Management's Discussion and Analysis of

ALUULA COMPOSITES INC.

For the three-months and fiscal years ended October 31, 2023 and 2022

NOTICE

The following management discussion and analysis ("MD&A") provides information concerning Aluula Composites Inc.'s (the "Company") financial condition for the three months and fiscal years ending October 31, 2023 and 2022. This MD&A should be read in conjunction with the Company's audited consolidated financial statements and notes thereto for the years ended October 31, 2023 and 2022 (the "Consolidated Financial Statements"). Additional information related to the Company is available on the Company's website www.aluula.com and on sedarplus.ca.

This MD&A was prepared by the Company's management and was approved by the board of directors on February 27, 2024. All amounts are in Canadian dollars unless otherwise stated.

DEFINITIONS

In this document, the terms "we", "us", "our", and "Company" refer to ALUULA Composites Inc. on a consolidated basis. "ALUULA" refers to the standalone entity ALUULA Composites Inc., and "Ocean Rodeo" refers to the standalone entity Ocean Rodeo Sports Inc. As Ocean Rodeo was acquired by ALUULA on October 31, 2022, consolidated figures from the statement of comprehensive income exclude the results of Ocean Rodeo for the year ended October 31, 2022, by necessity.

"2022" and future years refer to our fiscal years, which run from November 1 to October 31. Any references to a calendar year or other period will be noted as such.

The term "Consolidated Financial Statements" refers to the Company's audited consolidated financial statement for the years ended October 31, 2023 and 2022 unless indicated otherwise.

The term "brand partners" does not refer to formal partnerships with our customers. The term refers to marketing relationships with our customers who use ALUULA's technology as a brand ingredient in their products.

Other capitalized terms in this document are defined at the time of their first use.

This document contains trademarks and trade names associated with the Company and are referred to without the TM symbol. However, these trademarks and trade names are the property of their respective owners.

FORWARD-LOOKING INFORMATION

Certain statements contained in this MD&A are forward-looking and may constitute "forward-looking information" within the meaning of applicable securities legislation. When used in this document, the words "may", "would", "could", "will", "intend", "plan", "propose", "anticipate", "expect" or "believe" used by any of the Company's management are intended to identify forward-looking statements. Such statements reflect the Company's forecasts, estimates and expectations as they relate to the management's current views based on their experience and expertise with respect to future events and are subject to certain risks, uncertainties, and assumptions. Many factors could cause the Company's actual results, performance, or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. There can be no assurance that it will be completed as proposed or completed at all. The Company does not intend, and does not assume any obligation, to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future results, events or developments unless required by law.

COMPARATIVE INFORMATION

Unless indicated otherwise, all comparative figures for the three-month and fiscal year ending October 31, 2023, are referring to the results for the three- month and fiscal year ending October 31, 2022.

ACCOUNTING FRAMEWORK

The Company's Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") using the accounting policies described in Note 3 of those Consolidated Financial Statements.

This MD&A may make reference to certain non-IFRS measures. These measures are not recognized measures under IFRS, and do not have a standardized meaning prescribed by IFRS and are therefore unlikely to be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of our results of operations from management's perspective. Accordingly, these measures should not be considered in isolation nor as a substitute for analysis of our financial information reported under IFRS.

ACCOUNTING ESTIMATES AND ASSUMPTIONS

Management is required to make estimates, judgements and assumptions in preparation of the Consolidated Financial Statements in accordance with IFRS. These estimates affect the reported amounts of assets and liabilities at the date of the Consolidated Financial Statements, and the amounts of reported revenue and expenses during the reporting period.

ROUNDING AND PERCENTAGES

Rounded numbers are used throughout this MD&A, with all year-over-year percentage changes calculated in whole dollar amounts.

COMPANY AND INDUSTRY OVERVIEW

COMPANY STRUCTURE

ALUULA was incorporated on July 18, 2019, and Ocean Rodeo was incorporated on January 12, 2001, both under the British Columbia Business Corporations Act. Both legal entities are domiciled in Victoria, BC Canada with registered offices at 300 - 4240 Glanford Avenue. The Company's management and most staff are also located in Victoria.

On October 31, 2022, ALUULA acquired all the outstanding shares of Ocean Rodeo. Due to the timing of its acquisition by ALUULA, Ocean Rodeo's revenues and expenses are not included in the Company's consolidated results for the year ended October 31, 2022, or the comparative interim periods as reported in this MD&A unless specifically mentioned.

On April 14, 2023, Bastion Square Partners Inc. ("BSP"), a Canadian company previously listed on the TSX Venture exchange under the symbol BASQ.P, acquired all the outstanding shares of ALUULA by way of a three-cornered amalgamation with BSP changing its name to ALUULA Composites Inc. and ALUULA changing its name to ALUULA Composites Canada Inc. The transaction was accounted for as a Reverse Takeover ("RTO") and the resulting financial statements are presented as a continuance of ALUULA (accounting acquirer), and comparative figures presented in the consolidated financial statements are those of ALUULA.

ALUULA operates within the composite materials industry selling to customers within a variety of markets, having originally launched in the windsport market. The Company services this market through ALUULA as an ingredient brand and directly by its subsidiary, Ocean Rodeo, as a designer and seller of high-end windsport products.

CORE BUSINESS

ALUULA

ALUULA's core business is the development, assembly, and sale of a broad range of composite materials to globally recognized industry partner brands within a variety of commercial markets. ALUULA leverages a patented process to fuse high tech fibers and technical coatings together at a molecular level without the use of heavy glues. Compared to conventional coated and laminated woven fabrics, ALUULA's products are lighter, stronger, more durable and UV resistant than incumbent materials and recycle-ready at the end of their useful life.

ALUULA's most mature market is the windsport market where its ALUULA Gold™ ("Gold") product has successfully displaced Dacron as the leading material used in manufacturing premium priced kites and wings. With Gold materials demonstrating clear competitive advantages on weight and durability compared to incumbent materials, ALUULA realized that its process supports the production of a variety of soft composite materials capable of disrupting markets beyond windsport. While the windsport market has generated the majority of ALUULA's sales to date, customer inquiries from various industries have helped the Company understand that its materials have strong potential in markets that are significantly larger than windsport.

During 2023 ALUULA began working with customers across several vertical markets including Outdoor, Sailing, and Airships. Working in partnership with these customers in order to successfully replace incumbent materials in these new markets, ALUULA has developed additional products including ALUULA Durlyte™ ("Durlyte"), and ALUULA Graflyte™. ("Graflyte"). The Durlyte product is ideal for use in applications where abrasion resistance and extreme toughness are critical, for example in inflatable rafts. The Graflyte product is waterproof, UV resistant, and puncture resistant. This fabric is ideal for use in applications where lightness and strength are important, for example with ultralight packs.

ALUULA's commercialization process involves multiple steps in partnership with its customers and from initial contact through to final product launch can be time consuming to help ensure the launch is successful. After the market demand and potential customer is validated, the process starts with a needs analysis where ALUULA gathers information on what product characteristics are important to the customer. This is followed by ALUULA sending sample materials for testing. ALUULA then collaborates with brands on product development and advises on ideal manufacturing techniques. Brands will then manufacture prototype products which are field tested. Once field testing has successfully concluded, ALUULA works with the brand and/ or their manufacturer to launch full scale commercialization. Although this long sales cycle results in delayed revenue it is essential for ALUULA to help ensure successful long-term customer and brand relationships where the unique ALUULA materials are constructed into high value products.

Trends within the Company's most active vertical markets are discussed below.

Windsport industry

The windsport market benefited from a growth surge during the COVID-19 pandemic, however consumer demand shifted at the end of 2022 leading to the overstocking of kites and wings. This overstocking has resulted in windsport brands reducing the number of new products manufactured while they focus on selling finished goods in stock.

ALUULA onboarded eight new windsport brands in fiscal 2023, six of which have launched premium priced products featuring ALUULA materials. While the premium end of the market was not as significantly impacted by the post COVID softness, initial customer orders have been lower than expected. The current overstocking is expected to continue to impact order volumes into fiscal 2024.

Outdoor industry

The Outdoor industry addressable market for ALUULA includes packs and bags, tents, bikes and bike accessories, inflatable rafts, impact protection, and outdoor safety and survival. The Graflyte product is a natural fit for this industry and can be substituted for incumbent materials in the manufacturing process.

During its fiscal 2023 year, ALUULA finalized material specifications for its Durlyte and Graflyte products. These products were developed with the goal of gaining a competitive advantage in the Outdoor market. At the end of October 2023, ALUULA was at various sales cycle stages with over 10 brands in the Outdoor industry across ranging from needs analysis to field testing prototype products.

Sailing industry

ALUULA has the ability to disrupt the Sailing industry with its light, durable, recycle-ready materials. While this industry shares similarities with the ALUULA windsport category, it has unique commercialization needs and is therefore managed separately. ALUULA continues to build brand awareness and expand sales in this industry.

During the fiscal 2023 year, ALUULA's Durlyte product was field tested in The Ocean Race, a round-the-world racing challenge, where the material exceeded expectations and performed under extreme conditions. Collaboration with industry leaders to field test products provides ALUULA with critical feedback which enables the Company to continue to enhance and improve product qualities and offerings.

Airship industry

The Airship industry represents a significant sales opportunity due to the large amounts of material needed per Airship. Airships are typically constructed with a durable outer hull and an internal gas bladder system. The ALUULA process supports the creation of custom composites to suit this market due to our products' lightweight nature, durability, and ability to hold helium.

During the fiscal 2023 year, ALUULA finalized the development of new gas holding materials and is actively collaborating with companies in this industry on both product development and commercialization strategies for fiscal 2024.

OCEAN RODEO

Ocean Rodeo specializes in the design and production of wind sports equipment, including kites, wings, boards, and a range of accessories and apparel for wind sports enthusiasts. Ocean Rodeo uses composite materials in the production of its products to ensure high performance and durability.

In 2019, Ocean Rodeo's founders invented the ALUULA process to gain a competitive advantage in the windsport industry. At the time, all market competitors used the same input materials to manufacture kites and wings and leveraged marketing budgets to differentiate their brands. Ocean Rodeo was first to field test products manufactured with ALUULA materials and successfully demonstrated their superior performance.

Ocean Rodeo holds multiple patents related to the design of wind sports equipment. Ocean Rodeo created the world's first kites and wings featuring an all ALUULA canopy and airframe using the new ALUULA Aeris™ ("Aeris) and ALUULA AerisX™ ("AerisX") products; the world's first flexible kiteboards; and the world's first Dacron reinforced kites. Ocean Rodeo has also introduced the Go-Joe leashless board recovery device, a board recovery device officially endorsed and promoted by both the International Kiteboarding Organization and the Professional Air Sports Association

Ocean Rodeo sells its products to distributors, dealers, and individuals worldwide, and sponsors team riders competing at the highest level windsport events. By focusing its strategy on product innovation using ALUULA materials, Ocean Rodeo is able to demonstrate to the windsport market the possibilities that come with manufacturing with ALUULA materials. While generating thjrd party sales revenues, Ocean Rodeo acts as a critical R&D hub for ALUULA in winsdsport and across the other key vertical markets.

FOURTH QUARTER IN REVIEW

During the fourth quarter, the Company's primary focus was on achieving the following milestones, which were identified as fundamental to supporting growth in the fiscal 2024 year.

Increase market share in the windsport market

The Company continues to gain momentum in the windsport market which represents the nearest term sales opportunities for ALUULA. Over the past two fiscal years, ALUULA commercialized with a limited number of brand partners to showcase its materials' competitive advantages. With the Gold product's superior performance now successfully demonstrated, ALUULA is securing commitments from additional windsport brands. During Q4 2023, six new brands launched products with the Gold material and an additional five are expected to follow in the first half of 2024. The Company's sale pipeline is strong and includes twelve windsport brands at various sales cycle stages.

Expand sales pipeline in non-windsport markets

Entering into 2024, the Company is uniquely positioned to expand its product offering and capitalize on sales opportunities across numerous markets. During Q4, 2023 the Company identified key non-windsport markets to pursue, finalized material specifications for products aimed at those markets (Durlyte and Graflyte), announced a partnership with Arc'teryx, and prepared to show case those products and network with target customers at the November 2023 ISPO tradeshow in Munich. Enabled by these new products, the Company's non-windsport pipeline now includes various opportunities with the most advanced being within the Outdoor industry with bag and pack brands.

Build the leadership team

During the fourth quarter, ALUULA expanded its leadership team to include a Director of Production. ALUULA's new hire Mike Olson brings to the team 24 years of progressive leadership experience across a range of businesses including Fortune 500 companies, Lean Six Sigma certifications, and a Bachelor of Commerce specializing in Supply Chain Management. Since starting at ALUULA, Mike has implemented process improvements, introduced enhanced quality controls, performed a comprehensive inventory count and negotiated better terms with key suppliers. Mike will play a key role in establishing, tracking and analyzing production metrics to ensure the Company is maximizing its gross margins.

Subsequent to year end, the Company also added Sage Berryman as President to its leadership team. Sage brings capital markets experience, decades of executive experience and a proven track record of building sustainable growth in organizations ranging from startup to those with over 400 employees.

Continue to innovate

During the fourth quarter, the Company continued to innovate products and manufacturing processes unique to ALUULA materials. New products include a fire-retardant soft composite material that passed key tests required prior to selective use within highly regulated industries such as aerospace, a new interface film that allows for the bonding of dissimilar materials for use primarily in inflatable rafts and structures, and new materials with unique helium gas-holding capabilities targeted for the Airship industry. New manufacturing techniques developed for use with specific ALUULA products include new no-sew seams, which enable more efficient and cost-effective production while yielding a lighter stronger finished good. During 2023 and continuing into 2024, ALUULA has also been evolving its proprietary manufacturing processes to ensure the products continue to better meet their customers evolving requirements.

LEGAL AND REGULATORY ENVIRONMENT

The Company is subject to the general business requirements of operating within Canada, particularly within British Columbia. This includes the following applicable Employment Standards guidelines, employment tax rules, Workers Compensation regulations, Goods and Services Tax and Provincial Sales Tax requirements, and business licensing requirements.

Outside of Canada, the Company may be subject to import duties, tariffs, value-added taxes, and applicable Consumer Guarantee Law. The Company has no employees outside of Canada.

FINANCIAL PERFORMANCE

The following table is a management level summary of the Company's financial results for the three-month and fiscal year ended October 31, 2023 and 2022 with relevant variance analysis below. Certain balances included in the October 31, 2022 financial results have been restated for comparative purposes, see Note 26 to the Consolidated Financial Statements for details.

Due to the timing of the acquisition of Ocean Rodeo by ALUULA on October 31, 2022, the consolidated statement of net loss and comprehensive loss for the three-months and fiscal year ended October 31, 2023, contains the results of Ocean Rodeo while the 2022 comparative results do not.

	For the three-month period ended		For the fiscal year ended	
	October 31 2023	October 31 2022	October 31 2023	October 31 2022
Sales	$ 1,720,612	$ 693,150	$ 7,347,300	$ 2,743,481
Cost of sales	1,519,177	382,395	5,472,007	1,649,542
Gross profit	201,435	310,755	1,875,293	1,093,939
Gross margin %	12%	45%	26%	40%
Operating expenses:				
Salaries and benefits	526,991	243,052	2,172,125	952,306
General and administrative	599,676	173,956	2,075,255	861,863
Marketing	148,079	21,804	552,003	86,997
Research and development	62,733	65,286	160,377	171,627
Share-based compensation	52,855	4,938	502,384	19,750
	1,390,334	509,036	5,462,144	2,092,543
Loss before interest, tax and amortization	(1,188,899)	(198,281)	(3,586,851)	(998,604)
Listing expense	-	-	(1,640,538)	-
Other income	68,229	430,511	227,883	644,616
Interest and bank charges	(13,836)	(46,614)	(240,071)	(134,360)
Depreciation and amortization	(133,206)	11,836	(507,698)	(94,720)
Loss before taxes	(1,267,712)	197,452	(5,747,275)	(583,068)
Deferred tax recovery	423,461	162,360	591,848	101,498
Net income (loss) and comprehensive loss	$ (844,251)	$ 359,812	$ (5,155,427)	$ (481,570)

For the three-month periods ended October 31, 2023, and October 31, 2022:

Sales

Sales for the fourth quarter ending October 31, 2023 ("Q4 2023") were $1,720,612 compared to $693,150 for the fourth quarter ending October 31, 2022 ("Q42022"). The $1,027,462 quarter over quarter increase was primarily due to the addition of Ocean Rodeo's sales of $839,417 which were not included in Q42022 based on the timing of ALUULA's acquisition of Ocean Rodeo.

ALUULA's standalone sales increased by $188,045 or 27% in Q42023 compared to Q42022 primarily due to an increase in sales to the windsport market. The quarter over quarter growth in sales is tracking below the fiscal year over year growth rate of 52% discussed later in this MD&A due to timing differences associated with sales orders shipped to a key windsport customer. During the fiscal 2023 year, this customer increased their sales orders by $807,170 compared to the prior fiscal year. ALUULA was able to manufacture and ship the majority of products from these sales orders during the first three quarters of the fiscal 2023. The result is that Q4 2023 sales from this customer were $347,541 lower than Q42022 which negatively impacts the quarter over quarter sales increase percentage.

ALUULA considers companies purchasing more than 1000 square meters of material as commercialized. During Q42023, ALUULA sold 22,908 square meters to five customers at an average price of $33 per square meter compared to 27,432 square meters sold to two customers in Q42022 at an average price of $30 per square meter. This marginal decrease in square meters sold quarter over quarter was due to a timing difference associated with the shipment of products to a key customer during the year as discussed above. This marginal decrease in square meters sold was offset by an increase in average price resulting in a quarter over quarter sales increase.

<u>Cost of sales and gross margin</u>
Q42023 Cost of sales increased to $1,519,177 compared to $382,395 for Q42022 while gross margin decreased from 45% in Q42022 to 12% in Q42023.

Ocean Rodeo's cost of sales for the Q42023 year were $835,242 and its gross margin was 0.5%. As noted earlier, Ocean Rodeo was acquired by ALUULA on October 31, 2022 therefore the company's results are not included in Q42022. Ocean Rodeo's 0.5% gross margin is below the historical average of approximately 40%. Q42023 margins were negatively impacted by the windsport overstocking matter highlighted earlier in this MD&A and by the accounting treatment applied to ALUULA's acquisition of Ocean Rodeo which occurred on October 31, 2022. In order to address overstocking, Ocean Rodeo performed a comprehensive review of its finished goods inventory during Q42023. Obsolete inventory was written off while older stock was sold at discounted prices. Normalized margins were negatively impacted by approximately 25% due to the inventory write-off and 10% from the selloff of older inventory at a discounted price. When ALUULA acquired Ocean Rodeo, accounting standards required that ALUULA value Ocean Rodeo's inventory on hand (the "Acquisition Inventory") at its fair market value, which was deemed to be the sales price for those finished goods. Therefore, as Acquisition Inventory is sold, it generates a zero margin (as the cost equals fair value which equals the sales price). Acquisition Inventory sold during QY2023 resulted in a negative impact to normalized margins of approximately 5%. The remaining balance of Acquisition Inventory at October 31, 2023 was $271,682.

ALUULA's stand alone cost of sales for Q42023 were $683,935 with a gross margin of 22%. Cost of sales for Q42022 were $382,395 with a gross margin of 45%. The quarter over quarter decrease in ALUULA's gross margin was due to the write off of inventory during the quarter (12% impact), higher freight cost (3% impact) and an increase in interest from prospective customers across new market verticals that had an impact on overall production efficiency. As ALUULA increases the number of prospects in its sales pipeline, it manufactures more sample materials and small batches for prototype products to meet demand. Fulfilling these small batch orders across multiple material types is critical to securing future commercialized sales orders however it results in lower production efficiency which negatively impacted Q42023 gross margin.

<u>Salaries and benefits</u>
Salaries and benefits expense was $526,991 in Q42023 compared to $243,052 in Q42022 representing a quarter over quarter increase of $283,939. The inclusion of Ocean Rodeo's Q42023 salaries and benefits in the consolidated results contributed $162,561 to the increase. ALUULA's standalone salaries and benefits increased by $105,899 quarter over quarter due to the addition of new roles to support the

company's growth including a CFO, Director of Production, Marketing Manager and Engineer. The Company incurred $15,479 in salaries and benefits paid to its board of directors during Q42023. No such costs were incurred in Q4 2022.

General and administrative

General and administrative ("G&A") expense was $599,676 in Q42023 compared to $173,956 in Q42022 representing an increase of $425,720. The inclusion of Ocean Rodeo's Q42023 G&A expense in the consolidated results contributed $239,882 to the quarter over quarter increase. Ocean Rodeo's G&A expenses are comprised primarily of rent, commercial insurance, warranty costs, freight and license fees paid for the Company's ERP system.

ALUULA's standalone G&A expense increased by $97,711 quarter over quarter primarily due to an increase in warranty provisions calculated using historical experience applied to increased materials sold during the year. The Company incurred $88,127 in incremental G&A costs during Q4 2023, the majority of which are legal and auditing fees, that were a direct result of having a public listing on the TSX Venture Exchange. No such costs were incurred in Q42022.

Marketing

Marketing expense was $148,079 in Q42023 compared to $21,804 in Q42022 representing a quarter over quarter increase of $126,275. The inclusion of Ocean Rodeo's Q42023 marketing expenses in the consolidated results contributed $117,926 to the quarter over quarter increase. Ocean Rodeo's marketing expense includes the cost of third-party marketing consultants, team riders and advertising content.

ALUULA's standalone Marketing expense increased marginally by $8,350 quarter over quarter due to the creation of additional advertising materials targeted toward new market verticals.

Research and development

Research and development expense was $62,733 in Q42023 compared to $65,286 in Q42022 representing a quarter over quarter decrease of $2,533. The inclusion of Ocean Rodeo's Q42023 research and development expenses resulted in a quarter over quarter increase of $5,994. ALUULA's standalone research and development decreased marginally by $8,547 due to minor variances in the purchase of test materials.

Other income

Other income reported for Q42023 was $68,229 compared to $430,511 for FY2022. The quarter over quarter reduction was primarily due to the recognition of $363,682 of other income in Q42022 related to the cancellation of a lease liability associated with a licensing agreement that did not recur in fiscal 2023.

Interest expense

Interest expense for Q42023 was $13,836 compared to $46,614 for Q42022. The $32,778 quarter over quarter decrease was due to the July 2023 repayment of all interest-bearing credit facilities, the majority of which had been drawn on during the Q42022 period.

Depreciation and Amortization

Depreciation and amortization expense increased by $145,042 to $133,205 in Q42023 compared to Q4 2022. The quarter over quarter increase was due to the amortization of Ocean Rodeo's intangible assets which were written up to fair value on acquisition, the inclusion of deprecation on Ocean Rodeo's property and equipment in Q42023 results but not the Q42022 results and the allocation in Q42023 of depreciation expense related to the warehouse space and production equipment to inventory and cost of sales as applicable.

Deferred taxes

Deferred tax recovery increased from $162,360 in Q42022 to $423,461 in Q42023 primarily due to an increase in tax losses recognized in Q42023.

For the years ended October 31, 2023 and 2022:

Sales
Sales for the fiscal year ending October 31, 2023 ("FY2023") were $7,347,300 compared to $2,742,481 for the fiscal year ending October 31, 2022 ("FY2022"). The $4,603,819 year over year increase was primarily due to the inclusion of Ocean Rodeo's sales of $3,185,614 in the FY2023 consolidated results. ALUULA acquired Ocean Rodeo on October 31, 2022, and as such, FY2022 does not include Ocean Rodeo's sales.

ALUULA's standalone sales increased by $1,418,205 or 52% in FY2023 compared to FY2022. During FY2023, ALUULA onboarded three new customers representing five windsport brands which drove the year over year increase in sales. During FY2023, ALUULA had customers in the sales cycle stage that involves manufacturing prototype products for the Sailing and Outdoor markets. ALUULA generated $392,674 in sales from small batch sales orders at an average price of $37 per square meter.

ALUULA considers companies purchasing more than 1000 square meters of material as fully commercialized. During FY2023, Aluula sold 112,611 square meters to eight customers at an average price of $33 per square meter compared to 100,542 square meters sold to four customers in FY2022 at an average price of $26 per square meter.

Cost of sales and gross margin
FY2023 Cost of sales increased to $5,472,007 compared to $1,649,542 for FY2022 while gross margin decreased from 40% in FY2022 to 26% in FY2023.

Ocean Rodeo's cost of sales for the FY2023 year were $2,578,194 and its gross margins were 19%. As noted earlier, Ocean Rodeo was acquired by ALUULA on October 31, 2022 therefore the company's results are not included in FY2022. Ocean Rodeo's 19% gross margins are below the historical average of approximately 40%. FY2023 margins were negatively impacted by the windsport overstocking matter highlighted earlier in this MD&A and by the accounting treatment applied to ALUULA's acquisition of Ocean Rodeo on October 31, 2022. In order to address overstocking, Ocean Rodeo performed a comprehensive review of its finished goods inventory in Q4 2023. Obsolete inventory was written off while older stock was sold at discounted prices. This resulted in a negative impact to normalized margins of approximately 15%. When ALUULA acquired Ocean Rodeo, accounting standards required that ALUULA value Ocean Rodeo's inventory on hand (the "Acquisition Inventory") at its then fair market value, which was deemed to be the then selling prices for those finished goods. Therefore, as Acquisition Inventory is sold, it generates a zero margin (as the cost equals fair value). Acquisition Inventory sold during FY2023 resulted in a negative impact to normalized margins of approximately 9%. The remaining balance of Acquisition Inventory at October 31, 2023 was $271,682.

ALUULA's stand alone cost of sales for FY2023 were $2,893,813 with gross margins of 30% compared to FY2022 where cost of sales were $1,649,542 and gross margin were 40%. The year over year reduction to ALUULA's gross margins was due to the write off of inventory (5% impact) and an increase in interest from prospective customers across new market verticals that had an impact on overall production efficiency. As ALUULA increases the number of prospects in its sales pipeline, it manufactures more sample materials and small batches for prototype products to meet demand. Fulfilling these small batch orders across multiple material types is critical to securing future commercialized sales orders however it results in lower production efficiency which negatively impacted FY2023 gross margin.

Salaries and benefits
Salaries and benefits expense was $2,172,125 in FY2023 compared to $952,306 in FY2022 representing a year over year increase of $1,219,819. The inclusion of Ocean Rodeo's FY2023 salaries and benefits in the consolidated results contributed $756,117 to the increase. ALUULA's standalone salaries and benefits increased by $429,558 year over year due to the addition of new roles to support the company's growth including a Chief Financial Officer, Director of Production, Marketing Manager and Engineer.

General and administrative

General and administrative ("G&A") expense was $2,075,255 in FY2023 compared to $861,863 in FY2022 representing an increase of $1,213,392. The inclusion of Ocean Rodeo's FY2023 general and administrative expenses in the consolidated results contributed $970,772 to the year over year increase. Ocean Rodeo's G&A expenses are comprised primarily of rent, commercial insurance, warranty costs, freight and license fees paid for the company's ERP system.

ALUULA's standalone G&A expense increased by $25,970 year over year due to marginal increases in freight costs and warranty provisions calculated using historical experience applied to increased materials sold during the year. The Company incurred $216,650 in incremental G&A costs in FY2023, the majority of which are legal and audit fees, that were a direct result of the public listing on the TSX Venture Exchange. No such costs were incurred in FY2022.

Marketing

Marketing expense was $552,003 in FY2023 compared to $86,997 in FY2022 representing a year over year increase of $465,006. The inclusion of Ocean Rodeo's FY2023 marketing expenses in the consolidated results contributed $430,672 to the year over year increase. Ocean Rodeo's marketing expense includes the cost of third-party marketing consultants, team riders and advertising content.

ALUULA's standalone Marketing expense increased by $34,334 year over year due to the creation of additional advertising materials targeted toward new market verticals.

Research and development

Research and development expense was $160,377 in FY2023 compared to $171,627 in FY2022 representing a year over year decrease of $11,250. The inclusion of Ocean Rodeo's FY2023 research and development expenses resulted in a year over year increase of $115,594. ALUULA's standalone research and development costs decreased by $126,844 primarily because the FY2022 expense included the write off of over $70,000 in obsolete test materials.

Listing expense

In FY2023, the Company recognized a listing expense of $1,640,538 associated with its April 2023 RTO as outlined in Note 4 to the Consolidated Financial Statements. The listing expense was the deemed cost to the Company of obtaining its public listing on the TSX Venture Exchange and was calculated by subtracting the net assets the Company acquired during the RTO by the deemed consideration paid for BSP's common shares.

Other income

Other income reported for FY2023 was $227,883 compared to $644,616 for FY2022. The year over year reduction was primarily due to the recognition of $363,682 of other income in FY2022 related to the cancellation of a lease liability associated with a licensing agreement that did not recur in FY2023.

Interest expense

Interest expense for FY2023 was $240,071 compared to $134,360 for FY2022. The $105,711 year over year increase was due to the inclusion of Ocean Rodeo's interest expense of $72,131 in the FY2023 results and ALUULA leveraging various interest-bearing credit facilities during the first half of the fiscal 2023 year as compared to the fiscal 2022 year.

Depreciation and Amortization

Depreciation and amortization expense for FY2023 was $507,698 compared to $94,720 for FY2022. The $412,978 year over year increase was primarily due to the amortization of Ocean Rodeo's intangible assets which were written up to fair value on acquisition. Also contributing to the increase is the depreciation of Ocean Rodeo's property and equipment, which is included in the FY2023 results but not the FY2022 results.

Deferred taxes

Deferred tax recovery increased from $101,498 in FY2022 to $591,848 in FY2023 primarily due to an increase in tax losses recognized in FY2023 arising from Ocean Rodeo and ALUULA's combined fiscal year 2023 results.

SUMMARY OF QUARTERLY RESULTS

The following table is a management level summary of the financial results of the Company for each of the three-month periods ending:

	October 31, 2023 ("Q42023")	July 31, 2023 ("Q32023")	April 30, 2023 ("Q22023")	January 31, 2023 ("Q12023")	October 31, 2022 ("Q42022")	July 31, 2022 ("Q32022")	April 30, 2022 ("Q22022")	January 31, 2022 ("Q12022")
Sales *	$ 1,720,612	$ 2,163,621	$ 2,009,365	$ 1,453,702	$ 693,150	$ 832,569	$ 523,613	$ 694,149
Net and comprehensive loss	(844,251)	(533,880)	(2,612,145)	(1,165,151)	359,812	(111,575)	(176,091)	(553,716)
Loss per share basic and diluted **	$ (0.00)	$ (0.00)	$ (0.02)	$ (0.01)	$ 0.00	$ (0.00)	$ (0.00)	$ (0.01)

Sales and net and comprehensive loss amounts pre-April 2023 RTO are the results of ALUULA Composite Canada Inc.

* Restated for reclassification of shipping revenue and warranty expense as outlined in Note 26 to the Consolidated Financial Statements.

** Through the reverse takeover transaction described in Notes 1 and 4 to the Consolidated Financial Statements, the holders of common shares of Aluula received 16.05 common shares in the Company for each Aluula share held immediately prior to the amalgamation. All per share amounts presented in these tables have been adjusted to reflect this ratio.

	July 31, 2023	April 30, 2023	January 31, 2023	October 31, 2022	July 31, 2022	April 30, 2022	January 31, 2022
Sales - as originally reported	2,174,595	1,937,193	1,448,515	700,382	862,253	556,915	664,532
Restatement - shipping revenue	(51,374)	(21,555)	(29,039)	(7,232)	(31,146)	(33,302)	(12,254)
Restatement - warranty expense	40,400	93,727	34,226	-	1,462	-	41,871
Sales - restated	2,163,621	2,009,365	1,453,702	693,150	832,569	523,613	694,149

Sales

Sales reported in Q12023 were the lowest for the fiscal 2023 year due to a working capital shortage that impacted the Company's ability to fulfill sales orders. With the completion of the RTO in April 2023, the Company's working capital supported the purchase of raw materials needed to fulfill sales orders resulting in a 38% increase to sales for the Q22023 period. Ocean Rodeo reported its highest sales for the fiscal year during Q32023, as this quarter coincides with peak ordering times for its customers as they stock up for the summer season. Ocean Rodeo's Q42023 sales were $423,211 lower than Q32023 which is the primary driver for the Company's overall quarterly sales decrease.

Sales and net loss and comprehensive for the fiscal 2022 quarters are ALUULA standalone results as the acquisition of Ocean Rodeo occurred on October 31, 2022 and represent results from commercializing across the windsport industry.

Net and comprehensive loss

The Company's net and comprehensive loss for Q12022 was impacted by lower sales and gross margins due to the working capital constraints outlined above. The $2,612,145 net and comprehensive loss for Q22023, included certain expenses incurred as a result of the Company's April 2023 RTO (listing expense ($1,640,538) and stock compensation expense ($390,317)). If those expenses were excluded, the adjusted net and comprehensive loss for Q22023 would have been $581,290 (the "Adjusted Q22023 Net and Comprehensive Loss). The Q32023 net and comprehensive loss was marginally lower than the Adjusted Q22023 Net and Comprehensive Loss as the Company reported an increase in sales and margins while keeping expenses flat. The Q42023 net and comprehensive loss increased by $310,371 compared to Q32023 primarily due to a decrease in gross margins as well as an increase warranty provisions, marketing and research and development expenses incurred during the period.

BALANCE SHEET ANALYSIS, LIQUIDITY, AND CAPITAL RESOURCES

ANALYSIS OF STATEMENT OF FINANCIAL POSITION

The following table presents selected information from the October 31, 2023 Consolidated Financial Statements, followed by a variance analysis below:

	October 31, 2023	October 31, 2022
Selected assets		
Cash and cash equivalents	733,368	295,377
Trade and other receivables	1,969,008	1,378,890
Inventory	1,560,222	2,166,825
Selected liabilities		
Bank indebtedness	-	2,744,697
Trade and other payables	983,311	985,448
Long-term debt *	818,351	1,259,405
Lease obligations *	406,657	978,928

* Current and long term portions combined for this analysis

<u>Cash and cash equivalents / bank indebtedness</u>

Cash and cash equivalents balance as at October 31, 2023 was $733,368, which is $437,991 higher than the balance at the end of October 2022. The increase in cash is primarily due to the completion of the RTO transaction and concurrent private placement in April 2023 as well as the additional private placement closed in July 2023. This increase to cash was deployed to repay its various interest-bearing credit facilities, facilitate the purchase of raw materials required to fulfill increasing sales orders, investigate commercialization at wider width and fund operating losses.

<u>Trade and other receivables</u>

Trade and other receivables increased from $1,378,890 at the end of October 2022 to $1,969,008 as at October 31, 2023. The $590,118 increase is primarily due to an increase in ALUULA's trade receivables resulting from an increase in year over year sales. The Company's current account receivables comprise 63% of the balance owing while 27% or $518,428 is over 90 days. Of the balance over 90 days, $512,265 is receivable from Ocean Rodeo's third-party production factory for ALUULA materials purchased at the end of fiscal 2022. As the factory utilizes materials in the manufacturing of finished goods for Ocean Rodeo, the accounts receivable is drawn down. Ocean Rodeo's sales orders for new products slowed in fiscal 2023 as it focused on selling existing finished goods inventory and as such the factory receivable has aged. Ocean Rodeo is planning to increase new product sales orders throughout fiscal 2024 which will result in a decrease to this receivable balance. The Company has recorded expected credit losses of $18,146 as of October 31, 2023, compared to $41,437 as of October 31, 2022.

<u>Inventory</u>

Inventory balance as at October 31, 2023 was $1,560,222, a decrease of $606,603 compared to the balance at October 31, 2022. This year over year decrease is driven by a $1,527,101 reduction in finished goods inventory, which was primarily due to Ocean Rodeo actively selling through overstocked inventory during the fiscal 2023 year. Offsetting this decrease in finished goods inventory was a $876,630 increase in raw materials inventory purchased to enable ALULUA to fulfill its Q1 2024 sales orders.

Trade and other payables

Trade and other payables were consistent between October 31, 2022 and October 31, 2023, decreasing by a nominal $2,137. Trade payables, accrued liabilities and credit card payables decreased by $181,390 as at October 31, 2023 compared to October 31, 2022 because the Company had sufficient working capital to support timely payment of vendor invoices. Offsetting this decrease was a $187,640 increase to warranty provision booked during the year calculated using historical experience applied to increased materials sold during the year.

Long-term debt

As at October 31, 2022, the Company had interest-bearing and interest free loans totaling $1,259,405. During the fiscal 2023 year, the Company repaid its interest-bearing facilities leaving a remaining debt balance of $818,351 at October 31, 2023.

Lease obligations

As of October 31, 2023, the Company's lease obligations consist of right-of-use lease obligations for the rental of office and production space. Lease obligations decreased compared to October 31, 2022, primarily due to the full repayment in July 2023 of manufacturing equipment leases as well as the reduction in leased office facilities. In December 2022, lease obligations decreased by $189,208 when the Company was released from a long-term lease for redundant office facilities.

Off-balance sheet arrangements

As of the date of this MD&A, the Company has not entered into any off-balance sheet arrangements.

CASH FLOW FROM OPERATING, INVESTING, AND FINANCING ACTIVITES

Analysis of cash flows:

		2023		2022
Cash used in operating activities	$	(3,170,974)	$	(945,478)
Cash provided by (used in) investing activities		1,174,468		(819,026)
Cash provided by (used in) financing activities		5,219,195		(580,946)
Increase (decrease) in cash and cash equivalents	$	3,222,688	$	(2,345,450)

Operating activities

Cash used in operating activities was $3,170,974 for the fiscal 2023 year compared to $945,478 for the fiscal 2022 year. The increase in cash used for operations is due to increased net loss and comprehensive loss as well as a working capital mismatch between timing of when raw materials are purchased for use in production and when accounts receivable from customer sales are collected, which currently ranges from 4 – 7 months depending on vendor terms and customer credit terms in place. As the sales increase, the requirement to purchase materials increase and this working capital mismatch results in an increased use in cash.

Investing activities

For the fiscal year ending October 31, 2023, the Company generated cash flow from investing activities primarily due to the receipt of funds, net of liabilities acquired, upon completion of the RTO ($1,359,461) offset by minor investments in production equipment and patents. During fiscal 2022, the Company used $819,026 in investing activities which was made up primarily of new equipment purchases and the acquisition of Ocean Rodeo.

Financing activities
For the fiscal year ended October 31, 2023, the Company generated $5,219,195 of cash flow from financing activities. The inflow of funds was due to the issuance of share capital during the April 2023 RTO and private placement and the subsequent July 2023 private placement. Funds generated from these financing activities were primarily deployed to repay long-term debt and lease obligations.

WORKING CAPITAL AND DEBT MANAGEMENT

The Company funds its operations, including capital expenditures, debt repayments, and other financing needs, through a combination of sources. These sources include loans and equity issuances. The various facilities are utilized based on overall cost of financing and availability of cash flows. Where government grants for interest free or forgivable loans are available to the Company, management applies for funding and has had success obtaining such funding historically. Interest free and partially forgivable loans have been received from PacifiCan. The Company is currently funding its operations through equity issuances and is exploring various sources of additional capital. Below is a summary of transactions from the FY2023 year:

On April 14, 2023, the Company completed an Amalgamation Agreement with ALUULA Composites Canada Inc. ("ALUULA Canada"), in which the Company acquired 100% of the outstanding shares of ALUULA Canada in exchange for shares of the Company (the "RTO").

The RTO was structured as a three-cornered amalgamation pursuant to the provisions of the Business Corporations Act (British Columbia) (the "BCABC"), whereby the Company incorporated a wholly owned subsidiary under the BCABC which amalgamated with ALUULA Canada to form a newly amalgamated company that is continuing as a wholly owned subsidiary of the Company. To effect the Proposed Transaction, the Company acquired all the outstanding shares of ALUULA Canada, and in exchange ALUULA Canada's shareholders received common shares in the Company. The aggregate consideration issued was $21,001,123 and the Company issued 175,009,365 shares.

In connection with the RTO, the Company conducted a concurrent private placement of subscription receipts, raising net proceeds of $2,966,821, at $0.12 per share issued.

On December 21, 2022, Gustavson Capital Corporation ("GCC"), a shareholder in BSP, loaned $750,000 to the Company. The loan bears interest at 7% per annum, compounded monthly. The GCC loan and interest was repaid in April 2023.

On July 12, 2023, the Company completed a bought deal and private placement led by Haywood Securities Inc. ("Haywood") for gross proceeds of $3,673,492.95 (The "Offering") through the issuance of 24,489,953 units (the "Units"), at a price of $0.15 each, which are comprised of one common share of the Company and one common share purchase warrant ("Warrant"). Each Warrant entitles the holder to purchase one common share of the Company at a price of $0.25 per share for a period of 24 months ended July 12, 2025. In connection with the Offering, the Company paid Haywood a cash commission of $220,409.58, issued to Haywood 1,469,397 broker warrants which are exercisable to acquire Units at the issue price, and paid Haywood a corporate finance fee comprised of $45,918.40 in cash and $137,756.25 payable in Units (918,375 Units).

A portion of proceeds from the Offering were deployed to repay interest bearing debt including Bank of Nova Scotia lines of credit, term loans, and manufacturing equipment leases. As of October 31, 2023, the Company's only debt includes non-interest-bearing loans from Western Economic Diversification Canada, a Canadian government program recently renamed Pacific Economic Development Canada ("PacifiCan"). The Company retains a credit card facility with the Bank of Nova Scotia which is used for purchasing efficiency.

The Company chose to repay most of its debt since a predominantly equity-based structure aligns better to the planned growth profile of the Company.

On May 1, May 11, and May 29, 2023, Haywood exercised a total of 147,930 broker warrants in exchange for 147,930 common shares at a price of $0.10 per share for net proceeds of $14,793. A total of 375,000 broker warrants had been issued to Haywood on BSP's 2021 initial public offering and 227,070 remain outstanding as of October 31, 2023. These warrants are exercisable up to October 12, 2024.

CONTRACTUAL OBLIGATIONS

The Company is subject to contractual obligations, including office and warehouse leases, machinery and equipment leases, and long-term debt repayments.

Management cancelled a related party office and warehouse lease during Q1 2023 as the space was no longer required to support operations. This cancellation resulted in a reduction of contractual obligations of $8,001 per quarter and a total of $93,333 through December 2025.

PRODUCTION CAPACITY AND CAPITAL EXPENDITURES

<u>Fusion Pods</u>
An ALUULA fusion pod is a standalone unit that converts input materials into finished composites. Each pod requires two to three production staff to operate. Management closely monitors production scheduling and capacity. Production staff perform machine maintenance and cleaning during existing downtime where possible.

A new fusion pod was constructed during the first half of fiscal 2022 to increase automation and consistency and add a new level of quality control to our process. This new fusion pod was put into use in Q3 2022 and is the primary manufacturing line by the Company to create its composite materials. The Company has initiated development on a new wider format pod which could produce rolled fabric at a width of 1.6 meters and is exploring the most efficient way to commercialize at this larger width.

<u>Other Equipment</u>
The Company invests in research and development equipment to test new composite materials, new input materials, and existing input materials from new sources. The materials are subject to tests including strength, abrasion resistance, UV resistance, permeability, and accelerated life cycle testing. Equipment is also purchased to assist with new assembly methods, such as heat welding and other alternatives to sewing.

<u>Patents & Molds</u>
Where management feels it is warranted, patents are sought out to protect both designs and processes in certain global jurisdictions. The legal costs of acquiring these patents are capitalized as intangible assets where appropriate. In addition, some Ocean Rodeo products require the creation of molds for the external manufacturing of certain products. These molds are purchased from a supplier and capitalized as property and equipment.

RESEARCH AND DEVELOPMENT ("R&D")

ALUULA has a patented, highly customizable process for assembling composite materials. R&D activities are key to the Company's success and are separated into three main areas:

<u>Customization of the ALUULA process</u>
When the sales opportunity warrants, the R&D team works closely with brand partners to customize materials to meet their needs. Through this collaboration process we determine material specifications required and apply our internal knowledge of the ALUULA process and the chemical and physical properties of potential input materials to develop new composite materials or methodologies to meet their needs. Once finalized we work with the brand partner's manufacturer to ensure smooth integration of our materials into their processes.

Where we feel there is an opportunity to use existing ALUULA materials to replace existing alternatives, R&D may also proactively create a sample finished product to demonstrate the use case to a prospective brand partner. Once they see the benefit of using ALUULA we work with them to tailor our composites to meet their specifications.

The current production pod can produce approximately 25,000 square meters in a month of production. Management estimates the volume can be increased to as much as 42,000 meters per month, with additional costs for employees to run multiple shifts per day and on weekends. The fixed costs embedded in the rolled fabric are less than 10% of the total cost of each meter, so the increased production would not have a significant impact on gross margin percentage, instead, any increased production would enable more fabric to be created and sold in a period which would increase overall gross profit.

Based on brand partner feedback, the Company commenced the design and planning for production at a 1.6 meter width in fiscal 2023. Current materials are produced at 0.925 meter width. ALUULA started at the slimmer width so the initial variables involved would be easier to control as the Company developed the industrial process. The Company plans to transition to the wider 1.6 meter width as it allows customers to create their products with better nesting of their material for less waste and fewer seams, reducing labour and assembly time.

<u>Quality control and improvements to the ALUULA process</u>
Our fusion pods are custom designed, proprietary equipment. As such, the R&D team continues to work with the production team to investigate process improvements and machine enhancements to improve efficiency, quality, and production capacity. Where risks are identified they investigate whether an improvement could occur or whether to implement a compensating control.

During the fiscal year ended October 31, 2023, the R&D team implemented the following improvements:

- The Company now receives and reviews manufacturing reports for the rolled fabric materials acquired from vendors. Employees review the reports for the raw materials to ensure our requirements are met, with any non-compliant materials being rejected and sent back to the manufacturer.
- Input materials are tested every 50 meters before they are used in production (previous testing was once every 2,000 meters) and post manufacturing, a fusion bond strength test is completed every 50 meters. The pre-production test ensures all raw materials meet minimum standards and the post-production test provides assurance that all finished goods meet customer requirements.
- The Company contracted with a new primary supplier that is SA9100 and ISO 9001 compliant. Input materials meeting stringent requirements is key to the continued growth of the company and as such, the Company plans to invest further into improved materials and processes. This is a key improvement in quality control and the Company continues to implement procurement and production changes as the consistent production of the highest quality fabrics is a focus for ALUULA.

<u>Windsport product development</u>
The Ocean Rodeo R&D and design team has significant experience designing and working with products in the windsport industry. This allows them to create unique products within windsport, but also to apply new techniques and technologies to all areas of ALUULA R&D.

EQUITY

As outlined in Note 4 to the Consolidated Financial Statements, the Company completed a RTO BSP in April 2023. To effect the acquisition, BSP issued 175,009,365 shares at a ratio of 1:26.05 for 100% of the outstanding shares of ALUULA. All share, option, and per share amounts presented in this MD&A have been adjusted to reflect this ratio.

As of October 31, 2023, the Company had 250,565,629 shares issued and outstanding, 27,104,795 warrants outstanding and 12,996,905 stock options outstanding.

More detail on these transactions can be found in Notes 18 and 19 of the Consolidated Financial Statements.

TAX MATTERS

The Company is considered to be operating in Canada for tax purposes and falls under the jurisdiction of the Canadian Income Tax Act. In the ordinary course of business, the Company may be subject to tax audits and certain matters may be reviewed and challenged by tax authorities.

ACCOUNTING POLICIES AND ESTIMATES

Management is required to make estimates, judgements, and assumptions in preparation of the Consolidated Financial Statements in accordance with IFRS. These estimates affect the reported amounts of assets and liabilities at the date of the Consolidated Financial Statements, and the amounts of reported revenue and expenses during the reporting period.

CRITICAL ACCOUNTING ESTIMATES

The Company's significant judgement and estimates made in preparation of the Consolidated Financial Statements are described in Note 2 of those financial statements, with the associated accounting policies described in Note 3.

FUTURE ACCOUNTING PRONOUNCEMENTS

No new significant accounting standards were adopted during the fiscal year ended October 31, 2023. Future accounting pronouncements are disclosed in Note 3 of the Consolidated Financial Statements.

FAIR VALUE MEASUREMENTS

A number of the Company's financial instruments are recognized at fair value. Fair value is discussed in detail in the Consolidated Financial Statements. There have been no changes to the fair value policies during the fiscal year ended October 31, 2023.

KEY RISKS AND RISK MANAGEMENT

Management defines risk as the probability of a future event that could negatively affect the financial condition and/or results of operations of the Company. The following section describes specific and general risks that could affect the Company. As it is difficult to predict whether any risk will be realized or its related consequences will occur, the actual effect of any risk on the business could be materially different from that anticipated. The following descriptions of risk do not include all possible risks as there may be other risks of which Management is currently unaware or currently believe to be immaterial.

Effective risk management is vital to the ongoing growth and success of the Company. As the Company is still in its growth stage, management's focus began with mitigating the key risks as they were identified, with additional risk management being added over time.

STRATEGIC RISKS

Reputation

As an early-stage innovative company earning its market share with multiple customers in multiple vertical markets, we must meet expectations on deliverability and quality while we also scale up rapidly. There is risk of reputational damage and liability if composite materials experience quality control issues or do not hold up in the long-term.

Management has mitigated the risk of quality control issues through the implementation processes discussed in Quality control discussion within he Research and Development section of this MD&A.

New Markets

We are actively working to expose the Company's composite materials to markets outside windsports with an expectation of future commercialization within these other markets. There is risk that this may not be successful, or that it will take longer than expected, delaying expected scaling of the Company's production levels and associated revenues.

Management mitigates the risk of delayed entry by building forecasts conservatively, with the understanding that not all opportunities will materialize within the expected timelines. The best case scenario is built out, with the actual revenue forecasts prepared based on probabilities of success within the forecast period.

OPERATIONAL RISKS

Confidentiality of trade secrets

The Company relies on closely held trade secrets in addition to the intellectual property that has been obtained over the years. There is a risk that an individual could gain access to trade secrets and share this information publicly, limiting or eliminating our competitive advantage.

Management mitigates the risk of exposed trade secrets through limiting the number of individuals with access to key process information, by limiting access to both the office and production facilities, and by obtaining signed NDAs from any individuals who will be exposed to any level of the trade secrets.

Supply chain and associated cash flows

Supply chain management includes maintaining the ability to source input materials in a timely manner, verifying the quality of those input materials, and managing the cost of those input materials. The majority of the raw materials purchased by the Company for use in production are non-specialized in nature, and readily available from various suppliers. In specific instances the Company relies on one supplier to meet our raw material needs. We require access to sufficient working capital to purchase these raw materials in advance of production, including allowing time for shipment from international suppliers to our warehouse in Victoria. There is risk that these materials may be delayed, resulting in production slowdowns and delayed collection of receivables from customers.

Management mitigates supply chain risk in the following ways:

- We invest in research and quality control up front to determine the best sources of raw materials, both for cost and flexibility to meet our specifications.
- We prepare a detailed production planning schedule including lag times for receipt of raw materials.
- We have invested in shipping insurance to cover losses that may occur on incoming materials.
- We store our raw materials and finished goods in our own warehouse with limited access to the facility by outsiders.
- We remain in constant communication with key suppliers and occasionally make site visits to both strengthen the relationship and monitor quality control.

Management mitigates cash flow risk by negotiating credit terms with key suppliers, matching order quantities with sales forecasts and maintaining key relationships enabling access to additional capital to ensure sufficient cash is on hand to support the raw materials requirements of the business.

Excess production

As ALUULA is early in the growth stage, there is risk attached to producing finished composites in advance of purchase order demand, as overproduction could divert the Company's working capital from other areas.

Management mitigates the risk of overproduction by, where possible, only purchasing raw materials to meet upcoming purchase orders from customers, and by only producing to meet the demand of those confirmed purchase orders.

Cyber security

The Company relies on a number of electronic systems to store and process data. There is risk of data loss if one of our providers experiences a data breach or loss of backups. Management has implemented contracts with and uses the services of well-established or off-the-shelf service providers to meet these needs, such as Google, Microsoft, Dropbox, and NetSuite, to minimize both our exposure to risk of data loss and the requirements of maintaining physical server space.

Employees and management are often subject to phishing attempts, primarily through email. The risk of data loss or wire fraud associated with these attempts is mitigated through employees being centralized in one office, secondary approvals for bank payments, and having open discussions with other staff when attacks occur ensuring the office is aware of the attempt.

Data and information

The Company retains certain customer data, as required to operate the business. When customer credit card information is stored, we follow the customer data retention policies set out by the Payment Card Industry Security Standards Council.

Employee retention and dependence on key personnel

The Company employs skilled employees with industry and company specific knowledge across many facets of its operations. The retention and satisfaction of these employees is important to the ongoing success of the business, particularly where they oversee many aspects of the business or where little redundancy is built in. Failure to retain key employees and directors or to attract and retain new employees with the required skills could have an adverse impact on the Company's growth and profitability.

Management looks to retain employees by offering fair and equitable compensation packages which include competitive salaries with performance-based upside, an optional benefits package, and ensuring a strong work-life balance with minimal overtime. The Executive Leadership Team is actively involved in day-to-day operations, working closely with staff in various departments while also allowing them to own their roles and allowing all staff to feel invested in the success of the Company.

FINANCIAL RISKS

The Company's is exposed to a number of financial risks during the normal course of business. These risks are discussed in more detail in Note 17 the Consolidated Financial Statements.

Credit risk

Credit risk is the risk that a counterparty will not meet its obligations, typically under a customer contract or of a financial instrument, leading to a financial loss. Management has a number of mitigating policies in place, including the following:

- We transact with Scotia Bank, a reputable Canadian bank.
- Customers who wish to trade on credit terms are subject to a credit verification process.
- We obtain customer deposits, where possible, where the Company is incurring out-of-pocket costs that cannot be recovered through retention and sale of the product being manufactured.
- We obtain payment prior to shipping for customers who are not subject to credit terms.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. Management mitigates liquidity risk by monitoring forecasted and actual cash flows, and proactively managing the maturity profiles of financial assets and liabilities.

Foreign currency risk

Foreign exchange risk is the risk that the value of financial instruments or cash flows will fluctuate due to changes in foreign exchange rates. A significant portion of the Company's revenues and associated receivables are generated and held in foreign currencies. This risk is naturally mitigated by the purchase of input materials in foreign currencies. As the Company's cash flows become more predictable, it will explore the implantation of a formal hedging policy.

Interest rate risk

Interest rate risk is the risk the fair value of future cash flows of a financial instrument will fluctuate because of changes in market rates. As of October 31, 2023, the Company had repaid its interest-bearing debt, Management mitigates Interest rate risk by seeking out alternate sources of financing and securing fixed-rate or equity based financing where rates are favourable.

INTERNAL CONTROLS AND PROCEDURES

QUALITY CONTROLS

Quality control procedures are vital to the Company's success to reduce the risk of warranties, returns, and damaged customer relationships. Management is responsible for creating and implementing effective systems, controls, and processes for both operations and financial reporting.

ALUULA composite materials

Quality control measures are undertaken at many steps throughout the ALUULA process. To select raw materials, our R&D team tests each input material to ensure we are purchasing from reliable sources that meet our quality control specifications. Where raw materials require modification prior to use in our assembly process we contract a reputable factory and remain in constant communication as to the specifications that must be met. As required, ALUULA staff visit the facility to ensure compliance with specifications. Raw materials are visually inspected once received, and continuously during the assembly process.

Once composite materials are assembled, we perform a two-step quality control check. A final visual inspection during the re-rolling and packaging stage to check for imperfections and contaminates, and material sample is taken each day to be tested for thickness, weight, tensile strength, and water absorption. A Quality Control Report is prepared for inclusion with each shipment.

Any changes to the production process are carefully tested and verified using our standard quality control procedures prior to implementation in full-scale production to ensure the minimum specifications are still being met.

Ocean Rodeo windsport products

Ocean Rodeo's finished products are purchased from established overseas manufacturers. Each delivery of finished goods for resale is subject to the manufacturer's quality control process, and in the case of kites and wings we also contract a third party to conduct secondary quality control review.

FINANCIAL CONTROLS

The Company has financial controls in place to mitigate financial risks:

Segregation of cash

There is an inherent risk of loss due to fraud and error with cash and banking. The Company limits banking access to members of finance who require access and executive with signing authority. Generating transfers of cash outside of the Company's bank requires a minimum of three people to create and authorize payments.

Use of Enterprise Reporting Planning ("ERP") software

The Company has invested in cloud-based ERP software system for managing data, including its sales, production, and accounting records. Access to the ERP is user based, and employees have role-based permissions assigned to limit access to their areas of responsibility.

External review and tax preparation

Financial statements are internally prepared and are subject to an annual financial statement audit on a consolidated basis. Income tax is externally reviewed and filed, and an external SR&ED consultant is engaged to ensure appropriateness and completeness of submissions.

ENVIRONMENTAL SUSTAINABILITY

The ALUULA process uses no adhesives or volatile substances and does not produce wastewater. It is our intent to ensure that all ALUULA produced composites are single polymer and therefore inherently recycle ready. The majority of our products are already 100% recycle ready, and we continue to work on new materials with the same qualities. All our packaging is recycled material, and we take pride in minimizing packaging waste. Our team is also working with our partners to try to create easy access to recycling processes for end-of-life products.

OUTLOOK

The Company is focused on continuing to work with its growing list of brand partners to develop and deliver innovative products maximizing the benefits of the lighter, stronger and more sustainable materials they have developed. This co-development process ensures that the Company is building partnerships with the brands they support as they work together towards commercialization of more products built with ALUULA composites at their core.

Windsport will continue to be the largest vertical for the Company and we anticipate a gradual rebound in end user demand in 2024. Larger market opportunities such as performance outdoor recreation including backpacks, tents and sailing will also contribute to revenue for the Company during fiscal 2024. Market opportunities in industrial and commercial applications, although earlier stage, also offer substantial growth potential enabled by ALUULA's fusion process. This will drive innovative product designs and performance, and aim to meet the widespread demand for recyclable materials.

The Company will continue to grow its line of innovative composite materials to their core brand partners based on the market need collaboratively defined which helps ensure that the market demand is justifying the research and development efforts. Continued focus on the patented manufacturing processes will work to improve efficiencies and profitability over time. Product innovation, evolution, efficiency and recyclability are key attributes for ALUULA's brand partners and focus in these areas will continue to drive revenues in fiscal 2024.

RELATED PARTY TRANSACTIONS

Director related transactions:

The Company leased office and warehouse space from an immediate family member of a director until the lease was cancelled in December 2022. Payments for this lease totaled $12,377 for the year ended October 31, 2023 (2022 - $49,506). Additional payments of $45,000 (2022 - $74,000) were made to this related party during the year ended October 31, 2023 for the collateralization of the building against the term loan with Scotia Bank.

Upon closing of the RTO, the Company paid $766,829 to the Gustavson Capital Corporation ("GCC"), which is controlled by a director of the Company, for repayment of a $750,000 promissory note plus accrued interest at 7%.

At October 31, 2023, loans to shareholders existed in the amount of nil (October 31, 2022 – $2,122,802). These loans bore no interest and were not repayable on demand. During the period, $139,800 of loans to shareholders were repaid in cash or forgiven and the remaining $1,983,002 was repaid by the issuance of shares. In addition, at October 31, 2023 there were payables of nil (2022 - $197,092) owing to shareholders, and receivables of nil (2022 - $5,855) for transactions in the normal course of business.

The Company has a royalty agreement with Epic Ventures Inc, which is controlled by a director of the Company, pursuant to which royalties are paid on each square meter of certain patented materials, in exchange for Epic Venture Inc's assignment of the applicable patents to the Company. As at October 31, 2023, royalties of $295,891 were paid to the related company (2022 - $93,847).

The Company made payments to Xlynx Materials Inc., which is controlled by a director of the Company, for consulting services of $2,017 during the year ended October 31, 2023 (October 31, 2022 - $4,095).

Affiliates:
The Company shares leased office and warehouse space with Ocean Rodeo, a related company under common management that was acquired by Aluula on October 31, 2022. Aluula and Ocean Rodeo also share staffing resources and are part of one overall cash management group.

Key management compensation:
The Company's key management personnel includes the Executive Leadership Team, which is comprised of the Chief Executive Officer, Chief Financial Officer, and Chief Operating Officer. The Executive Leadership Team has the authority and responsibility for overseeing, planning, directing and controlling the Company's activities.

Total compensation expense paid to the Executive Leadership Team for the year ended October 31, 2023 was $725,371 (2022 - $281,270), which includes $203,571 (2022 - $14,492) in share-based payments. Employment agreements with the members of the Executive Leadership Team provide for severance payments if the executive is terminated without cause totaling $280,000 (2022 - $328,000).

SUBSEQUENT EVENTS

Repayment of CEBA loan:
Subsequent to year end, the Company repaid $40,000 of the $60,000 Government of Canada loan received as part of the Canada Emergency Benefit Account. The loan was repaid prior to the January 18, 2024 deadline qualifying the Company for $20,000 in loan forgiveness.

Extension of RRRF loans:
Subsequent to year-end, the Government of Canada and Western Economic Development Canada extended the repayment with debt forgiveness deadline from December 31, 2023 to March 28, 2024. If the Company does not take advantage of the debt forgiveness, repayments will occur over 24 months rather than 36 months.

Promissory note:
On December 29, 2023, the Company entered into a $1,000,000 short-term loan agreement with 0876991 B.C. Ltd., a related party. The loan bears interest at a rate of 12% per annum and is due on July 1, 2024.

Customer claim:
In June 2019, Ocean Rodeo signed a contract (the 'Contract") with a third-party customer (the "Customer") outlining the terms under which Ocean Rodeo would supply kites and bars (the "Products') to the Customer. Subsequent to year end, Ocean Rodeo received correspondence from the Customer claiming certain Products purchased under the terms of the Contract had quality issues which resulted in higher-than-expected return rates and the Customer's eventual withdrawal of those Product from their sales channels. The Customer is seeking reimbursement for Product return and recall costs totaling approximately $225,000. The Customer has also requested the right to return Products purchased and shipped at the end of fiscal 2023 (including reimbursement of freight charges incurred) totaling approximately $65,000. The Company has reviewed the Contract, facts and circumstances, and historical correspondence surrounding the Customer's claim and is of the opinion that the claim is not supported. The Company believes the claim meets the definition of a contingent liability under IAS 37 and no amount has been recorded in these 2023 consolidated financial statements.

Stock option plan:
Subsequent to year end, the Company announced that it had adopted a 10% fixed stock option plan (the "New Plan"), which replaced the Company's 10% rolling stock option plan. The new stock option plan is in compliance with the policies of the TSX Venture Exchange (the "TSXV") and permits the Company to grant stock options to eligible participants until the Company is able to hold an annual general meeting to seek approval for a 10% rolling stock option plan. The New Plan was approved by the TSXV and provides for the granting of up to 25,056,562 options. On February 12, 2024, the Company granted 10,500,000 to the incoming President.