Aleafia Health
SCIENCE SEEDING WELLNESS

ALEAFIA HEALTH INC.

UNAUDITED INTERIM CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS
(expressed in Canadian Dollars)
FOR THE NINE MONTHS ENDED
SEPTEMBER 30, 2021 and 2020

MANAGEMENT'S RESPONSIBILITY

To the Shareholders of Aleafia Health Inc.:

The accompanying unaudited interim condensed consolidated financial statements of Aleafia Health Inc. and its subsidiaries (the "Company") were prepared by management, which is responsible for the integrity and fairness of the information presented, including the many amounts that out of necessity are based on estimates and judgements. These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards.

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 these interim condensed consolidated financial statements.

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

November 11, 2021

"Geoffrey Benic"	*"Matthew Sale"*
Geoff Benic Chief Executive Officer	Matthew Sale Chief Financial Officer

ALEAFIA HEALTH INC.

Unaudited Interim Condensed Consolidated Statements of Financial Position

As at September 30, 2021 and December 31, 2020

(Amounts reflected in thousands of Canadian dollars)

	Note	September 30, 2021	December 31, 2020
		$	$
ASSETS			
Current			
Cash and cash equivalents		**4,688**	30,529
Marketable securities	3	**6,650**	—
Trade and other receivables		**8,224**	13,041
Tax receivables		**2,165**	4,537
Prepaids and deposits		**4,031**	5,063
Inventory	9	**33,868**	27,242
Biological assets	10	**10,268**	2,511
		69,894	82,923
Non-current			
Property, plant, and equipment	5	**73,927**	78,469
Deferred expenses		—	460
Right-of-use assets	4	**2,051**	2,782
Investments	11	**6,836**	6,620
Intangible assets	6	—	54,715
Goodwill	6	—	11,314
		82,814	154,360
TOTAL ASSETS		**152,708**	237,283
LIABILITIES			
Current			
Accounts payable and accrued liabilities	8	**20,492**	20,166
Lease liability	4	**515**	441
Credit facility	13	**9,942**	—
Convertible debt	12	**34,741**	24,361
Deferred revenue		**60**	73
		65,750	45,041
Non-current			
Lease liability	4	**2,018**	2,726
Convertible debt	12	—	32,441
Deferred tax liability		—	2,854
		2,018	38,021
TOTAL LIABILITIES		**67,768**	83,062
SHAREHOLDER'S EQUITY			
Share capital	7	**404,347**	384,265
Contributed surplus	7	**89,868**	85,025
Deficit		**(409,275)**	(315,069)
		84,940	154,221
TOTAL LIABILITIES AND EQUITY		**152,708**	237,283

COMMITMENTS AND CONTINGENCIES (Note 16)

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

Approved and authorized for issue on behalf of the board on November 11, 2021.

"Carlo Sistilli" — Carlo Sistilli - Director

"Lu Galasso" — Lu Galasso - Director

ALEAFIA HEALTH INC.

Unaudited Interim Condensed Consolidated Statements of Loss and Comprehensive Loss

For the three months and nine months ended September 30, 2021 and 2020

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

	Notes	September 30, 2021	September 30, 2020	September 30, 2021	September 30, 2020
		$	$	$	$
Revenue					
Sale of cannabis		**11,843**	4,434	**29,093**	27,637
Clinic revenue	2	**95**	723	**2,005**	2,373
		11,938	5,157	**31,098**	30,010
Excise taxes		**2,357**	189	**3,779**	671
		9,581	4,968	**27,319**	29,339
Cost of sales					
Doctor services		**–**	372	**1,128**	1,081
Costs of goods sales		**13,114**	4,141	**22,698**	12,686
Gross profit before fair value adjustment		**(3,533)**	455	**3,493**	15,572
Fair value changes in biological assets and changes in inventory sold	10	**3,435**	(10,708)	**6,086**	(18,027)
Gross profit (loss)		**(98)**	(10,253)	**9,579**	(2,455)
Expenses					
General and administrative		**2,772**	3,751	**11,385**	9,792
Wages and benefits		**4,233**	1,917	**10,875**	7,514
Amortization and depreciation		**1,836**	3,273	**5,349**	7,515
Share-based compensation expense		**1,050**	648	**2,168**	2,108
Bad debt expense		**2,225**	500	**9,944**	904
Business transaction costs		**865**	816	**3,379**	3,322
		12,981	10,905	**43,100**	31,155
Other expenses (income)					
Interest expense, net		**1,982**	3,062	**5,975**	8,538
Realized gain on LP settlement		**–**	–	**–**	(6,344)
Gain on sale of assets	3	**–**	–	**(12,092)**	–
Unrealized loss (gain) on marketable securities	3	**6,300**	(61)	**5,600**	(66)
Impairment of intangible assets	6	**53,093**	–	**53,093**	–
Impairment of goodwill	6	**11,314**	–	**11,314**	–
Non-operating loss (income)		**8**	(4)	**(351)**	(407)
		72,697	2,997	**63,539**	1,721
Net loss before income taxes		**(85,776)**	(24,155)	**(97,060)**	(35,331)
Income tax					
Current income tax recovery		**–**	(1,400)	**–**	–
Deferred income tax recovery		**(2,854)**	(2,994)	**(2,854)**	(5,394)
Net loss and comprehensive loss		**(82,922)**	(19,761)	**(94,206)**	(29,937)
Loss per share, basic and diluted		**(0.25)**	(0.06)	**(0.29)**	(0.10)
Weighted average common shares outstanding		**330,911,197**	301,004,648	**324,288,393**	288,339,792

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 the nine months ended September 30, 2020 and 2021

(Amounts reflected in thousands of Canadian dollars, except share and warrant amounts)

	Number of Shares	Amount	Contributed Surplus	Deficit	Total
	#	$	$	$	$
Balances, December 31, 2020	301,269,686	384,265	85,025	(315,069)	154,221
Share issuance costs	–	(1,714)	–	–	(1,714)
Issuance of common shares	27,777,500	19,053	3,836	–	22,889
Shares issued under stock option plan	781,250	959	(334)	–	625
Shares issued under deferred share unit plan	89,709	65	–	–	65
Shares issued from warrants exercised	1,050,890	1,719	(958)	–	761
Warrants issued	–	–	131	–	131
Share-based compensation expense	–	–	2,168	–	2,168
Net loss for the period	–	–	–	(94,206)	(94,206)
Balances, September 30, 2021	**330,969,035**	**404,347**	**89,868**	**(409,275)**	**84,940**

	Number of Shares	Amount	Contributed Surplus	Deficit	Total
	#	$	$	$	$
Balances, December 31, 2019	277,893,686	371,744	80,601	(67,831)	384,514
Issuance of common shares	23,000,000	12,383	–	–	12,383
Shares issued under stock option plan	375,500	635	(541)	–	94
Shares issued from warrants exercised	500	–	–	–	–
Warrants issued	–	–	567	–	567
Share-based compensation expense	–	–	3,109	48	3,157
Net loss for the period	–	–	–	(29,937)	(29,937)
Balances, September 30, 2020	**301,269,686**	**384,762**	**83,736**	**(97,720)**	**370,778**

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, 2020 and 2021
(Amounts reflected in thousands of Canadian dollars)

	September 30, 2021	September 30, 2020
	$	$
Operating activities		
Net loss for the period	**(94,206)**	(29,937)
Adjustments for non-cash items:		
Depreciation	**4,941**	4,493
Amortization	**1,622**	3,022
Share-based compensation expense	**2,168**	3,157
Interest accretion	**4,182**	4,223
Bad debt expense	**9,944**	–
Deferred income tax recovery	**(2,854)**	(5,394)
Realized gain on LP settlement	**–**	(6,344)
Gain on sale of assets	**(12,092)**	–
Unrealized loss on marketable securities	**5,600**	66
Impairment of intangible assets	**53,093**	–
Impairment of goodwill	**11,314**	–
Fair value changes in biological assets and changes in inventory sold	**(6,086)**	18,027
	(22,374)	(8,687)
Changes in operating working capital:		
Marketable securities	**–**	(7,397)
Trade receivable	**(5,343)**	(5,820)
Tax receivable	**2,372**	1,874
Prepaids and deposits	**173**	17,289
Inventory	**(5,167)**	15,085
Biological assets	**(798)**	(34,422)
Accounts payable and accrued liabilities	**1,609**	5,216
Deferred revenue	**(13)**	(46)
Cash received from LP settlement	**–**	15,500
Net cash used in operating activities	**(29,541)**	(1,408)
Investing activities		
Investment in retail store operations	**–**	(907)
Deferred expenses	**460**	222
Acquisition of property, plant and equipment	**(2,664)**	(17,216)
Net cash used in investing activities	**(2,204)**	(17,901)
Financing activities		
Lease liability payments	**(1,007)**	(423)
Repayment of convertible debt	**(25,650)**	–
Warrants and stock options exercised	**1,386**	94
Proceeds from credit facility	**10,000**	–
Proceeds from the issuance of common shares	**21,175**	12,950
Net cash provided by financing activities	**5,904**	12,621
Change in cash and cash equivalents	**(25,841)**	(6,688)
Cash and cash equivalents, beginning of period	**30,529**	41,247
Cash and cash equivalents, end of period	**4,688**	34,559

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

Note 1 Nature of Operations

Aleafia Health (the "Company") is a publicly traded corporation incorporated under the laws of Ontario. Aleafia Health's head and registered office is currently located at 85 Basaltic Road, Concord, Ontario and its corporate website is www.AleafiaHealth.com.

The Company is a vertically integrated and federally licensed Canadian cannabis company offering cannabis health and wellness services and products in Canada. The Company has developed an international footprint, with subsidiaries or investments in German and Australian medical cannabis companies and makes products available in both markets. The Company owns and operates a virtual network of medical cannabis clinics staffed by physicians and nurse practitioners.

The Company owns three licensed cannabis production facilities and operates a strategically located distribution centre all in the province of Ontario, including the first large-scale, outdoor cultivation facility in Canadian history. The Company produces a diverse portfolio of cannabis and cannabis derivative products including oils, capsules, edibles, sublingual strips, and vapes, for sale in Canada in the medical and adult-use markets, and in select international jurisdiction.

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").

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" which was subsequently changed to "AH"on May 27, 2020. Emblem Shares were delisted from the TSXV on March 18, 2019.

As at September 30, 2021, the Company had not generated a profit and had accumulated a deficit of $409,275. The Company's operations and expenditures have been funded by the issuance of equity, a credit facility and convertible debt. Refer to Note 14, liquidity risk for further discussion.

The Board of Directors approved these interim condensed consolidated financial statements on November 11, 2021.

Note 2 Basis of Presentation

These unaudited interim condensed consolidated financial statements as at and for the nine months ended September 30, 2021 and 2020 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 interim condensed consolidated financial statements reflect the accounting policies and disclosures described in Note 2 and to the Company's audited consolidated financial statements for the year ended December 31, 2020, and accordingly, should be read in conjunction with those audited consolidated financial statements and the notes thereto.

The unaudited interim condensed consolidated financial statements have been prepared on the historical cost basis, with the exception of financial instruments which are measured at fair value. In addition, these unaudited interim condensed consolidated financial statements have been prepared using the accrual basis of accounting, except for cash flow information. The functional currency of the Company and its wholly owned subsidiaries is the Canadian dollar.

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

Consolidation

These consolidated financial statements comprise the financial statements of the Company and its subsidiaries, as presented below. Subsidiaries are those entities which the Company controls by having the power to govern the financial and operational policies of the entity. This control is generally evidenced through owning more than 50% of the voting rights or currently exercisable potential voting rights of a company's share capital. All intercompany transactions and balances have been eliminated.

Subsidiary	Ownership
	%
Aleafia Inc.	100
Canabo Medical Corporation ("Canabo")	100
Aleafia Farms Inc. ("Aleafia Farms")	100
Emblem Corp. ("Emblem")	100
Emblem Cannabis Corporation ("ECC")	100
GrowWise Health Limited ("GrowWise")	100
Emblem Realty Limited ("Emblem Realty")	100
Emblem Germany GmbH	60
Aleafia Brands Inc. (inactive)	100
Aleafia Retail Inc. (inactive)	100
2672533 Ontario Inc (inactive)	100
2676063 Ontario Inc.(inactive)	100

Reclassification of comparative period presentation

Certain prior period amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations, only classifications of certain revenue classifications. Consultation revenue and research revenue have been combined and renamed clinic revenue due to the declining significance of these revenue sources.

	Three months ended		Nine months ended	
	Sept 30, 2021	**Sept 30, 2020**	**Sept 30, 2021**	**Sept 30, 2020**
Reclassification:	$	$	$	$
Consultation revenue	**95**	474	**1,486**	1,414
Research revenue	**–**	249	**519**	959
Clinic revenue	**95**	723	**2,005**	2,373

Additionally, the following distribution costs related to sales have been reclassified from general and administrative to cost of sales.

Three months ended		Nine months ended	
Sept 30, 2021	**Sept 30, 2020**	**Sept 30, 2021**	**Sept 30, 2020**
$	$	$	$
450	252	**1,257**	712

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

Note 3 Marketable Securities

On May 10, 2021, the Company (specifically, wholly owned subsidiaries, Canabo and GrowWise) completed the sale of certain clinic related assets to Myconic Capital Corp (d.b.a Ketamine One Capital Limited). Pursuant to the Asset Purchase Agreement (the "APA"), certain inventory and equipment was sold, in addition to the assignment of research revenue and clinic leases. The Company continues to staff and operate the clinics through a services agreement. In consideration for the sale and assignment of certain agreements, Myconic Capital Corp, issued and delivered a total of 7,000,000 common shares subject to statutory and contractual lock up provisions, with a fair value of $12,250 on the date of closing.

The sale resulted in the derecognition of certain right of use assets with a net book value of $255 and related lease obligations of $330. In addition, equipment with a net book value of $232 were sold.

The gain on sale of Canabo and GrowWise net assets was determined as follows:

	$
Consideration	12,250
Assets sold/assigned	(487)
Liabilities assumed	329
Gain on sale	**12,092**

The Myconic Capital Corp common shares are classified as fair value through profit and loss. The marketable securities are classified as Level 1 on the fair value hierarchy as they have quoted prices in an active market.

During the third quarter of 2021, 2,100,000 common shares became available to trade. The remaining 4,900,000 common shares become available to trade as follows:

Number of shares	Earliest trade date
1,750,000	November 11, 2021
1,750,000	February 11, 2022
1,400,000	May 11, 2022

During the three and nine months ended September 30, 2021, the Company recorded an unrealized loss on the shares of Myconic Capital Corp for $6,300 and $5,600, respectively. This has been recorded in the unaudited interim condensed consolidated statements of loss and comprehensive loss as other expenses with a corresponding decrease to marketable securities on the unaudited interim condensed consolidated statements of position.

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

Note 4 Right-of-Use Asset and Lease Liability

RIGHT-OF-USE ASSET

	$
Cost	
Balance, December 31, 2019	1,591
New leases	2,472
Termination of lease	(69)
Balance, December 31, 2020	3,994
New leases	130
Termination of lease	(1,210)
Balance, September 30, 2021	2,914
Accumulated amortization	
Balance, December 31, 2019	(520)
Amortization	(692)
Balance, December 31, 2020	(1,212)
Termination of lease	682
Amortization	(333)
Balance, September 30, 2021	(863)
Net book value, December 31, 2020	2,782
Net book value, September 30, 2021	**2,051**

LEASE LIABILITY

	$
Balance, December 31, 2019	1,207
New leases	2,472
Derecognition of lease liability	(69)
Interest accretion	695
Payments	(1,138)
Balance, December 31, 2020	3,167
New leases	130
Derecognition of lease liability	(350)
Interest accretion	593
Payments	(1,007)
Balance, September 30, 2021	**2,533**
Current portion	**515**
Long-term portion	**2,018**

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

Note 5 Property, Plant and Equipment

	Computer and Software	Equipment and Furniture	Leasehold Improvements	Land	Buildings	Total
	$	$	$	$	$	$
Cost						
Balance, December 31, 2019	758	12,025	5,453	7,637	40,446	66,319
Additions	218	1,955	320	100	18,796	21,389
Balance, December 31, 2020	976	13,980	5,773	7,737	59,242	87,708
Additions	54	2,672	28	—	1,434	4,188
Disposals	(315)	(965)	(175)	—	(892)	(2,347)
Balance, September 30, 2021	715	15,687	5,626	7,737	59,784	89,549
Accumulated depreciation						
Balance, December 31, 2019	(225)	(803)	(272)	—	(681)	(1,981)
Depreciation	(193)	(2,013)	(311)	—	(4,741)	(7,258)
Balance, December 31, 2020	(418)	(2,816)	(583)	—	(5,422)	(9,239)
Depreciation	(119)	(1,683)	(239)	—	(4,891)	(6,932)
Disposals	244	179	126	—	—	549
Balance, September 30, 2021	(293)	(4,320)	(696)	—	(10,313)	15,622)
Net book value						
As at December 31, 2020	558	11,164	5,190	7,737	53,820	78,469
As at September 30, 2021	**422**	**11,367**	**4,930**	**7,737**	**49,471**	**73,927**

Depreciation relating to manufacturing equipment and production facilities for owned and right-of-use lease assets is capitalized to biological assets and inventory and is expensed to cost of sales upon the sale of goods. During the nine months ended September 2021, the Company recognized depreciation expense of $6,932 (September 30, 2020 – $4,449), of which $536 (September 30, 2020 – $Nil) was included in cost of sales, $4,073 (September 30, 2020 – $Nil) was included in operating expenses, and the remaining balance of $2,323 (December 31, 2020 – $Nil) was included in biological assets and inventory.

During the nine months ended September 30, 2021, the Company had additions of $4,188, of which $859 was previously recorded as deposit on the consolidated statements of financial position.

Note 6 Goodwill and Intangible Assets

Goodwill and Intangible Asset Impairment

During the three months ended September 30, 2021, the Company recognized non-cash impairment charges of $11,314 related to goodwill and $53,093 related to its intangible assets subject to amortization. In response to indicators of impairment identified during the third quarter, the Company performed an impairment analysis on its intangible assets subject to amortization and goodwill for each cash generating unit ("CGU"). The recoverable amounts for each CGU were based on its value in use ("VIU") which was determined to be less than its carrying value. The VIU was estimated using level 3 inputs and a discounted cash flow analysis approach. The significant assumptions applied in the determination of the recoverable amount are described below for the discounted cash flow method: Estimated cash flows were projected based on actual operating results from internal sources as well as industry and market trends. Estimated cash flows are based on historical trends, planned growth initiatives, industry and market growth trends and third party research reports and estimates. The Company utilized a five-year forecast and accounted for long-term growth using a terminal value assuming a 2.5% growth rate. The weighted average cost of capital ("WACC") was estimated based on the risk-free rate, equity risk premium and after-tax cost of debt. As a result of the analysis, it was determined that all three CGU's had carrying values greater than the recoverable amounts. As at September 30, 2021, the net book value of the goodwill and intangibles is $Nil (December 31, 2020 – goodwill $11,314; intangible assets $54,714).

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

	Grow License	Patient List	Brand Licenses	Emblem Brands	Emblem License	Other	Total
	$	$	$	$	$	$	$
Cost							
Balance, December 31, 2019	9,770	12,416	12,260	15,100	34,000	3,357	86,903
Impairment write down	—	(12,416)	(12,260)	(1,931)	—	(1,158)	(27,765)
Balance, December 31, 2020	9,770	—	—	13,169	34,000	2,199	59,138
Impairment write down	(9,770)	—	—	(13,169)	(34,000)	(2,199)	(59,138)
Balance, September 30, 2021	—	—	—	—	—	—	—
Accumulated depreciation							
Balance, December 31, 2019	(803)	(2,197)	(885)	(130)	(1,122)	(515)	(5,651)
Amortization	(391)	(1,242)	(818)	(165)	(1,413)	(388)	(4,421)
Impairment write down	—	3,439	1,703	—	—	507	5,649
Balance, December 31, 2020	(1,194)	—	—	(295)	(2,539)	(396)	(4,423)
Depreciation	(293)	—	—	(110)	(1,063)	(155)	(1,621)
Impairment write down	1,487	—	—	405	3,601	551	6,044
Balance, September 30, 2021	—	—	—	—	—	—	—
Net book value							
As at December 31, 2020	8,576	—	—	12,874	31,461	1,803	54,715
As at September 30, 2021	—	—	—	—	—	—	—

During the nine months ended September 30, 2021, the Company recognized amortization expense of $1,622 (September 30, 2020 – $3,315), of which $679 (September 30, 2020 – $Nil) was included in cost of sales and $943 (September 30, 2020 – $Nil) was included in operating expenses.

Note 7 Share Capital

Authorized

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

Issued and Outstanding

As at September 30, 2021, there were 330,969,035 common shares issued and outstanding.

During the nine months ended September 30, 2021, the Company issued 387,500 common shares, under its at-the-market equity program with an average price per share of $0.40, resulting in net proceeds of $154.

On March 9, 2021, the Company closed a bought deal offering for a total issuance of 27,390,000 units of the Company at a price per unit of $0.83 for gross proceeds of $22,700, which includes a partial exercise of the over-allotment option. Each unit consists of one common share in the capital of the Company and one-half of one common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at an exercise price of $1.05, for a period of 24 months following the closing of the offering. On March 9, 2021, the market price of the Company's common shares was $0.69 per share. Using the residual method, the Company assigned a total value of $3,800 to the 13,695,000 warrants issued. The Company paid $1,700 in transaction costs. In connection with the bought deal, the Company issued 621,000 compensation warrants to the brokers. Each of the compensation warrant entitles the holder to purchase one common share at an exercise price of $0.83, for a period of 24 months following the closing of the offering. The fair value of the compensation warrants was determined to be nominal.

During the nine months ended September 30, 2021, the Company issued 781,250 common shares for stock options exercised with gross proceeds of $625. The Company reclassified fair value of $334 for the options from contributed surplus to share capital in connection with the option exercises.

During the nine months ended September 30, 2021, the company issued 89,709 common shares for deferred share units ("DSUs") exercised. As a result, the DSU liability was reduced by $65 with a corresponding increase to share capital.

During the nine months ended September 30, 2021, the Company issued 1,050,890 common shares for warrants exercised with gross proceeds of $761. The Company reclassified the fair value of $958 for the warrants from contributed surplus to share capital in connection with the warrant exercises.

During the year ended December 31, 2020, the Company issued 23,000,000 common shares at a price of $0.65 per share for aggregate gross proceeds of $15,000 which includes the full exercise of the over-allotment option and paid $1,000 as transaction costs in cash and issuance of brokers' warrants. Each unit consisted of one common share of the Company and one half of one common share purchase warrant with an exercise price of $0.80 and expiring in three years. In connection with the bought deal, the Company issued 1,207,500 compensation warrants and 11,500,000 subscriber warrants to the shareholders.

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 20% 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.

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

The total stock option expense recognized as share-based compensation expense for the nine months ended September 30, 2021 was $2,168 (September 30, 2020 – $2,108).

The following table summarizes information relating to outstanding and exercisable stock options as of December 31, 2020 and September 30, 2021:

	Options	Weighted average exercise price
	#	$
Balance, December 31, 2019	24,979,725	1.22
Granted	5,030,431	0.52
Exercised/released	(375,500)	0.25
Forfeited/cancelled/expired	(3,374,024)	1.55
Balance December 31, 2020	26,260,632	1.06
Granted	8,624,569	0.45
Exercised/released	(781,250)	0.65
Forfeited/cancelled/expired	(2,180,000)	0.26
Balance, September 30, 2021	**31,923,951**	**0.96**
Vested, September 30, 2021	20,980,742	1.18
Unvested, September 30, 2021	10,943,209	0.53

The fair values of the stock options granted during the nine months ended September 30, 2021, were estimated using the Black-Scholes option pricing model with following weighted average assumptions:

Weighted average share price	$0.24
Weighted average risk-free interest rate	0.55%
Weighted expected life-years	2.8 years
Weighted average expected volatility	89%
Weighted expected dividends	Nil
Forfeiture rate	0%

Restricted Share Units (“RSUs”)

The Company has a restricted share unit plan (the “RSU Plan”). For each RSU granted under the plan, the Company recognizes an expense equal to the market value of a common share at the date of grant based on the number of RSUs expected to vest over the term of the vesting period, with a corresponding credit to equity for share-based compensation expense anticipated to be equity settled. RSUs under the RSU plan may vest immediately or become exercisable in various increments based on conditions as determined by the Board. In determining the amount of share-based compensation, the Company used the closing price of the common shares on the RSU grant date.

During the nine months ended September 30, 2021, 1,110,000 RSUs were granted (December 31, 2020 – $Nil) with a fair value of $0.42 per RSU. The RSUs vest in tranches with 1/12 vesting every three months over 36 months, commencing September 30, 2021. An additional 114,000 RSUs were granted which cliff vest on April 1, 2022. The total RSU expense recognized as share-based compensation expense for the nine months ended September 30, 2021, was $61 (September 30, 2020 – $Nil).

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

A summary of the RSUs granted and outstanding as at September 30, 2021 is as follows:

	#
Balance, December 31, 2020	–
Granted	1,110,000
Exercise/released	(83,000)
Balance, September 30, 2021	**1,027,000**

Deferred Share Unit Plan for Directors

At the Company's annual general meeting on June 30, 2020, shareholders passed a resolution approving the Aleafia Health Inc. a deferred share unit plan (the "DSU Plan"), which was implemented in during the year ended December 31, 2020.

The purpose of the DSU Plan is to promote a greater alignment of long-term interests between eligible participants (being non-executive directors only) and the Company and its shareholders, to provide a compensation system for non-employee directors that, together with the other director compensation mechanisms of the Company, is reflective of the responsibility, commitment and risk accompanying membership on the Board and the performance of the duties required of the various committees of the Board.

The deferred share units are settled in either cash or shares or combination of both, at the election of the board of Directors. The DSUs have been classified at liability in anticipation of cash settlement and are revalued at each reporting period using the quarter end trading price.

During the nine months ended September 30, 2021, the Company issued 491,433 DSUs (December 31, 2020 – 148,431 DSUs). As at September 30, 2021, there were 447,100 DSUs issued and outstanding. As at September 30, 2021, the fair value of the DSU liability is $127 (December 31, 2020 – $73). The DSU liability is included in accounts payable and accrued liabilities on the unaudited interim consolidated statements of financial position.

A summary of the DSUs granted and outstanding as at September 30, 2021 is as follows:

	#
Balance, December 31, 2020	148,431
Granted	491,433
Exercised/released	(192,764)
Balance, September 30, 2021	**447,100**

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

Warrants

As at December 31, 2020 and September 30, 2021, the Company had the following warrants outstanding:

	Warrants outstanding	Weighted average exercise price
	#	$
Balance, December 31, 2019	60,264,816	2.05
Issued	12,707,000	0.80
Exercised	(500)	0.80
Expired	(22,749,342)	3.12
Balance, December 31, 2020	50,221,974	1.17
Issued	15,316,000	0.99
Exercised	(1,050,890)	0.74
Expired	(1,003,663)	0.90
Balance, September 30, 2021	**63,483,421**	**1.16**

On September 30, 2021, the Company had outstanding warrants entitling the holders to acquire additional common shares as follows:

	Expiry date	Warrants	Weighted average exercise price
		#	$
Warrants Issued by Aleafia	June 27, 2022 - May 29, 2023	56,463,650	1.19
Legacy warrants issued by Emblem	June 23, 2021 - Dec 6, 2021	7,019,771	0.90
Outstanding and exercisable, September 30, 2021		**63,483,421**	**1.16**

Note 8 Related Party Balances and Transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the otherparty or exercise significant influence over the other party in making financial and operating decisions. Related parties may be individuals or corporate entities to which directors and management are affiliated with. 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 management of the Company.

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

The Company had the following transactions with the officers and directors of the Company for the nine months ended:

	September 30, 2021	September 30, 2020
	$	$
Wages and Benefits: Directors	529	105
Wages and Benefits: Management	1,887	1,457
Share based compensation: Directors	57	207
Share based compensation: Management	903	2,015
	3,515	**2,625**

As at September 30, 2021, an amount of $139 was due to directors and management (December 31, 2020 – $150). These amounts are non-interest bearing, unsecured, due on demand and included in accounts payable and accrued liabilities on the unaudited interim consolidated statements of financial position.

Note 9 Inventory

Inventory is comprised of the following items as at:

	September 30, 2021	December 31, 2020
	$	$
Finished goods	3,009	3,890
Work-in-progress	30,917	21,919
Supplies and consumables	2,324	1,433
Inventory provision	(2,382)	–
Total inventory	**33,868**	**27,242**

During the quarter, the Company estimated an inventory provision for slow moving inventory and write downs to net realizable value in the amount of $2,382. This is recorded to cost of sales in the unaudited interim consolidated statements of loss and comprehensive loss.

The fair value adjustment to biological assets and inventory sold consists of the following for the nine months ended:

	September 30, 2021	September 30, 2020
	$	$
Realized fair value amounts included in inventory sold	5,221	33,116
Change in fair value on growth of biological assets	(11,307)	(15,089)
Loss (gain)	**(6,086)**	**18,027**

Note 10 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 traded 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 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.

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

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, 2021, the biological assets strains consisted of indoor plants which were on average 44% complete and outdoor plants which were on average 92% complete.

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 December 31, 2020 and September 30, 2021 as required by IFRS 13 fair value measurement.

	$
Balance, December 31, 2019	971
Changes in fair value less costs to sell due to biological transformation	7,870
Production costs capitalized to biological assets	5,419
Transferred to inventory upon harvest	(11,749)
Balance, December 31, 2020	2,511
Changes in fair value less costs to sell due to biological transformation	11,307
Production costs capitalized to biological assets	9,764
Transferred to inventory upon harvest	(13,314)
Balance, September 30, 2021	**10,268**

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

	Indoor	**Outdoor**
Average transfer price per gram ($)	0.75	0.15
Average yield per plant (grams)	70	750
Average of growth cycle (weeks)	12	16

The Company values 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.

The unrealized gain on biological assets and inventory sold for the nine months ended September 30, 2021 was $6,086 (September 30, 2020 – unrealized loss of $18,027).

Note 11 Investments

On November 22, 2018, the Company entered into a Master Joint Venture Agreement ("the Agreement") with SPE Finance LLC ("SPE") 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 for the issuance of 99 common shares of OPC and as a result owns 9.9% of the outstanding common shares of OPC. For accounting purposes, the Company classified its interest in OPC at fair value through profit and loss and as an investment.

OPC is a private entity without observable market prices for its common shares and this investment is measured at its estimated fair value which is calculated based on a valuation technique that uses inputs derived by management which are considered level 3 in the fair value hierarchy (see Note 14). The Company has reviewed the results of operations of OPC based on the financial information provided by management of OPC and prepared a cash flow projection. The Company used a discount rate of 15% to estimate the recoverable cash flows at December 31, 2020 and September 30, 2021.

The Company invested $100 in CannaPacific in January 2019, $600 in April 2019 and $216 in June 2021.

CannaPacific is a private entity without observable market prices for its common shares and this investment is measured at its estimated fair value which is calculated based on a valuation technique that uses inputs derived by management which are considered level 2 in the fair value hierarchy (see Note 13). The investment is recorded its estimated fair value of $2,800. During the year ended December 31, 2020, the Company recorded an unrealized gain in fair value of $1,900. There has been no change in the estimated fair value as at September 30, 2021.

Note 12 Convertible Debt

Aleafia Convertible Debt

In June 2019, the Company issued 40,250 additional convertible debentures units (the "Aleafia Convertible Debt Unit") for gross proceeds of $40,300. The Aleafia 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 accelerate the expiry date of the common share purchase warrants with 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.

During 2019, Debenture holders converted $2,900 debentures to common shares. Accordingly, the remaining principal balance to be paid upon maturity is $37,350.

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

	$
Balance, December 31, 2019	51,009
Amortization of transaction costs	2,081
Interest accretion	3,712
Balance, December 31, 2020	56,802
Repayment of convertible debt	(24,689)
Interest accretion	2,628
Balance, September 30, 2021	**34,741**

Emblem Convertible Debt

On completion of the Arrangement, Aleafia Health assumed the obligations of the convertible debentures previously issued by Emblem Corp. in February 2018 pursuant to a supplemental trust indenture dated March 2019 (the "Supplemental Indenture"). These convertible debentures were originally sold at a price of $1,000 per unit for gross proceeds of $25,000. Under the Supplemental Indenture, the convertible debentures are subject to the following terms:

- a maturity date of February 2, 2021,
- an interest rate of 8% per annum, payable semi-annually, and;
- convertible at $2.3875 per share, subject to adjustment in certain events, at the option of the holder.

Upon maturity on February 2, 2021, the debt was repaid in full.

Note 13 Credit Facility

Credit Facility

On August 23, 2021, the Company entered into a secured Credit Agreement, to receive $10,000 for working capital and general corporate purposes. The term of the loan is for one year and bears simple interest at a rate of 12%. Accrued interest may either be paid monthly in arrears or upon maturity of the facility. In addition, 1,000,000 common share purchase warrants with an exercise price of $0.32 were granted and vest in four tranches of 250,000 quarterly commencing November 20, 2021. The warrants were ascribed a valued of $131, using Black Scholes pricing model.

The facility is secured by first lien mortgages on the Paris, Ontario and Grimsby, Ontario production facilities.

The total interest expense for the quarter was $193 and is included in net interest expense on the interim condensed consolidated statements of loss and comprehensive loss.

	$
Balance, December 31, 2020	—
Amortized cost	9,749
Interest accretion	58
Accrued interest	135
Balance, September 30, 2021	**9,942**

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

Note 14 Financial Instruments and Financial Risks

Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, marketable securities trade and other receivables, investments, accounts payable, lease liability, credit facility and convertible debt. The following table summarizes the carrying values of the Company's financial instruments by measurement category:

	September 30, 2021	December 31, 2020
	$	$
Fair value through profit and loss (i)	18,174	37,149
Assets, amortized cost (ii)	8,224	13,041
Liabilities, amortized cost (iii)	67,708	80,135

(i) Cash and cash equivalents, investments, and marketable securities
(ii) Trade and other receivables
(iii) Accounts payable, lease liability, credit facility and convertible debt

The Company classifies its fair value measurements in accordance with an established hierarchy that prioritizes 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
- 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:

	Level 1	Level 2	Level 3	Total
	$	$	$	$
Cash and cash equivalents	4,688	—	—	4,688
Marketable securities	6,650	—	—	6,650
Investments	—	2,836	4,000	6,836
Total	**11,338**	**2,836**	**4,000**	**18,174**

The carrying value of trade receivables and accounts payable are a reasonable approximation of their fair value due to their short-term nature. The carrying value of lease liability, credit facility and convertible debt are a reasonable approximation of their value based on market interest rates for similar instruments as at September 30, 2021.

During the nine months ended September 30, 2021, there have been no transfers between Level 1, Level 2, and Level 3 fair value measurements. There has been no change in fair value of the Company's investment in OPC (classified as Level 3) as disclosed in Note 12. The value of investment is assessed based on discounted cash flow model. The following factors have a potential impact on net earnings/loss based on various combinations of changes in unobservable inputs in the Company's internal valuation models for its investment in OPC:

- Fair value of investment: $4,000
- After-tax discount rate: 13% to 19%

- Adjustment of management revenue received due to risk and uncertainties:(15%) / +15%
- Hypothetical $ change effect on fair value measurement and net income /loss for the year: ($1M) - $2M

The analysis assumes variation within a reasonable possible range determined by Company based on an analysis of the return, management's knowledge of the cannabis retails store market and the potential impact on the changes in the interest rates.

The impact on the internal valuation models from changes in significant unobservable inputs deemed to be subject to the judgement and estimates disclosed above shows the hypothetical increase (decrease) in net earnings / loss. Changes in the after- tax discount rates, adjustment for risk and uncertainty over amounts of payment to be received, each in isolation, would hypothetically change the fair value of the Company's investments as noted above. Generally, an increase (decrease) in long term growth rates, or a decrease (increase) in after-tax discounts rates, would result in higher (lower) fair value of the Company's investment in OPC.

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. The Company has a strong, disciplined risk culture where managing risk is the 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.

The Company has identified the following potential risk areas:

Currency risk

The Company's expenses are largely 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 assets or liabilities. The Company is attracting foreign investments and in future, the Company's financial assets and liabilities may comprise of foreign currency marketable securities, convertible notes, long term investments and promissory notes.

Interest rate risk

The Company is exposed to interest rate risk on the variable rate of interest earned on bank deposits and cash flow risk on convertible debts. The fair value interest rate risk on bank deposits is insignificant as the deposits are short-term in nature. The interest rate risk on convertible debt is insignificant due to fixed rate of interest on convertible debt. The Company has not entered any derivative instruments to manage interest rate fluctuations.

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 transacts with a high-quality financial institution for cash and cash equivalents and short-term investments. The Company has recently experienced credit risk associated with its accounts receivable and intends to do a credit assessment on customers with concentration risk.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company has experienced recurring losses and has a cumulative deficit of $409,275. Cash flow from operations is negative due in part to the high rate of revenue growth the company has experienced which has driven a requirement for working capital and selling, general & administrative investment.

As at September 30, 2021, the Company has total current assets of $69,894 and total current liabilities of $65,750, providing for net current assets of $4,144. Within its current asset base are cash and cash equivalents and marketable securities of $11,338.

The Company's objectives when managing its liquidity and capital resources are to ensure sufficient liquidity to: meet its financial obligations and execute its operating and strategic plans for at least the next twelve months. Management closely monitors the liquidity position and expects to have adequate sources of funding to finance the Company's projects and operations. The Company manages liquidity risk by: seeking out new debt and equity financing options, reviewing its capital structure to optimize the cost of capital, maintaining the continuity of equity and debt funding options, managing its non-cash current assets to ensure the timely conversion to cash, and putting in plans in place to meet its financial obligations as they come due.

The Company has multiple options to meet its liquidity needs including: converting its non-cash working capital to cash, issuance of common shares via its at-the-market equity financing program, issuing common shares via a public equity offering, share capital, and seeking out new debt financing options.

The Company's ability to meet its commitments to sustain operations and settle its obligations as they become due within the next twelve months and its exposure to liquidity risk is dependent on the Company's ability to:

- Refinance or amend the term of its convertible debentures and credit facility;
- Raise additional debt and equity financing; and
- Realize cash flow from operations which is subject to significant judgements and estimates, the most significant of which is the Company's sales projections and its ability to realize its assets and discharge its liabilities in the normal course of business.

While, the Company has been successful in obtaining financing to date and believes it will be able to obtain sufficient funds in the future and ultimately achieve profitability and positive cash flows from operations, there can be no assurance that the Company will achieve profitability and be able to obtain sufficient financing in the future on terms favourable for the Company.

Note 15 Management of Capital

The Company's objectives when managing capital are to sustain a 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, the credit facility and convertible debt. The Company manages the capital structure and adjusts 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.

(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

Note 16 Commitments and Contingencies

	Less than 2 years	2 to 5 years	Total
Purchase commitments	937	—	937
Total	**937**	**—**	**937**

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 interim condensed consolidated financial statements.

Certain of Emblem Corp.'s former executives have been named in a claim commenced March 20, 2015 in the Ontario Superior Court of Justice that also identifies Emblem Corp. and Emblem in relation to certain services provided to the Emblem Corp. parties by an individual. The plaintiff has claimed $10 million in damages. The claim is being contested and the action is currently at the discovery stage. The outcome of this legal matter is subject to negotiations by the officers of the Company and the Company believes its is unlikely to be impacted and accordingly, no amount has been provided for. A separate claim was also initiated by Tayts on March 22, 2019, in the Ontario Superior Court of Justice against Emblem and Emblem Corp. arising out of the same facts and seeking the same damages. The claim is contested but pleadings have not yet concluded.

On June 16, 2020, a class-action lawsuit was issued in Calgary, Alberta by Lisa Marie Langevin as the proposed representative plaintiff. The claim has been filed against most of the cannabis manufacturers in Canada and includes, among the many defendants, Emblem Corp. and Aleafia Health. The claim alleges that the THC and CBD levels in the products manufactured and/or sold by the defendants differed from what was represented on packaging, specifically alleging that THC and CBD levels were found to be significantly higher than indicated in some products while others may have had significantly lower levels. The action is seeking $500 million (or such other amount as may be proven at trial) for all Canadians who purchased medicinal cannabis products on or after June 16, 2010, as well as Canadians who legally purchased cannabis for recreational purposes on or after October 17, 2018. The claim also seeks $5,000,000 in punitive damages. Ms. Langevin has not alleged that she ever purchased product from Emblem or Aleafia Health. The case is at its earliest stages and has not been certified as a class proceeding. The Company believes it has good defences to the claim and intends to vigorously defend the claim. Accordingly, at this stage no amount has been provided for in the consolidated statements of financial position in respect of this claim.