ALEAFIA HEALTH INC.

UNAUDITED INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(expressed in Canadian Dollars)

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2019 AND 2018

ALEAFIA HEALTH INC.

Table of Contents | **Page**

November 12, 2019

To the Shareholders of Aleafia Health Inc.:

The accompanying interim condensed consolidated financial statements of Aleafia Health Inc. were prepared by management, which is responsible for the integrity and fairness of the information presented, including the many amounts that out of necessity be based on estimates and judgements. These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards. Financial information presented elsewhere in this report is consistent with these condensed interim consolidated financial statements.

In fulfilling its responsibilities, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded, and financial records are properly maintained to provide reliable information for the preparation of consolidated financial statements.

The Board of Directors oversees the responsibilities of the management for financial reporting through an Audit Committee, which is composed entirely of independent directors. This Committee reviews our condensed interim consolidated financial statements and recommends them to the Board for approval. They meet regularly with the management to review internal control procedures, advise directors on auditing matters and financial reporting issues.

Signed:

"Geoff Benic"
Geoff Benic,
Chief Executive Officer
Toronto, Ontario

"Benjamin Ferdinand"
Benjamin Ferdinand,
Chief Financial Officer
Toronto, Ontario

ALEAFIA HEALTH INC.
Unaudited Interim Condensed Consolidated Statements of Financial Position
As at September 30, 2019 and December 31, 2018
(Expressed in Canadian dollars)

	Note	September 30, 2019	December 31, 2018
		$	$
ASSETS			
CURRENT			
Cash and cash equivalents		51,586,707	26,406,978
Marketable securities		5,585,399	-
Accounts receivable		8,469,882	2,028,332
Prepaid expenses		7,166,912	222,817
Inventory	11	7,817,160	356,359
Biological assets	12	13,657,050	233,333
		94,283,110	29,247,819
NON-CURRENT			
Prepaid deposit for property, plant and equipment		24,875,779	3,749,289
Property, plant and equipment	6	62,128,264	13,779,799
Deferred expenses		1,026,133	-
Right of use asset	3	1,201,124	-
Investments	13	4,616,040	4,000,000
Intangible assets	7	82,571,533	34,373,642
Goodwill	5	186,635,140	12,713,882
		363,054,013	68,616,612
TOTAL ASSETS		**457,337,123**	**97,864,431**
LIABILITIES			
CURRENT			
Accounts payable and accrued liabilities	9	10,246,499	3,281,020
Lease liability	3	476,780	-
Deferred revenue		148,480	213,763
		10,871,759	3,494,783
NON-CURRENT			
Lease liability	3	837,713	-
Convertible debt	14	50,238,454	-
Deferred tax liability		2,356,599	2,436,439
		53,432,766	2,436,439
TOTAL LIABILITIES		**64,304,525**	**5,931,222**
SHAREHOLDERS' EQUITY			
Share capital	8	371,311,464	104,455,368
Warrants	8	44,700,859	748,228
Contributed surplus	8	35,098,099	14,954,088
Deficit		(58,077,824)	(28,224,475)
		393,032,598	91,933,209
TOTAL LIABILITIES AND EQUITY		**457,337,123**	**97,864,431**

COMMITMENTS AND CONTINGENCY (Note 16)

Approved and authorized for issue on behalf of the Board on November 12, 2019

"Julian Fantino"	*"Lea Ray"*
Julian Fantino	Lea Ray
Director	Director

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

ALEAFIA HEALTH INC.
Unaudited Interim Condensed Consolidated Statements of Comprehensive Loss
For Three and Nine months ended September 30, 2019 and 2018
(Expressed in Canadian dollars)

	Note	Three months ended September 30		Nine months ended September 30	
		2019	**2018**	**2019**	**2018**
Revenue		$	$	$	$
Consultation services		714,808	423,685	2,141,442	1,008,747
Research		417,755	612,224	1,404,586	1,247,634
Sale of cannabis		4,156,968	429,146	7,219,541	429,146
Total Revenue		5,289,531	1,465,055	10,765,569	2,685,527
Excise taxes		331,310	-	442,915	-
Net Revenue		4,958,221	1,465,055	10,322,654	2,685,527
Cost of sales					
Doctor Services		496,849	336,286	1,504,405	726,362
Inventory expensed to cost of sales, before fair value adjustment		2,181,872	-	5,756,803	485
Realized fair value adjustment of biological asset		247,854	-	735,040	-
Gross profit before fair value adjustments		2,031,646	1,128,769	2,326,406	1,958,680
Unrealized gain on fair value of biological assets	12	10,365,635	908,907	12,913,256	908,907
Gross profit		12,397,281	2,037,676	15,239,662	2,867,587
Expenses					
Wages and benefits		2,484,302	864,315	6,496,514	2,402,543
General and administration		2,321,093	1,130,357	14,549,945	2,396,021
Business advisory fees		402,886	1,051,702	3,582,237	1,473,177
Amortization and depreciation		2,840,207	1,104,035	3,711,847	1,385,170
Share-based payments		411,209	1,457,476	12,582,165	2,072,401
		8,459,697	5,607,885	40,922,708	9,729,312
Operating Income (loss)		**3,937,583**	**(3,570,209)**	**(25,683,046)**	**(6,861,725)**
Other items					
Interest (income) expense		2,405,327	(174,910)	4,297,566	(286,696)
Unrealized loss on marketable securities		(29,370)	-	825,902	-
Non operating expenses		(297,499)	-	(300,842)	-
Net profit (loss) before income taxes		1,859,125	(3,395,299)	(30,505,672)	(6,575,029)
Deferred Income Tax					
Deferred income tax recovery		-	-	657,464	-
Net profit (loss) and Comprehensive loss for the period		1,859,125	(3,395,299)	(29,848,208)	(6,575,029)
Earnings per share– Basic and diluted		**0.01**	**(0.02)**	**(0.14)**	**(0.06)**
Weighted Average Common Shares Outstanding		**276,233,539**	**135,989,842**	**211,547,125**	**106,139,213**

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

ALEAFIA HEALTH INC.
Unaudited Interim Condensed Consolidated Statements of Changes in Equity
For nine months ended September 30, 2019 and 2018
(Expressed in Canadian dollars)

September 30, 2019	**Common Shares**		**Warrants**				
	Number of Shares	**Amount**	**Number of Warrants**	**Amount**	**Contributed Surplus**	**Deficit**	**Total**
		$		$	$	$	$
Balance, December 31, 2018	**157,848,812**	**104,455,368**	**9,228,590**	**748,228**	**14,954,088**	**(28,229,616)**	**91,928,068**
Shares issued from warrants exercised	1,204,514	1,813,331	(1,204,514)	(138,225)	-	-	1,675,106
Shares issued from options exercised	631,559	990,268	-	-	(1,197,922)	-	(207,654)
Warrants deemed issued for Emblem	-	-	39,286,213	42,775,100	-	-	42,775,100
Warrants issued for Convertible Debt	-	-	27,460,168	-	-	-	-
Warrants issued for Convertible Debt-Issuance costs	-	-	-		-	-	-
Shares issued for conversion of convertible debentures	1,972,784	2,900,000	-	-	-	-	2,900,000
Warrants expired	-	-	(8,040,198)	-	-	-	-
Share options deemed issued for Emblem	-	-	-	-	5,921,622	-	5,921,622
Shares issued for Emblem	110,823,349	252,677,236	-	-	-	-	252,677,236
Shares/Warrants issued for services	2,356,255	5,315,261	1,915,900	1,315,756		-	6,631,017
Equity component of Convertible Debt	-	-	-	-	6,087,070	-	6,087,070
Shares Issued for services	2,000,000	3,160,000	-	-	-	-	3,160,000
Share-based payments	-	-	-	-	9,333,241	-	9,333,241
Net loss for the period	-	-	-	-	-	(29,848,208)	(29,848,208)
Balance, September 30, 2019	**276,837,273**	**371,311,464**	**68,646,159**	**44,700,859**	**35,098,099**	**(58,077,824)**	**393,032,598**

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

ALEAFIA HEALTH INC.
Unaudited Interim Condensed Consolidated Statements of Changes in Equity
For nine months ended September 30, 2019 and 2018
(Expressed in Canadian dollars)

September 30, 2018	Common Shares		Warrants				
	Number of Shares	Amount	Number of Warrants	Amount	Contributed Surplus	Deficit	Total
		$		$	$	$	$
Balance, December 31, 2017	**73,670,000**	**12,285,030**	**-**	**-**	**8,323,573**	**(9,691,899)**	**10,916,704**
Common Shares issued for cash	24,171,000	30,213,750	-	-	-	-	30,213,750
Share issue costs	-	(1,934,840)	-	-	-	-	(1,934,840)
Broker warrants	-	(1,241,212)	2,025,380	1,241,212	-	-	-
Common Shares deemed to be issued on RTO	38,103,461	26,194,098	-	-	-	-	26,194,098
Warrants deemed to be issued on amalgamation	-	-	203,350	59,087	-	-	59,087
Shares for exercised Broker warrants	871,810	1,432,841	(889,810)	(495,591)	-	-	937,250
Shares for exercised Subscriber warrants	2,730,000	4,777,500	-	-	-	-	4,777,500
Warrants issued Canntrust	-	-	500,000	286,657	-	-	286,657
Common shares issued exercise of options	759,472	1,003,910	-	-	(359,448)	-	644,462
Shares issued for Services	1,500,000	930,000	-	-	-	-	930,000
Share - based payments	-	-	-	-	2,072,401	-	2,072,401
Net loss for the period	-	-	-	-	-	(6,575,029)	(6,575,029)
Balance, September 30 , 2018	**141,805,743**	**73,661,077**	**1,838,920**	**1,091,365**	**10,036,526**	**(16,266,928)**	**68,522,040**

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

ALEAFIA HEALTH INC.
Unaudited Interim Condensed Consolidated Statements of Cash Flows
For the nine months ended September 30, 2019 and 2018
(Expressed in Canadian dollars)

	Nine months ended September 30	
	2019	**2018**
	$	$
Cash provided by (used in)		
Operating activities		
Net loss for the period	(29,848,208)	(6,575,029)
Adjustment to reconcile net income (loss) to net cash provided by operating activities		
Depreciation	1,302,481	1,385,170
Amortization	2,247,109	
Share based consulting fees	6,000,469	3,289,058
Stock-based compensation	12,582,165	-
Accretion	1,439,282	-
Gain on sale of Land	(166,029)	-
Deferred income tax recovery	(657,464)	-
Unrealized loss on marketable securities	825,902	-
Unrealized gain on fair value biological assets	(12,913,256)	-
	(19,187,549)	(1,900,801)
Changes in operating assets and liabilities		
Prepaid expenses	(2,910,496)	(292,040)
Accounts receivable	(3,819,897)	(1,026,159)
Marketable securities	594,887	-
Biological asset	(28,365)	(908,907)
Inventory	(2,196,471)	(1,156)
Accounts payable and accrued liabilities	(1,730,394)	751,910
Non -cash working capital acquired on amalgamation	-	(901,590)
Deferred revenues	(65,283)	514,589
Net cash used in operating activities	(29,343,568)	(3,764,154)
Cash flows to investing activities:		
Investment in CannaPacific	(616,040)	-
Cash acquired on amalgamation	22,050,853	6,916,819
Deferred expenses	(1,026,133)	-
Sale proceeds of land	8,709,818	-
Acquisition of property plant and equipment	(13,270,887)	(12,027,038)
Net cash provided by investing activities	15,847,611	(5,110,219)
Cash flows from financing activities:		
Lease liability payments	(467,685)	-
Repayment of mortgage	-	(4,000,000)
Convertible debt	35,744,275	-
Warrants and options exercised	3,299,096	6,359,212
Proceeds from the issuance of common stock	100,000	28,278,909
Net cash provided by financing activities	38,675,686	30,638,121
Change in cash	25,179,729	21,763,748
Cash, beginning of period	26,406,978	1,057,231
Cash, end of period	51,586,707	22,820,979

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

1. NATURE OF OPERATIONS

Aleafia Health Inc. ("Aleafia Health") is a vertically integrated and federally licensed Canadian cannabis company offering health and wellness services. The Company's four primary business units are Cannabis Cultivation & Products, Health & Wellness Clinics, Cannabis Education and Consumer Experience with e-commerce, retail distribution and provincial supply agreements.

The Company owns three cannabis product and cultivation facilities, two of which are licensed and operational. The Company produces a diverse portfolio of commercially proven, high-margin derivative products including flower, pre-rolls, oil drops, oil capsules and oil sprays. Aleafia Health operates the largest national network of medical cannabis clinics and education centers staffed by physicians, nurse practitioners and educators.

The Company's head and registered office is located at 8810 Jane Street, 2nd floor, Concord, Ontario and its corporate website is AleafiaHealth.com.

Aleafia Health was originally incorporated under the *Business Corporations Act* (British Columbia) as Wyn Metals on February 2, 2007. On March 26, 2018, concurrent with the completion of a business combination with Canabo Medical Inc., the Company changed its name to "Aleafia Health Inc." On June 27, 2018, the Company continued into Ontario under the *Business Corporations Act* (Ontario). For further information on these transactions, please refer to the Company's Annual Information Form dated April 29, 2019.

On March 14, 2019, the Company acquired Emblem Corp. by way of a statutory plan of arrangement under the provisions of the *Canada Business Corporations Act* (the "Arrangement"), pursuant to which, among other things, Aleafia Health acquired all of the issued and outstanding common shares of Emblem Corp. following Emblem's amalgamation with Aleafia Health's wholly-owned subsidiary, 11208578 Canada Inc., to form a new wholly-owned subsidiary of the Company continuing as "Emblem Corp." ("Emblem"), see *"Note 5. Business Combination and Asset Acquisition – Emblem Corp.".*

Following the completion of the Arrangement, on March 19, 2019, the common shares of the Company ceased trading on the TSX Venture Exchange Inc. ("TSXV") and commenced trading on the Toronto Stock Exchange ("TSX") under its existing symbol "ALEF". Emblem Shares were delisted from the TSXV on March 18, 2019. The Company's common shares are listed under the symbol "ALEF" on the Toronto Stock Exchange, "ALEAF" on the OTC, "ARAH" on the Frankfurt Stock Exchange (FRA) and "THCX" on the New York Stock Exchange (NYSE).

2. BASIS OF PRESENTATION

These unaudited condensed interim consolidated financial statements as at and for the three months and nine months ended September 30, 2019 and 2018 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and in accordance with IAS 34, Interim Financial Reporting ("IAS 34"). The accounting policies, methods of computation and presentation applied in these unaudited condensed interim consolidated financial statements are consistent with those of the previous fiscal year. These unaudited condensed interim consolidated financial statements reflect the accounting policies and disclosures described in Notes 2, 3 and 4 to the Company's audited consolidated financial statements for the year ended December 31, 2018 with the exception of any change set out below and accordingly, should be read in conjunction with those audited consolidated financial statements and the notes thereto.

2. BASIS OF PRESENTATION (continued)

Biological Assets

The Company measures biological assets consisting of cannabis plants at fair value less cost to sell up to the point of harvest. Unrealized gains or losses arising from the changes in fair value less cost to sell during the period are recognized in the consolidated statement of comprehensive loss. The Company capitalizes all the direct and indirect costs as incurred related to the transformation of biological assets between the initial planting to the point of harvest including labour, labour related, fertilizer, utilities and facility costs and amortization of related production equipment. Seeds are measured at fair market value. Upon harvest, the fair value adjustments including all the capitalized costs are transferred from biological assets to inventory and form the cost basis of the inventory.

Inventory

The Company values inventories of harvested bulk cannabis and finished goods at the lower of cost and net realizable value. Inventories of harvested cannabis are transferred from biological assets at their fair value at harvest, which becomes the initial cost. Fair value includes capitalized costs and unrealized fair value adjustments. Any subsequent post-harvest costs are capitalized to inventory to the extent that cost is less than net realizable value. Inventories of fertilizers and nutrients include costs of purchases net of vendor allowances plus other costs, such as transportation, that are directly incurred to bring the inventories to their present location and condition. 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. The cost of inventories is determined using the weighted average cost basis.

Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage, or declining market prices. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is apparent evidence of an increase in selling price then the amount of the write down previously recorded is reversed. Storage costs, indirect administrative overhead, and certain other selling costs related to inventories are expensed in the period incurred.

As noted above the Company changed its accounting policy to capitalize all of its direct and indirect costs related to the transformation of its biological assets. The differences related to the prior periods from the change in accounting policy, in the Company's opinion, are not considered material and as a result will be made on a prospective basis.

Adoption of IFRS 16 Leases ("IFRS 16")

In January 2016, the IASB issued IFRS 16 – Leases ("IFRS 16") which replaces IAS 17 – Leases and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, distinguishing between a lease and a service contract based on whether the customer controls the asset. For those assets determined to meet the definition of a lease, IFRS 16 introduces significant changes to the accounting by lessees, introducing a single, on-balance sheet accounting model that is similar to the current finance lease accounting, with limited exceptions for short-term leases or leases of low value assets. Lessor accounting remains similar to current accounting practice. IFRS 16 is effective for annual periods beginning on or after January 1, 2019. This standard sets out a new model for lease accounting. A lessee can choose to apply IFRS 16 using either a full retrospective approach or a modified retrospective approach. The Company has applied IFRS 16 at the date it becomes effective using a modified retrospective approach. By applying this method, the comparative information for the 2018 fiscal year has not been restated.

2. BASIS OF PRESENTATION (continued)

At the inception of a contract, the Company assesses whether a contract is or contains a lease. If so, the Company recognizes a right-of-use asset and a lease liability at the lease commencement date. The right of use asset is initially measured at cost, which consists of:

- The amount of the initial measurement of the lease liability
- Any lease payments made at or before the commencement date
- Any indirect costs incurred
- An estimate of costs to dismantle or remove the underlying asset or to restore the site on which the asset is located
- Any incentives received from the lessor

The Company has elected not to recognize right of use assets and lease liabilities for short-term lease that have a lease term of 12 months or less and leases of low value assets. The lease payments associated with these leases are expensed on a straight-line basis over the lease term.

On January 1, 2019, the Company adopted IFRS 16 Leases ("IFRS 16") using the modified retrospective approach which does not require restatement of prior period financial information as it recognizes the cumulative effect as an adjustment to opening retained earnings and applies the standard prospectively.

On adoption of IFRS 16, the Company's lease liabilities related to contracts classified as leases are measured at the discounted present value of the remaining minimum lease payments, excluding short-term and low-value leases. The right of-use assets recognized were measured at amounts equal to the present value of the lease obligations. The weighted average incremental borrowing rate used to determine the lease liability at adoption was approximately 15%. The right-of-use assets and lease liability recognized relate to the Company's premises under lease.

The cumulative effect of initially applying IFRS 16 was recognized as a $1,590,651 right-of-use asset (Note 3) with a corresponding lease liability (Note 3).

In applying IFRS 16 for the first time, the Company used the following practical expedients permitted by the standard:

- Apply a single discount rate to a portfolio of leases with similar characteristics;
- Account for leases with a remaining term of less than 12 months as at January 1, 2019 as short-term leases;
- Account for lease payments as an expense and not recognize a right-of-use asset if the underlying asset is of low dollar value; and
- The use of hindsight in determining the lease term where the contract contains terms to extend or terminate the lease.

Upon the adoption of IFRS 16, the Company adopted the following significant accounting policy effective January 1, 2019:

Leases

A contract is a lease (or may contain a lease) if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. A lease liability is recognized at the commencement of the lease term at the present value of the lease payments that are not paid at that date. At the commencement date, a corresponding right-of-use asset is recognized at the amount of the lease liability, adjusted for lease incentives received, retirement costs and initial direct costs. Depreciation is recognized on the right-of-use asset over the lease term. Interest expense is recognized on the lease liabilities using the effective interest rate method and payments are applied against the lease liability. Payments received for the sublease of right-of-use assets are recognized as sublease revenue.

(Expressed in Canadian dollars)

2. BASIS OF PRESENTATION (continued)

Key areas where management has made judgments, estimates, and assumptions related to the application of IFRS 16 include:

- The incremental borrowing rates are based on judgments including economic environment, term, currency, and the underlying risk inherent to the asset. The carrying balance of the right-of-use assets, lease liabilities, and the resulting interest expense and depreciation expense, may differ due to changes in the market conditions and lease term.
- Lease terms are based on assumptions regarding extension terms that allow for operational flexibility and future market conditions.

3. RIGHT-OF-USE ASSET AND LEASE LIABILITY

RIGHT-OF-USE ASSET

	$
Cost	
Balance, December 31, 2018	-
Recognition upon adoption of IFRS 16	1,590,651
Balance, September 30, 2019	1,590,651
Accumulated Amortization	
Balance, December 31, 2018	-
Amortization	(389,527)
Balance, September 30, 2019	(389,527)
Net book value, December 31, 2018	**-**
Net book value, September 30, 2019	**1,201,124**

LEASE LIABILITY

	$
Balance, December 31, 2018	-
Recognition upon adoption of IFRS 16	1,590,651
Interest expense	247,470
Payments	(523,628)
Balance, September 30, 2019	1,314,493
Current portion of lease liability	**476,780**
Long-term portion of lease liability	**837,713**

The Company recognized right-of-use asset and a corresponding lease liability upon the adoption of IFRS 16 related to its premises under lease (see Note 2). Interest expense is recognized on the lease liabilities and payments are applied against the lease liability.

4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS

The preparation of these consolidated financial statements requires management to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting year. Actual outcomes could differ from these estimates. These consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the

4. SIGNIFICANT ACCOUNTING ESTIMATES AND JUDGMENTS (continued)

financial statements and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the year in which the estimate is revised and future years if the revision affects both current and future years. These estimates are based on historical experience, current and future economic conditions and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, 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.

Biological assets and inventory

In calculating the value of the biological assets and inventory, management is required to make a number of estimates, including estimating the stage of growth of the cannabis up to the point of harvest, harvesting costs, selling costs, sales price, wastage and expected yields for the cannabis plant. In calculating final inventory values, management is required to determine an estimate of spoiled or expired inventory and compares the inventory cost to estimated net realizable value.

Estimated useful lives and impairment considerations

Depreciation and amortization of property, plant and equipment and intangible assets are dependent upon estimates of useful lives, which are determined through the exercise of judgment.
The assessment of any impairment of these assets is dependent upon estimates of recoverable amounts that take into account factors such as economic and market conditions and the useful lives of assets.

Business combinations

Judgment is used in determining whether an acquisition is a business combination or an asset acquisition. In a business combination, all identifiable assets, liabilities and contingent liabilities

acquired are recorded at their fair values. In determining the allocation of the purchase price in a business combination, including any acquisition related contingent consideration, estimates including market based and appraisal values are used. The contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity

Research revenue

Estimates are used when the Company recognizes certain research revenue depending on how frequently patients visit the clinics and what portion of the upfront deposits are considered deferred.

Share-based compensation and warrants

In calculating the share-based compensation expense, key estimates such as the rate of forfeiture of options granted, the expected life of the option, the volatility of the Company's stock price and the risk-free interest rate are used. In calculating the fair value of the warrants, the Company includes key estimates such as the volatility of the Company's stock price, the value of the common share, and the risk-free interest rate.

(Expressed in Canadian dollars)

5. BUSINESS COMBINATION AND ASSET ACQUISITION

Aleafia Farms Inc.

Pursuant to an assignment agreement dated October 4, 2017 (the "Assignment"), Aleafia Inc. was assigned the rights, title and interest to acquire 100% of the issued and outstanding common shares of Aleafia Farms (Note 1) and certain other assets described in a Purchase Agreement dated September 25, 2015 ("Original Purchase Agreement"). Under the terms of Original Purchase Agreement, the purchaser had the rights to acquire 100% of Aleafia Farms and other certain assets for $6,950,000 of which $2,950,000 was to be paid in cash and $4,000,000 could be paid in cash or by an open Vendor Take Back mortgage. The Original Purchase Agreement was amended on December 11, 2017 to include a $4,000,000 Vendor Take Back mortgage at a rate of 3% due on April 1, 2018, secured by the underlying land and buildings and other certain payment terms were amended but the purchase price remained the same. A deposit of $50,000 was paid by the previous purchasers and was not reimbursed by Aleafia Inc. The acquisition of Aleafia Farms was made to directly support its clinic operations.

In consideration for the Assignment Aleafia Inc. paid $1,000,000 in cash and issued 24,000,000 common shares with an estimated fair value of $6,000,000. The acquisition was accounted for as a business combination as the assets acquired and liabilities assumed constitute a business. The transaction was accounted for using the acquisition method of accounting whereby the assets acquired, and the liabilities assumed were recorded at their estimated fair value at the acquisition date.

The Company applied a market approach, and specifically the mergers and acquisition method, for measuring the fair value of the license to produce medical cannabis. This valuation model uses data from actual market transactions regarding the sale of similar companies or groups of assets to determine the price of the asset under review. The Company used other valuation methodologies to value the remaining assets and liabilities.

The allocation of the components of total consideration to the net assets acquired was as follows:

Consideration	**$**
Cash	3,900,000
Vendor take-back mortgage	4,000,000
Common shares issued	6,000,000
Total consideration paid	13,900,000
Net assets acquired	**$**
Buildings	362,472
House	133,240
Land	735,000
License	9,770,000
OPA power contracts	299,000
Deferred income tax liability	(2,464,000)
	8,835,712
Goodwill acquired	5,064,288
Total net assets acquired	13,900,000

The Company repaid the vendor take-back mortgage of $4,000,000 during the prior year.

The resulting goodwill represents the sales and growth potential of Aleafia Farms and will not be deductible for tax purposes.

5. BUSINESS COMBINATION AND ASSET ACQUISITION (continued)

Flying High Brands Inc.

On November 22, 2018, the Company entered into a Master Joint Venture Agreement ("the Agreement") with SPE Finance LLC ("Serruya") to establish a joint venture for the purpose of licensing from Serruya, certain brands of cannabis and cannabis products in Canada. The joint venture was incorporated under the name Flying High Brands Inc. ("FHBI") the Company paid $1,000,000 for 30 common shares of FHBI and issued 6,000,000 common shares with a fair value $12,060,000 for 480 common shares of FHBI. As a result, the Company controls 51% of FHBI. The other 49% is owned by Serruya. In conjunction with the Agreement Serruya entered into a licensing agreement with FHBI for the use of certain name brands. It is intended that FHBI will have multiple income streams throughout the retail value chain and will use the Company's cannabis products for those purposes.

For accounting purposes, the Company controls FHBI and as a result has consolidated its operations from the date of acquisition. The Company determined that this transaction is an asset acquisition as the assets acquired did not constitute a business as defined by IFRS 3. The purchase price of the shares was allocated to intangible assets – license. The Company also incurred acquisition costs of $200,000.

Emblem Corp.

On March 14, 2019, the Company completed the acquisition of Emblem pursuant to a plan of arrangement under the provisions of the Canada Business Corporation Act (the "Arrangement"). Pursuant to the Arrangement, the Company acquired all of the issued and outstanding Emblem shares in exchange for common shares of Aleafia following Emblem's amalgamation with the Company's wholly owned subsidiary, 11208578 Canada Inc., to form a new wholly owned subsidiary of the Company continuing as "Emblem Corp'. Pursuant to the Arrangement, Emblem shareholders were entitled to receive 0.8377 of an Aleafia common share for each Emblem share held prior to the Arrangement (the "Consideration") with any fractional Aleafia common share being rounded down to nearest whole Aleafia Health common share. The Emblem shares were delisted from the TSXV at the close of business on March 18, 2019.

Prior to the completion of the Arrangement, Emblem had outstanding three classes of warrants to purchase Emblem shares listed on TSXV. The listed warrants, with the exception of any listed Emblem Warrants that were exercised prior to closing of the Arrangement, remain outstanding as warrants of "Emblem Corp" that upon exercise will entitle the holder thereof to receive the Consideration.

Former options to purchase Emblem shares were replaced, pursuant to the Arrangement, with replacement Aleafia Health (on the same terms as the Emblem options), such that upon exercise with entitle the holder thereof to receive the Consideration.

The acquisition was accounted for as a business combination as the assets acquired and liabilities assumed constitute a business. The transaction was accounted for using the acquisition method of accounting whereby the assets acquired, and the liabilities assumed were recorded at their estimated fair value at the acquisition date.

The Company applied various valuation techniques in order to measure the assets acquired and the liabilities assumed in the business combination.

The initial accounting for this business combination is incomplete and the Company is reporting provisional amounts for the items for which the accounting is incomplete. These provisional amounts may be adjusted during the measurement period, or additional assets or liabilities may be recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

(Expressed in Canadian dollars)

5. BUSINESS COMBINATION AND ASSET ACQUISITION (continued)

At the date of acquisition, the provisional consideration paid, and estimated fair values of the assets and liabilities of Emblem were as follows:

Consideration	**$**
Common shares issued (110,823,349 shares at $2.28)	252,677,236
Warrants issued	42,775,100
Replacement share options	5,921,622
Total consideration	**301,373,958**

Net assets acquired	**$**
Net Tangible assets	77,585,324
Emblem Brand	9,025,000
Growwise brand	4,428,000
Symbl brand	1,674,000
License	33,416,000
IP R&D	639,000
SDM Distribution agreement	1,263,000
Deferred income tax liability	(577,624)
	127,452,700
Goodwill acquired	173,921,258
Total net assets acquired	**301,373,958**

The resulting goodwill represents the sales and growth potential of Emblem and will not be deductible for tax purposes.

Had the business combination occurred on January 1, 2019, management estimated that the revenue of the Company would have increased by approximately $1,735,000 and the net loss of the Company would have increased by approximately $20,700,000 for the period ended September 30, 2019. Emblem expenses include approximately $13,100,000 in one-time, non-recurring expenses as a result of the acquisition of Emblem by the Company, including advisory fees and termination payments.

BUSINESS AMALGAMATION

On March 26, 2018, Aleafia Inc. and 2412550 Ontario Inc., an indirect subsidiary of Canabo Medical Inc. (“Canabo”) amalgamated pursuant to an Amalgamation Agreement (“Agreement”). Pursuant to the Agreement, all of the shareholders of Aleafia Inc. received one common share of Canabo for each common share of Aleafia Inc. held. In addition, all of the outstanding stock options and share purchase warrants of Aleafia Inc. were exchanged for stock options and share purchase warrants of Canabo on an equivalent basis (the “Transaction”).

Following the completion of the Transaction, Aleafia shareholders held approximately 71% of the total issued shares of Canabo. Canabo will continue to be the listed issuer (the “Resulting Issuer”). The Transaction was treated as a Fundamental Acquisition pursuant to the policies of the TSXV and for financial reporting purposes the Transaction was treated as a reverse-take-over.

(Expressed in Canadian dollars)

5. BUSINESS COMBINATION AND ASSET ACQUISITION (continued)

The reverse-take-over acquisition was recognized as a business combination as Canabo's assets acquired and liabilities assumed constitute a business. The Transaction was accounted for using the acquisition method of accounting whereby the assets acquired, and the liabilities assumed were recorded at their estimated fair value at the acquisition date.

The Company applied various valuation models and methods in order to measure the fair values of the assets acquired and liabilities assumed.

The allocation of the components of total consideration to the net assets acquired was as follows:

Consideration	**$**
Fair value of common shares issued	26,291,388
Fair value of stock options deemed to be issued	163,729
Fair value of warrants deemed to be issued	159,777
Total consideration	26,614,894

Net assets acquired	**$**
Current assets	7,840,722
Equipment	151,145
Intangible asset – brand name	308,765
Intangible asset – patient list	12,415,920
Intangible asset – scientific and medical research assets	849,000
Current liabilities	(1,619,986)
Deferred income tax liability	(980,266)
	18,965,300
Goodwill acquired	7,649,594
Total net assets acquired	26,614,894

The resulting goodwill represents the sales and growth potential of Canabo and will not be deductible for tax purposes.

6. PROPERTY, PLANT AND EQUIPMENT

PROPERTY PLANT AND EQUIPMENT

	Computer and Software	Equipment and Furniture	Leasehold Improvements	Land	Buildings and Houses	Total
Cost	$	$	$	$	$	$
Balance, Dec 31, 2018	205,967	3,070,868	116,837	1,812,852	8,763,698	13,970,222
Business acquisition	42,311	2,232,824	5,301,834	13,062,817	22,969,567	43,609,353
Additions/Disposals	349,911	5,051,316	33,570	(7,238,322)	7,845,117	6,041,592
Balance, September 30, 2019	598,189	10,355,008	5,452,241	7,637,347	39,578,382	63,621,167
Accumulated Depreciation						
Balance, Dec 31, 2018	(75,130)	(35,585)	(31,799)	-	(47,909)	(190,423)
Depreciation	(141,442)	(643,553)	(164,475)	-	(353,010)	(1,302,480)
Balance, September 30, 2019	(216,572)	(679,138)	(196,274)	-	(400,919)	(1,492,903)
Carrying Amounts						
As at Dec 31, 2018	130,837	3,035,283	85,038	1,812,852	8,715,789	13,779,799
As at September 30, 2019	**381,617**	**9,675,870**	**5,255,967**	**7,637,347**	**39,177,463**	**62,128,264**

(Expressed in Canadian dollars)

7. INTANGIBLE ASSETS

	Grow License	OPA Power Contracts	Brand Name	Patient List	SRED	Serruya License	Emblem Brands	License	IP R&D	Agreement	Total
	$	$	$	$	$	$	$	$	$	$	$
Additions from incorporation and acquisitions	9,770,000	299,000	308,765	12,415,920	849,000	12,260,000	-	-	-	-	35,902,685
Amortization	(411,800)	(21,357)	(47,515)	(955,071)	(93,300)		-	-	-	-	(1,529,043)
Balance, December 31, 2018	9,358,200	277,643	261,250	11,460,849	755,700	12,260,000	-	-	-	-	34,373,642
Additions (Note 4)	-	-	-	-	-	-	15,127,000	33,416,000	639,000	1,263,000	50,445,000
Amortization	(293,100)	(16,018)	(46,315)	(931,194)	(90,964)	(681,111)	(90,675)	-	-	(97,732)	(2,247,109)
Balance, September 30, 2019	**9,065,100**	**261,625**	**214,934**	**10,529,655**	**664,736**	**11,578,889**	**15,036,325**	**33,416,000**	**639,000**	**1,165,268**	**82,571,533**

Intangible assets as presented in the schedule arose from separate arms-length transactions:

i) the purchase of Aleafia Farms and
ii) the amalgamation with Canabo Medical Inc.
iii) the acquisition of Flying High Brands Inc.
iv) the acquisition of Emblem Corp.

The transactions and the allocation of the purchase price are described in detail in note 5.

8. SHARE CAPITAL

a) Authorized

The Company is authorized to issue an unlimited number of common shares without par value.

b) Issued and Outstanding

As at September 30, 2019, there were 276,837,273 common shares issued and outstanding

<u>During the nine months ended September 30, 2019, the Company had the following transactions:</u>

The Company issued 1,204,514 common shares from warrants for gross proceeds of $1,657,106.

The Company issued 2,331,255 common shares as a success fee in connection with the Emblem transaction described in Note 5 and the Company issued 2,000,000 shares to Lucas Escott in April 25, 2019 for services rendered for the farms.

On March 14, 2019 in connection with the acquisition of Emblem, the Company issued 110,823,349 common shares as a purchase consideration. The common shares had a fair value of $252,677,236 and were measured using the market price of the Company's shares.

The Company issued 631,559 common shares for gross proceeds of $1,641,715 from exercise of stock options.

During the third quarter ended in September 30,2019 Convertible debt holders redeemed their holdings of $2,900,000 convertible debts into equity and received 1,972,784 equity shares for the value of $2,900,000.

(Expressed in Canadian dollars)

8. SHARE CAPITAL (continued)

c) Warrants

In addition to the issuance of subscribers and broker's warrants as described in Note (b) above, the Company issued 500,000 warrants to CannTrust Inc. ("CannTrust") pursuant to a genetic supply agreement with CannTrust. Warrants are exercisable at $0.55 per share until June 11, 2020. The fair value of the 500,000 warrants was $286,657 and was estimated using the Black-Scholes option pricing model.

As at September 30, 2019 the Company had following warrants outstanding:

Continuity Schedule Warrants: September 30, 2019

	Warrants outstanding	Weighted average exercise price $	Weighted average remaining contractual life (years)
Outstanding and exercisable, September 30, 2019			
Warrants Issued CannTrust	500,000	0.55	0.75
Warrants Issued Emblem	39,286,213	2.47	1.14
Warrants Issued With Convertible Debt	27,370,000	1.55	2.75
Broker Warrants Issued	1,915,900	1.47	2.75
Warrants Exercised	(425,954)	1.39	
Outstanding and exercisable, September 30, 2019	**68,646,159**	**2.04**	

Continuity Schedule Warrants: December 31, 2018

	Warrants outstanding	Weighted average exercise price	Weighted average remaining contactual life (in years)
Outstanding and exercisable, December 31, 2017	-	-	-
Broker Warrants Issued	1,336,920	1.25	0.75
Broker Warrants Issued	668,460	1.75	0.75
Subscriber Warrants Issued	12,085,500	1.75	0.75
Warrants Issued CannTrust	500,000	0.55	1.50
Deemed to be issued on business Amalgamation	203,350	0.50	-
Warrants Exercised	(5,565,640)	1.59	-
Outstanding and exercisable, December 31, 2018	**9,228,590**	**1.67**	**0.80**

(Expressed in Canadian dollars)

8. SHARE CAPITAL (continued)

At September 30, 2019, the Company had outstanding warrants entitling the holders to acquire additional common shares as follows:

Outstanding and Exercisable	Expiry Date	Number of warrants	Weighted Average Exercise price
			$
Warrants Issued by Aleafia	June 11, 2020 - June 27, 2022	29,785,900	1.53
Warrants issued by Legacy Emblem	Dec 6, 2019 - Dec 6, 2021	38,860,259	2.43
Outstanding and exercisable, September 30, 2019		**68,646,159**	2.04

Stock Options

d) Stock Options

The Company has adopted a stock option plan (the "Plan"), providing the Board of Directors with the discretion to issue an equivalent number of options of up to 10% of the issued and outstanding share capital. Stock options are granted with an exercise price of not less than the closing share price of the day preceding the date of grant.

The Company recognizes the fair values of the options granted over the vesting periods and recorded $9,333,241 during the nine months ended September 30, 2019 (nine months ended September 30, 2018 - $2,072,401). The fair values of the stock options granted above were estimated using the Black-Scholes option pricing model with the following assumptions:

The following table summarizes information relating to outstanding and exercisable stock options as at September 30,2019:

Continuity Schedule	Number of Options	Weighted Average Exercise Price
		$
Options Outstanding December 31, 2018	12,651,289	1.01
Options deemed to be issued on business amalgamation	4,626,892	1.71
Options Issued	10,758,495	1.22
Options Cancelled & Expired	(1,841,485)	1.00
Options Exercised	(657,559)	0.48
Options outstanding - September 30, 2019	25,537,632	1.22
Vested, September 30, 2019	19,027,882	1.26
Unvested, September 30, 2019	6,509,750	1.10

(Expressed in Canadian dollars)

8. SHARE CAPITAL (continued)

Share Commitments

Patient operating agreement

On March 28, 2017, Canabo Medical Inc. signed a Patient Operating Agreement ("Agreement") with Peak Pulmonary Consulting Inc. ("Peak Medical Group"). The Peak Medical Group will provide medical marijuana treatments and therapies within the Pinnacle Medical Centers through its wholly-owned subsidiary CieloMed. Pinnacle Medical Centers currently provide medical services to over 55,000 patients in Alberta.

Under the terms of the Agreement, Peak Medical Group will provide physicians and clinic space to assess up to 20,000 new patients under the Company's medical marijuana assessment, prescribing, educational procedures and protocols.

All resulting patients under this Agreement will also be enrolled in the Company's medical data collection program.

Operational services will be provided by Peak Medical Group under the terms of a share exchange agreement ("SEA") with the Company. Under the terms of the SEA, Canabo will acquire all the issued and outstanding shares of CieloMed on the earlier of: CieloMed assessing a minimum of 20,000 patients under the Company's medical marijuana protocols; or five years from the date of the SEA. At closing, based on an 8-day volume weighted average trading price for the year immediately preceding the execution of the Letter of Intent, the Company will issue up to approximately 1,869,000 common shares (up to 5.1% of the issued and outstanding shares of the Company), representing up to a maximum deemed value of $1,600,000 in the Company's shares. Any shares issued under the SEA will be subject to a 12-month voluntary pooling agreement.

The agreement is subject to both parties maintaining certain performance and quality assurance provisions, the execution of the SEA and is subject to TSX-V approval.

9. RELATED PARTY BALANCES AND TRANSACTIONS

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

Key management includes directors and key officers of the Company, including the President, CEO and Chief Financial Officer.

During the year quarter ended September 30,2019 and year ended December 31, 2018, the Company had the following transactions with the officers and directors of the Company.

The following amounts are due to related parties:

	Three Months Ended Sept 30, 2019	Three Months Ended Sep 30, 2018	Nine Months Ended Sept 30, 2019	Nine Months Ended Sept 30, 2018
Wages & Benefits	$230,854	$170,750	$914,805	$787,418

	September 30, 2019	December 31, 2018
	$	$
Accounts payable and accrued liabilities	520,312	26,718

(Expressed in Canadian dollars)

9. RELATED PARTY BALANCES AND TRANSACTIONS (continued)

As at September 30, 2019, the amount of $520,312 was due to directors and officers.

The amounts are non-interest bearing, unsecured and are due upon demand.

10. MANAGEMENT OF CAPITAL

The Company's objectives when managing capital are to sustain sufficient capital base so as to maintain investor, creditor and customer confidence and to sustain the future development of the business. The Company does not have any externally imposed capital requirements to which it is subject.

The Company defines capital as the aggregate of its shareholders' equity, long term debt and convertible debt. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares or dispose of assets or adjust the amount of cash.

11. INVENTORY

The Company values inventories at the lower of cost and net realizable value. Inventories of harvested cannabis are transferred from biological assets at their fair value at harvest, which becomes the initial deemed cost. Any subsequent post-harvest costs are capitalized to inventory to the extent that cost is less than net realizable value. Inventories of fertilizers and nutrients include costs of purchases net of vendor allowances plus other costs, such as transportation, that are directly incurred to bring the inventories to their present location and condition. 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. The cost of inventories is determined using the weighted average cost basis.

Inventories are written down to net realizable value when the cost of inventories is estimated to be unrecoverable due to obsolescence, damage, or declining market prices. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is apparent evidence of an increase in selling price, then the amount of the write down previously recorded is reversed. Storage costs, indirect administrative overhead, and certain other selling costs related to inventories are expensed in the year incurred.

As of September 30, 2019, the Company had $7,817,160 as inventory.

Inventory	**$**
Balance as at December 31, 2018	356,359
Acquisition of Emplem	4,776,012
Transfer from biological assets	335,516
Inventory purchased during the year	2,349,275
Balance as at September 30, 2019	7,817,160

(Expressed in Canadian dollars)

11. INVENTORY (continued)

Inventory is comprised of the following items:

	September 30, 2019
	$
Finished goods	5,614,889
Work-in- Progress	2,174,993
Supplies and consumables	27,278
Total inventory	7,817,160

12. BIOLOGICAL ASSETS

Biological assets are valued in accordance with IAS 41. The Company's biological assets consist of cannabis plants. As there is no actively trading commodity market for these, the valuation of these biological assets is obtained using valuation techniques where the inputs are based upon unobservable market data which are considered to be level 3 inputs under IFRS. These inputs are subject to volatility in market prices and several uncontrollable factors could significantly affect the fair value of biological assets in future. The fair value is determined using a valuation model to estimate expected harvest yield per plant applied to the estimated price per gram less processing and selling costs. The Company capitalizes all the direct and indirect costs as incurred related to the transformation of biological assets and measures biological assets consisting of cannabis plants at fair value less cost to sell up to the point of harvest, which becomes the basis for the cost of finished goods inventories after harvest. Unrealized gains or losses arising from changes in fair value less cost to sell during the year are included in the results of operations of the related year.

The Company's estimates are subject to change and differences from the anticipated yield will be reflected in the gain or loss on biological assets in future years.

As of September 30, 2019, the biological assets strains at the flowering phase were on average 87% complete for indoor and outdoor plants and strains at indoor plants at vegetative state on average 93% complete. As of September 30, 2019, it was estimated that the Company's biological assets would yield approximately 7,308,612 grams of medical cannabis when harvested.

The following table depicts the changes in the fair value measurement (unrealized gain/loss resulting from fair value changes on growth of biological assets) and the fair value of biological assets as of September 30, 2019 as required by IFRS 13 fair value measurement.

The carrying value of biological assets are as follows:

Biological assets

Biological asset are comprised of:	**$**
Balance as at December 31,2018	233,333
Changes in fair value less costs to sell due to biological transformation	12,913,256
Acquisition of Emblem	392,045
Production costs capitalized to biological assets	453,932
Transferred to Inventory upon harvest(reflected as other current assets)	(335,516)
Balance as at September 30,2019	13,657,050

In determining the fair value of biological assets, management had made the following estimates in the valuation model:

(Expressed in Canadian dollars)

12. BIOLOGICAL ASSETS (continued)

Significant assumptions	**Indoor**	**Outdoor**
Average transfer price per gram ($)	4.50	1.25
Average yield per plant (grams)	129	1000
Average stage of growth (weeks)	6	12

	Estimated Grams	**Estimated total**
Bio Assets	**11,715,594**	**$13,657,050**

The Company values medical cannabis plants at fair value. Management determined cost approximates fair value from the date of receiving the vegetative plants until halfway through the flowering cycle of plants. Measurement of the biological transformation of the plant at fair value begins in the fourth week prior to harvest and is recognized evenly until the point of harvest. The number of weeks in the growing cycle is between twelve and sixteen weeks from propagation to harvest.

Management has quantified the sensitivity of the inputs and determined the following:

- Selling price per gram - a decrease in the average selling price per gram by 5% would result in the biological asset value decreasing by $123,117 and inventory decreasing by $12,079.
- Harvest yield per plant - a decrease in the harvest yield per plant of 5% would result in the biological asset value decreasing by $39,194.

The unrealized gain for biological assets for the nine months ended September 2019 was $12,913,256 (September 30, 2018 - $908,907).

13. INVESTMENT

On November 22, 2018, the Company entered into a Master Joint Venture Agreement (“the Agreement”) with SPE Finance LLC (“Serruya”) to establish a joint venture for the purpose of owning and managing retail stores with a focus on selling cannabis and cannabis-related products across Canada and internationally (excluding the United States of America). The intention is to create, fund and govern the operations of the joint venture in the form of a corporation to carry on business. The joint venture was incorporated under the name One Plant (Retail) Corp. (“OPC”).

The Company paid $4,000,000 for the issuance of 99 common shares of OPC and as a result owns 9.9% of the outstanding common shares of OPC.

The Company invested $100,718 in CannaPacific in January 2019 and $515,322 in April 2019.

For accounting purposes, the Company classified its interest in OPC at fair value through profit and loss and as an investment.

(Expressed in Canadian dollars)

14. CONVERTIBLE DEBT

In February 2018, the Company issued convertible debentures (the "Feb 2018 Convertible Debt"). The Feb 2018 Convertible Debt was sold at a price of $1,000 for gross proceeds of $25,000,000, under the

following terms:

- A maturity date of February 2, 2021;
- An interest rate of 8% per annum, payable semi-annually;
- Convertible at $2.39 per share, subject to adjustment in certain events, at the option of the holder; and
- The Company may require the conversion of the full principal amount of the outstanding convertible debentures at the conversion price on not less than 30 days' notice, should the daily volume weighted average trading price of the outstanding common shares of the Company on the TSXV be greater than $3.45 for any 10 consecutive days.

In June 2019, the Company issued 40,250 additional convertible debentures units (the "June 2019 Convertible Debt Unit") for gross proceeds of $40,250,000. The June 2019 Convertible Debt Unit consists of one $1,000 principal amount of unsecured convertible debenture of the Company and 680 common share purchase warrants, under the following terms:

- A maturity date of June 27, 2022;
- An interest rate of 8.5% per annum; payable semi-annually;
- Convertible at $1.55 per share until June 27, 2022 at the option of the holder; and the Company may require conversion of the full principal amount outstanding convertible debenture at the conversion price on not less than 30 days' notice, should the daily volume weighted average trading price of the outstanding common shares of the Company on the TSX be greater than $3.10 for 20 consecutive trading days.
- Debenture debt holders converted $2,900,000 debentures to 1,972,784 equity shares.

	September 30, 2019
	$
Balance at beginning of the period	-
Acquisition of Emblem	19,651,968
Issuance of convertible debentures	40,250,000
Transaction costs deferred	(3,300,954)
Initial present value discounts	(6,087,070)
Amortization of transaction costs	701,518
Amortization of present value discounts	2,087,992
Debentures converted into common shares	(3,065,000)
Balance at end of the period	**50,238,454**

The following schedule illustrates the equity component of convertible **debt issued by Aleafia on June 27, 2019.**

	Fair Value	Percentage composition	Transaction costs allocation	Initial measurement - Fair Value less transaction costs
Convertible Debt	$ 34,162,930	85%	$ 3,300,954	$ 30,861,976
Equity component of convertible Debt	$ 6,087,070	15%	$ 588,156	$ 5,498,914
Total	**$ 40,250,000**	100%	**$ 3,889,110**	**$ 36,360,890**

(Expressed in Canadian dollars)

15. FINANCIAL INSTRUMENTS AND FINANCIAL RISKS

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, marketable securities, accounts receivable, investments, accounts payable, long-term debt and convertible debt.

The following table summarizes the carrying values of the Company's financial instruments by measurement category:

	September 30, 2019	December 31, 2018
	$	$
FVTPL (i)	61,788,145	30,406,978
Assets - Amortized cost (ii)	8,469,882	2,028,332
Liabilities - Amortized cost (iii)	61,799,446	3,281,020

(i) Cash and cash equivalents, investments and marketable securities
(ii) Accounts receivable.
(iii) Accounts payable, long term debt and convertible debt.

The Company classifies its fair value measurements in accordance with an established hierarchy that priorities the inputs in valuation techniques used to measure fair value as follows:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly, and

Level 3 - Inputs that are not based on observable market data.

The following table sets for the Company's financial assets measured at fair value on a recurring basis by level within the fair value hierarchy:

	Fair Value Measurements Using			
	Quoted Prices in Active Markets For Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	**Total**
	$	$	$	**$**
Cash	51,586,707	-	-	**51,586,707**
Marketable securities	3,928,790	-	1,656,608	**5,585,398**
Investments	-	4,616,040	-	**4,616,040**
Total	**55,515,497**	**4,616,040**	**1,656,608**	**61,788,145**

The carrying value of accounts receivable and accounts payable are a reasonable approximation of their fair value due to their short-term nature. The carrying value of long-term debt and convertible debt are a reasonable approximation of their value based on market interest rate for similar instruments as at September 30, 2019.

15. FINANCIAL INSTRUMENTS AND FINANCIAL RISKS (continued)

Risk Management.

Effective risk management is fundamental to the success of the organization and is recognized as key in the Company's overall approach to strategy management. Aleafia has a strong, disciplined risk culture where managing risk is responsibility shared by all of the company's employees.

The primary goals of the risk management are to ensure that the outcomes of risk-taking activities are consistent with Company's strategies and the risk appetite and that there is an appropriate balance between risk and reward in order to maximize shareholder value.

Aleafia has identified the below potential risk categories.

(i) *Currency risk*

The Company's expenses are denominated in Canadian dollars. The Company's corporate office is based in Canada and current exposure to exchange rate fluctuations is minimal.

The Company does not have any significant foreign currency denominated monetary liabilities. The principal business of the Company is the identification and evaluation of assets or a business and once identified or evaluated, to negotiate an acquisition or participation in a business subject to receipt of shareholder approval and acceptance by regulatory authorities. The Company is attracting foreign investors and in future, the Company's financial assets and liabilities will comprise of foreign currency marketable securities, convertible notes, long term investments and promissory notes

(ii) *Interest rate risk*

The Company is exposed to interest rate risk on the variable rate of interest earned on bank deposits. The fair value interest rate risk on bank deposits is insignificant as the deposits are short-term nature.

The Company has not entered any derivative instruments to manage interest rate fluctuations.

(iii) *Credit risk*

Credit risk is the risk of loss associated with the counterparty's inability to fulfill its payment obligations. Financial instruments that potentially subject the Company to concentrations of credit risks consist principally of cash and cash equivalents, trade and other receivables and short-term investments. The risk exposure is limited to their carrying values reflected on the statement of financial position. To minimize the credit risk the Company places these instruments with a high-quality financial institution. There are no expected credit losses as the Company does not invest in asset backed investments. Trade and other receivables mainly consist of trade account receivable and goods and services taxes (GST/HST) recoverable.

(iv) *Liquidity risk*

In the management of liquidity risk of the Company, the Company maintains a balance between continuity of funding and the flexibility through the use of borrowings. The Company manages liquidity risk through the management of its capital structure. As at September 30, 2019 the Company's contractual obligations consist of accounts payable and lease liability, which has a contractual maturity date within one year. Management closely monitors the liquidity position and expects to have adequate sources of funding to finance the Company's projects and operations. Based on the

(Expressed in Canadian dollars)

Company's working capital position and the current ratio analysis at September 30, 2019, management regards the liquidity risk is very minimal.

16. COMMITMENTS AND CONTINGENCIES

The Company has entered into arrangements for office, clinic space, cannabis supply and plant construction contracts:

Commitments	**Less than 2 years**	**2 to 5 years**	**Total**
	$	**$**	**$**
Cannabis supply agreements	100,299,000	228,498,000	328,797,000
Plant construction contracts	5,941,000	-	5,941,000
Long term arrangements on office space	1,151,656	277,529	1,429,185
Service contract	88,000	-	88,000
TOTAL	**107,479,656**	**228,775,529**	**336,255,185**

The Company also has car lease commitments. The minimum lease payments are as follows.

Year	**Amount($)**
2019	4,023
2020	16,093
2021	4,782

The Company has deposited $22,755,625 with Aphria under a Cannabis supply agreement. As per this agreement the parties agree that the amount of Cannabis Product in any monthly Purchase Order will be the Monthly Minimum Quantity.

Certain of Emblem's former executives have been named in a claim that also identifies Emblem in relation to certain services provided by an individual. It is the Company's determination that the claim of $10 million is primarily against the founders of Emblem and not Emblem itself. The claim for damages against Emblem, specifically, is not pleaded with sufficiency particularity to allow an accurate assessment of the quantum of damages being sought against Emblem. The likely measure of damages sought will either be the market value of the services the plaintiff provided to Emblem or the degree to which Emblem was enriched by those services. The Company is of the view that the amount of the claim bears no relationship to the value of the services provided. The outcome of this legal matter is subject to negotiations by the officers of the Company and the Company believes it is unlikely to be impacted and accordingly, no amount has been provided for.

In the ordinary course of business, from time to time, the Company may be involved in various claims related to its commercial and/or corporate activities. Although such matters cannot be predicted with certainty, management does not consider the Company's exposure to these claims to be material to these consolidated financial statements.

17. NOTABLE SUBSEQUENT EVENTS

1. On Oct 4, 2019, the Company completed the construction of its Paris Processing facility Phase II expansion. The facility produces high-margin, value-added cannabis health and wellness products, such as oral spray, oil and other extracts.

2. On October 8, 2019, the Company cancelled a supply agreement with Aphria Inc ("Aphria") due to Aphria's consistent failure to meet supply obligations.