

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

**IN THE MATTER OF THE *COMPANIE'S CREDITORS
ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED**

**AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT,
OF HYDRX FARMS LTD., CANNSCIENCE INNOVATIONS INC. AND SCIENTUS
PHARMA INC. (together, the "Applicants")**

REPORT OF THE PROPOSED MONITOR

MARCH 22, 2021

INTRODUCTION

1. Schwartz Levitsky Feldman Inc. ("SLF" or the "Proposed Monitor") understands that Dominic Serafino ("Serafino"), an independent director of the Applicant, Hydrx Farms Ltd. has brought an application (the "CCAA Application") in his capacity and as an interested party before the Court returnable on March 22, 2021, seeking an initial order (the "Proposed Initial Order") pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("CCAA") to, among other things, obtain a stay of proceedings to allow the Applicants an opportunity to restructure their business and affairs. The Applicants proposes that SLF be appointed as Monitor in these CCAA proceedings (in such capacity, the "Monitor").
2. This Report (the "Report") has been prepared by the SLF as the Proposed Monitor (the "Proposed Monitor") in order to provide information to this Court for its consideration in respect of the Applicants' CCAA Application.

PURPOSE

3. The purpose of this Report is to provide the Court with the below noted information:
 - a. SLF's qualifications to act as Monitor;
 - b. an overview of the business of the Applicant, Hydrx Farms Ltd ("Hydrx"). The proposed Monitor understands that Hydrx is the only Applicant that carries on any active business;
 - c. background pertaining to the circumstances leading to the Applicants' decision to commence CCAA proceedings;
 - d. an overview of the Hydrx's 13-week cash flow forecast (the "Cash Flow Forecast") and the Proposed Monitor's comments regarding the reasonableness thereof; and
 - e. additional relevant matters regarding the relief sought in the Proposed Initial Order.

TERMS OF REFERENCE

4. In preparing this Report and making the comments herein, the Proposed Monitor has been provided with, and has relied upon, unaudited financial information, books and records prepared by Hydrx, discussions with management of Hydrx ("Management"), and information from other third-party sources (collectively, the "Information"). Except as described in this Report in respect of the Cash Flow Forecast.
 - a. the Proposed Monitor has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Proposed Monitor has not audited or otherwise attempted to verify the accuracy or completeness of such information in a manner that would wholly or partially comply with Generally Accepted Auditing Standards ("GAAS") pursuant to the Chartered Professional Accountants Canada Handbook and, accordingly, the Proposed Monitor expresses no opinion or other form of assurance contemplated under GAAS in respect of the Information; and
 - b. some of the information referred to in this Report consists of forecasts and projections. An examination or review of the financial forecast and projections,

as outlined in the Chartered Professional Accountants Canada Handbook, has not been performed.

5. Future oriented financial information referred to in this Report was prepared based on Management's estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, even if the assumptions materialize, and the variations could be significant.
6. Unless otherwise indicated, the Proposed Monitor's understanding of factual matters expressed in this Report concerning the Applicants and their business is based on the information, and not independent factual determinations made or confirmed to date by the Proposed Monitor.
7. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian dollars.

SLF'S QUALIFICATION TO ACT AS MONITOR

8. SLF is a licensed insolvency trustee within the meaning of section 2 of the *Bankruptcy and Insolvency Act* (Canada). SLF is not subject to any of the restrictions set out in section 11.7 (2) of the CCAA on who may be appointed as Monitor.
9. As discussed in further detail later in this Report, SLF has developed an understanding of the Hydrx's operations, and cash flow, and will be able to very quickly and seamlessly perform its responsibilities as Monitor, if appointed.
10. The Proposed Monitor has retained Paliare Roland Rosenberg Rothstein LLP ("Paliare") to act as its independent counsel.

OVERVIEW OF THE APPLICANTS

11. This Report should be read in conjunction with the Affidavit of Serafino sworn March 19, 2021 (the "Serafino Affidavit") for additional background and financial information with respect to the Applicants. Any terms not expressly defined herein are otherwise defined in the Serafino Affidavit.

12. Hydrx is a private corporation incorporated on April 29, 2014 under the *Canada Business Corporations Act*.
13. Hydrx has two wholly owned subsidiaries, Scientus Pharma Inc. (“Scientus Pharma”) and CannScience Innovations Inc. (“CannScience”). Scientus Pharma was incorporated on the premise that it would be the go forward corporate name of Hydrx if the business ever went public and CannScience was acquired in March 2017 principally for its patents. Neither company has carried on any active business while owned by Hydrx.
14. Hydrx is a vertically integrated Health Canada licensed cannabis company with a focus on developing and manufacturing cannabinoid derivative products for the medical and recreational markets.
15. The company was approved by Health Canada for Controlled Dry Substances Licensed Dealer in October of 2016 and subsequently received a Licensed Product Cultivation License in September of 2017 which was subsequently amended to include, among other things:
 - (i) cultivation;
 - (ii) the sale of dried flowers;
 - (iii) the processing of capsules and oils;
 - (iv) the sale of capsules and oils; and
 - (v) the processing and sale of edibles and extracts.
16. Hydrx operates out of a 46,000 square foot facility which it owns at 1130 Champlain Court, Whitby, Ontario.
17. In August 2017 Hydrx financed its operations through the issuance of a convertible debenture from Aphria Inc. for \$ 11,500,000 (the “Aphria Secured Debenture”) and the issuance of shares to raise in excess of \$ 86,000,000.
18. The Aphria Secured Debenture originally had a two-year term, bore interest at 8% and was convertible into common shares of Hydrx. The Aphria Secured Debenture is secured by all of the property, undertakings, assets and rights of Hydrx. The Aphria Secured Debenture had an original maturity date of August 14, 2019 which was subsequently extended. The Aphria Secured Debenture is in default.

19. To date, Hydrx has accumulated losses in excess of \$ 55,000,000 and its operations are basically shut down due to liquidity problems. Hydrx is unable to; process inventory, pay suppliers or commit to new sales contracts without an immediate cash injection.
20. All of Hydrx's employees have been laid off and only a few consultants remain with the company maintain the company's license and standing with Health Canada.

CIRCUMSTANCES LEADING TO THE APPLICANTS' CCAA FILING

A. THE APHRIA SECURED DEBENTURE IS IN DEFAULT

21. In 2019, the company was experiencing liquidity problems and continued losses.
22. In July 2020, Hydrx was approached by World Class Extractions ("WCE"), a public company specializing in extraction and processing technologies in the cannabis industry and First Republic Capital Corp. ("FRC"), an investment dealer registered as an Exempt Market Dealer.
23. Hydrx, WCE and FRC had various discussions about an investment in Hydrx but, ultimately these discussions did not materialize.
24. Shortly after these discussions broke off, WCE and FRC purchased and took an assignment of the Aphria Secured Debenture for \$ 5,000,000 through a company called Cobra Ventures Inc. ("Cobra"). All rights to convert the Aphria Secured Debenture into shares of Hydrx had previously expired and the debenture was in default at the time of its assignment.
25. At the time of the purchase and assignment of the Aphria Secured Debenture, Cobra was owned fifty percent by WCE and fifty percent by FRC.
26. By the time Aphria's Secured Debenture had been assigned to Cobra, Hydrx had no working capital and all of its independent directors had resigned other than Serafino. At that time, Cobra requested that a FRC representative, Goldstein ("Goldstein"), and a WCE representative be appointed to the Hydrx board.
27. Over the next three months, Cobra funded some of Hydrx's operations. In August 2020, Cobra proposed to extend the maturity date of the Aphria Secured Debenture that was in default for a year for in exchange for a \$ 2,000,000 fee made up of \$ 1,000,000 in shares and \$ 1,000,000 in cash.

28. On October 26, 2020, Goldstein and Rosey Mondin (“Mondin”) of WCE were appointed to the Hydrx board of directors (the “Board”) and the Board was increased from one director (Serafino) to three directors (Goldstein, Serafino and Mondin).
29. Around December 2020, WCE requested and was bought out of the now assigned Aphria Secured Debenture by Cobra and Mondin resigned, leaving the Board with two directors, Goldstein and Serafino.
30. In order to finance the purchase of the WCE’s interest in the Aphria Secured Debenture, Cobra borrowed \$ 4,000,000 from Windsor Private Capital Limited Partnership (“WPC”) in connection with this transaction, Cobra pledged its rights in the Aphria Secured Debenture and gave WPC 10% of its equity.
31. The Proposed Monitor has been advised that Hydrx’s Board was not made aware of the transactions between Cobra and WCE.
32. On December 22, 2020, Cobra made formal demand on Hydrx for the repayment of the Aphria Secured Debenture and issued a Notice of Intention to Enforce its Security under subsection 244(1) of the *Bankruptcy and Insolvency Act*.
33. Hydrx was and remains unable to repay the Aphria Secured Debenture.
34. In January 2021, Serafino, on behalf of Hydrx, engaged in negotiations and discussions with Goldstein, on behalf of Cobra, in respect of the Aphria Secured Debenture assigned to Cobra. Ultimately, however, the parties were unable to reach any agreement.
35. Given Goldstein’s relationship with Cobra (Hydrx’s principal secured creditor by virtue of Cobra holding the Aphria Secured Debenture), the Board is deadlocked in relation to its ability to deal with the Aphria Secured Debenture now held by Cobra. This deadlock has impaired Hydrx’s ability to raise capital, refinance the Aphria Secured Debenture and move forward with its business plans generally.

B. SUPPLIERS

36. Hydrx currently owes \$2,300,000 to a number of suppliers and third party service providers.

37. This includes numerous critical suppliers such as security providers, insurance providers and utility providers that are essential to Hydrx's operations and the maintenance and continuity of Health Canada licenses.

C. LITIGATION

38. The Applicants are currently the subject of six legal proceedings:
- a) On January 19, 2017, Zidane Capital Corp. commenced an action in the Supreme Court of British Columbia against Hydrx for an unspecified amount in damages in relation to the purported breach of an alleged amalgamation agreement between the Plaintiff and Hydrx.
 - b) On July 27, 2018, Jacob Securities Inc. and Sasha Jacob commenced an action in the Ontario Superior Court of Justice (Commercial List) seeking an Order that Scientus Pharma deliver 421,377 shares and 165,239 warrants in Scientus Pharma or, alternatively an equivalent amount in monetary damages, plus \$ 162,296.43 in alleged unpaid commissions and \$ 45,000 in alleged unpaid expenses. Scientus Pharma denies the allegations and has defended the action.
 - c) On May 8, 2020, The Cadillac Fairview Corporation Limited commenced an action in the Ontario Superior Court of Justice against Hydrx claiming \$ 1,091,231.55 in damages for an alleged breach of a commercial lease. The independent director has not been advised if this lawsuit has been defended.
 - d) In early 2021 Hydrx was served with three separate lawsuits by three former employees for severance related issues.

D. FACTORY CONTROL

39. The majority of Hydrx's employees were laid off in March 2020 and, currently, the factory is from time to time being staffed by consultants of Canntab Therapeutics Limited ("Canntab"), a public company controlled by FRC. It is not clear if the staffing costs are being paid for by Cobra for the benefit of Canntab or Hydrx.

E. HEALTH CANADA LICENSES

40. *The Cannabis Act* regulates the possession, cultivation, production, distribution, sale, research, testing, import and export and promotion of cannabis based products.

41. With Canntab in control of the factory, Hydrx's "Responsible Person" with Health Canada has been taking instructions from Canntab which could be detrimental to Hydrx's licenses.

F. SALES CONTRACTS

42. Hydrx has on hand two letters of intention from arm's length parties which, if formalized, will generate in the 13 week period, gross revenues of \$ 521,000. The potential annualized revenue of these opportunities, in total, is approximately nine million dollars.
43. It is the Proposed Monitor's understanding that many other licensed producers of cannabis have similar financial issues but the proposed CCAA proceedings will allow Hydrx the opportunity to:
 - a) move forward from a conflicted and deadlocked Board of Directors;
 - b) negotiate with critical suppliers;
 - c) settle litigation;
 - d) maintain and protect its Health Care License; and
 - e) negotiate and consummate new sales and revenue generating opportunities.

OVERVIEW OF HYDRX'S THIRTEEN WEEK CASH FLOW PROJECTION

44. Hydrx, with the assistance of the Proposed Monitor, has prepared a Cash Flow Forecast for the 13-week period from March 22, 2021 to the week ending June 25, 2021 (the "Cash Flow Period") for the purpose of projecting Hydrx's estimated liquidity needs during the Cash Flow Period. A copy of the Cash Flow Forecast is attached as Appendix "A" to this report.
45. The Cash Flow Forecast is presented on a weekly basis during the Cash Flow Period and represents the estimates of management for the projected cash flow during the Cash Flow Period. The Cash Flow Forecast has been prepared by the Applicants using probability and hypothetical assumptions (the "Assumptions") set out in the notes of the Cash Flow Forecast.

46. The Proposed Monitor has reviewed the Cash Flow Forecast through inquiries, analytical procedures, discussions, and review of documents related to the Information supplied to it by certain key members of management and consultants of the Applicant. Based on the Proposed Monitors review, nothing has come to its attention that caused it to believe, in all material respects, that:
- a. the Assumptions are not consistent with the purpose of the Cash Flow Forecast;
 - b. as at the date of this Report, the Assumptions are not suitably supported and consistent with the plans of the Applicants' or do not provide a reasonable basis for the Cash Flow Forecast, given the probable and hypothetical assumptions; or
 - c. the Cash Flow Forecast does not reflect the Assumptions.
47. Hydrx has three bank accounts with the Royal Bank of Canada ("RBC"). The accounts are: one RBC Canadian chequing account used as its main operating account, one RBC US account used for US dollar transactions and one RBC high interest account used to manage cash balances and gain interest.
48. The Cash Flow Forecast includes weekly interest payments to Cobra of \$ 8,333.00 regarding the outstanding loan to WPC of \$ 4,000,000 at 10% which was used to pay out WCE. Hydrx has included these payments in its forecast in order to allow Cobra the ability to pay the interest on this loan.
49. The Cash Flow Forecast shows that during the Cash Flow Period, the Applicants' projected estimated disbursements of approximately \$ 773,000 and receipts of \$ 1,021,000 including the financing of up to \$ 500,000 from the Restart Group. The Restart Group is a group of related individuals to the company who have agreed to finance the company during the initial stay period to keep the cash flow of the company revenue neutral. The Cash Flow Forecast projects that the Applicants' will have sufficient liquidity during the first 13 weeks of the CCAA proceedings, due to the funding from the Restart Group. The Proposed Monitor has confirmed the \$ 500,000 from the Restart Group is currently available in a solicitor's trust account.
50. The last financial information for Hydrx is a balance sheet dated October 31, 2020. A copy of the Balance Sheet is attached as Appendix "B" to this report.

CONCLUSIONS AND RECOMMENDATIONS

51. The Proposed Monitor has reviewed the Applicants' CCAA application materials and has consented to act as Monitor of the Applicants, should this Court grant the Proposed Initial Order.
52. For the reasons stated herein, the Proposed Monitor believes it is appropriate for the Applicants' to be granted protection under the CCAA and respectfully requests that the Court grant the Proposed Initial Order.

All of which is respectfully submitted this 19th day of March, 2021.

**SCHWARTZ LEVITSKY FELDMAN INC., in its capacity
as Proposed Monitor of the Applicant, and not in
its corporate or personal capacity.**

A handwritten signature in black ink, appearing to read 'Alan Page', written over a horizontal line.

Per: Alan Page, CPA, CA, CIRP, LIT

APPENDIX A

Hydrix Farms Ltd. 4 Week Cash Flow Summary	Week 1 19-Mar	Week 2 26-Mar	Week 3 2-Apr	Week 4 9-Apr	Week 5 16-Apr	Week 6 23-Apr	Week 7 30-Apr	Week 8 7-May	Week 9 14-May	Week 10 21-May	Week 11 28-May	Week 12 4-Jun	Week 13 11-Jun	Total
CASH IN TRUST														
Receipts														
Medical Cannabis Sales (1)	-	2,050	4,100	6,800	11,800	27,200	27,200	33,640	14,800	14,800	16,200	16,200	18,000	131,600
Contract Processing (2)	-	6,000	11,500	-	-	-	-	6,000	33,640	36,400	36,400	36,400	36,400	311,980
Retail Sales (3)	-	-	-	-	-	-	-	-	6,000	10,200	16,600	16,600	16,600	78,000
Operating Disbursements														
Payroll and Benefits (4)	(9,000)	(9,000)	(9,000)	(9,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(12,000)	(144,000)
Consulting Fees (5)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(4,800)	(62,400)
General Labour	-	(900)	(1,725)	(4,080)	(4,080)	(4,080)	(5,046)	(5,046)	(5,460)	(5,460)	(5,460)	(5,460)	(5,460)	(52,257)
COGS	-	(308)	(1,208)	(2,340)	(5,100)	(5,850)	(5,940)	(6,906)	(7,266)	(7,680)	(7,890)	(7,890)	(8,160)	(66,537)
Supplies and Raw Materials	(1,800)	(1,800)	-	-	-	(1,800)	-	-	-	-	-	-	-	(5,400)
Regulatory Advisor	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(2,625)	(34,125)
Utilities	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(500)	(6,500)
Office Administration	(7,025)	(7,025)	(7,025)	(7,025)	(9,500)	(9,500)	(9,500)	(9,500)	(9,500)	(9,500)	(9,500)	(9,500)	(9,500)	(113,600)
Other Operating Expenses (6)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(8,333)	(108,333)
Interest	(1,000)	-	(12,000)	-	(12,000)	-	-	-	-	-	-	-	-	(25,000)
Capital Expenditures	(35,083)	(35,291)	(47,216)	(38,703)	(46,938)	(61,488)	(48,744)	(49,710)	(50,484)	(50,898)	(51,108)	(51,108)	(51,378)	(618,152)
Total Operating Disbursements	(50,000)	(50,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(5,000)	(155,000)
Restructuring Professional Fees	(85,083)	(82,241)	(44,166)	(28,103)	(17,938)	(27,488)	(8,144)	(2,670)	(1,044)	5,502	13,092	13,092	14,622	
Net Cash Inflows / (Outflows)														
Cash														
Beginning Balance (7)	500,000	414,917	331,676	287,510	259,407	241,468	213,980	205,836	203,165	202,121	207,623	220,714	233,806	
Net Cash Inflows / (Outflows)	(85,083)	(82,241)	(44,166)	(28,103)	(17,938)	(27,488)	(8,144)	(2,670)	(1,044)	5,502	13,092	13,092	14,622	
Ending Balance	414,917	331,676	287,510	259,407	241,468	213,980	205,836	203,165	202,121	207,623	220,714	233,806	248,428	

Notes:
 (1) Existing inventory to be marketed on Hydrix.ca medical sales platform
 (2) Contract Processing revenue contracts have been executed and will start production March 15
 (3) Retail sales can commence following 60 day notification period to Health Canada
 (4) Employees have been laid off or furloughed in 2020
 (5) Key Personnel are currently engaged as consultants
 (6) Repairs, Reconfigure production line for new contract
 (7) Includes \$500,000 from the Restart Group to be used as needed

Base Annual Fixed Operating Expenses

Insurance	\$132,000
Electricity	\$72,000
Nat Gas	\$36,000
Property Tax	\$96,000
Water/Sewer	\$18,000
Security Monitoring	\$12,000
Software License	\$31,200
Pest Control	\$6,000
Health Canada License Fees	\$24,000
Urgent Maint.	\$12,000
Prevenative Maint.	\$12,000
PPE, Cleaning, etc	\$12,000
Total Annual Operating Expenses	\$463,200

Monthly Base Operating	\$38,600
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Key Employees	Title	Weekly Rate
Employee 1	Head of Security	\$1,800
Employee 2	Registered Person In Charge (RPIC)	\$1,800
Employee 3	Quality Assurance Person (QAP)	\$1,800
Employee 4	Operation Manager	\$1,800
Employee 5	Chief Financial Officer	\$1,800
Employee 6 starting Week 6	General	\$1,500
Employee 7 starting Week 6	General	\$1,500
Weekly Burn		\$12,000

Production Labour

4 Processing Specialists	\$30 per hour, 40 per week each	\$4,800
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Key Suppliers

Insurance

Property tax

Electricity

Natural gas

Water and Sewer

Ample Organics (Seed to sale tracking software, Health Canada compliance)

Pest Control

Security System Monitoring

Health Canada license fees

CRA Excise and Alcohol

Bell Canada (internet connection needed for online sales)

Office365 for email

Webhosting for online sales

GS1 Canada for product GTINs

Canspace.ca – domain registrar. Annual per domain, random dates, roughly \$20 each.

Inmotion Hosting – 6 month renewal. Just renewed in the last 48 hours, so we're good here for roughly 6 months.

SRFax – fax service for customer RX's, billed annually, next payment not due until November, again worth mentioning.

PO Box. Due for renewal before end of March, I think its annual. \$2xx.00 due in the next couple of weeks.

Miller Waste

APPENDIX B

HydRx Farms Ltd.

Balance Sheet

As at October 31st,

2020

Assets

Current assets

Cash	4,580
Other receivables	20721.27
Inventories	2,450,000
deposits	29,509
	<u>2,504,811</u>

Intangible assets	30,258,033
Goodwill	16,072,080
Property, plant and equipment	13,736,752
	<u>60,066,865</u>
Total Assets	<u>62,571,676</u>

Liabilities

Current liabilities

Trade and other payables	-2,293,253
Convertible debentures	-10,993,726
	<u>-13,286,979</u>
Deferred tax liability	<u>-7,955,912</u>

Shareholders' equity

Common shares	-90,409,208
Warrants	-1,975,138
Contributed surplus	-5,448,971
Deficit	56,504,533
	<u>-41,328,784</u>

Liabilities and Shareholders equity	-62,571,675
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