

## HILL STREET BEVERAGE COMPANY INC.

### MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE THREE MONTH PERIOD ENDING SEPTEMBER 30, 2018

The following management's discussion and analysis ("**MD&A**") provides a review of the activities, results of operations and financial condition of Hill Street Beverage Company Inc. (the "**Company**", "**Hill Street**", "**we**", or "**our**") for the three months ended September 30, 2018 in comparison with the three months ended September 30, 2017 and the year ended June 30, 2018. These comments should be read in conjunction with the audited financial statements for the years ended June 30 2018 and 2017 and accompanying notes included therein, which have been prepared in accordance with International Financial Reporting Standards ("**IFRS**"). This MD&A has been prepared as of November 28th, 2018. Additional information relating to Hill Street is available on SEDAR.

All amounts are stated in Canadian dollars unless otherwise identified.

#### **FORWARD-LOOKING STATEMENTS**

Except for the historical information contained herein, the discussion in this MD&A contains certain forward-looking statements that involve risks and uncertainties, such as statements of Hill Street's plans, objectives, strategies, expectations and intentions. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "may", "will", "expect", "intend", "anticipate", "seek", "plan", "believe" or "continue" or the negatives of these terms or variations of them or similar terminology. Although Hill Street believes that the expectations and assumptions reflected in these forward-looking statements are reasonable, undue reliance should not be placed on these forward-looking statements. These forward-looking statements are not guarantees and reflect Hill Street's views as of November 28, 2018 with respect to future events. Future events are subject to certain risks, uncertainties and assumptions, which may cause actual performance and financial results to differ materially from such forward-looking statements. The forward-looking statements, including the statements regarding expected volumes, operating efficiencies and costs are based on, among other things, the following material factors and assumptions: sales volumes in the quarter will increase; no material changes in consumer preferences; brewing, blending, and packaging efficiencies will improve; the cost of input materials for brewing and blending will increase; competitive activity from other manufacturers will continue; foreign currency exchange rates will change; continued interest in and uptake of cannabis and cannabis-infused edible products; no material change to the regulatory environment in which Hill Street operates and no material supply, cost or quality control issues with vendors. Readers are urged to consider the foregoing factors and assumptions when reading the forward-looking statements and for more information regarding the risks, uncertainties and assumptions that could cause Hill Street's actual financial results to differ from the forward-looking statements, to also refer to the remainder of the discussion in this MD&A, Hill Street's various other public filings as and when released by Hill Street. The forward-looking statements included in this MD&A are made only as of November 28, 2018 and, except as required by applicable securities laws, Hill Street does not undertake to publicly update such forward-looking statements to reflect new information, future events or otherwise.

#### **Overall Performance**

The quarter ended September 30, 2018 represents the first quarter for the Company for the fiscal year ending June 30, 2019.

On July 24, 2018, the Company completed a reverse takeover transaction (the "**RTO**") with Hill Street Marketing Inc. ("**HSM**"), pursuant to the terms of a definitive acquisition agreement dated July 24, 2018 (the "**HSM Acquisition Agreement**"). In accordance with the terms of the HSM Acquisition Agreement, the Company acquired, by way of three corner amalgamation, all of the outstanding securities of HSM in exchange for shares and other securities of the Company. In particular each HSM common share was exchanged for 65.358 common

shares in the capital of the Company (“**Common Shares**”) and each outstanding HSM warrant was exchanged for sixty (60) warrants to purchase Common Shares of the Company. The RTO constituted the Company's Qualifying Transaction under the policies of the TSX Venture Exchange. As a result of the RTO, the former shareholders of HSM acquired control of the Company. In connection with the RTO, the Company issued 51,635,093 Common Shares and 8,674,800 warrants, to the former security holders of HSM. Following completion of the RTO, the business of the Company became the business of HSM, and the year end of the Company became the year end of HSM and was changed to June 30. This MD&A represents the first full reporting period for the Company following the completion of the RTO.

In October 2018, the *Cannabis Act (Canada)* came into force across Canada, which regulates the producing, possessing and selling of recreational cannabis. Hill Street anticipates that one of the preferred methods for ingesting recreational cannabis products will be in beverage form. Current legislation does not permit the selling of cannabis-infused beverages.

Hill Street intends to be one of the first beverage companies in Canada to launch a full portfolio of infused beverages in time for Canada’s legalization of edible forms of cannabis, anticipated for October 2019. Building upon its award-winning alcohol-free beverages, Hill Street hopes to offer consumers great tasting alternatives to alcohol using cannabis as a stimulant, as well as a portfolio of beverages that will be built upon cannabis’ purported and known therapeutic properties. This undertaking is no small feat, given constantly changing rules issued by the various levels of government.

In spite of a high degree of ambiguity accompanying cannabis legalization, Hill Street continues to advance the development of production facilities, technologies and processes. During the quarter, the Company submitted a license application to Health Canada to become a standard processor of cannabis which should allow the Company to be able to produce cannabis-infused beverages once legislation permits.

Hill Street is nearing the completion of its proof of concept for a state of the art de-alcoholization system, which will be able to completely eliminate alcohol in fine vintage wines and craft beers with the least amount of impact on the aroma and taste of the beverages. We are also nearing the completion of the first implementation of the infusion technology we licensed from Lexaria Bioscience for use in a commercial beverage production facility. These initiatives will create a significant barrier to entry for competitors, and have already started to garner significant interest from other beverage makers who will seek to have us co-pack beverages for them using these processes.

Hill Street is also garnering a great deal of interest from distributors and retailers, who are keen to carry its products into the cannabis market when edibles are legalized. While there is still nearly a year before anticipated legalization, retailers are beginning to develop their store planograms, order management systems, and other important decisions about their merchandising strategies that we will need to respond to in the coming months. The Company expects to make further announcements regarding its distribution strategies in early calendar 2019.

Hill Street continues to engage with licensed producers (LPs) about the opportunity for strategic investment in Hill Street and its business, as well as pursuing product development and research partnerships. While there is nothing to announce at this time, much work has been done by management to determine who will be the best cannabis partners for Hill Street, and indeed whether one is even necessary for Hill Street to compete effectively in the market. In the immediate lead up to the launch of the legal recreational market most LPs were focused on last-minute supply and distribution challenges. Now that the industry is settling into stable supply for the adult use market, conversations with major licensed producers have advanced, and Hill Street continues to be optimistic about its ability to either attract a significant LP as a partner, or secure a supply of cannabis that will allow its beverages to be significantly differentiated from other offerings in the market.

During the quarter ended September 30, 2018, Hill Street and its management team participated in a number of major cannabis trade shows, media interviews, and grocery industry conferences with great success. The Company’s attendance at the Niagara GrowUp conference in September, was highlighted by its booth being

overwhelmed by both consumers and trade executives who were keen to learn about its proposed wine and beer offerings, as well as interest from major wineries and licensed producers. Subsequent to the quarter ended, the Company's participation in the Grocery Innovations conference, the largest Canadian grocery trade show, resulted in significant new listings which have been previously announced.

While management continues to believe that the production and sale of cannabis-infused products is the most promising opportunity for the Company, until edibles are legalized in Canada, Hill Street will continue to build distribution and critical mass for its alcohol free brands at grocery, drug, mass merchants and independent retailers. Hill Street's corporate brand visibility on shelf and online should continue to expand commensurate with increased listings.

The Company's brand, partner, and channel marketing programs differentiate its approach to creating the awareness and demand needed to increase run rate sell through. With the strong distribution gains in place, the Company's marketing efforts should begin to play an important role in offtake. Hill Street's efforts in this regard are starting to show results, as revenues for the quarter ended September 30, 2018 increased approximately 112% compared to the quarter ended September 30, 2017 and almost 412% compared to the quarter ended June 30, 2018.

## **DESCRIPTION OF THE BUSINESS**

The Company presently has one business segment, the marketing and distribution of alcohol-free beer and wine in Canada and, to a much lesser extent, the United States. Hill Street sells its products online and in approximately 4,000 recognized retail chain stores through licensed distributors in Canada. Subsequent to the end of the quarter, the Company also announced significant new distribution and retail listings, giving it an addressable retail market of nearly 7,000 stores, with significant new coverage of the independent retail channel across Canada via National Importers, and the depanneur retail segment in Quebec via Clark, Drouin, Lefebvre. It also provides a direct consumer subscription service at [www.hillstreetbevco.com](http://www.hillstreetbevco.com).

## **INNOVATIVE PRODUCTS AND ADDRESSABLE MARKETS**

### **Non-Alcoholic Adult Beverages**

Hill Street purchases retail sales data from Nielsen in order to get accurate insights on a national and regional basis, in addition to regularly acquiring insights on a global basis from published reports. According to the leading beverage industry market research firm<sup>1</sup>, the non-alcoholic wine and beer market consistently ranks as one of the fastest growing sectors in the global beverage industry and is expected to generate 8.5% CAGR globally until 2025. In addition, according to Nielsen data, in Canada, the segment has experienced annual growth in excess of 20% a year for the past few years, which has seen the launch of new alcohol-free beer brands from the top brewers in the world, in addition to new craft beer offerings from regional and local brewers. Hill Street has acquired a significant part of this growth, leveraging our relationship with major national retailers to expand our presence on shelf, as well as securing the opportunity to produce private label versions of our products for major retailers such as President's Choice De-Alcoholized Wine. We have seen our presence in major retailers increase significantly in eighteen months from about 1,200 stores, to nearly 4,000 as of the end of the first quarter, with subsequent additions of new customers taking us to an addressable retail presence of around 7,000 stores in time for the major selling season (summer 2019). In normal course of business, acquiring a listing in a major retailer can take up to six months for the product to start appearing on retail shelves.

Our innovative "Hill Street Challenge" marketing campaign has proven a rallying cry for media, social media, and our medical research partners, and will become a centerpiece for the Company's marketing efforts going forward. Consumers are encouraged to "take the Hill Street Challenge" and go thirty days with no alcohol, consuming Hill Street brand products instead, with the tag line, "Cheers to a better you." The Company intends to capitalize on

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<sup>1</sup> Mintel, Global Food and Drink Trends, 2019.

the growing trend for moderation, responsible consumption, and the decline in alcohol consumption amongst millennials who have been declared by USA Today as the most teetotaling generation in a century with nearly 26% choosing not to consume alcohol. The Company test marketed the Hill Street Challenge during the quarter ended September 30, 2018, during which traffic to our web site increased significantly. This significant interest has given the Company the confidence to roll out the campaign during the traditional “Dry January” period when consumers are looking to get a new start on the year and cut back on their alcohol consumption.

We have also launched four (4) new wine stock keeping units (“SKUs”), including Cabernet Sauvignon, Shiraz, Brut Rose, and Sauvignon Blanc. We are also preparing to launch two (2) additional new beer SKUs, including an Amber Ale, and a Double IPA, to capitalize on the demand among craft beer drinkers for more intense flavours and aromas. Our main private label customer has placed orders for additional SKUs and has increased distribution of their existing products. Our shelf presence in select major retail customers has increased from four (4) SKUs to eleven (11) SKUs in the past six months, which we expect will result in increased revenues in future periods, particularly fiscal 2020, beginning in July 2019.

### **Cannabis-infused Adult Beverages**

In addition to building our alcohol-free beverage business, Hill Street recognized early that regulations would prohibit alcohol and cannabis to be included together in a commercial product. Therefore, if a beer or wine company wanted to make cannabis-infused versions of their wine or beer, they must first be able to produce great tasting alcohol-free versions of their brands before they can add the cannabis. Hill Street is an award-winning producer of alcohol-free adult beverages with over a decade of experience in producing these products. We began our search for technology solutions to infuse our beverages with cannabis, which resulted in our completing a license agreement with Lexaria Bioscience during the quarter, providing us with access to technology to render cannabis into an odorless and tasteless water-soluble powder which can then be added to our alcohol-free beverages.

While it is impossible to accurately measure the exact size of the market potential for cannabis-infused beverages in Canada, we can look to external research sources to determine how big an opportunity this market presents for the Company. According to Statistics Canada, there are approximately 20 million consumers who drink alcohol. Per capita, the Canadian consumer drank approximately 255 (371 ml size) bottles per capita in 2015, the last year data was available. This means that more than 5 billion bottles of beer were consumed during that year. The annual decline of beer consumption in Canada is 0.7%, as consumers trend to moderation and look for alternatives to alcohol given its negative impact on their health and lifestyle. According to recent research released by Deloitte, approximately 30% of the Canadian population is interested in trying cannabis edibles, including beverages. If they all chose to switch to cannabis-infused beer, the size of the beer market alone would be 1.6 billion bottles, or almost 66 million standard cases of 24 bottles of cannabis-infused beer per year. At an average wholesale price of \$36 per case, \$2.36 billion in market potential.

Similarly, wine currently represents approximately 31% of the revenue for the alcohol industry. If 30% of those who drink wine are likely to try cannabis-infused beverages, that results in approximately 2.1 million bottles of wine, or nearly 250,000 cases simply to satisfy the curiosity of the consumer approaching this new market. At an average \$20 per bottle, approximately \$42 million dollars’ worth of wine would be needed to be available to just to meet initial market demand.

Hill Street believes that the cannabis-infused beverage segment can best be described as three distinct beverage categories: 1) “Heighten” (adult recreational use); 2) “Help” (therapeutic or functional beverages); and 3) “Heal” (medicinal or prescription beverages). We intend to market beverages for the adult use and therapeutic or functional beverage categories, and to explore co-packing partnerships with major licensed producers to address the prescription drug or medicinal segment.

Hill Street intends to meet this potential demand with the same type of high quality and award-winning products we have produced for the alcohol-free category, and with the same level of focus on brand development, sales and distribution.

### SELECTED QUARTERLY INFORMATION

The following table summarizes certain financial information of the Company for the quarters indicated below:

	Sept. 30, 2018	June 30, 2018	Mar 31, 2018	Dec 31, 2017	Sept 30, 2017	June 30, 2017	Mar 31, 2017	Dec 31, 2016
Gross Revenue	\$793,867	\$155,140	\$364,427	\$599,048	\$373,040	\$395,365	\$76,579	\$357,885
Net Revenue	\$511,607	\$81,943	\$248,093	\$125,485	\$202,754	\$116,503	\$8,153	\$222,523
Direct Costs	\$294,613	\$98,912	\$19,898	\$244,532	\$120,377	\$174,861	\$15,017	\$130,612
Gross Profit	\$216,994	\$-16,969	\$228,195	\$119,047	\$82,377	\$-58,358	\$-6,864	\$91,911
Net Loss (gain)	\$10,137,920	\$1,392,424	\$644,880	\$439,405	\$166,527	\$818,883	\$182,416	\$766,933
Total Assets	\$4,502,946	\$2,845,751	\$1,650,397	\$598,745	\$725,053	\$518,429	\$557,771	\$308,144
Total Liabilities	\$1,069,283	\$1,387,534	\$674,059	\$1,753,076	\$1,602,343	\$1,247,770	\$1,073,006	\$2,549,848
Shareholder Equity	\$3,433,633	\$1,458,217	\$976,338	\$-1,154,331	\$-876,290	\$-729,341	\$-515,235	\$-2,241,704

### RESULTS OF OPERATIONS

The following table summarizes certain financial information of the Company for the quarter ended September 30, 2018 and the year ended June 30, 2018.

Results for the Period Ended	Quarter Ended September 30, 2018	Quarter Ended September 30, 2017
<b>Gross Revenue</b>	\$793,867	\$373,040
<b>Chargebacks, finance fees, and listing fees</b>	\$282,260	\$170,286
<b>Net Revenue</b>	\$511,607	\$202,754
<b>Direct Costs</b>	\$294,613	\$120,377
<b>Gross profit</b>	<b>\$216,994</b>	<b>\$82,377</b>
<b>Operating Expenses</b>	<b>\$886,829</b>	<b>\$254,402</b>
<b>Other One-time Expenses</b>	<b>\$304,675</b>	<b>\$-</b>
<b>Non Cash Expenses</b>	<b>\$221,286</b>	<b>\$-</b>
<b>Loss before other income (Expense)</b>	<b>\$1,195,796</b>	<b>\$172,025</b>
<b>Other income (Expenses)</b>		
Charges related to RTO	\$(8,921,869)	\$-
Foreign exchange gain (loss)	\$(14,888)	\$5,498
Write-off of inventory	\$(8,007)	\$-
Other Income	\$2,640	\$-
<b>Loss and comprehensive loss for the period</b>	<b>\$10,137,920</b>	<b>\$166,527</b>
<b>Basic and diluted loss per common share</b>	<b>\$0.16</b>	<b>\$0.33</b>
<b>Weighted average number of common shares outstanding</b>	<b>64,157,068</b>	<b>500,878</b>

## REVENUES

During the quarter ended September 30, 2018, the Company recorded gross revenues of \$793,867 compared to \$373,040 for the quarter ended September 30, 2017, representing an increase of approximately 112%. Net revenues for the quarter ended September 30, 2018 were \$511,607 compared to \$202,755 in the quarter ended September 30, 2017, representing an increase of approximately 152%. Net revenues are calculated by deducting from gross revenues the costs chargebacks, distribution fees and listing fees paid to distribute products.

The Company believes that this increase in revenues was driven principally by two factors, the first relates to increased marketing, advertising and promotional efforts of the Company, and the second relates to the efforts of its new distributors.

For the quarter ended September 30, 2018, Hill Street had net loss of \$10,137,920 compared to a loss of \$166,527 in the quarter ended September 30, 2017. This loss was driven principally by onetime, non-cash expenses of the Company relating to the completion of the RTO.

In February 2018, Hill Street terminated its four year old partnership with Tree of Life, its retail distributor and sales agency. The contractual termination period of 120 days was mutually reduced to 90 days and effective June 1, 2018, a new retail distributor (C.B. Powell) and a boutique Sales Broker (North South Management) were hired to drive key account distribution. No account level interaction with the new distributor or broker was permitted during the transition period and sales revenue during the transition period was down 36% compared to the same period for the year prior.

Since June 1, 2018, the new sales broker has made significant progress representing Hill Street products building its distribution base in the grocery channel. Sobeys has recently listed six (6) SKUs across the country where previously the Company had zero distribution in Western Canada. Loblaws has recently committed to carry Hill Street's line of craft beers. Quebec has traditionally been the largest market for alcohol free products in Canada, as such the Company has recently contracted the services of C.D.L., a full service distributor and sales company to offer its products in that province.

All of the revenue for the quarter ended September 30, 2018 was sourced from existing accounts. New distribution revenue should appear in the subsequent quarters, with pipeline orders to support Sobeys western Canada.

Chargebacks were \$282,260 in for the quarter ended September 30, 2018 compared to \$170,286 for the quarter ended September 30, 2017. Distribution fees were \$160,913 in the quarter compared to \$82,193 in 2017.

Chargebacks are fees charged by retailers and distributors for advertising and promotion programs, internal freight for distant retailers, broken or out of date stock, and out of stock penalties. Distribution fees include direct fees charged by distributors to distribute product, and financing fees. Listing fees represent the fees charged by retailers to have product available for sale in such retail establishments.

Chargebacks, distribution fees and listing fees represented 36% of gross revenues for the quarter ended September 30, 2018, compared to 46% for the quarter ended September 30, 2017. The drop in these fees can be attributed to our new distributor relationships discussed above.

## COST OF SALES/DIRECT COSTS

Direct costs were \$294,613 for the quarter and three months ended September 30, 2018, an increase from \$120,377 for the previous quarter and three months ended September 30, 2017. Cost of sales represented 37% of gross revenue in the quarter compared to 32% in 2017. This increase was primarily driven by an increase in finished wine product costs and associated foreign exchange.

## **OPERATING EXPENSES**

Operating expenses include marketing expenses, bank charges, commissions, depreciation, dues and licenses professional fees, salaries, and other general and administrative expenses. For the quarter ended September 30, 2018, operating expenses totaled \$886,829, compared to \$254,402 for the quarter ended September 30, 2017, representing an almost five fold increase year to year. The principal drivers of the increase in operating expenses were advertising and promotion expenses, and labour costs, which accounted for \$563,416 for the quarter ended September 30, 2018, compared to \$144,343 for the quarter ended September 30, 2017. The Company anticipates that revenues will continue to increase in subsequent quarters and will more than offset operating expenditures. The Company will be reviewing and tracking these items in subsequent quarters.

## **ONE TIME AND NON CASH EXPENSES**

In addition to ordinary operating expenses, the Company incurred a number of one-time expenses during the quarter ended September 30, 2018 totaling \$304,675. These expenses are comprised of expenses of the Company relating to the RTO and expenses of the Company relating to its cannabis licencing efforts. The Company also incurred non-cash expense of \$221,019.

## **NET EARNINGS**

As noted above, the Company completed the RTO with HSM during the quarter ended September 30, 2018. The acquisition of HSM was accounted for as reverse takeover transaction that was not a business combination and effectively a capital transaction of the Company at a deemed (non-cash) expense of \$8,921,870. As a result of this accounting treatment, the Company recorded net loss \$10,137,920 for the quarter ended September 30, 2018, compared to a loss of \$166,527 for the quarter ended September 30, 2017.

The basic and diluted loss per share for the three months ended September 30, 2018 were 0.16 per share. The basic and diluted earnings per share for the three months ended September 30, 2017 were 0.33 per share.

## **LIQUIDITY AND CAPITAL RESOURCES**

### **FINANCIAL POSITION**

The Company's principal capital needs surround the expectation of increased distribution and marketing in order to capitalize on the growth of the alcohol free beverage segment, together with its investment in scaling technology associated with the production of cannabis-infused beverages. Since its formation, the Company has financed its additional cash requirements through revenues generated from operations, issuance of securities and borrowing from shareholders and other lenders. Management believes that over the short-term, there will be significant growth in revenues as it continues to pursue an aggressive marketing strategy, and its strategy relating to cannabis-infused products, however, the Company will likely require additional capital to achieve these goals. Currently the Corporation is in discussions with LPs and other strategic partners that could potentially help finance this growth.

### **WORKING CAPITAL**

Working capital represents current assets less current liabilities. As of September 30, 2018, the Company had a positive working capital of \$3,430,236 compared to a working capital of \$1,454,523 for the three months and quarter ended September 30, 2017. The Company believes that its current marketing strategy of growing consumer awareness is beginning to show signs of success as evidenced by the higher revenues observed for the Company for the quarter.

## CASH FLOWS

During the quarter ended September 30, 2018, Hill Street generated negative cash flows from operations of \$1,738,095 compared to negative cash flow of \$94,474 during the quarter ended September 30, 2017. The amount of cash (used) in investing activities in the quarter ended September 30, 2018 was \$NIL compared to \$64 in the quarter ended September 30, 2017. The amount of cash provided by financing activities during the quarter ended September 30, 2018 was \$2,748,578 compared to \$244,250 in the quarter ended September 30, 2017.

## CONTRACTUAL OBLIGATIONS

A summary of the Company's contractual obligations for future periods is as follows:

Contractual Obligations	Payments due by Period					Total
	2019	2020	2021	2022	2023	
Bank Debt Obligations (principal and interest)	\$0	\$0	\$0	\$0	\$0	\$0
Contractual Royalty Obligations	\$190,500	\$125,000	\$25,000	\$12,500	\$0	\$353,000
Operating Leases	\$0	\$0	\$0	\$0	\$0	\$0
Purchase Obligations	\$0	\$0	\$0	\$0	\$0	\$0
Other Debt Obligations	\$0	\$0	\$0	\$0	\$0	\$0
<i>Total</i>	\$190,500	\$125,000	\$25,000	\$12,500	\$0	\$353,000

## SHARE CAPITAL

The Company is authorized to issue an unlimited number of Common Shares of which 87,107,861 Common Shares are issued and outstanding as of the date hereof.

## CAPITAL RESOURCES

As of September 30, 2018, the Company did not have commitments for capital expenditures.

## OFF BALANCE SHEET ARRANGEMENTS

Hill Street does not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the financial performance or financial condition of the Company.

## TRANSACTIONS WITH RELATED PARTIES

The Company considers its executive officers and directors to be key management personnel. The Company incurred the following amounts to related parties during the respective periods for key management personnel compensation.

During three month period ended September 30,	2018	2017
Management Salaries	165,562	84,924

Included in accounts payable as at September 30, 2018 is \$107,909 (June 30, 2018: \$127,040) payable to Directors and Officers of the Company for management compensation. The amount is non-interest bearing, unsecured and due on demand.



## **LEGAL PROCEEDINGS**

There are no legal proceedings material to Hill Street to which Hill Street is a party to or of which any of its property is the subject matter, and there are no such proceedings known to Hill Street to be contemplated.

## **CRITICAL ACCOUNTING ESTIMATES**

The determination of income tax is inherently complex and requires making certain estimates and assumptions about future events. While income tax filings are subject to audits and reassessments, the Company has adequately provided for all income tax obligations. However, changes in facts and circumstances as a result of income tax audits, reassessments, jurisprudence and any new legislation may result in an increase or decrease in the provision for income taxes.

Calculation of the net book value of machinery and equipment requires Management to make estimates of the useful economic life of the assets, residual value at the end of the asset's useful economic life, method of depreciation and whether impairment in value has occurred. Residual values of the assets, estimated useful lives and depreciation methodology are reviewed annually with prospective application of any changes, if deemed appropriate. Changes to estimates could be caused by a variety of factors, including changes to the physical life of the assets. A change in any of the estimates would result in a change in the amount of depreciation and, as a result, a charge to net income recorded in the period in which the change occurs, with a similar change in the carrying value of the asset on the balance sheet.

## **CRITICAL FUTURE ACCOUNTING POLICIES**

IFRS 9: New standard that replaced IAS 39 for classification and measurement, tentatively effective for annual periods beginning on or after January 1, 2018. Partial replacement of IAS 39 Financial Instruments: Recognition and Measurement. This standard is effective for annual periods beginning on or after January 1, 2018. The Company adopted IFRS 9 effective July 1, 2018.

IFRS 15 deals with revenue recognition and establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Revenue is recognized when a customer obtains control of a good or service and thus has the ability to direct the use and obtain the benefits from the good or service. The standard replaces IAS 18 'Revenue' and IAS 11 'Construction contracts' and related interpretations. The Company adopted IFRS 15 effective July 1, 2018.

IFRS 16, "Leases", was issued in January 2016, and replaces IAS 17, "Leases" ("IAS 17"). IFRS 16 eliminates the classification of leases as either operating leases or finance leases as is required by IAS 17 and, instead, introduces a single lessee accounting model. Certain leases will be exempt from these requirements. IFRS 16 is effective for periods beginning on or after January 1, 2019. The Company has evaluated the impact of this standard and does not expect it to have a material impact.