CANOPY GROWTH CORPORATION

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FOR THE THREE AND SIX MONTHS ENDED SEPTEMBER 30, 2020

NOVEMBER 9, 2020

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

Introduction

This Management's Discussion and Analysis ("MD&A") should be read together with other information, including our unaudited condensed interim consolidated financial statements and the related notes to those statements included in Part I, Item 1 of this Quarterly Report (the "Interim Financial Statements"), our consolidated financial statements appearing in our Annual Report on Form 10-K for the year ended March 31, 2020 (as amended, the "Annual Report") and Part I, Item 1A, Risk Factors, of the Annual Report. This MD&A provides additional information on our business, recent developments, financial condition, cash flows and results of operations, and is organized as follows:

- *Part 1 - Business Overview.* This section provides a general description of our business, which we believe is important in understanding the results of our operations, financial condition, and potential future trends.
- *Part 2 - Results of Operations.* This section provides an analysis of our results of operations for the second quarter of fiscal 2021 in comparison to the second quarter of fiscal 2020, and for the six months ended September 30, 2020 in comparison to the six months ended September 30, 2019.
- *Part 3 - Financial Liquidity and Capital Resources.* This section provides an analysis of our cash flows and outstanding debt and commitments. Included in this analysis is a discussion of the amount of financial capacity available to fund our ongoing operations and future commitments.

We prepare and report our Interim Financial Statements in accordance with U.S. GAAP. Our Interim Financial Statements, and the financial information contained herein, are reported in thousands of Canadian dollars, except share and per share amounts or as otherwise stated. We have determined that the Canadian dollar is the most relevant and appropriate reporting currency as, despite continuing shifts in the relative size of our operations across multiple geographies, the majority of our operations are conducted in Canadian dollars and our financial results are prepared and reviewed internally by management in Canadian dollars.

Special Note Regarding Forward-Looking Statements

This Quarterly Report contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and other applicable securities laws, which involve certain known and unknown risks and uncertainties. Forward-looking statements predict or describe our future operations, business plans, business and investment strategies and the performance of our investments. These forward-looking statements are generally identified by their use of such terms and phrases as "intend," "goal," "strategy," "estimate," "expect," "project," "projections," "forecasts," "plans," "seeks," "anticipates," "potential," "proposed," "will," "should," "could," "would," "may," "likely," "designed to," "foreseeable future," "believe," "scheduled" and other similar expressions. Our actual results or outcomes may differ materially from those anticipated. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made.

Forward-looking statements include, but are not limited to, statements with respect to:

- the uncertainties associated with the COVID-19 pandemic, including our ability to continue operations, the ability of our suppliers and distribution channels to continue to operate, the use of our products by consumers, disruptions to the global and local economies due to related stay-at-home orders, quarantine policies and restrictions on travel, trade and business operations and a reduction in discretionary consumer spending;
- laws and regulations and any amendments thereto applicable to our business and the impact thereof, including uncertainty regarding the application of U.S. state and federal law to U.S. hemp (including CBD) products and the scope of any regulations by the U.S. Federal Drug Administration, the U.S. Federal Trade Commission, the U.S. Patent and Trademark Office, the U.S. Department of Agriculture (the "USDA") and any state equivalent regulatory agencies over U.S. hemp (including CBD) products;
- expectations regarding the regulation of the U.S. hemp industry in the U.S., including the promulgation of regulations for the U.S. hemp industry by the USDA;
- expectations regarding the potential success of, and the costs and benefits associated with, our acquisitions, joint ventures, strategic alliances and equity investments;
- the amended plan of arrangement with Acreage Holdings, Inc. ("Acreage"), including the satisfaction or waiver of the conditions to closing of such acquisition;
- the grant, renewal and impact of any license or supplemental license to conduct activities with cannabis or any amendments thereof;
- our international activities and joint venture interests, including required regulatory approvals and licensing, anticipated costs and timing, and expected impact;
- the ability to successfully create and launch brands and further create, launch and scale cannabis-based products and U.S. hemp-derived consumer products in jurisdictions where such products are legal and that we currently operate in;
- the benefits, viability, safety, efficacy, dosing and social acceptance of cannabis, including CBD and other cannabinoids;

- the anticipated benefits and impact of the investment in us (the "CBI Group Investments") by Constellation Brands, Inc. ("CBI") and its affiliates (together, the "CBI Group");
- the potential exercise of the warrants held by the CBI Group, pre-emptive rights and/or top-up rights in connection with the CBI Group Investments, including proceeds to us that may result therefrom or the potential conversion of notes held by the CBI Group in connection with the CBI Group Investments;
- expectations regarding the use of proceeds of equity financings, including the proceeds from the CBI Group Investments;
- the legalization of the use of cannabis for medical or recreational in jurisdictions outside of Canada, the related timing and impact thereof and our intentions to participate in such markets, if and when such use is legalized;
- our ability to execute on our strategy and the anticipated benefits of such strategy;
- the ongoing impact of the legalization of cannabis product types and forms for recreational use in Canada, including federal, provincial, territorial and municipal regulations pertaining thereto, the related timing and impact thereof and our intentions to participate in such markets;
- the ongoing impact of developing provincial, territorial and municipal regulations pertaining to the sale and distribution of cannabis, the related timing and impact thereof, as well as the restrictions on federally regulated cannabis producers participating in certain retail markets and our intentions to participate in such markets to the extent permissible;
- the future performance of our business and operations;
- our competitive advantages and business strategies;
- the competitive conditions of the industry;
- the expected growth in the number of customers using our products;
- our ability or plans to identify, develop, commercialize or expand our technology and research and development initiatives in cannabinoids, or the success thereof;
- expectations regarding revenues, expenses and anticipated cash needs;
- expectations regarding cash flow, liquidity and sources of funding;
- expectations regarding capital expenditures;
- the expansion of our production and manufacturing, the costs and timing associated therewith and the receipt of applicable production and sale licenses;
- the expected growth in our growing, production and supply chain capacities;
- expectations regarding the resolution of litigation and other legal proceedings;
- expectations with respect to future production costs;
- expectations with respect to future sales and distribution channels;
- the expected methods to be used to distribute and sell our products;
- our future product offerings;
- the anticipated future gross margins of our operations;
- accounting standards and estimates;
- expectations regarding our distribution network; and
- expectations regarding the costs and benefits associated with our contracts and agreements with third parties, including under our third-party supply and manufacturing agreements.

Certain of the forward-looking statements contained herein concerning the industries in which we conduct our business are based on estimates prepared by us using data from publicly available governmental sources, market research, industry analysis and on assumptions based on data and knowledge of these industries, which we believe to be reasonable. However, although generally indicative of relative market positions, market shares and performance characteristics, such data is inherently imprecise. The industries in which we conduct our business involve risks and uncertainties that are subject to change based on various factors, which are described further below.

The forward-looking statements contained herein are based upon certain material assumptions that were applied in drawing a conclusion or making a forecast or projection, including: (i) management's perceptions of historical trends, current conditions and expected future developments; (ii) our ability to generate cash flow from operations; (iii) general economic, financial market, regulatory and political conditions in which we operate; (iv) the production and manufacturing capabilities and output from our facilities and our joint ventures, strategic alliances and equity investments; (v) consumer interest in our products; (vi) competition; (vii) anticipated and unanticipated costs; (viii) government regulation of our activities and products including but not limited to the areas of taxation and environmental protection; (ix) the timely receipt of any required regulatory authorizations, approvals, consents, permits and/or licenses; (x) our ability to obtain qualified staff, equipment and services in a timely and cost-efficient manner; (xi) our ability to conduct operations in a safe, efficient and effective manner; (xii) our ability to realize anticipated benefits, synergies or generate revenue, profits or value from our recent acquisitions into our existing operations; (xiii) our ability to continue to operate in light of the COVID-19 pandemic and the impact of the pandemic on demand for, and sales of, our products and our distribution channels; and (xiv) other considerations that management believes to be appropriate in the circumstances. While our management considers these assumptions to be reasonable based on information currently available to management, there is no assurance that such expectations will prove to be correct.

By their nature, forward-looking statements are subject to inherent risks and uncertainties that may be general or specific and which give rise to the possibility that expectations, forecasts, predictions, projections or conclusions will not prove to be accurate, that assumptions may not be correct and that objectives, strategic goals and priorities will not be achieved. A variety of factors, including known and unknown risks, many of which are beyond our control, could cause actual results to differ materially from the forward-looking statements in this Quarterly Report and other reports we file with, or furnish to, the Securities and Exchange Commission (the "SEC") and other regulatory agencies and made by our directors, officers, other employees and other persons authorized to speak on our behalf. Such factors include, without limitation, changes in laws, regulations and guidelines and our compliance with such laws, regulations and guidelines; the risk that the COVID-19 pandemic may disrupt our operations and those of our suppliers and distribution channels and negatively impact the use of our products; consumer demand for cannabis and U.S. hemp products; our reliance on licenses issued by and contractual arrangements with various federal and provincial governmental authorities; future levels of revenues and the impact of increasing levels of competition; our ability to manage disruptions in credit markets or changes to our credit rating; future levels of capital, environmental or maintenance expenditures, general and administrative and other expenses; the success or timing of completion of ongoing or anticipated capital or maintenance projects; business strategies, growth opportunities and expected investment; the adequacy of our capital resources and liquidity, including but not limited to, availability of sufficient cash flow to execute our business plan (either within the expected timeframe or at all); the potential effects of judicial or other proceedings on our business, financial condition, results of operations and cash flows; volatility in and/or degradation of general economic, market, industry or business conditions; our exposure to risks related to an agricultural business, including wholesale price volatility and variable product quality; compliance with applicable environmental, economic, health and safety, energy and other policies and regulations and in particular health concerns with respect to vaping and the use of cannabis and U.S. hemp products in vaping devices; the anticipated effects of actions of third parties such as competitors, activist investors or federal, state, provincial, territorial or local regulatory authorities, self-regulatory organizations, plaintiffs in litigation or persons threatening litigation; changes in regulatory requirements in relation to our business and products; and the factors discussed under the heading "Risk Factors" in the Annual Report. Readers are cautioned to consider these and other factors, uncertainties and potential events carefully and not to put undue reliance on forward-looking statements.

Forward-looking statements are provided for the purposes of assisting the reader in understanding our financial performance, financial position and cash flows as of and for periods ended on certain dates and to present information about management's current expectations and plans relating to the future, and the reader is cautioned that the forward-looking statements may not be appropriate for any other purpose. While we believe that the assumptions and expectations reflected in the forward-looking statements are reasonable based on information currently available to management, there is no assurance that such assumptions and expectations will prove to have been correct. Forward-looking statements are made as of the date they are made and are based on the beliefs, estimates, expectations and opinions of management on that date. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, estimates or opinions, future events or results or otherwise or to explain any material difference between subsequent actual events and such forward-looking statements, except as required by law. The forward-looking statements contained in this Quarterly Report and other reports we file with, or furnish to, the SEC and other regulatory agencies and made by our directors, officers, other employees and other persons authorized to speak on our behalf are expressly qualified in their entirety by these cautionary statements.

Part 1 - Business Overview

We are a leading cannabis company with operations in countries across the world. We produce, distribute and sell a diverse range of cannabis and hemp-based products and other consumer products for both recreational and medical purposes under a portfolio of distinct brands in Canada pursuant to the *Cannabis Act*, and globally pursuant to applicable international and Canadian legislation, regulations and permits.

On October 17, 2018, the *Cannabis Act* came into effect in Canada, regulating both the medical and recreational cannabis markets in Canada and providing provincial, territorial and municipal governments the authority to prescribe regulations regarding the distribution and sale of recreational cannabis. On October 17, 2019, the second phase of recreational cannabis products, specifically, ingestible cannabis, cannabis extracts and cannabis topical products (referred to as "Cannabis 2.0"), were legalized pursuant to certain amendments to the regulations under the *Cannabis Act*. We began selling our cannabis-infused chocolates, cannabis-infused beverage offerings, vape pen power sources and pod-based vape devices across Canada in the fourth quarter of fiscal 2020, with these products complementing our existing flower, oil and softgel products. Our 510-threaded vape cartridges began shipping into the market in April 2020, with product availability varying based on provincial and territorial regulations. Our recreational cannabis products are predominantly sold to provincial and territorial agencies under a "business-to-business" wholesale model, with those provincial and territorial agencies then being responsible for the distribution of our products to brick-and-mortar stores and for online retail sales. We have also opened a network of Tweed and Tokyo Smoke retail stores across Canada, where permissible, to promote brand awareness and drive consumer demand under a "business-to-consumer" model.

Our Spectrum Therapeutics medical division is a global leader in medical cannabis. Spectrum Therapeutics produces and distributes a diverse portfolio of medical cannabis products to healthcare practitioners and medical customers in Canada, and in several other countries where it is federally permissible to do so, and Spectrum Therapeutics also offers education, resource and support programs. In April 2019, we acquired C^3 Cannabinoid Compound Company ("C^3"), Europe's largest cannabinoid-based pharmaceuticals company and a leading manufacturer of dronabinol, a registered active pharmaceutical ingredient in Germany and certain other European countries. The addition of dronabinol has allowed us to expand our portfolio of medical cannabis offerings for our customers in countries where permissible.

Subsequent to the passage of the U.S. Agricultural Improvement Act of 2018 in December 2018, we began building our hemp supply chain in the United States through our investment in hemp growing capability and in processing, extraction and finished goods manufacturing facilities. We sell a line of hemp-derived CBD isolate products under the First & Free brand, including oils, softgels and topical creams, and in September 2020, we launched Martha Stewart CBD, a new line of premium quality, hemp-derived wellness gummies, oils and softgels. In June 2019, we implemented a plan of arrangement (the "Prior Arrangement") pursuant to an arrangement agreement (the "Arrangement Agreement") with Acreage, a U.S. multi-state cannabis operator. Pursuant to the Prior Arrangement, following the occurrence or waiver (at our discretion) of changes in U.S. federal law to permit the general cultivation, distribution, and possession of marijuana or to remove the regulation of such activities from the federal laws of the United States (the "Triggering Event") and subject to the satisfaction or waiver of the conditions set out in the Arrangement Agreement, we agreed to acquire all of the issued and outstanding shares of Acreage. In June 2020, we entered into the Proposal Agreement (as defined below) with Acreage to amend the terms of the Prior Arrangement. In September 2020, following receipt of all required approvals, we entered into a second amendment to the Arrangement Agreement with Acreage and implemented an amended and restated plan of arrangement (the "Amended Arrangement"); refer to "Recent Developments" below for further information. The acquisition of Acreage, if completed, will provide a pathway into cannabis markets in the United States; however, we and Acreage will continue to operate as independent companies until the acquisition of Acreage is completed.

Our other product offerings, which are sold by our subsidiaries in jurisdictions where it is permissible to do so, include (i) vaporizers sold by Storz & Bickel GmbH & Co. KG ("Storz & Bickel"); (ii) beauty, skincare, wellness and sleep products, some of which have been blended with hemp-derived CBD isolate, sold by This Works Products Limited ("This Works"); and (iii) sports nutrition beverages, mixes, protein, gum and mints, some of which have been infused with hemp-derived CBD isolate, sold by BioSteel.

The majority of our products contain THC, CBD, or a combination of these two cannabinoids which are found in the Cannabis sativa plant species. THC is the primary psychoactive or intoxicating cannabinoid found in cannabis. We also refer throughout this MD&A to "hemp", which is a term used to classify varieties of the Cannabis sativa plant that contain CBD and 0.3% or less THC content (by dry weight). Conversely, the term "marijuana" refers to varieties of the Cannabis sativa plant with more than 0.3% THC content and moderate levels of CBD.

Our licensed operational capacity in Canada includes indoor, greenhouse and outdoor cultivation space; post-harvest processing and cannabinoid extraction capability; advanced manufacturing capability for vape products, softgel encapsulation and pre-rolled joints; a beverage production facility; and a chocolate manufacturing facility. These infrastructure investments allow us to supply the recreational and medical markets with a complimentary balance of flower products and extracted cannabinoid input for our oil, CBD and Cannabis 2.0 products. Additionally, we have built a hemp supply chain in the United States, and we hold the necessary licenses to cultivate and produce cannabis in Denmark, allowing us to supply the domestic European market.

We operate in two reportable segments:

- Cannabis, Hemp and Other Consumer Products, which encompasses the production, distribution and sale of a diverse range of cannabis, hemp-based, and other consumer products in Canada and internationally pursuant to applicable international and domestic legislation, regulations and permits; and
- Canopy Rivers Inc. ("Canopy Rivers"), a publicly-traded company in Canada, through which we provide growth capital and strategic support in the global cannabis sector, where federally lawful. Canopy Rivers did not generate net revenue in the three and six months ended September 30, 2020.

Update on the COVID-19 Pandemic

Management has continued to closely monitor the impact of the COVID-19 global pandemic, with a focus on the health and safety of our employees, business continuity and supporting our communities. We established a COVID-19 Management Committee shortly after the declaration of COVID-19 as a global pandemic and implemented various measures to reduce the spread of the virus, as highlighted in the MD&A section of our Annual Report. We have continued to operate under the preventative measures as previously described and have experienced minimal disruption to our production and supply chain. As of the date of the filing of this Quarterly Report, all 32 of our corporate-owned retail stores are open and offering click-and-collect and in-store shopping. Our Canadian medical business, which operates as an e-commerce channel, has continued largely unchanged. Our international medical business operates primarily as a pharmacy model, with pharmacies being deemed essential businesses in Germany and other European countries in which we conduct business. In addition, since our non-production workforce continues to effectively work remotely using various technology tools, we are able to maintain our full operations and internal controls over financial reporting and disclosures.

Given the uncertainties associated with the COVID-19 pandemic, including those related to the use of our products by consumers, disruptions to the global and local economies due to related stay-at-home orders, quarantine policies and restrictions on travel, trade and business operations and a reduction in discretionary consumer spending, we are unable to estimate the impact of the COVID-19 pandemic on our business, financial condition, results of operations, and/or cash flows. The uncertain nature of the impacts of the COVID-19 pandemic may continue to affect our results of operations for the balance of fiscal 2021.

We believe we have sufficient liquidity available from cash and cash equivalents and short-term investments on hand of $673.3 million and $1.0 billion, respectively, at September 30, 2020, and from available capacity under our revolving debt facility to enable us to meet our working capital and other operating requirements, fund growth initiatives and capital expenditures, settle our liabilities, and repay scheduled principal and interest payments on debt. Refer to "Part 3 – Financial Liquidity and Capital Resources" for further information.

Recent Developments

Amendments to Acreage Arrangement

On June 24, 2020, we entered into a proposal agreement (the "Proposal Agreement") with Acreage to amend the terms of the Prior Arrangement made pursuant to the Arrangement Agreement between us and Acreage dated April 18, 2019, as amended on May 15, 2019. Pursuant to the terms of the Prior Arrangement, shareholders of Acreage and holders of certain securities convertible into Existing SVS (as defined below) as of June 26, 2019, received an immediate aggregate total payment of US$300.0 million ($395.2 million) in exchange for granting Canopy Growth both the right and the obligation (the "Acreage financial instrument") to acquire all of the issued and outstanding shares of Acreage following the occurrence or waiver of the Triggering Event and subject to the satisfaction or waiver of the conditions set out in the Arrangement Agreement.

In September 2020, Acreage obtained the requisite approvals of the shareholders of Acreage and the Supreme Court of British Columbia and on September 23, 2020, Canopy Growth and Acreage entered into a second amendment to the Arrangement Agreement and implemented the Amended Arrangement. The Amended Arrangement provides for, among other things, the following:

- A capital reorganization of Acreage (the "Capital Reorganization"), pursuant to which Acreage amended its Notice of Articles and Articles to, among other things, create the Fixed Shares (as defined below), the Floating Shares (as defined below) and the Fixed Multiple Shares (as defined below) and remove the existing Acreage subordinated voting shares (the "Existing SVS"), the existing Acreage proportionate voting shares (the "Existing PVS") and the existing Acreage multiple voting shares (the "Existing MVS"). Pursuant to the Capital Reorganization (i) each outstanding Existing SVS was exchanged for 0.7 of a Fixed Share and 0.3 of a Floating Share; (ii) each outstanding Existing PVS was exchanged for 28 Fixed Shares and 12 Floating Shares; and (iii) each outstanding Existing MVS was exchanged for 0.7 of a Fixed Multiple Share and 0.3 of a Floating Share;
- The new Class E subordinated voting shares (the "Fixed Shares") have the same attributes as the Existing SVS and are listed on the Canadian Securities Exchange (the "CSE") under the ticker symbol ACRG.A.U. Following the occurrence or waiver (at the discretion of Canopy Growth) of the Triggering Event and subject to the satisfaction or waiver of the conditions set out in the Arrangement Agreement (as modified in connection with the Amended Arrangement), Canopy Growth will acquire all of the issued and outstanding Fixed Shares based on an amended exchange ratio equal to 0.3048 of a common share to be received for each Fixed Share held (reduced from 0.5818 per Existing SVS pursuant to the Prior Arrangement). The foregoing exchange ratio for the Fixed Shares is subject to adjustment in accordance with the Amended Arrangement if, among other things, Acreage issues greater than the permitted number of Fixed Shares;
- The new Class D subordinated voting shares (the "Floating Shares") are listed on the CSE under the ticker symbol ACRG.B.U. Upon the occurrence or waiver (at the discretion of Canopy Growth) of the Triggering Event, Canopy Growth will have the right exercisable for a period of 30 days, to acquire all of the issued and outstanding Floating Shares for cash or common shares or a combination thereof, in Canopy Growth's sole discretion at a price equal to the 30-day volume weighted average trading price of the Floating Shares on the CSE, subject to a minimum call price of US$6.41 per Floating Share. The foregoing exchange ratio for the Floating Shares is subject to adjustment in accordance with the Amended Arrangement if Acreage issues greater than the permitted number of Floating Shares. The acquisition of the Floating Shares, if acquired, will take place concurrently with the closing of the acquisition of the Fixed Shares;
- The new Class F multiple voting shares (the "Fixed Multiple Shares") have the same attributes as the Existing MVS, provided that each Fixed Multiple Share entitles the holder thereof to 4,300 votes per share at shareholder meetings of Acreage. Immediately prior to the acquisition of the Fixed Shares, each issued and outstanding Fixed Multiple Share will automatically be exchanged for one Fixed Share and thereafter be acquired by Canopy Growth upon the same terms and conditions as the acquisition of the Fixed Shares;
- If the occurrence or waiver of the Triggering Event does not occur within 10 years from the date the Amended Arrangement was implemented (being September 23, 2020), Canopy Growth's rights to acquire both the Fixed Shares and the Floating Shares will terminate;
- Upon implementation of the Amended Arrangement, Canopy Growth made a cash payment to the shareholders of Acreage and holders of certain securities convertible into Existing SVS in the aggregate amount of US$37.5 million ($49.8 million); and
- Acreage is only permitted to issue an aggregate of up to 32,700,000 Fixed Shares and Floating Shares.

In connection with the implementation of the Amended Arrangement, we advanced US$50.0 million ($67.0 million) to Universal Hemp, LLC, a wholly-owned subsidiary of Acreage ("Acreage Hempco") pursuant to the terms of a secured debenture ("debenture"). In accordance with the terms of the debenture, the funds cannot be used, directly or indirectly, in connection with or for any cannabis or cannabis-related operations in the United States, unless and until such operations comply with all applicable laws of the United States. The debenture bears interest at a rate of 6.1% per annum, matures 10 years from the implementation of the Amended Arrangement or such earlier date in accordance with the terms of the debenture, and all interest payments made pursuant to the debenture are payable in cash by Acreage Hempco. The debenture is not convertible and is not guaranteed by Acreage. An additional US$50.0 million may be advanced pursuant to the debenture subject to the satisfaction of certain conditions by Acreage Hempco.

PharmHouse

PharmHouse Inc. (“PharmHouse”), a joint venture formed on May 7, 2018, between Canopy Rivers and 2615975 Ontario Limited (the “PharmHouse JV Partner”), is a company licensed to cultivate cannabis under the Cannabis Act.

CCAA Proceedings

During the three months ended September 30, 2020, it was determined that the previously anticipated timeline for PharmHouse to generate cash flows from its offtake agreements with Canopy Growth and TerrAscend Canada Inc. would not be met, and the ultimate timing and receipt of cash inflows pursuant to these agreements became uncertain. As a result of this, as well as broader sector-wide challenges impacting the Canadian cannabis industry, PharmHouse did not have sufficient liquidity and capital resources to meet its business objectives and became unable to meet its financial obligations as they became due.

Accordingly, on September 15, 2020, PharmHouse obtained an order (the “Initial Order”) from the Ontario Superior Court of Justice (the “Court”) granting PharmHouse creditor protection under the Companies’ Creditors Arrangement Act (“CCAA”) (the “CCAA Proceedings”). The Court appointed an independent professional services firm to act as the Monitor of PharmHouse in the CCAA Proceedings while PharmHouse explores a restructuring of its business and operations (the “Restructuring”).

PharmHouse Recoverability Assessment

As a result of the CCAA Proceedings and the Restructuring, we determined that there were indicators of impairment present for its investments in various PharmHouse-related financial assets. These investments are described below.

We performed impairment testing for the various PharmHouse-related financial assets by estimating the fair value of PharmHouse en bloc. Due to the lack of profitable operating history for PharmHouse as a cannabis entity, we estimated the fair value of PharmHouse en bloc using an asset-based approach to value PharmHouse’s assets under an orderly liquidation scenario where cannabis operations are not continued at PharmHouse’s facility and the greenhouse is sold for purposes other than cannabis cultivation. This amount was then compared to the carrying values of the various PharmHouse-related financial instruments held by Canopy Growth, in sequence based on the priority of claims on PharmHouse’s assets (the “PharmHouse Recoverability Assessment”). The significant components of this fair value analysis included PharmHouse’s greenhouse facility and retrofits, separable machinery and equipment, saleable inventory, and cash. Significant unobservable inputs used to determine the fair value of PharmHouse’s assets include the selling price per square foot for PharmHouse’s greenhouse facility; the recoverability percentage on the liquidation of PharmHouse’s property, plant and equipment; the selling price per gram of PharmHouse’s existing cannabis inventory; and adjustments for the risk of fair value changes and liquidity. Based on the foregoing, we estimated the recoverable value of PharmHouse’s assets in an orderly liquidation scenario to be approximately $65.0 million. The impact of the PharmHouse Recoverability Assessment on Canopy Growth’s various PharmHouse-related financial instruments is described below.

PharmHouse Financial Guarantee

As at September 30, 2020, PharmHouse had entered a syndicated credit agreement with amended terms (the “PharmHouse Credit Agreement”) with a number of Canadian banks to provide PharmHouse with a committed, non-revolving credit facility (the “PharmHouse Credit Facility”) with a maximum principal amount of $90.0 million, which was fully drawn. The obligations of PharmHouse under the PharmHouse Credit Facility are secured by guarantees of Canopy Rivers and Canopy Rivers Corporation (“CRC”, a wholly-owned subsidiary of Canopy Rivers), and a pledge by CRC of all of the shares of PharmHouse held by it (the “PharmHouse Financial Guarantee”). Accordingly, if PharmHouse is not able to generate sufficient cash flows to service its obligations pursuant to the PharmHouse Credit Facility, we may be required to recognize a financial liability relating to all or a portion of the PharmHouse Financial Guarantee. The PharmHouse Credit Agreement also contains certain representations and warranties and affirmative covenants applicable to Canopy Growth.

Based on the PharmHouse Recoverability Assessment described above, we determined that the fair value of PharmHouse’s assets under an orderly liquidation scenario where the facility is not used for cannabis operations may be less than the principal amount owed by PharmHouse pursuant to the PharmHouse Credit Facility. Accordingly, we estimated that we have a financial liability related to the PharmHouse Financial Guarantee, reflecting the estimated shortfall between the recoverable amount of PharmHouse en bloc and our exposure to the PharmHouse Credit Facility.

As at September 30, 2020, we estimated the current expected credit loss related to its contingent obligation under the PharmHouse Financial Guarantee to be $25.0 million, and recognized a financial liability for this amount in the consolidated balance sheet (March 31, 2020 – $nil) and the associated current expected credit loss in net income (loss) for the three and six months ended September 30, 2020 (three and six months ended September 30, 2019 – $nil).

Other financial assets, including loans receivable

As at September 30, 2020, we had advanced $40.0 million of secured debt financing pursuant to a shareholder loan agreement with PharmHouse (March 31, 2020 – $40.0 million). The shareholder loan has a three-year term and an annual interest rate of 12%, with interest calculated monthly (effective as at the date principal is advanced) and payable quarterly upon the achievement of certain sales-related milestones.

As at September 30, 2020, we had advanced $2.5 million to PharmHouse pursuant to a secured demand promissory note (March 31, 2020 – $2.5 million). The secured demand promissory note is non-interest bearing both before and after demand or default. Based on the terms of the secured demand promissory note, we had recognized the secured demand promissory note as a financial asset initially recorded at fair value and subsequently measured at amortized cost.

On August 4, 2020, we entered into an unsecured demand promissory note agreement with PharmHouse, pursuant to which it made total advances of $1.2 million between August 4, 2020, and September 8, 2020. The unsecured promissory note bears interest at a rate of 12% per annum, calculated and compounded monthly, and is payable on the demand date. Based on the terms of the unsecured demand promissory note, we recognized the instrument as a financial asset initially recorded at fair value and subsequently measured at amortized cost.

Pursuant to the Initial Order, we entered into an agreement to provide a super-priority, debtor-in-possession ("DIP") interim, non-revolving credit facility up to a maximum principal amount of $7.2 million (the "DIP Financing") to enable PharmHouse to continue its day-to-day operations throughout the anticipated Restructuring. The DIP Financing bears interest at a rate of 8% per annum, calculated and compounded monthly and payable on the maturity date, which is the earlier of December 29, 2020, and the date the CCAA Proceedings are terminated. As at September 30, 2020, we had advanced $2.1 million pursuant to the DIP Financing.

As a result of the PharmHouse Recoverability Assessment described above, we recognized current expected credit losses of $25.0 million related to its contingent obligation under the PharmHouse Financial Guarantee and concluded that the following amounts may not be recoverable: (i) $2.1 million advanced pursuant to DIP Financing; (ii) $40.0 million advanced under the shareholder loan agreement; (iii) $2.5 million advanced under the secured demand promissory note; (iv) $1.2 million advanced under the unsecured demand promissory note; and (v) $9.0 million in interest receivable in relation to the aforementioned financial instruments. Additionally, it was determined that certain advances in the amount of $15.0 million provided to PharmHouse by Canopy Growth may not be recoverable. Accordingly, we recorded expected credit losses on financial assets and related charges of $94.7 million for the three and six months ended September 30, 2020.

PharmHouse equity method investment

As at September 30, 2020, we owned 10,998,660 common shares of PharmHouse (March 31, 2020 – 10,998,660 common shares), representing a 49% equity interest on a non-diluted basis. We have not yet received any distributions on account of its common share investment in PharmHouse. As a result of the PharmHouse Recoverability Assessment described above, we determined that there was an other-than-temporary-impairment and recognized an impairment charge for the full amount of its equity method investment of $32.4 million or the three and six months ended September 30, 2020 (three and six months ended September 30, 2019 – $nil).

British Columbia Production Facility

On November 1, 2020, a production facility owned by the Company in Delta, British Columbia was damaged by a fire. The facility has been non-operational since March 2020. We are in the process of assessing the impact of the fire, including the extent of damages and potential insurance recoveries. As a result, an estimate of the financial effect on our consolidated financial statements is uncertain at this time.

Part 2 - Results of Operations

Discussion of Second Quarter of Fiscal 2021 Results of Operations

(in thousands of Canadian dollars, except share amounts and where otherwise indicated)	Three months ended September 30, 2020	Three months ended September 30, 2019	Change	% Change
Selected financial information:				
Net revenue	$ 135,266	$ 76,613	$ 58,653	77%
Gross margin percentage	19%	5%	-	14%
Net (loss) income	$ (96,552)	$ 242,650	$ (339,202)	(140%)
Net (loss) income attributable to Canopy Growth Corporation	$ (32,061)	$ 258,918	$ (290,979)	(112%)
(Loss) earnings per share - basic	$ (0.09)	$ 0.75	$ (0.84)	(112%)
(Loss) earnings per share - diluted[1]	$ (0.09)	$ 0.25	$ (0.34)	(136%)

[1]For the three months ended September 30, 2020, the weighted average number of outstanding common shares, basic and diluted, totaled 371,520,534. For the three months ended September 30, 2019, the weighted average number of outstanding common shares, basic and diluted, totaled 347,226,921 and 380,323,118, respectively.

Revenue

Revenue by Channel *(in thousands of Canadian dollars)*	Three months ended September 30, 2020	Three months ended September 30, 2019	$ Change	% Change
Recreational net revenue				
Business-to-business[1]	$ 42,223	$ 8,854	$ 33,369	377%
Business-to-consumer	18,709	13,100	5,609	43%
	60,932	21,954	38,978	178%
Medical net revenue				
Canadian[2]	13,888	12,964	924	7%
International	17,474	18,090	(616)	(3%)
	31,362	31,054	308	1%
Cannabis net revenue	92,294	53,008	39,286	74%
Other revenue	42,972	23,605	19,367	82%
Net revenue	$ 135,266	$ 76,613	$ 58,653	77%

[1] Reflects excise taxes of $14,200 and other revenue adjustments, representing our determination of returns and pricing adjustments, of $3,750 for the three months ended September 30, 2020 (three months ended September 30, 2019 - excise taxes of $7,823 and other revenue adjustments of $32,727).

[2] Reflects excise taxes of $1,362 for the three months ended September 30, 2020 (three months ended September 30, 2019 - $1,185).

Revenue by Form	Three months ended September 30,			
(in thousands of Canadian dollars)	2020	2019	$ Change	% Change
Recreational revenue by form				
Dry bud[1]	$ 63,895	$ 59,040	$ 4,855	8%
Oils and softgels[1]	7,021	3,464	3,557	103%
Cannabis 2.0 products	7,966	-	7,966	-
Other revenue adjustments	(3,750)	(32,727)	28,977	89%
Excise taxes	(14,200)	(7,823)	(6,377)	(82%)
	60,932	21,954	38,978	178%
Medical revenue by form				
Dry bud	8,942	9,576	(634)	(7%)
Oils and softgels	23,053	22,663	390	2%
Cannabis 2.0 products	729	-	729	-
Excise taxes	(1,362)	(1,185)	(177)	(15%)
	31,362	31,054	308	1%
Cannabis net revenue	92,294	53,008	39,286	74%
Other revenue	42,972	23,605	19,367	82%
Net revenue	$ 135,266	$ 76,613	$ 58,653	77%

[1] Excludes the impact of other revenue adjustments.

Net revenue in the second quarter of fiscal 2021 was $135.3 million, as compared to $76.6 million in the second quarter of fiscal 2020. The year-over-year increase is primarily attributable to (i) the year-over-year increase in Canadian recreational net revenue; and (ii) the year-over-year increase in other revenue primarily resulting from continued strong performance by Storz & Bickel and the acquisition of BioSteel in October 2019.

Recreational

Canadian recreational net revenue in the second quarter of fiscal 2021 was $60.9 million, as compared to $22.0 million in the second quarter of fiscal 2020.

Net revenue from the business-to-business channel in the second quarter of fiscal 2021 was $42.2 million, as compared to $8.9 million in the second quarter of fiscal 2020. Net revenue in the second quarter of fiscal 2020 was impacted by other revenue adjustments in the amount of $32.7 million related to our determination, at that time, of returns and pricing adjustments associated primarily with the risk of over-supply of certain oil and softgel products. We also benefited in the second quarter of fiscal 2021 from (i) an overall increase in demand resulting from the opening of 185 new retail stores across Canada in the second quarter of fiscal 2021, 46 of which were in Ontario; (ii) an increase in sales of our dry bud product, largely resulting from a competitive repositioning of our product offerings in the value-priced dried flower category that was implemented in the first quarter of fiscal 2021; and (iii) the introduction of our Cannabis 2.0 products, which represented approximately 8% of gross revenue from the business-to-business channel in the second quarter of fiscal 2021. Our cannabis-infused beverage products represented approximately 72% of our Cannabis 2.0 sales in the second quarter of fiscal 2021. These variances resulting in year-over-year net revenue growth were partially offset by an increase in excise taxes of $6.4 million, due primarily to an increase in the volume of value-priced dried flower product sold compared to the prior year.

Revenue from the business-to-consumer channel in the second quarter of fiscal 2021 was $18.7 million, as compared to $13.1 million in the second quarter of fiscal 2020. The year-over-year increase is primarily attributable to (i) year-over-year same-store sales growth of 44%. We benefitted in the second quarter of fiscal 2021 from increased traffic and ticket size at our retail stores as we broadened our brand and product offerings at our retail locations, including the introduction of new value-priced dried flower products, vapes, and cannabis-infused beverages. Additionally, we saw an increase in foot traffic as the Canadian provinces relaxed COVID-19 measures, our communities re-opened, and our stores returned to normal operations; and (ii) the build-out of our retail store platform across Canada. At September 30, 2020, we operated 32 corporate-owned Tweed and Tokyo Smoke retail stores, an increase of 11 stores from September 30, 2019.

Medical

Medical cannabis net revenue in the second quarter of fiscal 2021 was $31.4 million, as compared to $31.1 million in the second quarter of fiscal 2020. Canadian medical net revenue in the second quarter of fiscal 2021 was $13.9 million, as compared to $13.0 million in the second quarter of fiscal 2020. The year-over-year increase is due primarily to an increase in the average order size by our medical customers, resulting largely from (i) the continued broadening of our brand and medical cannabis product offerings available on the Spectrum Therapeutics online store; and (ii) the convenience of our trusted e-commerce channel, which benefited from the slower-than-expected opening of recreational retail stores in Ontario in recent months due largely to the COVID-19 pandemic.

International medical revenue in the second quarter of fiscal 2021 was $17.5 million, a 3% decrease from $18.1 million in the second quarter of fiscal 2020. Our international medical revenue in the second quarter of fiscal 2021 was comprised of revenue from C^3 and our German medical business of $13.6 million and $3.9 million, respectively, compared to $14.0 million and $4.1 million, respectively, in the second quarter of fiscal 2020.

Other

Other revenue is comprised of revenue related to (i) vaporizers sold by Storz & Bickel; (ii) beauty, skincare, wellness and sleep products, some of which have been blended with hemp-derived CBD isolate, sold by This Works; (iii) sports nutrition beverages, mixes, protein, gum and mints, some of which have been infused with hemp-derived CBD isolate, sold by BioSteel; and (iv) other strategic revenue sources such as our clinic partners.

Other revenue in the second quarter of fiscal 2021 was $43.0 million, as compared to $23.6 million in the second quarter of fiscal 2020. The year-over-year increase of $19.4 million is primarily due to increases in revenue from both Storz & Bickel and This Works, and the acquisition of BioSteel in October 2019. Revenue from Storz & Bickel was $21.8 million in the second quarter of fiscal 2021, a year-over-year increase of $10.9 million due primarily to the expansion of our distribution network in the United States. Additionally, This Works contributed revenue totaling $7.8 million in the second quarter of fiscal 2021, a year-over-year increase of $2.0 million due primarily to the expansion of distribution to both direct-to-consumer and third-party e-commerce channels and new product launches. These factors were partially offset by the impact of lower traffic at brick-and-mortar retail stores in the United Kingdom related to the COVID-19 pandemic.

Cost of Goods Sold and Gross Margin

	Three months ended September 30,			
(in thousands of Canadian dollars except where indicated)	2020	2019	$ Change	% Change
Net revenue	$ 135,266	$ 76,613	$ 58,653	77%
Cost of goods sold	$ 109,186	$ 72,970	$ 36,216	50%
Gross margin	26,080	3,643	22,437	616%
Gross margin percentage	19%	5%	-	14%

Cost of goods sold in the second quarter of fiscal 2021 was $109.2 million, as compared to $73.0 million in the second quarter of fiscal 2020. Our gross margin in the second quarter of fiscal 2021 was $26.1 million, or 19% of net revenue, as compared to a gross margin of $3.6 million and gross margin percentage of 5% of net revenue in the second quarter of fiscal 2020. In the second quarter of fiscal 2021, our gross margin percentage was primarily impacted by operating costs relating to facilities not yet cultivating or producing cannabis, not yet producing cannabis-related products or having under-utilized capacity. In the second quarter of fiscal 2021, these costs amounted to $28.2 million and primarily related to (i) start-up costs associated with our indoor cultivation facility in Newfoundland and our gummy production facility in Smiths Falls; and (ii) under-utilized capacity associated with our chocolate factory and vape production facilities in Smiths Falls.

Comparatively, our gross margin percentage in the second quarter of fiscal 2020 was impacted by (i) charges of $17.0 million for excess finished recreational cannabis inventory recorded primarily in connection with our evaluation of the estimated on-hand provincial and territorial inventory levels at that time; (ii) the impact on gross margin of $9.2 million reflecting the returns and pricing adjustments relating primarily to the over-supply of certain oil and softgel products; and (iii) other adjustments related to the net realizable value of inventory. Further, we incurred operating costs of $10.5 million relating to facilities not yet cultivating or processing cannabis, not yet producing cannabis-related products or having under-utilized capacity, primarily related to start-up costs associated with our advanced manufacturing and beverage facilities in Smiths Falls and our greenhouse in Denmark.

Operating Expenses

(in thousands of Canadian dollars)	Three months ended September 30, 2020	2019	$ Change	% Change
Operating expenses				
General and administrative	$ 69,555	$ 94,228	$ (24,673)	(26%)
Sales and marketing	43,373	62,089	(18,716)	(30%)
Research and development	14,166	11,935	2,231	19%
Acquisition-related costs	3,472	2,562	910	36%
Depreciation and amortization	16,687	10,787	5,900	55%
Selling, general and administrative expenses	147,253	181,601	(34,348)	(19%)
Share-based compensation	19,901	83,767	(63,866)	(76%)
Share-based compensation related to acquisition milestones	2,083	9,114	(7,031)	(77%)
Share-based compensation expense	21,984	92,881	(70,897)	(76%)
Expected credit losses on financial assets and related charges	94,745	-	94,745	-
Asset impairment and restructuring costs	46,363	-	46,363	-
Total operating expenses	$ 310,345	$ 274,482	$ 35,863	13%

Selling, general and administrative expenses

Selling, general and administrative expenses in the second quarter of fiscal 2021 were $147.3 million, as compared to $181.6 million in the second quarter of fiscal 2020.

General and administrative expense in the second quarter of fiscal 2021 was $69.6 million, as compared to $94.2 million in the second quarter of fiscal 2020. The year-over-year decrease is due primarily to:

- Losses recorded in the second quarter of fiscal 2020 of $10.8 million related to legal disputes with a third-party supplier, and $8.8 million associated with additional reserves on onerous lease obligations. These losses did not recur in the second quarter of fiscal 2021.
- A reduction in costs attributable to the restructuring actions initiated in the fourth quarter of fiscal 2020, resulting from an organizational and strategic review of our business. Accordingly, as we exited non-strategic geographies, rationalized our production capability and infrastructure footprint, and began streamlining our operations, we realized reductions related to (i) compensation costs for finance, information technology, legal and other administrative functions; (ii) facilities and insurance costs; and (iii) scaling-back on our expansion and business development initiatives. Partially offsetting these cost reductions was a year-over-year increase in third-party professional fees associated with the organizational and strategic review of our business, and third-party information technology costs to support our business.

Sales and marketing expense in the second quarter of fiscal 2021 was $43.4 million, as compared to $62.1 million in the second quarter of fiscal 2020. In the comparative prior period we incurred (i) costs attributable to product marketing and brand awareness advertising and media campaigns in support of the launch of our Cannabis 2.0 portfolio of products and the launch of our First & Free line of CBD products in the United States, and (ii) staffing costs associated with servicing our Canadian and United States markets in the areas of creative design and advertising, brand insights and launch support, and brand management. These costs did not recur to the same extent in the second quarter of fiscal 2021, as we rationalized our Canadian marketing organization in April 2020, delayed or cancelled various planned product and brand marketing initiatives across our business due to measures established to contain the spread of the COVID-19 pandemic, and incurred significantly reduced travel costs due to travel restrictions. The above factors that resulted in a year-over-year decrease in sales and marketing expense were partially offset by (i) higher advertising and promotion expenses associated with new market awareness campaigns in support of price changes and new product launches for our Canadian recreational cannabis business, and in support of the Martha Stewart line of CBD products in the United States; and (ii) the growth in our business as compared to the second quarter of fiscal 2020 resulting primarily from the acquisitions of C^3 in April 2019, This Works in May 2019 and BioSteel in October 2019.

Research and development expense in the second quarter of fiscal 2021 was $14.2 million, as compared to $11.9 million in the second quarter of fiscal 2020. The year-over-year increase is primarily attributable to (i) higher third-party professional fees, particularly associated with conducting research and testing for dronabinol-based health products and therapies. Specifically, costs increased year-over-year due to the acquisition of C^3 in April 2019; and (ii) costs related to research and development of patent-protected technology, most notably in relation to product innovation, plant science and extraction technology. The above factors that resulted in a year-over-year increase in research and development expense were partially offset by lower third-party professional fees associated with a refocusing of Spectrum Therapeutics' research objectives.

Acquisition-related costs in the second quarter of fiscal 2021 were $3.5 million, as compared to $2.6 million in the second quarter of fiscal 2020. In the second quarter of fiscal 2021, costs were incurred in relation to implementing the Amended Arrangement with Acreage, as described in "Recent Developments" above. Comparatively, in the second quarter of fiscal 2020, costs were incurred primarily in relation to the acquisition of BioSteel, which closed in October 2019, and evaluating other potential acquisition opportunities.

Depreciation and amortization expense in the second quarter of fiscal 2021 was $16.7 million, as compared to $10.8 million in the second quarter of fiscal 2020. The year-over-year increase is primarily attributable to the growth in our business over the past year with the acquisitions of C^3, BioSteel and This Works, and our investment in the build-out of our infrastructure across Canada over the past year.

Share-based compensation expense

Share-based compensation expense in the second quarter of fiscal 2021 was $19.9 million, as compared to $83.8 million in the second quarter of fiscal 2020. The year-over-year decrease is primarily attributable to:

- The significant number of stock options that were granted in previous years at relatively higher exercise prices, which impacted share-based compensation expense more significantly in previous periods. We granted 22.1 million stock options in fiscal 2019 at a weighted average price of $51.49 per option, as compared to 9.5 million options in fiscal 2020 at a weighted average price of $33.87. The decrease in the number of stock option grants from fiscal 2019 to fiscal 2020 was due to the modification of our share-based compensation program in fiscal 2020; only 295,451 options were granted in the six months ended September 30, 2020, as compared to 5.3 million in the comparative period; and
- The forfeiture or cancellation of 5.9 million stock options in fiscal 2020 and another 5.5 million stock options in the six months ended September 30, 2020 resulting primarily from restructuring actions commenced in the fourth quarter of fiscal 2020. These forfeitures and cancellations also contributed to a year-over-year reduction in share-based compensation expense.

As a result of the changes described above to our share-based compensation program leading to a reduction in the number of stock option grants, and the forfeiture or cancellation of stock options in recent quarters, 25.9 million stock options were outstanding at September 30, 2020, as compared to 32.9 million at September 30, 2019.

Share-based compensation expense related to acquisition milestones in the second quarter of fiscal 2021 was $2.1 million, as compared to $9.1 million in the second quarter of fiscal 2020. The year-over-year decrease is primarily related to (i) the restructuring of our operations in Colombia in the fourth quarter of fiscal 2020, which resulted in the acceleration of share-based compensation expense related to the unvested milestones associated with the acquisitions of Spectrum Colombia S.A.S. ("Spectrum Colombia") and Canindica Capital Ltd. ("Canindica") (as a result, there is no remaining share-based compensation expense to be recognized in association with these acquisitions); and (ii) the achievement, in earlier quarters, of major milestones associated with the acquisitions of Spectrum Colombia, Canindica, and Spectrum Cannabis Denmark Aps ("Spectrum Denmark"), which had resulted in the recognition of share-based compensation expense at that time.

Expected credit losses on financial assets and related charges

In the second quarter of fiscal 2021, we recorded expected credit losses on financial assets and related charges in the amount of $94.7 million, as discussed in "Recent Developments" above.

Asset impairment and restructuring costs

Asset impairment and restructuring costs recorded in operating expenses in the second quarter of fiscal 2021 were $46.4 million. We recorded (i) adjustments related to changes in the estimated fair value of certain of our Canadian production facilities from March 31, 2020; and (ii) charges related to rationalizing certain research and development activities.

Other

	Three months ended September 30,			
(in thousands of Canadian dollars)	2020	2019	$ Change	% Change
Loss from equity method investments	$ (32,991)	$ (2,171)	$ (30,820)	(1420%)
Other income (expense), net	221,256	509,893	(288,637)	(57%)
Income tax (expense) recovery	(552)	5,767	(6,319)	(110%)

Loss from equity method investments

The loss from equity method investments in the second quarter of fiscal 2021 was $33.0 million, as compared to $2.2 million in the second quarter of fiscal 2020. The year-over-year increase in the loss is primarily attributable to impairment charges of $32.4

million recognized in the second quarter of fiscal 2021 relating to our equity method investment in PharmHouse, as discussed in "Recent Developments" above.

Other income (expense), net

Other income (expense), net in the second quarter of fiscal 2021 was $221.3 million, as compared to $509.9 million in the second quarter of fiscal 2020. The year-over-year decrease of $288.6 million is primarily attributable to:

- A decrease in non-cash income of $576.7 million related to fair value changes on the warrant derivative liability associated with the Tranche B Warrants held by CBI. The decrease of $65.2 million in the fair value of the warrant derivative liability (resulting in non-cash income) in the second quarter of fiscal 2021 is primarily attributable to a decline of approximately 15% in our share price from July 1, 2020 to September 30, 2020 and changes during the quarter in certain other assumptions used to value the liability, including the risk-free interest rate. Comparatively, the decrease of $641.9 million in the fair value of the warrant derivative liability in the second quarter of fiscal 2020 was attributable to a decline of approximately 42% in our share price from July 1, 2019 to September 30, 2019.
- Change of $176.3 million, from an income amount of $164.4 million in the second quarter of fiscal 2020 to an expense amount of $11.9 million in the second quarter of fiscal 2021, related to the non-cash fair value changes on our senior convertible notes. The year-over-year change is primarily due to the larger decline in our share price in the second quarter of fiscal 2020 (approximately 42%) relative to the decline in the second quarter of fiscal 2021 (15%), along with year-over-year changes in credit spreads.
- A decrease in interest income of $13.7 million, primarily attributable to the year-over-year decrease in our cash and cash equivalents and short-term investments balances and lower interest rates relative to the prior year.
- Change of $323.3 million related to the fair value changes on the liability arising from the Acreage Arrangement, from an expense amount of $235.2 million in the second quarter of fiscal 2020 to an income amount of $88.2 million in the second quarter of fiscal 2021. The current quarter income amount, associated with a decrease in the liability arising from the Acreage Arrangement, is primarily attributable to the implementation of the Amended Arrangement with Acreage in September 2020, as described above in "Recent Developments". On a quarterly basis, we determine the fair value of the Acreage financial instrument using a probability-weighted expected return model, incorporating several potential scenarios and outcomes associated with our arrangement with Acreage. The implementation of the Amended Arrangement in September 2020 resulted in (i) an incremental payment to Acreage shareholders of US$37.5 million ($49.8 million); (ii) the loan advance of US$50.0 million ($67.0 million) to Acreage Hempco pursuant to the debenture and the removal of the estimated discount on the loan, now captured through the loan's recognition at fair value at September 30, 2020; and (iii) the removal of the uncertainties related to the approval and implementation of the terms of the Amended Arrangement, including the reset of the exchange ratio, that existed at June 30, 2020 and had impacted our model and resulted in a higher liability amount at that time. Comparatively, the expense amount of $235.2 million in the second quarter of fiscal 2020 was primarily attributable to overall declines in both Canopy Growth's and Acreage's share prices, as well as share prices across multi-state cannabis operators in the United States.
- Change of $151.8 million related to non-cash fair value changes on our other financial assets, from an expense amount of $69.7 million in the second quarter of fiscal 2020 to an income amount of $82.1 million in the second quarter of fiscal 2021. The current quarter changes are primarily attributable to fair value increases relating to our investments in the TerrAscend exchangeable shares ($61.0 million), and the TerrAscend Canada secured debenture and TerrAscend warrants (totaling $55.9 million), driven largely by an increase of approximately 101% in TerrAscend's share price from July 1 to September 30, 2020. Comparatively, in the second quarter of fiscal 2020 the expense amount was primarily driven by decreases of $40.0 million and $25.0 million in the fair value of our exchangeable shares in TerrAscend and warrants in the capital of SLANG Worldwide Inc., respectively, which were in-line with declines in share prices across multi-state cannabis operators in the United States. Partially offsetting these year-over-year fair value increases was a fair value decrease of $23.3 million representing the difference between the loan advanced to Acreage Hempco, and the debenture's estimated fair value using a discounted cash flow model. The discount resulted from our assessment of the market interest rate currently available on comparable issuances of debt relative to the debenture's stated interest rate of 6.1% per annum.

Income tax (expense) recovery

Income tax expense in the second quarter of fiscal 2021 was $0.6 million, compared to income tax recovery of $5.8 million in the second quarter of fiscal 2020. In the second quarter of fiscal 2021, the income tax expense consisted of a deferred income tax recovery of $1.1 million (compared to a recovery of $11.9 million in the second quarter of fiscal 2020) and current income tax expense of $1.6 million (compared to an expense of $6.1 million in the second quarter of fiscal 2020).

The decrease of $10.8 million in the deferred income tax recovery is primarily a result of (i) recording a reduction in deferred tax liabilities that arose in connection with the required revaluation of the accounting carrying value, but not the tax basis, of property, plant and equipment, intangible assets, and other financial assets; and (ii) the recognition of losses carried forward net of the use of losses carried forward from prior years for which a deferred tax asset had been recorded. In connection with certain deferred tax assets, mainly in respect of losses for tax purposes, where the accounting criteria for recognition of an asset has yet to be satisfied and it is not probable that they will be used, the deferred tax asset has not been recognized.

The decrease of $4.5 million in the current income tax expense arose primarily in connection with acquired legal entities that generated income for tax purposes during prior periods that could not be reduced by the group's tax attributes but whose current period income will now be reduced by the group's tax attributes.

Net (Loss) Income

Net loss in the second quarter of fiscal 2021 was $96.6 million, as compared to net income of $242.7 million in the second quarter of fiscal 2020. The year-over-year change from net income to net loss is primarily attributable to the year-over-year decrease in other income (expense), net, and the other variances described above.

Segmented Analysis

In the second quarters of fiscal 2021 and fiscal 2020, all of our revenue was earned by the Cannabis, Hemp and Other Consumer Products segment. Canopy Rivers contributed a net loss of $91.8 million in the second quarter of fiscal 2021, of which $24.7 million was attributable to Canopy Growth. In the second quarter of fiscal 2020, Canopy Rivers contributed a net loss of $2.7 million, of which $0.7 million was attributable to Canopy Growth. The increase in the net loss reflects the impairment losses and expected credit losses related to the PharmHouse equity method investment and associated financial assets, as described under "Recent Developments" above.

Adjusted EBITDA (Non-GAAP Measure)

Our "Adjusted EBITDA" is a non-GAAP measure used by management that is not defined by U.S. GAAP and may not be comparable to similar measures presented by other companies. Management calculates Adjusted EBITDA as the reported net (loss) income, adjusted to exclude income tax recovery (expense); other income (expense), net; loss on equity method investments; share-based compensation expense; depreciation and amortization expense; asset impairment and restructuring costs; expected credit losses on financial assets and related charges; and charges related to the flow-through of inventory step-up on business combinations, and further adjusted to remove acquisition-related costs. Accordingly, management believes that Adjusted EBITDA provides meaningful and useful financial information as this measure demonstrates the operating performance of businesses.

The following table presents Adjusted EBITDA for the three months ended September 30, 2020 and 2019:

	Three months ended September 30,			
(in thousands of Canadian dollars)	2020	2019	$ Change	% Change
Net (loss) income	$ (96,552)	$ 242,650	$ (339,202)	(140%)
Income tax expense (recovery)	552	(5,767)	6,319	110%
Other (income) expense, net	(221,256)	(509,893)	288,637	57%
Loss on equity method investments	32,991	2,171	30,820	1420%
Share-based compensation[1]	21,984	92,881	(70,897)	(76%)
Acquisition-related costs	3,472	2,562	910	36%
Depreciation and amortization[1]	31,758	25,016	6,742	27%
Asset impairment and restructuring costs	46,363	-	46,363	-
Expected credit losses on financial assets and related charges	94,745	-	94,745	-
Charges related to the flow-through of inventory step-up on business combinations	281	-	281	-
Adjusted EBITDA[2]	$ (85,662)	$ (150,380)	$ 64,718	43%

[1] From Condensed Interim Consolidated Statements of Cash Flows.

[2]Adjusted EBITDA is a non-GAAP measure and is calculated as the reported net (loss) income, adjusted to exclude income tax (expense) recovery; other income (expense), net; loss on equity method investments; share-based compensation expense; depreciation and amortization expense; asset impairment and restructuring costs; expected credit losses on financial assets and related charges; and charges related to the flow-through of inventory step-up on business combinations, and further adjusted to remove acquisition-related costs.

The Adjusted EBITDA loss in the second quarter of fiscal 2021 was $85.7 million, as compared to the Adjusted EBITDA loss of $150.4 million in the second quarter of fiscal 2020. The year-over-year decrease in the Adjusted EBITDA loss is primarily attributable to the improvement in our gross margin percentage, and a year-over-year reduction in our selling, general and administrative expense.

Discussion of Results of Operations for the Six Months Ended September 30, 2020

(in thousands of Canadian dollars, except share amounts and where otherwise indicated)	Six months ended September 30, 2020	2019	Change	% Change
Selected financial information:				
Net revenue	$ 245,682	$ 167,095	$ 78,587	47%
Gross margin percentage	13%	13%	-	-
Net (loss) income	$ (224,874)	$ 48,599	$ (273,473)	(563%)
Net (loss) income attributable to Canopy Growth Corporation	$ (140,562)	$ 73,049	$ (213,611)	(292%)
(Loss) earnings per share - basic	$ (0.38)	$ 0.21	$ (0.59)	(281%)
(Loss) earnings per share - diluted[1]	$ (0.38)	$ 0.19	$ (0.57)	(300%)

[1]For the six months ended September 30, 2020, the weighted average number of outstanding common shares, basic and diluted, totaled 367,663,135. For the six months ended September 30, 2019, the weighted average number of outstanding common shares, basic and diluted, totaled 346,028,903 and 382,765,533, respectively.

Revenue

Revenue by Channel *(in thousands of Canadian dollars)*	Six months ended September 30, 2020	2019	$ Change	% Change
Recreational net revenue				
Business-to-business[1]	$ 77,157	$ 47,735	$ 29,422	62%
Business-to-consumer	28,039	23,738	4,301	18%
	105,196	71,473	33,723	47%
Medical net revenue				
Canadian[2]	27,798	24,650	3,148	13%
International	37,665	28,586	9,079	32%
	65,463	53,236	12,227	23%
Cannabis net revenue	170,659	124,709	45,950	37%
Other revenue	75,023	42,386	32,637	77%
Net revenue	$ 245,682	$ 167,095	$ 78,587	47%

[1] Reflects excise taxes of $21,446 and other revenue adjustments, representing our determination of returns and pricing adjustments, of $7,150 for the six months ended September 30, 2020 (six months ended September 30, 2019 - excise taxes of $19,367 and other revenue adjustments of $40,727).

[2] Reflects excise taxes of $2,788 for the six months ended September 30, 2020 (six months ended September 30, 2019 - $2,550).

Revenue by Form	Six months ended September 30,			
(in thousands of Canadian dollars)	2020	2019	$ Change	% Change
Recreational revenue by form				
Dry bud[1]	$ 104,024	$ 119,894	$ (15,870)	(13%)
Oils and softgels[1]	14,742	11,673	3,069	26%
Cannabis 2.0 products	15,026	-	15,026	-
Other revenue adjustments	(7,150)	(40,727)	33,577	82%
Excise taxes	(21,446)	(19,367)	(2,079)	(11%)
	105,196	71,473	33,723	47%
Medical revenue by form				
Dry bud	19,147	16,786	2,361	14%
Oils and softgels	48,061	39,000	9,061	23%
Cannabis 2.0 products	1,043	-	1,043	-
Excise taxes	(2,788)	(2,550)	(238)	(9%)
	65,463	53,236	12,227	23%
Cannabis net revenue	170,659	124,709	45,950	37%
Other revenue	75,023	42,386	32,637	77%
Net revenue	$ 245,682	$ 167,095	$ 78,587	47%

[1] Excludes the impact of other revenue adjustments.

Net revenue in the six months ended September 30, 2020 was $245.7 million, as compared to $167.1 million in the six months ended September 30, 2019. The year-over-year increase is primarily attributable to (i) the increase in Canadian recreational net revenue; (ii) the increase in other revenue resulting from strong performance by Storz & Bickel, a full six months of revenue contribution from This Works (acquired in May 2019), and the acquisition of BioSteel in October 2019; and (iii) the increase in medical net revenue, which was primarily due to a full six months of revenue contribution from C³ (acquired in April 2019), and year-over-year growth in our German and Canadian medical businesses.

Recreational

Canadian recreational net revenue in the six months ended September 30, 2020 was $105.2 million, as compared to $71.5 million in the six months ended September 30, 2019.

Net revenue from the business-to-business channel in the six months ended September 30, 2020 was $77.2 million, as compared to $47.7 million in the six months ended September 30, 2019. Net revenue in the six months ended September 30, 2019 was impacted by other revenue adjustments in the amount of $40.7 million related to our determination, at that time, of returns and pricing adjustments associated primarily to the risk of over-supply of certain oil and softgel products. We also benefited in the current period from (i) an overall increase in demand resulting from the opening of over 315 new retail stores across Canada in the six months ended September 30, 2020; and (ii) the introduction of our portfolio of Cannabis 2.0 product offerings, which represented approximately 10% of gross revenue from the business-to-business channel. These favorable year-over-year variances were partially offset by lower sales of our dry bud products. We took steps to reposition our product offerings in the value-priced dried flower category in the first quarter of fiscal 2021, the effect of which contributed to a year-over-year improvement in our sales in this category in the second quarter of fiscal 2021. However, increased competition in that particular category of the recreational market – in the form of the number of competitive offerings, particularly those with higher THC potency, and aggressive pricing strategies adopted by some market participants – impacted sales of our dry bud products in the first quarter of fiscal 2021 and resulted in a decline in our dry bud sales during the six months ended September 30, 2020 as compared to the prior year.

Revenue from the business-to-consumer channel in the six months ended September 30, 2020 was $28.0 million, as compared to $23.7 million in the six months ended September 30, 2019. The year-over-year increase is primarily attributable to (i) increased traffic and ticket size at our retail stores, due largely to the broadening of our brand and product offerings at our retail locations, including the introduction of new value-priced dried flower products, vapes, and cannabis-infused beverages; and (ii) the build-out of our retail store platform across Canada to 32 corporate-owned Tweed and Tokyo Smoke retail stores at September 30, 2020, a year-over-year increase of 11 stores. Partially offsetting this increase was the adverse impact, predominantly in the first quarter of fiscal 2021, of the temporary closure of our retail stores in response to the COVID-19 pandemic and their re-opening, beginning in mid-April, with reduced hours and under a “click-and-collect” model with curbside pickup or delivery.

Medical

Medical cannabis net revenue in the six months ended September 30, 2020 was $65.5 million, as compared to $53.2 million in the six months ended September 30, 2019. Canadian medical net revenue in the six months ended September 30, 2020 was $27.8

million, as compared to $24.7 million in the six months ended September 30, 2019. The year-over-year increase is due primarily to (i) the prior year period being impacted by the transition of our medical customers to the Spectrum Therapeutics online store and its more medical-focused range of cannabis products prior to the opening of the Canadian recreational market in October 2018 (since that transition, we have broadened our brand and medical cannabis product offerings available on the Spectrum Therapeutics online store in response to medical customer demand); and (ii) the convenience of our trusted e-commerce channel, which has been benefitting from the slower-than-expected opening of recreational retail stores in Ontario in fiscal 2021 due largely to the COVID-19 pandemic.

International medical revenue in the six months ended September 30, 2020 was $37.7 million, as compared to $28.6 million in the six months ended September 30, 2019. C^3 (acquired in April 2019) contributed a full six months of revenue totaling $28.9 million in the current period, a year-over-year increase of $6.1 million. Additionally, the year-over-year growth in our German medical business of $3.0 million is primarily attributable to the resolution of supply constraints we had experienced early in the prior fiscal year, and which were largely associated with the opening of the recreational cannabis market in Canada.

<u>Other</u>

Other revenue in the six months ended September 30, 2020 was $75.0 million, as compared to $42.4 million in the six months ended September 30, 2019. The year-over-year increase of $32.6 million is primarily due to an increase in revenue from Storz & Bickel, a full six months of revenue contribution from both This Works (acquired in May 2019), and the acquisition of BioSteel in October 2019. Revenue from Storz & Bickel was $39.0 million in the six months ended September 30, 2020, a year-over-year increase of $18.4 million due primarily to strong sales performance and an expansion of our distribution network in the United States. Additionally, This Works contributed a full period of revenue totaling $13.9 million in the six months ended September 30, 2020, a year-over-year increase of $5.7 million due primarily to one incremental month of contribution in the six months ended September 30, 2020, the expansion of distribution to both direct-to-consumer and third-party e-commerce channels, and new product launches. These factors were only partially offset by the impact of the closure of brick-and-mortar retail stores and measures in relation to the COVID-19 pandemic.

Cost of Goods Sold and Gross Margin

	Six months ended September 30,			
(in thousands of Canadian dollars except where indicated)	2020	2019	$ Change	% Change
Net revenue	$ 245,682	$ 167,095	$ 78,587	47%
Cost of goods sold	$ 213,107	$ 145,162	$ 67,945	47%
Gross margin	32,575	21,933	10,642	49%
Gross margin percentage	13%	13%	-	0%

Cost of goods sold in the six months ended September 30, 2020 was $213.1 million, as compared to $145.2 million in the six months ended September 30, 2019. Our gross margin in the six months ended September 30, 2020 was $32.6 million, or 13% of net revenue, as compared to a gross margin of $21.9 million and gross margin percentage of 13% of net revenue in the six months ended September 30, 2019. In the six months ended September 30, 2020, our gross margin percentage was adversely impacted by the following:

- The impact of operating costs relating to facilities not yet cultivating or producing cannabis, not yet producing cannabis-related products or having under-utilized capacity. In the six months ended September 30, 2020, these costs amounted to $36.9 million and primarily related to (i) start-up costs associated with our indoor cultivation facility in Newfoundland, our gummy production facility in Smiths Falls, and our greenhouse in Denmark, and (ii) under-utilized capacity associated with our chocolate, beverage and vape production facilities in Smiths Falls; and
- Lower production output in the six months ended September 30, 2020, particularly in Canada, to align with current and expected market demand. Lower production output, coupled with (i) our fixed costs representing a high proportion of our overall cultivation and manufacturing cost structure; and (ii) the gradual reduction of our variable costs late in the current period, resulted in the under-absorption of these fixed and variable costs and an adverse impact on gross margin in the current period. In connection with these changes to our production strategy we also adjusted our cannabis production profile to focus on higher-potency strains which are more in-demand in the current market, resulting in additional inventory charges in the six months ended September 30, 2020.

Comparatively, our gross margin percentage in the six months ended September 30, 2019 was impacted by (i) charges of $17.0 million for excess finished recreational cannabis inventory recorded primarily in connection with our evaluation of the estimated on-hand provincial and territorial inventory levels at that time; (ii) the impact on gross margin of $9.2 million reflecting the returns and pricing adjustments relating primarily to the over-supply of certain oil and softgel products; and (iii) other adjustments related to the net realizable value of inventory. Additionally, we incurred operating costs of $26.8 million relating to facilities not yet cultivating or processing cannabis, not yet producing cannabis-related products or having under-utilized capacity, primarily related to start-up costs associated with our advanced manufacturing and beverage facilities in Smiths Falls, and our greenhouse in Denmark.

Operating Expenses

(in thousands of Canadian dollars)	Six months ended September 30, 2020	2019	$ Change	% Change
Operating expenses				
General and administrative	$ 134,382	$ 157,516	$ (23,134)	(15%)
Sales and marketing	81,142	112,636	(31,494)	(28%)
Research and development	27,825	20,425	7,400	36%
Acquisition-related costs	4,866	15,744	(10,878)	(69%)
Depreciation and amortization	34,430	20,927	13,503	65%
Selling, general and administrative expenses	282,645	327,248	(44,603)	(14%)
Share-based compensation	48,460	160,848	(112,388)	(70%)
Share-based compensation related to acquisition milestones	4,209	19,395	(15,186)	(78%)
Share-based compensation expense	52,669	180,243	(127,574)	(71%)
Expected credit losses on financial assets and related charges	94,745	-	94,745	-
Asset impairment and restructuring costs	59,157	-	59,157	-
Total operating expenses	$ 489,216	$ 507,491	$ (18,275)	(4%)

Selling, general and administrative expenses

Selling, general and administrative expenses in the six months ended September 30, 2020 were $282.6 million, as compared to $327.2 million in the six months ended September 30, 2019.

General and administrative expense in the six months ended September 30, 2020 was $134.4 million, as compared to $157.5 million in the six months ended September 30, 2019. The year-over-year decrease is primarily attributable to:

- Losses recorded in the second quarter of fiscal 2020 of $10.8 million related to legal disputes with a third-party supplier, and $8.8 million associated with additional reserves on onerous lease obligations. These losses did not recur in the current period.
- A reduction in costs attributable to the restructuring actions initiated in the fourth quarter of fiscal 2020, as described above in our analysis of our results of operations for the second quarter of fiscal 2021. Partially offsetting these cost reductions were a year-over-year increase in third-party professional fees associated with the organizational and strategic review of our business.

Sales and marketing expense in the six months ended September 30, 2020 was $81.1 million, as compared to $112.6 million in the six months ended September 30, 2019. In the comparative period we incurred costs attributable to (i) creative design, brand insights and product marketing campaigns in preparation for the launch of our Cannabis 2.0 portfolio of products and the launch of our First & Free line of CBD products in the United States; (ii) staffing costs associated with servicing our Canadian and United States markets in the areas of creative design and advertising, brand insights and launch support, and brand management; and (iii) media and advertisement placement campaigns to drive brand awareness and educate consumers in support of our Tweed, Tokyo Smoke and other recreational brands at the onset of the opening of the Canadian recreational market in October 2018. These costs did not recur to the same extent in the six months ended September 30, 2020, as we rationalized our Canadian marketing organization in April 2020, delayed or cancelled various product and brand marketing initiatives across our business due to measures established to contain the spread of COVID-19, and incurred significantly reduced travel costs due to travel restrictions.

The above factors resulting in a year-over-year decrease in sales and marketing expense were partially offset by higher compensation costs related to our marketing and sales capabilities servicing (i) the United States market, where initiatives continue to commercialize and drive brand and product awareness for our Martha Stewart line of CBD products; and (ii) the growth in our business as compared to the prior period resulting from the acquisitions of C^3 in April 2019, This Works in May 2019 and BioSteel in October 2019.

Research and development expense in the six months ended September 30, 2020 was $27.8 million, as compared to $20.4 million in the six months ended September 30, 2019. The year-over-year increase is primarily attributable to (i) higher compensation costs associated with an increase in the number of employees conducting research and developing patent-protected technology, most notably in relation to our Cannabis 2.0 products and other product innovation initiatives, plant science and extraction technology; and (ii) a year-over-year increase in costs associated with conducting external laboratory research, testing and clinical trials for CBD, dronabinol, and other cannabinoid-based human and animal health products and therapies. The above factors resulting in a year-over-year increase in research and development expense were partially offset by lower travel costs resulting from travel restrictions due to the COVID-19 pandemic, and lower third-party professional fees associated with a refocusing of Spectrum Therapeutics' research objectives.

Acquisition-related costs in the six months ended September 30, 2020 were $4.9 million, as compared to $15.7 million in the six months ended September 30, 2019. The year-over-year decrease is primarily attributable to more mergers and acquisitions activity in the six months ended September 30, 2019, which included entering into and implementing the Arrangement Agreement with Acreage, closing the acquisitions of C^3 and This Works. Additionally, costs were incurred in relation to the acquisition of BioSteel, which closed in October 2019, and evaluating other potential acquisition opportunities. Comparatively, in the six months ended September 30, 2020, our primary mergers and acquisitions activity related to entering into the Proposal Agreement and Amended Arrangement with Acreage in the first quarter of fiscal 2021, and implementing the Amended Arrangement in the second quarter of fiscal 2021, as described in “Recent Developments” above.

Depreciation and amortization expense in the six months ended September 30, 2020 was $34.4 million, as compared to $20.9 million in the six months ended September 30, 2019. The year-over-year increase is primarily attributable to substantial completion of the build-out of our infrastructure across Canada over the past year, the growth in our business over the past year with the acquisitions of C^3, BioSteel and This Works, and our investment in our infrastructure in Europe and the United States.

Share-based compensation expense

Share-based compensation expense in the six months ended September 30, 2020 was $48.5 million, as compared to $160.8 million in the six months ended September 30, 2019. The year-over-year decrease is primarily attributable to:

- The significant number of stock options that were granted in previous years at relatively higher exercise prices, which impacted share-based compensation expense more significantly in previous periods. We granted 22.1 million stock options in fiscal 2019 at a weighted average price of $51.49 per option, as compared to 9.5 million options in fiscal 2020 at a weighted average price of $33.87. The year-over-year decrease in the number of stock option grants was due to the modification of our share-based compensation program in the first half of fiscal 2020, and only 295,451 options were granted in the first quarter of fiscal 2021; and
- The forfeiture or cancellation of 5.9 million stock options in fiscal 2020 and another 5.5 million stock options in the six months ended September 30, 2020 resulting primarily from restructuring actions commenced in the fourth quarter of fiscal 2020. These forfeitures and cancellations also resulted in a year-over-year reduction in share-based compensation expense.

Share-based compensation expense related to acquisition milestones in the six months ended September 30, 2020 was $4.2 million, as compared to $19.4 million in the six months ended September 30, 2019. The year-over-year decrease is primarily related to (i) the restructuring of our operations in Colombia in the fourth quarter of fiscal 2020, which resulted in the acceleration of share-based compensation expense related to the unvested milestones associated with the acquisitions of Spectrum Colombia and Canindica (as a result, there is no remaining share-based compensation expense to be recognized in association with the Spectrum Colombia acquisition and only a minimal amount was recognized in connection with the Canindica acquisition in the current period); and (ii) the achievement, in earlier quarters, of major milestones associated with the acquisitions of Spectrum Colombia, Canindica, and Spectrum Denmark, which had resulted in the recognition of share-based compensation expense at that time.

Expected credit losses on financial assets and related charges

In the six months ended September 30, 2020, we recorded expected credit losses on financial assets and related charges in the amount of $94.7 million, as discussed in “Recent Developments” above.

Asset impairment and restructuring costs

Asset impairment and restructuring costs recorded in operating expenses in the six months ended September 30, 2020 were $59.2 million. In the first quarter of fiscal 2021, we completed certain of the restructuring actions that had commenced in the previous fiscal year, and recorded final adjustments related to changes in certain estimates recorded at March 31, 2020. In addition, we incurred additional costs in the first quarter of fiscal 2021 related primarily to the rationalization of our marketing organization in April 2020. In the second quarter of fiscal 2021, we recorded (i) adjustments related to changes in the estimated fair value of certain of our Canadian production facilities from March 31, 2020; and (ii) charges related to rationalizing certain research and development activities. As a result, in the six months ended September 30, 2020, we recognized asset impairment and restructuring costs of $59.2 million in relation to (i) changes in the estimated fair value of certain of our Canadian production facilities, and costs associated with their closure; (ii) completing the exit of our operations in South Africa and Lesotho; (iii) employee-related costs associated with rationalizing certain marketing activities; and (iv) charges related to rationalizing certain research and development activities.

Other

	Six months ended September 30,			
(in thousands of Canadian dollars)	2020	2019	$ Change	% Change
Loss from equity method investments	$ (40,180)	$ (4,004)	$ (36,176)	(903%)
Other income (expense), net	269,461	542,661	(273,200)	(50%)
Income tax recovery (expense)	2,486	(4,500)	6,986	155%

Loss from equity method investments

The loss from equity method investments in the six months ended September 30, 2020 was $40.2 million, as compared to $4.0 million in the six months ended September 30, 2019. The year-over-year increase in the loss is primarily attributable to impairment charges of $32.4 million recognized in the second quarter of fiscal 2021 relating to our equity method investment in PharmHouse, as discussed in "Recent Developments" above.

Other income (expense), net

Other income (expense), net in the six months ended September 30, 2020 was $269.5 million, as compared to $542.7 million in the six months ended September 30, 2019. The year-over-year decrease of $273.2 million is primarily attributable to:

- A decrease in in non-cash income of $566.2 million related to fair value changes on the warrant derivative liability associated with the Tranche B Warrants held by CBI. The decrease of $100.5 million in the fair value of the warrant derivative liability (resulting in non-cash income) in the six months ended September 30, 2020 is primarily attributable to changes during the period in certain of the assumptions used to value the liability, most notably the decrease in the risk-free interest rate and a slight decrease in the price of our common shares, and the shorter time to maturity of the warrants. Comparatively, the decrease of $666.7 million in the fair value of the warrant derivative liability during the six months ended September 30, 2019 was primarily attributable to a decline of approximately 43% in our share price from the time the terms of the Tranche B Warrants were amended in late June 2019 to September 30, 2019.
- Change of $228.1 million, from an income amount of $195.8 million in the six months ended September 30, 2019 to an expense amount of $32.3 million in the six months ended September 30, 2020, related to the non-cash fair value changes on our senior convertible notes. The year-over-year change is primarily due to the larger decline in our share price in the six months ended September 30, 2019 (47%) relative to the decline in the six months ended September 30, 2020 (1%).
- A decrease in interest income of $27.4 million, primarily attributable to the year-over-year decrease in our cash and cash equivalents and short-term investments balances and lower interest rates relative to the prior year.
- Changes of $288.3 million related the fair value changes on the liability arising from the Acreage Arrangement, from an expense amount of $235.2 million in the six months ended September 30, 2019 to an income amount of $53.2 million in the six months ended September 30, 2020. The current period income amount, associated with a decrease in the liability arising from the Acreage Arrangement, is primarily attributable to the implementation of the Amended Arrangement with Acreage, as described above in "Recent Developments". Specifically, the Amended Arrangement included a reset of the exchange ratio and resulted in other changes to potential scenarios and outcomes associated with our arrangement with Acreage that had been considered in prior valuation models, and had resulted in higher liability balances at those times. Comparatively, the expense amount of $235.2 million in the six months ended September 30, 2019 was primarily attributable to overall declines in both Canopy Growth's and Acreage's share prices, as well as share prices across multi-state cannabis operators in the United States.
- Change of $214.7 million related to non-cash fair value changes on our other financial assets, from an expense amount of $110.8 million in the six months ended September 30, 2019 to an income amount of $103.9 million in the six months ended September 30, 2020. The current period changes are primarily attributable to fair value increases relating to our investments in the TerrAscend exchangeable shares ($67.0 million), and the TerrAscend Canada secured debenture and the TerrAscend warrants ($77.2 million), driven largely by an increase of approximately 136% in TerrAscend's share price from April 1, 2020 to September 30, 2020. Comparatively, in the six months ended September 30, 2019, the expense amount was primarily driven by decreases of $60.0 million and $33.0 million in the fair value of our exchangeable shares in TerrAscend and warrants in the capital of SLANG Worldwide Inc., respectively. Partially offsetting these year-over-year fair value increases was a fair value decrease of $23.3 million representing the difference between the loan advanced to Acreage Hempco and the debenture's estimated fair value measured using a discounted cash flow model.
- Change of $44.5 million related to non-cash fair value changes on acquisition related contingent consideration, from an expense amount in the six months ended September 30, 2019 to an income amount in the six months ended September 30, 2020. In fiscal 2019 we acquired ebbu Inc. ("ebbu"), and the consideration paid included contingent consideration related to the achievement, by ebbu, of certain scientific related milestones. The year-over-year change in the fair value of the acquisition related contingent consideration is primarily attributable to changes in our assessment of the probability and timing of ebbu achieving certain of these milestones.

Income tax recovery (expense)

Income tax recovery in the six months ended September 30, 2020 was $2.5 million, compared to income tax expense of $4.5 million in the six months ended September 30, 2019. In the six months ended September 30, 2020, the income tax recovery consisted of a deferred income tax recovery of $3.2 million (compared to a recovery of $3.6 million in the six months ended September 30, 2019) and current income tax expense of $0.7 million (compared to an expense of $8.1 million in the six months ended September 30, 2019).

The decrease of $0.4 million in the deferred income tax recovery is primarily a result of (i) recording a reduction in deferred tax liabilities that arose in connection with the required revaluation of the accounting carrying value, but not the tax basis, of property, plant and equipment, intangible assets, and other financial assets; and (ii) the recognition of losses carried forward net of the use of losses carried forward from prior years for which a deferred tax asset had been recorded. In connection with certain deferred tax assets, mainly in respect of losses for tax purposes, where the accounting criteria for recognition of an asset has yet to be satisfied and it is not probable that they will be used, the deferred tax asset has not been recognized.

The decrease of $7.4 million in the current income tax expense arose primarily in connection with acquired legal entities that generated income for tax purposes during prior periods that could not be reduced by the group's tax attributes but whose current period income will now be reduced by the group's tax attributes.

Net (Loss) Income

Net loss in the six months ended September 30, 2020 was $224.9 million, as compared to net income of $48.6 million in the six months ended September 30, 2019. The change from net income to net loss is primarily attributable to the year-over-year decrease in other income (expense), net, and the other variances described above.

Segmented Analysis

In the six months ended September 30, 2020 and 2019, all of our revenue was earned by the Cannabis, Hemp and Other Consumer Products segment. Canopy Rivers contributed a net loss of $97.1 million in the six months ended September 30, 2020, of which $26.1 million was attributable to Canopy Growth. In the six months ended September 30, 2019, Canopy Rivers contributed a net loss of $6.0 million, of which $1.6 million was attributable to Canopy Growth. The increase in the net loss reflects the impairment losses and expected credit losses related to the PharmHouse equity method investment and associated financial assets, as described under "Recent Developments" above.

Adjusted EBITDA (Non-GAAP Measure)

The following table presents Adjusted EBITDA for the six months ended September 30, 2020 and 2019:

	Six months ended September 30,			
(in thousands of Canadian dollars)	2020	2019	$ Change	% Change
Net (loss) income	$ (224,874)	$ 48,599	$ (273,473)	(563%)
Income tax (recovery) expense	(2,486)	4,500	(6,986)	(155%)
Other (income) expense, net	(269,461)	(542,661)	273,200	50%
Loss on equity method investments	40,180	4,004	36,176	903%
Share-based compensation[1]	52,669	180,243	(127,574)	(71%)
Acquisition-related costs	4,866	15,744	(10,878)	(69%)
Depreciation and amortization[1]	65,805	45,768	20,037	44%
Asset impairment and restructuring costs	59,157	-	59,157	-
Expected credit losses on financial assets and related charges	94,745	-	94,745	-
Charges related to the flow-through of inventory step-up on business combinations	1,494	-	1,494	-
Adjusted EBITDA[2]	$ (177,905)	$ (243,803)	$ 65,898	27%

[1] From Condensed Interim Consolidated Statements of Cash Flows.
[2] Adjusted EBITDA is a non-GAAP measure and is calculated as the reported net (loss) income, adjusted to exclude income tax (expense) recovery; other income (expense), net; loss on equity method investments; share-based compensation expense; depreciation and amortization expense; asset impairment and restructuring costs; expected credit losses on financial assets and related charges; and charges related to the flow-through of inventory step-up on business combinations, and further adjusted to remove acquisition-related costs.

The Adjusted EBITDA loss in the six months ended September 30, 2020 was $177.9 million, as compared to the Adjusted EBITDA loss of $243.8 million in the six months ended September 30, 2019. The year-over-year decrease in the Adjusted EBITDA loss is primarily attributable to the improvement in our gross margin, and a year-over-year reduction in our selling, general and administrative expenses.

Part 3 – Financial Liquidity and Capital Resources

We manage liquidity risk by reviewing, on an ongoing basis, our sources of liquidity and capital requirements. As of September 30, 2020, we had cash and cash equivalents of $673.3 million and short-term investments of $1.0 billion, which are predominantly invested in liquid securities issued by the United States and Canadian governments. Additionally, we have capacity of $34.7 million under our $40.0 million revolving debt facility with Farm Credit Canada ("FCC"). In evaluating our capital requirements, including the impact, if any, on our business from the COVID-19 pandemic, and our ability to fund the execution of our strategy, we believe we have adequate available liquidity to enable us to meet our working capital and other operating requirements, fund growth initiatives and capital expenditures, settle our liabilities, and repay scheduled principal and interest payments on debt for at least the next twelve months.

Our objective is to generate sufficient cash to fund our operating requirements and expansion plans. To date, we have incurred net losses on a U.S. GAAP basis and Adjusted EBITDA losses, and our cash and cash equivalents have decreased $629.9 million from March 31, 2020 (and, together with short-term investments, decreased $254.3 million from March 31, 2020), as discussed in the "Cash Flows" section below. However, management anticipates the success and eventual profitability of the business. We have also ensured that we have access to public capital markets through our U.S. and Canadian public stock exchange listings. However, there can be no assurance that we will gain adequate market acceptance for our products or be able to generate sufficient positive cash flow to achieve our business plans. In the six months ended September 30, 2020, our purchases of and deposits on property, plant and equipment totaled $90.2 million, which were funded out of available cash, cash equivalents and short-term investments. Included in our purchase obligations for fiscal 2021, as reflected under the heading "Contractual Obligations and Commitments" in the MD&A section of our Annual Report, are commitments for the purchase of property, plant and equipment totaling $73.2 million in fiscal 2021. We expect to continue funding these purchases with our available cash, cash equivalents and short-term investments. Therefore, we are subject to risks including, but not limited to, our inability to raise additional funds through debt and/or equity financing to support our continued development, including capital expenditure requirements, operating requirements and to meet our liabilities and commitments as they come due.

Cash Flows

	Six months ended September 30,	
(in thousands of Canadian dollars)	2020	2019
Net cash (used in) provided by:		
Operating activities	$ (280,295)	$ (372,085)
Investing activities	(568,130)	(935,468)
Financing activities	250,805	(62,508)
Effect of exchange rate changes on cash and cash equivalents	(32,269)	(8,305)
Net decrease in cash and cash equivalents	(629,889)	(1,378,366)
Cash and cash equivalents, beginning of year	1,303,176	2,480,830
Cash and cash equivalents, end of period	$ 673,287	$ 1,102,464

Operating activities

Cash used in operating activities in the six months ended September 30, 2020 totaled $280.3 million, as compared to cash used of $372.1 million in the six months ended September 30, 2019. The year-over-year decrease in the cash used in operating activities was primarily due to the year-over-year reduction in our working capital spending on inventory primarily attributable to the lower production output in the six months ended September 30, 2020, as described in the "Cost of Goods Sold and Gross Margin" section above. This factor was partially offset by the change from net income in the second quarter of fiscal 2020 to a net loss in the second quarter of fiscal 2021 and an overall decrease in the non-cash income and expense items impacting net (loss) income.

Investing activities

The cash used in investing activities totaled $568.1 million in the six months ended September 30, 2020, as compared to cash used of $935.5 million in the six months ended September 30, 2019. In the six months ended September 30, 2020, we invested $90.2 million, primarily in our production infrastructure in the United States, an expansion of our Storz & Bickel facilities, and our indoor facility in Newfoundland. Comparatively, in the six months ended September 30, 2019, we invested $440.2 million in expanding our growing capacity, and the construction of advanced manufacturing capability and a bottling plant at our Smiths Falls location. The year-over-year decrease in our purchases of property, plant and equipment reflects the substantial completion of our cultivation and Cannabis 2.0 infrastructure build-out, and the shift in strategy to an asset-light model in certain markets and sustaining and process improvement investments.

In the six months ended September 30, 2020, we did not complete any acquisitions, whereas in the six months ended September 30, 2019, cash outflows related to acquisitions totaled $416.0, with the most notable outflows relating to our acquisitions of C^3 and

This Works. We completed strategic investments totaling $124.4 million in the six months ended September 30, 2020, including the payment of $49.8 million to Acreage shareholders upon implementation of the Amended Arrangement, and the loan advance of $67.0 million to Acreage Hempco. This compares to strategic investments totaling $431.6 million in the six months ended September 30, 2019, which most notably included the $395.2 million investment in the Acreage financial instrument. Finally, in the six months ended September 30, 2020, we made payments totaling $6.4 million for acquisition-related liabilities, as compared to $21.4 million in the six months ended September 30, 2019 as we continue to draw-down on the amounts owing in relation to acquisitions completed in prior years.

Additional cash inflows during the six months ended September 30, 2020 related to proceeds of $18.3 million from the sale of a portfolio of patents in Germany, and $10.0 million related to a recovery of amounts related to construction financing.

Partially offsetting these decreases in cash outflows was the net purchase of short-term investments in the six months ended September 30, 2020 in the amount of $367.8 million, as compared to the net redemption of short-term investments of $388.0 million in the six months ended September 30, 2019. The year-over-year change reflects our investment of the proceeds from CBI exercising their warrants during the quarter (see below) in relatively safe, liquid investments. Comparatively, in the first quarter of fiscal 2020 we redeemed short-term investments for use for the purposes described above.

Financing activities

The cash provided by financing activities totaled $250.8 million in the six months ended September 30, 2020, as compared to cash used of $62.5 million in the six months ended September 30, 2019. In the six months ended September 30, 2020, we received proceeds of $245.0 million in relation to CBI exercising 18.9 million warrants to purchase our common shares. Comparatively, in the six months ended September 30, 2019, we repaid the Alberta Treasury Board financing in the amount of $95.2 million and made other scheduled debt repayments.

Free Cash Flow (Non-GAAP Measure)

Free cash flow is a non-GAAP measure used by management that is not defined by U.S. GAAP and may not be comparable to similar measures presented by other companies. Management believes that free cash flow presents meaningful information regarding the amount of cash flow required to maintain and organically expand our business, and that the free cash flow measure provides meaningful information regarding our liquidity requirements.

	Three months ended September 30,		Six months ended September 30,	
(in thousands of Canadian dollars)	2020	2019	2020	2019
Net cash used in operating activities	$ (161,749)	$ (213,795)	$ (280,295)	$ (372,085)
Purchases of and deposits on property, plant and equipment	(28,648)	(228,326)	(90,195)	(440,150)
Free cash flow[1]	$ (190,397)	$ (442,121)	$ (370,490)	$ (812,235)

[1]Free cash flow is a non-GAAP measure, and is calculated as net cash provided by (used in) operating activities, less purchases of and deposits on property, plant and equipment.

Free cash flow in the second quarter of fiscal 2021 was an outflow of $190.4 million, as compared to an outflow of $442.1 million in the second quarter of fiscal 2020. The year-over-year decrease in the outflow reflects the decrease in the cash used for operating activities, as described above, and the substantial completion of our cultivation and Cannabis 2.0 infrastructure build-out over the past year and the shift in strategy to an asset-light model in certain markets.

Free cash flow in the six months ended September 30, 2020 was an outflow of $370.5 million, as compared to an outflow of $812.2 million in the six months ended September 30, 2019. The year-over-year decrease in the outflow reflects the decrease in the cash used for operating activities, as described above, and the substantial completion of our infrastructure build-out and shift to a sustaining and process improvement investment strategy.

Debt

Since our formation, we have financed our cash requirements primarily through the issuance of capital stock, including the $5.1 billion investment by CBI in the third quarter of fiscal 2019, and debt. Total debt outstanding as of September 30, 2020 was $533.7 million, as compared to $465.4 million as of March 31, 2020. The total principal amount owing, which excludes fair value adjustments related to our convertible senior notes, was $611.5 million at September 30, 2020, relatively consistent with the principal amount owing of $615.2 million at March 31, 2020.

Convertible senior notes

In June 2018, we issued convertible senior notes with an aggregate principal amount of $600.0 million. The notes bear interest at a rate of 4.25% per annum, payable semi-annually on January 15th and July 15th of each year commencing January 15, 2019. The notes mature on July 15, 2023. Holders of the notes may convert the notes at their option at any time from January 15, 2023 to the maturity date. CBI holds $200.0 million of these notes.

Other

On August 13, 2019, we entered into a $40.0 million revolving debt facility with FCC. This facility replaced all previous loans with FCC and is secured by our property on Niagara-on-the-Lake, Ontario. The outstanding balance at September 30, 2020 is $5.3 million, and the facility bears interest of 3.45%, or the FCC prime rate plus 1.0%, and matures on September 3, 2024. The outstanding balance plus accrued interest was repaid in October 2020.

The revolving debt facility agreement with FCC includes affirmative, negative and financial covenants. As of September 30, 2020, we are in compliance with all covenants in the revolving debt facility agreement.

Further information regarding our debt issuances, including the conversion rights of the senior convertible notes, is included in Note 16 of the Interim Financial Statements.

Contractual Obligations and Commitments

Except for the PharmHouse Financial Guarantee, as described in "Recent Developments" above, there have been no material changes to our contractual obligations and commitments from the information provided in the MD&A section in our Annual Report.

Off-Balance Sheet Arrangements

Except for the PharmHouse Financial Guarantee, as described in "Recent Developments" above, we have no off-balance sheet arrangements that have, or are reasonably likely to have, a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Critical Accounting Policies and Estimates

There have been no material changes to our critical accounting policies and estimates from the information provided in the MD&A section in our Annual Report.