



**PureKana LLC**

**MANAGEMENT DISCUSSION & ANALYSIS**

**For the Three and Twelve Months Ended December 31, 2019**

**Dated: November 20, 2020**

This Management's Discussion and Analysis ("**MD&A**") of PureKana LLC ("**we**," "**us**," "**our**," "**PureKana**" or the "**Company**") is dated November 20, 2020 and relates to the consolidated financial position and results of operations of the Company. This MD&A provides a review of the financial results for the three and twelve months ended December 31, 2019, compared to the same periods in the prior year and should be read in conjunction with the audited financial statements and accompanying notes of the Company for the year ended December 31, 2019. All financial information reflected herein is expressed in US dollars and determined on the basis of International Financial Reporting Standards ("**IFRS**").

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of the reporting period, which could result in a material adjustment to the carrying amounts of assets and liabilities and disclosure of contingent assets or liabilities in the event that actual results differ from assumptions made, relate to, but are not limited to, the following: determining the accrued liabilities; revenue recognition; estimate of inventory net realizable value; going concern assumption. While management believes the estimates used are reasonable, actual results could differ from those estimates and could impact future results of operations and cash flows.

PureKana has issued reports on certain non-IFRS measures that are used by management to evaluate the Company's performance. Because non-IFRS measures do not have a standardized meaning, securities regulations require that non-IFRS measures be clearly defined and quantified, and reconciled with their nearest IFRS measure. Where non-IFRS measures are reported, PureKana has provided the definition and reconciliation to their nearest IFRS measure under the heading "*Non-GAAP Financial Measures*".

## **FORWARD LOOKING STATEMENTS**

Certain information provided in this MD&A constitutes forward-looking statements or information (collectively, "forward-looking statements"). Forward-looking statements are typically identified by words such as "may", "will", "should", "could", "anticipate", "expect", "project", "estimate", "forecast", "plan", "intend", "target", "believe" and similar words suggesting future outcomes or statements regarding an outlook. Although these forward-looking statements are based on assumptions the Company considers to be reasonable based on the information available on the date such statements are made, such statements are not guarantees of future performance and readers are cautioned against placing undue reliance on forward-looking statements. By their nature, these statements involve a variety of assumptions, known and unknown risks and uncertainties, and other factors which may cause actual results, levels of activity, and achievements to differ materially from those expressed or implied by such statements. The forward-looking statements contained in this MD&A are based on certain assumptions and analysis by management of the Company ("**Management**") in light of its experience and perception of historical trends, current conditions and expected future development and other factors that it believes are appropriate. The material factors and assumptions used to develop the forward-looking statements herein include, but are not limited to, the following: (i) the impact of the COVID-19 pandemic (ii) the regulatory climate in which the Company operates; (iii) the continued sales success of the Company's products; (iv) the continued success of sales and

marketing activities; (v) there will be no significant delays in the development and commercialization of the Company's products; (vi) there will be no significant reduction in the availability of qualified and cost-effective human resources; (vii) new products will continue to be added to the Company's portfolio; (viii) demand for hemp-based wellness products will continue to grow in the foreseeable future; (ix) there will be no significant barriers to the acceptance of the Company's products in the market; (x) the Company will be able to maintain compliance with applicable contractual and regulatory obligations and requirements; (x) there will be adequate liquidity available to the Company to carry out its operations; and (xi) products do not develop that would render the Company's current and future product offerings undesirable and the Company is otherwise able to minimize the impact of competition and keep pace with changing consumer preferences; and (xii) the Company will be able to successfully manage and integrate acquisitions, if any.

The Company's forward-looking statements are subject to risks and uncertainties pertaining to, among other things, the adverse impact of the COVID-19 pandemic to our operations, our supply chain, our distribution chain, and to the broader market for our products, revenue fluctuations, nature of government regulations (both domestic and foreign), economic conditions, loss of key customers, retention and availability of executive talent, competing products, the effectiveness of ecommerce marketing strategies, loss of proprietary information, product acceptance, internet and system infrastructure functionality, information technology security, cash available to fund operations, availability of capital and, international and political considerations, the successful integration of acquired businesses, if any, as well as the risks and uncertainties discussed under the heading "*Risks and Uncertainties*" in this MD&A. The impact of any one risk, uncertainty, or factor on a particular forward-looking statement is not determinable with certainty as these are interdependent, and the Company's future course of action depends on Management's assessment of all information available at the relevant time. Except to the extent required by law, the Company assumes no obligation to publicly update or revise any forward-looking statements made in this MD&A, whether as a result of new information, future events, or otherwise. All subsequent forward-looking statements, whether written or oral, attributable to the Company or persons acting on the Company's behalf, are expressly qualified in their entirety by these cautionary statements.

## **COMPANY OVERVIEW**

PureKana was organized as a limited liability company in Arizona, United States on May 31, 2017. The Company converted to a Delaware LLC on December 27th, 2019. On that day, a 50.1% controlling interest was sold by the founding members to Heavenly Rx Ltd. The Company's principal business office is located at 6710 N Scottsdale Road, Paradise Valley, Arizona, 85253, United States and its registered and records office is located at 9 E. Lookerman Street, Suite 311, Dover, Delaware 19901.

The Company operates in one reportable segment being the sale of hemp-based cannabidiol ("**CBD**") related products with sales principally generated from the United States. Hemp extracts are produced from Industrial Hemp, which is defined as the plant *Cannabis sativa L.* and any part of that plant, including the seeds thereof and

all derivatives, extracts, cannabinoids, isomers, acids, salts, and salts of isomers, whether growing or not, with a delta-9 tetrahydrocannabinol concentration of not more than 0.3% THC. The Company works closely with manufacturers who have the licenses required to manufacture CBD consumer products and e-commerce partners for the sale and distribution of its products.

Revenues from sale of CBD related products were principally generated in the United States.

The Company offers a diverse range of CBD products to its customers including ingestibles (tinctures, capsules and gummies) and topicals. The Company's primary source of revenue is from its PureKana.com ecommerce website, however it has recently expanding its sales to retail stores. These retail stores include large retail chains as well as small independent retailers. The Company does not use affiliate marketing as it sees better margin through generating a sale directly through its own marketing efforts and has cultivated a valuable database of customer information over the past three years. PureKana has focused on brand building since its inception and currently has one the leading positions with social media following of its brand in the US. PureKana currently has over 98,000 Instagram followers making it one of the leading CBD brands followed on this influential social media platform.

The Company also has followed a tight operating model that efficiently generates sales while maintaining tight control over its expenses. The Company's operating model therefore has focused on developing key strategic relationships with CBD product vendors to produce its products rather than a classic vertically integrated model that other competitors have followed. We have strategic partners in fulfillment, marketing and customer service that have provided PureKana with an ability to scale its business without significant need for capital investment. PureKana has been able to quickly develop its revenues since its inception as result of its agile partnership model and below benchmark fixed costs.

## **FACTORS AFFECTING THE COMPANY'S PERFORMANCE**

The Company's performance and future success depends on a number of factors. These factors are also subject to a number of inherent risks and challenges, some of which are discussed below and referred to under the heading "*Risk and Uncertainties*".

### **The COVID-19 Pandemic**

Since December 31, 2019, the outbreak of the novel strain of coronavirus, identified as COVID-19, has resulted in governments worldwide enacting measures to combat the spread of the virus, including in the United States. These measures, which include the implementation of travel restriction, self-isolation measures, and physical distancing, have caused material disruption to businesses globally, resulting in an economic slowdown. Global equity markets have experienced significant volatility and weakness. Governments and central banks have reacted with significant monetary and fiscal interventions designed to stabilize economic conditions. The deterioration of economic conditions to date has

resulted in a surge in unemployment and may lead to a deterioration in consumer balance sheets, all of which may impact consumer spending behavior and could adversely affect the Company's financial performance.

The duration and impact of the COVID-19 outbreak is unknown at this time, as is the efficacy of the response measures. It is impossible to forecast the duration and full scope of the economic impact of COVID-19 and other consequential changes it will have on the Company's business, operations and prospects, both in the short term and in the long term. See also "*Risks and Uncertainties - Impacts of COVID-19 to the Company's Business*" below.

### **Branding**

The Company believes that its brand image and awareness is built around consumer trust with a focus on quality. Maintaining and enhancing its brand image and increasing brand awareness in its current markets and in new markets where the Company had limited brand recognition is critical to its continued success.

Maintaining and enhancing the Company's brand image and increasing brand awareness may require the Company to make investments in areas such as marketing, product development, brand development, employee training and public relations, and may require the Company to incur other costs associated with continuing to expand e-commerce sales. These investments may be substantial, and the Company's efforts may not ultimately be successful. Failure to maintain and enhance the Company's brand in any of its key markets may materially and adversely affect the Company's business, results of operations or financial condition.

### **Product Innovation and Planning**

The Company believes that product innovation is integral to its success and it continues to focus on innovation as a key pillar of growth. The Company's business is subject to changing consumer trends and preferences. The success of new product offerings depends upon a number of factors, including the Company's ability to: (i) accurately anticipate customer needs; (ii) develop new products that meet these needs; (iii) successfully commercialize new products in a timely manner; (iv) price products competitively; (v) deliver products in sufficient volumes and in a timely manner; and (vi) differentiate product offerings from those of competitors.

### **Management and Growth of E-Commerce Sales**

Management and growth of the Company's e-commerce sales are essential to growth. The usability of and client experience provided by the Company's e-commerce platform is critical to the success and growth of its e-commerce sales. Any extended software disruption of the Company's e-commerce platform or the failure on the part of the Company to provide an attractive, effective, reliable, user friendly e-commerce platform that offers a wide assortment of merchandise with rapid delivery options and that continually meets the changing expectations of online customers could place the Company at a competitive disadvantage, result in the loss of revenue or harm the Company's reputation with

customers and could have a material adverse effect on business and results of operations. The Company also depends on third-party service providers for its e-commerce platform and any service disruption on their part could affect customer ability to access the Company's website resulting in loss of revenue or harm to reputation.

The success of the Company's e-commerce sales is also dependent on the Company's ability to successfully manage the costs, difficulties and competitive pressures associated with shipping, including inventory management and distribution, and compliance with governing statutes, laws, regulations and regulatory policies in the jurisdictions to which products are shipped, including laws governing the operating and marketing of e-commerce websites, as well as the collection, storage and use of information on consumers interacting with these websites. If the Company is unable to expand or update its e-commerce site commensurately with competitors, manage shipping and successfully respond to the risks inherent to e-commerce, the Company's financial position and results of operations may be negatively impacted.

Furthermore, if the Company is unable successfully capitalize on digital marketing channels to drive client acquisition and retention, including search engine optimization, email marketing, improved product descriptions, data driven category naming, and the leveraging of social media, the Company's financial position and results of operations may be negatively impacted. Periodic changes to search engine algorithms, which retrieve data from search indices and deliver ranked search results, produce changes in search engine results pages (SERPs). Any changes to these algorithms and therefore search engine results pages could reduce visibility of, and traffic on, the Company's e-commerce website and negatively impact the Company's financial position and results of operations.

## **Competition**

The market for hemp-based CBD wellness products is highly competitive. The competition consists of publicly and privately-owned companies, which tend to be highly fragmented in terms of geographic market coverage, vertical integration and products offered. With the Company's strong brand status and innovative products, Management believes the Company is well-positioned to capitalize on favorable long-term trends in the hemp-based CBD wellness products segment as the FDA establishes guidelines on how the industry will operate.

## **Growth Strategies**

The Company has a successful history of growing revenue and it believes it has a strong growth strategy aimed at meeting or exceeding industry growth rates. The Company's future depends, in part, on Management's ability to implement its growth strategy including (i) product innovations; (ii) management and growth of e-commerce sales; and (iii) growth in retail, wholesale and distributor partnerships. The ability of the Company to implement this growth strategy depends on, among other things, its ability to develop new products that appeal to consumers, maintain and expand brand loyalty and brand recognition, maintain and improve competitive position in the market, and identify and successfully enter, and market products in new geographic areas and segments as well the ability to successfully navigate legislative and regulatory uncertainties. See "*Risks and Uncertainties*".

## Regulation

The Company is subject to the local, state, and federal laws in the jurisdictions in which it operates. Outside of the United States, the Company's products may be subject to tariffs, treaties and various trade agreements as well as laws affecting the importation of consumer goods and the retail sale of hemp-derived products. The Agricultural Improvement Act of 2018 (the "**2018 Farm Bill**") became law on December 20, 2018. The 2018 Farm Bill removed hemp from the list of controlled substances under the Controlled Substances Act. The 2018 Farm Bill also redefined hemp to include its "derivatives, extracts, and cannabinoids", and accordingly removed popular hemp products, such as CBD from the purview of the U.S. Drug Enforcement Agency ("**DEA**"). Although the DEA no longer regulates hemp, the U.S. Food and Drug Administration ("**FDA**") retains its authority to regulate ingestible and topical products, including those that contain hemp and hemp extracts such as CBD. The FDA governs the regulations applicable to the Company as a vendor and marketer of hemp-derived products. These include regulations for nutrition and allergen labeling and label claim regulations; rules for submission of received serious adverse event reports; and safety requirements, including, as applicable, new dietary ingredient ("**NDI**") and generally recognized as safe ("**GRAS**") regulations. The FDA has stated its concerns over drug claims being made about products that contain CBD, as well as the agency's position that under the Food, Drug and Cosmetic Act ("**FD&C Act**") CBD cannot be marketed in a food or a dietary supplement because a product containing CBD was approved as a drug and substantial clinical trials studying CBD as a new drug were made public prior to the marketing of any food or dietary supplements containing CBD, and therefore dietary supplements or food are precluded from containing this ingredient (the "**Prior Drug Exclusion** "). The Company believes there are significant arguments against this position in that all conditions of the applicable statute must be met before the Prior Drug Exclusion applies. Importantly, there have been recent regulatory and legislative developments, described in more detail under the heading "Regulatory Framework" in the filing statement, which may provide a pathway for allowing hemp-derived compounds, such as CBD, in foods and dietary supplements.

## CORPORATE HIGHLIGHTS

### Insight Driven New Products Launched in 2019

Leveraging a consumer insight platform, PureKana launched a number of new products in 2019 including new flavors of tinctures, CBD tincture products that contain a higher amount of CBD (2500 MG and 5000 MG), CBD beverage enhancers, CBD picks, and new OTC strength topicals.

### New Customer Service Partnership established

PureKana partnered with a US based customer service organization to increase its scale and capacity to handle its customer inquiries in May of 2019 to ensure the customer service experience offered by PureKana was scalable as its volumes increased.

### **New online fraud prevention software implemented**

PureKana successfully implemented a leading online fraud prevention software in May of 2019. This software has allowed the Company to greatly reduce its online customer fraud while still achieving a very high level of transaction approval. This move was also seen positively by its Merchant processor in an environment where other CBD online providers were being dropped by their merchant processors due to high levels of chargebacks and fraud.

### **PureKana moves to a new Fulfillment Partner to provide it with increased scale and lower operating costs.**

PureKana partnered with an experienced warehouse and fulfillment provider in the US to increase its scale and capacity to handle larger volumes of daily orders in September 2019.

### **PureKana achieved PCI compliance with its website.**

PureKana successfully achieved PCI compliance in the fall of 2019. This designation is greatly valued by the credit card companies and merchant processors as it demonstrates PureKana's control over its customer's personal information including their credit card information.

### **New Investor in PureKana LLC**

The Company converted to a Delaware LLC on December 27th, 2019. On that day, a 50.1% controlling interest was sold by the founding members to Heavenly Rx Ltd. Heavenly Rx Ltd brought to PureKana LLC experienced personnel who know the retail business (Offline) to compliment PureKana's success in the online business with its CBD products.

### **PureKana was a key sponsor of USA CBD Expo at Las Vegas February 2020**

The Company was one of the key sponsors at the USA CBD Expo held in Las Vegas in February 2020. One of the key objectives of the Company was to develop its offline business accounts. PureKana was able to further this objective substantially and developed a number of leads and offline accounts as a result.

### **PureKana secures RiteAid as a customer**

The Company secured RiteAid as a key customer in the first quarter of 2020 for its offline business (B2B segment). The first shipment of products occurred in May 2020. In addition to our strong online platform, in Q3 2020 PureKana will be distributed in the food, drug, and convenience channels.

### **PureKana launches AM/PM products**

The Company launched key innovation with its new active ingredient product line in May 2020. This product line is intended to bring increased efficacy to its CBD products for its customer base. PureKana's AM capsules are formulated with a proprietary natural energy blend that is designed to give you a boost when you need it most. PureKana's PM capsules are formulated with a proprietary natural sleep blend that will help support sound, restful sleep and relaxation. In Q3 2020, PureKana will continue its expansion into active ingredients to drive efficacy. New innovation offerings are ready for launch in the needstate areas of sleep, energy, pain, calm, wellness, and immunity.



## SELECTED FINANCIAL DATA

The following table sets forth selected financial information for the periods indicated.

U.S. \$ millions	Year ended December 31,		
	2019	2018	2017
<b>Revenue</b>	\$ 25.3	\$ 15.5	\$ 1.4
Gross (loss) profit	16.8	10.0	0.9
Operating Expenses	11.1	6.2	0.6
Other (income) and expense, net	0.0	0.1	0.0
(Loss) income before taxes	5.8	3.9	0.3
Net (loss) income	5.8	3.9	0.0
Adjusted EBITDA	5.8	3.9	0.0

Assets:	Year ended December 31,		
	2019	2018	2017
Cash and cash equivalents	\$ 1.1	\$ 1.3	\$ 0.0
Total Assets	3.7	3.3	0.4

Liabilities:			
Long-Term Liabilities	\$ 0.1	\$ 0	\$ 0
Total Liabilities	1.3	0.9	0.2

Cash Flow:	Year ended December 31,		
	2019	2018	2017
Net Cash provided (used) by operating activities	\$ 5.5	\$ 3.2	\$ 0.0
Net Cash provided (used) by investing activities			0.0
Net Cash provided (used) by financing activities	(5.8)	(1.8)	(0.0)

## FINANCIAL INFORMATION

The following table sets forth selected financial information for the periods indicated

U.S. \$ millions	Three months ended December 31,		Year ended December 31,	
	2019	2018	2019	2018
<b>Revenue</b>	\$ 4.8	\$ 5.6	\$ 25.3	\$ 15.5
Gross (loss) profit	3.0	3.6	16.8	10.0
Operating Expenses	2.1	2.9	11.0	6.2
Other (income) and expense, net	0.0	0.0	0.0	0.1
(Loss) income before taxes	0.9	0.7	5.8	4.0
Net (loss) income	0.9	0.7	5.8	4.0
EBITDA	0.9	0.8	5.8	3.9

## RESULTS FROM OPERATIONS

### Revenue

US millions	Three months ended December 31, 2019		Twelve months ended December 31, 2019	
	2019	2018	2019	2018
<b>Revenue</b>	\$ 4.8	\$ 5.6	\$ 25.3	\$ 15.5
Direct to Consumer	4.6	5.6	24.4	15.5
Business to Business	0.2	-	0.9	-

Revenue for the three months ended December 31, 2019 was \$4.8 million, a decrease of \$0.8 million (15%) compared to \$5.6 million for the previous year. Gross Revenue before discounts was \$6.4 million for the three months ended December 31, 2019 compared to \$6.4 million in the previous period was however flat. The lower net revenue reflected a more competitive market for online CBD sales in the fourth quarter of 2019 as the Company's discounts increased from an average of 12% for the three months ended December 31, 2018 to an average of 26% for the three months ended December 31, 2019. Revenue is generated by two segments, Direct to Consumer ("**DTC**") and Business to Business ("**B2B**"). The DTC business accounted for 96% of fourth quarter 2019 revenues and the B2B accounted for 4% compared to the previous year's quarter 100% DTC. The Company had just launched its B2B sales business at the end of 2018. DTC revenue growth was driven by increased consumer demand for CBD products, the Company's proprietary direct marketing strategies and PureKana's brand recognition by consumers.

Revenue for the twelve months ended December 31, 2019 was \$25.3 million, an increase of \$9.8 million (63%) compared to \$15.5 million for the previous year. Revenue is generated by two segments, DTC and B2B. The DTC business accounted for 96% of 2019 revenues and the B2B accounted for 4% compared to the previous year 100% DTC. The Company had just

launched its B2B sales business at the end of 2018. DTC revenue growth was driven by increased consumer demand for CBD products, the Company's proprietary direct marketing strategies and PureKana's brand recognition by consumers.

### Cost of sales

\$US millions	Three months ended December 31, 2019		Twelve months ended December 31, 2019	
	2019	2018	2019	2018
<b>Cost of Sales</b>	\$ 1.8	\$ 2.0	\$ 8.5	\$ 5.5
Product costs	1.3	1.3	5.5	3.6
Merchant Processing Fees	0.3	0.3	1.4	1.0
Fulfillment Costs	0.2	0.4	1.6	0.9

Cost of sales for the three months ended December 31, 2019 was \$1.8 million, a decrease of \$0.2 million (10%) compared to \$2.0 million for the previous year. The 10% decrease in cost of sales was driven by the decrease in revenues for the company. The major components of cost of sales are product cost, merchant processing fees and fulfillment and delivery costs. Product costs accounted for 72%, merchant processing fees accounted for 17% and fulfillment and delivery costs accounted for 11% of cost of sales for the year ended December 31, 2019 compared to the previous year (Product costs 66%, merchant processing fees accounted for 17% and fulfillment and delivery costs accounted for 17%). Product costs can vary directly based on the crop price of hemp and the CBD derivatives from those crops. Merchant processing fees can be affected by the risk perceived of the CBD industry as well as how well a company can manage its customers data security and fraud. Fulfillment costs can be affected by a material increase in delivery costs with the main courier companies.

Cost of sales for the twelve months ended December 31, 2019 was \$8.5 million, an increase of \$3.0 million (55%) compared to \$5.5 million for the previous year. The 55% increase in cost of sales was driven by the increase in revenues for the company. The major components of cost of sales are product cost, merchant processing fees and fulfillment and delivery costs. Product costs accounted for 64%, merchant processing fees accounted for 19% and fulfillment and delivery costs accounted for 17% of cost of sales for the year ended December 31, 2019 compared to the previous year (Product costs 66%, merchant processing fees accounted for 17% and fulfillment and delivery costs accounted for 17%). Product costs can vary directly based on the crop price of hemp and the CBD derivatives from those crops. Merchant processing fees can be affected by the risk perceived of the CBD industry as well as how well a company can manage its customers data security and fraud. Fulfillment costs can be affected by a material increase in delivery costs with the main courier companies.

### Gross Profit

\$US millions	Three months ended December 31, 2019		Twelve months ended December 31, 2019	
	2019	2018	2019	2018
<b>Gross Profit</b>	\$ 2.9	\$ 3.6	\$ 16.8	\$ 10.0
% Sales	62%	64%	66%	65%

Gross Profit for the quarter ended December 31, 2019 was \$2.9 million a decrease of \$0.7 million (18%) compared to \$3.6 million for the previous year. The 18% decrease in gross profit in 2019 can be attributed to the decrease in revenue.

Gross Profit for the twelve months ended December 31, 2019 was \$16.8 million an increase of \$6.8 million (68%) compared to \$10.0 million for the previous year. The 68% increase in gross profit in 2019 can be attributed to the increase in revenue.

## Expenses

\$US millions	Three months ended December 31, 2019		Twelve months ended December 31, 2019	
	2019	2018	2019	2018
<b>Expenses</b>	\$ 2.1	\$ 2.9	\$ 11.0	\$ 6.2
Marketing	1.8	1.8	8.1	4.4
Salaries	0.2	0.2	0.7	0.4
Professional Fees	0.4	0.3	1.2	0.4
Customer Service	0.2	0.0	0.5	0.2
Travel	0.1	0.0	0.2	0.1
Allowance for Bad Debt (Recoveries)	(0.8)	0.5	(0.1)	0.5
Other Gen & Admin	0.2	0.1	0.4	0.2

PureKana expenses for the three months ended December 31, 2019 were \$2.1 million, a reduction of \$0.8 million (28%) compared to the prior period of \$2.9 million. The reduction was driven by a recovery against previous impairment charges on the Company's accounts receivable with a formal merchant processor. This recovery accounted for (\$0.8) million for three months ended December 31, 2019 compared to an impairment charge in the prior period of \$0.5 million. Marketing fees accounted for \$1.8 million or 86% of fourth quarter 2019 expenses compared to \$1.8 million in previous period (62%). Salaries accounted for \$0.2 million or 10% of fourth quarter 2019 expenses compared to \$0.2 million in previous period (7%). Professional fees which includes consulting, audit and legal services accounted for \$0.4 million or 19% of fourth quarter 2019 expenses compared to \$0.3 million in previous period (10%). Customer service payments accounted for \$0.2 million or 10% of fourth quarter 2019 expenses compared to \$0.0 million in previous period (1%). Other general and administration expenses accounted for \$0.2 million or 10% of fourth quarter 2019 expenses compared to \$0.1 million in previous period (3%).

PureKana expenses for the twelve months ended December 31, 2019 were \$11.0 million, an increase of \$4.8 million (77%) compared to the prior period of \$6.2 million. The increase was lead by an increase in marketing expenses of \$3.7 million driven by the increase in DTC sales, higher levels of personnel related expenses of \$0.3 million and professional fees of \$0.8 million. Marketing fees accounted for \$8.1 million or 74% of annual 2019 expenses compared to \$4.4 million in previous period (71%). Salaries accounted for \$0.7 million or 6% of annal 2019 expenses compared to \$0.4 million in previous period (6%). Professional fees which include consulting, audit and legal services accounted for \$1.2 million or 11% of annual 2019 expenses compared to \$0.4 million in previous period (6%). Customer service payments accounted for \$0.5 million or 5% of annual 2019 expenses compared to \$0.2 million in previous period (3%).

## Net Income

\$US millions	Three months ended December 31, 2019		Twelve months ended December 31, 2019	
	2019	2018	2019	2018
<b>Net Income</b>	\$ 0.9	\$ 0.7	\$ 5.8	\$ 3.9

Net income for the three months ended December 31, 2019 was \$0.9 million an increase of \$0.2 million compared to the prior period (\$0.7 million). The \$0.1 million increase in net income was attributable to (1) a decrease in expenses of \$0.8 million which was offset by (2) decrease in gross profit of \$0.7 million.

Net income for the twelve months ended December 31, 2019 was \$5.8 million an increase of \$1.9 million compared to the prior period (\$3.9 million). The \$1.9 million increase in net income was attributable to (1) an increase in gross profit of \$6.8 million which was offset by (2) an increase in expenses of \$4.9 million.

## LIQUIDITY & CAPITAL RESOURCES

	December 31, 2019	December 31, 2018
<b>Assets:</b>		
Cash and cash equivalents	\$ 1.1	\$ 1.3
Accounts Receivable	0.9	1.0
Inventory	1.3	0.5
Deposits and Prepaid Expenses	0.3	0.4
Long term assets	0.1	-
<b>Total Assets</b>	<b>3.7</b>	<b>3.2</b>
<b>Liabilities:</b>		
Current Liabilities	\$ 1.2	\$ 0.9
Long-Term Liabilities	0.1	-
<b>Total Liabilities</b>	<b>1.3</b>	<b>0.9</b>
<b>Working Capital</b>	<b>\$ 2.3</b>	<b>\$ 2.3</b>

The Company's primary liquidity and capital requirements are for inventory and general corporate purposes. The Company currently has a cash balance of \$1.1 million at December 31, 2019 and along with cash flows from operations, will provide capital to support the growth of the business and for general corporate purposes.

The Company's working capital was comparable at \$2.3 million for the period ending December 31, 2019 compared to \$2.3 million in the previous period. The Company has no debt as of December 31, 2019. The Company's cash on hand reduced slightly by \$0.2 million to \$1.1

million as of December 31, 2019 compared to \$1.3 million in the previous period. The Company has sufficient cash flow operations to support its growth in revenues for the twelve months ended December 31, 2019 which increased by 63% for the twelve months ended December 31, 2019 compared to the prior year. The Company continues to focus on improving payment terms with its key vendors as another key initiative to maintain and improve its positive working capital position.

The Company's ability to fund operating expenses will depend on its future operating performance which will be affected by general economic, financial, regulatory, FDA, and other factors including factors beyond the Company's control (See "*Risk and Uncertainties*").

Management continually assesses liquidity in terms of the ability to generate sufficient cash flow to fund the business. Net cash flow is affected by the following items: (i) operating activities, including the level of amounts receivable, accounts payable, accrued liabilities and unearned revenue and deposits; (ii) investing activities (iii) financing activities.

#### **Cash flow: Three months ended December 31, 2019 and 2018.**

**Cash generated from operating activities** was \$1.0 million in the three-month period ended December 31, 2019, compared to \$0.7 million generated from operating activities in the same period of 2018. This increase of \$0.3 million in cash generated from operating activities was the result of (1) a decrease in cash generated in operating activities before the impact of non-cash working capital of \$0.5 million and (2) a decrease in cash generated by non-cash working capital of \$0.1 million for the three months ended March 31, 2020, compared to the comparative 2019 period.

**Cash used by investing activities** was \$0.0 million during the first quarter of 2020, compared to cash used by investing activities of \$0.0 million in the same period in 2019.

**Cash used in financing activities** was \$2.2 million in the first quarter of 2020 compared to cash used of \$0.6 million in the same period in 2019 or an increase of \$1.6 million. The \$1.6 million net increase in cash used in financing activities in the fourth quarter of 2018, compared to the prior period, was due to (1) increases in distributions to members of the Company of \$1.6 million.

#### **Cash flow: Twelve months ended December 31, 2019 and 2018.**

**Cash generated from operating activities** was \$5.5 million in the twelve-month period ended December 31, 2019, compared to \$3.2 million generated from operating activities in the same period of 2018. This year-over-year increase of \$2.3 million in cash generated from operating activities was the result of (1) an increase in cash generated in operating activities before the impact of non-cash working capital of \$1.4 million and (2) an increase in cash generated by non-cash working capital of \$0.9 million for the twelve months ended December 31, 2019, compared to the comparative 2018 period.

**Cash used by investing activities** was \$0.0 million for the twelve months ended December 31, 2019, compared to cash used by investing activities of \$0.0 million in the same period in 2018.

**Cash used in financing activities** was \$5.8 for the twelve months ended December 31, 2019 compared to cash used of \$1.8 million in the same period in 2018 or an increase of

\$3.9 million. The \$3.9 million net increase in cash used in financing activities in the fourth quarter of 2018, compared to the prior period, was due to (1) increases in distributions to members of the Company of \$3.9 million.

## FINANCIAL RESOURCES

Cash and cash equivalents decreased by \$0.3 million during the year 2019, relative to 2018. Working capital of \$2.3 million comparable as of December 31, 2019.

Current assets as at December 31, 2019 were \$3.6 million including \$1.1 million in cash, \$0.9 in accounts receivable, \$1.3 million of inventory and \$0.4 million in prepaid expenses and reflects a \$0.3 million increase over the balance as of December 31, 2018. Current liabilities as at December 31, 2019 were \$1.2 million consisting primarily of accounts payable and accrued liabilities and reflect an increase of \$0.3 million over the balance as of the previous period.

The Company's working capital and working capital requirements fluctuate from quarter to quarter depending on, among other factors, key consumer holidays (second fourth quarter each year), new product introductions and vendor lead times. The Company's principal working capital needs include accounts receivable, inventory, prepaid expenses, and accounts payable.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company had no off-balance sheet arrangements.

## RELATED PARTY TRANSACTIONS

Key management personnel include those persons having the authority and responsibility of planning, directing, and executing the activities of the Company. The Company has determined that its key management personnel consist of the Company's officers.

There was no key management compensation in 2019 or 2018.

Two related party transactions were entered into during the year ended December 31, 2019 with a company owned by one of the members of the Company. These transactions were entered into as commercial transactions to purchase inventory by the Company in the amount of \$149,190.

## QUARTERLY RESULTS

USD Millions	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019
Revenue	1.7	4.0	4.2	5.6	5.4	9.1	6.0	4.8
Gross Profit	1.0	3.0	2.4	3.6	3.7	6.1	4.1	2.9
Expenses	0.6	1.3	1.3	2.9	2.9	3.4	2.7	2.0
Net Income	0.4	1.8	1.0	0.7	0.8	2.7	1.4	0.9

The Company has seen significant growth in its revenues since the first quarter of 2018. Gross profit and net income have also increased significantly since the first quarter of 2018. The online CBD market experienced increased competition in the second half of 2019 resulting in lower

revenues for the third and fourth quarter of 2019. The Company has been able to maintain healthy gross margins during the eight quarters as it has one of the premium brands available in the US CBD marketplace. The Company has achieved positive net income for each of the eight quarters for the period January 1, 2018 through December 31, 2019.

## PROPOSED TRANSACTION

The Company entered into a business combination agreement (the “**Business Combination Agreement**”) dated November 20, 2020 among AF1 Capital Corp. (“**AF1**”), Heavenly Rx Ltd. (“**Heavenly**”), Heavenly Rx, LLC, Cody Alt and Jeff Yauck, pursuant to which AF1 has agreed to acquire Heavenly’s indirectly-held 50.1% equity interest in the Company. Pursuant to the Business Combination Agreement, AF1 and Heavenly agree to effect the combination of the respective businesses and assets by way of a triangular merger (“**Merger**”) among AF1, a Delaware subsidiary of AF1 and a Delaware subsidiary of Heavenly in accordance with Delaware law.

As a result of the Merger, AF1 will indirectly hold 50.1% of the Company’s outstanding units. Following completion of the Merger, AF1 will change its name to “PureK Holdings Corp.” and the business of PureKana will essentially become the business of AF1, as the resulting issuer. The transaction is subject to TSX Venture Exchange approval and other conditions.

## NON-GAAP FINANCIAL MEASURES

Earnings before Interest tax and depreciation (EBITDA)

\$US millions	Three months ended December 31, 2019		Twelve months ended December 31, 2019	
	2019	2018	2019	2018
<b>Net Income</b>	\$ 0.9	\$ 0.8	\$ 5.8	\$ 3.9
Depreciation & Amortization	0.0	-	0.0	0.0
Interest Expenses	0.0	-	0.0	0.0
Income Taxes	-	-	-	-
<b>EBITDA</b>	<b>0.9</b>	<b>0.8</b>	<b>5.8</b>	<b>3.9</b>
<b>% Sales</b>	<b>19%</b>	<b>14%</b>	<b>23%</b>	<b>25%</b>

EBITDA for the three months ended December 31, 2019 was \$0.9 million an increase of \$0.1 million compared to the prior period (\$0.8 million). The \$0.1 million increase in EBITDA was attributable to (1) a decrease in expenses of \$0.8 million which was offset by (2) decrease in gross profit of \$0.7 million.

EBITDA for the twelve months ended December 31, 2019 was \$5.8 million an increase of \$1.9 million compared to the prior period (\$3.9 million). The \$1.9 million increase in EBITDA was attributable to (1) an increase in gross profit of \$6.8 million which was offset by (2) an increase in expenses of \$4.8 million.



## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

### **Revenue Recognition**

The Company recognizes revenue when products are shipped, and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable.

### **Use of estimates**

The preparation of consolidated financial statements in conformity with IFRS requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include; allowances for doubtful accounts, inventory, and provisions for other contingencies.

Information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment within the next financial year include the following:

### **Inventory**

The Company periodically reviews the value of items in inventory and provides write-downs or write-offs of inventory based on its assessment of market conditions, including forecasted demand compared to quantities on hand, as well as other factors such as potential excess or aged inventories based on product shelf life, and other factors that affect inventory obsolescence.

### **Leases**

The application of IFRS 16 “Leases” requires significant judgements and certain key estimations to be made. Critical judgements required in the application of IFRS 16 include the following (i) identifying whether a contract includes a lease; (ii) determining whether it is reasonably certain that an extension or termination option will be exercised; (iii) determining whether variable payments are in-substance fixes; (iv) establishing whether there are multiple leases in an arrangement; and (v) determining the stand-alone selling price of lease and non-lease components. Key sources of estimation uncertainty in the application of IFRS 16 include the following: (i) estimating the lease term; (ii) determining the appropriate rate to discount lease payments; and (iii) assessing whether a right-of-use (RoU) asset is impaired.

On January 1, 2019, the Company adopted IFRS 16 Leases (“**IFRS 16**”). The Company adopted IFRS 16 using the modified retrospective approach and therefore, the comparative information has not been restated and continues to be reported under IAS 17 Leases and IFRIC 4 Determining whether an arrangement contains a lease.

#### *Policy applicable from January 1, 2019*

At inception of a contract, the Company assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use

of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Company assesses whether:

- the contract involves the use of an identified asset - this may be specified explicitly or implicitly, and should be physically distinct or represent substantially all of the capacity of a physically distinct asset. If the supplier has a substantive substitution right, then the asset is not identified;
- the Company has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use; and
- the Company has the right to direct the use of the asset. The Company has this right when it has the decision-making rights that are most relevant to changing how and for what purpose the asset is used. In rare cases where all the decisions about how and for what purpose the asset is used are predetermined, the Company has the right to direct the use of the asset if either:
  - the Company has the right to operate the asset; or
  - the Company has designed the asset in a way that predetermines how and for what purpose it will be used.

At inception or on reassessment of a contract that contains a lease component, the Company allocates the consideration in the contract to each lease component on the basis of their relative stand-alone prices. However, for the leases of real estate, in which it is a lessee, the Company has elected not to separate non-lease components and account for the lease and non-lease components as a single lease component.

*Policy applicable before January 1, 2019*

There are no lease contracts prior to January 1, 2019.

The Company recognizes a right-of-use asset and a lease liability at the lease commencement date. The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property and equipment.

In addition, the right-of-use asset is periodically reduced by impairment losses, if any, and adjusted for certain remeasurements of the lease liability. The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate.

Generally, the Company uses its incremental borrowing rate as the discount rate. Lease payments included in the measurement of the lease liability comprise:

- fixed payments, including in-substance fixed payments;
- variable lease payments that depend on an index or a rate, initially measured using the index or rate as at the commencement date;
- amounts expected to be payable under a residual value guarantee; and
- the exercise price under a purchase option that the Company is reasonably certain to exercise, lease payments in an optional renewal period if the Company is reasonably certain to exercise an extension option, and penalties for early termination of a lease unless the Company is reasonably certain not to terminate early.

The lease liability is measured at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset, or is recorded in profit or loss if the carrying amount of the right-of-use asset has been reduced to zero.

The Company presents right-of-use assets and lease liabilities in the liabilities section in the balance sheet.

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

## **FINANCIAL AND OTHER INSTRUMENTS**

The Company's financial instruments consist of cash, accounts receivable, credit card processor, accounts payable and accrued liabilities, and lease liability.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below.

### **Fair value of financial assets and liabilities**

IFRS 13 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The three levels of the fair value hierarchy are as follows:

Level 1: Unadjusted quoted prices in active markets for identical assets or liabilities,

Level 2: Inputs other than quoted prices that are observable for the asset or liability either directly (i.e.: As prices) or indirectly (i.e.: derived from prices); and

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

The fair value of cash is measured at cost. The carrying values of cash, accounts receivable, credit card processors, accounts payable and accrued liabilities, and lease liability approximate their respective fair values due to the short-term nature of these instruments.

The following table summarizes the Company's financial instruments at December 31, 2019:

	Financial assets at amortized cost	Other financial liabilities	Total
<b>Financial Assets:</b>			
Cash	\$ 1,061,746	\$ -	\$ 1,061,746
Accounts receivable, credit card processor	864,938	-	864,938
	<b>\$ 1,926,684</b>	<b>\$ -</b>	<b>\$ 1,926,684</b>
<b>Financial Liabilities:</b>			
Accounts payable and accrued liabilities	\$ -	\$ 1,136,151	\$ 1,136,151
Lease Liability	-	128,727	128,727
	<b>\$ -</b>	<b>\$ 1,264,878</b>	<b>\$ 1,264,878</b>

The following table summarizes the Company's financial instruments at December 31, 2018:

	Financial assets at amortized cost	Other financial liabilities	Total
<b>Financial Assets:</b>			
Cash	\$ 1,326,174	\$ -	\$ 1,326,174
Accounts receivables, credit card processor	1,042,736	-	1,042,736
	<b>\$ 2,368,910</b>	<b>\$ -</b>	<b>\$ 2,368,910</b>
<b>Financial Liabilities:</b>			
Accounts payable and accrued liabilities	\$ -	\$ 552,972	\$ 552,972
	<b>\$ -</b>	<b>\$ 552,972</b>	<b>\$ 552,972</b>

### Financial instrument risk management

The Company's financial instrument exposures and the impact on its financial instruments are summarized below:

#### Credit risk

Credit risk is the risk of loss associated with a customer's or counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash and accounts

receivable. Cash is held with reputable United States financial institutions, from which management believes the risk of loss is remote. The Company's maximum credit risk exposure is equivalent to the carrying value of these instruments. The Company has, and intends, to adhere strictly to the state statutes and regulations in its operations.

As at December 31, 2019, the Company's aging of accounts receivable, credit card processor is as follows:

Days	December 31, 2019
0-30 <sup>(1)</sup>	\$ 864,938
31-90	-
90-180	-
> 180	-
	<b>\$ 864,938</b>

**Note:**

(1) Balance was collected in full subsequent to the period ended December 31, 2019.

As at December 31, 2018, the Company's aging of accounts receivable, credit card processor is as follows:

Days	December 31, 2018
0-30 <sup>(1)</sup>	\$ 1,042,736
31-90	-
90-180	-
> 180	-
	<b>\$ 1,042,736</b>

**Note:**

(1) Balance was collected in full subsequent to the period ended December 31, 2018.

### Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2019 the Company's financial liabilities consist of accounts payable and accrued liabilities, and lease liability, which have contractual maturities within one year. The Company manages liquidity risk by reviewing its capital requirements on an ongoing basis. The Company regards liquidity risk to be low as it has sufficient working capital to for at least the next twelve months.

### Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company holds cash in accounts with variable interest rates, and currently does not carry variable interest-bearing debt. It is management's opinion that the Company is not exposed to significant interest rate risk.

## **OUTSTANDING SHARE DATA**

As at December 31, 2019, the Company had one class of units of ownership, of which there were 100,000 company units issued and outstanding. There were no other securities of the Company outstanding as at December 31, 2019.

## **RISKS AND UNCERTAINTIES**

The Company's performance and results of operations are subject to various risks and uncertainties described herein and under the heading "Risk Factors" in the filing statement of AF1 Capital Corp. dated November 20, 2020. Prospective investors should carefully consider the specific risk factors discussed before making an investment decision. Additional risks and uncertainties not currently known to the Company may also have an adverse effect on the Company's business. If any of the risks discussed actually occur, the Company's business, financial condition, capital resources, and results or future operations could be materially adversely affected.