ALEAFIA HEALTH INC.

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

MANAGEMENT'S RESPONSIBILITY

To the Shareholders of Aleafia Health Inc.:

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

In fulfilling its responsibilities, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded, and financial records are properly maintained to provide reliable information for the preparation of these interim condensed consolidated financial statements.

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

August 12, 2021

"Geoffrey Benic"

Geoff Benic
Chief Executive Officer

"Matthew Sale"

Matthew Sale
Chief Financial Officer

ALEAFIA HEALTH INC.

Unaudited Interim Condensed Consolidated Statements of Financial Position

As at June 30, 2021 and December 31, 2020

(Amounts reflected in thousands of Canadian dollars)

	Note	June 30, 2021	December 31, 2020
		$	$
ASSETS			
Current			
Cash and cash equivalents		**4,854**	30,529
Restricted marketable securities	3	**12,950**	—
Trade and other receivables		**4,675**	13,041
Tax receivables		**3,495**	4,537
Prepaids and deposits		**4,493**	5,063
Inventory	10	**32,022**	27,242
Biological assets	11	**8,566**	2,511
		71,055	82,923
Non-current			
Property, plant, and equipment	5	**76,333**	78,469
Deferred expenses		**62**	460
Right-of-use assets	4	**2,189**	2,782
Investments	12	**6,836**	6,620
Intangible assets	6	**53,634**	54,715
Goodwill		**11,314**	11,314
		150,368	154,360
TOTAL ASSETS		**221,423**	237,283
LIABILITIES			
Current			
Accounts payable and accrued liabilities	8	**15,387**	20,166
Lease liability	4	**509**	441
Convertible debt	13	**33,931**	24,361
Deferred revenue		**74**	73
		49,901	45,041
Non-current			
Lease liability	4	**2,111**	2,726
Convertible debt	13	—	32,441
Deferred tax liability		**2,854**	2,854
		4,965	38,021
TOTAL LIABILITIES		**54,866**	83,062
SHAREHOLDER'S EQUITY			
Share capital	7	**404,223**	384,265
Contributed surplus	7	**88,687**	85,025
Deficit		**(326,353)**	(315,069)
		166,557	154,221
TOTAL LIABILITIES AND EQUITY		**221,423**	237,283

COMMITMENTS AND CONTINGENCIES (Note 15)

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

Approved and Authorized for issue on behalf of the board on August 12, 2021.

"Carlo Sistilli "
Carlo Sistilli - Director

"Michael LeClair"
Michael LeClair- Director

ALEAFIA HEALTH INC.

Unaudited Interim Condensed Consolidated Statements of Loss and Comprehensive Loss

For the three months and six months ended June 30, 2021 and 2020
(Amounts reflected in thousands of Canadian dollars, except share and per share amounts)

		Three months ended		Six months ended	
	Note	June 30, 2021	June 30, 2020	June 30, 2021	June 30, 2020
		$	$	$	$
Revenue					
Sale of cannabis		**10,561**	9,240	**17,250**	23,203
Clinic revenue		**1,089**	780	**1,910**	1,650
		11,650	10,020	**19,160**	24,853
Excise taxes		**978**	245	**1,422**	482
		10,672	9,775	**17,738**	24,371
Cost of sales					
Doctor services		**422**	240	**1,082**	709
Inventory expensed to cost of sales		**5,702**	6,033	**8,823**	8,085
Gross profit before fair value adjustment		**4,548**	3,502	**7,833**	15,577
Fair value changes in biological assets and changes in inventory sold	11	**3,572**	(1,102)	**2,651**	(7,319)
Gross profit		**8,120**	2,400	**10,484**	8,258
Expenses					
General and administrative		**4,828**	3,392	**9,420**	6,501
Wages and benefits		**4,337**	3,112	**6,641**	5,597
Amortization and depreciation		**1,714**	2,228	**3,513**	4,242
Share-based payments		**539**	494	**1,118**	1,460
Bad debt expense		**7,161**	300	**7,719**	404
Business transaction costs		**1,061**	1,996	**2,515**	2,506
		19,640	11,522	**30,926**	20,710
Operating loss		**(11,520)**	(9,122)	**(20,442)**	(12,452)
Other expenses (income)					
Interest expense, net		**1,755**	2,828	**3,993**	5,476
Realized gain on LP settlement		**–**	(6,344)	**–**	(6,344)
Gain on sale of assets	3	**(12,092)**	–	**(12,092)**	–
Unrealized loss/(gain) on marketable securities	3	**(700)**	276	**(700)**	(5)
Non-operating income		**(447)**	(362)	**(359)**	(403)
		(11,484)	(3,602)	**(9,158)**	(1,276)
Net loss before income taxes		**(36)**	(5,520)	**(11,284)**	(11,176)
Income tax					
Current income tax expense (recovery)		**–**	(300)	**–**	1,400
Deferred income tax expense (recovery)		**–**	(1,200)	**–**	(2,400)
Net loss and comprehensive loss		**(36)**	(4,020)	**(11,284)**	(10,176)
Loss per share, basic and diluted		**(0.00)**	(0.01)	**(0.04)**	(0.04)
Weighted average common shares outstanding		**330,523,293**	285,981,867	**320,922,887**	281,937,777

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

ALEAFIA HEALTH INC.

Unaudited Interim Condensed Consolidated Statements of Changes in Equity

For the six months ended June 30, 2020 and 2021

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

	Common shares				
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
	#	$	$	$	$
Balances, December 31, 2020	301,269,686	384,265	85,025	(315,069)	154,221
Share issuance costs	–	(1,714)	–	–	(1,714)
Issuance of shares	27,621,500	18,994	3,836	–	22,830
Shares issued from options exercised	781,250	959	(334)	–	625
Shares issued from warrants exercised	1,050,890	1,719	(958)	–	761
Share-based payments	–	–	1,118	–	1,118
Net loss for the period	–	–	–	(11,284)	(11,284)
Balances, June 30, 2021	**330,723,326**	**404,223**	**88,687**	**(326,353)**	**166,557**

	Common shares				
	Number of Shares	Amount	Contributed Surplus	Deficit	Total
	#	$	$	$	$
Balances, December 31, 2019	277,893,686	371,744	80,601	(67,831)	384,514
Issuance of common stock	23,000,000	13,017	–	–	13,017
Shares issued from options exercised	500	1	(1)	–	–
Warrants issued for issuance of shares	–	–	(67)	–	(67)
Share-based payments	–	–	2,461	48	2,509
Net loss for the period	–	–	–	(10,176)	(10,176)
Balances, June 30, 2020	**300,894,186**	**384,762**	**82,994**	**(77,959)**	**389,797**

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

ALEAFIA HEALTH INC.

Unaudited Interim Condensed Consolidated Statements of Cash Flows

For the six months ended June 30, 2020 and 2021
(Amounts reflected in thousands of Canadian dollars)

	June 30, 2021	June 30, 2020
	$	$
Operating activities		
Net loss for the period		
Adjustments for non-cash items:	**(11,284)**	(10,176)
Depreciation	**3,209**	2,227
Amortization	**1,081**	2,015
Share based payments	**1,118**	2,460
Accretion	**3,203**	2,732
Bad debt expense	**7,719**	–
Current income tax liability	**–**	1,400
Deferred income tax recovery	**–**	(2,400)
Realized gain on LP settlement	**–**	(6,344)
Gain on sale of assets	**(12,092)**	–
Unrealized gain on marketable securities	**(700)**	(5)
Fair value changes in biological assets and changes in inventory sold	**(2,651)**	7,319
	(10,397)	(772)
Changes in operating working capital		
Trade receivable	**648**	(14,502)
Prepaids and deposits	**(714)**	17,208
Marketable securities	**–**	(102)
Biological asset	**(5,315)**	(1,196)
Inventory	**(1,265)**	(9,112)
Tax receivable	**1,042**	1,637
Accounts payable and accrued liabilities	**(3,688)**	(3,594)
Cash received from LP settlement	**–**	15,500
Deferred revenues	**(1)**	(40)
Net cash provided by (used in) operating activities	**(19,690)**	5,027
Investing activities		
Investment in retail store operations	**(216)**	(800)
Deferred expenses	**398**	302
Acquisition of property, plant and equipment	**(2,300)**	(13,131)
Net cash used in investing activities	**(2,118)**	(13,629)
Financing activities		
Lease liability payments	**(719)**	(246)
Repayment of convertible debt	**(25,650)**	–
Warrants and options exercised	**1,386**	1
Proceeds from the issuance of stock	**21,116**	12,999
Net cash provided by (used in) financing activities	**(3,867)**	12,754
Change in cash and cash equivalents	**(25,675)**	4,152
Cash and cash equivalents, beginning of period	**30,529**	41,247
Cash and cash equivalents, end of period	**4,854**	45,399

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

Note 1 Nature of Operations

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

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

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

On March 14, 2019, the Company acquired Emblem Corp. by way of a statutory plan of arrangement under the provisions of the *Canada Business Corporations Act* (the "Arrangement"), pursuant to which, among other things, Aleafia Health acquired all of the issued and outstanding common shares of Emblem Corp. following Emblem's amalgamation with Aleafia Health's wholly-owned subsidiary, 11208578 Canada Inc., to form a new wholly-owned subsidiary of the Company continuing as "Emblem Corp." ("Emblem"), see *"Note 16. Business Combination and Asset Acquisition"*.

Following the completion of the Arrangement, on March 19, 2019, the common shares of the Company ceased trading on the TSX Venture Exchange Inc. ("TSXV") and commenced trading on the Toronto Stock Exchange ("TSX") under its existing symbol "ALEF" which was subsequently changed to "AH"on May 27, 2020. Emblem Shares were delisted from the TSXV on March 18, 2019.

As at June 30, 2021, the Company had not generated a profit and had accumulated a deficit of $326 million. The Company's operations and expenditures have been funded by the issuance of equity and convertible debt.

The Board of Directors approved these interim condensed consolidated financial statements on August 12, 2021.

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

Note 2 Basis of Presentation

These unaudited condensed interim consolidated financial statements as at and for the six months ended June 30, 2021 and 2020 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and in accordance with IAS 34, Interim Financial Reporting ("IAS 34"). The accounting policies, methods of computation and presentation applied in these unaudited condensed interim consolidated financial statements are consistent with those of the previous fiscal year. These unaudited condensed interim consolidated financial statements reflect the accounting policies and disclosures described in Notes 2 and to the Company's audited consolidated financial statements for the year ended December 31, and accordingly, should be read in conjunction with those audited consolidated financial statements and the notes thereto.

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

Consolidation

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

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

Reclassification of comparative period presentation

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

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

	Three months ended		Six months ended	
	June 30, 2021	**June 30, 2020**	**June 30, 2021**	**June 30, 2020**
Reclassification:	$	$	$	$
Consultation revenue	**926**	304	**1,391**	940
Research revenue	**163**	476	**519**	710
Clinic revenue	**1,089**	780	**1,910**	1,650

Note 3 Restricted Marketable Securities

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

The sale resulted in the derecognition of certain right of use assets with a net book value of $255 and related lease obligations of $329. In addition, equipment with a net book value of $232 were sold.

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

The following table indicates when the common share become available to trade:

Number of shares	Earliest trade date
350,000	September 11, 2021
1,750,000	September 11, 2021
1,750,000	November 11, 2021
1,750,000	February 11, 2022
1,400,000	May 11, 2022

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

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

During the quarter, the Company recorded an unrealized gain on the shares held for trading of Myconic Capital Corp in the amount of $700. This has been recorded in the unaudited condensed interim consolidated statements of loss and comprehensive loss as other income with a corresponding increase to restricted marketable securities on the unaudited condensed interim consolidated statements of position.

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

Note 4 Right-of-Use Asset and Lease Liability

RIGHT-OF-USE ASSET

	$
Cost	
Balance, December 31, 2019	1,591
New leases	2,472
Termination of lease	(69)
Balance, December 31, 2020	3,994
New leases	98
Termination of lease	(1,147)
Balance, June 30, 2021	2,945
Accumulated amortization	
Balance, December 31, 2019	(520)
Amortization	(692)
Balance, December 31, 2020	(1,212)
Termination of lease	682
Amortization	(226)
Balance, June 30, 2021	(756)
Net book value, December 31, 2020	2,782
Net book value, June 30, 2021	**2,189**

LEASE LIABILITY

	$
Balance, December 31, 2019	1,207
New leases	2,472
Derecognition of lease liability	(69)
Interest accretion	695
Payments	(1,138)
Balance, December 31, 2020	3,167
New leases	98
Derecognition of lease liability	(350)
Interest accretion	424
Payments	(719)
Balance, June 30, 2021	**2,620**
Current portion	**509**
Long-term portion	**2,111**

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

Note 5 Property, Plant and Equipment

	Computer and Software	Equipment and Furniture	Leasehold Improvements	Land	Buildings	Total
	$	$	$	$	$	$
Cost						
Balance, December 31, 2019	758	12,025	5,453	7,637	40,446	66,319
Additions	218	1,955	320	100	18,796	21,389
Balance, December 31, 2020	976	13,980	5,773	7,737	59,242	87,708
Additions	42	2,672	28	-	842	3,584
Disposals	(315)	(300)	(175)	-	(892)	(1,682)
Balance, June 30, 2021	703	16,352	5,626	7,737	59,192	89,610
Accumulated Depreciation						
Balance, December 31, 2019	(225)	(803)	(272)	-	(681)	(1,981)
Depreciation	(193)	(2,013)	(311)	-	(4,741)	(7,258)
Balance, December 31, 2020	(418)	(2,816)	(583)	-	(5,422)	(9,239)
Depreciation	(82)	(1,123)	(158)	-	(3,224)	(4,587)
Disposals	244	179	126	-	-	549
Balance, June 30, 2021	(256)	(3,760)	(615)	-	(8,646)	(13,277)
Net Book Value						
As at December 31, 2020	558	11,164	5,190	7,737	53,820	78,469
As at June 30, 2021	**447**	**12,592**	**5,011**	**7,737**	**50,546**	**76,333**

Depreciation relating to manufacturing equipment and production facilities for owned and right-of-use lease assets is capitalized to biological assets and inventory and is expensed to cost of sales upon the sale of goods. During the six months ended June 2021, the Company recognized depreciation expense of $4,587 (June 30, 2020 – $1,920), of which $324 (June 30, 2020 – $Nil) was included in cost of sales, $2,659 (June 30, 2020 – $Nil) was included in operating expenses, and the remaining balance of $1,604 (December 31, 2020 – $Nil) was included in biological assets and inventory.

During the quarter, the Company had additions of $3,584, of which $1,284 was previously recorded as deposit on the consolidated statements of financial position.

Note 6 Intangible Assets

During the six months ended June 30, 2021, the Company recognized amortization expense of $1,081 (June 30, 2020 – $2,010), of which $452 (June 30, 2020 – $Nil) was included in cost of sales and $629 (June 30, 2020 – $Nil) was included in operating expenses.

During the year ended December 31, 2020, the Company recognized non-cash impairment charges of $22.1 million related to its intangible assets. There have been no impairment write-downs recognized during the six months ended June 30, 2021.

Note 7 Share Capital

Authorized

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

Issued and Outstanding

As at June 30, 2021, there were 330,723,326 common shares issued and outstanding.

During the period ended June 30, 2021, the Company issued 231,500 common shares at an average price per share of $0.41, for gross proceeds of $95 under its at-the-market equity program.

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

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

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

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

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

Warrants

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

	Warrants outstanding	Weighted average exercise price
	#	$
Warrants outstanding and exercisable, December 31, 2019	60,264,816	2.05
Warrants issued	12,707,000	0.80
Warrants exercised	(500)	0.80
Warrants expired	(22,749,342)	3.12
Outstanding and exercisable, December 31, 2020	50,221,974	1.17
Warrants issued	14,316,000	1.25
Warrants expired	(1,003,663)	0.90
Warrants exercised	(1,050,890)	0.74
Outstanding and exercisable, June 30, 2021	**62,483,421**	**1.16**

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

Outstanding and exercisable	Expiry date	Warrants	Weighted average exercise price
		#	$
Warrants Issued by Aleafia	June 27, 2022 - May 29, 2023	55,463,650	1.20
Legacy warrants issued by Emblem	June 23, 2021 - Dec 6, 2021	7,019,771	0.75
Outstanding and exercisable, June 30, 2021		**62,483,421**	**1.16**

Stock Options

The Company has adopted a stock option plan (the "Plan"), providing the Board of Directors with the discretion to issue an equivalent number of options of up to 20% of the issued and outstanding share capital. Stock options are granted with an exercise price of not less than the closing share price of the day preceding the date of grant.

The total stock option expense recognized as share-based compensation for the six months ended June 30, 2021, was $1,118 (June 30, 2020 – $1,460).

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

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

	Options	Weighted average exercise price
	#	$
Outstanding, December 31, 2019	24,979,725	1.22
Granted	5,030,431	0.52
Exercised/Released	(375,500)	0.25
Cancelled and expired	(3,374,024)	1.55
Options outstanding, December 31, 2020	26,260,632	1.06
Options issued	7,880,410	0.43
Options expired	(2,150,000)	0.25
Options exercised	(781,250)	0.65
Options outstanding, June 30, 2021	**31,209,792**	**0.97**
Vested, June 30, 2021	17,586,201	1.29
Unvested, June 30, 2021	13,623,591	0.56

The fair values of the stock options granted during the six months ended June 31, 2021, were estimated using the Black-Scholes option pricing model with following weighted average assumptions:

Weighted average share price	$0.38
Weighted average risk-free interest rate	0.29%
Weighted expected life-years	2.69 years
Weighted average expected volatility	90%
Weighted expected dividends	Nil
Forfeiture rate	0%

Restricted Share Units

The Company has a restricted share unit plan (the "RSU Plan"). For each RSU granted under the plan, the Company recognizes an expense equal to the market value of a common share at the date of grant based on the number of RSUs expected to vest over the term of the vesting period, with a corresponding credit to equity for share-based payments anticipated to be equity settled. RSUs under the RSU plan may vest immediately or become exercisable in various increments based on conditionsas determined by the Board. In determining the amount of share-based compensation, the Company used the closing price of the common shares on the RSU grant date. Under the plan, a maximum of 4,000,000 common shares may be issuable.

During the quarter, 987,000 RSUs were granted (December 31, 2020 – $Nil) with a fair value of $0.42 per RSU. The RSUs vests in tranches with 1/12 vesting every three months over 36 months, commencing September 30, 2021. An additional 114,000 RSUs were granted which cliff vest on April 1, 2022. The total RSU expense recognized as share-based compensation for the six months ended June 30, 2021, was $10 (June 30, 2020 – $Nil).

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

Deferred Share Unit Plan for Directors

At the Company's annual general meeting on June 30, 2020, shareholders passed a resolution approving the Aleafia Health Inc. a deferred share unit plan (the "DSU Plan"), which was implemented in Q4 2020.

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

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

During the six months ended June 30, 2021, the Company issued 307,410 DSUs (December 31, 2020 – 148,431 DSUs). As at June 30, 2021, there were 455,841 DSUs issued and outstanding. As at June 30, 2021, the value of the DSU liability is $185 (December 31, 2020 – $73). The DSU liability is recorded in accounts payable and accrued liabilities in the consolidated statements of financial position.

Note 8 Related Party Balances and Transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources or obligations between related parties.

Key management includes directors and key officers of the Company.

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

	June 30, 2021	June 30, 2020
	$	$
Wages and Benefits: Directors	333	227
Wages and Benefits: Management	923	923
Accounts payable and accrued liabilities: Directors	-	90
Accounts payable and accrued liabilities: Management	55	80
Share based compensation: Directors	138	138
Share based compensation: Management	966	1,167
	2,415	**2,625**

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

As at June 30, 2021, an amount of $55 was due to directors and management (December 31, 2020 - $150). These amounts are non-interest bearing, unsecured, due on demand and included in accounts payable and accrued liabilities.

Note 9 Management of Capital

The Company's objectives when managing capital are to sustain a sufficient capital base so as to maintain investor, creditor, and customer confidence and to sustain the future development of the business. The Company does not have any externally imposed capital requirements to which it is subject.

The Company defines capital as the aggregate of its shareholders' equity and convertible debt. The Company manages the capital structure and adjusts it in light of changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may attempt to issue new shares or dispose of assets or adjust the amount of cash.

Note 10 Inventory

Inventory is comprised of the following items:

	June 30, 2021	December 31, 2020
	$	$
Finished goods	3,714	3,890
Work-in-progress	26,805	21,919
Supplies and consumables	1,503	1,433
Total inventory	**32,022**	**27,242**

The fair value adjustment to biological assets and inventory sold consists of the following.

	Six months ended June 30, 2021	Six months ended June 30, 2020
	$	$
Realized fair value amounts included in inventory sold	(46)	3,160
Change in fair value on growth of biological assets	(2,605)	4,159
	(2,651)	**7,319**

Note 11 Biological Assets

Biological assets are valued in accordance with IAS 41. The Company's biological assets consist of cannabis plants. As there is no actively traded commodity market for these, the valuation of these biological assets is obtained using valuation techniques where the inputs are based upon unobservable market data which are considered to be level 3 inputs under IFRS. These inputs are subject to volatility in market prices and several uncontrollable factors could significantly affect the fair value of biological assets in future. The fair value is determined using a valuation model to estimate expected harvest yield per plant applied to the estimated price per gram less processing and selling costs. The Company capitalizes all the direct and indirect costs as incurred related to the transformation of biological assets and measures biological assets consisting of cannabis plants at fair value less cost to sell up to the point of harvest, which becomes the basis for the cost of finished goods inventories after harvest. Unrealized gains or losses arising from changes in fair value less cost to sell during the year are included in the results of operations of the related year.

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

The Company's estimates are subject to change and differences from the anticipated yield will be reflected in the gain or loss on biological assets in future years. As of June 30, 2021, the biological assets strains consisted of indoor plants which were on average 49% complete and outdoor plants which were on average 33% complete.

The following table depicts the changes in the fair value measurement (unrealized gain/loss resulting from fair value changes on growth of biological assets) and the fair value of biological assets as of December 30, 2020 and June 30, 2021 as required by IFRS 13 fair value measurement.

	$
Balance as at December 31, 2019	971
Changes in fair value less costs to sell due to biological transformation	7,870
Production costs capitalized to biological assets	5,419
Transferred to inventory upon harvest	(11,749)
Balance, December 31, 2020	2,511
Changes in fair value less costs to sell due to biological transformation	2,605
Products costs capitalized to biological assets	6,650
Transferred to inventory upon harvest	(3,200)
Balance, June 30, 2021	**8,566**

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

	Indoor	Outdoor
Average transfer price per gram ($)	0.75	0.25
Average yield per plant (grams)	125	750
Average of growth cycle (weeks)	12	16

The Company values medical cannabis plants at fair value. Management determined cost approximates fair value from the date of receiving the vegetative plants until halfway through the flowering cycle of plants. Measurement of the biological transformation of the plant at fair value begins in the fourth week prior to harvest and is recognized evenly until the point of harvest. The number of weeks in the growing cycle is between twelve and sixteen weeks from propagation to harvest.

The unrealized gain on biological assets for the six months ended June 30, 2021 was $2,651 (June 30, 2020 – $3,221).

Note 12 Investments

On November 22, 2018, the Company entered into a Master Joint Venture Agreement ("the Agreement") with SPE Finance LLC ("SPE") to establish a joint venture for the purpose of owning andmanaging retail stores with a focus on selling cannabis and cannabis-related products across Canada and internationally (excluding the United States of America). The intention is to create, fund and govern the operations of the joint venture in the form of a corporation to carry on business. The joint venture was incorporated under the name One Plant (Retail) Corp. ("OPC").

The Company paid $4.0 million for the issuance of 99 common shares of OPC and as a result owns 9.9% of the outstanding common shares of OPC. On April 1, 2020 Flying High Inc. invested $0.8 million in OPC and the Company recorded the transaction as an investment. For accounting purposes, the Company classified its interest in OPC at fair value through profit and loss and as an investment.

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

The Company invested $0.1 million in CannaPacific in January 2019, $0.6 million in April 2019 and $0.2 million in June 2021.

CannaPacific is a private entity without observable market prices for its common shares and this investment is measured at its estimated fair value which is calculated based on a valuation technique that uses inputs derived by management which are considered level 2 in the fair value hierarchy (see Note 14). The investment is recorded its estimated fair value of $2.8 million. During the year ended December 31, 2020, the Company recorded an unrealized gain in fair value of $1.9 million. There has been no change in the estimated fair value at June 30, 2021.

Note 13 Convertible Debt

Emblem Convertible Debt

On completion of the Arrangement, Aleafia Health assumed the obligations of the convertible debentures previously issued by Emblem Corp. in February 2018 pursuant to a supplemental trust indenture dated March 2019 (the "Supplemental Indenture"). These convertible debentures were originally sold at a price of $1,000 per unit for gross proceeds of $25.0 million. Under the Supplemental Indenture, the convertible debentures are subject to the following terms:

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

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

- Aleafia Health may require the conversion of the full principal amount of the outstanding convertible debentures at the conversion price on not less than 30 days' notice, should the daily volume weighted average trading price of the outstanding common shares of Aleafia Health on the TSX be greater than $4.12 for any 10 consecutive days.

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

Aleafia Convertible Debt

In June 2019, the Company issued 40,250 additional convertible debentures units (the "Aleafia Convertible Debt Unit") for gross proceeds of $40.3 million. The Aleafia Convertible Debt Unit consists of one $1,000 principal amount of unsecured convertible debenture of the Company and 680 common share purchase warrants, under the following terms:

- A maturity date of June 27, 2022,
- An interest rate of 8.5% per annum, payable semi-annually,
- Convertible at $1.55 per share until June 27, 2022, at the option of the holder, and;
- The Company may require conversion of the full principal amount outstanding convertible debenture at the conversion price on not less than 30 days' notice, should the daily volume weighted average trading price of the outstanding common shares of the Company on the TSX be greater than $3.10 for 20 consecutive trading days.

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

Convertible debt

	$
Balance as at December 31, 2019	51,009
Amortization of transaction costs	2,081
Interest accretion	3,712
Balance as at December 31, 2020	56,802
Amortization of transaction costs	630
Repayment of convertible debt	(24,689)
Interest payments	(1,753)
Interest accretion	2,941
Balance as at June 30, 2021	**33,931**
Current portion	**33,931**
Long-term portion	–

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

Note 14 Financial Instruments and Financial Risks

Fair Value of Financial Instruments

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

	June 30, 2021	December 31, 2020
	$	$
FVTPL (i)	24,640	37,149
Assets, amortized cost (ii)	4,675	13,041
Liabilities, amortized cost (iii)	51,938	80,135

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

The Company classifies its fair value measurements in accordance with an established hierarchy that prioritizes the inputs in valuation techniques used to measure fair value as follows:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities
- Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly
- Level 3 - Inputs that are not based on observable market data

The following table sets for the Company's financial assets measured at fair value on a recurring basis by level within the fair value hierarchy:

	Quoted Prices in Active Markets for Identical Instruments	Significant Other Observable Inputs	Significant Unobservable Inputs	
	Level 1	Level 2	Level 3	Total
	$	$	$	$
Cash and cash equivalents	4,854	–	–	4,854
Marketable securities	12,950	–	–	12,950
Investments	–	2,836	4,000	6,836
Total	**17,804**	**2,836**	**4,000**	**24,640**

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

During the six months ended June 30, 2021 and the year ended December 31, 2020, there have been no transfers between Level 1, Level 2, and Level 3 fair value measurements. There has been no change in fair value of the Company's investment in OPC (classified as Level 3) as disclosed in Note 12. The value of investment is assessed based on discounted cash flow model. The following factors have a potential impact on net earnings/loss based on various combinations of changes in unobservable inputs in the Company's internal valuation models for its investment in OPC:

- Fair value of investment: $4,000
- After-tax discount rate: 13% to 19%
- Adjustment of management revenue received due to risk and uncertainties:(15%) / +15%
- Hypothetical $ change effect on fair value measurement and net income /loss for the year: ($1M) - $2M.

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

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

Risk Management

Effective risk management is fundamental to the success of the organization and is recognized as key in the Company's overall approach to strategy management. Aleafia has a strong, disciplined risk culture where managing risk is the responsibility shared by all of the company's employees.

The primary goals of the risk management are to ensure that the outcomes of risk-taking activities are consistent with Company's strategies and the risk appetite and that there is an appropriate balance between risk and reward in order to maximize shareholder value.

Aleafia has identified the below potential risk categories:

a) Currency risk

The Company's expenses are denominated in Canadian dollars. The Company's corporate office is based in Canada and current exposure to exchange rate fluctuations is minimal.

The Company does not have any significant foreign currency denominated monetary assets or liabilities. The Company is attracting foreign investments and in future, the Company's financial assets and liabilities may comprise of foreign currency marketable securities, convertible notes, long term investments and promissory notes.

b) Interest rate risk

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

c) Credit risk

Credit risk is the risk of loss associated with the counterparty's inability to fulfill its payment obligations. Financial instruments that potentially subject the Company to concentrations of credit risks consist principally of cash and cash equivalents, trade and other receivables and short-term investments. The risk exposure is limited to their carrying values reflected on the statement of financial position. To minimize the credit risk, the Company transacts with a high-quality financial institution for cash and cash equivalents and short term investments. The Company performs a credit risk assessment on all potential new customers and on an ongoing basis reviews such risk assessment.

d) Liquidity risk

In the management of liquidity risk of the Company, the Company maintains a balance between continuity of funding and the flexibility through the use of borrowings. The Company manages liquidity risk through the management of its capital structure. As at June 30, 2021 the Company's contractual obligations consist of accounts payable and accrued liabilities, convertible debt, and lease liability, which has a contractual maturity date within one year. Management closely monitors the liquidity position and has adequate sources of funding to finance the Company's projects and operations.

Note 15 Commitments and Contingencies

	Less than 2 years	2 to 5 years	Total
Long-term arrangements on facilities	628	1,877	2,505
Car lease	2	—	2
Total	**630**	**1,877**	**2,507**

In the ordinary course of business, from time to time, the Company may be involved in various claims related to its commercial and/or corporate activities. Although such matters cannot be predicted with certainty, management does not consider the Company's exposure to these claims to be material to these interim condensed consolidated financial statements.

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

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