**AUXLY CANNABIS GROUP INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**FOR THE THREE AND TWELVE MONTHS ENDED DECEMBER 31, 2021**

**Dated March 30, 2022**

## Table of Contents

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis ("**MD&A**") was prepared as of March 30, 2022 unless otherwise indicated. This MD&A reviews the operating results, financial position and liquidity of Auxly Cannabis Group Inc. ("**Auxly**", "**we**", "**our**", or the "**Company**"). All amounts are stated in millions of Canadian dollars unless otherwise noted, except common shares ("**Shares**"), options, and per Share amounts. This MD&A should be read in conjunction with the consolidated financial statements and accompanying notes thereto for the year ended December 31, 2021.

This MD&A may contain forward-looking information that is based on the Company's expectations, estimates and projections regarding its business and the economic environment in which it operates. Forward-looking information contained herein is made as of the date of this MD&A and is not a guarantee of future performance and involves risks and uncertainties that are difficult to control or predict. Readers should refer to the "*Forward Looking Statements*" section in this MD&A. This MD&A makes reference to certain financial measures, including non-GAAP measures and readers should refer to the "*Non-GAAP Measures*" section in this MD&A.

Certain comparative amounts have been retrospectively restated in this MD&A as a result of the sale of KGK Science Inc. ("**KGK**") which occurred during the second quarter of 2021. Historical results of operations and cash flows associated with KGK have been aggregated and presented as discontinued operations as applicable, with Adjusted EBITDA presented on a continuing operations basis.

## DESCRIPTION OF BUSINESS

### Our Business

We are a leading Canadian consumer packaged goods company in the cannabis products market, headquartered in Toronto, Canada. Our focus is on developing, manufacturing and distributing branded cannabis products that delight wellness and recreational consumers.

Our vision is to be a leader in branded cannabis products that deliver on our consumer promise of quality, safety and efficacy.

### Canadian Market

On October 17, 2018, the Cannabis Act came into force, initially permitting the recreational sale of certain classes of cannabis products, including dried cannabis, fresh cannabis, cannabis plants, cannabis seeds, and cannabis oil (collectively referred to as "**Cannabis 1.0 Products**"). On October 17, 2019, edible cannabis, cannabis extracts and cannabis topicals were added to the authorized classes of cannabis (collectively referred to as "**Cannabis 2.0 Products**", and together with Cannabis 1.0 Products, collectively referred to as "**Cannabis Products**") and such Cannabis 2.0 Products were first available for sale on December 16, 2019. Since 2019, Health Canada undertook a consultation, established a Scientific Advisory Committee, and has been engaged in discussions regarding the possible legalization of Cannabis Health Products, which would permit the making of health claims in respect of cannabis products without the required oversight of a practitioner such as a doctor but such products are not currently permitted.

## Canadian Strategy and Capabilities

### *Brand Portfolio and Product Offering*

We have created a portfolio of brands designed for a broad market of cannabis consumers, with differentiation in price points across targeted consumer segments.

## Our Brands

**BACK FORTY**

Take a Trip. Explore the Back Forty. Back Forty is all about embracing simplicity and getting back to basics. Back Forty's mission is to bring consumers a simple, uncomplicated cannabis product that already feels familiar. With its suite of high-potency products, Back Forty provides consumers with a better experience, for less.

**FORAY**

Foray is a versatile, modern, and inviting cannabis brand, designed for the curious. Foray is an accessible entry point for anybody—at any stage of their cannabis journey. Designed for the curious, Foray is an approachable brand that aims to both celebrate and guide one's foray into cannabis, ultimately inviting them to see cannabis differently.

**DOSECANN**

We believe in the natural potential of cannabis. Backed by science and advanced research and development, Dosecann products are driving today's innovation and establishing tomorrow's standards. Cannabis down to a science.

**KOLAB PROJECT**

A refined collection of high-quality cannabis products and design-focused, purposeful goods. We connect consumers with a carefully selected group of collaborators in order to create products that are inspired by their ever-evolving needs.

Based upon consumer insights, Auxly has developed a broad portfolio of Cannabis Products to meet the evolving needs and preferences of Canadian cannabis consumers. Our initial focus was on the development of Cannabis 2.0 Products and we were one of the first cannabis companies to distribute and sell Cannabis 2.0 Products across Canada following their legalization.

We were the top-selling licensed producer of Cannabis 2.0 Products nationally in 2020 and 2021. The Company introduced a variety of Cannabis 1.0 Products to the market throughout 2021 and ended the year as the #5 licensed producer in Canada by total recreational retail sales as reported by Headset Canadian Insights Data ("**Headset**")[1].

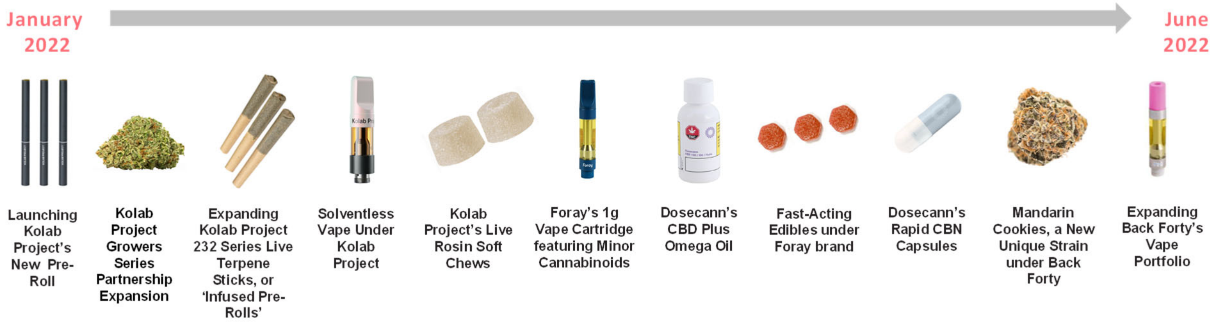
Our Cannabis Products available during the fourth quarter of 2021 are described below by brand and product format:


**Products Available by Brand**

| KOLAB PROJECT | Dosecann | BACK FORTY | Foray |
|---|---|---|---|
| 510 Vape Cartridges | Cannabis Oil Drops | 510 Vape Cartridges | 510 Vape Cartridges |
| All-in-one Vape Pens | Capsules | Dried Flower | All-in-one Vape Pens |
| Dried Flower | Topicals | Milled Flower | Hard Candy |
| Pre-rolled Cannabis | Edibles | Pre-rolled Cannabis | Chocolates |
| Infused Pre-rolls | | Chocolates | Soft Chews |
| Concentrates | | Soft Chews | |
| Chocolates | | | |
| Soft Chews | | | |

[1] Data provided by Headset as at February 10, 2022.

Our Cannabis Products have been well received by consumers. We plan to further strengthen our brand recognition by using consumer insights to drive innovation as we continue to introduce new Cannabis Products to the Canadian market, with an emphasis on expanding our dried flower and pre-roll offerings. The Company's upcoming product offerings are presented below.




### *Distribution*

Given the current provincial legislative framework in Canada, we have pursued a multifaceted strategy to gain access to Canadian consumers. This includes supply arrangements with provincial control boards and retailers, including our partnership with Medical Cannabis by Shoppers Drug Mart Inc., a brokerage agreement with Kindred Partners Inc. ("**Kindred**") to act as our strategic sales agent, and strong relationships with major Canadian retailers.

We have secured listings and sold our Cannabis Products in all provinces except Quebec (where the regulations for Cannabis 2.0 Products are more restrictive). We have obtained the necessary pre-authorization to enter into public contracts in Quebec and continue to explore listings for certain products that comply with Quebec's regulatory requirements.

### *Cannabis Operations, Product R&D and Manufacturing*

In December 2021, the Company made the decision to rename certain subsidiaries to better align stakeholder communications, vision and values under the Auxly brand. Dosecann LD Inc. is now Auxly Charlottetown Inc. ("**Auxly Charlottetown**"), Kolab Project Inc. is now Auxly Ottawa Inc. ("**Auxly Ottawa**"), Sunens Farms Inc. is now Auxly Leamington Inc. ("**Auxly Leamington**"), Robinsons Cannabis Incorporated is now Auxly Annapolis Inc. ("**Auxly Annapolis**") and Robinsons Outdoor Grow Incorporated is now Auxly Annapolis OG Inc. ("**Auxly Annapolis OG**") (see "*Cultivation Supply*" in this MD&A for further information on Auxly Annapolis and Auxly Annapolis OG).

<u>Auxly Charlottetown (formerly Dosecann)</u>

In May 2018, we acquired our subsidiary Auxly Charlottetown, and its purpose-built, GMP-compliant cannabis processing facility located in Charlottetown, Prince Edward Island. The Company conducts its primary extraction, product development, manufacturing and R&D activities for its Cannabis Products in-house at the Auxly Charlottetown facility. Auxly Charlottetown holds licences for processing, analytical testing and research under the Cannabis Act. The full perimeter of the 52,000 square foot facility is currently licensed under the Cannabis Regulations for the production, storage and sale of Cannabis Products.

Product development is led by Auxly Charlottetown's team, who have experience in the pharmaceutical, food, scientific research and product development fields. As the Company's manufacturing hub, this facility provides the Company with the ability to be responsive to changing industry regulation and evolving consumer preferences. Auxly Charlottetown is authorized to conduct broad in-house analytical and sensory testing, incorporating consumer input and feedback on attributes such as flavour, aroma, texture or mouthfeel, to better evaluate later-stage product formulations.

As at December 31, 2021, expenditures of approximately $1.2 million were made towards the purchase of automation equipment, the expansion of extraction and throughput capabilities and security enhancements at the Auxly Charlottetown facility. The Company anticipates that further expenditures of approximately $2.5-4.0 million will be made towards these same initiatives in 2022.

Auxly Ottawa (formerly Kolab Project)

In October 2017, we acquired our subsidiary Auxly Ottawa and its facility located in Carleton Place, Ontario. Auxly Ottawa holds licences for cultivation and processing under the Cannabis Act. In 2020, we made the strategic decision to cease cultivation at the facility and shift our focus to the manufacturing, processing and distribution of pre-roll and dried flower Cannabis Products. Auxly Ottawa is the Company's hub for the processing and packaging of its Cannabis 1.0 Products, including the Kolab Project Growers Series, Back Forty 40s, Kolab Project 950 Series pre-rolls and Back Forty dried and milled flower products.

Near the end of 2020, the Company undertook new capital projects to increase pre-roll production volumes at the Auxly Ottawa facility through the purchase, installation and commissioning of automated manufacturing and packaging equipment and minor associated building alterations, which would quintuple output from the facility. The manufacturing equipment was installed and commissioned during the second quarter of 2021, however, the packaging automation equipment was delayed and received by the Company in February 2022. As at December 31, 2021, expenditures of approximately $4.0 million have been made towards the completion of this project. Due to increased demand for Cannabis 1.0 Products, we expect to incur expenditures of approximately $3.0-4.0 million towards capital projects focused on flower and pre-rolled cannabis automation throughout 2022, including the commissioning of the previously noted packaging automation equipment received in February 2022.

Curative Cannabis

On July 5, 2021, the Company completed the sale of its interest in 2368523 Ontario Ltd. (d/b/a Curative Cannabis) ("**Curative**") to a private purchaser for total proceeds to the Company of $6 million. The disposition of this non-core asset allowed the Company to strengthen its financial position with non-dilutive capital that it could deploy into its core business.

### *Cultivation Supply*

We have simplified our cultivation supply chain through the acquisition of Auxly Leamington in November 2021, which provides the Company with a secure and cost-efficient source of dried cannabis, milled flower and extraction materials. Prior to the acquisition of Auxly Leamington, the Company was dependent on third party wholesale purchases, and we will continue to opportunistically make wholesale purchases to supplement production from Auxly Leamington as required and to support the production of certain of our Cannabis Products. The majority of the Company's current CBD inventory was purchased from licensed hemp sellers in Prince Edward Island prior to 2021.

Auxly Leamington (formerly Sunens)

We acquired 100% of Auxly Leamington, our former joint venture with partner Peter Quiring, on November 22, 2021. See "*Recent Developments: Fourth Quarter 2021 To Date – Auxly Acquires*

*100% Ownership of Auxly Leamington and Amends Credit Facility*" in this MD&A. Auxly Leamington is comprised of a 1.1 million square foot highly automated greenhouse in Leamington, Ontario, which holds licences for cultivation and processing under the Cannabis Act, authorizing the cultivation, processing, storage and sale of Cannabis Products. Auxly Leamington utilizes a perpetual harvest methodology which results in a continuous supply of cannabis as well as increased flexibility in adjusting production capacity to demand as required. On November 25, 2021, Auxly Leamington received approval from Health Canada for the expansion of the site perimeter, allowing for the future use of additional processing and storage space. Following approval of the amendment, the total area of the licensed perimeter stands at 866,000 square feet. Auxly Leamington intends to use this space to introduce environmentally controlled processing rooms and high efficiency automation equipment to expand its manufacturing capabilities. Auxly Leamington is producing award-winning cannabis strains, including popular Back Forty strains Wedding Pie, Animal Mints and Fruity Pebbles OG, all of which are sold to and used exclusively by the Company in its full suite of Cannabis Products. In addition, Auxly Leamington possesses an extensive genetic library and continues to evaluate all opportunities to acquire new cultivars suited for Auxly's portfolio of Cannabis Products. We expect to incur expenditures at this facility of approximately $3.0-4.0 million towards capital projects throughout 2022.

Funding for the initial project budget was provided by the Company in the form of an equity contribution and a subordinated promissory note totaling approximately $98.5 million provided prior to 2020, and a $84 million secured credit facility underwritten by a syndicate of lenders led by the Bank of Montreal ("**BMO**"). The Company's contribution along with the credit facility comprised the required expenditures for the initial budgeted construction of the facility. Concurrently with the Auxly Leamington acquisition, the Company and Auxly Leamington amended and restated the secured credit facility with BMO and the same syndicate of lenders thereby remedying the defaults noted by BMO on April 16, 2021. Under the amended and restated secured credit facility, Auxly made a $15 million cash payment towards the outstanding principal balance of the credit facility and the maturity date of the credit facility was extended by a year to September 30, 2023, with an option for Auxly Leamington to extend for an additional year by making a further principal repayment of $5 million by December 31, 2022. The obligations of Auxly Leamington under the credit facility also continue to be supported by an unsecured $33 million limited resource guarantee provided by the Company. The principal owing under the credit facility at December 31, 2021 was approximately $62.5 million.

<u>Auxly Annapolis (formerly Robinsons) and Auxly Annapolis OG (formderly Robinsons Outdoor Grow)</u>

Auxly Annapolis holds licences for cultivation and processing under the Cannabis Act for its purpose-built 27,700 square foot indoor cannabis cultivation facility located in Kentville, Nova Scotia, and was initially focused on the production of high-quality craft cannabis under a stand-alone Robinsons brand. In an effort to streamline distribution, promotional expenditures and better respond to targeted consumer preferences, Robinsons products were transitioned to the Kolab Project Growers Series.

Auxly Annapolis holds licences for cultivation and processing under the Cannabis Act and is an outdoor cannabis cultivation project comprised of over 158 acres of land located in Hortonville, Nova Scotia. The Company never commenced outdoor cultivation activities at the Auxly Annapolis OG facility, and the facility was being used for additional storage and processing capacity for the Company to manage its dried flower and finished goods inventory.

On February 7, 2022, Auxly announced that it ceased operations at the Auxly Annapolis and Auxly Annapolis OG facilities and intends to divest of the non-core assets and apply the proceeds from any such sale to support its ongoing operations, see "*Recent Developments: Fourth Quarter 2021 To Date – Auxly Announces Cultivation Optimization Plan and Related Cost Savings Initiatives*" in this MD&A.

### *Strategic Partners*

Imperial Brands

Through our strategic partnership with Imperial Brands PLC ("**Imperial Brands**"), Auxly was granted global licenses to Imperial Brands vaping technology for cannabis uses, and access to its vapour innovation business, Nerudia, and Imperial Brands will use Auxly as its exclusive partner for the future development, manufacture, commercialization, sale and distribution of cannabis products of any kind anywhere in the world. Auxly has elected to its Board of Directors one out of six director nominees and one non-voting observer, each designated by Imperial Brands. Auxly will continue to leverage the expertise of these Imperial Brands representatives to improve its corporate and product stewardship governance practices. On November 1, 2021, Murray McGowan, Chief Strategy and Development Officer for Imperial Brands, was appointed to Auxly's Board of Directors as Imperial Brands' director nominee. Mr. McGowan replaced the previous Imperial Brands' nominee Conrad Tate. Mr. Tate left Imperial Brands in October 2021, but, at the request of the Company, agreed to remain on the Board of Directors as an independent director.

Capsugel

Capsugel Inc. ("**Capsugel**"), a subsidiary of Lonza Group Ltd. ("**Lonza**"), designs, develops and manufactures a wide range of innovative dosage forms for the biopharmaceutical and consumer health & nutrition industries. Capsugel leased Auxly Charlottetown equipment for capsule filling and sealing, including a LEMS® machine, Lonza's proprietary liquid-filled Capsugel® Licaps® capsules and rights to its capsule filling and sealing LEMS® technology.

Natures Crops

Natures Crops International ("**Natures Crops**") is a vertically integrated grower and manufacturer of plant-based specialty oils. Pursuant to a supply agreement with Natures Crops, Auxly Leamington holds an exclusive global licence for the use of omega-rich Ahiflower® seed oil in all Cannabis Products sold in any dosage form, including oils, capsules, soft gels and any other pill format.

Inner Spirit

On May 5, 2021 Sundial Growers Inc. ("**Sundial**") announced that it had entered into an arrangement agreement with Inner Spirit Holdings Ltd. ("**Inner Spirit**") to acquire all of the issued and outstanding common shares of Inner Spirit ("**Inner Spirit Shares**") for consideration per Inner Spirit Share consisting of (i) $0.30 in cash and (ii) 0.0835 of a common share of Sundial, which acquisition was subsequently completed on July 20, 2021. As an early investor and strategic partner of Inner Spirit, at the time of the acquisition the Company held a 9.8% share ownership position in Inner Spirit, resulting in total proceeds of approximately $8 million to the Company from the acquisition during the third quarter of 2021.

CannTx

On July 14, 2021, Entourage Health Corp. (previously WeedMD Inc.) ("**Entourage**") announced that it had entered into a definitive acquisition agreement to acquire all of the issued and outstanding shares of CannTx Life Sciences Inc. (“**CannTx**”) in an all-stock transaction, which acquisition was subsequently completed on November 1, 2021. Upon closing of the acquisition, Entourage issued an aggregate of 57,352,488 Entourage common shares (“**Entourage Shares**”) to CannTx shareholders. As a shareholder of CannTx, and in consideration for the termination of its streaming agreement with CannTx, the Company received total consideration of 14,742,479 Entourage Shares as a result of the acquisition.

***International Operations***

Presently the Company does not have any active international operations. In the third quarter of 2020, the Company ceased all activities at its subsidiary Inverell S.A. (“**Inverell**”) in Uruguay due to the slower than anticipated pace of cannabis-specific regulatory development in Latin America. Auxly is continuing to monitor the progress of other jurisdictions towards recreational and medical cannabis legalization, including the United States and Europe.

## OUTLOOK

In 2021, we remained focused on building on our success as a market leader in Cannabis 2.0 Products, while pursuing focused expansion of our Cannabis 1.0 Products. Our objectives for 2021 were as follows:

- Continued leadership and strength in the Cannabis 2.0 Products market:
    - We ended the year as the #1 licensed producer in Cannabis 2.0 Product sales in the country, with a 14.8% share of the 2.0 market and was a top 5 licensed producer across all Cannabis 2.0 Product categories that we participated in.
    - This was driven by our leadership position in national vape sales, where we continued to lead the market, securing 23% share of market for the year, and maintaining the #1 licensed producer position in the category overall. All three of our vape brands – Back Forty, Kolab Project and Foray – secured a spot in the top 5 selling brands across the country, with Back Forty achieving the #1 brand position for the year with over 12% market share. Both Back Forty and Kolab Project brands received top honours at this year’s Kind Awards for “Best Sativa Cartridge” and “Best Indica Cartridge”, as determined by a panel of nearly 250 budtenders across the country.
    - We expanded our Cannabis 2.0 Product portfolio with the successful launch of concentrates in March 2021 and topicals in May 2021. Dosecann’s Daily Relief CBD Cream combines high-quality CBD extract with Natralipid® Meadowfoam seed oil to deliver an industry-leading potency and unsurpassed stability to users and was recognized for its innovation at this year’s Kind Awards, winning the “Best Topical” category. Kolab Project’s potent, high-quality concentrates quickly became a favourite with Canadian consumers as sales propelled us into the top #4 licensed producer position for the year in the concentrates category.
- Focused expansion of Cannabis 1.0 Products:
    - We successfully expanded our Cannabis 1.0 Product portfolio with the launch of new and exciting product formats, including Back Forty 40s, which after just a few months on the market were recognized as the “Best Indica Pre-roll” by the 2021 Kind Awards.

- As two of the largest cannabis categories, we focused our efforts on growing sales in both dried flower and pre-rolls throughout the year and saw tremendous results, including:
  - Moving from the #30 licensed producer in dried flower sales in 2020 to the #7 licensed producer in 2021, securing 5.1% share of market nationally.
  - Our Back Forty secured the #4 brand position in Ontario – a province with over 160 listed brands in the dried flower category – with over 5% share of market.
  - Back Forty's unique strains became a consumer favorite, with its Wedding Pie 28g SKU quickly establishing itself as one of the best-selling flower SKUs in Ontario.
  - Moving from the #19 licensed producer in pre-roll sales in 2020 to the #8 ranked producer nationally in 2021, in large part driven by the launch of Back Forty 40's where our innovative, single-strain, straight roll format quickly gained 3.6% share of the pre-roll market and became a consumer favourite.
- The acquisition of Auxly Leamington materially enhanced our cultivation capabilities and ensures surety of supply of low cost, high-quality cannabis, and genetic exclusivity for our consumer brands.

- Become a top 5 licensed producer in Canada by total market share in adult recreational cannabis sales:
  - We became the #5 licensed producer in Canada by total market share by the end of 2021.
  - Through our continued dedication to our targeted consumers, we significantly increased our market share over the course of 2021, almost doubling our position year-over-year and ending the year with 7.4% share of market nationally.
  - Leveraging our deep consumer insights and differentiated product innovation to meet the growing and evolving demands of our consumers, we successfully launched 51 new SKUs into the Canadian market throughout the year including 14 line-extensions, 37 unique SKUs and 10 first-to-market products.
  - We expanded our distribution footprint through our dedicated internal sales team and strategic partnership with Kindred, ending the year with presence in over 92% of retail stores across the country.
- Continue to take measures to improve cash flows and finance the business:
  - Cash flows and financing of the business improved dramatically with total net cash used of $5.9 million in 2021 as compared to a use of $22.9 million in 2020.
  - Cash used in operating activities before net working capital improved over 2020 by approximately $14.5 million primarily as a result of:
    - Significantly higher net revenues of $83.8 million in 2021 as compared to $46.7 million during the same period in 2020, an improvement of 79% primarily due to our expansion into Cannabis 1.0 Products and continued leadership in Cannabis 2.0 Products;

        - Gross profit improvements to $19.3 million. Despite product mix changes, gross margin improved to 23% for the year ended December 31, 2021 as compared to $9.8 million or 21% during the same period in 2020; and
        - SG&A expenditures were contained to $45.7 million in 2021 as compared to $46.6 million for the same period in 2020.
    - Deployed capital prudently, towards the purchase, installation and commissioning of automated manufacturing and packaging equipment, and prioritized near term benefits in support of net revenues and/or Gross Profit Margin[2] enhancement. During 2021, capital expenditures, excluding the impact of Auxly Leamington, were approximately $4.9 million as compared to $20.6 million in 2020.
- Become Adjusted EBITDA positive by the end of the calendar year;
    - As anticipated and previously communicated to shareholders during our earnings calls earlier this year, we were unable to achieve positive Adjusted EBITDA during 2021. Global supply chain constraints, increased cost of goods, price compression and equipment delays constrained output and negatively impacted our revenues and costs.
    - Despite these challenges, we were able to move closer towards our target of becoming Adjusted EBITDA positive. For the year ending December 31, 2021, Adjusted EBITDA improved by approximately $6.9 million over 2020, an improvement of 24%, led by net revenues which were 79% higher than 2020 which contributed to improved profit margins, along with a SG&A decrease of $0.9 million, or 2%, inclusive of Auxly Leamington expenses post acquisition.
- Leverage the Auxly Leamington facility to establish a secure supply of cannabis and reduce reliance on open market purchasing;
    - We simplified our cultivation supply chain through the acquisition of Auxly Leamington in November 2021, providing us with enhanced cultivation capabilities.
    - Auxly Leamington provides us with a secure and cost-efficient source of dried cannabis, milled flower and extraction materials.
    - Auxly Leamington enhances our ability to remain focused on our consumers and be responsive to their increasing demand for our branded flower products by providing us with exclusive access to a genetics catalogue of over 150 unique cultivars.
- Explore possible cannabis market entry strategies in regulated international markets, on an asset light basis.
    - While we continued to be focused on the Canadian recreational market, we undertook an internal review in 2021 and has identified international markets of interest and considered preferred market entry routes to those markets. The acquisition of Auxly Leamington provides us the ability to explore international medical export opportunities while continuing to prioritize the fulfilment of domestic demand.

Looking ahead to 2022, we remain committed to building on our success as a Canadian market leader. We plan to drive organic growth through continued innovation, increased brand traction,

[2]Gross Profit Margin is a supplemental financial measure – See “*Non-GAAP Measures*” in this MD&A.

and ubiquitous distribution, while prioritizing operational efficiencies and profitability. Our high-level objectives for 2022 are:

- Improve revenue and Gross Profit Margin to achieve positive Adjusted EBITDA
    - Our key priority in 2022 is to achieve Adjusted EBITDA profitability by continuing to grow top line revenue while enhancing Gross Profit Margins through leveraging the increasing flower output from our Auxly Leamington facility, focused and differentiated brand and product offerings, increased depth and breadth of distribution, and cost optimization through investments in automation to increase production capabilities and efficiency and continuous improvement initiatives.

- Win with consumers and increase brand traction
    - We will continue to be deeply committed to understanding our targeted consumers and developing products and brands that help them live happier lives. Driven by deep consumer insights we will continue to evolve our brand portfolio to earn and keep the trust and loyalty of its customers and consumers and be the choice of consumers in-store. We will service the evolving preferences of our consumers by delivering new and innovative branded products to market and ensuring that our consumers can access those products broadly and reliably.

## COVID-19 PANDEMIC

On March 11, 2020, the World Health Organization recognized the outbreak of COVID-19 as a pandemic, which has had a profound impact on the global economy. The pandemic has continued to be a rapidly changing situation through 2021 and into 2022, and the provincial and territorial responses to the pandemic continue to evolve.

As of the date of this MD&A, the majority of temporary provincial lockdown measures and other pandemic restrictions, which were implemented by provinces and territories at the beginning of the pandemic, and which continued into 2021 and 2022, have now been eased in most areas as vaccination rates have risen and COVID-19 cases fall across the country, but there is still a possibility that lockdown measures could be imposed again if there is an increase in COVID-19 cases. On March 1, 2022, all remaining capacity limits and vaccine mandates were lifted by the Ontario government, which means all retail stores, including retail cannabis stores, are open for in-store sales without any capacity limits. In Ontario, as a temporary measure during lockdowns and stay-at-home orders, retail cannabis stores were permitted to remain open for curbside pickup and delivery, and the Ontario Government has since announced that as of March 15, 2022, retail cannabis stores will be permitted to offer curbside pickup and delivery on a permanent basis. As of the date of this MD&A, the majority of pandemic protocols across the country have been lifted, but lockdowns and other restrictive measures could be reimposed if there is an increase in COVID-19 cases across provinces and territories, which could have a materially negative impact on the Company's sales, cash flows and results of operations.

In response to the pandemic, the Company implemented safety measures to protect employees and consumers and is continuing to monitor and comply with all federal and provincial regulations and guidelines while keeping our facilities operating. The Company’s cultivation and processing facilities have remained open and operational and employees at the Company’s corporate head office in Toronto and other non-production staff at our cannabis facilities are currently operating under a part-time work from home model.

## RECENT DEVELOPMENTS: Fourth Quarter 2021 To Date

*Auxly Announces Cultivation Optimization Plan and Related Cost Savings Initiatives*

On February 7, 2022, the Company announced the closure of its Auxly Annapolis and Auxly Annapolis OG facilities located in Kentville and Hortonville, Nova Scotia, to focus its efforts on streamlining and simplifying its cultivation platform and reducing costs. Through streamlining its cultivation footprint, the Company will be able to focus efforts and resources on optimizing the output of high-quality cannabis from its newly acquired large-scale greenhouse cultivation facility, Auxly Leamington. The Company intends to divest these non-core assets and apply the proceeds from any such sale to support the Company's ongoing operations.

*Auxly Maintains Top Position in 2.0, Dominates Vape Sales and Grows National Market Share Through 1.0 Expansion in 2021*

On January 13, 2022, the Company reported its continued national leadership in Cannabis 2.0 Product sales in 2021, securing a 15% share of the growing category, as confirmed by Headset. The Company's #1 spot is driven by its dominance in the vapour segment, where it achieved 23% national market share for the year, with all three of its vape brands – Back Forty, Kolab Project and Foray – securing a spot in the top 5 selling brands across the country.

*Canada's Budtenders Have Spoken! Auxly Brands Win Big at 2021 Kind Awards*

On December 16, 2021, the Company announced that it received four awards for its popular consumer brands Back Forty, Kolab Project and Dosecann at the second annual *Kind Awards.* These awards are published in Kind Magazine and recognize the very best in Canadian cannabis, as determined by a panel of nearly 250 budtenders across Canada.

*Auxly Acquires 100% Ownership of Auxly Leamington and Amends Credit Facility*

On November 22, 2021, the Company announced that it had acquired 100% ownership of Auxly Leamington (formerly Sunens Farms Inc.) and concurrently amended and restated Auxly Leamington's secured credit facility that was entered into in September 2019 underwritten by a syndicate of lenders led by BMO (as amended, the "**Amended and Restated Credit Facility**").

Pursuant to a share purchase agreement between Auxly and Peter Quiring, Auxly acquired all of the issued and outstanding securities of Auxly Leamington not already owned by Auxly from Peter Quiring for consideration of: (i) $1.6 million, comprised of $500,000 in cash and $1.1 million in Shares; (ii) a $3.4 million unsecured promissory note payable over 30 months in equal monthly installments with the first payment due 12 months after the date of closing; and (iii) the transfer of certain non-core assets of Auxly Leamington. Concurrent with the acquisition, Auxly Leamington entered into the Amended and Restated Credit Facility with the following terms:

- an immediate cash payment by Auxly of $15 million applied to the outstanding principal balance of the revolving credit facility, bringing the outstanding principal amount thereunder to $62.5 million;
- extension of the maturity date by a year to September 30, 2023, with an option for Auxly Leamington to extend for an additional year by making a further principal repayment of $5 million by December 31, 2022; and
- the obligations of Auxly Leamington under the Amended and Restated Credit Facility continue to be supported by an unsecured $33 million limited recourse guarantee by

Auxly, and a pledge by the Company of all of its securities of Auxly Leamington with new revenue and EBITDA covenants.

*Auxly Achieves Key 2021 Target and Launches Exciting Fall Innovation Portfolio*

On November 10, 2021, the Company announced its fall product lineup packed with innovative new products, flavours and formulations designed to delight Canadian cannabis consumers. The product launches included: new seasonal confections that evoke the cozy warmth of the holidays; brand-new innovations; extensions of existing product lines that take Auxly brands in new directions; new dried-flower strains; and new flavours & formulations for Auxly's industry-leading vape portfolio. The Company also announced that a strong performance for the month of October helped Auxly reach one of its key objectives for the 2021 fiscal year, by achieving the #5 position among Canadian licensed producers, with a 7.3% share of the national market, as confirmed by Headset.

*Auxly Strengthens Board of Directors with Appointment of Murray McGowan*

On November 2, 2021, the Company announced that, in connection with its strategic partnership with Imperial Brands, the Company had appointed Murray McGowan, Chief Strategy and Development Office for Imperial, to its Board of Directors, effective November 1, 2021. Mr. McGowan will join the Auxly Board of Directors as Imperial Brands' director designee, replacing previous Imperial nominee Conrad Tate, who will remain on the Board as an independent director. Following the appointment of Mr. McGowan, the Board is comprised of six directors.

*Auxly Ends Third Quarter 2021 as #6 Licensed Producer in Canada with 6.4% Total National Market Share*

On October 18, 2021, the Company announced that it had moved to the #6 licensed producer position in Canada for total cannabis sales as of the end of Q3 2021, after continuing to win with Canadian consumers and gaining market share through its expanded, high-quality and innovative portfolio of branded cannabis products.

## FINANCIAL HIGHLIGHTS AND KEY PERFORMANCE INDICATORS

| (000's)<br>For the years ended December 31: | **2021** | 2020 | Change | Change |
|---|---|---|---|---|
| Total net revenues | **83,829** | 46,719 | 37,110 | 79% |
| Net income/(loss)* | **(33,739)** | (85,426) | 51,687 | 61% |
| Net income/(loss) from continuing operations* | **(45,895)** | (83,889) | 37,994 | 45% |
| Adjusted EBITDA** | **(21,672)** | (28,523) | 6,852 | 24% |
| Weighted average shares outstanding | **783,379,798** | 631,528,750 | 151,851,048 | 24% |

*Attributable to shareholders of the Company

**Adjusted EBITDA is a Non-IFRS financial measure. Refer to the Non-GAAP Measures section in this MD&A for definitions

***Debt is a supplementary financial measure. Refer to the Non-GAAP Measures section in this MD&A for definitions

| As at:<br>(000's) | | **December 31, 2021** | | December 31, 2020 | | Change | Change |
|---|---|---|---|---|---|---|---|
| Cash and equivalents | **$** | **14,754** | $ | 20,657 | $ | (5,903) | -29% |
| Total assets | **$** | **450,422** | $ | 378,963 | $ | 71,459 | 19% |
| Debt*** | **$** | **168,809** | $ | 114,825 | $ | 53,984 | 47% |

For the year ended December 31, 2021, net revenues were $83.8 million, an increase of approximately $37.1 million over the same period of 2020. Sales for the year improved primarily due to increases in Auxly's adult recreational retail sales and expansion into Cannabis 1.0 Products.

Net losses attributable to shareholders of $33.7 million improved by $51.7 million from a loss of $85.4 million for the year ended December 31, 2020, primarily due to improved gross profits, total other income including a net gain from discontinued operations, a gain from the amendments to the debentures held by Imperial Brands and income tax recoveries, partially offset by additional depreciation, amortization and interest expense.

Adjusted EBITDA of negative $21.7 million improved by approximately $6.9 million from negative $28.5 million primarily as a result of increased gross profits partially offset by increased selling, general and administrative expenses during the year.

Cash and equivalents were $14.8 million on December 31, 2021, a decrease of $5.9 million from December 31, 2020. The net cash decrease was due to negative cash from operating activities, investing activities and the acquisition of Auxly Leamington that was partially offset by proceeds from financing activities which include the equity offerings completed in 2021.

For the year ended December 31, 2021, the average number of Shares outstanding increased to 783.4 million Shares, an increase of 151.9 million Shares or 24% over 2020 primarily as a result of equity offerings completed in 2021 including Shares issued under the Company's at-the-market equity program ("**ATM Program**")

## RESULTS OF OPERATIONS

| (000's)<br>For the years ended December 31: | | 2021 | | 2020 |
|---|---|---|---|---|
| **CONTINUING OPERATIONS** | | | | |
| **Revenue** | | | | |
| Revenue from sales of cannabis products | **$** | **120,824** | $ | 57,182 |
| Other revenues | | **-** | | 70 |
| Excise taxes | | **(36,995)** | | (10,533) |
| **Total net revenue** | | **83,829** | | 46,719 |
| **Costs of sales** | | | | |
| Costs of finished cannabis inventory sold | | **62,754** | | 33,858 |
| Inventory (gain)/impairment | | **3,264** | | 3,393 |
| **Gross profit excluding fair value items** | | **17,811** | | 9,468 |
| Unrealized fair value gain/(loss) on biological transformation | | **2,384** | | 537 |
| Realized fair value gain/(loss) on inventory | | **(905)** | | (193) |
| **Gross profit** | | **19,290** | | 9,812 |
| **Expenses** | | | | |
| Selling, general, and administrative expenses | | **45,721** | | 46,629 |
| Depreciation and amortization | | **12,507** | | 8,981 |
| Interest expense | | **17,668** | | 12,984 |
| **Total expenses** | | **75,896** | | 68,594 |
| **Other income/(loss)** | | | | |
| Fair value gain/(loss) for financial instruments accounted under FVTPL | | **6** | | (4,408) |
| Interest and other income | | **1,591** | | 477 |
| Impairment of long-term assets | | **(11,426)** | | (6,146) |
| Gain/(loss) on settlement of assets and liabilities and other expenses | | **20,289** | | (9,682) |
| Gain/(loss) on disposal of subsidiary | | **1,355** | | - |
| Share of gain/(loss) on investment in joint venture | | **(4,661)** | | (7,407) |
| Foreign exchange gain/(loss) | | **(788)** | | (627) |
| **Total other income/(loss)** | | **6,366** | | (27,793) |
| **Net loss before income tax** | | **(50,240)** | | (86,575) |
| Income tax recovery | | **4,330** | | 681 |
| **Net loss from continuing operations** | **$** | **(45,910)** | $ | (85,894) |
| **Net income/(loss) from discontinued operations** | | **12,156** | | (1,537) |
| **Net income/(loss)** | **$** | **(33,754)** | $ | (87,431) |
| **Net income/(loss) attributable to shareholders of the Company** | **$** | **(33,739)** | $ | (85,426) |
| **Net loss attributable to non-controlling interest** | | **(15)** | | (2,005) |
| **Adjusted EBITDA** (3) | **$** | **(21,672)** | $ | (28,523) |
| From continuing operations | **$** | **(0.06)** | $ | (0.14) |
| From discontinued operations | | **0.02** | | (0.00) |
| **Net income/(loss) per common share (basic and diluted)** | **$** | **(0.04)** | $ | (0.14) |
| **Weighted average shares outstanding (basic and diluted)** | | **783,379,798** | | 631,528,750 |

(3) This is a non-GAAP financial measure. See section "*Non-GAAP Measures*" for more information on each supplementary financial measure.

### *Net Revenue*

For the year ended December 31, 2021, net revenues were $83.8 million as compared to $46.7 million during the same period in 2020, an improvement of 79%. Revenue in 2021 was comprised of approximately 69% in Cannabis 2.0 Product sales, with the remainder from Cannabis 1.0 Product sales. Net revenues improved as a result of the Company's expansion into Cannabis 1.0 Products and continued leadership in Cannabis 2.0 Products. Consistent with prior periods, as the Company does not participate in the Quebec market, approximately 85% of cannabis sales throughout 2021 originated from sales to British Columbia, Alberta and Ontario.

### *Gross Profit*

Auxly realized a gross profit of $19.3 million resulting in a 23% Gross Profit Margin during the year ended December 31, 2021, compared to $9.8 million (21%) during the same period in 2020. Gross profits improved over 2021 however they were impacted by the Company's expansion into Cannabis 1.0 Products which presently have lower average profit margins as compared to Cannabis 2.0 Products. Following the acquisition of Auxly Leamington, the Company recognizes gross profit or loss from Auxly Leamington only as product is sold to the Company's customers after being further processed by Auxly Ottawa or Auxly Charlottetown. For the six weeks to December 31, 2021, the Company realized approximately $0.4 million of additional gross profit as a result of the acquisition of Auxly Leamington. Prior to the acquisition of Auxly Leamington, the net earnings of Auxly Leamington were recorded in other income and expenses on an equity basis in proportion to the Company's ownership in the joint venture.

Inventory impairment was $3.3 million for the year which was similar to the same period in 2020. For 2021, the amounts relate to the obsolescence of certain retired products and packaging, and reductions in the net realizable value of dried cannabis under the Company's product specifications.

Unrealized fair value gains and losses on biological assets and realized fair value gains and losses on inventory in 2021 primarily relate to Auxly Leamington. In 2020, Auxly Leamington was accounted for under the equity method.

### *Total Expenses*

Selling, general and administrative expenses ("**SG&A**") are comprised of wages and benefits, office and administrative, professional fees, business developments, share-based payments, and selling expenses. SG&A expenses were $45.7 million for 2021, which was approximately $0.9 million lower than 2020.

Wages and benefits were $17.8 million for 2021 approximately $3.4 million lower than the same period of 2020, primarily from workforce reductions at the Company's discontinued cultivation project in Uruguay (Inverell) of approximately $1.2 million with the remainder of the savings coming from headcount reductions and absorption changes in the rest of the Company.

Office and administrative expenses of $13.6 million in 2021 increased by $1.6 million compared to the same period in 2020. The increased expenditures primarily relate to increased operating costs associated with the development and sale of Cannabis Products, TSX listing fees, and Dosecann rent, partially offset by approximately $0.8 million of reduced expenditures at Inverell.

Auxly's professional fees were $2.9 million in 2021, which was consistent with 2020. Professional fees incurred during the period primarily related to accounting fees, regulatory matters, reporting issuer fees, and legal fees associated with certain corporate activities.

Business development expenses were $0.3 million for the year ended December 31, 2021, as compared to $0.5 million during the same period in 2020. The decrease of $0.2 million is primarily due to a reduction in acquisition, business development and travel related expenses primarily as a result of the on-going COVID-19 pandemic.

Share-based compensation was $1.4 million for the year ended December 31, 2021, as compared to $4.3 million during the same period in 2020. The reduction in expense of $2.9 million as compared to 2020 reflects the impact of lower share prices and the aging of outstanding options.

Selling expenses were $9.6 million for the year ended December 31, 2021, an increase of $4.0 million over the same period in 2020, as a result of cannabis sales activities comprised of brokerage fees earned by Kindred, Health Canada fees related to higher revenues, and increased marketing initiatives for Cannabis Products.

Depreciation and amortization expenses were $12.5 million for the year ended December 31, 2021, $3.5 million greater than the same period of 2020. The increase in expense during the current period is primarily related to additional capital expenditures and inclusion of Auxly Leamington, partially offset by amounts related to Inverell in 2020.

Interest expenses were $17.7 million in 2021, an increase of $4.7 million over 2020 primarily as a result of interest expense and accretion on the $123 million Imperial Brands Debenture and changes related to the amendments thereof, increased leases and debt assumed as a result of the acquisition of Auxly Leamington.

***Total Other Incomes and Losses***

Fair value changes on financial instruments arise on changes in value of promissory notes and level two securities held. For the year ended December 31, 2021, the Company reported a net fair value gain of $Nil. The $4.4 million loss for the year ended December 31, 2020 was the result of more significant valuation reductions and a larger securities portfolio during 2020.

The Company recorded interest and other incomes of $1.6 million for the year ended December 31, 2021, with increases over the same periods of 2020 primarily due to changes in interest accretion on the promissory note while Auxly Leamington was the Company's joint venture.

Impairment of long-term assets of $11.4 million in 2021 relates to the sale of Curative where the carrying value exceeded the proceeds of sale. During 2020, the Company recognized an impairment loss on long-term assets of $6.2 million related to Inverell, its discontinued cultivation project in Uruguay.

Gains and losses on settlement of assets and liabilities and other expenses was a gain of $20.3 million in 2021 primarily related to a $16.6 million gain associated with the Imperial Brands Debenture amendments and a $4.2 million first quarter gain on the settlement of a $5.8 million liability associated with a non-monetary product exchange with another licensed producer.

The gain on disposal of subsidiary in 2021 of $1.4 million relates to the final accounting of the Curative sale transaction for assets that were not classified as held for sale prior to closing the transaction in July 2021.

The share of loss on investment in joint venture of $4.7 million represents the Company's proportionate share of Auxly Leamington's earnings prior to the acquisition date.

Auxly is exposed to foreign exchange fluctuations from the U.S. dollar to CAD dollar exchange rate primarily related to inventory, capital purchases and Inverell net assets. During the year ended December 31, 2021, the Company reported a foreign exchange loss of $0.8 million as compared to a loss of $0.6 million during the same period of 2020.

### *Net Income and Loss*

Net losses attributable to shareholders of the Company were $33.7 million for the year ended December 31, 2021, representing a net loss of $0.06 per share on a basic and diluted basis. The improvement of approximately $51.7 million relative to the same period in 2020 was primarily a result of net income of $12.2 million related to the sale of KGK, recognition of a gain from the Imperial Brands Debenture amendments, improvements in continuing operating gross profits and income tax recoveries, partially offset by an impairment charge related to the Curative recoverable amount, losses on the investment in Auxly Leamington while it was recorded as a joint venture and higher interest and depreciation and amortization expenses.

### *Adjusted EBITDA*

Adjusted EBITDA of negative $21.7 million in 2021 improved by approximately $6.9 million over the same period in 2020 primarily driven by greater gross profits and partially offset by higher selling and office expenses.

### *Discontinued Operations*

On May 27, 2021, the Company announced that it had reached an agreement to sell KGK to Myconic Capital Corp. (now Wellbeing Digital Sciences Inc.) ("**Wellbeing**"), and on June 2, 2021, completed the sale of KGK to Wellbeing. As a result of the sale, results from operations and cash flows from KGK have been presented as discontinued operations, as applicable, on a retrospective basis. The results of operations for the discontinued operations are presented below.

| | | **Year ended December 31, 2021** | | Year ended December 31, 2020 |
|---|---|---|---|---|
| **Revenue** | **$** | **2,214** | $ | 4,077 |
| Cost of sales | | **2,109** | $ | 2,750 |
| **Gross profit** | **$** | **105** | $ | 1,327 |
| Operating expenses, net of government subsidies | | **90** | $ | 2,864 |
| Gain on disposal, before tax | | **12,141** | $ | - |
| **Net income/(loss) before tax from discontinued operations** | **$** | **12,156** | $ | (1,537) |
| Income tax recovery | | **-** | $ | - |
| **Net income/(loss) from discontinued operations** | **$** | **12,156** | $ | (1,537) |

## SUMMARY OF QUARTERLY RESULTS

The following table summarizes comparative quarterly results for the last eight quarters.

| (000's) | **Q4/21** | Q3/21 | Q2/21 | Q1/21 | Q4/20 | Q3/20 | Q2/20 | Q1/20 |
|---|---|---|---|---|---|---|---|---|
| **CONTINUING OPERATIONS** | | | | | | | | |
| Total net revenues | **29,318** | 24,493 | 20,852 | 9,166 | 18,246 | 12,598 | 6,867 | 9,008 |
| Net losses* | **(18,376)** | (13,527) | (3,676) | (10,316) | (25,804) | (17,597) | (29,175) | (11,313) |
| Adjusted EBITDA** | **(6,043)** | (6,099) | (2,989) | (6,540) | (4,631) | (6,417) | (10,312) | (7,163) |
| Average shares outstanding (000's) | **829,480** | 825,613 | 762,653 | 714,041 | 640,923 | 631,950 | 627,822 | 625,242 |
| Per share: Basic & diluted loss | **(0.02)** | (0.02) | (0.00) | (0.01) | (0.04) | (0.03) | (0.05) | (0.02) |

*attributable to shareholders of the Company and excludes discontinued operations.

**Adjusted EBITDA is a Non-IFRS financial measure. Refer to the Non-GAAP Measures section in this MD&A for definitions.

The Company commenced cannabis sales to the Canadian adult recreational market with the legalization of Cannabis 2.0 Products in the fourth quarter of 2019. Since that date, the Company has become a leader in Cannabis 2.0 Products and has continued to introduce new products including Cannabis 1.0 Products to increase total net revenues. Net revenues during the second quarter of 2020 were impacted during the first wave of the COVID-19 pandemic and in the first quarter of 2021 as a result of changes to the Company's provincial customers' inventory management practices and increased restrictions during the third wave of the COVID-19 pandemic.

Net losses from continuing operations have fluctuated over the eight quarters primarily as a result of other losses which include impairment charges, fair value adjustments and losses on settlement of assets and liabilities. Results for Q2 2021 improved primarily as a result of increased income tax recoveries and recognition of a gain from the Imperial Brands Debenture amendments, partially offset by total other losses.

Adjusted EBITDA has fluctuated with changes in total net revenues, changes to product mix with an increase of Cannabis 1.0 Products which presently have lower Gross Profit Margins, and the timing of SG&A expenditures, in particular selling expenses.

The increases in average outstanding Shares reflect financing activities (issuance and exchange of Shares, exercise of warrants, options and conversion of convertible debentures).

## FOURTH QUARTER RESULTS OF OPERATIONS

| (000's)<br>For the three months ended December 31: | **2021** | 2020 |
|---|---|---|
| **CONTINUING OPERATIONS** | | |
| **Revenue** | | |
| Revenue from sales of cannabis products | **$ 43,304** | $ 23,152 |
| Other revenues | **-** | - |
| Excise taxes | **(13,986)** | (4,895) |
| **Total net revenue** | **29,318** | 18,257 |
| **Costs of sales** | | |
| Costs of finished cannabis inventory sold | **23,374** | 14,202 |
| Inventory (gain)/impairment | **2,194** | 1,763 |
| **Gross profit excluding fair value items** | **3,750** | 2,292 |
| Unrealized fair value gain/(loss) on biological transformation | **1,462** | 215 |
| Realized fair value gain/(loss) on inventory | **(904)** | - |
| **Gross profit** | **4,308** | 2,507 |
| **Expenses** | | |
| Selling, general, and administrative expenses | **12,888** | 9,355 |
| Depreciation and amortization | **5,678** | 2,328 |
| Interest expense | **4,348** | 3,814 |
| **Total expenses** | **22,914** | 15,497 |
| **Other income/(loss)** | | |
| Fair value gain/(loss) for financial instruments accounted under FVTPL | **(408)** | 262 |
| Interest and other income | **308** | (321) |
| Impairment of long-term assets | **-** | (1,784) |
| Gain/(loss) on settlement of assets and liabilities and other expenses | **(815)** | (6,043) |
| Gain/(loss) on disposal of subsidiary | **-** | - |
| Share of gain/(loss) on investment in joint venture | **1,387** | (4,412) |
| Foreign exchange gain/(loss) | **(242)** | (749) |
| **Total other income/(loss)** | **230** | (13,047) |
| **Net loss before income tax** | **(18,376)** | (26,037) |
| Income tax recovery | **-** | 24 |
| **Net loss from continuing operations** | **$ (18,376)** | $ (26,013) |
| **Net income/(loss) from discontinued operations** | **-** | (1,162) |
| **Net income/(loss)** | **$ (18,376)** | $ (27,176) |
| **Net income/(loss) attributable to shareholders of the Company** | **$ (18,376)** | $ (26,967) |
| **Net loss attributable to non-controlling interest** | **-** | (209) |
| **Adjusted EBITDA** | **$ (6,043)** | $ (4,631) |
| From continuing operations | **$ (0.02)** | $ (0.04) |
| From discontinued operations | **-** | - |
| **Net income/(loss) per common share (basic and diluted)** | **$ (0.02)** | $ (0.04) |
| **Weighted average shares outstanding (basic and diluted)** | **829,479,680** | 631,949,685 |

Unless stated otherwise, the narrative in this section is in reference to the operating results for the fourth quarter of 2021 as compared to the same period in 2020.

### *Net Revenue*

In the fourth quarter of 2021, the Company realized its goal of maintaining a leadership position in the sale of Cannabis 2.0 Products and achieving a top five licensed producer position overall including the sale of Cannabis 1.0 Products as confirmed by Headset. Net revenues were $29.3 million, approximately $11 million or 61% higher than 2020. During the quarter, vape products comprised approximately 71% of Cannabis 2.0 Products sales and sale of Cannabis 1.0 Products contributed approximately 41% towards net revenues. Cannabis net revenues were $18.3 million during the quarter ended December 31, 2020, which were primarily comprised of Cannabis 2.0 Products.

### *Gross Profit*

Auxly achieved a gross profit of $4.3 million in the fourth quarter of 2021, compared to a gross profit of $2.5 million for the fourth quarter of 2020. Gross Profit Margin was approximately 15% whereas Cost of Finished Cannabis Inventory Sold Margin[4] was 20%. Gross profits were impacted by an increase in sales of Cannabis 1.0 Products which have an improving gross profit profile, however, one that is still below Cannabis 2.0 Products. For the six weeks to December 31, 2021, the Company realized approximately $0.4 million of additional gross profit as a result of the acquisition of Auxly Leamington. Inventory impairments increased by approximately $0.4 million in 2021 as compared to 2020, reflecting charges related to obsolescence of certain retired products and packaging, and reductions in the net realizable value of dried cannabis under the Company's product specifications. Unrealized fair value gains and losses on biological assets and realized fair value gains and losses on inventory in 2021 primarily relate to Auxly Leamington. Prior to the acquisition, Auxly Leamington was accounted for under the equity method.

### *Total Expenses*

Selling, general and administrative expenses of $12.9 million during the fourth quarter of 2021 increased by $3.5 million over the same period in 2020. The increase in expenses included greater wages and salaries of $1.6 million for additional employees hired to support increased revenues and the impact of the Auxly Leamington acquisition. Increased office and administrative expenditures of $0.6 million reflect the impact of the Auxly Leamington acquisition, higher outbound freight charges, personal protection supplies and research initiatives, while selling expenditures increased by $1.2 million in support of revenue and brand development.

Depreciation and amortization expenses increased to $5.7 million in the fourth quarter of 2021 as a result of additional capital expenditures and right of use asset additions in the current year, the inclusion of Auxly Leamington, a reduction following the impairment of intangibles in 2020, the write-off of Inverell assets and certain adjustments reflected in the fourth quarter of 2020.

Interest expenses were $4.3 million for the three months ended December 31, 2021, which reflects an increase of $0.5 million from 2020, primarily as a result of amendments to the Imperial Brands Debenture, resulting in greater non-cash interest accretion for accounting purposes.

---

[4] Cost of Finished Cannabis Inventory Sold Margin is a supplemental financial measure – See "*Non-GAAP Measures*" in this MD&A.

### *Total Other Incomes and Losses*

For the quarter, net total other income was $0.2 million primarily comprised of $1.4 million in a gain on share of investment in joint venture offset by a number of smaller amounts and a loss of $0.8 million on settlement of assets and liabilities.

### *Net Losses*

Net losses improved by $7.4 million to $18.4 million in 2021 from a net loss of $26.0 million in 2020. The improvement in net losses is primarily the result of greater gross profits of $1.8 million, total other incomes of $13.3 million partially offset by higher total expenses of $7.8 million.

### *Adjusted EBITDA*

Adjusted EBITDA of negative $6.0 million in the fourth quarter of 2021 declined by approximately $1.4 million compared to the same period in 2020 primarily as a result of higher SG&A, inclusive of the Auxly Leamington acquisition, partially offset by increased gross profit.

## TRANSACTIONS WITH RELATED PARTIES

*Key management and director compensation*

Auxly's key management personnel have authority and responsibility for overseeing, planning, directing and controlling the activities of the Company. Key management personnel include members of the Board of Directors and executive officers. Compensation of key management personnel may include short-term and long-term benefits, as applicable, including salaries, bonuses, stock options or post-employment benefits. Compensation provided to current and key management is as follows:

| For the periods ended: | | **Year ended December 31,** | | |
|---|---|---|---|---|
| | | **2021** | | 2020 |
| Short-term benefits | **$** | **2,149** | $ | 2,058 |
| Long-term benefits | | **337** | | 1,377 |
| **Total** | **$** | **2,486** | $ | 3,435 |

*Other related party transactions*

Terrene Ltd. provides strategic planning and advisory services to the Company on a periodic basis. Vikram Bawa, an independent director, is the Managing Partner of Terrene Ltd. For the year ended December 31, 2021, the Company has incurred fifty thousand dollars (2020 – $Nil) in expenses.

Global Public Affairs Inc. provides government relations and strategic counsel to the Company on a periodic basis. Genevieve Young, Chair of the Company's Board of Directors, is the President and Chief Operating Officer of Global Public Affairs Inc. For the year ended December 31, 2021, the Company has incurred twenty-three thousand dollars (2020 – $Nil) in expenses.

## LIQUIDITY AND CAPITAL RESOURCES

| (000s)<br>For the years ended December 31: | | **2021** | | 2020 |
|---|---|---|---|---|
| Cash used in continuing operating activities | **$** | **(48,948)** | $ | (33,448) |
| Net change in investments | | **17,707** | | 6,199 |
| Net capital expenditures | | **(378)** | | (20,566) |
| Cash used in continuing investing activities | | **17,329** | | (14,367) |
| Net cash from continuing financing activities | | **26,597** | | 25,089 |
| Net cash provided/(used) from discontinued operations | | **(881)** | | (194) |
| Cash position at the beginning of the period | | **20,657** | | 43,577 |
| Cash position, end of period | **$** | **14,754** | $ | 20,657 |

Auxly's objectives when managing its liquidity and capital resources are to safeguard its ability to continue as a going concern and to maintain a flexible capital structure which optimizes the cost of capital within a framework of acceptable risk. Auxly considers its capital structure to include debt and shareholders' equity.

Auxly manages its capital structure by preparing rolling cash flow forecasts, monitoring the condition and value of assets available for use as well as those assets being used as security in financing arrangements, seeking flexibility in financing arrangements, and establishing programs to monitor and maintain compliance with terms of financing agreements.

Auxly is dependent on expected business growth, changes in the business environment and capital markets as its source of operating capital and may issue additional Shares or debt, acquire or dispose of assets to maintain or adjust its capital structure.

During the year ended December 31, 2021, Auxly used $48.9 million in operating activities from continuing operations, including $29.7 million in working capital primarily associated with increased accounts receivable, prepaid expenses and inventories.

Net investing activities from continuing operations for the year ended December 31, 2021, were a source of $17.3 million and primarily relate to the proceeds from the sale of Sundial shares following its acquisition of Inner Spirit and the sale of Curative partially offset by the purchase of capital equipment of $4.1 million. Net financing activities from continuing operations were $26.6 million for the year ended December 31, 2021, primarily reflecting a private placement and two prospectus offerings completed during 2021, partially offset by the $15.0 million debt payment upon acquisition of Auxly Leamington.

Auxly believes it has liquidity and capital resources to meet its short-term obligations for the next 12 months. The Company will consider the need for additional funding to further strengthen its balance sheet, or in anticipation of, or response to, changing business and industry conditions, and priorities for various projects in the coming year. Accordingly, management has the ability to defer certain capital expenditures and commitments, reduce overheads and consider a variety of options to finance the business including dilutive and non-dilutive offerings. As part of the financing considerations, Auxly considers which options will best optimize interest rates and fees, term length, security provided, covenants, dilution and the impact on future business plans.

Auxly's business is subject to risks and uncertainties that could significantly impair Auxly's ability to raise funds or to generate profits sufficient to meet future obligations, operational, or development needs. See "*COVID-19 Pandemic*" and "*Risk Factors*" in this MD&A for information on the risks and uncertainties that could have a negative effect on Auxly's liquidity.

## OUTSTANDING SHARE DATA

Auxly's authorized share capital consists of an unlimited number of Shares. The following table quantifies the number of issued and outstanding Shares and exercisable securities.

| | March 30, 2022 | December 31, 2021 | December 31, 2020 |
|---|---|---|---|
| Issued Shares | 889,522,672 | 850,732,172 | 691,861,024 |
| Escrowed shares | 6,994,190 | 6,994,190 | 10,994,190 |
| Outstanding shares | 882,528,482 | 843,737,982 | 680,866,834 |
| | | | |
| Exercisable securities | | | |
| Warrants | 122,542,280 | 122,542,280 | 56,021,747 |
| Convertible Debentures | 188,089,377 | 188,089,377 | 188,089,377 |
| Options | 28,423,009 | 28,920,509 | 40,890,608 |

Shares outstanding in 2021 increased by approximately 162.9 million to 843.7 million primarily as a result of the issuance of equity of 136.1 million Shares pursuant to prospectus and private placement offerings during the year, 11.1 million Shares issued under the ATM program, 5.1 million upon the exercise of options, 4.0 million Shares issued in connection with the acquisition of Auxly Leamington, 3.0 million Shares released from escrow and 3.5 million Shares related to the exercise of warrants.

In conjunction with the prospectus and private placement offerings in 2021, 72.0 million warrants were issued inclusive of broker warrants, partially offset by the exercise of 3.5 million warrants and the cancellation of 2.0 million warrants in connection with the Auxly Leamington acquisition. The number of options outstanding declined by 12 million to 28.9 million in 2021 from 40.9 million in 2020 primarily due to the exercise of 5.1 million options and forfeiture of 14.5 million options, partially offset by the issuance of 7.6 million options.

## NON-GAAP MEASURES

The consolidated financial statements of Auxly are prepared in accordance with IFRS. Auxly's basis of presentation and significant accounting policies are summarized in detail in notes 2 and 3 of the annual consolidated financial statements for the year ended December 31, 2021.

This MD&A makes reference to certain financial measures, including non-GAAP measures that are historical, non-IFRS measures that are forward-looking, and supplementary financial measures. Management uses these financial measures for the purpose of comparison to prior periods and the development of future projections and earnings growth prospects. This information is also used by management to measure the profitability of ongoing operations and in analyzing our business performance and trends. These measures are not recognized measures under IFRS, do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of our results of operations from management's perspective. Accordingly, they should not be considered in isolation nor as a substitute for analysis of our financial information reported under IFRS. We use the following non-GAAP financial measures: "EBITDA", "Adjusted EBITDA," and the supplementary financial measures of "Cost of Finished Cannabis Inventory Sold Margin", "Gross Profit Margin", and "Debt."

## Financial Measures

### *EBITDA and Adjusted EBITDA*

These are non-GAAP measures used in the cannabis industry and by the Company to assess operating performance removing the impacts and volatility of non-cash adjustments. The definition may differ by issuer. EBITDA and Adjusted EBITDA used by the Company are reconciled with net loss from continuing operations of the Company, an IFRS measure, in the section "Results of Operations" in this MD&A. The calculation of Adjusted EBITDA is comprised of the net loss from continuing operations of the Company added or subtracted as applicable as provided in the detailed reconciliation found in this MD&A. There are a number of individual financial statement adjustments however, they are inclusive of, interest expense and income, income taxes, depreciation and amortizations, fair value gains or losses, impairments or settlements, foreign exchange, changes in the share of joint venture investments, share based compensation, gains or losses on the sale or disposal of assets and any other unusual items. The Adjusted EBITDA reconciliation is as follows:

| (000's) | **Q4/21** | Q3/21 | Q2/21 | Q1/21 | Q4/20 | Q3/20 | Q2/20 | Q1/20 |
|---|---|---|---|---|---|---|---|---|
| Net loss from continuing operations | **$ (18,376)** | $ (13,527) | $ (3,685) | $ (10,322) | $ (26,012) | $ (17,655) | $ (30,466) | $ (11,760) |
| Interest expense | **4,348** | 3,932 | 4,787 | 4,601 | 3,814 | 3,651 | 3,339 | 2,180 |
| Interest income | **(308)** | (436) | (431) | (416) | 310 | (381) | (345) | (61) |
| Income tax recovery | - | - | (4,291) | (39) | (24) | (90) | (567) | - |
| Depreciation and amortization included in cost of sales | **689** | 386 | 326 | 141 | 208 | 267 | 176 | 245 |
| Depreciation and amortization included in expenses | **5,678** | 2,223 | 2,174 | 2,432 | 2,328 | 2,076 | 2,688 | 1,889 |
| **EBITDA** | **(7,969)** | (7,422) | (1,120) | (3,603) | (19,376) | (12,132) | (25,175) | (7,507) |
| Impairment of Inventory | **2,194** | 716 | 124 | 230 | 1,763 | (312) | 668 | 1,274 |
| Unrealized fair value loss / (gain) on biological transformation | **(1,462)** | (352) | (315) | (255) | (215) | (172) | (201) | 51 |
| Realized fair value loss / (gain) on inventory | **904** | 1 | 1 | (1) | - | (2) | 15 | 180 |
| Share-based compensation | **212** | 55 | 960 | 206 | 472 | 1,178 | 1,282 | 1,417 |
| Fair value loss / (gain) for financial instruments accounted under FVTPL | **408** | (223) | (75) | (116) | (262) | 34 | 4,521 | 115 |
| Impairment of long-term assets | **-** | 60 | 11,366 | - | 1,784 | (144) | 4,506 | - |
| (Gain) / loss on settlement of assets, liabilities and disposals | **815** | (1,396) | (16,995) | (4,068) | 6,042 | 3,453 | 2,020 | (1,834) |
| Share of loss on investment in joint venture | **(1,387)** | 3,095 | 2,494 | 459 | 4,412 | 1,214 | 996 | 785 |
| Foreign exchange loss / (gain) | **242** | (633) | 571 | 608 | 749 | 466 | 1,056 | (1,644) |
| **Adjusted EBITDA** | **$ (6,043)** | $ (6,099) | $ (2,989) | $ (6,540) | $ (4,631) | $ (6,417) | $ (10,312) | $ (7,163) |

## Supplementary Financial Measures

*Cost of Finished Cannabis Inventory Sold Margin*

"Cost of Finished Cannabis Inventory Sold Margin" is a supplementary financial measure and is defined as Cost of Finished Cannabis Inventory Sold divided by revenue.

*Gross Profit Margin*

"Gross Profit Margin" is defined as gross profit divided by revenue. Gross Profit Margin is a supplementary financial measure.

*Debt*

"Debt" is defined as current and long-term debt and is a supplementary financial measure. It is a useful measure in managing our capital structure and financing requirements.

## COMMITMENTS AND OFF-BALANCE SHEET ARRANGEMENTS

As at December 31, 2021, the Company has entered into certain agreements which commit the Company to future funding following a mutually agreed upon event or events. Commitments have not been described where agreements are insufficiently advanced, unlikely to progress further or amounts are indeterminable.

The Company has funding commitments as follows:

As part of the $62.5 million in debt financing provided by a syndicate led by BMO towards the construction of the Auxly Leamington purpose-built greenhouse facility, the Company has guaranteed payments up to $33 million in the event of default;

During the period 2022 to 2024, the Company has committed to a fixed/variable structure with Kindred for brokerage services, whereby Kindred will market the Company's portfolio of brands across Canada. The fixed amount of the fixed/variable structure will be approximately $3.6 million annually;

Annual payments of $0.3 million USD for five years to June 2025 to Natures Crops for the global exclusivity rights to Ahiflower® seed oil for use in Cannabis 2.0 Products;

Payments of $1.0 million USD in 2022 to Capsugel, as part of a multi-year licensing arrangement with Lonza;

Payments of an aggregate of €1.9 million in 2022 for cannabis equipment to expand the Company's pre-roll and dried flower capabilities;

Annual payment of $0.1 million for minimum annual volume requirement with Union Gas, with agreement ending August 1, 2029; and

Annual payment of approximately $0.1 million until 2024 for guaranteed minimum purchase of bulk carbon dioxide with Air Liquide.

The Company has commitments in respect of long-term debt obligations and leases relating to office spaces, equipment and land which will require payments as follows:

| | 2022 | 2023 | 2024 | 2025 | Thereafter | Total |
|---|---|---|---|---|---|---|
| Lease obligations | $ 4,949 | $ 3,386 | $ 2,895 | $ 2,749 | $ 12,732 | **$ 26,711** |
| Loans payable obligations | 5,881 | 34,282 | 5,308 | 4,096 | 23,100 | **72,667** |
| Promissory note obligations | 1,410 | 3,718 | 1,549 | - | - | **6,677** |
| Convertible debenture obligations | 11,648 | - | 147,408 | - | - | **159,056** |
| **Total** | **$ 23,888** | **$ 41,386** | **$ 157,160** | **$ 6,845** | **$ 35,832** | **$ 265,111** |

Long-term debt obligations include principal and interest on the Imperial Brands Debenture maturing on September 25, 2024. Pursuant to the amendments to the Debenture, interest payable may also be converted to Shares or capitalized and paid at maturity.

Concurrently with the acquisition of Auxly Leamington, Auxly Leamington and Fresh Energy Inc. agreed to complete the transfer of (or part of) a load facility located at 525 County Rd. 14, Mersea RD 9 PH 5 (the "**Transfer**") for which Auxly Leamington shall pay Fresh Energy consideration of:

- an unsecured promissory note in the principal amount of $3,000 payable in monthly instalments of $100 for 30 months and;

- contingent consideration payable of $500 upon the completion of effecting such Transfer, included in the consideration paid for the acquisition of Auxly Leamington.

Auxly has funding commitments of an aggregate of €19,820 from 2022 to 2024 to Van der Knapp Group of Companies related to the lease of an organic growing concept. As part of this acquisition of Auxly Leamington, Auxly agreed to continue to temporarily lease the organic growing concept until it can be transferred to Peter Quiring, upon which, Auxly's commitments to the Van der Knapp Group of Companies related to the organic growing concept will be extinguished. Such transfer is anticipated to occur in the second fiscal quarter of 2022.

The Company, its subsidiaries and joint ventures are involved in litigation matters arising out of the ordinary course and conduct of its business. Although such matters cannot be predicted with certainty, management does not consider the Company's exposure to litigation to be material to the consolidated financial statements.

## CRITICAL ACCOUNTING ESTIMATES

The preparation of consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, and revenue and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The effect of a change in an accounting estimate is recognized prospectively by including it in comprehensive income in the period of the change, if the change affects that period only; or in the period of the change and future periods, if the change affects both.

Areas requiring estimates and judgements are as follows:

*Business combinations*

In a business combination, substantially all identifiable assets, liabilities and contingent liabilities acquired are recorded at the date of acquisition at their respective fair values. One of the most significant areas of judgment and estimation relates to the determination of the fair value of these assets and liabilities, including the fair value of contingent consideration, if applicable. If any intangible assets are identified, depending on the type of intangible asset and the complexity of determining its fair value, an independent external valuation expert may develop the fair value, using appropriate valuation techniques, which are generally based on a forecast of the total expected future net cash flows. These valuations are linked closely to the assumptions made by management regarding the future performance of the assets concerned and any changes in the discount rate applied. In certain circumstances where estimates have been made, the Company may obtain third-party valuations of certain assets, which could result in further refinement of the fair-value allocation of certain purchase prices and accounting adjustments.

*Impairment of goodwill and intangible assets*

The carrying value of goodwill and intangibles is reviewed annually for impairment or more frequently when there are indicators that impairment may have occurred. The Company's impairment tests for goodwill and intangible assets are based on the comparison of the carrying amount of the CGU and the recoverable amount, which is the greater of value in use calculations that use a discounted cash flow model and estimated fair value less cost of disposal. The determination of the Company's CGUs are based on management's judgement.

The value-in-use calculations employ the following key assumptions: future cash flows, growth projections including economic risk assumptions and estimates of achieving key operating metrics. The cash flows are derived from the Company's budget for the future and do not include restructuring activities that the Company is not yet committed to or significant future investments that will enhance the asset base of the CGU being tested. The recoverable amount is most sensitive to the discount rate used for the discounted cash flow model as well as the expected future cash inflows and the growth rate used for extrapolation purposes. The estimated fair value less cost of disposal is based on assessment of comparable company multiples and precedent transactions.

*Control, joint control or level of influence*

When determining the appropriate basis of accounting for the Company's interests in affiliates, the Company makes judgments about the degree of influence that it exerts directly or through an arrangement over the investees' relevant activities.

*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, average or expected selling prices and list prices, expected yields for the cannabis plants, and oil conversion factors. In calculating final inventory values, management compares the inventory cost to estimated net realizable value. Further information on estimates used in determining the fair value of biological assets is contained in note 6.

*Estimated useful lives and depreciation and amortization of property, plant and equipment and intangible assets*

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 consider factors such as economic and market conditions and the useful lives of assets.

*Share-based compensation*

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.

*Fair value measurements*

Certain of the Company's assets and liabilities are measured at fair value. In estimating the fair value of Level 2 investments, the Company uses key inputs including the share price of underlying securities, annualized volatility, the risk-free interest rate, the dividend yield, and the expected life of the security. In estimating the fair value of Level 3 investments, the Company uses market-observable data to the extent it is available.

*Inputs when using Black-Scholes valuation model*

The estimates used in determining the stock option and warrant fair values, utilizes estimates made by management in determining the appropriate input variables in the Black-Scholes valuation model. Inputs subject to estimates include volatility, forfeiture rates, estimated lives and market rates.

*Discount rates*

The discount rates used to calculate the purchase price allocation, impairment analysis, net present value of notes receivable, the convertible debentures and the notes payable are based on management's best estimates of an approximate industry peer group weighted average cost of capital and management's best estimate of the Company's risk levels.

Changes in the general economic environment could result in significant changes to this estimate.

*Convertible instruments*

Convertible debentures are compound financial instruments which are accounted for separately by their components: a financial liability and an equity instrument. The financial liability, which represents the obligation to pay coupon interest on the convertible debentures in the future, is initially measured at its fair value and subsequently measured at amortized cost. The residual amount is accounted for as an equity instrument at issuance.

The identification of convertible debenture components is based on interpretations of the substance of the contractual arrangement and therefore requires judgment from management. The separation of the components affects the initial recognition of the convertible debenture at issuance and the subsequent recognition of interest on the liability component. The determination of the fair value of the liability is also based on a number of assumptions, including contractual future cash flows, discount rates and the presence of any derivative financial instruments.

## DISCLOSURE AND INTERNAL CONTROLS AND PROCEDURES

Internal controls over financial reporting (ICFR) and disclosure controls and procedures (DCP) are designed to provide reasonable assurance that material information required to be publicly disclosed is gathered and reported on a timely basis so that appropriate decisions can be made regarding public disclosure.

Auxly's certifying officers have designed, and assessed the design of, ICFR to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financials for external purposes in accordance with IFRS using the criteria set forth in the Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission ("**COSO**"). In addition, the Company's certifying officers and its disclosure committee have designed, and assessed the design of, a system of DCP to provide reasonable assurance that (i) material information relating to Auxly, including its consolidated subsidiaries, is made known to them and others; and (ii) information required to be disclosed by Auxly in its annual filings, interim filings and other reports filed or submitted by Auxly under securities legislation is recorded, processed, summarized and reporting within the time periods specified.

The Company has used the Internal Control – Integrated Framework (2013) from COSO in order to assess the effectiveness of the Company's internal control over financial reporting. There are no material weaknesses relating to the design of either ICFR or DCP at December 31 2021. There have been no changes to our ICFR during the quarter and the year ended December 31, 2021, that has materially affected, or is reasonably likely to materially affect Auxly's ICFR.

The Company has limited the scope of the design of its DCP and ICFR to exclude controls, policies and procedures of Auxly Leamington, which the Company acquired on November 22, 2021. Prior to the acquisition, the Company had a 45% interest and did not have the ability to design and evaluate controls, policies and procedures carried out by that entity.

Auxly Leamington's contribution to the Company's consolidated financial statements prior to the acquisition based upon the equity method, was a loss of $4.7 million with net income of $0.3 million thereafter to December 31, 2021. In addition, Auxly Leamington's current assets and current liabilities were approximately 10% and 20% of the consolidated current assets and current liabilities, respectively, and its long-term assets and long-term liabilities were approximately 22% and 30% of consolidated long-term assets and long-term liabilities, respectively.

The Company is currently in the process of documenting and evaluating the controls, policies and procedures in respect of Auxly Leamington. Auxly's assessment is limited to the internal controls over the inclusion of its results in the consolidated financial statements.

The financial statements include approximately six weeks of Auxly Leamington's results since the acquisition on November 22, 2021.

## CHANGES IN ACCOUNTING POLICIES

### *Future changes in accounting standards*

*Amendments to IAS 1: Presentation of Financial Statements: Classification of Liabilities as Current or Non-current*

In January 2020, the IASB issued amendments to clarify the requirements for classifying liabilities as current or non-current. The amendments specify that the conditions that exist at the end of a reporting period are those which will be used to determine if a right to defer settlement of a liability exists. The amendments also clarify the situations that are considered a settlement of a liability. The amendments are effective January 1, 2022, with early adoption permitted. The amendments are to be applied retrospectively. The Company did not early adopt these amendments and no material impact is expected on its consolidated financial statements.

*Amendments to IAS 8, Definition of Accounting Estimates*

In February 2021, IASB issued amendments to IAS 8 to replace the definition of a change in accounting estimates with a definition of accounting estimates. Under the new definition, accounting estimates are "monetary amounts in financial statements that are subject to measurement uncertainty." The amendment provides clarification to help entities to distinguish between accounting policies and accounting estimates. The amendments are effective for annual reporting periods beginning on or after January 1, 2023. The Company is assessing the impact of adopting these amendments on its consolidated financial statements.

*Amendments to IAS 12, Deferred Tax related to Assets and Liabilities arising from a Single Transaction*

In May 2021, IASB issued amendments to IAS 12 to narrow the scope of the initial recognition exemption so that it does not apply to transactions that give rise to equal and offset temporary differences. As a result, companies will need to recognize a deferred tax asset and deferred tax liability for temporary differences arising on initial recognition of transactions such as leases and decommissioning obligations. The amendments are effective for annual reporting periods beginning on or after January 1, 2023 and are to be applied retrospectively. The Company is assessing the impact of adopting these amendments on its consolidated financial statements.

*Amendments to IFRS 9: Financial Instruments*

As part of its 2018-2020 annual improvements to IFRS standards process, the IASB issued amendment to IFRS 9. The amendment clarifies the fees that an entity includes when assessing whether the terms of a new or modified financial liability are substantially different from the terms of the original financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf. An entity applies the amendment to financial liabilities that are modified or exchanged on or after the beginning of the annual reporting period in which the entity first applies the amendment. The amendment is effective for annual reporting periods beginning on or after January 1, 2022, with early adoption permitted. The Company did not early adopt these amendments and no material impact is expected on its consolidated financial statements.

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

The amendment specifies that the "cost of fulfilling" a contract comprises the "costs that relate directly to the contract." Costs that relate directly to a contract can either be incremental costs of fulfilling that contract or an allocation of other costs that relate directly to fulfilling contracts. The amendment is effective for annual periods beginning on or after January 1, 2022, with early application permitted. The Company did not early adopt these amendments and no material impact is expected on its consolidated financial statements.

## FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Auxly's financial instruments include cash and cash equivalents, short-term investments, note and other receivables, long-term investments, debt obligation receivable in product equivalent, accounts payable and accrued liabilities, short and long-term loans, convertible debenture and interest payable on convertible debt. Cash and cash equivalents and short-term investments are exposed to credit risk and Auxly reduces its credit risks by placing these instruments with institutions of high credit worthiness. Note receivables and debt obligation receivable in product equivalent relates to outstanding loans and Auxly mitigates the credit risk by entering into agreements and reviewing its exposure to credit risk on a regular basis. Auxly is exposed to liquidity risk with respect to its trade and other payables and Auxly manages liquidity risk by maintaining sufficient cash balances for settlement of financial liabilities on their due dates.

## RISK FACTORS

Auxly's business and structure are subject to a number of risks and uncertainties which could cause future results to differ materially from those described herein, including without limitation, the risk factors discussed in Auxly's Annual Information Form dated March 30, 2022, which risk factors are incorporated by reference into this document and should be reviewed by all readers. These documents as well as additional information regarding Auxly can be found on SEDAR at www.sedar.com.

## FORWARD LOOKING STATEMENTS

This MD&A and the documents incorporated by reference herein contain certain statements which contain "forward-looking information" within the meaning of Canadian securities legislation (each a "forward-looking statement"). No assurance can be given that the expectations in any forward-looking statement will prove to be correct and, as such, the forward-looking statements included in this MD&A should not be unduly relied upon. Forward-looking information is by its nature prospective and requires Auxly to make certain assumptions and is subject to inherent risks and uncertainties. All statements, other than statements of historical fact included in this MD&A, including information that address activities, events or developments that the Company expects or anticipates will or may occur in the future, are forward-looking statements. The use of any of the words "anticipates", "plans", "contemplates", "continues", "estimates", "expects", "intends", "proposes", "might", "may", "will", "shall", "projects", "should", "could", "would", "believe", "predict", "forecast", "pursue", "potential", "capable", "budget" and similar expressions are intended to identify forward-looking statements. Forward-looking statements in this MD&A may include, but is not limited to, statements pertaining to:

- the competitive and business strategies of the Company;
- the intention to grow the business, operations and existing and potential activities of the Company;
- the sufficiency of the Company's resources to fund continued operations;
- the Company's expectations regarding its future sales;
- the Company's response to the COVID-19 pandemic;
- the impact of the COVID-19 pandemic on the Company's current and future operations;
- the success, and integration of operations, of the entities the Company acquires and the Company's collaborations;
- the ongoing construction, expansions and improvements of the Company's facilities, including Auxly Charlottetown, Auxly Leamington, and Auxly Ottawa, and the timing thereof;
- inventory and production capacity, including discussions of plans or potential for expansion of capacity at existing or new facilities;
- the market for the Company's current and proposed product offerings, as well as the Company's ability to capture and maintain market share;
- the distribution methods expected to be used by the Company to deliver its products;
- the benefits and applications of the Company's current and proposed product offering and expected sales mix thereof;
- development of brands, product diversification and future corporate development;
- the competitive landscape in which the Company operates and the Company's market expertise;
- expectations regarding the Company's ability to raise additional financing to further the Company's investment in the business;
- the intention of the Company to sell Auxly Annapolis and Auxly Annapolis OG and the proposed use of any proceeds;
- the applicable legislation, regulations and licensing related and any amendments thereof related to the cultivation, production, processing, distribution and sale of cannabis products by the Company's subsidiaries and other business interests;

- the ability of the Company to use consumer insights to drive innovation; continuously innovate new cannabis products; and introduce innovative cannabis products to the market;
- the ability of the Company, its subsidiaries and its cultivation partners to cultivate, produce, process, distribute or sell cannabis and cannabis products;
- expectations regarding the Company's licences, including in respect of the grant and maintenance of licences under the Cannabis Act, the Cannabis Regulations and the Industrial Hemp Regulations enacted pursuant to the Cannabis Act, and the permitted activities thereunder;
- the fluctuations in the price of Shares and the market for the Shares;
- the ability of the Company to continue as a going concern;
- future liquidity and financial position;
- the Company's growth strategy, targets for future growth and projections of the results of such growth;
- the expectation and timing of future revenues and of positive Adjusted EBITDA;
- expectations regarding the Company's expansion of sales, operations and investment into foreign jurisdictions;
- the anticipated benefits of the Company's acquisition of Auxly Leamington;
- the ability of the Company to generate cash flow from operations and from financing activities; and
- Auxly's competitive position.

The forward-looking statements in this MD&A are based on information currently available and what management believes are reasonable assumptions. Forward-looking statements speak only to such assumptions as of the date of this MD&A. In addition, this MD&A may contain forward-looking statements attributed to third party industry sources, the accuracy of which has not been verified by Auxly. The purpose of forward-looking information is to provide the reader with a description of management's expectations, and such forward-looking information may not be appropriate for any other purpose.

Forward-looking statements are subject to known and unknown risks, uncertainties and other factors, that may cause the actual results, performance or achievements of the Company to be materially different from those expressed or implied by the forward-looking statements. A number of factors could cause actual results to differ materially from a conclusion, forecast or projection contained in the forward-looking statements in this MD&A including, but not limited to, whether:

- current and future management will abide by the business objectives and strategies outlined herein;
- the Company will retain and supplement its Board of Directors and management, or otherwise engage consultants and advisors, having knowledge of the industries in which Auxly participates;
- the Company will be able to continue as a going concern, will have sufficient working capital and be able to secure adequate financing required in the future on acceptable terms to develop its business and continue operations;

- the Company will be able to continue to attract, develop, motivate and retain highly qualified and skilled employees;
- no adverse changes will be made to the regulatory framework governing cannabis, taxes and all other applicable matters in the jurisdictions in which the Company conducts business and any other jurisdiction in which the Company may conduct business in the future;
- the Company will be able to generate cash flow from operations, including, where applicable, the cultivation, production, processing, distribution and sale of Cannabis Products;
- the Company will be able to execute on its business strategy;
- the Company's subsidiaries will be able to meet the governmental and regulatory requirements necessary to maintain their licences;
- general economic, financial market, regulatory and political conditions in which Auxly operates will remain the same;
- the Company will be able to compete in the cannabis industry;
- there are not materially more closures or lockdowns related to the COVID-19 pandemic;
- the Company will be able to manage anticipated and unanticipated costs;
- the Company will be able to successfully integrate Auxly Leamington's operations with its own; and whether the expected benefits of the acquisition materialize in the manner expected, or at all;
- Auxly Leamington will generate sufficient cash flow to satisfy its payment obligations under the Amended and Restated Credit Facility; and whether Auxly Leamington will remain in compliance with its operating covenants under the Amended and Restated Credit Facility;
- Auxly will be able to maintain effective internal controls over financial reporting and disclosure, controls and procedures;
- there will not be material price compression in the cannabis industry;
- the Company will be able to continue to achieve its target SG&A expenses;
- the Company will be able to increase revenues and achieve positive Adjusted EBITDA;
- the Company will be able to continue to further expand production capacity and introduce new product formats;
- the Company will be able to sell Auxly Annapolis and Auxly Annapolis OG;
- the Company will be able to successfully launch and commercialize new brands, create new product formats and enter into new markets; and
- there is acceptance and demand for current and future Company products by consumers and provincial purchasers;

Although management believes that the expectations represented in such forward-looking statements are reasonable, there is no assurance that such expectations will prove to have been correct. Auxly cannot guarantee future results, performance or achievements.

Readers are further cautioned that the preparation of financial statements in accordance with IFRS requires management to make certain judgments and estimates that affect the reported amount of assets, liabilities, revenues and expenses. These estimates may impact the financial performance of Auxly when further information becomes available.