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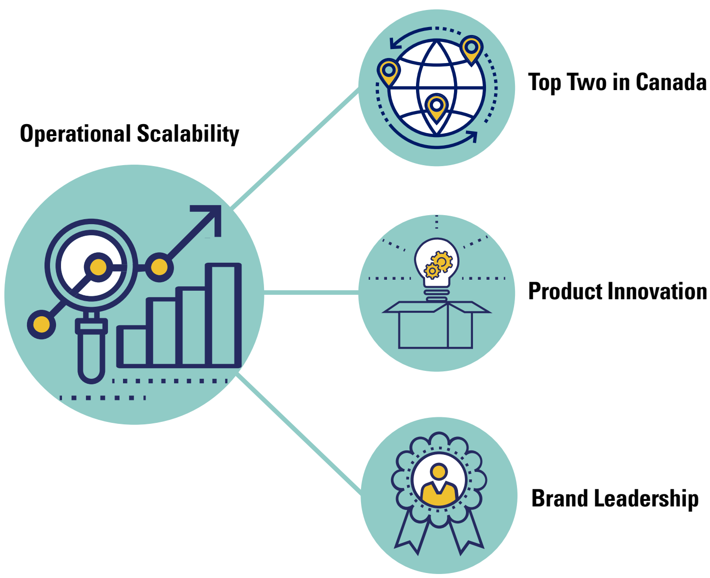
2018 annual report

HEXO AT A GLANCE

	For the three months ended		For the 12 months ended		For the three months ended
	July 31, 2018	July 31, 2017	**July 31, 2018**	July 31, 2017	April 30, 2018
Revenue (thousands)	**$ 1,410**	$ 862	**$ 4,934**	$ 4,097	$ 1,240
Total gram equivalents sold	**152,288**	96,744	**538,886**	405,164	134,253
Revenue per gram	**$ 9.26**	$ 9.00			$ 9.24
Cash and cash equivalents, and short-term investments (thousands)			**$ 244,789**	$ 41,324	



Financial Highlights

- Revenue per gram increased to $9.26 per gram equivalent from $9.24 in the prior quarter, and $9.00 in the fourth quarter of fiscal 2017.
- Revenue increased 14% to $1,410,656 quarter over quarter, and the volume of cannabis dried grams and gram equivalents sold increased 13% to 152,288 from the third quarter of fiscal 2018.
- Ontario-based sales increased 15% during the quarter ended July 31, 2018.
- Cash and short-term investments were $244.8 million as at July 31, 2018, and the balance sheet remained debt free.

Corporate Highlights

- • Formation of the joint venture "Truss" with Molson Canada to pursue opportunities to develop non-alcoholic, cannabis-infused beverages for the Canadian market.
- First global foray by partnering with Greek company Qannabos to establish a Eurozone processing, production and distribution centre in Greece, including the development of 350,000 sq. ft. of licensed infrastructure.
- First harvests from new 250,000 sq. ft. greenhouse, expected to increase annual production capacity to 25,000 kg of dried cannabis.
- Acquisition of a 25% interest in a 2,004,000 sq. ft. facility in Belleville, Ontario, providing capacity for the manufacturing of advanced cannabis products.
- Supply agreements with the Ontario Cannabis Store and the British Columbia Liquor Distribution Branch to supply the award-winning sublingual mist Elixir products; an additional Ontario agreement to supply Fleur de Lune, an intimate cannabis oil.
- Partnership with Metro Supply Chain Group to manage a Montreal warehouse and distribution centre for Quebec adult-use web orders for the SQDC, in modern 58,000 sq. ft. facility.
- Strategic investment of $10 million in the independent retailer Fire & Flower, through a convertible note receivable.
- Foundation and framing for a new 1,000,000 sq. ft. greenhouse completed (project remains on schedule).

We completed our first greenhouse in December 2016, and have since broken ground on multiple expansions.

MOMENTS LIKE THIS HAPPEN ONCE IN A LIFETIME

By innovating today, HEXO Corp. is preparing for the future of adult-use cannabis.

We are responsible, we are diligent, we are strategic. We are also bold. And that's how we are securing long-term value for shareholders.

A LETTER FROM THE CEO

Dear Shareholders,

Five years ago, Adam Miron and I sat in a basement and envisioned a company. We were driven by a belief that cannabis could have measurably positive impacts for adults who use it responsibly. I had experience in finance and operations. Adam brought political acumen. Together, we would rally a team with the right blend of marketing, branding, quality, sales and product deployment expertise. We would create HEXO Corp.

At the beginning of this past year, we had grown our team to nearly 50 employees, had 45,000 sq. ft. of greenhouse space and were selling 24 different medical cannabis products under our Hydropothecary brand. Less than a year later, we have 270 employees and are on track to have 1.3 million sq. ft. of greenhouse space by year's end. And, of course, we are entering a whole new world of legal adult-use cannabis.

We are committed to sustainable operations and good governance that will secure long-term value for our communities, our employees and our shareholders.

I am proud to say that HEXO Corp. has the right combination of history, momentum and enthusiasm to enter the post-legalization world confidently and boldly. Indeed, we are among a small number of companies positioned to shape it.

Our Strategy

With your help, we have raised $316.5 million in public markets since July 2017. And with zero debt held, we are one of the best-capitalized companies in our industry as we begin selling adult-use cannabis in our home province of Quebec, as well as other Canadian markets.

We aim to capitalize upon this favourable position as we execute our plan to grow into an international consumer packaged goods company. We will do so through our four strategic pillars.

Top Two in Canada

We became a licensed producer ("LP") in March 2014, joining just over a dozen or so other LPs, and sold our first product just over a year later. Today, we have landmark supply agreements in place with five provincial governments, including a five-year contract with Quebec's Société québécoise du cannabis ("SQDC") that's worth $1 billion or more in revenue. That represents 35% of the province's adult-use sales in the first year of legalization. In total, we have provincial or private retail distribution agreements in most major markets in Canada. Studies have estimated the legal Canadian market will be $10 billion a year; we anticipate having a 12%–15% market share in 2019.

In the coming year, our top priority is to serve our home base through flawless execution of our SQDC agreement, while deliberately expanding our product offerings in other markets through our house of brands strategy.

Canada is ultimately a platform for bigger things. As a top licensed producer at home, we will position ourselves as an international player – ready for other adult-use markets to open up. We intend to secure 2% or more of what we expect will be a $250 billion global market.

Brand Leadership

We have served the medical market with award-winning products for over three years through our Hydropothecary brand. With our adult-use HEXO brand, and strategic house of brands approach, we will build upon our existing customer knowledge with data-driven analysis and activation outreach. By striving to understand adult-use consumers and their preferences better than our competitors, we will create a host of products geared toward specific value segments. Varying in concentration, price point and format, these new and exciting products will be category leaders.

With a range of offerings that consumers want – and that they can trust to deliver consistently great experiences – we will put our brand at the top of mind in every market we serve.

New Product Innovation

We are proud of our award-winning cannabis products, and the loyalty of our customers. At the same time, we know that cannabis products today do not necessarily look like those of tomorrow. Legalization and partnerships with leading consumer packaged goods ("CPG") companies will drive research and innovation. By identifying, developing and launching new products, we will remain on the vanguard for years to come.

Operational Scalability

At the end of the day, creating new products, building brand leadership and positioning ourselves as a leading licensed producer all depend on our ability to scale operations and deliver on our promises. As our 2018 growth demonstrates, we are actively investing in people, processes and systems that ensure the highest-quality products at sustainable operating costs.

Operational scalability also ensures that we can honour the commitments we've made with provincial and private partners, and guarantees the uncompromised quality and safety of our products. As our recent facility expansion proves, our track record is best in class.

The Responsible Way Ahead

HEXO Corp. is helping shape an entirely new legal market. That's an exciting opportunity, but also a humbling one. We have a responsibility to ensure that we help educate our customer, recognize the potential adverse effects of our products, mitigate our environmental footprint and give back to our community.

Whether it's through carbon and greenhouse gas inventories of our facilities, working with Ottawa Riverkeeper to protect our local watershed or supporting the Campaign for Cannabis Amnesty to help those convicted of simple possession charges, we are committed to being a responsible corporate citizen.

We also know that true responsibility goes beyond photo-ops and oversized cheques. That's why we are committed to sustainable operations and good governance that will secure long-term value for our community, our employees and our shareholders.

As we sat in that basement, Adam and I didn't know what the future of cannabis had in store, but we envisioned a $1 billion company that could be part of that future. Having achieved that and more, today we share a vision with you to build a Fortune 500 CPG company – a true house of brands for cannabis.

Sébastien St-Louis, CEO
October 25, 2018

Sébastien St-Louis, CEO

THE MOMENT

Proudly based in Gatineau, Quebec, we remain committed to our home province.

Waves of Change

We may be the first G20 country to fully decriminalize cannabis, but Uruguay legalized it five years ago. Many of the country's Latin American neighbours are also relaxing prohibitions, especially on medical cannabis. Similarly, such European countries as Germany, Italy, Greece and the United Kingdom are paving the way for a continental green rush by relaxing bans on medical use. From our vantage point in Canada, we know the tide is turning.

Nearly 20 years ago, in 2001, Canada was at the forefront of change when it became the first country to legalize medical cannabis. Now, with its October 2018 legalization of adult-use recreational cannabis, Canada has undone a 95-year-old ban and once again taken a major step forward.

In fact, as provinces and territories allow adult-use sales from coast to coast, the country is staking a strong leadership claim in an emerging $250 billion global market. For those Canadian companies prepared to make a difference, this is a once-in-a-lifetime moment to shape an industry – not just at home but around the world.

A Historic Relationship

Humans have cultivated cannabis for nearly 5,000 years for a reason: the flowering plant's molecular properties have tremendous social, health and wellness benefits when used responsibly. Indigenous to Central and South Asia, the plant and its many applications spread throughout the world – reaching the Middle East and Africa thousands of years ago and the Western Hemisphere by the mid-sixteenth century.

But colonial restriction efforts throughout Asia and Latin America, as well as efforts in the United States and Canada in the early 20th century, culminated in widespread prohibition and stigmatization of cannabis.

The Seeds of Change

Canada paved the way for medical cannabis and was joined by such countries as Portugal, Belgium, Chile, Brazil and the Czech Republic. Just as jurisdictions followed Canada's lead on the medical front – allowing the use of cannabis to treat pain, nausea and other conditions – an increasing number are poised to similarly decriminalize adult use. Soon, consumers around the world will look for a whole host of products that deliver consistently great experiences. And they'll turn to companies they can trust.

Change Makers

With legalization, first on a national then international scale, cannabis will emerge from the shadows as an amazingly adaptable consumer good. Like other consumer packaged goods – from coffee to alcohol, chocolate to potato chips, shampoo to cosmetics – it lends itself to just a handful of truly global players with expertise in production, distribution, sales and brand loyalty, and, importantly, market-defining innovation.


We enter an age of adult-use cannabis with both provincial and private retail distribution deals.

The global cannabis market will inevitably consolidate. But in the not-so-distant future, lists of $100 billion CPG businesses will include one or two companies that were able to fully capitalize on this historic moment. These will be household names, with concentrated brand value and name recognition on par with leaders in soft drinks and alcohol. There are only a handful of cannabis companies with a credible shot of making that list – and we believe HEXO Corp. is among them.

As a Canadian company with a first-mover advantage, we have methodically built a foundation to shape and define the cannabis market – particularly in the minds of consumers and investors.


Our emulsification and formulation technologies help ensure consistent harvest quality.

We offer decarb in six different ways, all ready for consumption.

We are on track to have 1.3 million sq. ft. of completed greenhouse space by December 2018.

OUR FOUNDATION

In June 2013, Canada enacted the *Marihuana for Medical Purposes Regulations* ("MMPR"), which replaced earlier rules governing access and use of medical cannabis. What became known as HEXO Corp. was founded three months later, with the creation of The Hydropothecary Corporation in August 2013.

In the months and years that followed, we began harvesting plants, establishing lasting relationships with medical patients and building infrastructure unrivalled by any other licensed producer in Canada. Put another way, we began laying the groundwork to capitalize on the inevitable legalization of adult-use cannabis at home and around the world.

Scaling Up

With our culture of innovation, HEXO Corp. never stands still. Just over a year after our founding, we proved the viability of greenhouse cannabis cultivation with our original first-of-its-kind facility in Gatineau, Quebec. We soon needed much more than 7,000 sq. ft., and we got to work.

Today, HEXO Corp.'s licensed facilities total 310,000 sq. ft., with an annual production capacity of 25,000 kg of dried product. In addition to our 35,000 sq. ft. greenhouse completed in 2017 and one that totals 250,000 sq. ft. completed in mid-2018, our facilities include warehouse and distribution spaces, as well as laboratories to advance cultivation methods and develop products.

Of course, like the industry itself, our infrastructure is expanding quickly: we recently acquired space in Belleville, Ontario, and have plans to establish a sizable facility in Greece through our joint venture partnership with Qannabos. HEXO Corp. is also on track to open a 1 million sq. ft. greenhouse in December 2018. The size of 17 football fields, the new greenhouse will help increase our annual production capacity to 108,000 kg.

We have a demonstrated record of hitting targets. With our existing footprint and on-schedule expansion plans, we are ready for the first year of legalized cannabis – and to meet the needs of a growing market.

Meeting the Demand

Prudent infrastructure expansion, along with regulatory know-how and unmatched expertise, has positioned us to meet demand while exceeding expectations through our medical brand, Hydropothecary, and its diverse product line.

Backed by our reliable record, and proven capacity to deliver orders, HEXO Corp. enters the post-legalization world with industry-leading supply agreements. A landmark contract with the Société québécoise du cannabis ("SQDC"), in our home province, will supply Quebec with 200,000 kg or more of cannabis over five years. That accounts for a projected 35% of provincial sales in the first year of legalization – and represents $1 billion in potential revenues.

Other agreements with provincial bodies in Ontario, British Columbia and Saskatchewan, as well as with private retailer Fire & Flower, mean that HEXO Corp. has among the highest revenue visibility of any cannabis company in Canada or the world.

Distributing the Product

The ability to cultivate cannabis is essential, but so is the ability to distribute innovative products to retail partners and end-users. In 2018, we established a 58,000 sq. ft. distribution and storage centre in Montreal, which the veteran logistics services provider Metro Supply Chain Inc. will operate on our behalf.

The partnership is just one way HEXO Corp. is ensuring flawless delivery – for end-users and investors alike.

We have a track record of delivering infrastructure projects on time.

We have grown from 50 employees to 270 in less than a year.

Operational scalability is a strategic cornerstone of our success.

House of Glass

Our continual harvest strategy – which sees sun-grown plants harvested every week – relies on aggressive expansion plans. Our advanced greenhouses allow us to scale production while controlling capital costs and ensuring quality consistency. They also mean we can produce cannabis more efficiently compared to other methods. By utilizing solar energy, we consume less electricity per gram. We also require less water. The approach is good for the plants, good for the environment and good for our bottom line.

OUR EXECUTION

Whether we're cultivating plants or innovating products, we embrace exacting scientific standards.

And the Winner Is

We know how to innovate products that get people's attention. Two years ago, for example, we launched decarb, an activated cannabis powder designed for oral consumption. And last year, we launched Elixir, Canada's first and only line of cannabis peppermint oil sublingual sprays. Customers have responded well to both products, as has the industry: decarb and Elixir received multiple recognitions at the 2017 Canadian Cannabis Awards, with decarb winning Best New Cannabis Product.

Having built a solid foundation – and with infrastructure and distribution channels in place ahead of schedule – HEXO Corp. enters the first year of legalization as a vertically integrated CPG company with momentum.

We have already sold over 1 million grams of cannabis to thousands of Canadian patients who look to us for consistently safe, high-quality products. With each sale, we deliver just that – while building brand value and awareness.

A Name You Can Trust

At HEXO Corp., we are more than a cannabinoid compound provider. We are a strategic market leader with a solid history of technology, innovation and branding – and the trust of our customers. That makes us an attractive partner in the post-legalization world.

Cannabis-based products will take many forms in the coming years, including vapes, edibles and other delivery methods we have yet to imagine. But consider infused non-alcoholic beverages. We went out to the marketplace and spoke to leading beverage players looking to tap into smokeless cannabis. We looked for a prospective partner with a skill set and industry knowledge that would complement our own. We found such a partner in Molson Canada.

Through Truss – the joint venture we announced with Molson Canada in August 2018 – we are at the forefront of the cannabis-infused beverage market. The partnership combines Molson Canada's storied industry experience and distribution expertise with HEXO Corp.'s proprietary emulsification and formulation technologies and history of product innovation. And for consumers, it will deliver products backed by brand names with built-in trust.

A Eurozone Foothold

As we position ourselves for post-legalization in Canada, we are also laying the groundwork for adult-use markets elsewhere. Through our joint venture with Qannabos, for example, we will establish a 350,000 sq. ft. licensed facility in Greece, which will increase our production capacity and enable us to serve legal markets in the United Kingdom, France and other jurisdictions.

By selling high-quality HEXO products in Europe today, we can build brand recognition and loyalty that will translate to our success in adult-use markets tomorrow.

Partnerships That Will Shape an Industry

HEXO Corp. enjoys an enviable position – we are one of just two licensed producers to have partnered with a Fortune 500 company, and we are actively exploring additional vertical relationships in food, cosmetics and other product areas. We are reaching out to trusted CPG brands and learning how we can complement their cannabis strategies in ways that drive shared value.

Because we can offer licensed infrastructure, innovative extraction technologies, exciting products, access to legal adult-use markets and first-mover advantage – all of it right out of the gate – we're demonstrating the true power of HEXO.

Our joint venture with Molson Canada is a game changer.

Our products undergo thorough in-house and third party chemical analysis.

Whether through HEXO or Hydropothecary, we offer rigorously tested cannabis products of uncompromising quality.

OUR FUTURE

We are building a consumer-centric house of brands.

Picture a day when two colleagues go for a business lunch and instead of ordering two glasses of wine they order a cannabis-infused beverage. They'll enjoy a quick-onset, quick-offset experience. And because the formulation will be just right, they'll return to work without feeling groggy.

Or imagine a day when an amateur athlete turns to a cannabis-based product to treat inflammation instead of ibuprofen. She'll be back on the court or running the trail without the side effects.

This is the face of adult-use cannabis.

More to Come

Through provincial and private retail agreements – and by making strategic investments in our people – we are actively leveraging our capacity to scale production and distribution. Whether through online or brick-and-mortar sales, millions of Canadian consumers can enjoy premium HEXO-branded products right from the start of legalization.

At the start, we're able to offer those consumers dried product, sublingual sprays, intimate oils and decarboxylated powders. But we are constantly researching new ways of consumption, different ways to unlock the benefits of cannabis. In future, we will offer soft-gel capsules, topicals, anti-inflammatories and other products we haven't imagined yet.

Guided by market research and good corporate governance, we'll develop quality products and offer them throughout Canada, and in legal adult-use markets around the world.

A Valuable House of Brands

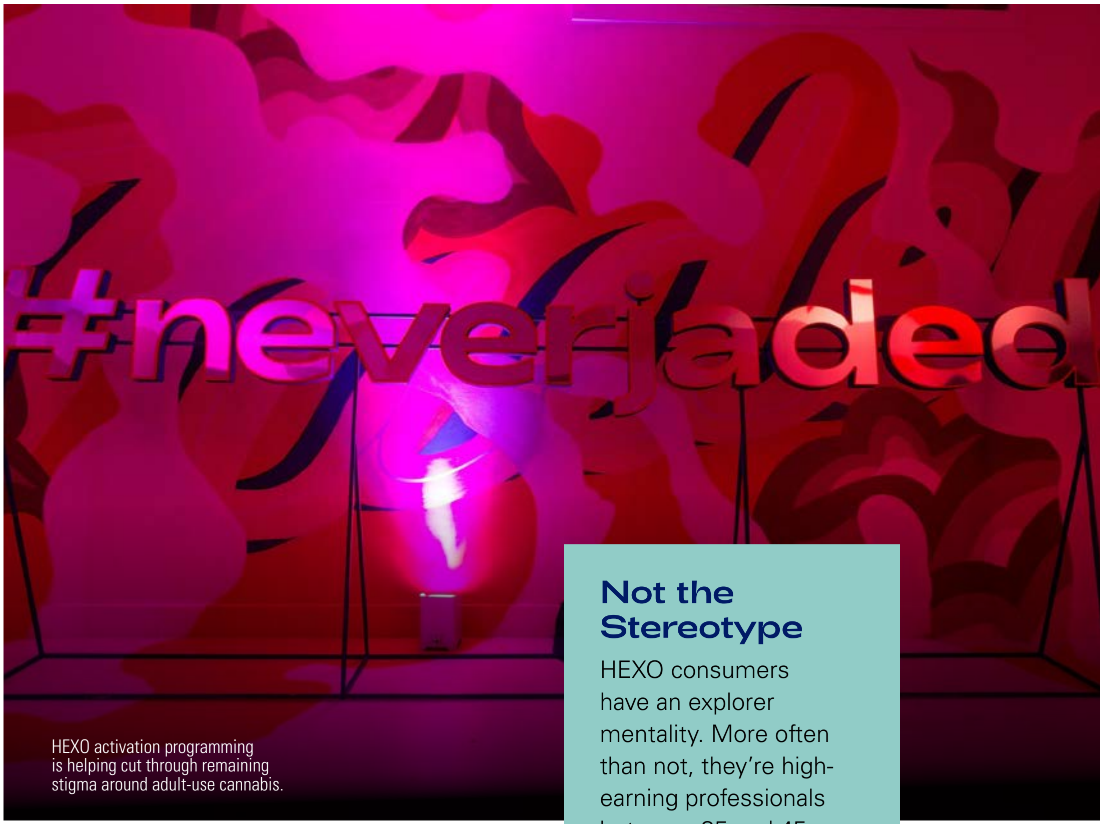
When discerning consumers scan the shelves (or menus) for a wide range of cannabis products – from beverages to cosmetics, from edibles to vapes – they will look for brand names they know. They will look for brand names they trust. They will look for HEXO.

By building a leading house of brands, one that offers a range of price points and formulations, we are establishing a strong market share and positioning HEXO Corp. as a top earnings per share company.

Powering a Rare Opportunity

Whether it's in our greenhouses and research facilities, in our face-to-face interactions with pharmacists and retail sales associates or through our joint ventures with Fortune 500 companies, HEXO Corp. employees have the enthusiasm, vision and discipline to shape an entirely new market from scratch.

At HEXO Corp., we are powering a rare opportunity for our partners, our customers and our investors.



HEXO activation programming is helping cut through remaining stigma around adult-use cannabis.

Not the Stereotype

HEXO consumers have an explorer mentality. More often than not, they're high-earning professionals between 35 and 45. They're educated, curious and active. We are connecting with those consumers through "activation programming" like our Never Jaded series. By pairing brand awareness with cultural events they already enjoy – things like music, e-sports, celebrity chef demonstrations – we are reaching influencers who will tell their networks about adult-use cannabis, generally, and HEXO products, specifically.

Through influencers and education alike, we are reaching consumers throughout Canada.

Management Discussion & Analysis

For the three and 12 months ended July 31, 2018
(In thousands of Canadian dollars, except share and per share amounts, and where otherwise noted)

This management discussion and analysis ("MD&A") of the financial condition and results of operations of HEXO Corp. (formerly The Hydropothecary Corporation) and our wholly owned subsidiaries (collectively, "we" or "us" or "our" or "Company" or "HEXO Corp.") is for the three and 12 months ended July 31, 2018 ("Fiscal 2018"). It is supplemental to, and should be read in conjunction with, our audited consolidated financial statements and the accompanying notes for the fiscal year ended July 31, 2018. Our consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts presented herein are stated in Canadian dollars, unless otherwise indicated.

This MD&A has been prepared by reference to the MD&A disclosure requirements established under National Instrument 51-102, Continuous Disclosure Obligations, *of the Canadian Securities Administrators. Additional information regarding the Company is available on our websites at thehydropothecary.com or hexo.com or through the SEDAR website at sedar.com.*

Certain information in this MD&A contains or incorporates comments that constitute forward-looking information within the meaning of applicable securities legislation. Forward-looking information, in general, can be identified by the use of forward-looking terminology such as "may", "expect", "intend", "estimate", "anticipate", "believe", "should", "plans", "continue", "objective", or similar expressions suggesting future outcomes or events. They include, but are not limited to, statements with respect to expectations, projections or other characterizations of future events or circumstances; our objectives, goals, strategies, beliefs, intentions, plans, estimates, projections and outlook, including statements relating to our plans and objectives; estimates or predictions of actions of customers, suppliers, competitors or regulatory authorities; and statements regarding our future economic performance. Such statements are not historical facts but instead represent management beliefs regarding future events, many of which, by their nature, are inherently uncertain and beyond management control. We have based these forward-looking statements on our current expectations about future events. Although the forward-looking statements contained in this MD&A are based on what we believe are reasonable assumptions, these assumptions are subject to a number of risks beyond our control, and there can be no assurance that actual results will be consistent with these forward-looking statements. Factors that could cause actual results to differ materially from those set forth in the forward-looking statements and information include, but are not limited to, financial risks; industry competition; general economic conditions and global events; product development, facility and technological risks; changes to government laws, regulations or policies, including tax; agricultural risks; supply risks; product risks; dependence on senior management; sufficiency of insurance; and other risks and factors described from time to time in the documents filed by us with securities regulators. For more information on the risk factors that could cause our actual results to differ from current expectations, see "Risk Factors". All forward-looking information is provided as of the date of this MD&A. We do not undertake to update any such forward-looking information whether as a result of new information, future events or otherwise, except as required by law.

This MD&A is dated October 25, 2018.

Company Overview

The Company was founded in 2013 for the purpose of producing medical cannabis under Health Canada's *Marihuana for Medical Purposes Regulations* ("MMPR"). We became the 17th licensed producer in Canada in March 2014 and made our first sale of medical cannabis in May 2015. We were the first licensed producer in Quebec and are the only publicly traded cannabis company headquartered in the province.

The MMPR was replaced by the *Access to Cannabis for Medical Purposes Regulations* ("ACMPR") in August 2016. Under our current ACMPR license, we are authorized to produce and sell cannabis to medical patients and adult recreational users in dried and oil formats. Our license has a term ending on October 15, 2019, and we are not currently aware of any circumstances that would impede renewal.

Ultimately, we are a vertically integrated consumer packaged goods company in the medical and emerging legal adult-use cannabis market. Our primary business is to cultivate, process, package and distribute cannabis through our facilities in Gatineau, Quebec, in order to serve the medical and adult-use cannabis markets across Canada and internationally where regulations allow. We have expanded operations to include a corporate office location in Gatineau, Quebec, additional advanced processing and manufacturing space in Belleville, Ontario, and a distribution centre located in Montreal, Quebec.

To date, we have sold over 1 million grams of medical cannabis to thousands of patients across Canada who count on us for safe, high-quality products. We have developed an extensive and award-winning product range, as well as valuable experience and knowledge, while serving these patients. This positions us well to serve the legal adult-use market. We currently possess the single largest and longest national forward supply amount among all licensed producers, based upon the announced provincial supply agreements. In Quebec alone, we will supply 20,000 kg in the first year of legalized adult-use cannabis and up to approximately 200,000 kg over the first five years of legalized adult-use cannabis.

As at October 19, 2018, we hold 310,000 sq. ft. of licensed production space, with a 25,000 kg annual production capacity; an additional 1,000,000 sq. ft. under construction; 2,060,000 sq. ft. of commercial real estate for distribution and product research and development needs; another 58,000 sq. ft. of leased distribution space in Montreal, Quebec, and leased commercial office spaces in downtown Gatineau, Quebec.

We employ approximately 220 people, including 81 people in operations, manufacturing and processing; 53 in sales and marketing; 40 in cultivation and harvesting; 39 in corporate services and executive; and seven in quality assurance and research and development.

We are among the cannabis industry's top innovators, with products such as Elixir, Canada's first and only line of cannabis peppermint oil sublingual sprays, and the award-winning decarb, an activated cannabis powder designed for oral consumption. Further, we are delivering on product innovation through our joint venture with Molson Canada, which positions us at the forefront of the cannabis-infused beverage market.

Investors have responded positively to both our strategy and execution, as evidenced by the $316.5 million we have raised in public markets since July 2017 and by our corresponding zero debt held, making us one of the best-capitalized companies in the industry.

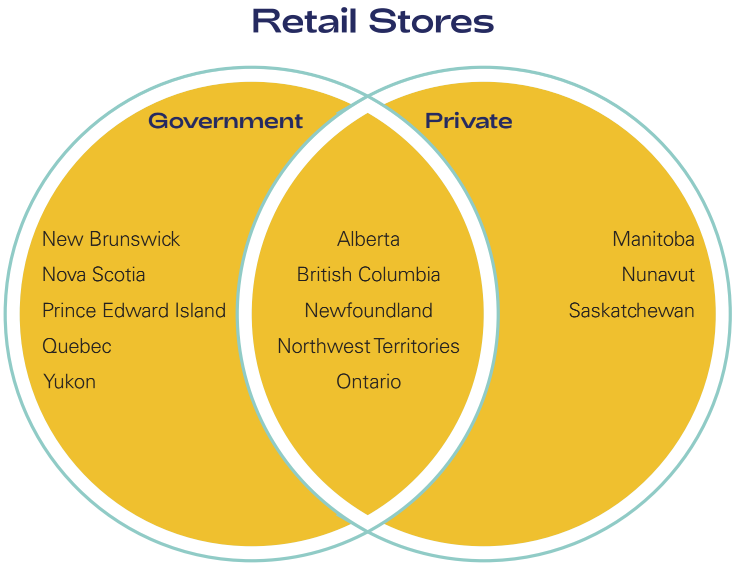
We do not, and do not intend to, engage in direct or indirect business with any business that derives revenue, directly or indirectly, from the sale of cannabis or cannabis products in the United States or any other jurisdiction where the sale of cannabis is unlawful under applicable laws.

Canadian Cannabis Market

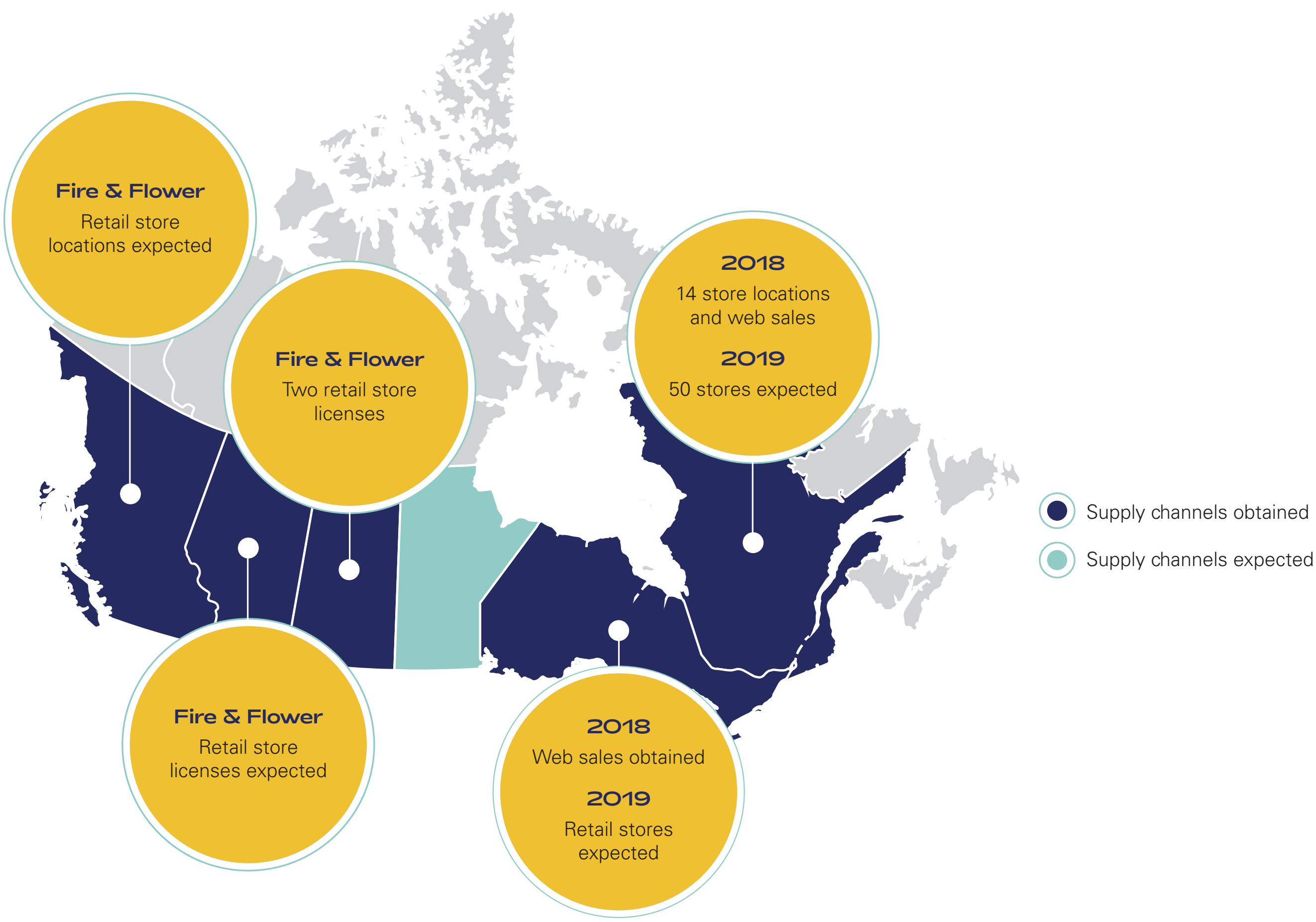
According to Statistics Canada, nearly five million Canadians purchased approximately 760,000 kg of cannabis worth $5.7 billion in 2017, mostly from illegal sources. The federal agency estimates that the average price was $7.50 per gram. Various market studies have estimated the size of the legal Canadian cannabis market at over $10 billion per year. We are uniquely positioned to serve that market through holding the largest forward supply contract of all licensed producers.

As of August 13, 2018, all provinces and territories have announced their cannabis market retail approach, ranging from privately owned stores to government-owned retail, as well as a combined approach in several jurisdictions. We have positioned ourselves through strategic supply agreements with the Quebec, Ontario and British Columbia provincial governments, as well as through an investment in the private cannabis retail sector, in order to offer our award-winning and innovative products across all channels throughout Canada.

Anticipated retail distribution channels by province and territory:



We have established supply channels within five provinces – Quebec, Ontario, Saskatchewan, Alberta and British Columbia – through supply agreements with both governmental boards and private retailers. We hold the single largest forward supply contract among licensed producers, based upon announced agreements for year one of legalization, with 20,000 kg to be supplied to Quebec in the first year.



QUEBEC

In Quebec, which has a population of 8.45 million, or approximately 23% of the Canadian population, the Société québécoise du cannabis ("SQDC") operates the distribution and sale of adult-use cannabis. The SQDC has established 15 retail locations throughout the province, for in-store cannabis sales. It expects to increase this number to 50 locations within the first year of legalization. It will also sell cannabis online.

In the first year of legalization, we hold a 35% market share in Quebec. Our agreement with the SQDC spans a potential five-year period, with us supplying 200,000 kg or more of cannabis, representing $1 billion in potential revenues.

In addition, we have reached a distribution agreement with the SQDC, in which we will house and distribute all of the SQDC's online sales to end-users. This includes the product of all licensed producers with established supply agreements held with the SQDC.

ONTARIO

In Ontario, which has a population of 14.4 million, or approximately 40% of the Canadian population, the government has announced that it will offer consumers a variety of cannabis products through the Ontario Cannabis Store ("OCS") online web sales in 2018. The province will also allow privately owned retail locations that serve the adult-use market. Initially, products will include dried cannabis, oil and capsule products, pre-rolled, and clones and seeds.

We have entered into a supply agreement with the OCS, in which we will supply the province with THC and CBD Elixir and Fleur de Lune products, two of our most innovative oil-based and smokeless offerings. In the future, once our 1 million sq. ft. greenhouse expansion is complete in December 2018, we will offer our full suite of products. This approach will allow us to initially serve the Ontario market for smokeless cannabis products through the OCS.

BRITISH COLUMBIA

British Columbia, which has a population of 4.6 million, or approximately 13% of the Canadian population, will serve the adult-use cannabis market through a dual private–government approach. The British Columbia Liquor Distribution Branch ("BCLDB") will manage the distribution of cannabis and cannabis-based products. We hold a supply agreement with the BCLDB, in which we will supply our THC and CBD oil-based Elixir and Fleur de Lune products.

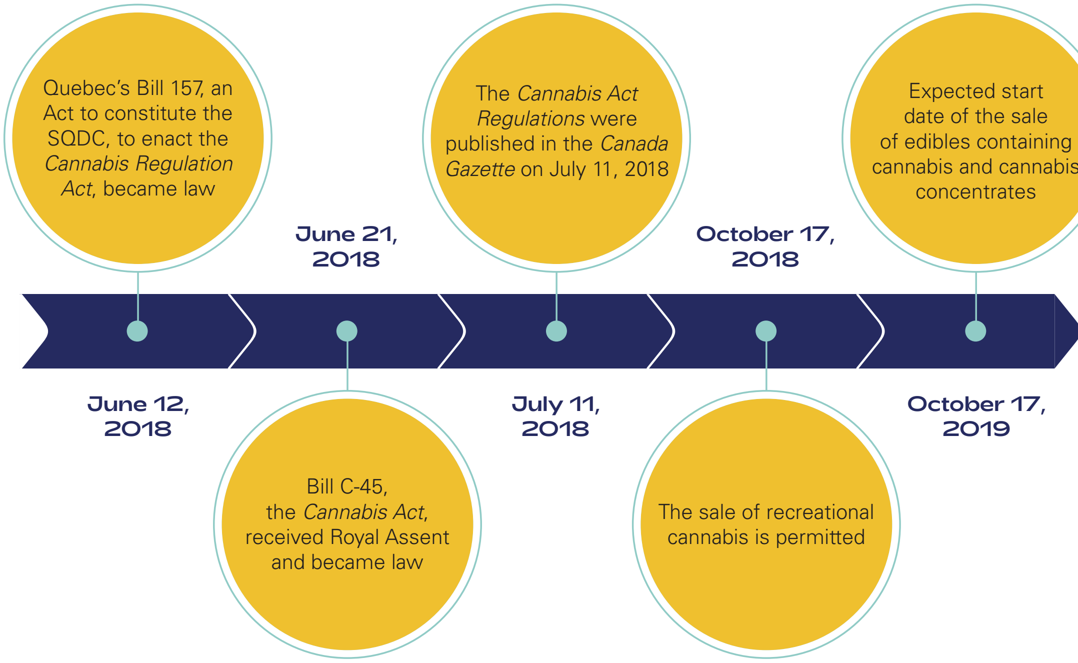
We have also aligned ourselves with Fire & Flower ("F&F"), a private cannabis retailer, through a strategic investment of a $10 million convertible loan. F&F is expected to hold store locations throughout British Columbia, allowing HEXO products to be distributed via the private retail route in tandem with the BCLDB.

OTHER CANADIAN PRIVATE MARKETS

We expect to enter the remaining private-sector Canadian cannabis markets via strategic investments in private retailers, such as our investment in F&F. Currently, F&F holds two licenses for retail locations within Saskatchewan and is undergoing the licensing process in Alberta, with 37 locations pending. F&F has also begun the process of acquiring licenses and locations in Manitoba.

CANADIAN LEGISLATIVE LANDSCAPE

Regulation of the sale of adult-use cannabis in retail and online environments is the responsibility of the provinces and territories. Only licensed producers will be authorized to sell cannabis within the adult-use market. As at July 31, 2018, there are 114 licensed producers under the ACMPR.



Strategic Priorities

Since inception, we have laid the foundation to be a world leader that serves both adult-use and medical cannabis markets. In everything we do – cultivation, production, product development, innovation, distribution – we exercise rigour in order to offer medical cannabis patients and adult recreational users uncompromising quality and safety, while earning and maintaining the trust of all of our stakeholders. We believe that we can leverage our demonstrated success in Canada to global cannabis markets.

Given the different regulations governing the sale of adult-use cannabis across Canada, the number of large-scale licensed producers and today's limited but growing cultivation capacity, among other factors, we believe the initial years following legalization will be the most critical in determining the future shape of the cannabis industry in Canada, and we believe early distribution and financial performance will be critical to securing a market leader position.

For this and other reasons, we have deliberately set out to build a commanding position in our initial jurisdiction, Quebec, while making strategic inroads in select other markets across the country through provincial supply agreements and private retail partnerships. Now entering the adult-use market as one of the top producers and suppliers, we are looking beyond the Canadian border to take HEXO Corp. international, where regulations permit. We are making continuous efforts to assess global opportunities in current and future medical and adult-use markets, including Europe, where we are currently expanding into Greece.

We have positioned ourselves to meet the smokeless cannabis alternative market demand through our joint venture with Molson Canada, and we continue to explore other opportunities for similar ventures in this market. Even as we continue to prove our business model and operational excellence in Quebec and across the country, the Company has already established itself as a desirable business partner for cannabis control authorities, private retail, and Fortune 500 joint-arrangement partners across Canada and globally.

Our uncompromising commitment to quality and safety is supported by our compliance with Health Canada's stringent quality control requirements, our pharmaceutical-grade production system, full seed-to-sale traceability, third party independent testing and an online system to post our product testing results.

Our overall strategy is built on four pillars: be a top two market share licensed producer in Canada, demonstrate brand leadership, innovate products – and support that work through operational scalability. As we enter the adult-use market, we are focused on the execution of these four strategic priorities.

Operational Scalability

Invest in people, processes and systems to deliver on market demands, adapt to new opportunities and provide users with high-quality products at sustainable operating costs.

Top Two in Canada

Our top priorities are to execute and deliver on the SQDC contract, to serve and expand large-scale distribution across Canada and globally, and to become a top two licensed producer by market share in Canada.

Product Innovation

Continue to innovate and lead the market in identifying, developing and launching new cannabis-based products.

Brand Leadership

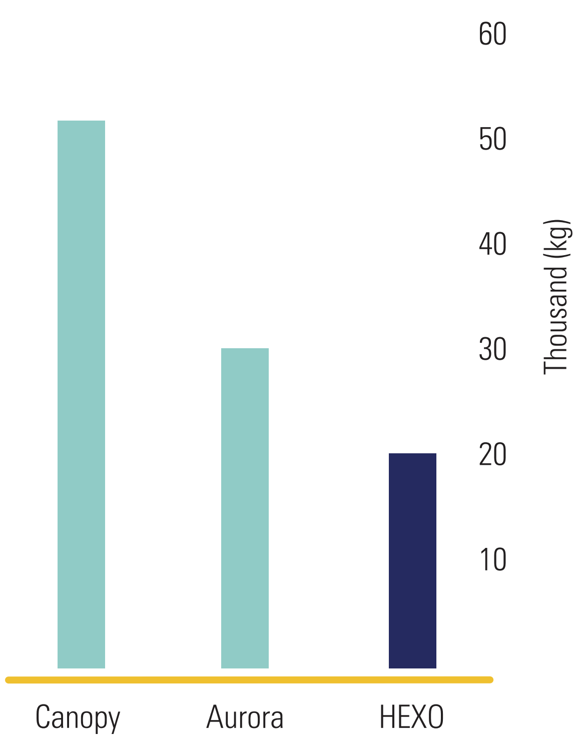
Further develop our house of brands using data-driven, in-depth knowledge of our customers and their preferences, ensuring we meet the full range of desired products within the market.

Top Two in Canada

After establishing a dominant presence within our home market of Quebec, we look to expand nationally on a larger scale. Our objective is to execute on our supply agreements with the OCS and the BCLDB, as well as on our long-term supply agreement with the SQDC, and to successfully manage our recently announced distribution centre responsible for all SQDC online sale–based cannabis distribution. We also possess a strategic relationship with the private cannabis retailer F&F. This private retail presence will allow us to expand our expected distribution presence across six provinces and secure a top two public forward sales contract ranking.

Forward Sales Contract Rank

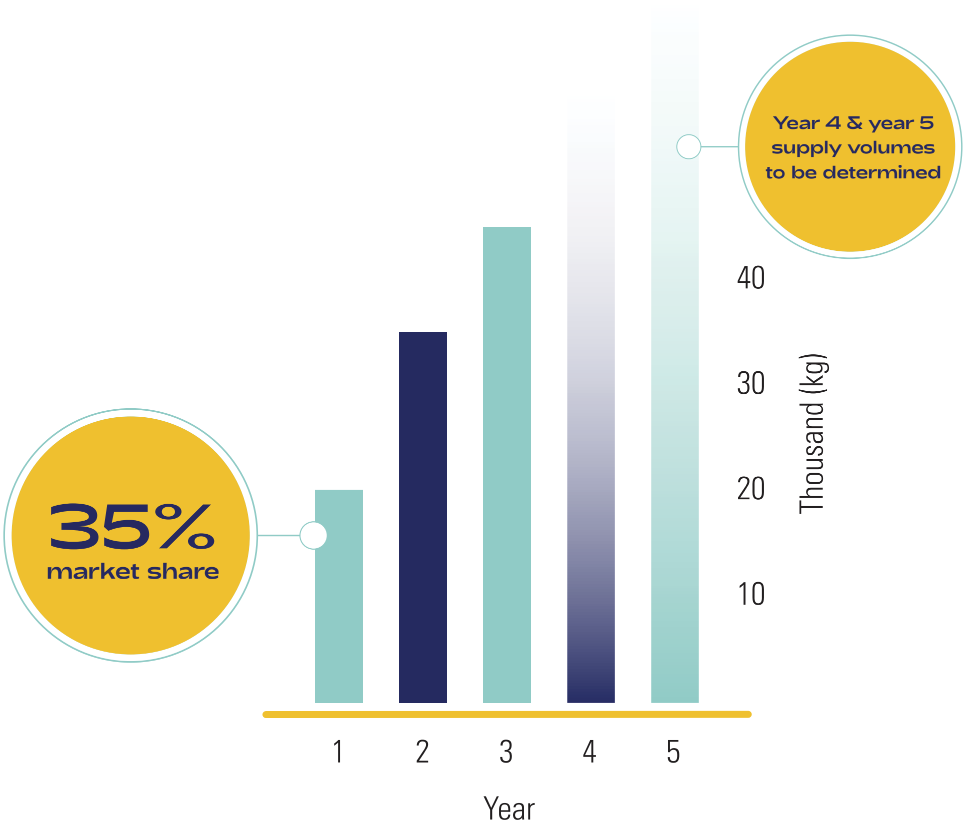
Based on quantities announced in provincial supply agreements



SQDC SUPPLY AGREEMENT

The strategic value of our SQDC relationship cannot be understated. We hold the single largest forward contract in the history of the emerging cannabis industry with the SQDC and are the preferred supplier for cannabis products for the Quebec market for the first five years following legalization. We will supply the SQDC with 20,000 kg of products in the first year, and we expect to supply 35,000 kg and 45,000 kg in years two and three, respectively. Thereafter, based on an expected market growth rate of 10%, we intend to supply 49,500 kg and 54,450 kg in years four and five, respectively. The Company estimates the total volume to be supplied over the five-year term of the agreement to be in excess of 200,000 kg. Based on the current agreements signed between the SQDC and five other licensed producers, we have obtained the highest year one volume, representing approximately 35% market share within Quebec, and we are aiming to remain the largest supplier in subsequent years.

Volume and Market Share % in the Province of Quebec



Brand

Since our inception as a medical cannabis producer in 2013, we have built a trusted brand. Our robust product development team has introduced products that offer consumers a full range of experiences and price points, including a variety of ways to consume cannabis. This team works hand-in-hand with our marketing team in leveraging these products to build brand awareness in a highly regulated environment.

HEXO – ADULT-USE

During this past quarter, the Company announced HEXO as the adult-use brand name that will serve the legalized Canadian adult-use market. The goal of HEXO is to continue to offer a premium house of brands, signalling innovation, quality and consistency of experience, and become a top two Canadian market share brand and obtain a 2% international market share. As a brand, HEXO shares the same focus on award-winning product innovation and high-quality cannabis that the market has come to expect from its medical sister brand, Hydropothecary.

HYDROPOTHECARY – MEDICAL

Hydropothecary sells premium as well as mid-market medical cannabis, offering over 24 products in dried, decarb and oil formats. Hydropothecary has been serving the medical market with its award-winning products for over three years, and will continue to serve our medical patients with the utmost levels of quality and customer service.

HEXO PRODUCT OFFERINGS

Initially, HEXO will offer dried cannabis and cannabis-derived products under three product types: dried cannabis, cannabis oils and decarb.

Dried Cannabis – Premium and mid-range products offered under the Time of Day and H2 lines. Both lines offer a relatively wide spectrum of CBD and THC levels, through sativa, hybrid and indica plant strains. HEXO offers 15 dried marijuana products priced between $3 and $15 a gram. Each product is carefully selected to treat symptoms universally reported by patients and meet the needs of adult consumers.

Oil-Based Products – Elixir, a cannabis oil sublingual mist product line, includes both a high THC and high CBD content, and is Canada's only peppermint-based cannabis oil product. Fleur de Lune is one of Canada's first cannabis-based THC intimate oils. Both products provide alternative, smokeless methods to consume cannabis. HEXO offers three oil-based products priced between $69 and $89 per bottle, as well as an intimate-use oil product priced at $59 per 60 ml spray bottle.

Decarb – Decarb is an activated fine-milled cannabis powder product offered in a range of high to low CBD and THC content. Decarb is offered in six products, priced between $3 and $15 a gram.

Decarb was voted "Top New Product" at the 2017 Canadian Cannabis Awards; Elixir received third place in the same category, as well as second place in "Top High THC Oil". We also received top honours in the packaging category.

Product Innovation

Our strategic priorities reflect our belief that companies that achieve large-scale distribution and high brand awareness will drive long-term shareholder value in our industry. We aim to be the best partner for provincial cannabis distribution and retail authorities, while being recognized for delivering the best user experiences across the full spectrum of products, price points and delivery methods.

We continue to position ourselves to meet the expected edibles market demand and consumer-preferred products for October 2019. This includes, but is not limited to, vapes; cosmetics; edibles such as confectionary and baked and dairy goods; and non-alcoholic beverages, through our joint venture with Molson Canada.

Our focus on research, innovation and product development also reflects our strategic priorities. We are actively exploring ways to increase our expertise related to cannabis applications and forms of delivery, and to expand our product range and brand portfolio. Activities include current and potential partnerships, joint ventures and strategic acquisitions of intellectual property and related transactions.

The cannabis industry has already recognized us as an innovative leader, as demonstrated by our award-winning and nominated products Elixir and decarb. During the quarter, we launched Fleur de Lune, one of Canada's first intimate-use cannabis oils.

Beyond the funds required for our currently planned investments in cultivation capacity, we expect to allocate the majority of our capital to branding, product innovation, international expansion and production, while remaining alert for strategic transactions that create shareholder value. Supporting this focus is the acquisition of the Belleville, Ontario, facility, which among other purposes will serve to house research and development activities for the Company and its future products. This approach will directly support our continued leadership position in the Canadian cannabis market – as both a distributor and a product innovator.

Scalability

We have been cultivating cannabis for four years under the ACMPR regulatory regime, growing and producing high-quality cannabis with consistent yields. We are constantly evaluating and updating our cultivating practices and technology to further drive efficiencies.

We chose to locate in Gatineau, Quebec, because we believe the province offers the ideal conditions for cannabis production. The key is an abundant supply of renewable electricity at competitive rates, combined with abundant water resources and the availability of skilled people.

On the border of Canada's two largest consumer markets, Quebec and Ontario, our main campus positions us in close proximity to two of the country's major urban areas, Greater Montreal and the National Capital Region. Furthermore, we have acquired facilities in Belleville, Ontario, ideally situated between the National Capital Region and Toronto, and in Montreal, which conveniently serves central Quebec.

Our current licensed facilities total approximately 310,000 sq. ft. They include our original 7,000 sq. ft. greenhouse, a 35,000 sq. ft. greenhouse completed in 2017, a 250,000 sq. ft. greenhouse completed in July 2018, a warehouse, two stand-alone laboratories and two modular buildings for final packaging and customer service, all located on our 143-acre land parcel. The annual production capacity of these facilities is estimated at approximately 25,000 kg of dried cannabis.

As of July 23, 2018, all 10 zones of the 250,000 sq. ft. greenhouse were fully licensed by Health Canada and plants were transferred in. The corresponding first harvests were executed in mid-September. This expansion increased our annual production capacity by approximately 21,400 kg of dried cannabis to 25,000 kg.

In December 2017, we acquired an adjacent 78-acre land parcel upon which we are building a 1 million sq. ft. greenhouse. This newest expansion is well underway, with the foundation and frame in place and the roof significantly completed. It is expected to be completed in December 2018. Once completed and licensed by Health Canada, our total annual production capacity will rise to approximately 108,000 kg of dried cannabis.

Subsequent to year-end, we announced a partnership to expand into Europe. A 350,000 sq. ft. licensed facility will be established in Greece through our joint venture with Qannabos. This venture will result in additional production capacity and Eurozone foothold to serve legal cannabis markets in the United Kingdom, France and other jurisdictions where regulations permit.

We have accumulated a strong and skillful workforce, as well as a top management group which provides cannabis-specific industry expertise and other relevant business knowledge derived from a variety of industries and markets.

Distribution

In terms of processing and distribution capacity, we have significantly increased our capabilities in the three months ended July 31, 2018, as annual production increased to approximately 25,000 kg with the activation and full licensing of our new 250,000 sq. ft. greenhouse. Our extensive 1 million sq. ft. greenhouse project – which features a state-of-the-art processing, packaging and distribution centre and is on target to be completed by calendar year-end – will further increase production capacity to approximately 108,000 kg.

The Company recently acquired a 2 million sq. ft. facility in Belleville, Ontario, through a joint venture with a related party for the purposes of manufacturing value-added cannabis products and increasing capacity for distribution and storage. The centralized location and the Company's first facility outside of Quebec is ideally situated along primary shipping routes to distribute our products and fulfill commitments across Canada. This facility will provide a regulatory keyhole to our partners and future partners so that they may enter the cannabis industry with HEXO Corp. and will have access to licensed infrastructure once the facility is licensed by Health Canada. This acquisition further delivers on our national expansion strategy and ensures necessary capacity for the manufacture of advanced cannabis products, including cosmetics, vapes, non-alcoholic beverages and other edibles.

Subsequent to year-end, the Company also bolstered its distribution capacity with the announcement of the newly established distribution and storage centre formed with Metro Supply Chain Inc. This 58,000 sq. ft. facility in Montreal, Quebec, was strategically acquired for logistical purposes. Through it, we will supply cannabis for all direct-to-customer sales placed in Quebec through the SQDC's online store. Additionally, through the distribution centre we will house, supply and distribute direct-to-customers the cannabis products of all licensed producers who have contracts with the SQDC.

The Company has positioned itself for the private retail distribution through an issued $10 million convertible note debenture as a strategic investment in the private cannabis retailer F&F. F&F has applied for 37 retail store licenses in the province of Alberta, targeted eight applications in British Columbia, identified 16 potential operations in Manitoba and been awarded two retail stores in the province of Saskatchewan.

Distribution Strategy

1

Deliver to Quebec on SQDC supply and distribution agreements.

Positioning to reach 90% of Canadian markets through strategic product offerings such as Elixir.

2

Roll out new cannabis beverage products nationally via the joint venture with Molson Canada.

Full product rollout across all of Canada.

International expansion in Latin America and Europe.

3

Enter the U.S. market, subject to expected approvals and regulatory change.

Corporate Highlights

Molson Canada Joint Venture – Truss

On August 1, 2018, we announced that we have entered into a definitive agreement to form a joint venture (the "JV") with Molson Canada ("Molson"), to pursue opportunities in the non-alcoholic, cannabis-infused beverages market. The JV was to be structured as a stand-alone start-up with its own board of directors and an independent management team. Molson would have a 57.5% controlling interest, with the Company owning the remaining balance. We and Molson closed the transaction to form the JV, called "Truss", on these terms on October 4, 2018. In connection with the closing of the transaction, we issued 11,500,000 common share purchase warrants to an affiliate of Molson, each of which is exercisable to purchase one common share of the Company at a price of $6.00 per share for three years. Molson brings to the JV years of related beverage industry experience, product innovation and distribution expertise. This, paired with the Company's history of innovating and delivering quality cannabis products to the market, positions the Company to be at the forefront of the Canadian cannabis beverage market.

Supply Agreement with the Ontario Cannabis Store

On August 20, 2018, we announced that we have entered into a supply agreement with the Ontario Cannabis Store ("OCS"). Under the agreement, we will supply Ontario with our award-winning Elixir product line, which will be offered in several formulations such as THC, CBD or 1:1, in either a peppermint oil or a medium-chain triglyceride ("MCT") carrier oil. We will also supply the OCS with the newly launched Fleur de Lune intimate-use cannabis oil. Both products are smokeless and easy to use, and will be sold in childproof packaging.

Expansion into Greece

On September 26, 2018, we announced the partnership with the Greek company Qannabos ("QNBS"). Together, we will create a partnership supported by the development of 350,000 sq. ft. of licensed infrastructure, which we will use for the manufacturing, processing and distribution of medical cannabis. This expansion is our first international expansion and will allow us to serve the medical markets of the United Kingdom, France and other European jurisdictions, where regulations permit, with our full suite of products.

HEXO Brand

On May 24, 2018, we announced the launch of our new sister brand, HEXO, for the recreational adult-use cannabis market. HEXO will bring the same award-winning product innovation and high-quality cannabis that the Hydropothecary brand has established over the past three years. The Company will continue to deliver premium cannabis under the Hydropothecary brand to serve the medical market going forward.

Corporate Name Change

On August 28, 2018, the Company held a special meeting during which shareholders passed to change officially the legal name of The Hydropothecary Corporation to HEXO Corp.

Graduation to the Toronto Stock Exchange

On June 22, 2018, we graduated from the TSX Venture Exchange ("TSXV") to the Toronto Stock Exchange ("TSX") and our common shares and common share purchase warrants were listed and started trading on the TSX under the symbols "HEXO" and "HEXO.WT", respectively. Graduating to the TSX presents the opportunity for increased access to capital, greater market visibility, increased oversight, enhanced reputation in meeting the required standards of a senior exchange and increased liquidity on world markets.

Supply Agreement with BC Liquor Distribution Board

On July 11, 2018, we announced that we have entered into a memorandum of understanding with British Columbia's Liquor Distribution Branch ("BCLDB"). The Company will supply the province through the BCLDB with its award-winning Elixir products.

250,000 Sq. Ft. B6 Greenhouse and B5 Expansion Are Fully Licensed and Operational

As of October 10, 2018, all 10 growing zones and warehouse of the new state-of-the-art 250,000 sq. ft. greenhouse and the B5 expansion area have received final licensing from Health Canada, increasing annual production to approximately 25,000 kg of dried cannabis. The advanced manufacturing facilities include areas for dewaxing, distillation, milling and extraction that will provide the Company the capability to transform, manufacture and package cannabis in a wide range of products. The expansion also includes secondary trimming zones, additional storage areas and cleaning rooms. The additional facilities and associated production capacity have positioned the Company to meet the SQDC first-year demand of 20,000 kg.

Fire & Flower

On July 26, 2018, we announced the $10 million strategic investment in the western-based Canadian retail operation Fire & Flower ("F&F"). The investment was made through the purchase of a $10 million convertible debenture of F&F which entitles HEXO Corp. to convert the principal amount of the debenture into common shares of F&F at the maturity date of July 31, 2019, or in the event of a triggering event as defined by the debenture agreement. F&F has applied for 37 retail store licenses in Alberta and has been awarded two retail stores in the province of Saskatchewan. We intend to secure additional distribution for our oil-based products in these provinces. This is another step towards achieving our strategic goal of entering the national cannabis market on a large distribution scale.

Acquisition of 2 Million Sq. Ft. Facility in Belleville, Ontario

On September 10, 2018, we announced the acquisition of a 2 million sq. ft. facility in Belleville, Ontario, through a joint venture established with a related party, Olegna Holdings Inc. ("Olegna"). The Company acquired a 25% interest in the joint venture, with the remaining balance belonging to Olegna. The joint venture purchased the facility in part by a $20 million loan issued by HEXO Corp. repayable within 120 days, bearing an annual 4% interest rate, payable monthly. As part of the agreement, HEXO Corp. will be the anchor tenant for a period of 20 years. The facility will be utilized as a centre of research and development and manufacturing. This is the first HEXO Corp. facility established outside of Quebec, further delivering on the Company's national expansion strategy and providing capacity for the manufacturing of advanced cannabis products, including cosmetics, vapes, non-alcoholic beverages and other edibles to be supplied across Canada. Furthermore, this facility provides a regulatory keyhole for current and future partners to immediately access the cannabis space and licensed infrastructure.

Warehouse and Distribution Centre

On September 19, 2018, we announced the storage and distribution arrangement with Metro Supply Chain Group Inc. ("Metro"). Under the agreement, HEXO Corp. and Metro will manage and run the 58,000 sq. ft. storage and distribution facility in Montreal, Quebec, to house and supply the cannabis products of all licensed producers who hold supply contracts with the Société québécoise du cannabis ("SQDC"). The distribution centre will serve as the sole distribution point for all direct-to-customer shipments within the province of Quebec for orders placed through the SQDC.

Additionally, HEXO Corp. has attained accreditation from the Autorité des marchés financiers to contract with government organizations such as the SQDC. This is a required authorization for companies conducting over $1 million in business with the government of Quebec for both services and the supply of products.

Executive Appointments

During the quarter, we bolstered our executive team with the addition of two experienced professionals to our leadership team.

Nick Davies, Vice-President of Marketing – Nick is an accomplished marketing executive with over two decades of experience building trusted global brands and market-leading products. Nick has been involved with several successful businesses, including Puma, Coleman, Virgin and Corel. Nick has earned a reputation as an energetic marketing leader known for building high-quality consumer experiences. As Executive Vice-President at Corel, he held global P&L responsibility for the graphics and productivity division, and led the company's expansion into new international markets. Nick is a graduate of the European Business School and holds an MBA from INSEAD.

Dominique Jones, Vice-President of Human Resources – Dominique offers more than 20 years' experience in leading organizations through periods of exceptional growth, with a career spanning six industries and three continents. Most recently, Dominique served as Chief Operating Officer for an education software company and before that as Chief People Officer of Halogen Software, where she led the company's people through an IPO to sale. Of particular note, Dominique led significant culture change initiatives and designed and implemented award-winning leadership and high-potential development programs. She brings to the team a passion for coaching and team-building.

Non-IFRS Measures

We have included certain non-IFRS performance measures in this MD&A, including weighted average cash cost of dried inventory sold per gram and adjusted gross margin, as defined in this section. We employ these measures internally to measure our operating and financial performance.

We believe that these non-IFRS financial measures, in addition to conventional measures prepared in accordance with IFRS, enable investors to evaluate our operating results, underlying performance and future prospects in a manner similar to management.

As there are no standardized methods of calculating these non-IFRS measures, our methods may differ from those used by others, and accordingly, these measures may not be directly comparable to similarly titled measures used by others. Accordingly, these non-IFRS measures are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

WEIGHTED AVERAGE CASH COST OF DRIED INVENTORY SOLD PER GRAM

Weighted average cash cost of dried inventory sold per gram includes direct costs associated with the growing, harvesting and processing of inventory sold such as labour, utilities, fertilizer costs, biological control costs, general supplies and materials, curing, milling, quality assurance and testing of inventory sold in the period.

We believe this measure provides useful information as it measures production efficiency and may be a benchmark against our competitors.

ADJUSTED GROSS MARGIN

We use adjusted gross margin to provide a better representation of performance in the period by excluding non-cash fair value measurements as required by IFRS. We believe this measure provides useful information as it represents the gross margin for management purposes based on cost to produce, package and ship inventory sold, exclusive of any fair value measurements as required by IFRS. The metric is calculated by removing all amounts related to biological asset fair value accounting under IFRS, including gains on transformation of biological assets and the cost of finished harvest inventory sold, which represents the fair value measured portion of inventory cost ("fair value cost adjustment") recognized as cost of goods sold.

We believe this measure provides useful information as it measures production efficiency and may be a benchmark against our competitors.

Operational and Financial Highlights

KEY FINANCIAL PERFORMANCE INDICATORS

		Q4 '18		Q3 '18		Q2 '18		Q1 '18		Q4 '17
Revenue	**$**	**1,410**	$	1,240	$	1,182	$	1,102	$	862
Dried grams and gram equivalents sold		**152,288**		134,253		131,501		120,844		95,735
Revenue/gram equivalent	**$**	**9.26**	$	9.24	$	8.99	$	9.12	$	9.00
Weighted average cash cost of dried inventory sold per gram	**$**	**0.90**	$	0.88	$	0.97	$	1.07	$	1.05

INCREASED REVENUES

- Revenue per gram equivalent increased to $9.26 per gram equivalent from $9.24 in the prior quarter, and $9.00 in the fourth quarter of fiscal 2017. Gram equivalents are utilized to provide a representation of dried grams utilized within our oil products. The gram equivalency factor was an average of 6.73 dried grams per unit sold in the quarter.
- Revenue increased 64% to $1,410 compared to $862 in the fourth quarter of fiscal 2017. Higher revenue was driven mainly by increased oil sales volume which command a higher revenue per gram equivalent than dried products as well as by an increase to dried product sales. Compared to the prior quarter, the sequential revenue growth was 14% due to increased sales volume in both dried and oil products. This was partially offset by a decrease in dried product revenue per gram of $0.12. Sales in Ontario increased by 15% in the quarter.
- Sales volume increased 59% to 152,288 gram equivalents, compared to 95,735 in the same prior year period. This is due to a higher market acceptance and an increased consumer desire for smokeless products as oil sales increased to account for 21% of total sales in the quarter. Dried grams sold increased 33% compared to the same prior year period. On a sequential basis, sales volume increased 13% compared to the third quarter of fiscal 2018, primarily driven by a 30% increase in oil sales.

- Furthermore, sales were increased through new relationships with an additional eight clinics during the quarter, further expanding and diversifying our patient base and medical market presence, which we continue to serve under the Hydropothecary brand. We had relationships with 147 clinic locations as at the end of the quarter.

CASH COST PER GRAM

- Weighted average cash cost of dried inventory sold per gram as at July 31, 2018 increased 2% to $0.90, compared to $0.88 in the prior quarter. These results reflect the start of the expected interim period of higher production costs to be realized as operations trend towards full capacity with the utilization of the newly online facilities and equipment. Efficiencies of scale are expected once full capacity and utilization is obtained.

ORGANIZATION'S HEADCOUNT

- As a result of the growing scale of operations, our headcount rose by 61% to 220 employees as at July 31, 2018 from the previous quarter's headcount of 137 on April 30, 2018.

FACILITY EXPANSION

- As of July 23, 2018, all 10 greenhouse zones of the new 250,000 sq. ft. B6 facility have been completed and fully licensed, as well as the expansion project to the existing B5 facility. The new facility and expansion increase the current production capacity to 25,000 kg per year. Along with the B9 expansion which is currently under construction, total expected production capacity will increase to 108,000 kg annually. The current annual production estimate of 25,000 kg and future annual production estimate of 108,000 kg are based upon the estimated square footage of cultivation space and the ratio of dried cannabis cultivated per plant, which is derived from the historical output of the existing facilities and estimates of future production capabilities.
- Subsequent to the three months ended July 31, 2018, the Company expanded into Ontario through the acquisition of a 2,000,000 sq. ft. facility in Belleville, Ontario, through a joint venture with a related party. The facility was acquired for the purpose of providing capacity for further research and development over enhanced cannabis products as well as for its strategic logistical position to serve the province of Ontario and Canada.
- Also, subsequent to the quarter ended July 31, 2018, the Company leased a 58,000 sq. ft. facility in Montreal, Quebec, for the purposes of housing and distributing the cannabis products of all licensed producers supplying the SQDC with product for the adult-use market.
- Due to significant growth over the past fiscal year, in June 2018 we secured an additional office space in our current office building in Gatineau, Quebec. The space will primarily house the executive team, as well as the finance, marketing, government relations, legal, compliance and communications departments, with the possibility of further expansion as the Company and headcount continue to grow.

PRODUCT LINE EXPANSION

- On July 16, 2018, we launched Fleur de Lune, one of Canada's first intimate-use cannabis oil products. With 7–10 mg/ml of THC per 60 ml bottle, Fleur de Lune offers HEXO users a new and innovative method of use.

FINANCIAL POSITION

- As at July 31, 2018, we held cash and short-term investments of $244,789 and continued to hold no debt on our balance sheet.

Summary of Results

Summary of results for the three- and 12-month periods ended July 31, 2018 and July 31, 2017:

	For the three months ended		For the 12 months ended	
Income statement snapshot	**July 31, 2018**	July 31, 2017	**July 31, 2018**	July 31, 2017
Revenue	**$ 1,410**	$ 862	**$ 4,934**	$ 4,097
Gross margin before fair value adjustments and amortization	**$ 711**	$ 751	**$ 2,841**	$ 2,634
Gross margin before amortization	**$ 519**	$ 3,062	**$ 6,400**	$ 6,448
Operating expenses	**$ 10,713**	$ 2,347	**$ 24,367**	$ 7,932
(Loss)/income from operations	**$ (10,194)**	$ 716	**$ (17,967)**	$ (1,483)
Other income/(expenses)	**$ (315)**	$ 219	**$ (5,383)**	$ (10,934)
Net income (loss)	**$ (10,509)**	$ 935	**$ (23,350)**	$ (12,418)
Weighted average shares outstanding	**193,629,116**	71,782,223	**134,171,509**	58,556,121
Net income (loss) per share	**$ (0.05)**	$ (0.01)	**$ (0.17)**	$ (0.21)

* As a result of a business combination completed on March 15, 2017, pre-consolidation THCX shares were exchanged at a rate of six to one. Shares after this date have been stated using post-consolidation figures. (See Note 4 to the consolidated financial statements for the year ended July 31, 2018.)

Revenue

	For the three months ended		For the 12 months ended	
	July 31, 2018	July 31, 2017	**July 31, 2018**	July 31, 2017
Revenue	**$ 1,410**	$ 862	**$ 4,934**	$ 4,097
Total gram equivalents sold	**152,288**	95,735	**538,886**	405,164

Revenue for the fourth quarter ended July 31, 2018 increased 64% to $1,410 compared to $862 in the same period in fiscal 2017. Higher revenue was driven mainly by increased Elixir and H2 (mid-range line) sales volume, as Elixir was introduced in late Q4 '17 and H2 sales volume increased by 70%. Compared to the prior quarter, the sequential revenue increase was 14%, reflecting a higher total of volume sold, primarily driven by a 31% increase in oil sales.

Sales volume increased 59% to 152,288 gram equivalents, compared to 95,735 in the same prior year period, due to an increase in our oil-based products as the product mix purchased by customers shifted towards smoke-free alternatives. Total dried grams sold increased 33%. Revenue per gram equivalent increased to $9.26 as compared to $9.00 in the same prior year period, mainly as a result of higher sales of our Elixir product line, which contributes a higher revenue per gram equivalent than dried product.

On a sequential basis, sales volume increased 14% compared to the third quarter of fiscal 2018, essentially for the same reasons as noted above.

For the 12 months ended July 31, 2018, revenue increased 20% to $4,934 compared to $4,097 in the same period in fiscal 2017. Sales volume increased 33% to 538,886 gram equivalents, compared to 404,158 in the same prior year period.

Cost of Sales

Cost of goods sold includes the direct costs of materials and labour related to inventory sold, and includes harvesting, processing, packaging and shipping costs.

Fair value adjustment on sale of inventory includes the fair value of biological assets included in the value of inventory transferred to cost of sales.

Fair value of biological assets represents the increase or decrease in fair value of plants during the growing process less expected cost to complete and selling costs and includes certain management estimates.

	For the three months ended		For the 12 months ended	
	July 31, 2018	July 31, 2017	**July 31, 2018**	July 31, 2017
Cost of sales	**$ 700**	$ 111	**$ 2,093**	$ 1,463
Loss on write-down of inventory	**–**	139	**–**	613
Fair value adjustment on sale of inventory	**455**	78	**2,289**	577
Fair value adjustment on biological assets	**(1,171)**	(3,003)	**(7,340)**	(5,004)
Adjustment to net realizable value of inventory	**906**	–	**1,491**	–
Total fair value adjustment	**$ 190**	$ (2,925)	**$ (3,560)**	$ (4,427)

Cost of sales for the quarter ended July 31, 2018 was $700, compared to $111 for the same quarter ended July 31, 2017. Included in the cost of sales for the quarter ended July 31, 2017 is the $139 write-down of inventories due to the Company's voluntary recall in May 2017 and water-damaged inventory, which when excluded yields additional cost of sales of $613 for the 12 months ended July 31, 2017. The increase in cost of sales is the result of increased sales volumes and an increase to transformation, packaging and shipping costs.

Fair value adjustment on the sale of inventory for the fourth quarter ended July 31, 2018 was $455 compared to $78 for the same quarter ended July 31, 2017. This is due to the increase in production scale and total sales. The adjustment to net realizable value of inventory increased from the same quarter ended July 31, 2017 to $906 due to the decrease in the estimated market selling price input of inventory valuation. This is due to the onset of the adult-use market and reflects competitive market prices. The increase in the 12 months ended July 31, 2018 adjustment of $1,491 is also due to the above.

Fair value adjustment on biological assets for the fourth quarter ended July 31, 2018 was ($1,171) compared to ($3,003) for the same quarter ended July 31, 2017. This is due to a significant decrease in the average dried gram market selling price input due to the onset of the adult-use market. This decrease is offset by the increase in the total number of plants as the first harvests of the B6 greenhouse began in July 2018. The increase in scale and total plants on hand is the result of preparing for the adult-use market, which began October 17, 2018.

Operating Expenses

	For the three months ended		For the 12 months ended	
	July 31, 2018	July 31, 2017	**July 31, 2018**	July 31, 2017
General and administration	**$ 4,300**	$ 1,206	**$ 9,374**	$ 3,609
Marketing and promotion	**3,807**	749	**8,335**	3,072
Stock-based compensation	**1,933**	193	**4,997**	659
Amortization of property, plant and equipment	**421**	135	**896**	360
Amortization of intangible assets	**252**	64	**765**	232
Total	**$ 10,713**	$ 2,347	**$ 24,367**	$ 7,932

Operating expenses include marketing and promotion, general and administrative, research and development, stock-based compensation, and amortization expenses. Marketing and promotion expenses include customer acquisition costs, customer experience costs, salaries for marketing and promotion staff, general corporate communications expenses, and research and development costs. General and administrative expenses include salaries for administrative staff and executive salaries as well as general corporate expenditures including legal, insurance and professional fees.

GENERAL AND ADMINISTRATIVE

General and administrative expenses increased to $4,300 in the fourth quarter, compared to $1,206 for the same period in fiscal 2017. This increase reflects the general growing scale of our operations, including an increase in general, finance and administrative staffing and additional rental space. Consulting and professional fees increased by $1,904 and $728, respectively, as a result of the increased financial reporting and control-based regulatory requirements accompanying public status on the TSX-V and subsequently the TSX, as well as increased compliance costs as a publicly listed company.

For the 12 months ended July 31, 2018, general and administrative expenses increased to $9,374 compared to $3,609 for the same period in fiscal 2017. The increase is consistent with the explanation as stated above.

MARKETING AND PROMOTION

Marketing and promotion expenses increased to $3,807 in the fourth quarter, compared to $749 for the same period in fiscal 2017. This primarily reflects additional marketing and promotional events undertaken in the quarter as we build brand recognition and establish HEXO in the recreational cannabis market. This is inclusive of higher staff and travel-related expenses, printing and promotional materials as well as advertisement costs. This is consistent with our focus to prepare for the legalization of the adult recreational market.

For the 12 months ended July 31, 2018, marketing and promotion expenses increased to $8,335, compared to $3,072 for the same period in fiscal 2017. The increase is consistent with the explanation as stated above.

AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT

Amortization of property, plant and equipment increased to $421 in the fourth quarter, compared with $135 for the same period in fiscal 2017. The increase is the direct result of the Company's newly built greenhouses and cultivation equipment becoming operational. Additionally, increases to cultivation and production equipment were incurred in order to support the larger production demands.

For the 12 months ended July 31, 2018, property, plant and equipment depreciation expenses increased to $896, compared to $360 for the same period in fiscal 2017. The increase is consistent with the explanation as stated above.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets increased to $252 in the fourth quarter, compared with $64 for the same period in fiscal 2017. The increase is the result of a change in the expected useful life of certain software as we prepared for the implementation of a new ERP system, which will replace certain software programs we currently use and the establishment of an online sales platform.

For the 12 months ended July 31, 2018, intangible asset depreciation expenses increased to $765, compared to $232 for the same period in fiscal 2017. The increase is consistent with the explanation as stated above.

Loss from Operations

Income/(loss) from operations for the fourth quarter was ($10,194), compared to $716 for the same period in fiscal 2017. The increased loss from operations is due mainly to higher expenses in line with the expanding scale of operations as we prepare for the legalization of the adult recreational market.

For the 12 months ended July 31, 2018, loss from operations was ($17,967), compared to ($1,483) in the same prior year period for the same reasons as the change for the three-month period.

Other Income/Expenses

Other income/(expense) was ($315) and ($5,383) for the three and 12 months ended July 31, 2018 ($219 and ($10,934) for the three and 12 months ended July 31, 2017, respectively). Revaluation of financial instruments of ($5,091) in the latest quarter reflects the revaluation of an embedded derivative related to $3,275 of USD convertible debentures issued and converted in the prior year. Additionally, we incurred interest income for the three months ended July 31, 2018 and July 31, 2017 of $854 and $61, respectively. Interest expenses of $Nil and $75 were realized for the three months ended July 31, 2018 and July 31, 2017, respectively. This increase reflects the interest generated from the acquired short-term investments during the quarter ended July 31, 2018.

Non-IFRS Measures

Weighted average cash cost of dried inventory sold per gram

Weighted average cash cost of dried inventory sold per gram includes direct costs associated with the growing, harvesting and processing of inventory sold such as labour, utilities, fertilizer costs, biological control costs, general supplies and materials, curing, milling, quality assurance and testing of inventory sold in the period.

As there are no standardized methods of calculating this non-IFRS measure, our methods may differ from those used by others, and accordingly, the use of this measure may not be directly comparable to similarly titled measures used by others. Accordingly, these non-IFRS measures are intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

Weighted average cash cost of dried inventory sold is calculated as follows:

		Q4 '18		Q3 '18		Q2 '18		Q1 '18		Q4 '17
Cost of goods sold	**$**	**700**	$	479	$	451	$	463	$	663
Less:										
Order fulfillment costs[1]	**$**	**(453)**	$	(335)	$	(286)	$	(307)	$	(273)
Cannabis oil conversion costs	**$**	**(133)**	$	(43)	$	(41)	$	(32)	$	(37)
Recall of inventory write-down	**$**	**–**	$	–	$	–	$	–	$	(139)
	$	**114**	$	101	$	124	$	124	$	214
Number of dried grams sold		**127,252**		114,968		127,769		115,768		95,735
Weighted average cash cost of dried inventory sold (g)	**$**	**0.90**	$	0.88	$	0.97	$	1.07	$	2.23

1 Order fulfillment costs are excluded from the calculation of weighted average cash cost of dried inventory sold as this non-IFRS metric is utilized to demonstrate the burdened cash cost of producing, cultivating and bringing a gram of dried inventory to the state of a finished good to be sold during the period.

Weighted average cash cost of dried inventory sold per gram declined 60% year over year to $0.90 for the fourth quarter ended July 31, 2018, compared to $2.23 for the same prior year quarter. Cost per gram sold has been trending downward cumulatively as a result of improvements in the cultivation processes and economies of scale resulting from the full utilization of a higher production capacity.

The weighted average cash cost of dried inventory sold increased slightly to $0.90 from $0.88 as compared to the three months ended April 30, 2018. This trend is expected to continue in the short term, as the Company moves towards full efficiencies of scale and utilization of the new facilities as well as beginning increased levels of production to meet the demand of the adult recreational market.

During the prior year quarter ended July 31, 2017, the Company recorded a write-down of inventories related to the Company's voluntary recall and water-damaged goods.

Biological Assets – Fair Value Measurements

As at July 31, 2018, the changes in the carrying value of biological assets are as follows:

	July 31, 2018	July 31, 2017
Carrying amount, beginning of period	**$ 1,504**	$ 121
Production costs capitalized	**993**	659
Net increase in fair value due to biological transformation less cost to sell	**7,340**	5,004
Transferred to inventory upon harvest	**(7,505)**	(4,280)
Carrying amount, end of period	**$ 2,332**	$ 1,504

Our biological assets consist of cannabis plants, from seeds all the way through to mature plants. As at July 31, 2018, the carrying amount of biological assets consisted of $6 in seeds and $2,326 in cannabis plants ($6 in seeds and $1,498 in cannabis plants as at July 31, 2017). The increase in the carrying amount of biological assets is attributable to an increase in plants on hand and offset by the market selling price decrease as a result of the adult-use market. The significant estimates used in determining the fair value of cannabis on plants are as follows:

- yield by plant;
- stage of growth estimated as the percentage of costs incurred as a percentage of total cost as applied to the estimated total fair value per gram (less fulfillment costs) to arrive at an in-process fair value for estimated biological assets which have not yet been harvested;
- percentage of costs incurred for each stage of plant growth; and
- fair value selling price per gram less cost to complete and cost to sell.

We view our biological assets as Level 3 fair value estimates and estimate the probability of certain harvest rates at various stages of growth. As at July 31, 2018, it is expected that our biological assets will yield approximately 4,373,775 grams (July 31, 2017 – 700,169 grams). Our estimates are, by their nature, subject to change. Changes in the anticipated yield will be reflected in future changes in the fair values of biological assets.

The valuation of biological assets is based on an income approach in which the fair value at the point of harvesting is estimated based on selling prices less the costs to sell. For in-process biological assets, the fair value at point of harvest is adjusted based on the stage of growth at period end. Stage of growth is determined by reference to the plant's life relative to the stages within the harvest cycle.

Management's identified significant unobservable inputs, their range of values and sensitivity analysis are presented in the table below:

Unobservable inputs	Input values	Sensitivity analysis
Average selling price Obtained through actual retail prices on a per strain basis	$4.66 per dried gram	An increase or decrease of 5% applied to the average selling price would result in a change of approximately $329,000 to the valuation.
Yield per plant Obtained through historical harvest cycle results on a per strain basis	50–235 grams per plant	An increase or decrease of 5% applied to the average yield per plant would not result in a material change in valuation.
Stage of growth Obtained through the estimates of stage of completion within the harvest cycle	Average of 32% completion	An increase or decrease of 5% applied to the average stage of growth per plant would result in a change of approximately $320,000 in valuation.

Quarterly Results

The following table presents certain unaudited financial information for each of the eight fiscal quarters up to and including the quarter ended July 31, 2018. The information has been derived from our unaudited consolidated financial statements, which in management's opinion have been prepared on a basis consistent with the consolidated financial statements for the year ended July 31, 2018. Past performance is not a guarantee of future performance, and this information is not necessarily indicative of results for any future period.

	Q4 '18 July 31, 2018	Q3 '18 April 30, 2018	Q2 '18 January 31, 2018	Q1 '18 October 31, 2017
Revenue	**$ 1,410**	$ 1,240	$ 1,182	$ 1,102
Net income (loss)	**(10,194)**	(1,971)	(8,952)	(1,918)
Income (loss) per share – basic	**(0.05)**	(0.01)	(0.10)	(0.03)
Income (loss) per share – fully diluted	**(0.05)**	(0.01)	(0.10)	(0.03)

	Q4 '17 July 31, 2017	Q3 '17 April 30, 2017	Q2 '17 January 31, 2017	Q1 '17 October 31, 2016
Revenue	$ 862	$ 1,182	$ 914	$ 1,139
Net income (loss)	935	(11,808)	(1,114)	(430)
Income (loss) per share – basic	0.02	(0.17)	(0.02)	(0.01)
Income (loss) per share – fully diluted	0.01	(0.17)	(0.02)	(0.01)

Financial Position

The following table provides a summary of our interim condensed financial position as at July 31, 2018 and July 31, 2017:

	July 31, 2018	July 31, 2017
Total assets	**$ 334,997**	$ 56,179
Total liabilities	**12,124**	23,739
Share capital	**347,233**	45,159
Share-based payment reserve	**6,139**	1,562
Contributed surplus	**–**	1,775
Warrants	**12,635**	3,728
Deficit	**(43,134)**	(19,785)

Total Assets

Total assets increased to $334,997 as at July 31, 2018 from $56,179 as at July 31, 2017, primarily due to financings, capital asset additions related to facility expansion and an increase in inventory as we move closer to the opening of the adult-use market. Since July 31, 2017, we have raised gross proceeds of approximately $218,500 through two financings and $74,366 raised gross proceeds through exercised warrants. At July 31, 2018, we had a cash balance of $39,342 and short-term investments of $205,447.

Total Liabilities

Total liabilities decreased to $12,124 as at July 31, 2018 from $23,739 as at July 31, 2017, primarily due to the conversion of the unsecured convertible debentures from our July 2017 financing, partially offset by an increase to accounts payable as operations continue to grow. Total liabilities include a warrant liability of $3,130 as at July 31, 2018, from $1,356 as at July 31, 2017, recorded at fair value, related to a private placement completed in the prior year. The increase in the value of the fair value of the warrant liability is the result of changes in the share price and foreign exchange rate in the period, partially offset by the reduction in the number of warrants outstanding.

Share Capital

Share capital increased to $347,233 as at July 31, 2018 from $45,159 as at July 31, 2017, primarily due to the closing of the January 2018 financing, the conversion of the unsecured convertible debentures from our July 2017 and November 2017 financings, as well as warrant exercises. During the three months period ended, the Company finalized the acceleration of the November 2017 outstanding warrants expiry date. The resulting exercised warrants increased share capital by $40,873.

Liquidity and Capital Resources

Liquidity

Our objectives when managing our liquidity and capital structure are to maintain sufficient cash to fund operating and organic growth requirements, and to meet contractual obligations. Our ability to reach profitability is dependent on successful implementation of our business strategy. While management is confident in the future success of the business, there can be no assurance that our products will gain adequate market penetration or acceptance or generate sufficient revenue to reach profitability.

As at July 31, 2018, we had $39,342 of cash and cash equivalents on hand, $205,447 of short-term investments, $644 of trade receivables, and $8,995 of accounts payable and accrued liabilities. As at July 31, 2017, we had $38,453 of cash and cash equivalents on hand, $2,872 of short-term investments, $351 of trade receivables, $1,672 of accounts payable and accrued liabilities, and $20,639 in 8% unsecured convertible debentures.

Liquidity	**12 months ended July 31, 2018**	12 months ended July 31, 2017
Operating activities	**$ (22,185)**	$ (5,311)
Financing activities	**283,150**	48,172
Investing activities	**(260,077)**	(6,339)

Operating Activities

Net cash used in operating activities for the 12 months ended July 31, 2018 was $22,185 as a result of the net loss for the 12 months ended of $23,350, and a decrease in non-cash working capital of $7,213, partially offset by non-cash expense of $8,738. In the same prior year period, cash used in operating activities was $5,311, reflecting the net loss of $12,418, net non-cash income of $5,890, and a decrease in working capital of $1,217. The change in cash flow reflects $7,340 of an unrealized change in the fair value of biological assets and increased inventory stock and prepaid expenses of $2,503 and $4,003, respectively.

Financing Activities

Net cash received from financing activities for the 12 months ended July 31, 2018 was $283,150, reflecting the issuance of $149,500 in units from the January 2018 equity financing, $69,000 from the November 2017 convertible debenture financing, and $74,366 related to the exercise of warrants.

Investing Activities

For the 12 months ended July 31, 2018, we used $260,077 for investing activities, primarily due to the acquisition of $202,575 short-term investments. The balance was used in the construction of our new 250,000 sq. ft. greenhouse and the continuing construction of our 1,000,000 sq. ft. greenhouse of approximately $45,721. During the period, we continued additions to our software, licenses and online platforms of $1,780. Also during the period, a $10,000 convertible note receivable was issued to Fire & Flower.

Capital Resources

As at July 31, 2018, total current assets less accounts payable totalled $267,625. The exercise of all the issued and outstanding warrants, as at July 31, 2018, would result in an increase in cash of approximately $115,251, and the exercise of all stock options would increase cash by approximately $43,459.

Upon the completion of the Molson joint venture transaction, the Company issued 11,500,000 common share warrants with an exercise price of $6.00 per warrant. This would increase cash by approximately $69,000.

Management believes that current working capital provides sufficient funds to fund current expansion projects and meet contractual obligations for the next 12 months. We periodically evaluate the opportunity to raise additional funds through the public or private placement of equity capital to strengthen our financial position and to provide sufficient cash reserves for growth and development of the business.

Our authorized share capital is comprised of an unlimited number of common shares. The table below outlines the number of issued and outstanding common shares, warrants and options as at July 31, 2017, July 31, 2018 and October 25, 2018.

	October 25, 2018	July 31, 2018	July 31, 2017
Common shares	**197,092,917**	193,629,116	76,192,990
Warrants	**34,931,058**	26,425,504	20,994,123
Options	**14,938,837**	14,388,066	5,748,169
Total	**246,962,812**	234,442,686	102,935,282

Off-Balance Sheet Arrangements and Contractual Obligations

We have no off-balance sheet arrangements.

We have certain contractual financial obligations related to service agreements and construction contracts for the construction in progress shown in Note 8 of the consolidated financial statements and the accompanying notes for the three and 12 months ended July 31, 2018.

These contracts have optional renewal terms that we may exercise at our option. The annual minimum payments payable under these contracts over the next five years are as follows:

Fiscal year	2019	2020	2021	2022	**Total**
Amount	$ 61,766	$ 891	$ 854	$ 801	**$ 64,311**

Financial Risk Management

We are exposed to risks of varying degrees of significance which could affect our ability to achieve our strategic objectives for growth. The main objectives of our risk management process are to ensure that risks are properly identified and that the capital base is adequate in relation to these risks. The principal financial risks to which we are exposed are described below.

Interest Risk

Our exposure to interest rate risk only relates to any investments of surplus cash. We may invest surplus cash in highly liquid investments with short terms to maturity that would accumulate interest at prevailing rates for such investments. As at July 31, 2018, we had short term investments of $205,447.

Credit Risk

Credit risk is the risk of financial loss to us if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from our trade receivables and convertible note receivable. As at July 31, 2018, we are exposed to credit-related losses in the event of non-performance by the counterparties.

We provide credit to our customers in the normal course of business and have established credit evaluation and monitoring processes to mitigate credit risk. Since the majority of the sales are transacted with clients covered under various insurance programs, we have limited credit risk.

Credit risk from the convertible note receivable arises from the possibility that principal and/or interest due may become uncollectible. The Company mitigates this risk by managing and monitoring the underlying business relationship.

The carrying amount of cash and cash equivalents, short-term investments, trade receivables and convertible note receivable represents the maximum exposure to credit risk and as at July 31, 2018, this amounted to $255,432. The cash and short-term investments are held with well-established financial institutions in Canada. Since our inception, no losses have been incurred in relation to cash held by our financial institution. The trade receivables balance is held with one of the largest medical insurance companies in Canada.

Liquidity Risk

Liquidity risk is the risk that we will not be able to meet our financial obligations as they become due. We manage our liquidity risk by reviewing on an ongoing basis our capital requirements. As at July 31, 2018, we had $244,789 of cash and short-term investments.

We are obligated to pay accounts payable and accrued liabilities with a carrying amount and contractual cash flows amounting to $8,995 due in the next 12 months.

The carrying values of cash, trade receivables, accounts payable and accrued liabilities approximate their fair values due to their short term to maturity.

Critical Accounting Assumptions

Our financial statements are prepared in accordance with IFRS. Management makes estimates and assumptions and uses judgment in applying these accounting policies and reporting the amounts of assets and liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. Significant estimates in the accompanying financial statements relate to the valuation of biological assets and inventory, stock-based compensation, warrants, the estimated useful lives of property, plant and equipment, and intangible assets. Actual results could differ from these estimates. Our critical accounting assumptions are presented in Note 3 of the Company's annual audited consolidated financial statements for the fiscal year ended July 31, 2018, which is available under HEXO's profile on SEDAR.

Upcoming Changes in Accounting Policies

The following are new and revised IFRS standards in issue, but not yet effective.

IFRS 9, *Financial Instruments*

IFRS 9 was issued by the International Accounting Standards Board ("IASB") in November 2009 and October 2010 and will replace IAS 39. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Two measurement categories continue to exist to account for financial liabilities in IFRS 9, fair value through profit or loss ("FVTPL") and amortized cost. Financial liabilities held for trading are measured at FVTPL, and all other financial liabilities are measured at amortized cost unless the fair value option is applied. The treatment of embedded derivatives under the new standard is consistent with IAS 39 and is applied to financial liabilities and non-derivative hosts not within the scope of the standard. The Company adopted IFRS 9 effective August 1, 2018. The Company has completed its assessment of the impact of this new standard and expects no changes.

IFRS 7, *Financial Instruments: Disclosure*

IFRS 7, *Financial Instruments: Disclosure*, was amended to require additional disclosures on transition from IAS 39 to IFRS 9. IFRS 7 is effective on adoption of IFRS 9, which is effective for annual periods commencing on or after January 1, 2018. The Company adopted the amendments to IFRS 7 on August 1, 2018 and does not expect the implementation will result in a significant effect to the financial statements.

IFRS 15, *Revenue from Contracts with Customers*

IFRS 15 was issued by the IASB in May 2014 and specifies how and when revenue should be recognized based on a five-step model, which is applied to all contracts with customers. On April 12, 2016, the IASB published final clarifications to IFRS 15 with respect to identifying performance obligations, principal versus agent considerations, and licensing. The Company adopted IFRS 15 effective August 1, 2018. The Company has completed its assessment of the impact of this new standard and has noted beyond the required additional disclosures, there exist no material changes to the financial statements or required retroactive adjustments to the retained earnings.

IFRS 16, *Leases*

IFRS 16 was issued by the IASB in January 2016, and specifies the requirements to recognize, measure, present and disclose leases. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted. The Company is assessing the impact of the new or revised IFRS standard in issue but not yet effective on its consolidated financial statements.

Related Party Transactions

Key Management Personnel Compensation

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling our operations, directly or indirectly. Our key management personnel are the members of the executive management team and Board of Directors, who collectively control approximately 8.77% of the outstanding common shares as at July 31, 2018 (July 31, 2017 – 25.11%).

Compensation provided to key management for the three and 12 months ended July 31, 2018 and July 31, 2017 was as follows:

	For the three months ended		For the 12 months ended	
	July 31, 2018	July 31, 2017	**July 31, 2018**	July 31, 2017
Salary and/or consulting fees	**$ 739**	$ 438	**$ 2,244**	$ 1,270
Stock-based compensation	**1,272**	231	**3,836**	512
Total	**$ 2,011**	$ 669	**$ 6,080**	$ 1,782

Unless otherwise stated, the below granted stock options will vest on the one-year anniversary of the date of grant and the balance will vest quarterly over two years thereafter.

On July 11, 2018, the Company granted certain of its directors and officers a total of 4,325,000 stock options with an exercise price of $4.89.

On April 16, 2018, the Company granted certain executives of the Company a total of 845,000 stock options with an exercise price of $4.27.

On March 12, 2018, the Company granted certain executives of the Company a total of 325,000 stock options with an exercise price of $3.89.

On December 4, 2017, the Company granted certain directors and executives a total of 1,750,000 stock options with an exercise price of $2.69, half of which vested immediately and the balance over a three-year period.

On September 8, 2017, the Company granted certain of our executives a total of 650,000 stock options with an exercise price of $1.37.

The Company leased a building to a related party for $0.7 per month as part of a usufruct agreement. The related party used this property as a personal residence. On December 2, 2016, we reached an agreement with the related party to terminate the usufruct. In exchange, we paid the related party $46. Gaining access to this building provides us with additional office space and thereby reduces the need to rent or build additional offices in the short term.

Subsequent to the quarter ended July 31, 2018, the Company announced the acquisition of a new facility. The building is owned by Belleville Complex Inc., a joint venture in which HEXO will hold a 25% interest and Olegna will hold a 75% interest. Olegna is controlled by a HEXO director and a non–arm's length related party. In addition to its initial lease of 500,000 sq. ft. of the space under a long-term lease, HEXO will have rights of first offer and first refusal to lease the remaining space in the building. As part of the transaction, HEXO has loaned $20,000 to Belleville Complex to acquire the building. The loan will be repaid within 120 days from September 7, 2018, and as of October 7, 2018, bore interest at an annual rate of 4%, which interest shall be payable monthly. The loan is secured by a first mortgage over the building. HEXO has also agreed to be the anchor tenant of the facility for a period of 20 years.

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed by the related parties.

Internal Controls over Financial Reporting

In accordance with National Instrument 52-109, *Certification of Disclosure in Issuers' Annual and Interim Filings*, management is responsible for establishing and maintaining adequate disclosure controls and procedures ("DCP") and internal control over financial reporting ("ICFR"). On June 22, 2018, the Company commenced trading on the TSX, graduating from the TSX Venture Exchange. The Company's CEO and CFO will be required to file certifications relating to DCP and ICFR for the Company in connection with its interim and annual filings, commencing with the three months ended October 31, 2018, the second reporting period ended after the Company became a non-venture issuer on the TSX.

Risk Factors

Our overall performance and results of operations are subject to various risks and uncertainties which could cause actual performance, results and achievements to differ materially from those expressed or implied by forward-looking statements and forward-looking information, including, without limitation, the following factors, which are discussed in our Annual Information Form dated October 26, 2018 available under our profile on www.sedar.com, which risk factors are incorporated by reference into this document, and should be reviewed in detail by all readers:

- We operate in a dynamic, rapidly changing environment that involves risks and uncertainties, and as a result, management expectations may not be realized for a number of reasons. An investment in our securities is speculative and involves a high degree of risk and uncertainty.
- Reliance on management's and key persons' ability to execute on strategy. This exposes us to management's ability to perform, as well as the risk of management leaving the Company.
- We face intense competition from licensed producers and other companies, some of which may have greater financial resources and more industry, manufacturing and marketing experience than we do.
- The number of licences granted, and the number of licensed producers ultimately authorized by Health Canada could have an impact on our operations. We expect to face additional competition from new market entrants that are granted licences under the ACMPR or existing licence holders which are not yet active in the industry.
- We may be subject to growth-related risks including capacity constraints and pressure on our internal systems and controls. Our ability to manage growth effectively will require it to continue to implement and improve our operational and financial systems and to expand, train and manage our employee base.
- We maintain various types of insurance such as, but not limited to, errors and omissions insurance; directors' and officers' insurance; property coverage; and general commercial insurance, recall insurance, cyber security insurance, warehouseman insurance and cargo insurance. A judgment against any member of the Company in excess of available coverage could have a material adverse effect on us in terms of damages awarded and the impact on our reputation.
- Given the nature of our business, we may from time to time be subject to claims or complaints from investors or others in the normal course of business which could adversely affect the public's perception of the Company.
- We may become party to litigation from time to time in the ordinary course of business which could adversely affect our business.
- Failure to adhere to laws and regulations may result in possible sanctions including the revocation or imposition of conditions on licenses to operate our business; the suspension or expulsion from a particular market or jurisdiction or of our key personnel; and the imposition of fines and censures.
- Achievement of our business objectives is contingent, in part, upon compliance with regulatory requirements enacted by these governmental authorities and obtaining all regulatory approvals, where necessary, for the production and sale of our products. We cannot predict the time required to secure all appropriate regulatory approvals for our products, or the extent of testing and documentation that may be required by governmental authorities.
- While to the knowledge of our management, it is currently in compliance with all laws, regulations and guidelines relating to the marketing, acquisition, manufacture, management, transportation, storage, sale and disposal of cannabis and also including laws and regulations relating to health and safety, the conduct of operations and the protection of the environment, changes to such laws, regulations and guidelines due to matters beyond our control may cause adverse effects to our operations.
- Our business operations are dependent on our licence under the ACMPR. The licence must be renewed by Health Canada. Our current licence expires on October 15, 2019. Failure to comply with the requirements of the licence or any failure to renew the licence would have a material adverse impact on our business, financial condition and operating results.
- Our activities and resources are currently primarily focused on our production facilities on the Gatineau campus, and we will continue to be focused on this facility for the foreseeable future. Adverse changes or developments affecting the Gatineau campus would have a material and adverse effect on our business, financial condition and prospects.
- We have incurred operating losses since commencing operations and may incur losses in the future and may not achieve profitability.

- Our growth strategy contemplates outfitting the Company's multiple facilities with additional production resources. There is a risk that these additional resources will not be completed on time, on budget, or at all.
- A key aspect of our business is growing cannabis, and as such we are exposed to the risks inherent in any agriculture business, such as disease spread, hazards, pests and similar agricultural risks that may create crop failures and supply interruptions for our customers.
- Our cannabis growing operations consume considerable energy, making us vulnerable to rising energy costs. Rising or volatile energy costs may adversely impact our business and our ability to operate profitably.
- We believe the cannabis industry is highly dependent upon consumer perception regarding the safety, efficacy and quality of the cannabis produced. Consumer perception of our products can be significantly influenced by scientific research or findings, regulatory investigations, litigation, media attention and other publicity regarding the consumption of cannabis products. There can be no assurance that future scientific research, findings, regulatory proceedings, litigation, media attention or other research findings or publicity will be favourable to the cannabis market or any particular product, or consistent with earlier publicity.
- As a manufacturer and distributor of products designed to be ingested or inhaled by humans, we face an inherent risk of exposure to product liability claims, regulatory action and litigation if our products are alleged to have caused significant loss or injury. In addition, the manufacture and sale of our products involve the risk of injury or loss to consumers due to tampering by unauthorized third parties, product contamination, unauthorized use by consumers or other third parties.
- Manufacturers and distributors of products are sometimes subject to the recall or return of their products for a variety of reasons, including product defects, such as contamination, unintended harmful side effects or interactions with other substances, packaging safety and inadequate or inaccurate labelling disclosure.
- Our business is dependent on a number of key inputs and their related costs including raw materials and supplies related to our growing operations, as well as electricity, water and other local utilities. Any significant interruption or negative change in the availability or economics of the supply chain for key inputs could materially impact our business, financial condition and operating results.
- We must rely largely on our own market research to forecast sales as detailed forecasts are not generally obtainable from other sources at this early stage of the medical marijuana industry in Canada.
- We have no earnings or dividend record and may not pay any dividends on our common shares in the foreseeable future.
- Our common shares are listed on the TSX; however, there can be no assurance that an active and liquid market for the common shares will be maintained, and an investor may find it difficult to resell such shares.
- The market price for our common shares may be volatile and subject to wide fluctuations in response to numerous factors, including governmental and regulatory regimes, community support for the cannabis industry, variations in our operating results, changes in our business prospects, as well as many other factors that are beyond.
- We may issue additional common shares in the future, which may dilute a shareholder's holdings in the Company.
- Our operations are subject to environmental and safety laws and regulations concerning, among other things, emissions and discharges to water, air and land, the handling and disposal of hazardous and non-hazardous materials and wastes, and employee health and safety. We will incur ongoing costs and obligations related to compliance with environmental and employee health and safety matters. Failure to comply with environmental and safety laws and regulations may result in additional costs for corrective measures, in penalties or in restrictions on our manufacturing operations.
- The development of our business and operating results may be hindered by applicable restrictions on sales and marketing activities imposed by Health Canada.
- In the fiscal year 2018, the Company initiated the implementation of new ERP systems. The implementation is expected to be completed in the fiscal year ended July 31, 2019. Upon full commencement of the implementation, the scoping, requirements definition, business process definition, design and testing of the integrated ERP system could result in problems which could, in turn, result in disruption, delays and errors to the operations and processes within the business and/or inaccurate information for management and financial reporting.

- We are exposed to the risk that our employees, independent contractors and consultants may engage in fraudulent or other illegal activity. Misconduct by these parties could include intentional, reckless and/or negligent conduct or disclosure of unauthorized activities to the Company that violates: (i) government regulations; (ii) manufacturing standards; (iii) federal and provincial healthcare fraud and abuse laws and regulations; or (iv) laws that require the true, complete and accurate reporting of financial information or data.
- Our TSX's listing conditions required us to deliver an undertaking confirming that, while listed on the TSX, we will only conduct the business of production, acquisition, sale and distribution of cannabis in Canada as permitted under the Health Canada license.
- The Company is subject to continuous evolving corporate governance, internal controls and disclosure regulations that may increase the risk of non-compliance, which could adversely impact the Company, its market perception and valuation.
- The Company is subject to changed rules and regulations as implemented by a number of governmental and self-regulated bodies, including, but not limited to, the Canadian Securities Administration, the TSX and the International Accounting Standards Board. These rules and regulations continue to evolve in scope and complexity, creating many new requirements.

MNP LLP

Independent Auditors' Report

To the Shareholders of HEXO Corp.:

We have audited the accompanying consolidated financial statements of HEXO Corp., which comprise the consolidated statements of financial position as at July 31, 2018 and July 31, 2017, and the consolidated statements of loss and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of HEXO Corp. as at July 31, 2018 and July 31, 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

MNP LLP

Chartered Professional Accountants

Licensed Public Accountants

Ottawa, Ontario

October 25, 2018

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Consolidated Statements of Financial Position

(in Canadian dollars)

As at	Note	July 31, 2018	July 31, 2017
Assets			
Current assets			
Cash and cash equivalents		**$ 39,341,688**	$ 38,452,823
Short-term investments	5	**205,446,830**	2,871,550
Trade receivables		**643,596**	351,207
Commodity taxes recoverable		**4,237,465**	495,783
Convertible note receivable	13	**10,000,000**	–
Prepaid expenses		**4,203,693**	200,677
Inventory	6	**10,414,624**	3,689,239
Biological assets	7	**2,331,959**	1,504,186
		276,619,855	47,565,465
Property, plant and equipment	8	**54,333,051**	5,849,695
Intangible assets and other longer-term assets	9	**4,044,527**	2,763,764
		$ 334,997,433	$ 56,178,924
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		**$ 8,994,789**	$ 1,672,406
Interest payable	10	**–**	72,511
Warrant liability	10, 11	**3,129,769**	1,355,587
		12,124,558	3,100,504
Unsecured convertible debentures	10	**–**	20,638,930
		$ 12,124,558	$ 23,739,434
Shareholders' equity			
Share capital	11	**$ 347,232,724**	$ 45,159,336
Share-based payment reserve	11	**6,139,179**	1,561,587
Contributed surplus		**–**	1,774,880
Warrants	11	**12,635,339**	3,728,255
Deficit		**(43,134,367)**	(19,784,568)
		$ 322,872,875	$ 32,439,490
		$ 334,997,433	$ 56,178,924

Approved by the Board

/s/ Jason Ewart, Director /s/ Michael Munzar, Director

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

Consolidated Statements of Loss and Comprehensive Loss

(in Canadian dollars)

For the years ended	Note	July 31, 2018	July 31, 2017
Revenue		**$ 4,933,952**	$ 4,096,841
Cost of goods sold	6	**2,093,043**	1,462,522
Gross margin before fair value adjustments and amortization		**2,840,909**	2,634,319
Fair value adjustment on sale of inventory	6	**2,288,975**	576,872
Fair value adjustment on biological assets	7	**(7,339,566)**	(5,003,822)
Adjustment to net realizable value of inventory	6	**1,491,070**	–
Loss on write-down of inventory	6	**–**	613,074
Gross margin before amortization		**$ 6,400,430**	$ 6,448,195
Operating expenses			
General and administrative		**9,374,438**	3,608,595
Marketing and promotion		**8,335,083**	3,072,802
Stock-based compensation	11	**4,996,513**	658,620
Amortization of property, plant and equipment	8	**895,714**	359,967
Amortization of intangible assets	9	**765,238**	231,685
	16	**$ 24,366,986**	$ 7,931,669
Loss from operations		**(17,966,556)**	(1,483,474)
Revaluation of financial instruments gain/(loss)	10	**(5,091,460)**	(9,169,275)
RTO listing expense	4	**–**	(951,024)
Loss on investment	19, 20	**(649,714)**	–
Loss on disposal of assets		**–**	(56,356)
Foreign exchange gain/(loss)		**(228,012)**	(326,981)
Interest expense	10	**(1,529,408)**	(522,618)
Interest income		**2,115,351**	92,158
Net loss and comprehensive loss attributable to shareholders		**$ (23,349,799)**	$ (12,417,570)
Net loss per share, basic and diluted		**$ (0.17)**	$ (0.21)
Weighted average number of outstanding shares			
Basic and diluted	12	**134,171,509**	58,556,121

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

Consolidated Statements of Changes in Shareholders' Equity

(in Canadian dollars)

For the years ended July 31, 2018 and 2017	Note	Number common shares	Share capital	Share-based payment reserve	Warrants	Contributed surplus	Deficit	Shareholders' equity
Balance, August 1, 2017		76,192,990	$ 45,159,336	$ 1,561,587	$ 3,728,255	$ 1,774,880	$ (19,784,568)	$ 32,439,490
Issuance of 7% unsecured convertible debentures	10	–	–	–	3,529,770	7,283,084	–	10,812,854
Issuance of units	11	37,375,000	139,029,262	–	10,470,738	–	–	149,500,000
Issuance costs	11	–	(7,342,461)	–	(768,186)	(505,767)	–	(8,616,414)
Issuance of broker/finder warrants	11	–	–	–	2,351,615	–	–	2,351,615
Conversion of 8% unsecured convertible debentures	10	15,853,887	23,462,232	–	–	(1,742,779)	–	21,719,453
Conversion of 7% unsecured convertible debentures	10	31,384,081	61,555,345	–	–	(6,809,418)	–	54,745,927
Exercise of stock options	11	907,273	1,008,775	(418,921)	–	–	–	589,854
Exercise of warrants	10, 11	27,897,087	75,254,494	–	(5,029,415)	–	–	70,225,079
Exercise of broker/finder warrants	11	4,018,798	9,105,741	–	(1,647,438)	–	–	7,458,303
Stock-based compensation	11	–	–	4,996,513	–	–	–	4,996,513
Net loss		–	–	–	–	–	(23,349,799)	(23,349,799)
Balance at July 31, 2018		**193,629,116**	**$ 347,232,724**	**$ 6,139,179**	**$ 12,635,339**	**$ –**	**$ (43,134,367)**	**$ 322,872,875**
Balance, August 1, 2016		39,305,832	$ 12,756,262	$ 937,065	$ 1,370,579	$ 89,601	$ (7,366,998)	$ 7,786,509
Issuance of units	11	338,274	192,253	–	61,453	–	–	253,706
Private placement	11	8,571,432	5,000,002	–	–	–	–	5,000,002
Concurrent financing	11	20,010,000	15,007,501	–	–	–	–	15,007,501
Shares issued for reverse acquisition		1,837,770	1,378,332	70,253	–	–	–	1,448,585
Share issuance costs	11	–	(2,246,704)	–	–	–	–	(2,246,704)
Issuance of broker/finder warrants	11	–	–	–	1,236,428	–	–	1,236,428
Exercise of stock options	11	162,504	136,603	(104,351)	–	–	–	32,252
Exercise of warrants	10, 11	828,694	1,033,772	–	(93,858)	–	–	939,914
Issuance of 8% unsecured convertible debentures	10	–	–	–	1,084,433	1,742,779	–	2,827,212
Conversion of secured convertible debentures	10	4,678,494	11,570,911	–	–	–	–	11,570,911
Conversion of unsecured convertible debentures	10	459,990	330,404	–	69,220	(57,500)	–	342,124
Stock-based compensation	11	–	–	658,620	–	–	–	658,620
Net loss		–	–	–	–	–	(12,417,570)	(12,417,570)
Balance at July 31, 2017		**76,192,990**	**$ 45,159,336**	**$ 1,561,587**	**$ 3,728,255**	**$ 1,774,880**	**$ (19,784,568)**	**$ 32,439,490**

Outstanding number of shares has been retrospectively adjusted to reflect a share exchange in connection with the Qualifying Transaction (Note 1) six common shares of the Company for every one share of The Hydropothecary Corporation, which was effected in March 2017.

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

Consolidated Statements of Cash Flows

(in Canadian dollars)

For the years ended	Note	**July 31, 2018**	July 31, 2017
Operating activities			
Net loss and comprehensive loss		**$ (23,349,799)**	$ (12,417,570)
Items not affecting cash			
Amortization of property, plant and equipment	8	**895,714**	359,967
Amortization of intangible assets	9	**765,238**	231,685
Loss on disposal of property, plant and equipment		**–**	56,356
Unrealized revaluation gain on biological assets	7	**(7,339,566)**	(5,663,161)
Foreign exchange		**–**	(119,429)
Fair value adjustment on inventory sold		**2,288,975**	–
Stock-based compensation	11	**4,996,513**	658,620
Non-cash interest expense		**312,043**	198,533
Accretion of convertible debt	10	**1,368,014**	201,447
RTO listing expense		**–**	796,475
Revaluation of foreign currency denominated warrants		**5,091,460**	9,169,275
Changes in non-cash operating working capital items			
Trade receivables		**(292,389)**	692,158
Commodity taxes recoverable		**(3,741,682)**	(512,221)
Prepaid expenses		**(4,003,016)**	(160,044)
Inventory		**(2,502,567)**	1,121,828
Accounts payable and accrued liabilities		**3,399,059**	75,034
Interest payable	10	**(72,511)**	–
Cash and cash equivalents used in operating activities		**(22,184,514)**	(5,311,047)
Financing activities			
Issuance of units	11	**149,500,000**	503,717
Issuance of common shares – Private Placement	11	**–**	5,000,002
Issuance of common shares – Concurrent Financing	11	**–**	15,007,501
Issuance of common shares – RTO	10	**–**	647,214
Issuance of secured convertible debentures	10	**69,000,000**	4,403,893
Issuance costs	11	**(10,305,552)**	(3,239,937)
Exercise of stock options		**589,854**	32,252
Exercise of warrants		**74,366,104**	716,926
Issuance of unsecured convertible debentures	9	**–**	25,100,000
Cash provided by financing activities		**283,150,406**	48,171,568
Investing activities			
Acquisition of short-term investment	5	**(202,575,280)**	(2,871,550)
Convertible note receivable	13	**(10,000,000)**	–
Acquisition of property, plant and equipment	8	**(45,721,503)**	(3,105,919)
Purchase of intangible assets	9	**(1,780,244)**	(361,683)
Cash used in investing activities		**(260,077,027)**	(6,339,152)
Decrease in cash and cash equivalents		**888,865**	36,521,369
Cash and cash equivalents, beginning of year		**38,452,823**	1,931,454
Cash and cash equivalents, end of year		**$ 39,341,688**	$ 38,452,823

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

Notes to the Consolidated Financial Statements

For the fiscal years ended July 31, 2018 and 2017
(in Canadian dollars)

1. Description of Business

HEXO Corp. (formerly The Hydropothecary Corporation), formerly BFK Capital Corp. (the "Company"), has one wholly owned subsidiary, HEXO Operations Inc. (formerly 10074241 Canada Inc.) ("HOI"). HOI has three wholly owned subsidiaries: 167151 Canada Inc., Banta Health Group and Coral Health Group (together "HEXO"). HEXO is a producer of cannabis and its site is licensed by Health Canada for production and sale. Its head office is located at 240 – 490 Boulevard Sainte-Joseph, Gatineau, Quebec, Canada. The Company is a publicly traded corporation, incorporated in Ontario. The Company's common shares are listed on the Toronto Stock Exchange ("TSX"), under the trading symbol "HEXO".

The Company was incorporated under the name BFK Capital Corp. by articles of incorporation pursuant to the provisions of the *Business Corporations Act* (Ontario) on October 29, 2013, and after completing its initial public offering of shares on the TSX-V on November 17, 2014, it was classified as a Capital Pool Corporation as defined in policy 2.4 of the TSX-V. The principal business of the Company at that time was to identify and evaluate businesses or assets with a view to completing a qualifying transaction (a "Qualifying Transaction") under relevant policies of the TSX-V. The Company had one wholly-owned subsidiary, HOI, which was incorporated with the sole purpose of facilitating a future Qualifying Transaction.

On March 15, 2017, the Company completed its Qualifying Transaction which was effective pursuant to an agreement between the Company and the legacy entity, The Hydropothecary Corporation ("Hydropothecary"). As part of the Qualifying Transaction, the Company changed its name to The Hydropothecary Corporation and consolidated its 2,756,655 shares on a 1.5 to 1 basis to 1,837,770. Following this change, Hydropothecary amalgamated with 10100170 Canada Inc., which resulted in the creation of a new entity, 10074241 Canada Inc. ("HOI"). In connection with that amalgamation, HEXO acquired all of the issued and outstanding shares of the Company and the former shareholders of Hydropothecary received a total of 68,428,824 post-consolidation common shares. Immediately following closing, the Company had a total 70,266,594 common shares outstanding.

Upon closing of the transaction, the shareholders of Hydropothecary owned 97.4% of the common shares of the Company, and as a result, the transaction is considered a reverse acquisition of the Company by Hydropothecary. For accounting purposes, Hydropothecary is considered the acquirer and the Company is considered the acquiree. Accordingly, the annual consolidated financial statements are in the name of HEXO Corp. (formerly BFK Capital Corp.); however, they are a continuation of the financial statements of Hydropothecary. Additional information on the transaction is disclosed in Note 4.

Shareholder approval of the Company's name change to HEXO Corp. formerly The Hydropothecary Corporation occurred August 28, 2018. See subsequent event details as presented in Note 24.

2. Basis of Presentation

Statement of Compliance

The annual consolidated financial statements have been prepared in compliance with International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS").

These annual consolidated financial statements were approved and authorized for issue by the Board of Directors on October 25, 2018.

Basis of Measurement and Consolidation

The annual consolidated financial statements have been prepared on a historical cost basis except for cash and cash equivalents, short-term investments, biological assets, convertible note receivable, the warrant liability, and unsecured debenture conversion liability, which are measured at fair value on a recurring basis and include the accounts of the Company and entities controlled by the Company and its subsidiaries. They include its wholly owned subsidiary, HOI (formerly 10074241 Canada Inc.). They also include 167151 Canada Inc., Banta Health Group and Coral Health Group, three wholly owned subsidiaries of HEXO Operations Inc. They also include the accounts of 8980268 Canada Inc., a company for which HOI holds a right to acquire the outstanding shares at any time for a nominal amount. All subsidiaries are located in Canada.

Historical cost is the fair value of the consideration given in exchange for goods and services based upon the fair value at the time of the transaction of the consideration provided.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these annual consolidated financial statements is determined on such a basis, except for share-based payment transactions that are within the scope of IFRS 2, S*hare-Based Payment,* and measurements that have some similarities to fair value but are not fair value, such as net realizable value in IAS 2, *Inventories*.

In addition, for financial reporting purposes, fair value measurements are categorized into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

Level 1 – inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;

Level 2 – inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and

Level 3 – inputs are unobservable inputs for the asset or liability.

The preparation of these annual consolidated financial statements requires the use of certain critical accounting estimates, which requires management to exercise judgment in applying the Company's accounting policies. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to these annual consolidated financial statements, have been set out in Note 3.

Functional and Presentation Currency

These annual consolidated financial statements are presented in Canadian dollars, the functional currency of the Company and its subsidiaries.

3. Significant Accounting Policies

(a) Foreign Currency Translation

Foreign currency transactions are translated into Canadian dollars at exchange rates in effect on the date of the transactions. Monetary assets and liabilities denominated in foreign currencies at the consolidated statement of financial position date are translated to Canadian dollars at the foreign exchange rate applicable at that date. Realized and unrealized exchange gains and losses are recognized through profit or loss.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

(b) Cash and Cash Equivalents

Cash and cash equivalents are comprised of cash and highly liquid investments that are readily convertibles into known amounts of cash with original maturities of three months or less.

(c) Short-Term Investments

Short-term investments are comprised of liquid investments with maturities between three and 12 months. Short-term investments are recognized initially at fair value and subsequently adjusted to fair value through profit or loss.

(d) Biological Assets

The Company measures biological assets consisting of cannabis plants using the income approach at fair value less costs to sell up to the point of harvest, which becomes the basis for the cost of finished goods inventories after harvest. Biological assets are considered Level 3 fair value estimates. The Company capitalizes all the direct and indirect costs as incurred related to the biological transformation of the biological assets between the point of initial recognition and the point of harvest including labour-related costs, grow consumables, materials, utilities, facilities costs, quality and testing costs. The identified capitalized direct and indirect costs of biological assets are subsequently recorded within the line item "cost of goods sold" on the statement of loss and comprehensive loss in the period that the related product is sold. Unrealized gains or losses arising from changes in fair value less cost to sell during the year are included in the results of operations and presented on a separate line of statement of comprehensive loss of the related year.

(e) Inventory

Inventory is valued at the lower of cost and net realizable value. Cost is determined using the weighted average method. Inventories of harvested cannabis are transferred from biological assets at their fair value at harvest, which becomes the initial deemed cost of the inventory. Any subsequent post-harvest costs are capitalized to inventory to the extent that cost is less than net realizable value. Subsequent costs include materials and labour involved in manicuring, drying, testing, irradiation, packaging and quality assurance. The identified capitalized direct and indirect costs related to inventory are subsequently recorded within cost of goods sold on the statement of loss and comprehensive loss at the time the product is sold, with the exclusion of realized fair value amounts included in inventory sold, which are recorded as a separate line within gross margin before amortization on the statement of loss and comprehensive loss. Net realizable value is determined as the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale. Packaging and supplies are initially valued at cost and subsequently at the lower of cost and net realizable value.

(f) Property, Plant and Equipment

Property, plant and equipment is measured at cost less accumulated amortization and impairment losses. Amortization is provided using the following terms and method:

Land	Not amortized	No term
Buildings	Straight line	5 to 20 years
Leasehold improvements	Straight line	Lease term
Furniture and equipment	Straight line	5 years
Cultivation and production equipment	Straight line	5 to 20 years
Vehicles	Straight line	5 years
Computers	Straight line	3 years
Construction in progress	Not amortized	No term

An asset's residual value, useful life and amortization method are reviewed at each financial year and adjusted if appropriate. When parts of an item of equipment have different useful lives, they are accounted for as separate items (major components) of property, plant and equipment.

Gains and losses on disposal of an item of equipment are determined by comparing the proceeds from disposal with the carrying amount of the equipment and are recognized in profit or loss.

Construction in progress is transferred to property, plant and equipment when the assets are available for use and amortization of the assets commences at that point.

(g) Finite Life Intangible Assets

Finite life intangible assets are recorded at cost less accumulated amortization and accumulated impairment losses. Amortization is provided on a straight-line basis over the following terms:

Domain names	10 years
Health Canada licenses	20 years
Software	3 to 5 years

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

(h) Investments at Cost

Investments in equity instruments that do not have a quoted price in an active market and whose fair value cannot be reliably measured are recorded at cost.

(i) Impairment of Long-Lived Assets

Long-lived assets, including property, plant and equipment and intangible assets, are reviewed for impairment at the end of each financial reporting period or whenever events or changes in circumstances indicate that the carrying amount of an asset exceeds its recoverable amount. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash-generating unit, or "CGU"). The recoverable amount of an asset or a CGU is the higher of its fair value, less costs of disposal, and its value in use. If the carrying amount of an asset exceeds its recoverable amount, an impairment charge is recognized immediately in profit or loss by the amount by which the carrying amount of the asset exceeds the recoverable amount. Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimate of recoverable amount, and the carrying amount that would have been recorded had no impairment loss been recognized previously.

(j) Leased Assets

Leases are classified as an operating lease whenever the terms of the lease do not transfer substantially all of the risks and rewards of ownership to the lessee. Lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which the economic benefits are consumed.

(k) Revenue Recognition

The Company only ships product when there is a reasonable expectation of payment from the customer. Accordingly, the Company recognizes revenue at the fair value when it has transferred the significant risks and rewards of ownership to its customers, the collection of payment is reasonably assured, and the amount receivable is fixed or determinable.

(l) Cost of Goods Sold

Cost of goods sold includes cost of inventory expensed, packaging costs, shipping costs and related labour.

(m) Research and Development

Research costs are expensed as incurred. Development expenditures are capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Company intends to and has sufficient resources to complete development to use or sell the asset. Other development expenditures are recognized in profit and loss as incurred. To date, no development costs have been capitalized.

(n) Income Taxes

The Company uses the liability method to account for income taxes. Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the carrying amounts of existing assets and liabilities for accounting purposes, and the irrespective tax bases. Deferred income tax assets and liabilities are measured using tax rates that have been enacted or substantively enacted applied to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in statutory tax rates is recognized in profit or loss in the year of change. Deferred income tax assets are recorded when their recoverability is considered probable and are reviewed at the end of each reporting period.

(o) Share-Based Compensation

The Company has an employee stock option plan. The Company measures equity settled share-based payments based on their fair value at the grant date and recognizes compensation expense over the vesting period based on the Company's estimate of equity instruments that will eventually vest. Forfeitures are adjusted for on an actual basis. The impact of the revision of the original estimate is recognized in profit or loss such that the cumulative expense reflects the revised estimate. The number of vested options ultimately exercised by holders does not impact the expense recorded in any period. For stock options granted to non-employees, the compensation expense is measured at the fair value of goods and services received except where the fair value cannot be estimated, in which case it is measured at the fair value of the equity instruments granted. The fair value of share-based compensation to non-employees is periodically remeasured until counterparty performance is complete, and any change therein is recognized over the period and in the same manner as if the Company had paid cash instead of paying with or using equity instruments. Consideration paid by employees or non-employees on the exercise of stock options is recorded as share capital and the related share-based compensation is transferred from share-based payment reserve to share capital.

(p) Loss per Share

Loss per common share represents loss for the period attributable to common shareholders divided by the weighted average number of common shares outstanding during the year. Diluted loss per common share is calculated by dividing the applicable loss for the year by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued during the year.

(q) Borrowing Costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

All other borrowing costs are recognized in profit or loss in the period which they are incurred.

(r) Financial Instruments

Financial assets are classified into one of four categories: fair value through profit and loss ("FVTPL"), held-to-maturity ("HTM"), available for sale ("AFS"), and loans and receivable.

(i) FVTPL FINANCIAL ASSETS

Financial assets are classified as FVTPL when the financial asset is held for trading or it is designated as FVTPL. Financial assets classified as FVTPL are stated at fair value with any resulting gain or loss recognized in the consolidated statements of loss. Transaction costs are expensed as incurred. The fair values of financial assets in this category are determined by reference to active market transactions or by using a valuation technique where no active market exists.

(ii) HTM INVESTMENTS

HTM investments are non-derivative financial assets with fixed or determinable payments and fixed maturity other than loans and receivables. Investments are classified as HTM if the Company has the intention and ability to hold them until maturity. HTM investments are recognized on a trade-date basis and are initially measured at fair value, including transaction costs, and subsequently at amortized cost using the effective interest method.

(iii) AFS FINANCIAL ASSETS

AFS financial assets are those non-derivative financial assets that are designated as available for sale or are not classified in any of the other categories. Gains and losses arising from changes in fair value are recognized in other comprehensive income. When the asset is disposed of or is determined to be impaired, the cumulative gain or loss recognized in other comprehensive income is reclassified from the equity reserve to profit or loss.

(iv) LOANS AND RECEIVABLES

Loans and receivables are non-derivative financial assets having fixed or determinable payments that are not quoted in an active market. They are initially recognized at the transaction value and subsequently carried at amortized cost using the effective interest method less any impairment losses. Discounting is omitted where the effect of discounting is immaterial.

(v) FINANCIAL LIABILITIES AND OTHER FINANCIAL LIABILITIES

Financial liabilities are classified as either financial liabilities at FVTPL or other financial liabilities. Financial liabilities at FVTPL are stated at fair value, with changes being recognized through the consolidated statements of loss. The fair values of financial liabilities at FVTPL are determined by reference to active market transactions or by using a valuation technique where no active market exists. Other financial liabilities are initially measured at fair value, net of transaction costs, and are subsequently measured at amortized cost using the effective interest method.

(vi) CLASSIFICATION OF FINANCIAL INSTRUMENTS

The Company classifies its financial assets and liabilities depending on the purpose for which the financial instruments were acquired, their characteristics, and management intent as outlined below:

Instrument	Classification	Level	Fair value method
Cash and cash equivalents	FVTPL	Level 1	Carrying amount (approximates fair value due to short-term nature)
Short-term investments	FVTPL	Level 1	Carrying amount (approximates fair value due to short-term nature)
Trade receivables	Loans and receivables	n/a	Carrying amount (approximates fair value due to short-term nature)
Convertible note receivable	FVTPL	Level 2	Discounted cash flow model
Accounts payable and accrued liabilities	Other financial liabilities	n/a	Carrying amount (approximates fair value due to short-term nature)
Convertible debentures	Other financial liabilities	Level 2	Black-Scholes-Merton model
Warrant liability	FVTPL	Level 1	Black-Scholes-Merton model

There have been no transfers between fair value levels during the current year and prior year. There were no unrealized or realized gains or losses related to changes in fair value levels.

(vii) EMBEDDED DERIVATIVES

Derivatives are initially measured at fair value in conjunction with the host contract; no bifurcation is performed, and any directly attributable transaction costs are recognized in profit or loss as incurred. Subsequent to initial recognition, the entire instrument, including the embedded derivative, is measured at fair value and changes therein are recognized in profit or loss. The Company has a convertible loan receivable whereby the balance can be converted into equity. See Note 13 for transaction and valuation details.

(viii) COMPOUND INSTRUMENTS

The component parts of compound instruments (convertible debentures) issued by the Company are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. A conversion option that will be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Company's own equity instruments is an equity instrument.

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible instruments. This amount is recorded as a liability on an amortized cost basis using the effective interest rate method until extinguished upon conversion or at the instrument's maturity date.

The conversion option classified as equity is determined by deducting the amount of the liability component from the fair value of the compound instrument as a whole. This is recognized and included in equity, and is not subsequently remeasured. In addition, the conversion option classified as equity will remain in equity. No gain or loss is recognized in profit or loss upon conversion or expiration of the conversion option.

Transaction costs that relate to the issue of the convertible debentures are allocated to the liability and equity components in proportion to the allocation of the gross proceeds. Transaction costs relating to the equity component are recognized directly in equity. Transaction costs relating to the liability component are included in the carrying amount of the liability component and are amortized over the term of the convertible debentures using the effective interest method.

For compound instruments with non-equity derivatives, the fair value of the embedded derivative is determined first based on the contractual terms, and the initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.

(ix) EFFECTIVE INTEREST METHOD

The effective interest method is a method of calculating the amortized cost of a financial instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

(x) TRANSACTION COSTS

Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

(xi) IMPAIRMENT OF FINANCIAL ASSETS

Financial assets, other than those classified at fair value through profit and loss, are assessed for indicators of impairment at the end of the reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

(s) Critical Accounting Estimates and Judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

VALUATION OF BIOLOGICAL ASSETS AND INVENTORY

In calculating the value of the biological assets and inventory, management is required to make a number of estimates, including estimating the stage of growth of the cannabis, harvesting costs, selling costs, sales price and expected yields for the cannabis plant. In calculating final inventory values, management is required to determine an estimate of spoiled or expired inventory and compares the inventory cost versus net realizable value.

ESTIMATED USEFUL LIVES AND AMORTIZATION OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS

Amortization of property, plant and equipment and intangible assets are dependent upon estimates of useful lives, which are determined through the exercise of judgment. The assessment of any impairment of these assets is dependent upon estimates of recoverable amounts that take into account factors such as economic and market conditions and the useful lives of assets.

SHARE-BASED COMPENSATION

In calculating the share-based compensation expense, key estimates such as the value of the common share, the rate of forfeiture of options granted, the expected life of the option, the volatility of the Company's stock price and the risk-free interest rate are used.

WARRANTS

In calculating the value of the warrants, key estimates such as the value of the common share, the expected life of the warrant, the volatility of the Company's stock price and the risk-free interest rate are used.

All broker/compensation warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be reliably measured.

PROVISIONS

Provisions are recognized when the Company has a present obligation, legal or constructive, as a result of a previous event, if it is probable that the Company will be required to settle the obligation and a reliable estimate can be made of the obligation. The amount recognized is the best estimate of the expenditure required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligations. Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate of the expected future cash flows.

ALLOCATION OF PURCHASE PRICE

In determining the allocation of the purchase price, estimates are used based on market research and appraisal values.

CONVERTIBLE NOTE RECEIVABLE

The fair value of the convertible note receivable is determined using valuation techniques. The Company uses judgment to select the methods used to make certain assumptions and in performing the fair value calculations in order to determine the values attributed to the instrument at the time of their issuance and the subsequent measurement at fair value on a recurring basis. These valuation estimates could be significantly different because of the use of judgment and the inherent uncertainty in estimating the fair value of the convertible note receivable that are not quoted in an active market.

(t) Changes to Accounting Standards and Interpretations

NEW AND REVISED IFRS IN ISSUE BUT NOT YET EFFECTIVE

IFRS 9, Financial Instruments

IFRS 9 was issued by the International Accounting Standards Board ("IASB") in November 2009 and October 2010 and will replace IAS 39. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Two measurement categories continue to exist to account for financial liabilities in IFRS 9, fair value through profit or loss ("FVTPL") and amortized cost. Financial liabilities held for trading are measured at FVTPL, and all other financial liabilities are measured at amortized cost unless the fair value option is applied. The treatment of embedded derivatives under the new standard is consistent with IAS 39 and is applied to financial liabilities and non-derivative hosts not within the scope of the standard. The Company will adopt IFRS 9 effective August 1, 2018. The Company has completed its assessment of the impact of this new standard. Investments currently measured at cost will be measured at FVTPL, and the Company expects no significant changes as a result of this or elsewhere in the application of the new standard.

IFRS 7, Financial Instruments: Disclosure

IFRS 7, *Financial Instruments: Disclosure*, was amended to require additional disclosures on transition from IAS 39 to IFRS 9. IFRS 7 is effective on adoption of IFRS 9, which is effective for annual periods commencing on or after January 1, 2018. The Company intends to adopt the amendments to IFRS 7 on August 1, 2018 and does not expect the implementation will result in a significant effect to the financial statements.

IFRS 15, Revenue from Contracts with Customers

IFRS 15 was issued by the IASB in May 2014 and specifies how and when revenue should be recognized based on a five-step model, which is applied to all contracts with customers. On April 12, 2016, the IASB published final clarifications to IFRS 15 with respect to identifying performance obligations, principal versus agent considerations, and licensing. The Company will adopt IFRS 15 effective August 1, 2018. The Company has completed its assessment of the impact of this new standard and has noted beyond the required additional disclosures, there exist no material changes to the financial statements or required retroactive adjustments to the retained earnings.

IFRS 16, Leases

IFRS 16 was issued by the IASB in January 2016, and specifies the requirements to recognize, measure, present and disclose leases. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with early adoption permitted.

The Company is assessing the impact of the new or revised IFRS standard in issue but not yet effective on its consolidated financial statements.

4. Reverse Acquisition

On March 15, 2017, BFK Capital Corp. completed its Qualifying Transaction, which was effected pursuant to an agreement between BFK Capital Corp. and Hydropothecary. Pursuant to the agreement, BFK Capital Corp. acquired all of the issued and outstanding shares of Hydropothecary. The former shareholders of Hydropothecary received an aggregate of 68,428,824 post-consolidation common shares of BFK Capital Corp. for all the outstanding Hydropothecary common shares.

The transaction was a reverse acquisition of BFK Capital Corp. and has been accounted for under IFRS 2, *Share-Based Payment*. Accordingly, the transaction has been accounted for at the fair value of the equity instruments granted by the shareholders of Hydropothecary to the shareholders and option holders of BFK Capital Corp. The difference between the fair value of the consideration (including the outstanding options) and the fair value of BFK Capital Corp.'s net assets has been recognized as a listing expense in the consolidated statements of comprehensive loss for the fiscal year ended July 31, 2017. The options were valued using the Black-Scholes-Merton option pricing model with the following variables: share price of $0.75; expected life of two years; $Nil dividends; 100% volatility; and risk-free interest rate of 1.34%. Additional legal and consulting fees of $154,549 were incurred to complete the transaction.

The results of operations of BFK Capital Corp. are included in the condensed interim consolidated financial statements of HEXO from the date of the reverse acquisition, March 15, 2017.

The following represents management's estimate of the fair value of the net assets acquired and total consideration transferred at March 15, 2017 as a result of the reverse acquisition.

Fair value of BFK shares prior to transaction (1,837,770 at $0.75 per share)	$	1,378,332
Options		70,253
Total consideration transferred		1,448,585
Net assets acquired		(652,110)
Excess attributed to cost of listing		796,475
Professional, consulting and other fees		154,549
RTO listing expense	$	951,024
Net assets acquired include:		
Cash	$	647,214
Prepaid expense		4,896
Total net assets acquired	$	652,110

5. Short-Term Investments

Short-term investments consist of in various guaranteed investment certificates, term deposits, and fixed income securities that mature on dates between January 27, 2019 and June 21, 2019 with annual interest rates ranging from 0.45% to 2.30%.

Short-term investments are comprised of liquid investments with maturities of less than 12 months. Short-term investments are recognized initially at fair value and subsequently adjusted to fair value through profit or loss. The Company intends to hold the high interest savings funds for a period greater than three months. Short-term investments contain restricted funds of $3,117,000 due to a held letter of credit (see Note 19).

	Interest rate	Maturity date	**July 31, 2018**	July 31, 2017
Guaranteed investment certificates	0.45%–0.5%	January 27, 2019 to June 21, 2019	**$ 712,284**	$ 2,871,550
Term deposits	1.2%–1.75%	To desired term	**49,483,945**	–
High interest savings accounts	1.4%–4.25%	April 26, 2019 to desired term	**155,250,602**	–
			$ 205,446,830	$ 2,871,550

6. Inventory

	July 31, 2018			July 31, 2017
	Capitalized cost	Biological asset fair value adjustment	Total	Total
Dried cannabis	**$ 2,115,464**	**$ 4,440,195**	**$ 6,555,659**	$ 3,517,609
Oils	**2,280,780**	**881,432**	**3,162,212**	106,893
Packaging and supplies	**696,753**	**–**	**696,753**	64,737
	$ 5,092,997	**$ 5,321,627**	**$ 10,414,624**	$ 3,689,239

The inventory expensed to cost of goods sold in the year ended July 31, 2018 was $964,956 (July 31, 2017 – $952,968).

Included in inventory expensed to cost of goods sold is the fair value adjustment on the sale of inventory of $2,288,975 for the year ended July 31, 2018 (July 31, 2017 – $576,872).

During the year ended July 31, 2018, the Company recorded an adjustment to the net realizable value of inventories of $1,491,070 (July 31, 2017 – $Nil). This was due to the decrease in the estimated market selling price input of the inventory valuation which was caused by the onset of the adult-use market and is reflective of competitive market prices.

During the year ended July 31, 2017, the Company recorded a write-down of inventories in the amount of $613,074, of which $494,810 related to the Company's voluntary recall and $118,264 as a result of a flood at the Company's facility.

7. Biological Assets

The Company's biological assets consist of cannabis plants, from seeds all the way through to mature plants. The changes in the carrying value of biological assets are as follows:

	July 31, 2018	July 31, 2017
Carrying amount, beginning of period	**$ 1,504,186**	$ 120,667
Production costs capitalized	**993,469**	659,339
Net increase in fair value due to biological transformation less cost to sell	**7,339,566**	5,003,822
Transferred to inventory upon harvest	**(7,505,262)**	(4,279,642)
Carrying amount, end of period	**$ 2,331,959**	$ 1,504,186

As at July 31, 2018, the fair value of biological assets included $6,200 in seeds and $2,325,759 in cannabis plants ($6,200 in seeds and $1,497,986 in cannabis plants as at July 31, 2017). The significant estimates used in determining the fair value of cannabis plants are as follows:

- yield by plant;
- stage of growth estimated as the percentage of costs incurred as a percentage of total cost as applied to the estimated total fair value per gram (less fulfillment costs) to arrive at an in-process fair value for estimated biological assets, which have not yet been harvested;
- percentage of costs incurred for each stage of plant growth; and
- fair value selling price per gram less cost to complete and cost to sell.

All biological assets are classified as current assets on the balance sheet and are considered Level 3 fair value estimates (Note 2). As at July 31, 2018, it is expected that the Company's biological assets will yield approximately 4,373,775 grams of cannabis (July 31, 2017 – 700,169 grams of cannabis). The Company's estimates are, by their nature, subject to change. Changes in the anticipated yield will be reflected in future changes in the fair values of biological assets.

The valuation of biological assets is based on an income approach in which the fair value at the point of harvesting is estimated based on selling prices less the costs to sell. For in-process biological assets, the fair value at point of harvest is adjusted based on the stage of growth at period end. Stage of growth is determined by reference to the plant's life relative to the stages within the harvest cycle.

Management's identified significant unobservable inputs, their range of values and sensitivity analysis are presented in the table below:

Unobservable inputs	Input values	Sensitivity analysis
Average selling price		
Obtained through actual retail prices on a per strain basis	$4.66 per dried gram	An increase or decrease of 5% applied to the average selling price would result in a change of approximately $329,000 to the valuation.
Yield per plant		
Obtained through historical harvest cycle results on a per strain basis	50–235 grams per plant	An increase or decrease of 5% applied to the average yield per plant would not result in a material change in valuation.
Stage of growth		
Obtained through the estimates of stage of completion within the harvest cycle	Average of 32% completion	An increase or decrease of 5% applied to the average stage of growth per plant would result in a change of approximately $320,000 in valuation.

8. Property, Plant and Equipment

Cost	Balance at July 31, 2017	Additions	Adjustments	**Balance at July 31, 2018**
Land	$ 358,405	$ 680,315	$ –	**$ 1,038,720**
Buildings	3,744,759	3,930,217	24,860,752	**32,535,728**
Leasehold improvements	–	205,456	–	**205,456**
Furniture and equipment	900,395	1,232,613	(472,320)	**1,660,688**
Cultivation and production equipment	379,992	3,165,199	486,438	**4,031,629**
Vehicles	113,926	32,900	4,425	**151,251**
Computers	233,685	425,117	–	**658,802**
Construction in progress	605,015	39,707,253	(24,879,295)	**15,432,973**
	$ 6,336,177	$ 49,379,070	$ –	**$ 55,715,247**

Accumulated amortization	Balance at July 31, 2017	Amortization	Adjustments	**Balance at July 31, 2018**
Land	$ –	$ –	$ –	**$ –**
Buildings	194,187	338,993	–	**533,180**
Leasehold improvements	–	8,313	–	**8,313**
Furniture and equipment	165,086	195,086	167,384	**527,556**
Cultivation and production equipment	23,068	213,075	(167,384)	**68,759**
Vehicles	25,589	30,203	–	**55,792**
Computers	78,552	110,044	–	**188,596**
	$ 486,482	$ 895,714	$ –	**$ 1,382,196**
Net carrying value	$ 5,849,695			**$ 54,333,051**

As at July 31, 2018, there was $3,920,069 (July 31, 2017 – $262,502) of property, plant and equipment in accounts payable and accrued liabilities.

Buildings consist of $993,611 (July 31, 2017 – $72,000) of capitalized borrowing costs. Adjustments reflect the activation of an asset's useful life, transitioning from construction in progress to the appropriate property, plant and equipment classification. Adjustments, as well, consist of re-classifications.

Cost	Balance at July 31, 2016	Additions	Disposals	Adjustments	Balance at July 31, 2017
Land	$ 105,000	$ 253,405	$ –	$ –	$ 358,405
Buildings	917,087	1,212,399	(25,000)	1,640,273	3,744,759
Furniture and equipment	320,586	649,189	(69,380)	–	900,395
Cultivation and production equipment	–	373,249	–	6,743	379,992
Vehicles	37,537	76,389	–	–	113,926
Computers	91,298	160,147	(17,760)	–	233,685
Construction in progress	1,647,017	605,014	–	(1,647,016)	605,015
	$ 3,118,525	$ 3,329,792	$ (112,140)	$ –	$ 6,336,177

Accumulated amortization	Balance at July 31, 2016	Amortization	Disposals/ adjustments	Adjustments	Balance at July 31, 2017
Land	$ –	$ –	$ –	$ –	$ –
Buildings	54,095	146,414	(3,420)	(2,902)	194,187
Furniture and equipment	67,224	133,334	(38,292)	2,820	165,086
Cultivation and production equipment	–	23,068	–	–	23,068
Vehicles	15,535	10,054	–	–	25,589
Computers	45,445	47,097	(14,072)	82	78,552
	$ 182,299	$ 359,967	$ (55,784)	$ –	$ 486,482
Net carrying value	$ 2,936,226				$ 5,849,695

9. Intangible Assets and Other Longer-Term Assets

Cost	Balance at July 31, 2017	Additions	Disposals/ adjustments	**Balance at July 31, 2018**
ACMPR license	$ 2,544,696	$ –	$ –	**$ 2,544,696**
Software	651,247	1,148,892	–	**1,800,139**
Domain names	–	585,283	–	**585,283**
Investments held at cost	–	100,000	–	**100,000**
Capitalized transaction costs	–	211,826	–	**211,826**
	$ 3,195,943	$ 2,046,001	$ –	**$ 5,241,944**

Accumulated amortization	Balance at July 31, 2017	Amortization	Disposals/ adjustments	**Balance at July 31, 2018**
ACMPR license	$ 276,909	$ 126,181	$ –	**$ 403,090**
Software	155,270	629,302	–	**784,572**
Domain name	–	9,755	–	**9,755**
	$ 432,179	$ 765,238	$ –	**$ 1,197,417**
Net carrying value	$ 2,763,764			**$ 4,044,527**

Software includes $647,311 and $257,666 relating to an enterprise resource planning software and online sales platform, respectively, that are not yet available for use. Accordingly, no amortization has been taken during the fiscal year ended July 31, 2018. The Company expects that both assets will be fully available for use in the first quarter of fiscal 2019.

As at July 31, 2018, there was $265,757 (July 31, 2017 – $Nil) of intangible assets in accounts payable and accrued liabilities.

Capitalized transaction costs are those incurred with respect to the definitive agreement to form a joint venture subsequent to the year ended July 31, 2018 (Note 24).

Cost	Balance at July 31, 2016	Additions	Disposals/ adjustments	Balance at July 31, 2017
ACMPR license	$ 2,544,696	$ –	$ –	$ 2,544,696
Software	289,564	361,683	–	651,247
Domain names	6,596	–	(6,596)	–
	$ 2,840,856	$ 361,683	$ (6,596)	$ 3,195,943

Accumulated amortization	Balance at July 31, 2016	Amortization	Disposals/ adjustments	Balance at July 31, 2017
ACMPR license	$ 149,008	127,901	$ –	$ 276,909
Software	51,486	103,784	–	155,270
Domain name	6,596	–	6,596	–
	$ 207,090	$ 231,685	$ 6,596	$ 432,179
Net carrying value	$ 2,633,766			$ 2,763,764

During the fiscal year ended July 31, 2018, the Company conducted a review of its intangible assets, which resulted in changes in the expected usage of its software. Certain assets, which management previously intended to use for five years from the date of purchase, were replaced during the fiscal year as well as September 2018. As a result, the expected useful lives of these assets decreased. The effect of these changes on actual and expected depreciation expense, in current and future years, respectively, is as follows.

	2018	2019	2020	2021	2022	Later
(Decrease) increase in amortization expense	$ 309,253	$ (87,478)	$ (119,136)	$ (99,874)	$ (2,765)	$ –

10. Convertible Debentures

	2016 unsecured convertible debentures	2017 secured convertible debentures	2017 unsecured convertible debentures 8%	2017 unsecured convertible debentures 7%	Total
Balance at July 31, 2016	306,205	–	–	–	**306,205**
Gross proceeds	–	4,403,893	25,100,000	–	**29,503,893**
Issuance costs	–	(718,661)	(1,703,602)	–	**(12,422,263)**
Warrants, net of issuance costs	–	(461,065)	(1,084,433)	–	**(1,545,478)**
Conversion feature, net of issuance costs	–	(557,009)	(1,742,779)	–	**(2,299,788)**
Accretion	35,919	215,875	69,744	–	**321,538**
Foreign exchange	–	(119,429)	–	–	**(119,429)**
Conversion of debenture	(132,124)	(2,763,624)	–	–	**(3,105,748)**
Balance at July 31, 2017	–	–	20,638,930	–	**20,638,930**
Gross proceeds	–	–	–	69,000,000	**69,000,000**
Issuance costs	–	–	–	(4,791,642)	**(4,791,642)**
Warrants, net of issuance costs	–	–	–	(3,284,648)	**(3,284,648)**
Conversion feature, net of issuance costs	–	–	–	(6,777,317)	**(6,777,317)**
Accretion	–	–	814,304	553,710	**1,368,014**
Conversion of debenture	–	–	(21,453,234)	(54,700,103)	**(76,153,337)**
Balance at July 31, 2018	–	–	–	–	**–**

2016 Unsecured Convertible Debentures

In March 2017, debenture holders converted their debentures to equity. The debentures had a book value of $342,124 ($345,000 face value) and contributed surplus (equity component) of $57,500. The conversion resulted in the issuance of 459,990 units at a price of $0.75 per unit. The 459,990 warrants issued were valued at $69,220 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.60; expected life of two years; $Nil dividends; 64.5% volatility; and risk-free interest rate of 0.59%. Accordingly, share capital was increased at the date of conversion by the carrying value of the debentures of $342,124, which included $35,919 of accreted interest.

2017 Secured Convertible Debentures

In November 2016, the Company issued $4,403,893 (US$3,275,000) principal amount of secured debentures through a brokered private placement. The debentures bear interest at 8% per annum and mature on December 31, 2019. Interest for the first year of the term of the debentures will be accrued and paid in arrears, following which, interest will be accrued and paid quarterly in arrears. The debentures are convertible into common shares of the Company at US$0.70 at the option of the holder. The debentures will automatically convert to common shares after the Company becomes a reporting issuer on a Canadian or United States exchange and maintains a volume weighted average trading price equal to or exceeding the conversion price of the debentures for 15 days. The obligations of the Company under the debentures are secured by a first priority security interest against all of the assets of the Company. The debenture holders received 2,339,208 warrants, one for every two common shares that would be issued assuming full conversion of the debentures. The warrants have a three-year term, expiring November 13, 2019, and have an exercise price of US$0.76.

The Company identified embedded derivatives related to the above described debentures. These embedded derivatives included variable conversion feature liability and the warrant liability. The accounting treatment of the derivative financial instruments requires that the Company record the fair value of the derivatives as at the inception date of the debentures and to fair value as at each subsequent reporting date.

The Company allocated the proceeds first to the warrant liability and the conversion feature liability based on their fair value, and the residual proceeds represented the fair value of the debentures. The fair values of the embedded derivatives were determined using the Black-Scholes-Merton option pricing model.

The warrant liability was valued with a fair value of $550,955 (US$409,723) using the following assumptions:

- stock price of $0.75 (US$0.56);
- exchange rate of 1.3447;
- expected life of three years;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 1.25%.

The conversion feature liability was initially valued with a fair value of $665,632 (US$495,004) using the following assumptions:

- stock price of $0.75 (US$0.56);
- expected life of 15 months;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 1.25%.

The residual proceeds of $3,187,306 (US$2,370,273) represent the fair value of the debenture.

In connection with the closing of the debentures, the Company paid a placement agent fee of $560,152 (US$416,563) from the gross proceeds of the financing and incurred an additional $62,996 of financing costs. The Company also issued broker warrants exercisable to acquire 62,381 common shares at an exercise price of US$0.70 per share.

The broker warrants were attributed a fair value of $95,513 (US$71,029) based on the Black-Scholes-Merton option pricing model with the following assumptions:

- stock price of $0.75 (US$0.56);
- expected life of three years;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 1.25%.

The total financing costs amounted to $718,661 and were allocated on a pro-rata basis as follows: debenture – $520,128, conversion liability – $108,623, and warrant liability – $89,910. The issue costs allocated to the conversion feature liability and the warrant liability, totalling $198,533, were included in financing charges on the statement of comprehensive loss.

Pursuant to the debenture agreement, on April 11, 2017 ("the date of conversion") the debentures automatically converted to 4,678,494 common shares at a conversion price of US$0.70 after the Company became a reporting issuer on the TSX-V and by maintaining a volume weighted average trading price equal to or exceeding the conversion price of the debentures for 15 days.

Up to and including the date of conversion, the accreted interest on the debentures was $145,628 (US$109,232), and $70,247 for the deferred financing fees, for the fiscal year ended July 31, 2017; both are recorded as interest expense on the statement of comprehensive loss. Additionally, as the debentures are a monetary liability, they were re-translated on the date of conversion, resulting in a value of $3,213,505 (US$2,261,041), and a foreign exchange gain of $119,429 was recorded in foreign exchange on the statement of comprehensive loss. Accordingly, the debentures at the date of conversion were valued at $2,763,624, which consisted of the debenture value of $3,213,505 less unamortized financing fees of $449,881.

The conversion liability was revalued on the date of conversion using the Black-Scholes-Merton option pricing model. The conversion liability was revalued to $8,807,287 (US$6,606,126):

- stock price of $2.79 converted to US$2.09;
- expected life of 12.6 months;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 1.25%;
- USD/CAD exchange rate of 1.3332.

Accordingly, the loss on the revaluation of the conversion liability was $8,141,655, which is recorded in the revaluation of financial instruments account on the statement of comprehensive loss. Therefore, on April 11, 2017, the conversion of the debentures and the corresponding conversion liability resulted in an increase to share capital of $11,570,911 for the 4,678,494 common shares issued.

During the fiscal year ended July 31, 2017, 285,708 of the warrants were exercised, for total proceeds of $292,302 (US$217,138, based on an exercise price of US$0.76). On the various dates of exercise, the warrant liability was revalued using the Black-Scholes-Merton option pricing model. Overall, the value of the warrants exercised was $222,988 (US$165,182) using the following variables: stock price of US$1.26–$1.32; expected life of 12 months; $Nil dividends; 60% volatility; risk-free interest rate of 1.25%; and USD/CAD exchange rate of 1.3490–1.3503. The exercise of these warrants resulted in an increase to share capital of $515,290.

During the fiscal year ended July 31, 2018, 1,124,958 warrants were exercised, for total proceeds of $1,076,576 (US$844,828, based on an exercise price of US$0.76). On the various dates of exercise, the warrant liability was revalued using the Black-Scholes-Merton option pricing model. Overall, the liability value of the warrants exercised was $3,317,278 (US$2,633,514) using the following variables:

- stock price of various;
- expected life of 12 months;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 0.75%;
- USD/CAD exchange rate of various.

The exercise of these warrants resulted in an increase to share capital of $4,393,854.

The remaining warrant liability was revalued on July 31, 2018 using the Black-Scholes-Merton option pricing model. The warrant liability was revalued to $3,129,769 (US$2,404,370) with a stock price of US$3.34; expected life of 12 months; $Nil dividends; 60% volatility; risk-free interest rate of 0.75%; and USD/CAD exchange rate of 1.3017. The (loss)/gain on the revaluation of the warrant liability for the three and 12 months ended July 31, 2018 was $173,890 and $5,091,460, which is recorded in the revaluation of financial instruments account on the statement of comprehensive loss.

The following table summarizes warrant liability activity during the fiscal years ended July 31, 2018 and July 31, 2017.

	July 31, 2018	July 31, 2017
Opening balance	**$ 1,355,587**	$ –
Granted	**–**	–
Expired	**–**	–
Exercised	**(3,317,278)**	(7,813,688)
Revaluation due to foreign exchange	**5,091,460**	9,169,275
Closing balance	**$ 3,129,769**	$ 1,355,587

2017 Unsecured Convertible Debentures 8%

On July 18, 2017, the Company issued $25,100,000 principal amount of unsecured debentures through a brokered private placement. The debentures bear interest at 8% per annum and mature on June 30, 2019. Interest will be accrued and paid semi-annually in arrears. The debentures are convertible into common shares of the Company at $1.60 at the option of the holder. Beginning after November 19, 2017, the Company may force the conversion of the debentures on 30 days' prior written notice should the daily weighted average trading price of the common shares of the Company be greater than $2.25 for any 15 consecutive trading days. The debenture holders received 7,856,300 warrants: 313 for every $1,000 unit. The warrants have a two-year term, expiring July 18, 2019, and have an exercise price of $2.00. Beginning after November 19, 2017, the Company has the right to accelerate the expiry of the warrants should the closing trading price of the common shares of the Company be greater than $3.00 for any 15 consecutive trading days.

On initial recognition, the residual method was used to allocate the fair value of the warrants and conversion option. The fair value of the liability component was calculated as $22,066,925 using a discount rate of 16%. The residual proceeds of $3,033,075 were allocated between the warrants and conversion option on a pro-rata basis relative to their fair values. The fair values of the warrants and conversion option were determined using the Black-Scholes-Merton option pricing model.

The warrants were valued with a fair value of $1,929,098 using the following assumptions:

- stock price of $1.26;
- expected life of two years;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 1.27%.

The conversion option was valued with a fair value of $3,100,227 using the following assumptions:

- stock price of $1.26;
- expected life of one year;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 1.27%.

Based on the fair value of the warrants and conversion option, the residual proceeds of $3,033,075 were allocated as $1,163,396 to the warrants and $1,869,679 to the conversion option.

In connection with the closing of the debentures, the Company paid a placement fee of $1,292,010 from the gross proceeds of the financing and incurred an additional $218,990 of financing costs. The Company also issued broker warrants exercisable to acquire 784,375 common shares at an exercise price of $2.00 per share.

The broker warrants were attributed a fair value of $192,602 based on the Black-Scholes-Merton option pricing model with the following assumptions:

- stock price of $1.26;
- expected life of two years;
- $Nil dividends;
- 60% volatility;
- risk-free interest rate of 1.27%.

The total financing costs amounted to $1,703,602 and were allocated on pro-rata basis as follows: debt – $1,497,739, conversion option – $126,900, and the warrants – $78,963.

Pursuant to the agreement, on November 22, 2017 the Company announced that it had elected to exercise its right to convert all of the outstanding principal amount of the debentures and unpaid accrued interest thereon into common shares. The Company became entitled to force the conversion of the 8.0% Debentures on November 19, 2017 on the basis that the volume weighted average price ("VWAP") of the common shares on the TSXV for 15 consecutive trading days was equal to or exceeded $2.25. For the 15 consecutive trading days preceding November 19, 2017, the VWAP of the common shares was $2.56. The Company provided the holders of the 8.0% Debentures with the required 30 days' advance written notice of the conversion, and the effective date for the conversion was December 27, 2017.

Pursuant to the conversion of the 8.0% Debentures, holders of the 8.0% Debentures received 625 common shares for each $1,000 principal amount of 8.0% Debentures held. In addition, the accrued and unpaid interest on each $1,000 principal amount of the 8.0% Debentures for the period from issuance on July 18, 2017 to, but excluding, the conversion date was $36.00, and 8.0% Debenture holders received an additional 22.5 common shares for each $1,000 principal amount of 8.0% Debentures held on account of accrued and unpaid interest, for a total of 647.5 common shares for each $1,000 principal amount of 8.0% Debentures held at the conversion date. Accordingly, at the date of conversion, the carrying value of the debentures of $21,453,234, interest payable paid through shares of $266,219 and the conversion feature of $1,742,779 resulted in the cumulative increase to share capital of $23,462,232.

Interest expensed to the statement of loss and comprehensive loss was $417,718 and interest capitalized to property, plant and equipment was $921,611 for the year ended July 31, 2018 (2017 – $70,255 and $72,000, respectively). Accretion for the fiscal year ended July 31, 2018 was $814,304 (2017 – $69,744). During the year, the Company paid $266,219 of interest owing through shares, and $331,317 of interest owing in cash (2017 – $Nil). The accrued interest payable as at July 31, 2018 was $Nil (2017 – $72,511).

2018 UNSECURED CONVERTIBLE DEBENTURES 7%

On November 24, 2017, the Company issued $69,000,000 principal amount of unsecured debentures through a brokered private placement. The debentures bear interest at 7% per annum and mature on November 24, 2020. Interest will be accrued and paid semi-annually in arrears. The debentures were convertible into common shares of the Company at $2.20 at the option of the holder. The Company may force the conversion of the debentures on 30 days' prior written notice should the daily weighted average trading price of the common shares of the Company be greater than $3.15 for any 10 consecutive trading days. The debenture holders received 15,663,000 warrants, 227 for every $1,000 unit. The warrants have a two-year term, expiring November 24, 2019, and have an exercise price of $3.00. The Company has the right to accelerate the expiry of the warrants should the closing trading price of the common shares of the Company be greater than $4.50 for any 10 consecutive trading days.

On initial recognition, the residual method was used to allocate the fair value of the warrants and conversion option. The fair value of the liability component was calculated as $58,187,146 using a discount rate of 14%. The residual proceeds of $10,812,854 were allocated between the warrants and conversion option on a pro-rata basis relative to their fair values. The fair values of the warrants and conversion option were determined using the Black-Scholes-Merton option pricing model.

The warrants were valued with a fair value of $8,647,797 using the following assumptions:

- stock price of $2.62;
- expected life of one year;
- $Nil dividends;
- 65% volatility;
- risk-free interest rate of 1.25%.

The conversion option was valued with a fair value of $17,843,269 using the following assumptions:

- stock price of $2.62;
- expected life of three months;
- $Nil dividends;
- 65% volatility;
- risk-free interest rate of 1.25%.

Based on the fair value of the warrants and conversion option, the residual proceeds of $10,812,854 were allocated as $3,529,770 to the warrants and $7,283,084 to the conversion option, less allocation of issuance costs.

In connection with the closing of the debentures, the Company paid a placement fee of $3,450,000 from the gross proceeds of the financing and incurred an additional $475,824 of issuance costs. The Company also issued broker warrants exercisable to acquire 1,568,181 common shares at an exercise price of $3.00 per share.

The broker warrants were attributed a fair value of $865,818 based on the Black-Scholes-Merton option pricing model with the following assumptions:

- stock price of $2.62;
- expected life of one year;
- $Nil dividends;
- 65% volatility;
- risk-free interest rate of 1.25%.

The total issuance costs amounted to $4,791,642 and were allocated on pro-rata basis as follows: debt – $4,040,753, conversion option – $505,767, and the warrants – $245,122.

On December 15, 2017, the Company announced that it had elected to exercise its right to convert all of the outstanding principal amount of the Company's 7.0% Debentures and unpaid accrued interest thereon into common shares. The Company became entitled to force the conversion of the 7.0% Debentures on December 13, 2017 on the basis that the VWAP of the common shares on the TSXV for 10 consecutive trading days was equal to or exceeded $3.15. For the 10 consecutive trading days preceding December 13, 2017, the VWAP of the common shares was $3.32. The Company provided the holders of the 7.0% Debentures with the required 30 days' advance written notice of the conversion, and the effective date for the conversion was January 15, 2018.

Pursuant to the conversion of the 7.0% Debentures, holders of the 7.0% Debentures received 454.54 common shares for each $1,000 principal amount of 7.0% Debentures held. In addition, the accrued and unpaid interest on each $1,000 principal amount of the 7.0% Debentures for the period from December 31, 2017 (the interest payment scheduled for December 31, 2017 was paid in cash) up to, but excluding, the conversion date, was $2.92, and 7.0% Debenture holders received an additional 1.33 common shares for each $1,000 principal amount of 7.0% Debentures held on account of accrued and unpaid interest, for a total of 455.87 common shares for each $1,000 principal amount of 7.0% Debentures held. Accordingly, at the date of conversion, the carrying value of the debentures of $54,700,103, interest payable paid through shares of $45,824 and the conversion feature of $6,809,418 resulted in the cumulative increase to share capital of $61,555,345.

Interest expensed to the statement of loss and comprehensive loss was $1,111,690 (2017 – $Nil). Accretion for the fiscal year ended July 31, 2018 was $553,710 (2017 – $Nil). During the year, the Company paid $45,824 of interest owing through shares, and $512,156 of interest owing in cash (2017 – $Nil). The accrued interest payable as at July 31, 2018 was $Nil (2017 – $Nil).

The unsecured convertible debentures balance net of interest payable was $Nil and $20,638,930 for the fiscal years ended July 31, 2018 and July 31, 2017, respectively.

11. Share Capital

(a) Authorized

An unlimited number of common shares

(b) Issued and Outstanding

During the first quarter of fiscal 2017, the Company issued 338,274 units in a private placement at $0.75 per unit, generating gross proceeds of $253,706. A unit provides the holder with one common share and one common share purchase warrant. The warrant entitles the holder the option to buy a share at the price of $0.83 for three years from date of issuance. The value of the warrants was estimated using the Black-Scholes-Merton option pricing model with the following variables: stock price of $0.57; expected life of three years; $Nil dividends; 64.5% volatility; and risk-free interest rate of 0.60%. The value of the warrants was estimated to be $61,453. As a result, the residual value of the common shares was calculated to be $192,253.

Share issue costs relating to the equity financing in the first quarter of fiscal 2017 amounted to $6,308. $617 of the costs were related to 2,664 warrants issued that have an $0.83 exercise price and expire in five years. These warrants were issued to a broker in relation to the sale of 338,274 units. The warrants were valued using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.52; expected life of five years; $Nil dividends; 64.5% volatility; and risk-free interest rate of 0.60%. $97 of the costs were related to 798 warrants issued that have a $0.75 exercise price and expire in one year. These warrants were issued to a financing consultant in relation to a finder's fee for the sale of 13,332 units. The warrants were valued using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.63; expected life of one year; $Nil dividends; 64.5% volatility; and risk-free interest rate of 0.69%. In both cases, the warrants issued provide the holders with the option to purchase one common share.

During the second quarter of fiscal 2017, the Company issued 4,285,716 common shares at $0.58 per common share for total proceeds of $2,500,001 from a group of private investors ("Investors"). As part of the private placement, the Investors have the right to nominate up to two directors supported by an agreement between certain shareholders. The Investors have a call option to purchase another 4,285,716 common shares at a price of $0.58 per share prior to May 31, 2017. The Company also has a put option to purchase another 4,285,716 common shares at the subscription price of $0.58 prior to June 30, 2017, so long as the Company attains revenues of $3,500,000 between January 1, 2017 and May 31, 2017.

In connection with the closing of this placement, the Company incurred share issuance costs of $147,014 and issued 342,852 broker warrants with an exercise price of $0.75 and a five-year term. The warrants were valued using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.75; expected life of five years; $Nil dividends; 73.2% volatility; and risk-free interest rate of 0.75%. The value of the broker warrants was estimated to be $152,890. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

During the second quarter of fiscal year 2017, the Company completed a concurrent financing through an agent, pursuant to which it issued 17,517,042 common shares at a price of $0.75 per share for gross proceeds of $13,137,782 ("Concurrent Financing"). In connection with the closing of the Concurrent Financing, the Company paid the agent a cash commission of $803,487, equal to 7% of the gross proceeds from the Concurrent Financing, subject to a reduced commission of 3.5% for certain subscribers on a President's List of the Company. The Company also issued to the agent warrants exercisable to acquire 1,071,318 common shares, being that number of common shares as was equal to 7% of the number of common shares sold under the Concurrent Financing, subject to a reduced percentage of 3.5% for certain subscribers on the President's List, at an exercise price of $0.75 per share and a two-year term. The warrants were valued at $323,653 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.75; expected life of two years; $Nil dividends; 73.2% volatility; and risk-free interest rate of 1.25%. Additional transaction costs of $82,329 were included in share issuance costs. The Company also issued 44,940 broker warrants with an exercise price of $0.75 and a two-year term. The warrants were valued at $13,576 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.75; expected life of two years; $Nil dividends; 73.2% volatility; and risk-free interest rate of 1.25%.

These warrants were recorded as a share issuance cost in the statement of changes in shareholders' equity. The agent warrants and broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

During the second quarter of fiscal 2017, the Company also issued the following warrants:

- 203,202 warrants in exchange for services rendered by two service providers:
  - The Company issued 120,000 warrants with an exercise price of US$0.70 and expiring in May 2018. The warrants were valued at $24,411 (US$18,760) using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.75; expected life of 18 months; $Nil dividends; 73.2% volatility; risk-free interest rate of 1.25%; and USD/CAD exchange rate of 1.3447. 30,000 warrants were exercised on April 28, 2017. These warrants were recorded as a share issuance cost in the statements of changes in shareholders' equity.
  - The Company issued another 83,202 warrants with an exercise price of $0.75 and expiring in three years. The warrants were valued at $30,184 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.75; expected life of three years; $Nil dividends; 73.2% volatility; and risk-free interest rate of 1.25%. These warrants were recorded as a share issuance cost in the statements of changes in shareholders' equity.

During the third quarter of fiscal 2017, the Company issued 2,492,958 shares for $0.75 per share for gross proceeds of $1,869,719. These shares were issued pursuant to an agent's option under the Concurrent Financing completed in December 2016, in which 17,400,000 shares were offered, which allowed the agent to sell an additional number of shares equal to 15% of the number of offered shares.

The Company paid share issuance costs of $146,792 and issued 174,504 warrants to the broker. The warrants have an exercise price of $0.75 and expire in two years. The warrants were valued at $167,222 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $1.55; expected life of two years; $Nil dividends; 73.2% volatility; and risk-free interest rate of 1.25%. These warrants were recorded as a share issuance cost in the statements of shareholders' equity. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

During the third quarter of fiscal 2017, the Company issued 4,285,716 common shares at a price of $0.58 per share, for total proceeds of $2,500,001, pursuant to a call option issued to a group of private investors on November 4, 2016.

As described in Note 10, Convertible Debentures, the Company issued unsecured debentures in the third and fourth quarters of fiscal 2016. On March 16, 2017, $345,000 of the debentures held by six individuals were converted into 459,990 common shares at a price of $0.75 per unit. In relation to the conversion of this debt, 459,990 warrants were issued. The warrants were valued at $69,220 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $0.60; expected life of two years; $Nil dividends; 64.5% volatility; and risk-free interest rate of 0.59%.

As described in Note 10, Convertible Debentures, the Company issued secured debentures in the second quarter of fiscal 2017. On April 11, 2017, the debentures automatically converted to 4,678,494 common shares at a conversion price of US$0.70 after the Company became a reporting issuer on the TSX-V and maintained a volume weighted average trading price equal to or exceeding the conversion price of the debentures for 15 days.

As described in Note 10, Convertible Debentures, during the fourth quarter of 2017, 7,856,300 warrants were issued in relation to the issuance of convertible debt. The allocation of the proceeds to these warrants was $1,163,396. In relation to this financing, the Company issued 784,375 broker agent warrants that have an exercise price of $2.00 and expire in two years. The warrants were valued at $192,602 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $1.52; expected life of two years; $Nil dividends; 73.2% volatility; and risk-free interest rate of 1.27%. The value of the broker warrants, and other financing costs, were allocated on a pro-rata basis based on the allocated fair value of each component of this financing, as detailed in Note 10, Convertible Debentures. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

In relation to the third quarter of fiscal 2017 issuance of 4,285,716 common shares, during the fourth quarter of fiscal 2017 the Company issued 342,852 broker warrants with an exercise price of $0.75 and a five-year term from the date of listing. The warrants were valued at $238,753 using the Black-Scholes-Merton option pricing model and the following variables: stock price of $1.25; expected life of two years; $Nil dividends; 73.2% volatility; and risk-free interest rate of 1.25%. The broker warrants were measured at the fair value of the equity instruments granted, as the fair value of the related services cannot be measured reliably.

During the first quarter of fiscal 2018, 481,896 warrants with exercise prices of $0.75 and US$0.70 were exercised for proceeds of $405,778, resulting in the issuance of 481,896 common shares.

During the second quarter of fiscal 2018, the Company issued 15,687,500 common shares from the conversion of the 8% unsecured convertible debentures and 166,387 common shares in lieu of accrued interest, as described in Note 10, Convertible Debentures.

On January 2, 2018, the Company announced that it had elected to exercise its right to accelerate the expiry date of the common share purchase warrants issued under the 8% convertible debentures. The Company became entitled to accelerate the expiry date of the warrants on December 27, 2017 on the basis that the closing trading price of the common shares on the TSXV exceeded $3.00 for 15 consecutive trading days. The expiry date for the warrants was accelerated from July 18, 2019 to February 1, 2018. During the second quarter of fiscal 2018, the Company issued 7,799,960 common shares related to the exercise of warrants associated with the 8% convertible debentures.

During the second quarter of fiscal 2018, the Company issued 31,363,252 common shares from the conversion of the 7% unsecured convertible debentures and 20,829 common shares in lieu of accrued interest, as described in Note 10, Convertible Debentures. The Company issued 2,922,393 common shares related to the exercise of warrants from the 7% unsecured convertible debentures.

During the second quarter of fiscal 2018, in addition to common shares issued related to the exercise of warrants associated with the convertible debentures, 5,025,627 warrants with exercise prices of $0.75 and US$0.70 were exercised, resulting in the issuance of 5,021,940 common shares. Total proceeds from the exercise of warrants were $30,936,897.

On January 30, 2018, the Company closed a bought deal public offering of 37,375,000 units at a price of $4.00 per unit for gross proceeds of $149,500,000. Each unit consisted of one common share and one-half of one share purchase warrant of the Company. Each warrant is exercisable into one common share at a price of $5.60 per share for a period of two years. The fair value of the warrants at the date of grant was estimated at $0.56 per warrant based on the following weighted average assumptions:

- stock price of $3.93;
- expected life of one year;
- $Nil dividends;
- 65% volatility;
- risk-free interest rate of 1.25%.

Total cash share issue costs amounted to $6,379,728, which consisted of underwriters' commissions of $5,980,000, underwriters' expenses of $10,000, underwriters' legal fees of $96,522 and incurred $311,206 of additional cash issuance costs. In addition, the Company issued an aggregate of 1,495,000 compensation warrants to the underwriters at a fair value of $1,485,797. The compensation warrants have an exercise price of $4.00 and expire January 30, 2020. The fair value of the compensation warrants at the date of grant was estimated at $0.99 per warrant based on the following weighted average assumptions:

- stock price of $3.93;
- expected life of one year;
- $Nil dividends;
- 65% volatility;
- risk-free interest rate of 1.25%.

The Company allocated $7,342,461 of the issuance costs to the common shares and $523,064 to the warrants.

During the third quarter of fiscal 2018, 2,474,813 warrants with exercise prices ranging from $0.75 to $5.60 and US$0.76 were exercised for proceeds of $4,422,747, resulting in the issuance of 2,474,813 common shares.

On May 24, 2018, the Company announced that it had elected to exercise its right to accelerate the expiry date governing the common share purchase warrants issued November 24, 2017. Pursuant to the terms of the warrant indenture, the Company elected its right to accelerate the expiry date of the remaining 5,261,043 warrants from November 24, 2019 to June 25, 2018. As at the date of expiry, all warrants were exercised. The accelerated expiry date also applied to the remaining 1,568,181 compensation warrants originally issued to certain investment banks on November 24, 2017. As at the date of expiry, 1,505,453 compensation warrants were exercised and 62,728 warrants expired.

During the fourth quarter of fiscal 2018, 13,214,883 warrants with exercise prices ranging from $0.75 to $5.60 and US$0.76 were exercised for proceeds of $38,600,682, resulting in the issuance of 13,214,883 common shares.

As at July 31, 2018, there were 193,629,116 common shares outstanding and 26,425,504 warrants outstanding.

The following is a summary of warrants on July 31, 2018.

	Number outstanding		Book value
Warrants issued with $0.75 units			
Exercise price of $0.83 expiring April 28, 2019	13,332	$	2,389
Exercise price of $0.83 expiring May 19, 2019	19,332		3,457
Exercise price of $0.83 expiring June 2, 2019	333,330		59,598
Exercise price of $0.83 expiring June 6, 2019	144,000		25,747
Exercise price of $0.83 expiring June 8, 2019	1,333,332		261,998
Exercise price of $0.83 expiring June 23, 2019	66,672		11,921
Exercise price of $0.83 expiring June 28, 2019	266,670		47,680
Exercise price of $0.83 expiring July 21, 2019	100,008		17,881
Exercise price of $0.83 expiring July 25, 2019	66,672		11,921
Exercise price of $0.83 expiring July 28, 2019	420,000		75,095
Exercise price of $0.83 expiring August 12, 2019	33,336		6,056
Exercise price of $0.83 expiring August 18, 2019	266,676		47,681
Exercise price of $0.83 expiring August 31, 2019	39,600		7,194
Exercise price of $0.83 expiring September 26, 2019	72,000		13,080
Exercise price of $0.83 expiring October 17, 2019	60,000		10,900
2015 secured convertible debenture warrants			
Exercise price of $0.75 expiring July 15, 2019	1,318,332		253,155
2016 unsecured convertible debenture warrants			
Exercise price of $0.83 expiring July 18, 2019	100,002		15,047
2018 Equity financing			
Exercise price of $5.60 expiring January 30, 2020	18,570,500		9,981,561
Broker/consultant warrants			
Exercise price of $0.75 expiring March 15, 2019	302,861		158,308
Exercise price of $0.75 expiring November 9, 2019	41,598		15,091
Exercise price of US$0.70 expiring November 14, 2019	45,143		11,147
Exercise price of $0.75 expiring November 3, 2021	244,284		108,935
Exercise price of $0.75 expiring March 14, 2022	144,282		100,474
Exercise price of $4.00 expiring January 30, 2020	1,495,000		1,389,023
	25,496,962	$	12,635,339
2016 secured convertible debenture warrants			
Exercise price of US$0.76 expiring November 14, 2019	928,542		3,129,769
	26,425,504	$	15,765,108

The following table summarizes warrant activity during the fiscal years ended July 31, 2018 and July 31, 2017.

	July 31, 2018		July 31, 2017	
	Number of warrants	**Weighted average exercise price**	Number of warrants	Weighted average exercise price
Outstanding, beginning of period	**20,994,123**	**1.31**	7,504,062	0.86
Expired during period	**(62,728)**	**3.00**	–	–
Issued during period	**37,413,681**	**4.34**	14,335,563	1.95
Exercised during period	**(31,919,572)**	**2.33**	(845,502)	1.16
Outstanding, end of period	**26,425,504**	**4.35**	20,994,123	1.31

Stock Option Plan

The Company has a share option plan (the "Plan") that is administered by the Board of Directors, who establish exercise prices and expiry dates, which are up to 10 years from issuance as determined by the Board at the time of issuance. Unless otherwise determined by the Board, options issued under the Plan vest over a three-year period except for options granted to consultants or persons employed in investor relations activities (as defined in the policies of the TSX), which vest in stages over 12 months with no more than one-quarter of the options vesting in any three-month period. The maximum number of common shares reserved for issuance for options that may be granted under the Plan is 19,362,911 common shares as at July 31, 2018.

The following table summarizes the stock option grants during the fiscal year ended July 31, 2018.

			Options granted			
Grant date		Exercise price	Executive and directors	Non-executive employees	Vesting terms	Vesting period
September 8, 2017	$	1.37	650,000	1,000	Terms A	10 years
November 6, 2017	$	2.48	125,000	3,000	Terms A	10 years
December 4, 2017	$	2.69	1,750,000	20,000	Terms B	10 years
January 29, 2018	$	4.24	–	261,000	Terms A, C	10 years
March 12, 2018	$	3.89	325,000	–	Terms A	10 years
April 16, 2018	$	4.27	845,000	61,500	Terms A	10 years
June 8, 2018	$	5.14	–	441,000	Terms A	10 years
July 11, 2018	$	4.89	4,325,000	1,366,500	Terms A	10 years

Vesting terms A – One-third of the options will vest on the one-year anniversary of the date of grant, and the balance will vest quarterly over two years thereafter.

Vesting terms B – Half of the options will vest immediately, and the balance will vest annually over three years thereafter.

Vesting terms C – Based upon organizational milestones.

The following table summarizes stock option activity during the fiscal years ended July 31, 2018 and July 31, 2017.

	July 31, 2018		July 31, 2017	
	Options issued	**Weighted average exercise price**	Options issued	Weighted average exercise price
Opening balance	**5,748,169**	**$ 0.68**	3,481,896	$ 0.49
Granted	**10,174,000**	**4.16**	2,428,777	0.92
Expired	**–**	**–**	–	–
Forfeited	**(626,830)**	**3.44**	–	–
Exercised	**(907,273)**	**0.65**	(162,504)	0.19
Closing balance	**14,388,066**	**$ 1.05**	5,748,169	$ 0.68

The weighted average share price at the time of exercise during the period was $4.31 (July 31, 2017 – $0.76).

The following table summarizes information concerning stock options outstanding as at July 31, 2018.

Exercise price	Number outstanding	Weighted average remaining contractual life (years)	Number exercisable	Weighted average remaining contractual life (years)
$ 0.16	570,000	0.01	570,000	0.11
0.58	1,241,900	0.05	1,241,900	1.81
0.75	2,248,996	0.12	1,466,496	2.64
1.27	606,670	0.05	202,670	0.42
1.37	651,000	0.06	–	–
2.48	128,000	0.02	–	–
2.69	1,695,000	0.32	885,000	1.89
3.89	325,000	0.09	–	–
4.24	258,000	0.08	–	–
4.27	885,000	0.26	–	–
4.89	5,667,500	1.93	–	–
$ 5.14	111,000	0.04	–	–
	14,388,066		4,366,066	

Stock-based Compensation

For the fiscal year ended July 31, 2018, the Company recorded $4,996,513 respectively (July 31, 2017 – $658,620) in stock-based compensation expense related to employee options, which are measured at fair value at the date of grant and are expensed over the vesting period. In determining the amount of stock-based compensation, the Company used the Black-Scholes-Merton option pricing model to establish the fair value of options granted by applying the following assumptions:

	July 31, 2018	July 31, 2017
Exercise price	**$1.37–$5.14**	$0.16–$1.55
Risk-free interest rate	**2.06%–2.37%**	1.27%–1.73%
Expected life of options (years)	**7**	3–7
Expected annualized volatility	**65%**	65%–73%

Volatility was estimated using the average historical volatility of the comparable companies in the industry that have trading history and volatility history.

12. Net Loss per Share

The following securities could potentially dilute basic net loss per share in the future but have not been included in diluted loss per share because their effect was anti-dilutive:

	July 31, 2018	July 31, 2017
2017 unsecured convertible debentures	**–**	15,687,500
Options	**14,388,066**	5,748,169
Warrants issued with $0.75 units	**3,234,960**	4,911,186
2015 secured convertible debenture warrants	**1,318,332**	2,210,358
2015 secured convertible debenture amendment warrants	**–**	237,612
2015 unsecured convertible debenture amendment warrants	**–**	38,100
2016 unsecured convertible debenture warrants	**100,002**	426,660
2016 secured convertible debenture warrants	**928,542**	2,053,500
2017 8% unsecured convertible debenture warrants	**–**	7,856,300
2017 7% unsecured convertible debenture warrants	**–**	–
2018 equity warrants	**18,570,500**	–
Convertible debenture broker/finder warrants	**2,273,168**	3,260,407
	40,813,570	42,429,792

13. Convertible Note Receivable

On July 26, 2018, the Company lent $10,000,000 to an unrelated entity, Fire and Flower ("FF"), in the form of an unsecured and subordinated convertible debenture. The convertible debenture bears interest at 8%, paid semi-annually, matures July 31, 2019 and includes the right to convert the debenture into common shares of FF at the lesser of $1.15 or 90% of the deemed price per common share upon maturity or a triggering event as defined within the agreement.

The option to settle the loan in common shares represents a call option to the Company and is included in the fair value of the loan. There existed an insignificant difference in fair value between the initial recognition date of July 26, 2018 and the reporting date of July 31, 2018, and accordingly the transaction price approximated the fair value of the note.

As at July 31, 2018, the Company's note receivable from FF did not earn any interest.

14. Segmented Information

The Company operates in one operating segment.

All property, plant and equipment and intangible assets are located in Canada.

15. Financial Instruments

Interest Risk

The Company's exposure to interest rate risk only relates to any investments of surplus cash. The Company may invest surplus cash in highly liquid investments with short terms to maturity that would accumulate interest at prevailing rates for such investments. As at July 31, 2018, the Company had short-term investments of $205,446,830.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's trade receivables and convertible note receivable. As at July 31, 2018, the Company was exposed to credit-related losses in the event of non-performance by the counterparties.

The Company provides credit to its customers in the normal course of business and has established credit evaluation and monitoring processes to mitigate credit risk. Since the majority of the sales are transacted with clients that are covered under various insurance programs, the Company has limited credit risk.

Cash and cash equivalents are held by one of the largest co-operative financial groups in Canada. The short-term investments are held in various guaranteed investment certificates, term deposits, and fixed income securities. Since the inception of the Company, no losses have been incurred in relation to cash held by the financial institution. The trade receivable balance is held with one of the largest medical insurance companies in Canada. Credit risk from the convertible note receivable arises from the possibility that principal and/or interest due may become uncollectible. The Company mitigates this risk by managing and monitoring the underlying business relationship.

The carrying amount of cash and cash equivalents, short-term investments, trade receivables and convertible note receivable represents the maximum exposure to credit risk, and as at July 31, 2018, this amounted to $255,432,114.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company manages its liquidity risk by reviewing on an ongoing basis its capital requirements. As at July 31, 2018, the Company had $244,788,518 of cash and cash equivalents and short-term investments.

The Company is obligated to pay accounts payable and accrued liabilities with a carrying amount and contractual cash flows amounting to $8,994,789 due in the next 12 months.

The carrying values of cash, trade receivables, accounts payable and accrued liabilities approximate their fair values due to their short term to maturity.

16. Operating Expenses by Nature

	July 31, 2018	July 31, 2017
Salaries and benefits	**$ 6,992,321**	$ 3,092,745
Stock-based compensation	**4,996,513**	658,620
Consulting	**3,659,069**	285,081
Marketing and promotion	**2,447,069**	1,234,807
Professional fees	**1,761,437**	547,300
General and administrative	**1,441,830**	786,021
Facilities	**919,799**	499,642
Amortization of property, plant and equipment	**895,714**	359,468
Amortization of intangible assets	**765,238**	231,685
Travel	**487,996**	236,300
Total	**$ 24,366,986**	$ 7,931,669

17. Related Party Disclosure

Key Management Personnel Compensation

Key management personnel are those persons having the authority and responsibility for planning, directing and controlling the Company's operations, directly or indirectly. The key management personnel of the Company are the members of the executive management team and Board of Directors, and they control approximately 8.77% of the outstanding shares of the Company as at July 31, 2018 (July 31, 2017 – 25.11%).

Compensation provided to key management during the period was as follows:

		July 31, 2018		July 31, 2017
Salary and/or consulting fees	**$**	**2,244,006**	$	1,269,825
Stock-based compensation		**3,835,733**		512,056
	$	**6,079,739**	$	1,781,881

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed by the related parties.

Unless otherwise stated, the below granted stock options will vest on the one-year anniversary of the date of grant and the balance will vest quarterly over two years thereafter.

On July 11, 2018, the Company granted certain directors and executives of the Company a total of 4,325,000 stock options with an exercise price of $4.89.

On April 16, 2018, the Company granted certain directors and executives of the Company a total of 845,000 stock options with an exercise price of $4.27.

On March 12, 2018, the Company granted certain directors and executives of the Company a total of 325,000 stock options with an exercise price of $3.89.

On December 4, 2017, the Company granted certain directors and executives of the Company a total of 1,750,000 stock options with an exercise price of $2.69, of which half of the options will vest immediately, and the balance will vest annually over three years thereafter.

On November 6, 2017, the Company granted certain directors of the Company a total of 125,000 stock options with an exercise price of $2.48.

On September 8, 2017, the Company granted certain executives of the Company a total of 650,000 stock options with an exercise price of $1.37.

On July 24, 2017, the Company granted certain directors and executives of the Company a total of 125,000 stock options with an exercise price of $1.27. On November 15, 2016, the Company granted certain directors and executives of the Company a total of 1,227,000 stock options with an exercise price of $0.75.

The Company leased a building to a related party for $700 per month as part of a usufruct agreement. The related party used this property as a personal residence. On December 2, 2016, the related party and the Company reached an agreement to terminate the usufruct. In exchange for abandoning the usufruct, the Company paid the related party $46,000. Gaining access to this building provides the Company with additional office space and thereby reduces the need to rent or build additional offices.

18. Capital Management

The Company's objective is to maintain sufficient capital so as to maintain investor, creditor and customer confidence and to sustain future development of the business and provide the ability to continue as a going concern. Management defines capital as the Company's shareholders' equity. The Board of Directors does not establish quantitative return on capital criteria for management. The Company has not paid any dividends to its shareholders. The Company is not subject to any externally imposed capital requirements.

As at July 31, 2018, total managed capital was comprised of shareholders' equity of $322,872,875 (July 31, 2017 – $32,439,490). There were no changes in the Company's approach to capital management during the period.

19. Commitments and Contingencies

The Company has certain contractual financial obligations related to service agreements, purchase agreements and construction contracts.

Some of these contracts have optional renewal terms that the Company may exercise at its option. The annual minimum payments payable under these obligations over the next five years are as follows:

Fiscal year	2019	2020	2021	2022	2023	Total
Amount	$ 61,765,917	$ 890,659	$ 853,851	$ 800,569	$ Nil	$ 64,310,996

Letter of Credit

On June 28, 2018, the Company executed a letter of credit with a Canadian credit union as required under an agreement with a public utility provider entitling the Company up to a maximum limit of $3,117,000, subject to certain operational requirements. The letter of credit has a one-year expiry from the date of issue. The credit facility is secured by a guaranteed investment certificate ("GIC"). As at July 31, 2018, the letter of credit has not been drawn upon and is in compliance with the specified requirements.

Surety Bond

On June 28, 2018, the Company entered into an indemnity agreement to obtain a commercial surety bond with a North American insurance provider entitling the Company up to a maximum of $2,000,000. The bond bears a premium at 0.1% annually. The Company obtained the surety bond as required under the Canada Revenue Agency's excise tax laws for the transporting of commercial goods throughout Canada.

Litigation and Contingent Recovery

The Company is currently taking legal action to recover an investment loss incurred during the three months ended July 31, 2018. There is no reasonable estimate for the amount of financial recovery, and no financial asset has been recognized as at the year ended July 31, 2018.

20. Loss on Investment

During the fiscal year ended July 31, 2018, the Company realized a loss on investment activities in the amount of $649,714. The Company is currently taking legal action to recover the loss.

21. Fair Value of Financial Instruments

The carrying values of the financial instruments as at July 31, 2018 are summarized in the following table:

	Loans and receivables	Financial assets designated as FVTPL	Other financial liabilities	Financial liabilities designated as FVTPL	Total
Assets	$	$	$	$	$
Cash and cash equivalents	–	39,341,688	–	–	39,341,688
Short-term investments	–	205,446,830	–	–	205,446,830
Trade receivables	643,596	–	–	–	643,596
Convertible note receivable	–	10,000,000	–	–	10,000,000
Liabilities	$	$	$	$	$
Accounts payable and accrued liabilities	–	–	8,994,789	–	8,994,789
Convertible debentures	–	–	–	–	–
Warrant liability	–	–	–	3,129,769	3,129,769

The carrying values of trade receivables and accounts payable and accrued liabilities approximate their fair values due to their relatively short periods to maturity.

22. Income Taxes

Income tax expense recognized in comprehensive loss consists of the following components:

	July 31, 2018	July 31, 2017
Current tax for the year	**$ –**	$ –
Adjustments of previous years	**–**	–
Total	**$ –**	$ –

Components of deferred income tax expense (recovery)

	July 31, 2018	July 31, 2017
Origination and reversal of temporary differences	**$ (6,779,861)**	$ 130,384
Difference between statutory tax rate and deferred tax rate	**(6,771)**	(471,075)
Change in temporary differences for which no deferred tax assets are recorded	**6,786,632**	340,691
Deferred income tax (recovery)	**$ –**	$ –

The Company's expected tax rate is different from the combined federal and provincial income tax rate in Canada. These differences result from the following elements:

	July 31, 2018	July 31, 2017
Expected tax rate	**26.9%**	26.9%
Earnings before income taxes	**$ (23,349,799)**	$ (10,263,937)
Expected tax benefit resulting from loss	**(6,281,096)**	(3,327,909)
Adjustments for the following items:		
Tax rate differences	**(6,771)**	–
Changes in foreign tax rates	**–**	–
Foreign exchange	**–**	–
Permanent differences	**3,094,793**	2,922,013
Change in temporary differences for which no tax assets are recorded	**2,400,826**	340,691
True up and other	**792,248**	65,205
	$ –	$ –

The following is a reconciliation of the deferred tax assets and liabilities recognized by the Company.

	Opening August 1, 2017	Recognized in income	Recognized in Equity/OCI	Ending July 31, 2018
Deductible temporary differences	$ 812,864	$ –	$ (812,864)	$ –
Taxable temporary differences	–	(117,094)	–	(117,094)
Biological assets	–	(457,986)	–	(457,986)
Inventory	–	(1,431,518)	–	(1,431,518)
Loss carryforward	–	2,006,598	–	2,006,598
Share issue costs	–	–	–	–
Intangible assets	–	–	–	–
Revaluation of financial instruments – Equity	(812,864)	–	812,864	–
	$ –	$ –	$ –	$ –

	Opening August 1, 2016	Recognized in income	Recognized in Equity/OCI	Ending July 31, 2017
Deferred tax assets	$ –	$ –	$ 812,864	$ 812,864
Loss carryforward	–	–	–	–
Share issue costs – Equity	–	–	–	–
Deferred tax liabilities	–	–	–	–
Revaluation of financial instruments – Equity	–	–	(812,864)	(812,864)
	$ –	$ –	$ –	$ –

Deferred income taxes reflect the impact of loss carryforwards and of temporary differences between amounts of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws. At July 31, 2018, deductible temporary differences and unused tax losses for which no deferred tax assets have been recognized are attributable to the following:

	July 31, 2018	July 31, 2017
Losses carried forward	**$ 20,671,803**	$ 8,198,562
Research and development expenditures	**265,821**	74,000
Share issue costs	**13,351,528**	–
Accounting amortization in deficit (excess) of tax	**–**	1,201,803
	$ 34,289,152	$ 9,474,365

The Company has approximate non-capital losses available to reduce future years' federal and provincial taxable income, which expires as follows:

2034	$ 763,471
2035	2,143,509
2036	2,944,011
2037	3,182,286
2038	19,098,000
	$ 28,131,277

23. Comparative Amounts

Certain comparative amounts have been reclassified to conform to the current presentation, none of which were material.

24. Subsequent Events

Molson Coors Canada Joint Venture – Truss

On August 1, 2018, the Company announced it had entered into a definitive agreement to form Truss, a joint venture with Molson Coors Canada (the "Partner"), the Canadian business unit of Molson Coors Brewing Company, to pursue opportunities in the non-alcoholic, cannabis-infused beverages market. Truss will be structured as a stand-alone start-up company with its own board of directors and an independent management team. The Partner will have a 57.5% controlling interest with the Company controlling the remaining balance. On October 4, 2018, the transaction was finalized. In connection with the transaction, HEXO has issued the Partner 11,500,000 common share warrants at an exercise price of $6.00 for a period of three years.

Amalgamation of Subsidiary

On August 1, 2018, the operating subsidiary amalgamated with its previously wholly owned subsidiary, 167151 Canada Inc., pursuant to a vertical amalgamation. The resulting entity retained the name HEXO Operations Inc.

Supply Agreement with Ontario Cannabis Store

On August 20, 2018, the Company announced that it had entered into a supply agreement with the Ontario Cannabis Store ("OCS"). Under the agreement, the Company will supply the province with product which will be offered in several formulations.

Shareholder Approval of Corporate Name Change

On August 28, 2018, following a special meeting of the shareholders, the proposed change of the Company's name to HEXO Corp. and implementation of the new omnibus plan was approved through a majority vote.

Acquisition of 2 Million Sq. Ft. Facility in Belleville, Ontario

On September 10, 2018, the Company announced the acquisition of a 2 million sq. ft. facility in Belleville, Ontario, through a joint venture established with a related party, Olegna Holdings Inc. (entity under the control of a HEXO board member, "Olegna"). The Company acquired a 25% interest in the joint venture with the remaining balance belonging to Olegna. The joint venture purchased the facility in part by a $20,000,000 loan issued by HEXO repayable within 120 days, bearing an annual 4% interest rate, payable monthly. As part of the agreement, the Company will be the anchor tenant for a period of 20 years.

Warehouse and Distribution Centre

On September 19, 2018, the Company announced the storage and distribution arrangement with Metro Supply Chain Group Inc. ("Metro"). Under the agreement, HEXO and Metro will manage and run the 58,000 sq. ft. storage and distribution facility in Montreal, Quebec, to house and supply the cannabis products of all licensed producers who hold supply contracts with the Société québécoise du cannabis ("SQDC"). The distribution centre will serve as the sole distribution point for all direct-to-customer shipments within the province of Quebec for orders placed through the SQDC.

Expansion into Greece

On September 26, 2018, we announced the partnership with the Greek company Qannabos ("QNBS"). Together we will create a joint venture supported by the development of 350,000 sq. ft. of licensed infrastructure, which we will use for the manufacturing, processing and distribution of medical cannabis.

STRONG GOVERNANCE

BOARD OF DIRECTORS

NATHALIE BOURQUE
Member of the Audit Committee, Chair of the Human Resources and Corporate Governance Committee

Ms. Bourque is a member of the board of Alimentation Couche-Tard and Héroux-Devtek. She held the position of Vice-President, Public Affairs and Global Communications at CAE Inc. from 2005 until her retirement in February 2015. Prior to joining CAE, Ms. Bourque was a partner at NATIONAL Public Relations where she was responsible for numerous clients in the financial, biopharmaceutical, retail and entertainment areas. Previously, she worked for various communications companies and has also worked for accounting firms in marketing. She was a member of the Board of Financial Services of the Caisse de dépôt et placement du Québec and Horizon Science and Technology. She also served as President of the MBA Association and Le Cercle Finance et Placement du Québec. She was also a Governor of McGIll University and was on the board of Maison MarieVincent. Ms. Bourque has a BA from Laval University and an MBA from McGill University.

VINCENT CHIARA
Director, Member of the Human Resources and Corporate Governance Committee

Mr. Chiara is the President and sole owner of Groupe Mach Inc. ("Mach"). He began his career in 1984 as a lawyer specializing in real estate transactions and corporate litigation. In 1999, he ceased practising law and focused on real estate acquisitions and property development through Mach, a private holding company. Mach and its affiliates hold significant investments representing approximately 26 million sq. ft. of real estate (office, retail, residential, industrial and hotel) located primarily in Montreal and Quebec City, including the Stock Exchange Tower, the CIBC Tower, the Sun Life Building, the CBC Tower and the University Complex. Mach continues to acquire and redevelop properties across North America while maintaining its institutional reputation within the market.

JASON EWART
Director, Chair of the Audit Committee, Member of the Audit Committee

Mr. Ewart is a corporate director who was the co-founder and the former Chief Executive Officer and Chief Operating Officer of Fountain Capital Corporation from 2003 until October 2017. Mr. Ewart was a market analyst with A&E Capital Funding Inc. and Bradstone Equity Partners Inc. between 1998 and 2002 and Vice-President of Quest Investment Corporation between 2002 and 2003. He has experience with bridge financing, financial analysis, quantitative modelling, equities trading and mergers and acquisitions. Mr. Ewart holds an economics degree from McGill University.

BOARD OF DIRECTORS, Continued

ADAM MIRON
Chief Brand Officer and Director

Mr. Miron has been the Chief Brand Officer of HEXO since August 2013. Mr. Miron is the co-founder of iPolitics.ca and was its Chief Information Officer from 2010 to 2013. He was also the National Director of the Federal Liberal Commission from 2007 to 2009 and was responsible for the Liberal Party of Canada's online election campaigns. He has experience with online marketing and sales, and brand development. Mr. Miron has also run political campaigns in Canada and abroad.

DR. MICHAEL MUNZAR
Director, Chairman of the Board, Member of the Audit Committee, Member of the Human Resources and Corporate Governance Committee

Dr. Munzar is a clinician and is currently serving as Medical Director of Statcare medical clinic in Pointe Claire, Quebec. In addition, Dr. Munzar is on the board of directors of Osta Biotechnologies Inc., and has held the position of Vice-President of Medical and Regulatory Affairs at Osta since 2005. He served as Medical Director of Nymox Pharmaceutical Corporation (NASDAQ:NYMX) from 1996 to 2004 and as the President of Serex Inc., a wholly owned subsidiary of Nymox, from 2000 to 2004. Dr. Munzar has experience in the regulatory development of drugs and medical devices. He obtained his MDCM from McGill University in 1979.

SÉBASTIEN ST-LOUIS
President and Chief Executive Officer and Director

Sébastien St-Louis is an entrepreneur with strong leadership abilities, financial acumen and operational expertise. Sébastien has wide-ranging business experience in manufacturing, distribution, trade finance and commercial lending. He has advised Canadian business owners and CEOs across multiple industry sectors, while structuring and closing $200 million in financing to support their export and growth initiatives.

Sébastien co-founded HEXO Corp. with one goal in mind: to create a world-class company based on the highest standards of product quality and safety. Since 2013, he has secured more than $260 million in financing for the company. His leadership has been instrumental in navigating the company through regulatory, financing and start-up challenges en route to becoming the only significant licensed cannabis producer in Quebec and, upon completion of two fully funded expansion projects currently underway, one of the largest in Canada. Sébastien holds an MBA in Finance from the Université du Québec à Montréal and completed his Bachelor of Arts (Economics) from the University of Ottawa in 18 months.

General Corporate Information

Corporate Office

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Offices 102 and 204
Gatineau, QC J8Y 3W9
Phone: 1-866-438-8429

Auditors

MNP LLP
mnp.ca/en

Registrar and Transfer Agent

TSX Trust Company
301 – 100 Adelaide Street West
Toronto, ON M5H 4H1
Phone: 1-866-393-4891 ext. 205
tmxeinvestorservices@tmx.com

Stock Exchange Listing

HEXO Corp. trades on the TSX under the ticker symbol "HEXO". Shares cannot be purchased directly from the Company.

Investor Relations Inquiries

Email:
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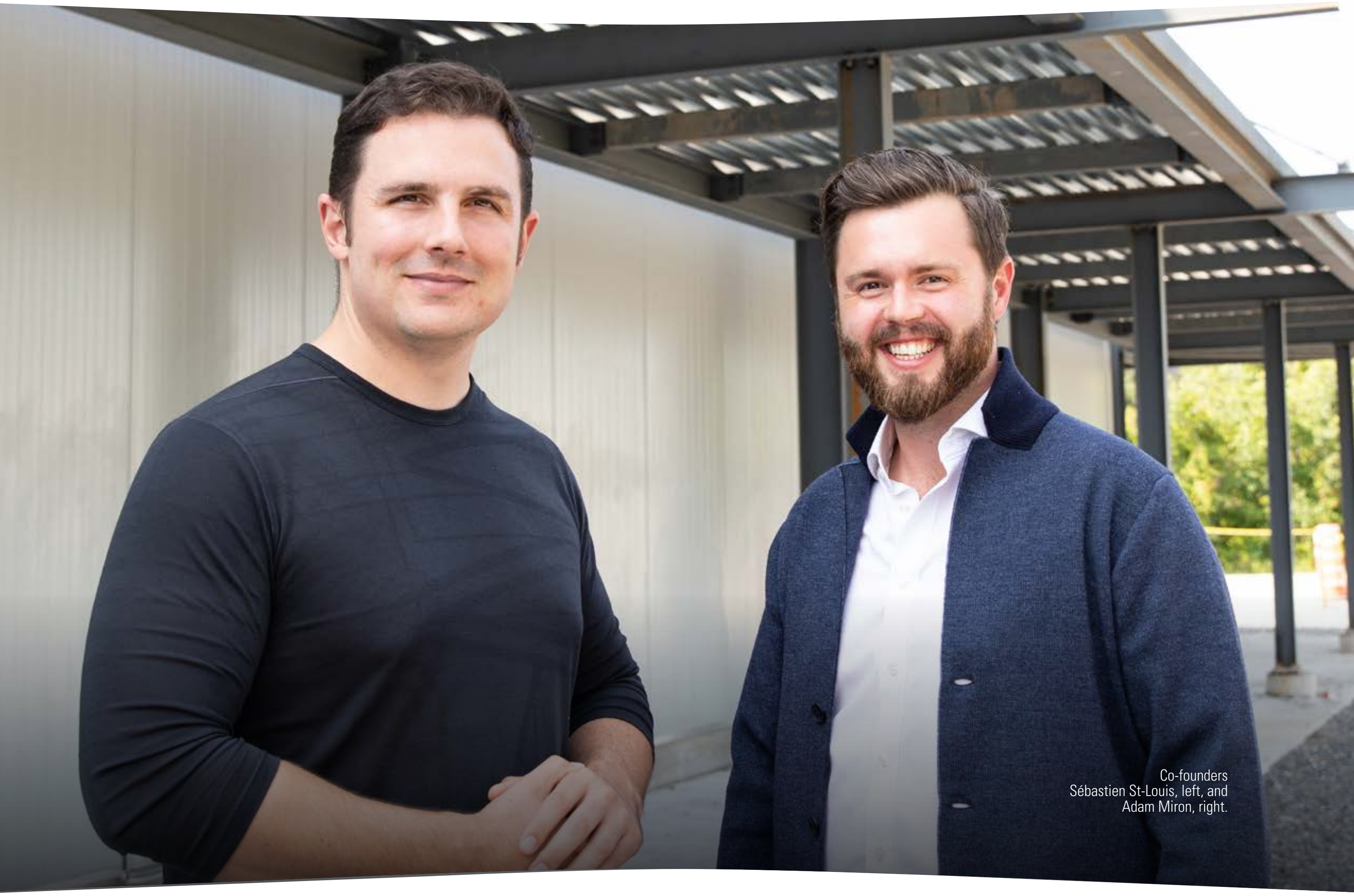
Website:
ir.hexo.com

Additional financial information has been filed electronically with various securities regulators in Canada through the System for Electronic Document Analysis and Retrieval (SEDAR), sedar.com.



Co-founders
Sébastien St-Louis, left, and
Adam Miron, right.

"Consumer-centric brand companies capable of delivering consistently great experiences – that's the future of cannabis. It's a future for true leaders. A future for HEXO Corp."

- Sébastien St-Louis, CEO

Concept and Design: THE WORKS DESIGN COMMUNICATIONS worksdesign.com