ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Preface

In preparing this Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A"), we have taken into account all information available to us up to April 19, 2018, the date of this MD&A. The audited annual consolidated financial statements and this MD&A were reviewed by the Company's Audit Committee and were approved and authorized for issuance by our Board of Directors on April 19, 2018.

All financial information contained in this annual MD&A and in the audited annual consolidated financial statements has been prepared in accordance with International Financial Reporting Standards ("IFRS"), as issued by the IASB, except for certain non-GAAP information discussed in this Annual Report on Form 10-K. As a foreign private issuer, we are permitted to file our audited consolidated financial statements with the SEC under IFRS without a reconciliation to U.S. generally accepted accounting principle ("GAAP"). As a result, we do not prepare a reconciliation of our results to GAAP. It is possible that certain of our accounting policies could be different from GAAP. All monetary amounts in this MD&A are expressed in Canadian dollars, except for share and per share data and where otherwise indicated.

This MD&A should be read in conjunction with the audited consolidated financial statements and the notes thereto of the Company as at February 3, 2018 and January 28, 2017 and for the years February 3, 2018, January 28, 2017 and January 30, 2016 which are contained in this Annual Report on Form 10-K.

Accounting Periods

All references to "Fiscal 2017" are to the Company's fiscal year ended February 3, 2018. All references to "Fiscal 2016" are to the Company's fiscal year ended January 28, 2017 and all references to "Fiscal 2015" are to the Company's fiscal year ended January 30, 2016.

The Company's fiscal year ends on the Saturday closest to the end of January, typically resulting in a 52-week year, but occasionally giving rise to an additional week, resulting in a 53-week year. The years ended January 30, 2016 and January 28, 2017 cover a 52-week period. The year ended February 3, 2018 covers a 53-week fiscal period.

Overview

We are a branded retailer of specialty tea, offering a differentiated selection of proprietary loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories, food and beverages primarily through 240 company-operated DAVIDsTEA stores as of February 3, 2018, and our website, davidstea.com. We are building a brand that seeks to expand the definition of tea with innovative products that consumers can explore in an open and inviting retail environment. We strive to make tea a multi-sensory experience by facilitating interaction with our products through education and sampling so that our customers appreciate the compelling attributes of tea as well as the ease of preparation.

Factors affecting our performance

We believe that our performance and future success depend on a number of factors that present significant opportunities for us and may pose risks and challenges, including those discussed below and in the "Risk Factors" section of this Form 10-K.

- *E-Commerce.* We expect to capitalize on consumer's shift from brick and mortar stores to e commerce. In Fiscal 2017, we made a significant investment in our e-commerce website, which is a core part of DAVIDsTEA's plans to grow online sales. This has begun to show results, with double digit growth in our e-commerce sales as compared to the fourth quarter of Fiscal 2016. In Fiscal 2018, we expect to continue to improve our web presence by focusing on site capacity and page load times, improving additional mobile functionality, and adding marketing features and functionality. We also anticipate that our e-commerce platform will enable us to start selling on Amazon before Holiday 2018. These initiatives will require significant investment, and if we are unable to implement them in a timely fashion, our operating results may suffer.

- *Store philosophy*. We are focused on improving the productivity of existing stores and evaluating the closure of non-performing stores. In Fiscal 2017, we looked critically at the performance of our stores, including their locations and the lease terms, resulting in an impairment charge of $15.1 million. We expect to continue critical management of our store portfolio. In addition, in 2018, we expect to renovate up to five of our stores to be similar to our DT 2.0, hybrid concept. These stores enable customers to "self-explore" and buy pre-packaged teas, helping accelerate service levels and reduce wait times. Elements of these concept stores will become key components of our future store renovation program. Impairments, closures and renovations will have a significant cash and non-cash impact on our financial results, and, if our efforts our unsuccessful, our operating results may suffer.

- *Distribution and merchandise.* We are in the process of exploring ways in which our customers can interact with our product beyond our stores and e-commerce, including opportunities to expand wholesale distribution from HRI (Hotel, Restaurant and Institution) to other channels including grocery and wholesale. We are also in the process of re-focusing our product mix to focus on our loose-leaf tea and to streamline our offering of tea accessories. These efforts are preliminary and, once fully adopted, may not impact our revenue, preliminarily or at all.

Fiscal 2017 Highlights

During Fiscal 2017, we grew our sales from $216.0 million to $224.0 million, representing growth of 3.7% over the prior year. We added 9 net new stores, increasing our store base from 231 to 240 stores, representing growth of 3.9%.

How we assess our performance

The key measures we use to evaluate the performance of our business and the execution of our strategy are set forth below:

Sales. Sales consist primarily of sales from our retail stores and e-commerce site. Our business is seasonal and, as a result, our sales fluctuate from quarter to quarter. Sales are traditionally highest in the fourth fiscal quarter, which includes the holiday sales period, and tend to be lowest in the second and third fiscal quarter because of lower customer traffic in our locations in the summer months.

The specialty retail industry is cyclical, and our sales are affected by general economic conditions. A number of factors that influence the level of consumer spending, including economic conditions and the level of disposable consumer income, consumer debt, interest rates and consumer confidence can affect purchases of our products.

Sales also include gift card breakage income.

Comparable Sales. Comparable sales refer to year-over-year comparison information for comparable stores and e-commerce. Our stores are added to the comparable sales calculation in the beginning of their thirteenth month of operation. As a result, data regarding comparable sales may not be comparable to similarly titled data from other retailers.

The 53rd week in Fiscal 2017 caused a one-week shift in our fiscal calendar. As a result, comparable sales for Fiscal 2017 are calculated using the comparable 52 weeks of Fiscal 2016. We compare the 52-week period ended January 27, 2018 with the 52-week period ended January 28, 2017. As such, changes in comparable store sales are not consistent with changes in net sales reported for the fiscal periods.

Measuring the change in year-over-year comparable sales allows us to evaluate how our business is performing. Various factors affect comparable sales, including:

- our ability to anticipate and respond effectively to consumer preference, buying and economic trends;

- our ability to provide a product offering that generates new and repeat visits to our stores and online;
- the customer experience we provide in our stores and online;
- the level of customer traffic near our locations in which we operate;
- the number of customer transactions and average ticket in our stores and online;
- the pricing of our tea, tea accessories, and food and beverages;
- our ability to obtain and distribute product efficiently;
- our opening of new stores in the vicinity of our existing stores; and
- the opening or closing of competitor stores near our stores.

Non-Comparable Sales. Non-comparable sales include sales from stores prior to the beginning of their thirteenth fiscal month of operation and wholesale sales channel, which includes sales to grocery, hotels, restaurants and institutions, office and workplace locations and food services, as well as corporate gifting. As we pursue our growth strategy, we expect that a significant percentage of our sales will continue to come from non-comparable sales.

Gross Profit. Gross profit is equal to our sales less our cost of sales. Cost of sales includes product costs, freight costs, store occupancy costs and distribution costs.

Selling, General and Administration Expenses. Selling, general and administration expenses consist of store operating expenses and other general and administration expenses, including store impairments and provision for onerous contracts. Store operating expenses consist of all store expenses excluding occupancy related costs (which are included in costs of sales). General and administration costs consist of salaries and other payroll costs, travel, professional fees, stock compensation, marketing expenses, information technology and other operating costs.

General and administration costs, which are generally fixed in nature, do not vary proportionally with sales to the same degree as our cost of sales. We believe that these costs will decrease as a percentage of sales over time. Accordingly, this expense as a percentage of sales is usually higher in lower volume quarters and lower in higher volume quarters.

We present Adjusted selling, general and administration expenses as a supplemental measure because we believe it facilitates a comparative assessment of our selling, general and administration expenses under IFRS, while isolating the effects of some items that vary from period to period. It is reconciled to its nearest IFRS measure on page 35 of this Annual Report on Form 10-K.

Results from Operating Activities. Results from operating activities consist of our gross profit less our selling, general and administration expenses.

We present Adjusted results from operating activities as a supplemental measure because we believe it facilitates a comparative assessment of our operating performance relative to our performance based on our results under IFRS, while isolating the effects of some items that vary from period to period. It is reconciled to its nearest IFRS measure on page 36 of this Annual Report on Form 10-K.

Finance Costs. Finance costs consists of cash and imputed non-cash charges related to our credit facility, long-term debt, finance lease obligations, the loan from the controlling shareholder and the Series A, A-1 and A-2 preferred shares.

Finance Income. Finance income consists of interest income on cash balances.

Provision for Income Tax. Provision for income tax consists of federal, provincial, state and local current and deferred income taxes.

Adjusted EBITDA. We present Adjusted EBITDA as a supplemental performance measure because we believe it facilitates a comparative assessment of our operating performance relative to our performance based on our results under IFRS, while isolating the effects of some items that vary from period to period. Specifically, Adjusted EBITDA allows for an assessment of our operating performance and our ability to service or incur indebtedness without the effect of non-cash charges, such as depreciation, amortization, finance costs, deferred rent, non-cash compensation expense, costs related to onerous contracts or contracts where we expect the costs of the obligations to exceed the economic benefit, gain (loss) on derivative financial instruments, loss on disposal of property and equipment, impairment of property and equipment and certain non-recurring expenses. This measure also functions as a benchmark to evaluate our operating performance. For a reconciliation of net income (loss) to Adjusted EBITDA, refer to page 36 of this Annual Report on Form 10-K.

Selected Operating and Financial Highlights

Results of Operations

The following table summarizes key components of our results of operations for the year indicated:

	For the year ended		
	February 3, 2018	January 28, 2017	January 30, 2016
Consolidated statement of income (loss) data:			
Sales	**$ 224,015**	$ 215,984	$ 180,690
Cost of sales	**116,772**	107,534	85,359
Gross profit	**107,243**	108,450	95,331
Selling, general and administration expenses	**131,930**	114,756	80,116
Results from operating activities	**(24,687)**	(6,306)	15,215
Finance costs	**2,371**	76	1,051
Finance income	**(567)**	(479)	(348)
Accretion of preferred shares	**—**	—	401
Loss from embedded derivative on Series A, A-1 and A-2 preferred shares	**—**	—	140,874
Loss before income taxes	**(26,491)**	(5,903)	(126,763)
Provision for income tax (recovery)	**2,010**	(2,235)	4,668
Net loss	**$ (28,501)**	$ (3,668)	$ (131,431)
Percentage of sales:			
Sales	**100.0%**	100.0%	100.0%
Cost of sales	**52.1%**	49.8%	47.2%
Gross profit	**47.9%**	50.2%	52.8%
Selling, general and administration expenses	**58.9%**	53.1%	44.3%
Results from operating activities	**(11.0%)**	(2.9%)	8.5%
Finance costs	**1.1%**	0.0%	0.6%
Finance income	**(0.3%)**	(0.2%)	(0.2%)
Accretion of preferred shares	**0.0%**	0.0%	0.2%
Loss from embedded derivative on Series A, A-1 and A-2 preferred shares	**0.0%**	0.0%	78.0%
Loss before income taxes	**(11.8%)**	(2.7%)	(70.1%)
Provision for income tax (recovery)	**0.9%**	(1.0%)	2.6%
Net loss	**(12.7%)**	(1.7%)	(72.7%)
Other financial and operations data:			
Adjusted EBITDA (1)	$ **12,819**	$ 22,957	$ 24,606
Adjusted EBITDA as a percentage of sales	**5.7%**	10.6%	13.6%
Number of stores at end of year	**240**	231	193
Comparable sales growth (decline) for year (2)	**(6.0%)**	2.2%	6.6%

(1) For a reconciliation of Adjusted EBITDA to net income see "—Non-IFRS Metrics" below.

(2) Comparable sales refer to year-over-year comparison information for comparable stores and e-commerce. Our stores are added to the comparable sales calculation in the beginning of their thirteenth month of operation.

Non-IFRS Metrics

Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA is not a presentation made in accordance with IFRS, and the use of the term Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA may differ from similar measures reported by other companies. We believe that Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA provides investors with useful information with respect to our historical operations. Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA are not measurements of our financial performance under IFRS and should not be considered in isolation or as an alternative to net income, net cash provided by operating, investing or financing activities or any other financial statement data presented as indicators of financial performance or liquidity, each as presented in accordance with IFRS. We understand that although Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA are frequently used by securities analysts, lenders and others in their evaluation of companies, it has limitations as an analytical tool, and should not be considered in isolation, or as a substitute for analysis of our results as reported under IFRS. Some of these limitations are:

- Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

- Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA does not reflect the cash requirements necessary to service interest or principal payments on our debt; and

- Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements.

Because of these limitations, Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA should not be considered as discretionary cash available to us to reinvest in the growth of our business or as a measure of cash that will be available to us to meet our obligations.

The following tables present a reconciliation of Adjusted selling, general and administration expenses, Adjusted results from operating activities and Adjusted EBITDA to our net income (loss) determined in accordance with IFRS:

Reconciliation of Adjusted selling, general and administration expenses

	For the year ended		
(in thousands)	**February 3, 2018**	**January 28, 2017**	**January 30, 2016**
Selling, general and administration expenses	131,930	114,756	80,116
Executive and employee separation costs (a)	2,225	1,267	—
Impairment of property and equipment (b)	15,069	7,516	—
Impact of onerous contracts (c)	7,854	8,140	—
Loss on disposal of property and equipment (d)	—	311	292
Adjusted selling, general and administration expenses	**$ 106,782**	$ 97,522	79,824

(a) Executive and employee separation costs represent salary owed to certain former executives and employees of $2,033 [Fiscal 2016 - $835] payable as part of their separation of employment from the Company and stock-based compensation expense of $192 [Fiscal 2016 - $432] relating to the vesting of equity awards as part of their separation of employment from the Company.

(b) Represents costs related to impairment of property and equipment for stores.

(c) Represents provision, non-cash reversals, and utilization related to certain stores where the unavoidable costs of meeting the obligations under the lease agreements are expected to exceed the economic benefits expected to be received from the contract.

(d) For Fiscal 2016, represents non-cash costs related to the loss on disposal of property and equipment due to construction of a new store concept at an existing store location. For Fiscal 2015, represents non-cash costs related to the loss on disposal of property and equipment due to the closure of one store due to termination of sub-lease.

Reconciliation of Adjusted results from operating activities

(in thousands)	For the year ended February 3, 2018	January 28, 2017	January 30, 2016
Results from operating activities	(24,687)	(6,306)	15,215
Executive and employee separation costs (a)	2,225	1,267	—
Impairment of property and equipment (b)	15,069	7,516	—
Impact of onerous contracts (c)	7,854	8,140	—
Loss on disposal of property and equipment (d)	—	311	292
Adjusted results from operating activities	$ 461	$ 10,928	$ 15,507

(a) Executive and employee separation costs represent salary owed to certain former executives and employees of $2,033 [Fiscal 2016 - $835] payable as part of their separation of employment from the Company and stock-based compensation expense of $192 [Fiscal 2016 - $432] relating to the vesting of equity awards as part of their separation of employment from the Company.

(b) Represents costs related to impairment of property and equipment for stores.

(c) Represents provision, non-cash reversals, and utilization related to certain stores where the unavoidable costs of meeting the obligations under the lease agreements are expected to exceed the economic benefits expected to be received from the contract.

(d) For Fiscal 2016, represents non-cash costs related to the loss on disposal of property and equipment due to construction of a new store concept at an existing store location. For Fiscal 2015, represents non-cash costs related to the loss on disposal of property and equipment due to the closure of one store due to termination of sub-lease.

Reconciliation of Adjusted EBITDA to our net income (loss)

(in thousands)	For the year ended February 3, 2018	January 28, 2017	January 30, 2016
Net loss	$ (28,501)	$ (3,668)	$ (131,431)
Finance costs	2,371	76	1,051
Finance income	(567)	(479)	(348)
Depreciation and amortization	9,905	8,827	6,445
Loss on disposal of property and equipment	82	45	5
Provision for income tax (recovery)	2,010	(2,235)	4,668
EBITDA	**$ (14,700)**	**$ 2,566**	**$ (119,610)**
Additional adjustments:			
Stock-based compensation expense (a)	2,021	2,264	1,749
Executive and employee separation costs related to salary (b)	2,033	835	—
Impairment of property and equipment (c)	15,069	7,516	—
Impact of onerous contracts (d)	7,854	8,140	(265)
Deferred rent (e)	542	1,325	1,165
Loss on disposal of property and equipment (f)	—	311	292
Accretion of preferred shares (g)	—	—	401
Loss from embedded derivative on Series A, A-1 and A-2 preferred shares (h)	—	—	140,874
Adjusted EBITDA	**$ 12,819**	**$ 22,957**	**$ 24,606**

(a) Represents non-cash stock-based compensation expense.

(b) Executive and employee separation costs related to salary represent salary owed to certain former executives and employees as part of their separation of employment from the Company.

(c) Represents costs related to impairment of property and equipment for stores.

(d) Represents provision, non-cash reversals, and utilization related to certain stores where the unavoidable costs of meeting the obligations under the lease agreements are expected to exceed the economic benefits expected to be received from the contract.

(e) Represents the extent to which our annual rent expense has been above or below our cash rent payments.

(f) For Fiscal 2016, represents non-cash costs related to the loss on disposal of property and equipment due to construction of a new store concept at an existing store location. For Fiscal 2015, represents non-cash costs related to the loss on disposal of property and equipment due to the closure of one store due to termination of sub-lease.

(g) Represents non-cash accretion expense on our preferred shares. In connection with the completion of our IPO on June 10, 2015, all of our outstanding preferred shares were converted automatically into common shares.

(h) Represents non-cash market loss for the conversion feature of the Series A, A-1 and A-2 preferred shares. In connection with our IPO, this liability was converted into equity.

Fiscal Year Ended February 3, 2018 Compared to Fiscal Year Ended January 28, 2017

Sales. Sales for Fiscal 2017 increased 3.7%, or $8.0 million, to $224.0 million from $216.0 million in Fiscal 2016, comprising $12.1 million in comparable sales decrease and $20.1 million increase in non-comparable sales. For Fiscal 2017, comparable sales decreased by 6.0% and non-comparable sales increased primarily due to an additional 9 net stores opened as of the end of Fiscal 2017 as compared to the end of Fiscal 2016 and due to non-comparable sales for the 38 net stores opened in Fiscal 2016.

Gross Profit. Gross profit decreased by 1.2%, or $1.3 million, to $107.2 million in Fiscal 2017 from $108.5 million in Fiscal 2016. Gross profit as a percentage of sales decreased to 47.9% in Fiscal 2017 from 50.2% in Fiscal 2016. The decrease in gross profit as a percent of sales was primarily due to additional promotional activity and deleveraging of fixed costs due to the negative 6.0% comparative sales for the year.

Selling, General and Administration Expenses. Selling, general and administration expenses increased by 14.9%, or $17.1 million, to $131.9 million in Fiscal 2017 from $114.8 million in Fiscal 2016. As a percentage of sales, selling, general and administration expenses increased to 58.9% in Fiscal 2017 from 53.1% in Fiscal 2016. Excluding employee separation costs, impairment of property and equipment, impact of onerous contracts, as well as loss on disposal of property and equipment in Fiscal 2016, selling, general and administration expenses increased 9.5% to $106.8 million in Fiscal 2017 from $97.5 million in Fiscal 2016, due primarily to the hiring of additional staff to support the growth of the Company, including new stores, and higher store operating expenses to support the operations of 240 stores as of February 3, 2018 as compared to 231 stores as of January 28, 2017. As a percentage of sales, selling, general and administration expenses excluding the impacts referenced above increased to 47.7% from 45.1%.

Results from Operating Activities. Results from operating activities decreased by $18.4 million, to $(24.7) million in Fiscal 2017 from $(6.3) million in Fiscal 2016. Excluding executive separation costs, impairment of property and equipment, impact of onerous contracts, as well as the loss on disposal of property and equipment in Fiscal 2016, results from operating activities decreased to $0.5 million in Fiscal 2017 from $10.9 million in Fiscal 2016.

Finance Costs. Finance costs increased by $2.3 million to $2.4 million in Fiscal 2017 from $0.1 million in Fiscal 2016, as a result of a higher accretion expense on the provision for onerous contracts.

Finance Income. Finance income increased by $0.1 million, or 20.0%, to $0.6 million in Fiscal 2017 from $0.5 million in Fiscal 2016, as a result of interest income generated on cash on hand.

Provision (Recovery) for Income Tax. Provision for income tax increased by $4.2 million, to $2.0 million in Fiscal 2017 from a recovery for income taxes of $(2.2) million in Fiscal 2016. The increase in the provision for income taxes was due primarily to a write-down of the deferred income tax assets related to the U.S. entity, as well as a decrease in the U.S. statutory income tax rates. In December 2017, the Tax Cuts and Jobs Act ("U.S. Tax Reform") was signed into law, which reduced the U.S. federal corporate income tax rate from 35% to 21%, effective January 1, 2018. As a result, the Company's net deferred taxes reported on the balance sheet were required to be re-measured using the newly enacted rates. Our effective tax rates were (7.6)% and 37.9% in Fiscal 2017 and 2016, respectively. The effective tax rate decreased as a result of the write-down of the deferred income tax assets related to the U.S. entity, as well as a decrease in the U.S. statutory income tax rates.

Fiscal Year Ended January 28, 2017 Compared to Fiscal Year Ended January 30, 2016

Sales. Sales for Fiscal 2016 increased 19.5%, or $35.3 million, to $216.0 million from $180.7 million in Fiscal 2015, comprising $3.9 million in comparable sales and $31.4 million in non-comparable sales. For Fiscal 2016, comparable sales increased by 2.2% and non-comparable sales increased primarily due to an additional 38 net stores opened as of the end of Fiscal 2016 as compared to the end of Fiscal 2015 and due to non-comparable sales for the 39 net stores opened in Fiscal 2015.

Gross Profit. Gross profit increased by 13.9%, or $13.2 million, to $108.5 million in Fiscal 2016 from $95.3 million in Fiscal 2015. Gross profit as a percentage of sales decreased to 50.2% in Fiscal 2016 from 52.8% in Fiscal 2015, driven by additional promotional activity, a shift in product sales mix and the adverse impact from the stronger U.S. dollar on U.S. dollar denominated purchases.

Selling, General and Administration Expenses. Selling, general and administration expenses increased by 43.3%, or $34.7 million, to $114.8 million in Fiscal 2016 from $80.1 million in Fiscal 2015. As a percentage of sales, selling, general and administration expenses increased to 53.1% in Fiscal 2016 from 44.3% in Fiscal 2015. Excluding executive separation costs, impairment of property and equipment, provision for onerous contracts and loss on disposal of property and equipment in Fiscal 2016, as well as loss on disposal of property and equipment in Fiscal 2015, selling, general and administration expenses increased 22.2% to $97.5 million in Fiscal 2016 from $79.8 million in Fiscal 2015, due primarily to the hiring of additional staff to support the growth of the Company, including new stores, and higher store operating expenses to support the operations of 231 stores as of January 28, 2017 as compared to 193 stores as of January 30, 2016, as well a full year of public company costs. As a percentage of sales, selling, general and administration expenses excluding the impacts referenced above increased to 45.1% from 44.2%.

Results from Operating Activities. Results from operating activities decreased by $21.5 million, to $(6.3) million in Fiscal 2016 from $15.2 million in Fiscal 2015. Excluding executive separation costs, impairment of property and equipment, provision for onerous contracts and loss on disposal of property and equipment in Fiscal 2016, as well as the loss on disposal of property and equipment in Fiscal 2015, results from operating activities decreased to $10.9 million in Fiscal 2016 from $15.5 million in Fiscal 2015.

Finance Costs. Finance costs decreased by $1.0 million, or 90.9%, to $0.1 million in Fiscal 2016 from $1.1 million in Fiscal 2015, as a result of the repayment of the then-outstanding term loans, loan from the controlling shareholder and amounts borrowed under our Revolving Facility and no accrued dividends due to the conversion of Series A, A-1 and A-2 preferred shares to common shares, during the second quarter of Fiscal 2016.

Finance Income. Finance income increased by $0.2 million, or 66.7%, to $0.5 million in Fiscal 2016 from $0.3 million in Fiscal 2015, as a result of interest income generated on cash on hand.

Provision for Income Tax. Provision (recovery) for income tax decreased by $6.9 million, to $(2.2) million in Fiscal 2016 from $4.7 million in Fiscal 2015. The decrease in the provision for income taxes was due primarily to lower results from operating activities. Our effective tax rates were 37.9% and (3.7%) in Fiscal 2016 and 2015, respectively. The effective tax rate increased as a result of the loss from embedded derivative on Series A, A-1 and A-2 preferred shares not recurring in Fiscal 2016 due to their conversion and cancellation.

Liquidity and Capital Resources

As of February 3, 2018 we had $63.5 million of cash primarily held with major Canadian financial institutions. Our working capital was $77.2 million as of February 3, 2018, compared to $78.7 million as at January 28, 2017.

Our primary sources of liquidity are cash on hand, cash flows from operations and borrowings under our revolving credit facility. Our primary cash needs are to support the increase in inventories as we expand the number of our stores, and for capital expenditures related to new stores and store renovations.

Capital expenditures typically vary depending on the timing of new stores openings and infrastructure-related investments. During Fiscal 2017, capital expenditures totaled $12.6 million. We devoted approximately 80% of our capital expenditures to construct, lease and open 11 new stores in Canada and 5 new stores in the United States, as well as renovate a number of existing stores. The remainder of the capital expenditures was used to make continued investments in our infrastructure.

Our primary working capital requirements are for the purchase of store inventory and payment of payroll, rent and other store operating costs. Our working capital requirements fluctuate during the year, rising in the second and third fiscal quarters as we take title to increasing quantities of inventory in anticipation of our peak selling season in the fourth fiscal quarter. Historically, we have funded our capital expenditures and working capital requirements with borrowings under our long-term debt and finance lease facilities and revolving credit facilities. Following our IPO, we funded our capital expenditures and working capital requirements with cash from our IPO and net cash from our operating activities.

We believe that our cash position, net cash provided by operating activities and available borrowings under our revolving credit facility will be adequate to finance our planned capital expenditures and working capital requirements for the foreseeable future.

Cash Flow

A summary of our cash flows from operating, investing and financing activities is presented in the following table:

	For the year ended		
	February 3, 2018	**January 28, 2017**	**January 30, 2016**
Cash flows provided by (used in):			
Operating activities	**$ 9,858**	$ 11,162	$ 15,592
Investing activities	**(12,596)**	(22,015)	(18,024)
Financing activities	**1,782**	2,779	55,162
Increase (decrease) in cash	**$ (956)**	$ (8,074)	$ 52,730

Cash Flows Provided by Operating Activities

	For the year ended		
	February 3, 2018	**January 28, 2017**	**January 30, 2016**
Cash flows provided by (used in) operating activities:			
Net loss	**$ (28,501)**	$ (3,668)	$ (131,431)
Depreciation of property and equipment	**8,431**	8,069	5,832
Amortization of intangible assets	**1,474**	758	613
Loss on disposal of property and equipment	**82**	356	297
Impairment of property and equipment	**15,069**	7,516	—
Deferred rent	**542**	1,325	1,165
Provision (recovery) for onerous contracts	**10,321**	8,140	(265)
Stock-based compensation expense	**2,021**	2,264	1,749
Settlement related to cashless exercise of stock options, net of income taxes recovered	**—**	—	(2,976)
Amortization of financing fees	**79**	75	241
Accretion on provisions	**2,292**	—	—
Accretion of preferred shares	**—**	—	401
Loss from embedded derivative on Series A, A-1, A-2 preferred shares	**—**	—	140,874
Deferred income taxes (recovered)	**3,585**	(4,380)	1,364
Net change in other non-cash working capital balances related to operations	**(5,537)**	(9,293)	(2,272)
Cash flows provided by operating activities	**$ 9,858**	$ 11,162	$ 15,592

Net cash provided by operating activities decreased to $9.9 million in Fiscal 2017 from $11.2 million in Fiscal 2016. The decrease in the cash flows provided by operating activities was due mainly to lower results from operating activities, partially offset by lower investment in working capital, primarily inventory.

The decrease in inventories of $6.8 million in Fiscal 2017 reflects a planned reduction due to excess inventories in Fiscal 2016 that were related primarily to sales shortfalls. The decrease in trade and other payables of $5.3 million is mainly due to decrease in inventories in Fiscal 2017 compared to Fiscal 2016.

Net cash provided by operating activities decreased to $11.2 million in Fiscal 2016 from $15.6 million in Fiscal 2015. The decrease in the cash flows provided by operating activities was due to lower results from operating activities and investments in working capital, primarily inventory.

The increase in inventories of $13.5 million in Fiscal 2016 reflects excess inventories related to sales shortfalls, the increase in the number of stores in our network, higher inventory costs due to higher U.S. dollar, and investment in new merchandising initiatives. The increase in trade and other payables of $5.2 million is mainly due to the higher inventory levels and other expenses to support higher volume of sales in Fiscal 2016 compared to Fiscal 2015.

Cash Flows Used in Investing Activities

Capital expenditures decreased $9.4 million, to $12.6 million in Fiscal 2017 from $22.0 million in Fiscal 2016. This decrease was due primarily to a reduction in new store openings costs and renovations of existing stores, partially offset by an increase in the investment in information systems.

Capital expenditures increased $4.0 million, to $22.0 million in Fiscal 2016 from $18.0 million in Fiscal 2015. This increase was due primarily to renovations of existing stores as well as investment in information systems.

Cash Flows Provided by Financing Activities

	For the year ended		
	February 3, 2018	**January 28, 2017**	**January 30, 2016**
Cash flows provided by (used in) financing activities:			
Repayment of finance lease obligations	**$ —**	$ —	$ (552)
Proceeds from issuance of long-term debt	**—**	—	9,996
Repayment of long-term debt	**—**	—	(20,010)
Repayment of loan from the controlling shareholder	**—**	—	(2,952)
Proceeds from issuance of common shares pursuant to exercise of stock options	**1,782**	2,779	143
Gross proceeds of initial public offering ("IPO")	**—**	—	79,370
IPO-related expenses	**—**	—	(10,661)
Financing fees	**—**	—	(172)
Cash flows provided by financing activities	**$ 1,782**	$ 2,779	$ 55,162

Net cash provided by financing activities decreased by $1.0 million to $1.8 million in Fiscal 2017 from $2.8 million in Fiscal 2016 due to a decrease in the proceeds from issuance of common shares upon exercise of stock options.

Net cash provided by financing activities decreased by $52.4 million to $2.8 million in Fiscal 2016 from $55.2 million in Fiscal 2015 due to our initial public offering that occurred on June 10, 2015. Cash flows from financing activities in Fiscal 2015 consisted primarily of borrowing and payments on our term facilities and their related financing costs and proceeds from share issuances.

Credit Facility with Bank of Montreal

The Company has a credit arrangement (hereinafter referred to as “Credit Agreement”) with the Bank of Montreal (“BMO”) that provides for a three-year revolving term facility, maturing October 31, 2019, in the principal amount of $20.0 million (which we refer to as the “Revolving Facility”) or the equivalent amount in U.S. dollars, repayable at any time. The Credit Agreement also provides for an accordion feature whereby we may, at any time prior to the end of the three-year term and with the permission of BMO, request an increase to the Revolving Facility by an amount not greater than $10.0 million.

On June 11, 2015, immediately following our IPO, we fully repaid the advances under the Revolving Facility using proceeds from the offering and cash on hand. As at February 3, 2018, we did not have any borrowings on the Revolving Facility.

The Credit Agreement subjects us to certain financial covenants. Without the prior written consent of BMO, our fixed charge coverage ratio may not be less than 1.25:1.00 and our leverage ratio may not exceed 3.00:1.00. In addition, our net tangible worth may not be less than $30.0 million.

Borrowings under the Revolving Facility are available in the form of Canadian dollar advances, U.S. dollar advances, prime rate loans, banker’s acceptances, U.S. base rate loans and LIBOR loans. Further, up to an aggregate maximum amount of $2.0 million, or the equivalent amount in other currencies authorized by BMO, is available by way of letters of credit or letters of guarantees for terms of not more than 364 days. The Revolving Facility bears interest based on our adjusted leverage ratio. In the event our adjusted leverage ratio is equal to or less than 3.00:1.00, the Revolving Facility bears interest at (a) the bank's prime rate plus 0.50% per annum, (b) the bank's U.S. base rate plus 0.50% per annum, (c) LIBOR plus 1.50% per annum, subject to availability, or (d) 1.50% on the face amount of each banker's acceptance, letter of credit or letter of guarantee, as applicable. A standby fee of 0.30% will be paid on the daily principal amount of the unused portion of the Revolving Facility. Should our adjusted leverage ratio be greater than 3.00:1.00 but less than 4.00:1.00, the Revolving Facility bears interest at (a) the bank's prime rate plus 0.75% per annum, (b) the bank's U.S. base rate plus 0.75% per annum, (c) LIBOR plus 1.75% per annum, subject to availability, or (d) 1.75% on the face amount of each banker's acceptance, letter of credit or letter of guarantee, as applicable. A standby fee of 0.35% will be paid on the daily principal amount of the unused portion of the Revolving Facility. If our adjusted leverage ratio is greater than 4.00:1.00, the Revolving Facility bears interest at (a) bank's prime rate plus 1.25% per annum, (b) the bank's U.S. base rate plus 1.25% per annum, (c) LIBOR plus 2.25% per annum, subject to availability, or (d) 2.25% on the face amount of each banker's acceptance, letter of credit or letter of guarantee, as applicable. A standby fee of 0.45% will be paid on the daily principal amount of the unused portion of the Revolving Facility.

The Credit Agreement is collateralized by a first lien security interest in all of our assets in the amount of $37.5 million, a general security agreement, registered in each Canadian province in which we do business, creating a first priority charge on all assets.

The Credit Agreement contains a number of covenants that, among other things and subject to certain exceptions, restrict our ability to become guarantor or endorser or otherwise become liable upon any note or other obligation other than in the normal course of business. We also cannot make any dividend payments. As at February 3, 2018, we are in compliance with these covenants.

Term Loan with Rainy Day Investments Ltd.

On June 11, 2015, immediately following our IPO, we fully repaid the term loan with Rainy Day Investments Ltd. (referred to as "Loan from the controlling shareholder" in this Annual Report) using proceeds from our IPO and cash on hand. As at February 3, 2018, we did not have any borrowings with Rainy Day Investments Ltd.

Off-Balance Sheet Arrangements

Other than operating lease obligations, we have no off-balance sheet obligations.

Contractual Obligations and Commitments

In the normal course of business, we enter into contractual obligations that will require us to disburse cash over future periods. All commitments have been recorded in our consolidated balance sheets, except for purchase obligations and minimum annual lease payments under operating leases. The following table summarizes our contractual obligations as of February 3, 2018, and the effect such obligations are expected to have on our liquidity and cash flows in future periods.

	Payments due by period				
(dollars in thousands)	**Total**	**less than 1 year**	**Between 1 and 3 years**	**Between 3 and 5 years**	**More than 5 years**
Trade and other payables	**14,392**	14,392	—	—	—
Operating lease obligations (1)	**134,965**	19,840	56,892	29,952	28,281
Purchase obligations (2)	**8,820**	8,820	—	—	—
Total	**158,177**	43,052	56,892	29,952	28,281

(1) Operating lease obligations under long-term operating leases is exclusive of certain operating costs for which the Company is responsible. Certain of the operating lease agreements provide for additional rentals based on sales.

(2) Includes amounts pertaining to agreements to purchase goods or services that are enforceable and legally binding on the Company.

Critical Accounting Policies and Estimates

Our discussion and analysis of operating results and financial condition are based upon our financial statements. The preparation of financial statements requires us to estimate the effect of various matters that are inherently uncertain as of the date of the financial statements. Each of these required estimates varies in regard to the level of judgment involved and its potential impact on our reported financial results. Estimates are deemed critical when a different estimate could have reasonably been used or where changes in the estimates are reasonably likely to occur from period to period, and would materially impact our financial position, changes in financial position or results of operations. Our significant accounting policies are discussed under Note 3 to our consolidated financial statements included elsewhere in this Annual Report.

Key sources of estimation uncertainty

Key sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year are as follows:

Recoverability and impairment of non-financial assets. Leasehold improvements and furniture and equipment are reviewed for impairment if events or changes in circumstances indicate that the carrying amount may not be recoverable. A review for impairment is conducted by comparing the carrying amount of the Cash Generating Units (CGU)' assets with their respective recoverable amounts based on value in use. Value in use is determined based on management's best estimate of expected future cash flows, which includes estimates of growth rates, from use over the remaining lease term and discounted using a pre-tax weighted average cost of capital.

Income taxes. To determine the extent to which deferred income tax assets can be recognized, management estimates the amount of probable future taxable profits that will be available against which deductible temporary differences and unused tax losses can be used. Such estimates are made as part of the budget and strategic plan by tax jurisdiction. Management exercises judgment to determine the extent to which realization of future taxable benefits is probable considering factors such as the number of years included in the forecast period and prudent tax planning strategies.

Critical judgments in applying accounting policies

We believe the following are critical judgments that management has made in the process of applying accounting policies that have the most significant effect on the amounts recognized in our consolidated financial statements:

Impairment of non-financial assets. Management is required to make significant judgments in determining if individual commercial premises in which it carries out its activities are individual CGUs, or if these units should be aggregated at a district or regional level to form a CGU. The significant judgments applied by management in determining if stores should be aggregated in a given geographic area to form a CGU include the determination of expected customer behavior and whether customers could interchangeably shop in any of the stores in a given area and whether management views the cash flows of the stores in the group as interdependent.

Income taxes. We may be subject to audits related to tax risks, and uncertainties exist with respect to the interpretation of tax regulations, changes in tax laws, and the amount and timing of future taxable income. Differences arising between the actual results and the assumptions made, or future changes to such assumptions, could necessitate future adjustments to taxable income and income tax expense already recorded. We establish provisions if required, based on reasonable estimates, for possible consequences of audits by the tax authorities. The amount of such provisions is based on various factors, such as experience of previous tax audits and differing interpretations of tax regulations by the entity and the responsible tax authority, which may arise on a wide variety of issues.

Recently Issued Accounting Standards

Information on significant new accounting standards and amendments issued but not yet adopted is described below.

IFRS 9, "Financial Instruments", for which the final version was issued in July 2014 by the IASB, replaces IAS 39, "Financial Instruments: Recognition and Measurement" and all previous versions of IFRS 9. IFRS 9 brings together all three aspects of the accounting for financial instruments project: classification and measurement, impairment and hedge accounting. IFRS 9 is effective for annual periods beginning on or after January 1, 2018, with early adoption permitted. Except for hedge accounting, retrospective application is required but providing comparative information is not compulsory. For hedge accounting, the requirements are generally applied prospectively, with some limited exceptions. The Company plans to adopt the new standard on the required effective date. The Company is currently assessing the impact of the adoption of this standard on its consolidated financial statements and related note disclosures. The Company has performed a high-level impact assessment of all three aspects of IFRS 9. This preliminary assessment is based on currently available information and may be subject to changes arising from further detailed analyses. Overall, the Company does not expect a material impact on its consolidated financial statements.

a) *Classification and measurement*. The Company does not expect a material impact on its consolidated financial statements in applying the classification and measurement requirements of IFRS 9.

b) *Impairment*. IFRS 9 requires the Company to record expected credit losses on all of its debt securities, loans and trade receivables, either on a 12-month or lifetime basis. The Company expects to apply the simplified approach and record lifetime expected losses on all trade receivables. The Company will need to perform a detailed analysis which considers all reasonable and supportable information, including forward-looking elements to determine the extent of the impact. Based on its existing trade receivables, the Company does not expect the IFRS 9 expected credit loss model to have a material impact on its consolidated financial statements.

c) *Hedge accounting*. The Company believes that all existing hedge relationships that are currently designated in effective hedging relationships still qualify for hedge accounting under IFRS 9. As IFRS 9 does not change the general principles of how an entity accounts for effective hedges, the adoption of IFRS 9 will not have a material impact on the Company's hedge accounting.

IFRS 15, "Revenue from Contracts with Customers" ("IFRS 15") replaces IAS 11, "Construction Contracts", and IAS 18, "Revenue", as well as various interpretations regarding revenue. This standard introduces a single model for recognizing revenue that applies to all contracts with customers, except for contracts that are within the scope of standards on leases, insurance and financial instruments. This standard also requires enhanced disclosures. Adoption of IFRS 15 is mandatory and will be effective for annual periods beginning on or after January 1, 2018. The Company has completed an assessment of significant contracts with customers and has determined the preliminary expected impacts of the adoption of IFRS 15 on its consolidated financial statements. The implementation of IFRS 15 will impact the allocation of revenue that is deferred in relation to its customer loyalty award programs. Revenue is currently allocated to the customer loyalty awards using the residual fair value method. Under IFRS 15, consideration will be allocated between the loyalty program awards and the goods on which the awards were earned, based on their relative stand-alone selling prices. The Company does not expect that the change in allocation of revenue that is deferred in relation to its customer loyalty program will have a material impact on retained earnings as at February 4, 2018. The Company continues to assess the impact of the disclosure requirements under IFRS 15 on the its consolidated financial statements.

IFRS 16, "Leases" ("IFRS 16") replaces IAS 17, "Leases". This standard provides a single model for leases abolishing the current distinction between finance and operating leases, with most leases being recognized on the balance sheet. Certain exemptions will apply for short-term leases and leases of low value assets. The new standard will be effective for annual periods beginning on or after January 1, 2019. Early application is permitted, provided the new revenue standard, IFRS 15, has been applied, or is applied at the same date as IFRS 16. The Company has performed a preliminary assessment of the potential impact of the adoption of IFRS 16 on its consolidated financial statements. The Company expects the adoption of IFRS 16 will have a significant impact as the Company will recognize new assets and liabilities for its operating leases of retail stores. In addition, the nature and timing of expenses related to those leases will change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of use assets and interest expense on lease liabilities. The Company has not yet determined which transition method it will apply or whether it will use the optional exemptions or practical expedients under the standard. The Company expects to disclose additional detailed information, including its transition method, any practical expedients elected and estimated quantitative financial effects, before the adoption of IFRS 16.

IFRIC 22, "Foreign Currency Transactions and Advance Consideration" ("IFRIC 22"). In December 2016, the IASB issued IFRIC 22, which addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) and on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. IFRIC 22 is effective for annual periods beginning on or after January 1, 2018. Early adoption is permitted. The Company is in the process of evaluating the impact of adopting the interpretation of IFRIC 22 on its consolidated financial statements.

IFRIC 23, "Uncertainty over Income Tax Treatments", was issued by the IASB in June 2017. The Interpretation provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. The Interpretation is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted. The Interpretation requires an entity to:

- Contemplate whether uncertain tax treatments should be considered separately, or together as a group, based on which approach provides better predictions of the resolution;
- Reflect an uncertainty in the amount of income tax payable (recoverable) if it is probable that it will pay (or recover) an amount for the uncertainty; and
- Measure a tax uncertainty based on the most likely amount or expected value depending on whichever method better predicts the amount payable (recoverable).

The Company does not expect a material impact from the adoption of IFRIC 23 on its consolidated financial statements.

JOBS Act Exemptions and Foreign Private Issuer Status

We qualify as an "emerging growth company" as defined in the JOBS Act. An emerging growth company may take advantage of specified reduced reporting and other burdens that are otherwise applicable generally to public companies. This includes an exemption from the auditor attestation requirement in the assessment of our internal control over financial reporting pursuant to the Sarbanes-Oxley Act. We may take advantage of this exemption for up to five years or such earlier time that we are no longer an emerging growth company. We will cease to be an emerging growth company if we (1) have US$1.0 billion or more in annual revenue as of the end of our fiscal year, (2) are a large accelerated filer and have more than US$700.0 million in market value of our common shares held by non-affiliates as of the end of our second fiscal quarter or (3) issue more than US$1.0 billion of non-convertible debt securities over a three-year period. We may choose to take advantage of some but not all of these reduced burdens.

We do not take advantage of the extended transition period provided under Section 7(a)(2)(B) of the Securities Act for complying with new or revised accounting standards. We report under the Exchange Act as a non-U.S. company with foreign private issuer status. Even after we no longer qualify as an emerging growth company, as long as we qualify as a foreign private issuer under the Exchange Act we will be exempt from certain provisions of the Exchange Act that are applicable to U.S. domestic public companies, including:

- the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations in respect of a security registered under the Exchange Act;
- the sections of the Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and liability for insiders who profit from trades made in a short period of time;
- the rules under the Exchange Act requiring the filing with the SEC of quarterly reports on Form 10-Q containing unaudited financial and other specified information, or current reports on Form 8-K, upon the occurrence of specified significant events; and
- Regulation FD, which regulates selective disclosures of material information by issuers.

ITEM 7A. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk in interest rates on debt and foreign currency on purchases of our teas and tea accessories.

Interest Rate Risk

Our borrowings under our Revolving Facility carry floating interest rates tied to our lender's prime rate, and therefore, our consolidated statements of income (loss) and cash flows will be exposed to changes in interest rates in fiscal periods in which we have debt outstanding. As at February 3, 2018, we have no indebtedness under our Revolving Facility.

Foreign Exchange Risk

A significant portion of our tea and tea accessory purchases are in U.S. dollars as is our revenue from U.S. stores and U.S. e-commerce customers. As a result, our statement of income (loss) and cash flows could be adversely impacted by changes in exchange rates, primarily between the U.S. dollar and the Canadian dollar. During the year, in order to protect ourselves from the risk of losses should the value of the Canadian dollar decline in relation to the U.S. dollar, we entered into forward contracts of $30.0 million to fix the exchange rate of 80% to 90% of our expected February 2018 to September 2018 U.S. dollar purchases in respect of our inventory.