

**PART I—FINANCIAL INFORMATION**

**Item 1. Financial Statements.**

**TILRAY, INC.**  
**Condensed Consolidated Balance Sheets**  
(in thousands of U.S. dollars, except for share and par value data, unaudited)

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 100,159	\$ 487,255
Short-term investments	22,213	30,335
Accounts receivable, net of allowance for doubtful accounts of \$612 and \$292, respectively	36,040	16,525
Other receivables	2,886	969
Inventory	110,487	16,211
Prepaid expenses and other current assets	58,895	3,007
<b>Total current assets</b>	<u>330,680</u>	<u>554,302</u>
Property and equipment, net	166,489	80,214
Intangible assets, net	329,928	4,486
Goodwill	163,041	—
Investments	42,318	16,911
Deposits and other assets	7,744	754
<b>Total assets</b>	<u>\$ 1,040,200</u>	<u>\$ 656,667</u>
<b>Liabilities</b>		
Current liabilities		
Accounts payable	58,688	10,649
Accrued expenses and other current liabilities	71,387	14,818
Accrued obligations under capital lease	127	470
<b>Total current liabilities</b>	<u>130,202</u>	<u>25,937</u>
Accrued obligations under capital lease	9,166	8,286
Deferred tax liability	57,100	4,424
Convertible Notes, net of issuance cost	427,983	420,367
<b>Total liabilities</b>	<u>\$ 624,451</u>	<u>\$ 459,014</u>
<b>Stockholders' equity</b>		
Class 1 common stock (\$0.0001 par value, 250,000,000 shares authorized; 16,666,667 shares issued and outstanding)	2	2
Class 2 common stock (\$0.0001 par value; 500,000,000 shares authorized; 83,605,076 and 76,504,200 shares issued and outstanding, respectively)	8	8
Additional paid-in capital	623,254	302,057
Accumulated other comprehensive income	1,694	3,763
Accumulated deficit	(209,209)	(108,177)
<b>Total stockholders' equity</b>	<u>415,749</u>	<u>197,653</u>
<b>Total liabilities and stockholders' equity</b>	<u>\$ 1,040,200</u>	<u>\$ 656,667</u>

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

**TILRAY, INC.**  
**Condensed Consolidated Statements of Net Loss and Comprehensive Loss**  
(in thousands of U.S. dollars, except for share and per share data, unaudited)

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Revenue	\$ 51,101	\$ 10,047	\$ 120,043	\$ 27,599
Cost of sales	35,248	6,979	86,532	16,458
Gross profit	15,853	3,068	33,511	11,141
General and administrative expense	19,978	7,001	49,240	16,488
Sales and marketing expense	16,974	3,493	39,161	9,061
Depreciation and amortization expense	3,190	529	7,438	1,032
Stock-based compensation expense	8,315	11,245	21,206	16,877
Research and development expense	2,315	802	4,891	2,416
Loss from equity method investments	1,837	—	1,837	—
Acquisition-related (income) expense, net	(13,454)	10	(6,598)	10
Operating loss	(23,302)	(20,012)	(83,664)	(34,743)
Foreign exchange loss (gain), net	2,585	(1,591)	1,153	913
Interest expense, net	8,687	480	26,018	1,393
Finance income from ABG Profit Participation Arrangement	(210)	—	(557)	—
Other income, net	(1,313)	(225)	(5,661)	(422)
Loss before income taxes	(33,051)	(18,676)	(104,617)	(36,627)
Deferred income tax expense (recovery)	2,432	—	(3,987)	—
Current income tax expense	195	24	402	87
Net loss	<u>\$ (35,678)</u>	<u>\$ (18,700)</u>	<u>\$ (101,032)</u>	<u>\$ (36,714)</u>
Net loss per share - basic and diluted	(0.36)	(0.20)	(1.04)	(0.39)
Weighted average shares used in computation of net loss per share - basic and diluted	98,130,507	93,144,042	96,742,626	93,144,042
Net loss	\$ (35,678)	\$ (18,700)	\$ (101,032)	\$ (36,714)
Foreign currency translation loss	(4,863)	(451)	(2,414)	(538)
Unrealized (loss) gain on cash equivalents and investments	(301)	—	345	—
Other comprehensive loss	(5,164)	(451)	(2,069)	(538)
Comprehensive loss	<u>\$ (40,842)</u>	<u>\$ (19,151)</u>	<u>\$ (103,101)</u>	<u>\$ (37,252)</u>

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**TILRAY, INC.**  
**Condensed Consolidated Statements of Stockholders' Equity**  
(in thousands of U.S. dollars, except for share data, unaudited)

	Common stock		Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Total equity (deficit)
	Number of shares	Amount				
Balance as of December 31, 2018	93,170,867	\$ 10	\$ 302,057	\$ 3,763	\$ (108,177)	\$ 197,653
Shares issued for Natura acquisition	180,332	—	15,100	—	—	15,100
Shares issued for Manitoba Harvest acquisition	1,209,946	—	96,844	—	—	96,844
Shares issued for ABG Profit Participation Arrangement	1,680,214	—	125,097	—	—	125,097
Receivable for ABG Profit Participation Arrangement, net of finance income	—	—	(30,292)	—	—	(30,292)
Shares issued under stock-based compensation plans	545,000	—	931	—	—	931
Shares issued for employee compensation	11,868	—	649	—	—	649
Stock-based compensation expense	—	—	5,306	—	—	5,306
Other comprehensive income	—	—	—	933	—	933
Net loss	—	—	—	—	(30,301)	(30,301)
Balance as of March 31, 2019	96,798,227	10	515,692	4,696	(138,478)	381,920
Shares issued under stock-based compensation plans	530,943	—	3,483	—	—	3,483
Shares issued for investment	28,361	—	70	—	—	70
Stock-based compensation expense	—	—	7,585	—	—	7,585
Other comprehensive income	—	—	—	2,162	—	2,162
Net loss	—	—	—	—	(35,053)	(35,053)
Balance as of June 30, 2019	97,357,531	10	526,830	6,858	(173,531)	360,167
Shares issued for common stock at-the-market, net of issuance costs	1,344,166	—	37,445	—	—	37,445
Shares issued for Manitoba Harvest acquisition	899,306	—	31,866	—	—	31,866
Shares issued for investments and S&S acquisition	433,338	—	14,438	—	—	14,438
Finance income for receivable for ABG Profit Participation Arrangement	—	—	1,393	—	—	1,393
Shares issued under stock-based compensation plans	237,402	—	2,967	—	—	2,967
Stock-based compensation expense	—	—	8,315	—	—	8,315
Other comprehensive loss	—	—	—	(5,164)	—	(5,164)
Net loss	—	—	—	—	(35,678)	(35,678)
Balance as of September 30, 2019	100,271,743	\$ 10	\$ 623,254	\$ 1,694	\$ (209,209)	\$ 415,749

**TILRAY, INC.**  
**Condensed Consolidated Statements of Stockholders' Equity**  
(in thousands of U.S. dollars, except for share data, unaudited)

	Convertible preferred shares		Common stock		Additional paid-in capital	Accumulated other comprehensive income	Accumulated deficit	Total equity (deficit)
	Number of shares	Amount	Number of shares	Amount				
Balance as of December 31, 2017	—	\$ —	—	\$ —	\$ 31,736	\$ 3,866	\$ (40,454)	\$ (4,852)
Shares issued for convertible preferred stock, net of issuance costs	7,794,042	1	—	—	52,639	—	—	52,640
Shares issued for common stock, net of issuance costs	—	—	75,000,000	8	—	—	—	8
Stock-based compensation expense	—	—	—	—	31	—	—	31
Other comprehensive loss	—	—	—	—	—	(1)	—	(1)
Net loss	—	—	—	—	—	—	(5,181)	(5,181)
Balance as of March 31, 2018	7,794,042	1	75,000,000	8	84,406	3,865	(45,635)	42,645
Stock-based compensation expense	—	—	—	—	5,601	—	—	5,601
Other comprehensive loss	—	—	—	—	—	(86)	—	(86)
Net loss	—	—	—	—	—	—	(12,833)	(12,833)
Balance as of June 30, 2018	7,794,042	1	75,000,000	8	90,007	3,779	(58,468)	35,327
Conversion of preferred stock	(7,794,042)	(1)	7,794,042	1	—	—	—	—
Shares issued for common stock, net of issuance costs	—	—	10,350,000	1	160,692	—	—	160,693
Stock-based compensation expense	—	—	—	—	11,245	—	—	11,245
Other comprehensive loss	—	—	—	—	—	(451)	—	(451)
Net loss	—	—	—	—	—	—	(18,700)	(18,700)
Balance as of September 30, 2018	—	\$ —	\$ 93,144,042	\$ 10	\$ 261,944	\$ 3,328	\$ (77,168)	\$ 188,114

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

**TILRAY, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
(in thousands of U.S. dollars, unaudited)

	Nine months ended September 30,	
	2019	2018
<b>Operating activities</b>		
Net loss	\$ (101,032)	\$ (36,714)
Adjusted for the following items:		
Depreciation and amortization expense	10,441	2,552
Stock-based compensation expense	21,206	16,877
Change in fair value of contingent consideration	(17,019)	—
Loss from equity method investments	1,837	—
Deferred taxes	(3,987)	—
Amortization of discount on Convertible Notes	7,616	—
Other operating activities	1,755	1,618
Changes in non-cash working capital:		
Accounts receivable	(13,102)	(4,808)
Other receivables	(1,917)	(3,553)
Inventory	(73,758)	(7,754)
Prepaid expenses and other current assets	(54,607)	(4,686)
Accounts payable	38,773	4,500
Accrued expenses and other current liabilities	16,539	5,528
Net cash used in operating activities	<u>(167,255)</u>	<u>(26,440)</u>
<b>Investing activities</b>		
Acquisition of Manitoba Harvest, net of cash acquired	(151,003)	—
Acquisition of Natura, net of cash acquired	(15,083)	—
Investment in ABG Profit Participation Arrangement	(33,333)	—
Investment in equity method investees and S&S acquisition	(14,302)	—
Change in deposits and other assets	85	—
Purchases of short-term and non-current investments	(8,486)	(44,061)
Proceeds from sales and maturities of short-term investments	8,640	29,393
Purchases of property and equipment	(50,421)	(38,076)
Disposals of property and equipment	—	34
Purchases of intangible assets	(941)	(834)
Net cash used in investing activities	<u>(264,844)</u>	<u>(53,544)</u>
<b>Financing activities</b>		
Proceeds from at-the-market equity offering, net of costs	37,445	—
Proceeds from ABG Profit Participation Arrangement	3,333	—
Repayment under Privateer debt facilities	—	(36,940)
Advances under Privateer debt and construction facilities	—	3,700
Proceeds from issuance of common stock pursuant to IPO, net	—	160,785
Proceeds from Preferred Shares - Series A, net	—	52,638
Proceeds from exercise of stock options	4,885	—
Minimum lease payments under capital lease	(565)	(516)
Net cash provided by financing activities	<u>45,098</u>	<u>179,667</u>
Effect of foreign currency translation on cash and cash equivalents	(95)	2,239
<b>Cash and cash equivalents</b>		
(Decrease) increase in cash and cash equivalents	<u>(387,096)</u>	<u>101,922</u>
Cash and cash equivalents, beginning of period	487,255	2,323
Cash and cash equivalents, end of period	<u>\$ 100,159</u>	<u>\$ 104,245</u>
<b>Supplemental Disclosure for Cash Flow Information</b>		
Cash paid for interest	\$ 17,613	\$ 930
Non-cash investing activities		
Acquisition of Manitoba Harvest	\$ 157,917	\$ —
Acquisition of Natura	\$ 38,980	\$ —
Investment in ABG Profit Participation Arrangement, net of receivable	\$ 94,805	\$ —
Purchases of investments and S&S acquisition	\$ 14,508	\$ —

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

**Tilray, Inc.**  
**Notes to Condensed Consolidated Financial Statements**  
**(in thousands, except for shares and per share amounts, unaudited)**

**1. Summary of Significant Accounting Policies**

*Basis of presentation*

The accompanying unaudited condensed consolidated financial statements (the “financial statements”) reflect the accounts of Tilray, Inc. and its wholly owned subsidiaries (collectively “Tilray”, the “Company”, “we”, “our”, or “us”). The financial statements were prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) and pursuant to the rules and regulations of the United States Securities and Exchange Commission (“SEC”) for interim financial information. Accordingly, these financial statements do not include all the information and footnotes required for annual financial statements and should be read in conjunction with the audited consolidated financial statements included in the Company’s annual report on Form 10-K for the year ended December 31, 2018 (the “Annual Financial Statements”).

These financial statements reflect all adjustments, consisting solely of normal recurring adjustments, which, in the opinion of management, are necessary for a fair presentation of the Company’s financial position and results of operations. The results of operations for the three and nine months ended September 30, 2019 and 2018 are not necessarily indicative of results that can be expected for the full year.

The Condensed Consolidated Statement of Net Loss and Comprehensive Loss for the three and nine months ended September 30, 2018 were reclassified to conform to the current period’s presentation. Specifically, depreciation and amortization expense as well as acquisition-related (income) expense, net, which were formerly presented as part of general and administrative expenses, are now presented separately.

Other than as described below, there were no changes to our significant accounting policies described in our Annual Financial Statements that had a material impact on our financial statements and related notes.

*Emerging growth company status*

The Company is an emerging growth company under the JOBS Act and has elected to take advantage of the extended transition period for complying with new or revised accounting standards applicable to public companies. Because the market value of the Company’s Class 2 common stock held by non-affiliates exceeded \$700 million as of June 30, 2019, the Company will be deemed a large accelerated filer under the Exchange Act and will lose emerging growth company status as of December 31, 2019.

*Business combinations and goodwill*

The Company accounts for business combinations using the acquisition method in accordance with ASC 805 “Business Combinations,” which requires recognition of assets acquired and liabilities assumed, including contingent assets and liabilities, at their respective fair values on the date of acquisition. Any excess of the purchase consideration over the net fair value of tangible and identified intangible assets acquired less liabilities assumed is recorded as goodwill. The costs of business acquisitions, including fees for accounting, legal, professional consulting and valuation specialists, are expensed as incurred. Purchase price allocations may be preliminary and, during the measurement period not to exceed one year from the date of acquisition, changes in assumptions and estimates that result in adjustments to the fair value of assets acquired and liabilities assumed are recorded in the period the adjustments are determined.

For business combinations achieved in stages, the Company’s previously held interest in the acquiree is remeasured at its acquisition date fair value, with the resulting gain or loss recorded in the Consolidated Statements of Net Loss and Comprehensive Loss. For a pre-existing relationship between the Company and acquiree that is not extinguished on the business combination, such a relationship is considered effectively settled as part of the business combination even if it is not legally cancelled. At the acquisition date, it becomes an intercompany relationship and is eliminated upon consolidation.

The estimated fair value of acquired assets and assumed liabilities are determined primarily using a discounted cash flow approach, with estimated cash flows discounted at a rate that the Company believes a market participant would determine to be commensurate with the inherent risks associated with the asset and related estimated cash flow streams. Contingent consideration in a business combination is remeasured at fair value each reporting period until the contingency is resolved and any change in fair value from either the passage of time or events occurring after the acquisition date, is recorded within acquisition-related (income) expense, net on the Consolidated Statements of Net Loss and Comprehensive Loss.

### *Intangible assets*

The Company records intangible assets at cost, net of accumulated amortization and accumulated impairment losses, if any. Cost is measured based on the fair values of cash consideration paid and equity interests issued. The cost of an intangible asset acquired in a business combination is its acquisition date fair value.

Amortization of definite life intangible assets is calculated on a straight-line basis over the estimated useful lives of the assets as follows:

Patents	20 years
Customer relationships	14 to 16 years
Developed technology	10 years
Websites	3 years
Supply contract	3 years
Licenses	2 years

The Company has rights under the ABG Profit Participation Arrangement, trademarks and a cultivation license with indefinite life. Intangible assets that are determined to have an indefinite life are not amortized, but tested for impairment annually or more frequently when indicators of impairment exist. If the carrying value of an individual indefinite-lived intangible asset exceeds its fair value, such individual indefinite-life intangible asset is impaired by the amount of the excess.

### *Equity method investments*

Investments in entities over which the Company has significant influence but not a controlling interest are accounted for using the equity method, with the Company's share of earnings or losses reported in loss from equity method investments on the Consolidated Statements of Net Loss and Comprehensive Loss. Equity method investments are recorded at cost, plus the Company's share of undistributed earnings or losses, within investments on the Consolidated Balance Sheets.

The Company assesses investment in equity method investments if there is reason to believe an impairment may have occurred including, but not limited to, ongoing operating losses, projected decreases in earnings, increases in the weighted-average cost of capital, or significant business disruptions. The significant assumptions used to estimate fair value include revenue growth and profitability, capital spending, depreciation and taxes, foreign currency exchange rates, and discount rate. By their nature, these projections and assumptions are uncertain. If it is determined that the current fair value of an investment is less than the carrying value of the investment, the Company will assess if the shortfall is of a temporary or permanent nature and write down the investment to its fair value if it is concluded the impairment is other than temporary.

### *Stock-based payments*

Fully vested, non-forfeitable equity instruments issued to parties other than employees are measured on the date they are issued where there is no specific performance required by the grantee to retain those equity instruments. Stock-based payment transactions with non-employees are measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Where fully vested, non-forfeitable equity instruments are granted to parties other than employees in exchange for notes or financing receivable, the note or receivable is presented in additional paid-in capital on the Consolidated Balance Sheets.

### *Impairment of goodwill and indefinite life intangible assets*

Goodwill and indefinite life intangible assets are tested for impairment annually, or more frequently when events or circumstances indicate that impairment may have occurred. As part of the impairment evaluation, the Company may elect to perform an assessment of qualitative factors. If this qualitative assessment indicates that it is more likely than not that the fair value of the indefinite-lived intangible asset or the reporting unit (for goodwill) is less than its carrying value, a quantitative impairment test to compare the fair value to the carrying value and record an impairment charge if the carrying value exceeds the fair value is conducted.

### *Significant estimates and judgments*

The preparation of the Company's financial statements requires management to make estimates, assumptions and judgments that affect the reported amounts of revenue, expenses, assets, liabilities, accompanying disclosures and the disclosure of contingent liabilities. These estimates and judgments are subject to change based on experience and new information. Uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amounts of assets or liabilities affecting future periods. Estimates and judgments are reviewed on an ongoing basis. Revisions to estimates are recognized prospectively. Financial statement areas that require significant estimates and judgments are as follows:

Business combinations – The Company uses judgment in applying the acquisition method of accounting for business combinations and estimates to value identifiable assets and liabilities at the acquisition date. Estimates are used to determine cash flow projections, including the period of future benefit, and future growth and discount rates, among other factors. The values allocated to the acquired assets and liabilities assumed affect the amount of goodwill recorded on acquisition. Fair value is typically estimated using the present value of future discounted cash flows, an income approach. Significant estimates in the discounted cash flow model include the discount rate, rates of future revenue growth and profitability of the acquired business, and working capital effects. The discount rate considers the relevant risk associated with business-specific characteristics and the uncertainty related to the ability to achieve projected cash flows. These estimates and the resulting valuations require significant judgment.

Contingent consideration – Contingent consideration is subject to measurement uncertainty as the financial impact will only be confirmed by the outcome of a future event. The assessment of contingent consideration involves a significant amount of judgment, including determining a reliable estimate of the amount of cash outflow required to settle the obligation based on significant unobservable inputs as well as estimates around the probability and timing of satisfying the future events on which the contingent consideration is based.

Asset impairment – Asset impairment tests require the allocation of assets to asset groups, which requires significant judgment and interpretation with respect to the integration between the assets and shared resources. Asset impairment tests require the determination of whether there is an indication of impairment. The assessment of whether an indication of impairment exists is performed at the end of each reporting period and requires the application of judgment, historical experience, and external and internal sources of information.

Stock-based payments – Stock-based payment transactions are measured and recognized based on estimated fair value, which requires judgment in determining the appropriate valuation model and assumptions, including discount for shares not registered with the Securities Exchange Commission (“SEC”) subject to transfer restrictions.

Imputed interest for loans receivable – In connection with the loans obtained as part of the ABG Profit Participation Arrangement, judgment is required to estimate the prevailing market interest rate at each time a loan is issued.

#### *New accounting pronouncements not yet adopted*

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standard Update (“ASU”) 2014-09, Revenue from Contracts with Customers (Topic 606), a new standard on revenue recognition. Further, the FASB issued a number of additional ASUs regarding the new revenue recognition standard. The new standard, as amended, will supersede existing revenue recognition guidance and apply to all entities that enter into contracts to provide goods or services to customers. In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers – Deferral of the Effective Date, which amends ASU 2014-09 to defer the effective date by one year. For public companies, the new standard is effective for annual reporting periods beginning after December 31, 2017, including interim periods within that reporting period. For all other entities, including emerging growth companies, this standard is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. The Company is evaluating the impact on the financial statements, including both the quantitative impact of recognition and presentation of related disclosures, and expects to implement the provisions of ASU 2014-09 for the annual financial statements for the year ended December 31, 2019.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10) – Recognition and Measurement of Financial Assets and Financial Liabilities, which requires all investments in equity securities with readily determinable fair value to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under the equity method of accounting or those that result in consolidation of the investee). ASU 2016-01 is intended to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information and removes the requirement to disclose the methods and significant assumptions used to estimate the fair value for financial instruments measured at amortized cost on the balance sheet. For public companies, the new standard is effective for annual periods beginning after December 15, 2017, including interim periods within the fiscal year. For all other entities, including emerging growth companies, ASU 2016-01 is effective for annual periods beginning after December 15, 2018, and interim periods within annual periods beginning after December 15, 2019. The Company is evaluating the impact on the financial statements and expects to implement the provisions of ASU 2016-01 for the annual financial statements for the year ended December 31, 2019.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes the current accounting for leases and while retaining two distinct types of leases, finance and operating, (1) requires lessees to record a right of use asset and a related liability for the rights and obligations associated with a lease, regardless of lease classification, and recognize lease expense in a manner similar to current accounting, (2) eliminates most real estate specific lease provisions, and (3) aligns many of the underlying lessor model principles with those in the new revenue standard. Leases with a term of 12 months or less will be accounted for similar to existing guidance for operating leases today. For public companies, the new standard is effective for annual and interim periods in fiscal years beginning after December 15, 2018. For all other entities, including emerging growth companies, this standard is effective for annual reporting periods beginning after December 15, 2019, and interim periods within fiscal years beginning after December 2020. Earlier application is permitted. The Company is evaluating the impact on the financial statements and expects to implement the provisions of ASU 2016-02 for the annual financial statements for the year ended December 31, 2019 using the modified retrospective transition method with a cumulative adjustment to retained earnings rather than retrospectively adjusting prior periods. This adoption approach will result in a balance sheet presentation that is not comparable to the prior period in the first year of adoption. On adoption, our operating leases, excluding those with terms less than 12 months, will be discounted and recorded as assets and liabilities on our consolidated balance sheet.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. ASU 2016-13 requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Adoption of ASU 2016-13 will require financial institutions and other organizations to use forward-looking information to better formulate their credit loss estimates. In addition, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This update will be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is evaluating the impact on the financial statements and expects to implement the provisions of ASU 2016-13 as of January 1, 2020.

In August 2018, the FASB issued ASU 2018-13, Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement (Topic 820). ASU 2018-13 adds, modifies, and removes certain fair value measurement disclosure requirements. ASU 2018-13 is effective for annual and interim periods beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the impact on the financial statements and expects to implement the provisions of ASU 2018-13 as of January 1, 2020.

## 2. Investments

Long-term investments are comprised of the following items:

	September 30, 2019	December 31, 2018
Investments under the cost method	\$ 20,731	\$ 15,066
Investment in securities under available-for-sale method	9,531	1,845
Equity method investments	12,056	—
Total investments	<u>\$ 42,318</u>	<u>\$ 16,911</u>

As of September 30, 2019, total unrealized loss recognized in accumulated other comprehensive income related to long-term available-for-sale equity securities from initial recognition was \$538 (December 31, 2018 – \$802).

As of September 30, 2019, equity method investments primarily relates to the Company’s joint venture with Anheuser-Busch InBev (“AB InBev”) entered in December 2018 to research and develop non-alcohol beverages containing cannabis. Under the terms of the arrangement, the Company and AB InBev each have 50% ownership and 50% voting interest. During the nine months ended September 30, 2019, the Company contributed \$10,090 to the joint venture.

## 3. Fair Value Measurement

The Company complies with ASC 820, Fair Value Measurements, for its financial assets and liabilities that are re-measured and reported at fair value at each reporting period, and non-financial assets and liabilities that are re-measured and reported at fair value at least annually. In general, fair values determined by Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are observable such as quoted prices, interest rates and yield curves. Fair values determined by Level 3 inputs are unobservable data points for the asset or liability, and includes situations where there is little, if any, market activity for the asset or liability.

The following table presents information about the Company's assets that are measured at fair value on a recurring basis as of September 30, 2019 and December 31, 2018, and indicates the fair value hierarchy of the valuation techniques the Company utilized to determine such fair value:

	Quoted prices in active markets for identical assets (Level 1)	Other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
<b>September 30, 2019</b>				
<b>Investments</b>				
Short-term investments	\$ 22,213	\$ —	\$ —	\$ 22,213
Investment in equity securities under available-for-sale method	3,357	—	—	3,357
Investment in debt securities under available-for-sale method	—	1,174	5,000	6,174
Total investments	25,570	1,174	5,000	31,744
Acquisition-related contingent consideration	—	—	(34,034)	(34,034)
Total	<u>\$ 25,570</u>	<u>\$ 1,174</u>	<u>\$ (29,034)</u>	<u>\$ (2,290)</u>
<b>December 31, 2018</b>				
Cash equivalents	\$ 203,761	\$ —	\$ —	\$ 203,761
<b>Investments</b>				
Short-term investments	30,335	—	—	30,335
Investment in equity securities under available-for-sale method	1,163	682	—	1,845
Total investments	31,498	682	—	32,180
Total	<u>\$ 235,259</u>	<u>\$ 682</u>	<u>\$ —</u>	<u>\$ 235,941</u>

As of September 30, 2019, the carrying amount of short-term investments, which includes corporate bonds and treasury bills, includes an unrealized gain recognized in accumulated other comprehensive income of \$17 (December 31, 2018 – gain of \$69). For the three and nine months ended September 30, 2019, \$751 and \$2,741, respectively, were reclassified from other comprehensive (loss) income to other income, net for realized gains on short-term investments. No amounts were reclassified for the comparative periods in 2018. Contractual maturities for debt securities under available-for-sale method are less than three years. Contingent consideration is recorded within accrued expenses and other current liabilities and primarily reflects the consideration for: (i) the acquisition of Manitoba Harvest payable in shares of Class 2 common stock contingent on revenues earned in 2019, and (ii) the acquisition of Natura payable in shares of Class 2 common stock contingent on production levels. Refer to Note 9 for details. There were no transfers between fair value measurement hierarchy levels during the three months ended September 30, 2019.

#### 4. Inventory

Inventory is comprised of the following items:

	<u>September 30, 2019</u>	<u>December 31, 2018</u>
Raw materials	\$ 5,362	\$ 2,132
Work-in-process	81,342	12,812
Finished goods	23,783	1,267
Total	<u>\$ 110,487</u>	<u>\$ 16,211</u>

Inventory is written down for any obsolescence or when the net realizable value of inventory is less than the carrying value. For the three and nine months ended September 30, 2019, the Company recorded write-downs within work-in-process of \$201 and \$726, respectively, (2018 – \$795 and \$1,498) in cost of sales. As of September 30, 2019, the Company's inventory balance is in excess of historical sales for the past twelve months. This increase in inventory primarily relates to cannabis derivative products in anticipation for the next phase of the adult-use market given legislation effective in December 2019. Management believes no loss will be incurred on its disposition.

## 5. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets is comprised of the following items:

	September 30, 2019	December 31, 2018
Deposits	\$ 45,255	\$ 1,511
Prepaid expenses	8,904	1,496
Loan receivable	3,817	—
Other current assets	919	—
Total	<u>\$ 58,895</u>	<u>\$ 3,007</u>

Deposits include prepayments on future purchases of inventory to secure supply. The loan receivable relates to a working capital loan to 420 Investments Ltd. (“FOUR20”) until the closing of the acquisition anticipated in the first quarter of 2020 upon regulatory approval.

## 6. Property and Equipment, Net

Property and equipment, net consists of the following:

	September 30, 2019	December 31, 2018
Land	\$ 5,585	\$ 4,498
Buildings and leasehold improvements	94,695	51,111
Laboratory and manufacturing equipment	25,229	6,131
Office and computer equipment	3,289	970
Assets under capital lease	9,989	9,661
Construction in process	41,719	15,343
	<u>180,506</u>	<u>87,714</u>
Less: accumulated depreciation and amortization	(14,017)	(7,500)
Total	<u>\$ 166,489</u>	<u>\$ 80,214</u>

For the three and nine months ended September 30, 2019, depreciation expense related to general office space and equipment was \$197 and \$741, respectively (2018 – \$34 and \$93). In addition, depreciation expense included in cost of sales relating to manufacturing equipment and production facilities was \$1,496 and \$3,003 for the three and nine months ended September 30, 2019, respectively, (2018 – \$208 and \$467) with the remaining depreciation included in inventory.

For the three and nine months ended September 30, 2019, capitalized interest included in construction-in-progress was \$140 and \$306, respectively (2018 – nil and \$169).

The Company had \$94,906 in property and equipment additions related to building and leasehold improvements, laboratory and manufacturing equipment, office and computer equipment and construction in process during the nine months ended September 30, 2019 (2018 – \$35,725). Additions to building and leasehold improvements primarily relate to the Company’s acquisitions of Manitoba Harvest and Natura. Additions to construction in process primarily relate to the ongoing construction of the Company’s London, Ontario and Portugal facilities.

## 7. Intangible Assets

Intangible assets are comprised of the following items:

	Weighted Average Amortization Period (in years)	September 30, 2019			December 31, 2018		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Customer relationships	15	\$ 133,501	\$ 4,903	\$ 128,598	\$ —	\$ —	\$ —
Developed technology	9	6,947	405	6,542	—	—	—
Websites	2	4,824	3,006	1,818	3,755	2,253	1,502
Alef license	2	4,086	—	4,086	2,984	—	2,984
Other intangibles	3	3,086	70	3,016	—	—	—
Cultivation license	Indefinite	10,496	—	10,496	—	—	—
Trademarks	Indefinite	56,006	—	56,006	—	—	—
Rights under ABG Profit Participation Arrangement	Indefinite	119,366	—	119,366	—	—	—
<b>Total</b>		<b>\$ 338,312</b>	<b>\$ 8,384</b>	<b>\$ 329,928</b>	<b>\$ 6,739</b>	<b>\$ 2,253</b>	<b>\$ 4,486</b>

The net carrying value of intangible assets not yet available for use as of September 30, 2019 was \$6,427 (December 31, 2018 – \$3,027). At September 30, 2019, this consisted of the Alef license and a supply contract arising from the acquisition of Natura.

Intangible asset additions for the nine months ended September 30, 2019 primarily related to customer relationships, developed technology and trademarks as part of the acquisition of Manitoba Harvest as well as cultivation license and supply contract as part of the acquisition of Natura. Refer to Note 15 for details. Moreover, indefinite-lived rights under the ABG Profit Participation Arrangement were acquired in the first quarter of 2019. Refer to Note 14 for details.

The amortization expense for the next five years on intangibles assets in use are as follows: remaining in 2019 – \$2,555; 2020 – \$10,223; 2021 – \$9,658; 2022 – \$9,318; 2023 – \$9,207, and thereafter – \$103,099.

## 8. Goodwill

The following table shows the change in carrying amount of goodwill:

Balance as of December 31, 2018	\$	—
Acquisition of Manitoba Harvest		131,082
Acquisition of Natura		26,974
Acquisition of S&S		5,493
Foreign currency translation adjustment		(508)
Balance as of September 30, 2019	\$	<u>163,041</u>

## 9. Accounts Payable, Accrued Expenses and Other Current Liabilities

Accounts payable, accrued expenses and other current liabilities are comprised of the following items:

	September 30, 2019	December 31, 2018
Accounts payable - trade	\$ 58,411	\$ 9,716
Accounts payable - related parties	277	933
<b>Total accounts payable</b>	<b>\$ 58,688</b>	<b>\$ 10,649</b>
Accrued interest on Convertible Notes	\$ 11,875	\$ 5,302
Accrued payroll	7,559	3,278
Accrued legal and professional fees	452	565
Contingent consideration for acquisitions	34,034	—
Other accrued expenses and current liabilities	17,467	5,673
<b>Total accrued expenses and other current liabilities</b>	<b>\$ 71,387</b>	<b>\$ 14,818</b>

As part of the acquisition of Manitoba Harvest (see Note 15), the Company entered into a contingent consideration arrangement whereby the Company may pay a maximum of \$37,129 (C\$49,000) payable in shares of Class 2 common stock. The payment amount is based on gross branded cannabidiol (“CBD”) product sales in the United States for the period from January 1, 2019 to December 31, 2019. The estimated fair value of the contingent consideration was valued using a probability-weighted discounted cash flow model based on internal forecasts and the estimated cost of debt for the Company. The contingent consideration is reassessed and adjusted to fair value each quarter through acquisition-related (income) expense, net. The fair value of contingent consideration decreased \$7,562 from the closing date to September 30, 2019 primarily due to updated forecasts and actual results to date.

As part of the acquisition of Natura (see Note 15), the Company entered into a contingent consideration arrangement whereby the Company issued promissory notes with an aggregate principal amount of \$26,205 (C\$34,500). The ultimate payment amounts are based on production levels of consumer grade dry finished cannabis flower from Natura facilities during four periods from February 1, 2019 to January 31, 2020 and are payable in shares of Class 2 common stock. The estimated fair value of the contingent consideration on the acquisition date was valued using a discounted cash flow analysis based on internal forecasts projected using a Monte Carlo simulation model, an expected quarterly production distribution function, and a weighted average cost of capital adjusted to account for revenue risk derived as of February 15, 2019. The contingent consideration is reassessed and adjusted to fair value each quarter through acquisition-related (income) expense, net, valued using a probability-weighted discounted cash flow model based on internal forecasts and the estimated cost of debt for the Company. The fair value of contingent consideration decreased \$9,294 from the closing date to September 30, 2019 primarily due to updated forecasts and actual results to date.

## 10. Convertible Notes

In October 2018, the Company issued convertible senior notes with a face value of \$475,000 (the “Convertible Notes”). The net proceeds from the offering were approximately \$460,134, after deducting commissions and other fees and expenses payable by the Company. The Convertible Notes bear interest at a rate of 5.00% per annum, payable semi-annually in arrears on April 1 and October 1 of each year, beginning on April 1, 2019. Additional interest may accrue on the Convertible Notes in specified circumstances. The Convertible Notes will mature on October 1, 2023, unless earlier repurchased, redeemed or converted. There are no principal payments required over the five-year term of the Convertible Notes, except in the case of redemption or events of defaults.

To the extent the Company so elects, the sole remedy for an event of default relating to certain failures by the Company to comply with certain reporting covenants in the Indenture will, for the first 365 days after such event of default, consist exclusively of the right to receive additional interest on the notes. Upon conversion, the Company will pay or deliver, as the case may be, cash, shares of our common stock or a combination of cash and shares of our common stock, at the Company’s election (the “cash conversion option”). The initial conversion rate for the Convertible Notes is 5.9735 shares of common stock per one thousand dollar principal amount of notes, which is equivalent to an initial conversion price of approximately \$167.41 per share of common stock. Throughout the term of the Convertible Notes, the conversion rate may be adjusted upon the occurrence of certain events.

Prior to the close of business on the business day immediately preceding April 1, 2023, the Convertible Notes will be convertible only under the specified circumstances. On or after April 1, 2023 until the close of business on the business day immediately preceding the maturity date, holders may convert all or any portion of their Convertible Notes, in multiples of one thousand dollar principal amount, at the option of the holder regardless of the aforementioned circumstances.

As of September 30, 2019, the Convertible Notes are not yet convertible. The Convertible Notes will become convertible upon the satisfaction of the above circumstances. Transaction costs attributable to the Convertible Notes totaling \$13,467 are amortized as non-cash interest expense over the term of the Convertible Notes. As of September 30, 2019, the Company was in compliance with all the covenants set forth under the indenture.

The following table sets forth the net carrying amount of the Convertible Notes:

	September 30, 2019	December 31, 2018
5.00% Convertible Notes	\$ 475,000	\$ 475,000
Unamortized discount	(35,897)	(41,687)
Unamortized transaction costs	(11,120)	(12,946)
Net carrying amount	<u>\$ 427,983</u>	<u>\$ 420,367</u>

The following table sets forth total interest expense recognized related to the Convertible Notes:

	Nine months ended September 30,	
	2019	2018
Contractual coupon interest	\$ 17,813	\$ —
Amortization of discount	5,790	—
Amortization of transaction costs	1,826	—
Total	<u>\$ 25,429</u>	<u>\$ —</u>

## 11. Stockholders' Equity

### *Common and convertible preferred stock*

The Company's certificate of incorporation authorized the Company to issue the following classes of shares with the following par value and voting rights as of September 30, 2019. The liquidation and dividend rights are identical among Class 1 common stock and Class 2 common stock, and all classes of common stock share equally in our earnings and losses.

	<u>Par Value</u>	<u>Authorized</u>	<u>Voting Rights</u>
Class 1 common stock	\$ 0.0001	250,000,000	10 votes for each share
Class 2 common stock	\$ 0.0001	500,000,000	1 vote for each share
Convertible preferred stock	\$ 0.0001	10,000,000	N/A

In connection with the profit participation agreement with ABG Intermediate Holdings 2, LLC ("ABG"), the Company issued 840,107 shares of Class 2 common stock in January 2019 and 840,107 shares of Class 2 common stock in March 2019 at a deemed issuance price of \$79.35 per share. Given that the shares of Class 2 common stock issued to ABG were not registered with the SEC and subject to transfer restrictions, the fair values of the issuances were \$89.13 and \$59.77 per share, respectively, as recorded in the Condensed Consolidated Statements of Stockholders' Equity. Refer to Note 14 for details.

In February 2019, the Company issued 180,332 shares of Class 2 common stock at a deemed issuance price of \$83.73 per share in connection with the closing of the Natura acquisition. Refer to Note 15 for details.

In connection with the acquisition of Manitoba Harvest, the Company issued 1,209,946 shares of Class 2 common stock in March 2019 at a deemed issuance price of \$80.04 per share on closing and 899,306 shares of Class 2 common stock in August 2019 at a deemed issuance price of \$35.48 per share as share consideration six months after close. Refer to Note 15 for details.

On September 10, 2019, the Company entered into a sales agreement with Cowen and Company, LLC pursuant to which the Company can issue and sell, through a sales agent, shares of Class 2 common stock from time to time up to up to an aggregate offering price of \$400 million through an "at-the-market" equity offering program. During the three months ended September 30, 2019, the Company issued 1,344,166 shares of Class 2 common stock for gross proceeds of \$38,209 (net proceeds of \$37,445) under the program.

## 12. General and Administrative Expenses

General and administrative expenses are comprised of the following items:

	<u>Three months ended September 30,</u>		<u>Nine months ended September 30,</u>	
	<u>2019</u>	<u>2018</u>	<u>2019</u>	<u>2018</u>
Salaries	\$ 8,637	\$ 2,846	\$ 22,289	\$ 6,203
Professional fees	6,051	1,438	12,716	4,094
Travel expenses	1,448	411	3,330	1,130
Other expenses	3,842	2,306	10,905	5,061
Total	<u>\$ 19,978</u>	<u>\$ 7,001</u>	<u>\$ 49,240</u>	<u>\$ 16,488</u>

## 13. Stock-based Compensation

### *Original Stock Option Plan*

Certain employees of the Company participate in the equity-based compensation plan of Privateer Holdings, Inc. (the "Original Plan") under the terms and valuation method detailed in our Annual Financial Statements. For the three and nine months ended September 30, 2019, the total stock-based compensation expense associated with the Original Plan was \$143 and \$411, respectively (2018 – \$76 and \$276).

Stock option activity under the Original Plan is as follows:

	Stock options	Weighted- average exercise price	Weighted- average remaining contractual term (years)	Aggregate intrinsic value
Balance December 31, 2018	592,594	\$ 4.14	8.1	\$ 989
Allocated to Tilray	143,794	4.21		
Exercised	(20,162)	3.88		
Forfeited	(6,686)	4.24		
Cancelled	(8,267)	3.48		
Balance September 30, 2019	701,273	\$ 4.22	7.5	\$ 13,153
Vested and expected to vest, September 30, 2019	645,722	\$ 4.06	7.5	\$ 12,203
Vested and exercisable, September 30, 2019	394,288	\$ 3.27	7.1	\$ 7,731

No stock options were granted under the Original Plan during the nine months ended September 30, 2019 (2018 - 301,442). As of September 30, 2019, the total remaining unrecognized stock-based compensation expense related to non-vested stock options amounted to \$757 which will be recognized over the weighted-average remaining requisite service period of approximately 0.8 year. The total fair value of stock options vested during the nine months ended September 30, 2019 was \$478 (2018 - \$524).

#### *New Stock Option and Restricted Stock Unit Plan*

The Company adopted the 2018 Equity Incentive Plan (the “New Plan”) as amended and approved by stockholders in May 2018 under the terms and valuation methods detailed in our Annual Financial Statements. As of September 30, 2019, 12,926,172 shares were reserved for issuance under the New Plan. For the three and nine months ended September 30, 2019, total stock-based compensation expense associated with the New Plan was \$8,172 and \$20,795, respectively (2018 - \$11,245 and \$16,877).

Stock option and restricted stock unit (“RSU”) activity under the New Plan are as follows:

#### *Time-based stock option activity*

	Stock options	Weighted- average exercise price	Weighted- average remaining contractual term (years)	Aggregate intrinsic value
Balance December 31, 2018	6,015,041	\$ 13.54	7.7	\$ 342,916
Granted	10,000	70.25		
Exercised	(549,533)	7.76		
Forfeited	(58,936)	28.40		
Balance September 30, 2019	5,416,572	\$ 14.06	8.7	\$ 81,894
Vested and expected to vest, September 30, 2019	5,248,544	\$ 13.91	8.7	\$ 79,591
Vested and exercisable, September 30, 2019	2,221,809	\$ 11.53	8.7	\$ 35,249

The weighted-average fair values of stock options granted during the nine months ended September 30, 2019 was \$12.01 per share. During the nine months ended September 30, 2018, 6,106,011 time-based stock options were granted under the New Plan. As of September 30, 2019, the total remaining unrecognized compensation expense related to non-vested stock options of \$25,391 will be recognized over the weighted-average remaining requisite service period of approximately 2.1 years. The total fair value of stock options vested for the nine months ended September 30, 2019 was \$11,734 (2018 - nil).

*Performance-based stock option activity*

	Stock options	Weighted- average exercise price	Weighted- average remaining contractual term (years)	Aggregate intrinsic value
Balance December 31, 2018	600,000	\$ 7.76	9.4	\$ 37,668
Exercised	(80,000)	7.76		
Balance September 30, 2019	520,000	\$ 7.76	8.6	\$ 8,830
Vested and exercisable, September 30, 2019	520,000	\$ 7.76	8.6	\$ 8,830

No performance-based stock options were granted under the New Plan during the nine months ended September 30, 2019. During the nine months ended September 30, 2018, 600,000 performance-based stock options were granted under the New Plan. As of September 30, 2019, there was no remaining unrecognized compensation expense related to non-vested stock options. The total fair value of stock options vested as of September 30, 2019 was \$2,159 (December 31, 2018 – \$1,246).

*Time-based RSU activity*

	Time-based RSUs	Weighted-average grant-date fair value per share
Non-vested December 31, 2018	237,222	\$ 49.86
Granted	944,616	50.51
Issued on vesting	(54,635)	12.45
Forfeited	(42,715)	59.99
Non-vested September 30, 2019	1,084,488	\$ 51.91

As of September 30, 2019, \$43,372 of total unrecognized compensation expense related to non-vested time-based RSUs will be recognized over a weighted-average period of 2.5 years. During the nine months ended September 30, 2018, 140,000 time-based RSUs were granted under the New Plan.

*Performance-based RSUs activity*

	Performance-based RSUs	Weighted-average grant-date fair value per share
Non-vested December 31, 2018	1,050,000	\$ 7.76
Issued on vesting	(731,250)	7.76
Non-vested September 30, 2019	318,750	\$ 7.76

As of September 30, 2019, \$465 of total unrecognized compensation expense related to non-vested performance-based RSUs will be recognized over a weighted-average period of 1.3 years. During the nine months ended September 30, 2018, 1,050,000 performance-based RSUs were granted under the New Plan.

#### **14. ABG Profit Participation Arrangement**

On January 14, 2019, the Company entered into a Profit Participation Arrangement with ABG Intermediate Holdings 2, LLC (“ABG”) that offers the Company: (i) participation rights in up to 49% of the net (i.e. post-expense) cannabis revenues from certain existing ABG brands in perpetuity, (ii) guaranteed minimum receipt of \$10,000 annually for ten years (prorated based on total consideration paid to ABG) in quarterly payments for participation rights, (iii) preferred supplier rights of all cannabinoid ingredients for products under cannabis-related licenses of certain existing ABG brands in perpetuity, (iv) preferred royalty rates for the Company to license and develop cannabis products for certain existing ABG brands, and (v) first negotiation and matching rights related to participation rights in net cannabis revenues for any additional brands acquired by ABG after entering into the Profit Participation Arrangement.

As consideration for this arrangement, the Company issued 840,107 shares of Class 2 common stock and paid \$20,000 in cash in January 2019, paid \$13,333 in cash in February 2019, and issued 840,107 shares of Class 2 common stock in March 2019. Under the terms of the arrangement, the Company shall pay \$83,333, in a combination of Class 2 common stock and up to \$16,667 in cash at ABG's election, upon certain triggers relating to the regulatory status of tetrahydrocannabinol ("THC") in the United States or receipt of \$5,000 in participation rights distributions from cannabis products containing THC outside the United States, in accordance with terms outlined in the arrangement. The Company will record a liability related to this contingent payment when the triggers are met and the consideration becomes payable.

Since the arrangement conveys a right for the Company to receive guaranteed minimum cash from ABG over ten years, it meets the definition of a loan pursuant to ASC 310 "Receivables." As of September 30, 2019 \$447 was recorded in other receivables and \$6,958 in deposits and other assets for the current and non-current portions of the loans relating to cash paid to ABG. The portion of the loans relating to shares issued to ABG of \$30,705 is recorded within additional paid-in capital as of September 30, 2019. The allocation of the loans between the asset and equity portions was determined on a relative fair value basis. As the loans have no stated interest rate, fair value was determined using the present value of the expected cash flows at a 12% discount rate, which reflects an appropriate market rate for each loan at the time it was issued. Interest on the loan is calculated using the effective interest rate method and recognized in finance income from ABG Profit Participation Arrangement on the Condensed Consolidated Statements of Net Loss and Comprehensive Loss for the portion of the loan relating to cash paid to ABG, and in additional paid-in capital on the Condensed Consolidated Balance Sheets for the portion relating to shares issued to ABG.

As of September 30, 2019, the Company recorded intangible assets with indefinite life in the amount of \$119,366 for the participation rights, preferred supplier rights, and preferred royalty rights under the Profit Participation Arrangement, as described above. The cost of these intangible assets was calculated using the fair value of the cash paid and shares issued, less the fair value attributable to the loan described above.

## 15. Business Combinations

### *Acquisition of Manitoba Harvest*

On February 28, 2019, the Company completed the acquisition of all issued and outstanding shares of FHF Holdings Ltd. ("Manitoba Harvest"). Manitoba Harvest develops and distributes a diverse portfolio of hemp-based natural food and wellness products and enables the Company to expand into the growing CBD product market in the United States.

During the three months ended September 30, 2019, the Company revised the preliminary purchase price of the Manitoba Harvest acquisition to include withholding tax amounts related to the acquisition. The Company also revised the preliminary allocation of the purchase price to assets acquired and liabilities assumed at the acquisition date, resulting in a \$3,401 increase in goodwill and \$781 decrease in deferred tax liability. The final purchase price allocation will be adjusted as needed, pending the finalization of estimates and assumptions used in valuing the deferred tax liability, among other identifiable assets acquired and liabilities assumed, and will be finalized no later than one year after the acquisition date. The goodwill of \$131,082 is attributable to factors such as market share, reputation with customers and vendors, and the skilled workforce of Manitoba Harvest. Goodwill is not deductible for tax purposes. The gross contractual amount of receivables is \$6,340, of which approximately \$133 is not expected to be collected.

The financial results of Manitoba Harvest are included in the Company's financial statements since acquisition close. The Consolidated Statements of Net Loss and Comprehensive Loss include revenue of \$15,568 and \$41,084, and net income of \$4,173 and loss of \$695 of Manitoba Harvest for the three and nine months ended September 30, 2019, respectively. The Company incurred acquisition costs of \$1,328 for the acquisition of Manitoba Harvest.

### *Acquisition of Natura*

On February 15, 2019, the Company acquired the remaining 97% issued and outstanding shares of Natura Naturals Holdings Inc. ("Natura"). Natura is licensed to cultivate and produce medical cannabis, expanding the Company's capacity to supply high-quality branded cannabis products to the Canadian market.

During the three months ended September 30, 2019, the Company revised the preliminary allocation of the purchase price to assets acquired and liabilities assumed at the acquisition date for the acquisition of Natura. This resulted in a \$2,144 increase in both deferred tax liability and goodwill. The final purchase price allocation will be adjusted as needed, pending the finalization of estimates and assumptions used in valuing property and equipment, intangible assets, and deferred tax liability, among other identifiable assets acquired and liabilities assumed, and will be finalized no later than one year after the acquisition date. The goodwill of \$26,974 is attributable to factors such as strong supply chain, quality of products and the skilled workforce of Natura. Goodwill is not deductible for tax purposes.

The financial results of Natura are included in the Company's financial statements since acquisition close. The Consolidated Statements of Net Loss and Comprehensive Loss include revenue of \$3,017 and \$8,193, and net income of \$119 and net loss of \$396 for the three and nine months ended September 30, 2019, respectively. The Company incurred acquisition costs of \$824 for the acquisition of Natura.

The preliminary purchase price of the Manitoba Harvest and Natura acquisitions are calculated as follows:

	<u>Manitoba Harvest</u>	<u>Natura</u>
Cash paid on closing	\$ 118,767	\$ 15,252
Cash paid six months after closing	37,490	—
Class 2 common stock issued on closing <sup>(1)(2)</sup>	96,844	15,100
Class 2 common stock issued six months after closing <sup>(1)</sup>	31,866	—
Working capital adjustment	280	—
Contingent consideration	29,207	20,007
Fair value of previously held interest <sup>(3)</sup>	—	1,565
Effective settlement of pre-existing debt <sup>(4)</sup>	—	2,308
<b>Total fair value of consideration transferred</b>	<b>\$ 314,454</b>	<b>\$ 54,232</b>

- (1) For the acquisition of Manitoba Harvest, 1,209,946 shares of Class 2 common stock were issued on closing and 899,306 shares of Class 2 common stock were issued six months after closing.
- (2) For the acquisition of Natura, 180,332 shares of Class 2 common stock were issued on closing.
- (3) The fair value of the Company's investment in Natura on the acquisition date was determined based on the fair value of total consideration transferred and reflected book value on the acquisition date.
- (4) The Company held C\$3,000 convertible debt of Natura at the acquisition date. On acquisition, this debt and related accrued interest was effectively settled.

The preliminary allocations of the purchase price to assets acquired and liabilities assumed on the respective acquisition dates of Manitoba Harvest and Natura are as follows:

	<u>Manitoba Harvest</u>	<u>Natura</u>
<b>Assets</b>		
Cash and cash equivalents	\$ 5,534	\$ 169
Accounts receivable	6,207	109
Inventory	15,331	3,482
Prepaid expenses and other current assets	1,030	166
Property and equipment	23,581	17,435
Intangible assets	195,966	12,834
Goodwill	131,082	26,974
<b>Total assets</b>	<b>378,731</b>	<b>61,169</b>
<b>Liabilities</b>		
Accounts payable	4,973	3,280
Accrued expenses and other current liabilities	4,911	876
Deferred tax liability	54,393	2,781
<b>Total liabilities</b>	<b>64,277</b>	<b>6,937</b>
<b>Net assets acquired</b>	<b>\$ 314,454</b>	<b>\$ 54,232</b>

#### *Acquisition of S&S*

On July 11, 2019, the Company acquired all issued and outstanding shares of Smith & Sinclair Ltd. ("S&S"), which crafts edible candies, fragrances and creative consumables in the United Kingdom and enables the Company to develop CBD-infused edibles and beverages as well as alcohol-infused edibles for distribution in Canada, United States and Europe. The preliminary purchase consideration of \$8,002 includes \$2,440 (£1,940) in cash paid on closing, 79,289 shares of Class 2 common stock issued on closing, and contingent consideration up to \$3,095 (£2,472) payable in Class 2 common stock based on revenue targets during two periods from January 1, 2019 to December 31, 2020 as well as (i) launches of CBD products in the United States and Europe and (ii) launch of CBD or THC products in Canada by June 1, 2020.

#### *Supplemental pro forma information*

The unaudited pro forma information for the periods set forth below gives effect to the acquisitions of Manitoba Harvest and Natura as if the acquisitions had occurred as of January 1, 2018. This pro forma information is presented for informational purposes only and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisitions been consummated as of that time:

	<u>Nine months ended September 30</u>	
	<u>2019</u>	<u>2018</u>
Revenue	\$ 130,808	\$ 86,730
Net loss	(105,363)	(59,839)
Net loss per share - basic and diluted	(1.08)	(0.63)

### *Acquisition-related (income) expense, net*

Acquisition-related (income) expense, net for the three and nine months ended September 30, 2019 are comprised of the following items:

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Acquisition and integration expense	\$ 3,533	\$ 10	\$ 10,421	\$ 10
Change in fair value of contingent consideration	(16,987)	—	(17,019)	—
Total	<u>\$ (13,454)</u>	<u>\$ 10</u>	<u>\$ (6,598)</u>	<u>\$ 10</u>

## **16. Financial Instruments**

### *Credit risk*

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's cash and cash equivalents, accounts receivable and short-term investments.

The Company's cash and cash equivalents are deposited in major financial institutions in Canada, Australia, Portugal, Germany, Netherlands and the United States. To date, the Company has not experienced any losses on its cash deposits. Accounts receivable are unsecured and the Company does not require collateral from its customers.

The Company is also exposed to credit risk from the potential default by any of its counterparties on its financial assets.

The Company evaluates the collectability of its accounts receivable and provides an allowance for potential credit losses as necessary. As of September 30, 2019 and December 31, 2018, the Company was not exposed to any significant credit risk related to counterparty performance of outstanding accounts receivable.

### *Foreign currency risk*

As the Company conducts its business in many areas of the world involving transactions denominated in a variety of currencies, the Company is exposed to foreign currency risk. A significant portion of the Company's assets, revenue, and expenses are denominated in Canadian dollars. A 10% change in the exchange rates for the Canadian dollar would affect the carrying value of net assets by approximately \$4,208 as of September 30, 2019, with a corresponding impact to accumulated other comprehensive income.

### *Liquidity risk*

The Company's objective is to have sufficient liquidity to meet its liabilities when due. The Company monitors its cash balances and cash flows generated from operations to meet its requirements. As of September 30, 2019, the most significant financial liabilities are Convertible Notes, contingent consideration, accounts payable and accrued expenses.

## **17. Related-Party Transactions**

The Company was a wholly owned subsidiary of Privateer Holdings, Inc. ("Privateer") prior to its Series A preferred stock financing and initial public offering. As of September 30, 2019, Privateer holds more than 10% of the Company's outstanding shares of Class 2 common stock and holds 100% of the Company's Class 1 common stock.

During the second quarter of 2019, the Company assumed a real estate operating lease upon assignment from Privateer. In connection with this lease, the Company reimbursed Privateer \$2,070 for leasehold improvements at cost and \$1,000 for the security deposit held by the landlord at cost, recorded within property and equipment and deposits and other assets, respectively, on the Condensed Consolidated Balance Sheets as of September 30, 2019.

Pursuant to the Subversive Capital Alliance Agreement dated May 15, 2018 between Privateer and Subversive Capital, LLC ("Subversive") as agent for Privateer, Subversive held 5,530 shares of S&S at a cost of £347.96 per share (£1,924 in aggregate) on July 11, 2019. Subversive is a company controlled by Michael Auerbach, who is a member of the Company's Board of Directors. On July 11, 2019, the Subversive Capital Alliance Agreement was terminated in connection with the Company's acquisition of S&S and the Company paid £1,924 in cash to Subversive for the 5,530 shares, which represented approximately 30% ownership of S&S and only the original cost basis in such shares. The cash paid to Subversive as part of the purchase consideration for the acquisition of S&S reflected no gain on its investment, thereby eliminating any economic conflict of interest or appearance thereof. In accordance with the Company's Related-Persons Transactions Policy, the Audit Committee of the Board of Directors, comprised solely of the independent directors, approved the acquisition of S&S and the payment to Subversive.

### Privateer management fees

Management services charged by Privateer for services performed include management services, support services, business development services and research and development services recorded in operating expenses for the three and nine months ended September 30, 2019 in the amounts of nil and \$106, respectively (2018 – \$1,014 and \$2,887). Depending on the nature of the services performed, these expenses are included within general and administrative expenses, sales and marketing expenses or research and development expenses in the Consolidated Statements of Net Loss and Comprehensive Loss. Pursuant to the Company's agreement with Privateer entered in February 2018 and terminated in February 2019, personnel compensation was charged at cost plus a 3.0% markup and other services at cost. As of September 30, 2019, no amounts were recorded within accounts payable for management services due to Privateer (December 31, 2018 – \$3,878).

### Ten Eleven management fees

In February 2019, the Company entered into a management agreement with Ten Eleven Management LLC doing business as Privateer Management ("Ten Eleven"), pursuant to which Ten Eleven provides the Company with certain general administrative and corporate services on an as-requested basis for a monthly service fee. This agreement ends on December 31, 2019 and the Company does not intend to renew the agreement. As of September 30, 2019, the owners of Ten Eleven collectively hold more than 10% of the Company's outstanding shares of Class 2 common stock and more than 10% of the Company's Class 1 common stock indirectly through investment in Privateer. During the three and nine months ended September 30, 2019, management services of \$75 and \$200, respectively, were recorded within general and administrative expense in the Consolidated Statements of Net Loss and Comprehensive Loss. No amounts were recorded for the comparative periods in 2018. As of September 30, 2019, \$25 due to Ten Eleven for management services was recorded within accounts payable (December 31, 2018 – nil).

## 18. Business Segment Information

Segment reporting is prepared on the same basis that the Company's Chief Executive Officer, who is the Company's chief operating decision maker, manages the business, makes operating decisions and assesses performance. Management has determined that the Company operates in one segment: the development and sale of cannabis products.

Revenue for the three and nine months ended September 30, 2019 includes \$2,931 and \$8,707, respectively, of excise taxes. There was no excise tax for the comparative periods in 2018. Sources of revenue were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Dried cannabis	\$ 29,412	\$ 4,832	\$ 62,214	\$ 14,701
Cannabis extracts	5,819	5,180	16,172	12,725
Hemp products	15,650	—	41,167	—
Accessories and other	220	35	490	173
Total	<u>\$ 51,101</u>	<u>\$ 10,047</u>	<u>\$ 120,043</u>	<u>\$ 27,599</u>

Revenue attributed to geographic region based on the location of the customer was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2019	2018	2019	2018
Canada	\$ 33,585	\$ 8,746	\$ 81,138	\$ 25,758
United States	10,836	—	28,407	—
Other countries	6,680	1,301	10,498	1,841
Total	<u>\$ 51,101</u>	<u>\$ 10,047</u>	<u>\$ 120,043</u>	<u>\$ 27,599</u>

Long-lived assets consisting of property and equipment, net of accumulated depreciation, attributed to geographic regions based on their physical location were as follows:

	September 30, 2019	December 31, 2018
Canada	\$ 132,365	\$ 64,687
Portugal	30,758	15,455
United States	2,755	—
Other countries	611	72
Total	<u>\$ 166,489</u>	<u>\$ 80,214</u>

Three customers accounted for 20%, 14%, and 10% of our revenue, respectively, for the three months ended September 30, 2019. Two customers accounted for 12% and 11% of our revenue, respectively, for the nine months ended September 30, 2019. One customer accounted for 28% and 29% of the Company's revenue for the three and nine months ended September 30, 2018, respectively.

Two customers accounted for 16% and 10%, respectively, of our accounts receivable balance as of September 30, 2019. Two customers accounted for 30% and 16%, respectively, of our accounts receivable balance as of December 31, 2018.