

## MANAGEMENT'S DISCUSSION AND ANALYSIS

For the quarter ended September 30, 2018 and 2017

The following Management's Discussion and Analysis ("MD&A") is prepared as at November 14, 2018 and is based on the consolidated financial position and operating results of Leon's Furniture Limited/Meubles Leon Ltée (the "Company") as of September 30, 2018 and for the three and nine months ended September 30, 2018, and 2017. It should be read in conjunction with the fiscal year 2017 consolidated financial statements and the notes thereto. For additional detail and information relating to the Company, readers are referred to the fiscal 2017 quarterly financial statements and corresponding MD&As which are published separately and available at [www.sedar.com](http://www.sedar.com).

### **Cautionary Statement Regarding Forward-Looking Statements**

This MD&A is intended to provide readers with the information that management believes is required to gain an understanding of Leon's Furniture Limited's current results and to assess the Company's future prospects. This MD&A, and in particular the section under heading "Outlook", includes forward-looking statements, which are based on certain assumptions and reflect Leon's Furniture Limited's current plans and expectations. These forward-looking statements are subject to a number of risks and uncertainties that could cause actual results and future prospects to differ materially from current expectations. Some of the factors that can cause actual results to differ materially from current expectations are: a drop in consumer confidence; dependency on product from third party suppliers, further changes to the Canadian bank lending rates; and further fluctuations of the Canadian dollar versus the US dollar. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. Readers of this report are cautioned that actual events and results may vary.

### **Financial Statements Governance Practice**

Leon's Furniture Limited's unaudited interim condensed consolidated financial statements have been prepared in accordance with the requirements of IAS 34, Interim Financial Reporting as issued by the International Accounting Standards Board ("IASB"), which is within the framework of International Financial Reporting Standards ("IFRS"). The amounts expressed are in Canadian dollars. Per share amounts are calculated using the weighted average number of shares outstanding before and after considering the potential dilutive effects of the convertible debentures for the applicable period.

The Audit Committee of the Board of Directors of Leon's Furniture Limited reviewed the MD&A and the unaudited interim condensed consolidated financial statements, and recommended that the Board of Directors approve them. Following review by the full Board, the unaudited interim condensed consolidated financial statements and MD&A were approved on November 14, 2018.

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## 1. BUSINESS OVERVIEW

Leon's Furniture Limited is the largest network of home furniture, appliances and electronics, and mattress stores in Canada. Our retail banners include: Leon's; The Brick; Brick Outlet and The Brick Mattress Store. As well, The Brick's Midnorthern Appliance banner alongside with the Appliance Canada banner, makes the Company the country's largest commercial retailer of appliances to builders, developers, hotels and property management companies. Finally, the Company operates three ecommerce sites: leons.ca, thebrick.com and furniture.ca.

The Company's repair service division, Trans Global Services ("TGS"), provides household furniture, electronics and appliance repair services to its customers. TGS has contracts to support several manufacturer's warranty service work in addition to servicing a number of individual programs offered by other dealers. This division also performs work for products sold with extended warranties and is an integral part of the retail offering. These extended warranties, underwritten by the Company's wholly-owned subsidiaries are offered on appliances, electronics and furniture to provide coverage that extends beyond the manufacturer's warranty period by up to five years. The warranty contracts provide both repair and replacement service depending upon the nature of the warranty claim.

The Company's wholly-owned subsidiaries Trans Global Insurance Company ("TGI") and its sister company, Trans Global Life Insurance Company ("TGLI") also offer credit insurance on the customer's outstanding financing balances and third party customer balances. This credit insurance coverage includes life, dismemberment, disability, critical illness, and involuntary unemployment. These credit insurance policies are underwritten by TGI and TGLI as they are licensed as insurance companies in all Canadian provinces and territories.

The Company has foreign operations in Asia, through its wholly owned subsidiary First Oceans Trading Corporation. These operations relate to the Company's import and quality control program for sourcing products from Asia for resale in Canada through its retail operations.

The Company has 304 retail stores from coast to coast in Canada under the various banners indicated below:

<b>Banner</b>	<b>Number of Stores as at December 31,</b>			<b>Number of Stores as at September 30,</b>
	<b>2017</b>	<b>Opened</b>	<b>Closed</b>	<b>2018</b>
Leon's banner corporate stores	50	—	—	50
Leon's banner franchise stores	36	—	—	36
Appliance Canada banner stores	4	1	—	5
The Brick banner corporate stores <sup>1</sup>	114	—	—	114
The Brick banner franchise stores	65	—	(1)	64
The Brick Mattress Store banner locations	23	1	—	24
Brick Outlet	12	—	(1)	11
<b>Total number of stores</b>	<b>304</b>	<b>2</b>	<b>(2)</b>	<b>304</b>

<sup>1</sup>Includes the Midnorthern Appliance banner

## 2. NON-IFRS FINANCIAL MEASURES

The Company uses financial measures that do not have standardized meaning under IFRS and may not be comparable to similar measures presented by other entities. The Company calculates the non-IFRS measures by adjusting certain IFRS measures for specific items the Company believes are significant, but not reflective of underlying operations in the period, as detailed below:

<b>Non-IFRS Measure</b>	<b>IFRS Measure</b>
Adjusted net income	Net income
Adjusted income before income taxes	Income before income taxes
Adjusted earnings per share – basic	Earnings per share – basic
Adjusted earnings per share – diluted	Earnings per share – diluted
Adjusted EBITDA	Net income

### **Adjusted Net Income**

Leon’s calculates comparable measures by excluding the effect of the mark-to-market adjustments included in the Company’s selling, general and administrative (“SG&A”) income statement line item, related to the net effect of USD-denominated forward contracts and an interest rate swap on the Company’s term credit facility. The Company uses forward currency contracts to manage the risk associated with its USD-denominated purchases and an interest rate swap to manage interest rate risk on its term credit facility which began in 2014 in accordance with the Company’s corporate treasury policy.

Management believes excluding from income the effect of these mark-to-market valuations and changes thereto, until settlement, better aligns the intent and financial effect of these contracts with the underlying cash flows. Similarly, excluding from income the effect of non-recurring expenses better reflects Leon’s normalized SG&A as a percentage of revenue in the period.

The following is a reconciliation of reported net income to adjusted net income, basic and diluted earnings per share to adjusted basic and diluted earnings per share:

	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
(\$ in thousands except per share amounts )				
<b>Net income</b>	<b>33,744</b>	34,338	<b>72,245</b>	61,814
After-tax mark-to-market (gain)/loss on financial derivative instruments	<b>518</b>	54	(3,843)	1,088
<b>Adjusted net income</b>	<b>34,262</b>	34,392	<b>68,402</b>	62,902
Basic earnings per share	\$ <b>0.44</b>	\$ 0.48	\$ <b>0.95</b>	\$ 0.86
Diluted earnings per share	\$ <b>0.41</b>	\$ 0.42	\$ <b>0.88</b>	\$ 0.77
Adjusted basic earnings per share	\$ <b>0.45</b>	\$ 0.48	\$ <b>0.90</b>	\$ 0.87
Adjusted diluted earnings per share	\$ <b>0.42</b>	\$ 0.42	\$ <b>0.84</b>	\$ 0.78

### **Adjusted EBITDA**

Adjusted earnings before interest, income taxes, depreciation and amortization, mark-to-market adjustment due to the changes in the fair value of the Company's financial derivative instruments and any non-recurring charges to income ("Adjusted EBITDA") is a non-IFRS financial measure used by the Company. The Company considers Adjusted EBITDA to be an effective measure of profitability on an operational basis and is commonly regarded as an indirect measure of operating cash flow, a significant indicator of success for many businesses. Adjusted EBITDA is a non-IFRS financial measure used by the Company. The Company's Adjusted EBITDA may not be comparable to the Adjusted EBITDA measure of other companies, but in management's view appropriately reflects Leon's specific financial condition. This measure is not intended to replace net income, which, as determined in accordance with IFRS, is an indicator of operating performance.

The following is a reconciliation of reported net income to adjusted EBITDA:

(\$ in thousands)	For the three months ended September 30		For the nine months ended September 30	
	2018	2017	2018	2017
<b>Net income</b>	<b>33,744</b>	34,338	<b>72,245</b>	61,814
Income tax expense	<b>11,778</b>	12,088	<b>25,565</b>	22,754
Net finance costs	<b>1,732</b>	2,800	<b>5,383</b>	8,186
Depreciation and amortization	<b>9,570</b>	9,729	<b>28,441</b>	28,953
Mark-to-market (gain)/loss on financial derivative instruments	<b>706</b>	74	<b>(5,237)</b>	1,491
<b>Adjusted EBITDA</b>	<b>57,530</b>	59,029	<b>126,397</b>	123,198

### **Same Store Sales**

Same store sales are defined as sales generated by stores that have been open for more than 12 months on a fiscal basis. Same store sales is not an earnings measure recognized by IFRS, and does not have a standardized meaning prescribed by IFRS, but it is a key indicator used by the Company to measure performance against prior period results. Same store sales as discussed in this MD&A may not be comparable to similar measures presented by other issuers, however this measure is commonly used in the retail industry. We believe that disclosing this measure is meaningful to investors because it enables them to better understand the level of growth of our business.

### **Total System Wide Sales**

Total system wide sales refer to the aggregation of revenue recognized in the Company's consolidated financial statements plus the franchise sales occurring at franchise stores to their customers which are not included in the revenue figure presented in the Company's consolidated financial statements. Total system wide sales is not a measure recognized by IFRS and does not have a standardized meaning prescribed by IFRS, but it is a key indicator used by the Company to measure performance against prior period results. Therefore, total system wide sales as discussed in this MD&A may not be comparable to similar measures presented by other issuers. We believe that disclosing this measure is meaningful to investors because it serves as an indicator of the strength of the Company's overall store network, which ultimately impacts financial performance.

**Franchise Sales**

Franchise sales figures refer to sales occurring at franchise stores to their customers which are not included in the revenue figures presented in the Company's consolidated financial statements, or in the same store sales figures in this MD&A. Franchise sales is not a measure recognized by IFRS, and does not have a standardized meaning prescribed by IFRS, but it is a key indicator used by the Company to measure performance against prior period results. Therefore, franchise sales as discussed in this MD&A may not be comparable to similar measures presented by other issuers. Once again, we believe that disclosing this measure is meaningful to investors because it serves as an indicator of the strength of the Company's brands, which ultimately impacts financial performance.

### 3. RESULTS OF OPERATIONS

#### Summary financial highlights for the quarters ended September 30, 2018 and September 30, 2017

(\$ in thousands except % and per share amounts)	For the three months ended September 30th			
	2018	2017	\$ Increase (Decrease)	% Increase (Decrease)
Total system wide sales <sup>(1)</sup>	707,058	706,534	524	0.1%
Franchise sales <sup>(1)</sup>	114,729	111,094	3,635	3.3%
Revenue <sup>(2)</sup>	592,329	595,440	(3,111)	(0.5%)
Cost of sales	333,965	341,333	(7,368)	(2.2%)
Gross profit	258,364	254,107	4,257	1.7%
<i>Gross profit margin as a percentage of revenue</i>	43.62%	42.68%		
Selling, general and administrative expenses <sup>(2)</sup> (excluding mark-to-market impact) <sup>(1)</sup>	210,404	204,807	5,597	2.7%
<i>SG&amp;A as a percentage of revenue</i>	35.52%	34.40%		
Income before net finance costs and income tax expense (excluding mark-to-market impact) <sup>(1)</sup>	47,960	49,300	(1,340)	(2.7%)
Net finance costs	(1,732)	(2,800)	1,068	(38.1%)
Income before income taxes (excluding mark-to-market impact) <sup>(1)</sup>	46,228	46,500	(272)	(0.6%)
Income tax expense	11,966	12,108	(142)	(1.2%)
Adjusted net income <sup>(1)</sup>	34,262	34,392	(130)	(0.4%)
<i>Adjusted net income as a percentage of revenue <sup>(1)</sup></i>	5.78%	5.78%		
After-tax mark-to-market (gain)/loss on financial derivative instruments <sup>(1)</sup>	518	54	464	
Net income	33,744	34,338	(594)	(1.7%)
Basic weighted average number of common shares	76,330,438	72,291,447		
Basic earnings per share	\$ 0.44	\$ 0.48	\$ (0.04)	(8.3%)
Adjusted basic earnings per share <sup>(1)</sup>	\$ 0.45	\$ 0.48	\$ (0.03)	(6.2%)
Diluted weighted average number of common shares	82,807,258	82,900,372		
Diluted earnings per share	\$ 0.41	\$ 0.42	\$ (0.01)	(2.4%)
Adjusted diluted earnings per share <sup>(1)</sup>	\$ 0.42	\$ 0.42	\$ -	0.0%
Common share dividends declared	\$ 0.14	\$ 0.12	\$ 0.02	16.7%

(1) Non-IFRS financial measures. Refer to section 2 in this MD&A for additional information.

(2) Reclassified comparative results to conform to the presentation of the three months ended September 30, 2018

#### Same Store Sales <sup>(1)</sup>

(\$ in thousands except %)	For the three months ended September 30			
	2018	2017	\$ Decrease	% Decrease
Same store sales <sup>(1)</sup>	579,662	589,001	(9,339)	(1.59%)

(1) Non-IFRS financial measure. Refer to section 2 in this MD&A for additional information.

## **Third Quarter Overall Performance**

### **Revenue**

For the three months ended September 30, 2018, revenue was \$592,329,000 compared to \$595,440,000 in the prior year's third quarter. Revenue decreased by 0.5% as compared to the prior quarter mainly due to a decrease in appliance sales in certain regional markets.

### **Same Store Sales<sup>(1)</sup>**

Overall, same store corporate sales decreased 1.59%.

### **Gross Profit**

The gross profit margin for the third quarter 2018 increased from 42.68% to 43.62% compared to the prior year's third quarter as a result of a favourable product mix.

### **Selling, general and administrative expenses (excluding mark-to-market)<sup>(1)</sup>**

Excluding the mark-to-market impact of the Company's financial derivatives, comprised of foreign exchange forwards and a fixed interest rate swap, SG&A as a percentage of revenue increased from 34.40% to 35.52% compared to the prior year period. The change is due primarily to an anticipated increase in finance charges related to financed sales and incremental marketing spend related to targeted promotions in the quarter.

### **Adjusted Net Income<sup>(1)</sup> and Adjusted Diluted Earnings Per Share<sup>(1)</sup>**

As we continue to pay down debt, we have reduced our net debt finance charges by \$1,068,000 between the comparative quarters. As a result of the factors above, adjusted net income for the third quarter of 2018 was \$34,262,000. This resulted in an adjusted diluted earnings per share of \$0.42 in the quarter (\$34,392,000, \$0.42 adjusted diluted earnings per share in 2017).

### **Net Income and Diluted Earnings Per Share**

Including the mark-to-market impact of the Company's financial derivatives, net income for the third quarter of 2018 was \$33,744,000, \$0.41 per diluted earnings per share (\$34,338,000, \$0.42 per diluted earnings per share in 2017).

<sup>(1)</sup> Non-IFRS financial measure. Refer to section 2 in this MD&A for additional information.

**Consolidated operating results for the nine months ended September 30, 2018 and September 30, 2017**

(\$ in thousands except % and per share amounts)	For the nine months ended September 30th			
	2018	2017	\$ Increase (Decrease)	% Increase (Decrease)
Total system wide sales <sup>(1)</sup>	<b>1,961,100</b>	1,917,998	43,102	2.2%
Franchise sales <sup>(1)</sup>	<b>321,323</b>	299,470	21,853	7.3%
Revenue <sup>(2)</sup>	<b>1,639,777</b>	1,618,528	21,249	1.3%
Cost of sales	<b>931,279</b>	928,305	2,974	0.3%
Gross profit	<b>708,498</b>	690,223	18,275	2.6%
<i>Gross profit margin as a percentage of revenue</i>	<b>43.21%</b>	42.65%		
Selling, general and administrative expenses <sup>(2)</sup> (excluding mark-to-market impact) <sup>(1)</sup>	<b>610,542</b>	595,979	14,563	2.4%
<i>SG&amp;A as a percentage of revenue</i>	<b>37.23%</b>	36.82%		
Income before net finance costs and income tax expense (excluding mark-to-market impact) <sup>(1)</sup>	<b>97,956</b>	94,244	3,712	3.9%
Net finance costs	<b>(5,383)</b>	(8,186)	2,803	(34.2%)
Income before income taxes (excluding mark-to-market impact) <sup>(1)</sup>	<b>92,573</b>	86,058	6,515	7.6%
Income tax expense	<b>24,171</b>	23,156	1,015	4.4%
Adjusted net income <sup>(1)</sup>	<b>68,402</b>	62,902	5,500	8.7%
<i>Adjusted net income as a percentage of revenue <sup>(1)</sup></i>	<b>4.17%</b>	3.89%		
After-tax mark-to-market (gain)/loss on financial derivative instruments <sup>(1)</sup>	<b>(3,843)</b>	1,088	(4,931)	
Net income	<b>72,245</b>	61,814	10,431	16.9%
Basic weighted average number of common shares	<b>76,359,769</b>	72,170,931		
Basic earnings per share	<b>\$ 0.95</b>	\$ 0.86	\$ 0.09	10.5%
Adjusted basic earnings per share <sup>(1)</sup>	<b>\$ 0.90</b>	\$ 0.87	\$ 0.03	3.4%
Diluted weighted average number of common shares	<b>82,892,853</b>	82,919,132		
Diluted earnings per share	<b>\$ 0.88</b>	\$ 0.77	\$ 0.11	14.3%
Adjusted diluted earnings per share <sup>(1)</sup>	<b>\$ 0.84</b>	\$ 0.78	\$ 0.06	7.7%
Common share dividends declared	<b>\$ 0.38</b>	\$ 0.36	\$ 0.02	5.6%

(1) Non-IFRS financial measures. Refer to section 2 in this MD&A for additional information.

(2) Reclassified comparative results to conform to the presentation of the nine months ended September 30, 2018

**Same Store Sales <sup>(1)</sup>**

(\$ in thousands except %)	For the nine months ended September 30			
	2018	2017	\$ Increase	% Increase
Same store sales <sup>(1)</sup>	<b>1,607,818</b>	1,602,265	5,553	0.4%

(1) Non-IFRS financial measure. Refer to section 2 in this MD&A for additional information.

### Revenue

For the nine months ended September 30, 2018, revenue was \$1,639,777,000 compared to \$1,618,528,000 for the prior year's nine-month period. Revenue increased \$21,249,000 or 1.3% for the comparative quarters as we continue to see growth in certain product categories.

### Same Store Sales<sup>(1)</sup>

Overall, same store corporate sales increased 0.4%.

### Gross Profit

The gross profit margin for the nine months ended September 30, 2018 increased from 42.65% to 43.21% compared to the prior year's nine-month period. The gross margin increased as a result of targeted promotions that were designed to alter the sales mix to enhance profitability in our product categories.

### Selling, general and administrative expenses (excluding mark-to-market)<sup>(1)</sup>

Excluding the mark-to-market impact of the Company's financial derivatives, comprised of foreign exchange forwards and a fixed interest rate swap, SG&A as a percentage of revenue was higher at 37.23%, an increase of 41 basis points over the prior year's nine-month period, due to increases in advertising expenditures and increases to finance charges related to financed sales.

### Adjusted Net Income<sup>(1)</sup> and Adjusted Diluted Earnings Per Share<sup>(1)</sup>

As we continue to reduce our debt this has enabled us to reduce our net debt finance charges by \$2,803,000 between comparative periods. As a result of the factors above, adjusted net income for the nine-month period ending September 30, 2018 was \$68,402,000. This resulted in an adjusted diluted earnings per share of \$0.84 (\$62,902,000, \$0.78 adjusted diluted earnings per share in 2017), an increase of 7.7%.

### Net Income and Diluted Earnings Per Share

Including the mark-to-market impact of the Company's financial derivatives, net income for the nine-month period ending September 30, 2018 was \$72,245,000, \$0.88 diluted earnings per share (net income of \$61,814,000, \$0.77 diluted earnings per share for the nine-month period ended September 30, 2017).

#### 4. SUMMARY OF CONSOLIDATED QUARTERLY RESULTS

The table below highlights the variability of quarterly results and the impact of seasonality on the Company's results. The Company's profitability is typically lower in the first half of the year, since retail sales are traditionally higher in the third and fourth quarters.

(\$ in thousands) - except per share data	Quarter Ended September 30 <sup>(2)</sup>		Quarter Ended June 30 <sup>(2)</sup>		Quarter Ended March 31		Quarter Ended December 31	
	2018	2017	2018	2017	2018	2017	2017	2016
Total system wide sales <sup>(1)</sup>	707,058	706,534	650,012	637,475	601,142	573,988	722,259	704,742
Franchise sales <sup>(1)</sup>	114,729	111,094	103,283	98,576	100,423	89,799	126,404	116,361
Revenue <sup>(2)</sup>	592,329	595,440	546,729	538,899	500,719	484,189	595,855	588,381
Net income	33,744	34,338	23,975	18,863	14,526	8,614	34,778	37,233
Adjusted net income <sup>(1)</sup>	34,262	34,392	22,595	19,968	11,545	8,543	36,119	34,745
Basic earnings per share	\$ 0.44	\$ 0.48	\$ 0.31	\$ 0.26	\$ 0.19	\$ 0.12	\$ 0.46	\$ 0.52
Diluted earnings per share	\$ 0.41	\$ 0.42	\$ 0.29	\$ 0.24	\$ 0.18	\$ 0.11	\$ 0.43	\$ 0.46
Adjusted basic earnings per share <sup>(1)</sup>	\$ 0.45	\$ 0.48	\$ 0.30	\$ 0.28	\$ 0.15	\$ 0.12	\$ 0.48	\$ 0.48
Adjusted diluted per share <sup>(1)</sup>	\$ 0.42	\$ 0.42	\$ 0.28	\$ 0.25	\$ 0.14	\$ 0.11	\$ 0.45	\$ 0.43

(1) Non-IFRS financial measure. Refer to section 2 in this MD&A for additional information.

(2) Reclassified comparative results to conform to the presentation for the period September 30, 2018

#### 5. FINANCIAL POSITION

(\$ in thousands)	September 30, 2018	December 31, 2017	September 30, 2017
Total assets	1,631,037	1,661,455	1,621,110
Total non-current liabilities	438,524	468,569	510,590

##### Assets

Total assets at September 30, 2018 of \$1,631,037,000 were \$30,418,000 lower than the \$1,661,455,000 reported at December 31, 2017. The principal component of this net change was due to a decrease in trade receivables of \$25,079,000.

Trade receivables decreased due to the settlement of finance sales from the year-end Boxing week sales.

##### Non-Current Liabilities

Non-current liabilities of \$438,524,000 were \$30,045,000 lower than the \$468,569,000 reported at December 31, 2017. The decrease is primarily the result of the repayment of the term loan of \$30,000,000.

## 6. LIQUIDITY AND CAPITAL RESOURCES

The following table provides a summarized statement of cash flows for the three months ended September 30, 2018 and September 30, 2017 and for the nine months ended September 30, 2018 and September 30, 2017:

Source (Use) of Cash (\$ in thousands)	For the three months ended September 30			For the nine months ended September 30		
	2018	2017	\$ Increase (Decrease)	2018	2017	\$ Increase (Decrease)
Cash provided by operating activities before changes in non-cash working capital items	44,108	48,511	(4,402)	104,301	96,121	8,180
Changes in non-cash working capital items	1,566	36,962	(35,395)	(17,462)	1,864	(19,326)
Cash provided by operating activities	45,674	85,473	(39,799)	86,839	97,985	(11,146)
Cash used in investing activities	(6,345)	(15,776)	9,431	(19,952)	(65,657)	45,705
Cash used in financing activities	(26,121)	(40,405)	14,284	(61,703)	(59,641)	(2,062)
<b>Increase/(decrease) in cash and cash equivalents</b>	<b>13,208</b>	<b>29,292</b>	<b>(16,084)</b>	<b>5,184</b>	<b>(27,313)</b>	<b>32,497</b>

### Cash Provided By Operating Activities

Cash from operating activities consist primarily of net income adjusted for certain non-cash items, including depreciation and amortization and the effect of changes in non-cash working capital items, primarily receivables, inventories, deferred acquisition costs, accounts payable, income taxes payable, customer deposits and deferred rent liabilities and lease inducements.

In the third quarter of 2018, cash provided by operating activities changed by \$39,799,000 compared to the prior year's quarter. The net decrease is due to the change in trade receivables and inventory of \$11,504,000 and \$9,848,000, respectively, which were offset by the change in trade payables of \$55,007,000 and income taxes of \$4,108,000.

### Cash Used In Investing Activities

Investing activities relate primarily to capital expenditures and the purchase and sale of debt and equity instruments.

In the third quarter of 2018, cash used in investing activities decreased by \$9,431,000 compared to the prior year's quarter. This change is the result of decreased purchases of property, plant and equipment of \$6,230,000 and the increase of proceeds on sale of fixed assets of \$4,707,000 and the net decrease on debt and equity instruments of \$1,733,000.

### Cash Used in Financing Activities

Financing activities consist primarily of cash used to pay dividends and the loans and borrowings used to acquire The Brick.

In the third quarter of 2018, cash used in financing activities changed by \$14,284,000 compared to the prior year's quarter. The change relates to the repayment of the term loan of \$30,000,000 in the prior year's quarter compared to the repayment of the term loan of \$15,000,000 in the current quarter.

### Adequacy of Financial Resources

At September 30, 2018, the Company's current assets exceeded its current liabilities by \$206,612,000 and its cash and cash equivalents, restricted marketable securities, and debt and equity instruments were \$136,747,000 compared to \$117,312,000 at December 31, 2017. Under the Company's Senior Secured Credit Agreement, we had unused borrowing capacity of \$49,351,000 as at September 30, 2018 (\$49,351,000 as at December 31, 2017). The Company believes that its existing financing resources together with its continuing profitable results from operations will provide a sound liquidity and working capital position throughout the next twelve months.

### Contractual Commitments

(\$ in thousands)	Payments Due by Period				
	Total	Under 1 year	1-3 years	3-5 years	More than 5 years
Contractual Obligations					
Long term debt	253,781	7,629	198,371	3,008	44,773
Operating leases <sup>(1)</sup>	388,566	87,120	141,161	103,929	56,356
Trade and other payables	220,905	220,905	-	-	-
Finance lease liabilities	10,861	1,848	3,817	3,853	1,343
<b>Total Contractual Obligations</b>	<b>874,113</b>	<b>317,502</b>	<b>343,349</b>	<b>110,790</b>	<b>102,472</b>

(1) The Company is obligated under operating leases to future minimum rental payments for various land and building sites across Canada

## 7. OUTLOOK

Overall, despite the challenging retail conditions in certain markets, we were able to maintain our profitability in the third quarter of 2018. We have demonstrated our commitment to deleveraging the balance sheet since we acquired The Brick in March 2013, which will continue to allow us to focus on increasing market share in existing and new markets going forward. We are pleased with our recent replatforming of our three eCommerce properties, leons.ca, thebrick.com and furniture.ca as we believe our commitment to continuously invest in digital innovation will drive more customers to both our online eCommerce presence and our 304 physical locations.

## 8. OUTSTANDING COMMON SHARES

At September 30, 2018, there were 76,420,070 common shares issued and outstanding. During the quarter ended September 30, 2018, 11,693 series 2009 shares, 4,515 series 2012 shares, and 1,375 series 2013 shares were converted into common shares. For details on the Company's commitments related to its redeemable shares please refer to Note 9 of the unaudited interim condensed consolidated financial statements.

## 9. RELATED PARTY TRANSACTIONS

As at September 30, 2018, we had no transactions with related parties as defined in IAS 24, *Related Party Disclosures*, except those pertaining to transactions with key management personnel in the ordinary course of their employment.

## 10. CRITICAL ASSUMPTIONS

### Use of Estimates and Judgments

Management has exercised judgment in the process of applying the Company's accounting policies. The preparation of condensed consolidated interim financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the consolidated balance sheet dates and the reported amounts of revenue and expenses during the reporting period. Estimates and other judgments are continuously 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 could differ from those estimates. The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of the condensed interim consolidated financial statements.

#### Extended warranty revenue recognition

The Company offers extended warranties on certain merchandise. Management has applied judgment in determining the basis upon and period over which to recognize deferred warranty revenue.

#### Inventories

The Company estimates the net realizable value as the amount at which inventories are expected to be sold by taking into account fluctuations of retail prices due to prevailing market conditions. If required, inventories are written down to net realizable value when the cost of inventories is estimated to not be recoverable due to obsolescence, damage or declining sales prices.

Reserves for slow moving and damaged inventory are deducted in the Company's valuation of inventories. Management has estimated the amount of reserve for slow moving inventory based on the Company's historic retail experience.

#### Impairment of property, plant and equipment

The Company exercises judgment in the determination of cash-generating units ("CGUs") for purposes of assessing any impairment of property, plant and equipment, as well as in determining whether there are indicators of impairment present. Should indicators of impairment be present, management estimates the recoverable amount of the relevant CGU. This estimation requires assumptions about future cash flows, margins and discount rates.

#### Impairment of goodwill and intangible assets

The Company tests goodwill and indefinite life intangible assets at least annually and reviews other long-lived intangible assets for any indication that the asset might be impaired. Significant judgments are required in determining the CGUs or groups of CGUs for purposes of assessing impairment. Significant judgments are also required in determining whether to allocate goodwill to CGUs or groups of CGUs. When performing impairment tests, the Company estimates the recoverable amount of the CGUs or groups of CGUs to which goodwill and indefinite life intangible assets have been allocated using a discounted cash flow model that requires assumptions about future cash flows, margins and discount rates.

## Provisions

The Company exercises judgment in the determination of recognizing a provision. The Company recognizes a provision when it has a present legal or constructive obligation as a result of a past event and a reliable estimate of the obligation can be made. Significant judgments are required to be made in determining what the probable outflow of resources will be required to settle the obligation.

## Materiality

In preparing this MD&A and the information contained herein, management considers the likelihood that a reasonable investor would be influenced to buy or not buy, or to sell or hold securities of the Company if such information were omitted or misstated. This concept of materiality is consistent with the notion of materiality applied to financial statements and contained in IFRS.

## **Recent Accounting Pronouncements**

### Accounting standards and amendments issued but not yet adopted

#### *IFRS 16, Leases (“IFRS 16”)*

In January 2016, the IASB issued IFRS 16, which will replace IAS 17, Leases (“IAS 17”). IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and requires lessees to account for all leases under a single on-balance sheet model similar to the accounting for finance leases under IAS 17. The new standard will be effective for fiscal years beginning on or after January 1, 2019.

At the commencement date of a lease, a lessee will recognise a liability to make lease payments (i.e., the lease liability) and an asset representing the right to use the underlying asset during the lease term (i.e., the right-of-use asset). Lessees will be required to separately recognise the interest expense on the lease liability and the depreciation expense on the right-of-use asset. The standard includes two recognition exemptions for lessees – leases of ‘low-value’ assets (e.g., personal computers) and short-term leases (i.e., leases with a lease term of 12 months or less). The Company will apply these exemptions where applicable.

Under IFRS 16, the lessor’s accounting for operating and finance leases will remain substantially unchanged.

The Company expects the following changes:

- The amount of total assets and total liabilities will increase due to the recognition of right-of-use assets and financial liabilities for future payment obligations from leases previously classified as operating leases.
- Operating lease payments which are currently included under Selling, General and Administrative Expenses on the Consolidated Statement of Income will be replaced with Depreciation, (included under Selling, General and Administrative Expenses), from the right-of-use asset and interest expense, (included under Finance Costs), from the lease liability.

As the Company has significant contractual obligations in the form of operating leases under IAS 17, Management have decided to apply this standard using the Modified Retrospective Approach in line with IFRS 16 paragraphs C7-13 which will recognize

any differences, if any, between the opening right-of-use asset and the opening finance lease liability as an adjustment to equity as at January 1, 2019.

#### *IFRS 17, Insurance Contracts (“IFRS 17”)*

IFRS 17 was issued in May 2017, which will replace IFRS 4, Insurance Contracts. IFRS 17 establishes the principles for the recognition, measurement, presentation and disclosure of insurance contract liabilities. The new standard is effective for annual periods beginning on or after January 1, 2021, to be applied retrospectively. If full retrospective application to a group of contracts is impractical, the modified retrospective or fair value methods may be used. Earlier adoption is permitted, provided the Company also applies IFRS 9 and IFRS 15 on or before the date it first applies IFRS 17. The Company is currently analyzing the new standard to determine its impact on the Company’s consolidated financial statements, particularly the insurance sales revenue stream.

#### *IFRS Interpretation Committee Interpretation 23, Uncertainty over Income Tax Treatments (“IFRIC 23”)*

IFRIC 23 was issued in September 2017 and is effective for years beginning on or after January 1, 2019, to be applied retrospectively. IFRIC 23 provides guidance on applying the recognition and measurement requirements in IAS 12, Income Taxes, when there is uncertainty over income tax treatments including, but not limited to, whether uncertain tax treatments should be considered together or separately based on which approach better predicts resolution of the uncertainty. The Company is currently analyzing the impact of IFRIC 23 on the Company’s consolidated financial statements.

#### Adoption of new or revised amended accounting standards

The Company has adopted the IFRS pronouncements listed below as at January 1, 2018, in accordance with the transitional provisions outlined in the respective standard.

#### *IFRS 15, Revenue from Contracts with Customers (“IFRS 15”)*

IFRS 15, Revenue from Contracts with Customers, was issued in May 2014, which replaces IAS 11, Construction Contracts, IAS 18, Revenue Recognition, and related Interpretations. IFRS 15 provides a single, principles based five-step model that will apply to all contracts with customers with limited exceptions, including, but not limited to, leases within the scope of IAS 17; financial instruments and other contractual rights or obligations within the scope of IFRS 9, IFRS 10, Consolidated Financial Statements and IFRS 11, Joint Arrangements. Under IFRS 15, revenue is recognized at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer.

The standard requires entities to exercise judgement, taking into consideration all of the relevant facts and circumstances when applying each step of the model to contracts with their customers. The standard also specifies the accounting for the incremental costs of obtaining a contract and the costs directly related to fulfilling a contract.

The Company has performed a detailed impact assessment, identifying all current sources of revenue and analyzing the accounting requirements for each under IFRS 15. The Company adopted IFRS 15 using the full retrospective method and has concluded that there is no impact in relation to IFRS 15 because the Company’s analysis of contracts relating to sale of goods by corporate stores and income from franchise operations under the new revenue recognition standard supports the current

process of recognition at a point in time when control is transferred to the customer. Extended warranty revenue will be deferred and subsequently recognized over time which is consistent with the current revenue model. The impact to the interim condensed consolidated financial statements is limited to additional disclosure on the disaggregation of the Company's revenue streams, as included in Note 16 to the condensed consolidated interim financial statements.

### *IFRS 9, Financial Instruments ("IFRS 9")*

IFRS 9 was issued on July 24, 2014 and the new standard must be applied retrospectively with some exemptions. The core areas addressed within IFRS 9 are classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting. The Company has applied IFRS 9 retrospectively, with the initial application date of January 1, 2018. Consistent with the transitional provisions in IFRS 9 paragraph 7.2.15, comparative information has not been restated.

#### Classification and measurement

Under IFRS 9, existing IAS 39 classification and measurement categories are being replaced with fair value through the income statement, fair value through other comprehensive income and amortized cost.

The details of changes are disclosed below:

- The Company reclassified financial assets from loans and receivables to amortized cost.
- Equity instruments at FVOCI – represent securities that the Company intends to hold for the long-term for strategic purposes. As permitted by IFRS 9, these investments have been designated at the date of initial application as measured at FVOCI. Unlike IAS 39, there will be no recycling to profit or loss on derecognition and these securities are not subject to an impairment assessment. Interest income and dividend income will continue to be recognized in net income. Under IAS 39, the Company's equity instruments were classified as available-for-sale.
- Debt instruments at FVOCI – represent securities the Company holds to collect contractual cash flows and to sell. Upon derecognition, gains and losses will be recycled to the profit or loss. Under IAS 39, the Company's debt instruments at FVOCI were classified under restricted marketable securities and available-for-sale financial assets.
- Debt instruments at FVPL – represent securities the Company has concluded that are neither held to collect contractual cash flows, nor managed under an objective that results in both collecting the contractual cash flows and selling the investment. Under IAS 39, the Company's debt instruments at FVPL were classified under available-for-sale financial assets.

#### Impairment of financial assets

IFRS 9 replaces the incurred loss model from IAS 39 by introducing a new 'expected credit loss' model for calculating impairment of financial assets. IFRS 9 specifies different approaches for measuring and recognizing expected credit losses, by considering only defaults in the next 12 months and/or the full remaining life of the financial asset. The expected credit loss model requires a credit loss to be reflected in profit and loss immediately after an asset or receivable is acquired and subsequent changes in expected credit losses at each reporting date reflecting the change in credit risk. IFRS 9 provides a simplified

approach for certain trade receivables and IFRS 15 contract assets. Due to the terms offered to customers and the Company's policy on providing for expected credit losses, the Company concludes that there is no impact on its allowance for its expected credit losses.

## **11. RISKS AND UNCERTAINTIES**

Careful consideration should be given to the following risk factors. These descriptions of risks are not the only ones facing the Company. Additional risks and uncertainties not presently known to Leon's, or that the Company deems immaterial, may also impair the operations of the Company. If any of such risks actually occur, the business, financial condition, liquidity, and results of operations of the Company could be materially adversely affected.

Readers of this MD&A are also encouraged to refer to Leon's Annual Information Form ("AIF") dated March 28, 2018 which provides information on the risk factors facing the Company. The March 28, 2018 AIF can be found on line at [www.sedar.com](http://www.sedar.com).

### Sensitivity to General Economic Conditions

The household furniture, mattress, appliance and home electronics retailing industry in Canada has historically been subject to cyclical variations in the general economy and to uncertainty regarding future economic prospects. The Company's sales are impacted by the health of the economy in Canada as a whole, and in the regional markets in which the Company operates.

The Company's sales and financial results are subject to numerous uncertainties. Weakness in sales or consumer confidence could result in an increasingly challenging operating environment.

### Maintaining Profitability & Managing Growth

There can be no assurance that the Company's business and growth strategy will enable it to sustain profitability in future periods. The Company's future operating results will depend on a number of factors, including (i) the Company's ability to continue to successfully execute its strategic initiatives, (ii) the level of competition in the household furniture, mattress, appliance and home electronics retailing industry in the markets in which the Company operates, (iii) the Company's ability to remain a low-cost retailer, (iv) the Company's ability to realize increased sales and greater levels of profitability through its retail stores, (v) the effectiveness of the Company's marketing programs, (vi) the Company's ability to successfully identify and respond to changes in fashion trends and consumer tastes in the household furniture, mattress, appliance and home electronics retailing industry, (vii) the Company's ability to maintain cost effective delivery of its products, (viii) the Company's ability to hire, train, manage and retain qualified retail store management and sales professionals, (ix) the Company's ability to continuously improve its service to achieve new and enhanced customer benefits and better quality, and (x) general economic conditions and consumer confidence.

### Financial Condition of Commercial Sales Customers & Franchisees

Through its commercial sales division, the Company sells products and extends credit to high-rise and condominium builders who purchase large quantities of products. The Company also sells products and extends credit to its franchisees. Negative changes in the financial condition of a significant commercial sales customer or a franchisee could impact on the Company's receivables and ultimately result in the Company having to take a bad-debt write-off in excess of allowance for bad debts. The

occurrence of such an event could have a material adverse effect on the Company's business, financial condition, liquidity and results of operations.

### Competition

The household furniture, mattress, appliance and home electronics retailing industry is highly competitive and highly fragmented. The Company faces competition in all regions in which its operations are located by existing stores that sell similar products and also by stores that may be opened in the future by existing or new competitors in such markets. The Company competes directly with many different types of retail stores that sell many of the products sold by the Company. Such competitors include (i) department stores, (ii) specialty stores (such as specialty electronics, appliance, or mattress retailers), (iii) other national or regional chains offering household furniture, mattresses, appliances and home electronics, and (iv) other independent retailers, particularly those associated with larger buying groups. The highly competitive nature of the industry means the Company is constantly subject to the risk of losing market share to its competitors. As a result, the Company may not be able to maintain or to raise the prices of its products in response to competitive pressures. In addition, the entrance of additional competitors to the markets in which the Company operates, particularly large furniture, appliance or electronics retailers from the United States could increase the competitive pressure on the Company and have a material adverse effect on the Company's market share. The actions and strategies of the Company's current and potential competitors could have a material adverse effect on the Company's business, financial condition, liquidity and results of operations.

## **12. CONTROLS AND PROCEDURES**

### **Disclosure Controls & Procedures**

Management is responsible for establishing and maintaining a system of disclosure controls and procedures to provide reasonable assurance that all material information relating to the Company is gathered and reported on a timely basis to senior management, including the Chief Executive Officer and Chief Financial Officer so that appropriate decisions can be made by them regarding public disclosure. Based on the evaluation of disclosure controls and procedures, the CEO and CFO have concluded that the Company's disclosure controls and procedures were effective as at September 30, 2018.

### **Internal Controls over Financial Reporting**

Management is also responsible for establishing and maintaining disclosure controls and procedures and internal controls over financial reporting for the Company. The control framework used in the design of disclosure controls and procedures and internal control over financial reporting is based on the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control-Integrated Framework (2013).

Management, including the CEO and CFO, does not expect that the Company's disclosure controls or internal controls over financial reporting will prevent or detect all errors and all fraud or will be effective under all potential future conditions. A control system is subject to inherent limitations and, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control systems objectives will be met. During the three months ended September 30, 2018, there have been no changes in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.