

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

For the quarters ended March 31, 2019 and 2018

The following Management's Discussion and Analysis ("MD&A") is prepared as at May 14, 2019 and is based on the consolidated financial position and operating results of Leon's Furniture Limited/Meubles Leon Ltée (the "Company") as of March 31, 2019 and for the three months ended March 31, 2019. It should be read in conjunction with the fiscal year 2018 consolidated financial statements and the notes thereto. For additional detail and information relating to the Company, readers are referred to the fiscal 2018 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 May 14, 2019.

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## 1. BUSINESS OVERVIEW

Leon's Furniture Limited is the largest network of home furniture, appliances, 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 and the Caribbean, through its wholly owned subsidiaries First Oceans Trading Corporation and King & State Limited, respectively. 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, and the retail banners that sell their extended warranties on appliances and electronics to their customers, respectively.

The Company has 302 retail stores from coast to coast in Canada under the various banners indicated below:

Banner	Number of Stores as at December 31,			Number of Stores as at March 31,
	2018	Opened	Closed	2019
Leon's banner corporate stores	50	—	—	50
Leon's banner franchise stores	36	—	(2)	34
Appliance Canada banner stores	5	—	—	5
The Brick banner corporate stores <sup>1</sup>	113	1	—	114
The Brick banner franchise stores	64	—	(1)	63
The Brick Mattress Store banner locations	25	1	—	26
Brick Outlet	10	—	—	10
Total number of stores	303	2	(3)	302

<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 changes in fair value of derivative instruments, 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 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.

The following two tables reconcile reported net income and earnings per share as stated in the Company’s Interim Condensed Consolidated Statements of Income to adjusted net income and earnings per share excluding the impact of IFRS 16. As the Company implemented IFRS 16, “Leases”, on January 1, 2019 using the modified retrospective approach, the amounts listed in the table below related to the first quarter of 2019 reflect lease accounting under IFRS 16 for net income, adjusted net income, basic and diluted earnings per share, and adjusted basic and adjusted diluted earnings per share. The comparative quarter of 2018 has not been restated. See Section 10, “Recent Accounting Pronouncements”, of this MD&A for additional information on the implementation of IFRS 16.

(\$ in thousands except per share amounts)	<b>For the three months ended March 31</b>	
	<b>2019</b>	<b>2018</b>
<b>Net Income</b> <sup>(1)</sup>	<b>9,334</b>	14,526
After-tax mark-to-market (gain)/loss on financial derivative instruments	<b>80</b>	(2,981)
<b>Adjusted net income</b> <sup>(1)</sup>	<b>9,414</b>	11,545
Impact of IFRS 16 on an after-tax basis	<b>4,511</b>	-
<b>Adjusted Net Income excluding impact of IFRS 16</b>	<b>13,925</b>	11,545

(1) The Company implemented IFRS 16, “Leases”, on January 1, 2019 using the modified retrospective approach. As a result, the Company’s first quarter of 2019 reflects lease accounting under IFRS 16, the comparative quarter has not been restated.

	For the three months ended March 31			
	2019 <sup>(1)</sup>	IFRS 16 Adjustments	2019 <sup>(2)</sup>	2018 <sup>(1)</sup>
Basic earnings per share	\$ 0.12	\$ 0.06	\$ 0.18	\$ 0.19
Diluted earnings per share	\$ 0.11	\$ 0.06	\$ 0.17	\$ 0.18
Adjusted basic earnings per share	\$ 0.12	\$ 0.06	\$ 0.18	\$ 0.15
Adjusted diluted earnings per share	\$ 0.11	\$ 0.06	\$ 0.17	\$ 0.14

(1) As reported in the Company's Q1 2019 Interim Condensed Consolidated Statements of Income for basic and diluted earnings per share amounts

(2) These amounts exclude the impact of IFRS 16 adjustments in the current quarter

In 2016, the IASB issued IFRS 16, "Leases", replacing IAS 17 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 Company implemented the standard on January 1, 2019 using the modified retrospective approach, therefore the Company's 2019 first quarter results reflect lease accounting under IFRS 16. Prior year results have not been restated. See Section 10, "Recent Accounting Pronouncements", of this MD&A for more information on the implementation of IFRS 16.

The implementation of IFRS 16 significantly increased the assets and liabilities of the Company's balance sheet and changed the timing and presentation of lease-related expenses in the Company's financial results. The Company recorded a right-of-use asset of \$430,480,000 and a lease liability of \$414,940,000 under this new standard. Under IFRS 16, the depreciation expense on leased assets and interest expense on lease liabilities replaced rent expense, which was previously recognized on a straight-line basis in operating income under IAS 17 over the term of a lease.

Therefore, normalized for this year-over-year impact of increased depreciation, amortization and lease interest expenses related to IFRS 16 implementation in the current quarter, adjusted net income increased \$2,380,000, an increase of 20.6% over the prior year's quarter. Additionally, adjusted diluted earnings per share for the Company increased by \$0.03 to \$0.17 per share, an increase of 21.4% over the prior year's quarter.

### **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 March 31	
	2019 <sup>(1)</sup>	2018
<b>Net Income</b> <sup>(1)</sup>	<b>9,334</b>	14,526
Income tax expense <sup>(1)</sup>	<b>3,204</b>	5,104
Net finance costs <sup>(1)</sup>	<b>6,297</b>	1,848
Depreciation and amortization <sup>(1)</sup>	<b>31,724</b>	9,160
Mark-to-market (gain)/loss on financial derivative instruments	<b>110</b>	(4,062)
<b>Adjusted EBITDA</b> <sup>(1)</sup>	<b>50,669</b>	26,576

(1) The Company implemented IFRS 16, "Leases", on January 1, 2019 using the modified retrospective approach. As a result, the Company's first quarter of 2019 reflects lease accounting under IFRS 16, while the comparative quarter has not been restated.

### **Adjusted EBITDA excluding the impact of IFRS 16**

(\$ in thousands)	For the three months ended March 31	
	2019	2018
<b>Adjusted EBITDA</b> <sup>(1)</sup>	<b>50,669</b>	26,576
Impact of IFRS 16 (net)	<b>(21,929)</b>	-
<b>Adjusted EBITDA including the impact of IFRS 16</b>	<b>28,740</b>	26,576

(1) The Company implemented IFRS 16, "Leases", on January 1, 2019 using the modified retrospective approach. As a result, the Company's first quarter of 2019 reflects lease accounting under IFRS 16, while the comparative quarter has not been restated. See Section 10, "Recent Accounting Pronouncements", of this MD&A for additional information on the impact of IFRS 16.

Under IFRS 16, the depreciation and amortization expense on leased assets and interest expense on lease liabilities replaced rent expense, which was previously recognized on a straight-line basis in operating income under IAS 17 over the term of the lease. Normalized for the year-over-year impact of increased depreciation, amortization and lease interest expenses due to the implementation of IFRS 16 on January 1, 2019, adjusted EBITDA increased \$2,164,000 in the quarter, an increase of 8.1% over the three months ended March 31, 2018.

### **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 March 31, 2019 and March 31, 2018

Unless otherwise indicated, all financial information includes the implementation of IFRS 16, “Leases”.

(\$ in thousands except % and per share amounts)	For the three months ended March 31			
	2019 <sup>(2)</sup>	2018 <sup>(2)</sup>	\$ Increase (Decrease)	% Increase (Decrease)
Total system wide sales <sup>(1)</sup>	597,158	601,142	(3,984)	(0.7%)
Franchise sales <sup>(1)</sup>	97,417	100,423	(3,006)	(3.0%)
Revenue	499,741	500,719	(978)	(0.2%)
Cost of sales	283,574	286,401	(2,827)	(1.0%)
Gross profit	216,167	214,318	1,849	0.9%
<i>Gross profit margin as a percentage of revenue</i>	43.26%	42.80%		
Selling, general and administrative expenses <sup>(2)</sup>	197,222	196,902	320	0.2%
<i>SG&amp;A as a percentage of revenue <sup>(2)(3)</sup></i>	39.46%	39.32%		
Income before net finance costs and income tax expense <sup>(2)</sup>	18,945	17,416	1,529	8.8%
Net finance costs <sup>(2)</sup>	6,297	1,848	(4,449)	240.7%
Income before income taxes <sup>(1)(2)</sup>	12,648	15,568	(2,920)	(18.8%)
Income tax expense <sup>(1)(2)</sup>	3,234	4,023	(789)	(19.6%)
Adjusted net income <sup>(1)(2)</sup>	9,414	11,545	(2,131)	(18.5%)
<i>Adjusted net income as a percentage of revenue <sup>(1)(2)</sup></i>	1.88%	2.32%		
After-tax mark-to-market (gain)/loss on financial derivative instruments <sup>(1)</sup>	80	(2,981)	3,061	(102.7%)
Net income <sup>(2)</sup>	9,334	14,526	(5,192)	(35.7%)
Basic weighted average number of common shares	77,566,054	76,304,308		
Basic earnings per share <sup>(2)</sup>	\$ 0.12	\$ 0.19	(0.07)	(36.8%)
Adjusted basic earnings per share <sup>(1)(2)</sup>	\$ 0.12	\$ 0.15	(0.03)	(20.0%)
Diluted weighted average number of common shares	85,045,127	82,892,712		
Diluted earnings per share <sup>(2)</sup>	\$ 0.11	\$ 0.18	(0.07)	(38.9%)
Adjusted diluted earnings per share <sup>(1)(2)</sup>	\$ 0.11	\$ 0.14	(0.03)	(21.4%)
Common share dividends declared	\$ 0.14	\$ 0.12	\$ 0.02	16.7%

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

(2) The Company implemented IFRS 16, “Leases”, on January 1, 2019 using the modified retrospective approach. As a result, the Company’s first quarter of 2019 reflects lease accounting under IFRS 16, while the comparative quarter has not been restated. Refer to section 2 in this MD&A for additional information.

(3) Selling, general and administrative expenses (“SG&A”)

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

(\$ in thousands except %)	For the three months ended March 31			
	2019	2018	\$ Decrease	% Decrease
Same store sales <sup>(1)</sup>	485,149	490,069	(4,920)	(1.0%)

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

## **First quarter overall performance**

### **Revenue**

For the three months ended March 31, 2019, revenue was \$499,741,000 compared to \$500,719,000 in the prior year's first quarter, a decrease of 0.2%.

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

Overall, same store corporate sales decreased 1% compared to the prior year's first quarter.

### **Gross Profit**

The gross profit margin for the first quarter 2019 increased from 42.80% to 43.26% compared to the prior year's first quarter as a result of a favourable product mix of furniture sales.

### **Selling, general and administrative expenses**

SG&A as a percentage of revenue in the current quarter was relatively flat as compared to the prior year's first quarter when normalized for the impact of IFRS 16 in the current quarter. The increase of 14 bps included the unfavourable impact of IFRS 16 in the quarter of approximately \$522,000, which is primarily due to a net increase in depreciation and amortization expenses of the Company's right-of-use assets over the reduction in rent expenses. Normalized for these impacts, the Company's SG&A as a percentage of revenue in the current quarter was 39.36% as compared to 39.32% in the prior year's quarter. This was due to effectively managing payroll costs and digital commerce expenses while at the same time increasing advertising spend in the current quarter that was targeted to drive customers to the Company's websites and retail stores.

### **Adjusted EBITDA<sup>(1)</sup>**

Adjusted EBITDA increased \$24,093,000 in the quarter, an increase of 90.7% as compared to the prior year's quarter. This increase has been driven primarily by two factors, the first is the implementation of IFRS 16 by the Company commencing on January 1, 2019 on a modified retrospective approach, which results in the prior year's quarter to not be restated, and the second was due to improvement in gross margin percentage in the current quarter aided by keeping operating expenses in check and a reduction in net finance costs that exclude the impact of IFRS 16. Under the new lease standard, the depreciation and amortization expense on leased assets and interest expense on lease liabilities replaced rent expense, which was previously recognized on a straight-line basis in operating income under IAS 17 over the term of the lease. Normalized for the impact of implementing the new lease standard, adjusted EBITDA increased \$2,164,000 in the quarter, an increase of 8.1% over the three months ended March 31, 2018, with the remainder of the overall increase of \$21,929,000 driven solely by the change in the lease standard implemented by the Company on January 1, 2019.

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

Adjusted net income decreased \$2,131,000 in the quarter due to the Company implementing IFRS 16 on January 1, 2019 using the modified retrospective approach. As a result, the Company's first quarter of 2019 reflects lease accounting under IFRS 16, while the comparison quarter has not been restated. Normalized for the quarter-over-quarter after tax impact of \$4,511,000 due to a net increase in depreciation and amortization expense and lease interest expense offset by a reduction in rent expense related to the IFRS 16 implementation in the current quarter, adjusted net income in the current quarter totaled \$13,925,000 an

increase of \$2,380,000 or 20.6% over the prior year's quarter. As a result of these adjustments, adjusted diluted earnings per share for the Company increased by \$0.03 to \$0.17 per share, an increase of 21.4% over the prior year's quarter.

#### Net Income and Diluted Earnings Per Share

Including the impact of the implementation of IFRS 16 in the current quarter and the mark-to-market impact of the Company's financial derivatives, net income for the first quarter of 2019 was \$9,334,000, \$0.11 per diluted earnings per share (net income \$14,526,000, \$0.18 per diluted earnings per share in 2018).

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

#### **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.

##### **SUMMARY OF CONSOLIDATED QUARTERLY RESULTS**

(\$ in thousands) - except per share data	Quarter ended March 31		Quarter ended December 31		Quarter ended September 30		Quarter ended June 30	
	2019	2018 <sup>(3)</sup>	2018 <sup>(3)</sup>	2017 <sup>(3)</sup>	2018 <sup>(3)</sup>	2017 <sup>(3)</sup>	2018 <sup>(3)</sup>	2017 <sup>(3)</sup>
Total system wide sales <sup>(1)</sup>	597,158	601,142	726,547	723,255	707,058	706,534	650,012	637,475
Franchise sales <sup>(1)</sup>	97,417	100,423	124,887	126,404	114,729	111,094	103,283	98,576
Revenue	499,741	500,719	601,660	596,851	592,329	595,440	546,729	538,899
Net income <sup>(3)</sup>	9,334	14,526	38,785	34,778	33,744	34,338	23,975	18,863
Adjusted net income <sup>(1)(2)(3)</sup>	9,414	11,545	38,289	36,119	34,262	34,392	22,595	19,968
Basic earnings per share <sup>(3)</sup>	\$ 0.12	\$ 0.19	\$ 0.51	\$ 0.46	\$ 0.44	\$ 0.48	\$ 0.31	\$ 0.26
Diluted earnings per share <sup>(3)</sup>	\$ 0.11	\$ 0.18	\$ 0.48	\$ 0.43	\$ 0.41	\$ 0.42	\$ 0.29	\$ 0.24
Adjusted basic earnings per share <sup>(1)(2)(3)(4)</sup>	\$ 0.18	\$ 0.15	\$ 0.50	\$ 0.48	\$ 0.45	\$ 0.48	\$ 0.30	\$ 0.28
Adjusted diluted per share <sup>(1)(3)(4)</sup>	\$ 0.17	\$ 0.14	\$ 0.47	\$ 0.45	\$ 0.42	\$ 0.42	\$ 0.28	\$ 0.25

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

<sup>(2)</sup> Refer to section 2 - Adjusted net income

<sup>(3)</sup> These quarters have not been restated for the implementation of IFRS 16

<sup>(4)</sup> These amounts have been adjusted to exclude the impact of IFRS 16 due to the implementation of IFRS 16 on a modified retrospective approach

#### **5. FINANCIAL POSITION**

(\$ in thousands)	March 31, 2019	December 31, 2018	March 31, 2018
Total assets	2,042,833	1,723,572	1,610,074
Total non-current liabilities	583,852	258,690	461,474

#### Assets

Total assets at March 31, 2019 of \$2,042,834,000 were \$319,262,000 higher than the \$1,723,572,000 reported at December 31, 2018. The majority of this change was driven by an increase to property, plant and equipment of approximately \$392,512,000 which was offset by a decrease in cash and cash equivalents and trade receivables. The increase to property, plant and equipment was due to the implementation of IFRS 16 effective January 1, 2019. Trade receivables decreased due to the settlement of finance sales from year-end Boxing week sales.

### Non-Current Liabilities

Non-current liabilities of \$538,852,000 were \$325,162,000 higher than the \$258,690,000 reported at December 31, 2018. This is a result of the increase in lease liability due to the implementation of IFRS 16 for the period ended March 31, 2019.

## **6. LIQUIDITY AND CAPITAL RESOURCES**

The following table provides a summarized statement of cash flows for the three months ended March 31, 2019 and March 31, 2018:

Source (Use) of Cash (\$ in thousands)	For the three months ended March 31		
	2019	2018	\$ Increase (Decrease)
Cash provided/(used) by operating activities before changes in non-cash working capital items	42,082	24,479	17,603
Changes in non-cash working capital items	(82,943)	(12,388)	(70,555)
Cash provided/(used) by operating activities	(40,861)	12,091	(52,952)
Cash used in investing activities	(6,481)	(8,074)	1,593
Cash used in financing activities	(37,758)	(14,342)	(23,416)
<b>Decrease in cash and cash equivalents</b>	<b>(85,100)</b>	<b>(10,325)</b>	<b>(74,775)</b>

### Cash Provided/(Used) 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, customers' deposits and deferred rent liabilities and lease inducements.

In the first quarter of 2019, cash provided by operating activities changed by \$52,952,000 compared to the prior year's quarter. The net decrease is due to the change in trade receivables, inventories, trade and other payables and customers' deposits which is offset by the increase in depreciation and amortization and net finance costs of \$26,466,000 which is due to the impact of IFRS 16.

### Cash Used In Investing Activities

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

In the first quarter of 2019, cash used in investing activities decreased by \$1,593,000 compared to the prior year's quarter. This change is due to the decrease in debt and equity instruments and purchase of property plant and equipment of \$942,000 and \$176,000, respectively. The Company also had an increase in interest received of \$390,000.

### Cash Used in Financing Activities

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

In the first quarter of 2019, cash used in financing activities changed by \$23,416,000 compared to the prior year's quarter. The change relates to the net increase in lease repayments and interest paid due to the implementation of IFRS 16 of \$17,065,000 and \$6,595,000, respectively.

### Adequacy of Financial Resources

At March 31, 2019, the Company's current liabilities exceeded its current assets by \$4,536,000 and its cash and cash equivalents, restricted marketable securities, and debt and equity instruments were \$107,872,000 compared to \$184,882,000 at December 31, 2018. Under the Company's Senior Secured Credit Agreement, we had unused borrowing capacity of \$49,336,000 as at March 31, 2019 (\$49,351,000 as at March 31, 2018). 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
Loans and other borrowings	199,581	144,938	3,012	51,631	-
Trade and other payables	213,106	213,106	-	-	-
Lease liabilities	420,031	70,264	119,278	119,278	111,212
<b>Total</b>	<b>832,719</b>	<b>428,308</b>	<b>122,290</b>	<b>170,909</b>	<b>111,212</b>

## **7. OUTLOOK**

Despite the uncertainty over certain key economic indicators, we believe that the overall economy remains relatively strong. Although it is difficult to gauge future consumer confidence and what impact it may have on retail, we remain confident that our sales and profitability will increase. Given the Company's strong financial position, our principal objective is to increase market share and profitability. We remain focused on our commitment to continuously invest in digital innovation that will drive more customers to both our online eCommerce presence and our 302 physical locations across Canada.

## **8. OUTSTANDING COMMON SHARES**

At March 31, 2019, there were 77,633,941 common shares issued and outstanding. During the quarter ended March 31, 2019, 44,475 series 2009 shares, 3,709 series 2012 shares, 85,605 series 2013 shares, 8,749 series 2014 and 60,745 series 2015 shares were converted into common shares. For details on the Company's commitments related to its redeemable shares please refer to Note 10.2 of the of the unaudited interim condensed consolidated financial statements.

## **9. RELATED PARTY TRANSACTIONS**

For the three months ended March 31, 2019, 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 interim condensed consolidated 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 interim condensed 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.

### Leases

Management exercises judgment in the process of applying IFRS 16 and determining the appropriate lease term on a lease by lease basis. Management considers many factors including any events that create an economic incentive to exercise a renewal option including store performance, expected future performance and past business practice. Renewal options are only included if Management are reasonably certain that the option will be renewed. Management considers reasonably certain to be a very high threshold.

### 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 implemented in 2019**

The Company has adopted the new IFRS accounting standards listed below as at January 1, 2019, in accordance with the transitional provisions outlined in the respective standard.

## **IFRS 16, Leases (“IFRS 16”)**

In January 2016, the IASB issued IFRS 16, which replaces IAS 17, IFRIC 4, *Determines whether an Arrangement contains a Lease*, SIC-15, *Operating Leases-Incentives* and SIC-27, *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*. 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.

As the Company has significant contractual obligations in the form of real estate operating leases, the Company applied IFRS 16 using the modified retrospective approach. The comparatives for the 2018 financial reporting period are not restated as permitted under the transition provisions in the standard.

At the commencement date of a lease, a lessee will recognize 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 recognize 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., laptop computers) and short-term leases (i.e., leases with a lease term of 12 months or less). The Company has applied these exemptions where applicable.

Lessor accounting under IFRS 16 is substantially unchanged under IAS 17. Lessors will continue to classify leases as either operating or finance leases using similar principles as in IAS 17. Therefore, IFRS 16 did not have an impact for leases where the Company is the lessor.

The main changes to lease accounting as a result of IFRS 16 including the following:

- The amount of total assets and total liabilities increased 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 were previously included in selling, general and administrative expenses on the consolidated statements of income are replaced with depreciation expense (included in selling, general and administrative expenses) from the right-of-use asset and interest expense (included under net finance costs) from the lease liability.

The Company did not restate comparative information and has elected to use the following practical expedients:

- the Company has not reassessed, under IFRS 16, contracts that were identified as leases under the previous standard (IAS 17);
- the Company will use a single discount rate to a portfolio of leases with reasonably similar underlying characteristics;
- the Company has excluded initial direct costs from measurement of the right-of-use asset at the date of initial application;

- the Company has relied on its assessment of whether leases are onerous immediately before the date of initial application;

On transition to IFRS 16, the Company also elected to apply the practical expedient to grandfather the assessment of which transactions are leases. It applied IFRS 16 only to contracts that were previously identified as leases. Contracts that were not identified as leases under IAS 17 and IFRIC 4 were not reassessed for whether there is a lease. Therefore, the definition of a lease under IFRS 16 was applied only to contracts entered into or changed on or after January 1, 2019.

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 \$11,021 that was previously included under deferred rent and leasehold inducements with a corresponding adjustment to the right-of-use asset.

The Company did not change the initial carrying amounts of recognized assets and liabilities at the date of initial application for leases previously classified as finance leases (i.e., the right-of-use assets and lease liabilities equal the lease assets and liabilities recognized under IAS 17). The requirements of IFRS 16 was applied to these leases from January 1, 2019.

Upon transition, the Company has derecognized the asset related to favourable or unfavourable terms of an operating lease acquired as part of a business combination with a corresponding adjustment to the right-of-use asset.

#### **Opening reconciliation of lease liability**

A reconciliation of the lease liability as at December 31, 2018 compared to January 1, 2019 is as follows:

(\$ in thousands)	<b>As at January 1, 2019</b>
Operating lease commitments as at December 31, 2018	462,581
Weighted average incremental borrowing rate as at January 1, 2019	5%
Discounted operating lease commitments as at January 1, 2019	414,940
<b>Add:</b>	
Commitments relating to leases previously classified as finance leases	9,199
Lease liabilities as at January 1, 2019	<b>424,139</b>

### Impact to opening statements of financial position

The following table summarizes the impact of adopting IFRS 16, on January 1, 2019:

(\$ in thousands)	As previously reported	Adjustments	As restated
<b>ASSETS</b>			
Property, plant and equipment	321,597	430,480	752,077
Intangibles	300,896	(26,402)	274,494
<b>Total Assets</b>	<b>622,493</b>	<b>404,078</b>	<b>1,026,571</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Trade and other payables	(247,136)	(159)	(247,295)
Lease liability	(1,415)	(37,526)	(38,941)
<b>Total Current Liabilities</b>	<b>(248,551)</b>	<b>(37,685)</b>	<b>(286,236)</b>
Lease liability	(7,784)	(377,414)	(385,198)
Deferred rent & leasehold inducements	(11,021)	11,021	—
<b>Total Liabilities</b>	<b>(267,356)</b>	<b>(404,078)</b>	<b>(671,434)</b>
Retained Earnings	743,399	—	743,399

### The effect of adoption of IFRS 16 is as follows:

Impact on the interim condensed consolidated statements of income:

(\$ in thousands)	Three months ended March 31, 2019
Rent expense	(21,760)
Fleet expense	(169)
Depreciation & amortization	22,451
<b>Total operating expenses</b>	<b>522</b>
Finance costs	5,269
<b>Net income before income tax</b>	<b>5,791</b>
Income tax expense	(1,280)
<b>Net income for the period</b>	<b>4,511</b>

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

IFRIC 23 was issued in June 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 adoption of this interpretation did not have a material impact on the interim condensed consolidated financial statements.

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

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

In May 2017, the IASB issued IFRS 17, which replaces IFRS 4, Insurance Contracts (“IFRS 4”). IFRS 17 establishes new principles for the recognition, measurement, presentation and disclosure of insurance contracts. IFRS 17 applies to all types of insurance contracts regardless of the type of entities that issue them, as well as to certain guarantees and financial instruments with discretionary participation features. IFRS 17 provides a comprehensive model for insurance contracts, covering all relevant accounting aspects. The core of IFRS 17 is the general model, supplemented by:

- A specific adaptation for contracts with direct participation features (the variable fee approach)
- A simplified approach (the premium allocation approach) mainly for short-duration contracts

IFRS 17 is effective for annual periods beginning on or after January 1, 2021. Retrospective application is required. The Company plans to adopt the new standard on the effective date. The IASB has tentatively decided to defer the effective date of IFRS 17 to annual periods beginning on or after January 1, 2022. The Company is currently analyzing the impact these standards will have on its financial statements.

## **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 February 27, 2019, which provides information on the risk factors facing the Company. The February 27, 2019 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 March 31, 2019.

### **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 March 31, 2019, 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.