The Management's Discussion and Analysis of Financial Condition and Results of Operations for DIRTT Environmental Solutions Ltd. ("MD&A") is also included in the Form 10-Q for the period ended September 30, 2022 filed on SEDAR on November 14, 2022 in its entirety ("Form 10-Q"). Capitalized terms without definition in this MD&A are as defined elsewhere in the Form 10-Q. All references to US$ or $ are to U.S. dollars and references to C$ are to Canadian dollars.

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

The following discussion and analysis of our financial condition and results of operations should be read together with our unaudited interim condensed consolidated financial statements and related notes and other financial information appearing in this Quarterly Report. This discussion contains forward-looking statements reflecting our current expectations and estimates and assumptions concerning events and financial trends that may affect our future operating results or financial position. Actual results and the timing of events may differ materially from those contained in these forward-looking statements due to a number of factors, including those described under the headings "Risk Factors" and "Cautionary Statement Regarding Forward-Looking Statements" appearing elsewhere in this Quarterly Report.

Summary of Financial Results

DIRTT Environmental Solutions Ltd. and its subsidiary ("DIRTT", the "Company", "we" or "our") is a global leader in industrialized construction. DIRTT's system of physical products and digital tools empowers organizations, together with construction and design leaders, to build high-performing, adaptable, interior environments. Operating in the workplace, healthcare, education, and public sector markets, DIRTT's system provides total design freedom, and greater certainty in cost, schedule, and outcomes.

DIRTT's proprietary design integration software, ICE® ("ICE" or "ICE software"), translates the vision of architects and designers into a 3D model that also acts as manufacturing information. ICE is also licensed to unrelated companies and Construction Partners of the Company.

Key Third Quarter 2022 Highlights

- Revenues were $46.7 million, an increase of $12.6 million or 37% from $34.1 million for the same period in 2021, and a $2.0 million or 5% increase from the second quarter of 2022.
- In July 2022, the Company announced, and successfully implemented, a price increase of approximately 10% across most product lines. This price increase, along with the increases announced in November 2021 and June 2022, were made in response to rapid and continued inflationary pressures impacting nearly all of our material and labor input costs. Our third quarter product sales reflected approximately half of the price increases previously announced. We expect the price increases to be further realized in the fourth quarter of 2022.
- Gross profit and gross profit margin for the third quarter of 2022 was $7.0 million or 15.0% of revenue, an increase of $0.7 million or 12% from $6.3 million in the second quarter of 2022, an increase of $4.6 million or 186% from $2.5 million or 7.2% of revenue for the same period of 2021. Cost of sales includes $1.0 million of accelerated amortization on software associated with the Reflect and other discontinued product lines, which were discontinued during the third quarter of 2022.
- Adjusted Gross Profit (see "– Non-GAAP Financial Measures") for the third quarter of 2022 was $10.1 million. This represents a $1.6 million (19.8%) increase over the second quarter of 2022 and a $5.4 million (112.5%) increase over the third quarter of 2021. Adjusted Gross Profit Margin (see "– Non-GAAP Financial Measures") for the third quarter of 2022 was 21.7%, a 280 bps improvement over the second quarter 2022 and a 770 bps improvement over the third quarter 2021. Third quarter results include certain inventory write-downs of $1.0 million (2.1%, as a percent of total revenue), primarily related to the discontinuance of the Reflect and other product lines. The improved Adjusted Gross Profit and Adjusted Gross Profit Margin have been driven by a combination of improved demand for our products and commercial discipline. The Company benefited from a weakening Canadian dollar with an approximate benefit of $0.6 million on Canadian Dollar denominated manufacturing costs compared to the third quarter of 2021.
- During the third quarter of 2022, we have continued to align our manufacturing footprint and salaried workforce with our current activity levels. In July 2022, we announced a further reduction of salaried positions and in August 2022, we announced the temporary closure of our Rock Hill Facility as the Calgary manufacturing facility has sufficient capacity to absorb production and meet expected demand for the near term. These changes are expected to result in approximately $5.0 million in annualized savings. One-time costs associated with the reorganization activities in the third quarter were $3.4 million but added back to Adjusted EBITDA.

- Net loss for the third quarter of 2022 was $6.7 million compared to $15.4 million for the same period of 2021. The lower net loss is primarily the result of the higher gross profit margin explained above of $4.6 million, a $4.2 million increase in government subsidies, a $0.8 million increase in foreign exchange gain and a $2.9 million reduction in operating expenses offset by a $0.5 million increase in interest expense and $3.4 million of reorganization costs.
- Adjusted EBITDA (see "– Non-GAAP Financial Measures") for the third quarter of 2022 was a $5.4 million loss or (11.6)%, an improvement of $7.9 million from a $13.3 million loss or (39.1)% for the third quarter of 2021 and an improvement of $4.0 million from a $9.4 million loss or (21.1)% for the second quarter of 2022.
- The Company used approximately $12.5 million of cash in the third quarter compared to $21.3 million and $19.1 million in the first and second quarter 2022, respectively. This included approximately $3.4 million in the quarter ($15.1 million year to date) of reorganization costs. Excluding these amounts, net of working capital, cash used would have been $9.1 million in the third quarter of 2022 compared to $16.2 million and $12.6 million in the first and second quarter of 2022, respectively.
- On November 14, 2022, the Company entered into a Private Placement of 8.8 million shares to the two largest shareholders and all our directors and officers with expected proceeds of approximately $3.0 million, subject to certain pricing mechanisms, with an additional minimum aggregated value of $2.0 million committed to backstopping any rights offering occurring in the next twelve months.
- The Company continues to evaluate certain non-dilutive, strategic cash initiatives expected to generate additional cash flows by early 2023.

Outlook

Third quarter 2022 revenues were in line with expectations and grew sequentially over the second quarter and the same period last year. As of October 1, 2022, our 12-month forward pipeline, which represents known projects and leads at various stages of maturation which our sales teams are working to convert into orders, increased by 10% to $395 million from $359 million at July 1, 2022. The increase is a function of the impact of our price increases, discussed above, and additional leads added to the pipeline. The pipeline comprises 63% commercial, 22% healthcare, 6% education and 9% government verticals The relative split between verticals remains consistent with pre-pandemic actual percentage results.

Overall, volumes have remained relatively consistent between the second and third quarters of 2022. While the increase in our sales pipeline is a positive indicator of the Company's future revenue potential, we have been experiencing uneven demand flow in both lead and order conversion. Further, we have experienced higher than usual push out rates on orders, a trend that many other construction and product companies are seeing as well. We believe the primary factor has been jobsite readiness. Further, rising material input costs have forced many contractors to re-evaluate pricing and project profitability. These factors have all served to stretch construction schedules, and by extension, the timing at which our products are ordered. We believe these trends will normalize over time.

The Company's current and immediate focus continues to be unlocking manufacturing capacity, improving revenues and profitability and accelerating the Company's near-term progress towards cashflow breakeven and beyond, and managing liquidity. Under new leadership, the following actions have been, or are in the process of being, completed, and are discussed in more detail below:

- Creating a more comprehensive, focused Project Enablement Team to provide first class support to our partners from quote to delivery.
- Reestablishing bi-weekly communications and close collaboration with our Partner Advisory Council and monthly discussions with our entire partner network.
- Identifying and taking steps to unlock manufacturing capacity through additions to our hourly workforce and implementation of manufacturing improvements.
- Offering a suite of newly implemented incentives, including certain rebate and quick pay discount programs to our Construction Partners that are in good standing.

- Evaluating several supply chain optimization projects that aim to improve Sales and Operational Planning and reduce slow moving and/or obsolete inventory items.
- Tightly managing discretionary spend and overtime during periods of order volatility.

As a part of managing our working capital, we are working on managing our inventory levels, which built up during the year (primarily in aluminum extrusions). The increase in our inventory levels primarily reflects our difficulty in increasing order, and, therefore, actual production relative to expectations as previously described, but also reflects the increased cost of raw materials. As communicated in the second quarter, we have taken steps to moderate such supply and saw a drawdown of inventory by $2.0 million in the third quarter of 2022. As a result of the steps mentioned, we are to approaching monthly cashflow breakeven (see "–Liquidity and Capital Resources").

As revenues improve, including the effect of the price increases above, and the cost reduction initiatives take hold, we expect to continue to progress toward an improvement in net loss and Adjusted EBITDA breakeven in the fourth quarter of 2022. Unrestricted cash and net working capital at September 30, 2022 was $6.8 million and $26.9 million, compared to $19.7 million and $31.6 million at June 30, 2022, respectively, and $60.3 million and $66.7 million at December 31, 2021, respectively. The Company's asset backed credit facility, which is based upon a percentage of accounts receivable and inventory, remains undrawn at September 30, 2022 with approximately C$12.4 million ($9.0 million) available. The Company continues to focus on revenue growth and cost initiatives to positively affect DIRTT's balance sheet, cash flow and profitability and expects to see a trend of increasing monthly working capital by year end.

Non-GAAP Financial Measures

Note Regarding Use of Non-GAAP Financial Measures

Our condensed consolidated interim financial statements are prepared in accordance with GAAP. These GAAP financial statements include non-cash charges and other charges and benefits that we believe are unusual or infrequent in nature or that we believe may make comparisons to our prior or future performance difficult.

As a result, we also provide financial information in this Quarterly Report that is not prepared in accordance with GAAP and should not be considered as an alternative to the information prepared in accordance with GAAP. Management uses these non-GAAP financial measures in its review and evaluation of the financial performance of the Company. We believe that these non-GAAP financial measures also provide additional insight to investors and securities analysts as supplemental information to our GAAP results and as a basis to compare our financial performance period-over-period and to compare our financial performance with that of other companies. We believe that these non-GAAP financial measures facilitate comparisons of our core operating results from period to period and to other companies by removing the effects of our capital structure (net interest income on cash deposits, interest expense on outstanding debt and debt facilities, or foreign exchange movements), asset base (depreciation and amortization), the impact of under-utilized capacity on gross profit, tax consequences, reorganization expense and stock-based compensation. We remove the impact of all foreign exchange from Adjusted EBITDA. Foreign exchange gains and losses can vary significantly period-to-period due to the impact of changes in the U.S. and Canadian dollar exchange rates on foreign currency denominated monetary items on the balance sheet and are not reflective of the underlying operations of the Company. We remove the impact of under-utilized capacity from gross profit, and fixed production overheads are allocated to inventory on the basis of normal capacity of the production facilities. In periods where production levels are abnormally low, unallocated overheads are recognized as an expense in the period in which they are incurred. In addition, management bases certain forward-looking estimates and budgets on non-GAAP financial measures, primarily Adjusted EBITDA.

Government subsidies, depreciation and amortization, stock-based compensation expense, reorganization expense, foreign exchange gains and losses and impairment expenses are excluded from our non-GAAP financial measures because management considers them to be outside of the Company's core operating results, even though some of those receipts and expenses may recur, and because management believes that each of these items can distort the trends associated with the Company's ongoing performance. We believe that excluding these receipts and expenses provides investors and management with greater visibility to the underlying performance of the business operations, enhances consistency and comparativeness with results in prior periods that do not, or future periods that may not, include such items, and facilitates comparison with the results of other companies in our industry.

The following non-GAAP financial measures are presented in this Quarterly Report, and a description of the calculation for each measure is included.

Adjusted Gross Profit	Gross profit before deductions for costs of under-utilized capacity, depreciation and amortization
Adjusted Gross Profit Margin	Adjusted Gross Profit divided by revenue
EBITDA	Net income before interest, taxes, depreciation and amortization
Adjusted EBITDA	EBITDA adjusted to remove foreign exchange gains or losses; impairment expenses; reorganization expenses, stock-based compensation expense; government subsidies, and any other non-core gains or losses
Adjusted EBITDA Margin	Adjusted EBITDA divided by revenue

You should carefully evaluate these non-GAAP financial measures, the adjustments included in them, and the reasons we consider them appropriate for analysis supplemental to our GAAP information. Each of these non-GAAP financial measures has important limitations as an analytical tool due to exclusion of some but not all items that affect the most directly comparable GAAP financial measures. You should not consider any of these non-GAAP financial measures in isolation or as substitutes for an analysis of our results as reported under GAAP. You should also be aware that we may recognize income or incur expenses in the future that are the same as, or similar to, some of the adjustments in these non-GAAP financial measures. Because these non-GAAP financial measures may be defined differently by other companies in our industry, our definitions of these non-GAAP financial measures may not be comparable to similarly titled measures of other companies, thereby diminishing their utility.

Results of Operations

Three and Nine Months Ended September 30, 2022, Compared to Three and Nine Months Ended September 30, 2021

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2022	2021	% Change	2022	2021	% Change
	($ in thousands)			($ in thousands)		
Revenue	46,747	34,098	37	129,734	104,665	24
Gross Profit[(1)]	7,008	2,450	186	16,571	15,044	10
Gross Profit Margin	15.0%	7.2%		12.8%	14.4%	
Operating Expenses						
Sales and Marketing	6,089	7,536	(19)	21,094	21,770	(3)
General and Administrative	6,542	7,546	(13)	21,412	22,567	(5)
Operations Support	2,321	2,374	(2)	7,347	6,884	7
Technology and Development	1,695	2,146	(21)	5,714	6,005	(5)
Stock-Based Compensation	918	837	10	3,546	3,792	(6)
Reorganization	3,426	-	100	12,281	-	100
Total Operating Expenses	**20,991**	**20,439**	**3**	**71,394**	**61,018**	**17**
Operating Loss	**(13,983)**	**(17,989)**	**(22)**	**(54,823)**	**(45,974)**	**19**
Operating Margin	**(29.9)%**	**(52.8)%**		**(42.3)%**	**(43.9)%**	

(1) Gross Profit for the three and nine month periods ended September 30, 2022 includes $1.0 million primarily related to the write off of inventory of discontinued product lines, and $1.0 million and $2.1 million, respectively of accelerated depreciation and amortization on software associated with discontinued product lines and the closure of the Phoenix Facility

Revenue

Revenue reflects sales to our Construction Partners for resale to their clients and, in limited circumstances, our direct sales to clients. Our revenue is generally affected by the timing of when orders are executed, particularly large orders, which can add variability to our financial results and shift revenue between quarters.

The following table sets forth the contribution to revenue of our DIRTT product and service offerings:

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2022	**2021**	**% Change**	**2022**	**2021**	**% Change**
		($ in thousands)			**($ in thousands)**	
Product	39,092	29,569	32	110,383	91,867	20
Transportation	5,022	3,294	52	13,878	9,277	50
License fees from Construction Partners	193	191	1	588	539	9
Total product revenue	**44,307**	**33,054**	**34**	**124,849**	**101,683**	**23**
Installation and other services	2,440	1,044	134	4,885	2,982	64
	46,747	**34,098**	**37**	**129,734**	**104,665**	**24**

During the quarter ended September 30, 2022, revenue was $46.7 million, an increase of $12.6 million or 37% from the same period in 2021. This also reflects a $2.0 million or 5% increase in revenues from the second quarter of 2022. Revenue for the nine months ended September 30, 2022 was $129.7 million, an increase of $25.1 million or 24% from the nine months ended September 30, 2021. The first quarter of 2022 marked the transition of the COVID-19 pandemic to an endemic with the broad easing of health restrictions, including work-from-home mandates, across North America. While the resurgence in COVID-19 infections due to the Omicron variant at the beginning of the year temporarily sent many employees back to their home offices and delayed return dates, the Company and our Construction Partners experienced an uptick in planning activity and opportunity growth in our commercial vertical which began to translate into orders in March 2022 that has continued into the third quarter.

In response to significant increases in the costs of raw materials, shipping materials, labor and freight, effective November 16, 2021, DIRTT increased product and transportation prices on new projects by approximately 6.5%, with the benefits largely expected to be realized in 2022. On February 17, 2022, we implemented a further price increase of 5% that came into effect June 1, 2022. On June 21, 2022 an additional price increase of 10% was announced effective July 21, 2022. Our third quarter product sales reflected approximately 40% and 15% of these June and July price increases, respectively. We expect the price increases to be further realized in the fourth quarter of 2022. During the third quarter, DIRTT also terminated the 20% pilot price reduction program on its Reflect and Inspire product lines that it announced in February 2022 as a result of the combination of increased aluminum prices and the unanticipated impact that the increased demand placed on our productive capacity due to the immaturity of production processes related to these product lines. In August 2022, with consideration to the production process and profitability, we discontinued the Reflect product line.

Installation and other services revenue was $2.4 million and $4.9 million for the three and nine months ended September 30, 2022 respectively, compared to $1.0 million and $3.0 million in the same period of 2021. This revenue primarily reflects services performed by our ICE and design teams for third parties. Except in limited circumstances, our Construction Partners, rather than the Company, perform installation services, and accordingly, we are not anticipating significant growth in this revenue stream.

Our success is partly dependent on our ability to profitably develop our Construction Partner network to expand our market penetration and ensure best practices are shared across local markets. At September 30, 2022, we had 69 (December 31, 2021: 69) Construction Partners servicing multiple locations. During 2021 and the first quarter of 2022, we made several changes and upgrades to our Construction Partner network, expanding our relationships with new and existing partners and ending our relationships with others. In February 2022, we announced the establishment of a Partner Advisory Council to provide a greater link with Construction Partners and end clients who they service. The Partner Advisory Council will offer advice on sales and marketing effectiveness, product issues and new market needs, market conditions, competitive landscape, marketing support and other related areas of mutual interest.

We periodically analyze our revenue growth by vertical markets in the defined markets of commercial, healthcare, government and education. The following table presents our product and transportation revenue by vertical market:

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2022	2021	% Change	2022	2021	% Change
	($ in thousands)			($ in thousands)		
Commercial	31,796	20,805	53	85,458	55,981	53
Healthcare	3,638	5,017	(27)	15,693	25,680	(39)
Government	3,358	3,149	7	11,680	11,579	1
Education	5,322	3,892	37	11,430	7,904	45
License fees from Construction Partners	193	191	1	588	539	9
Total product revenue	**44,307**	**33,054**	**34**	**124,849**	**101,683**	**23**
Service revenue	2,440	1,044	134	4,885	2,982	64
	46,747	**34,098**	**37**	**129,734**	**104,665**	**24**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2022	2021	2022	2021
	(in %)		(in %)	
Commercial	72	63	69	56
Healthcare	8	15	13	25
Government	8	10	9	11
Education	12	12	9	8
Total Product Revenue[(1)]	**100**	**100**	**100**	**100**

(1) Excludes license fees from Construction Partners.

Commercial revenues increased by 53% in the three and nine month periods ended September 30, 2022 from the same prior year periods, reflecting improving market conditions as health restrictions and work-from-home requirements ease and include one large customer in the technology sector with revenue of $2.4 million and $7.9 million for the respective periods. Healthcare decreased by 27% and 39% in the three and nine months ended September 30, 2022, respectively, from the same periods in 2021. Such sales tend to be larger individual projects and are subject to timing due to a typically longer sales cycle, resulting in variability in sales levels. In 2021, we had one large healthcare project with revenue of $6.9 million which did not recur in 2022.

Education sales in the three and nine months ended September 30, 2022 increased by 37% and 45%, respectively, over the prior periods. At the beginning of the pandemic, education spending effectively paused with many institutions suspending in-person classes. There were no individually significant education projects and the increases represent higher volumes of projects due to the easing of health restrictions and many students returning to in-person learning. Government revenues in the three and nine months ended September 30, 2022 increased by 7% and 1%, respectively, over the prior year periods.

Revenue continues to be derived almost exclusively from projects in North America and predominantly from the United States. The following table presents our revenue dispersion by geography:

	For the Three Months Ended September 30,			For the Nine Months Ended September 30,		
	2022	2021	% Change	2022	2021	% Change
	($ in thousands)			($ in thousands)		
Canada	7,191	4,405	63	19,859	11,860	67
U.S.	39,556	29,693	33	109,875	92,805	18
	46,747	**34,098**	**37**	**129,734**	**104,665**	**24**

Historically, approximately 15-25% and 75-85% of revenues are derived from sales to Canada and the United States, respectively. In the quarter ended September 30, 2020, revenues from Canada fell to 9% of total sales while sales to the United States increased to 91%. The geographical split for the first three quarters of 2022 began to return to historical averages and reflects the easing of health restrictions in Canada which occurred later than in the United States.

Sales and Marketing Expenses

Sales and marketing expenses decreased by $1.4 million and $0.7 million to $6.1 million and $21.1 million for the three and nine months ended September 30, 2022, from $7.5 million and $21.8 million for the three and nine months ended September 30, 2021 respectively. The decrease was largely related to a decrease of $1.3 million and $2.2 million for the three and nine months ended September 30, 2022, respectively, in salaries and benefits costs. The decrease in the nine months ended September 30, 2022 was offset by a $1.5 million increase in travel, meals and entertainment expenses as business activity has increased and restrictions on travel have eased.

General and Administrative Expenses

General and administrative expenses decreased $1.0 million and $1.2 million to $6.5 million and $21.4 million for the three and nine months ended September 30, 2022 from $7.5 million and $22.6 million for the three and nine months ended September 30, 2021. The decrease in the three months ended September 30, 2022 was related to lower salaries and benefits costs associated with the planned headcount reductions as part of our cost savings initiatives and lower professional services costs. For the nine month period ended September 30, 2022, approximately $1.8 million of incremental professional fees associated with the contested election of directors was offset by lower salaries and benefits cost.

Operations Support Expenses

Operations support is comprised primarily of project managers, order entry and other professionals that facilitate the integration of our Construction Partner project execution and our manufacturing operations. Operations support expenses decreased by $0.1 million from $2.4 million to $2.3 million in the three months ended September 30, 2022 from the same period of 2021. The decrease was due to reduced travel costs in the quarter.

Operations support expenses increased $0.5 million from $6.9 million for the nine months ended September 30, 2021 to $7.3 million for the nine months ended September 30, 2022. The increase was due to a decrease in salaries and benefits capitalized to internal projects of $0.4 million with the completion of the Rock Hill Facility and the DIRTT Experience Centre ("DXC") in Dallas and an increase in salaries and benefits of $0.1 million for the nine month period ended September 30, 2022 compared to the previous year same period.

Technology and Development Expenses

Technology and development expenses relate to non-capitalizable costs associated with our product and software development teams and are primarily comprised of salaries and benefits of technical staff.

Technology and development expenses for the three and nine month period ended September 30, 2022 decreased by $0.5 million and $0.3 million, respectively, from the prior period costs to $1.7 million and $5.7 million. The decrease was related to reductions in salaries and benefits offset by lower capitalized costs due to fewer internal projects. For the nine months ended September 30, 2022, professional service fees also decreased by $0.2 million compared to the prior year period.

Stock-Based Compensation

Stock-based compensation expense for the three and nine months ended September 30, 2022 was $0.9 million and $3.5 million compared to $0.8 million and $3.8 million for the same periods in 2021. The movement in this expense was largely the impact of grants of RSUs to the Company's employees, including those in lieu of cash compensation to the Company's former interim Chief Executive Officer in January 2022 and DSUs granted to the Board of Directors, lowered by the impact of fair value adjustments on cash settled awards as a result of our share price decreasing during the quarter and nine months ended September 30, 2022. The Board of Directors receives 100% of their remuneration in DSUs.

Reorganization

For the three and nine months ended September 30, 2022, we incurred $3.4 million and $12.3 million in reorganization costs, respectively. Reorganization costs for the quarter include termination benefits, and costs associated with the temporary suspension of the Rock Hill Facility. For the nine month period ended September 30, 2022, reorganization costs also include insurance costs incurred on change of control of the board, and costs associated with the closure of the Phoenix Facility.

We have undertaken several initiatives to align our manufacturing footprint with our current activity levels. This included the closure of the Phoenix Facility which was substantially completed in the second quarter of 2022, with related manufacturing to be undertaken by both our Savannah and Calgary aluminum facilities. Of the initial estimate of cost savings of approximately $2.4 million from this closure, we expect to realize annualized savings of approximately $1.0 million as $1.4 million of work force reductions were offset by additions in Calgary and Savannah due to increased demand. On August 23, 2022, we announced the temporary closure of our Rock Hill Facility, as the Calgary manufacturing facility has sufficient capacity to absorb production and meet expected demand for the near term.

Additionally, in February 2022, we announced a reduction of our salaried workforce including manufacturing and office positions which, along with other cost reduction initiatives, were expected to yield annualized savings of approximately $13.0 million. The reductions were followed by a further reduction of salaried positions, as announced in July 2022, and the temporary closure of our Rock Hill Facility, announced in August 2022, which are expected to result in approximately $5.0 million in annualized savings. Of these cost reduction initiatives, $14.0 million was implemented during the first three quarters of 2022, $3.0 million is expected to be implemented in the fourth quarter of 2022, and $1.0 million, comprised of certain manufacturing positions, has been deferred as we work to increase manufacturing headcount in light of increased demand.

Government Subsidies

During the quarter ended September 30, 2022, the Company determined it was eligible for the ERC in the United States established by Section 2301 of the CARES Act and has a filed a claim for $7.3 million payroll tax credits ($7.1 million net of expenses). The Company received subsidies of $3.4 and $7.5 million during the three and nine months ended September 30, 2021 under Canadian government programs CEWS and CERS. Upon finalization of 2021 compensation to specified executives, approximately C$0.5 million ($0.4 million) of previously-received subsidies were repaid to the Canadian authorities in the second quarter of 2022. The amount was fully provided for in the third quarter of 2021 and the Company reversed a $0.6 million incremental provision related to this that was no longer necessary in the first quarter of 2022. The last claim period under the CEWS and CERS programs expired on October 23, 2021.

Interest expense

Interest expense increased by $0.5 million from $0.8 million for the three months ended September 30, 2022 to $1.3 million compared to September 30, 2021 and by $1.8 million from $2.1 million in the nine months ended September 30, 2022 to $3.9 million compared to September 30, 2021. The increased interest expense is a result of the issuance of C$35.0 million ($27.4 million) of Debentures in December 2021 and draws on the Leasing Facilities.

Income Tax

The provision for income taxes comprises U.S. and Canadian federal, state and provincial taxes based on pre-tax income. The Company incurred a minimal income tax recovery during the three and nine months ended September 30, 2022, compared to a $0.1 million and $0.3 million expense for the same period of 2021. As at September 30, 2022 the Company had a valuation allowance of $28.1 million (December 31, 2021 $17.3 million) against deferred tax assets due to ongoing near term uncertainties on the business caused by the COVID-19 pandemic and the related decline in business activity which impacted our ability to generate sufficient taxable income in Canada and the United States to fully deduct historical losses. As at September 30, 2022, we had C$107.2 million of non-capital loss carry-forwards in Canada and $49.5 million in the United States. These loss carry-forwards will begin to expire in 2032.

Net Loss

Net loss decreased to $6.7 million or $0.08 net loss per share in the three months ended September 30, 2022 from a net loss of $15.4 million or $0.18 net loss per share for the quarter ended September 30, 2021. The decreased loss is primarily the result of a $4.6 million increase in gross profit, a $4.2 million increase in government subsidies and a $0.8 million increase in foreign exchange gain. These were offset by a $0.6 million increase in operating expenses (which includes $3.4 million of reorganization expenses), and a $0.5 million increase in interest expense.

Net loss increased to $49.1 million or $0.56 net loss per share for the nine months ended September 30, 2022 from a net loss of $37.7 million or $0.44 net loss per share for the nine months ended September 30, 2021. The increased loss is primarily the result of a $10.4 million increase in operating expenses (which includes $12.3 million of reorganization expenses and $1.8 million of incremental professional fees as described previously), a $1.8 million increase in interest expense and a $2.7 million decrease in government subsidies offset by an increase in gross margin of $1.5 million and an increase in foreign exchange gain of $1.6 million.

EBITDA and Adjusted EBITDA for the Three and Nine Months Ended September 30, 2022 and 2021

The following table presents a reconciliation for the third quarter and year to date results of 2022 and 2021 of EBITDA and Adjusted EBITDA to our net loss, which is the most directly comparable GAAP measure for the periods presented:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2022	2021	2022	2021
	($ in thousands)		($ in thousands)	
Net loss for the period	(6,727)	(15,419)	(49,057)	(37,656)
Add back (deduct):				
Interest Expense	1,276	823	3,935	2,117
Interest Income	(19)	(20)	(50)	(62)
Income Tax expense (recovery)	(16)	88	(16)	347
Depreciation and Amortization	4,236	3,815	12,202	10,638
EBITDA	**(1,250)**	**(10,713)**	**(32,986)**	**(24,616)**
Foreign Exchange Gains	(1,356)	(526)	(1,870)	(286)
Stock-Based Compensation	918	837	3,546	3,792
Government Subsidies	(7,141)	(2,935)	(7,765)	(10,434)
Reorganization Expense	3,426	-	12,281	-
Adjusted EBITDA	**(5,403)**	**(13,337)**	**(26,794)**	**(31,544)**
Net Loss Margin[(1)]	**(14.4)%**	**(45.2)%**	**(37.8)%**	**(36.0)%**
Adjusted EBITDA Margin	**(11.6)%**	**(39.1)%**	**(20.7)%**	**(30.1)%**

(1) Net loss divided by revenue.

For the three months ended September 30, 2022, Adjusted EBITDA and Adjusted EBITDA Margin increased by $7.9 million to a $5.4 million loss or (11.6)% from $13.3 million loss or (39.1)% in the same period of 2021. This primarily reflects a $5.4 million increase in Adjusted Gross Profit, $2.1 million decrease in salaries and benefits costs due to headcount reductions, $0.5 million reduction of professional fees and other cost reductions.

For the nine months ended September 30, 2022, Adjusted EBITDA and Adjusted EBITDA Margin increased by $4.8 million to a $26.8 million loss or (20.7)% from $31.5 million loss or (30.1)% in the same period of 2021. This primarily reflects a $2.2 million increase in Adjusted Gross Profit, a $5.1 million reduction in salaries and benefits costs due to headcount reductions (offset by a reduction in capitalized salaries of $1.1 million due to fewer internal projects), $1.8 million of costs of underutilized capacity in the first quarter of 2021 that did not recur in 2022, offset by $1.8 million of incremental professional fees as described previously and $1.5 million increase in travel and entertainment costs due to increased business activity and easing of travel restrictions.

Adjusted Gross Profit and Adjusted Gross Profit Margin for the Three and Nine Months Ended September 30, 2022 and 2021

The following table presents a reconciliation for the three and nine months ended September 30, 2022 and 2021 of Adjusted Gross Profit to our gross profit, which is the most directly comparable GAAP measure for the periods presented:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2022	2021	2022	2021
	($ in thousands)		($ in thousands)	
Gross profit	7,008	2,450	16,571	15,044
Gross profit margin	15.0%	7.2%	12.8%	14.4%
Add: Depreciation and amortization expense	3,132	2,321	8,792	6,383
Add: Costs of under-utilized capacity	-	-	-	1,756
Adjusted Gross Profit	**10,140**	**4,771**	**25,363**	**23,183**
Adjusted Gross Profit Margin	**21.7%**	**14.0%**	**19.6%**	**22.1%**

There have been significant and industry wide inflationary increases in the realized cost of materials, transportation, labor and packaging which have impacted DIRTT since the second half of 2021. In addition, in the second quarter and in response to a sustained increase in demand that began in the first quarter of 2022, the Company began efforts to increase its manufacturing labor headcount but experienced the ongoing effects of a tight labor market. This has made it more difficult than expected to attract and retain skilled labor, particularly at our Savannah manufacturing facility, and as a result the Company increased hourly rates by 6% on average to increase its overall competitiveness. To address these cost increases, the Company implemented a series of price increases starting with a 6.5% increase effective November 1, 2021, an additional 5% price increase effective June 1, 2022 and a further 10% price increase effective July 21, 2022 and continues to monitor raw material, labor and other costs to determine whether further action is necessary.

Gross profit and gross profit margin increased to $7.0 million or 15.0% for the three months ended September 30, 2022, from $2.5 million or 7.2% for the three months ended September 30, 2021. Adjusted Gross Profit and Adjusted Gross Profit Margin increased to $10.1 million or 21.7% for the three months ended September 30, 2022, from $4.8 million or 14.0% for the three months ended September 30, 2021. The 7.7% increase in Adjusted Gross Profit Margin was a result of improved labor efficiency which benefited gross profit by 4.9%, and the benefit of higher revenues on fixed costs which improved gross profit by 5.1%, offset by a $1.0 million charge, or 2.1% of gross profit, due to the write down of inventory related to Reflect and other discontinued product lines. Materials, transportation and other variable costs reduced gross profit by 0.6% as our price increases realized to date did not fully offset cost increases. We expect a higher realization of enacted price increases from the fourth quarter. Gross profit was impacted by a $1.0 million increase in depreciation and amortization in the quarter on account of accelerated depreciation on software associated with discontinued product lines. Gross profit for the third quarter benefited by approximately $0.6 million from the impact of the weakening Canadian dollar on U.S. dollar reported results, which is included in the above variances.

For the nine month period ended September 30, 2022, gross profit and gross profit margin increased to $16.6 million or 12.8% from $15.0 million or 14.4% for the nine month period ended September 30, 2021. Adjusted Gross Profit and Adjusted Gross Profit Margin decreased to $25.4 million or 19.6% for the nine months ended September 30, 2022, from $23.2 million or 22.1% for the nine months ended September 30, 2021. The 2.6% decrease in Adjusted Gross Profit was a result of higher materials, transportation, packaging and other variable costs which reduced gross profit by 4.4%. As previously discussed, price increases that were put in place over the last twelve months lagged cost increases. We expect the price increases to be further realized in the fourth quarter which will reduce variable costs as a percentage of revenues closer to historical levels. As a result of higher sales activities, gross profit benefited by 1.6% and 2.6% on utilization of labor and fixed costs, respectively. Labor costs increased $2.3 million for the year-to-date period as we incurred incremental costs during the second quarter associated with moving production to Calgary and Savannah on closure of the Phoenix Facility, rate increases, and adding capacity following an improvement in demand. Fixed costs increased $1.6 million due to cost inflations and the impact of adding the Rock Hill Facility in 2021 to the fixed cost base. In the current year we incurred a $0.8 million charge, or 0.6% of gross profit, due to the write down of inventory related to Reflect and other discontinued product lines. Prior year Adjusted Gross Profit benefited from the removal of $1.8 million, or 1.7% Adjusted Gross Profit impact, on under-utilized capacity not captured in product costs. Gross profit was impacted by $2.1 million of incremental depreciation and amortization on the acceleration of useful lives associated with discontinued product lines and the Phoenix Facility. Gross profit for the year to date benefited by approximately $0.9 million from the impact of the weakening Canadian dollar on U.S. dollar reported results, which is included in the above variances.

During the fourth quarter of 2019, we determined that we were carrying abnormal excess capacity in our manufacturing facilities as a result of the slowdown in sales and determined certain production overheads should be directly expensed in cost of sales, representing production overheads that were not attributable to production. In the first quarter of 2021, we experienced the full impact of the slowdown in non-residential construction activity on our business. In anticipation of a recovery in demand for our products and services and to preserve our skilled workforce, we deliberately maintained manufacturing headcount, while implementing selective furlough days, in the first quarter of 2021 despite the shortfall in revenues relative to capacity. As a result, in the first quarter of 2021 we separately classified $1.8 million as costs related to our under-utilized capacity (1.2% of 2021 first quarter gross profit margin) in cost of sales. For the remaining quarters of 2021 and 2022, we did not have abnormal excess capacity as our workforce was better aligned with current production volumes.

Liquidity and Capital Resources

Cash and cash equivalents at September 30, 2022 totaled $6.8 million, a decrease of $53.5 million from December 31, 2021. The decrease in cash over the nine month period primarily reflects the impact of $47.5 million cash used in operations, of which $1.8 million related to one-time costs associated with the contested director election and $12.3 million of reorganization costs. In addition, capital expenditures totaled $3.6 million and scheduled Leasing Facilities repayments totaled $1.9 million. These outflows were offset by a C$0.9 million ($0.7 million) draw under the Canada Leasing Facility received in April 2022.

The impact of COVID-19 on the Company's sales and operations has been severe, including a contraction of demand since the beginning of the pandemic and more recently, significant inflation on raw material costs. This has resulted in a significant usage of cash which we have financed through existing cash on hand and financings as described further below. Furthermore, we have implemented multiple initiatives to reduce our overall fixed cost base, including the closure of our Phoenix Facility in the second quarter of 2022, reduction in our hourly headcount in 2021 and salaried headcount reductions and other cost savings initiatives in February 2022 and July 2022. In August 2022 we announced the temporary suspension of operations at the Rock Hill Facility as we have sufficient capacity at our other facilities to manage current demand. This suspension of operations will reduce costs in the interim.

We have also implemented three price increases to mitigate the inflationary effect, comprised of 6.5% effective November 1, 2021, 5% effective June 1, 2022 and a further 10% effective July 21, 2022. We continue to monitor the cost of our raw materials and labor to determine whether further price increases are warranted. Since March 2022, however, the Company and its Construction Partners have experienced an increase in demand, particularly within its commercial and education verticals, with the broad lifting of health restrictions across North America. In response the Company began efforts to increase manufacturing headcount within its Calgary and Savannah facilities to enable it to meet both near-term demand and anticipated sustained increases. We have increased wage rates in both Canada and the United States to increase our competitiveness in what is proving to be a tight labor market, particularly in Savannah. We are also taking steps to decongest our manufacturing processes to return productivity to pre-pandemic levels. We have started to realize the benefits of the price increases, manufacturing headcount additions, training and debottlenecking in the latter part of the third quarter and expect to see further benefits in the fourth quarter.

The cost reductions and price increases discussed above positively benefited our third quarter results, and have reduced our rate of cash usage. We expect a greater impact of these actions to be realized in the fourth quarter and thereafter. While these actions, combined with an increasing project pipeline is promising, we continue to see unpredictability in our pace of orders.

Accordingly, we are taking several strategic actions to improve our balance sheet in the short term. First, we have determined our eligibility for the ERC for the first three quarters of 2021 and have filed a claim for $7.3 million in payroll tax credits ($7.1 million net of expenses). Second, we have certain properties that are currently owned that we are evaluating for sale and leasing back. We do not intend to vacate these premises as they still serve a valuable aspect of our value proposition, but we expect to receive a one-time cash payment, in exchange for future rent payments. Third, historically we have licensed the use of ICE software to certain strategic partners for use in their business, and DIRTT has provided licensing and developer software support for these counterparties. We are in the process of evaluating multiple initiatives related to the further use of ICE software by third parties. We expect these strategic initiatives to result in positive cash inflows in 2023.

To bridge any cash requirements between now and the completion and closing of these strategic transactions, the Company entered into irrevocable subscription agreements with its two largest shareholders, 22NW and 726 and all the directors and officers of the Company on November 14, 2022 to issue up to 8.8 million shares for gross proceeds of approximately $3.0 million, based on the higher of the Nasdaq closing price on November 14, 2022, and the volume weighted average trading price of the common shares on the Toronto Stock Exchange for the 5 days following the announcement. In addition, in connection with the Private Placement, the two shareholders, or their principals, have irrevocably committed to backstopping any rights offering occurring by the Company in the next twelve months in the aggregate amount of $2.0 million and the shortfall, if any, between the maximum anticipated gross proceeds under the Private Placement, being $3.0 million, and the actual gross proceeds received by the Company.

We believe completion of these strategic transactions and the Private Placement will improve our balance sheet and accordingly confidence in our business, benefiting our pipeline conversion which will enable us to cross the threshold of activity which will get us to cashflow breakeven.

We have assessed the Company's liquidity using multiple downside and upside scenarios, taking into account these circumstances, our sales outlook for the next twelve months and actions in combination with existing cash balances, available credit facilities, the strategic transactions and Private Placement discussed previously, and potential equity or debt financing. Based upon this analysis, we believe the Company has sufficient liquidity to remain a going concern for at least the next 12 months. However, a number of factors, including our ability to satisfy the expected growth in pipeline demand and those discussed below, could adversely impact our liquidity over such period.

To the extent that existing cash and cash equivalents, available facilities and increased liquidity from the aforementioned strategic actions are not sufficient to fund future activities, we may seek to raise additional funds through equity or debt financings. If additional funds are raised through the incurrence of indebtedness, such indebtedness may have rights that are senior to holders of our Debentures and our equity securities or contain instruments that may be dilutive to our existing shareholders. Any additional equity or debt financing may be dilutive to our existing shareholders. While we are confident in our ability to access capital markets when needed or under acceptable terms, there can be no absolute assurance we will be able to do so.

During 2021, we completed financings to increase our liquidity in light of the highly uncertain economic conditions caused by the pandemic. In January 2021, we issued C$40.3 million of the January Debentures for net proceeds after costs of C$37.6 million ($29.5 million). The January Debentures accrue interest at a rate of 6.00% per annum and are convertible into common shares of DIRTT at an exercise price of C$4.65 per common share, or if not converted will mature and be repayable on the January Debenture Maturity Date. Interest and principal are payable in cash or shares at the option of the Company.

In February 2021, we entered into the RBC Facility, a C$25.0 million senior secured revolving credit facility with RBC. Under the RBC Facility, the "Borrowing Base" is a maximum of 90% of investment grade or insured accounts receivable plus 85% of eligible accounts receivable plus the lesser of 75% of the book value of eligible inventory and 85% of the net orderly liquidation value of eligible inventory less any reserves for potential prior ranking claims. Available borrowings under the RBC Facility at September 30, 2022 were C$12.4 million ($9.0 million).

In December 2021, we issued C$35.0 million of the December Debentures for net proceeds after costs of C$32.7 million ($25.6 million). The December Debentures accrue interest at a rate of 6.25% per annum and are convertible into common shares of DIRTT at an exercise price of C$4.20 per common share, or if not converted will mature and be repayable on the December Debenture Maturity Date. Interest and principal are payable in cash or shares at the option of the Company.

The Company has a C$5.0 million Canada Leasing Facility of which C$4.5 million ($3.4 million) has been drawn, and a $14.0 million U.S. Leasing Facility of which $13.3 million has been drawn with RBC and one of its affiliates. The Leasing Facilities are available for equipment expenditures and certain equipment expenditures already incurred.

The following table summarizes our consolidated cash flows for the periods indicated:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2022	2021	2022	2021
	($ in thousands)		($ in thousands)	
Net cash flows (used in) provided by operating activities	(10,667)	(12,191)	(47,509)	(23,872)
Net cash flows used in investing activities	(644)	(2,210)	(3,595)	(12,556)
Net cash flows (used in) provided by financing activities	(912)	(520)	(1,802)	36,083
Effect of foreign exchange on cash, cash equivalents and restricted cash	(293)	(130)	(73)	581
Net (decrease) increase in cash, cash equivalents and restricted cash	**(12,516)**	**(15,051)**	**(52,979)**	**236**
Cash, cash equivalents and restricted cash, beginning of period	22,945	61,133	63,408	45,846
Cash, cash equivalents and restricted cash, end of period	**10,429**	**46,082**	**10,429**	**46,082**

Operating Activities

Net cash flows used in operating activities were $10.7 million for the three months ended September 30, 2022 compared to $12.2 million in the three months ended September 30, 2021. Included in the $10.7 million used in operating activities in the third quarter of 2022 are $3.4 million of reorganization costs. Excluding these amounts, cashflows used in operations would have been $7.3 million in the third quarter of 2022 compared to $12.2 million cash provided by operations in the same period of 2021, with the decrease reflecting an increase of $5.4 million of Adjusted Gross Profit offset by working capital timing. Apart from the above noted items, working capital changes primarily reflect increased accounts payable due to higher activity and timing of payments, a decrease in inventory as we use the inventory built up in the first half of the year discussed below, and reduced deposits on orders from customers offset by the receivable related to the government subsidies.

Net cash flows used in operating activities were $47.5 million for the nine months ended September 30, 2022 compared to $23.9 million in the nine months ended September 30, 2021. Included in the $47.5 million used in operating activities in the nine months ended September 30, 2022 are $12.3 million of reorganization costs, $1.8 million of professional fees associated with the contested director election, and $6.1 million of increased inventory where the Company took on incremental inventory from suppliers to mitigate against potential supply chain disruption, offset by the receipt of a $3.2 million income tax refund related to 2020. We have since taken steps to adjust our aluminum supply and expect to begin drawing down such inventory in the third and fourth quarter. Excluding these amounts, cashflow used in operations would have been $30.6 million in the nine months ended September 30, 2022 compared to $24.3 million cash used in operations in the same period of 2021, with the increase in cash used reflecting a decrease of government subsidies received and working capital timing. Apart from the above noted items, working capital changes primarily reflect government subsidies receivable offset by higher accounts payable due to higher activity and timing of payments.

Investing Activities

We invested $0.4 million and $2.2 million in property, plant and equipment during the three and nine months ended September 30, 2022, respectively, compared to $1.8 million and $10.5 million during the three and nine months ended September 30, 2021. The expenditure for the three months ended September 30, 2022 comprised of $0.1 million of manufacturing upgrades, $0.1 million of leasehold improvements and $0.1 million related to our website design. The expenditure for the nine months ended September 30, 2022 comprised of $1.0 million of working capital changes, $0.7 million of manufacturing upgrades, $0.2 million related to our website design and $0.3 million related to DXC refreshes and IT equipment. The decrease in investing activities is largely due to reduced spending as the Rock Hill Facility and Dallas DXC were completed in 2021.

We invested $0.4 million on capitalized software during the three months ended September 30, 2022, as compared to $0.5 million in the three months ended September 30, 2021 and $1.3 million for the nine months ended September 30, 2022 compared to $1.9 million for the comparative period.

Our 2022 capital expenditure program was comprised of approximately $2.5 million related to refreshes of DXCs, continued enhancement of our customer relationship management system and website redesign, approximately $2.5 million on software development and approximately $2.0 million on manufacturing and other capital upgrades of which actual expenditures have been less than budget.

Financing Activities

For the three and nine months ended September 30, 2022, $0.9 million and $1.8 million of cash was used in financing activities, comprising mainly of $0.6 million and $1.9 million of scheduled payments under the Leasing Facilities and $0.3 million and $0.6 million relating to taxes paid on RSU vestings for the three and nine month period ended September 30, 2022 respectively. During the second quarter, we received C$0.9 million ($0.7 million) under the Canada Leasing Facility. For the three and nine months ended September 30, 2021, $0.5 million of cash was used and $36.1 million of cash was provided by financing activities, respectively, mainly due to the proceeds received from the issuance of C$40.3 million of Debentures in January 2021 and the receipt of $8.4 million of cash consideration under the U.S. Leasing Facility.

We currently expect to fund anticipated future investments with available cash, including the proceeds from Debentures issued in 2021, and drawings on the RBC Facility. We also expect to pursue additional strategic actions to improve available cash, which includes filing an application for ERC for the first three quarters of 2021 for $7.1 million, net of expenses, evaluating properties we own for sale and lease back, evaluating multiple initiatives related to the use of our ICE software and the Private Placement of common shares. Refer to "–Liquidity and Capital Resources" for further details. We do not expect to make any further draws under the Leasing Facilities. Apart from cash flow from operations, issuing equity and debt has been our primary source of capital to date. Additional debt or equity financing may be pursued in the future as we deem appropriate. We may also use debt or pursue equity financing depending on the price of our common shares at the time, interest rates, and nature of the investment opportunity and economic climate. No assurance can be given that any of these actions will be successful, will be sufficient for our needs.

Credit Facility

On February 12, 2021, the Company entered into the RBC Facility. Under the RBC Facility, the Borrowing Base is up to a maximum of 90% of investment grade or insured accounts receivable plus 85% of eligible accounts receivable plus the lesser of 75% of the book value of eligible inventory and 85% of the net orderly liquidation value of eligible inventory less any reserves for potential prior ranking claims. At September 30, 2022, available borrowings are C$12.4 million ($9.0 million), of which no amounts have been drawn. Interest is calculated at the Canadian or

U.S. prime rate plus 30 basis points or at the Canadian Dollar Offered Rate or LIBOR plus 155 basis points. Under the RBC Facility, if the Aggregate Excess Availability is less than C$5.0 million, the Company is subject to a FCCR covenant of 1.10:1 on a trailing twelve-month basis until such time the borrowing availability net of unrestricted cash exceeds C$5.0 million for at least thirty consecutive calendar days. Additionally, if the FCCR has been below 1.10:1 for the three immediately preceding months, the Company is required to maintain a reserve account equal to the aggregate of one year of payments on outstanding loans on the Leasing Facilities. The Company did not meet the three-month FCCR requirement during the third quarter of 2022, which resulted in requiring the restriction of $3.6 million of cash. Should an event of default occur, or the Aggregate Excess Availability be less than C$6.25 million for five consecutive business days, the Company would enter a cash dominion period whereby the Company's bank accounts would be blocked by RBC and daily balances will set-off any borrowings and any remaining amounts made available to the Company.

During 2020, the Company entered into the Leasing Facilities, consisting of the C$5.0 million Canada Leasing Facility and the $14.0 million U.S. Leasing Facility with RBC, which are available for equipment expenditures and certain equipment expenditures already incurred. The Leasing Facilities, respectively, have seven and five-year terms and bear interest at 4.25% and 5.59%. The U.S. Leasing Facility is amortized over a six-year term and is extendible at the Company's option for an additional year.

The Company has drawn $13.3 million of cash consideration under the U.S. Leasing Facility and commenced the lease term in 2020 for the equipment at the Rock Hill Facility. The Company has drawn C$4.5 million ($3.4 million) of cash consideration under the Canada Leasing Facility and commenced the lease term for the Canadian equipment expenditures during 2020. C$0.9 million ($0.7 million) of the Canada Leasing Facility was drawn in the three months ended June 30, 2022.

We are restricted from paying dividends unless Payment Conditions (as defined in the RBC Facility) are met, including having a net borrowing availability of at least C$10 million over the proceeding 30-day period, and having a trailing twelve-month fixed charge coverage ratio above 1.10:1 and certain other conditions. The RBC Facility is currently secured by substantially all of our real property located in Canada and the United States.

Contractual Obligations

There have been no material changes in our contractual obligations during the three months ended September 30, 2022, as compared to those disclosed in "Management's Discussion and Analysis of Financial Condition and Results of Operations – Contractual Obligations" in our Annual Report on Form 10-K, other than additional commitments related to the extension of our headquarters lease in Calgary. See Note 14, "Commitments" to our interim condensed consolidated financial statements in this Quarterly Report for additional information.

Significant Accounting Policies and Estimates

There have been no material changes in our significant accounting policies during the three months ended September 30, 2022, as compared to those disclosed in "Management's Discussion and Analysis of Financial Condition and Results of Operations – Significant Accounting Policies and Estimates" in our Annual Report on Form 10-K. For information regarding significant accounting policies and estimates, please refer to Item 7 and Item 8 in our Annual Report on Form 10-K. As disclosed in Note 6, "Adoption of New and Revised Accounting Standards" to our condensed consolidated interim financial statements appearing in this Quarterly Report, we adopted Accounting Standards Update No. 2021-10, *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance.* The ASU provides guidance on required disclosures with respect to government assistance in a company's notes to the annual financial statements. The amendments in the ASU are effective for periods beginning after December 15, 2021. The Company has adopted this standard effective January 1, 2022 and notes there is no impact of this standard on our accounting or disclosures of government assistance.

Recent Accounting Pronouncements

For information regarding recent accounting pronouncements, please refer to Note 6, "Adoption of New and Revised Accounting Standards" to our condensed consolidated interim financial statements and "–Significant Accounting Policies and Estimates" appearing in this Quarterly Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our market risk exposures since our disclosures in our Annual Report on Form 10-K. For information regarding our exposure to certain market risks, please refer to Item 7A. "Quantitative and Qualitative Disclosures about Market Risk" in our Annual Report on Form 10-K.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the Company's reports filed or submitted under the Exchange Act is accumulated and communicated to management, including our principal executive officers and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

As required by Rule 13a-15 under the Exchange Act, our principal executive officers and principal financial officer carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2022. Based upon their evaluation, our principal executive officers and principal financial officer concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the quarter ended September 30, 2022, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

We are pursuing multiple lawsuits against our former founders, Mogens Smed and Barrie Loberg, their new company Falkbuilt Ltd., and other related individual and corporate defendants for violations of fiduciary duties and noncompetition and non-solicitation covenants contained in their executive employment agreements, and the misappropriation of our confidential and proprietary information in violation of numerous Canadian and U.S. state, and federal laws pertaining to the protection of our trade secrets and proprietary information and the prevention of false advertising and deceptive trade practices. There have been no material developments in the legal proceedings previously disclosed in our Annual Report on Form 10-K, as supplemented by our Quarterly Report on Form 10-Q for the quarters ended March 31, 2022 and June 30, 2022, filed with the SEC and applicable securities commissions or similar regulatory authorities in Canada on May 4, 2022 and July 27, 2022 respectively.

Item 1A. Risk Factors

In addition to the other information set forth in this Quarterly Report on Form 10-Q, you should carefully consider the risk factors and other cautionary statements described under the heading "Risk Factors" included in our Annual Report on Form 10-K, as supplemented by our Quarterly Report on Form 10-Q for the quarter ended March 31, 2022 and June 30, 2022, filed with the SEC and applicable securities commissions or similar regulatory authorities in Canada on May 4, 2022 and July 27, 2022, which could materially affect our businesses, financial condition, or results of operations. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and results of operations.

Our share price has been and may continue to be volatile, which could cause the value of your investment to decline. If we fail to comply with the continuing listing standards of Nasdaq, our securities could be delisted.

Our common shares are currently listed on the Toronto Stock Exchange under the symbol "DRT" and on Nasdaq under the symbol "DRTT". The price of our common shares has in the past fluctuated significantly, and may fluctuate significantly in the future, depending upon a number of factors, many of which are beyond our control and may adversely affect the market price of our common shares. These factors include: (i) variations in quarterly results of operations; (ii) deviations in our earnings from publicly disclosed forward-looking guidance; (iii) changes in earnings estimates by analysts; (iv) our announcements or our competitors' announcements of significant contracts, acquisitions, strategic partnerships or joint ventures; (v) general conditions in the offsite construction and manufacturing industries; (vi) sales of our common shares by our significant shareholders; (vii) fluctuations in stock market price and volume; and (viii) other general economic conditions.

In the past, following periods of volatility in the trading price of a company's securities, securities class action litigation has been brought against that company. If our share price is volatile, we may become the target of securities litigation in both the United States and Canada. Securities litigation could result in substantial costs and divert management's attention and resources from our business and could have an adverse effect on our business, financial condition and results of operations.

Further, if the closing bid price of our common shares is below the $1.00 Nasdaq minimum requirement for 30 consecutive business days, we may become subject to delisting proceedings. On September 7, 2022, we received a letter from Nasdaq that we have not been in compliance with the minimum bid price requirement set forth in Nasdaq Listing Rule 5450(a)(1) for a period of 30 consecutive business days. In accordance with Nasdaq Listing Rule 5810(c)(3)(A), we are provided a compliance period of 180 calendar days from the date of the notice to regain compliance with the minimum closing bid price requirement. If we do not regain compliance during the compliance period, we may be afforded a second 180 calendar day period to regain compliance if, among other things, we meet certain listing requirements of, and elect to transfer to, the Nasdaq Capital Market. We can achieve compliance with the minimum bid price requirement if, during either compliance period, the closing bid price per share of our common shares is at least $1.00 for a minimum of ten consecutive business days. We intend to monitor the closing bid price of our common shares and assess potential actions to regain compliance, but there is no assurance that we will be able to regain compliance, including under the specified timeframes.

Any delisting of our securities could have an adverse effect on the market price of, and the efficiency of the trading market for, our securities, not only in terms of the number of shares that can be bought and sold at a given price, but also through delays in the timing of transactions and less coverage of us by securities analysts, if any. Also, if in the future we were to determine that we need to seek additional equity capital, having been delisted or being subject to delisting proceedings could have an adverse effect on our ability to raise capital in the public or private markets.

We are under the leadership of a reconstituted Board of Directors who plan to implement a variety of operational, organizational, cultural and other changes to our business, and we may not be able to achieve some or all of the anticipated benefits of this transformation plan. We are also undergoing changes at a senior management level, including the appointment of a new Chief Executive Officer in June 2022.

Our Board of Directors was entirely reconstituted at our annual and special meeting of shareholders held on April 26, 2022 and, following that meeting, Geoffrey Krause and Jeffrey Calkins were appointed Interim Co-Chief Executive Officers. In June 2022, Jeffrey Calkins and Jennifer Warawa departed the company and a new Chief Executive Officer, Benjamin Urban was appointed. Messrs. Urban and Noll were also appointed to our Board of Directors in June 2022. On July 27, 2022, the Company announced additional leadership changes, including the departures of Charles Kraus, Senior Vice President and General Counsel and Colin Blehm, Vice President Product Development, and the promotion of Trevor Didluck to Vice President Product Development. Nandini Somayaji has been promoted to Senior Vice President Talent, General Counsel & Corporate Secretary. On August 5, 2022, Mary Garden departed the Board of Directors. Geoffrey Krause, DIRTT's former Chief Financial Officer retired from the Company, effective September 30, 2022 and Bradley Little was appointed as the incoming Chief Financial Officer effective August 23, 2022. On August 29, 2022, Richard Hunter was appointed as DIRTT's new Chief Operating Officer. On October 20, 2022, Jeff Dopheide as appointed as Chief Revenue Officer, effective November 15, 2022. As a result of these events, the timely integration of senior management will be critical in the successful implementation of the Board of Directors' plans. There can be no assurance that we will be able to successfully implement the plan or otherwise realize the anticipated benefits of the plan, and we may encounter short-term disruptions of certain aspects of our business as elements of the plan are implemented.

In addition to overseeing the changes to DIRTT's leadership described above, since its election, the reconstituted Board of Directors has undertaken an extensive review of DIRTT's operations, a process which is still ongoing (see Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations – Outlook", above), and are in the process of implementing a variety of operational, organizational, cultural and other changes to our business, including plans to meet pipeline demand and expand revenues. We may not be successful in achieving some or all of the anticipated benefits of these plans, which may have an adverse effect on our results from operations and financial condition. Specifically, we are addressing the following issues:

- *Ability to increase manufacturing capacity to service current pipeline:*

  As at October 1, 2022, DIRTT's 12-month forward pipeline, which represents known projects and leads at various stages of maturation which our sales teams are working to convert into orders, increased by 10% to $395 million from $359 million as at July 1, 2022 and 24% from $318 million as at April 1, 2022. Servicing of this pipeline and capturing the underlying revenue growth is dependent upon the Company's ability to ramp up production capabilities on a timely basis. The Board of Directors and DIRTT's management team have prioritized removing constraints in DIRTT's manufacturing processes and are pursuing a number of initiatives including increased hourly labor, improved hourly labor retention and streamlined manufacturing processes. DIRTT may not be successful in implementing such initiatives and may be negatively impacted by the competitive nature of attracting personnel and other current market conditions. DIRTT may not be able meet such demand and capture the underlying revenue growth which could adversely affect the Company's results of operations and financial condition.

- *Discounting and raw material cost inflation impacts on profitability:*

  DIRTT's gross margins and resulting profitability have been negatively affected by the impacts of material cost inflation and the use of increased discounting to drive higher demand. DIRTT has taken steps to improve gross margin by reducing discounts and increasing prices, including a 5% price increase at June 1, 2022 and a further 10% price increase at July 21, 2022. If we are unable to realize the effects of reduced discounting or price increases, if inflationary increases continue without corresponding increases in our pricing or if such reduced discounting and price increases cause a material impact on demand, DIRTT's results of operations and financial condition could be adversely impacted.

- *The effectiveness of certain elements of DIRTT's administrative systems:*

  DIRTT has identified the need to upgrade its inventory management and cost accounting systems. Other information technology may require investment in the future. However, the success, in whole or in part, of this investment cannot be guaranteed.

We have negative cash flow from operating activities

We had negative cash flow from operating activities for the three and nine month period ended September 30, 2022. Continued negative operating cash flow may compromise our ability to make interest and principal payments on the convertible unsecured subordinated debentures issued on January 25, 2021 and December 1, 2021 (collectively, the "Debentures") on a timely basis, or at all, our ability to execute our strategic plan and confidence in our business. Until we are able to generate positive cash flow from operating activities, our ability to finance our operations will be dependent on our cash reserves and available credit facilities and, if required, our ability to obtain additional external financing. Although we anticipate we will have positive cash flow from operating activities in future periods, we cannot guarantee that such future cash flow will be sufficient or that a prolonged recovery from the COVID-19 pandemic, or other changes to our circumstances, will not necessitate additional financial resources to fund our operating activities. In response to our negative cash flow from operations, we have undertaken several strategic actions and a Private Placement to improve our balance sheet in the short term, see "–Liquidity and Capital Resources". Although we anticipate these actions will strengthen our balance sheet and liquidity position, we cannot guarantee that such future cash flow will be sufficient or that a prolonged recovery from the COVID-19 pandemic, or other changes to our circumstances, will not necessitate additional financial resources to fund our operating activities.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not Applicable.

Item 5. Other Information

Not Applicable.