

On May 27, 2021 the Company closed an offering of USD\$360,000 aggregate principal amount of senior secured convertible notes, sold at a price of USD\$327,600 representing a discount of 9%. The Notes will mature on May 1, 2023. If not previously converted,

all principal repayments of the notes will be made at a price equal to 110% of the principal amount of the notes being repaid. See Note 19 of the Company's annual audited consolidated financial statements for full details.

On August 30, 2021, the Company utilized the senior secured convertible note's net, unrestricted proceeds to fund a significant portion of the \$400 million cash component of acquiring Redecan. Management assessed the available financing options and determined the issuance of the convertible note was appropriate and the best available option in order to secure the definitive purchase agreement to acquire Canada's largest private cannabis licensed producer.

## Capitalization Table

The capitalization information in the table below presents the balances of issued and outstanding common shares and other convertible securities as at the Company's fiscal years ended of July 31, 2021 and 2020, and the date of this MD&A.

	October 29, 2021	July 31, 2021	July 31, 2020
Common shares	311,650,794	<b>152,645,946</b>	120,616,437
Warrants	35,308,552	<b>36,986,570</b>	33,379,408
Options	11,930,292	<b>12,018,143</b>	7,503,690
Restricted share units	550,832	<b>550,832</b>	587,108
Convertible debentures	3,175,633	<b>3,175,633</b>	3,175,633
Senior convertible note <sup>1</sup>	207,988,980	<b>84,501,262</b>	
<b>Total</b>	<b>570,605,083</b>	<b>289,878,386</b>	165,262,276

<sup>1</sup> Estimated based on the assumption all remaining principal at 110% is converted at 88% of the current share price.

The following table summarizes the Company's stock options outstanding as at July 31, 2021.

	Number outstanding	Weighted average remaining life (years)	Number exercisable	Weighted average remaining life (years)
\$2.32-\$10.76	8,292,550	8.82	1,853,536	6.30
\$15.56-\$26.16	1,576,409	7.79	1,779,478	7.33
\$28.52-\$34.00	2,141,186	7.40	474,040	7.50
\$47.36-\$234.76	7,998	0.35	7,333	0.32
	<b>12,018,143</b>		<b>4,114,387</b>	

The following table summarizes RSU activity during the year ended July 31, 2021 and the year ended July 31, 2020.

	July 31, 2021		July 31, 2020	
	Units	Value of units on grant date	Units	Value of units on grant date
Opening balance	587,108	\$ 8.41	–	\$ –
Granted	24,008	3.17-7.17	609,636	8.52
Acquired and reissued through acquisition	223,506	8.61	–	–
Exercised - equity settled	(223,506)	8.61	–	–
Exercised - cash settled	(25,483)	5.62-8.60	–	–
Forfeited	(34,801)	11.76	(22,528)	11.76
<b>Closing balance</b>	<b>550,832</b>	<b>\$ 7.91</b>	<b>587,108</b>	<b>\$ 8.41</b>

As at July 31, 2021, 155,513 RSU's are vested and outstanding.

The following table summarizes warrant activity during the year ended July 31, 2021 and year ended July 31, 2020.

	July 31, 2021		July 31, 2020	
	Number of warrants	Weighted average exercise price <sup>1</sup>	Number of warrants	Weighted average exercise price <sup>1</sup>
Outstanding, beginning of year	33,379,408	\$ 7.60	7,396,359	\$ 39.80
Expired and cancelled	(535,889)	4.09	(3,889,871)	49.00
Issued on acquisition	5,970,370	14.59	–	–
Issued	–	–	30,976,389	4.96
Exercised	(2,146,931)	4.10	(1,103,469)	3.88
<b>Outstanding, end of year</b>	<b>36,666,958</b>	<b>\$ 8.85</b>	<b>33,379,408</b>	<b>\$ 7.60</b>

<sup>1</sup> USD denominated warrant's exercise price have been converted to the CAD equivalent as at the period end for presentation purposes

## Off-Balance Sheet Arrangements and Contractual Obligations

The Company does not have any off-balance sheet arrangements.

### Commitments

The Company has certain contractual financial obligations related to service agreements, purchase agreements, rental agreements and construction contracts. These contracts have optional renewal terms that we may exercise at our option. The annual minimum payments payable under these contracts over the next five years are as follows:

Year ended July 31, 2021	2022	2023 – 2024	2025 – 2026	Thereafter	Total
Accounts payable and accrued liabilities	\$ 63,557	\$ –	\$ –	\$ –	\$ 63,557
Excise taxes payable	6,591	–	–	–	6,591
Onerous contract	4,763	–	–	–	4,763
Convertible debt	371,105	33,089	–	–	404,194
Lease obligations	4,742	7,707	7,835	28,836	49,120
Capital projects <sup>(1)</sup>	8,065	18	26	–	8,109
Service contracts	4,904	295	20	–	5,219
Lease based operating expenses <sup>(2)</sup>	3,547	6,693	8,211	13,472	31,923
	467,274	47,802	16,092	42,308	573,476

(1) Note the Company presents in commitments on capital projects on the basis of committed amounts to enacted purchase orders and therefore, inherently there may be differences between committed capital and approved budgets for capital projects. Refer 'HEXO GROUP OF FACILITIES' for a general summary of these projects and their respective remaining approved capital budgets.

(2) Lease based operating expense represent the variable operating expenses associated with the lease obligation under IFRS 16, Under IFRS all amounts charged that have no minimum fixed charge are considered variable and not capitalized.

### LITIGATION

#### Class Actions

As of July 31, 2021, the Company and its Chief Executive Officer are defendants in a putative class-action lawsuit pending in the Québec Superior Court brought on behalf of certain purchasers of shares of the Company and filed on November 19, 2019. The lawsuit asserts causes of action for misrepresentations under the Québec Securities Act and the Civil Code of Québec in connection with certain statements contained in HEXO's prospectus, public documents and public oral statements between April 11, 2018 and November 15, 2019. The allegations relate to: (1) statements made by the Company regarding its agreement with the Province of Québec to supply cannabis; (2) statements made by the Company regarding its acquisition of Newstrike, particularly the licensing of the Newstrike facilities and the forecasted synergies and/savings from the Newstrike acquisition; (3) statements made by the Company about the net revenues in Q4 2019 and fiscal year 2020; and (4) the certifications by Louis St-Louis and the underwriters of the Company. The plaintiffs seek to represent a class comprised of Québec residents who acquired the Company's securities either in an Offering (primary market) or on the secondary market during such period and seek compensatory damages for all monetary losses and costs. The amount claimed for damages has not been quantified.

As of July 31, 2021, the Company is named as a defendant in a proposed consumer protection class action filed on June 16, 2020, in the Court of Queens' Bench in Alberta on behalf of residents of Canada who purchased cannabis products over specified periods of time. Several other licensed producers are also named as co-defendants in the action. The lawsuit asserts causes of action, including for breach of contract and breach of consumer protection legislation, arising out of allegations that the Tetrahydrocannabinol (THC) or Cannabidiol (CBD) content of medicinal and recreational cannabis products sold by the Company and the other defendants to consumers was different from what was advertised on the products' labels. Many of the cannabis products sold by the Company and other defendants were allegedly sold to consumers in containers using plastic bottles or caps that may have rapidly absorbed or degraded the THC or CBD content within them. By allegedly over-representing the true amount of THC or CBD in the products, the plaintiff claims that consumers would be required to consume substantially more product than they otherwise would have in order to obtain the desired effects or, in the alternative, would have consumed the product without obtaining the desired effects. The action has not yet been certified as a class action.

#### MediPharm

As of July 31, 2020, the Company is subject to a lawsuit filed against HEXO Operations by MediPharm Labs Inc. ("MediPharm") seeking \$9,800 for alleged non-payment of cannabis resin it supplied to HEXO Operations pursuant to a supply agreement dated February 11, 2019 between MediPharm and HEXO Operations' former subsidiary, Up Cannabis, which was a subsidiary of

Newstrike and was amalgamated with HEXO Operations, together with Newstrike and certain other affiliates, in August 2019. HEXO intends to vigorously defend itself against the claim and has filed a defence and counterclaim which alleges, among other things, that the supply agreement is void as it was entered into in bad faith. The full amount of Medipharm's claim is contested by the Company, and the Company is seeking repayment of the full value of the supply agreement in the amount of \$35,000 from Medipharm in its counterclaim.

On June 1, 2021, by way of the business acquisition of Zenabis, the Company assumed senior notes payable and the following litigation with the associated lender of the notes (Note 21b). Upon closing the acquisition of Zenabis, the Company was in default under the debenture due to the failure to obtain the lenders consent for a change of control. On February 19, 2021, Zenabis filed a petition in the Supreme Court of British Columbia for a determination of the amount required to repay and terminate the debenture and to obtain discharges of the debenture and related security. The lender took the position that the amount to discharge the debenture and related securities was approximately \$72,000. The Company believes the amount is approximately \$53,000, which has been provided for in the consolidated financial statements. Under the senior secured convertible note agreement (Note 19), the Company has restricted funds to satisfy this liability (Note 6). The difference largely relates to whether a prepayment fee and default fees are payable under the debenture and to the amount to buyout and discharge of a revenue based royalty liability. The petition was heard on March 29, March 30, March 31, April 1, April 15 and May 14, 2021. The Judge's decision remains on reserve and no indication as to the likely timing of its release has been provided.

## Financial Risk Management

We are exposed to risks of varying degrees of significance which could affect our ability to achieve our strategic objectives for growth. The main objectives of our risk management process are to ensure that risks are properly identified and that the capital base is adequate in relation to these risks. The principal financial risks to which we are exposed are described below.

### Market Risk

#### *Interest Risk*

The Company has minimal exposure to interest rate risk related to any investments of cash and cash equivalents. The Company may invest cash in highly liquid investments with short terms to maturity that would accumulate interest at prevailing rates for such investments. As at July 31, 2021, the Company has \$50,159 in notes payable (July 31, 2020 – \$29,930) (Note 21) that bear interest at a fixed rate and therefore are not subject to interest risk (July 31, 2020 - not material). The Company hold senior secured convertible debt (Note 19) that bears no cash interest and is repayable at a fixed rate of 110% of the face value.

#### *Price Risk*

Price risk is the risk of variability in fair value due to movements in equity or market prices.

#### Financial assets

The Company's level 1 and 2 investments are susceptible to price risk arising from uncertainties about their future outlook, future values and the impact of market conditions. The fair value of marketable securities and derivatives held in publicly traded entities is based on quoted market prices, which the shares of the investments can be exchanged for.

#### Financial liabilities

The Company elected an early conversion option in the year ended July 31, 2020 in which \$29,860 of the aggregate principal amount of its 8% unsecured convertible debentures (Note 18) were converted, which partially mitigates the Company's Price Risk.

The Company obtained an amendment to the Senior secured convertible notes equity condition (subsequent to July 31, 2021) effectively reducing the equity conditions market price threshold allowing the Company increased discretion over redemption payments to be repaid in cash or equity (Note 19). The sensitivity of the Senior secured convertible note due to price risk is disclosed in Note 19.

If the July 31, 2021 fair value of these financial assets and liabilities were to increase or decrease by 10% the Company would incur a related increase or decrease to Comprehensive loss of an estimated \$37,100 (July 31, 2020 – no material impact). The price risk exposure as at July 31, 2021 and July 31, 2020 is presented in the table below.

	July 31, 2021	July 31, 2020
	\$	\$
Financial assets	2,492	2,692
Financial liabilities	(373,432)	(3,450)
<b>Total exposure</b>	<b>(370,940)</b>	<b>(758)</b>

### Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash held in escrow, restricted cash and trade receivables. As at July 31, 2021, the Company was exposed to credit related losses in the event of non-performance by the counterparties.

The Company provides credit to its customers in the normal course of business and has established credit evaluation and monitoring processes to mitigate credit risk. Since the majority of the medical sales are transacted with clients that are covered under various insurance programs, and adult use sales are transacted with crown corporations, the Company has limited credit risk.

Cash and cash equivalents, restricted funds and cash held in escrow are held with three Canadian commercial banks that hold Dun & Bradstreet credit ratings of AA (July 31, 2020 – AA), an American commercial bank with a credit rating of A- and \$111 is held with a credit union that does not have a publicly available credit rating. Certain restricted funds in the amount of \$29,999 are managed by an insurer and are held as a cell captive within a Bermuda based private institution which does not have a publicly available credit rating, however the utilized custodian is Citibank which holds a credit rating of A+.

The majority of the trade receivables balance is held with crown corporations of Quebec, Ontario and Alberta. Creditworthiness of a counterparty is evaluated prior to the granting of credit. The Company has estimated the expected credit loss using a lifetime credit loss approach. The current expected credit loss for the year ended July 31, 2021 is \$66 (July 31, 2020 - \$35).

In measuring the expected credit losses, the adult-use cannabis trade receivables have been assessed on a per customer basis as they consist of a low number of material contracts. Medical trade receivables have been assessed collectively as they have similar credit risk characteristics. They have been grouped based on the days past due.

The carrying amount of cash and cash equivalents, cash held in escrow, restricted cash and trade receivables represents the maximum exposure to credit risk and as at July 31, 2021; this amounted to \$522,908 (July 31, 2020 – \$211,860). Subsequent to July 31, 2021 the cash held in escrow has been utilized to fund the Redecan acquisition (Note 38).

The following table summarizes the Company's aging of trade receivables as at July 31, 2021 and July 31, 2020:

	July 31, 2021	July 31, 2020
0–30 days	\$ 22,971	\$ 15,253
31–60 days	12,390	2,972
61–90 days	1,435	412
Over 90 days	625	789
<b>Total</b>	<b>37,421</b>	<b>19,426</b>

### Economic Dependence Risk

Economic dependence risk is the risk of reliance upon a select number of customers, which significantly impacts the financial performance of the Company. For the year ended July 31, 2021, the Company's recorded sales to the crown corporations; Société québécoise du cannabis ("SQDC") the Ontario Cannabis Store ("OCS") and the Alberta Gaming, Liquor and Cannabis agency ("ALGC") representing 42%, 20% and 14%, respectively (July 31, 2020 – one crown corporation representing 70%) of total applicable periods net cannabis sales.

The Company holds trade receivables from the crown corporations SQDC, OCS and the AGLC representing 13%, 29% and 13%, respectively, of total trade receivable, respectively as at July 31, 2021 (July 31, 2020 – the two crown corporations SQDC and OCS representing 47% and 25% of total trade receivables, respectively).

### Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due (See note 2 – *Going Concern*). The Company manages liquidity risk by reviewing on an ongoing basis, its capital requirements. As at July 31, 2021, the Company has \$67,462 (July 31, 2020 – \$184,173) of cash and cash equivalents and \$37,421 (July 31, 2020 – \$19,426) in trade receivables. The Company has current liabilities of \$503,638 on the statement of financial position. As well the Company has contractual commitments of \$18,244 due before July 31, 2022. The Company has restricted funds to satisfy debt of \$50,159, presented in current liabilities (Note 6). The maturity analysis of undiscounted cash flows for lease obligation and convertible debentures is disclosed in Note 20 and Note 18 respectively.

Current financial liabilities include the Company's obligation on the senior secured convertible note (Note 19). The Company plans to settle this liability in equity. However, if the Company is unable to meet the requirements Equity Condition Waiver (Note 19) the Holder may demand settlement in cash. The analysis of potential cash outflow to redeem the Note up to the earliest maturity date is given below. Subsequent to the year-end, the Company settled the optional redemption payments for August 2021, September 2021 and October 2021 in equity. The Company has also received a cash settlement waiver for the May 2023 and November 2021 optional redemptions.

The following table provides an analysis of contractual maturities for financial liabilities.

Fiscal year	2022	2023	2024	2025	Thereafter	Total
Accounts payable and accrued liabilities	\$ 63,557	\$ —	\$ —	\$ —	\$ —	\$ 63,557
Excise taxes payable	6,591	—	—	—	—	6,591
Loans and borrowings	60,297	—	—	—	—	60,297
Convertible debentures	6,716	41,273	—	—	—	47,989
Undiscounted future lease payments	6,155	5,785	6,073	5,561	54,796	78,370
	143,316	47,058	6,073	5,561	54,796	256,804
Senior secured convertible note <sup>1</sup>	315,289	143,421	—	—	—	458,710
<b>Total</b>	<b>458,605</b>	<b>190,479</b>	<b>6,073</b>	<b>5,561</b>	<b>54,796</b>	<b>715,514</b>

<sup>1</sup> The senior secured convertible note have been valued using the July 31, 2021 US/CAD foreign exchange rate. The Company's ability to settle the note in equity or cash is dependent upon the conditions as stated in Note 19.

## Foreign Currency Risk

On July 31, 2021, the Company holds certain financial assets and liabilities denominated in United States Dollars ("US\$") which consist of cash and cash equivalents, cash in escrow, restricted funds, the senior secured convertible note and warrant liabilities. The Company does not currently use foreign exchange contracts to hedge its exposure of its foreign currency cash flows as management has determined that this risk is not significant. The Company closely monitors relevant economic information to minimize its net exposure to foreign currency risk. The Company is exposed to unrealized foreign exchange risk through its cash and cash equivalents. As at July 31, 2021, approximately \$434,838 (US\$348,931) (July 31, 2020 – \$42,981 (US\$57,652)) of the Company's cash and cash equivalents was in US. A 1% change in the foreign exchange rate would result in a change of \$4,348 to the unrealized gain or loss on foreign exchange or on the gain or loss on financial instrument revaluation of US denominated warrants. Subsequent to year end, cash held in escrow has been utilized to fund the acquisition of Redecan (Note 38).

The Company's Senior secured convertible note is denominated in US\$. The Company plans to settle this debt in equity. However, if the Company is unable to meet the equity settlement condition or secure cash settlement waivers, the settlement may entail cash outflow. The sensitivity of the Senior secured convertible note due to foreign currency risk is disclosed in Note 19.

## Critical Accounting Assumptions

Our critical accounting assumptions are presented in Note 4 of the Company's annual audited consolidated financial statements for the year ended July 31, 2021, and in certain cases the financial statement note itself. The annual audited consolidated financial statements are available under HEXO's profile on SEDAR and EDGAR.

### Senior Secured USD\$390 million Convertible Note

	July 31, 2021	July 31, 2021
<b>Senior Secured Convertible Note</b>	<b>US\$</b>	<b>\$</b>
Opening balance, beginning of the year	—	—
Issued at fair value	407,284	491,714
Early conversions	(413)	(497)
Redemptions	(27,500)	(33,525)
Gain on fair value adjustment	(14,524)	(18,100)
Foreign exchange loss	—	15,081
Ending balance, end of the year	364,847	454,673
<b>Unrecognized Day 1 Loss</b>		
Opening balance, beginning of the year	—	—
Unrecognized loss at issuance	(79,684)	(96,203)
Recognized loss	7,470	9,229
Ending balance, end of the year	(72,214)	(86,974)
<b>Total balance, end of year, net</b>	<b>292,633</b>	<b>367,699</b>
Current portion	292,633	367,699
Non-current	—	—

On May 27, 2021 (the "issuance date"), the Company issued a Senior Secured Convertible Note (the "Note") directly to an institutional purchaser and certain of its affiliates or related funds (collectively, the "Holder") at a principal amount of \$434,628 (US\$360,000). The Note was sold at a purchase price of \$395,511 (US \$327,600), or approximately 91% of the principal amount ("transaction price"). The Note bears no periodic cash interest payments and is repayable on May 1, 2023 (the "maturity date") at 110% of the principal amount (the "Redemption Amount"), if not converted or redeemed earlier. The Redemption Amount on issuance date was \$478,091 (US\$396,000). The Company used a portion of the net proceeds of the Note to fund the Redecan

Acquisition (Note 38). The Note is secured against the assets of HEXO Operations Inc. and, its subsidiaries, as well as the assets of HEXO USA Inc and its subsidiaries.

The Note can be converted in full or in part by the Holder into freely tradeable common shares of the Company at any time before the second last trading day before the maturity date at a conversion rate of 142.6533 common shares per US\$1 ("conversion rate"). The Note includes different conversion and redemption options (summarized below) available to the Holder and the Company, subject to certain terms and limitations. At any given point, the beneficial ownership of the Holder in the Company is restricted to 9.99% (the "maximum ownership threshold"). Any conversion or redemption option exercised in common shares which would result in the Holder exceeding the maximum ownership threshold is null and void. Any outstanding payments due on maturity date will be settled in cash.

Other than the above-mentioned conversion feature, the Holder has the following conversion and redemption options available:

- **Early Conversion Option:** The Holder had the option to early convert the instrument up to \$60,365 (US\$50,000) at an early conversion rate during the fifteen trading day period following the announcement of the acquisition of Redecan which occurred on May 28, 2021. This was partially exercised by the Holder as shown in the table below. Under the terms of the Note, the Company was required to pay a cash amount equal to 10% of the principal amount converted, such that the Company effectively settled 110% of the principal amount.
- **Optional Redemption Option:** The Holder has the option to require monthly redemptions, of US\$15,000 (or US\$20,000 from October 2021 to September 2022) of the principal amount, on a monthly basis, plus any amounts deferred from any previous months up to US\$50,000. These monthly redemptions can be settled in either cash or equity at 110% of the principal amount. However, in order to retain the right to settle the monthly redemptions in equity, the Company must meet certain conditions for each of the 20 previous trading days, including (i) a daily volume weighted average price per common share on the Nasdaq Capital Market ("VWAP") above US\$5.00; (ii) a daily dollar trading volume (as reported on Bloomberg) of common shares over US \$10,000 on the Nasdaq Capital Market; and (iii) the related equity issuance cannot result in the Holder exceeding a beneficial ownership greater than 9.99% of the common shares of the Company. In the event that these conditions are not met, the Company must seek a waiver from the Holder in order to settle each monthly redemption in equity ("Equity Condition Waiver"). If the Holder does not grant the Equity Condition Waiver, the monthly redemption is required to be settled in cash. Subsequent to year end, on October 22, 2021, the Company negotiated an amendment to the terms of the Note which resulted in reducing the daily VWAP attached to the Equity Condition Waiver condition from US\$5.00 to US\$1.50.
- **Fundamental Change Repurchase option:** The Holder can also require the Company to repurchase the convertible note in the event of a fundamental change as defined in the agreement.

The Company has the following conversion option:

- **Forced Conversion:** The Company has an option, subject to certain conditions, to force the holder to redeem the outstanding principal at a forced conversion price if the Daily VWAP is greater than 150% of the conversion price on each of 20 consecutive trading days after the issue date. The Company may elect to redeem all or a portion of the Principal Amount into common shares or cash. An additional amount of 5% of the Principal Amount at the time of the forced conversion will also be payable in cash by the Company to the Holder unless the Daily VWAP exceeds 175% of the conversion price for five days for each of the 20 previous trading days.

The conversion rate applied to equity settlements is calculated in reference to 88.0% of the lesser of (i) the average of the daily VWAPs during the five VWAP trading day period ending on the VWAP trading day immediately prior to the settlement date, and (ii) the fifteen VWAP trading day period ending on the VWAP trading day immediately prior to the settlement date.

Additionally, up until the date of shareholder approval of the Note, shortfall cash payments were required to be made by the Company on any redemptions made under the terms of the Note. Shareholder approval was obtained on August 28, 2021, and as such, no further cash shortfall payments will be required from that date. Shortfall cash payments settled in the period are disclosed below.

The Note includes a number of financial and non-financial covenants, including:

- a requirement to maintain US\$95,000 on deposit with a collateral agent, a portion of which is set aside to fund the repayment of the Senior notes payable (Note 21(b)). On July 23, 2021, the Note was amended to reduce the collateral amount on deposit to US\$80,000.
- Beginning for the quarter ending January 31, 2022, the Company will be subject to a minimum adjusted EBITDA covenant, as defined in the agreement.

The Note represents a hybrid instrument with multiple embedded derivatives requiring separation. The Note, as a whole, has been designated as FVTPL, as at least one of the derivatives does significantly modify the cash flows of the Note and it is clear with limited analysis that separation is not prohibited. The changes in fair value of the instrument are recorded in the Statement of loss

with changes in credit spread being recognized through Other comprehensive income. The transaction costs of \$18,078 (US\$14,975) have been recognized in the statement of loss during the period.

The fair value of the Note at inception was \$491,714 determined using the partial differential equation method with the following inputs; Share Price \$6.53; Volatility 85%, Risk-free rate 0.227%; Credit spread 16.06%; Dividend yield \$nil and Dilution 284.6 million common shares. The partial differential equation determines the fair value of the note by using an iterative approach to solve the differential equation that the instrument satisfies. The Note is classified as Level 2 in the fair value hierarchy.

The fair value of the Note at initial recognition was determined using a valuation technique that includes unobservable inputs. The Company identified a difference between the transaction price and the fair value of \$96.2 million (US\$79.7 million) (the "Day 1 loss"). The Company believes that time is the factor that market participants would take into account when pricing the note. Therefore, the unrecognized Day 1 loss is recognized on a straight line basis in the statement of net loss over the contractual life of the Note.

The following table represents the movement of redemption amounts in the year ended July 31, 2021. As disclosed above, redemptions are made at 110% of the principal amount owed.

	Shares Issued	Redemption Amount
Balance, beginning of year		\$ —
<b><i>Issuances:</i></b>		
Initial issuance		478,091
<b><i>Settlements:</i></b>		
Early conversion option	53,495	(497)
Optional redemption options	4,548,746	(33,525)
Foreign exchange loss		14,641
Balance, end of year		<b>458,710</b>

<sup>1</sup>Shortfall cash payments of \$3,893 are presented as share issuance costs in shareholders' equity.

At July 31, 2021 the fair value of the Note was determined to be \$454,673 and was fair valued using the following inputs; Share Price \$3.98; Volatility 85%, Risk-free rate 0.327%; Credit spread 15.44%; and a Dividend \$nil. The gain on fair value adjustments related to changes in credit spread amounted to \$1,590 (July 31, 2020 - \$nil).

An increase/decrease in the US\$/CA\$ foreign exchange rate of 1% would result in a foreign exchange loss/gain adjustment of \$4,547. Further, an increase/decrease of credit spread by 1% and share price of the Company by 10% would change the fair value of the instrument by \$2,614 and \$7,443 respectively.

The following table depicts amounts that can be demanded by the Holder in accordance with the monthly redemption option up to the instrument's maturity date, reflective of 110% of the principal amount of Note.

Fiscal Year	Redemption amount	Redemption amount
	US\$	\$
2022	253,000	315,289
2023	115,087	143,421
<b>Total</b>	<b>368,087</b>	<b>458,710</b>

## Related Party Transactions

### Key Management Personnel Compensation

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the Company's operations, directly or indirectly. The key management personnel of the Company are the members of the executive management team and Board of Directors. Other significant related party transactions and presented in Note 29 of the Company's 2021 annual consolidate financial statements.

Compensation provided to key management during the period was as follows:

For the year ended	July 31, 2021	July 31, 2020
Salary and/or consulting fees	\$ 2,321	\$ 3,069
Termination benefits	1,008	1,043
Bonus compensation	800	42
Stock-based compensation	6,800	15,702
<b>Total</b>	<b>10,929</b>	<b>19,856</b>

## Management's Report on Internal Controls over Financial Reporting

### *Internal Controls over Financial Reporting*

In accordance with National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings ("NI 52-109") and Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934 within the U.S., the establishment and maintenance of Disclosure Controls and Procedures ("DCP") and Internal Control Over Financial Reporting ("ICFR") is the responsibility of management. DCP and ICFR has been designed by management to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with International Financial Reporting Standards ("IFRS").

The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluations of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. These inherent limitations include, but are not limited to, human error and circumvention of controls and as such, there can be no assurance that the controls will prevent or detect all misstatements due to errors or fraud, if any.

Management has assessed the effectiveness of our internal control over financial reporting based on the criteria set forth in the Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The scope of management's assessment of internal control over financial recording excludes 14% of our consolidated total assets and 5% of our consolidated net revenues related to Zenabis Global Inc., which was acquired on June 1, 2021.

Management concluded that internal control over financial reporting was not effective as of July 31, 2021 as a result of material weaknesses in internal control over financial reporting.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. In connection with the assessment of the effectiveness of our internal control over financial reporting, our management identified material weaknesses that existed as of July 31, 2021. For the year ended July 31, 2020, the Company identified material weaknesses in the control environment, risk assessment processes, information technology general controls, the functionality of the enterprise resource planning (ERP), reliance on complex spreadsheets, procurement, fixed assets and period end financial reporting. While these material weaknesses remain unremediated, as a result of improvements in our monitoring processes, we have identified additional areas of material weakness and have expanded our disclosure to present these under three main areas: (i) Control environment, (ii) Control activities and (iii) Information Technology General Controls.

#### *(i) Control Environment*

The Company did not design or implement adequate oversight processes and structures, or an organizational design to support the achievement of the Company's objectives in relation to internal controls. The Company identified multiple deficiencies in internal controls, primarily due to the control environment not being mature enough to support the increasing complexity of the business and rapid expansion through acquisitions. As a result, pervasive issues exist within the control environment that impact the ability of the Company to maintain effective internal control over financial reporting. In addition, accountability for adherence to policies and processes across the organization was not consistently enforced; and as such, there is increased likelihood of misstatements occurring. This material weakness contributed to the following further material weaknesses:

- Risk assessment procedures did not fully identify risks of misstatement that could, individually or in combination with others, increase the vulnerability of the Company to material misstatements to the financial statements, whether intentional or unintentional.
- Monitoring activities did not operate effectively to identify control gaps and control deficiencies in significant processes in a timely manner. In addition, monitoring activities did not operate to identify new risks related to changes in the business, and as such, these risks were not assessed or responded to in the internal control environment.
- While the Company is not aware of any material fraud or suspected fraud, anti-fraud control activities were not designed to effectively mitigate the risk of fraud events occurring or not being detected in a timely manner to an acceptable level. Control deficiencies were identified in both the fraud risk assessment and the design and monitoring of Company's whistleblower hotline.
- Information and communication processes did not effectively operate to ensure that appropriate and accurate information was available to financial reporting personnel on a timely basis to fulfill their roles and responsibilities.

These entity level control deficiencies did not result in a misstatement to the financial statements; however, when aggregated, could impact the ability of the Company to maintain a system of effective internal control, including an effective anti-fraud program. These deficiencies could potentially reduce the likelihood of preventing or detecting misstatements, which could impact multiple financial statement accounts and disclosures. Accordingly, management has determined the above deficiencies constitute a material weakness, both individually and in aggregate

*(ii) Control Activities*

We previously identified material weaknesses in our internal control over financial reporting that continue to exist. Through the period, the Company did not design and maintain an effective control environment commensurate with its financial reporting requirements. Specifically, the Company did not reassess resource requirements to support the increasing complexity of the business and rapid expansion through acquisitions. As a result, there was not a complement of personnel with an appropriate level of internal controls and accounting knowledge, training and experience commensurate with our financial reporting requirements throughout the fiscal period. This resulted in an inability to consistently establish appropriate authorities and responsibilities in pursuit of financial reporting objectives and insufficient segregation of duties in our finance and accounting functions. This material weakness contributed to the following further material weaknesses:

- The Company did not design and maintain effective controls over the period-end financial reporting process to achieve complete, accurate and timely financial accounting, reporting and disclosures. Specifically, the Company did not consistently maintain formal accounting policies, procedures and appropriate controls over the preparation and review of account reconciliations and journal entries.
- The Company did not design and consistently maintain effective controls to achieve reasonable assurance that transactions are properly initiated, authorized, recorded and reported. Specifically, the Company did not design and consistently maintain controls over a number of significant processes, including loans and borrowings, convertible debentures purchases to pay, inventory, biological assets, property, plant and equipment, intangible assets, leases, investments, tax and equity.
- The Company did not design and maintain processes and controls to analyze, account for and disclose non-routine, unusual or complex transactions. Specifically, the Company did not design and maintain controls to timely analyze and account for the senior secured convertible note, impairment of non-financial assets, and non-routine complex transactions including the accounting and reporting related to the acquisition of Zenabis Global Inc.

These material weaknesses resulted in audit adjustments to loans and borrowings, senior secured convertible note, leases, and related right of use assets, accruals, various expense line items and related financial statement disclosures, which were recorded prior to the issuance of the consolidated financial statements as of and for the year ended July 31, 2021. Additionally, these material weaknesses, individually and in the aggregate, could result in a material misstatement of the Company's accounts or disclosures that would not be prevented or detected.

*(iii) Information Technology General Controls*

The Company did not design and maintain effective controls over information technology ("IT") general controls for information systems that are relevant to the preparation of its financial statements, specifically, with respect to: (i) program change management controls for financial systems to ensure that IT program and data changes affecting financial IT applications and underlying accounting records are identified, tested, authorized and implemented appropriately; (ii) user access controls to ensure appropriate segregation of duties and that adequately restrict user and privileged access to financial applications, programs, and data to appropriate company personnel; (iii) computer operations controls to ensure that critical batch jobs are monitored and the design and operating effectiveness of controls at service organisations are evaluated on a timely basis, and (iv) testing and data validation

controls for program development to ensure that new software and application development is aligned with business and IT requirements.

These IT deficiencies did not result in a misstatement to the financial statements; however, the deficiencies, when aggregated, could impact maintaining effective segregation of duties, as well as the effectiveness of IT-dependent controls (such as automated controls that address the risk of material misstatement to one or more assertions, along with the IT general controls and underlying data that support the effectiveness of system-generated data and reports) that could result in misstatements potentially impacting all financial statement accounts and disclosures that would not be prevented or detected. Accordingly, management has determined these deficiencies in the aggregate constitute a material weakness.

### **Status of Remediation Plan**

As disclosed in the prior year, management, with the assistance of external consultants, began reviewing and revising our internal control over financial reporting. Management is committed to implementing changes to our internal control over financial reporting to ensure that the control deficiencies that contributed to the material weaknesses are remediated. The following remedial activities are in process:

- We are in the process of implementing additional ongoing oversight, training and communication programs for management and personnel to reinforce the Company's standard of conduct, enhance understanding of assessed risks, and clarify individual responsibility for control activities at various levels within the Company.
- We have increased the number of finance and accounting personnel and have redesigned financial reporting structures within the organization to establish clear responsibility and accountability for key financial reporting processes and controls. We have identified the need for additional financial reporting personnel with an appropriate level of internal controls and accounting knowledge, training and experience commensurate with our financial reporting requirements, and are actively working to identify additional resources.
- We have established an internal audit function and engaged external consultants to assist management with the design and implementation of internal controls, including IT general controls. As a result, a substantial project was commenced to reassess risks related to financial reporting, understand and document significant financial reporting processes, and to reassess the design and operation of key controls. This project is expected to continue until management has determined that deficiencies have been remediated and are operating effectively over a full fiscal period.
- We are in the process of assessing and designing a more robust anti-fraud program, inclusive of transitioning service providers for the monitoring of the Whistleblower hotline to ensure prompt, competent, and confidential review, investigation, and resolution of instances of non-compliance and allegations involving fraud and misconduct. Subsequent procedures were performed to ensure appropriate, independent investigation and resolution throughout the fiscal period.
- We are in the design and development stage of an ERP and IT ecosystem project, including a new cultivation management software application, which will be implemented in the next fiscal year and replace our existing ERP system. This will improve functionality, with an additional focus on ensuring that system design addresses the existing IT general control deficiencies relating to system development, data migration and change and user access management. This will also support remediation of material weaknesses relating to control activities.
- We commenced a full ERP user access review to identify any instances of inappropriate access, as well as assess any instances where users have been assigned incompatible duties and responsibilities. Moving forward this will be performed on a quarterly basis. User access deficiencies are not fully remediated as access controls have not been subject to operating effectiveness testing.
- We implemented automated purchase-to-pay approval workflows and authorization of journal entries within the existing ERP in the current fiscal period to assist in addressing segregation of duties. While management determined that the design of both purchase-to-pay and journal entry authorization controls were effective, the IT general control deficiencies in aggregate adversely impacted the operating effectiveness of these controls, as both are IT-dependent.

While we believe these actions will remediate the material weaknesses, we have not completed all the corrective processes, procedures and related evaluation or remediation that we believe are necessary. As we continue to evaluate and work to remediate the material weaknesses, we may need to take additional measures to address the control deficiencies. Until the remediation steps set forth above, including the efforts to implement any additional control activities identified through our remediation processes, are fully implemented and concluded to be operating effectively, the material weaknesses described above will not be considered fully remediated.

The effectiveness of the Company's internal control over financial reporting as of July 31, 2021 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

### ***Changes in Internal Control Over Financial Reporting***

Other than disclosed above, there have been no changes in the Company's internal control over financial reporting during the Company's fiscal quarter ended July 31, 2021 that have materially affected or are reasonably likely to materially affect its internal control over financial reporting.

## Risk Factors

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Our overall performance and results of operations are subject to various risks and uncertainties that may materially and adversely affect our business, products, financial condition and operations and may cause actual performance, results and achievements to differ materially from those expressed or implied by forward-looking statements and forward-looking information, including, without limitation, the following factors, some of which, as well as other factors, are discussed in our Annual Information Form dated October 29, 2021 available under our profile on [www.sedar.com](http://www.sedar.com), which risk factors should be reviewed in detail by all readers:

- Existing funds on hand, when combined with operational cash flow, are not sufficient to fund existing debt repayments, capex budgets, and potential cash requirements under the Senior Secured Convertible Note. Management is exploring several options to secure the necessary financing, which could include the issuance of new public or private equity or debt instruments, supplemented with operating cash inflows from operations. Nevertheless, there is no assurance that certain sources of additional future funding will be available to the Company or will be available on terms which are acceptable to management. These circumstances create material uncertainties that lend substantial doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the appropriateness of the use of accounting principles applicable to a going concern. The Company's ability to continue as a going concern is dependent upon its ability to fund the repayment of existing borrowings, secure additional financing and to generate positive cash flows from operations. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary if the company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.
- Our business operations are dependent on our licence under the Cannabis Regulations. These licenses expire on various dates and must be renewed by Health Canada. Failure to comply with the requirements of our licenses or any failure to renew the license would have a material adverse impact on our business, financial condition and operating results.
- Achievement of our business objectives is contingent, in part, upon compliance with regulatory requirements enacted by these governmental authorities and obtaining all regulatory approvals, where necessary, for the production and sale of our products. We cannot predict the time required to secure all appropriate regulatory approvals for our products, or the extent of testing and documentation that may be required by governmental authorities.
- While to the knowledge of our management, the Company is currently in compliance with all laws, regulations and guidelines relating to the marketing, acquisition, manufacture, management, transportation, storage, sale and disposal of cannabis as well as including laws and regulations relating to health and safety, the conduct of operations and the protection of the environment, changes to such laws, regulations and guidelines due to matters beyond our control may cause adverse effects to our operations.
- We operate in a dynamic, rapidly changing environment that involves risks and uncertainties, and as a result, management expectations may not be realized for a number of reasons.
- The volatile Canadian cannabis industry has resulted in several of the Company's peers to undergo rightsizing efforts which could saturate the market with similar assets the Company may intend to sell. This could result in further future losses and/or the inability for the Company to liquidate certain of its unneeded assets.
- If the principal amount of the Senior Secured Convertible Notes is not converted into Common Shares or the Company does not pay or is not able to pay for any redemptions of the Senior Secured Convertible Notes in Common Shares, servicing the debt under the Senior Secured Convertible Notes requires a significant amount of cash, and the Company may not have sufficient cash flow from its business to pay its obligations under the Senior Secured Convertible Notes.
- The Company's ability to make scheduled payments of principal or to pay redemption payments or other amounts payable under the Senior Secured Convertible Notes or to refinance the Senior Secured Convertible Notes depends on our future performance, which is subject to economic, financial, competitive and other factors, some of which are beyond our control. The terms of the Senior Secured Convertible Notes require us to pay approximately USD\$396.0 million to repay or redeem the full principal amount of the Notes at maturity, and the Purchaser has the right to require the Company to pay the Optional Redemption Payments and certain other amounts under the Senior Secured Convertible Notes. The Company's business may not generate cash flow from operations in the future sufficient to satisfy our obligations under the Notes. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as reducing or delaying investments or capital expenditures, selling assets, refinancing or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance the Senior Secured Convertible Notes will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on the Senior Secured Convertible Notes.
- The conversion of the Senior Secured Convertible Notes or the satisfaction of redemption payments and other amounts payable under the Senior Secured Convertible Notes in Common Shares will dilute the ownership interests of existing shareholders to the extent we deliver shares upon conversion or redemption of the Senior Secured Convertible Notes. Any sales in the public market of

the Common Shares issuable upon such conversion or redemption could adversely affect prevailing market prices of our Common Shares. In addition, the existence of the Notes may encourage short selling by market participants because the conversion of the Senior Secured Convertible Notes or the satisfaction of redemption payments and other amounts payable under the Senior Secured Convertible Notes in Common Shares could be used to satisfy short positions, or anticipated conversion or satisfaction of redemption payments and other amounts payable under the Senior Secured Convertible Notes in Common Shares could depress the price of our Common Shares.

- The Fundamental Change repurchase and redemption features of the Notes may delay or prevent an otherwise beneficial attempt to take over the Company. The terms of the Senior Secured Convertible Notes require us to repurchase the Notes in the event of a Fundamental Change. A takeover of the Company would trigger an option of the Purchaser to require us to repurchase the Senior Secured Convertible Notes. This may have the effect of delaying or preventing a takeover of the Company that would otherwise be beneficial.
- The Company will be subject to certain covenants set forth in the Senior Secured Convertible Notes. The Notes will contain customary events of default, including for non-payment, misrepresentation, breach of covenants, defaults under other material indebtedness, material adverse change, bankruptcy, change of control and material judgments. Among other things, we will be required to maintain a minimum liquidity of at least USD\$35.0 million at all times, and in some cases, of at least USD\$95.0 million. Upon an Event of Default, the outstanding principal amount of the Notes plus any other amounts owed under the Notes will become immediately due and payable. In such a circumstance, the Company may not be able to make accelerated payments required under the Senior Secured Convertible Notes, and the Purchaser could foreclose on the Company's assets. An Event of Default would also likely significantly diminish the market price of our Common Shares.
- There is no guarantee that an investment in the Notes will earn any positive return in the short or long term. A purchase of Senior Secured Convertible Notes under the Offering involves a high degree of risk and should be undertaken only by investors whose financial resources are sufficient to enable them to assume such risks and who have no need for immediate liquidity in their investment.
- There is no established trading market for the Senior Secured Convertible Notes, and the Company does not expect such a market to develop. The Company does not plan on making an application to list the Senior Secured Convertible Notes on the TSX, NYSE, or any other securities exchange or other trading system. This may affect the pricing of the Senior Secured Convertible Notes in the secondary market, the transparency and availability of trading prices, the liquidity of the Senior Secured Convertible Notes, and the extent of issuer regulation. In addition, the Senior Secured Convertible Notes are initially issued in registered form, and there is no obligation to deposit the notes with a Canadian or U.S. depository, which may create complications in the process of transferring the physical Notes. Investors in the Notes may not be able to sell the Notes at prices or in amounts they desire, or at all.
- The Company may not be successful in the integration of acquisitions into our business (see '*Cautionary Statement Regarding Forward-Looking Statements*').
- We have identified multiple material weaknesses in our internal controls as of July 31, 2021, and if we fail to maintain an effective system of internal controls, our ability to accurately and timely report our financial results or prevent fraud may be adversely affected, and investor confidence and the market price of HEXO's shares may be adversely affected. In the course of preparing and auditing our consolidated financial statements for the year ended July 31, 2021, we and our independent registered public accounting firm identified multiple material weaknesses in our internal control over financial reporting as of July 31, 2021. In accordance with reporting requirements set forth by the SEC, a material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our Company's annual or interim consolidated financial statements will not be prevented or detected on a timely basis. The material weaknesses are identified in "Management's Report on Internal Control over Financial Reporting" section of this MD&A. We have begun and will continue to implement measures to address the material weaknesses. However, the implementation of those measures may not fully remediate the material weaknesses in a timely manner. In the future, we may determine that we have additional material weaknesses or other deficiencies, or our independent registered public accounting firm may disagree with our management's assessment of the effectiveness of our internal controls. Our failure to correct these material weaknesses or our failure to discover and address any other material weaknesses could result in inaccuracies in our financial statements and impair our ability to comply with the applicable financial reporting requirements and related regulatory filings on a timely basis. Moreover, ineffective internal control over financial reporting could significantly hinder our ability to prevent fraud.
- The market price of the Common Shares may be volatile and subject to wide fluctuations in response to numerous factors, many of which are beyond HEXO's control. Companies in the cannabis sector, including HEXO, have also been experiencing extreme volatility in their trading prices. This volatility may affect the ability of holders of Common Shares to sell their securities at an advantageous price. Market price fluctuations in the Common Shares may be due to the Company's operating results failing to meet expectations of securities analysts or investors in any period, downward revision in securities analysts' estimates, adverse changes in general market or industry conditions or economic trends, acquisitions, dispositions or other material public announcements by the Company or its competitors, the COVID-19 pandemic, or a variety of other factors. These broad market fluctuations may adversely affect the trading price of the Common Shares.

- Financial markets historically at times experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of companies and that have often been unrelated to the operating performance, underlying asset values or prospects of such companies. Accordingly, the market price of the Common Shares may decline even if the Company's operating results, underlying asset values or prospects have not changed. Additionally, these factors, as well as other related factors, may cause decreases in asset values that are deemed to be other than temporary, which may result in impairment losses. Continuing fluctuations in price and volume may occur. If such increased levels of volatility and market turmoil continue, the Company's operations could be adversely impacted and the trading price of the Common Shares may be materially and adversely affected.
- We may issue additional securities to finance future activities outside of the Offering. The Company's articles permit the issuance of an unlimited number of Common Shares, and shareholders will have no pre-emptive rights in connection with such further issuances. The directors of the Company have discretion to determine the price and the terms of further issuances. Moreover, additional Common Shares will be issued by the Company on any exercise of options or other security-based compensation awards outstanding or issued by the Company, upon any exercise of outstanding common share purchase warrants, and upon any conversion or repayment in Common Shares of the principal amount of the Company's outstanding convertible debentures. We cannot predict the size of future issuances of securities or the effect, if any, that future issuances and sales of securities will have on the market price of the Common Shares. Sales or issuances of substantial numbers of Common Shares, or the perception that such sales could occur, may adversely affect prevailing market prices of the Common Shares. In connection with any issuance of Common Shares, investors will suffer dilution to their voting power and we may experience dilution in our earnings per share.
- The continued spread of COVID-19 nationally and globally could also disrupt our cultivation and processing activities, supply chains and sales channels, and result in a reduction in supply of, or demand for, the company's products as a result of travel restrictions, work refusals by and mandatory accommodations for employees, changing demand by consumers, mass quarantines, confinements, lock-downs or government-imposed closures in Canada or abroad, which could adversely impact materially the company's business, operations or financial results.
- Since the latter part of February 2020, financial markets have experienced significant volatility in response to the developing COVID-19 pandemic and equity markets in particular have experienced significant declines. The continued spread of COVID-19 nationally and globally may impact the Company's ability raise sufficient capital.
- We operate within a still young and evolving industry and are exposed to certain risks surrounding the fair value inputs related to the valuation of our biological assets and inventories, which may lead to certain impairments and write-offs. These inputs include but are not limited to market pricings, external and internal demand for cannabis and cannabis products and by-products.
- Reliance on management and key persons' ability to execute on strategy. This exposes us to management's ability to perform, as well as the risk of management leaving the Company.
- We face intense competition from licensed producers and other companies, some of which may have greater financial resources and more industry, manufacturing and marketing experience than we do.
- We may be subject to growth-related risks including capacity constraints and pressure on our internal systems and controls. Our ability to manage growth effectively will require it to continue to implement and improve our operational and financial systems and to expand, train and manage our employee base.
- Conversely, we may be subject to growth decline related risks including reduced capacity needs and inactivity of our internal systems and related assets. Our ability to manage growth volatility effectively will require us to continue to monitor our external industry environment and modify our internal operations accordingly.
- Given the nature of our business, we may from time to time be subject to claims or complaints from investors or others in the normal course of business which could adversely affect the public's perception of the Company.
- We are currently a party to certain class action and other lawsuits as discussed elsewhere in this MD&A and we may become party to additional litigation from time to time in the ordinary course of business which could adversely affect our business.
- Failure to adhere to laws and regulations may result in possible sanctions including the revocation or imposition of conditions on licenses to operate our business; the suspension or expulsion from a particular market or jurisdiction or of our key personnel; and the imposition of fines and censures.
- The potential expansion into international operations will result in increased operational, regulatory and other risks.
- There may be a risk of corruption and fraud in any emerging markets in which the Company expands too.
- The Company's ability to successfully identify and make beneficial acquisitions and/or establish joint ventures or investments in associates, as well as successfully integrate these future acquisitions into the Company's operations.
- The development of our business and operating results may be hindered by applicable restrictions on sales and marketing activities imposed by Health Canada.

- Adverse changes or developments affecting the Company's facility's and sites may have a material and adverse effect on our business, financial condition and prospects.
- The adult-use cannabis industry has encountered and may continue to encounter price compressions, which may adversely impact the Company's profitability. In addition, such price compressions, as well as, or together with, oversupply of certain types of inventory in the industry, may result in the Company incurring additional impairment losses on inventory in the event the cost of our inventory exceeds its net realizable value. The continuing evolution of these market conditions represent ongoing uncertainties that may affect the Company's future financial results.
- We have incurred operating losses since commencing operations and may incur losses in the future and may not achieve profitability.
- Our growth strategy contemplates outfitting the Company's multiple facilities with additional production resources. There is a risk that these additional resources will not be completed on time, on budget, or at all.
- A key aspect of our business is growing cannabis, and as such we are exposed to the risks inherent in any agriculture business, such as disease spread, hazards, pests and similar agricultural risks that may create crop failures and supply interruptions for our customers.
- We believe the cannabis industry is highly dependent upon consumer perception regarding the safety, efficacy and quality of the cannabis produced. Consumer perception of our products can be significantly influenced by scientific research or findings, regulatory investigations, litigation, media attention and other publicity regarding the consumption of cannabis products. There can be no assurance that future scientific research, findings, regulatory proceedings, litigation, media attention or other research findings or publicity will be favourable to the cannabis market or any particular product, or consistent with earlier publicity.
- As a manufacturer and distributor of products designed to be ingested or inhaled by humans, we face an inherent risk of exposure to product liability claims, regulatory action and litigation if our products are alleged to have caused significant loss or injury. In addition, the manufacture and sale of our products involve the risk of injury or loss to consumers due to tampering by unauthorized third parties, product contamination, unauthorized use by consumers or other third parties.
- Manufacturers and distributors of products are sometimes subject to the recall or return of their products for a variety of reasons, including product defects, such as contamination, unintended harmful side effects or interactions with other substances, packaging safety and inadequate or inaccurate labelling disclosure.
- Our business is dependent on a number of key inputs and their related costs including raw materials and supplies related to our growing operations, as well as electricity, water and other local utilities. Any significant interruption or negative change in the availability or economics of the supply chain for key inputs could materially impact our business, financial condition and operating results.
- Conflicts of interest may arise between the Company and its directors.
- We may not pay any dividends on our common shares in the foreseeable future.
- The Company may be at risk as a result of breaches of security at its facilities or in respect of electronic documents, data storage and risks related to breaches of applicable privacy laws, cyber security risks, loss of information and computer systems.
- Our common shares are listed on the TSX and Nasdaq; however, there can be no assurance that an active and liquid market for the common shares will be maintained, and an investor may find it difficult to resell such shares.
- There is no assurance the Company will continue to meet the listing requirements of the TSX and/or Nasdaq.
- The Company is subject to restrictions from the TSX and Nasdaq which may constrain the Company's ability to expand its business internationally.
- The market price for our common shares may be volatile and subject to wide fluctuations in response to numerous factors, including governmental and regulatory regimes, community support for the cannabis industry, variations in our operating results, changes in our business prospects, as well as many other factors that are beyond our control. The Company must rely largely on its own market research to forecast sales as detailed forecasts are not generally obtainable from other sources at this early stage of the recreational marijuana industry in Canada.
- An investment in our securities is speculative and involves a high degree of risk and uncertainty.
- We may issue additional common shares in the future, which may dilute a shareholder's holdings in the Company.
- The Company may be unable to successfully achieve the objectives of our strategic alliances.
- The Company's operations are subject to increased risk as a result of international expansion.
- The Company operates in a highly regulated industry which could discourage any takeover offers.
- We maintain or self-insure various types of insurance such as, but not limited to, errors and omissions insurance; directors' and officers' insurance; property coverage; and general commercial insurance, recall insurance, cyber security insurance,

warehouseman insurance and cargo insurance. A judgment against any member of the Company in excess of available coverage could have a material adverse effect on us in terms of damages awarded and the impact on our reputation.

- Based upon the nature of the Company's current business activities, the Company does not believe it is currently an "investment company" ("IC") under the U.S. Investment Company Act of 1940. However, the tests for determining IC status are based upon the composition of the assets of the Company and its subsidiaries and affiliates from time to time, and it is difficult to make accurate predictions of future assets. Accordingly, there can be no assurance that the Company will not become an IC in the future. A corporation generally will be considered an IC if; more than 40% of the value of its total assets excluding cash and U.S. government securities are comprised of investment securities, which generally include any securities of an entity the corporation does not control. If the Company were to become an IC, it would not be able to conduct public offerings of securities in the U.S.
- Our operations are subject to environmental and safety laws and regulations concerning, among other things, emissions and discharges to water, air and land, the handling and disposal of hazardous and non-hazardous materials and wastes, and employee health and safety. We will incur ongoing costs and obligations related to compliance with environmental and employee health and safety matters. Failure to comply with environmental and safety laws and regulations may result in additional costs for corrective measures, in penalties or in restrictions on our manufacturing operations.
- The Company's ERP may impact the scoping, requirements definition, business process definition, design and testing of the integrated ERP system could result in problems which could, in turn, result in disruption, delays and errors to the operations and processes within the business and/or inaccurate information for management and financial reporting.
- The Company may not be able to develop and maintain strong internal controls and be SOX compliant by the mandated deadline.
- We are exposed to the risk that our employees, independent contractors and consultants may engage in fraudulent or other illegal activity. Misconduct by these parties could include intentional, reckless and/or negligent conduct or disclosure of unauthorized activities to the Company that violates: (i) government regulations; (ii) manufacturing standards; (iii) federal and provincial healthcare fraud and abuse laws and regulations; or (iv) laws that require the true, complete and accurate reporting of financial information or data.
- The Company is subject to continuous evolving corporate governance, internal controls and disclosure regulations that may increase the risk of non-compliance, which could adversely impact the Company, its market perception and valuation.
- The Company expects to incur a number of infrequent transaction-related costs associated with completing the Acquisitions that will be incurred whether or not the Acquisitions completed.

## Non-IFRS Measures

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The Company has included certain non-IFRS performance measures in this MD&A, as defined in this section. We employ these measures internally to measure our operating and financial performance. We believe that these non-IFRS financial measures, in addition to conventional measures prepared in accordance with IFRS, enable investors to evaluate our operating results, underlying performance and future prospects in a manner similar to management.

As there are no standardized methods of calculating these non-IFRS measures, our methods may differ from those used by others, and accordingly, these measures may not be directly comparable to similarly titled measures used by others. Accordingly, these non-IFRS measures are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

### ADJUSTED EARNINGS BEFORE INTEREST, TAXES, DEPRECIATION AND AMORTIZATION ("Adjusted EBITDA")

The Company has identified Adjusted EBITDA as a relevant industry performance indicator. Adjusted EBITDA is a non-GAAP financial measure that does not have any standardized meaning prescribed by IFRS and may not be comparable to similar measures presented by other companies. The Company calculates Adjusted EBITDA as Total net loss, plus (minus) income taxes (recovery), plus (minus) finance expense (income) net, plus depreciation, plus amortization, plus (minus) investment (gains) losses, plus (minus) non-cash fair value adjustments, plus (minus) infrequent expenses, plus (minus) other non-cash items. See Adjusted EBITDA table for those items comprising investment (gains)/losses, non-cash fair value adjustments, infrequent expenses and other non-cash items. Management believes this measure provides useful information as it is a commonly used measure in the capital markets to approximate operating earnings.

### GROSS PROFIT BEFORE ADJUSTMENTS

This measure is utilized for those reasons as presented in "Gross profit before fair value adjustments" with the adjustment that this metric excludes the write-offs of inventory and biological assets, write downs to net realizable value and destruction costs. The Company has identified this metric as useful and relevant information as it represents the gross profit for operational purposes based on costs to produce, package and ship inventory sold, exclusive of impairments and other write downs due to changes to internal or external influences impacting the net realizable value of inventory and inventory disposal costs.

## Key Operating Performance Indicators

We have included certain key operating performance indicators within this MD&A, as defined in this section. We utilize these metrics internally for a range of purposes such as critical inputs in fair valuation techniques to evaluating the operating performance results in a given period.

#### **EXPECTED PLANT YIELD**

The expected plant yield is utilized in the valuation of biological assets on hand as at the period end. This represents an unobservable input to a level 3 fair value estimate and is derived from the Company's historical harvests as well as the expertise of the appropriate personnel. A sensitivity analysis over this input was performed and included in the 'Biological Assets – Fair Value Measurement' section below.

#### **PRODUCTION CAPACITY**

The production capacity disclosed within this MD&A represents management's best estimate and is derived from the historical actual output of production as well as the use of cultivation expertise existing within the Company.

#### **KILOGRAMS HARVESTED**

The kilograms harvested during the period representing the amount of dried gram and dried gram equivalents harvested and produced from biological assets but not necessarily sold during the period.

#### **ORGANIC GROWTH/VARIANCES**

This refers the Company's period over period results of the legacy HEXO operations and does not include financial contributions from business acquisitions during the specified periods.

### **Other Defined Additional IFRS Measure**

We have included the below additional IFRS measures as these represent cannabis industry financial statement line items and are present within the Company's statement of loss and comprehensive loss for the three and nine months ended April 30, 2021.

#### **GROSS PROFIT BEFORE FAIR VALUE ADJUSTMENTS**

We utilize this measure to provide a representation of performance in the period by excluding the fair value measurements as required by IFRS, realized fair value amounts on inventory sold and unrealized gain on changes in fair value of biological assets. We believe this measure provides useful information as it represents the gross profit for management purposes based on cost to produce, package and ship inventory sold, exclusive of any fair value measurements as required by IFRS. The metric is calculated by removing all amounts related to biological asset fair value accounting under IFRS, including gains on transformation of biological assets and the cost of finished harvest inventory sold, which represents the fair value measured portion of inventory cost ("fair value cost adjustment") recognized as cost of goods sold. In accordance with CSA Staff Notice 51-357 issued in October 2018, we utilize an adjusted gross profit to provide a representation of performance in the period by excluding non-cash fair value measurements as required by IFRS. We believe this measure provides useful information as it represents the gross profit for management purposes based on cost to produce, package and ship inventory sold, exclusive of any fair value measurements as required by IFRS. The metric is calculated by removing all amounts related to biological asset fair value accounting under IFRS, including gains on transformation of biological assets and the cost of finished harvest inventory sold as well as fair value adjustments to net realizable value, which represents the fair value measured portion of inventory cost ("fair value cost adjustment") recognized as cost of goods sold.

#### **ADULT-USE NON-BEVERAGE REVENUES & BEVERAGE REVENUES**

We utilize this differentiation to allow the user to identify the revenue streams generated by the Company's perpetual sales activity vs. the future "to be" discontinued sales stream, cannabis infused beverages. As discussed in section 'Beverage Based Adult-Use Sales,' the cannabis infused beverage revenues, as at the date of this MD&A, are intended to cease to be recognized by the Company as direct sales at the point in time when the business venture Truss obtains the appropriate cannabis licensing under Health Canada.

## **Cautionary Statement Regarding Forward-Looking Statements**

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Certain information in this MD&A contains or incorporates comments that constitute forward-looking information within the meaning of applicable securities legislation. Forward-looking information, in general, can be identified by the use of forward-looking terminology such as "may", "expect", "intend", "estimate", "anticipate", "believe", "should", "plans", "continue", "objective", or similar expressions suggesting future outcomes or events. They include, but are not limited to, statements with respect to expectations, projections or other characterizations of future events or circumstances; our objectives, goals, strategies, beliefs, intentions, plans, estimates, projections and outlook, including statements relating to our plans and objectives; estimates or predictions of actions of customers, suppliers, competitors or regulatory authorities; and statements regarding our future economic performance, as well as statements with respect to:

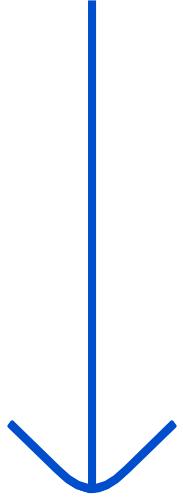
- the competitive and business strategies of the Company;
- the intention to grow the business, operations and potential activities of the Company, including entering into joint ventures and partnerships and leveraging the brands of third parties through joint ventures and partnerships;

- the ongoing expansion of the Company's facilities, its costs and receipt of approval from Health Canada to complete such expansion and increase production and sale capacity;
- the expansion of business activities, including current and potential acquisitions;;
- the Company's acquisition of Zenabis Global Inc. and the future impact thereof;
- the Company's proposed acquisition of 48North Cannabis Corp. and the future impact thereof;
- the Company's proposed acquisition of Redecan. and the future impact thereof;
- the expected sales mix of offered products;
- the development and authorization of new products, including cannabis edibles, beverages and extract products ("cannabis derivatives"), and the timing of launch of such new products;
- the competitive conditions of the industry, including the Company's ability to maintain or grow its market share;
- the Company's Truss and Truss CBD USA business ventures with Molson Coors and the future impact thereof;
- the Company's Keystone Isolation Technologies business venture and the future impact thereof;
- the expansion of the Company's business, operations and potential activities outside of the Canadian market, including but not limited to the U.S., Europe and other international jurisdictions;
- the event of a default event and whether the Company has the ability to fund arising obligations;
- whether the Company will have sufficient working capital and its ability to raise additional financing required in order to develop its business and continue operations;
- the applicable laws, regulations and any amendments thereof;
- the grant, renewal and impact of any licence or supplemental licence to conduct activities with cannabis or any amendments thereof;
- the filing of trademark and patent applications and the successful registration of same;
- the anticipated future gross margins of the Company's operations;
- the performance of the Company's business and operations;
- securities class action and other litigation to which the Company is subject; and
- the impact of the COVID-19 coronavirus pandemic on the operations of the Company.

Such statements are not historical facts but instead represent management beliefs regarding future events, many of which, by their nature, are inherently uncertain and beyond management control. We have based these forward-looking statements on our current expectations about future events and certain assumptions including, but not limited to:

- the Company's ability to implement its growth strategies;
- the Company's ability to complete the conversion, improvements or buildup of its owned and leased facilities on time and on budget;
- the Company's competitive advantages;
- the development of new products and product formats for the Company's products;
- the Company's ability to obtain and maintain financing on acceptable terms;
- the impact of competition;
- the changes and trends in the cannabis industry;
- changes in laws, rules and regulations;
- the Company's ability to maintain and renew required licences;
- the Company's ability to maintain good business relationships with its customers, distributors and other strategic partners;
- the Company's ability to keep pace with changing consumer preferences;
- the Company's ability to protect intellectual property;
- the Company's ability to manage and integrate acquisitions;
- the Company's ability to retain key personnel; and
- the absence of material adverse changes in the industry or global economy, including as a result of the COVID-19 pandemic.

Although any forward-looking statements contained in this MD&A are based on what we believe are reasonable assumptions, these assumptions are subject to a number of risks beyond our control, and there can be no assurance that actual results will be consistent with these forward-looking statements. Factors that could cause actual results to differ materially from those set forth in the forward-looking statements and information include, but are not limited to, financial risks; industry competition; general economic conditions and global events; product development, facility and technological risks; changes to government laws, regulations or policies, including tax; agricultural risks; supply risks; product risks; dependence on senior management; sufficiency of insurance; and other risks and factors described from time to time in the documents filed by us with securities regulators. For more information on the risk factors that could cause our actual results to differ from current expectations, see "Risk Factors". All forward-looking information is provided as of the date of this MD&A. We do not undertake to update any such forward-looking information whether as a result of new information, future events or otherwise, except as required by law.



# **HEXO Corp.**

## **Consolidated Financial Statements**

**For the years ended  
July 31, 2021 and 2020**



## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of HEXO Corp.

### **Opinions on the Financial Statements and Internal Control over Financial Reporting**

We have audited the accompanying consolidated statements of financial position of HEXO Corp. and its subsidiaries (together, the Company) as of July 31, 2021 and 2020, and the related consolidated statements of net loss and comprehensive loss, of changes in shareholders' equity and of cash flows for the years then ended, including the related notes (collectively referred to as the consolidated financial statements). We also have audited the Company's internal control over financial reporting as of July 31, 2021, based on criteria established in *Internal Control – Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of July 31, 2021 and 2020, and its financial performance and its cash flows for the years then ended in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board. Also in our opinion, the Company did not maintain, in all material respects, effective internal control over financial reporting as of July 31, 2021, based on criteria established in *Internal Control – Integrated Framework* (2013) issued by the COSO because material weaknesses in internal control over financial reporting existed as of that date related to the Company's control environment, risk assessment procedures, monitoring activities, anti-fraud control activities, information and communication processes, control activities, period-end financial reporting, non-routine, unusual or complex transactions, transaction-level control activities, and information technology general controls.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis. The material weaknesses referred to above are described in Management's Report on Internal Controls over Financial Reporting included in the 2021 Management's Discussion & Analysis. We considered these material weaknesses in determining the nature, timing, and extent of audit tests applied in our audit of the 2021 consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements.

### ***Substantial Doubt about the Company's Ability to Continue as a Going Concern***

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations, has had cash outflows from operating activities, and has financial liabilities that may require significant cash outflows over the next twelve months, that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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#### *Change in Accounting Principle*

As discussed in note 4 to the consolidated financial statements, the Company changed the manner in which it accounts for leases as of August 1, 2019.

#### **Basis for Opinions**

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in management's report referred to above. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As described in Management's Report on Internal Controls over Financial Reporting, management has excluded Zenabis Global Inc. from its assessment of internal control over financial reporting as of July 31, 2021 because it was acquired by the Company in a purchase business combination during 2021. We have also excluded Zenabis Global Inc. from our audit of internal control over financial reporting. Zenabis Global Inc. is a wholly-owned subsidiary whose total assets and total revenues excluded from management's assessment and our audit of internal control over financial reporting represent 14% and 5%, respectively, of the related consolidated financial statement amounts as of and for the year ended July 31, 2021.



### **Definition and Limitations of Internal Control over Financial Reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

### **Critical Audit Matters**

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that (i) relate to accounts or disclosures that are material to the consolidated financial statements and (ii) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

#### *Fair value component of biological assets harvested into dried cannabis inventory*

As described in notes 4, 9 and 10 to the consolidated financial statements, the Company measures biological assets using the income approach at fair value less costs to sell at the point of harvest (fair value component), which becomes the basis for the cost of related inventories after harvest. The Company transferred \$89.8 million from biological assets to dried cannabis inventory for the year ended July 31, 2021. The dried cannabis inventory cost as of July 31, 2021 includes a fair value component of \$24.3 million which represents the fair value less cost to sell of the biological asset at the point of harvest. Determining the fair value component requires management to make significant estimates, judgment and assumptions in the fair value less cost to sell model relating to expected yields for the cannabis plants, sales price and expected post-harvesting costs.



The principal considerations for our determination that performing procedures relating to the fair value component of biological assets harvested into dried cannabis inventory is a critical audit matter are the significant judgment by management when determining the fair value less cost to sell of the biological asset at the point of harvest which includes assumptions when determining the fair value less costs to sell. As described in the "Opinions on the Financial Statements and Internal Control over Financial Reporting" section, material weaknesses were identified related to this matter. This led to a high degree of auditor judgment, subjectivity, and effort in performing procedures to evaluate management's determination of the fair value component and the significant assumptions related to expected yields for the cannabis plants, sales price and expected post-harvesting costs.

Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included, among others, testing management's process for determining the fair value component; evaluating the appropriateness of the method and model used to calculate the fair value component; testing the completeness and accuracy of the underlying data used in the model; and evaluating the reasonableness of the significant assumptions used by management. Evaluating the reasonableness of the significant assumptions used by management related to expected yields for the cannabis plants, sales price and expected post-harvesting costs involved evaluating whether the assumptions used by management were reasonable by considering actual historical information; consistency with evidence obtained in other areas of the audit; recent market data; and considering sensitivities over significant assumptions.

*Valuation of the acquired cultivation and processing license as part of the acquisition of Zenabis Global Inc.*

As described in notes 4 and 15 to the consolidated financial statements, the Company completed the acquisition of Zenabis Global Inc. (acquired business) for a purchase consideration of \$211.8 million. The net assets acquired included a \$28.9 million cultivation and processing license. Management applied judgment in estimating the fair value of the acquired cultivation and processing license. The Company recorded the acquired cultivation and processing license at fair value using a discounted cash flow methodology, which involved significant assumptions such as forecasted gross margin and estimated time to obtain a license and complete cultivation and production ramp-up.

The principal considerations for our determination that performing procedures relating to the valuation of the acquired cultivation and processing license as part of the acquisition of Zenabis Global Inc. is a critical audit matter are the judgment by management when developing the fair value of the acquired cultivation and processing license, the significant audit effort in evaluating the significant assumptions related to forecasted gross margin and estimated time to obtain a license and complete cultivation and production ramp-up, and the audit effort involved the use of professionals with specialized skill and knowledge. As described in the "Opinions on the Financial Statements and Internal Control over Financial Reporting" section, a material weakness was identified related to this matter. This led to the high degree of auditor judgment and subjectivity in performing procedures relating to the fair value of the acquired cultivation and processing license and the significant assumptions.



Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included, among others, reading the purchase agreement, and testing management's process for estimating the fair value of the cultivation and processing license acquired. Testing management's process included evaluating the appropriateness of the valuation method, testing the completeness and accuracy of the underlying data used in the valuation method, and evaluating the reasonableness of significant assumptions used by management. Evaluating the reasonableness of the significant assumption used by management related to forecasted gross margin involved considering the past performance of the acquired business, other comparable peer data, as well as assessing whether this assumption was consistent with evidence obtained in other areas of the audit. Evaluating the reasonableness of the significant assumption used by management related to estimated time to obtain a license and complete cultivation and production ramp-up involved considering the past experience in developing licensed facilities and other comparable peer data. Professionals with specialized skill and knowledge were used to assist in evaluating the appropriateness of the Company's valuation method and the reasonableness of the forecasted gross margin assumption.

*Accounting for the Day 1 loss in the senior secured convertible note*

As described in notes 4 and 19 to the consolidated financial statements, on May 27, 2021 the Company issued a US\$ denominated senior secured convertible note (the Note) at a principal amount of \$434.6 million (US\$360.0 million). The Note was sold at a transaction price of \$395.5 million (US\$327.6 million). The Note includes multiple embedded derivatives and has been designated in its entirety as a financial liability at fair value through profit and loss. Management determined that the fair value of the Note on issuance does not equal the transaction price, which was attributed, among other things, to a premium paid as a result of the limited time available to close the financing required to secure the Redecan acquisition. The fair value of the Note at initial recognition, determined using a valuation technique that includes unobservable inputs, was \$491.7 million (US\$407.3 million), resulting in a difference between the transaction price and the fair value of \$96.2 million (US\$79.7 million) (Day 1 loss). Management determined that the Day 1 loss cannot be recognized in the consolidated statement of net loss and comprehensive loss on initial recognition of the Note but should be deferred and recognized as a loss only to the extent that it arises from a change in a factor that market participants would take into account when pricing the Note. Management determined that time is such a factor specific to the Note and the Day 1 loss is recognized on a straight line basis in the consolidated statement of net loss and comprehensive loss over the contractual life of the Note. Management used significant judgment to determine the accounting for the Day 1 loss in the Note.

The principal considerations for our determination that performing procedures relating to the accounting for the Day 1 loss in the senior secured convertible note is a critical audit matter are the significant judgment by management in determining the accounting for the Day 1 loss in the Note. As described in the "Opinions on the Financial Statements and Internal Control over Financial Reporting" section, a material weakness was identified related to this matter. This led to a high degree of auditor judgment, subjectivity and effort in performing procedures and evaluating audit evidence related to management's assessment of the accounting for the Day 1 loss in the Note.



Addressing the matter involved performing procedures and evaluating audit evidence in connection with forming our overall opinion on the consolidated financial statements. These procedures included, among others, reading the Note agreement; evaluating whether the key terms in management's accounting memorandum have been appropriately identified; evaluating the reasonableness of management's assessment that unobservable inputs in the valuation technique led to the deferral of the Day 1 loss in the Note by considering the limited time available to close the financing required to secure the Redecan acquisition, the factors specific to the transaction and the Note, the inputs applied in the fair value of the Note, and consistency with evidence obtained in other areas of the audit; evaluating the reasonableness of management's assessment that time is the factor that market participants would take into account when pricing the Note by considering the terms of the Note agreement; and evaluating the sufficiency of the Company's consolidated financial statement disclosures related to this matter.

**/s/PricewaterhouseCoopers LLP**

Chartered Professional Accountants, Licensed Public Accountants

Ottawa, Canada  
October 29, 2021

We have served as the Company's auditor since 2020.

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## Consolidated Statements of Financial Position

(expressed in thousands of Canadian Dollars)

As at	Note	July 31, 2021	July 31, 2020
<b>Assets</b>		\$	\$
Current assets			
Cash and cash equivalents	5	67,462	184,173
Restricted funds	6	132,246	8,261
Cash held in escrow	7	285,779	—
Trade receivables	26	37,421	19,426
Commodity taxes recoverable and other receivables	8	13,549	16,733
Prepaid expenses		7,490	4,606
Inventory	9	135,327	64,933
Biological assets	10	14,284	7,571
		<b>693,558</b>	<b>305,703</b>
Non-current assets			
Property, plant and equipment	13	393,902	285,366
Intangible assets	14	50,608	16,008
Investment in associate and joint ventures	11	74,679	76,306
Lease receivable		4,453	3,865
License and prepaid royalty		—	1,020
Long-term investments	12	2,492	3,209
Prepaid expenses		3,922	1,392
Goodwill	16	88,189	—
Total assets		<b>1,311,803</b>	<b>692,869</b>
<b>Liabilities</b>			
Current liabilities			
Accounts payable and accrued liabilities		63,557	32,451
Excise taxes payable		6,591	7,121
Warrant liabilities	17	5,733	3,450
Lease liability	20	1,730	4,772
Loans and borrowings – current	21	50,159	29,930
Convertible debentures – current	18	3,406	—
Senior secured convertible note	19	367,699	—
Onerous contract	31	4,763	4,763
		<b>503,638</b>	<b>82,487</b>
Non-current liabilities			
Lease liability	20	42,155	24,344
Convertible debentures	18	33,089	28,969
Deferred income tax liability	37	136	—
Other long-term liabilities		520	393
Total liabilities		<b>579,538</b>	<b>136,193</b>
<b>Shareholders' equity</b>			
Share capital	22	1,267,967	1,023,788
Share-based payment reserve	24	69,750	65,746
Warrant reserve	23	124,112	95,617
Contributed surplus		41,290	27,377
Accumulated deficit		(773,993)	(659,231)
Accumulated other comprehensive income		1,152	—
Total equity attributable to shareholders of HEXO Corp.		<b>730,278</b>	<b>553,297</b>
Non-controlling interest	33	1,987	3,379
Total shareholders' equity		<b>732,265</b>	<b>556,676</b>
Total liabilities and shareholders' equity		<b>1,311,803</b>	<b>692,869</b>
Going Concern (Note 2)			
Commitments and contingencies (Note 31)			
Subsequent events (Note 38)			

Approved by the Board of Directors

/s/ Jason Ewart, Director

/s/ Michael Munzar, Director

# Consolidated Statements of Net Loss and Comprehensive Loss

(expressed in thousands of Canadian Dollars, except per share data)

For the year ended	Note	July 31, 2021	July 31, 2020
Revenue from sale of goods	34	173,081	110,149
Excise taxes		(49,583)	(29,598)
Net revenue from sale of goods		123,498	80,551
Ancillary revenue		271	233
Net revenue		123,769	80,784
Cost of goods sold	9,24	94,703	127,205
Gross profit/(loss) before fair value adjustments		29,066	(46,421)
Fair value component in inventory sold	9	31,767	40,910
Unrealized gain on changes in fair value of biological assets	10	(51,499)	(29,356)
Gross profit/(loss)		48,798	(57,975)
Operating expenses			
Selling, general and administrative	27	58,187	52,793
Marketing and promotion		10,348	12,474
Share-based compensation	27	11,731	25,790
Research and development		3,835	4,639
Depreciation of property, plant and equipment	13	6,097	6,072
Amortization of intangible assets	14	2,050	3,939
Restructuring costs		3,283	4,767
Impairment of property, plant and equipment	13	20,230	79,418
Impairment of intangible assets	14	—	108,189
Impairment of goodwill		—	111,877
Recognition of onerous contract		—	4,763
Disposal of long-lived assets		1,294	—
Loss/(gain) on disposal of property, plant and equipment		64	3,855
Acquisition and transaction costs		17,174	—
		134,293	418,576
Loss from operations		(85,495)	(476,551)
Interest income (expense), net	28	(30,523)	(8,141)
Non-operating income (expense), net	28	859	(67,820)
Loss and comprehensive loss attributable to shareholders before tax		(115,159)	(552,512)
Current and deferred tax recovery	37	397	6,023
Net loss		(114,762)	(546,489)
Other comprehensive income			
Foreign currency translation		(17)	—
Gain on fair value due to changes in credit spread, net of tax		1,169	—
Net loss and comprehensive loss		(113,610)	(546,489)
Comprehensive loss attributable to:			
Shareholders of HEXO Corp.		(113,477)	(546,489)
Non-controlling interest		(133)	—
		(113,610)	(546,489)
Net loss and comprehensive loss per share, basic and diluted		(0.89)	(7.08)
<b>Weighted average number of outstanding shares</b>			
Basic and diluted	25	<b>127,300,903</b>	77,376,174

## Consolidated Statements of Changes in Shareholders' Equity

(expressed in thousands of Canadian Dollars, except per share data)

For the year ended	Note	Number of common shares	Share capital	Share-based payment reserve	Warrant reserves	Contributed surplus	Accumulated OCI	Accumulated deficit	Non-controlling interest	Total equity
Balance at July 31, 2019		64,245,441	\$ 799,706	\$ 40,315	\$ 60,433	\$ —	\$ —	\$ (112,742)	\$ 1,000	\$ 788,712
June 2020 at the market offering		8,235,620	33,263	—	—	—	—	—	—	33,263
May 2020 at the market offering		15,985,000	43,495	—	10,998	—	—	—	—	54,493
April 2020 underwritten offering		14,950,000	22,928	—	20,182	—	—	—	—	43,110
\$70m private placement unsecured convertible debenture		—	—	—	—	23,902	—	—	—	23,902
USD\$25m registered offering		3,742,516	25,229	—	—	—	—	—	—	25,229
USD\$20m registered offering		2,994,012	21,073	—	—	—	—	—	—	21,073
Early conversion of debentures		9,331,250	72,005	—	13,354	(10,362)	—	—	—	74,997
Issuance fees		—	—	—	—	(27)	—	—	—	(27)
Expiry of warrants		—	—	—	(7,881)	7,881	—	—	—	—
Exercise of warrants		1,103,469	5,866	—	(1,469)	—	—	—	—	4,397
Exercise of stock options	24	29,133	223	(89)	—	—	—	—	—	134
Expiry of stock options		—	—	(5,983)	—	5,983	—	—	—	—
Equity-settled share-based payments	18,21	—	—	31,503	—	—	—	—	—	31,503
Non-controlling interest		—	—	—	—	—	—	—	2,379	2,379
Net loss		—	—	—	—	—	—	(546,489)	—	(546,489)
<b>Balance at July 31, 2020</b>		<b>120,616,441</b>	<b>1,023,788</b>	<b>65,746</b>	<b>95,617</b>	<b>27,377</b>	<b>—</b>	<b>(659,231)</b>	<b>3,379</b>	<b>556,676</b>
June 2020 at the market offering	22	244,875	—	—	—	—	—	—	—	—
May 2021 at the market offering, net	22	6,373,926	45,257	—	—	—	—	—	—	45,257
Acquisition of Zenabis Global Inc	15	17,579,336	151,358	7,282	32,354	—	—	—	(1,340)	189,654
Transaction costs	15	448,639	3,612	—	—	—	—	—	—	3,612
Senior secured convertible note, net		4,602,241	29,540	—	—	—	—	—	—	29,540
Exercise of stock options	24	410,051	3,213	(1,983)	—	—	—	—	—	1,230
Exercise of equity settled RSUs		223,506	1,267	(1,554)	—	—	—	—	—	(287)
Expiry of stock options		—	—	(12,891)	—	12,891	—	—	—	—
Exercise of warrants	23	2,146,931	9,932	—	(3,126)	—	—	—	—	6,806
Expiry of warrants		—	—	—	(733)	733	—	—	—	—
Equity-settled share-based payments	24	—	—	13,150	—	—	—	—	—	13,150
Other comprehensive income		—	—	—	—	—	1,152	—	—	1,152
Non-controlling interest	33	—	—	—	—	289	—	—	—	289
Net loss		—	—	—	—	—	—	(114,762)	(52)	(114,814)
<b>Balance at July 31, 2021</b>		<b>152,645,946</b>	<b>1,267,967</b>	<b>69,750</b>	<b>124,112</b>	<b>41,290</b>	<b>1,152</b>	<b>(773,993)</b>	<b>1,987</b>	<b>732,265</b>

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

# Consolidated Statements of Cash Flows

(expressed in thousands of Canadian Dollars)

For the year ended	Note	July 31, 2021	July 31, 2020
<b>Operating activities</b>		\$	\$
Net loss		(114,762)	(546,489)
Items not affecting cash	36	71,263	508,484
Changes in non-cash operating working capital items	36	431	(56,549)
Cash used in operating activities		(43,068)	(94,554)
<b>Financing activities</b>			
Proceeds from issuance of senior secured note, net	19	377,433	—
Proceeds from issuance of common shares, net		46,140	186,673
Shortfall payments and other transaction costs		(4,482)	—
Proceeds from the exercise of stock options	24	1,230	134
Payments on RSU exercise	24	(287)	—
Proceeds from the exercise of warrants	23	6,806	4,291
Repayments of term loan	21	(38,415)	(3,500)
Interest paid on term loan		(2,035)	(1,849)
Lease payments	20	(4,835)	(4,341)
Issuance of unsecured convertible debentures	18	—	70,000
Interest paid on unsecured convertible debentures	18	(3,583)	(3,205)
Cash provided financing activities		377,972	248,203
<b>Investing activities</b>			
Settlement of short-term investments		—	25,420
Proceeds from sale of investments		—	7,871
Cash outflows to restricted cash	6	(120,985)	13,089
Cash outflows to cash held in escrow	7	(276,654)	—
Net cash acquired on business combination	15	2,804	—
Issuance of convertible debenture receivable	15	(19,500)	—
Proceeds from sale of property, plant and equipment		93	10,966
Acquisition of property, plant and equipment		(30,004)	(109,040)
Purchase of intangible assets		(2,336)	(856)
Investment in associates and joint ventures	11	(5,033)	(30,494)
Cash used in investing activities		(451,615)	(83,044)
(Decrease)/increase in cash and cash equivalents		(116,711)	70,605
Cash and cash equivalents, beginning of year		184,173	113,568
<b>Cash and cash equivalents, end of year</b>		<b>67,462</b>	<b>184,173</b>

Supplemental cashflow information in Note 36

# Notes to the Consolidated Financial Statements

For the years ended July 31, 2021 and 2020

(expressed in thousands of Canadian Dollars, except share amounts or where otherwise stated)

## 1. Description of Business

HEXO Corp. ("HEXO" or the "Company"), is a publicly traded corporation, incorporated in Ontario, Canada. HEXO is licensed to produce and sell cannabis and cannabis products under the Cannabis Act. The head office is located at 120 Chemin de la Rive, Gatineau, Canada. The Company's common shares are listed on the Toronto Stock Exchange ("TSX") and the National Association of Securities Dealers Automated Quotations ("Nasdaq"), both under the trading symbol "HEXO". The Company was listed on the New York Stock Exchange up to August 24, 2021, at which time the Company transferred its US listing to the Nasdaq.

## 2. Going Concern

These consolidated financial statements have been prepared using International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board applicable to a going concern, which assumes that the Company will be able to continue its operations and will be able to realize its assets and settle its liabilities in the normal course of business as they come due in the foreseeable future.

For the year ended July 31, 2021, the Company reported an operating loss of \$85,495; cash outflows from operating activities of \$43,068 and an accumulated deficit of \$773,993. In addition, the Cash held in escrow were released subsequent to year end to finance the Redecan acquisition (Note 38).

Under the terms of the Senior Secured Convertible Note, the holder has the option to require monthly redemptions, which are settled in either cash or equity. In order to retain the right to settle the monthly redemptions in either cash or equity, the Company must maintain, for each of the 20 previous trading days, a daily volume weighted average price per common share on the Nasdaq Capital Market ("VWAP") above US\$1.50, as well as meet certain other conditions (Note 19). In the event that these conditions are not met, the Company must seek a waiver from the holder in order to settle each monthly redemption in equity (the "Equity Condition Waiver"). If the holder does not grant the Equity Condition Waiver, the monthly redemption is required to be settled in cash. These monthly redemptions may result in significant cash outflows over the next twelve months (Note 19).

On October 22, 2021, the Company negotiated an amendment to the terms of the Senior Secured Convertible Note which resulted in reducing the daily VWAP attached to the Equity Condition Waiver from US\$5.00 to US\$1.50. In addition, to date, when requested, the holder has granted the Equity Condition Waiver and has permitted settlement of the monthly redemptions in equity. However, there can be no assurances that the Equity Conditions Waiver will continue to be met, or if they are not met, that the holder will continue to grant equity waivers to permit settlement of the monthly redemptions in equity. As such, there exists a risk that significant cash outflows may be required over the next twelve months under the terms of the Senior Secured Convertible Note.

Existing funds on hand, when combined with operational cash flow, are not sufficient to fund existing debt repayments, capex budgets, and potential cash requirements under the Senior Secured Convertible Note. Management is exploring several options to secure the necessary financing, which could include the issuance of new public or private equity or debt instruments, supplemented with operating cash inflows from operations. Nevertheless, there is no assurance that certain sources of additional future funding will be available to the Company or will be available on terms which are acceptable to management.

These circumstances create material uncertainties that lend substantial doubt as to the ability of the Company to meet its obligations as they come due and, accordingly, the appropriateness of the use of accounting principles applicable to a going concern. The Company's ability to continue as a going concern is dependent upon its ability to fund the repayment of existing borrowings, secure additional financing and to generate positive cash flows from operations. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary if the company were unable to realize its assets and settle its liabilities as a going concern in the normal course of operations. Such adjustments could be material.

### **3. Basis of Preparation**

#### **i. Statement of Compliance**

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

These consolidated financial statements were approved and authorized for issue by the Board of Directors on October 29, 2021.

#### **ii. Basis of Measurement**

The consolidated financial statements have been prepared on a historical cost basis except for certain financial instruments which are carried at fair value and biological assets carried at fair value less cost to sell, as detailed in the Company's accounting policies.

#### **iii. Functional and Presentation Currency**

The consolidated financial statements are presented in Canadian dollars, which is the parent's functional currency. Each entity within the Company determines its own functional currency based on the primary economic environment in which it operates.

#### **iv. Uncertainty of COVID-19 Pandemic**

In March 2020, the World Health Organization declared the outbreak of COVID-19 a global pandemic. More recently, outbreaks of COVID-19 variants across the globe continue to prolong the pandemic. In response to the outbreak, governmental authorities in Canada and internationally have introduced various recommendations and measures to try to limit the pandemic, including travel restrictions, border closures, non-essential business closures, quarantines, self-isolations, shelters-in-place and social distancing. These measures are continuously monitored and modified by the applicable governmental authorities in Canada and certain of these remained in effect as at July 31, 2021.

The production and sale of cannabis in Canada was deemed an essential service throughout the year ended July 31, 2021 and 2020. However, the industry was impacted by the COVID-19 restriction of limited in store shopping at retailers. The Company regularly monitors the impact of the ongoing pandemic on all aspects of its business and operations and as of July 31, 2021, we have not observed any material changes to the Company's operations.

#### **v. Share Consolidation**

The Company finalized a share consolidation on the basis of four pre-consolidation common shares for one post-consolidation common share (4:1) by way of shareholder approval at the annual and special meeting of shareholders held December 11, 2020 (the "Share Consolidation"). The Share Consolidation was effected by the filing of articles of amendment to the Company's articles under the Business Corporations Act (Ontario) on December 18, 2020. All balances of common shares, common share purchase warrants, stock options and restricted share units herein are reflective of the Share Consolidation (unless otherwise noted).

#### **Basis of Consolidation**

##### **SUBSIDIARIES**

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity and be exposed to, or have rights to, the variable returns from its activities. The financial statements of subsidiaries are consolidated from the date that control commences until the date that control ceases. All intercompany transactions, balances, and unrealized gains and losses are eliminated upon consolidation.

Non-controlling interest ("NCI") represents the portion of equity ownership in subsidiaries not attributable to the Company's shareholders. NCI is initially measured as the proportionate share of its interest in the acquiree's identifiable net assets as at the date of acquisition and subsequently adjusted for the proportionate share of net earnings and other comprehensive income (loss) attributable to the NCI, as well as any dividends or distributions paid to the NCI. Non-controlling interests in the results and equity of subsidiaries are shown separately in the consolidated statements of loss and comprehensive loss, statements of changes in equity and balance sheets respectively.

<u>PRINCIPAL OPERATING SUBSIDIARIES</u>	<u>JURISDICTION</u>	<u>INTEREST HELD</u>	<u>PRINCIPAL ACTIVITY</u>
HEXO Operations Inc.	Quebec, Canada	100%	To produce and sell cannabis and cannabis products under the Cannabis Act.
HEXO USA Inc.	Delaware, USA	100%	To facilitate expansion into the US market.
Zenabis Global Inc.	British Columbia, Canada	100%	To produce and sell cannabis and cannabis products under the Cannabis Act.
Keystone Isolation Technologies Inc. ("KIT")	Ontario, Canada	60%	To provide the Company with extraction technology to supply of CBD and THC to supply the Canadian and global market for cannabis derivatives
Keystone Isolation Technologies USA LLC. ("KIT USA")	Colorado, USA	100%	To allow for in state, HEXO controlled cannabis extraction activity to support the manufacturing of CBD beverages and future products in the U.S. (where permissible)

#### **JOINT ARRANGEMENTS AND ASSOCIATES**

Investments in joint arrangements are classified as either joint operations or joint ventures. The classification depends on the contractual rights and obligations of each investor, rather than the legal structure of the joint arrangement. The Company currently holds interests in joint ventures but has no interest in joint operations.

##### Joint ventures

Interests in joint ventures are accounted for using the equity method (see "Equity Method" below), after initially being recognized at cost in the consolidated balance sheet.

The following are the Company's joint venture however, none are considered material to the Company:

<u>JOINT VENTURE</u>	<u>JURISDICTION</u>	<u>INTEREST HELD</u>	<u>PRINCIPAL ACTIVITY</u>
Belleville Complex Inc.	Ontario, Canada	25%	The venture was established to manage the property of the Belleville facility.

##### Associate

Associates are all entities over which the Company has significant influence but not control or joint control. This is generally the case where the Company holds between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting (see "Equity Method" below), after initially being recognized at cost.

The following associates are significant to the Company; however, only Truss Limited Partnership is considered material to the Company:

<u>SIGNIFICANT ASSOCIATES</u>	<u>JURISDICTION</u>	<u>INTEREST HELD</u>	<u>PRINCIPAL ACTIVITY</u>
Truss Limited Partnership ("Truss LP")	Ontario, Canada	42.5%	To pursue opportunities to develop non-alcoholic, cannabis infused beverages for the Canadian market.
Truss CBD USA LLP ("Truss CBD US")	Colorado USA	42.5%	To explore opportunities for non-alcoholic hemp derived CBD beverages in the State of Colorado.

#### **EQUITY METHOD**

Under the equity method of accounting, investments in associate and joint ventures are initially recognized at cost and adjusted thereafter to recognize the Company's share of the post-acquisition profits or losses of the investee in profit or loss, and the Company's share of movements in other comprehensive income of the investee in other comprehensive income. Dividends received or receivable from associates and joint ventures are recognized as a reduction in the carrying amount of the investment.

Where the Company's share of losses in an equity-accounted investment equals or exceeds its interest in the entity, including any other unsecured long-term receivables, the Company does not recognize further losses, unless it has incurred obligations or made payments on behalf of the other entity.

Unrealized gains on transactions between the Company and its associates and joint ventures are eliminated to the extent of the Company's interest in these entities. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of equity-accounted investees have been changed where necessary to ensure consistency with the policies adopted by the Company.

The carrying amount of equity-accounted investments is tested for impairment in accordance with the policy described in note 4(m).

#### **OPERATING SEGMENTS**

An operating segment is a component of the Company for which discrete financial information is available and whose operating results are regularly reviewed by the entity's chief operating decision maker, the board of directors, to make decisions about resources to be allocated to the segment and assess its performance, and that engages in business activities from which it may earn revenue and incur expenses. The Company only has one operating segment.

### **4. Significant Accounting Policies and Pronouncements**

#### **(a) CASH AND CASH EQUIVALENTS**

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

#### **(b) RESTRICTED FUNDS**

Restricted funds represent cash that is pledged as collateral or guarantees for certain of the Company's projects, obligations, and agreements.

Funds related to the Company's captive insurance program are included in restricted funds. Captive Insurance is coverage for the Company's directors and officers that has been secured through a Captive Cell program ("the Captive Program"). The Captive Program was effected by entering into a participation agreement with a registered insurer for the purposes of holding and managing the Company's coverage funds through a separate cell account (the "Cell Captive"). Captive Program funds are held as cash in the Cell Captive with the possibility of reinvestment into short-term investments and/or marketable securities in the future. As the funds cannot be transferred to other parts of the group without providing 6 month notice, the funds are disclosed as Restricted cash. The Company recognizes gains and losses from, interest, foreign exchange activity and/or fair market value adjustments through the Statement of Loss and Comprehensive Loss.

#### **(c) CASH HELD IN ESCROW**

Cash held in escrow is cash that is held by independent escrow agents to fund future acquisitions but restricted by certain release conditions.

#### **(d) SHORT TERM INVESTMENTS**

Short term investments are comprised of liquid investments with maturities between 3 and 12 months. Short term investments are measured at amortized cost using the effective interest method, less loss allowance.

#### **(e) TRADE RECEIVABLES**

Trade receivables are recognized initially at the amount of consideration that is unconditional, unless they contain significant financing components when they are recognized at fair value. Trade receivables are subsequently measured at amortized cost using the effective interest method, less loss allowance.

#### **(f) COMMODITY TAX RECOVERABLES & OTHER RECEIVABLES**

Commodity tax recoverable and other receivables are initially measured at fair value and subsequently measured at amortized cost, less any provisions for impairment.

#### **(g) BIOLOGICAL ASSETS**

The Company measures biological assets consisting of cannabis plants using the income approach at fair value less costs to sell at the point of harvest, which becomes the basis for the cost of related inventories after harvest. The Company capitalizes all the direct and indirect costs as incurred related to the biological transformation of the biological assets between the point of initial recognition and the point of harvest including labour related costs (including share-based compensation), grow consumables, materials, utilities, facilities costs, depreciation, overhead, quality and testing costs. The identified capitalized direct and indirect costs of biological assets are

subsequently recorded within the line item 'costs of goods sold' on the statement of loss and comprehensive loss in the period that the related product is sold. Unrealized gains or losses arising from changes in fair value less cost to sell during the period are included in the results of operations and presented on a separate line of statement of comprehensive loss of the related period.

**(h) INVENTORY**

Inventory is valued at the lower of cost and net realizable value. Cost is determined using the weighted average method. Inventories of harvested cannabis ("Dried cannabis") are transferred from biological assets at their fair value at harvest, which becomes the initial deemed cost of the inventory. Any subsequent post-harvest costs are capitalized to inventory to the extent that cost is less than net realizable value. Subsequent costs include materials, overhead, depreciation, amortization, and labor related costs (including share-based compensation) involved in packaging and quality assurance. The identified capitalized direct and indirect costs related to inventory are subsequently recorded within 'cost of goods sold' on the statement of loss and comprehensive loss at the time the product is sold, with the exclusion of realized fair value amounts included in inventory sold which are recorded as a separate line within gross profit. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs 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.

**(i) PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment is measured at cost less accumulated depreciation and impairment losses. Cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the group and the cost of the item can be measured reliably. The carrying amount of any component accounted for as a separate asset is derecognized when replaced. All other repairs and maintenance are charged to profit or loss during the reporting period in which they are incurred.

Construction in progress is transferred to a depreciable asset class property, plant and equipment when the assets are available for use and depreciation of the assets commences at that point.

Depreciation is provided using the following terms and methods:

<b>Asset</b>	<b>Method</b>	<b>Term</b>
Land	Not depreciated	No term
Buildings	Straight line	5 to 40 years
Leasehold improvements	Straight line	lease term
Furniture and equipment	Straight line	5 years
Cultivation and production equipment	Straight line	5 to 20 years
Vehicles	Straight line	5 years
Computers	Straight line	3 years

An asset's residual value and useful life are reviewed at each reporting date and adjusted if appropriate. When parts of an item of equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment. Gains and losses on disposal of an item of equipment are determined by comparing the proceeds from disposal with the carrying amount of the equipment and are recognized in profit or loss.

**(j) FINITE LIFE INTANGIBLE ASSETS**

Finite life intangible assets are measured at cost less accumulated amortization and accumulated impairment losses. Amortization is provided on a straight-line basis over the following terms:

<b>Asset</b>	<b>Method</b>	<b>Term</b>
Domain names	Straight line	10 years
Health Canada licenses	Straight line	20 years
Software	Straight line	3-5 years
Patents	Straight line	20 years
Finite life, brands	Straight line	3 years

The estimated useful life is reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Research expenditure and development expenditure that do not meet the recognition criteria for intangible assets are recognized as an expense as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period.

**(k) INDEFINITE LIFE INTANGIBLE ASSETS**

Indefinite intangible assets are deemed to have no foreseeable limit over which the asset is expected to generate net cash inflows. Following initial recognition, intangible assets with indefinite useful lives are carried at cost less any accumulated impairment losses and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. The Company intends to utilize the brand indefinitely. The capitalized indefinite life brand consists of the Company's premium Up brand, which was recognized upon the acquisition of Newstrike in May 2019.

Brand	Not amortized	Indefinite
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**(l) GOODWILL**

Goodwill is not amortized but it is tested for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired and is carried at cost less accumulated impairment losses.

Goodwill is allocated to cash-generating units ("CGUs") for the purpose of impairment testing. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the business combination in which the goodwill arose. The units or groups of units are identified at the lowest level at which goodwill is monitored for internal management purposes, being the Company's single operating segment.

**(m) IMPAIRMENT OF NON-FINANCIAL ASSETS**

Goodwill and intangible assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment, or more frequently if events or changes in circumstances indicate that they might be impaired. Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's or CGU's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal ("FVLCD") and value in use ("VIU"). For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (CGUs). Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

The estimated useful life is reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Research expenditure and development expenditure that do not meet the recognition criteria for intangible assets are recognized as an expense as incurred. Development costs previously recognized as an expense are not recognized as an asset in a subsequent period.

In assessing the VIU, the estimated future cash flows are discounted to their present value using a pre- tax discount rate that reflects current market assessments of the time value of money to the Company and the risks specific to the asset. In determining FVLCD an appropriate valuation model is used. Where the carrying amount of a CGU exceeds its recoverable amount, the CGU is considered impaired and is written down to its recoverable amount. Any impairment loss is recorded in earnings and previously recognized impairment losses (excluding the impairment of Goodwill) are reversed or partially reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognized, in which case, the carrying amount of the asset is increased to its recoverable amount. The new carrying amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognized.

**(n) BUSINESS ACQUISITIONS**

The acquisition method is used to account for all business combinations, regardless of whether equity instruments or other assets are acquired. Operating results are included in the consolidated financial statements as of the acquisition date. The consideration transferred for the acquisition comprises the:

- fair values of the assets transferred;
- liabilities incurred to the former owners of the acquired business;
- equity interests issued by the Company;
- fair value of any asset or liability resulting from a contingent consideration arrangement; and
- fair value of any pre-existing equity interest in the subsidiary.

Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, with the exceptions of leases under IFRS 16 and deferred taxes. The Company recognizes any non-controlling interest in the acquired entity on an acquisition-by-acquisition basis either at fair value or at the non-controlling interest's proportionate share of the acquired entity's net identifiable assets. The Company has one year from the acquisition date to finalize the estimates and assumptions that support the finalized fair value analysis and purchase price allocation. Until this time, these values reported are subject to change. Changes to fair values and allocations are retrospectively adjusted in subsequent periods.

Acquisition-related costs are expensed as incurred and are presented under 'Acquisition and transaction costs' in the consolidated statements of loss and comprehensive loss.

The excess of the consideration transferred, amount of any non-controlling interest in the acquired entity, and acquisition-date fair value of any previous equity interest in the acquired entity over the fair value of the net identifiable assets acquired is recorded as goodwill. If those amounts are less than the fair value of the net identifiable assets of the business acquired, the difference is recognized directly in profit or loss as a bargain purchase.

Where settlement of any part of cash consideration is deferred, the amounts payable in the future are discounted to their present value as at the date of exchange. The discount rate used is the entity's incremental borrowing rate, being the rate at which a similar borrowing could be obtained from an independent financier under comparable terms and conditions.

Contingent consideration is classified either as equity or a financial liability. Amounts classified as a financial liability are subsequently remeasured to fair value, with changes in fair value recognized in profit or loss. If the business combination is achieved in stages, the acquisition date carrying value of the acquirer's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date. Any gains or losses arising from such remeasurement are recognized in profit or loss.

**(o) NON-CURRENT ASSETS (OR DISPOSAL GROUPS) HELD FOR SALE**

Non-current assets (or disposal groups) are classified as held for sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use and a sale is considered highly probable. They are measured at the lower of their carrying amount and fair value less costs to sell, except for assets such as deferred tax assets, assets arising from employee benefits, financial assets and investment property that are carried at fair value and contractual rights under insurance contracts, which are specifically exempt from this requirement.

An impairment loss is recognized for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell. A gain is recognized for any subsequent increases in fair value less costs of disposal of an asset (or disposal group), but not in excess of any cumulative impairment loss previously recognized. A gain or loss not previously recognized by the date of the sale of the non-current asset (or disposal group) is recognized at the date of derecognition.

Non-current assets (including those part of a disposal group) are not depreciated or amortized while they are classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale continue to be recognized.

Non-current assets classified as held for sale are presented separately from the other assets in the balance sheet. The liabilities of a disposal group classified as held for sale are presented separately from other liabilities in the balance sheet.

**(p) ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

Accounts payable and accrued liabilities represent liabilities for goods and services provided to the Company prior to the end of the financial year which are unpaid. The amounts are unsecured and are usually paid within 30 days of recognition. Trade and other payables are presented as current liabilities unless payment is not due within 12 months after the reporting period. Accounts payable and accrued liabilities are recognized initially at their fair value and subsequently measured at amortized cost using the effective interest method.

**(q) REVENUErecognition**

Revenue from the direct sale of cannabis to customers for a fixed price is recognized when the Company transfers the control of the good(s) to the customer upon delivery and acceptance by the customer. The Company recognizes revenue in an amount that reflects the consideration which the Company expects to receive taking into

account the impact which may arise from any rights of return on sales, price concessions or similar obligations. Net revenue is presented net of taxes, estimated returns, allowances and discounts.

Canada Revenue Agency ("CRA") levies excise taxes on the sale of medical and adult-use cannabis products. The Company becomes liable for these excise duties when cannabis products are delivered to the customer. The excise taxes payable is the higher of (i) a flat-rate duty which is imposed when a cannabis product is packaged, and (ii) an ad valorem duty that is imposed when a cannabis product is delivered to the customer.

Effective May 1, 2019, excise tax calculated on edible cannabis products, cannabis extracts and cannabis topicals will prospectively be calculated as a flat rate based on the quantity of total tetrahydrocannabinol (THC) contained in the final product. There were no changes in the legislation in calculating excise taxes for fresh cannabis, dried cannabis, seeds and plants. Net revenue from sale of goods, as presented on the consolidated statements of comprehensive (loss) income, represents revenue from the sale of goods less applicable excise taxes.

**(r) COST OF GOODS SOLD**

Cost of goods sold includes cost of inventory expensed, packaging costs, shipping costs and related labor.

**(s) INCOME TAXES**

The income tax expense or recovery for the period is the tax payable on the current period's taxable income, based on the applicable income tax rate for each jurisdiction, adjusted by changes in deferred tax assets and liabilities attributable to temporary differences and to unused tax losses.

The current income tax expense or recovery is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Company and its subsidiaries and associates operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and considers whether it is probable that a taxation authority will accept an uncertain tax treatment. The Company measures its tax balances either based on the most likely amount or the expected value, depending on which method provides a better prediction of the resolution of the uncertainty.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, deferred tax liabilities are not recognized if they arise from the initial recognition of goodwill. Deferred income tax is also not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that, at the time of the transaction, affects neither accounting nor taxable profit or loss.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realized or the deferred income tax liability is settled.

**(t) SHARE-BASED COMPENSATION**

The Company has an employee stock option plan. The Company measures equity settled share-based payments based on their fair value at the grant date and recognizes compensation expense over the vesting period based on the Company's estimate of equity instruments that will eventually vest. Forfeitures are adjusted for on an actual basis. The impact of the revision of the original estimate is recognized in profit or loss such that the cumulative expense reflects the revised estimate. For stock options granted to non-employees the compensation expense is measured at the fair value of goods and services received except where the fair value cannot be estimated, in which case it is measured at the fair value of the equity instruments granted. Consideration paid by employees or non-employees on the exercise of stock options is recorded as share capital and the related share-based compensation is transferred from share-based payment reserve to share capital..

**(u) RESTRICTED SHARE UNITS ("RSU's")**

RSUs are cash or equity settled share-based payments granted to certain employees, directors and executives within the Company. RSUs are measured at their initial fair value on the date of the grant utilizing the Black-Scholes Merton model. The fair value of cash-settled RSUs is revalued at each period end and is recognized as share-based compensation expense over the vesting period with a corresponding adjustment to the liability. Upon the settlement of cash based RSUs, which are valued at the market value at the time of exercise, the related liability is transferred to share capital. The fair value of equity-settled RSUs are recognized in the share-based reserve at the grant date. Upon the settlement of equity-based payments, RSUs are settled in the form of common shares and the related share-based reserve is transferred to share capital.

Amounts recorded for forfeited RSUs are transferred to the accumulated deficit in the year of forfeiture or expiry.

**(v) LOSS PER SHARE**

Loss per common share represents loss for the period attributable to common shareholders divided by the weighted average number of common shares outstanding during the year. Diluted loss per common share is calculated by dividing the applicable loss for the year by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the year. The calculation of diluted loss per share excludes the effects of various conversions and exercise of options and warrants that would be anti-dilutive.

**(w) BORROWING COSTS**

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognized in profit or loss in the period which they are incurred.

**(x) FINANCIAL INSTRUMENTS**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provision of the respective instrument.

The Company classifies its financial assets in the following measurement categories:

- those to be measured subsequently at fair value (either through OCI or through profit or loss), and
- those to be measured at amortized cost.

The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows.

The Company has made the following classifications:

Financial assets	IFRS 9 Classification
Cash and cash equivalents	Amortized cost
Restricted funds	Amortized cost
Short-term investments	Amortized cost
Trade receivables	Amortized cost
Convertible debenture receivable	FVTPL
Long term investments	FVTPL
Financial liabilities	
Accounts payable and accrued liabilities	Amortized cost
Warrant liabilities	FVTPL
Deferred rent liability	Amortized cost
Convertible debentures	Amortized cost
Senior secured convertible note	FVTPL
Lease liabilities	Amortized cost
Loans and borrowings	Amortized cost

*(i) Fair Value Through Profit or Loss ("FVTPL") Financial Assets*

Financial assets classified and measured at FVTPL are those assets that do not meet the criteria to be classified at amortized cost or at FVTOCI. This category includes debt instruments whose cash flow characteristics are not solely payments of principal and interest ("SPPI") or are not held within a business model whose objective is either to collect contractual cash flows, or to both collect contractual cash flows and sell the financial asset.

*(ii) Amortized Cost Financial Assets*

Financial assets at amortized cost are non-derivative financial assets which are held within a business model whose objective is to hold assets to collect contractual cash flows and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. An amortized cost financial asset is initially measured at fair value, including transaction costs and subsequently at amortized cost using the effective interest rate.

*(iii) Impairment of Financial Assets*

Financial assets, other than those classified at fair value through profit and loss, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

*(iv) Financial Liabilities and Other Financial Liabilities*

Financial liabilities are classified as either financial liabilities at FVTPL or other financial liabilities. Financial liabilities mandatory classified at FVTPL, such derivates, are stated at fair value, with changes being recognized through the consolidated statements of loss. Other financial liabilities are initially measured at fair value, net of transaction costs, and are subsequently measured at amortized cost using the effective interest method.

Senior secured convertible note issued in currency other than the functional currency of the Company are classified entirely as liabilities. As the Note contains equity and non-equity embedded derivatives, they are designated at fair value through profit or loss on initial recognition when embedded features are not separated.

The component of fair value changes relating to the Company's own credit risk is recognized in other comprehensive loss. Amounts recorded in other comprehensive loss related to credit risk are not subject to recycling in profit or loss but are transferred to retained earnings when realized. Financial liabilities are classified as current when the Company does not retain an unconditional right to defer settlement, due to a conversion feature or otherwise, beyond 12 months from the reporting date.

*(v) Derivatives*

Derivatives are initially measured at fair value and are subsequently measured at FVTPL. If the transaction price does not equal to fair value at the point of initial recognition, management measures the fair value of each component of the investment and any unrealized gains or losses at inception are either recognized in profit or loss or initially unrecognized and recognized over the term of the investment, depending on whether the valuation inputs are based on observable market data. The resulting unrealized gain or loss at inception and subsequent changes in fair value are recognized in profit or loss for the period. Transaction costs, which are directly attributable to the acquisition of the investment, are expensed as incurred.

*(vi) Convertible Debentures*

The component parts of compound instruments (convertible debentures) issued by the Company are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. A conversion option that will be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is an equity instrument.

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible instruments. This amount is recorded as a liability on an amortized cost basis using the effective interest rate method until extinguished upon conversion or at the instrument's maturity date.

The conversion option classified as equity is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognized and included in equity and is not subsequently remeasured. In addition, the conversion option classified as equity will remain in equity. No gain or loss is recognized in profit or loss upon conversion or expiration of the conversion option.

Transaction costs that relate to the issue of the convertible debentures are allocated to the liability and equity components in proportion to the allocation of the gross proceeds. Transaction costs relating to the equity component are recognized directly in equity. Transaction costs relating to the liability component are included in the carrying amount of the liability component and are amortized over the term of the convertible debentures using the effective interest method.

For compound instruments with non-equity derivatives, the fair value of the embedded derivative is determined first based on the contractual terms, and the initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.

*(vii) Transaction Costs*

Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction

costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

*Fair value on initial recognition*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique. If, after considering the terms of the transaction, the Company determines that the fair value of a financial instrument at initial recognition differs from the transaction price, the difference is recognized as a gain or loss in the statement of loss only if fair value is evidenced by quoted prices or based on a valuation technique that uses only data from observable markets. In all other cases, the difference is deferred and recognized systematically to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price. Any subsequent measurement of the instrument excludes the balance of the deferred day one gain or loss.

**(y) FOREIGN CURRENCY TRANSLATION**

Foreign currency transactions are translated into Canadian dollars at exchange rates in effect on the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the consolidated statement of financial position date are translated to Canadian dollars at the foreign exchange rate applicable at that date. Realized and unrealized exchange gains and losses are recognized through profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

*Foreign Operations*

The assets and liabilities of foreign operations are translated to the presentation currency at exchange rates at the reporting date. The income and expenses of foreign operations are translated to the presentation currency using average exchange rates for the month during which the transactions occurred. Foreign currency differences are recognized in Other Comprehensive Loss in the Accumulated Other Comprehensive Loss account.

**(z) SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGEMENTS**

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

**Significant Accounting Judgements**

*Impairment of non-financial assets*

Non-financial asset impairment tests require the allocation of assets to CGUs or CGU groups, which requires significant judgement and interpretation with respect to the integration between assets, the existence of active markets, similar exposure to market risks, shared resources and assets, and the way in which management monitors the operations.

Non-financial asset impairment tests require the determination of whether there is an indication of impairment. The assessment of whether there is any indication of impairment is performed at the end of each reporting period, and requires the application of judgement, historical experience, and use of external and internal sources of information

*Revenue – Principal versus Agent*

The Company evaluates whether it is the principal (reports on gross basis) or agent (reports on a net basis) for revenues generated by the direct sale of cannabis infused beverages (“CIB’s”). The Company control’s the CIB’s prior to the sale to its customers as regulated and mandated under the Cannabis Act and Health Canada legislation. The Company’s control is evidenced by our sole ability to possess the CIB’s once the cannabis distillate has been added and thus establishing the inventory as a cannabis product requiring it to be held by a licensed producer. It is further evidenced by the Company possessing the sole ability to monetize the sale of CIB’s through the held sales agreements and purchase orders with customers. The Company presents the revenues from the sale of CIBs on a gross basis.

*Senior Secured Convertible Note*

Management used significant judgement to determine that the fair value of the Note on issuance does not equal the transaction price, which was attributed, among other things, to a premium paid as a result of the limited time available to close the financing required to secure the Redecan acquisition. The resulting difference between the transaction price and the fair value on initial recognition (the “Day 1 loss”) is deferred as the fair value of the Note is based on a valuation technique where not all the inputs are observable. The unrecognized Day 1 loss will be recorded in the statement of net loss only to the extent

that it arises from a change in factor that market participants would take into account when pricing the Note. The Company believes that time is such a factor specific to the Note and the Day 1 loss is recognized on a straight line basis in the statement of net loss over the contractual life of the note.

#### Going Concern and Liquidity

In assessing the Company's ability to continue as a going concern, management utilizes significant estimates in the forecasting of future cash flows. Critical input estimates such as economic conditions, market demands, production quality, integrated operating activities, capital project expenditures and convertible debt repayments are used.

### **Significant Accounting Estimates**

#### Valuation of Biological Assets

In determining the fair value less costs to sell of biological assets, management is required to make a number of significant estimates, judgement and assumptions, including estimating the expected yields for the cannabis plants, sales price and expected post-harvesting costs.

A weighted average of current observable market sales prices for cannabis derived products, less costs to sell, is used to estimate the sales price input in the fair value less costs to sell model.

#### Valuation of Inventory

In calculating the net realizable value (NRV) of inventory, management determines the selling prices based on current observable market sales prices, selling costs, and includes an estimate of spoiled or expired inventory based on the most reliable evidence available at the time, to record inventory at the lower of cost or net realizable value.

#### Impairment of non-financial assets

Non-financial asset impairment tests require the estimation of the recoverable amount of the asset or CGU, which is the higher of its fair value less costs of disposal and its value in use. The fair value less costs of disposal calculation is based on available data from binding sales transactions conducted at arm's length for similar assets, valuation appraisals, or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the Company's approved budget for the first year and the Company's forecast for the next four years and do not include restructuring activities that the Company is not yet committed to, or significant future investments that will enhance the performance of the asset or CGU being tested. The recoverable amount is sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash flows and the growth rate used for extrapolation purposes. These estimates are most relevant to goodwill, property, plant and equipment and intangible assets.

#### Provisions

Provisions are recognized when the Company has a present obligation, legal or constructive as a result of a previous event, if it is probable that the Company will be required to settle the obligation and a reliable estimate can be made of the obligation. The amount recognized is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligations. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate of the expected future cash flows.

#### Business Combination

Management performs a valuation analysis to allocate the purchase price based on the acquisition date fair values of the identifiable assets acquired and liabilities assumed. Determining the fair value of identifiable assets acquired and liabilities assumed on the acquisition date, require the use of judgement and estimates. The significant estimates related to estimating the fair value of the acquired cultivation and processing license intangible asset, involved significant assumptions such as forecasted gross margin, and the delay in cultivation and production ramp-up. Management also exercises judgement in estimating the probability and timing of future cash flows and uses a discounted cash flow methodology as the basis for estimating fair value. Valuations are highly dependent on the inputs used and assumptions made by management regarding the future performance of these assets and any changes in the discount rate applied.

Determining the fair value of the assumed debenture required the use of significant judgement given the default claims of the Debenture at acquisition and the legal proceedings underway with the lender (see Note 31). As the lender claimed the debenture is in default, management also exercised judgement in estimating the amount required to repay and terminate the Debenture and contingencies attached to the claim.

#### Convertible Debentures

Convertible debentures are financial instruments which are accounted for separately dependent on the nature of their components: a financial liability and an equity instrument. The identification of such components embedded within a convertible debenture requires significant estimates including discount rates and future cash flows. The conversion option has a fixed conversion rate thus the financial liability, which represents the obligation to pay coupon interest on the convertible debentures in the future, is initially measured at its fair value and subsequently measured at amortized cost. The residual balance, or conversion feature is accounted for as equity at issuance. Transaction costs are apportioned to the debt liability and equity component in proportion to the allocation of proceeds.

## New and Amended Standards

Effective August 1, 2020, the Company adopted the following accounting pronouncements:

### Amendments to IFRS 3: Definition of a Business

In October 2018, the IASB issued "Definition of a Business (Amendments to IFRS 3)". The amendments clarify the definition of a business, with the objective of assisting entities to determine whether a transaction should be accounted for as a business combination or as an asset acquisition. The amendment provides an assessment framework to determine when a series of integrated activities is not a business. The amendments are effective for business combinations occurring on or after the beginning of the first annual reporting period beginning on or after January 1, 2020. The Company adopted the Amendments to IFRS 3 effective August 1, 2020 with no impact to the Company's consolidated financial statements.

### Amendments to IFRS 9, IASB 39 and IFRS 7: Interest Rate Benchmark Reform

The amendments revise the existing requirements for hedge accounting and are designed to support the provision of useful financial information by companies during the period of uncertainty arising from the phasing out of interest-rate benchmarks such as Interbank Offered Rates ("IBOR"). The amendments modify some specific hedge accounting requirements to provide relief from potential effects of the uncertainty caused by the IBOR reform. In addition, the amendments require companies to provide additional information to investors about their hedging relationships which are directly affected by these uncertainties. The amendments are effective for annual periods beginning on or after January 1, 2020, with earlier application permitted. The Company adopted the Amendments to IFRS 9, IAS 39 and IFRS 7 effective August 1, 2020 with no impact on the Company's consolidated financial statements.

## New Accounting Policies Not Yet Effective

The following IFRS standards have been recently issued by the IASB. Pronouncements that are irrelevant or not expected to have a significant impact have been excluded.

### Amendments to IAS 1: Classification of Liabilities as Current or Non-current

The amendment clarifies the requirements relating to determining if a liability should be presented as current or non-current in the statement of financial position. Under the new requirement, the assessment of whether a liability is presented as current or non-current is based on the contractual arrangements in place as at the reporting date and does not impact the amount or timing of recognition. The amendment applies retrospectively for annual reporting periods beginning on or after January 1, 2022. The Company is currently evaluating the potential impact of these amendments on the Company's consolidated financial statements

### Amendments to IAS 12: Deferred Tax related to Assets and Liabilities arising from a Single Transaction

The amendment narrowed the scope of certain recognition exemptions so that it no longer applies to transactions that, on initial recognition, give rise to equal taxable and deductible temporary differences. An entity applies the amendments to transactions that occur on or after the beginning of the earliest comparative period presented. It also, at the beginning of the earliest comparative period presented, recognizes deferred tax for all temporary differences related to leases and decommissioning obligations and recognizes the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at that date. The amendment is effective for annual periods beginning on or after January 1, 2023 with early application permitted. The Company is currently evaluating the potential impact of these amendments on the Company's consolidated financial statements.

### Amendments to IAS 37: Onerous Contracts and the Cost of Fulfilling a Contract

The amendment specifies that the 'cost of fulfilling' a contract comprises the 'costs that relate directly to the contract'. Costs that relate directly to a contract can either be incremental costs of fulfilling that contract or an allocation of other costs that relate directly to fulfilling contracts. The amendment is effective for annual periods beginning on or after January 1, 2022 with early application permitted. The Company is currently evaluating the potential impact of these amendments on the Company's consolidated financial statements.

### Amendments to IAS 16: Property Plant and Equipment: Proceeds before intended use

The amendment clarifies the accounting for the net proceeds from selling any items produced while bringing an item of property plant and equipment into use. The amendment prohibits a company from deducting from the cost of property plant and equipment proceeds from selling items produced while the company is preparing that assets for its intended use. The company will recognize such sales proceeds and related costs in profit and loss. The amendment is effective for annual periods beginning on or after January 1, 2022 with early application permitted. The Company is currently evaluating the potential impact of this amendment on the Company's financial statements.

**Previously Adopted Accounting Policies Effective August 1, 2019**

**IFRS 16, LEASES**

The Company adopted IFRS 16 *Leases* on August 1, 2019, which introduces a new approach to lease accounting. The Company adopted the standard using the modified retrospective approach, which recognized the cumulative impact on the opening balance sheet and applies the standard prospectively. This cumulative impact is included in the comparative information in Note 13.

At the inception of a contract, the Company assesses whether the contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. This policy is applied to contracts entered, or modified, on or after August 1, 2019.

**Practical expedients**

Effective August 1, 2019, the IFRS 16 transition date, the Company elected to use the following practical expedients under the modified retrospective transition approach:

- Leases with lease terms of less than twelve months (short-term leases) and leases of low-value assets (less than \$5,000 U.S. dollars) (low-value leases) that have been identified at transition were not recognized in the consolidated statement of financial position;
- Right-of-use assets on transition were measured at the amount equal to the lease liabilities at transition, adjusted by the amount of any prepaid or accrued lease payments;
- For certain leases having associated initial direct costs, the Company, at initial measurement on transition, excluded these direct costs from the measurement of the right-of-use assets;
- Application of a single discount rate to portfolios of leases with similar characteristics on transition; and
- Any provision for onerous lease contracts previously recognized at the date of adoption of IFRS 16 has been applied to the associated right-of-use asset recognized upon transition.

**The Company as a lessee**

Where the Company is a lessee, a right-of-use asset representing the right to use the underlying asset with a corresponding lease liability is recognized when the leased asset becomes available for use by the Company.

The right-of-use asset is recognized at cost and is depreciated on a straight-line basis over the shorter of the estimated useful life of the asset and the lease term. The cost of the right-of-use asset is based on the following:

- the amount of initial recognition of related lease liability;
- adjusted by any lease payments made on or before inception of the lease;
- increased by any initial direct costs incurred; and
- decreased by lease incentives received and any costs to dismantle the leased asset.

The lease term includes consideration of an option to extend or to terminate if the Company is reasonably certain to exercise that option. In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability.

Lease liabilities are initially recognized at the present value of the lease payments. The lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate. Subsequent to recognition, lease liabilities are measured at amortized cost using the effective interest rate method. Lease liabilities are remeasured when there is a change in future lease payments arising mainly from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, renewal or termination option.

The payments related to short-term leases and low-value leases are recognized as other expenses over the lease term in the statement of loss and comprehensive loss.

**The Company as a lessor**

The Company's consolidated financial statements were not impacted by the adoption of IFRS 16 *Leases* in relation to lessor accounting. Lessors will continue with the dual classification model for recognized leases with the resultant accounting remaining unchanged from IAS 17, *Leases*.

**Impact of Change in Accounting Policy**

On August 1, 2019, the Company recognized \$21,360 of right-of-use assets and \$21,360 of operating lease liabilities. The Company applied its weighted average incremental borrowing rate as at August 1, 2019 to determine the amount of lease liabilities. The effect of the adjustment to the amounts recognized in the Company's consolidated statement of financial position at August 1, 2019.

## 5. Cash and Cash Equivalents

	Interest rate	July 31, 2021	July 31, 2020
Operating cash	—	\$ 31,702	\$ 70,318
High interest savings accounts	0.60%	35,760	113,855
Cash and cash equivalents		67,462	184,173

## 6. Restricted Funds

	July 31, 2021	July 31, 2020
Debt service reserve account – Term loan (Note 21a)	\$ —	\$ 8,191
Letters of credit, collateral and guarantees for purchases	2,552	70
Restricted cash under terms of the Senior Secured Convertible Note (Note 19)	99,696	—
Cash restricted in captive insurance subsidiary	29,998	—
Total	132,246	8,261

## 7. Cash Held in Escrow

On May 27, 2021, the Company issued US\$360 million in a senior secured convertible note at a purchase price of US\$327.6 million (Note 19). Under the senior secured convertible note agreement, US\$229.32 million of the proceeds were immediately placed into an escrow account. The Cash held in escrow was used subsequent to year-end to partially fund the acquisition of all of the outstanding shares of the entities that carry on the business of Redecan (the “Redecan Acquisition”) (Note 38).

## 8. Commodity Taxes Recoverable and Other Receivables

	July 31, 2021	July 31, 2020
Commodity taxes recoverable	\$ 56	\$ 12,821
Lease receivable – current <sup>1</sup>	107	630
Receivable on conversion of Inner Spirit Holdings Shares (Note 12)	2,698	—
Loan receivable <sup>2</sup>	5,000	—
Other receivables	5,688	3,282
Total	\$ 13,549	\$ 16,733

<sup>1</sup> A related party capital lease receivable related to Truss Limited Partnership (Note 29).

<sup>2</sup> A short term bridge loan issued to 48North who was subsequently acquired by the Company on September 1, 2021 (Note 38).

## 9. Inventory

	As at July 31, 2021		
	Capitalized cost	Biological asset fair value adjustment	Total
Dried cannabis	\$ 81,784	\$ 24,257	\$ 106,041
Purchased dried cannabis	1,754	—	1,754
Extracts	11,945	4,411	16,356
Purchased extracts	2,247	—	2,247
Packaging and supplies	8,929	—	8,929
	\$ 106,659	\$ 28,668	\$ 135,327

	As at July 31, 2020		
	Capitalized cost	Biological asset fair value adjustment	Total
Dried cannabis	\$ 29,702	\$ 16,981	\$ 46,683
Purchased dried cannabis	1,956	—	1,956
Extracts	4,828	385	5,213
Purchased extracts	5,977	—	5,977
Hemp derived distillate	566	—	566
Packaging and supplies	4,538	—	4,538
	\$ 47,567	\$ 17,366	\$ 64,933

The Company recognizes the costs (capitalized cost and biological asset fair value adjustment) of harvested cannabis inventory expensed in two separate lines on the consolidated statement of net loss: (i) Capitalized costs relating to inventory expensed and included in Cost of goods sold amounted to \$94,703 for the year ended July 31, 2021 (July 31, 2020 – \$127,205) (ii) The fair value component (biological asset fair value adjustments) of inventory sold on the consolidated statement of net loss was \$31,767 for

the year ended July 31, 2021, (July 31, 2020 – \$40,910). During the year ended July 31, 2021, the Company reversed previous inventory write downs of \$2,927, (July 31, 2020 – \$nil) recorded in costs of good sold \$688 (July 31, 2020 – \$nil) recorded in fair value component on inventory sold on the statement of loss.

Total share-based compensation capitalized in inventory in the year ended July 31, 2021 was \$1,505 (July 31, 2020 – \$6,105). Total depreciation capitalized in inventory in the year ended July 31, 2021 was \$15,677 (July 31, 2020 – \$11,988).

## 10. Biological Assets

The Company's biological assets consist of cannabis plants throughout the growth cycle, from mother plants to plants in propagation, vegetative and flowering stages. The changes in the carrying value of biological assets are as follows:

<i>For the years ended</i>	<b>July 31, 2021</b>	<b>July 31, 2020</b>
Balance, beginning of year	<b>\$ 7,571</b>	\$ 7,371
Acquired on business combination	<b>8,892</b>	–
Production costs capitalized	<b>36,156</b>	38,638
Net increase in fair value due to biological transformation and estimates	<b>51,499</b>	29,356
Harvested cannabis transferred to inventory	<b>(89,834)</b>	(67,131)
Disposal of biological assets	<b>–</b>	(663)
Balance, end of year	<b>14,284</b>	7,571

The valuation of biological assets is based on an income approach (Level 3) in which the fair value at the point of harvesting is estimated based on selling prices less the costs to sell. For in process biological assets (growing plants), the fair value at the point of harvest is adjusted based on the stage of growth at period-end. Harvested cannabis is transferred from biological assets at their fair value at harvest.

The inputs and assumptions used in determining the fair value of cannabis plants are as follows:

- yield per plant;
- stage of growth percentage, estimated as age of plant from date of harvest as a percentage of total days in an average growing cycle, as applied to the estimated total fair value per gram (less fulfilment costs) to arrive at an in-process fair value for estimated biological assets to be harvested;
- selling price per gram;
- post-harvest cost (cost to complete and cost to sell) per gram; and
- destruction/wastage of plants during the harvesting and processing process.

The table below summarized the significant inputs and assumptions used in the fair value model, their weighted average range of value and sensitivity analysis:

<b>Significant inputs and assumptions</b>	<b>Input values</b>		<b>An increase or decrease of 5% applied to the unobservable input would result in a change to the fair value of approximately</b>	
	<b>July 31, 2021</b>	<b>July 31, 2020</b>	<b>July 31, 2021</b>	<b>July 31, 2020</b>
<b>Weighted average selling price</b> Derived from actual retail prices on a per product basis using the expected Flower and Trim yields per plant. Which is expected to approximate future selling prices and where applicable, considering strains.	\$3.05 per dried gram	\$3.23 per dried gram	\$746	\$550
<b>Yield per plant</b> Derived from historical harvest cycle results on a per strain basis, which is expected to be harvested from plants.	24-116 grams per plant	46 – 135 grams per plant	\$460	\$376
<b>Post-harvest cost</b> Derived from historical costs of production activities on a per product basis.	\$0.67-\$0.84 per dried gram	\$0.26-\$0.81 per dried gram	\$636	\$219

## 11. Investments in Associates & Joint Ventures

	July 31, 2021			July 31, 2020		
	Truss LP	Other	Total	Truss LP	Other	Total
Opening Balance	\$ 74,966	\$ 1,340	\$ 76,306	\$ 51,786	\$ 1,063	\$ 52,849
Cash contributed to investment	4,250	783	5,033	29,155	1,231	30,386
Capitalized transaction costs	—	—	—	—	109	109
Share of net (loss)	(6,343)	(162)	(6,505)	(5,975)	(356)	(6,331)
Impairment	—	—	—	—	(707)	(707)
Foreign exchange loss through OCI	—	(155)	(155)	—	—	—
Ending Balance	72,873	1,806	74,679	74,966	1,340	76,306

### Truss LP

The Truss LP was formed between the Company and Molson Coors Canada (the “Partner”) and is a standalone entity, incorporated in Canada, with its own board of directors and an independent management team. The Partner holds 57,500 common shares representing 57.5% controlling interest in Truss LP with the Company holding 42,500 common shares and representing the remaining 42.5%. Truss LP is a private limited partnership and its principal operating activities consist of pursuing opportunities to develop non-alcoholic, cannabis-infused beverages.

As at	Truss LP	
	July 31, 2021	July 31, 2020
<b>Statement of Financial Position</b>		
Cash and cash equivalents	6,757	19,561
Other current assets	14,182	7,867
Non- current assets	67,766	66,863
Current liabilities	11,184	11,112
Non-current liabilities	8,667	8,903
<b>Year ended</b>		
	July 31, 2021	July 31, 2020
<b>Statement of Comprehensive Loss</b>		
Revenue	6,498 <sup>(1)</sup>	705 <sup>(1)</sup>
Operating expenses excluding depreciation and amortization	(14,261)	(12,647)
Depreciation and amortization	(4,884)	(617)
Other expenses	—	(7)
Loss from operations	(14,643)	(13,827)
Other income	130	1
Interest expenses	(412)	(233)
Income tax expenses	—	—
Total comprehensive loss	(14,925)	(14,059)

<sup>1</sup>The revenues of Truss LP are rental fees paid by the Company for the HEXO CIB sublease it has with the sub-lessor, Truss LP.

The following table is a reconciliation of summarized financial information of the Company’s significant investment in Truss LP to the carrying amount of the investment for the year ended July 31, 2021 and 2020.

For the year ended	July 31, 2021	July 31, 2020
Opening net assets	\$ 74,964	\$ 20,423
Acquisition of associate/capital calls	10,000	68,600
Total comprehensive loss	(14,925)	(14,059)
<b>Closing net assets</b>	<b>70,039</b>	<b>74,964</b>
Interest in associate	42.5%	42.5%
<b>Interest in associate value</b>	<b>29,767</b>	<b>31,860</b>
Fair value of warrant consideration	42,386	42,386
Capitalized transaction costs	720	720
<b>Total interest in associate value</b>	<b>72,873</b>	<b>74,966</b>

## 12. Long-term Investments

	Fair value July 31, 2020	Transfer	Divestiture	Change in fair value	Fair value July 31, 2021
<b>Level 1 Investments</b>				\$	\$
Fire and Flower common shares	1,292	—	—	(65)	1,227
Sundial Growers Inc. common shares	—	720	—	(99)	621
Inner Spirit Holdings Ltd common shares	1,260	(720)	(2,698)	2,158	—
Other long-term investments	517	—	(13)	—	504
<b>Level 3 Investments</b>				\$	\$
Segra International Corp.	140	—	—	—	140
<b>Total</b>	<b>3,209</b>	<b>—</b>	<b>(2,711)</b>	<b>1,994</b>	<b>2,492</b>

	Fair value July 31, 2019	Investment	Divestiture	Change in fair value	Fair value July 31, 2020
<b>Level 1 Investments</b>	\$	\$	\$	\$	\$
Fire and Flower common shares	—	1,232	—	60	1,292
Inner Spirit common shares	3,000	—	(643)	(1,097)	1,260
Other long-term investments	—	517	—	—	517
<b>Level 2 Investments</b>					
Inner Spirit common share purchase warrants	403	—	—	(403)	—
<b>Level 3 Investments</b>					
Greentank Technologies	6,574	—	—	(6,574)	—
Neal Brothers Inc.	4,000	—	—	(4,000)	—
Segra International Corp.	300	—	—	(160)	140
<b>Total</b>	<b>14,277</b>	<b>1,749</b>	<b>(643)</b>	<b>(12,174)</b>	<b>3,209</b>

The Company's Level 1 publicly traded investments were initially acquired as strategic investments in Canadian cannabis private retailers and are held for the long term. The investments have been classified as non-current.

### Fire & Flower Holdings Corp.

On November 30, 2019, the Company obtained 1,000,000 common shares in Fire & Flower Holdings Corp., a publicly traded company, through the conversion of its \$800 zero interest bearing convertible debentures, at a conversion rate of \$0.80 per common share. The fair value of the shares upon conversion was \$920.

On February 11, 2020, the Company received an additional 319,377 common shares of Fire & Flower as settlement for accrued and unpaid interest on the Fire and Flower convertible debentures. The fair value of the shares on settlement was \$1,232.

The Company holds 1,319,377 common shares in Fire & Flower at July 31, 2021 (July 31, 2020 - 1,319,377). The common shares were revalued to \$1,227 using the quoted share price at July 31, 2021 of \$0.93 (July 31, 2020 - \$0.98).

### Sundial Growers Inc. / Inner Spirit Holdings Ltd.

On May 24, 2019, on acquisition of Newstrike, the Company acquired 15,000,000 common shares in Inner Spirit Holdings Ltd., which were valued at \$2,850 on initial recognition. During the year ended July 31, 2020, the Company disposed of 6,005,500 common shares, at prices ranging from \$0.09-\$0.15 per share, resulting in a gain of \$24. The remaining 8,994,500 shares held at July 31, 2020 were valued based upon the market price of \$0.14 per share resulting in a fair value of \$1,260 at July 31, 2020.

On July 21, 2021, Sundial Growers Inc. ("Sundial") acquired all of the issued and outstanding common shares of Inner Spirit Holdings Ltd. The consideration per Inner Spirit common share consisted of (i) \$0.30 in cash and (ii) 0.0835 of a common share of Sundial.

The Company received 751,041 common shares of Sundial and a cash component of \$2,698, which is presented in Other receivables. The Sundial shares were fair valued on July 21, 2021 (initial recognition) and July 31, 2021 at quoted share prices of \$0.87 and \$0.82, respectively.

### 13. Property, Plant and Equipment

Cost	Land	Buildings	Leasehold improvements	Cultivation and production equipment	Furniture, computers, vehicles and equipment	Construction in progress	Right-of-Use assets	Total
At July 31, 2019	\$ 5,339	150,834	\$ 627	\$ 42,029	\$ 10,368	\$ 57,550	\$ —	\$ 266,747
Additions	—	24,432	1,395	14,969	9,404	66,246	24,405	140,851
Disposals	(3,683)	(18,260)	—	(13,402)	(909)	(5,428)	—	(41,682)
Transfers	—	7,943	22,417	(10,135)	8	(20,233)	—	—
At July 31, 2020	1,656	164,949	24,439	33,461	18,871	98,135	24,405	365,916
Business acquisition	1,100	95,788	—	6,154	8,578	395	17,059	129,074
Additions	—	1,213	63	2,284	294	16,960	—	20,814
Disposals	—	1	—	(67)	—	—	(1,055)	(1,121)
Transfers	—	3,951	17,649	884	1,388	(23,544)	—	328
<b>At July 31, 2021</b>	<b>2,756</b>	<b>265,902</b>	<b>42,151</b>	<b>42,716</b>	<b>29,131</b>	<b>91,946</b>	<b>40,409</b>	<b>515,011</b>
<b>Accumulated depreciation and impairments</b>								
At July 31, 2019	—	4,392	130	2,216	1,216	—	—	7,954
Depreciation	—	7,395	879	3,702	3,562	—	2,522	18,060
Transfers	—	—	—	271	(271)	—	—	—
Disposals	—	(17,081)	—	(7,435)	(366)	—	—	(24,882)
Impairments	307	19,006	—	9,937	—	48,990	1,178	79,418
At July 31, 2020	307	13,712	1,009	8,691	4,141	48,990	3,700	80,550
Depreciation	—	7,981	2,173	5,145	4,229	—	2,246	21,774
Transfers	—	(110)	(16)	(78)	(277)	—	—	(481)
Disposals	—	—	—	—	—	—	(964)	(964)
Impairments	—	160	85	2,104	61	—	17,820	20,230
<b>At July 31, 2021</b>	<b>307</b>	<b>21,743</b>	<b>3,251</b>	<b>15,862</b>	<b>8,154</b>	<b>48,990</b>	<b>22,802</b>	<b>121,109</b>
<b>Net book value</b>								
At July 31, 2019	5,339	146,442	497	39,813	9,152	57,550	—	258,793
At July 31, 2020	1,349	151,237	23,430	24,770	14,730	49,145	20,705	285,366
<b>At July 31, 2021</b>	<b>2,449</b>	<b>244,159</b>	<b>38,900</b>	<b>26,854</b>	<b>20,977</b>	<b>42,956</b>	<b>17,607</b>	<b>393,902</b>

During the year ended July 31, 2021, the Company capitalized \$15,677 (July 31, 2020 – \$11,988) of depreciation to inventory. During the year ended July 31, 2021, depreciation expensed to the consolidated statement of loss and comprehensive loss was \$6,097 (July 31, 2020 – \$6,072).

Capitalized borrowing costs to buildings in the year ended July 31, 2021 was \$1,269 (July 31, 2020 – \$2,385) at an average interest rate of 5.6% (July 31, 2020 – 7.22%). Transfers from construction in progress during the year reflect the activation of an asset's useful life, transitioning from construction in progress to the appropriate property, plant and equipment classification.

#### Impairment of right of use assets

During the year ended July 31, 2021, the Company impaired \$17,820 (July 31, 2020 - \$1,178) of right of use assets related to the Company's Langley and Montreal facilities.

Subsequent to the acquisition of Zenabis (Note 15), the Company in order to recognize the synergies, assessed the output capacity of its production and cultivation facilities and made the decision to exit the Langley lease. As a result, the carrying amount of the associated right of use asset of \$17,059 was impaired as the Company has assessed the recoverable amount at \$nil. During the year ended July 31, 2021 the Company identified its Montreal research lab lease, which resulted in impairment losses of \$761. The recoverable amount of the assets was determined to be nil, as the assets have no continuing use to the Company. The associated lease liabilities remain as at July 31, 2021 (Note 20).

#### Impairment of cultivation and production equipment

During the year ended July 31, 2021, the Company identified impairments of certain packaging equipment that is no longer expected to be used. As a result of this, impairment losses of \$2,104 (July 31, 2020 - \$9,937) were recorded.

*Impairment and Sale of Niagara Facility*

On March 2, 2020, the Company completed a strategic review of its cultivation capacity and made the decision to market the Niagara facility for sale. As a result, the carrying amount of the Niagara facility was expected to be recovered principally through its sale. The Niagara facility was acquired from Newstrike in May 2019 and consists primarily of equipment, cultivation and processing facilities and land assets that are included within property, plant and equipment, as well as related cultivation and processing licenses that are recorded as intangible assets. These assets were previously included in the HEXO CGU.

The recoverable amount was determined by reference to fair value less costs of disposal using a market approach. The market approach was based on comparable transactions for similar assets, which is categorized within Level 2 of the fair value hierarchy. As a result, an impairment loss of \$31,606 was recorded in property, plant and equipment. Additional impairment losses were recorded for cultivation and processing licenses (Note 14). On June 17, 2020, the Company closed the sale of the Niagara Facility for proceeds of \$12,250 and a loss on disposal of \$2,219 for the year ended July 31, 2020.

*Impairment of Certain Optimization Projects*

During the year ended July 31, 2020, the Company identified an impairment indicator for certain capital assets and expenditures made as a result of suspending certain optimization projects that were under construction. As a result, the Company recorded an impairment loss of \$43,585 relating to redundant and idle capital assets, as well as excess leasehold improvement expenditure that is not expected to contribute to future cash flows of the Company. The recoverable amount of the assets was determined to be zero, as the assets have no continuing use to the Company and negligible value would be derived from sale as the assets were highly customised for a specific purpose and location.

*Impairment of HEXO CGU*

At July 31, 2021, no indicators of impairment were identified for the HEXO CGU.

During the year ended July 31, 2020, an indicator of impairment was identified for the HEXO CGU as the carrying amount of the Company's total net assets significantly exceeded the Company's market capitalization. The HEXO CGU consists of the Company's Canadian cultivation and production facilities.

The recoverable amount of the CGU was determined based on fair value less cost of disposal using a market-based approach (Level 3) based on an income based discounted cash flow analysis (DCF). The Company uses its market capitalization and comparative market multiples to aid in validating the discounted cash flow results. The significant assumptions in the DCF analysis were as follows:

- i. Cash flows: Estimated cash flows were projected based on actual operating results from internal sources as well as industry and market trends. A discrete four year period was forecasted with an extended 5 year period calculated using the H-Model which is an alternative dividend discount model that assumes the growth rate will fall linearly to the terminal value with a short-term growth rate of 10% in the first year, declining each year over the 5 years to a terminal growth rate of 3%. If all other assumption were held constant and the short-term growth rate in the first year was decreased by 1%, the recoverable amount would decrease by approximately \$24,000;
- ii. Revenue and gross margin: Forecast revenues and resulting gross margin are based on internal projections, developed with reference to historical experience and external market information. If all other assumptions were held constant and forecasted revenues and resulting gross margin declined by 3%, the recoverable amount would decrease by approximately \$34,000;
- iii. Terminal value growth rate: Management used a 3% terminal growth rate which is based on historical and projected consumer inflation, historical and projected economic indicators, and projected industry growth. If all other assumption were held constant and the terminal growth rate was decreased by 1%, the recoverable amount would decrease by approximately \$38,000;
- iv. Discount rate: Management used a 14.1% post-tax discount rate which is reflective of an industry Weighted Average Cost of Capital ("WACC"). The WACC was estimated based on the risk-free rate, equity risk premium based on a direct comparison approach, a size premium and company specific risk, and after-tax cost of debt based on corporate bond yields. If all other assumption were held constant and the discount rate was increased by 1%, the recoverable amount would decrease by approximately \$59,000; and
- v. Tax rate: The tax rates used in determining the future cash flows were those substantively enacted at the respective valuation date.

## 14. Intangible Assets

Cost	Cultivating and processing license	Brands	Software	Domain names	Patents	Total
At July 31, 2019	\$ 116,433	\$ 8,440	\$ 3,558	\$ 585	\$ 1,231	\$ 130,247
Additions	—	—	702	—	875	1,577
Disposals	—	—	(550)	—	(173)	(723)
At July 31, 2020	116,433	8,440	3,710	585	1,933	131,101
Additions	—	—	1,546	—	790	2,336
Business acquisition	28,914	5,400	—	—	—	34,314
Disposals	—	—	(872)	—	—	(872)
<b>At July 31, 2021</b>	<b>145,347</b>	<b>13,840</b>	<b>4,384</b>	<b>585</b>	<b>2,723</b>	<b>166,879</b>
<b><i>Accumulated amortization and impairments</i></b>						
At July 31, 2019	1,601	—	1,269	66	29	2,965
Amortization	3,167	—	697	59	16	3,939
Impairment	106,189	2,000	—	—	—	108,189
At July 31, 2020	110,957	2,000	1,966	125	45	115,093
Amortization	765	170	922	59	134	2,050
Disposals	—	—	(872)	—	—	(872)
<b>At July 31, 2021</b>	<b>111,722</b>	<b>2,170</b>	<b>2,016</b>	<b>184</b>	<b>179</b>	<b>116,271</b>
<b><i>Net book value</i></b>						
At July 31, 2019	114,832	8,440	2,289	519	1,202	127,282
At July 31, 2020	5,476	6,440	1,744	460	1,888	16,008
<b>At July 31, 2021</b>	<b>33,625</b>	<b>11,670</b>	<b>2,368</b>	<b>401</b>	<b>2,544</b>	<b>50,608</b>

Research and development expenses in the year ended July 31, 2021 were \$3,835, (July 31, 2020 - \$4,639).

### Impairment

The Company recognized no intangible asset impairment losses during the year ended July 31, 2021.

In connection with the impairment loss recorded in the second quarter of fiscal 2020, for the Niagara facility, the Company recorded an impairment loss of \$106,189 relating to cultivation and processing licenses associated with the Niagara facility. The acquired brand from the 2019 acquisition of Newstrike Brands Limited was also impaired by \$2,000 as result of an impairment test as at July 31, 2020.

## 15. Business Acquisition

### **Acquisition of Zenabis Global Inc.**

On June 1, 2021, pre-market open, the Company acquired 100% of the issued and outstanding common shares of Zenabis Global Inc. ("Zenabis") pursuant to an arrangement agreement entered into on February 15, 2021. Zenabis is a Canadian-licensed cultivator and seller of medical and adult-use cannabis. Zenabis was acquired for its key brands, indoor growing capability and its established additional market share. Under the arrangement, each former Zenabis common share was exchanged for 0.01772 of a HEXO common share. In addition, all issued and outstanding stock options and compensation units of Zenabis were replaced with HEXO backed units, having the same terms but adjusted for the exchange ratio, and all issued and outstanding common share purchase warrants of Zenabis became exercisable for HEXO common shares adjusted for the exchange ratio.

The following table summarizes the purchase consideration and preliminary values of the net assets acquired from Zenabis on the acquisition date:

Consideration		Units	Unit Price (\$)	Fair Value (\$)
Shares issued	(i)	17,579,336	8.61	151,358
Replacement warrants outstanding	(ii)	5,196,164		32,354
Replacement stock options issued	(iii)	905,902		5,727
Replacement RSU's and DSU's issued		223,497		1,554
Settlement of pre-existing debt	(iv)	n/a		20,760
<b>Total fair value of consideration</b>				<b>211,753</b>

<b>Net assets acquired</b>	
Current assets	
Cash and cash equivalents	2,804
Accounts receivable	3,822
Other receivables	198
Excise taxes receivable	86
Inventory	40,636
Biological assets	8,892
Non-current assets	
Property, plant and equipment	129,074
Prepaid expenses	5,670
Cultivation and processing license	28,914
Brands	5,400
Goodwill	88,189
<b>Total assets</b>	<b>313,685</b>
Current liabilities	
Accounts payable and accrued liabilities	(22,161)
Loans	Note 21 (52,194)
Convertible debentures	(11,724)
Non-current liabilities	
Lease Liability	(17,059)
Deferred tax liabilities	(134)
<b>Total liabilities</b>	<b>(103,272)</b>
Non-controlling interest	1,340
<b>Total net assets acquired</b>	<b>211,753</b>

- (i) As the acquisition closed pre-markets on June 1, 2021, the share price is based upon the closing HEXO Corp. TSX market price of common shares on May 31, 2021.
- (ii) Warrants were valued using the Black-Scholes option pricing model as at the acquisition date June 1, 2021, using the following assumptions:
  - Risk free rate of 0.31%-0.74%
  - Expected life of 0.32 – 4.35 years
  - Volatility rate of 96%; determined using historical volatility data
  - Exercise prices of \$3.96-\$151.24
  - Share price of \$8.61
- (iii) All vested and replaced stock options were valued using the Black-Scholes option pricing model as at the acquisition date of June 1, 2021, using the following assumptions and inputs;
  - Risk free rate of 0.31%-0.74%
  - Expected life of 0.25 – 4.49 years
  - Volatility rate of 96%; determined using historical volatility data
  - Exercise prices of \$2.54 – \$234.7
  - Share price of \$8.61
- (iv) Prior to the transaction closing date, the Company entered into a convertible debt agreement with Zenabis in which the Company advanced \$19,500 in convertible debentures which bear interest of 8% annually and mature February 15, 2023. Both the issuer and lender accounted for the debentures as FVTPL. For purpose of the acquisition accounting the debentures, which had a fair value of \$20,760, were effectively settled at the acquisition date.

The fair value of the vested share based compensation as at the acquisition date was deemed consideration paid in the transaction. The fair value of those options not yet vested at the acquisition date was added to the Company's share-based payment reserve to be expensed over the remaining vesting period of the options as permitted under IFRS 3 – *Business Combinations*.

The identifiable cultivation and processing license ("the license") enables the Company to cultivate and produce cannabis products for sale, and was valued at \$28,914 using a with-or-without approach in an income based discounted cash flow ("DCF") valuation model (Level 3). The model estimates the value of the license as the difference between the present value of the future cash flows of the facility with-or-without a license in place, as at the acquisition date. Significant estimates in the model include the forecast

gross margin and the estimated time to obtain a licence and complete cultivation and production ramp up. The significant estimates in the DCF analysis were the forecasted gross margin and the estimated time to obtain a licence and complete cultivation and production ramp up. If all other assumptions were held constant, and the forecasted gross margin rate was decreased by 10%, the valuation of the cultivation and processing license would decrease by \$6,336. In the with-or-without approach, reducing the estimated time to obtain a licence and complete cultivation and production ramp up by six months would reduce the valuation of the license to \$18,665.

During the year ended July 31, 2021, Zenabis contributed net revenue of \$6,800 and a comprehensive net loss attributed to shareholders of \$1,513 to the Company's consolidated results since the date of acquisition. If the acquisition had occurred on August 1, 2020 management estimates that the Company's consolidated net revenue would have increased by \$54,746 and the comprehensive net loss would have increased by \$9,078 for the year ended July 31, 2021.

Goodwill arising from the acquisition represents the expected synergies, future income and growth, and other intangibles that do not qualify for separate recognition. None of the goodwill arising from the acquisition is expected to be deductible for tax purposes.

The Company recognized transaction costs of \$9,634 related to the acquisition (inclusive of \$3,614 in share-based compensation for issuance of 448,639 common shares).

## 16. Goodwill

	Newstrike Brands Ltd	Zenabis Global Ltd	Total
At July 31 ,2019	\$ 111,877	\$ —	\$ 111,877
Impairment	(111,877)	—	(111,877)
At July 31, 2020	—	—	—
Acquisition (Note 15)	—	88,189	88,189
<b>Balance as at July 31, 2021</b>	<b>—</b>	<b>88,189</b>	<b>88,189</b>

### Zenabis

Goodwill was recognized on acquisition of Zenabis on June 1, 2021 and was allocated to the company-wide level aggregated CGU level ("HEXO Corporate CGU"). Goodwill arising from the acquisition represents the expected synergies, future income and growth potential, and all other intangibles that do not qualify for separate recognition.

Management performed the annual impairment test of goodwill as at July 31, 2021 and no impairment loss was required to be recorded. The recoverable amount was determined based on fair value less cost of disposal using a market-based approach (Level 2) with reference to an adjusted current market capitalization of the Company.

The calculation of the adjusted market capitalization was based on a 20-day volume weighted average share price of the Company on July 31, 2021, adjusted for a control premium of 5%, which was estimated by reference to premiums in recent acquisitions involving control, and from data on empirical control premium studies that considered industry, pricing, background, deal size, and timing of the observed premiums. If all other assumptions were held constant, and the share price declined by 5%, the recoverable amount would have decreased by \$45,087. If all other assumptions were held constant and the control premium was increased by 5%, the recoverable amount would have increased by \$42,941.

### Newstrike Brands Ltd.

Goodwill was initially recognized on acquisition of Newstrike Brands Limited ("Newstrike") on May 24, 2019 and was monitored at the operating segment level, which is a company-wide level ("HEXO Corporate CGU"). On January 31, 2020, the carrying amount of the Company's total net assets significantly exceeded the Company's market capitalization. In addition, slower than expected retail store roll outs in Canada and delays in government approval for cannabis derivative products resulted in a constrained distribution channel, which have adversely affected overall market sales and profitability. As a result of these factors, management performed an indicator-based impairment test of goodwill as at January 31, 2020. The recoverable amount was determined based on fair value less cost of disposal using a market-based approach (Level 2) which considered both the adjusted current market capitalization of the Company and an income based discounted cash flow analysis (DCF).

The calculation of the adjusted market capitalization was based on the share price of the Company on January 31, 2020, adjusted for a control premium of 10%, which was estimated by reference to premiums in recent acquisitions involving control, and from data on empirical control premium studies that considered industry, pricing, background, deal size, and timing of the observed premiums. If all other assumptions were held constant, and the share price declined by 5%, the impairment loss would increase by \$26,647.

If all other assumption were held constant and the control premium was decreased by 5%, the impairment loss would increase by \$24,283. An income based Discounted cash flow ("DCF") analysis (Level 3) was also used to corroborate the results of the adjusted

market capitalisation-based valuation. The significant assumptions in the DCF analysis were as follows:

- i. Cash flows: Estimated cash flows were projected based on actual operating results from internal sources as well as industry and market trends. A discrete four-and-a-half-year period was forecasted with an extended 5 year period calculated using the H-Model which is an alternative dividend discount model that assumes the growth rate will fall linearly to the terminal value with a short-term growth rate of 10% in the first year, declining each year over the 5 years to a terminal growth rate of 3%. If all other assumption were held constant and the short-term growth rate in the first year was decreased by 1%, the impairment loss would increase by \$12,598;
- ii. Terminal value growth rate: Management used a 3% terminal growth rate which is based on historical and projected consumer inflation, historical and projected economic indicators, and projected industry growth. If all other assumption were held constant and the terminal growth rate was decreased by 1%, the impairment loss would increase by \$27,000;
- iii. Post-tax discount rate: Management used a 15.9% post-tax discount rate which is reflective of an industry Weighted Average Cost of Capital ("WACC"). The WACC was estimated based on the risk-free rate, equity risk premium based on a direct comparison approach, a size premium and company specific risk, and after-tax cost of debt based on corporate bond yields. If all other assumption were held constant and the discount rate was increased by 1%, the impairment loss would increase by \$53,933; and
- iv. Tax rate: The tax rates used in determining the future cash flows were those substantively enacted at the respective valuation date.

As a result, during the year ended July 31, 2020 management concluded that the carrying value of the HEXO Corporate CGU was higher than the recoverable amount and recorded a goodwill impairment loss of \$111,877.

## 17. Warrant Liabilities

	2017 Unsecured Convertible Debentures	US\$25,000 Registered Direct Offering	US\$20,000 Registered Direct Offering	Total
Opening balance as at August 1, 2019	\$ 493	\$ —	\$ —	\$ 493
Issued	—	5,629	3,967	9,596
Exercised	(106)	—	—	(106)
(Gain) on revaluation of financial instruments	(387)	(3,712)	(2,434)	(6,533)
Balance as at July 31, 2020	—	1,917	1,533	3,450
Loss on revaluation of financial instruments	—	1,269	1,014	2,283
<b>Balance as at July 31, 2021</b>	<b>—</b>	<b>3,186</b>	<b>2,547</b>	<b>5,733</b>

The warrants are classified as a liability because the exercise price is denominated in US dollars, which is different to the functional currency of the Company. Losses (gains) on revaluation of the warrant liabilities are presented in Non-operating income (expenses) on the consolidated statements of loss and comprehensive loss.

### USD\$20,000 Registered Direct Offering – Warrants

On January 21, 2020, the Company closed a registered direct offering with institutional investors for gross proceeds of US\$20,000. Under this offering, the Company originally issued 5,988,024 common share purchase warrants with an exercise price of US\$2.45 per share with a five year-term. As a result of the share consolidation completed on December 18, 2020 (Note 22), the number of warrants outstanding was reduced to 1,497,007 and the exercise price was increased to US\$9.80 per share. The warrant liability was measured at fair value using the Black-Scholes-Merton option pricing model (Level 2), using the following assumptions:

	As at July 31, 2021	As at July 31, 2020	Initial recognition January 20, 2020
Number of warrants	1,497,007	1,497,007	1,497,007
Share price	US\$3.97	US\$2.72	US\$5.80
Expected life	2.5 years	2.5 years	2.5 years
Dividend	US \$nil	US \$nil	US \$nil
Volatility	95%	97%	80%
Risk free rate	0.38%	0.22%	1.57%
Exchange rate (USD/CAD)	1.2462	1.3404	1.3116

US\$25,000 Registered Direct Offering – Warrants

On December 31, 2019, the Company closed a registered direct offering with institutional investors for gross proceeds of US\$25,000. Under this offering, the Company originally issued 7,485,032 common share purchase warrants with an exercise price of US\$2.45 per share with a five year-term. As a result of the share consolidation completed on December 18, 2020 (Note 22), the number of warrants outstanding was reduced to 1,871,259 and the exercise price was increased to US\$9.80 per share. The warrant liability was measured at fair value using the Black-Scholes-Merton option pricing model (Level 2), using the following assumptions:

	As at July 31, 2021	As at July 31, 2020	Initial recognition December 31, 2019
Number of warrants	1,871,259	1,871,259	1,871,259
Share price	US\$3.97	US\$2.72	US\$6.36
Expected life	2.5 years	2.5 years	2.5 years
Dividend	US \$nil	US \$nil	US \$nil
Volatility	95%	97%	79%
Risk free rate	0.38%	0.22%	1.71%
Exchange rate (USD/CAD)	1.2462	1.3404	1.2988

2017 Unsecured Convertible Debenture – Warrants

During the year ended July 31, 2020, 17,856 warrants were exercised prior to the expiry date of November 14, 2019, for cash proceeds of \$72 (US\$54), based on an exercise price of US\$3.04.

## 18. Convertible Debentures

	Note	July 31, 2021	July 31, 2020
Unsecured convertible debenture- March 2019	(a)	\$ 3,406	\$ –
Unsecured convertible debenture- December 2019	(b)	33,089	28,969
Unsecured convertible notes	(c)	–	–
Total convertible debentures		36,495	28,969
Current		3,406	–
Non-Current		33,089	28,969

(a) Unsecured Convertible Debenture March 2019

Balance as at July 31, 2020	\$	–
Acquired on business combination		3,722
Interest payments		(372)
Interest expense		56
<b>Balance as at July 31, 2021</b>	<b>\$</b>	<b>3,406</b>

On June 1, 2021, the Company completed its business acquisition of Zenabis (Note 15) which included the assumption of Zenabis' unsecured convertible debentures issued in March 2019. The debentures bear interest, payable in cash only, from the date of issue at 6.0% per annum, payable semi-annually on June 30 and December 31 of each year and are convertible at a price of \$147.29. The convertible debenture is convertible, at the option of the holder, into common shares of the Company at any time prior to the close of business on the last business day immediately preceding the maturity date. During the two months ended July 31, 2021, the accretion expense recognized in interest expense was \$56, and no unsecured convertible debentures were converted into common shares. Subsequent to year end, the debentures were repaid in full in cash of \$3,461.

(b) Unsecured Convertible Debenture December 2019

Balance as at July 31, 2019	\$	–
Issued at amortized cost, net issuance costs		45,922
Conversion		(20,602)
Interest expense		6,854
Interest paid		(3,205)
<b>Balance as at July 31, 2020</b>	<b>\$</b>	<b>28,969</b>
Interest expense		7,331
Interest paid		(3,211)
<b>Balance as at July 31, 2021</b>	<b>\$</b>	<b>33,089</b>

On December 5, 2019, the Company closed a \$70,000 private placement of convertible debentures. The Company issued a total of \$70,000 principal amount of 8.0% unsecured convertible debentures maturing on December 5, 2022 (the "Debentures"). The Debentures are convertible at the option of the holder at any time after December 7, 2020 and prior to maturity at a conversion price of \$12.64 per share (the "Conversion Price"), subject to adjustment in certain events. The Company may force the conversion of all of the then outstanding Debentures at the Conversion Price at any time after December 7, 2020 and prior to maturity on 30 days' notice if the daily volume weighted average trading price of the common shares of the Company is greater than \$30.00 for any 15 consecutive trading days.

The Company had the option to at any time on or before December 4, 2020, to repay all, but not less than all, of the principal amount of the Debentures, plus accrued and unpaid interest. Upon maturity, the holders of the Debentures have the right to require the Company to repay any principal amount of their Debentures through the issuance of common shares of the Company in satisfaction of such amounts at a price equal to the volume weighted average trading price of the common shares on the TSX for the five trading days immediately preceding the payment date.

**Early Conversion Inducement (common shares presented in pre 4:1 share consolidation figures)**

In May 2020, the Company provided notice to all holders of the Debentures of an option to voluntarily convert their Debentures into units of the Company (the "Conversion Units") at a discounted early conversion price of \$0.80 (the "Early Conversion Price") calculated based on the 5-day volume weighted average HEXO Corp. share price (the "VWAP") preceding the announcement. The VWAP utilised data from both the TSX and NYSE. Each Conversion Unit provided the holder one common share and one half common share purchase warrant (with an exercise price of \$1.00 and term of three years). The early conversion occurred in two phases, the first being on June 10, 2020 followed by the second and final phase June 30, 2020. During phases one and two, \$23,595 principal amount and \$6,265 principal amount of the Debentures were converted under the Early Conversion Price into 29,493,750 and 7,831,250 common shares and 14,746,875 and 3,915,625 common share purchase warrants of HEXO Corp., respectively. The reduction of the conversion price to induce early conversion resulted in a loss of \$54,283 during the year ended July 31, 2020, which is presented in Non-operating income (expense) in the statement of net loss. The loss is calculated as the difference between the fair value of the consideration the holders received on conversion under the revised terms and the fair value of the consideration the holders would have received under the original terms of the agreement.

On July 31, 2021, there remains \$40,140 in principal debentures (July 31, 2020 - \$40,140) outstanding. The accrued and unpaid interest as at July 31, 2021 was \$483 (July 31, 2020 - \$202).

(c) Unsecured Convertible Notes

<b>Balance as at July 31, 2020</b>	\$	-
Acquired on business combination	7,790	
Debt repayment	(7,790)	
<b>Balance as at July 31, 2021</b>	<b>\$</b>	<b>-</b>

On June 1, 2021, the Company completed its business acquisition of Zenabis (Note 15) and acquired unsecured convertible notes. The unsecured convertible notes were originally issued by the acquiree in October 2018 and matured on June 30, 2021. The notes bore interest of 6% and a conversion rate of \$147.86. The notes were repaid subsequent to the close of the acquisition.

**19. Senior Secured Convertible Note**

	July 31, 2021	July 31, 2021
<b>Senior Secured Convertible Note</b>		\$
Opening balance, beginning of the year	-	-
Issued at fair value	407,284	491,714
Early conversions	(413)	(497)
Redemptions	(27,500)	(33,525)
Gain on fair value adjustment	(14,524)	(18,100)
Foreign exchange loss	-	15,081
Ending balance, end of the year	364,847	454,673
<b>Unrecognized Day 1 Loss</b>		
Opening balance, beginning of the year	-	-
Unrecognized loss at issuance	(79,684)	(96,203)
Recognized loss	7,470	9,229
Ending balance, end of the year	(72,214)	(86,974)
<b>Total balance, end of year, net</b>	<b>292,633</b>	<b>367,699</b>
Current portion	292,633	367,699
Non-current	-	-

On May 27, 2021 (the "issuance date"), the Company issued a Senior Secured Convertible Note (the "Note") directly to an institutional purchaser and certain of its affiliates or related funds (collectively, the "Holder") at a principal amount of \$434,628 (US\$360,000). The

Note was sold at a purchase price of \$395,511 (US \$327,600), or approximately 91% of the principal amount ("transaction price"). The Note bears no periodic cash interest payments and is repayable on May 1, 2023 (the "maturity date") at 110% of the principal amount (the "Redemption Amount"), if not converted or redeemed earlier. The Redemption Amount on issuance date was \$478,091 (US\$396,000). The Company used a portion of the net proceeds of the Note to fund the Redecan Acquisition (Note 38). The Note is secured against the assets of HEXO Operations Inc. and, its subsidiaries, as well as the assets of HEXO USA Inc and its subsidiaries.

The Note can be converted in full or in part by the Holder into freely tradeable common shares of the Company at any time before the second last trading day before the maturity date at a conversion rate of 142.6533 common shares per US\$1 ("conversion rate"). The Note includes different conversion and redemption options (summarized below) available to the Holder and the Company, subject to certain terms and limitations. At any given point, the beneficial ownership of the Holder in the Company is restricted to 9.99% (the "maximum ownership threshold"). Any conversion or redemption option exercised in common shares which would result in the Holder exceeding the maximum ownership threshold is null and void. Any outstanding payments due on maturity date will be settled in cash.

Other than the above-mentioned conversion feature, the Holder has the following conversion and redemption options available:

- **Early Conversion Option:** The Holder had the option to early convert the instrument up to \$60,365 (US\$50,000) at an early conversion rate during the fifteen trading day period following the announcement of the acquisition of Redecan which occurred on May 28, 2021. This was partially exercised by the Holder as shown in the table below. Under the terms of the Note, the Company was required to pay a cash amount equal to 10% of the principal amount converted, such that the Company effectively settled 110% of the principal amount.
- **Optional Redemption Option:** The Holder has the option to require monthly redemptions, of US\$15,000 (or US\$20,000 from October 2021 to September 2022) of the principal amount, on a monthly basis, plus any amounts deferred from any previous months up to US\$50,000. These monthly redemptions can be settled in either cash or equity at 110% of the principal amount. However, in order to retain the right to settle the monthly redemptions in equity, the Company must meet certain conditions for each of the 20 previous trading days, including (i) a daily volume weighted average price per common share on the Nasdaq Capital Market ("VWAP") above US\$5.00; (ii) a daily dollar trading volume (as reported on Bloomberg) of common shares over US\$10,000 on the Nasdaq Capital Market; and (iii) the related equity issuance cannot result in the Holder exceeding a beneficial ownership greater than 9.99% of the common shares of the Company. In the event that these conditions are not met, the Company must seek a waiver from the Holder in order to settle each monthly redemption in equity ("Equity Condition Waiver"). If the Holder does not grant the Equity Condition Waiver, the monthly redemption is required to be settled in cash. Subsequent to year end, on October 22, 2021, the Company negotiated an amendment to the terms of the Note which resulted in reducing the daily VWAP attached to the Equity Condition Waiver condition from US\$5.00 to US\$1.50.
- **Fundamental Change Repurchase option:** The Holder can also require the Company to repurchase the convertible note in the event of a fundamental change as defined in the agreement.

The Company has the following conversion option:

- **Forced Conversion:** The Company has an option, subject to certain conditions, to force the holder to redeem the outstanding principal at a forced conversion price if the Daily VWAP is greater than 150% of the conversion price on each of 20 consecutive trading days after the issue date. The Company may elect to redeem all or a portion of the Principal Amount into common shares or cash. An additional amount of 5% of the Principal Amount at the time of the forced conversion will also be payable in cash by the Company to the Holder unless the Daily VWAP exceeds 175% of the conversion price for five days for each of the 20 previous trading days.

The conversion rate applied to equity settlements is calculated in reference to 88.0% of the lesser of (i) the average of the daily VWAPs during the five VWAP trading day period ending on the VWAP trading day immediately prior to the settlement date, and (ii) the fifteen VWAP trading day period ending on the VWAP trading day immediately prior to the settlement date.

Additionally, up until the date of shareholder approval of the Note, shortfall cash payments were required to be made by the Company on any redemptions made under the terms of the Note. Shareholder approval was obtained on August 28, 2021, and as such, no further cash shortfall payments will be required from that date. Shortfall cash payments settled in the period are disclosed below.

The Note includes a number of financial and non-financial covenants, including:

- a requirement to maintain US\$95,000 on deposit with a collateral agent, a portion of which is set aside to fund the repayment of the Senior notes payable (Note 21(b)). On July 23, 2021, the Note was amended to reduce the collateral amount on deposit to US\$80,000.
- Beginning for the quarter ending January 31, 2022, the Company will be subject to a minimum adjusted EBITDA covenant, as defined in the agreement.

The Note represents a hybrid instrument with multiple embedded derivatives requiring separation. The Note, as a whole, has been designated as FVTPL, as at least one of the derivatives does significantly modify the cash flows of the Note and it is clear with limited analysis that separation is not prohibited. The changes in fair value of the instrument are recorded in the Statement of loss with

changes in credit spread being recognized through Other comprehensive income. The transaction costs of \$18,078 (US\$14,975) have been recognized in the statement of loss during the period.

The fair value of the Note at inception was \$491,714 determined using the partial differential equation method with the following inputs; Share Price \$6.53; Volatility 85%, Risk-free rate 0.227%; Credit spread 16.06%; Dividend yield \$nil and Dilution 284.6 million common shares. The partial differential equation determines the fair value of the note by using an iterative approach to solve the differential equation that the instrument satisfies. The Note is classified as Level 2 in the fair value hierarchy.

The fair value of the Note at initial recognition was determined using a valuation technique that includes unobservable inputs. The Company identified a difference between the transaction price and the fair value of \$96.2 million (US\$79.7 million) (the "Day 1 loss"). The Company believes that time is the factor that market participants would take into account when pricing the note. Therefore, the unrecognized Day 1 loss is recognized on a straight line basis in the statement of net loss over the contractual life of the Note.

The following table represents the movement of redemption amounts in the year ended July 31, 2021. As disclosed above, redemptions are made at 110% of the principal amount owed.

	Shares Issued	Redemption Amount
Balance, beginning of year		\$ —
<b><i>Issuances:</i></b>		
Initial issuance		478,091
<b><i>Settlements:</i></b>		
Early conversion option	53,495	(497)
Optional redemption options	4,548,746	(33,525)
Foreign exchange loss		14,641
Balance, end of year		<b>458,710</b>

Shortfall cash payments of \$3,893 are presented as share issuance costs in shareholders' equity.

At July 31, 2021 the fair value of the Note was determined to be \$454,673 and was fair valued using the following inputs; Share Price \$3.98; Volatility 85%, Risk-free rate 0.327%; Credit spread 15.44%; and a Dividend \$nil. The gain on fair value adjustments related to changes in credit spread amounted to \$1,590 (July 31, 2020 - \$nil).

An increase/decrease in the US\$/CA\$ foreign exchange rate of 1% would result in a foreign exchange loss/gain adjustment of \$4,547. Further, an increase/decrease of credit spread by 1% and share price of the Company by 10% would change the fair value of the instrument by \$2,614 and \$7,443 respectively.

The following table depicts amounts that can be demanded by the Holder in accordance with the monthly redemption option up to the instrument's maturity date, reflective of 110% of the principal amount of Note.

Fiscal Year	Redemption amount	Redemption amount
	US\$	\$
2022	253,000	315,289
2023	115,087	143,421
<b>Total</b>	<b>368,087</b>	<b>458,710</b>

## 20. Lease Liabilities

The following is a continuity schedule of lease liabilities for the years ended July 31, 2021 and 2020:

	\$
<b>Balance at July 31, 2019</b>	—
Adjustment on adoption of IFRS 16	21,360
<b>Balance at August 1, 2019</b>	<b>21,360</b>
Lease additions	9,030
Lease payments	(4,341)
Interest expense on lease liabilities	3,067
<b>Balance at July 31, 2020</b>	<b>29,116</b>
Assumed on business combination (Note 15)	17,059
Lease disposals	(789)
Lease payments	(4,835)
Interest expense on lease liabilities	3,334
<b>Balance at July 31, 2021</b>	<b>43,885</b>
Current	1,730
Non-current	42,155

The Company's leases consist of administrative real estate leases and a production real estate property. Effective August 1, 2020, the Company exited two real estate leases and the related lease liability was reduced, resulting in a gain of \$181 recognized in Other income and losses on the consolidated statements of loss. During the year ended July 31, 2021 the associated right of use assets were impaired for a loss of 17,820 (Note 13). The Company expensed variable lease payments of \$3,885 for the year ended July 31, 2021 (July 31, 2020 – \$3,769).

The following table is the Company's lease obligations over the next five fiscal years and thereafter as at July 31, 2021:

Fiscal year	2022	2023 – 2024	2025 – 2026	Thereafter	Total
Lease obligations	\$ 6,155	\$ 11,858	\$ 10,835	\$ 49,522	\$ 78,370

## 21. Loans and Borrowings

The following table is the Company's loans and borrowings as at July 31, 2021

	July 31, 2021	July 31, 2020
Term Loan (A)	\$ —	\$ 29,930
Senior notes payable (B)	50,159	—
RDC Loan (C)	—	—
<b>Total Loans and Borrowings</b>	<b>50,159</b>	<b>29,930</b>
Current	50,159	29,930
Non-current	—	—

### A. Term Loan

On February 14, 2019, the Company entered into a syndicated credit facility with Canadian Imperial Bank of Commerce ("CIBC") as Sole Bookrunner, Co-Lead Arranger and Administrative Agent and Bank of Montreal as Co-Lead Arranger and Syndication Agent (together "the Lenders"). The Lenders provided the Company with up to \$65,000 in secured debt financing at a rate of interest that is expected to average in the mid-to-high 5% per annum range. The credit facility consisted of an up to \$50,000 term loan ("Term Loan") and up to a \$15,000 in a revolving credit facility which is limited to the Company's working capital assets available to support funded balances. The credit facility had a maturity date of February 14, 2022 and was secured against the Company's property, plant and equipment. The Company was to repay at minimum 2.5% of the initial amount drawn each quarter per the terms of the credit facility agreement. On February 14, 2019, the Company received \$35,000 on the Term Loan and incurred financing costs of \$1,347.

On July 31, 2020 the Company was not in compliance with an administrative banking covenant which mandated that the Company does not utilize a Canadian dollar operating bank account with any institution other than the Lenders. The Company was subject to the covenant 90 days after entering the syndicated credit facility on February 14, 2019. The Company received an amendment on October 29, 2020 allowing it to rectify this administrative breach by April 27, 2021. Due to the amendment being received after July 31, 2020 and within the three months ended October 31, 2020 the Company classified its Term Loan as a current liability on July 31, 2020. On April 30, 2021, the Company repaid the credit facility in full and therefore is no longer subject to the credit facility's financial or administrative covenants.

In the year ended July 31, 2021, total interest expenses were \$990 (July 31, 2020 - \$723) and total interest capitalized was \$419 (July 31, 2020 - \$896).

The following table illustrates the continuity schedule of the term loan as at July 31, 2021 and July 31, 2020:

	July 31, 2021	July 31, 2020
<b>Term loan</b>	\$	\$
Opening balance	30,625	34,125
Repayments	(30,625)	(3,500)
Ending balance	-	30,625
<b>Deferred financing costs</b>	\$	\$
Opening balance	(695)	(751)
Additions	(98)	(445)
Amortization of deferred finance costs	793	501
Ending balance	-	(695)
<b>Total term loan</b>	-	<b>29,930</b>
Current portion	-	29,930
Long-term portion	-	-

#### B. Senior Notes Payable

On June 1, 2021 as part of the Zenabis acquisition, the Company assumed senior notes which have a principal amount owing of \$51,875 and a maturity date of March 31, 2025. The senior notes bear interest at 14% per annum calculated and compounded monthly in arrears and payable to the lender on the first day of each month. The debt is secured against the assets of Zenabis Global Inc and its subsidiaries.

Prior to the business acquisition of Zenabis, certain covenants were claimed by the lender to be in breach, and a demand for repayment was received by the borrower. Zenabis filed a petition on February 19, 2021 for a determination of the amount required to repay and terminate the senior notes and to obtain discharges of the debenture and related security (Note 31). Further, the senior notes contain a covenant that requires lender permission for a change in control event. This was not obtained prior to the close of the acquisition of Zenabis and as such, the debt remains in default. Accordingly, the senior notes have been classified as current debt and recorded initially at fair value at the business acquisition date and amortized cost thereafter.

The following table illustrates the continuity schedule of the senior notes payable as at July 31, 2021 and July 31, 2020:

	July 31, 2021	July 31, 2020
<b>Opening Balance</b>	\$	\$
Assumed on business combination	50,138	-
Interest paid	(1,210)	-
Interest expense	1,231	-
<b>Closing Balance</b>	<b>50,159</b>	-
Current portion	50,159	-
Long-term portion	-	-

The following table represents the loans and borrowings repayment schedule as at July 31, 2021:

July 31, 2022	\$ 51,875
Thereafter	-
	<b>\$ 51,875</b>

#### C. RDC Loan

<b>Balance as at July 31, 2020</b>	\$ -
Acquired on business acquisition	2,056
Debt repayment	(2,056)
<b>Balance as at July 31, 2021</b>	<b>\$ -</b>

On June 1, 2021 the Company completed its business acquisition of Zenabis (Note 15) and assumed a loan payable. The loan payable was originally issued by the acquiree in August 2017 and matures on August 30, 2027. The loan bore interest of 6%. The loan was repaid subsequent to the close of the acquisition.

## 22. Share Capital

### (a) Authorized

An unlimited number of common shares and an unlimited number of special shares, issuable in series.

### (b) Share Consolidation

The Company finalized the share consolidation on the basis of four pre-consolidation common shares for one post-consolidation common share (4:1) by way of shareholder approval at the annual and special meeting of shareholders held December 11, 2020 (the "Consolidation"). The Consolidation was effected by the filing of articles of amendment to the Company's articles under the *Business Corporations Act* (Ontario) on December 18, 2020. The purpose of the proposed share consolidation was to increase the Company's common share price to regain compliance with the US\$1.00 minimum share price continued listing standard of the New York Stock Exchange.

All balances of common shares, common share purchase warrants, stock options and restricted share units herein are reflective of the Consolidation (unless otherwise noted).

### (c) Issued and Outstanding

As at July 31, 2021, a total of 152,645,946 (July 31, 2020 – 120,616,441) common shares were issued and outstanding. No special shares have been issued or are outstanding.

		Number of shares	Share Capital
<b>Balance at July 31, 2019</b>		64,245,441	\$ 799,706
June 2020 at the market offering	(ii)	8,235,620	33,263
May 2020 underwritten public offering	(iii)	15,985,000	43,495
April 2020 underwritten public offering	(iv)	14,950,000	22,928
January 2020 registered offering	(v)	2,994,012	21,073
December 2019 registered offering	(vi)	3,742,516	25,229
December 2019 private placement	Note 18	9,331,250	72,005
Exercise of options	Note 24	29,133	223
Exercise of warrants	Note 23	1,103,469	5,866
<b>Balance at July 31, 2020</b>		<b>120,616,441</b>	<b>\$ 1,023,788</b>
May 2021 at the market offering, net	(i)	6,373,926	45,257
June 2020 at the market offering	(ii)	244,875	–
Senior secured convertible note <sup>3</sup> , net	Note 19	4,602,241	29,540
Acquisition shares - Zenabis	Note 15	17,579,336	151,358
Transaction costs <sup>2</sup>	Note 15	448,639	3,612
Exercise of warrants	Note 23	2,146,931	9,932
Exercise of stock options	Note 24	410,051	3,213
Exercise of equity settled RSUs	Note 24	223,506	1,267
<b>Balance at July 31, 2021</b>		<b>152,645,946</b>	<b>\$ 1,267,967</b>

<sup>1</sup> Comparatives have been revised to reflect the December 8, 2020 4:1 share consolidation

<sup>2</sup> Common shares issued as commission payment to brokers on business acquisition.

<sup>3</sup> Issuance of equity on optional redemption payments.

#### (i) May 2021 At-the-market ("ATM") Offering

On May 11, 2021, the Company established an ATM equity program allowing the Company to issue up to \$150,000 (or its US equivalent) of common shares to the public. The program ceased activity on May 25, 2021 and a total of approximately \$46,987, (after foreign exchange gains) was generated through the issuance of 6,373,926 common shares in the year ended July 31, 2021. Issuance costs in the year ended July 31, 2021 were \$1,730.

#### (ii) June 2020 At-the-market ("ATM") Offering

On June 16, 2020, the Company established an ATM equity program allowing the Company to issue up to \$34,500 (or its US equivalent) of common shares to the public. The program closed on July 31, 2020 and a total of approximately \$34,551 (after foreign exchange gains) was generated through the issuance of 8,235,620 common shares in the year ended July 31, 2020. On July 31, 2020 a receivable of \$883 remained for irrevocable sales which occurred prior to year end and subsequently settled on August 5, 2020, at which time the remaining 244,875 shares were issued.

#### (iii) May 2020 Underwritten Public Offering

On May 21, 2020 the Company closed an underwritten public offering for total gross proceeds of \$57,545 through the issuance of 15,985,000 units at a price of \$3.60 per unit. Each unit contained one common share and one half common share purchase warrant at

an exercise price of \$4.20. The net contribution to share capital, after warrant reserve adjustment, was \$46,547 and total issuance costs amounted to \$3,052.

*(iv) April 2020 Underwritten Public Offering*

On April 13, 2020, the Company closed an underwritten public offering in which 14,950,000 units were issued at \$3.08 a unit for total gross proceeds of \$46,046. Each unit consisted of one common share and one common share purchase warrant at an exercise price of \$3.84. The net contribution to share capital after warrant reserve was \$25,863 and total issuance costs amounted to \$2,936.

*(v) January 2020 Registered Direct Offering*

On January 22, 2020, the Company closed a registered direct offering in which 2,994,012 common shares were issued at US\$6.68 each for total gross proceeds of \$26,290 (US\$20,000). Investors also received one half common share purchase warrant for each common share purchased at an exercise price of US\$9.80. The net contribution to share capital, after warrant reserve adjustment, was \$22,323 and total issuance costs amounted to \$1,250.

*(vi) December 2019 Registered Direct Offering*

On December 31, 2020, the Company closed a registered direct offering in which 3,742,516 common shares were issued at US\$6.68 each for total gross proceeds of \$32,411 (US\$25,000). Investors also received one half common share purchase warrant for each common share purchased at an exercise price of US\$9.80.

## 23. Common Share Purchase Warrants

The following table summarizes warrant activity during the year ended July 31, 2021 and year ended July 31, 2020.

	July 31, 2021		July 31, 2020	
	Number of warrants	Weighted average exercise price <sup>1</sup>	Number of warrants	Weighted average exercise price <sup>1</sup>
Outstanding, beginning of year	33,379,408	\$ 7.60	7,396,354	\$ 39.80
Expired and cancelled	(535,889)	4.09	(3,889,871)	49.00
Issued on acquisition	5,970,370	14.59	—	—
Issued	—	—	30,976,394	4.96
Exercised	(2,146,931)	4.10	(1,103,469)	3.88
Outstanding, end of year	36,666,958	\$ 8.85	33,379,408	\$ 7.60

<sup>1</sup> USD denominated warrant's exercise price have been converted to the CAD equivalent as at the period end for presentation purposes.

Of the Company's expired and cancelled warrants in the year ended July 31, 2021, 509,089 cancellations were due to cashless exercises of the Company's April 2020 and May 2020 warrants. In lieu of cash equal to the number of warrants exercised multiplied by the exercise price, the warrant holder forgoes the corresponding number of warrants which are effectively cancelled.

The following table summarizes the warrants issues during the years ended July 31, 2021 and July 31, 2020.

Issuance date	Exercise price	Warrants issued	Expiry period
December 31, 2019	US\$9.80	1,871,259	5 years
January 22, 2020	US\$9.80	1,497,007	5 years
April 13, 2020	\$3.84	14,950,000	5 years
May 21, 2020	\$4.20	7,992,500	5 years
June 10, 2020	\$4.00	3,686,721	3 years
June 30, 2020	\$4.00	978,907	3 years
<b>Total issued during the year ended July 31, 2020</b>		<b>30,976,394</b>	
June 01, 2021	\$3.96-\$155.19	5,970,370	0.17-4 years
<b>Total issued during the year ended July 31, 2021</b>		<b>5,970,370</b>	

All warrants issued during the year ended July 31, 2021 are related to replacement warrants issued upon the acquisition of Zenabis (Note 15).

The following is a consolidated summary of warrants outstanding as at July 31, 2021 and July 31, 2020.

		July 31, 2021		July 31, 2020
		Number outstanding	Book value	Number outstanding
<b>Classified as Equity</b>			\$	\$
June 2019 financing warrants				
Exercise price of \$63.16 expiring June 19, 2023	546,135	10,022	546,135	10,022
April 2020 underwritten public offering warrants				
Exercise price of \$3.84 expiring April 13, 2025	11,830,075	15,971	14,004,375	18,906
May 2020 underwritten public offering warrants				
Exercise price of \$4.20 expiring May 21, 2025	7,591,876	10,446	7,852,513	10,805
Conversion Unit warrants				
Exercise price of \$4.00 expiring June 10, 2023	3,686,721	11,427	3,686,721	11,426
Exercise price of \$4.00 expiring June 30, 2023	978,907	1,928	978,907	1,928
Broker / Consultant warrants				
Exercise price of \$3.00 expiring November 3, 2021	18,905	34	43,905	78
Exercise price of \$3.00 expiring March 14, 2022	23,571	66	23,571	66
Exercise price of \$63.16 expiring June 19, 2023	15	—	15	—
Molson warrants				
Exercise price of \$24.00 expiring October 4, 2021	2,875,000	42,386	2,875,000	42,386
Issued in connection with business acquisition				
Exercise price of \$3.96 expiring April 23, 2025	631,322	4,232	—	—
Exercise price of \$5.64 expiring September 23, 2025	1,228,873	7,902	—	—
Exercise price of \$8.47 expiring October 30, 2025	43,856	261	—	—
Exercise price of \$9.03 expiring June 25, 2025	3,205,378	18,236	—	—
Exercise price of \$11.29 expiring January 27, 2023	356,689	1,195	—	—
Exercise price of \$78.16 expiring August 21, 2022	15,992	3	—	—
Exercise price of \$102.71 expiring August 21, 2022	24,338	2	—	—
Exercise price of \$151.24 expiring September 27, 2021	14,617	—	—	—
Exercise price of \$155.19 expiring April 17, 2022	226,422	1	—	—
	33,298,692	124,112	30,011,142	95,617
<b>Classified as Liability</b>				
US\$25m Registered Direct Offering Warrants				
Exercise price of US\$9.80 expiring December 31, 2024	1,871,259	3,185	1,871,259	1,917
US\$20m Registered Direct Offering Warrants				
Exercise price of US\$9.80 expiring January 22, 2025	1,497,007	2,548	1,497,007	1,533
	3,368,266	5,733	3,368,266	3,450
	<b>36,666,958</b>	<b>129,845</b>	<b>33,379,408</b>	<b>99,067</b>

## 24. Share-based Compensation

### Omnibus Plan

The Company has a share option plan (the “Former Plan”), adopted in July 2017, that was administered by the Board of Directors who established exercise prices and expiry dates. Expiry dates are up to 10 years from issuance, as determined by the Board of Directors at the time of issuance. On June 28, 2018, the Board of Directors put forth a new share option plan (the “Omnibus Plan”) which was approved by shareholders on August 28, 2019. Unless otherwise determined by the Board of Directors, options issued under both the Former Plan and Omnibus Plan vest over a three-year period. The maximum number of common shares reserved for issuance for options that may be granted under the Omnibus Plan is 10% of the issued and outstanding common shares or 15,264,595 common shares as at July 31, 2021 (July 31, 2020 – 12,061,644). The Omnibus plan is subject to cash and equity settlement, the Former Plan , Newstrike plan and Zenabis plan are subject to equity settlements. Options issued prior to July 2018 under the outgoing plan and the options assumed through the acquisition of Newstrike and Zenabis do not contribute to the available option pool reserved for issuance. As of July 31, 2021, the Company had 10,624,759 issued and outstanding under the Omnibus Plan, 780,429 issued and outstanding under the Former Plan and 612,955 issued and outstanding under the assumed plan from business combinations.

## Stock Options

The following table summarizes stock option activity during the year ended July 31, 2021 and the year ended July 31, 2020.

	July 31, 2021		July 31, 2020	
	Number of options	Weighted exercise price	Number of options	Weighted average exercise price
Opening balance	7,503,691	\$ 16.30	6,072,245	\$ 23.48
Granted	5,273,906	5.21	2,986,507	6.48
Replacement options issued on acquisition	905,902	3.81	—	—
Forfeited	(630,473)	12.80	(1,145,610)	22.20
Expired	(624,832)	25.95	(380,318)	36.64
Exercised	(410,051)	3.00	(29,133)	4.60
Closing balance	12,018,143	\$ 10.63	7,503,691	\$ 16.30

The following table summarizes the stock option grants during the year ended July 31, 2021 and July 31, 2020:

Grant date	Exercise price (\$)	Options granted			Vesting terms	Expiry period
		Executives and directors	Non-executive employees	Total		
October 29, 2019	13.20	207,259	683,068	890,327	Terms A	10 years
January 29, 2020	7.20	—	73,255	73,255	Terms A	10 years
April 28, 2020	2.76	225,000	641,331	866,331	Terms A	10 years
June 26, 2020	4.08	763,756	183,103	946,859	Terms A	10 years
July 28, 2020	3.84	—	209,735	209,735	Terms A	10 years
<b>Total</b>	<b>1,196,015</b>		<b>1,790,492</b>	<b>2,986,507</b>		
October 30, 2020	3.88	349,652	315,358	665,010	Terms A	10 years
December 22, 2020	5.44	380,673	960,100	1,340,773	Terms A	10 years
April 28, 2021	7.54	—	85,389	85,389	Terms A	10 years
June 17, 2021	7.43	75,000	45,613	120,613	Terms A	10 years
July 29, 2021	5.24	580,164	2,481,957	3,062,121	Terms A	10 years
<b>Total</b>	<b>1,385,489</b>		<b>3,888,417</b>	<b>5,273,906</b>		

Vesting terms A – One-third of the options will vest on each of the one-year anniversaries of the date of grant over a three-year period.

The following table summarizes information concerning stock options outstanding as at July 31, 2021.

Exercise price	Number outstanding	Weighted average remaining life (years)	Number exercisable	Weighted average remaining life (years)
\$2.32–\$10.76	8,292,550	8.82	1,853,536	6.30
\$15.56–\$26.16	1,576,409	7.79	1,779,478	7.33
\$28.52–\$34.00	2,141,186	7.40	474,040	7.50
\$47.36–\$234.76	7,998	0.35	7,333	0.32
	<b>12,018,143</b>		<b>4,114,387</b>	

## Restricted Share Units (“RSUs”)

Under the Omnibus Plan, the Board of Directors is authorized to issue RSUs up to 10% of the issued and outstanding common shares, inclusive of the outstanding stock options. At the time of issuance, the Board of Directors establishes conversion values and expiry dates, which are up to 10 years from the date of issuance. The restriction criteria of the units are at the discretion of the Board of Directors and from time to time may be inclusive of Company based performance restrictions, employee-based performance restrictions or no restrictions to the units.

The following table summarizes RSU activity during the year ended July 31, 2021 and the year ended July 31, 2020.

	July 31, 2021		July 31, 2020	
	Units	Value of units on grant date	Units	Value of units on grant date
Opening balance	587,108	\$ 8.41	—	\$ —
Granted	24,008	3.17-7.17	609,636	8.52
Replacement units issued on acquisition	223,506	8.61	—	—
Exercised – equity settled	(223,506)	8.61	—	—
Exercised – cash settled	(25,483)	5.62-8.60	—	—
Forfeited	(34,801)	11.76	(22,528)	11.76
Closing balance	550,832	\$ 7.91	587,108	\$ 8.41

The following table summarizes the RSUs granted during the year ended July 31, 2021 and the year ended July 31, 2020.

Grant date	Unit value	RSUs granted		Vesting terms	Expiry period
		Executive and directors	Non-executive employees		
October 29, 2019	11.76	357,111	—	Terms A	10 years
June 26, 2020	3.96	252,525	—	Terms A	10 years
<b>Total</b>		<b>609,636</b>			
October 30, 2020	\$3.16	7,161	—	Terms A	10 years
June 17, 2021	7.17	9,413	—	Terms A	10 years
July 29, 2021	5.38	7,434	—	Terms A	10 years
<b>Total</b>		<b>24,008</b>			

Vesting terms A – One-third of the units vest on each of the one-year anniversaries for the first three years after the grant date.

### Share-based Compensation

Share-based compensation is measured at fair value at the date of grant and are expensed over the vesting period. In determining the amount of share-based compensation, the Company used the Black-Scholes-Merton option pricing model to establish the fair value of stock options and RSUs granted at the grant date by applying the following assumptions:

	July 31, 2021	July 31, 2020
Exercise price (weighted average)	\$17.03	\$26.04
Share price (weighted average)	\$17.19	\$26.44
Risk-free interest rate (weighted average)	1.24%	1.79%
Expected life (years) of options (weighted average)	5	5
Expected annualized volatility (weighted average)	85%	75%

Volatility was estimated using the average historical volatility of the Company and comparable companies in the industry that have trading history and volatility history.

For the year ended July 31, 2021, the Company allocated to inventory \$1,506, (July 31, 2020 – \$6,105) of share-based compensation applicable to direct and indirect labour in the cultivation and production process.

The cash-settled share-based compensation liability is presented in Other liabilities. The following table summarizes the Company's equity-settled and cash-settled share-based payments for the year ended July 30, 2021 and 2020.

	July 31, 2021	July 31, 2020
Stock option share-based compensation	\$12,863	\$31,503
RSU share-based compensation	287	—
<b>Total equity-settled share-based compensation</b>	<b>13,150</b>	<b>31,503</b>
RSU share-based compensation	127	393
<b>Total cash-settled share-based compensation</b>	<b>127</b>	<b>393</b>

### 25. Net Loss per Share

The following securities could potentially dilute basic net loss per share in the future but have not been included in diluted loss per share because their effect was anti-dilutive:

Instrument	July 31, 2021	July 31, 2020
Stock options	12,018,143	7,503,690
RSUs	550,832	587,108
Acquired and reissued warrants	5,747,487	—
2019 June financing warrants	546,135	546,135
US\$25m registered direct offering warrants	1,871,259	1,871,259
US\$20m registered direct offering warrants	1,497,007	1,497,007
2020 April underwritten public offering warrants	11,830,075	14,004,375
2020 May underwritten public offering warrants	7,591,876	7,852,513
Warrants issued under conversion of debentures	4,665,628	4,665,628
Joint venture issued warrants	2,875,000	2,875,000
Convertible debenture broker/finder warrants	42,491	67,491
	<b>49,235,933</b>	<b>41,470,206</b>

## 26. Financial Instruments

### Market Risk

#### *Interest Risk*

The Company has minimal exposure to interest rate risk related to any investments of cash and cash equivalents. The Company may invest cash in highly liquid investments with short terms to maturity that would accumulate interest at prevailing rates for such investments. As at July 31, 2021, the Company has \$50,159 in notes payable (July 31, 2020 – \$29,930) (Note 21) that bear interest at a fixed rate and therefore are not subject to interest risk (July 31, 2020 - not material). The Company hold senior secured convertible debt (Note 19) that bears no cash interest and is repayable at a fixed rate of 110% of the face value.

#### *Price Risk*

Price risk is the risk of variability in fair value due to movements in equity or market prices.

#### *Financial assets*

The Company's level 1 and 2 investments are susceptible to price risk arising from uncertainties about their future outlook, future values and the impact of market conditions. The fair value of marketable securities and derivatives held in publicly traded entities is based on quoted market prices, which the shares of the investments can be exchanged for.

#### *Financial liabilities*

The Company elected an early conversion option in the year ended July 31, 2020 in which \$29,860 of the aggregate principal amount of its 8% unsecured convertible debentures (Note 18) were converted, which partially mitigates the Company's Price Risk.

The Company obtained an amendment to the Senior secured convertible notes equity condition (subsequent to July 31, 2021) effectively reducing the equity conditions market price threshold allowing the Company increased discretion over redemption payments to be repaid in cash or equity (Note 19). The sensitivity of the Senior secured convertible note due to price risk is disclosed in Note 19.

If the July 31, 2021 fair value of these financial assets and liabilities were to increase or decrease by 10% the Company would incur a related increase or decrease to Comprehensive loss of an estimated \$37,100 (July 31, 2020 – no material impact). The price risk exposure as at July 31, 2021 and July 31, 2020 is presented in the table below.

	July 31, 2021	July 31, 2020
Financial assets	\$ 2,492	\$ 2,692
Financial liabilities	(373,432)	(3,450)
<b>Total exposure</b>	<b>(370,940)</b>	<b>(758)</b>

### Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's cash held in escrow, restricted cash and trade receivables. As at July 31, 2021, the Company was exposed to credit related losses in the event of non-performance by the counterparties.

The Company provides credit to its customers in the normal course of business and has established credit evaluation and monitoring processes to mitigate credit risk. Since the majority of the medical sales are transacted with clients that are covered under various insurance programs, and adult use sales are transacted with crown corporations, the Company has limited credit risk.

Cash and cash equivalents, restricted funds and cash held in escrow are held with three Canadian commercial banks that hold Dun & Bradstreet credit ratings of AA (July 31, 2020 – AA), an American commercial bank with a credit rating of A- and \$111 is held with a credit union that does not have a publicly available credit rating. Certain restricted funds in the amount of \$29,999 are managed by an insurer and are held as a cell captive within a Bermuda based private institution which does not have a publicly available credit rating, however the utilized custodian is Citibank which holds a credit rating of A+.

The majority of the trade receivables balance is held with crown corporations of Quebec, Ontario and Alberta. Creditworthiness of a counterparty is evaluated prior to the granting of credit. The Company has estimated the expected credit loss using a lifetime credit loss approach. The current expected credit loss for the year ended July 31, 2021 is \$66 (July 31, 2020 - \$35).

In measuring the expected credit losses, the adult-use cannabis trade receivables have been assessed on a per customer basis as they consist of a low number of material contracts. Medical trade receivables have been assessed collectively as they have similar credit risk characteristics. They have been grouped based on the days past due.

The carrying amount of cash and cash equivalents, cash held in escrow, restricted cash and trade receivables represents the maximum exposure to credit risk and as at July 31, 2021; this amounted to \$522,908 (July 31, 2020 – \$211,860). Subsequent to July 31, 2021 the cash held in escrow has been utilized to fund the Redecan acquisition (Note 38).

The following table summarizes the Company's aging of trade receivables as at July 31, 2021 and July 31, 2020:

	July 31, 2021	July 31, 2020
0–30 days	\$ 22,971	\$ 15,253
31–60 days	12,390	2,972
61–90 days	1,435	412
Over 90 days	625	789
<b>Total</b>	<b>37,421</b>	<b>19,426</b>

### Economic Dependence Risk

Economic dependence risk is the risk of reliance upon a select number of customers, which significantly impacts the financial performance of the Company. For the year ended July 31, 2021, the Company's recorded sales to the crown corporations; Société québécoise du cannabis ("SQDC") the Ontario Cannabis Store ("OCS") and the Alberta Gaming, Liquor and Cannabis agency ("AGLC") representing 42%, 20% and 14%, respectively (July 31, 2020 – one crown corporation representing 70%) of total applicable periods net cannabis sales.

The Company holds trade receivables from the crown corporations SQDC, OCS and the AGLC representing 13%, 29% and 13%, respectively, of total trade receivable, respectively as at July 31, 2021 (July 31, 2020 – the two crown corporations SQDC and OCS representing 47% and 25% of total trade receivables, respectively).

### Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due (See note 2 – *Going Concern*). The Company manages liquidity risk by reviewing on an ongoing basis, its capital requirements. As at July 31, 2021, the Company has \$67,462 (July 31, 2020 – \$184,173) of cash and cash equivalents and \$37,421 (July 31, 2020 – \$19,426) in trade receivables. The Company has current liabilities of \$503,638 on the statement of financial position. As well the Company has contractual commitments of \$18,244 due before July 31, 2022. The Company has restricted funds to satisfy debt of \$50,159, presented in current liabilities (Note 6). The maturity analysis of undiscounted cash flows for lease obligation and convertible debentures is disclosed in Note 20 and Note 18 respectively.

Current financial liabilities include the Company's obligation on the senior secured convertible note (Note 19). The Company plans to settle this liability in equity. However, if the Company is unable to meet the requirements Equity Condition Waiver (Note 19) the Holder may demand settlement in cash. The analysis of potential cash outflow to redeem the Note up to the earliest maturity date is given below. Subsequent to the year-end, the Company settled the optional redemption payments for August 2021, September 2021 and October 2021 in equity. The Company has also received a cash settlement waiver for the May 2023 and November 2021 optional redemptions.

The following table provides an analysis of contractual maturities for financial liabilities.

Fiscal year	2022	2023	2024	2025	Thereafter	Total
Accounts payable and accrued liabilities	\$ 63,557	\$ –	\$ –	\$ –	\$ –	\$ 63,557
Excise taxes payable	6,591	–	–	–	–	6,591
Loans and borrowings	60,297	–	–	–	–	60,297
Convertible debentures	6,716	41,273	–	–	–	47,989
Undiscounted future lease payments	6,155	5,785	6,073	5,561	54,796	78,370
	143,316	47,058	6,073	5,561	54,796	256,804
Senior secured convertible note <sup>1</sup>	315,289	143,421	–	–	–	458,710
<b>Total</b>	<b>458,605</b>	<b>190,479</b>	<b>6,073</b>	<b>5,561</b>	<b>54,796</b>	<b>715,514</b>

<sup>1</sup> The senior secured convertible note has been valued using the July 31, 2021 US/CAD foreign exchange rate. The Company's ability to settle the note in equity or cash is dependent upon meeting certain conditions as stated in Note 19.

### Foreign Currency Risk

On July 31, 2021, the Company holds certain financial assets and liabilities denominated in United States Dollars ("US\$") which consist of cash and cash equivalents, cash in escrow, restricted funds, the senior secured convertible note and warrant liabilities. The Company does not currently use foreign exchange contracts to hedge its exposure of its foreign currency cash flows as management has determined that this risk is not significant. The Company closely monitors relevant economic information to minimize its net exposure to foreign currency risk. The Company is exposed to unrealized foreign exchange risk through its cash and cash equivalents. As at July 31, 2021, approximately \$434,838 (US\$348,931) (July 31, 2020 – \$42,981 (US\$57,652)) of the Company's cash and cash equivalents was in US. A 1% change in the foreign exchange rate would result in a change of \$4,348 to the unrealized gain or loss on foreign exchange or on the gain or loss on financial instrument revaluation of US denominated warrants. Subsequent to year end, cash held in escrow has been utilized to fund the acquisition of Redecan (Note 38).

The Company's Senior secured convertible note is denominated in US\$. The Company plans to settle this debt in equity. However, if the Company is unable to meet the equity settlement condition or secure cash settlement waivers, the settlement may entail cash outflow. The sensitivity of the Senior secured convertible note due to foreign currency risk is disclosed in Note 19.

## 27. Operating Expenses by Nature

The following table disaggregates the selling, general and administrative expenses as presented on the Statement of Loss and Comprehensive Loss into specified classifications based upon their nature:

For the year ended	July 31, 2021	July 31, 2020
Salaries and benefits	\$ 21,116	12,202
Professional fees	11,962	9,811
Facilities	6,550	6,895
Selling, general and administrative	13,915	14,409
Consulting	4,379	7,425
Travel	265	2,051
<b>Total</b>	<b>58,187</b>	<b>52,793</b>

The following table summarizes the nature of share-based compensation in the period:

For the year ended	July 31, 2021	July 31, 2020
General and administrative related share-based compensation	\$ 10,945	24,650
Marketing and promotion related share-based compensation	786	1,140
<b>Total operating expense related share-based compensation</b>	<b>11,731</b>	<b>25,790</b>
Share based compensation capitalized to inventory	1,505	6,105
<b>Total share-based compensation</b>	<b>13,236</b>	<b>31,895</b>

The following table summarizes the total payroll related wages and benefits by nature in the period:

For the year ended	July 31, 2021	July 31, 2020
General and administrative related wages and benefits	\$ 21,116	12,202
Marketing and promotion related wages and benefits	5,543	5,625
Research and development related wages and benefits	2,706	2,717
<b>Total operating expense related wages and benefits</b>	<b>29,365</b>	<b>20,544</b>
Wages and benefits capitalized to inventory	14,993	21,128
<b>Total wages and benefits</b>	<b>44,358</b>	<b>41,672</b>

## 28. Other Income and Losses

For the year ended	July 31, 2021	July 31, 2020
Interest and financing expenses	\$ (32,124)	(10,043)
Interest income	1,601	1,902
<b>Interest income (expense), net</b>	<b>(30,523)</b>	<b>(8,141)</b>
Revaluation of warrant liabilities	(2,283)	6,533
Share of loss from investment in associates and joint ventures	(6,505)	(6,331)
Loss on Unsecured Convertible Debentures – December 2019	–	(54,283)
Fair value gain/(loss) on convertible debenture	1,260	(4,806)
Fair value loss on senior secured convertible note	(7,478)	–
Unrealized gain/(loss) on investments	1,994	(12,880)
Realized gain on investments	–	24
Foreign exchange gain/(loss)	9,108	1,392
Other income	4,763	2,531
<b>Non-operating income (expense), net</b>	<b>859</b>	<b>(67,820)</b>

## 29. Related Party Disclosure

### Compensation of Key Management

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the Company's operations, directly or indirectly. The key management personnel of the Company are the members of the executive management team and Board of Directors.

Compensation provided to key management during the year was as follows:

<i>For the year ended</i>	<b>July 31, 2021</b>	<b>July 31, 2020</b>
Salary and/or consulting fees	\$ 2,321	\$ 3,069
Termination benefits	1,008	1,043
Bonus compensation	800	42
Stock-based compensation	6,800	15,702
<b>Total</b>	<b>10,929</b>	<b>19,856</b>

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed by the related parties.

### Related Parties and Transactions

#### Belleville Complex Inc.

The Company holds a 25% interest in Belleville Complex Inc. ("BCI") with the related party Olegna Holdings Inc., a company owned and controlled by a director of the Company, holding the remaining 75% in BCI. BCI purchased a configured 2,004,000 sq. ft. facility through a \$20,279 loan issued and repaid during the year ended July 31, 2019. The Company will be the anchor tenant for a 15-year lease, with an option to renew for 15 years and additional space to rent. The Company has also subleased a portion of the space to Truss Limited Partnership (Note 11). Consideration for the 25% interest on the joint venture is deemed \$nil. The carrying value of BCI as at July 31, 2021 is \$798 (July 31, 2020 - \$nil).

The Company leases a space in Belleville from a related party BCI, that supports its manufacturing activities and is based in Belleville, Ontario. Under this lease arrangement, the Company incurred \$5,369 in lease and operating expenses during the year ended July 31, 2021 (July 31, 2020 - \$7,511). This lease liability is recognized on the Company's balance sheet under IFRS 16 (Note 20).

#### Truss LP

The Company owns a 42.5% interest in Truss LP and accounts for the interest as an investment in an associate (Note 11).

The Company subleases section of its Belleville lease to Truss LP this sublease is recognized as a finance lease receivable on the Company's balance sheet (Note 8). The Company recognizes a recovery on its partnership with Truss LP in Other receivables and Other income.

Under a Temporary Supply and Services Agreement ("TSSA") with Truss LP, the Company produces and packages cannabis infused beverages in the CIB Facility (located at the Belleville Facility) and in the Gatineau Facility, and markets and sells beverages for the legal adult-use markets in Canada, in each case subject to the terms of its regulatory approvals and applicable laws, all for its own account and as a stand-alone division of HEXO. Truss LP applied to be a licensed producer of Cannabis during the period, but until the time where Truss LP obtains all regulatory approval required under the Cannabis Act (Canada), the TSSA will remain in place. Under the TSSA, Truss LP will be an exclusive supplier to the Company of all property and all services required to carry on the business, other than specific services which are required to be provided by HEXO.

As a result of this arrangement, there is a net payable to Truss of \$6,928 at July 31, 2021 (July 31, 2020 - \$1,247). During the year ended July 31, 2021, the Company purchased \$7,624 (July 31, 2020 - \$2,159) of raw materials from Truss LP under the arrangement and received \$1,844 (July 31, 2020 - \$2,531) of Income.

## 30. Capital Management

The Company's objectives when managing capital are to (1) safeguard their ability to continue as a going concern, so that they can continue to provide returns for shareholders and benefits for other stakeholders, and (2) maintain an optimal capital structure to reduce the cost of capital.

Management defines capital as the Company's shareholders' equity and interest-bearing debt. The Board of Directors does not establish quantitative return on capital criteria for management. The Company has not paid any dividends to its shareholders. The Company is not subject to any externally imposed capital requirements other than the covenants related to the Company's debt instruments as set out in Notes 18 and 19.

As at July 31, 2021, total managed capital was \$732,265 (July 31, 2020 - \$556,676).

## 31. Commitments and Contingencies

### COMMITMENTS

The Company has certain contractual financial obligations related to service agreements, purchase agreements, rental agreements and construction contracts.

Some of these contracts have optional renewal terms that the Company may exercise at its option. The annual minimum payments payable under these obligations over the next five fiscal years and thereafter are as follows:

	\$
July 31, 2022	18,244
July 31, 2023	3,846
July 31, 2024	3,474
July 31, 2025	2,429
July 31, 2026	5,802
Thereafter	13,472
	47,267

See Note 20 for recognized contractual commitments regarding the Company's lease obligations under IFRS 16.

### LETTERS OF CREDIT

The Company holds a five-year letter of credit with a Canadian financial institution to provide a maximum of \$250 that amortizes \$50 annually until its expiry on July 14, 2024. As at July 31, 2021, the remaining balance of the letter of credit is \$200, was not drawn upon and is secured by cash held in collateral (Note 6).

On August 1, 2020, the Company reissued a pre-existing letter of credit with a Canadian financial institution under an agreement with a public utility provider entitling the utility provider to a maximum of \$2,581, subject to certain operational requirements. The letter of credit has a one-year expiry from the date of issuance with an auto renewal feature. On January 1, 2021, the letter of credit was reduced to \$2,352 by way of amendment. The letter of credit has not been drawn upon as at July 31, 2021. The letter of credit is secured by cash held in collateral (Note 6).

### CONTINGENCIES

The Company may be, from time to time, subject to various administrative and other legal proceedings arising in the ordinary course of business. Contingent liabilities associated with legal proceedings are recorded when a liability is probable, and the contingent liability can be reasonably estimated. While the following matters are ongoing, the Company disputes the allegations and intends to continue to vigorously defend against the claims.

As of July 31, 2021, the Company and its Chief Executive Officer are defendants in a putative class-action lawsuit pending in the Québec Superior Court brought on behalf of certain purchasers of shares of the Company and filed on November 19, 2019. The lawsuit asserts causes of action for misrepresentations under the Québec Securities Act and the Civil Code of Québec in connection with certain statements contained in HEXO's prospectus, public documents and public oral statements between April 11, 2018 and November 15, 2019. The allegations relate to: (1) statements made by the Company regarding its agreement with the Province of Québec to supply cannabis; (2) statements made by the Company regarding its acquisition of Newstrike, particularly the licensing of the Newstrike facilities and the forecasted synergies and/savings from the Newstrike acquisition; (3) statements made by the Company about the net revenues in Q4 2019 and fiscal year 2020; and (4) the certifications by Sébastien St-Louis and the underwriters of the Company. The plaintiffs seek to represent a class comprised of Québec residents who acquired the Company's securities either in an Offering (primary market) or on the secondary market during such period and seek compensatory damages for all monetary losses and costs. The amount claimed for damages has not been quantified and no accrual has been made as at July 31, 2021 (July 31, 2020 - \$nil).

As of July 31, 2021, the Company is named as a defendant in a proposed consumer protection class action filed on June 16, 2020, in the Court of Queens' Bench in Alberta on behalf of residents of Canada who purchased cannabis products over specified periods of time. Several other licensed producers are also named as co-defendants in the action. The lawsuit asserts causes of action, including for breach of contract and breach of consumer protection legislation, arising out of allegations that the Tetrahydrocannabinol (THC) or Cannabidiol (CBD) content of medicinal and recreational cannabis products sold by the Company and the other defendants to consumers was different from what was advertised on the products' labels. Many of the cannabis products sold by the Company and other defendants were allegedly sold to consumers in containers using plastic bottles or caps that may have rapidly absorbed or degraded the THC or CBD content within them. By allegedly over-representing the true amount of THC or CBD in the products, the plaintiff claims that consumers would be required to consume substantially more product than they otherwise would have in order to obtain the desired effects or, in the alternative, would have consumed the product without obtaining the desired effects. The action has not yet been certified as a class action.

On June 1, 2021, by way of the business acquisition of Zenabis, the Company assumed senior notes payable and the following litigation with the associated lender of the notes (Note 21b). Upon closing the acquisition of Zenabis, the Company was in default under the debenture due to the failure to obtain the lenders consent for a change of control. On February 19, 2021, Zenabis filed a petition in

the Supreme Court of British Columbia for a determination of the amount required to repay and terminate the debenture and to obtain discharges of the debenture and related security. The lender took the position that the amount to discharge the debenture and related securities was approximately \$72,000. The Company believes the amount is approximately \$53,000, which has been provided for in the consolidated financial statements. Under the senior secured convertible note agreement (Note 19), the Company has restricted funds to satisfy this liability (Note 6). The difference largely relates to whether a prepayment fee and default fees are payable under the debenture and to the amount to buyout and discharge of a revenue based royalty liability. The petition was heard on March 29, March 30, March 31, April 1, April 15 and May 14, 2021. The Judge's decision remains on reserve and no indication as to the likely timing of its release has been provided.

#### ONEROUS CONTRACT

During the year ended July 31, 2020, the Company recognized a \$4,763 onerous contract provision related to a fixed price supply agreement for the supply of certain cannabis products. The supply agreement is currently the subject of legal proceedings as disclosed above. The costs and purchase obligations under the contract exceed the economic benefits expected to be received. The related loss has been included in operating expenses in the year ended July 31, 2020. The onerous contract liability remains as at July 31, 2021.

## 32. Fair Value of Financial Instruments

The fair values of the financial instruments as at July 31, 2021 are summarized in the following table:

	Amortized cost	FVTPL	Total
<b>Assets</b>	\$	\$	\$
Cash and cash equivalents	67,462	—	67,462
Restricted funds	132,246	—	132,246
Trade receivables	37,421	—	37,421
Commodity taxes recoverable and other receivables	13,549	—	13,549
Lease receivable – long term	4,453	—	4,453
Long – term investments	—	2,492	2,492
<b>Liabilities</b>	\$	\$	\$
Accounts payable and accrued liabilities	63,557	—	63,557
Warrant liability	—	5,733	5,733
Convertible debt- current	3,406	—	3,406
Convertible debt	33,089	—	33,089
Senior secured convertible note – current	—	367,699	367,699
Loans and borrowings – current	50,159	—	50,159
Other long-term liabilities <sup>1</sup>	—	520	520

<sup>1</sup> Financial liability designated as FVTPL.

The fair values of the financial instruments as at July 31, 2020 are summarized in the following table:

	Amortized cost	FVTPL	Total
<b>Assets</b>	\$	\$	\$
Cash and cash equivalents	184,173	—	184,173
Restricted funds	8,261	—	8,261
Trade receivables	19,426	—	19,426
Commodity taxes recoverable and other receivables	16,773	—	16,773
Lease receivable – long term	3,865	—	3,865
Long – term investments	—	3,209	3,209
<b>Liabilities</b>	\$	\$	\$
Accounts payable and accrued liabilities	32,451	—	32,451
Warrant liability	—	3,450	3,450
Convertible debentures	28,969	—	28,969
Term loan – current	29,930	—	29,930
Other long-term liabilities <sup>1</sup>	—	393	393

<sup>1</sup> Financial liability designated as FVTPL.

The carrying values of cash and cash equivalents, restricted funds, cash held in escrow, short term investments, trade and other receivables, lease receivables, accounts payable and accrued liabilities, lease liabilities and term loan approximate their fair values due to their relatively short periods to maturity.

### 33. Non-Controlling Interest

The change in non-controlling interests is as follows.

	July 31, 2021	July 31, 2020
Balance, Beginning of year	\$ 3,379	\$ —
Non-controlling interest acquired on business combination	(1,340)	—
Partnership contributions	81	3,379
Share of comprehensive loss for the period	(133)	—
Balance, End of year	\$ 1,987	\$ 3,379

### Keystone Isolation Technology Inc

The Company holds a 60% interest in Keystone Isolation Technology Inc. ("KIT") which is intended to principally operate out of Belleville Facility, and the remaining 40% represents the non-controlling interest held by Chroma Global Technologies Ltd (the "Partner"). Under the terms of the shareholder agreement, the Company has contributed cash of \$4,699 (USD\$3,100). During the year ended July 31, 2021, the Partner contributed capital equipment in-kind of \$371 as required under the terms of the shareholders agreement. There remains approximately \$325 of an in-kind commissioning contribution to satisfy the acquisition terms of the shareholders agreement. KIT had no revenues or expenses during the year ended July 31, 2021 and the year ended July 31, 2020. The following table summarizes the information relating to the Company's non-controlling interest in KIT.

	July 31, 2021	July 31, 2020
Current assets	\$ —	\$ —
Non-current assets	8,651	7,455
Current liabilities	—	—
Non-current liabilities	—	—
Non-controlling interest (%)	40%	40%
Non-controlling interest	\$ 3,460	\$ 3,379

### ZenPharm Limited

The Company holds a 60% interest in ZenPharm Limited ("ZenPharm") obtained through the acquisition of Zenabis on June 1, 2021. ZenPharm was formed to service the European medical cannabis market. The following table is the summarized financial information of ZenPharm.

	July 31, 2021
Current assets	\$ 313
Non-current assets	141
Current liabilities	(3,233)
Non-current liabilities	—
Accumulated deficit	(133)
Non-controlling interest (%)	40%
Non-controlling interest	\$ (1,475)

### 34. Revenue from Sale of Goods

The Company disaggregated its revenues from the sale of goods between sales of cannabis beverages ("Cannabis beverage sales") and dried flower, vapes, and other cannabis products ("Cannabis sales excluding beverages"). The Company's cannabis beverage sales are derived from the Cannabis Infused Beverage ("CIB") line, which was established in order to manufacture, produce and sell cannabis beverage products. CIB operates under the Company's cannabis licensing and in compliance with Health Canada and the Cannabis Act's regulations. The Company has assessed the beverage revenue stream to be realized by the Company and presented on a gross basis as defined under IFRS 15. The Company will continue to operate CIB until Truss has obtained its independent licensing to cultivate and manufacture cannabis, at which point the operations will shift to Truss.

For the year ended	July 31, 2021			July 31, 2020		
Revenue stream	Cannabis sales excluding beverages	Cannabis beverage sales <sup>1</sup>	Total	Cannabis sales excluding beverages	Cannabis beverage sales	Total
Retail	\$ 143,098	15,821	158,919	\$ 101,713	2,851	104,564
Medical	1,769	—	1,769	3,299	—	3,299
Wholesale	2,458	—	2,458	995	—	995
International	9,935	—	9,935	1,291	—	1,291
Total revenue from sale of goods	157,260	15,821	173,081	107,298	2,851	110,149

<sup>1</sup> See Note 38 Subsequent Event – Truss Beverage Received Manufacturing Cannabis Licensing.

During the year ended July 31, 2021 the Company incurred \$3,736 (July 31, 2020 - \$6,942) of net sales provisions and price concessions.

### 35. Segmented Information

The Company operates under one material operating segment. Substantially all property, plant and equipment and intangible assets are located in Canada.

### 36. Operating Cash Flow

The following items comprise the Company's operating cash flow activity for the periods herein.

For the year ended	July 31, 2021	July 31, 2020
	\$	\$
Items not affecting cash		
Income tax recovery	(397)	(6,023)
Depreciation of property, plant and equipment	6,097	6,072
Depreciation of property, plant and equipment in cost of sales	8,601	3,567
Amortization of intangible assets	2,050	3,939
Loss on convertible debentures	6,218	4,806
Unrealized gain on changes in fair value of biological assets	(51,499)	(29,356)
Unrealized fair value adjustment on investments	(1,994)	12,880
Amortization of deferred financing costs	793	56
Interest and other income	5,837	9,921
Loss on induced conversion of debenture	—	54,283
Accretion of convertible debenture	4,075	—
Non-cash finance and transaction fees	21,690	—
Loss on investment	—	(24)
License depreciation and prepaid royalty expenses	118	389
Write-off of inventory and biological assets	2,182	5,055
Write down of inventory to net realizable value	2,927	68,319
Realized fair value amounts on inventory sold	31,767	40,910
Loss from investment in associate and joint ventures	6,505	6,331
Share-based compensation	14,859	25,790
Revaluation of financial instruments (gain)/loss	2,283	(6,533)
Impairment losses	20,230	299,484
Loss on onerous contract	—	4,763
Loss on long lived assets and disposal of property, plant and equipment	1,358	3,855
Gain on exit of lease	(789)	—
Foreign exchange gain	(11,648)	—
<b>Total items not affecting cash</b>	<b>71,263</b>	<b>508,484</b>
Changes in non-cash operating working capital items		
Trade receivables	(14,203)	267
Commodity taxes recoverable and other receivables	5,197	(784)
Prepaid expenses	(106)	5,717
Inventory	(52,539)	(100,492)
Biological assets	53,678	28,493
Accounts payable and accrued liabilities	8,848	6,623
Excise taxes payable	(444)	3,627
<b>Total non-cash operating working capital</b>	<b>431</b>	<b>(56,549)</b>

Additional supplementary cash flow information is as follows:

For the year ended	July 31, 2021	July 31, 2020
	\$	\$
Property, plant and equipment in accounts payable	1,152	19,751
Right-of-use asset additions	17,059	24,405
Capitalized borrowing costs	1,269	2,385
Interest paid	5,618	2,527

## 37. Income Taxes

Income tax expense recognized in comprehensive loss consists of the following components:

	July 31, 2021	July 31, 2020
Current tax for the year	\$ 22	\$ —
Adjustments of previous years	—	—
<b>Total</b>	<b>\$ 22</b>	<b>\$ —</b>

Components of deferred income tax expense (recovery):

	July 31, 2021	July 31, 2020
Origination and reversal of temporary differences	\$ (14,659)	\$ (98,141)
Difference between statutory tax rate and deferred tax rate	(249)	2,555
Change in temporary difference for which no deferred tax assets are recorded	14,489	89,563
<b>Deferred income tax (recovery)</b>	<b>\$ (419)</b>	<b>\$ (6,023)</b>

The Company's expected tax rate is different from the combined federal and provincial income tax rate in Canada. These differences result from the following elements:

	July 31, 2021	July 31, 2020
<b>Expected tax rate</b>	<b>26.50%</b>	26.54%
Earnings before income taxes	\$ (115,159)	\$ (552,512)
Expected tax benefit resulting from loss	(30,517)	(146,637)
Adjustments for the following items:		
Tax rate differences	(652)	2,555
Permanent differences	8,696	48,965
Change in temporary differences for which no tax assets are recorded	22,148	89,094
True up and other	(72)	—
	<b>\$ (397)</b>	<b>\$ (6,023)</b>

The following is a reconciliation of the deferred tax assets and liabilities recognized by the Company:

	Opening August 1, 2020	Recognize in income	Business Combination	Recognized in equity	Ending July 31, 2021
Taxable temporary differences	\$ 10,415	\$ (14,701)	\$ (310)	\$ (421)	\$ (5,017)
Biological assets	(1,330)	724	—	—	(606)
Inventory	(5,088)	1,514	(7,276)	—	(10,850)
Loss carryforward	—	14,028	14,665	—	28,693
Financing costs	—	(2,738)	2,738	—	—
Intangible assets	(3,997)	1,592	(9,951)	—	(12,356)
<b>Net deferred tax asset (liability)</b>	<b>—</b>	<b>419</b>	<b>(134)</b>	<b>(421)</b>	<b>(136)</b>

	Opening August 1, 2019	Recognized in income	Recognized in equity	Ending July 31, 2020
Taxable temporary differences	\$ 6,858	\$ 3,557	\$ —	\$ 10,415
Biological assets	(1,514)	184	—	(1,330)
Inventory	(2,920)	(2,168)	—	(5,088)
Loss carryforward	23,369	(23,369)	—	—
Financing costs	721	(721)	—	—
Intangible assets	(32,537)	28,540	—	(3,997)
<b>Net deferred tax asset (liability)</b>	<b>(6,023)</b>	<b>6,023</b>	<b>—</b>	<b>—</b>

Deferred income taxes reflect the impact of loss carryforwards and of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. At July 31, 2021 deductible temporary differences and unused tax losses for which no deferred tax assets have been recognized are attributable to the following:

	July 31, 2021	July 31, 2020
Deductible temporary differences	\$ 11,556	\$ 8,328
Taxable temporary differences	26,444	8,412
Investments	17,030	14,890
Losses carried forward	278,115	255,635
Research and development expenditures	1,817	669
Fixed Assets, intangibles and other assets	114,384	52,852
Financing costs	40,401	22,599
	489,747	363,385

The Company has approximated non-capital losses available to reduce future years' federal and provincial taxable income which expires as follows:

	\$
2022	219
2023	281
2024	164
2025	748
2026	632
2027	104
2028	2,092
2029	1,350
2030	75
2031	2,867
2032	3,018
2033	4,030
2034	1,772
2035	2,413
2036	12,889
2037	37,244
2038	64,821
2039	57,938
2040	157,595
2041	24,764
Indefinite	1,179
	376,195

## 38. Subsequent Events

### Transfer of US Stock exchange Listing from NYSE to the Nasdaq

On August 13, 2021, the Company applied to transfer its U.S. stock exchange listing from the New York Stock Exchange to the Nasdaq. The transfer was completed on August 24, 2021, at which point the common shares of HEXO began trading as a Nasdaq-listed security with the shares continuing to trade under the symbol "HEXO".

### Closing of Underwritten Public Offering for US\$144.8M

On August 24, 2021, the Company closed an underwritten public offering for total gross proceeds of US\$144,786. The Company sold 49,080,024 units of the Company at a price of US\$2.95 per unit under this offering. Each unit is comprised of one common share of the Company and one half of one common share purchase warrant of the Company. Each full warrant is exercisable to acquire one common share of the Company for a period of five years following the closing date of the Offering at an exercise price of US\$3.45.

### Acquisition of Redecan

On August 30, 2021 the Company completed its acquisition of all of the outstanding shares of the entities that carry on the business of Redecan, a privately-owned licensed producer which serves the Canadian adult-use and medical markets. At closing, HEXO paid the selling shareholders of Redecan \$400,000 in cash and delivered 69,721,116 newly issued common shares of HEXO with an approximate value of \$214,043. Upon closing the acquisition of Redecan, Peter James Montour joined the Company board of directors. Will Montour will act as non-voting observer on the board of directors, until his election to the board in accordance with the investor rights agreement undertaken at acquisition.

The transaction is expected to be treated as business acquisition under IFRS 3, accounted for using the acquisition method.

### Acquisition of 48North Cannabis Corp.

On September 1, 2021, HEXO completed the acquisition of 48North Cannabis Corp. ("48North"), a licensed cannabis producer that serves the Canadian medical and adult-use markets with a brand portfolio that includes: 48North, Trail Mix and Latitude.

The Company acquired all issued and outstanding common shares of 48North at a conversion rate of one common share of 48North to 0.02366 of a HEXO common share. The total number of shares acquired and reissued were 5,352,005 with an approximate value of \$16,951. Shares of 48North were de-listed from the TSX Venture Exchange on September 2, 2021.

The transaction is expected to be treated as business acquisition under IFRS 3, accounted for using the acquisition method.

**Truss Beverage Co. Receives Manufacturing Cannabis Licensing**

On October 1, 2021, Truss LP received their cannabis manufacturing licenses from Health Canada. As of the date of these financial statements, the Company continues to assess the financial and accounting impact of Truss Beverage Co. receiving their cannabis manufacturing license. The Company is in the process of establishing a new agreement between the Company and Truss LP which may result in the Company acting as an agent, facilitating sales between Truss LP and our customers, and therefore the Company would likely cease recording such sales on a gross basis.