

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, 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" in our Annual Report on Form 10-K dated April 12, 2017 and filed on April 13, 2017. Forward-looking statements speak only as of the date of this Quarterly Report on Form 10-Q. 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 2017" are to the Company's fiscal year ending February 3, 2018. All references to "Fiscal 2016" are to the Company's fiscal year ending 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 ending February 3, 2018 covers a 53-week fiscal period. The years ending January 28, 2017 and January 30, 2016 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 236 company-operated DAVIDsTEA stores as of October 28, 2017, and our website, davidstea.com. We are building a brand that seeks to expand the definition of tea with innovative products that consumers can explore in an open and inviting retail environment. We strive to make tea a multi-sensory experience by facilitating interaction with our products through education and sampling so that our customers appreciate the compelling attributes of tea as well as the ease of preparation.

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. Purchases of our products can be impacted by 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.

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, which includes sales to hotels, restaurants and institutions, office and workplace locations and food services, as well as corporate gifting. As we pursue our growth strategy, we expect that a significant percentage of our sales will continue to come from non-comparable sales.

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

Selling, General and Administration Expenses. Selling, general and administration expenses consist of store operating expenses and other general and administration expenses, including store impairments and provision (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 22 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.

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:

	<u>For the three months ended</u>		<u>For the nine months ended</u>	
	<u>October 28,</u> <u>2017</u>	<u>October 29,</u> <u>2016</u>	<u>October 28,</u> <u>2017</u>	<u>October 29,</u> <u>2016</u>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Consolidated statement of income (loss) data:				
Sales	\$ 42,997	\$ 44,134	\$ 137,353	\$ 129,682
Cost of sales	24,625	23,587	74,594	66,072
Gross profit	18,372	20,547	62,759	63,610
Selling, general and administration expenses	27,035	27,187	79,004	71,116
Results from operating activities	(8,663)	(6,640)	(16,245)	(7,506)
Finance costs	327	19	615	55
Finance income	(149)	(125)	(420)	(394)
Loss before income taxes	(8,841)	(6,534)	(16,440)	(7,167)
Income tax recovery	(2,356)	(1,574)	(4,030)	(1,454)
Net loss	\$ (6,485)	\$ (4,960)	\$ (12,410)	\$ (5,713)
Percentage of sales:				
Sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	57.3%	53.4%	54.3%	51.0%
Gross profit	42.7%	46.6%	45.7%	49.0%
Selling, general and administration expenses	62.9%	61.6%	57.5%	54.8%
Results from operating activities	(20.2%)	(15.0%)	(11.8%)	(5.8%)
Finance costs	0.7%	0.0%	0.4%	0.0%
Finance income	(0.3%)	(0.3%)	(0.3%)	(0.3%)
Loss before income taxes	(20.6%)	(14.8%)	(11.9%)	(5.5%)
Income tax recovery	(5.5%)	(3.6%)	(2.9%)	(1.1%)
Net loss	(15.1%)	(11.2%)	(9.0%)	(4.4%)
Other financial and operations data:				
Adjusted EBITDA (1)	\$ (2,887)	\$ 76	\$ (3,578)	\$ 4,823
Adjusted EBITDA as a percentage of sales	(6.7%)	0.2%	(2.6%)	3.7%
Number of stores at end of period	236	225	236	225
Comparable sales growth (decline) for period (2)	(6.8%)	0.8%	(4.5%)	3.5%

(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)	For the three months ended		For the nine months ended	
	October 28, 2017	October 29, 2016	October 28, 2017	October 29, 2016
Selling, general and administration expenses	27,035	27,187	79,004	71,116
Executive separation costs (a)	(1,112)	(594)	(2,074)	(594)
Impairment of property and equipment (b)	(2,658)	(2,516)	(4,971)	(2,516)
Impact of onerous contracts (c)	1,138	(48)	3,913	(48)
Loss on disposal of property and equipment (d)	—	(311)	—	(311)
Adjusted selling, general and administration expenses	\$ 24,403	\$ 23,718	\$ 75,872	\$ 67,647

- (a) For the current year periods, executive separation costs represent salary owed to former executives of \$1,070 and \$1,882 for the three and nine month periods ended October 28, 2017 as part of their separation of employment from the Company and stock-based compensation of \$42 and \$192 for the three and nine month periods ended October 28, 2017 relating to the vesting of equity awards due to the separation of employment from the Company. For the prior year periods, executive separation costs represent salary owed to the former Chief Executive Officer of \$505 payable as part of the separation agreement and stock-based compensation expense of \$89 relating to 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 non-cash costs related to the loss on disposal of property and equipment due to new store concept at an existing store location in the prior year periods.

Reconciliation of Adjusted results from operating activities

(in thousands)	<u>For the three months ended</u>		<u>For the nine months ended</u>	
	<u>October 28,</u> <u>2017</u>	<u>October 29,</u> <u>2016</u>	<u>October 28,</u> <u>2017</u>	<u>October 29,</u> <u>2016</u>
Results from operating activities	(8,663)	(6,640)	(16,245)	(7,506)
Executive separation costs (a)	1,112	594	2,074	594
Impairment of property and equipment (b)	2,658	2,516	4,971	2,516
Impact of onerous contracts (c)	(1,138)	48	(3,913)	48
Loss on disposal of property and equipment (d)	—	311	—	311
Adjusted results from operating activities	\$ (6,031)	\$ (3,171)	\$ (13,113)	\$ (4,037)

- (a) For the current year periods, executive separation costs represent salary owed to former executives of \$1,070 and \$1,882 for the three and nine month periods ended October 28, 2017 as part of their separation of employment from the Company and stock-based compensation of \$42 and \$192 for the three and nine month periods ended October 28, 2017 relating to the vesting of equity awards due to the separation of employment from the Company. For the prior year periods, executive separation costs represent salary owed to the former Chief Executive Officer of \$505 payable as part of the separation agreement and stock-based compensation expense of \$89 relating to 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 non-cash costs related to the loss on disposal of property and equipment due to new store concept at an existing store location in the prior year periods.

Reconciliation of Adjusted EBITDA to our net income (loss)

(in thousands)	<u>For the three months ended</u>		<u>For the nine months ended</u>	
	<u>October 28,</u> <u>2017</u>	<u>October 29,</u> <u>2016</u>	<u>October 28,</u> <u>2017</u>	<u>October 29,</u> <u>2016</u>
Net loss	\$ (6,485)	\$ (4,960)	\$ (12,410)	\$ (5,713)
Finance costs	327	19	615	55
Finance income	(149)	(125)	(420)	(394)
Depreciation and amortization	2,632	2,308	7,564	6,345
Loss on disposal of property and equipment	18	—	48	—
Income tax recovery	(2,356)	(1,574)	(4,030)	(1,454)
EBITDA	\$ (6,013)	\$ (4,332)	\$ (8,633)	\$ (1,161)
Additional adjustments:				
Stock-based compensation expense (a)	362	643	1,738	1,573
Executive separation costs related to salary (b)	1,070	505	1,882	505
Impairment of property and equipment (c)	2,658	2,516	4,971	2,516
Impact of onerous contracts (d)	(1,138)	48	(3,913)	48
Deferred rent (e)	174	385	377	1,031
Loss on disposal of property and equipment (f)	—	311	—	311
Adjusted EBITDA	\$ (2,887)	\$ 76	\$ (3,578)	\$ 4,823

- (a) Represents non-cash stock-based compensation expense.
- (b) For the current year periods, executive separation costs represent salary owed to former executives as part of their separation of employment from the Company. For the prior year periods, executive separation costs represent salary owed to the former Chief Executive Officer as part of the separation agreement.
- (c) Represents costs related to impairment of property and equipment for stores.
- (d) Represents provision, non-cash reversals, and utilization related to certain stores where the unavoidable costs of meeting the obligations under the lease agreements are expected to exceed the economic benefits expected to be received from the contract.
- (e) Represents the extent to which our annual rent expense has been above or below our cash rent payments.
- (f) Represents non-cash costs related to the loss on disposal of property and equipment due to new store concept at an existing store location in the prior year periods.

Three Months Ended October 28, 2017 Compared to Three Months Ended October 29, 2016

Sales. Sales for the three months ended October 28, 2017 decreased 2.5%, or \$1.1 million, to \$43.0 million from \$44.1 million for the three months ended October 29, 2016, comprising a \$2.7 million decrease in comparable sales and a \$1.6 million increase in non-comparable sales. Comparable sales decreased by 6.8% and non-comparable sales increased primarily due to an additional 11 net new stores opened as at October 28, 2017 as compared to October 29, 2016. Comparable sales decreased as we faced a more challenging overall consumer retail backdrop and we also faced challenges with our accessory and kits product assortment. The latter can be explained by a product offering which did not excite the customer and which we are working diligently on improving.

Gross Profit. Gross profit decreased by 10.2%, or \$2.1 million, to \$18.4 million for the three months ended October 28, 2017 from \$20.5 million for the three months ended October 29, 2016. Gross profit as a percentage of sales decreased to 42.7% for the three months ended October 28, 2017, from 46.6% for the three months ended October 29, 2016 primarily due to the planned clearance of seasonal products early in the quarter, additional promotional activity during the quarter, and deleveraging of fixed costs due to the negative 6.8% comparable sales this quarter.

Selling, General and Administration Expenses. Selling, general and administration expenses decreased by 0.7%, or \$0.2 million, to \$27.0 million in the three months ended October 28, 2017 from \$27.2 million for the three

months ended October 29, 2016. As a percentage of sales, selling, general and administration expenses increased to 62.9% for the three months ended October 28, 2017, as compared to 61.6% for the three months ended October 29, 2016. Excluding the impact of executive separation costs, impairment of property and equipment, and onerous contracts for the three months ended October 28, 2017, as well as loss on disposal of property and equipment for the three months ended October 29, 2016, selling, general and administration expenses increased to \$24.4 million in the three months ended October 28, 2017 from \$23.7 million for the three months ended October 29, 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 236 stores as of October 28, 2017 as compared to 225 stores as of October 29, 2016. As a percentage of sales, selling, general and administration expenses excluding these one-time costs increased to 56.7% from 53.7%, attributable to deleveraging of fixed costs due to the negative 6.8% comparable sales this quarter.

Results from Operating Activities. Results from operating activities decreased by \$2.1 million, to \$(8.7) million in the three months ended October 28, 2017 from \$(6.6) million in the three months ended October 29, 2016. Excluding the impact of executive separation costs, impairment of property and equipment, and onerous contracts for the three months ended October 28, 2017, as well as loss on disposal of property and equipment for the three months ended October 29, 2016, results from operating activities decreased by \$2.8 million, to \$(6.0) million from \$(3.2) million for the three months ended October 29, 2016.

Provision for Income Taxes (Recovery). Recovery for income taxes increased by \$0.8 million, to \$2.4 million for the three months ended October 28, 2017 from a recovery for income taxes of \$1.6 million for the three months ended October 29, 2016. The increase in the recovery for income taxes was due primarily to lower results from operating activities. Our effective tax rates were 26.7% and 24.1% for the three months ended October 28, 2017 and October 29, 2016, respectively. This increase in the effective tax rate is due primarily to the non-deductible items relative to the higher loss before income taxes versus the three-months ended October 29, 2016.

Nine Months Ended October 28, 2017 Compared to Nine Months Ended October 29, 2016

Sales. Sales for the nine months ended October 28, 2017 increased 5.9%, or \$7.7 million, to \$137.4 million from \$129.7 million for the nine months ended October 29, 2016, comprising a \$5.5 million decrease in comparable sales and a \$13.2 million increase in non-comparable sales. Comparable sales decreased by 4.5% and non-comparable sales increased primarily due to an additional 11 net new stores opened as at October 28, 2017 as compared to October 29, 2016. Comparable sales decreased as we faced more a challenging overall consumer retail backdrop and we also faced challenges with our accessory and kits product assortment in the third quarter, as described above.

Gross Profit. Gross profit decreased by 1.3%, or \$0.8 million, to \$62.8 million for the nine months ended October 28, 2017 from \$63.6 million for the nine months ended October 29, 2016. Gross profit as a percentage of sales decreased to 45.7% for the nine months ended October 28, 2017, from 49.0% for the nine months ended October 29, 2016 primarily due to the planned clearance of seasonal products, additional promotional activity, and deleveraging of fixed costs due to the negative 4.5% comparable sales for the year-to-date.

Selling, General and Administration Expenses. Selling, general and administration expenses increased by 11.1%, or \$7.9 million, to \$79.0 million in the nine months ended October 28, 2017 from \$71.1 million for the nine months ended October 29, 2016. As a percentage of sales, selling, general and administration expenses increased to 57.5% for the nine months ended October 28, 2017, as compared to 54.8% for the nine months ended October 29, 2016. Excluding the impact of executive separation costs, impairment of property and equipment, and onerous contracts for the nine months ended October 28, 2017, as well as loss on disposal of property and equipment for the nine months ended October 29, 2016, selling, general and administration expenses increased to \$75.9 million in the nine months ended October 28, 2017 from \$67.6 million for the nine months ended October 29, 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 236 stores as of October 28, 2017 as compared to 225 stores as of October 29, 2016. As a percentage of sales, selling, general and administration expenses excluding these one-time costs increased to 55.2% from 52.1%, attributable to deleveraging of fixed costs due to the negative 4.5% comparable sales for the nine months ended October 28, 2017.

Results from Operating Activities. Results from operating activities decreased by \$8.7 million, to \$(16.2) million in the nine months ended October 28, 2017 from \$(7.5) million in the nine months ended October 29, 2016. Excluding the impact of executive separation costs, impairment of property and equipment, and onerous contracts for the nine months ended October 28, 2017, as well as loss on disposal of property and equipment for the nine months ended October 29, 2016, results from operating activities decreased by \$9.1 million, to \$(13.1) million from \$(4.0) million for the nine months ended October 29, 2016.

Provision for Income Taxes (Recovery). Recovery for income taxes increased by \$2.5 million, to a recovery of \$4.0 million for the nine months ended October 28, 2017 from a recovery of \$1.5 million for the nine months ended October 29, 2016. The increase in the recovery for income taxes was due primarily to lower results from operating activities. Our effective tax rates were 24.5% and 20.3% for the nine months ended October 28, 2017 and October 29, 2016, respectively. This increase in the effective tax rate is due primarily to the non-deductible items relative to the higher loss before income taxes versus the nine months ended October 29, 2016.

Liquidity and Capital Resources

As at October 28, 2017 we had \$36.9 million of cash primarily held with major Canadian financial institutions. Our working capital was \$71.8 million as of October 28, 2017, compared to \$78.7 million as at January 28, 2017.

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

Capital expenditures typically vary depending on the timing of new stores openings and infrastructure-related investments. During fiscal 2017, we plan to spend approximately \$13.0-\$15.0 million on capital expenditures. We expect to construct, lease and open 11 new stores in Canada and 5 new stores in the United States, and renovate a number of existing stores. The remainder of the capital budget will be used to make continued investment in our infrastructure.

Our primary working capital requirements are for the purchase of store inventory and payment of payroll, rent and other store operating costs. Our working capital requirements fluctuate during the year, rising in the second and third fiscal quarters as we take title to increasing quantities of inventory in anticipation of our peak selling season in the fourth fiscal quarter. 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:

	<u>For the three months ended</u>		<u>For the nine months ended</u>	
	<u>October 28,</u>	<u>October 29,</u>	<u>October 28,</u>	<u>October 29,</u>
	<u>2017</u>	<u>2016</u>	<u>2017</u>	<u>2016</u>
Cash flows provided by (used in):				
Operating activities	\$ (16,134)	\$ (22,255)	\$ (19,976)	\$ (24,826)
Investing activities	(3,498)	(6,175)	(9,295)	(16,358)
Financing activities	90	962	1,696	1,806
Decrease in cash	\$ (19,542)	\$ (27,468)	\$ (27,575)	\$ (39,378)

Cash Flows Provided by (Used in) Operating Activities

Net cash flows used in operating activities decreased to \$(16.1) million for the three months ended October 28, 2017 from \$(22.3) million for the three months ended October 29, 2016. The decrease in the cash flows used in operating

activities was due primarily to the net loss for the quarter as well as investment in inventory to support the sales for the Holiday season. The improvement compared to last year is due to management efforts to improve inventory productivity.

Net cash used in operating activities decreased to \$(20.0) million for the nine months ended October 28, 2017 from \$(24.8) million for the nine months ended October 29, 2016. The decrease in the cash flows used in operating activities was due primarily to lower results from operating activities, partially offset by a reduction in inventory levels from year-end, as described above.

Cash Flows Provided by (Used in) Investing Activities

Capital expenditures decreased by \$2.7 million, to \$3.5 million for the three months ended October 28, 2017, from \$6.2 million for the three months ended October 29, 2016. This decrease was primarily due to the number of new store build-outs and the timing of investments in infrastructure. We opened 3 new stores for the three months ended October 28, 2017 compared to 17 new stores for the three months ended October 29, 2016.

Capital expenditures decreased by \$7.1 million, to \$9.3 million for the nine months ended October 28, 2017, from \$16.4 million for the nine months ended October 29, 2016. This decrease was primarily due to the number of new store build-outs and the timing of investments in infrastructure. We opened 12 new stores for the nine months ended October 28, 2017 compared to 32 new stores for the nine months ended October 29, 2016.

Cash Flows Provided By Financing Activities

Net cash flows provided by financing activities amounted to \$0.1 million for the three months ended October 28, 2017 due to proceeds from share issuances, compared to \$1.0 million for the three months ended October 29, 2016.

Net cash flows provided by financing activities amounted to \$1.7 million for the nine months ended October 28, 2017 due to proceeds from share issuances, compared to \$1.8 million for the nine months ended October 29, 2016.

Credit Facility with Bank of Montreal

The Company has a credit arrangement (hereinafter referred to as “Credit Agreement”) with the Bank of Montreal (“BMO”). The Credit agreement provides for a three-year revolving term facility, maturing October 31, 2019, in the principal amount of \$20.0 million (which we refers to as the “Revolving Facility”) or the equivalent amount in U.S. dollars, repayable at any time. The Credit Agreement also provides for an accordion feature whereby we may, at any time prior to the end of the term and with the permission of BMO, request an increase to the Revolving Facility by an amount not greater than \$10.0 million. As at October 28, 2017, we did not have any borrowings on the Revolving Facility.

The credit facility contains a number of financial and non-financial covenants that, among other things and subject to certain exceptions, restrict our ability to become guarantor or endorser or otherwise become liable upon any note or other obligation other than in the normal course of business. We also cannot make any dividend payments. As at October 28, 2017, we are in compliance with these covenants.

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 January 28, 2017, 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 January 28, 2017 included in our Annual Report on Form 10-K dated April 12, 2017 and filed on April 13, 2017. There have been no material changes to the critical accounting policies and estimates since January 28, 2017, other than as described below.

Recently Issued Accounting Standards

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

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

IFRS 15, “Revenue from Contracts with Customers” (“IFRS 15”) replaces IAS 11, “Construction Contracts”, and IAS 18, “Revenue”, as well as various interpretations regarding revenue. This standard introduces a single model for recognizing revenue that applies to all contracts with customers, except for contracts that are within the scope of standards on leases, insurance and financial instruments. This standard also requires enhanced disclosures. Adoption of IFRS 15 is mandatory and will be effective for annual periods beginning on or after January 1, 2018. The Company expects that the implementation of IFRS 15 will impact the allocation of revenue that is deferred in relation to its customer loyalty award programs. Revenue is currently allocated to the customer loyalty awards using the residual fair value method. Under IFRS 15, consideration will be allocated between the loyalty program awards and the goods on which the awards were earned, based on their relative stand-alone selling prices. The Company is currently assessing the impact of this change on its consolidated financial statements. As we continue our evaluation, we will further clarify the expected impact of the adoption of the standard, which we do not believe will be material.

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. Early application is permitted, provided the new revenue standard, IFRS 15, has been applied, or is applied at the same date as IFRS 16. The Company has performed a preliminary assessment of the potential impact of the adoption of IFRS 16 on its consolidated financial statements. The Company expects the adoption of IFRS 16 will have a significant impact as the Company will recognize new assets and liabilities for its operating leases of retail stores. In addition, the nature and timing of expenses related to those leases will change as IFRS 16 replaces the straight-line operating lease expense with a depreciation charge for right-of use assets and interest expense on lease liabilities. The Company has not yet determined which transition method

it will apply or whether it will use the optional exemptions or practical expedients under the standard. The Company expects to disclose additional detailed information, including its transition method, any practical expedients elected and estimated quantitative financial effects, before the adoption of IFRS 16.

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

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

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

The Company is in the process of evaluating the impact of adopting the interpretation 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 12, 2017 and filed on April 13, 2017.

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 October 28, 2017. 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 October 28, 2017, 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 nine-month period ended October 28, 2017, that have materially affected or are reasonably likely to materially affect our internal controls over financial reporting.