

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 December 13, 2019, the noon buying rate certified for customs purposes by the U.S. Federal Reserve Bank of New York was US\$1.00 = CAD\$1.3196.

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	
	November 2, 2019 \$	February 2, 2019 \$
ASSETS		
Current		
Cash	28,044	42,074
Accounts and other receivables [Note 12]	5,430	3,681
Inventories [Note 5]	32,638	34,353
Income tax receivable	1,195	4,107
Prepaid expenses and deposits	6,906	8,819
Total current assets	74,213	93,034
Property and equipment	20,557	23,788
Intangible assets	6,454	5,678
Right-of-use assets [Notes 3 and 6]	44,825	—
Total assets	146,049	122,500
LIABILITIES AND EQUITY		
Current		
Trade and other payables	21,155	20,951
Deferred revenue	5,619	6,241
Current portion of provisions [Note 3]	—	3,714
Current portion of lease liabilities [Note 3]	16,291	—
Total current liabilities	43,065	30,906
Deferred rent and lease inducements [Note 3]	—	8,698
Provisions [Note 3]	—	15,440
Non-current portion of lease liabilities [Note 3]	74,074	—
Total liabilities	117,139	55,044
Commitments and contingencies		
Equity		
Share capital [Note 8]	112,835	112,519
Contributed surplus	1,294	1,400
Deficit	(86,575)	(47,960)
Accumulated other comprehensive income	1,356	1,497
Total equity	28,910	67,456
Total liabilities and equity	146,049	122,500

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		For the nine months ended	
		November 2, 2019 \$	November 3, 2018 \$	November 2, 2019 \$	November 3, 2018 \$
Sales	[Note 13]	39,493	43,656	122,925	129,609
Cost of sales		18,139	25,275	53,430	71,193
Gross profit		21,354	18,381	69,495	58,416
Selling, general and administration expenses	[Note 10]	30,670	29,119	90,254	84,865
Results from operating activities		(9,316)	(10,738)	(20,759)	(26,449)
Finance costs		1,699	80	5,305	237
Finance income		(185)	(122)	(570)	(574)
Loss before income taxes		(10,830)	(10,696)	(25,494)	(26,112)
Provision for income tax (recovery)	[Note 9]	—	(1,635)	—	(5,851)
Net loss		(10,830)	(9,061)	(25,494)	(20,261)
Other comprehensive loss					
Items to be reclassified subsequently to income:					
Unrealized net gain on forward exchange contracts	[Note 14]	—	—	—	794
Realized net loss on forward exchange contracts reclassified to inventory		—	(425)	—	(565)
Provision for income tax recovery		—	113	—	(62)
Cumulative translation adjustment		(26)	(62)	(141)	(473)
Other comprehensive income (loss), net of tax		(26)	(374)	(141)	(306)
Total comprehensive loss		(10,856)	(9,435)	(25,635)	(20,567)
Net loss per share:					
Basic and fully diluted	[Note 11]	(0.42)	(0.35)	(0.98)	(0.78)
Weighted average number of shares outstanding					
Basic and fully diluted	[Note 11]	26,068,435	25,992,339	26,048,239	25,862,086

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		For the nine months ended	
	November 2, 2019	November 3, 2018	November 2, 2019	November 3, 2018
	\$	\$	\$	\$
OPERATING ACTIVITIES				
Net loss	(10,830)	(9,061)	(25,494)	(20,261)
Items not affecting cash:				
Depreciation of property and equipment	1,313	1,785	3,997	5,193
Amortization of intangible assets	517	377	1,372	905
Amortization of right-of-use assets	2,938	—	9,153	—
Loss on disposal of property and equipment	—	—	22	14
Impairment of property, equipment and right-of-use assets	2,051	725	7,076	3,285
Interest on lease liabilities	1,699	—	5,305	—
Deferred rent	—	74	—	(17)
Recovery for onerous contracts	—	3,414	—	5,306
Stock-based compensation expense	256	91	526	(7)
Amortization of financing fees	—	21	—	61
Accretion on provisions	—	60	—	177
Deferred income taxes	—	(2,575)	—	(3,921)
Sub-total	(2,056)	(5,089)	1,957	(9,265)
Net change in other non-cash working capital balances related to operations	6,842	(12,948)	6,272	(28,316)
Cash flows related to operating activities	4,786	(18,037)	8,229	(37,581)
FINANCING ACTIVITIES				
Proceed from issuance of common shares pursuant to exercise of stock options	9	8	9	82
Payment of lease liabilities	(5,720)	—	(17,342)	—
Cash flows related to financing activities	(5,711)	8	(17,333)	82
INVESTING ACTIVITIES				
Additions to property and equipment	(44)	(1,752)	(778)	(3,420)
Additions to intangible assets	(485)	(1,128)	(2,148)	(3,851)
Loan advance to a Company controlled by an executive employee	(227)	—	(2,000)	—
Cash flows related to investing activities	(756)	(2,880)	(4,926)	(7,271)
Decrease in cash during the period	(1,681)	(20,909)	(14,030)	(44,770)
Cash, beginning of the period	29,725	39,623	42,074	63,484
Cash, end of the period	28,044	18,714	28,044	18,714
Supplemental Information				
Cash paid for:				
Interest	—	—	—	—
Income taxes (classified as operating activity)	—	7	—	9
Cash received for:				
Interest	217	120	622	563
Income taxes (classified as operating activity)	2,780	—	2,948	—

See accompanying notes.

DAVIDsTEA Inc.

Incorporated under the laws of Canada

INTERIM CONSOLIDATED STATEMENTS OF EQUITY (DEFICIT)

[Unaudited and in thousands of Canadian dollars]

	Share Capital \$	Contributed Surplus \$	Deficit \$	Accumulated Other Comprehensive Income			Total Equity \$
				Accumulated Derivative Financial Instrument Adjustment \$	Accumulated Foreign Currency Translation Adjustment \$	Accumulated Other Comprehensive Income \$	
Balance, February 3, 2018	111,692	2,642	(14,721)	(167)	1,922	1,755	101,368
Net loss for the nine months ended November 3, 2018	—	—	(20,261)	—	—	—	(20,261)
Other comprehensive loss	—	—	—	167	(473)	(306)	(306)
Total comprehensive loss	—	—	(20,261)	167	(473)	(306)	(20,567)
Issuance of common shares	164	(82)	—	—	—	—	82
Common shares issued on vesting of restricted stock units	643	(1,322)	286	—	—	—	(393)
Stock-based compensation expense	—	(7)	—	—	—	—	(7)
Income tax impact associated with stock options	—	(1)	—	—	—	—	(1)
Balance, November 3, 2018	112,499	1,230	(34,696)	—	1,449	1,449	80,482
Balance, February 2, 2019	112,519	1,400	(47,960)	—	1,497	1,497	67,456
IFRS 16 adoption adjustment (1)	—	—	(13,333)	—	—	—	(13,333)
Adjusted balance at beginning of period	112,519	1,400	(61,293)	—	1,497	1,497	54,123
Net loss for the nine months ended November 2, 2019	—	—	(25,494)	—	—	—	(25,494)
Other comprehensive loss	—	—	—	—	(141)	(141)	(141)
Total comprehensive loss	—	—	(25,494)	—	(141)	(141)	(25,635)
Issuance of common shares	13	(4)	—	—	—	—	9
Common shares issued on vesting of restricted stock units	303	(628)	212	—	—	—	(113)
Stock-based compensation expense	—	526	—	—	—	—	526
Balance, November 2, 2019	112,835	1,294	(86,575)	—	1,356	1,356	28,910

(1) Restated – Note 3

See accompanying notes.

DAVIDsTEA Inc.

NOTES TO CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

For the three and nine-month periods ended November 2, 2019 and November 3, 2018 [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 and nine-month periods ended November 2, 2019 were authorized for issue in accordance with a resolution of the Board of Directors on December 20, 2019. 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 2, 2019, 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 2, 2019, other than as disclosed in note 3 below.

3. CHANGES IN ACCOUNTING POLICIES

During the course of the Company’s financial statement close process for the quarter ended November 2, 2019, accounting errors were identified in the assessment of impairment indicators upon completing the store impairment analysis under IAS 36, *Impairment of Assets* (“IAS 36”), subsequent to the adoption of IFRS 16, *Leases* (“IFRS 16”). When appropriately performing the assessment of impairment indicators with respect to the right-of-use assets (“ROU assets”) as at May 4, 2019 and August 3, 2019, impairment charges of \$13,924 and \$5,025 respectively were identified that would have been required to be recognized in the respective periods under the Company’s accounting policy for transition to IFRS 16, which included the use of the practical expedient for assessing impairment. Upon further review, the Company also determined that, pursuant to IFRS standards, its financial statements would be more relevant had they applied IAS 36 to assess impairment of ROU assets as of the date of initial adoption, instead of applying the available practical expedient. Accordingly, the Company elected to voluntarily change its accounting policy to perform an impairment assessment in accordance with IAS 36 at the date of transition to IFRS 16. The Company believes this change is more relevant because it more faithfully depicts the performance of the Company. Subsequent to the retrospective application of the change in accounting policy, the impairment charges were nil and \$5,025 for the quarter ended May 4, 2019 and the two quarters ended August 3, 2019, respectively.

Effects of the restatement

Based on the impairment test performed at February 3, 2019 upon the voluntary change to the Company’s method of transition to IFRS 16 to eliminate the use of the practical expedient, the Company’s ROU assets were impaired upon initial adoption by \$32,487 as compared to the application of the previously recognized onerous lease provisions of \$19,154 against the ROU assets. The difference that results from performing an IAS 36 impairment test at February 3, 2019 and the application of the practical expedient related to onerous leases results from a difference in the application of certain assumptions required under the two standards. The Company previously had recorded a reduction to the deficit of \$1,280 on transition to IFRS 16. After the application of the voluntary change in accounting policy, the deficit increased by \$14,613 to \$61,293. The additional reduction in the initial value of the ROU assets resulted in a decrease in amortization expense in the three-month periods ended May 4, 2019 and August 3, 2019 of \$689 and \$699 respectively.

The following table illustrates the effect of the voluntary change in accounting policy on the adoption of IFRS 16 as at February 3, 2019:

	February 2, 2019	IFRS 16 Adoption	February 3, 2019 As previously reported	Change in policy adjustment	February 3, 2019 Restated
ASSETS					
Right-of-use assets	-	75,596	75,596	(14,613)	60,983
Other assets	122,500	-	122,500	-	122,500
Total assets	122,500	75,596	198,096	(14,613)	183,483
LIABILITIES					
Lease liability	-	102,168	102,168	-	102,168
Deferred rent and lease inducements	8,698	(8,698)	-	-	-
Provisions	19,154	(19,154)	-	-	-
Other liabilities	27,192	-	27,192	-	27,192
Total liabilities	55,044	74,316	129,360	-	129,360
EQUITY					
Deficit	(47,960)	1,280	(46,680)	(14,613)	(61,293)
Other	115,416	-	115,416	-	115,416
Total equity	67,456	1,280	68,736	(14,613)	54,123
TOTAL LIABILITIES AND EQUITY	122,500	75,596	198,096	(14,613)	183,483

IFRS 16 – Leases

IFRS 16, “Leases” (“IFRS 16”) replaces IAS 17, “Leases” and related interpretations. The standard introduces a single on-balance sheet recognition and measurement model for lessees, eliminating the distinction between operating and finance leases. The lessee recognizes a right-of-use asset representing its control of and right to use the underlying asset and a lease liability representing its obligation to make future lease payments. Lessors continue to classify leases as finance and operating leases. Certain exemptions will apply for short-term leases and leases of low value assets. The new standard became effective for annual periods beginning on or after January 1, 2019.

a) Nature of the effect of adoption of IFRS 16 (*restated*)

The Company has adopted IFRS 16 as at February 3, 2019. Substantially all of the Company’s existing leases are real estate leases for its retail stores, warehouse and corporate head office. The adoption of IFRS 16 had a significant impact as the Company recognized new assets and liabilities. 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 elected to apply the modified retrospective method by setting right-of-use assets based on the lease liability at the date of initial application, adjusted by the amount of any prepaid or accrued lease payments with no restatement of the prior comparative period. Upon adoption of IFRS 16, the Company has applied the following practical expedients:

- applying IFRS 16 exclusively to contracts that were previously identified as leases applying IAS 17 at the date of initial application;
- applying a single discount rate to a portfolio of leases with reasonably similar characteristics;
-
- excluding initial direct costs from the measurement of the right-of-use asset at the date of initial application; and
- not separating the lease component and its associated non-lease component.

The effect of adoption of IFRS 16, including the voluntary change in accounting policy applied retroactively, as at February 3, 2019 is as follows:

	February 2, 2019	IFRS 16 Adoption	February 3, 2019 As previously reported	Change in policy adjustment	February 3, 2019 Restated
ASSETS					
Right-of-use assets	-	75,596	75,596	(14,613)	60,983
Other assets	122,500	-	122,500	-	122,500
Total assets	122,500	75,596	198,096	(14,613)	183,483
LIABILITIES					
Lease liability	-	102,168	102,168	-	102,168
Deferred rent and lease inducements	8,698	(8,698)	-	-	-
Provisions	19,154	(19,154)	-	-	-
Other liabilities	27,192	-	27,192	-	27,192
Total liabilities	55,044	74,316	129,360	-	129,360
EQUITY					
Deficit	(47,960)	1,280	(46,680)	(14,613)	(61,293)
Other	115,416	-	115,416	-	115,416
Total equity	67,456	1,280	68,736	(14,613)	54,123
TOTAL LIABILITIES AND EQUITY	122,500	75,596	198,096	(14,613)	183,483

For leases previously classified as operating leases, the Company recorded the right-of-use assets based on the amount equal to the lease liabilities, adjusted for any related prepaid and accrued lease payments previously recognized. Due to this, the Company derecognized an amount of \$8,698 that was previously included under deferred rent and leasehold inducements with a corresponding adjustment to the right-of-use asset.

The excess of onerous lease provision under IAS 37 over right-of-use asset at the date of transition (mainly due to the higher discount rate used to calculate the lease liability and related right-of-use asset) amounted to \$1,280 and was included in deficit.

The lease liabilities as at February 3, 2019 can be reconciled to the operating lease commitments as of February 2, 2019 as follows:

	February 3, 2019 \$
Minimum lease payments under operating lease	116,772
Discounted using a weighted average incremental borrowing rate of 6.63%	(24,484)
Discounted non-lease component associated with lease component pursuant to practical expedient	9,880
	102,168

Operating lease payments, which were previously included in cost of sales on the consolidated statement of income, are replaced with depreciation expenses (included in selling, general and administrative expenses) from the right-of-use asset and interest expense (included under finance costs) from the lease liability.

b) Summary of new accounting policies

Right-of-use assets

The Company recognises right-of-use assets at the commencement date of the lease (i.e., the date the underlying asset is available for use). Right-of-use assets are initially measured at cost, which includes the initial amount of lease liabilities adjusted for any initial direct costs incurred, and lease payments made at or before the commencement date less any lease incentives received.

The right-of-use assets are depreciated on a straight-line basis over the shorter of its estimated useful life and the lease term unless the Company is reasonably certain to obtain ownership of the leased asset at the end of the lease term. In addition the right-of-use assets are subject to impairment and adjusted for any remeasurement of lease liabilities. Amortization expense is recorded in selling, general and administrative expense.

Lease liabilities

At the commencement date of the lease, the Company recognises lease liabilities measured at the present value of lease payments to be made over the lease term. The lease payments include fixed payments (including in-substance fixed payments) less any lease incentives receivable, variable lease payments that depend on an index or a rate. The lease payments also include the exercise price of a purchase option reasonably certain to be exercised by the Company and payments of penalties for terminating a lease, if the lease term reflects the Company exercising the option to terminate. The variable lease payments that do not depend on an index or a rate are recognised as expense in the period on which the event or condition that triggers the payment occurs.

In calculating the present value of lease payments, the Company uses the incremental borrowing rate at the lease commencement date if the interest rate implicit in the lease is not readily determinable. After the commencement date, the amount of lease liabilities is increased to reflect the accretion of interest and reduced for the lease payments made. Interest accretion is recorded as interest expense in finance costs. In addition, the carrying amount of lease liabilities is remeasured if there is a modification, a change in the lease term, a change in the in-substance fixed lease payments or a change in the assessment to purchase the underlying asset. The Company has elected to apply the practical expedient to not separate the lease component and its associated non-lease component.

Short-term leases and leases of low-value assets

The Company applies the short-term lease recognition exemption to its short-term leases of machinery and equipment (i.e., those leases that have a lease term of 12 months or less from the commencement date and do not contain a purchase option). It also applies the lease of low-value assets recognition exemption to leases of office equipment that are considered of low value (i.e., below US \$5,000). Lease payments on short-term leases and leases of low-value assets are recognised as expense on a straight-line basis over the lease term.

Significant judgement in determining the lease term of contracts with renewal options

The Company determines the lease term as the non-cancellable term of the lease, together with any periods covered by an option to extend the lease if it is reasonably certain to be exercised, or any periods covered by an option to terminate the lease, if it is reasonably certain not to be exercised.

The Company has the option, under some of its leases to lease the assets for additional terms of three to five years. The Company applies judgement in evaluating whether it is reasonably certain to exercise the option to renew. That is, it considers all relevant factors that create an economic incentive for it to exercise the renewal, including store performance, expected future performance and past business practice. After the commencement date, the Company reassesses the lease term if there is a significant event or change in circumstances that is within its control and affects its ability to exercise (or not to exercise) the option to renew (e.g., a change in business strategy).

- c) Amounts recognized in the statement of financial position and profit or loss

Set out below are the carrying amounts of the Company's right-of-use assets and lease liabilities and the movements during the period:

	Right-of use assets \$	Lease liability \$
Balance, February 3, 2019	60,983	102,168
Amortization expense	(9,153)	—
Impairment of right-of-use assets	(7,076)	—
Interest Expense	—	5,305
Payments	—	(17,342)
CTA	71	234
Balance, November 2, 2019	44,825	90,365
Presented as:		
Current	—	16,291
Non-Current	44,825	74,074

The Company recognizes variable lease payments of \$409 and \$839 respectively for the three and nine months ended November 2, 2019.

IFRIC 23, “Uncertainty over Income Tax Treatments” (the “Interpretation”), 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 adoption of this interpretation did not have a significant impact on the Company’s 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 2, 2019.

5. INVENTORIES

	November 2, 2019	February 2, 2019
	\$	\$
Finished goods	28,391	28,991
Goods in transit	1,597	3,262
Packaging	2,650	2,100
	<u>32,638</u>	<u>34,353</u>

6. PROPERTY, EQUIPMENT AND RIGHT-OF-USE ASSETS

For the three and nine months ended November 2, 2019, an assessment of impairment indicators was performed which caused the Company to review the recoverable amount of the property, equipment and right-of-use assets for certain cash generating units (“CGUs”) with an indication of impairment. CGUs reviewed included stores performing below the Company’s expectations.

As a result, for the three and nine months ended November 2, 2019, an impairment loss for the right-of-use assets of \$2,051 and \$7,076, respectively, [November 3, 2018 — \$725 and \$3,285 related to store leasehold improvements, furniture and equipment, computer hardware] was recorded in the Canada and U.S. segments for \$949 and \$1,102, respectively, for the three months ended November 2, 2019 and \$3,429 and \$3,647, respectively, for the nine months ended November 2, 2019, respectively [November 3, 2018 — \$725 and nil, respectively, for the three months and \$3,096 and \$189, respectively, for the nine months]. These losses were determined by comparing the carrying amount of the CGU’s net assets with their respective recoverable amounts based on value in use. Value in use of \$1,613 [November 3, 2018 — nil] was determined based on management’s best estimate of expected future cash flows from use over the remaining lease terms, considering historical experience as well as current economic conditions, and was then discounted using a pre-tax discount rate of 11.9% [November 3, 2018 — 11.9%]. A reversal of impairment occurs when previously impaired CGUs see improved financial results. For the three and nine months ended November 2, 2019, no impairment losses were reversed [November 3, 2018 — nil]. Impairment losses are reversed only to the extent that the carrying amounts of the CGU’s net assets do not exceed the carrying amount that would have been determined, net of depreciation, if no impairment loss had been recognized.

7. REVOLVING FACILITY

On June 11, 2018, the Company amended its existing Credit Agreement (the “Amended Credit Agreement”). The Amended Credit Agreement provides for a two year revolving facility (“Amended Revolving Facility”) in the principal amount of \$15,000 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 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. Without the prior written consent of the lender, 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 \$15,000. The Amended Revolving Facility bears interest based on the Company’s adjusted leverage ratio, at the bank’s prime rate, U.S. bank rate or 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 credit facility also contains nonfinancial 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 November 2, 2019, the Company did not have any borrowings under the Amended Revolving Facility.

As at November 2, 2019, the Company is in breach of its fixed charge coverage ratio and certain nonfinancial covenants. BMO has temporarily agreed to forbear from exercising remedies under the Credit Agreement, however the Company cannot borrow under the facility.

The current lending agreement will be terminated on the earlier of (a) January 24, 2020, (b) the Company securing new financing. The Company is in good faith discussions with BMO to install an asset based lending facility that will provide a revolving facility at commercially reasonable terms.

8. SHARE CAPITAL

Authorized

An unlimited number of Common shares.

Issued and outstanding

	November 2, 2019	February 2, 2019
	\$	\$
Share Capital - 26,079,662 Common shares (February 2, 2019 - 26,011,817)	112,835	112,519

During the three and nine-month periods ended November 2, 2019 12,000 stock options were exercised for common shares for cash proceeds of \$9 [November 3, 2018 – 10,000 and 88,135 stock options for 88,135 common shares for cash proceeds of \$8 and \$82, respectively and 36,418 common shares for a non-cash settlement of nil and \$121 respectively].

In addition, during the three and nine-month periods ended November 2, 2019, 6,877 and 55,845 common shares, respectively [November 3, 2018 – 1,128 and 70,668 common shares respectively] were issued in relation to the vesting of restricted stock units (“RSU”), resulting in an increase in share capital of \$30 and \$303, net of tax [November 3, 2018 — \$7 and \$643, net of tax, respectively] and a reduction in contributed surplus of \$67 and \$628, respectively [November 3, 2018 — \$18 and \$1,322, respectively].

Stock-based compensation

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

	For the nine months ended			
	November 2, 2019		November 3, 2018	
	Options outstanding #	Weighted average exercise price \$	Options outstanding #	Weighted average exercise price \$
Outstanding, beginning of year	137,540	7.17	447,779	7.18
Issued	—	—	—	—
Exercised	(12,000)	0.77	(88,135)	2.76
Forfeitures	(35,001)	6.77	(220,791)	8.92
Outstanding, end of period	90,539	8.17	138,853	7.23
Exercisable, end of period	89,120	8.07	75,837	4.84

No stock options were granted during the three and nine-month periods ended November 2, 2019 and November 3, 2018.

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

	For the nine months ended			
	November 2, 2019		November 3, 2018	
	RSUs outstanding #	Weighted average fair value per unit (1) \$	RSUs outstanding #	Weighted average fair value per unit (1) \$
Outstanding, beginning of year	270,976	5.26	289,416	9.70
Granted	804,710	1.93	476,450	4.48
Forfeitures	(112,746)	3.46	(327,479)	6.45
Vested	(78,345)	5.52	(70,668)	9.08
Vested, withheld for tax	(59,134)	5.37	(69,017)	8.91
Outstanding, end of period	825,461	2.22	298,702	5.26

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

During the three and nine-month periods ended November 2, 2019, the Company recognized stock-based compensation expense of \$256 and \$526 respectively [November 3, 2018 — expense of \$91 and a net reversal of stock based compensation of \$7, respectively].

As at November 2, 2019, 1,744,529 common shares remain available for issuance under the 2015 Omnibus Plan.

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				For the nine months ended			
	November 2, 2019		November 3, 2018		November 2, 2019		November 3, 2018	
	%	\$	%	\$	%	\$	%	\$
Income tax recovery — statutory rate	26.8	(2,902)	26.9	(2,873)	26.8	(6,832)	26.9	(7,015)
Increase (decrease) in provision for income tax (recovery) resulting from:								
Non-deductible items	(0.7)	72	(0.4)	38	(0.6)	148	0.1	(31)
Unrecognized deferred income tax assets	(26.1)	2,830	(8.8)	940	(26.2)	6,684	(3.6)	940
Other	—	—	(2.4)	260	—	—	(1.0)	255
Income tax provision (recovery) — effective tax rate	—	—	15.3	(1,635)	—	—	22.4	(5,851)

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

	For the three months ended		For the nine months ended	
	November 2, 2019	November 3, 2018	November 2, 2019	November 3, 2018
	\$	\$	\$	\$
Income tax provision (recovery)				
Current	—	940	—	(1,930)
Deferred	—	(2,575)	—	(3,921)
	<u>—</u>	<u>(1,635)</u>	<u>—</u>	<u>(5,851)</u>

10. SELLING, GENERAL AND ADMINISTRATION EXPENSES

	For the three months ended		For the nine months ended	
	November 2, 2019	November 3, 2018	November 2, 2019	November 3, 2018
	\$	\$	\$	\$
Wages, salaries and employee benefits	15,690	16,767	46,999	49,031
Depreciation of property and equipment	1,313	1,785	3,997	5,193
Amortization of intangible assets	517	377	1,372	905
Amortization right-of-use asset	2,938	—	9,153	—
Loss on disposal of property and equipment	—	—	22	14
Impairment of property, equipment and right-of-use assets	2,051	725	7,076	3,285
Utilization of onerous contract	—	(2,126)	—	(4,820)
Recovery of provision for onerous contracts	—	3,414	—	5,306
Stock-based compensation	256	91	526	(7)
Executive separation cost related to salary	—	123	—	840
Strategic review and proxy contest	—	27	—	3,538
Other selling, general and administration	7,905	7,936	21,109	21,580
	<u>30,670</u>	<u>29,119</u>	<u>90,254</u>	<u>84,865</u>

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		For the nine months ended	
	November 2, 2019	November 3, 2018	November 2, 2019	November 3, 2018
	\$	\$	\$	\$
Net loss for basic EPS	(10,830)	(9,061)	(25,494)	(20,261)
Weighted average number of shares outstanding:				
Basic and fully diluted	26,068,435	25,992,339	26,048,239	25,862,086
Net loss per share:				
Basic and fully diluted	(0.42)	(0.35)	(0.98)	(0.78)

As a result of the net loss during the three and nine-month periods ended November 2, 2019 and November 3, 2018, the stock options and restricted stock units disclosed in Note 8 were anti-dilutive. Accordingly, diluted net loss per share for each period was the same as basic net loss per share.

12. RELATED PARTY DISCLOSURES

Transactions with related parties are measured at the exchange amount, being the consideration established and agreed to by the related parties.

During the three and nine-month periods ended November 2, 2019, the Company purchased merchandise for resale amounting to \$33 and \$48, respectively [November 3, 2018 - \$125 and \$222, respectively], and provided infrastructure and administrative services of

\$163 and \$222, respectively [November 3, 2018 - nil and nil, respectively] from and to a company controlled by one of its executive employees, respectively.

During the three and nine-month periods ended November 2, 2019, the Company purchased a perpetual license rights to a reporting data model and associated intellectual property for nil and \$200 [November 3, 2018 – nil and nil] and spent \$96 and \$164 [November 3, 2018 – nil] for consulting services from a related party of the principal shareholder.

Loan to a Company controlled by one of the Company’s executive employees

During the second quarter of 2019, the Company entered into a secured loan agreement with Oink Oink Candy Inc., doing business as “Squish”, as borrower, and Rainy Day Investments Ltd. (“RDI”), as guarantor pursuant to which the Company agreed to lend to Squish an amount of up to \$4 million, amended on September 13, 2019 to reflect a maximum amount available under the facility of \$2.0 million and a repayment date no later than December 31, 2019. As of November 2, 2019, \$2.0 million was outstanding under the agreement. The loan bears interest, payable monthly, at a rate of 1% over Bank of Montreal’s prime rate, which currently stands at 3.95%. RDI has guaranteed all of Squish’s obligations to the Company and, as security in full for the guarantee, has given a movable hypothec (or lien) in favour of the Company on its shares of DAVIDsTEA. Squish is a company controlled by Sarah Segal, an officer of DAVIDsTEA. RDI, the principal shareholder of DAVIDsTEA, is controlled by Herschel Segal, Executive Chairman, Interim Chief Executive Officer and a director of DAVIDsTEA. The Company and Squish previously entered into a Collaboration and Shared Services Agreement pursuant to which they collaborate on and share various services and infrastructure.

For the period ended November 2, 2019, the Company received \$36 [November 3, 2018 – nil] as interest on the secured loan.

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		For the nine months ended	
	November 2, 2019	November 3, 2018	November 2, 2019	November 3, 2018
	\$	\$	\$	\$
Tea	30,038	31,348	92,770	92,167
Tea accessories	6,199	8,478	20,482	25,979
Food and beverages	3,256	3,830	9,673	11,463
	<u>39,493</u>	<u>43,656</u>	<u>122,925</u>	<u>129,609</u>

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

	November 2, 2019 (1)	February 2, 2019
	\$	\$
Canada	62,840	27,996
US	8,996	1,470
Total	<u>71,836</u>	<u>29,466</u>

(1) Includes Right-of-use assets of \$37,136 in Canada and \$7,689 in US.

Results from operating activities before corporate expenses per country are as follows:

	For the three months ended			For the nine months ended		
	November 2, 2019			November 2, 2019		
	Canada	US	Consolidated	Canada	US	Consolidated
	\$	\$	\$	\$	\$	\$
Sales	30,909	8,584	39,493	95,439	27,486	122,925
Cost of sales	14,060	4,079	18,139	42,099	11,331	53,430
Gross profit	16,849	4,505	21,354	53,340	16,155	69,495
Selling, general and administration expenses (allocated)	16,057	4,433	20,490	45,628	13,712	59,340
Impairment of property, equipment and right-of-use assets	949	1,102	2,051	3,429	3,647	7,076
Results from operating activities before corporate expenses	(157)	(1,030)	(1,187)	4,283	(1,204)	3,079
Selling, general and administration expenses (non-allocated)			8,129			23,838
Results from operating activities			(9,316)			(20,759)
Finance costs			1,699			5,305
Finance income			(185)			(570)
Loss before income taxes			(10,830)			(25,494)

	For the three months ended			For the nine months ended		
	November 3, 2018			November 3, 2018		
	Canada	US	Consolidated	Canada	US	Consolidated
	\$	\$	\$	\$	\$	\$
Sales	34,709	8,947	43,656	103,091	26,518	129,609
Cost of sales	19,520	5,755	25,275	55,060	16,133	71,193
Gross profit	15,189	3,192	18,381	48,031	10,385	58,416
Selling, general and administration expenses (allocated)	13,872	4,513	18,385	40,794	12,907	53,701
Impairment of property, equipment and right-of-use assets	725	—	725	3,096	189	3,285
Impact of onerous contracts	133	1,155	1,288	1,129	(643)	486
Results from operating activities before corporate expenses	459	(2,476)	(2,017)	3,012	(2,068)	944
Selling, general and administration expenses (non-allocated)			8,721			27,393
Results from operating activities			(10,738)			(26,449)
Finance costs			80			237
Finance income			(122)			(574)
Loss before income taxes			(10,696)			(26,112)

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 loss in the amount of \$68.

The Company's foreign exchange exposure is as follows:

	November 2, 2019 US\$	February 2, 2019 US\$
Cash	1,431	267
Accounts receivable	1,396	1,142
Accounts payable	4,388	3,869

The Company's U.S. subsidiary's transactions are denominated in U.S. dollars. The Company had no foreign exchange contracts outstanding as at November 2, 2019.

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. The Company is exposed to cash flow risk under the Revolving Facility which bears interest at variable interest rates (Note 7). As at November 2, 2019, 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 November 2, 2019, the Company had \$28,044 in cash.

The Company expects to finance its working capital needs, store renovations, and investments in infrastructure through cash flows from operations 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. Accounts receivable primarily consists of receivables from retail customers who pay by credit card, recoveries of credits from suppliers for returned or damaged products, receivables from other companies for sales of products, gift cards and other services and a loan advance to Squish. Credit card payments have minimal credit risk, the limited number of corporate receivables is closely monitored and the risk for the loan advance is limited, as a result of the pledge of DAVIDsTEA's shares as security.

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. 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. There are no outstanding derivative financial instruments at November 2, 2019.

There were no transfers between Level 1, Level 2 and Level 3 of the fair value hierarchy during the three and nine-month periods ended November 2, 2019 and November 3, 2018.