

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 on Form 10-Q 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 2019" are to the Company's fiscal year ending February 1, 2020. 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. All references to "Fiscal 2015" are to the Company's fiscal year ended January 30, 2016.

The Company's fiscal year ends on the Saturday closest to the end of January, typically resulting in a 52-week year, but occasionally giving rise to an additional week, resulting in a 53-week year. The 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 239 company-operated DAVIDsTEA stores as of August 4, 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.

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 quarters 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 the 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 beginning 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 beginning on page 24 of this Quarterly Report on Form 10-Q.

Finance Costs. Finance costs consist of cash and imputed non-cash charges related to our credit, 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 beginning 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:

	<u>For the three months ended</u>		<u>For the six months ended</u>	
	<u>August 4,</u>	<u>July 29,</u>	<u>August 4,</u>	<u>July 29,</u>
	<u>2018</u>	<u>2017</u>	<u>2018</u>	<u>2017</u>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Consolidated statement of income (loss) data:				
Sales	\$ 40,167	\$ 45,687	\$ 85,953	\$ 94,356
Cost of sales	22,824	25,482	45,918	49,969
Gross profit	17,343	20,205	40,035	44,387
Selling, general and administration expenses	31,350	27,816	55,746	51,969
Results from operating activities	(14,007)	(7,611)	(15,711)	(7,582)
Finance costs	78	157	157	288
Finance income	(215)	(135)	(452)	(271)
Loss before income taxes	(13,870)	(7,633)	(15,416)	(7,599)
Recovery of income tax	(3,872)	(2,070)	(4,216)	(1,674)
Net loss	\$ (9,998)	\$ (5,563)	\$ (11,200)	\$ (5,925)
Percentage of sales:				
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	56.8%	55.8%	53.4%	53.0%
Gross profit	43.2%	44.2%	46.6%	47.0%
Selling, general and administration expenses	78.0%	60.9%	64.9%	55.1%
Results from operating activities	(34.8%)	(16.7%)	(18.3%)	(8.1%)
Finance costs	0.2%	0.3%	0.1%	0.3%
Finance income	(0.5%)	(0.3%)	(0.5%)	(0.3%)
Loss before income taxes	(34.5%)	(16.7%)	(17.9%)	(8.1%)
Recovery of income tax	(9.6%)	(4.5%)	(4.9%)	(1.8%)
Net loss	(24.9%)	(12.2%)	(13.0%)	(6.3%)
Other financial and operations data:				
Adjusted EBITDA (1)	\$ (5,564)	\$ (2,234)	\$ (5,964)	\$ (691)
Adjusted EBITDA as a percentage of sales	(13.9%)	(4.9%)	(6.9%)	(0.7%)
Number of stores at end of period	239	236	239	236
Comparable sales decline for period (2)	(14.8%)	(0.9%)	(10.8%)	(3.4%)

(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 provide 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)	For the three months ended		For the six months ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Selling, general and administration expenses	31,350	27,816	55,746	51,969
Executive separation costs (a)	(717)	(962)	(717)	(962)
Impairment of property and equipment (b)	(2,560)	(2,313)	(2,560)	(2,313)
Impact of onerous contracts (c)	(714)	1,360	802	2,775
Strategic review and proxy contest costs (d)	(2,717)	—	(3,511)	—
Adjusted selling, general and administration expenses	\$ 24,642	\$ 25,901	\$ 49,760	\$ 51,469

- (a) Executive separation costs represent mainly salary owed to certain former executives as part of their separation of employment from the Company. The three and six-month periods ended July 29, 2017 include \$150 of stock-based compensation relating to the vesting of equity awards pursuant to the separation agreement.
- (b) Represents costs related to impairment of property and equipment for stores.
- (c) Represents provision, non-cash reversals, and utilization related to certain stores where the unavoidable costs of meeting the obligations under the lease agreements are expected to exceed the economic benefits expected to be received from the contract.
- (d) Represents costs related to a corporate strategic review process as well as costs related to the proxy contest which culminated at the Company's annual meeting held on June 14, 2018. Costs for the three and six months ended August 4, 2018 include \$4 and \$389, respectively, related to the strategic review process, \$868 for incremental directors and officers run-off insurance costs incurred prior to the annual meeting on June 14, 2018, and \$1,845 and \$2,254, respectively, for costs incurred in connection with the proxy contest, including \$957 paid to Rainy Day Investments Ltd., a controlling shareholder, for third-party costs incurred by it, as approved by the independent members of the Board of Directors of the Company.

Reconciliation of Adjusted results from operating activities

(in thousands)	For the three months ended		For the six months ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Results from operating activities	(14,007)	(7,611)	(15,711)	(7,582)
Executive separation costs (a)	717	962	717	962
Impairment of property and equipment (b)	2,560	2,313	2,560	2,313
Impact of onerous contracts (c)	714	(1,360)	(802)	(2,775)
Strategic review and proxy contest costs (d)	2,717	—	3,511	—
Adjusted results from operating activities	\$ (7,299)	\$ (5,696)	\$ (9,725)	\$ (7,082)

- (a) Executive separation costs related to salary represent mainly salary owed to the former executives as part of their separation of employment from the Company. The three and six-month periods ended July 29, 2017 include \$150 of stock-based compensation relating to the vesting of equity awards pursuant to the separation agreement.
- (b) Represents costs related to impairment of property and equipment for stores.
- (c) Represents provision, non-cash reversals, and utilization related to certain stores where the unavoidable costs of meeting the obligations under the lease agreements are expected to exceed the economic benefits expected to be received from the contract.
- (d) Represents costs related to a corporate strategic review process as well as costs related to the proxy contest which culminated at the Company's annual meeting held on June 14, 2018. Costs for the three and six months ended August 4, 2018 include \$4 and \$389, respectively, related to the strategic review process, \$868 for incremental directors and officers run-off insurance costs incurred prior to the annual meeting on June 14, 2018, and \$1,845 and \$2,254, respectively, for costs incurred in connection with the proxy contest, including \$957 paid to Rainy Day Investments Ltd., a controlling shareholder, for third-party costs incurred by it, as approved by the independent members of the Board of Directors of the Company.

Reconciliation of Adjusted EBITDA to our net income (loss)

(in thousands)	For the three months ended		For the six months ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Net loss	\$ (9,998)	\$ (5,563)	\$ (11,200)	\$ (5,925)
Finance costs	78	157	157	288
Finance income	(215)	(135)	(452)	(271)
Depreciation and amortization	2,068	2,586	3,936	4,932
Loss on disposal of property and equipment	14	24	14	30
Recovery of income tax	(3,872)	(2,070)	(4,216)	(1,674)
EBITDA	\$ (11,925)	\$ (5,001)	\$ (11,761)	\$ (2,620)
Additional adjustments:				
Stock-based compensation expense (reversal) (a)	(393)	802	(98)	1,376
Executive separation costs related to salary (b)	717	812	717	812
Impairment of property and equipment (c)	2,560	2,313	2,560	2,313
Impact of onerous contracts (d)	714	(1,360)	(802)	(2,775)
Deferred rent (e)	46	200	(91)	203
Strategic review and proxy contest costs (f)	2,717	—	3,511	—
Adjusted EBITDA	\$ (5,564)	\$ (2,234)	\$ (5,964)	\$ (691)

- (a) Represents non-cash net stock-based compensation expense (reversal).
- (b) Executive separation costs related to salary represent salary owed to former executives as part of their separation of employment from the Company.

- (c) Represents costs related to impairment of property and equipment for stores.
- (d) Represents provision, non-cash reversals, and utilization related to certain stores where the unavoidable costs of meeting the obligations under the lease agreements are expected to exceed the economic benefits expected to be received from the contract.
- (e) Represents the extent to which the Company's annual rent expense has been above or below its cash rent payments.
- (f) Represents costs related to a corporate strategic review process as well as costs related to the proxy contest which culminated at the Company's annual meeting held on June 14, 2018. Costs for the three and six months ended August 4, 2018 include \$4 and \$389, respectively, related to the strategic review process, \$868 for incremental directors and officers run-off insurance costs incurred prior to the annual meeting on June 14, 2018, and \$1,845 and \$2,254, respectively, for costs incurred in connection with the proxy contest, including \$957 paid to Rainy Day Investments, a controlling shareholder, for third-party costs incurred by it, as approved by the independent members of the Board of Directors of the Company.

Three Months Ended August 4, 2018 to Three Months Ended July 29, 2017

Sales. Sales for the three months ended August 4, 2018 decreased 12.0%, or \$5.5 million, to \$40.2 million from \$45.7 million for the three months ended July 29, 2017, comprising a \$6.3 million decrease in comparable sales and a \$0.8 million increase in non-comparable sales. Comparable sales decreased by 14.8% and non-comparable sales increased primarily due to an additional three net new stores opened during the three months ended August 4, 2018 as compared to the three months ended July 29, 2017. Comparable sales decreased as the Company's product offering did not resonate with customers, the Company was less promotional as it moved to reduce its dependency on discounting, and had less product available for its semi-annual sale, as the Company was in a better seasonal inventory position compared to the prior year quarter. The Company has revised its merchandising strategy, which was not reflected in its second quarter assortment.

Gross Profit. Gross profit decreased by 14.4%, or \$2.9 million, to \$17.3 million for the three months ended August 4, 2018 from \$20.2 million for the three months ended July 29, 2017. Gross profit as a percentage of sales decreased to 43.2% for the three months ended August 4, 2018 from 44.2% for the three months ended July 29, 2017. Gross profit as a percent of sales was down from the prior year quarter as product margin increases, driven by less promotional activity and a shift in product sales mix, were offset by a deleveraging of fixed costs due to negative comparable sales.

Selling, General and Administration Expenses. Selling, general and administration expenses increased by 12.9%, or \$3.6 million, to \$31.4 million in the three months ended August 4, 2018 from \$27.8 million for the three months ended July 29, 2017. As a percentage of sales, selling, general and administration expenses increased to 78.0% for the three months ended August 4, 2018 as compared to 60.9% for the three months ended July 29, 2017. Excluding the impact of executive separation costs, impairment of property and equipment, onerous contracts and costs related to the strategic review and proxy contest for the three months ended August 4, 2018 and July 29, 2017, selling, general and administration expenses decreased to \$24.6 million in the three months ended August 4, 2018 from \$25.9 million for the three months ended July 29, 2017, due to lower stock-based compensation expense and depreciation and amortization expenses compared to the three months ended July 29, 2017. As a percentage of sales, selling, general and administration expenses excluding these items increased to 61.2% from 56.7%, due to deleveraging of fixed costs as a result of the negative comparable sales this quarter.

Results from Operating Activities. Results from operating activities decreased by \$6.4 million, to \$(14.0) million in the three months ended August 4, 2018 from \$(7.6) million in the three months ended July 29, 2017. Excluding the impact of executive separation costs, impairment of property and equipment, onerous contracts and the strategic review and proxy contest for the three months ended August 4, 2018 and July 29, 2017, results from operating activities decreased by \$1.6 million, to \$(7.3) million from \$(5.7) million, for the three months ended July 29, 2017.

Provision (Recovery) for Income Taxes. Recovery for income taxes increased by \$1.8 million, to \$3.9 million for the three months ended August 4, 2018 from \$2.1 million for the three months ended July 29, 2017. The increase in the recovery for income taxes was due primarily to lower results from operating activities. Our effective tax rates were 27.9% and 27.1% for the three months ended August 4, 2018 and July 29, 2017, respectively. The effective tax rate increased slightly due to certain non-deductible and other items for the three-months ended August 4, 2018.

Six Months Ended August 4, 2018 Compared to Six Months Ended July 29, 2017

Sales. Sales for the six months ended August 4, 2018 decreased 8.9%, or \$8.4 million, to \$86.0 million from \$94.4 million for the six months ended July 29, 2017, comprising a \$9.4 million decrease in comparable sales and a \$1.0 million increase in non-comparable sales. Comparable sales decreased by 10.8% and non-comparable sales increased primarily due to an additional three net new stores opened during the six months ended August 4, 2018 as compared to July 29, 2017. Comparable sales decreased as the Company's product offering did not resonate with its customers, the Company was less promotional, as it moved to reduce its dependency on discounting, and the Company had less product available for its semi-annual sale, as the Company was in a better seasonal inventory position compared to the prior year quarter. The Company has revised its merchandising strategy, which was not reflected in the first and second quarter assortment.

Gross Profit. Gross profit decreased by 9.9%, or \$4.4 million, to \$40.0 million for the six months ended August 4, 2018 from \$44.4 million for the six months ended July 29, 2017. Gross profit as a percentage of sales decreased to 46.6% for the six months ended August 4, 2018 from 47.0% for the six months ended July 29, 2017. Gross profit as a percent of sales was down from the prior year period as product margin increases, driven by less promotional activity and a shift in product sales mix, were offset by a deleveraging of fixed costs due to negative comparable sales.

Selling, General and Administration Expenses. Selling, general and administration expenses increased by 7.1%, or \$3.7 million, to \$55.7 million in the six months ended August 4, 2018 from \$52.0 million for the six months ended July 29, 2017. As a percentage of sales, selling, general and administration expenses increased to 64.9% for the six months ended August 4, 2018 as compared to 55.1% for the six months ended July 29, 2017. Excluding the impact of separation costs, impairment of property and equipment, onerous contracts and costs related to the strategic review and proxy contest for the six months ended August 4, 2018 and July 29, 2017, selling, general and administration expenses decreased to \$49.8 million in the six months ended August 4, 2018 from \$51.5 million for the six months ended July 29, 2017, primarily due to lower stock-based compensation expense and depreciation and amortization expenses compared to the six months ended July 29, 2017. As a percentage of sales, selling, general and administration expenses excluding the impact of these items increased to 57.9% from 54.6%, due to deleveraging of fixed costs as a result of the negative comparable sales this quarter.

Results from Operating Activities. Results from operating activities decreased by \$8.1 million, to \$(15.7) million in the six months ended August 4, 2018 from \$(7.6) million in the six months ended July 29, 2017. Excluding the impact of executive separation costs, impairment of property and equipment, onerous contracts and costs related to the strategic review and proxy contest for the six months ended August 4, 2018 and July 29, 2017, results from operating activities decreased by \$2.6 million, to \$(9.7) million from \$(7.1) million for the six months ended July 29, 2017.

Provision (Recovery) for Income Taxes. Recovery for income taxes increased by \$2.5 million, to a recovery of \$4.2 million for the six months ended August 4, 2018 from a recovery of \$1.7 million for the six months ended July 29, 2017. The increase in the recovery for income taxes was due primarily to lower results from operating activities. The Company's effective tax rates were 27.3% and 22.0% for the six months ended August 4, 2018 and July 29, 2017, respectively. This increase in the effective tax rate is due to non-deductible expenses and other items that result in an income tax expense on a low income before taxes base for the six months ended July 29, 2017.

Liquidity and Capital Resources

As at August 4, 2018, the Company had \$39.6 million of cash primarily held with major Canadian financial institutions. Working capital was \$65.7 million as of August 4, 2018, compared to \$77.2 million as at February 3, 2018.

The Company's primary sources of liquidity are cash on hand and cash flows from operations. The Company's primary cash needs are to support the increase in inventories as it expands the number of its 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.

The Company's primary working capital requirements are for the purchase of store inventory and payment of payroll, rent and other store operating costs. The Company's working capital requirements fluctuate during the year, rising in the second and third fiscal quarters as the Company takes title to increasing quantities of inventory in anticipation of its peak selling season in the fourth fiscal quarter. The Company funded its capital expenditures and working capital requirements from cash on hand and net cash provided by its operating activities.

The Company believes that its cash position, net cash provided by its operating activities will be adequate to finance its planned capital expenditures and working capital requirements for the foreseeable future.

Cash Flow

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

	For the three months ended		For the six months ended	
	August 4, 2018	July 29, 2017	August 4, 2018	July 29, 2017
Cash flows provided by (used in):				
Operating activities	\$(12,438)	\$ 2,819	\$(19,544)	\$(3,842)
Investing activities	(1,881)	(3,551)	(4,391)	(5,797)
Financing activities	74	791	74	1,606
Increase (decrease) in cash	<u>\$(14,245)</u>	<u>\$ 59</u>	<u>\$(23,861)</u>	<u>\$(8,033)</u>

Cash Flows Provided by (Used in) Operating Activities

Net cash used in operating activities decreased to \$(12.4) million for the three months ended August 4, 2018 from \$2.8 million for the three months ended July 29, 2017. The decrease in the cash flows used in operating activities was due primarily to lower results from operations and to an increase in working capital attributed to prepaid rents, due to the timing of quarter end, and higher investments in inventory in comparison to the three months ended July 29, 2017. In Fiscal 2017, the Company generated cash from inventory as it had built up higher levels of inventory going into the year.

Net cash used in operating activities decreased to \$(19.6) million for the six months ended August 4, 2018 from \$(3.8) million for the six months ended July 29, 2017. The decrease in the cash flows used in operating activities was due primarily to lower results from operations and to an increase in working capital attributed to prepaid rents, due to the timing of quarter end, and higher investments in inventory in comparison to the six months ended July 29, 2017. In Fiscal 2017, the Company generated cash from inventory as it had built up higher levels of inventory going into the year.

Cash Flows Provided by (Used in) Investing Activities

Capital expenditures decreased by \$1.7 million, to \$1.9 million for the three months ended August 4, 2018 from \$3.6 million for the three months ended July 29, 2017. The decrease was primarily due to a lower number of new store build-outs and store renovations.

Capital expenditures decreased by \$1.4 million, to \$4.4 million for the six months ended August 4, 2018 from \$5.8 million for the six months ended July 29, 2017. The decrease was primarily due to a lower number of new store build-outs and store renovations.

Cash Flows Provided By Financing Activities

Net cash flows provided by financing activities were \$0.1 million for the three and six months ended August 4, 2018 due to proceeds from share issuances, compared to \$0.8 million and \$1.6 million, respectively, for the three and six months ended July 29, 2017.

Credit Facility with Bank of Montreal

The Company has an amended credit arrangement (the “Amended Credit Agreement”) with the Bank of Montreal (“BMO”) which provides for a two-year revolving facility (“Amended Revolving Facility”). As at August 4, 2018, the Company did not have any borrowings under its Amended 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.

The Amended 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 August 4, 2018 and February 3, 2018, the Company did not have any borrowings under the Amended Revolving Facility

Off-Balance Sheet Arrangements

Other than operating lease obligations, the Company has no off-balance sheet obligations.

Contractual Obligations and Commitments

There have been no significant changes to the Company’s 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

The Company’s discussion and analysis of operating results and financial condition are based upon its financial statements. The preparation of financial statements requires the Company to estimate the effect of various matters that are inherently uncertain as of the date of the financial statements. Each of these required estimates varies in regard to the level of judgment involved and its potential impact on the 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 the Company’s financial position, changes in financial position or results of operations. The Company’s significant accounting policies are discussed under note 3 to its consolidated financial statements for the year ended February 3, 2018 included in the Annual Report on Form 10-K filed with the SEC on 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

As of February 4, 2018, the Company 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 the Company applied prospectively, it has applied IFRS 9 retrospectively, with the initial application date of February 4, 2018. Overall, there was no 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 the Company’s 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 the Company’s 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. IFRIC 23 provides guidance on the accounting for current and deferred tax liabilities and assets in circumstances in which there is uncertainty over income tax treatments. IFRIC 23 is effective for annual periods beginning on or after January 1, 2019. Earlier application is permitted. IFRIC 23 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 the Company’s Annual Report on Form 10-K for the year ended February 3, 2018.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company’s management, with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of its disclosure controls and procedures as of August 4, 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 the Company’s disclosure controls and procedures as of August 4, 2018, the Chief Executive Officer and Chief Financial Officer concluded that, as of such date, the Company’s disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There has been no changes in the Company’s internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the three and six-month periods ended August 4, 2018, that have materially affected or are reasonably likely to materially affect the Company’s internal controls over financial reporting.