Hot Topics in Continuous Disclosure and Prospectus Filings: What SME issuers need to know

February 5, 2020

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OSC SME Institute - Objectives

- Help SMEs navigate regulatory waters
- Demystify disclosure requirements so issuer can focus on building their business
- Provide an opportunity for information dialogue with OSC staff

ONTARIO SECURITIES COMMISSION

Agenda

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Hot Topics in Continuous Disclosure: Recent Developments and Key Findings

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Mining Disclosure – Recent developments

Role of NI 43-101 ➡ Disclosure

- *NI 43-101 sets minimum standards for disclosure - it does not prescribe how exploration programs are designed and executed or how mineral resource and mineral reserve estimates are prepared.*
- *This means the qualified person, with the required technical competence, relevant experience, professional ethics, and utilizing industry best practices plays a critical role in upholding the success, or failure, of the disclosure regime.*

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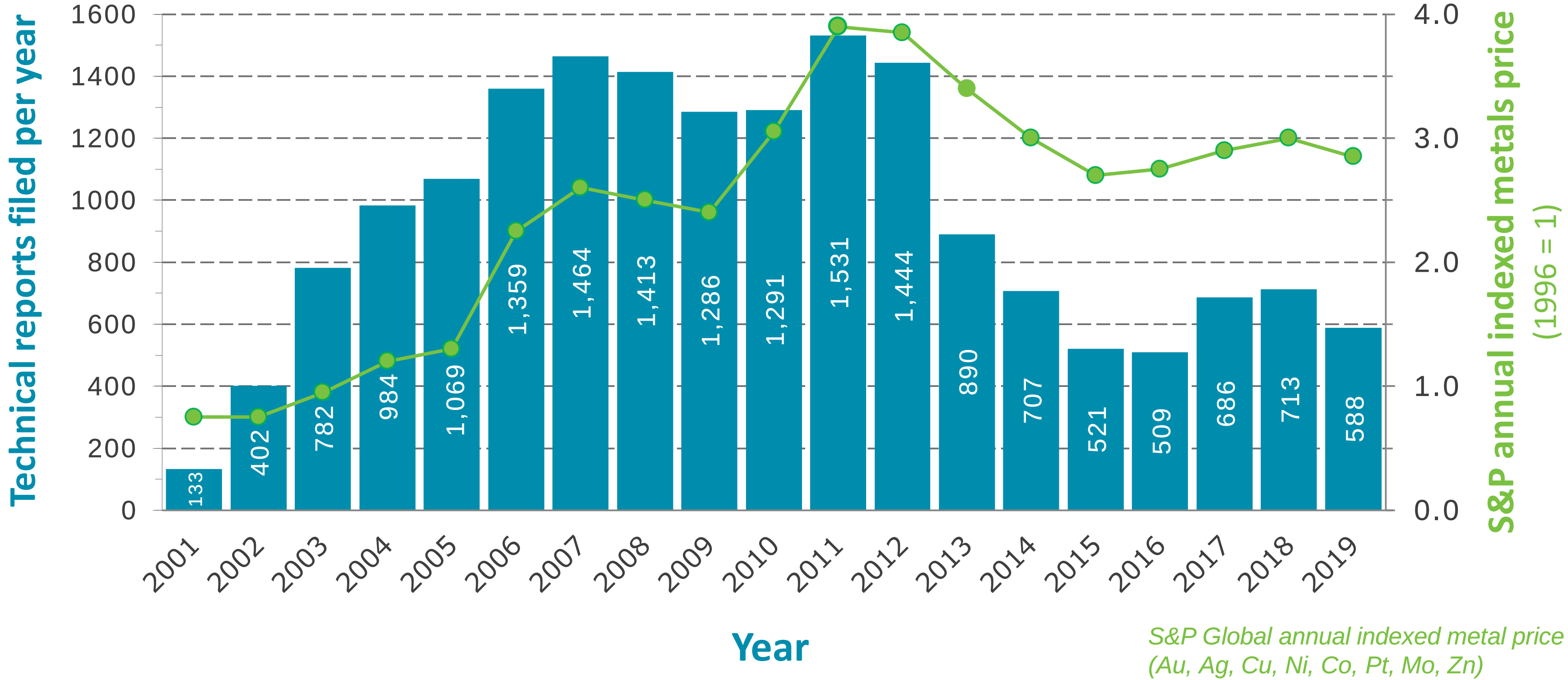
Technical reports filed / year (2001 to 2019)



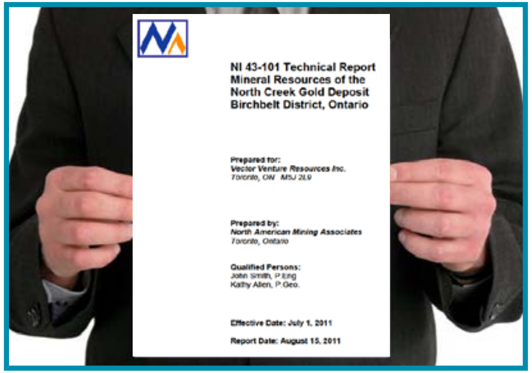
S&P Global annual indexed metal price (Au, Ag, Cu, Ni, Co, Pt, Mo, Zn)

What are the core principles of NI 43-101?

Qualified Person

Standards & Best Practices

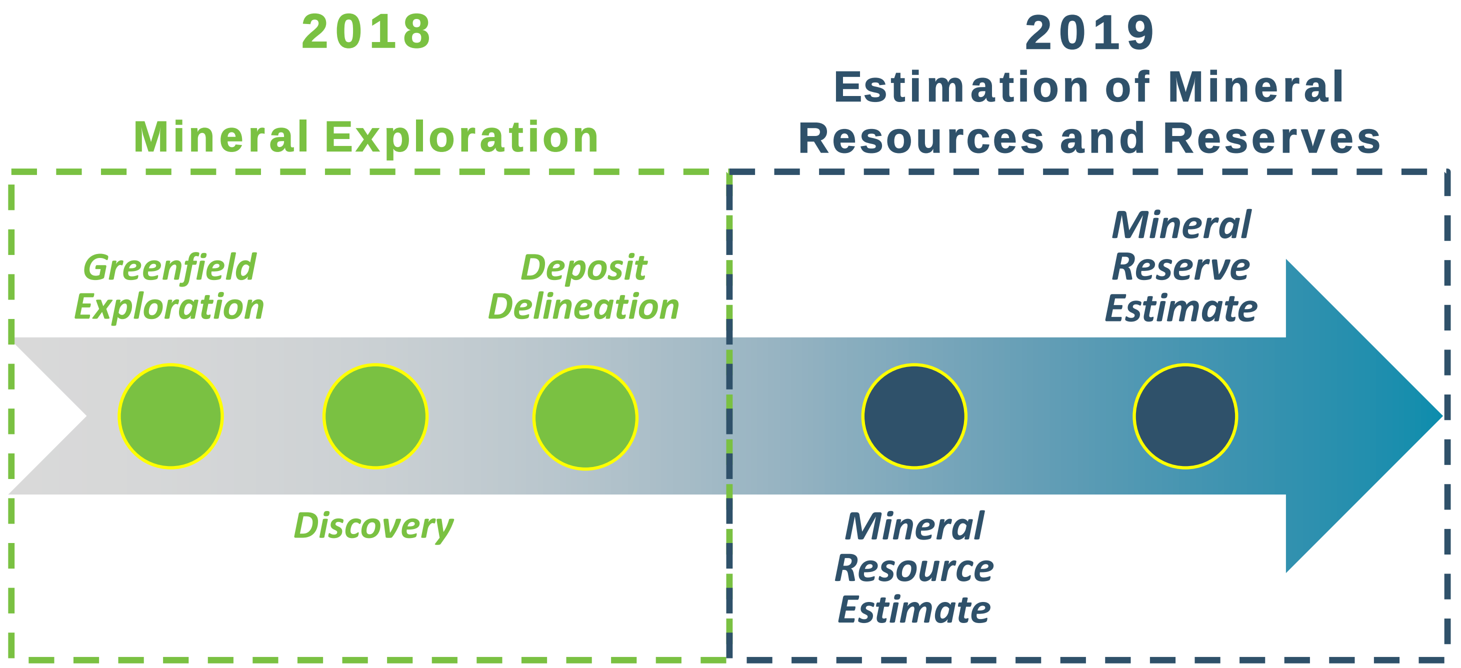
UPDATE



Technical Report

"Disclosure with professional accountability"

Updated CIM best practice guidelines



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CIM best practice guidelines

Exploration

NEW

CIM Mineral Exploration
Best Practice Guidelines

Prepared by the
CIM Mineral Resource and Mineral Reserve Committee
Adopted by CIM Council November 23, 2018

Canadian Institute of Mining, Metallurgy and Petroleum
Suite 1250, 3500 de Maisonneuve Blvd. West
Westmount, Quebec H3Z 3C1 CANADA
Tel.: (514) 939-2710 Fax: (514) 939-2714
mrmr.cim.org | www.cim.org

- Principle-based guidance
- Significantly updates and modernizes previous guidance
- More topics covered

https://mrmr.cim.org/en/best-practices/

Estimation of Resources & Reserves

NEW

CIM Estimation of Mineral Resources
and Mineral Reserves
Best Practice Guidelines

Prepared by the
CIM Mineral Resource and Mineral Reserve Committee

Adopted by the CIM Council on November 29, 2019

The Canadian Institute of Mining, Metallurgy and Petroleum
Suite 1250, 3500 de Maisonneuve Blvd. West
Westmount, Quebec H3Z 3C1 CANADA
Tel.: (514) 939-2710 Fax: (514) 939-2714

Top 5 deficiencies: NI 43-101 (Rule)

- **2.4 Disclosure of historical estimates**
  - Source and date, main assumptions used, cautionary language
- **3.3 Requirements for written disclosure of exploration information**
  - Analytical procedures & name of lab, QA/QC, true widths, higher grade intervals
- **2.3 Restricted disclosure**
  - PEA caution related to inferred, exploration target ranges, cautionary language
- **2.2 All disclosure of mineral resources or mineral reserves**
  - Resource & reserve categories, contained metal only, adding inferred
- **3.1 Written disclosure to include name of qualified person**
  - Qualified person’s name and relationship to the issuer

Top 5 deficiencies: Technical report (Report)

- **Item 3: Reliance on other experts**
  - Relying on other experts (Must be limited to legal, political, environmental, tax)
- **Item 12: Data verification**
  - No data verification by QP, lack of QP's opinion on adequacy of data
- **Item 11: Sample preparation, analyses and security**
  - QA/QC information, assay & analytical procedures, name of lab, sample preparation
- **Item 10: Drilling**
  - Location, azimuth, width, true width, higher grade intervals
- **Item 14: Mineral resource estimates**
  - Key assumptions, parameters, methods, discuss known material risks

SN 51-358 Climate change disclosures

CSA ACVM Canadian Securities Administrators Autorités canadiennes en valeurs mobilières

CSA Staff Notice 51-358
Reporting of Climate Change-related Risks

August 1, 2019

Executive summary

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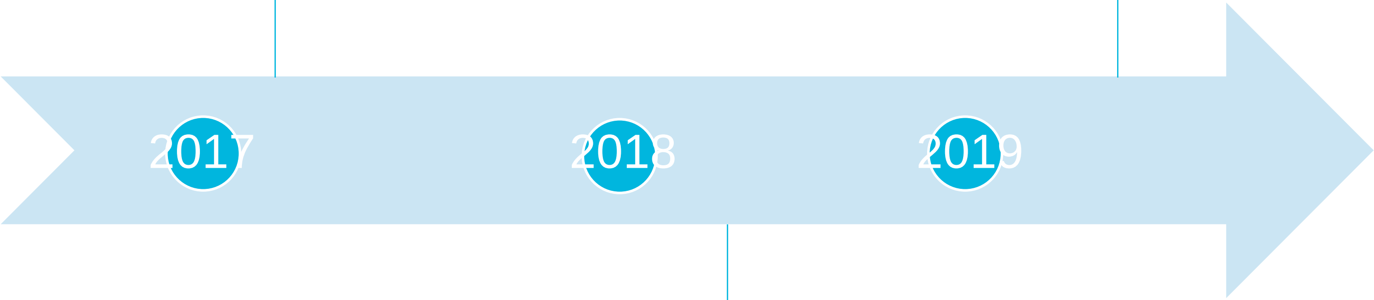
SN 51-358 Climate change disclosures

March 2017: CSA climate change- related disclosures initiative announced

August 2019: CSA Staff Guidance 51-358 *Reporting of Climate Change-related Risks*



April 2018: CSA Staff Notice 51-354 *Report on Climate Change-related Disclosures Project*

SN 51-358 Climate change disclosures

Role of board and management:

The guidance provides practical support to boards and management by providing select questions to help inform their consideration of material climate change-related risks and making appropriate disclosure

SN 51-358 Climate change disclosures

Materiality

Key stakeholder theme

Determining factor in any assessment of whether information is required to be disclosed – only material information needs to be included in an issuer’s AIF and MD&A

Guidance provides both general principles and specific considerations for determining materiality in the context of climate change-related risk

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SN 51-358 Climate change disclosures

Required disclosure

- Section 1.4(g) of Form 51-102F1 (MD&A)
- Section 5.2 of Form 51-102F2 (AIF)

Categories of climate change-related risks

- Physical risks – acute or chronic
- Transitional risk – reputational, market, regulatory, policy, legal and technology

Management Discussion & Analysis (MD&A)

- MD&A is a narrative explanation "through the eyes of management" which:
  - Provides a balanced discussion of an issuer's results, financial condition and future prospects – openly reporting bad news as well as good news
  - Helps current and prospective investors understand what the financial statements show and do not show
  - Discusses trends and risks that have affected or are reasonably likely to affect the financial statements in the future
  - Provides information about the quality and potential variability of an issuer's earnings and cash flow

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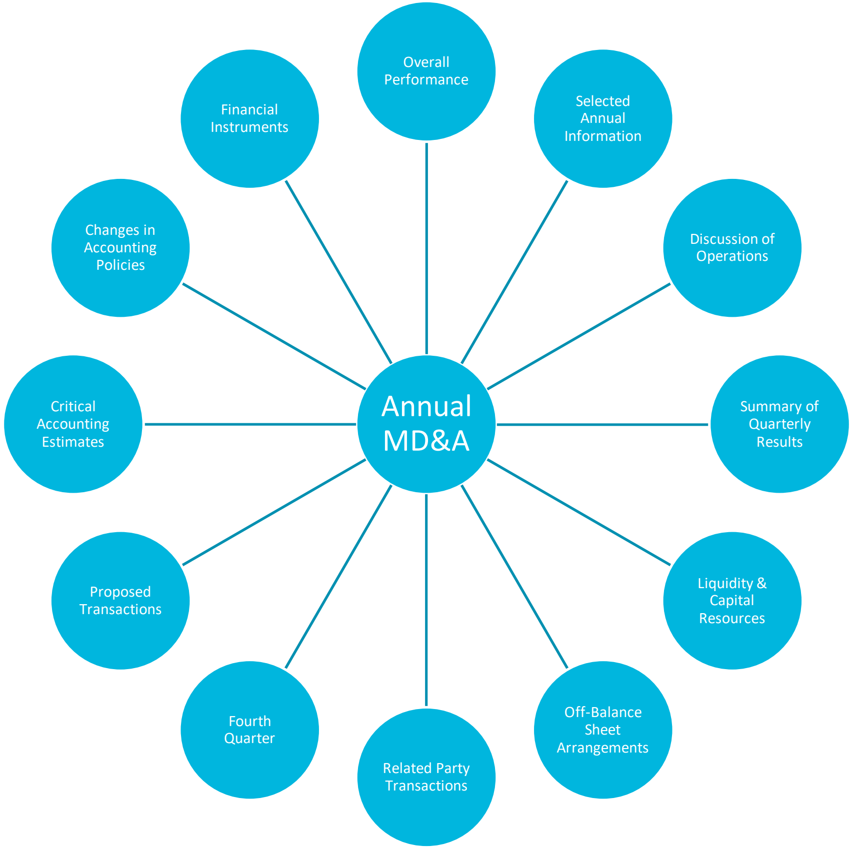
MD&A



MD&A – Discussion of Operations

- We continue to see issuers that provide boilerplate disclosure when discussing their results of operations, such as simply repeating information that is readily available in the financial statements.

- Issuers provide the year over year change in the balance without explaining, in sufficient detail, the key drivers and reasons contributing to the change.

Example of boilerplate disclosure:
The Company reported revenue of $7,600,000 for the year ended December 31, 2019, compared with $7,000,000 a year earlier, an increase of 9%. The growth is mainly due to an increase in the sales of product X.

Repetition from financial statements

No discussion of variances

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MD&A – Discussion of Operations

Areas	Considerations
Revenue	• Have changes caused by the following factors been disclosed? ▪ Selling prices ▪ Volume / quantity of goods and services ▪ Introduction of new products or services ▪ Any other factors
Costs	• Have changes caused by the following factors been disclosed? ▪ Labour and material costs ▪ Price changes ▪ Inventory adjustments

MD&A – Discussion of Operations: Projects not yet generating revenue

Significant Projects

- We continue to see issuers disclose or announce significant projects that are in the early stages of development, but fail to disclose sufficient information about the project. This issue is often observed with issuers who had a change of business and/or are in emerging industries.

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MD&A – Discussion of Operations: Projects not yet generating revenue

Overall plan for the project and/or business

- Current and long term plans
- Key milestones

Project Timeline

- Expected timeline
- Progress
- Expected revenue-generating date

Budget

- Estimated total expenditures
- Expenditures to date
- Expected timing
- Sources of funding

Regulatory and licensing requirements

- Anticipated timeline
- Related risks

Updates

- Status updates
- Delays, cost overruns

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MD&A – Discussion of Operations: Projects not yet generating revenue

Lacks Detail

Does not address future spending

Projects Not Yet Generating Revenue – Example of Boilerplate Disclosure:

In 2019, the Company continued its exploration efforts on the XYZ Lake property including additional drilling on the Fire Zone which continued to intersect significant zone of mineralization.

In 2020, the Company expects to continue its drilling efforts to outline the Fire Zone mineralization and also drill test the geophysical targets. The Company anticipates it will be in a position to disclose an initial mineral resource estimate on the XYZ Lake property in 2020.

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MD&A – Discussion of Operations: Projects not yet generating revenue

Projects Not Yet Generating Revenue – Example of Entity Specific Disclosure:
In 2019, the Company spent $873,100 on exploration expenses on the XYZ Lake property which consisted mainly of two phases of diamond drilling on the Fire Zone (totaling 25 holes for 4,820 metres) which were completed in February, 2019 and September, 2019. This drilling continued to outline significant zones of mineralization, the results of which were reported by the Company in news releases on May 30, 2019, June 24, 2019 and November 29, 2019.

In early 2020, the Company expects to spend approximately $800,000 conducting additional diamond drilling on the Fire Zone as well as follow-up drill testing of the high priority geophysical targets. It is expected that both drilling programs will consist of approximately 20 drill holes totaling about 5,000 metres. The Company anticipates it will be in a position to disclose an initial mineral resource estimate on the XYZ Lake property in 2020.

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MD&A – Discussion of Operations: Projects not yet generating revenue

Expenditures

Status compared to plan

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MD&A – Discussion of Operations: Projects not yet generating revenue

Areas	Considerations
Status	• Is there disclosure of the project's progress compared to the plan? • What is being planned next?
Expenditures	• Have the following been disclosed? ▪ Expenditures to date. ▪ Whether the issuer anticipates spending more than budget on each project. ▪ Amounts that need to be spent to take the project to next level and how it will be funded.

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MD&A - Discussion of Operations: Use of Proceeds from a Financing

Example of Boilerplate Disclosure

“Although the company intends to expend the net proceeds from the prospectus offering as described in its 2019 prospectus, there may be circumstances where for sound business reasons, a reallocation of funds may be deemed prudent or necessary. While actual expenditures may differ from the above amounts and allocations, the net proceeds will be used by the company in furtherance of its business.”

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MD&A - Discussion of Operations: Use of Proceeds from a Financing

Example of Entity Specific Disclosure

Phase	Previously Disclosed	Spent to Date	Variance	Reason	Revised Budget
R&D	$8,800	$10,500	$1,700	Additional design modifications required	$11,000
Testing	$1,200	Nil	($1,200)	Delayed start	$1,200
Total	$10,000	$10,500	$500		$12,200

MD&A - Discussion of Operations: Use of Proceeds from a Financing

Example of Entity Specific Disclosure

"The table above provides an update on the anticipated use of proceeds raised in the most recent financing, along with amounts actually expended and a description of the variances. The company recently determined that additional investment is required to get Project A to the testing phase. The final column of the table indicates the company's revised estimate of the total expenditure required to complete the indicated phase. Given the anticipated increased costs for Project A, the company was not able to use the funds for Project B as noted in the prospectus. The expected budget for Project B remains unchanged from that disclosed in the prospectus and the company is developing a strategy to ensure funding is available so that the time of Project B is not delayed."

MD&A - Discussion of Operations: Use of Proceeds from a Financing

Areas	Considerations
Variances	• How does the nature and amount of expenditures made by the company compare to the use of proceeds from previous financing? • How do variances impact future operations? • How will the variance affect the company's ability to achieve its business objectives and milestones? • Will the company require additional financing to meet its next milestone?
Disclosure	• Have the above items been disclosed? • Does the disclosure comply with MD&A requirements?

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MD&A - Related party disclosures

IAS 24	Form 51-102F1
• Relationship of parents and subsidiaries • Nature of the related party relationship • Amount of RPT, including commitments	• Relationship of related parties • Identity of related parties • Business purpose of the RPT • Recorded amount and measurement basis used • Ongoing commitments

The MD&A should complement and supplement the financial statements. While many of the MD&A requirements for RPTs in Form 51-102F1 are similar to the requirements under IAS 24, Form 51-102F1 specifically requires an issuer to identify the related person or entity, as well as to discuss the business purpose of the transaction.

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MD&A - Related party disclosures

Repetition from financial statements

Related party is not identified

No business purpose of the transactions were disclosed.

As at December 31, 2019, the Company was owed $10,000 from a related party (2018 - $7,500).

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MD&A - Related party disclosures

Related party is identified.

Business purpose of the transaction is disclosed.

Measurement basis of the loan is disclosed.

As at December 31, 2019, the Company was owed $9,742 (2018 - $12,000) from John Smith, the CEO of the Company. An amount of $12,000 was loaned to the CEO at the end of 2018 as a personal loan for a home. The Company offers personal loans for a home to all employees that have worked at the company for 5 years or more up to an amount of $15,000. The loan to the CEO carries interest at 3% and is payable in monthly instalments over a term of 5 years. The loan is carried at amortized cost.

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Forward-looking information

Forward-looking information
Disclosure regarding:

- possible events
- possible financial performance

Based on:

- future economic conditions
- future courses of action
- includes other information such as:
  - key performance indicators
  - FOFI
  - financial outlook
  - targeted efficiencies
  - metal price assumptions
  - projected production levels

FOFI
Forward-looking financial information presented in the format of historical financial statements.

Financial Outlook
Forward-looking financial information **NOT** presented in the format of historical financial statements.

Examples include:

- projected EBITDA
- projected earnings per share (EPS)
- revenue targets
- operating ratios
- R&D spending
- projected operating costs

Forward-looking information

- National Instrument 51-102 – Continuous Disclosure Obligations
  - PART 4A – Forward-looking information
  - PART 4B – FOFI and financial outlooks
  - Part 5.8 – Disclosure relating to previously disclosed material forward-looking information

Forward-looking information

- Example of deficient disclosure
- Since starting operations in 2018, we have focused on growing the number of new stores, and have seen a substantial increase in the pace of store openings as of the most recent quarter (with 17 of the 20 new stores for fiscal 2019 opened in Q4 2019), leading to accelerated sales. New store openings, sales levels and net income for the last two fiscal years are shown below.

	Year ended December 31, 2019 - opened	Year ended December 31, 2018 - opened
# of Stores	20	16
Sales	15M	12.6M

Growth targets(1) We will aggressively pursue growth opportunities, and anticipate that we will increase our store count by 70 new stores in 2020, to reach 106 stores by end of fiscal 2020. We also anticipate that we will reach 256 stores by end of fiscal 2021, and 400 stores by end of fiscal 2022. By rapidly growing our store base, we expect to grow sales to $500 million by the end of fiscal 2021.

(1) Certain disclosures, including the number of new stores and store count as well as future sales levels, represent forward-looking information within the meaning of securities legislation. Readers are urged to consider the risks, uncertainties and assumptions carefully in evaluating the forward-looking information and are cautioned not to place undue reliance on such information. See “Forward-looking Statements” in this MD&A.

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Forward-looking information

- Example of enhanced disclosure

Growth targets[(1)] We will aggressively pursue growth opportunities, and anticipate that we will increase our store count by 70 new stores in 2020, to reach 106 stores by end of fiscal 2020, which corresponds to expected sales of $50 to 80 million for fiscal 2020. We are focused on expanding the number of stores in a responsible manner and using a reasoned growth strategy, targeting major urban centres which meet pre-defined population and income criteria. Management believes this growth target is achievable based on the assumptions and factors disclosed below, and is committed to pursuing new growth opportunities and partnerships.

Assumptions:

- we have agreements, leases and planned launch dates in place for 40 of the 70 new store openings planned for 2020;
- we have substantially negotiated the terms for 15 of the 70 new store openings planned for 2020, but launch dates and locations are still being finalized;
- we are in active discussions with major retail partners for 15 of the 70 new store openings planned for 2020;
- we assume stores are opened evenly throughout the year, and generate on average approximately $0.7- $1.1 million in sales, depending on location.

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Forward-looking information

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Forward-looking information

- Updating previously disclosed forward-looking information

Assumptions for original targets	Q1 results to date
We have agreements, leases and planned launch dates in place for 40 of the 70 new store openings planned for 2020;	We have launched **15** of the 70 planned new store openings for 2020 and are on track to meet the previously disclosed target of 70 store openings in 2020. For the remaining target of **55** stores to be launched, We now have agreements in place for **40** stores planned for 2020.
We have substantially negotiated the terms for 15 of the 70 new store openings planned for 2020, but launch dates and locations are still being finalized;	We have substantially negotiated the terms for **15** additional store openings planned for 2020.
We are in active discussions with major retail partners for 15 of the 70 new store openings planned for 2020;	We have completed the negotiation for the 15 retail partners for new store openings in 2020.
We assume stores are opened evenly throughout the year, and generate on average approximately $0.7-$1.1 million in sales, depending on location.	Due to shift in retail consumer trends away from physical retail stores and towards digital platforms, we have revised our assumptions for average store sales to approximately $0.5 million - $0.8 million, for expected sales of $35M to $56M for fiscal 2020.

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Forward-looking information

- Updating previously disclosed forward-looking information
  - Updates to or notification that FLI is being withdrawn must be included in the MD&A or in a news release.
  - Section 5.8 of NI 51-102 provides flexibility to allow the updated information to be included in a news release as long as it is filed prior to the MD&A. In this case, the MD&A must refer to the news release to satisfy the requirements.
  - The disclosure and discussion of material differences between actual results and previously disclosed FOFI or financial outlook must be included in the MD&A; including this information in a news release instead of the MD&A is not permitted.

Overly promotional disclosure

- **CSA Staff Notice 51-356 *Problematic promotional activities by issuers***
  - Contains examples of promotional activities that may be misleading
  - Contains relevant requirements and guidance
    - National Policy 51-201 Disclosure Standards
    - CSA Multilateral Staff Notice 51-336 Issuers Using Mass Advertising
    - CSA Staff Notice 51-348 Staff's Review of Social Media Used by Reporting Issuers.

Non-GAAP Financial Measures

- A Non-GAAP Financial Measure is a numerical measure of an issuer's financial performance, financial position or cash flow that doesn't meet the criteria of the issuer's GAAP for presentation in its financial statements but is derived from a numerical measure in the financial statements.

GAAP

Examples of Non-GAAP Financial Measures

EBITDA

Free cash flow

Adjusted earnings per share

Cash cost per ounce

Other

Number of units

Number of subscribers

Volumetric information

Environmental measures (i.e. emissions)

Non-GAAP Financial Measures

CSA Staff Notice 52-306 (Revised) – *Non-GAAP Financial Measures*

MD&A

Financial and Operating

1. Equal or less prominence to GAAP measure

3. Name in a way that distinguishes it from Issuer's GAAP

...9

...millions)

...1

...99

212

Adjusted net earnings[1] 245

EBITDA[1] 241

274

2. "No standardized meaning"

...gs and
...easure
...under
...ompa
presented by other issuers.
reconciliation of each non-G...
directly comparable IFRS m...

4. Explain why non-GAAP measure is useful

NON-GAAP FINANCIAL PERFORMANCE MEASURES

EBITDA and Adjusted EBITDA

	12/31/19
($ millions)	
Net earnings (loss)	212
Interest	9
Taxes	8
Depreciation & Amortization	12
EBITDA	241
Imparment charges	23
Losses from disposition	10
	274

5. Quantitative reconciliation

...non-GAAP financial measure,
...net earnings...
...A and adjusted EBITDA are
...ce because ...
...nent to...

ONTARIO SECURITIES COMMISSION

Non-GAAP Financial Measures

CSA Notice and Request for Comment

Proposed National Instrument 52-112 Non-GAAP and Other Financial Measures Disclosure

Proposed Companion Policy 52-112 Non-GAAP and Other Financial Measures Disclosure

Related Proposed Consequential Amendments and Changes

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Intangible assets

Based on recent reviews completed by staff, we have identified the following areas that issuers should pay particular attention to:

- the issuer's assessment of the extent of the probability of expected future economic benefits to flow to the issuer from a particular acquired intangible asset; and

- the issuer's purchase price allocation when acquiring a business or group of assets.

Intangible assets

IAS 38 – Intangible Assets:

An intangible asset shall be recognized if, and only if:

a) **It is probable that the expected future benefits that are attributable to the asset will flow to the entity; and**

b) The cost of the asset can be measured reliably.

Examples of future economic benefits flowing from an intangible asset:

- Revenue from the sale of products or services;
- Cost savings; and
- Other benefits resulting from the use of the asset by the issuer.

Intangible assets

Staff's observations and areas of concern:

- issuers have not performed any assessments of the expected future economic benefits for each of the acquired intangible assets; and
- probable expected future economic benefits for each acquired intangible asset which did not align (i.e., were much lower) with the value assigned to the asset within the issuer's purchase price allocation.

- In certain scenarios, we may request that the issuer publicly disclose the underlying assumptions from their assessment including the reason for the discrepancies between the value assigned to the asset and its probable expected future economic benefits.

Intangible assets

IAS 38 – Intangible Assets

IFRS prevents issuers from recognizing an intangible asset for most costs incurred on self-developed internally generated brands, masterheads, publishing titles, customer lists and items similar in substance, as they cannot be distinguished from the cost of developing the business as a whole.

Example:

ACQUIREE:

Customer List	$0
Brand	$0

The company would have previously expensed costs related to these internally generated items.

ACQUIRER:

Customer List	$200,000
Brand	$500,000

Upon acquisition, the acquirer can now assign value to these items as intangible assets.

Intangible assets

JAN 1/2019

An issuer enters a letter of intent to purchase a business for 100,000 common shares. On this date, the issuer's shares are valued at $1.00 per share.

The issuer values the acquired patent at $80,000 based on its assessment of the expected future economic benefits that will flow to the issuer.

Consideration Paid:		
Common Shares (100,000 shares x $1.00)	**$**	**100,000**
Net Assets Acquired:		
Intangible Asset - Patent	$	80,000
Capital Asset - Building	$	20,000
Total Net Assets Acquired	**$**	**100,000**

AUG 13/19

At the time that the acquisition closes on August 13, 2020, the issuer's shares are now valued at $1.50 per share.

The issuer has allocated the additional purchase price to the patent despite initially valuing the patent at $80,000.

Consideration Paid:		
Common Shares (100,000 shares x $1.50)	**$**	**150,000**
Net Assets Acquired:		
Intangible Asset - Patent	$	130,000
Capital Asset - Building	$	20,000
Total Net Assets Acquired	**$**	**150,000**

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Intangible assets

Issuers are encouraged to:

- Consult with independent valuation experts
- Consult with your external auditors
- Review IFRS guidance on intangible assets, business combinations and asset acquisitions

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Disclosure of operating segments

- Segment disclosures required by IFRS 8 assist readers in analyzing issuers that are involved in diverse businesses.

- Investors and analysts have emphasized the importance of transparent disclosure of operating segments as it provides an analysis of the business through the eyes of management.

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Disclosure of operating segments

- Identification of the Chief Operating Decision Maker (CODM)
- Identification of operating segments
- Aggregation of operating segments to form reportable segments
- Change in reportable segments
- Entity-wide disclosures

Disclosure of operating segments

IFRS 8 – Operating Segments

Para 5: An operating segment is a component of an entity:

(A) that engages in business activities from which it may earn revenues and incur expenses,

(B) whose operating results are regularly reviewed by the entity's CODM, and

(C) for which discrete financial information is available.

Entity-level disclosures

Products / Services

Geography

Major Customers

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Entity-level disclosures

Products / Services

Geography

Major Customers

Entity-level disclosures

Products / Services

Geography

Major Customers

(2) Geographic information

Example of deficient disclosure

The Company earned revenues of $3.5 million during the year ended December 31, 2019, compared to $2.9 million during the year ended December 31, 2018. Revenues were generated in Canada, the U.S. and other European countries.

The issuer has not provided a breakdown of the revenues generated in Canada, the U.S. and Europe, nor has it provided disclosure of non-current assets by country.

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(2) Geographic information

Example of enhanced disclosure

The Company earned revenues of $3.5 million during the year ended December 31, 2019, compared to $2.9 million during the year ended December 31, 2018. Revenues were generated in Canada, the U.S. and other European countries, as further described in the table below.

Country	Revenues for the year ended December 31, 2019	Revenues for the year ended December 31, 2018	Non-current assets as at December 31, 2019	Non-current assets as at December 31, 2018
Canada	$1.5 million	$1 million	$5 million	$4.8 million
United States	$0.8 million	$0.5 million	$2 million	$1.5 million
Germany	$0.5 million	$0.3 million	$1 million	$1 million
France	$0.5 million	$0.8 million	$0.5 million	$0.3 million
Italy	$0.2 million	$0.3 million	$nil	$nil

the disclosure provides clear and detailed revenue and non-current asset information for individual countries.

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Entity-level disclosures

Products / Services

Geography

IFRS 8.34

Major Customers

(3) Major customers

Example of deficient disclosure
Approximately 70% of the Company's consolidated revenues are generated from sales made to three customers

the reporting issuer has only presented aggregated revenue information for its major customers rather than separately disclosing information for each major customer.

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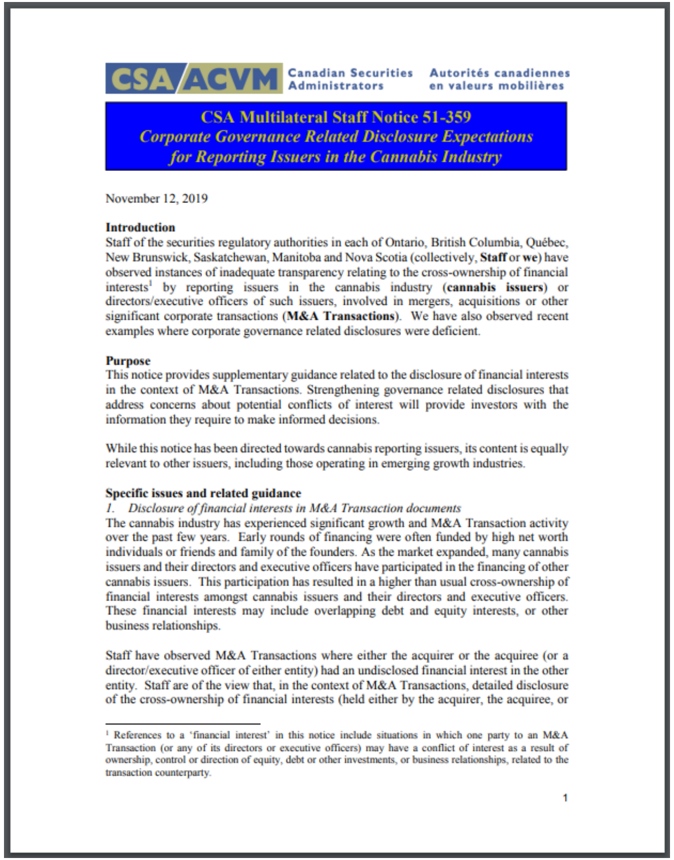
(3) Major customers

Example of enhanced disclosure
During the year ended December 31, 2019, the Company earned significant sales revenue from two customers in the amount of $633 (2018 - $650) and $563 (2018 - $642). The two customers were located in Brazil and Colombia, and are part of the management services segment.

the issuer has appropriately discussed the financial statement impact of each major customer separately and in sufficient detail rather than aggregating the data.

Emerging Market Update - Cannabis

- CSA Staff Notice 51-359 *Corporate Governance Related Disclosure Expectations for Reporting Issuers in the Cannabis Industry* was recently published on November 12, 2019.
- Provides certain governance-related disclosure expectations.



CSA ACVM Canadian Securities Administrators / Autorités canadiennes en valeurs mobilières

CSA Multilateral Staff Notice 51-359
Corporate Governance Related Disclosure Expectations for Reporting Issuers in the Cannabis Industry

November 12, 2019

Introduction
Staff of the securities regulatory authorities in each of Ontario, British Columbia, Québec, New Brunswick, Saskatchewan, Manitoba and Nova Scotia (collectively, **Staff** or **we**) have observed instances of inadequate transparency relating to the cross-ownership of financial interests[1] by reporting issuers in the cannabis industry (**cannabis issuers**) or directors/executive officers of such issuers, involved in mergers, acquisitions or other significant corporate transactions (**M&A Transactions**). We have also observed recent examples where corporate governance related disclosures were deficient.

Purpose
This notice provides supplementary guidance related to the disclosure of financial interests in the context of M&A Transactions. Strengthening governance related disclosures that address concerns about potential conflicts of interest will provide investors with the information they require to make informed decisions.

While this notice has been directed towards cannabis reporting issuers, its content is equally relevant to other issuers, including those operating in emerging growth industries.

Specific issues and related guidance
1. Disclosure of financial interests in M&A Transaction documents
The cannabis industry has experienced significant growth and M&A Transaction activity over the past few years. Early rounds of financing were often funded by high net worth individuals or friends and family of the founders. As the market expanded, many cannabis issuers and their directors and executive officers have participated in the financing of other cannabis issuers. This participation has resulted in a higher than usual cross-ownership of financial interests amongst cannabis issuers and their directors and executive officers. These financial interests may include overlapping debt and equity interests, or other business relationships.

Staff have observed M&A Transactions where either the acquirer or the acquiree (or a director/executive officer of either entity) had an undisclosed financial interest in the other entity. Staff are of the view that, in the context of M&A Transactions, detailed disclosure of the cross-ownership of financial interests (held either by the acquirer, the acquiree, or

[1] References to a 'financial interest' in this notice include situations in which one party to an M&A Transaction (or any of its directors or executive officers) may have a conflict of interest as a result of ownership, control or direction of equity, debt or other investments, or business relationships, related to the transaction counterparty.

1

Emerging Market Update - Cannabis

- Staff have observed instances of inadequate transparency relating to the cross-ownership of financial interests by cannabis reporting issuers involved in M&A transactions.

- Cross-ownership of financial interests is material information for investors and their investment/voting decisions and it should be disclosed.

- Disclosure is already required under the broad materiality disclosure requirements for documents being filed in connection with an M&A transaction.

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Emerging Market Update - Cannabis

- Other corporate governance considerations of heightened concern in the cannabis industry.

- Staff Notice does not introduce any new requirements but rather highlights existing requirements for issuers.

- Although targeted at the cannabis industry, the Staff Notice has application to other high growth emerging industries.

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Hot Topics in Prospectus Filings

Financial condition and sufficiency of proceeds

Receipt Refusal Provision:

Subsection 61(2)(c) of the *Securities Act* (Ontario) provides that:

"The Director shall not issue a receipt for a prospectus or an amendment to a prospectus if it appears to the Director that,…

the aggregate of,

(i) the proceeds from the sale of the securities under the prospectus that are to be paid into the treasury of the issuer, and

(ii) the other resources of the issuer,

is insufficient to accomplish the purpose of the issue stated in the prospectus…"

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Principal Purpose

- Investor protection concerns
- Integrity of capital markets

A principal purpose of the sufficiency of proceeds receipt refusal provision is to protect the integrity of the capital markets, which would be harmed if an issuer ceased operations due to insufficient funds shortly after completing a public securities offering.

CSA Staff Notice 41-307 – *Corporate Finance Prospectus Guidance – Concerns regarding an issuer's financial condition and the sufficiency of proceeds from a prospectus offering*

Sufficiency of Proceeds - Considerations

Staff expectations vary depending on the type of issuer. Some guidelines are included below:

Type of Issuer	Resources to meet short-term liquidity requirements
Exploration stage issuer	• Sufficient to reach completion of the next phase of a project
Development stage issuer	• Sufficient to achieve the issuer's next significant milestone
Research & development issuer	• Sufficient to achieve progress on the development of a key product
Issuer with active operations	• Ability to continue operations for the short term

Sufficiency of Proceeds - Considerations

(1) Can the issuer meet the next milestone in its development plan?

(2) Does the issuer have enough money to meet working capital and debt requirements in the near term?

(3) Does the issuer have enough money for exploration work?

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Sufficiency of Proceeds - Considerations

- Missing information regarding offering amount and pricing
- Offering structure
- Use of proceeds disclosure
- Risk factor disclosure
- Representations to support ability to continue operations

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Structure of Offering

For a specific purpose but does not address short-term liquidity requirements

Best efforts without minimum subscription

Insufficient minimum subscription amount

Base shelf prospectus

Use of Proceeds – Disclosure Requirements

- Disclose net proceeds of the offering
- Disclose each principal purpose – indebtedness, asset acquisition, insiders, research and development, etc.
- Avoid generic phrases such as "for general corporate purposes".
- Be specific and allocate approximate amounts where practicable.
- Refer to Item 6 of Form 41-101F1 *Information Required in a Prospectus*

Use of Proceeds – Business Objectives and Milestones

- The business objectives that the issuer expects to accomplish using the net proceeds.

- Describe each significant event that must occur for the business objectives to be met.

Example of Boilerplate Disclosure – Use of Proceeds

EXAMPLE - Boilerplate / generic "Use of Proceeds" disclosure
Net proceeds under the Offering is $5 million. The proceeds of the Offering will be used towards general corporate purposes, expansion of a production facility and potential strategic acquisitions.

The description is not sufficiently detailed, nor does it provide an allocation of the proceeds to each intended use.

Example of Detailed, Comprehensive Disclosure – Use of Proceeds

EXAMPLE - Detailed / comprehensive "Use of Proceeds" disclosure

Net proceeds under the Offering are estimated to be $5 million (net of underwriters' fees of $100 thousand), allocated as follows:

Facility expansion: We intend to expand our widget production facility, which is estimated to be completed in Q3 2019, and which we estimate will cost $4.2 million. The expansion is expected to increase capacity from 1,000 widgets per month to 1,500 widgets per month, and will help us reach our target revenue growth of $500,000 per month.

Advertising and marketing: Given our planned increase in capacity and increased demand, we plan to expand our current online and print advertising to support the increased capacity.

Use of Proceeds	***Allocation of proceeds***
Facility expansion	$4.2 million
Advertising and marketing	$0.8 million
Total	**$5.0 million**

This disclosure provides investors with detailed information about the use of proceeds.

Missing information – Offering amount/ Pricing

- We require information regarding the size of the offering.
- Staff require a reasonable opportunity to review previously bulleted information regarding the offering size, pricing, and use of proceeds prior to issuing a receipt for a final prospectus.
- If providing amounts for each use of proceeds is not practicable, we may accept an estimate or range, as applicable.

Reducing Regulatory Burden

Regulatory burden report – Nov 19, 2019

107 recommendations!

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Mining disclosure prospectus pre-file review

- **Mining disclosure prospectus pre-file review**
  - Increases deal certainty, and reduces risk of technical disclosure sidetracking short form prospectus offering
    - In place since June 2019

Pre-filing review of mining technical disclosure

Goal: Increase certainty and reduce risk that technical disclosure issues will disrupt mining issuer's short form prospectus offerings

Process: Request a pre-filing review of **previously filed** technical disclosure by filing an application with the OSC and paying the prospectus pre-filing fee

Review: Technical disclosure including:

- Annual information form (AIF)
- News releases
- Technical reports
- Website

Timing: About 10 days, but conditional on prospectus volumes

OSC Staff Notice 43-706 *Pre-filing Review of Mining Technical Disclosure (June 6, 2019)*

Reducing Regulatory Burden – Other Initiatives

Business Acquisition Report (BAR) Requirements

- CSA Notice and Request for Comment – *Proposed Amendments to NI 51-102 Continuous Disclosure Obligations and Changes to Certain Policies Related to the Business Acquisition Report Requirement*
- Proposed Amendments include a two-test trigger at 30% threshold

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Reducing Regulatory Burden – Other Initiatives

Electronic Access to Documents

- CSA Consultation Paper 51-405 – *Consideration of an Access Equals Delivery Model for Non-Investment Fund Reporting Issuers*

Crowdfunding

- Proposed crowdfunding prospectus and registration exemptions for start-ups and early stage businesses

Blanket Orders

- OSC now authorized to make exemptive relief orders applicable to a class of market participants

Questions?

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Appendix A – Contact Information

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