Consolidated Financial Statements of

# Alternate Health Corp.

December 31, 2018

Alternate Health Corp.
MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements and other financial information in this annual report were prepared by management of Alternate Health Corp., reviewed by the Audit Committee and approved by the Board of Directors.

Management is responsible for the consolidated financial statements and believes that they fairly present the Company's financial condition and results of operation in conformity with International Financial Reporting Standards. Management has included in the Company's consolidated financial statements amounts based on estimates and judgments that it believes are reasonable, under the circumstances.

To discharge its responsibilities for financial reporting and safeguarding of assets, management believes that it has established appropriate systems of internal accounting control which provide reasonable assurance that the financial records are reliable and form a proper basis for the timely and accurate preparation of financial statements. Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls should not exceed their expected benefits. Management further assures the quality of the financial records through careful selection and training of personnel and through the adoption and communication of financial and other relevant policies.

These financial statements have been audited by the shareholders' auditors, Davidson & Company LLP, and their report is presented herein.

"Howard Mann"
Chief Executive Officer
DATE: April 30, 2019

"Chris Boling", CPA,
Chief Financial Officer

# INDEPENDENT AUDITOR'S REPORT

To the Shareholders of
Alternate Health Corp.

***Opinion***

We have audited the accompanying consolidated financial statements of Alternate Health Corp. (the "Company"), which comprise the consolidated statement of financial position as at December 31, 2018, and the consolidated statements of loss and comprehensive loss, changes in equity and cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2018, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards ("IFRS").

***Basis for Opinion***

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our opinion.

***Material Uncertainty Related to Going Concern***

We draw attention to Note 1 of the consolidated financial statements, which indicates that the Company incurred a net loss of $23,988,170 during the year ended December 31, 2018 and, as of that date, the Company's current liabilities exceeded its current assets by $613,361. As stated in Note 1, these events and conditions indicate that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

***Other Matters***

The consolidated financial statements of Alternate Health Corp. for the year ended December 31, 2017 were audited by another auditor who expressed an unmodified opinion on those statements on April 30, 2018.

***Other Information***

Management is responsible for the other information. The other information obtained at the date of this auditor's report includes Management's Discussion and Analysis.

Our opinion on the consolidated financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We obtained Management's Discussion and Analysis prior to the date of this auditor's report. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

***Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

***Auditor's Responsibilities for the Audit of the Consolidated Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Peter Maloff.

**"DAVIDSON & COMPANY LLP"**

Vancouver, Canada

Chartered Professional Accountants

April 30, 2019

# Alternate Health Corp.

Consolidated Statement of Financial Position (in Canadian dollars)

| As at December 31 | | 2018 | | 2017 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| **Current assets** | | | | |
| Cash | $ | 3,902,769 | $ | 1,443,862 |
| Accounts receivable, net | | 62,988 | | 2,748,567 |
| HST receivable | | 68,602 | | 79,615 |
| Income taxes receivable | | - | | 135,491 |
| Due from related parties (Note 17) | | - | | 208,142 |
| Supplies on hand | | 17,053 | | 475,183 |
| Prepaid expenses and deposits | | 817,579 | | 575,748 |
| | | 4,868,991 | | 5,666,608 |
| **Non-current assets** | | | | |
| Convertible note receivable (Notes 5 & 17) | | - | | 665,200 |
| Long term investments (Note 6) | | 2,572,043 | | 5,082,277 |
| Property and equipment (Note 8) | | 650,507 | | 6,148,090 |
| Intangible assets (Note 9) | | 1,520,863 | | 2,367,722 |
| **Total non-currents assets** | | 4,743,413 | | 14,263,289 |
| | $ | 9,612,404 | $ | 19,929,897 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | | |
| **Current liabilities** | | | | |
| Accounts payable and accrued liabilities (Note 17) | $ | 5,407,360 | $ | 3,272,100 |
| Current portion of development fees payable (Note 10) | | 75,000 | | 75,000 |
| | | 5,482,360 | | 3,347,100 |
| **Non-current liabilities** | | | | |
| Convertible notes (Note 7) | | 2,519,083 | | - |
| Development fees payable to related party (Note 10) | | 536,134 | | 476,359 |
| **Total liabilities** | | 8,537,577 | | 3,823,459 |
| **Shareholders' equity** | | | | |
| Share capital (Note 13) | | 43,667,876 | | 36,670,560 |
| Warrants (Note 13) | | 4,263,621 | | 3,032,300 |
| Share-based reserve (Note 13) | | 3,730,806 | | 3,320,101 |
| Equity Component – Convertible Note | | 270,993 | | - |
| Deficit | | (49,802,217) | | (28,959,547) |
| Accumulated other comprehensive income | | (1,056,252) | | 2,043,024 |
| **Total shareholders' equity** | | 1,074,827 | | 16,106,438 |
| | $ | 9,612,404 | $ | 19,929,897 |

Approved by the Board of Directors: /s/"Howard Mann" Director /s/"Jim Tykoliz" Director

The accompanying notes are integral to these consolidated financial statements

# Alternate Health Corp.

Consolidated Statement of Loss and Comprehensive Loss (in Canadian dollars)

| For the years ended December 31, | | 2018 | 2017 |
|---|---|---|---|
| **Revenue** | $ | 577,170 | $ 13,254,790 |
| **Operating expenses** | | | |
| Advertising and promotion | | 264,655 | 284,902 |
| Depreciation and amortization of equipment and intangible assets (Note 8, 9) | | 1,131,471 | 1,367,939 |
| Accretion – convertible note (Note 7) | | 205,108 | - |
| Bad debts (Note 15) | | 2,712,020 | 426,555 |
| Consulting fees (Notes 17 & 19) | | 3,051,553 | 7,895,733 |
| Interest on long term liabilities | | 337,073 | 92,897 |
| Lab supplies | | 1,183,553 | 2,454,714 |
| Management fees (Note 17) | | - | 3,525,328 |
| Office and general | | 915,049 | 1,084,330 |
| Professional fees | | 3,758,254 | 2,353,372 |
| Rent and occupancy | | 1,152,702 | 1,085,335 |
| Repairs and maintenance | | 252,738 | 283,717 |
| Research and development | | 484,943 | 506,879 |
| Salaries and other benefits | | 4,165,817 | 4,308,217 |
| Share-based compensation (Note 13) | | 410,705 | 5,797,991 |
| Utilities | | 476,195 | 311,152 |
| **Operating expenses** | | 20,501,836 | 31,779,061 |
| **Loss before undernoted items and income taxes** | | (19,924,666) | (18,524,271) |
| **Other expenses/(income)** | | | |
| Bargain purchase on Alternate Health, Labs Inc. acquisition (Note 18) | | - | (2,246,396) |
| Loss on sale of property and equipment (Note 8) | | (455,548) | - |
| Write-down of property and equipment (Note 8) | | (3,414,933) | - |
| Write-down of intangible assets (Note 9) | | (689,702) | - |
| Gain / loss on foreign exchange | | (161,300) | 33,197 |
| Fair value change on long-term investments (Note 6) | | 1,339,479 | - |
| Investment income | | - | (79,337) |
| Allowance for recoverability of assets (Note 11) | | - | 12,219,785 |
| Write down of note receivable (Note 5) | | (681,500) | - |
| Loss on equity settlement on promissory note (Note 13) | | - | 459,039 |
| Income from equity accounted for investment | | - | (300,343) |
| Transaction costs | | - | 34,060 |
| | | (4,063,504) | 10,120,005 |
| **Loss before income taxes** | | (23,988,170) | (28,644,276) |
| **Income taxes (recovery) (Note 12)** | | | |
| Current | | - | (41,881) |
| Deferred | | - | (2,467,585) |
| | | - | (2,509,466) |
| **Net loss** | | (23,988,170) | (26,134,810) |
| **Other comprehensive income (loss)** | | | |
| Foreign currency translation differences for foreign operations | | 46,224 | (685,697) |
| Net unrealized gain on marketable securities | | - | 3,145,500 |
| Deferred tax expense (Note 12) | | - | (416,779) |
| **Other comprehensive income** | | 46,224 | 2,043,024 |
| **Total comprehensive loss** | $ | (23,941,946) | $ (24,091,786) |
| Basic and diluted loss per share (Note 13) | $ | (0.44) | $ (0.53) |
| Average weighted number of shares | | 54,162,456 | 49,754,515 |

The accompanying notes are integral to these consolidated financial statements

# Alternate Health Corp.

Consolidated Statement of Changes in Equity (in Canadian Dollars)

For the years ended December 31, 2018 and 2017

| | Number of shares | Share capital (Note 13) | Number of warrants | Warrants (Notes 13) | Share-based reserve (Note 13) | Equity Component Convertible Note | Accumulated other comprehensive income | Deficit | Total Shareholders' equity |
|---|---|---|---|---|---|---|---|---|---|
| **Balance at December 31, 2016** | 32,916,236 | $ 3,085,186 | 606,250 | $ 29,000 | $ 1,018,100 | $ | $ - | $ (2,824,737) | $ 1,307,549 |
| Issuance of common shares and warrants | 18,181,292 | 32,449,045 | - | 196,736 | - | - | - | - | 32,645,781 |
| Shares held in escrow | 935,000 | - | - | - | - | - | - | - | - |
| Stock-based compensation | - | - | 1,297,544 | 2,835,564 | 2,519,955 | - | - | - | 5,355,519 |
| Exercise of warrants for common shares | 581,250 | 900,875 | (581,250) | (29,000) | - | - | - | - | 871,875 |
| Expiration of warrants | - | - | (25,000) | - | - | - | - | - | - |
| Exercise of stock options | 17,500 | 235,454 | - | - | (217,954) | - | - | - | 17,500 |
| Net and other comprehensive loss | - | - | - | - | - | - | 2,043,024 | (26,134,810) | (24,091,786) |
| **Balance at December 31, 2017** | 52,631,278 | 36,670,560 | 1,297,544 | 3,032,300 | 3,320,101 | - | 2,043,024 | (28,959,547) | 16,106,438 |
| Reclassification (Note 2i) | - | - | - | - | - | - | (3,145,500) | 3,145,500 | - |
| Issuance of common shares | 15,745,818 | 6,997,316 | - | - | - | - | - | - | 6,997,316 |
| Shares returned to Treasury | (750,000) | - | - | - | - | - | - | - | - |
| Expiry of warrants | - | - | (180,000) | - | - | - | - | - | - |
| Share-based compensation | - | - | - | - | 410,705 | - | - | - | 410,705 |
| Issuance of warrants | - | - | 3,438,311 | 1,231,321 | - | - | - | - | 1,231,321 |
| Equity component of convertible note | - | - | - | - | - | 270,993 | - | - | 270,993 |
| Net and other comprehensive income (loss) | - | - | - | - | - | - | 46,224 | (23,988,170) | (23,941,946) |
| **Balance at December 31, 2018** | 67,627,096 | $ 43,667,876 | 4,555,855 | $ 4,263,621 | $ 3,730,806 | $ 270,993 | $ (1,056,252) | $ (49,802,217) | $ 1,074,827 |

The accompanying notes are integral to these consolidated financial statements

# Alternate Health Corp.

Consolidated Statement of Cash Flows (in Canadian dollars)

| For the year ended December 31 | 2018 | 2017 |
|---|---|---|
| **Cash provided from (used in)** | | |
| **Operating activities** | | |
| Net loss | $ (23,988,170) | $ (26,134,810) |
| Accretion of convertible note | 205,108 | - |
| Depreciation and amortization of equipment and intangible assets | 1,131,471 | 1,367,939 |
| Foreign exchange on convertible note | 10,776 | - |
| Interest accrued on development fees payable and convertible note | 180,223 | 63,159 |
| Loss on sale of property and equipment | 455,548 | - |
| Share-based payments | 1,617,788 | 11,938,174 |
| Fair value change on long-term investment | (1,339,479) | (56,694) |
| Write-down of note receivable | 681,500 | - |
| Write-down of property and equipment | 3,414,933 | - |
| Write-down of intangibles | 689,702 | - |
| Allowance for recoverability of assets (Note 11) | - | 12,219,785 |
| Bargain purchase on acquisition (Note 18) | - | (2,246,396) |
| Income from equity accounted for investment | - | (300,343) |
| Deferred tax | - | (2,467,585) |
| Change in non-cash working capital items (Note 14) | 5,258,442 | (909,159) |
| Cash used in operating activities | (11,682,158) | (6,525,930) |
| **Investing activities** | | |
| Proceeds from sale of long term investment | 3,850,970 | 90,905 |
| Proceeds from sale of property and equipment | 1,012,236 | - |
| Purchase of long-term investments | - | (1,969,902) |
| Receipts from due from related parties | - | 40,398 |
| Cash on acquisition of AHL (Note 18) | - | 8,295 |
| Purchase of property and equipment | (3,071) | (785,528) |
| Additions to intangible assets | - | (592,574) |
| Income distribution from equity accounted investment | - | 266,436 |
| Purchase of convertible note receivable (Note 5) | - | (665,200) |
| Cash from (used in) investing activities | 4,860,135 | (3,607,170) |
| **Financing activities** | | |
| Development fees payable to related party | - | (50,000) |
| Issuance of share capital, net of share issuance costs | 6,229,315 | 12,189,876 |
| Issuance of Convertible Debentures, net of cash transaction costs | 2,987,425 | - |
| Equipment lease payments | - | (962,434) |
| Cash from financing activities | 9,216,740 | 11,177,442 |
| Effect of movement of exchange rates | 64,190 | (170,483) |
| Increase in cash | 2,458,907 | 1,044,342 |
| Cash, beginning of year | 1,443,862 | 570,003 |
| Cash, end of year | $ 3,902,769 | $ 1,443,862 |

Supplemental cash flow information (note 14)

The accompanying notes are integral to these consolidated financial statements

## 1. Nature of operations

Alternate Health Corp. (“AHC”) (formerly 1017344 BC Ltd) was incorporated on October 29, 2014 under the Business Corporations Act of British Columbia (“the Act”), and on April 15, 2015 became a public company reporting issuer in Alberta and British Columbia by a Plan of Arrangement granted under the Act. It subsequently changed its name to Alternate Health Corp. On November 23, 2015, the AHC entered into a Share Exchange Agreement with Alternate Health Inc. (“AHI”) which was completed on December 22, 2016 and was accounted for as a reverse takeover of AHC by AHI. On January 1, 2017, AHC acquired 100% of the outstanding shares of Alternate Health Labs, Inc. (“AHL”) (Note 18).

The Company’s registered office is located at Suite 200, 99 Yorkville Avenue, Toronto, Ontario, Canada M5R 3K5 and its executive offices are located at 7373 Broadway Street, Suite 307, San Antonio, TX 78209.

Alternate Health Corp. and its subsidiaries (collectively “Alternate Health” or the “Company”) are a diverse healthcare provider that uses its expertise in technology and data analytics for patient care and research in the emerging medical cannabis industry. Through its subsidiaries, Alternate Health offers services ranging from medical practice and controlled substance management software, blood analysis and toxicology labs, clinical research and continuing education programs.

The Company is in the initial growth stage of the business life cycle and has not yet reached a profitable level of operations. Until the Company reaches profitability, its ability to continue as a going concern is dependent upon the availability of operating funds and long-term financing. Management is continuing to address the need to increase revenue, control costs, and obtain working capital and long-term financing. During the current year the Company incurred a net loss of $23,988,170 and the Company’s current liabilities exceeded its current assets by $613,369. These events and conditions indicate that a material uncertainty exists that may cast significant doubt on the Company’s ability to continue as a going concern.

The Company’s common shares are listed on the Canadian Securities Exchange (Stock Symbol: AHG and OTC in the United States (Stock Symbol: AHGIF).

## 2. Basis of Preparation

*Statement of Compliance*
These consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards ("IFRS") issued by the International Accounting Standards Board ("IASB"). The consolidated financial statements were authorized for issue by the Board of Directors on April 30, 2019.

*Basis of Measurement*
These consolidated financial statements have been prepared on the basis of historical costs except for financial instruments that are measured at fair value.

*Basis of Consolidation*
The consolidated financial statements are comprised of AHC and its wholly owned subsidiaries, which include:

| Entity | Abbreviation | Functional Currency |
|---|---|---|
| (a) Alternate Health Inc | AHI | CAD |
| (b) Canacard Inc | CCI | CAD |
| (c) Alternate Health USA | AHU | USD |
| (d) Alternate Health Labs | AHL | USD |
| (e) Alternate Medical Media | AMM | USD |

All intercompany balances and transactions have been eliminated. Subsidiaries are consolidated from the date of acquisition, being the date on which the Company has power to govern the financial and operating policies of an entity to obtain benefits from its activities and continue to be consolidated until the date such control ceases.

*Functional and Presentation Currency*
Items included in the consolidated financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates. The functional currency of the Company's subsidiaries are summarized above. The consolidated financial statements are presented in Canadian dollars, which is the parent Company's presentation and functional currency.

*Use of Estimates and Judgments*
The preparation of these consolidated financial statements requires management to make certain judgments, estimates and assumptions about the carrying amounts of assets and liabilities, revenue and expenses. These estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

**2. Basis of Preparation, continued**

The areas which require management to make significant judgments, estimates and assumptions in determining carrying values include, but are not limited to:

Revenue recognition and allowance for doubtful accounts
Revenue from laboratory billings are recognized when the services are performed, net of estimated discounts or other deductions including uncollectible amounts. An initial allowance is recorded based on historical patterns and allowances and specific risk that may increase or decrease the net recoverable amount. Allowances are recorded as a reduction of revenue at the time the revenues are recognized.

The Company carries trade accounts receivable at cost net of an allowance for doubtful accounts which provides for any uncertainty of collection. Judgment is required on the evaluation of future probable events that might impact a customer's ability or intention to make full payment of these accounts.

Acquisition accounting
Management uses judgment to determine whether an acquisition qualifies as an asset acquisition or a business combination by reviewing inputs, processes and outputs within a transaction. All identifiable assets, liabilities and contingent liabilities acquired are recognized at fair value on the date of acquisition. Various estimates are used to calculate the fair value of these assets and liabilities as at the date of the acquisition.

Intangible assets
The Company has capitalized certain costs of internally-generated intangible assets related to intellectual property development and the cost of obtaining distribution rights and licensing rights. Judgment is required in identifying whether a particular project can be properly classified as being in the development phase or not. In addition, judgment is required in order to identify and reliably measure the expenditures attributable to these development initiatives.

Certain intangibles assets were acquired through business combination. Purchase price allocations involved significant estimates and assumptions regarding cash flow projections, growth predictions and economic risk.

Useful life of equipment and intangible assets
The amortization method and useful lives reflect the pattern in which management expects the asset's future economic benefits to be consumed by the Company. Judgements are required in determining these expected useful lives.

## 2. Basis of Preparation, continued

Impairment of non-financial assets
Where there are indications that a non-financial asset may be impaired, the Company is required to estimate the asset's recoverable amount. Recoverable amount is the greater of value in use and fair value less costs to sell. Determining the value in use requires the Company to estimate expected future cash flows associated with the assets and a suitable discount rate in order to calculate present value. Management undertook an assessment for the CanaPass cash generating unit ("CGU"), this includes estimating expected patient use and factoring a discount rate that includes the uncertainty of the forecasts in order to calculate its present value. The Company reviews impairment on intangible assets with an indefinite life on an annual basis and intangible assets with a finite life and equipment whenever there are indicators of impairment.

Share-based payments
The Company measures equity-settled share-based payments to directors, employees and others providing similar services at the fair value of the equity instruments at the grant date. The Company also measures equity-settled share-based payments to other parties providing goods or services, including consultants, at the fair value of the equity instruments where the fair value of the goods or services received is not otherwise reliably measurable. The fair value determined at the grant date of the equity-settled share-based payments is calculated using the Black-Scholes option valuation model and is expensed according to the vesting term, based on the Company's estimate of equity instruments that will eventually vest, and credited to share-based reserve. These estimates affect the amount recognized as share-based compensation in the Company's statements of loss and comprehensive loss. At the end of each reporting period, the Company revises its estimate of the number of equity instruments expected to vest.

The use of the Black-Scholes model requires inputting a number of assumptions, including expected dividend yield, expected share price volatility, expected time until exercise and risk free interest rate. Although the assumptions used reflect management's best estimates, they involve inherent uncertainties based on conditions outside of the Company's control. If other assumptions were used, share-based expenses could be significantly impacted.

Deferred income tax assets and liabilities
Significant management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies. The actual amount of income taxes only becomes final upon filing and acceptance of the tax return by the relevant authorities, which occurs subsequent to the issuance of the consolidated financial statements.

Fair value of financial instruments
Determining the fair value requires judgment and is based on market prices or management's best estimate if there is no active market, or if the market is illiquid. When the fair value of a financial instrument cannot be derived from an active market, it is determined using other valuation techniques including internally generated adjustments to quoted prices in observable markets and discounted cash flows. The inputs to these models are taken from observable markets where possible, however, when not feasible, a degree of judgment is required in establishing fair values. The estimate includes consideration of inputs such as liquidity risk and credit risk. Changes in assumptions about these factors may affect the reported fair value of financial instruments.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 2. Basis of Preparation, continued

New and amended accounting pronouncements

The Company adopted the following new standard and interpretations issued by the IASB or International Financial Reporting Interpretation Committee ("IFRIC") as of January 1, 2018.

**IFRS 9 Financial Instruments**

On January 1, 2018, the Company adopted IFRS 9, which replaced *IAS 39 "Financial Instruments: Recognition and Measurement" ("IAS 39")*, on a retrospective basis using certain available transitional provisions. In accordance with the transitional provisions, the comparative information for prior periods have not been restated and the information presented for 2017 reflects the requirements of IAS 39 rather than IFRS 9.

The nature and effect of the changes to IFRS 9 are as follows:

i) Financial instrument classification and measurement

IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. The adoption of IFRS 9 did not have a significant effect on the Company's accounting policies related to financial liabilities and derivative financial instruments.

IFRS 9 provides a revised model for the classification and measurement of financial assets that eliminates the previous categories of financial assets under IAS 39 of "available-for-sale", "held-to-maturity", or "loans and receivables." Under IFRS 9, on initial recognition, a financial asset is classified as and measured at: amortized cost, fair value through profit or loss ("FVTPL", or fair value through other comprehensive income ("FVOCI"). The revised model for classifying financial assets results in classification according to their contractual cash flow characteristics and the business models under which they are held.

On initial recognition of an equity investment that is not held for trading, an irrevocable election is available to measure the investment at FVOCI whereby changes in the investment's fair value (realized and unrealized) will be recognized permanently in OCI with no reclassification to profit or loss. The election is available on an investment-by-investment basis.

The following table summarizes the impact of transition from IAS 39 to IFRS 9:

| | Measurement Category | | |
|---|---|---|---|
| **Asset/Liability** | **Original (IAS 39)** | **New (IFRS 9)** | **Subsequent measurement** |
| Cash | FVTPL | FVTPL | FVTPL |
| Accounts receivable | Loans and receivables | Amortized cost | Amortized cost |
| Due from related parties | Loans and receivables | Amortized cost | Amortized cost |
| Convertible note receivable | Loans and receivables | Amortized cost | Amortized cost |
| Long term investments | Available-for-sale | FVTPL | Fair value |
| Accounts payable and accrued liabilities | Other financial liabilities | Amortized cost | Amortized cost |
| Development fees payable | Other financial liabilities | Amortized cost | Amortized cost |
| Convertible notes | N/A | Amortized cost | Amortized cost |

## 2. Basis of Preparation, continued

The adoption of IFRS 9 did not result in any changes in the carrying values of any of the Company's financial instruments on the transition date.

The adoption of IFRS 9 resulted in long term investments being classified as FVTPL from Available-for-sale under IAS 39. The application of this classification resulted in $3,145,000 being reclassified from other comprehensive income to deficit on adoption.

ii) Impairment of financial assets

IFRS 9 replaced the 'incurred loss' model in IAS 39 with an 'expected credit loss' ("ECL") model. The new impairment model applies to financial assets classified as and measured at amortized cost, contract assets and investments in debt instruments measured at FVOCI, but not to investments in equity instruments. Under IFRS 9, credit losses are recognized earlier than under IAS 39. The adoption of the ECL model under IFRS 9 did not have an impact on the carrying values of any of the Company's financial assets on the transition date.

**IFRIC 22 Foreign Currency Transactions and Advance Consideration**

On January 1, 2018, the Company adopted IFRIC 22, which clarifies the date that should be used for translation when a foreign currency transaction involves an advance payment or receipt. The interpretation clarifies that the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of the advance consideration.

The adoption of IFRIC 22 did not have a material impact on the Company's financial statements and therefore no adjustment was recognized on transition.

**Revenue from contracts with customers ("IFRS 15")**

The core principle of this new standard is for companies to recognise revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration (that is, payment) to which the company expects to be entitled in exchange for those goods or services. The new standard also results in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improves guidance for multiple-element arrangements. This standard did not have a significant effect on the presentation and disclosure of the financial statements

## 3. Summary of significant accounting policies

These consolidated financial statements are prepared in accordance with IFRS. The significant policies are detailed as follows:

### (a) Business combinations

The Company accounts for business combinations using the acquisition method when control is transferred to the Company. The consideration transferred is measured at fair value, along with any identifiable net assets acquired. Subsequent changes in contingent consideration are accounted for through the consolidated statement of loss. Acquisition related costs are expensed as incurred.

Goodwill arising on acquisition is initially measured at cost, being the difference between the fair value of the consideration transferred and the net recognized amount (generally fair value) of the identifiable assets and liabilities assumed at the acquisition date. If the net of the amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the excess is recognized immediately in profit or loss as a bargain purchase gain.

### (b) Revenue recognition and deferred revenue

The Company recognizes revenue for laboratory and toxicology testing at the time test results are reported, which approximates when the services are provided. Services are provided to patients covered by various third-party payor programs, including managed care organizations, as well as the Medicare and Medicaid programs. Billings for services are included in revenue net of allowances for any contractual discounts and allowances for differences between the amounts billed and estimated program payment amounts.

The Company records the revenue from license fees on a straight-line basis over the term of the particular license.

Revenue from consulting services are recognized when services are rendered and collection is reasonably assured.

Amounts invoiced or received from customers in excess of the revenue as determined, are recorded on the consolidated statement of financial position as unearned revenue.

## 3. Summary of significant accounting policies, continued

### (c) Property and Equipment

Property and equipment is recorded at cost. The Company provides for amortization using the following methods at rates designed to amortize the cost of the equipment over their estimated useful lives. The annual amortization rates and methods are as follows:

| | | |
|---|---|---|
| Lab testing equipment | Straight-line | 10 years |
| Office furniture & equipment | Straight-line | 10 years |
| Leasehold improvements | Straight-line | 3 years |
| Computer equipment & software | Straight-line | 3 years |

The estimated useful lives and amortization methods are reviewed at the end of each annual reporting period, with the effect of any changes in estimates being accounted for on a prospective basis.

Equipment not available for use is not subject to amortization. In the year of disposal, the resulting gain or loss is included in the consolidated statements of loss and comprehensive loss and the cost of the equipment retired or otherwise disposed and the related accumulated amortization, are eliminated from these accounts.

## 3. Summary of significant accounting policies, continued

### (d) Intangible assets

Intangible assets with an indefinite useful life are recorded at cost less any write-down for impairment. For intangible assets with a finite useful life, the Company provides for amortization using the following straight-line methods designed to amortize the cost of the intangible assets over their estimated useful lives. The annual amortization rates and methods are as follows:

| | | |
|---|---|---|
| Software development costs | Straight-line | 10 years |
| Continuing medical education | Straight-line | 5 years |
| Software distribution rights | Straight-line | 10 years |
| Licensing rights | Straight-line | 5-10 years |
| Customer relationships | Straight-line | 5 years |
| CLIA Laboratory license | N/A | Indefinite Life |

The estimated useful lives and amortization methods are reviewed at the end of each annual reporting period, with the effect of any changes in estimates being accounted for on a prospective basis.

Internally-generated intangible assets
The Company has capitalized development expenditures that constitute internally-generated intangible assets. An intangible asset may be recognized in future periods if the Company can demonstrate:

(i) the technical feasibility of completing the intangible asset so it will be available for use or sale;
(ii) its intention to complete the intangible assets and use or sell it;
(iii) its ability to use or sell the intangible asset;
(iv) how the asset will generate probable future economic benefits;
(v) the availability of adequate technical, financial and other resources to complete the development and to use or to sell the intangible asset; and
(vi) the ability to measure reliably the expenditure attributable to the intangible asset during its development.

Development expenditures not satisfying the above criteria and expenditures on the research phase of internal projects are recognized in the consolidated statement of loss in the period in which they are incurred.

## 3. Summary of significant accounting policies, continued

### (e) Impairment of non-financial assets

The Company reviews its tangible and intangible assets subject to amortization for indications of impairment at the end of each reporting period or when events or changes in circumstances indicate that the carrying amount may not be recoverable. If any indication of impairment exists, the asset's recoverable amount is estimated. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash generating unit ("CGU") to which the assets belong. A CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.

An impairment loss is recognized when the carrying amount of an asset, or its CGU, exceeds its recoverable amount. The recoverable amount is the higher of fair value (less costs to sell) and value in use. In determining the value in use, the expected future cash flows from the asset are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses are recognized in profit or loss. Where an impairment loss subsequently reverses the carrying amount of the asset or CGU is increased by the revised estimate of its recoverable amount but not beyond the carrying amount that would have been determined had no impairment loss been recognized for the asset in the prior periods. A reversal of such impairment loss is also recognized in the consolidated statement of loss.

## 3. Summary of significant accounting policies, continued

### (f) Income taxes

Income tax expense consists of current and deferred tax expense. Current and deferred tax are recognized in consolidated statement of loss except to the extent that they relate to items recognized directly in equity or other comprehensive income.

Current tax is recognized and measured at the amount expected to be recovered from or payable to the taxation authorities based on the income tax rates enacted or substantively enacted at the end of the reporting period and includes any adjustment to taxes payable in respect of previous years.

Deferred tax is recognized on any temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable earnings. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized and the liability is settled. The effect of a change in the enacted or substantively enacted tax rates is recognized in profit or loss or in equity depending on the item to which the adjustment relates.

Deferred tax assets are recognized to the extent future recovery is probable. At each reporting period end, deferred tax assets are reduced to the extent that it is no longer probable that sufficient taxable earnings will be available to allow all or part of the asset to be recovered.

### (g) Foreign currency transactions and translation

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at period-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statement of loss and comprehensive loss.

Assets and liabilities of subsidiaries with applicable functional currencies other than the Canadian dollar are translated at period-end rates of exchange, and operating results are translated at average rates of exchange for the period. The resulting translation adjustments are included in other comprehensive income (loss).

Fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated based on the functional currency of the foreign entity.

**3. Summary of significant accounting policies, continued**

(h) **Financial instrument classification and measurement**

Financial assets are classified according to their contractual cash flow characteristics and the business models under which they are held. On initial recognition, a financial asset is classified as: amortized cost, FVTPL or FVOCI.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as FVTPL:

- it is held with the objective of collecting contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investment that is not held for trading, the Company may irrevocably elect to measure the investment at FVOCI whereby changes in the investment's fair value (realized and unrealized) will be recognized permanently in OCI with no reclassification to profit or loss. The election is made on an investment-by-investment basis.

All financial assets not classified as amortized cost or FVOCI are classified as and measured at FVTPL. This includes all derivative assets. On initial recognition, a financial asset that otherwise meets the requirements to be measured at amortized cost or FVOCI may be irrevocably designated as FVTPL if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

Financial instruments are measured on initial recognition at fair value, plus, in the case of financial instruments other than those classified as FVTPL, directly attributable transaction costs. Measurement of financial assets in subsequent periods depends on whether the financial asset has been classified as amortized cost, FVTPL or FVOCI. Measurement of financial liabilities subsequent to initial recognition depends on whether they are classified as amortized cost or FVTPL. Financial assets and financial liabilities classified as amortized cost are measured subsequent to initial recognition using the effective interest method.

Loss allowances for 'expected credit losses' are recognized on financial assets measured at amortized cost, contract assets and investments in debt instruments measured at FVOCI, but not to equity investments. A loss event is not required to have occurred before a credit loss is recognized.

The Company has classified and measured its financial instruments as described in Note 3.

## 3. Summary of significant accounting policies, continued

### (i) Share capital

Common shares are classified as equity. Incremental costs directly attributable to the issuance of shares are recognized as a deduction from equity. The Company currently has no other forms of equity authorized or issued other than common share ownership.

### (j) Earnings per share

Basic earnings (loss) per share ("EPS") is calculated by dividing profit or loss attributable to common shares by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by calculating the basic EPS and adjusting the earnings (loss) and number of shares for the effects of dilutive options, and other dilutive potential units. The effects of anti-dilutive potential units are ignored in calculating diluted EPS. All options are considered anti-dilutive when the Company is in a loss position.

### (k) Investment in associates

The Company accounts for its investment subject to significant influence using the equity method of accounting. Once significant influence is determined, the investment is initially recorded at cost, which is determined by the consideration paid at the date of acquisition, including transaction costs. The carrying value of the investment is then adjusted to include the Company’s pro-rata share of post-acquisition earnings of the investee less any dividends or distributions received.  There are no equity-accounted investments as at December 31, 2018.

### (l) Supplies on hand

Supplies on hand consist of lab supplies and are recorded at the lower of cost and replacement cost. Cost is determined using the weighted average method.

## 4. New accounting policies

Certain pronouncements were issued by the IASB or the IFRIC that are mandatory for accounting periods on or after January 1, 2019 or later periods. Many are not applicable or do not have a significant impact to the Company and have been excluded. The following have not yet been adopted by the Company and are being evaluated to determine their impact on the Company:

IFRS 16, Leases: In January 2016, the IASB issued the IFRS 16 Standard, which will supersede the current IAS 17, Leases Standard. IFRS 16 introduces a single accounting model for lessees and for all leases with a term of more than twelve months. A lessee will be required to recognize a right-of-use asset, which is its right to use that underlying asset and a lease liability, which represents the obligation to make the lease payments. The Standard is effective for annual periods beginning on or after January 1, 2019 with early adoption permitted if IFRS 15 has also been applied.

Management is expecting both assets and liabilities to increase due to the requirement to record a right-of-use asset and corresponding lease obligation using an initial present value of unavoidable future lease payments on the Consolidated Statement of Financial Position. It is also expected that there will be a decrease to rent and occupancy costs, an increase to finance costs, due to the accretion of the lease liability, and an increase to amortization of equipment on the Consolidated Statement of Operations and Comprehensive Income (Loss). Actual cash flows are expected to be unaffected, cash flows from operations are expected to increase and cash flows from financing activities are expected to decrease. As at December 31, 2018, Management estimates an impact of $891,000.

## 5. Convertible note receivable

On March 18, 2017, the Company purchased a USD$500,000 convertible debenture issued by Apri Health, Inc. ("Apri Note"). Apri Health develops and implements data analytics and related data mining solutions for healthcare providers and other customers serving the healthcare market. The Apri Note has a five-year term maturing April 2022 and bears interest at 4.5% interest per annum payable on maturity. The Apri Note is convertible into Apri Health common stock or other Apri Health securities under the following conditions:

- If Apri Health notifies the Company of its intent to repay the Apri Note prior to the maturity date;
- If the Apri Note is outstanding at the maturity date; or
- If there is a significant capital raise or liquidation event. If the capital financing is in excess of USD$10,000,000, the Company's conversion feature is at the capital financing price times eighty percent.

At the time of issuance, Apri Health was considered a related party of the Company; the companies had a common director that had significant influence over the operations of the Company. The director resigned in July 2017.

As at December 31, 2018, the Company determined the estimated recoverable amount of the Apri Note to be $nil. Accordingly, the Company recorded a write-down of $681,500 as the balance outstanding as at December 31, 2018.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 6. Long term Investments

| | | 2018 | | 2017 |
|---|---|---|---|---|
| National Access Cannabis Corp. (i) | $ | 1,494,865 | $ | 4,749,295 |
| High Times Holding Corp (ii) | | 1,077,178 | | 332,982 |
| **Total long-term investments** | $ | 2,572,043 | $ | 5,082,277 |

(i) During 2017, the Company acquired 7,221,000 common shares of National Access Cannabis Corp, a health care service provider that specializes in prescribing medical cannabis and provides members with ongoing education and care. During 2017, the Company also sold 132,500 common shares for proceeds of $57,780. As of December 31, 2017, the Company assessed the fair value of its investment at $4,749,295 and recognized an unrealized gain of $3,145,500 in other comprehensive income.

In accordance with adoption of IFRS 9 (Note 2i), the Company reclassified $3,145,000 from other comprehensive income to deficit.

During the year ended December 31, 2018 the Company sold 4,268,000 common shares for proceeds of $3,850,970. As at December 31, 2018 the Company has assessed the fair value of its investment at $1,494,865. The shares have been pledged as collateral for the Note Payable (Note 7).

The assessment is based on Level 1 inputs under the fair value hierarchy as the common shares are publicly traded.

(ii) In March 2017, the Company subscribed for 59,525 Class A common shares of High Times Holding Corp., a publication and resource for cannabis culture, for a cost of $332,982. During fiscal 2018 there was a forward split of 1.93 per share, resulting in the Company holdings 114,935 Class A common shares.

As of December 31, 2018, management has estimated the fair value to be $1,077,178 (2017 - $332,982). This assessment is based on Level 2 inputs under the fair value hierarchy, as there were other financing transactions within a similar series completed in December 2018.

The Company re-measures investments carried at FVTPL immediately prior to sale, the combined fair value gain on re-measurement of both investments sold and still held as at December 31, 2018 was $1,339,479

Notes to Consolidated Financial Statements (in Canadian dollars)

## 7. Convertible Notes

**June 22, 2018 Issuance**

On June 22, 2018 the Company entered into agreements to issue $1.3 million in convertible notes (the "Notes") plus 1,688,000 warrants (the "Warrants"). The Notes have a term of eighteen months from the date of issue and bear simple interest of 12% per annum, payable on a quarterly basis in arrears. Interest and principal under the Notes are convertible into the common shares of the Company at the option of the holder at $0.77 per common share during the term of the Notes. The Notes are secured by the pledge of 2.8 million common shares of National Access Cannabis Corp (Note ). The Company has the right to pay interest on the Notes in cash or shares.

Each warrant is exercisable to acquire one common share at an exercise price of $0.77 per share until June 22, 2021. The fair value of these warrants was estimated at $551,239 (Note 13), at the date of the issuance of the note using the Black-Scholes option pricing model with the following assumptions: Share price – $0.68, Annualized volatility – 80%; Risk-free interest rate – 2.00%; Dividend yield – 0%; and Expected life – 3 years.

For accounting purposes, the convertible debentures were separated into their liability and equity components using the effective interest method. The fair value of the liability component at the time of issue was determined based on an estimated rate of 15% for convertible debentures without the conversion feature. The fair value of the equity component of the conversion feature was determined as the difference between the face value of the convertible debenture and the fair value of the liability component.

Total issuance costs of $626,239 is comprised of the fair value of the warrants issued of $551,239 and cash costs of $75,000. $47,193 of the issuance costs have been allocated to the equity component of the convertible note.

| | | **Convertible note** |
|---|---|---|
| **Balance at December 31, 2017** | $ | - |
| Face value of debt upon issuance | | 1,300,000 |
| Less: Value of conversion option allocated to equity | | (97,967) |
| Less: Issuance costs allocated to debt component | | (579,046) |
| Initial balance of debt component | | 622,987 |
| Accretion | | 173,112 |
| Interest | | 78,000 |
| **Balance at December 31, 2018** | $ | 874,099 |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 7. Convertible Notes, continued

**August 31, 2018 Issuance**

On August 31, 2018 the Company entered a non-brokered private placement (the "Private Placement") of unsecured convertible notes (the "Notes") in the aggregate principal amount of $1,762,425 (US $1,350,000), maturing and payable on the date that is three years from the date of issuance. The Notes shall bear simple interest at a rate of 10% per annum. Interest is payable by the Company on a quarterly basis in arrears. The first interest payment will be September 30, 2018 and subsequent interest payment dates during the term will be December 31, March 31 and June 30. At the Noteholders' option, the Notes may be converted into common shares at a price of $ 0.59 per common share, subject to the policies of the Canadian Securities Exchange. Included in the convertible note placement is a US$775,000 (note 17) subscription by Dr. Michael Murphy, Chairman and CEO the Company.

For accounting purposes, the convertible debentures were separated into their liability and equity components using the effective interest method. The fair value of the liability component at the time of issue was determined based on an estimated rate of 18% for convertible debentures without the conversion feature. The fair value of the equity component of the conversion feature was determined as the difference between the face value of the convertible debenture and the fair value of the liability component.

| | | Convertible note |
|---|---|---|
| **Balance at December 31, 2017** | $ | - |
| Face value of debt upon issuance | | 1,762,425 |
| Less: Value of conversion option allocated to equity | | (220,219) |
| Initial balance of debt component | | 1,542,206 |
| Accretion | | 31,996 |
| Interest | | 58,748 |
| Foreign exchange | | 12,034 |
| **Balance at December 31, 2018** | $ | 1,644,984 |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 8. Property and equipment

| | Office Furniture & Equipment | Computer Equipment & Software | Leasehold Improvements | Lab Testing Equipment | Total |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| December 31, 2016 | $ 13,438 | $ - | $ - | $ - | $ 13,438 |
| Additions | 12,793 | 64,307 | 112,505 | 608,740 | 798,345 |
| Acquisition | 95,977 | 122,285 | 25,443 | 6,322,315 | 6,566,020 |
| Foreign currency translation | (6,787) | (10,284) | (5,512) | (479,204) | (501,787) |
| December 31, 2017 | 115,421 | 176,308 | 132,436 | 6,451,851 | 6,876,016 |
| Additions | - | 3,071 | - | - | 3,071 |
| Impairment on PP&E | (4,102) | (16,412) | (6,132) | (3,388,287) | (3,414,933) |
| Sold assets | - | - | - | (1,789,856) | (1,789,856) |
| Foreign currency translation | 12,225 | 30,178 | 16,891 | 94,355 | 153,649 |
| December 31, 2018 | $ 123,544 | $ 193,145 | $ 143,195 | $ 1,368,063 | $ 1,827,947 |
| **Accumulated Amortization** | | | | | |
| December 31, 2016 | $ (6,234) | $ - | $ - | $ - | $ (6,234) |
| Amortization | (12,688) | (58,066) | (14,979) | (661,285) | (747,018) |
| Foreign currency translation | 347 | 1,975 | 509 | 22,495 | 25,326 |
| December 31, 2017 | (18,575) | (56,091) | (14,470) | (638,790) | (727,926) |
| Amortization | (13,534) | (68,252) | (30,633) | (625,319) | (737,738) |
| Sold assets | - | - | - | 322,073 | 322,073 |
| Foreign currency translation | (1,404) | (5,837) | (1,781) | (24,827) | (33,849) |
| December 31, 2018 | $ (33,513) | $ (130,180) | $ (46,884) | $ (966,863) | $ (1,177,440) |
| **Net Book Value** | | | | | |
| December 31, 2017 | $ 96,846 | $ 120,217 | $ 117,966 | $ 5,813,061 | $ 6,148,090 |
| December 31, 2018 | $ 90,031 | $ 62,965 | $ 96,311 | $ 401,200 | $ 650,507 |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 9. Intangible assets

| | Software Development Costs | Licensing Rights | Software Distribution Rights | Continuing Medical Education | CLIA Lab License | Customer Relationships | Total |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| December 31, 2016 | $ 732,190 | $ - | $ 350,000 | $ 86,592 | $ - | $ - | $ 1,168,782 |
| Additions | - | 2,522,660 | - | 114,914 | - | - | 2,637,574 |
| Acquisition (Note 12) | - | - | - | - | 743,343 | 1,626,834 | 2,370,177 |
| Translation | - | - | - | - | (49,213) | | (49,213) |
| Impairment of asset | - | (1,658,972) | - | - | - | (1,386,034) | (3,045,006) |
| December 31, 2017 | 732,190 | 863,688 | 350,000 | 201,506 | 694,130 | 240,800 | 3,082,314 |
| Additions | - | 241,000 | - | - | - | - | 241,000 |
| Write-down | - | - | - | - | (689,702) | | (689,702) |
| Translation | - | - | - | - | (4,428) | - | (4,428) |
| December 31, 2018 | $ 732,190 | $ 1,104,688 | $ 350,000 | $ 201,507 | $ - | $ 240,800 | $ 2,629,185 |
| **Accumulated Amortization** | | | | | | | |
| December 31, 2016 | $ 146,437 | $ - | $ 20,417 | $ - | $ - | $ - | $ 166,854 |
| Amortization | 73,218 | 168,688 | 35,000 | 18,689 | - | 240,800 | 547,738 |
| December 31, 2017 | 230,998 | 168,688 | 55,417 | 18,689 | - | 240,800 | 714,592 |
| Amortization | 60,544 | 234,530 | 35,004 | 63,654 | - | - | 393,733 |
| December 31, 2018 | $ 291,542 | $ 403,218 | $ 90,421 | $ 82,343 | $ - | $ 240,800 | $ 1,108,325 |
| **Net Book Value** | | | | | | | |
| December 31, 2017 | $ 501,192 | $ 695,000 | $ 294,583 | $ 182,818 | $ 694,130 | $ - | $ 2,367,722 |
| December 31, 2018 | $ 440,648 | $ 701,470 | $ 259,579 | $ 119,164 | $ - | $ - | $ 1,520,863 |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 10. Development fees payable

The development fees payable are payable to a party related by virtue of the controlling shareholder of the party being a Director and significant shareholder of the Company. Terms of repayments are $75,000 annually commencing January 31, 2018 with a balloon payment of the outstanding balance of principal and all accrued interest on August 31, 2020. Interest on any unpaid amounts will accrue effective September 1, 2015 at an annual rate of fifteen percent (15%) until the principal and accrued interest has been repaid. Accrued interest as at December 31, 2018 is $212,634 (December 31, 2017 - $152,859). The balance owing may be prepaid in whole or in part at any time and from time to time with no prepayment penalty.

## 11. Allowance for recoverability of assets

Allowance for recoverability of assets includes impairment losses relate to the write-down of the carrying value of certain assets. In 2017, the Company recognized an impairment loss on the following assets:

| | | **2017** |
|---|---|---|
| (a) | Investment in equity investee (Notes 17) | $ 9,174,779 |
| (b) | Intangible asset – Pet formulations licensing rights | 383,972 |
| (b) | Intangible – CBD sublingual licensing rights | 1,275,000 |
| (c) | Intangible asset – Customer relationships | 1,386,034 |
| | | $ 12,219,785 |

(a) The investment in equity investee was written down to a nominal amount as the investee's equity interest in Sun Clinical Laboratory, LLC is not expected to generate income in the foreseeable future due to changes in reimbursement policies of major health insurance companies purchasing their services.
(b) The Company's Cannabidiol pet formulations licensing rights and CBD sublingual licensing rights were written down to a nominal amount until the Company can demonstrated they will be recoverable from future cash flows.
(c) On the acquisition of Alternate Health Labs Inc. ("AHL"), the Company acquired certain customer relationships (see Note 18). Subsequent to the acquisition, AHL converted from a reference laboratory to a full clinical laboratory, and as a result, it no longer anticipates generating revenues from the acquired reference lab customers, which resulted in the write-down of the related customer relationships intangible asset to a nominal amount.

As at and during the year ended December 31, 2018 there were no changes to the impairment assessment and accordingly no changes in the allowance for recoverability of assets.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 12. Income taxes

The reported income tax expense (recovery) differs from amounts computed by applying the combined federal and provincial income tax rates to the reported income (loss) before income taxes. The calculation of current and deferred taxes is as illustrated below:

| | 2018 | 2017 |
|---|---|---|
| Net loss before tax | $ (23,988,170) | $ (28,644,276) |
| Combined statutory income tax rate | 27% | 26.5% |
| Expected income tax expenses at current rate | (6,477,000) | (7,590,733) |
| Permanent differences | 1,353,000 | 1,213,629 |
| Change in deferred tax rates | (50,000) | 144,060 |
| Difference between Canada and foreign tax rates | 928,000 | (1,025,957) |
| Changes in deferred tax asset not recognized | 5,374,000 | 4,749,535 |
| Other | - | - |
| | $ - | $ (2,509,466) |
| Current income tax (recovery) | $ - | $ (41,881) |
| Deferred tax (recovery) | - | (2,467,585) |
| | $ - | $ (2,509,466) |

The significant components of the Company's deferred tax assets that have not been included on the consolidated statement of financial position are as follows:

| | 2018 | 2017 |
|---|---|---|
| Deferred tax assets (liabilities) | | |
| Equipment and intangible assets | $ 1,259,000 | $ 457,000 |
| Share issue costs | 142,000 | - |
| Investments | 1,956,000 | 1,548,000 |
| Inventory and other | 471,000 | - |
| Allowable capital losses | 92,000 | - |
| Equipment and intangible assets | 5,944,000 | 2,494,000 |
| | 9,873,000 | 4,499,000 |
| Unrecognized deferred tax assets | (9,873,00) | (4,499,000) |
| **Net deferred tax assets** | $ - | $ - |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 12. Income taxes, continued

The significant components of the Company's temporary differences, unused tax credits and unused tax losses that have not been included on the consolidated statement of financial position are as follows:

| | 2018 | Expiry Date Range | 2017 | Expiry Date Range |
|---|---|---|---|---|
| **Temporary Differences** | | | | |
| Equipment and intangible assets | 5,442,000 | No expiry date | 1,726,000 | No expiry date |
| Share issue costs | 526,000 | 2039 to 2041 | - | 2038 to 2040 |
| Investments | 9,355,000 | No expiry date | 5,842,000 | No expiry date |
| Inventory and other | 2,242,000 | No expiry date | - | No expiry date |
| Allowable capital losses | 341,000 | No expiry date | - | No expiry date |
| Non-capital losses available for future years | 12,725,000 | 2034 to 2038 | 9,351,000 | 2034 to 2037 |
| Canada | 12,006,000 | 2034 to 2038 | 9,559,000 | 2034 to 2037 |
| USA | 11,549,000 | 2037 to 2038 | 292,000 | 2037 |

As at December 31, 2018, the non-capital losses carried forward for tax purposes expire as follows:

| | Loss amount |
|---|---|
| Year of expiry | |
| 2035 | $ 21,748 |
| 2036 | 635,280 |
| 2037 | 8,255,391 |
| 2038 | 17,375,449 |
| | $ 26,287,868 |

## 13. Shareholders' equity

Authorized – Unlimited number of common shares without par value

The following shares, options and warrants were issued during fiscal 2018 and are summarized on the Statement of Changes in Equity, and are described more fully as follows:

(a) During 2018, 185,000 common shares previously issued and held in escrow were released at a value of $453,250 for services received in fiscal 2018 and recorded within consulting fees.
(b) 360,000 stock options valued at $410,705 were issued in consideration for consulting services rendered to the Company. The options were valued using the Black Scholes pricing model.
(c) During 2018, a total of 200,000 common shares valued at $241,000 were issued for the purchase of software licencing intangible assets.
(d) 125,001 common shares with a fair value of $73,751 were issued in consideration of various consulting services.
( e) 15,420,817 common shares were issued in private placement providing proceeds of $6,229,315.
(f) 750,000 common share purchase warrants valued at $218,019 were issued in consideration of various consulting services. The warrants were valued using the Black Scholes pricing model.
(g) 1,688,311 common share purchase warrants valued at $551,239 were issued in conjunction with the convertible note (Note 7).
(h) 750,000 common shares that were held in escrow were returned to Treasury.
(i) 1,000,000 common share purchase warrants valued at $462,063 were issued in consideration for FourTwenty, Inc., a Company owned by a Director of the Company (Note 16). The warrants were valued using the Black Scholes pricing model.

## 13. Shareholders' equity, continued

The following shares and warrants were issued in 2017:

(a) In January 2017, a total of 2,270,355 common shares were issued in consideration for the purchase of 100% of the issued and outstanding shares of Alternate Health Labs Inc. ("AHL") and to settle debts owed by AHL to Dr. Michael Murphy (Note 18).

(b) During 2017, a total of 5,243,294 common shares were issued in a private placement providing proceeds of $11,504,003 less share issuance costs of $638,052.

(c) During 2017, a total of 3,418,506 common shares were issued in consideration for commercialization licensing rights, cannabidiol, CBD & THC certification programs, and a renewal license agreement for non-pharmaceutical sublingual technology system, and other related consulting services.

(d) During 2017, a total of 1,297,544 common share purchase warrants were issued in consideration of various consulting services; 581,250 common share purchase warrants were exercised resulting in the issuance of 581,250 common shares providing proceeds of $871,875.

(e) During 2017, a total of 1,030,000 stock options were issued in consideration for various consulting and other services; 17,500 stock options were exercised resulting in the issuance of 17,500 common shares providing proceeds of $17,500.

(f) During 2017 a total of 4,557,150 common shares were issued in consideration for a 20% equity interest in Clover Trail Capital LLC, a company that in turn owns a 40% equity interest in Sun Clinical Laboratories LLC, which referred toxicology and blood samples to AHL for screening. The purchase also included the issuance of a note payable for USD$1,993,750 which was subsequently extinguished through the issuance of an additional 800,387 common shares.

(g) During 2017, a total of 2,641,600 common shares were issued in consideration for various consulting and other services rendered to the Company. Of these common shares, a total of 935,000 common shares were held in escrow pending the provision of the agreed services.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 13. Shareholders' equity, continued

**Warrants:**

| | Number | Amount |
|---|---|---|
| **Balance December 31, 2016** | 606,250 | $ 29,000 |
| Issuance for services rendered | 1,297,544 | 3,032,300 |
| Exercised | (581,250) | (29,000) |
| Expired | (25,000) | - |
| **Balance December 31, 2017** | 1,297,544 | 3,032,300 |
| Issuance with convertible note (Note 5) | 1,688,311 | 551,239 |
| Issuance for services rendered | 750,000 | 218,019 |
| Issuance for Four Twenty, Inc. (Note16) | 1,000,000 | 462,063 |
| Exercised | - | - |
| Expired | (180,000) | - |
| **Balance, December 31, 2018** | 4,555,855 | $ 4,263,621 |

| Warrants outstanding and exercisable at December 31, 2018 | Remaining life (months) | Weighted average exercise price | Expiry date |
|---|---|---|---|
| 200,000 | 6.5 | 3.05 | June 15, 2019 |
| 50,000 | 12 | 2.45 | December 6, 2019 |
| 1,688,311 | 29 | 0.77 | June 23, 2021 |
| 250,000 | 34 | 0.42 | October 30, 2021 |
| 250,000 | 35 | 0.42 | November 30, 2021 |
| 250.000 | 36 | 0.42 | December 30, 2021 |
| 867,544 | 39.5 | 3.91 | April 14, 2022 |
| 1,000,000 | 57.5 | 0.57 | October 15, 2023 |
| 4,555,855 | | $ 1.38 | |

## 13. Shareholders' equity, continued

The fair value of the warrants issued in 2018 for services rendered has been estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: risk free interest rate 2.17% (2017 – 1.66%); expected dividend yield 0% (2017 – 0%); and estimated volatility of 91% (2017 – 98%). The fair value of these warrants at time of issue were $218,019 ($3,032,300).

**Loss per share:**

Basic loss per share is calculated based on the weighted average number of common shares outstanding which for the year ended December 31, 2018 were 54,162,456 (December 31, 2017 – 49,754,515).

For the periods presented, all stock options and warrants are considered anti-dilutive when the Company is in a loss position; therefore, diluted loss per share is equal to basic loss per share.

Stock options and warrants have been excluded from the diluted earnings per share as these instruments are anti-dilutive.

**Share-based reserve and stock options:**

On November 24, 2015, the shareholders of the Company adopted a Stock Option Plan (the "Plan") which is administered by the directors of the Company. Under the Plan, the Company may grant to directors, officers, employees and consultants options to purchase shares of the Company. The Plan provides for the issuance of stock options up to 15% of the Company's issued and outstanding common shares. The Plan is a rolling plan such that the number of shares reserved for issuance will increase as the number of issued and outstanding common shares increases. Cancelled and expired Options are returned to the Plan. Options granted under the Plan are exercisable for a period as determined by the Board, from the date of the grant. The exercise price of the options shall be determined by the Board at the time of the grant but shall not be less than the greater of the closing market price of the Shares on (a) the trading day prior to the date of grant of the Options; and (b) the date of grant of the Options. In any event, no Options shall be granted which are exercisable at an Exercise Price of less than permitted by Canadian Stock Exchange Policy. An Exercise Price cannot be established unless the Options are allocated to a particular Option Holder.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 13. Shareholders' equity, continued

The granting of options is subject to the following conditions:

a) the aggregate number of shares which may be subject to issuance pursuant to Options granted under this Plan, inclusive of all other stock options outstanding shall not exceed 15% of the Shares issued and outstanding at the date of the grant of Options;
b) the number of Shares reserved for issuance under the Plan shall not exceed 5% of the issued shares of the Company to any one person (and companies wholly owned by that person) in any 12-month period, calculated on the date the Option is granted.

All options granted under the Stock Option Plan will expire not later than the date that is ten years from the date that such options are granted. Options terminate earlier as follows: (i) immediately in the event of dismissal with cause; (ii) 90 days from date of termination other than for cause; or (iii) one year from the date of death or disability. Options granted under the Stock Option Plan are not transferable or assignable other than by will or other testamentary instrument or pursuant to the laws of succession.

A summary of the stock options outstanding and exercisable under the plan as of December 31, 2018 and 2017 and changes during the periods are as follows:

| | **Options** | **Weighted Price** |
|---|---|---|
| Options outstanding and exercisable at December 31, 2016 | 1,800,000 | $ 1.00 |
| Granted | 1,030,000 | 3.41 |
| Exercised | (17,500) | 1.00 |
| Options Outstanding and exercisable at December 31, 2017 | 2,812,500 | 1.88 |
| Granted | 360,000 | 1.96 |
| Expired | (1,902,500) | 1.19 |
| Options outstanding and exercisable at December 31, 2018 | 1,270,000 | $ 2.95 |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 13. Shareholders' equity, continued

The following table summarizes additional disclosures on the stock options outstanding at December 31, 2018:

| Exercise price ($) | Number outstanding & exercisable | Remaining average life (months) | Fair value at time of issue ($) |
|---|---|---|---|
| 0.74 | 60,000 | 56.1 | 19,147 |
| 4.00 | 460,000 | 39.5 | 1,477,520 |
| 2.90 | 330,000 | 43.5 | 698,667 |
| 2.00 | 120,000 | 47.1 | 173,285 |
| 2.20 | 300,000 | 49.1 | 391,557 |
| | 1,270,000 | | |

The fair value of the options granted during the year ended December 31, 2018 has been estimated at the date of grant using the Black Scholes option pricing model with the following weighted-average assumptions: risk free interest rate of 2.56% (2017 - 1.69%); expected dividend yield of nil% (2017 - nil%); estimated volatility of 72.0% (2017 – 57.7% to 98.0%).

## 14. Supplemental cash flow information

| For the year ended December 31 | 2018 | 2017 |
|---|---|---|
| Accounts receivable | $ 2,771,717 | $ (863,186) |
| HST receivable | 11,013 | (55,144) |
| Income taxes receivable | 135,491 | (322,883) |
| Due from related parties | 208,142 | - |
| Supplies on hand | 474,412 | (491,913) |
| Prepaid expenses and deposits | (223,997) | (402,035) |
| Accounts payable and accrued liabilities | 1,881,664 | 1,393,197 |
| Deferred revenue | - | (167,195) |
| | $ 5,258,442 | $ (909,159) |

| | 2018 | 2017 |
|---|---|---|
| **Other significant non-cash transactions** | | |
| Issuance of common shares for goods and services | $ 768,001 | $ 21,395,498 |
| Reclassification to opening deficit | 3,145,500 | - |
| Warrants issued as transaction costs | 551,239 | - |
| Equity component of convertible debentures | 270,993 | - |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 15. Financial instruments

The Company's financial instruments are exposed to certain financial risks, including liquidity risk, interest rate risk, foreign currency risk and credit risk. The Company's exposure to these risks and its methods of managing the risks remain consistent with the prior year.

(a) Liquidity risk

Liquidity risk is the risk that the Company will not have sufficient cash resources to meet its financial obligations as they come due. The Company's liquidity and operating results may be adversely affected if the Company's access to financing capital is hindered, whether because of a downturn in market conditions, generally, or related to matters specific to the Company. The Company is exposed to this risk mainly with respect to its accounts payable and accrued liabilities, development fees payable and commitments (Note 16).

The Company has sustained losses since incorporation and has financed these losses through the issuance of equity offerings. Management believes that it has sufficient cash and access to a marketable security in the upcoming year to meet all its contractual obligations and fund any potential operating losses, which may occur.

The table below represents non-derivate financial liabilities by maturity based on the remaining period from December 31, 2018 to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows (excluding commitments Note 16):

| | Total | Under 1 year | 1-3 years | After 3 years |
|---|---|---|---|---|
| Accounts payable and accrued liabilities | $ 5,407,360 | $ 5,407,360 | $ - | $ - |
| Development fee payable | 611,134 | 75,000 | 536,134 | - |
| | $ 6,018,494 | $ 5,482,360 | $ 536,134 | $ - |

(b) Interest rate risk

Interest rate risk consists of:

(i) the extent to which payments made or received on the Company's monetary assets and liabilities are affected by changes in the prevailing market interest rates, and

(ii) the extent to which changes in prevailing market rates differ from the interest rate in the Company's monetary assets and liabilities.

Interest rate risk is a risk that the future cash flows of a financial instrument may fluctuate due to changes in market conditions. The Company's interest rate risk is related its convertible note receivable, the deferred development fee payable, and the convertible notes payable. The Company does not have any assets or liabilities with a variable interest rate, which minimizes the Company's exposure to fluctuations in interest rates. There have been no changes to the risk exposure from the prior year.

**15. Financial instruments, continued**

(c) Foreign currency risk

Foreign currency risk is created by fluctuations in the fair value or cash flows of financial instruments due to changes in foreign exchange rates and exposure because of the Company's US operations.

Although the Company is headquartered in Canada, the majority of the Company's revenues are in the United States.

Although management has deemed it not appropriate to utilize currency hedges, currency risk is managed by maintaining operations in the local currency, therefore avoiding foreign currency translations at the entity level. This decentralization acts as a natural hedge. Management continues to monitor this risk and may mitigate this risk with derivatives should the impact become material or effect the Company's business plan.

Foreign exchange sensitivity analysis:

An appreciation (depreciation) of the Canadian dollar against the U.S. dollar would have resulted in an increase (decrease) of $99,906 in the Company's net loss because of the Company's net exposure to currency risk through its current assets and liabilities denominated in U.S. dollars. This analysis is based on a foreign currency exchange rate variance of 5%, which the Company considered to be reasonably possible at December 31, 2018.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 15. Financial instruments, continued

(d) Fair value

IFRS 7 Financial Instruments: Disclosures requires disclosure of a three-level hierarchy ("FV hierarchy") that reflects the significance of the inputs used in making fair value assessments, measurements and disclosures. Fair values of assets and liabilities included in Level 1 are determined by referring to quoted price in an active market for identical assets or liabilities. Assets and liabilities included in Level 2 are those whose valuations are determined using inputs other than quoted prices for which all direct or indirect significant outputs are observable. Level 3 valuations are those based on inputs that are unobservable and significant to the overall fair value measurement.

The following table illustrates the classification of financial assets (liabilities) in the FV hierarchy:

| | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| **Financial assets** | | | |
| Cash | $ 1,443,862 | $ - | $ - |
| Accounts receivable | - | 2,748,567 | - |
| HST receivable | - | 79,615 | - |
| Due from related parties | - | 208,142 | - |
| Convertible note receivable from related party | - | - | 665,200 |
| Long term investments | 4,749,295 | 332,982 | - |
| **Financial liabilities** | | | |
| Accounts payable and accrued liabilities | - | (3,272,100) | - |
| Development fees payable to related party | - | (551,359) | - |
| As at December 31, 2017 | **$ 6,193,157** | **$ (454,153)** | **$ 665,200** |

| | Level 1 | Level 2 | Level 3 |
|---|---|---|---|
| **Financial assets** | | | |
| Cash | $ 3,902,769 | $ - | $ - |
| Accounts Receivable | - | 62,988 | - |
| HST receivable | - | 68,602 | - |
| Convertible note receivable from related party | - | - | - |
| Long term investments | 1,494,865 | 1,077,178 | - |
| **Financial liabilities** | | | |
| Accounts payable and accrued liabilities | - | (5,407,360) | - |
| Development fees payable to related party | - | (611,134) | - |
| As at December 31, 2018 | **$ 5,397,634** | **$ (4,809,726)** | **$ -** |

As at December 31, 2018 the carrying amount of cash, accounts receivable, HST receivable, due from related parties and accounts payable and accrued liabilities approximately their fair value due to their short-term nature. The carrying value of the development fees payable to related party approximates its fair value as its interest payable on outstanding amounts approximates the Company's current cost of debt.

During the year ended December 31, 2018, there were no transfer between any levels.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 15. Financial instruments, continued

(e) Credit risk

Credit risk is the risk that one party to a financial asset will cause a financial loss for the Company by failing to discharge an obligation. The Company's credit risk arises primarily from the Company's cash, accounts receivable, and investments. The Company provides credit to its customers in the normal course of its operations.

Credit risk with cash is minimized by ensuring this financial asset is place with financial institutions with high credit ratings.

HST receivable is comprised of refundable taxes receivable from the Canada Revenue Agency ("CRA"). Refundable taxes are subject to review by CRA, which may delay receipt. Management believes that the risk of the CRA failing to deliver payment to the Company is minimal.

## 16. Commitments

The Company entered into lease agreements for office facilities in USA. Minimum annual commitments for the next five years are as follows (USD):

| | | |
|---|---|---|
| 2019 | $ | 964,565 |
| 2020 | | 593,175 |
| 2021 | | 512,340 |
| 2022 | | 444,865 |
| 2023 | | 262,800 |
| | $ | 2,777,745 |

**FourTwenty, Inc**

During fiscal 2018, the Company acquired a 100% interest in FourTwenty, Inc ("FourTwenty"), for consideration of 1,000,000 common share purchase warrants. The purchase also includes a ten-year management agreement providing the management fee equal to 20% of the net revenue associated with the commercial cannabis activities in California. Prior to the Company's purchase of FourTwenty, its controlling member, George Mull, became a director and officer of the Company and as a result is a related party. The Company recorded the fair value of the purchase within research and development as the purpose of the acquisition was to develop the Company's presence in the California cannabis market.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 17. Related party transactions

(a) The Company incurred the following transactions with companies having directors and officers in common:

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Interest expense | $ | 165,408 | $ | 63,159 |
| Key management personnel and board of directors' cash-based compensation included in consulting fees | | 2,655,765 | | 1,690,645 |
| Key management personnel and board of directors' cash-based compensation included in salaries and benefits | | 384,968 | | 63,288 |
| Key management personnel and board of directors' share-based compensation (non-cash) | $ | 410,705 | $ | 5,797,991 |

The Company incurred the following consulting fees with related parties included in the table above:

(i) Consulting services of $490,864 paid to a company related by way of common directors and common significant shareholders.

(ii) Consulting services of $508,777 paid to a company related by way of common directors and common significant shareholders.

(iii) Consulting services of $815,503 to various directors, officers or shareholders of the Company.

(b) The Company is related to Sun Clinical Laboratory, LLC and LMK Management LLC through Dr. Michael Murphy, the controlling shareholder of these companies who is also a director and significant shareholder of the Company. The Company is also related to Sun Clinical Laboratory, LLC through the significant influence of its equity investee (Note 17f). Transactions and balances with these related parties are as follows:

| | | 2018 | | 2017 |
|---|---|---|---|---|
| Revenue from Sun Clinical Laboratory, LLC | $ | - | $ | 3,067,042 |
| Management fees to LMK Management LLC | | - | | 3,176,139 |

(c) Included in accounts payable and accrued liabilities are amounts owing to related parties by way of common directors and common significant shareholders:

| | 2018 | 2017 |
|---|---|---|
| LMK Management LLC | 2,144,094 | 2,026,514 |
| MLM Holdings | 635,856 | - |
| Cannabinoid SCI | 218,080 | - |
| KLC Holdings | 145,214 | - |
| Support Your Buds | 278,187 | - |
| Directors & Officers | 304,092 | - |
| | 3,725,523 | 2,026,514 |

Notes to Consolidated Financial Statements (in Canadian dollars)

## 17. Related party transactions, continued

(d) Due from related parties

| | 2018 | 2017 |
|---|---|---|
| D.C. Netcast Media Group Inc. | $ - | $ 48,142 |
| Support Your Buds LLC | - | 160,000 |
| | $ - | $ 208,142 |

DC Netcast Media Group Inc. is a company controlled by a Director and a significant shareholder of the Company. The amount due from DC Netcast Group Inc. has no fixed terms of repayment, is unsecured and carries no interest.

Support Yours Buds LLC is a company controlled by a significant shareholder of the Company. The amounts due from Support Your Buds LLC have no fixed terms of repayment, are unsecured and carry no interest.

(e) The Company has a convertible note receivable from Apri Health, Inc., which is related by virtue of having a director and officer in common at the time of purchase (Note 5). The director of Apri Health is no longer related to the Company at year end.

(f) Effective January 13, 2017 the Company acquired a 20% interest in Clover Trail Capital LLC ("Clover"), a company that in turn owns a 40% equity interest in Sun Clinical Laboratories LLC, an entity located in the US which refers toxicology and blood samples to AHL for screening, for consideration of 4,557,150 common shares. The purchase also included the issuance of a note payable for US$1,993,750 which was subsequently extinguished through the issuance of an additional 800,387 common shares.

Subsequent to the Company's purchase of Clover, its controlling member, Dr. Michael Murphy, became a director and officer of the Company and as a result is a related party. The Company accounts for its investment in Clover on an equity basis and recorded equity earnings of $300,343 and received a cash income distribution of $265,436 for the year ended December 31, 2017. As at and during the year ended December 31, 2017, the investment was written down.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 18. Acquisition of Alternate Health Labs, Inc.

In 2016, the Company entered a Lab Business Development Agreement ("LDA" agreement) with Dr. Michael Murphy ("Murphy") of San Antonio, Texas to establish and equip a licensed toxicology laboratory to be owned by a subsidiary of the Company. On January 1, 2017, the Company closed the transaction and acquired 100% of Alternate Health Labs Inc. ("AHL") from Murphy for total consideration of 2,270,355 common shares valued at $3,481,326.

The acquisition of AHL was accounted for using the purchase method of accounting in accordance with IFRS 3 with the results of operations consolidated with those of the Company effective January 1, 2017 and has contributed incremental revenue of USD$9,414,086 and income of USD$486,266 for the year ended December 31, 2017. Transaction costs associated with the transaction were minimal, have been expensed, and are included in the consolidated statement of loss and comprehensive loss.

The Company allocated the purchase price to the net identifiable assets and liabilities acquired based on their fair values at the time of the acquisition as follows:

| | |
|---|---|
| Fair value of assets and liabilities recognized on acquisition: | |
| Current assets | $ 2,185,275 |
| Property and equipment | 6,566,020 |
| Intangible asset – customer relationships | 1,626,834 |
| Intangible asset – CLIA lab license | 743,343 |
| Current liabilities | (1,916,105) |
| Assumed lease liabilities | (995,619) |
| Deferred tax liability | (2,482,026) |
| | 5,727,722 |
| Bargain purchase arising on acquisition | (2,246,396) |
| | $ 3,481,326 |

Under the LDA, the Company entered into a management agreement with LMK Management ("LMK"). LMK manages the laboratory and earns a management fee equal to 49% of the profits generated by particular lab tests, which are calculated by multiplying the number of monthly tests times a mutually agreed fee less all monthly fixed and variable expenses.

The customer relationships intangible relates to the fair value of the customer base for the reference laboratory. Subsequent to the acquisition, AHL converted from a reference laboratory to a full clinical laboratory. The customer relationships were subsequently written off during the year (Note 11(c)). The CLIA lab license relate to the licences required for the operation of laboratories in the US. The deferred tax liability relates primarily to temporary timing differences related to property and equipment and intangible assets. The bargain purchase arose as a result of the number of shares negotiated as consideration being negotiated a number of months prior to the final closing of the acquisition, with no adjustment clause related to operating performance up to the close date, which was stronger than originally anticipated during the negotiations.

The purchase price allocation has been finalized.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 19. Capital management

The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern while maintaining dividends to its shareholders and the growth of the Company's business.

The capital structure is comprised of the following:

| | 2018 | 2017 |
|---|---|---|
| Cash | $ 3,902,769 | $ 1,443,862 |
| Development fees payable | 611,134 | 551,359 |
| Shareholders' equity | 1,074,827 | 16,106,438 |
| | $ 5,588,730 | $ 18,101,659 |

The Company manages its capital structure and adjusts it in light of general economic conditions and the risk characteristics of the underlying assets and the Company’s working capital requirements. In order to maintain or adjust the capital structure, the Company, upon approval from its Board of Directors, may issue long-term debt, convertible debentures, issue shares, repurchase shares through a normal course issuer bid and pay dividends. The Board of Directors reviews and approves any material transactions not in the ordinary course of business, which may include various acquisition proposals, as well as capital and operating budgets. The Company is not subject to any externally imposed capital requirements.

## 20. Contingencies

**Litigation**
The Company and its wholly-owned US subsidiary, AHU, have been named by way of counterclaim, as counter-defendants, in a claim filed in federal court in California, by a third party with whom the Company had entered into an agreement for consulting services as part of the issuance of 2,968,506 in common shares as consideration. The counterclaimant is alleging various causes of action and is seeking, among other things, that the Company dismiss its original claim against the third party, special and general damages, costs, and removal of any restrictions on transfer of shares of the Company held by the third party. The Company believes the counterclaim has no merit and intends to vigorously defend the action, as well as pursue its original claim against the third party for, among other things, return of the shares previously issued to the third party.

On April 18, 2018, AHL was named in a multi party lawsuit by a health insurance company that was not a customer of AHL but of Sun Clinical Laboratory, LLC, a related party to AHL (Note 17). The suit alleges various causes of action including fraud and fraudulent non-disclosure. The Company is currently reviewing the allegations and claims by the health insurance company. The receipt and evaluation of the claims are in the early stages and as a result, management has determined that it is not clear whether there is an obligation as a result of past events and a reliable estimate of a potential payment, if any, is not yet determinable. Management intends to vigorously defend against these claims.

On June 11, 2018, AHL was named in a multi party lawsuit by a health insurance company that was not a customer of AHL but of Sun Clinical Laboratory, LLC, a related party to AHL (Note 17). The suit alleges various causes of action including fraud and fraudulent non-disclosure. The Company is currently reviewing the allegations and claims by the health insurance company. The receipt and evaluation of the claims are in the early stages and as a result, management has determined that it is not clear whether there is an obligation as a result of past events and a reliable estimate of a potential payment, if any, is not yet determinable. Management intends to vigorously defend against these claims.

On December 26, 2018, AHU, was named in a lawsuit alleging that the plaintiff, a terminated former employee, was owed back pay, certain other contract promises, and damages for alleged harassment by a prior employee of AHU. There has been an early mediation and the demand of the Plaintiff of $200,000 was rejected by AHU. Management intends to vigorously defend against these claims.

**Arbitration**
The Company and two wholly-owned subsidiaries, Alternate Health, Inc., and Alternate Health USA Inc. have been named by way of counterclaim, as counter-respondents, in a claim filed in an arbitration in California, by a third party with whom the Company had entered into a worldwide renewable license agreement as part of the issuance of 2,968,506 in common shares as consideration. The counterclaimant is alleging various causes of action and is seeking, among other things, that the Company dismiss its original claim against the third party, special and general damages, costs, and removal of any restrictions on transfer of shares of the Company held by the third party. The Company believes the counterclaim has no merit and intends to vigorously defend the action, as well as pursue its original claim against the third party for, among other things, return of the shares previously issued to the third party.

Notes to Consolidated Financial Statements (in Canadian dollars)

## 21. Segmented Information

For the year ended December 31, 2018, the Company reports operations in two reportable segments: Laboratory and toxicology services and licensing and medical software services. The Company has chosen to organize the entity around differences in products and service. Substantially all of the revenue for the year ended December 31, 2018 was derived from the Laboratory and toxicology services. The balance of revenue was derived from consulting and licensing services, which do not meet the quantitative thresholds to be disclosed as a separate reportable segment, which has been disclosed under Corporate and Other.

Management monitors the operating results of these segments separately to make decisions about resource allocation and performance. The Laboratory and toxicology service segment is located in the US. $475,654 of Licensing and medical software revenue is generated in the US. The remaining $101,516 of Licensing and medical software revenue is generated in Canada. All assets of Licensing and medical software service are held in Canada.

| | Laboratory and Toxicology Services | Corporate and Other | Total |
|---|---|---|---|
| Revenue | $ 531,103 | $ 46,067 | $ 577,170 |
| Depreciation and amortization | 735,264 | 396,207 | 1,131,471 |
| Other operating expenses | 15,597,481 | 8,537,228 | 19,370,365 |
| **Other income (expenses)** | | | |
| Loss on foreign exchange | - | (161,300) | (161,300) |
| Fair value change - investments | - | 1,339,479 | 1,339,479 |
| Loss on sale of equipment | (455,548) | - | (455,548) |
| Impairment of intangible asset | (689,702) | - | (689,702) |
| Impairment of investment | | (681,500) | (681,500) |
| Impairment of property and equipment | (3,414,933) | - | (3,414,933) |
| Tax expense (recovery) | - | - | - |
| Net income (loss) | (15,597,481) | (8,390,689) | (23,988,170) |
| Additions – Property and equipment | $ - | $ 3,071 | $ 3,071 |
| Additions – Intangible assets | - | 241,000 | 241,000 |
| Total assets | $ - | $ 9,612,404 | $ 9,612,404 |
| Total liabilities | $ - | (8,537,577) | (8,537,577) |

For the year ended December 31, 2017 and 2018, approximately 90% of total revenues are generated from two customers.

## 22. Subsequent Events

Subsequent to year end the Company completed the following transactions:

A) In January, Alternate Health ("Company") secured state licenses for the manufacturing and distribution of cannabis at its facility in Los Angeles, California in addition to its licenses in Humboldt County, California.

B) In March, the Company signed two agreements to in connection with the Company's California cannabis operations. The first agreement outlines Alternate Health's purchase of DTS Lab Services ("DTS"), a cannabis extracts company. The agreement details the purchase of all DTS's assets, extraction equipment and intellectual property, including the Dank Tank brand of extract vaporizers and cartridges. The second agreement is with two California cannabis companies to expand, build-out and manage a 60,000 square foot Adelanto facility. Alternate Health will take a 55% stake in both companies in return for providing equipment and managing operations, including producing wholesale extracts and manufacturing Dank Tank-branded products.