
FORM 10-Q

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended May 5, 2018.

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the transition period from to
Commission file number 001-37404

DAVIDsTEA Inc.

(Exact name of registrant as specified in its charter)

Canada
(State or other jurisdiction of
incorporation or organization)

98-1048842
(I.R.S. Employer
Identification No.)

5430 Ferrier
Mount-Royal, Québec, Canada, H4P 1M2
(Address of principal executive offices) (zip code)

(888) 873-0006
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12-b2 of the Exchange Act.

Large accelerated filer ☐
Non-accelerated filer ☐

Accelerated filer ☒
Smaller reporting company ☐

Emerging growth company ☒

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ☐ NO ☒

As of June 11, 2018, 25,935,377 common shares of the registrant were outstanding.

DAVIDsTEA Inc.

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DAVIDsTEA Inc. (the "Company"), a corporation incorporated under the *Canada Business Corporations Act*, qualifies as a foreign private issuer in the United States for purposes of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). As a foreign private issuer, the Company has chosen to file annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K with the United States Securities and Exchange Commission ("SEC") instead of filing the reporting forms available to foreign private issuers, although the Company is not required to do so.

In this quarterly report, unless otherwise specified, all monetary amounts are in Canadian dollars, all references to "\$," "C\$," "CAD," "CND\$," "Canadian dollars" and "dollars" mean Canadian dollars and all references to "U.S. dollars," "US\$" and "USD" mean U.S. dollars.

On June 8, 2018, the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York was US\$1.00 = \$1.2956.

Part I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

DAVIDsTEA Inc.

Incorporated under the laws of Canada

INTERIM CONSOLIDATED BALANCE SHEETS

[Unaudited and in thousands of Canadian dollars]

	As at	
	May 5, 2018 \$	February 3, 2018 \$
ASSETS		
Current		
Cash	53,868	63,484
Accounts and other receivables	3,697	3,131
Inventories [Note 5]	25,795	24,450
Income tax receivable	4,287	2,968
Prepaid expenses and deposits	9,076	7,712
Derivative financial instruments [Note 14]	917	—
Total current assets	97,640	101,745
Property and equipment	35,939	36,558
Intangible assets	5,843	4,439
Deferred income tax assets [Note 9]	3,881	5,194
Total assets	143,303	147,936
LIABILITIES AND EQUITY		
Current		
Trade and other payables	12,363	14,392
Deferred revenue	4,727	5,186
Current portion of provisions [Note 6]	3,016	4,693
Derivative financial instruments [Note 14]	—	229
Total current liabilities	20,106	24,500
Deferred rent and lease inducements	8,567	8,608
Provisions [Note 6]	13,842	13,460
Total liabilities	42,515	46,568
Equity		
Share capital [Note 8]	111,949	111,692
Contributed surplus	2,355	2,642
Deficit	(15,789)	(14,721)
Accumulated other comprehensive income	2,273	1,755
Total equity	100,788	101,368
	143,303	147,936

See accompanying notes

DAVIDsTEA Inc.

Incorporated under the laws of Canada

INTERIM CONSOLIDATED STATEMENTS OF INCOME (LOSS)

AND COMPREHENSIVE INCOME (LOSS)

[Unaudited and in thousands of Canadian dollars, except share and per share information]

		For the three months ended	
		May 5, 2018	April 29, 2017
		\$	\$
Sales	[Note 13]	45,786	48,669
Cost of sales		23,094	24,487
Gross profit		22,692	24,182
Selling, general and administration expenses	[Note 10]	24,396	24,153
Results from operating activities		(1,704)	29
Finance costs		79	131
Finance income		(237)	(136)
Income (loss) before income taxes		(1,546)	34
Provision for income tax (recovery)		(344)	396
Net loss		(1,202)	(362)
Other comprehensive income (loss)			
Items to be reclassified subsequently to income (loss):			
Cumulative translation adjustment		(321)	722
Items not to be reclassified subsequently to income (loss):			
Unrealized net gain on forward exchange contracts	[Note 14]	707	1,200
Realized net (gain) loss on forward exchange contracts reclassified to inventory		438	(453)
Provision for income tax on forward exchange contracts		(306)	(199)
Other comprehensive income, net of tax		518	1,270
Total comprehensive income (loss)		(684)	908
Net loss per share:			
Basic	[Note 11]	(0.05)	(0.01)
Fully diluted	[Note 11]	(0.05)	(0.01)
Weighted average number of shares outstanding			
— basic	[Note 11]	25,893,327	25,402,543
— fully diluted	[Note 11]	25,893,327	25,402,543

See accompanying notes

DAVIDsTEA Inc.

Incorporated under the laws of Canada

INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS

[Unaudited and in thousands of Canadian dollars]

	For the three months ended	
	May 5, 2018 \$	April 29, 2017 \$
OPERATING ACTIVITIES		
Net loss	(1,202)	(362)
Items not affecting cash:		
Depreciation of property and equipment	1,686	2,064
Amortization of intangible assets	182	282
Loss on disposal of property and equipment	—	6
Deferred rent	(137)	3
Recovery for onerous contracts	(176)	(886)
Stock-based compensation expense	295	574
Amortization of financing fees	20	20
Accretion on provisions	59	112
Deferred income taxes	956	1,000
	<u>1,683</u>	<u>2,813</u>
Net change in other non-cash working capital balances related to operations	(8,789)	(9,474)
Cash flows related to operating activities	<u>(7,106)</u>	<u>(6,661)</u>
FINANCING ACTIVITIES		
Proceeds from issuance of common shares pursuant to exercise of stock options	—	815
Cash flows related to financing activities	<u>—</u>	<u>815</u>
INVESTING ACTIVITIES		
Additions to property and equipment	(928)	(1,821)
Additions to intangible assets	(1,582)	(425)
Cash flows related to investing activities	<u>(2,510)</u>	<u>(2,246)</u>
Decrease in cash during the period	(9,616)	(8,092)
Cash, beginning of period	<u>63,484</u>	<u>64,440</u>
Cash, end of period	<u><u>53,868</u></u>	<u><u>56,348</u></u>
Supplemental Information		
Cash paid for:		
Interest	—	—
Income taxes (classified as operating activity)	—	496
Cash received for:		
Interest	233	160
Income taxes (classified as operating activity)	—	—

See accompanying notes

DAVIDsTEA Inc.

Incorporated under the laws of Canada

INTERIM CONSOLIDATED STATEMENTS OF EQUITY (DEFICIT)

[Unaudited and in thousands of Canadian dollars]

	<u>Accumulated Other Comprehensive Income</u>						
	Share	Contributed	Deficit	Accumulated	Accumulated	Accumulated	Total
	Capital	Surplus		Derivative	Foreign	Other	Equity
	\$	\$	\$	Financial	Currency	Comprehensive	\$
				Instrument	Translation	Income	
				Adjustment	Adjustment		
				\$	\$	\$	\$
Balance, January 28, 2017	263,828	8,833	(142,398)	333	2,854	3,187	133,450
Net loss for the three months ended April 29, 2017	—	—	(362)	—	—	—	(362)
Other comprehensive income	—	—	—	548	722	1,270	1,270
Total comprehensive income (loss)	—	—	(362)	548	722	1,270	908
Issuance of common shares	1,468	(653)	—	—	—	—	815
Common shares issued on vesting of restricted stock units	268	(554)	14	—	—	—	(272)
Stock-based compensation expense	—	574	—	—	—	—	574
Balance, April 29, 2017	265,564	8,200	(142,746)	881	3,576	4,457	135,475
Balance, February 3, 2018	111,692	2,642	(14,721)	(167)	1,922	1,755	101,368
Net loss for the three months ended May 5, 2018	—	—	(1,202)	—	—	—	(1,202)
Other comprehensive income (loss)	—	—	—	839	(321)	518	518
Total comprehensive income (loss)	—	—	(1,202)	839	(321)	518	(684)
Common shares issued on vesting of restricted stock units	257	(593)	134	—	—	—	(202)
Stock-based compensation expense	—	295	—	—	—	—	295
Income tax impact associated with stock options	—	11	—	—	—	—	11
Balance, May 5, 2018	111,949	2,355	(15,789)	672	1,601	2,273	100,788

See accompanying notes

DAVIDsTEA Inc.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three-month periods ended May 5, 2018 and April 29, 2017 [Unaudited]

[Amounts in thousands of Canadian dollars except share and per share amounts]

1. CORPORATE INFORMATION

The unaudited condensed interim consolidated financial statements of DAVIDsTEA Inc. and its subsidiary (collectively, the “Company”) for the three-month period ended May 5, 2018 were authorized for issue in accordance with a resolution of the Board of Directors on June 13, 2018. The Company is incorporated and domiciled in Canada and its shares are publicly traded on the NASDAQ Global Market under the symbol “DTEA”. The registered office is located at 5430, Ferrier St., Town of Mount-Royal, Quebec, Canada, H4P 1M2.

The Company is engaged in the retail and online sale of tea, tea accessories and food and beverages in Canada and the United States. The results of operations for the interim period are not necessarily indicative of the results of operations for the full year. Sales fluctuate from quarter to quarter. Sales are traditionally higher in the fourth fiscal quarter due to the year-end holiday season, and tend to be lowest in the second and third fiscal quarter because of lower customer traffic during the summer months.

2. STATEMENT OF COMPLIANCE AND BASIS OF PREPARATION

These unaudited condensed interim consolidated financial statements have been prepared in accordance with IAS 34, “Interim Financial Reporting” as issued by the International Accounting Standards Board (“IASB”). Accordingly, these financial statements do not include all of the financial statement disclosures required for annual financial statements and should be read in conjunction with the Company’s audited consolidated financial statements for the year ended February 3, 2018, which have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the IASB. In management’s opinion, the unaudited condensed interim consolidated financial statements reflect all the adjustments that are necessary for a fair presentation of the results for the interim period presented. These unaudited condensed interim consolidated financial statements have been prepared using the accounting policies and methods of computation as outlined in note 3 of the consolidated financial statements for the year ended February 3, 2018.

3. CHANGES IN ACCOUNTING POLICIES

During the three-month period ended May 5, 2018, the Company adopted IFRS 9, “Financial Instruments” (“IFRS 9”). IFRS 9 replaces IAS 39 Financial Instruments: Recognition and Measurement for annual periods beginning on or after 1 January 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting.

With the exception of hedge accounting, which the Company applied prospectively, the Company has applied IFRS 9 retrospectively, with the initial application date of February 4, 2018.

Overall, there was not a material impact on the Company’s consolidated financial statements.

- a) *Classification and measurement.* The Company did not identify any material impact on its consolidated financial statements in applying the classification and measurement requirements of IFRS 9. The following table presents the carrying amount of financial assets held by the Company at February 3, 2018 and their measurement category under IAS 39 and the new model under IFRS 9.

	February 3, 2018		February 3, 2018	
	Measurement category	Carrying Value \$	Measurement category	Carrying Value \$
Cash	FVTPL	63,484	FVTPL	63,484
Credit card cash clearing receivables	Amortized cost	1,291	Amortized cost	1,291
Other receivables	Amortized cost	1,840	Amortized cost	1,840
Derivative financial instruments	FVTPL	229	FVTPL	229

There has been no significant impact caused by the new classification of financial assets under IFRS 9. The classification of all financial liabilities as financial liabilities at amortized cost remains unchanged as well as their measurement resulting from their classification.

- 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 applied the simplified approach and records lifetime expected losses on all trade receivables. The Company performed a detailed analysis that considered all reasonable and supportable information, including forward-looking elements to determine the extent of the impact. The Company's IFRS 9 expected credit loss model did not 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 did not have a material impact on the Company's hedge accounting.

During the three-month period ended May 5, 2018, the Company adopted IFRS 15, "Revenue from Contracts with Customers" ("IFRS 15"). 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 is effective for annual periods beginning on or after January 1, 2018. The implementation of IFRS 15 impacts the allocation of revenue that is deferred in relation to its customer loyalty award programs. Prior to adoption, revenue was allocated to the customer loyalty awards using the residual fair value method. Under IFRS 15, consideration is allocated between the loyalty program awards and the goods on which the awards were earned, based on their relative stand-alone selling prices. The change in allocation of revenue that is deferred in relation to its customer loyalty program does not have a material impact on retained earnings as at February 4, 2018. Overall, there was not a material impact on the Company's consolidated financial statements.

During the three-month period ended May 5, 2018, the Company adopted 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. There was no material impact on the Company's consolidated financial statements.

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

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 with early application permitted. 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 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.

4. SIGNIFICANT ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

The preparation of condensed interim consolidated financial statements requires management to make estimates and assumptions using judgment that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expense during the reporting period. Estimates and other judgments are continually evaluated and are based on management’s experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Actual results may differ from those estimates.

In preparing these unaudited condensed interim consolidated financial statements, critical judgements made by management in applying the Company’s accounting policies and the key sources of estimation uncertainty were the same as those referred to in note 5 of the consolidated financial statements for the year ended February 3, 2018.

5. INVENTORIES

	May 5, 2018 \$	February 3, 2018 \$
Finished goods	23,388	17,600
Goods in transit	1,362	4,608
Packaging	1,045	2,242
	<u>25,795</u>	<u>24,450</u>

6. PROVISIONS

	For the three months ended May 5, 2018 \$
Opening balance	18,153
Utilization	(1,340)
Reversals	(176)
Settlements	(439)
Accretion expense	59
Cumulative translation adjustment	601
Ending balance	16,858
Less: Current portion	(3,016)
Long-term portion of provisions	13,842

Provisions for onerous contracts have been recognized in respect of store leases where the unavoidable costs of meeting the obligations under the lease agreements exceed the economic benefits expected to be received from the contract. The unavoidable costs reflect the present value of the lower of the expected cost of terminating the contract and the expected net cost of operating under the contract.

7. REVOLVING FACILITY

On June 11, 2018, the Company amended its existing Credit Agreement with BMO (“Amended Credit Agreement”). The Amended Credit Agreement provides for a two-year revolving facility (“Amended Revolving Facility”) in the principal amount of \$15.0 million or the equivalent in U.S. dollars, repayable at any time, two years from June 11, 2018, with no accordion feature. Borrowings under the Amended Revolving Facility may not exceed the lesser of the total commitment for the New Revolving Facility and the borrowing base, calculated as 75% of the face value of all eligible receivables plus 50% of the estimated value of all eligible inventory, less any priority payables.

The Amended Credit Agreement subjects the Company to certain financial covenants entered into between the Company and BMO. Without the prior written consent of BMO, the Company’s fixed charge coverage ratio may not be less than 1.10:1.00 and the Company’s leverage ratio may not exceed 3.00:1.00. In addition, the Company’s net tangible worth may not be less than \$65,000 and the Company’s minimum excess availability must not be less than \$15.0 million. The Amended Revolving Facility bears interest based on the Company’s adjusted leverage ratio, at the bank’s prime rate, U.S. bank rate and LIBOR plus a range from 0.5% to 2.5% per annum. A standby fee range of 0.3% to 0.5% will be paid on the daily principal amount of the unused portion of the Amended Revolving Facility. Prior to the amendment of the credit agreement on June 11, 2018, the Company was in breach of one of its financial covenants as at May 5, 2018, which also constituted an event of default under the derivative contracts.

The credit facility also contains non-financial covenants that, among other things and subject to certain exceptions, restrict the Company’s ability to become guarantor or endorser or otherwise become liable upon any note or other obligation other than in the normal course of business. The Company also cannot make any dividend payments.

As at May 5, 2018 and February 3, 2018, the Company did not have any borrowings on the Revolving Facility.

8. SHARE CAPITAL

Authorized

An unlimited number of Common shares.

Issued and outstanding

	May 5, 2018 \$	February 3, 2018 \$
25,915,157 Common shares [February 3, 2018 - 25,885,372 shares]	<u>111,949</u>	<u>111,692</u>
	<u>111,949</u>	<u>111,692</u>

During the three-month period ended May 5, 2018, no stock options were exercised for common shares [April 29, 2017 — 217,000 stock options for cash proceeds of \$815]. During the three-month period ended April 29, 2017, the carrying value of common shares included \$653, which corresponds to a reduction in contributed surplus associated to options exercised during the period.

In addition, during the three-month period ended May 5, 2018, 29,785 common shares [April 29, 2017 – 28,105 common shares] were issued in relation to the vesting of restricted stock units (“RSU”), resulting in an increase in share capital of \$257, net of tax [April 29, 2017 — \$268] and a reduction in contributed surplus of \$593 [April 29, 2017 — \$554].

Stock-based compensation

As at May 5, 2018, 402,532 common shares remain available for issuance under the 2015 Omnibus Plan.

No stock options were granted during the three-month period ended May 5, 2018. For the three-month period ended April 29, 2017, the weighted average fair value of options granted of \$2.39 was estimated using the Black Scholes option pricing model, using the following assumptions:

	<u>For the three months ended</u> <u>April 29,</u> <u>2017</u>
Risk-free interest rate	1.79 %
Expected volatility	27.4 %
Expected option life	4.0 years
Expected dividend yield	0 %
Exercise price	\$ 9.76

Expected volatility was estimated using historical volatility of similar companies whose share prices were publicly available.

A summary of the status of the Company's stock option plan and changes during the three-month period is presented below.

	For the three months ended			
	May 5, 2018		April 29, 2017	
	Options outstanding #	Weighted average exercise price \$	Options outstanding #	Weighted average exercise price \$
Outstanding, beginning of period	447,779	7.18	933,195	5.63
Issued	—	—	161,980	9.76
Exercised	—	—	(217,000)	3.76
Forfeitures	(55,342)	5.34	(30,040)	7.64
Outstanding, end of period	392,437	7.44	848,135	6.83
Exercisable, end of period	260,604	6.01	491,165	4.96

No stock options were exercised during the three-month period ended May 5, 2018. For the three-month period ended April 29, 2017, the weighted average share price at the date of exercise for stock options exercised was \$9.47.

A summary of the status of the Company's RSU plan and changes during the three-month period is presented below.

	For the three months ended			
	May 5, 2018		April 29, 2017	
	RSUs outstanding #	Weighted average fair value per unit (1) \$	RSUs outstanding #	Weighted average fair value per unit (1) \$
Outstanding, beginning of period	289,416	9.70	252,233	12.42
Granted	416,450	4.35	204,437	8.96
Forfeitures	(10,880)	(9.49)	(18,548)	9.79
Vested	(29,785)	(8.61)	(28,105)	10.05
Vested, withheld for tax	(31,694)	(8.58)	(30,119)	10.09
Outstanding, end of period	633,507	6.29	379,898	6.53

(1) Weighted average fair value per unit as at date of grant.

During the three-month period ended May 5, 2018, the Company recognized a stock-based compensation expense of \$295 [April 29, 2017 — \$574].

9. INCOME TAXES

Income tax expense is recognized based on management's best estimate of the weighted average annual income tax rate expected for the full fiscal year.

A reconciliation of the statutory income tax rate to the effective tax rate is as follows:

	For the three months ended			
	May 5, 2018		April 29, 2017	
	%	\$	%	\$
Income tax recovery — statutory rate	26.9	(416)	26.5	9
Increase (decrease) in provision for income tax (recovery) resulting from:				
Non-deductible items	(4.6)	71	364.7	124
Other	(0.1)	1	773.5	263
Income tax provision (recovery) — effective tax rate	22.2	(344)	1,164.7	396

A breakdown of the income tax provision (recovery) on the interim consolidated statement of income (loss) is as follows:

	For the three months ended	
	May 5, 2018	April 29, 2017
	\$	\$
Income tax provision (recovery)		
Current	(1,300)	(604)
Deferred	956	1,000
	(344)	396

10. SELLING, GENERAL AND ADMINISTRATION EXPENSES

	For the three months ended	
	May 5, 2018	April 29, 2017
	\$	\$
Wages, salaries and employee benefits	16,480	16,221
Depreciation of property and equipment	1,686	2,064
Amortization of intangible assets	182	282
Loss on disposal of property and equipment	—	6
Utilization for onerous contracts	(1,340)	(529)
Recovery for onerous contracts	(176)	(886)
Stock-based compensation	295	574
Other selling, general and administration	7,269	6,421
	24,396	24,153

11. EARNINGS PER SHARE

Basic earnings per share (“EPS”) amounts are calculated by dividing the net income (loss) for the period attributable to ordinary equity holders by the weighted average number of ordinary shares outstanding during the period. Diluted EPS amounts are calculated by dividing the net income (loss) attributable to ordinary equity holders (after adjusting for dividends) by the weighted average number of ordinary shares outstanding during the period plus the weighted average number of ordinary shares that would be issued on conversion of all the dilutive potential ordinary shares into ordinary shares, unless these would be anti-dilutive.

The following reflects the income and share data used in the basic and diluted EPS computations:

	For the three months ended	
	May 5, 2018	April 29, 2017
	\$	\$
Net loss for basic EPS	(1,202)	(362)
Weighted average number of shares outstanding — basic and fully diluted	25,893,327	25,402,543

As a result of the net loss during the three-month period ended May 5, 2018 and April 29, 2017, the stock options and restricted stock units disclosed in Note 8 are anti-dilutive.

12. RELATED PARTY DISCLOSURES

There have been no significant changes in related party transactions from those disclosed in the Company's audited annual consolidated financial statements for the year ended February 3, 2018.

During the three-month period ended May 5, 2018, the Company purchased merchandise from a company controlled by one of its executive employees amounting to \$64 [April 29, 2017 — nil].

13. SEGMENT INFORMATION

An operating segment is a component of the Company that engages in business activities from which it may earn revenues and incur expenses. The Company has reviewed its operations and determined that each of its retail stores represents an operating segment. However, because its retail stores have similar economic characteristics, sell similar products, have similar types of customers, and use similar distribution channels, the Company has determined that these operating segments can be aggregated at a geographic level. As a result, the Company has concluded that it has two reportable segments, Canada and the U.S., that derive their revenues from the retail and online sale of tea, tea accessories and food and beverages. The Company's Chief Executive Officer (the chief operating decision maker or "CODM") makes decisions about resources allocation and assesses performance at the country level, and for which discrete financial information is available.

The Company derives revenue from the following products:

	For the three months ended	
	May 5, 2018	April 29, 2017
	\$	\$
Tea	33,230	33,873
Tea accessories	8,714	10,509
Food and beverages	3,842	4,287
	45,786	48,669

Property and equipment and intangible assets by country are as follows:

	May 5, 2018	February 3, 2018
	\$	\$
Canada	37,917	37,234
US	3,865	3,763
Total	41,782	40,997

During the fourth quarter of fiscal 2017, the Company changed the measure of profit used by the CODM in measuring performance. Management believes that the new measure, being results from operating activities before corporate expenses by country, excluding intercompany profit, is the most relevant in evaluating results. The Company has retroactively revised the results by segment for the three-month period ended April 29, 2017. Results from operating activities before corporate expenses per country are as follows:

	For the three months ended May 5, 2018		
	Canada \$	US \$	Consolidated \$
Sales	36,532	9,254	45,786
Cost of sales	17,816	5,278	23,094
Gross profit	18,716	3,976	22,692
Selling, general and administration expenses (allocated)	13,384	4,158	17,542
Impact of onerous contracts	(192)	(1,324)	(1,516)
Results from operating activities before corporate expenses	5,524	1,142	6,666
Selling, general and administration expenses (non-allocated)			8,370
Results from operating activities			(1,704)
Finance costs			79
Finance income			(237)
Loss before income taxes			(1,546)

	For the three months ended April 29, 2017		
	Canada \$	US \$	Consolidated \$
Sales	39,952	8,717	48,669
Cost of sales	19,317	5,170	24,487
Gross profit	20,635	3,547	24,182
Selling, general and administration expenses (allocated)	12,609	4,293	16,902
Impact of onerous contracts	(27)	(1,388)	(1,415)
Results from operating activities before corporate expenses	8,053	642	8,695
Selling, general and administration expenses (non-allocated)			8,666
Results from operating activities			29
Finance costs			131
Finance income			(136)
Income before income taxes			34

14. FINANCIAL RISK MANAGEMENT

The Company's activities expose it to a variety of financial risks, including risks related to foreign exchange, interest rate, liquidity and credit.

Currency risk — foreign exchange risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Given that some of its purchases are denominated in U.S. dollars, the Company is exposed to foreign exchange risk. The Company's foreign exchange risk is largely limited to currency fluctuations between the Canadian and U.S. dollars. The Company is exposed to currency risk through its cash, accounts receivable and accounts payable denominated in U.S. dollars.

Assuming that all other variables remain constant, a revaluation of these monetary assets and liabilities due to a 5% rise or fall in the Canadian dollar against the U.S. dollar would have resulted in an increase or decrease to net income (loss) in the amount of \$76.

The Company's foreign exchange exposure is as follows:

	May 5, 2018 US\$	February 3, 2018 US\$
Cash	2,714	5,686
Accounts receivable	1,243	882
Accounts payable	2,440	2,555

The Company's U.S. subsidiary's transactions are denominated in U.S. dollars.

In order to protect itself from the risk of losses should the value of the Canadian dollar decline in relation to the U.S. dollar, the Company has entered into forward contracts to fix the exchange rate of 80% to 90% of its expected U.S. dollar inventory purchasing requirements, through September 2018. A forward foreign exchange contract is a contractual agreement to buy a specific currency at a specific price and date in the future. The Company designated the forward contracts as cash flow hedging instruments under IFRS 9. This has resulted in mark-to-market foreign exchange adjustments, for qualifying hedged instruments, being recorded as a component of other comprehensive income (loss) for the three-month period ended May 5, 2018. As at May 5, 2018, the designated portion of these hedges was considered effective.

The nominal and contract values of foreign exchange contracts outstanding as at May 5, 2018 are as follows:

	Contractual exchange rate	Nominal value US\$	Nominal value C\$	Term	Unrealized gain C\$
Purchase contracts					
U.S. dollar	1.2221	15,200	18,575	June 2018 to September 2018	917

The nominal and contract values of foreign exchange contracts outstanding as at April 29, 2017 are as follows:

	Contractual exchange rate	Nominal value US\$	Nominal value C\$	Term	Unrealized gain C\$
Purchase contracts					
U.S. dollar	1.3098	22,100	28,947	May 2017 to October 2017	1,200

Market risk — interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. Financial instruments that potentially subject the Company to cash flow interest rate risk include financial assets with variable interest rates and consists of cash. The Company is exposed to cash flow risk on its Revolving Facility which bears interest at variable interest rates (Note 7). As at May 5, 2018, the Company did not have any borrowings on the Revolving Facility.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company's approach to managing liquidity risk is to ensure, to the extent possible, that it will always have sufficient liquidity to meet liabilities when due. The Company's liquidity follows a seasonal pattern based on the timing of inventory purchases and capital expenditures. The Company is exposed to this risk mainly in respect of its trade and other payables.

As at May 5, 2018, the Company had \$53,868 in cash. In addition, as outlined in Note 7, the Company has a Revolving Facility of \$15,000, of which nil was drawn as at May 5, 2018.

The Company expects to finance its growth in store base, its store renovations and infrastructure investments through cash flows from operations, the Revolving Facility (Note 7) and cash on hand. The Company expects that its trade and other payables will be discharged within 90 days.

Credit risk

The Company is exposed to credit risk resulting from the possibility that counterparties may default on their financial obligations to the Company. The Company's maximum exposure to credit risk at the reporting date is equal to the carrying value of accounts receivable and derivative financial instruments. Accounts receivable primarily consists of receivables from retail customers who pay by credit card, recoveries of credits from suppliers for returned or damaged products, and receivables from other companies for sales of products, gift cards and other services. Credit card payments have minimal credit risk and the limited number of corporate receivables is closely monitored. The terms of foreign currency forward contracts included in derivative financial instruments have been negotiated to match the terms of the forecasted inventory purchase transactions. Both contractual parties have fully cash-collateralized the foreign currency forward contracts, and therefore, effectively eliminated any credit risk associated with the contracts (both the counterparty's and the Company's own credit risk).

Fair values

Financial assets and financial liabilities are measured on an ongoing basis at fair value or amortized cost, based on the guidance provided in IFRS 9 and as disclosed in Note 3 "Changes in Accounting Policies" in these unaudited condensed interim consolidated financial statements for the three-month period ended May 5, 2018. The fair values of derivative financial instruments have been determined by reference to forward exchange rates at the end of the reporting period and classified in Level 2 of the fair value hierarchy.

The Company enters into its foreign currency forward contracts with financial institutions with investment grade credit ratings. Foreign currency forward contracts are valued using valuation techniques with market observable inputs. The most frequently applied valuation techniques include forward pricing, using present value calculations. The models incorporate various inputs including the credit quality of counterparties, foreign exchange spot and forward rates, yield curves of the respective currencies, currency basis spreads between the respective currencies, interest rate curves and forward rate curves of the underlying commodity. All foreign currency forward contracts are fully cash collateralized, thereby mitigating both the counterparty and the Company's non-performance risk.

There were no transfers between Level 1, Level 2 and Level 3 of the fair value hierarchy during the three-month periods ended May 5, 2018 and April 29, 2017.

15. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform to the presentation adopted in the current year.

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

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

Forward-Looking Statements

Certain statements contained herein include statements that express our opinions, expectations, beliefs, plans, objectives, assumptions or projections regarding future events or future results and there are, or may be deemed to be, "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"). The following cautionary statements are being made pursuant to the provisions of the Act and with the intention of obtaining the benefits of the "safe harbor" provisions of the Act. These forward-looking statements can generally be identified by the use of forward-looking terminology, including the terms "believes," "expects," "may," "will," "should," "could," "seeks," "projects," "approximately," "intends," "plans," "estimates" or "anticipates," or, in each case, their negatives or other variations or comparable terminology. These forward-looking statements include all matters that are not historical facts. They appear in a number of places throughout this Quarterly Report and include statements regarding our intentions, beliefs or current expectations concerning, among other things, our results of operations, our turnaround strategy, our store renovation plans, expansion into new sales channels, financial condition, liquidity, prospects, new store opening projections, use of cash and operating and capital expenditures, impact of new accounting pronouncements, impact of improvements to internal control and financial reporting. These risks and uncertainties include, but are not limited to the risks described under the section entitled "Risk Factors" elsewhere in this Quarterly Report on Form 10-Q. Forward-looking statements speak only as of the date hereof. Except as required under federal securities laws and the rules and regulations of the SEC, we do not have any intention to update any forward-looking statements to reflect events or circumstances arising after the date of this Form 10-Q, whether as a result of new information, future events or otherwise. As a result of these risks and uncertainties, readers are cautioned not to place undue reliance on the forward-looking statements included in this Form 10-Q or that may be made elsewhere from time to time by, or on behalf of, us. All forward-looking statements attributable to us are expressly qualified by these cautionary statements.

Accounting Periods

All references to "Fiscal 2018" are to the Company's fiscal year ending February 2, 2019. 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.

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 year ended February 3, 2018 covers a 53-week fiscal period. The years ending February 2, 2019 and January 28, 2017 cover a 52-week period.

Overview

We are a retailer of specialty tea, offering a differentiated selection of proprietary loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories and food and beverages, primarily through 240 company-operated DAVIDsTEA stores as of May 5, 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 and online. We strive to make tea a multi-sensory experience in our stores 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 Quarterly Report on Form 10-Q.

- *E-Commerce.* There has been a decline in foot traffic at many of the malls in which our stores are located. We believe this is primarily as a result of consumers’ shift toward online shopping. We have aimed to capitalize on consumer’s shift from brick and mortar stores to e-commerce by making 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 in both the fourth quarter of Fiscal 2017 and the first quarter of Fiscal 2018. We also anticipate that our e-commerce platform will enable us to start selling on Amazon before fall 2018. These initiatives will require significant investment, and if we are unable to implement them in a timely fashion, and grow them at a pace to offset the decline in retail traffic we believe is caused by increased online shopping, 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 order to maximize our stores’ performance in an effort to reverse the trend of negative comparables that has emerged at some of our locations. In addition, in 2018, we expect to renovate up to five of our stores to be similar to our DAVIDsTEA 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 are 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 and kits. We believe that our product mix of accessories and kits have not resonated with our customers resulting in a negative impact to sales. Our management team has been proactively right-sizing the merchandise mix in order to provide our consumers with the teas and products that they have historically loved. These efforts are preliminary and, once fully adopted, may not impact our revenue, preliminarily or at all.

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. Recently, for example, there has been a decline in customer traffic at many malls in which our stores are located. This reduction in foot traffic, has had an impact on our sales at such stores.

Comparable Sales. Comparable sales refer to period-over-period 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.

Measuring the change in period-over-period 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 in the vicinity of 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 groceries, hotels, restaurants and institutions, office and workplace locations and food services, as well as corporate gifting.

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 (recovery) 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 23 of this Quarterly Report on Form 10-Q.

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 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. It is reconciled to its nearest IFRS measure on page 23 of this Quarterly Report on Form 10-Q.

Finance Costs. Finance costs consist of cash and imputed non-cash charges related to our credit facility, as well as the accretion expense on the provisions for onerous contracts.

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 (recovery) related to onerous contracts or contracts where we expect the costs of the obligations to exceed the economic benefit, 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. It is reconciled to its nearest IFRS measure on page 24 of this Quarterly Report on Form 10-Q.

Selected Operating and Financial Highlights

Results of Operations

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

	For the three months ended	
	May 5, 2018	April 29, 2017
	(unaudited)	(unaudited)
Consolidated statement of income (loss) data:		
Sales	\$ 45,786	\$ 48,669
Cost of sales	23,094	24,487
Gross profit	22,692	24,182
Selling, general and administration expenses	24,396	24,153
Results from operating activities	(1,704)	29
Finance costs	79	131
Finance income	(237)	(136)
Income (loss) before income taxes	(1,546)	34
Provision for income tax (recovery)	(344)	396
Net loss	\$ (1,202)	\$ (362)
Percentage of sales:		
Sales	100.0%	100.0%
Cost of sales	50.4%	50.3%
Gross profit	49.6%	49.7%
Selling, general and administration expenses	53.3%	49.6%
Results from operating activities	(3.7%)	0.1%
Finance costs	0.2%	0.3%
Finance income	(0.5%)	(0.3%)
Loss before income taxes	(3.4%)	0.1%
Provision for income tax (recovery)	(0.8%)	0.8%
Net loss	(2.6%)	(0.7%)
Other financial and operations data:		
Adjusted EBITDA (1)	\$ (400)	\$ 1,543
Adjusted EBITDA as a percentage of sales	(0.9%)	3.2%
Number of stores at end of period	240	232
Comparable sales growth (decline) for period (2)	(7.0%)	(5.7%)

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

(2) Comparable sales refer to period-over-period 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 are not a presentation made in accordance with IFRS, and the use of the terms 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, they have 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 do 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 do 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 reconciliations 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

(in thousands)	<u>For the three months ended</u>	
	<u>May 5, 2018</u>	<u>April 29, 2017</u>
Selling, general and administration expenses	24,396	24,153
Impact of onerous contracts (a)	1,516	1,415
Strategic review and proxy contest (b)	(794)	—
Adjusted selling, general and administration expenses	\$ 25,118	\$ 25,568

- (a) 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.
- (b) Represents costs related to the corporate strategic review process as well as costs related to the proxy contest.

Reconciliation of Adjusted results from operating activities

(in thousands)	<u>For the three months ended</u>	
	<u>May 5, 2018</u>	<u>April 29, 2017</u>
Results from operating activities	(1,704)	29
Impact of onerous contracts (a)	(1,516)	(1,415)
Strategic review and proxy contest (b)	794	—
Adjusted results from operating activities	\$ (2,426)	\$ (1,386)

- (a) 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.
- (b) Represents costs related to the corporate strategic review process as well as costs related to the proxy contest.

Reconciliation of Adjusted EBITDA to our net income (loss)

(in thousands)	For the three months ended	
	May 5, 2018	April 29, 2017
Net loss	\$ (1,202)	\$ (362)
Finance costs	79	131
Finance income	(237)	(136)
Depreciation and amortization	1,868	2,346
Loss on disposal of property and equipment	—	6
Provision for income tax (recovery)	(344)	396
EBITDA	\$ 164	\$ 2,381
Additional adjustments:		
Stock-based compensation expense (a)	295	574
Impact of onerous contracts (b)	(1,516)	(1,415)
Deferred rent (c)	(137)	3
Strategic review and proxy contest (d)	794	—
Adjusted EBITDA	\$ (400)	\$ 1,543

- (a) Represents non-cash stock-based compensation expense.
- (b) 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.
- (c) Represents the extent to which our annual rent expense has been above or below our cash rent payments.
- (d) Represents costs related to the corporate strategic review process as well as costs related to the proxy contest.

Three Months Ended May 5, 2018 to Three Months Ended April 29, 2017

Sales. Sales for the three months ended May 5, 2018 decreased 6.0%, or \$2.9 million, to \$45.8 million from \$48.7 million for the three months ended April 29, 2017, comprising a \$3.1 million decrease in comparable sales and a \$0.2 million increase in non-comparable sales. Comparable sales decreased by 7.0% and non-comparable sales increased primarily due to an additional 8 net new stores opened as at three months ended May 5, 2018 as compared to three months ended April 29, 2017. Comparable sales decreased as we continued to face a challenging overall consumer retail environment, with a decrease in mall traffic. We also faced challenges with our accessory and kits product assortment.

Gross Profit. Gross profit decreased by 6.2%, or \$1.5 million, to \$22.7 million for the three months ended May 5, 2018 from \$24.2 million for the three months ended April 29, 2017. Gross profit as a percentage of sales decreased slightly to 49.6% for the three months ended May 5, 2018, from 49.7% for the three months ended April 29, 2017. Gross profit as a percent of sales was stable with the prior year quarter as product margin increased, driven by less promotional activity and a shift in product sales mix, which was offset by a deleveraging of fixed costs due to negative comparable sales.

Selling, General and Administration Expenses. Selling, general and administration expenses increased by 0.8%, or \$0.2 million, to \$24.4 million in the three months ended May 5, 2018 from \$24.2 million for the three months ended April 29, 2017. As a percentage of sales, selling, general and administration expenses increased to 53.3% for the three months ended May 5, 2018, as compared to 49.6% for the three months ended April 29, 2017. Excluding the impact of onerous contracts and costs related to the strategic review and proxy contest for the three months ended May 5, 2018 and April 29, 2017, selling, general and administration expenses decreased to \$25.1 million in the three months ended May 5, 2018 from \$25.6 million for the three months ended April 29, 2017 which included the impact of the legislated minimum wage increases. As a percentage of sales, selling, general and administration expenses excluding these one-time items increased to 54.8% from 52.6%, due to deleveraging of fixed costs due to the negative comparable sales this quarter.

Results from Operating Activities. Results from operating activities decreased by \$(1.7) million, to \$(1.7) million in the three months ended May 5, 2018 from \$0.0 million in the three months ended April 29, 2017. Excluding the impact of onerous contracts and the strategic review and proxy contest for the three months ended May 5, 2018 and April 29, 2017, results from operating activities decreased by \$1.0 million, to \$(2.4) million from \$(1.4) million for the three months ended April 29, 2017.

Provision for Income Taxes (Recovery). Recovery for income taxes increased by \$0.7 million, to \$0.3 million for the three months ended May 5, 2018 from a provision for income taxes of \$0.4 million for the three months ended April 29, 2017. The increase in the recovery for income taxes was due primarily to lower results from operating activities. Our effective tax rates were 22.2% and 1164.7% for the three months ended May 5, 2018 and April 29, 2017, respectively. This decrease in the effective tax rate is due primarily to the high effective tax rate for the three months ended April 29, 2017, due to a high amount of non-deductible and other items relative to the low income before income taxes for the three-months ended April 29, 2017.

Three Months Ended April 29, 2017 Compared to Three Months Ended April 30, 2016

Sales. Sales for the three months ended April 29, 2017 increased 9.4%, or \$4.2 million, to \$48.7 million from \$44.5 million for the three months ended April 30, 2016, comprising a \$2.4 million decrease in comparable sales and a \$6.6 million increase in non-comparable sales. Comparable sales decreased by 5.7% and non-comparable sales increased primarily due to an additional 34 net new stores opened as at April 29, 2017 as compared to April 30, 2016. Comparable sales decreased as we faced more a challenging overall consumer retail backdrop.

Gross Profit. Gross profit increased by 4.3%, or \$1.0 million, to \$24.2 million for the three months ended April 29, 2017 from \$23.2 million for the three months ended April 30, 2016. Gross profit as a percentage of sales decreased to 49.7% for the three months ended April 29, 2017, from 52.1% for the three months ended April 30, 2016 driven by additional promotional activity, a shift in product sales mix and the adverse impact of the stronger U.S. dollar on U.S. dollar denominated purchases.

Selling, General and Administration Expenses. Selling, general and administration expenses increased by 14.7%, or \$3.1 million, to \$24.2 million in the three months ended April 29, 2017 from \$21.1 million for the three months ended April 30, 2016. As a percentage of sales, selling, general and administration expenses increased to 49.6% for the three months ended April 29, 2017, as compared to 47.5% for the three months ended April 30, 2016. Excluding the impact of onerous contracts for the three months ended April 29, 2017, selling, general and administration expenses increased to \$25.6 million in the three months ended April 29, 2017 from \$21.1 million for the three months ended April 30, 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 232 stores as of April 29, 2017 as compared to 198 stores as of April 30, 2016. As a percentage of sales, selling, general and administration expenses excluding the impact of onerous contracts increased to 52.6% from 47.5%.

Results from Operating Activities. Results from operating activities decreased by \$(2.0) million, to \$0.0 million in the three months ended April 29, 2017 from \$2.0 million in the three months ended April 30, 2016. Excluding the impact of onerous contracts for the three months ended April 29, 2017, results from operating activities decreased by \$3.4 million, to \$(1.4) million from \$2.0 million for the three months ended April 30, 2016.

Provision for Income Taxes. Provision for income taxes decreased by \$0.2 million, to \$0.4 million for the three months ended April 29, 2017 from a provision of \$0.6 million for the three months ended April 30, 2016. The decrease in the provision for income taxes was due primarily to lower results from operating activities. Our effective tax rates were 1164.7% and 29.3% for the three months ended April 29, 2017 and April 30, 2016, respectively. This increase in the effective tax rate is due to non-deductible expenses, differences in foreign tax rates vs. statutory income tax rates and other items that result in an income tax expense on a low income before taxes base for the three months ended April 29, 2017.

Liquidity and Capital Resources

As at May 5, 2018 we had \$53.9 million of cash primarily held with major Canadian financial institutions. Our working capital was \$77.5 million as of May 5, 2018, compared to \$77.2 million as at February 3, 2018.

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, store renovations and infrastructure investments.

Capital expenditures typically vary depending on the timing of new store openings, store renovations and infrastructure-related investments.

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. We funded our capital expenditures and working capital requirements from cash on hand and net cash provided by our operating activities.

We believe that our cash position, net cash provided by our 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 three months ended	
	May 5, 2018	April 29, 2017
Cash flows provided by (used in):		
Operating activities	\$ (7,106)	\$ (6,661)
Investing activities	(2,510)	(2,246)
Financing activities	—	815
Increase (decrease) in cash	\$ (9,616)	\$ (8,092)

Cash Flows Provided by (Used in) Operating Activities

Net cash used in operating activities decreased to \$(7.1) million for the three months ended May 5, 2018 from \$(6.7) million for the three months ended April 29, 2017. The decrease in the cash flows used in operating activities was due primarily to lower results from operations.

Cash Flows Provided by (Used in) Investing Activities

Capital expenditures increased by \$0.3 million, to \$2.5 million for the three months ended May 5, 2018, from \$2.2 million for the three months ended April 29, 2017. This increase was primarily due to higher investments in e-commerce systems and infrastructure.

Cash Flows Provided By Financing Activities

Net cash flows provided by financing activities were nil for the three months ended May 5, 2018, compared to \$0.8 million for the three months ended April 29, 2017, as no stock options were exercised during the three months ended May 5, 2018.

Credit Facility with Bank of Montreal

The Company has a credit arrangement (hereinafter referred to as “Credit Agreement”) with the Bank of Montreal (“BMO”). As at May 5, 2018, we did not have any borrowings on the Revolving Facility.

The Amended Credit Agreement subjects the Company to certain financial covenants entered into between the Company and BMO. Without the prior written consent of BMO, the Company’s fixed charge coverage ratio may not be less than 1.10:1.00 and the Company’s leverage ratio may not exceed 3.00:1.00. In addition, the Company’s net tangible worth may not be less than \$65,000 and the Company’s minimum excess availability must not be less than \$15.0 million. The Amended Revolving Facility bears interest based on the Company’s adjusted leverage ratio, at the bank’s prime rate, U.S. bank rate and LIBOR plus a range from 0.5% to 2.5% per annum. A standby fee range of 0.3% to 0.5% will be paid on the daily principal amount of the unused portion of the Amended Revolving Facility. Prior to the amendment of the credit agreement on June 11, 2018, the Company was in breach of one of its financial covenants as at May 5, 2018, which also constituted an event of default under the derivative contracts.

The credit facility also contains non-financial covenants that, among other things and subject to certain exceptions, restrict the Company’s ability to become guarantor or endorser or otherwise become liable upon any note or other obligation other than in the normal course of business. The Company also cannot make any dividend payments.

As at May 5, 2018 and February 3, 2018, the Company did not have any borrowings on the Revolving Facility

Off-Balance Sheet Arrangements

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

Contractual Obligations and Commitments

There have been no significant changes to our contractual obligations as disclosed in our consolidated financial statements for the fiscal year ended February 3, 2018, other than those which occur in the normal course of business.

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 judgement 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 for the year ended February 3, 2018 included in our Annual Report on Form 10-K dated April 19, 2018. There have been no material changes to the critical accounting policies and estimates since February 3, 2018, other than as described below.

Recently Issued Accounting Standards

During the three month period ended May 5, 2018, we adopted the new accounting standards described below.

IFRS 9, “Financial Instruments” (“IFRS 9”), 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. With the exception of hedge accounting, which we applied prospectively, we have applied IFRS 9 retrospectively, with the initial application date of February 4, 2018. Overall, there was not a material impact on the Company’s consolidated financial statements.

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 is effective for annual periods beginning on or after January 1, 2018. The implementation of IFRS 15 impacts the allocation of revenue that is deferred in relation to its customer loyalty award programs. Prior to adoption, revenue was allocated to the customer loyalty awards using the residual fair value method. Under IFRS 15, consideration is allocated between the loyalty program awards and the goods on which the awards were earned, based on their relative stand-alone selling prices. The change in allocation of revenue that is deferred in relation to its customer loyalty program does not have a material impact on retained earnings as at February 4, 2018. Overall, there was not a material impact on the Company's consolidated financial statements.

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. There was no material impact on the Company's consolidated financial statements.

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

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 in the statement of financial position. 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, with early application permitted. 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 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.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There has been no material change in the foreign exchange and interest rate risk discussed in "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K dated April 19, 2018.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of May 5, 2018. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (“Exchange Act”), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits 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 by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of May 5, 2018, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There has been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the three-month period ended May 5, 2018, that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

We are, from time to time, subject to claims and suits arising in the ordinary course of business. Although the outcome of these and other claims cannot be predicted with certainty, management does not believe that the ultimate resolution of any matters in which we are currently involved will have a material adverse effect on our financial position or on our results of operations.

On June 1, 2018 certain investment funds managed by Porchlight Equity Management LLC (the “Porchlight Funds”) filed an application for declaratory judgement in the superior court in the district of Montreal, Province of Quebec (the “action”) against our dissident shareholder, Herschel Segal, and Rainy Day. The Company was named as a *mise en cause*, also referred to as a third party defendant. The dispute relates to a 2013 settlement between the Porchlight Funds and Rainy Day, and alleges that, by launching the proxy contest in a bid to take over the Company’s board of directors, Mr. Segal and Rainy Day breached this agreement. The Company believes that the action will have no material impact on the Company’s business and operations.

Item 1A. Risk Factors

You should carefully consider the risks and uncertainties described below together with all of the other information contained in this Quarterly Report on Form 10-Q and in our other public disclosures. If any of the following risks actually occurs, our business, prospects, operating results and financial condition could suffer materially, the trading price of our common shares could decline and you could lose all or part of your investment. Although we believe that we have identified and discussed below the key risk factors affecting our business, there may be additional risks and uncertainties that are not presently known to us or that are currently deemed immaterial that may adversely affect our business and financial condition.

Risks Related to Our Business and Our Industry

We are in the process of implementing a shift in our business strategy, and our efforts may not result in a successful growth strategy or strategic alternatives.

Previously, we had relied on a retail-based growth strategy in Canada and the United States; however, we believe that centering our momentum around new store openings is less likely to be successful in the current retail environment. We believe there is merit in continuing a retail strategy in conjunction with an advanced e-commerce platform, enhanced marketing and merchandising, and expanded wholesale distribution and grocery strategy. We have not completed our transition to a new multi-channel strategy and have not set a timetable for the completion of the strategic review process. If we are not able to commit to a strategy on a timely basis, our operating results will likely be adversely affected.

In addition, our Board of Directors announced in December 2017 that it would be reviewing and considering strategic alternatives. These could include, but are not limited to, a potential financing, refinancing, restructuring, merger, acquisition, joint venture, divestiture or disposition of some or all of the Company’s assets outside of the ordinary course of business. There can be no assurance that this evaluation will result in a significant shift in our strategy. Our board has spent substantial time engaging with our significant shareholders following this announcement and as result of the proxy contest launched this spring. Our management team and other employees have been required to spend a significant additional amount of time addressing the proxy context and may spend additional time addressing potential strategic alternatives, which could mean that our normal operations receive less time and attention.

Our business largely depends on a strong brand image, and if we are unable to maintain and enhance our brand image, particularly in new markets where we have limited brand recognition, we may be unable to increase or maintain our level of sales.

We believe that our brand image and brand awareness are important to our business and potential future growth. We also believe that maintaining and enhancing our brand image is important to maintaining and expanding our customer base and retaining our employees. We have experienced a substantial amount of press this spring as a result of our public proxy fight. Some of this has been negative as the dissident shareholder has set about making his case to change our board of directors. If customers are concerned about the messaging directed to shareholders, this could have a negative impact on our brand image and, potentially, future operating results.

In addition, our ability to successfully integrate our strategy to expand into new channels or to maintain the strength and distinctiveness of our brand in our existing markets will be adversely impacted if we fail to connect with our target customers. Maintaining and enhancing our brand image may require us to continue to make substantial investments in areas such as merchandising, marketing, store operations, and employee training, which could adversely affect our cash flow and which may ultimately be unsuccessful. Furthermore, our brand image could be jeopardized if we fail to maintain high standards for merchandise quality, if we fail to comply with local laws and regulations if we experience negative publicity or other negative events that affect our image and reputation or as a result of communications by our shareholders. Some of these risks may be beyond our ability to control, such as the effects of negative publicity regarding our suppliers or our shareholders. Failure to successfully market and maintain our brand image could harm our business, results of operations and financial condition.

The retail industry in the United States and Canada has changed rapidly. If we are unable to adapt our business to these changes successfully, our results of operations may suffer.

In recent years, the retail industry has experienced dramatic changes. Online retail shopping is rapidly growing as a percentage of overall retail sales, and we expect the consumer shift to the e-commerce market will intensify. We believe that this has had a corresponding negative effect on mall traffic, including in malls where certain of our retail stores are located. As a greater portion of consumer expenditures with retailers occurs online and through mobile commerce applications, failure to successfully integrate our physical retail stores with digital retail may result in financial difficulties, including store closures, impairments, bankruptcies or liquidations. This could, in turn, have a material adverse effect on our results of operations, financial condition and cash flows. Our future success will be determined, in part, on our ability to identify and capitalize on retail trends, including technology, e-commerce and other process efficiencies that will better service our customers. Although our e-commerce sales have grown over the past few fiscal quarters, if we fail to compete online, our businesses, market share, results of operations and financial condition will be materially and adversely affected. There can be no assurance as to the future effect of such changes in the retail industry on our business or financial condition, results of operations or liquidity.

Like many other retailers, we are experiencing negative comparable store sales. If we are unable to modify our retail-based strategy and continue to grow our e-commerce business, we expect that our results of operations will continue to be adversely affected.

We may not be able to regain the levels of comparable sales that we have experienced historically. If our future comparable sales continue to decline our financial results will suffer. A variety of factors affect comparable sales including increasing consumer use of e-commerce, consumer tastes, competition, current economic conditions, pricing, competitive, inflation and weather conditions. These factors may cause our comparable sales results to be materially lower than previous periods and our expectations, which could harm our results of operations and result in a decline in the price of our common shares.

We have experienced a slowdown in the growth rate of our business during the past few years, and our former high levels of growth may not be achieved in future periods.

The growth rate of our business has slowed significantly during the last several years. Any potential future initiatives to support the growth of our business can negatively affect our gross margins in the short term and may

amplify fluctuations in our growth rate from quarter to quarter depending on the timing and extent of our realization of the costs and benefits of such initiatives. Some factors affecting our business are not within our control, including macroeconomic conditions and consumer behavior. Our business performance is also linked to the overall strength of consumer discretionary spending in markets in which we operate. Economic conditions affecting selected markets in which we operate can have an impact on the strength of our business in those local markets.

Unique factors in any given quarter may affect period-to-period comparisons such as seasonal fluctuations, promotional events and store openings, among other things. The results for any quarter are not necessarily indicative of the results that we may achieve for a full fiscal year. Our results of operations may also vary relative to corresponding periods in prior years. We may take certain pricing, merchandising or marketing actions that could have a disproportionate effect on our business, financial condition and results of operations in a particular quarter or selling season, and as a result we believe that period-to-period comparisons of our results of operations are not necessarily meaningful and cannot be relied upon as indicators of future performance. Numerous other factors affect period-to-period comparisons in our revenue and comparable brand revenue growth, including: the overall economic and general retail sales environment, including the effects of uncertainty or stock market volatility on consumer spending, consumer preferences and demand, the number, size and location of stores we open, close, remodel or expand in any period; our ability to efficiently source and distribute products, changes in our product offerings and the introduction and timing of introduction of new products and new product categories, promotional events, our competitors introducing similar products or merchandise formats, the timing of various holidays, including holidays with potentially heavy retail impact and the success of any marketing programs. We cannot assure you that we will succeed in offsetting any such expenses with increased efficiency or that cost increases associated with our business will not have an adverse effect on our financial results.

Expanding our focus to e-commerce, concept stores, and grocery alongside retail will require us to continue to expand and improve our operations and could strain our operational, managerial and administrative resources, which may adversely affect our business.

Growing our business in historically non-core channels will place increased demands on our operational, managerial, administrative and other resources, which may be inadequate to support our expansion. Our senior management team may be unable to effectively address challenges involved with expansion forecasts for the future. It may also require us to enhance our store management systems, financial and management controls and information systems, and to hire, train and retain regional directors, district managers, store managers and other personnel. Implementing new systems, controls and procedures, these additions to our infrastructure and any changes to our existing operational, managerial, administrative and other resources could negatively affect our results of operations and financial condition.

We face significant competition from other specialty tea and beverage retailers and retailers of grocery products, which could adversely affect our growth plans and us.

The U.S. and Canadian tea markets are highly fragmented. We compete directly with a large number of relatively small independently owned tea retailers and a number of regional tea retailers, as well as retailers of grocery products, including loose-leaf teas, tea sachets and other beverages. We must spend considerable resources to differentiate our customer and product experience. Some of our competitors may have greater financial, marketing and operating resources than we do. Therefore, despite our efforts, our competitors may be more successful than us in attracting customers.

We are subject to customer payment-related risks that could increase operating costs or exposure to fraud or theft, subject us to potential liability and potentially disrupt our business.

We accept payments using a variety of methods, including cash, credit and debit cards and gift cards. Acceptance of these payment options subjects us to rules, regulations, contractual obligations and compliance requirements, including payment network rules and operating guidelines, data security standards and certification requirements, and rules governing electronic funds transfers. For certain payment methods, including credit and debit cards, we pay interchange and other fees, which may increase over time and raise our operating costs. We rely on third

parties to provide payment processing services, including the processing of credit cards, debit cards, and other forms of electronic payment. If these companies become unable to provide these services to us, or if their systems are compromised, it could potentially disrupt our business. The payment methods that we offer also subject us to potential fraud and theft by criminals, who are becoming increasingly more sophisticated, seeking to obtain unauthorized access to or exploit weaknesses that may exist in the payment systems. If we fail to comply with applicable rules or requirements for the payment methods we accept, or if payment-related data is compromised due to a breach or misuse of data, we may be liable for costs incurred by payment card issuing banks and other third parties or subject to fines and higher transaction fees, or our ability to accept or facilitate certain types of payments may be impaired. In addition, our customers could lose confidence in certain payment types, which may result in a shift to other payment types or potential changes to our payment systems that may result in higher costs. As a result, our business and operating results could be adversely affected.

Continued decrease in customer traffic in the shopping malls or other locations in which our stores are located could cause our store-based sales suffer.

Our stores are located in shopping malls, including lifestyle centers and outlets, and on street locations. Sales at these stores are derived, to a significant degree, from the volume of customer traffic in those locations and in the surrounding area. Our stores historically benefited from the ability of shopping malls and centers to generate customer traffic near our stores. Our sales volume and customer traffic may be adversely affected by, among other things:

- continued shift of consumer shopping to e-commerce;
- a decrease in popularity of shopping malls or centers in which a significant number of our stores are located;
- the closing of a shopping mall's or center's "anchor" store or the stores of other key tenants, or;
- economic downturns in Canada, the United States or regionally;
- increases in fuel prices;
- changes in consumer demographics;
- deterioration in the financial condition of shopping mall and center operators or developers that could, for example, limit their ability to maintain and improve their facilities.

A reduction in customer traffic as a result of these or any other factors could have a material adverse effect on our business and results of operations.

In addition, severe weather conditions and other catastrophic occurrences in areas in which we have stores may have a material adverse effect on our results of operations at those locations. Such conditions may result in physical damage to our stores, loss of inventory, decreases in customer traffic and closure of one or more of our stores. Any of these factors may disrupt our business and have a material adverse effect on our financial condition and results of operations.

If we are unable to attract, train, assimilate and retain employees that embody our culture, including store personnel, store and district managers and regional directors, we may not be able to grow or successfully operate our business.

Our success depends in part upon our ability to attract, train, assimilate and retain a sufficient number of employees, including Tea Guides, store managers, district managers and regional directors, who understand and appreciate our culture, are able to represent our brand effectively and establish credibility with our customers. If we are unable to hire and retain store personnel capable of consistently providing a high-level of customer service, as demonstrated by their enthusiasm for our culture, understanding of our customers and knowledge of the loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories, food and beverages we offer, our ability to open new stores may be impaired, the performance of our existing and new stores could be materially adversely affected and our brand image may be negatively impacted. In addition, the rate of employee turnover in the retail industry is typically high and finding qualified candidates to fill positions may be difficult. Any failure to meet our staffing needs or any material increases in team member turnover rates could have a material adverse effect on our business or results of operations. We also rely on temporary or seasonal personnel to staff our stores and distribution centers. We may not be

able to find adequate temporary or seasonal personnel to staff our operations when needed, which may strain our existing personnel and negatively affect our operations.

Because our business is highly concentrated on a single, discretionary product category, namely tea, which includes loose-leaf teas, pre-packaged teas, tea sachets, and tea-related gifts, accessories, food and beverages, we are vulnerable to changes in consumer preferences and in economic conditions affecting disposable income that could harm our financial results.

Our business is not diversified and consists primarily of developing, sourcing, marketing and selling loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories, food and beverages. Consumer preferences often change rapidly and without warning, moving from one trend to another among many retail concepts. Therefore, our business is substantially dependent on our ability to educate consumers on the many positive attributes of tea and anticipate shifts in consumer tastes. Any future shifts in consumer preferences away from the consumption of beverages brewed from premium loose-leaf teas would also have a material adverse effect on our results of operations. Consumer purchases of specialty retail products, including our products, are historically affected by economic conditions such as changes in employment, salary and wage levels, the availability of consumer credit, inflation, interest rates, tax rates, fuel prices and the level of consumer confidence in prevailing and future economic conditions. These discretionary consumer purchases may decline during recessionary periods or at other times when disposable income is lower. Our financial performance may become susceptible to economic and other conditions in regions where we have a significant number of stores. Our continued success will depend, in part, on our ability to anticipate, identify and respond quickly to changing consumer preferences and economic conditions.

We rely on independent certification for a number of our products and our marketing of products marked “organic”, “fair trade” and “Kosher”. Loss of certification within our supply chain or as related to our manufacturing process or failure to comply with government regulations pertaining to the use of the term organic could harm our business.

We rely on independent certification, such as certifications of our products as “organic,” “Fair Trade,” or “Kosher,” to differentiate some of our products from others. We offer one of the largest certified organic collections of tea in North America amongst branded tea retailers. We must comply with the requirements of independent organizations or certification authorities in order to label our products as certified. The loss of any independent certifications could adversely affect our marketplace position, which could harm our business.

In addition, the U.S. Department of Agriculture and the Canadian Food Inspection Agency require that our certified organic products meet certain consistent, uniform standards. Compliance with such regulations could pose a significant burden on some of our suppliers, which could cause a disruption in some of our product offerings. Moreover, in the event of actual or alleged non-compliance, we might be forced to find an alternative supplier, which could adversely affect our business, results of operations and financial condition.

Our success depends, in part, on our ability to source, develop and market new varieties of teas and tea blends, tea-related gifts, accessories, food and beverages that meet our high standards and customer preferences.

We currently offer approximately 135 varieties of teas and tea blends, including approximately 75 new teas and tea blends each year, and a wide assortment of tea-related gifts, accessories and food. Our success depends in part on our ability to continually innovate, develop, source and market new varieties of loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories, food and beverages that both meet our standards for quality and appeal to customers’ preferences. We have conducted extensive customer market research in order to target our development, however, failure to innovate, develop, source and market new varieties of loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories, food and beverages that consumers want to buy could lead to a decrease in our sales and profitability.

We may experience negative effects to our brand and reputation from real or perceived quality or safety issues with our tea, tea accessories and food and beverages, which could have an adverse effect on our operating results.

We believe our customers rely on us to provide them with high-quality teas, tea accessories and food and beverages. Concerns regarding the safety of our teas, tea accessories and food and beverages or the safety and quality of our supply chain could cause consumers to avoid purchasing certain products from us or to seek alternative sources of tea, tea accessories and food and beverages, even if the basis for the concern has been addressed or is outside of our control. Adverse publicity about these concerns, whether or not ultimately based on fact, and whether or not involving teas, tea accessories and food and beverages sold at our stores, could discourage consumers from buying our teas, tea accessories and food and beverages and have an adverse effect on our brand, reputation and operating results.

Furthermore, the sale of teas, tea accessories and food and beverages entails a risk of product liability claims and the resulting negative publicity. For example, tea supplied to us could contain contaminants that, if not detected by us, could result in illness or death upon their consumption. Similarly, tea accessories and food and beverages could contain contaminants or contain design or manufacturing defects that could result in illness, injury or death. It is possible that product liability claims will be asserted against us in the future.

We may also be subject to involuntary product recalls or may voluntarily conduct a product recall. The costs associated with any future product recall could, individually and in the aggregate, be significant in any given fiscal year. In addition, any product recall, regardless of direct costs of the recall, may harm consumer perceptions of our teas, tea accessories and food and beverages and have a negative impact on our future sales and results of operations.

Any loss of confidence on the part of our customers in the safety and quality of our teas, tea accessories and food and beverages would be difficult and costly to overcome. Any such adverse effect could be exacerbated by our position in the market as a purveyor of quality teas, tea accessories and food and beverages and could significantly reduce our brand value. Issues regarding the safety of any teas, tea accessories and food and beverages sold by us, regardless of the cause, could have a substantial and adverse effect on our sales and operating results.

Use of social media may adversely affect our reputation or subject us to fines or other penalties.

Use of social media platforms and similar devices, including blogs, social media platforms, and other forms of Internet-based communications allows individuals access to a broad audience of consumers and other interested persons. As laws and regulations rapidly evolve to govern the use of these platforms and devices, the failure by us, our employees or third parties acting at our direction to abide by applicable laws and regulations in the use of these platforms and devices could adversely affect our reputation or subject us to fines or other penalties.

Consumers value readily available information concerning retailers and their goods and services and often act on such information without further investigation and without regard to its accuracy. Information concerning us may be posted on social media platforms and similar devices by unaffiliated third parties, whether seeking to pass themselves off as us or not, at any time, which may be adverse to our reputation or business. The harm may be immediate without affording us an opportunity for redress or correction.

Because we rely on a limited number of third-party suppliers and manufacturers, we may not be able to obtain quality products on a timely basis or in sufficient quantities.

We rely on a limited number of vendors to supply us with straight tea and specially blended teas on a continuous basis. Our financial performance depends in large part on our ability to purchase tea in sufficient quantities at competitive prices from these vendors. In general, we do not have long-term purchase contracts or other contractual assurances of continued supply, pricing or exclusive access to products from these vendors.

Any of our suppliers or manufacturers could discontinue supplying us with teas in sufficient quantities for a variety of reasons. The benefits we currently experience from our supplier and manufacturer relationships could be adversely affected if they:

- raise the prices they charge us;
- discontinue selling products to us;
- sell similar or identical products to our competitors; or
- enter into arrangements with competitors that could impair our ability to sell our suppliers' and manufacturers' products, including by giving our competitors exclusive licensing arrangements or exclusive access to tea blends or limiting our access to such arrangements or blends.

During Fiscal 2017, our five largest vendors represented approximately 78% of our total loose-leaf tea inventory purchases. Any disruption to these relationships could have a material adverse effect on our business.

Events that adversely affect our vendors could impair our ability to obtain inventory in the quantities and at the quality that we desire. Such events include difficulties or problems with our vendors' businesses, finances, labor relations, ability to import raw materials, costs, production, insurance and reputation, as well as natural disasters or other catastrophic occurrences.

More generally, if we experience significant increased demand for our loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories, food and beverages, or need to replace an existing vendor, additional supplies or additional manufacturing capacity may not be available when required on terms that are acceptable to us, or at all, and that any new vendor may not allocate sufficient capacity to us in order to meet our requirements, fill our orders in a timely manner or meet our strict quality requirements. In the event we are required to find new sources of supply, we may encounter delays in production, inconsistencies in quality and added costs as a result of the time it takes to train our suppliers and manufacturers in our methods, products and quality control standards. In particular, the loss of a tea vendor would necessitate that we work with our new vendors to replicate our tea blends, which could result in our inability to sell such tea blends for a period of time or in a change of quality in our tea blends. Any delays, interruption or increased costs in the supply of loose-leaf teas or the manufacture of our pre-packaged teas, tea sachets and tea-related gifts, accessories and food could have an adverse effect on our ability to meet customer demand for our products and result in lower sales and profitability both in the short and long term.

A shortage in the supply, a decrease in the quality or an increase in the price of tea and ingredients used in our tea blends, as a result of weather conditions, earthquakes, crop disease, pests or other natural or manmade causes could impose significant costs and losses on our business.

The supply and price of tea and ingredients used in our tea blends are subject to fluctuation, depending on demand and other factors outside of our control. The supply, quality and price of our teas and other ingredients can be affected by multiple factors in countries that produce tea or other ingredients, including political and economic conditions, civil and labor unrest, adverse weather conditions, including floods, drought and temperature extremes, earthquakes, tsunamis, and other natural disasters and related occurrences. This risk is particularly true with respect to regions or countries from which we source a significant percentage of our products. In extreme cases, entire tea harvests may be lost or may be negatively impacted in some geographic areas. These factors can increase costs and decrease sales, which may have a material adverse effect on our business, results of operations and financial condition.

Tea and other ingredients may be vulnerable to crop disease and pests, which may vary in severity and effect. The costs to control disease and pest damage vary depending on the severity of the damage and the extent of the plantings affected. Moreover, available technologies to control such conditions may not continue to be effective. These conditions can increase costs and decrease sales, which may have a material adverse effect on our business, results of operations and financial condition.

Our success depends substantially upon the retention of our senior management, and turnover of senior management could harm our business.

Our future success is substantially dependent on continued contributions of our senior management team and the retention of key members of our senior management, including Joel Silver, our current President and Chief Executive Officer, Howard Tafler, our current Chief Financial Officer and the other members of our executive team. We have had significant management turnover over the past 18 months. While we rebuilt almost 50% of the management team and filled all open positions in Fiscal 2017, our largest shareholder, Rainy Day, has publicly attacked the efforts of our management team. Significant turnover in our senior management could further deplete our institutional knowledge held by our existing senior management team. If we lose key executives or if any such personnel fails to perform in his or her current position, or if we are unable to attract and retain skilled personnel as needed, our business could suffer. We depend on the skills and abilities of these key personnel in managing the development, manufacturing, technical, marketing and sales aspects of our business, any part of which could be harmed by further turnover. In addition, investors and analysts could view any such departure negatively, which could cause the price of our common shares to decline.

We rely significantly on information technology systems and any failure, inadequacy, interruption or security failure of those systems could harm our ability to operate our business effectively.

We rely on our information technology systems to effectively manage our business data, communications, point-of-sale, supply chain, order entry and fulfillment, inventory and warehouse and distribution centers and other business processes. The failure of our systems to perform as we anticipate could disrupt our business and result in transaction errors, processing inefficiencies and the loss of sales, causing our business to suffer. Despite any precautions we may take, our information technology systems may be vulnerable to damage or interruption from circumstances beyond our control, including fire, natural disasters, systems failures, power outages, viruses, security breaches, cyber-attacks and terrorism, including breaches of our transaction processing or other systems that could result in the compromise of confidential company, customer or employee data. We maintain disaster recovery procedures, but there is no guarantee that these will be adequate in all circumstances. Any such damage or interruption could have a material adverse effect on our business, cause us to face significant fines, customer notice obligations or costly litigation, harm our reputation with our customers, require us to expend significant time and expense developing, maintaining or upgrading our information technology systems or prevent us from paying our vendors or employees, receiving payments from our customers or performing other information technology, administrative or outsourcing services on a timely basis. Furthermore, our ability to conduct our website operations may be affected by changes in foreign, state, provincial and federal privacy laws and we could incur significant costs in complying with the multitude of foreign, state, provincial and federal laws regarding the unauthorized disclosure of personal information. Although we carry business interruption insurance, our coverage may not be sufficient to compensate us for potentially significant losses in connection with the risks described above.

In addition, we are dependent on third-party hardware and software providers, including our website. We sell merchandise over the Internet through our website, which represents a growing percentage of our overall net sales. The successful operation of our e-commerce business depends on our ability to maintain the efficient and continuous operation of our website and our fulfillment operations, and to provide a shopping experience that will generate orders and return visits to our site. Our e-commerce operations are subject to numerous risks, including rapid technology change, unanticipated operating problems, credit card fraud and system failures or security breaches and the costs to address and remedy such failures or breaches. Additionally, our website operations as well as other information systems, may be affected by our reliance on third-party hardware and software providers, whose products and services are not within our control, making it more difficult for us to correct any defects; technology changes; risks related to the failure of computer systems through which we conduct our website operations; telecommunications failures; security breaches or attempts thereof; and, similar disruptions. Third-party hardware and software providers may not continue to make their products available to us on acceptable terms or at all and such providers may not maintain policies and practices regarding data privacy and security in compliance with all applicable laws. Any impairment in our relationships with such providers could have an adverse effect on our business.

Our marketing programs, digital initiatives and use of consumer information are governed by an evolving set of laws and enforcement trends and unfavorable changes in those laws or trends, or our failure to comply with existing or future laws, could substantially harm our business and results of operations.

We collect, maintain and use data, including personally identifiable information, provided to us through online activities and other customer interactions in our business. Our current and future marketing programs depend on our ability to collect, maintain and use this information, and our ability to do so is subject to evolving international and U.S. and Canadian federal, state and/or provincial laws and enforcement trends with respect to the foregoing. We strive to comply with all applicable laws and other legal obligations relating to privacy, data protection and consumer protection, including those relating to the use of data for marketing purposes. It is possible, however, that these requirements may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another, may conflict with other rules or may conflict with our practices. If so, we may suffer damage to our reputation and be subject to proceedings or actions against us by governmental entities or others. Any such proceeding or action could hurt our reputation, force us to spend significant amounts to defend our practices, distract our management, increase our costs of doing business and result in monetary liability.

In addition, as data privacy and marketing laws change, we may incur additional costs to ensure we remain in compliance. If applicable data privacy and marketing laws become more restrictive at the international, federal, state or provincial levels, our compliance costs may increase, our ability to effectively engage customers via personalized marketing may decrease, our investment in our e-commerce platform may not be fully realized, our opportunities for growth may be curtailed by our compliance capabilities or reputational harm and our potential liability for security breaches may increase.

Data security breaches could negatively affect our reputation, credibility and business.

We collect and store personal information relating to our customers and employees, including their personally identifiable information, and rely on third parties for the operation of our e-commerce site and for the various social media tools and websites we use as part of our marketing strategy. Consumers are increasingly concerned over the security of personal information transmitted over the Internet (or through other mechanisms), consumer identity theft and user privacy. Any perceived, attempted or actual unauthorized disclosure of personally identifiable information regarding our employees, customers or website visitors could harm our reputation and credibility, reduce our e-commerce sales, impair our ability to attract website visitors, reduce our ability to attract and retain customers and result in litigation against us or the imposition of significant fines or penalties and could require us to expend significant time and expense developing, maintaining or upgrading our information technology systems or prevent us from paying our vendors or employees, receiving payments from our customers or performing other information. We cannot assure you that any of our third-party service providers with access to such personally identifiable information will maintain policies and practices regarding data privacy and security in compliance with all applicable laws, or that they will not experience data security breaches or attempts thereof which could have a corresponding adverse effect on our business.

Recently, data security breaches suffered by well-known companies and institutions have attracted a substantial amount of media attention, prompting new foreign, federal, provincial and state laws and legislative proposals addressing data privacy and security, as well as increased data protection obligations imposed on merchants by credit card issuers. As a result, we may become subject to more extensive requirements to protect the customer information that we process in connection with the purchase of our products, resulting in increased compliance costs.

Fluctuations in our results of operations for the fourth fiscal quarter have a disproportionate effect on our overall financial condition and results of operations.

Our business is seasonal and, historically, we have realized a higher portion of our sales, net income and cash flow from operations in the fourth fiscal quarter, due to the impact of the holiday selling season. Any factors that harm our fourth fiscal quarter operating results, including disruptions in our supply chain, ability of our supply chain to handle higher volumes, adverse weather or unfavorable economic conditions, could have a disproportionate effect on our results of operations for the entire fiscal year.

In order to prepare for our peak shopping season, we must order and maintain higher quantities of inventory than we would carry at other times of the year. As a result, our working capital requirements also fluctuate during the year, increasing in the second and third fiscal quarters in anticipation of the fourth fiscal quarter. Any unanticipated decline in demand for our loose-leaf teas, pre-packaged teas, tea sachets, tea-related gifts, accessories and food during our peak shopping season could require us to sell excess inventory at a substantial markdown, which could diminish our brand and reduce our sales and gross profit.

Our quarterly results of operations may also fluctuate significantly as a result of a variety of other factors, including the timing of new store openings and the sales contributed by new stores. As a result, historical period-to-period comparisons of our sales and operating results are not necessarily indicative of future period-to-period results. You should not rely on the results of a single fiscal quarter, particularly the fourth fiscal quarter holiday season, as an indication of our annual results or our future performance.

Third-party failure to adequately receive, warehouse and ship our merchandise to our stores and e-commerce customers could result in lost sales or reduced demand for our teas, tea accessories and food and beverages.

We currently rely upon third-party warehouse facilities for the majority of our product receipts from vendors and shipments to our stores and e-commerce customers. Our utilization of third-party warehouse services for our merchandise is subject to risks, including employee strikes or their information technology systems failure. If we change warehousing companies, we could face logistical difficulties that could adversely affect our receipts and delivery of merchandise and we would incur costs and expend resources in connection with such change. Moreover, we may not be able to obtain terms as favorable as those we receive from our current third-party transportation providers in Canada and the United States that we currently use, which in turn would increase our costs and thereby adversely affect our operating results.

In addition, we currently rely upon third-party transportation providers for all of our product shipments from our distribution centers to our stores and e-commerce customers. Our utilization of third-party delivery services for our shipments is subject to risk, including increases in fuel prices, which would increase our shipping costs, employee strikes and inclement weather, which may affect third parties' abilities to provide delivery services that adequately meet our shipping needs. If we change shipping companies, we could face logistical difficulties that could adversely affect deliveries, and we would incur costs and expend resources in connection with such change. Moreover, we may not be able to obtain terms as favorable as those we receive from the third-party transportation providers in Canada and the United States that we currently use, which in turn would increase our costs and thereby adversely affect our operating results.

Our ability to source our loose-leaf teas, pre-packaged teas, tea sachets and tea-related gifts, accessories and food profitably or at all could be hurt if new trade restrictions are imposed or existing trade restrictions become more burdensome.

All of our teas and ingredients used in our blends are currently grown, and a substantial majority of our pre-packaged teas, tea sachets and tea-related gifts, accessories and food is currently manufactured outside of the United States and Canada. The United States, Canada, and the countries in which our products are produced or sold internationally have imposed and may impose additional quotas, duties, tariffs, or other restrictions or regulations, or may adversely adjust prevailing quota, duty or tariff levels. Countries impose, modify and remove tariffs and other trade restrictions in response to a diverse array of factors, including global and national economic and political conditions that make it impossible for us to predict future developments regarding tariffs and other trade restrictions. Trade restrictions, including tariffs, quotas, embargoes, safeguards and customs restrictions, could increase the cost or reduce the supply of teas, tea accessories and food available to us or may require us to modify our supply chain organization or other current business practices, any of which could harm our business, financial condition and results of operations.

In addition, there is a risk that our suppliers and manufacturers could fail to comply with applicable regulations, which could lead to investigations by the United States, Canadian or foreign government agencies responsible for international trade compliance. Resulting penalties or enforcement actions could delay future imports or exports or otherwise negatively affect our business.

Fluctuations in foreign currency exchange rates could harm our results of operations as well as the price of common shares and any dividends that we may pay.

Sales in the United States accounted for approximately 14%, 16%, and 17% of our total sales for Fiscal 2015, Fiscal 2016 and Fiscal 2017, respectively. The reporting currency for our combined consolidated financial statements is the Canadian dollar. Changes in exchange rates between the Canadian dollar and the U.S. dollar may have a significant, and potentially adverse, effect on our results of operations. Because we recognize sales in the United States in U.S. dollars, if the U.S. dollar weakens against the Canadian dollar, it would have a negative impact on our U.S. operating results upon translation of those results into Canadian dollars for the purposes of consolidation. Any hypothetical reduction in sales could be partially or completely offset by lower cost of sales and lower selling, general and administration expenses that are generated in U.S. dollars.

In addition, a majority of the purchases we make from our suppliers are denominated in U.S. dollars. As a result, a depreciation of the Canadian dollar against the U.S. dollar increases the cost of acquiring those supplies in Canadian dollars, which negatively affects our gross profit margin. During Fiscal 2017, we entered into forward contracts to fix the exchange rate of our expected U.S. dollar purchases in respect to our inventory. However, these may be inadequate in offsetting any gains and losses in foreign currency transactions, and such gains or losses could have a significant, and potentially adverse, effect on our results of operations.

Our earnings per share are reported in Canadian dollars, and accordingly may be translated into U.S. dollars by analysts or our investors. Given the foregoing, the value of an investment in our common shares to a U.S. shareholder will fluctuate as the U.S. dollar rises and falls against the Canadian dollar. Our decision to declare a dividend depends on results of operations reported in Canadian dollars, and we will declare dividends, if any, in Canadian dollars. As a result, U.S. and other shareholders seeking U.S. dollar total returns, including increases in the share price and dividends paid, are subject to foreign exchange risk as the U.S. dollar rises and falls against the Canadian dollar.

A widespread health epidemic could adversely affect our business.

Our business could be severely affected by a widespread regional, national or global health epidemic. A widespread health epidemic may cause customers to avoid public gathering places such as our stores or otherwise change their shopping behaviors. Additionally, a widespread health epidemic could adversely affect our business by disrupting production of products to our stores and by affecting our ability to appropriately staff our stores.

Changes in accounting standards may materially affect reporting of our financial condition and results from operations.

Accounting principles as per the International Financial Reporting Standards (“IFRS”) and related accounting pronouncements, implementation guidelines, and interpretations for many aspects of our business, such as accounting for inventories, intangible assets, store closures, sales, leases, insurance, income taxes, stock-based compensation, are complex and involved subjective judgements. Changes in these rules or their interpretation may significantly change or add significant volatility to our reported income or loss without a comparable underlying change in cash flows from operations. As a result, changes in accounting standards may materially affect our reported financial condition and results from operations.

Specifically, changes to financial accounting standards will require operating leases to be recognized on our balance sheet. We have significant obligations relating to our current operating leases, as all our existing stores are subject to leases.

The International Accounting Standards Board (“IASB”) released IFRS 16, “Leases” (“IFRS 16”) replacing IAS 17, “Leases”. This standard requires lessees to recognize assets and liabilities for most leases. 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.

Changes to estimates related to our property, fixtures and equipment or operating results that are lower than our current estimates at certain shop locations may cause us to incur impairment charges on certain long-lived assets, which may adversely affect our results of operations.

In accordance with accounting guidance as it relates to the impairment of long-lived assets, we make certain estimates and projections with regard to individual store operations, as well as our overall performance, in connection with our impairment analyses for long-lived assets. When impairment triggers are deemed to exist for any location, the recoverable amount is compared to its carrying value. If the carrying value exceeds the recoverable amount, an impairment charge equal to the difference between the carrying value and recoverable amount is recorded. The projections of future cash flows used in these analyses require the use of judgment and a number of estimates and projections of future operating results. If actual results differ from our estimates, additional charges for asset impairments may be required in the future. We have experienced significant impairment charges. If future impairment charges are significant, our reported operating results would be adversely affected.

We are subject to potential challenges relating to overtime pay and other regulations that affect our employees, which could cause our business, financial condition, results of operations or cash flows to suffer.

Various labor laws, including Canadian federal and provincial laws and U.S. federal and state laws, among others, govern our relationship with our employees and affect our operating costs. These laws include minimum wage requirements, overtime pay, unemployment tax rates, workers' compensation rates and citizenship requirements. These laws change frequently and may be difficult to interpret and apply. In particular, as a retailer, we may be subject to challenges regarding the application of overtime and related pay regulations to our employees. A determination that we do not comply with these laws could harm our brand image, business, financial condition and results of operation. Additional government-imposed increases in minimum wages, overtime pay, paid leaves of absence or mandated health benefits could also cause our business, financial condition, results of operations or cash flows to suffer.

If we face labor shortages or increased labor costs, our results of operations and our growth could be adversely affected.

Labor is a significant component of the cost of operating our business. Our ability to meet labor needs while controlling labor costs is subject to external factors, such as employment levels, prevailing wage rates, minimum wage legislation, changing demographics, health and other insurance costs and governmental labor and employment requirements. In the event of increasing wage rates, if we fail to increase our wages competitively, the quality of our workforce could decline, while increasing our wages could cause our earnings to decrease. If we face labor shortages or increased labor costs because of increased competition for employees from our competitors and other industries, higher employee-turnover rates, unionization of farm workers or increases in the federal- or state-mandated minimum wage, change in exempt and non-exempt status, or other employee benefits costs (including costs associated with health insurance coverage or workers' compensation insurance), our operating expenses could increase and our business, financial condition and results of operations could be materially and adversely affected.

Litigation may adversely affect our business, financial condition, results of operations or liquidity.

Our business is subject to the risk of litigation by employees, consumers, vendors, competitors, intellectual property rights holders, shareholders, government agencies and others through private actions, class actions, administrative proceedings, regulatory actions or other litigation. The outcome of litigation, particularly class action lawsuits, regulatory actions and intellectual property claims, is inherently difficult to assess or quantify. Plaintiffs in

these types of lawsuits may seek recovery of very large or indeterminate amounts, and the magnitude of the potential loss relating to these lawsuits may remain unknown for substantial periods of time. In addition, certain of these lawsuits, if decided adversely to us or settled by us, may result in liability material to our financial statements as a whole or may negatively affect our operating results if changes to our business operation are required. Regardless of the outcome or merit, the cost to defend future litigation may be significant and result in the diversion of management and other company resources. There also may be adverse publicity associated with litigation that could negatively affect customer perception of our business, regardless of whether the allegations are valid or whether we are ultimately found liable. As a result, litigation may adversely affect our business, financial condition, results of operations or liquidity.

Our failure to comply with existing or new regulations, both in the United States and Canada, or an adverse action regarding product claims or advertising could have a material adverse effect on our results of operations and financial condition.

Our business operations, including labeling, advertising, sourcing, distribution and sale of our products, are subject to regulation by various federal, state and local government entities and agencies, particularly the Food and Drug Administration (“FDA”), the Federal Trade Commission (“FTC”) and the Office of Foreign Asset Control (“OFAC”) in the United States, as well as Canadian entities and agencies, including the Canadian Food Inspection Agency. From time to time, we may be subject to challenges to our marketing, advertising or product claims in litigation or governmental, administrative or other regulatory proceedings. Failure to comply with applicable regulations or withstand such challenges could result in changes in our supply chain, product labeling, packaging or advertising, loss of market acceptance of the product by consumers, additional recordkeeping requirements, injunctions, product withdrawals, recalls, product seizures, fines, monetary settlements or criminal prosecution. Any of these actions could have a material adverse effect on our results of operations and financial condition.

In addition, consumers who allege that they were deceived by any statements that were made in advertising or labeling could bring a lawsuit against us under consumer protection laws. If we were subject to any such claims, while we would defend ourselves against such claims, we may ultimately be unsuccessful in our defense. Defending ourselves against such claims, regardless of their merit and ultimate outcome, would likely result in a significant distraction for management, be lengthy and costly and could adversely affect our results of operations and financial condition. In addition, the negative publicity surrounding any such claims could harm our reputation and brand image.

We may not be able to protect our intellectual property adequately, which could harm the value of our brand and adversely affect our business.

We believe that our intellectual property has substantial value and has contributed significantly to the success of our business. We pursue the registration of our domain names, trademarks, service marks and patentable technology in Canada, the United States and in certain other jurisdictions. In particular, our trademarks, including our registered DAVIDsTEA and DAVIDsTEA logo design trademarks and the unregistered names of a significant number of the varieties of specially blended teas that we sell, are valuable assets that reinforce the distinctiveness of our brand and our customers’ favorable perception of our stores.

We also strive to protect our intellectual property rights by relying on federal, state and common law rights, as well as contractual restrictions with our employees, contractors (including those who develop, source, manufacture, store and distribute our tea blends, tea accessories and other tea-related merchandise), vendors and other third parties. However, we may not enter into confidentiality and/or invention assignment agreements with every employee, contractor and service provider to protect our proprietary information and intellectual property ownership rights. Those agreements that we do execute may be breached, resulting in the unauthorized use or disclosure of our proprietary information. Individuals not subject to invention assignments agreements may make adverse ownership claims to our current and future intellectual property, and even the existence of executed confidentiality agreements may not deter independent development of similar intellectual property by others. In addition, although we have exclusivity agreements with each of our significant suppliers who performs blending services for us, or who has access to our designs, we may not be able to successfully protect the tea blends and designs to which such suppliers have access under trade secret laws, and the periods for exclusivity governing our tea blends last for periods as brief as 18 months. Unauthorized disclosure of or claims to our intellectual property or confidential information may adversely affect our business.

From time to time, third parties have used our trade dress and/or sold our products using our name without our consent, and, we believe, have infringed or misappropriated our intellectual property rights. We respond to these actions on a case-by-case basis and where appropriate may commence litigation to protect our intellectual property rights. However, we may not be able to detect unauthorized use of our intellectual property or to take appropriate steps to enforce, defend and assert our intellectual property in all instances.

Effective trade secret, patent, copyright, trademark and domain name protection is expensive to obtain, develop and maintain, in terms of both initial and ongoing registration or prosecution requirements and expenses and the costs of defending our rights. Our trademark rights and related registrations may be challenged in the future and could be opposed, canceled or narrowed. Our failure to register or protect our trademarks could prevent us in the future from using our trademarks or challenging third parties who use names and logos similar to our trademarks, which may in turn cause customer confusion, impede our marketing efforts, negatively affect customers' perception of our brand, stores and products, and adversely affect our sales and profitability. Moreover, intellectual property proceedings and infringement claims brought by or against us could result in substantial costs and a significant distraction for management and have a negative impact on our business. We cannot assure you that we are not infringing or violating, and have not infringed or violated, any third-party intellectual property rights, or that we will not be accused of doing so in the future.

In addition, although we have also taken steps to protect our intellectual property rights internationally, the laws of certain foreign countries may not protect intellectual property to the same extent as do the laws of the United States and Canada and mechanisms for enforcement of intellectual property rights may be inadequate in those countries. Other entities may have rights to trademarks that contain portions of our marks or may have registered similar or competing marks in foreign countries. There may also be other prior registrations in other foreign countries of which we are not aware. We may need to expend additional resources to defend our trademarks in these countries, and the inability to defend such trademarks could impair our brand or adversely affect the growth of our business internationally.

We are subject to the risks associated with leasing substantial amounts of space and are required to make substantial lease payments under our operating leases. Any failure to make these lease payments when due would likely harm our business, profitability and results of operations.

We do not own any real estate. Instead, we lease all of our store locations, our corporate offices in Montréal, Canada and a distribution center in Montréal, Canada. Our store leases typically have ten-year terms and generally require us to pay total rent per square foot that is reflective of our small average store square footage and premium locations. Many of our lease agreements have defined escalating rent provisions over the initial term and any extensions. Our substantial operating lease obligations could have significant negative consequences, including:

- requiring that an increased portion of our cash from operations and available cash on hand be applied to pay our lease obligations, thus reducing liquidity available for other purposes;
- increasing our vulnerability to adverse general economic and industry conditions;
- limiting our flexibility to plan for or react to changes in our business or in the industry in which we compete; and
- limiting our ability to obtain additional financing.

We depend on cash flow from operations to pay our lease expenses, finance our growth capital requirements and fulfill our other cash needs. If our business does not generate sufficient cash flow from operating activities to fund these requirements, we may not be able to achieve our growth plans, fund our other liquidity and capital needs or ultimately service our lease expenses, which would harm our business.

If an existing or future store is not profitable, and we decide to close it, we may nonetheless remain committed to perform our obligations under the applicable lease including, among other things, paying the base rent for the balance of the lease term. Moreover, even if a lease has an early cancellation clause, we may not satisfy the contractual requirements for early cancellation under that lease. In addition, as our leases expire, we may fail to negotiate renewals on commercially acceptable terms or at all, which could cause us to close stores in desirable locations. Even if we are able to renew existing leases, the terms of such renewal may not be as attractive as the expiring lease, which could

materially and adversely affect our results of operations. Of our current stores, two (2) store leases expire without an option to renew in Fiscal 2018 and two (2) store leases expire without an option to renew in Fiscal 2019. Our inability to enter into new leases, renew existing leases on terms acceptable to us, or be released from our obligations under leases for stores that we close could materially adversely affect us.

Our ability to use our net operating loss carryforwards in the United States may be subject to limitation in the event we experience an “ownership change.”

Under Section 382 of the Internal Revenue Code of 1986, as amended, our ability to utilize net operating loss carryforwards in any taxable year may be limited if we experience an “ownership change.” A Section 382 “ownership change” generally occurs if one or more shareholders or groups of shareholders who own at least 5% of our common shares increase their ownership by more than 50 percentage points over their lowest ownership percentage within a rolling three-year period. Any such limitation on the timing of utilizing our net operating loss carryforwards would increase the use of cash to settle our tax obligations. Accordingly, the application of Section 382 could have a material effect on the use of our net operating loss carryforwards, which could adversely affect our future cash flow from operations.

Changes in effective tax rates or adverse outcomes resulting from examination of our income or other tax returns could adversely affect our results from operations and financial condition.

We are subject to taxes by the U.S. federal and state tax authorities as well as Canadian federal, provincial and local tax authorities, and our tax liabilities will be affected by the allocation of profits and expenses to differing jurisdictions. Our future effective tax rates could be subject to volatility or adversely affected by a number of factors, including:

- changes in the valuation of our deferred tax assets and liabilities, including as a result of the tax reform bill in the United States known as the Tax Cuts and Jobs Act;
- expected timing and amount of the release of any tax valuation allowance;
- tax effects of stock-based compensation;
- changes in tax laws, regulations or interpretations thereof; or
- future earnings being lower than anticipated in jurisdictions where we have lower statutory tax rates and higher than anticipated earnings in jurisdictions where we have higher statutory tax rates.

In addition, we may be subject to audits of our income, sales and other transaction taxes by these tax authorities. Outcomes from these audits could have an adverse effect on our operating results and financial condition.

Risks Relating to Ownership of Our Common Shares

Our largest shareholder owns approximately 46% of our common shares, which may limit our minority shareholders’ ability to influence corporate matters.

Our largest shareholder, Rainy Day Investments, Ltd. (“Rainy Day”) owns approximately 46% of our common shares. Rainy Day may have the ability to influence the outcome of any corporate transaction or other matter submitted to shareholders for approval and the interests of Rainy Day may differ from the interests of our other shareholders.

Rainy Day, as our largest shareholder, has significant influence in electing our directors and, consequently, has a substantial say in the appointment of our executive officers, our management policies and strategic direction. In addition, certain matters, such as amendments to our articles of incorporation or votes regarding a potential merger or a sale of all or substantially all of our assets, require approval of at least two thirds of our shareholders; Rainy Day’s approval will be required to achieve any such threshold. Accordingly, should the interests of Rainy Day differ from those of other shareholders, the other shareholders are highly susceptible to the influence of Rainy Day’s votes.

Shareholder activism, including public criticism of our company or our management team or litigation, may adversely affect our stock price.

Responding to actions by activist stockholders can be costly and time-consuming and may divert the attention of management and our employees. We have experienced this recently in responding to the actions by Rainy Day, who has nominated a dissident slate of directors for election at our shareholders' meeting, to which our other significant shareholders have expressed disagreement. The review, consideration, and response to public announcements or criticism by any activist shareholder, or litigation initiated by such shareholders, requires the expenditure of significant time and resources by us. Such public disagreements, or a proxy contest for the election of directors at our annual meeting, could require us to incur significant legal fees and proxy solicitation expenses, may negatively affect our stock price, potentially result in litigation, and may have other material adverse effects on our business.

If we are unable to implement and maintain effective internal control over financial reporting in the future, we may fail to prevent or detect material misstatements in our financial statements, in which case investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common shares may be negatively affected.

As a public company, we are required to maintain internal controls over financial reporting and to report any material weaknesses in such internal controls. Our independent registered public accounting firm is not required to express an opinion as to the effectiveness of our internal control over financial reporting until after we are no longer an "emerging growth company," as defined in the JOBS Act. At such time, however, our independent registered public accounting firm may issue a report that is adverse in the event it is not satisfied with the level at which our internal control over financial reporting is documented, designed or operating.

The process of designing, implementing, and testing the internal control over financial reporting required to comply with this obligation is time-consuming, costly and complicated. If we identify material weaknesses in our internal control over financial reporting, if we are unable to comply with the requirements of Section 404 of the Sarbanes-Oxley Act in a timely manner or if our management is unable to report that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting once we are no longer an "emerging growth company," investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common shares could be negatively affected. We could also become subject to investigations by the NASDAQ Global Market on which our securities are listed, the SEC, or other regulatory authorities, which could require additional financial and management resources.

Our stock price may be volatile or may decline

Our common shares have traded as high as US\$29.97 and as low as US\$3.20 during the period from our IPO to June 8, 2018.

An active, liquid and orderly market for our common shares may not be sustained, which could depress the trading price of our common shares. An inactive market may also impair our ability to raise capital to continue to fund operations by selling shares and may impair our ability to acquire other companies or technologies by using our shares as consideration. In addition, broad market and industry factors, most of which we cannot control, may harm the price of our common shares, regardless of our actual operating performance. In addition, securities markets worldwide have experienced, and are likely to continue to experience, significant price and volume fluctuations. This market volatility, as well as general economic, market and political conditions and Canadian dollar exchange rate relative to the U.S. dollar, could subject the market price of our shares to wide price fluctuations regardless of our operating performance. Our operating results and the trading price of our shares may fluctuate in response to various factors, including:

- conditions or trends affecting our industry or the economy globally; in particular, in the retail sales environment;

- stock market price and volume fluctuations of other publicly traded companies and, in particular, those that are in the retail industry;
- fluctuations of the Canadian dollar exchange rate relative to the U.S. dollar;
- variations in our operating performance and the performance of our competitors;
- seasonal fluctuations;
- our entry into new markets;
- timing of new store openings and our levels of comparable sales;
- actual or anticipated fluctuations in our quarterly financial and operating results or other operating metrics, such as comparable store sales, that may be used by the investment community;
- changes in financial estimates by us or by any securities analysts who might cover our shares;
- issuance of new or changed securities analysts' reports or recommendations;
- loss of visibility as to investor expectations as a result of a lack of published reports from industry analysts;
- actions and announcements by us or our competitors, including new product offerings, significant acquisitions, strategic partnerships or divestitures;
- sales, or anticipated sales, of large blocks of our shares, including sales by our directors, officers or significant shareholders;
- additions or departures of key personnel;
- significant developments relating to our relationships with business partners, vendors and distributors;
- regulatory developments negatively affecting our industry;
- changes in accounting standards, policies, guidance, interpretation or principles;
- volatility in our share price, which may lead to higher share-based compensation expense under applicable accounting standards;
- speculation about our business in the press or investment community;
- investors' perception of the retail industry in general and our Company in particular; and
- other events beyond our control such as major catastrophic events, weather and war.

These and other factors, many of which are beyond our control, may cause our operating results and the market price and demand for our shares to fluctuate substantially. Fluctuations in our quarterly operating results could limit or prevent investors from readily selling their shares and may otherwise negatively affect the market price and liquidity of our shares. In addition, in the past, securities class action litigation has often been instituted against companies following periods of volatility in their stock price. If any of our shareholders brought a lawsuit against us, we could incur substantial costs defending the lawsuit. Such a lawsuit could also divert the time and attention of our management from our business, which could significantly harm our profitability and reputation.

Our articles, bylaws and certain Canadian legislation contain provisions that may have the effect of delaying or preventing a change in control.

Certain provisions of our articles of amendment and bylaws, together or separately, could discourage potential acquisition proposals, delay or prevent a change in control and limit the price that certain investors may be willing to pay for our common shares.

For instance, our bylaws contain provisions that establish certain advance notice procedures for nomination of candidates for election as directors at shareholders' meetings.

The *Investment Canada Act* requires that a "non-Canadian," as defined therein, file an application for review with the Minister responsible for the Investment Canada Act and obtain approval of the Minister prior to acquiring control of a Canadian business, where prescribed financial thresholds are exceeded. Otherwise, there are no limitations either under the laws of Canada or in our articles on the rights of non-Canadians to hold or vote our common shares.

Any of these provisions may discourage a potential acquirer from proposing or completing a transaction that may have otherwise presented a premium to our shareholders.

Because we are a federally incorporated Canadian corporation and the majority of our directors and officers are resident in Canada, it may be difficult for investors in the United States to enforce civil liabilities against us based solely upon the federal securities laws of the United States.

We are a federally incorporated Canadian corporation with our principal place of business in Canada. A majority of our directors and officers and the auditors named herein are residents of Canada and all or a substantial portion of our assets and those of such persons are located outside the United States. Consequently, it may be difficult for U.S. investors to effect service of process within the United States upon us or our directors or officers or such auditors who are not residents of the United States, or to realize in the United States upon judgments of courts of the United States predicated upon civil liabilities under the Securities Act. Investors should not assume that Canadian courts: (1) would enforce judgments of U.S. courts obtained in actions against us or such persons predicated upon the civil liability provisions of the U.S. federal securities laws or the securities or “blue sky” laws of any state within the United States or (2) would enforce, in original actions, liabilities against us or such persons predicated upon the U.S. federal securities laws or any such state securities or blue sky laws.

We may lose our foreign private issuer status in the future, which could result in significant additional costs and expenses.

As discussed above, we are a foreign private issuer, and therefore, we are not required to comply with all of the periodic disclosure and current reporting requirements of the Exchange Act. The determination of foreign private issuer status is made annually on the last business day of an issuer’s most recently completed second fiscal quarter, and, accordingly, the next determination will be made with respect to us on August 4, 2018. We would lose our foreign private issuer status if, for example, more than 50% of our common shares is directly or indirectly held by residents of the United States on August 4, 2018 and we fail to meet additional requirements necessary to maintain our foreign private issuer status. If we lose our foreign private issuer status on this date, we will be required to file with the SEC periodic reports on U.S. domestic issuer forms beginning at the end of this fiscal year and report our operating results in U.S. GAAP. We will also have to mandatorily comply with U.S. federal proxy requirements, and our officers, directors and principal shareholders will become subject to the short-swing profit disclosure and recovery provisions of Section 16 of the Exchange Act. In addition, we will lose our ability to rely upon exemptions from certain corporate governance requirements under the listing rules of The NASDAQ Global Market. As a U.S. listed public company that is not a foreign private issuer, we will incur significant additional legal, accounting and other expenses that we do not incur as a foreign private issuer, and accounting, reporting and other expenses in order to maintain a listing on a U.S. securities exchange. These expenses will relate to, among other things, the obligation to reconcile our financial information that is reported according to IFRS to U.S. GAAP and to report future results according to U.S. GAAP.

There could be adverse tax consequence for our shareholders in the United States if we are a passive foreign investment company.

Under United States federal income tax laws, if a company is, or for any past period was, a passive foreign investment company (“PFIC”), it could have adverse United States federal income tax consequences to U.S. shareholders even if the company is no longer a PFIC. The determination of whether we are a PFIC is a factual determination made annually based on all the facts and circumstances and thus is subject to change, and the principles and methodology used in determining whether a company is a PFIC are subject to interpretation. While we do not believe that we currently are or have been a PFIC, we could be a PFIC in the future. United States purchasers of our common shares are urged to consult their tax advisors concerning United States federal income tax consequences of holding our common shares if we are considered to be a PFIC.

If we are a PFIC, U.S. holders would be subject to adverse U.S. federal income tax consequences, such as ineligibility for any preferred tax rates on capital gains or on actual or deemed dividends, interest charges on certain taxes treated as deferred, and additional reporting requirements under U.S. federal income tax laws or regulations. Whether or not U.S. holders make a timely qualified electing fund, or QEF, election or mark-to-market election may affect the U.S. federal income tax consequences to U.S. holders with respect to the acquisition, ownership and disposition of our common shares and any distributions such U.S. holders may receive. Investors should consult their own tax advisors regarding all aspects of the application of the PFIC rules to our common shares.

Item 2. Unregistered Sales of Equity Securities**Recent Sales of Unregistered Securities**

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

(a) Exhibits:

- | | |
|------|---|
| 31.1 | Principal Executive Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to the Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Principal Financial Officer Certification Pursuant to Securities Exchange Act Rules 13a-14 and 15d-14 as Adopted Pursuant to the Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Principal Financial Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

DAVIDsTEA INC.

Date: June 13, 2018

By: /s/ Joel Silver

Name: Joel Silver

Title: President and Chief Executive Officer

**CERTIFICATION PURSUANT TO
SECURITIES EXCHANGE ACT RULES 13a-14 and 15d-14
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Joel Silver, President and Chief Executive Officer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended May 5, 2018 of DAVIDsTEA Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: June 13, 2018

/s/ Joel Silver

Joel Silver

President and Chief Executive Officer

**CERTIFICATION PURSUANT TO
SECURITIES EXCHANGE ACT RULES 13a-14 and 15d-14
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Howard Tafler, Chief Financial Officer, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q for the fiscal quarter ended May 5, 2018 of DAVIDsTEA Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: June 13, 2018

/s/ Howard Tafler
Howard Tafler
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of DAVIDsTEA Inc. (the “Company”) on Form 10-Q for the period ended May 5, 2018, as filed with the Securities and Exchange Commission (the “Report”), I, Joel Silver, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that based on my knowledge:

- 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 13, 2018

/s/ Joel Silver

Joel Silver

President and Chief Executive Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of DAVIDsTEA Inc. (the “Company”) on Form 10-Q for the period ended May 5, 2018, as filed with the Securities and Exchange Commission (the “Report”), I, Howard Tafler, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that based on my knowledge:

- 1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- 2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: June 13, 2018

/s/ Howard Tafler

Howard Tafler
Chief Financial Officer