



## ROOTS CORPORATION

### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Second Quarter Ended August 4, 2018)

The following Management's Discussion and Analysis ("**MD&A**") dated September 11, 2018 is intended to assist readers in understanding the business environment, strategies and performance and risk factors of Roots Corporation (together with its consolidated subsidiaries, referred to herein as "**Roots**", the "**Company**", "**us**", "**we**" or "**our**"). This MD&A provides the reader with a view and analysis, from the perspective of management, of the Company's financial results for the 13 and 26 week periods ended August 4, 2018. This MD&A should be read in conjunction with the unaudited interim condensed consolidated financial statements for the 13 and 26 week periods ended August 4, 2018, including the related notes thereto ("**Interim Financial Statements**"), and our audited consolidated financial statements for the fiscal year ended February 3, 2018, including the related notes thereto (the "**Annual Financial Statements**") and the related MD&A.

#### **Basis of Presentation**

Our Interim Financial Statements and Annual Financial Statements have been prepared in accordance with International Financial Reporting Standards ("**IFRS**") as issued by the International Accounting Standards Board ("**IASB**"), using the accounting policies described in our Interim Financial Statements and Annual Financial Statements. All amounts are presented in thousands of Canadian dollars, unless otherwise indicated.

All references in this MD&A to "**Q2 2018**" are to our fiscal quarter for the 13 week period ended August 4, 2018, and all references to "**Q2 2017**" are to our fiscal quarter for the 13 week period ended July 29, 2017. All references in this MD&A to "**YTD 2018**" or "**year-to-date 2018**" are to the 26 week period ended August 4, 2018, and all references to "**YTD 2017**" or "**year-to-date 2017**" are to the 26 week period ended July 29, 2017. All references in this MD&A to "**Fiscal 2016**" are to the 52 week fiscal year ended January 28, 2017, to "**Fiscal 2017**" are to the 53 week fiscal year ended February 3, 2018, to "**Fiscal 2018**" are to the 52 week fiscal year ending February 2, 2019, and to "**Fiscal 2019**" are to the 52 week fiscal year ending February 1, 2020.

The Interim Financial Statements and this MD&A were reviewed by our Audit Committee and approved by our Board of Directors (the "**Board**") on September 11, 2018.

Certain totals, subtotals, and percentages throughout this MD&A may not reconcile due to rounding. All information in this MD&A referring to per-share amounts, share units or option units are presented as if the Pre-Closing Capital Changes (as defined and discussed under the heading "Share Information – Prior to Completion of the IPO") was implemented at the beginning of the earliest comparable period.

## Cautionary Note Regarding Non-IFRS Measures and Industry Metrics

This MD&A makes reference to certain non-IFRS measures including certain metrics specific to the industry in which we operate. These measures are not recognized measures under IFRS, do not have a standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar measures presented by other companies. Rather, these measures are provided as additional information to complement those IFRS measures by providing further understanding of our results of operations from management's perspective. Accordingly, these measures are not intended to represent, and should not be considered as alternatives to, net income (loss) or other performance measures derived in accordance with IFRS as measures of operating performance or operating cash flows or as a measure of liquidity. In addition to our results determined in accordance with IFRS, we use non-IFRS measures including, "EBITDA", "Adjusted EBITDA", "Adjusted Net Income (Loss)", and "Adjusted Net Income (Loss) per Share". This MD&A also refers to "comparable sales growth", a commonly used metric in our industry but that may be calculated differently compared to other companies. We believe these non-IFRS measures and industry metrics provide useful information to both management and investors in measuring our financial performance and condition and highlight trends in our core business that may not otherwise be apparent when relying solely on IFRS measures.

Management also uses non-IFRS measures to exclude the impact of certain expenses and income that management does not believe reflect the Company's underlying operating performance and that make comparisons of underlying financial performance between periods difficult. Management also uses non-IFRS measures to measure our core financial and operating performance for business planning purposes and as a component in the determination of incentive compensation for salaried employees. The Company may exclude additional items, from time to time, if it believes doing so would result in a more effective analysis of our underlying operating performance.

**"EBITDA"** is defined as net income (loss) before interest expense, income taxes expense (recovery) and depreciation and amortization.

**"Adjusted EBITDA"** is defined as EBITDA, adjusted for the impact of certain income and expenses that are non-recurring, infrequent, or unusual in nature and would make comparisons of underlying financial performance between periods difficult. We believe that Adjusted EBITDA is useful, to both management and investors, in assessing the underlying performance of our ongoing operations and our ability to generate cash flows to fund our cash requirement.

**"Adjusted Net Income (Loss)"** is defined as net income (loss), adjusted for the impact of certain income and expenses that are non-recurring, infrequent, or unusual in nature, and would make comparisons of underlying financial performance between periods difficult, net of related tax effects. We believe that Adjusted Net Income (Loss) is useful, to both management and investors, in assessing the underlying performance of our ongoing operations.

**"Adjusted Net Income (Loss) per Share"** is defined as Adjusted Net Income (Loss), divided by the weighted average common shares outstanding during the periods presented. We believe that Adjusted Net Income (Loss) per Share is useful, to both management and investors, in assessing the underlying performance of our ongoing operations, on a per share basis.

**"Comparable Sales Growth"** is a retail industry metric used to compare the percentage change in sales derived from mature stores and e-commerce, in a certain period, compared to the sales from the same stores and e-commerce, in the same period of the prior year. We believe

comparable sales growth helps explain our sales growth in established stores and e-commerce, which may not otherwise be apparent when relying solely on year-over-year sales comparisons. Comparable sales growth is calculated based on sales (net of a provision for returns) from stores that have been opened for at least 52 weeks in our direct-to-consumer (“DTC”) segment, including e-commerce sales (net of a provision for returns) in our DTC segment, and excludes sales from stores during periods where the store was undergoing renovation.

Comparable sales growth calculation excludes the impact of foreign currency fluctuations. Beginning in Q2 2018, to be more consistent with other retailers, and as a result of our U.S. expansion strategy, we changed our calculation methodology by applying the prior year’s average monthly U.S. dollar to Canadian dollar exchange rates to both current year and prior year comparable sales to achieve a consistent basis for comparison. Prior to Q2 2018, comparable sales growth was calculated and presented using a U.S. dollar to Canadian dollar exchange rate of 1:1. The prior fiscal quarters presented in this MD&A have been recalculated and presented using this new constant currency calculation. However, even with these changes, our comparable sales growth may be calculated differently compared to other companies.

See “Reconciliation of Non-IFRS Measures” for a reconciliation of certain of the foregoing non-IFRS measures to their most directly comparable measures calculated in accordance with IFRS.

### **Cautionary Note Regarding Forward-Looking Information**

This MD&A contains “forward-looking information” within the meaning of applicable securities laws in Canada. Forward-looking information may relate to our future financial outlook and anticipated events or results and may include information regarding our business, financial position, results of operations, business strategy, growth plans and strategies, budgets, operations, financial results, taxes, plans and objectives. Particularly, information regarding our expectations of future results, performance, achievements, prospects or opportunities or the markets in which we operate is forward-looking information.

In some cases, forward-looking information can be identified by the use of forward-looking terminology such as “plans”, “targets”, “expects” or “does not expect”, “is expected”, “an opportunity exists”, “budget”, “scheduled”, “estimates”, “outlook”, “forecasts”, “projection”, “prospects”, “strategy”, “intends”, “anticipates”, “does not anticipate”, “believes”, or variations of such words and phrases or state that certain actions, events or results “may”, “could”, “would”, “should”, “might”, “will”, “will be taken”, “occur” or “be achieved”. In addition, any statements that refer to expectations, intentions, projections or other characterizations of future events or circumstances contain forward-looking information. Statements containing forward-looking information are not facts but instead represent management’s expectations, estimates and projections regarding future events or circumstances.

In addition, our assessments of, and targets for, annual sales, Adjusted EBITDA and Adjusted Net Income and certain other measures are considered forward-looking information. See “Financial Outlook” for additional information concerning our strategies, assumptions and market outlook in relation to these assessments.

Many factors could cause our actual results, level of activity, performance or achievements or future events or developments to differ materially from those expressed or implied by the forward-looking information, including, without limitation, the factors discussed in the “Risks and Uncertainties” section of this MD&A and in the “Risk Factors” section of our annual information form dated April 17, 2018 for Fiscal 2017 (the “AIF”). A copy of the AIF can be accessed under

our profile on the System for Electronic Document Analysis and Retrieval (“**SEDAR**”) at [www.sedar.com](http://www.sedar.com) and on our website at [www.roots.com](http://www.roots.com). These factors are not intended to represent a complete list of the factors that could affect us; however, these factors should be considered carefully.

The purpose of the forward-looking information is to provide the reader with a description of management’s current expectations regarding the Company’s financial performance and may not be appropriate for other purposes; readers should not place undue reliance on forward-looking information contained herein. To the extent any forward-looking information in this MD&A constitutes future-oriented financial information or financial outlook, within the meaning of applicable securities laws, such information is being provided to demonstrate the potential of the Company and readers are cautioned that this information may not be appropriate for any other purpose. Future-oriented financial information and financial outlook, as with forward-looking information generally, are based on current assumptions and subject to risks, uncertainties and other factors. Furthermore, unless otherwise stated, the forward-looking information contained in this MD&A are made as of the date of this MD&A, and we have no intention and undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except (i) as required under applicable securities laws in Canada and (ii) to provide updates in our annual MD&A for each fiscal year up to and including that in respect of Fiscal 2019 on our growth targets disclosed in our final prospectus (the “**Prospectus**”) dated October 18, 2017 in respect of our IPO (as defined below), including to provide information on our growth targets disclosed in such Prospectus, actual results and a discussion of material variances from our growth targets. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.

## **Overview**

Established in 1973, Roots is an iconic lifestyle brand with a rich Canadian heritage and a portfolio of premium apparel, leather goods, accessories and footwear. The design of our products is driven by global consumer insights, and supported by our flexible sourcing network, proven distribution footprint and Canadian leather manufacturing facility. Through our omni-channel footprint of 117 corporate retail stores in Canada, five corporate retail stores in the United States, 112 partner-operated stores in Taiwan, 27 partner-operated stores in China and our e-commerce platform, we are able to reach a broad cross-section of global consumers. Our products are worn by young professionals, students, families, athletes and entertainment icons.

On October 14, 2015, Searchlight Capital Partners, L.P. (“**Searchlight**”) incorporated Roots Corporation under the laws of Canada and its subsidiary, Roots USA Corporation, under the laws of the State of Delaware. Pursuant to a purchase and sale agreement dated October 21, 2015, Roots and its subsidiaries acquired substantially all of the assets of Roots Canada Ltd., Roots U.S.A., Inc., Roots America L.P., entities controlled by our founders Michael Budman and Don Green (the “**Founders**”), and all of the issued and outstanding shares of Roots International ULC, effective December 1, 2015 (the “**Acquisition**”).

## **Initial Public Offering**

On October 25, 2017, we successfully completed our initial public offering (the “**IPO**”) of our common shares (the “**Shares**”) at a price of \$12.00 per Share through a secondary sale of Shares by our principal shareholders. Our principal shareholders sold 16,667,000 Shares under the IPO for total gross proceeds of \$200,004 for the selling shareholders. The Company did not receive any of the proceeds from the IPO.

The Shares are listed for trading on the Toronto Stock Exchange (“**TSX**”) under the trading symbol “**ROOT**”.

In connection with and immediately prior to closing of the IPO, all outstanding Class A Shares, Class B Shares, options and restricted share units (“**RSUs**”) were effectively consolidated on a 0.214193-to-one basis into Shares or securities exercisable for Shares.

### **Factors Affecting our Performance**

We believe that our performance and future success depend on a number of factors that present significant opportunities for us. These factors are also subject to a number of inherent risks and challenges, some of which we discuss below. See also the “Risks and Uncertainties” section of this MD&A and the “Risk Factors” section of our AIF.

### ***Our Brand***

Roots is an iconic brand with a rich Canadian heritage and a portfolio of premium apparel, leather goods, accessories and footwear products. Our brand is well known in Canada and Taiwan, with growing customer awareness internationally. Maintaining and growing our brand awareness is critical to our continued success. Any loss of brand appeal from factors such as changing consumer trends and increased competition may adversely affect our business and financial results. To address this, we intend to continue our relentless focus on the customer with insights-driven designs, while leveraging recent operational investments, pursuing continued growth in Canada, expanding our United States and international footprint and deepening our leather and footwear product offerings to continue to attract customers in both existing and new markets.

### ***Growth in our Omni-Channel Business***

The success of our business is heavily dependent on our ability to continue to drive strong comparable sales in our DTC segment and grow our omni-channel footprint. This includes renovating and expanding our existing corporate retail stores, optimizing our e-commerce capabilities and selectively expanding our store base in both Canada and the United States. Our ability to successfully execute on our omni-channel strategy is an important driver of our longer-term growth.

### ***Growth in the Business of our International Operating Partners***

The success of our business is dependent on the performance of our international operating partner’s retail operations. Our ability to continue to recognize wholesale sales of Roots-branded products to our partner and to generate royalty revenue from our partner’s retail sales of Roots-branded products depends on our partner continuing to grow its business. Our partner’s ability to successfully execute on its omni-channel strategy and our ability to support our partner in this growth will impact the performance of our business. In addition, the success of our business is dependent on our ability to develop successful relationships with other international operating partners and support them in the growth of their retail and online sales of Roots-branded products.

### ***Product Development***

We are not defined by one product, season, geography, or demographic. With nearly five decades of product leadership, our product range is diversified across seasons and comprised of apparel, leather goods, accessories and footwear. Serving as the foundation of our distinct identity, many

of our enduring icons have been in our product assortment for decades and remain favourites among customers today. Our business will be affected by our ability to continue to develop products that resonate with consumers. In this regard, we have made significant investments in our merchandising team and have established a United Brand Range (“**UBR**”) initiative, which is a consumer-focused merchandising strategy focused on building a more simplified and scalable product assortment as well as a more consistent presentation that is coordinated across collections and categories, that we expect will help us to continue supporting the growth of our business. We also continue to introduce additional products to help mitigate the seasonal nature of our business and expand our addressable geographic market.

### **Foreign Exchange**

We generate the majority of our revenues in Canadian dollars, while a significant portion of our cost of goods sold is denominated in U.S. dollars, which exposes us to fluctuations in foreign currency exchange rates. Starting Fiscal 2017, we entered into hedging arrangements to help mitigate the risks associated with fluctuations in the U.S. dollar relative to the Canadian dollar. See “Financial Instruments” for a further discussion of our hedging arrangements.

### **Seasonality**

We experience seasonal fluctuations in the financial results of our retail business, as we generate a meaningful portion of our sales and earnings in our third and fourth fiscal quarters. Our working capital requirements generally increase in the periods preceding these peak periods, and it is not uncommon for our EBITDA to be negative in the first two fiscal quarters. The average portion of our annual sales generated during each quarter of a fiscal year over the last three completed fiscal years is outlined in the following table:

First fiscal quarter . . . . .	15%
Second fiscal quarter . . . . .	16%
Third fiscal quarter . . . . .	28%
Fourth fiscal quarter . . . . .	41%
Annual Total . . . . .	<u>100%</u>

### **Segments**

We report our results in two segments: (1) DTC and (2) Partners and Other. We measure each reportable operating segment’s performance based on sales and segment gross profit. Our DTC segment comprises sales through our corporate retail stores and e-commerce. Our Partners and Other segment consists primarily of the wholesale of Roots-branded products to our international operating partner and the royalties earned on the retail sales of Roots-branded products by our partner. Our Partners and Other segment also consists of royalties earned through the licensing of our brand to select manufacturing partners, the wholesale of Roots-branded products to select retail partners, and the sale of custom Roots-branded products to select business clients.

Our DTC and Partners and Other segments contributed 80.2% and 19.8% of our sales, respectively, in Q2 2018 (Q2 2017 – 80.3% and 19.7%, respectively). In YTD 2018, the DTC and Partners and Other segments represented 83.1% and 16.9% of our sales, respectively (YTD 2017 – 81.9% and 18.1%, respectively).

## Summary of Financial Performance

We refer the reader to the sections entitled “Components of our Results of Operations and Trends Affecting our Business” and “Cautionary Note Regarding Non-IFRS Measures and Industry Metrics” in this MD&A for the definition of the items discussed below and, when applicable, to the section entitled “Reconciliation of Non-IFRS Measures” for reconciliations of non-IFRS measures with the most directly comparable IFRS measure.

The following table summarizes our results of operations for the periods indicated:

CAD \$000s (except per share data)	Q2 2018	Q2 2017	YTD 2018	YTD 2017
<b>Statement of Net Loss Data:</b>				
Sales	60,197	58,115	111,226	106,346
Gross profit	33,145	31,004	62,215	56,962
Gross margin	55.1%	53.3%	55.9%	53.6%
Selling, general and administrative expenses	37,245	33,775	72,549	65,205
Loss before interest expense and income taxes recovery	(4,100)	(2,771)	(10,334)	(8,243)
Net loss	(4,081)	(3,226)	(9,671)	(8,339)
Basic loss per share	\$(0.10)	\$(0.08)	\$(0.23)	\$(0.20)
Diluted loss per share	\$(0.10)	\$(0.08)	\$(0.23)	\$(0.20)
<b>Non-IFRS Measures and Other Performance Measures:</b>				
Corporate stores, end of period	122	120	122	120
Comparable sales growth <sup>(1)</sup>	1.1%	16.3%	3.8%	9.8%
Adjusted EBITDA <sup>(1)</sup>	32	1,350	(3,083)	(382)
Adjusted Net Loss <sup>(1)</sup>	(2,360)	(1,429)	(6,827)	(5,045)
Adjusted Net Loss per Share <sup>(1)</sup>	\$(0.06)	\$(0.03)	\$(0.16)	\$(0.12)

Note:

(1) Comparable sales growth, Adjusted EBITDA, Adjusted Net Loss, and Adjusted Net Loss per Share are non-IFRS measures. See “Cautionary Note Regarding Non-IFRS Measures and Industry Metrics” for a description of these measures.

### **Selected Financial Results for Q2 2018 Compared to Q2 2017**

- Total sales increased by \$2,082, or 3.6%, to \$60,197 in Q2 2018, from \$58,115 in Q2 2017.
  - DTC sales increased by \$1,651, or 3.5%, in Q2 2018, compared to Q2 2017.
  - Partners and Other sales increased by \$431, or 3.8%, in Q2 2018, compared to Q2 2017.
- Comparable sales growth<sup>(1)</sup> was 1.1% for Q2 2018.
- Gross profit increased by \$2,141, or 6.9%, to \$33,145 in Q2 2018, from \$31,004 in Q2 2017.
  - DTC gross profit increased by \$1,914, or 7.0%, to \$29,311 in Q2 2018, from \$27,397 in Q2 2017, and as a percentage of sales (“**gross margin**”) increased to 60.7% in Q2 2018, from 58.7% in Q2 2017.
- Selling, general, and administrative expenses (“**SG&A expenses**”) increased by \$3,470, or 10.3%, to \$37,245 in Q2 2018, from \$33,775 in Q2 2017.

- Adjusted EBITDA<sup>(1)</sup> decreased by \$1,318, or 97.6%, to \$32 in Q2 2018, from \$1,350 in Q2 2017.
- Net loss increased by \$855, or 26.5%, to \$4,081 in Q2 2018, from \$3,226 in Q2 2017.
- Adjusted Net Loss<sup>(1)</sup> increased by \$931, or 65.2%, to a loss of \$2,360 in Q2 2018, from a loss of \$1,429 in Q2 2017.
- Basic loss per Share was \$0.10 in Q2 2018, up 25.0% from basic loss per Share of \$0.08 in Q2 2017.
- Adjusted Net Loss per Share<sup>(1)</sup> was \$0.06 in Q2 2018, up 100.0% from Adjusted Net Loss per Share of \$0.03 in Q2 2017.

### ***Selected Financial Results for YTD 2018 Compared to YTD 2017***

- Total sales increased by \$4,880, or 4.6%, to \$111,226 in YTD 2018, from \$106,346 in YTD 2017.
  - DTC sales increased by \$5,301, or 6.1%, in YTD 2018, compared to YTD 2017.
  - Partners and Other sales decreased by \$421, or 2.2%, in YTD 2018, compared to YTD 2017.
- Comparable sales growth<sup>(1)</sup> was 3.8% for YTD 2018.
- Gross profit increased by \$5,253, or 9.2%, to \$62,215 in YTD 2018, from \$56,962 in YTD 2017.
  - DTC gross profit increased by \$5,174, or 10.3%, to \$55,407 in YTD 2018, from \$50,233 in YTD 2017, and DTC gross margin increased to 59.9% in YTD 2018, from 57.6% in YTD 2017.
- SG&A expenses increased by \$7,344, or 11.3%, to \$72,549 in YTD 2018, from \$65,205 in YTD 2017.
- Adjusted EBITDA<sup>(1)</sup> decreased by \$2,701, or 707.1%, to a loss of \$3,083 in YTD 2018, from a loss of \$382 in YTD 2017.
- Net loss increased by \$1,332, or 16.0%, to \$9,671 in YTD 2018, from \$8,339 in YTD 2017.
- Adjusted Net Loss<sup>(1)</sup> increased by \$1,782, or 35.3%, to \$6,827 in YTD 2018, from \$5,045 in YTD 2017.
- Basic loss per Share was \$0.23 in YTD 2018, up 15.0% from basic loss per Share of \$0.20 in YTD 2017.
- Adjusted Net Loss per Share<sup>(1)</sup> was \$0.16 in YTD 2018, up 33.3% from Adjusted Net Loss per Share of \$0.12 in YTD 2017.

## Key Operational Developments

### Retail stores

We continue to execute on our strategy to grow our store network and optimize our existing retail stores. During year-to-date 2018, we opened six new corporate stores, completed major renovations on two of our existing stores, and relocated and expanded two of our existing stores. In particular, during Q2 2018 we:

- relocated and expanded our store at Scarborough Town Centre in Scarborough, Ontario on May 25, 2018;
- relocated and expanded our store at Halifax Shopping Centre in Halifax, Nova Scotia on May 31, 2018;
- opened a new store at Midtown Plaza in Saskatoon, Saskatchewan on June 13, 2018;
- opened a new store in Natick Mall in Natick, Massachusetts on June 28, 2018;
- opened a new store at Market Street in Lynnfield, Massachusetts on June 30, 2018;
- opened a new store at Fairview Pointe-Claire in Point-Claire, Quebec on July 26, 2018;
- completed renovations to our Roots Lodge store in Toronto, Ontario on July 27, 2018; and
- closed two stores to better optimize our real estate portfolio.

In addition, we opened a brand activation centre on Newbury Street in Boston, Massachusetts on June 15, 2018, and two pop-up stores, one in Richmond, British Columbia on May 17, 2018 and one in Toronto, Ontario on July 13, 2018.

The following table summarizes the change in our corporate store count for the periods indicated, excluding pop-up locations and our brand activation centre.

	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017
Number of stores, beginning of period . . . . .	120	119	120	120	118
New stores . . . . .	4	2	2	-	4
Closed stores . . . . .	2	1	3	-	2
<b>Number of stores, end of period . . . . .</b>	<b>122</b>	<b>120</b>	<b>119</b>	<b>120</b>	<b>120</b>
Stores renovated or relocated . . . . .	3	1	1	3	-

### International Partnerships

During Q2 2018, our international partner opened two new partner-operated stores in Taiwan and one new partner-operated store in China. Through continued efforts to optimize its overall store portfolio, our partner chose not to renew leases for two stores in Taiwan and four stores in China during Q2 2018. At quarter end, we had 112 partner-operated stores in Taiwan and 27 partner-operated stores in China, and, based on leasing activity, believe we remain on-track to achieve our target of 20 to 25 new stores by the end of Fiscal 2019.

## *Merchandising*

We continued to execute against our broader merchandising strategy of bringing better products and assortments to our global consumer base. Through our more formalized, repeatable and analysis-driven approach to line development, we are delivering coordinated collections across all lines of products, increasing productivity, improving costing, bringing the right products to the right stores, and benefiting from greater scalability. Our success on all of these fronts in the quarter are reflected in our top line improvements and expanded gross margins.

During the quarter, through our UBR initiative, we continued to edit out unproductive SKUs and amplify our best performing products. We reduced SKUs in certain categories and added SKUs in others. The net result was a 25% reduction in SKU count in the quarter compared to Q2 Fiscal 2016 as we saw year-over-year gains in areas such as dresses, graphic tees, and fleece.

## **Components of our Results of Operations and Trends Affecting our Business**

In assessing our results of operations and trends affecting our business, we consider a variety of financial and operating measures that affect our operating results.

### ***Sales***

Sales in our DTC segment include sales through our corporate retail stores in North America and through our e-commerce operations. Sales to customers through our corporate retail stores are recognized at the time of purchase, net of a provision for returns. E-commerce sales are recognized at the time of delivery, net of a provision for returns. The provision for returns is estimated based on the last 12 months' return rate for retail stores and e-commerce sales, respectively.

Sales in our Partners and Other segment consist primarily of wholesale sales to our international partner and other corporate customers, and royalty revenue earned from the retail sale of Roots-branded products by our international partner and other third-party licensees. Wholesale sales from the sale of goods is recognized when performance obligations of goods delivery have been passed to the customer which, depending on the specific contractual terms of each customer, is either at the time of shipment or receipt. Contractually, our international partner and wholesale partners are unable to return goods purchased from us. Royalty sales are earned and recognized on an accrual basis in accordance with the various contractual agreements, at the later of sale of licensed goods as reported by our international partner and other third-party licensees, and when all performance obligations pertaining to the royalty are satisfied.

### ***Gross Profit***

Gross profit is our sales less cost of goods sold. Cost of goods sold includes the cost of purchasing our products from manufacturers, including direct purchase costs, freight costs, and duty and non-refundable taxes. For select leather and footwear products manufactured by us in-house, cost of goods sold includes the cost of manufacturing our products, including raw materials, direct labour and overhead, plus freight costs. Cost of goods sold also includes variable distribution centre costs incurred to prepare our inventory for sale. Gross margin measures our gross profit as a percentage of sales.

The primary driver of our cost of goods sold is the cost of purchased products from our manufacturers, which is predominantly sourced in U.S. dollars and Canadian dollars. In Fiscal 2017, we implemented a hedging program to manage our foreign currency risk related to U.S. dollar inventory purchases. See “Financial Instruments”.

### ***Selling, General and Administrative Expenses***

SG&A expenses consist of selling costs to market and deliver our products to our consumers through our DTC segment, depreciation of store and e-commerce assets, and costs incurred to support the relationships with our retail partners and distributors through our Partners and Other segment. SG&A expenses also include our marketing and brand investment activities, and the corporate infrastructure required to support our ongoing business.

Selling costs as a percentage of sales is usually higher in the lower-volume first and second quarters of a fiscal year, and lower in the higher-volume third and fourth quarters of a fiscal year because a portion of these costs are relatively fixed. We expect our selling costs to increase as we continue to open new stores, grow our e-commerce business and increase our marketing and brand investment activities.

General and administrative expenses represent costs incurred in our corporate offices, primarily related to personnel costs, including salaries, variable-incentive compensation, benefits, share-based compensation, and marketing costs. It also includes depreciation and amortization expenses for all office support assets and intangible assets.

We have invested to support the growing volume and complexity of our business and anticipate continuing to do so in the future. As we continue to grow, we anticipate that we will be able to scale our investments and leverage our fixed costs.

Foreign exchange gains and losses, excluding changes in the fair value of foreign currency forward contracts (see “Financial Instruments”) are recorded in SG&A expenses and comprise translation of monetary assets and liabilities denominated in currencies other than the functional currency of the entity.

### ***Interest Expense***

Interest expense relates to our Credit Facilities. See “Indebtedness”.

### ***Income Taxes***

We are subject to income taxes in the jurisdictions in which we operate and, consequently, income taxes expense or recovery is a function of the allocation of taxable income by jurisdiction and the various activities that impact the timing of taxable events. The primary regions that determine the effective tax rate are Canada and the United States. Over the long-term, we expect our annual effective income tax rate to be, on average, approximately 27-28%, subject to changes to income tax rates and legislation in the jurisdictions in which we operate.

## Selected Consolidated Financial Information

The following table summarizes our recent results of operations for the periods indicated. The selected consolidated financial information set out below has been derived from our Interim Financial Statements.

CAD \$000s	<u>Q2 2018</u>	<u>Q2 2017</u>	<u>YTD 2018</u>	<u>YTD 2017</u>
<b>Sales</b>	<b>60,197</b>	<b>58,115</b>	<b>111,226</b>	<b>106,346</b>
Cost of goods sold	27,052	27,111	49,011	49,384
<b>Gross Profit</b>	<b>33,145</b>	<b>31,004</b>	<b>62,215</b>	<b>56,962</b>
Selling, general and administrative expenses	37,245	33,775	72,549	65,205
<b>Loss before interest expense and income taxes recovery</b>	<b>(4,100)</b>	<b>(2,771)</b>	<b>(10,334)</b>	<b>(8,243)</b>
Interest expense	1,191	1,592	2,343	2,980
<b>Loss before taxes</b>	<b>(5,291)</b>	<b>(4,363)</b>	<b>(12,677)</b>	<b>(11,223)</b>
Income taxes recovery	(1,210)	(1,137)	(3,006)	(2,884)
<b>Net loss</b>	<b>(4,081)</b>	<b>(3,226)</b>	<b>(9,671)</b>	<b>(8,339)</b>
Basic loss per Share <sup>(1)</sup>	(\$0.10)	\$(0.08)	\$(0.23)	\$(0.20)

The following table provides selected financial information for the periods indicated:

### Consolidated Statement of Financial Position Data:

CAD \$000s (except per Share amounts)	<u>As at August 4, 2018</u>	<u>As at July 29, 2017</u>
Current assets . . . . .	\$67,606	\$55,311
Non-current assets . . . . .	305,403	292,462
Current liabilities . . . . .	40,045	35,519
Non-current liabilities . . . . .	139,560	140,068
Distributions declared per Share <sup>(1)</sup> . . . . .	—	\$0.48

Note:

- (1) Calculated based on the number of outstanding Shares as if the Pre-Closing Capital Changes were implemented at the start of the period. At the time of distribution, prior to the Pre-Closing Capital Changes, the equivalent distributions per Share was \$0.10.

## Results of Operations

### Analysis of Results for Q2 2018 to Q2 2017 and YTD 2018 to YTD 2017

The following section provides an overview of our financial performance during Q2 2018 compared to Q2 2017 and during YTD 2018 compared to YTD 2017.

#### Sales

The following table presents our sales by segment for each of the periods indicated:

CAD \$000s	Q2 2018	Q2 2017	% Change	YTD 2018	YTD 2017	% Change
DTC .....	48,289	46,638	3.5%	92,451	87,150	6.1%
Partners and Other .....	11,908	11,477	3.8%	18,775	19,196	(2.2%)
<b>Total Sales</b> .....	<b>60,197</b>	<b>58,115</b>	<b>3.6%</b>	<b>111,226</b>	<b>106,346</b>	<b>4.6%</b>

Total sales were \$60,197 in Q2 2018 as compared to \$58,115 in Q2 2017, representing an increase of \$2,082, or 3.6%.

DTC sales increased \$1,651, or 3.5%, in Q2 2018 as compared to Q2 2017. The year-over-year improvement in DTC sales reflects positive comparable sales growth and new corporate store openings. Comparable Sales Growth for the quarter was 1.1%, reflecting consumers' positive response to certain new products, improved conversion and our continued success as an omni-channel retailer, which offset softer year-over-year store traffic, as Q2 2017 benefitted from one-time traffic and sales related to Canada 150 as well as a louder brand voice in Canada. We estimate that one-time Canada Collection by Roots™ product sales related to Canada 150 in Q2 2017 were approximately \$4,000, representing the largest single quarter impact (estimated \$8,000 to \$9,000 in one-time Canada Collection by Roots™ product sales for Fiscal 2017). While we faced store traffic headwinds related to Canada 150 in Q2 2018, consumers are increasingly embracing our omni-channel capabilities.

Sales in the Partners and Other segment increased by \$431, or 3.8%, in Q2 2018 as compared to Q2 2017. The year-over-year increase was driven by sales growth in Asia and the timing of certain sales to the Company's operating partner in Asia, which shifted from Q1 2018 into Q2 2018 (as noted in Q1 2018), which were partially offset by certain one-time Canada 150-related wholesale arrangements in Q2 2017 that did not reoccur in Q1 2018. The sales increase in the Partners and Other segment, largely denominated in U.S. dollars, was partially offset by the weaker U.S. dollar as compared to the Canadian dollar in Q2 2018 (average effective exchange rate of 1.31) compared to Q2 2017 (average effective exchange rate of 1.32). If the exchange rate had been 1.32 during the period, Q2 2018 sales in the Partners and Other segment would have increased by \$495, or 4.3%, as compared to Q2 2017.

YTD 2018 sales were \$111,226 as compared to \$106,346 during YTD 2017, representing an increase of \$4,880, or 4.6%.

DTC sales increased by \$5,301, or 6.1%, in YTD 2018 as compared to YTD 2017. The year-over-year improvement in DTC sales reflects positive comparable sales growth and new corporate store openings. YTD 2018 comparable sales growth was 3.8%, reflecting consumers' positive response to certain new products, improved conversion and our continued success as an omni-channel retailer. These operational gains offset the impact of the major ice storm in Q1 2018 that affected approximately 80% of our store network during the weekend of our primary marketing and consumer event for the first half of the year, as well as softer year-over-year store traffic in

Q2 2018 as we benefitted from a louder brand voice in Canada and one-time traffic and sales related to Canada 150, predominantly in Q2 2017. While we faced store traffic headwinds, consumers are increasingly embracing our omni-channel capabilities.

Sales in the Partners and Other segment decreased by \$421, or 2.2%, during YTD 2018 as compared to YTD 2017. The decrease in Partners and Other sales, largely denominated in U.S. dollars, was primarily driven by the weaker U.S. dollar during YTD 2018 (average effective exchange rate of 1.31) compared to YTD 2017 (average effective exchange rate of 1.32). If the exchange rate had been 1.32, YTD 2018 sales in the Partners and Other segment would have decreased by \$125, or 0.7%, as compared to YTD 2017. The decrease in YTD 2018 also reflects certain one-time Canada 150-related wholesale arrangements in Q2 2017 that did not reoccur in Q2 2018.

### **Gross Profit**

The following tables present our gross profit and gross margin by segment for each of the periods indicated:

<b>CAD \$000s</b>	<b>Q2 2018</b>	<b>Q2 2017</b>	<b>% Change</b>	<b>YTD 2018</b>	<b>YTD 2017</b>	<b>% Change</b>
DTC .....	29,311	27,397	7.0%	55,407	50,233	10.3%
Partners and Other .....	3,834	3,607	6.3%	6,808	6,729	1.2%
<b>Total Gross Profit</b> .....	<b>33,145</b>	<b>31,004</b>	<b>6.9%</b>	<b>62,215</b>	<b>56,962</b>	<b>9.2%</b>

<b>Gross profit as a percentage of sales</b>	<b>Q2 2018</b>	<b>Q2 2017</b>	<b>YTD 2018</b>	<b>YTD 2017</b>
DTC .....	60.7%	58.7%	59.9%	57.6%
Partners and Other .....	32.2%	31.4%	36.3%	35.1%
<b>Total Gross Margin</b> .....	<b>55.1%</b>	<b>53.3%</b>	<b>55.9%</b>	<b>53.6%</b>

Gross profit was \$33,145 in Q2 2018, as compared to \$31,004 in Q2 2017, representing an increase of \$2,141, or 6.9%.

Gross profit in the DTC segment increased \$1,914, or 7.0%, in Q2 2018 as compared to Q2 2017. The increase in gross profit in the DTC segment was primarily driven by the sales growth in Q2 2018, and a higher gross margin. Gross margin in the DTC segment was 60.7% in Q2 2018, up compared to 58.7% in Q2 2017, primarily as a result of improved product costing from our UBR initiative, and favourable foreign exchange rates on goods purchased in U.S. dollars.

Gross profit in the Partners and Other segment increased by \$227, or 6.3%, in Q2 2018 as compared to Q2 2017. The increase in gross profit in the Partners and Other segment was primarily driven by the increase in sales to our international operating partner.

Gross profit was \$62,215 during YTD 2018 as compared to \$56,962 in YTD 2017, representing an increase of \$5,253, or 9.2%.

Gross profit in the DTC segment increased by \$5,174, or 10.3%, during YTD 2018 as compared to YTD 2017. The increase in gross profit in the DTC segment was primarily driven by the sales growth during YTD 2018 and a higher gross margin. Gross margin in the DTC segment was 59.9% as compared to 57.6% in YTD 2017. The increase in gross margin was driven by improved product costing, largely as a result of our UBR initiative.

Gross profit in the Partners and Other segment increased by \$79, or 1.2%, during YTD 2018 as compared to YTD 2017. The growth in gross profit in this segment was primarily driven by a higher mix of sales from earned royalties, which generate a higher margin than our wholesale sales.

### ***Selling, General and Administrative Expenses***

SG&A expenses were \$37,245 in Q2 2018 as compared to \$33,775 in Q2 2017, representing an increase of \$3,470, or 10.3%. This increase primarily reflects selling costs increasing by \$2,748, or 6.3%, in Q2 2018 as compared to Q2 2017, driven by growth in sales and incremental personnel costs of \$470 relating to legislated minimum wage increases. General and administrative costs increased by \$722, or 6.1%, in Q2 2018 as compared to Q2 2017. The increase in general and administrative costs was primarily driven by an increase in marketing and advertising investments of \$1,104 to increase brand awareness and support new store openings, particularly in Boston and Washington, incremental costs incurred to operate as a public company of \$598 and higher salaries expense driven by an increase in headcount.

SG&A expenses were \$72,549 during YTD 2018 as compared to \$65,205 in YTD 2017, representing an increase of \$7,344, or 11.3%. This increase primarily reflects selling costs increasing by \$4,394, or 10.0%, in YTD 2018 as compared to YTD 2017, driven by the growth in sales and incremental personnel costs of \$825 relating to legislated minimum wage increases. General and administrative costs increased by \$2,950, or 13.8%, in YTD 2018 as compared to YTD 2017. The increase in general and administrative costs was primarily driven by an increase in marketing and advertising investments of \$1,898 to increase brand awareness and support new store openings, incremental costs incurred to operate as a public company of \$1,047, and higher salaries expense driven by an increase in headcount.

### ***Interest Expense***

Interest expense was \$1,191 in Q2 2018 as compared to \$1,592 in Q2 2017, representing a decrease of \$401, or 25.2%. During YTD 2018, interest expense was \$2,343 as compared to \$2,980 for the same period in the prior fiscal year, representing a decrease of \$637, or 21.4%. The decrease in interest expense related primarily to lower debt from repayment of the Term Credit Facility, and lower effective interest rates charged on the Credit Facilities as a result of the amendments made to the Credit Agreement and lowering our Trailing Leverage Multiple since Q2 2017. See “Indebtedness”.

### ***Income Taxes Recovery***

Income taxes recovery was \$1,210 in Q2 2018 as compared to \$1,137 in Q2 2017, representing an increase of \$73, or 6.4%. The effective tax recovery rate for Q2 2018 was 22.9% as compared to 26.1% in Q2 2017. The decrease in the effective income tax recovery rate is primarily attributable to an increase in non-deductible expenses incurred in Q2 2018 as compared to Q2 2017.

During YTD 2018, income taxes recovery was \$3,006 as compared to \$2,884 for the same period in the prior fiscal year, representing an increase of \$122, or 4.2%. The effective tax recovery rate during YTD 2018 was 23.7% as compared to 25.7% in YTD 2017. The change in the income tax recovery rate results from greater non-deductible expenses incurred in YTD 2018 as compared to YTD 2017.

## Net loss

Net loss was \$4,081 in Q2 2018 as compared to \$3,226 in Q2 2017, representing an increase of \$855, or 26.5%. The increase in net loss results from the factors described above.

During YTD 2018, net loss was \$9,671 as compared to \$8,339 in YTD 2017, representing an increase of \$1,332, or 16.0%. The increase in net loss results from the factors described above.

## Quarterly Financial Information

The following table summarizes the results of our operations for the eight most recently completed fiscal quarters. This unaudited quarterly information, other than comparable sales growth, has been prepared in accordance with IFRS. Due to seasonality, the results of operations for any quarter are not necessarily indicative of the results of operations for the fiscal year.

CAD \$000s (except per Share data) (Unaudited)	Q2 2018	Q1 2018	Q4 2017	Q3 2017	Q2 2017	Q1 2017	Q4 2016	Q3 2016
<b>Sales</b>	<b>60,197</b>	<b>51,029</b>	<b>130,021</b>	<b>89,690</b>	<b>58,115</b>	<b>48,231</b>	<b>111,172</b>	<b>79,384</b>
<b>Net Income (Loss)</b> . . . . .	<b>(4,081)</b>	<b>(5,590)</b>	<b>20,861</b>	<b>4,979</b>	<b>(3,226)</b>	<b>(5,113)</b>	<b>17,194</b>	<b>5,903</b>
<b>Net Earnings (Loss) per Share:</b>								
Basic earnings per Share <sup>(1)</sup> . . . . .	\$(0.10)	\$(0.13)	\$0.50	\$0.12	\$(0.08)	\$(0.12)	\$0.41	\$0.14
Diluted earnings per Share <sup>(1)</sup> . . . . .	\$(0.10)	\$(0.13)	\$0.49	\$0.12	\$(0.08)	\$(0.12)	\$0.41	\$0.14
<b>Other Performance Measures</b>								
Comparable sales growth <sup>(2)</sup> . . . . .	1.1%	6.8%	15.2%	10.0%	16.3%	3.5%	9.3%	2.7%
Corporate stores, end of period . . .	122	120	119	120	120	118	117	116

### Notes:

- (1) Basic and diluted earnings per Share are presented as if the Pre-Closing Capital Changes had been effected during all periods presented. See "Share Information – Prior to Completion of IPO".
- (2) Prior to Q2 2018, comparable sales growth was calculated and presented using a U.S. dollar to Canadian dollar exchange rate of 1:1. The prior fiscal quarters have been recalculated and presented using the new constant currency calculation. See "Cautionary Note Regarding Non-IFRS Measures and Industry Metrics".

## Summary of Non-IFRS Measures

The table below illustrates our EBITDA, Adjusted EBITDA, Adjusted Net Loss and Adjusted Net Loss per Share for the periods presented:

CAD \$000s (except per Share data)	Q2 2018	Q2 2017	YTD 2018	YTD 2017
EBITDA . . . . .	(1,109)	(44)	(4,591)	(2,901)
Adjusted EBITDA . . . . .	32	1,350	(3,083)	(382)
Adjusted Net Loss . . . . .	(2,360)	(1,429)	(6,827)	(5,045)
Adjusted Net Loss per Share <sup>(1)</sup> . . . . .	\$(0.06)	\$(0.03)	\$(0.16)	\$(0.12)

### Note:

- (1) Adjusted Net Loss per Share is presented as if the Pre-Closing Capital Changes was effected in all periods presented. See "Share Information – Prior to Completion of IPO".

See "Cautionary Note Regarding Non-IFRS Measures and Industry Metrics".

## Reconciliation of Non-IFRS Measures

The tables below provide a reconciliation of net loss to EBITDA, Adjusted EBITDA, and Adjusted Net Loss for the periods presented:

CAD \$000s	Q2 2018	Q2 2017	YTD 2018	YTD 2017
<b>Net loss</b> .....	<b>(4,081)</b>	<b>(3,226)</b>	<b>(9,671)</b>	<b>(8,339)</b>
<i>Add the impact of:</i>				
Interest expense .....	1,191	1,592	2,343	2,980
Income taxes recovery .....	(1,210)	(1,137)	(3,006)	(2,884)
Depreciation and amortization .....	2,991	2,727	5,743	5,342
<b>EBITDA</b> .....	<b>(1,109)</b>	<b>(44)</b>	<b>(4,591)</b>	<b>(2,901)</b>
<i>Add the impact of:</i>				
SG&A: Purchase accounting adjustments (a) .....	135	252	271	509
SG&A: IPO transaction costs (b) .....	—	206	60	206
SG&A: Shareholder fees and related costs (c) .....	—	619	—	725
SG&A: Acquisition transaction costs (d) .....	—	—	—	29
SG&A: Stock option expense (e) .....	705	93	1,315	195
SG&A: DC Relocation Project (f) .....	208	—	208	—
SG&A: Other non-recurring items (g) .....	75	81	224	431
SG&A: Non-cash rent adjustments (h) .....	18	143	(570)	424
<b>Adjusted EBITDA</b> .....	<b>32</b>	<b>1,350</b>	<b>(3,083)</b>	<b>(382)</b>

CAD \$000s	Q2 2018	Q2 2017	YTD 2018	YTD 2017
<b>Net loss</b> .....	<b>(4,081)</b>	<b>(3,226)</b>	<b>(9,671)</b>	<b>(8,339)</b>
<i>Add the impact of:</i>				
SG&A: Purchase accounting adjustments (a) .....	135	252	271	509
SG&A: IPO transaction costs (b) .....	—	206	60	206
SG&A: Shareholder fees and related costs (c) .....	—	619	—	725
SG&A: Acquisition transaction costs (d) .....	—	—	—	29
SG&A: Stock option expense (e) .....	705	93	1,315	195
SG&A: DC Relocation Project (f) .....	208	—	208	—
SG&A: Other non-recurring items (g) .....	75	81	224	431
SG&A: Non-cash rent adjustments (h) .....	18	143	(570)	424
SG&A: Amortization of intangible assets acquired by Searchlight (i) .....	949	1,022	1,898	1,898
Total adjustments .....	2,090	2,416	3,406	4,417
Tax effect of adjustments .....	(369)	(619)	(562)	(1,123)
<b>Adjusted Net Loss</b> .....	<b>(2,360)</b>	<b>(1,429)</b>	<b>(6,827)</b>	<b>(5,045)</b>

### Notes:

- (a) As a result of the Acquisition, we recognized an intangible asset for lease arrangements in the amount of \$6,310, which is amortized over the life of the leases and included in SG&A expenses. In our view, this cost does not reflect the underlying profitability of the business and would reduce the ability to compare such underlying results to historical periods prior to the Acquisition.
- (b) In connection with the IPO, we incurred expenses related to professional fees, legal, consulting, accounting, and travel that would otherwise not have been incurred and are not recurring.
- (c) Represents the amount paid pursuant to the management agreement with Searchlight and consulting agreements with the Founders and certain of their family members for ongoing consulting and other services. Subsequent to the IPO, the management agreement and Founder consulting services were terminated, and neither Searchlight nor the Founders and their family members will receive these fees from us in relation thereto going forward. See "Related Party Transactions".
- (d) In connection with the Acquisition, we incurred expenses related to professional fees, legal, consulting, and accounting that would otherwise not have been incurred and are not recurring.

- (e) Represents non-cash share-based compensation expense in respect of our Legacy Equity Incentive Plan, Legacy Employee Option Plan, and Omnibus Plan.
- (f) In 2018, we began the preparation to relocate our retail store and e-commerce fulfillment to a new, larger, and more technologically enhanced distribution centre. During this move, we will incur expenses related to areas such as training, testing, and administrative costs that we would otherwise not incur as part of our normal business operations, and these costs are not recurring.
- (g) Predominately represents expenses incurred in respect of the following matters: (i) one-time recruitment costs in Fiscal 2017 incurred as part of the Company's initial efforts to put in place key members of its management team and (ii) consulting costs in respect of the Company's UBR initiative relating to a non-recurring project to focus the Roots brand and streamline our product offering. These costs have been identified as one-time costs incurred in conjunction with the Acquisition and the implementation of a new senior management team. Management has determined that each of the above projects are non-recurring or infrequent in nature and, accordingly, such matters do not reflect the underlying profitability of the business and their inclusion would, therefore, reduce the ability to compare such underlying results to historical periods.
- (h) Under IFRS, we are required to recognize rent expense on a straight-line basis over the life of the lease. This adjustment removes the portion of the straight-line rent adjustment that is non-cash expense in the applicable financial period.
- (i) As a result of the Acquisition, intangibles relating to customer relationships of \$7,766 with a useful life of 10 years and licensing arrangements of \$25,910 with useful lives ranging from four to 13 years were recognized in accordance with IFRS 3. The amortization expense resulting from the recognition of these intangible assets are non-cash in nature and are a direct result of the Acquisition. If the Acquisition had not occurred, such intangibles would not have been recognized and, consequently, the associated expenses would not have been incurred. Management is of the view that these costs do not reflect the underlying profitability of the business and would, therefore, reduce the ability to compare such underlying results to historical periods prior to the Acquisition.

## Financial Condition, Liquidity and Capital Resources

### Overview

We principally use our funds for operating expenses, capital expenditures and debt service requirements. We believe that cash generated from operations, together with amounts available under our Credit Facilities, will be sufficient to meet our future operating expenses, capital expenditures and future debt service requirements. In addition, we believe that our capital structure provides us with significant financial flexibility to pursue our future growth strategies. However, our ability to fund operating expenses, capital expenditures and future debt service requirements will depend on, among other things, our future operating performance, which will be affected by general economic, financial and other factors, including factors beyond our control. See "Risks and Uncertainties" and "Factors Affecting our Performance" for additional information.

### Cash Flows

The following table presents our cash flows for each of the periods presented:

CAD\$000s	Q2 2018	Q2 2017	YTD 2018	YTD 2017
Net cash used in operating activities . . . . .	(16,267)	(12,132)	(24,009)	(16,533)
Net cash provided by (used in) financing activities . . . . .	19,323	(9,000)	27,992	(5,241)
Net cash used in investing activities . . . . .	(10,365)	(2,625)	(15,047)	(4,451)
<b>Change in cash and bank indebtedness . . . . .</b>	<b>(7,309)</b>	<b>(23,757)</b>	<b>(11,064)</b>	<b>(26,225)</b>

### Analysis of Cash Flows for Q2 2018 and YTD 2018 compared to Q2 2017 and YTD 2017

#### Cash Flows used in Operating Activities

For Q2 2018 and YTD 2018, cash flows used in operating activities totalled \$16,267 and \$24,009, respectively, compared to \$12,132 and \$16,533 in Q2 2017 and YTD 2017, respectively. The

cash flows used in operating activities is attributable to greater investments in inventory and the timing of certain working capital balances and tax instalments paid.

### ***Cash Flows from (used in) Financing Activities***

For Q2 2018 and YTD 2018, cash flows from (used in) financing activities amounted to \$19,323 and \$27,992, respectively, compared to \$(9,000) and \$(5,241) in Q2 2017 and YTD 2017, respectively. This change is largely driven by greater drawings on our Revolving Credit Facility during YTD 2018 to fund our operations and capital investments (\$30,000 drawn in YTD 2018 compared to \$21,000 drawn in YTD 2017). In addition, a one-time shareholder distribution in the amount of \$20,000 was paid in Q2 2017.

At the end of Q2 2018, the Company had a total amount outstanding under its Credit Facilities of \$114,692 (as at the end of Q2 2017 - \$122,063).

### ***Cash Flows used in Investing Activities***

For Q2 2018 and YTD 2018, cash flows used in investing activities amounted to \$10,365 and \$15,047, respectively, compared to \$2,625 and \$4,451 in Q2 2017 and YTD 2017, respectively. The changes are largely driven by continued investment in our DTC segment and supporting infrastructure, including capital expenditures related to the relocation of our distribution centre.

### **Indebtedness**

On December 1, 2015, the Company entered into a secured credit agreement (the “**Credit Agreement**”) with a syndicate of lenders to obtain an initial term loan (the “**Term Credit Facility**”) for an aggregate principal amount not exceeding \$111,000 and a revolving credit loan (the “**Revolving Credit Facility**”) not exceeding \$25,000, less the aggregate swing line loan of \$5,000 (together, the “**Credit Facilities**”).

On April 19, 2017, the Company amended the Credit Agreement to increase the availability under the Revolving Credit Facility to an amount not exceeding \$50,000, less the aggregate swing line loan of \$10,000.

On September 6, 2017, the Company further amended and extended the Credit Facilities. The Credit Facilities, as amended, are comprised of (i) the Revolving Credit Facility in the amount of \$50,000 and (ii) an approximately \$100,000 Term Credit Facility, both bearing interest in accordance with the Trailing Leverage Multiple and maturing on September 6, 2022.

The Credit Facilities include an accordion feature in the amount of \$25,000 and bear interest according to the type of borrowing advanced, which may be based on a reference rate of the U.S. base rate or the Canadian prime rate, plus a margin that ranges from 100 to 225 basis points (bps) or the LIBOR rate or bankers’ acceptances rate, plus a margin that ranges from 200 to 325 bps. The applicable margins are derived from our senior leverage ratio, as follows: (i) where the U.S. base rate or a Canadian prime rate is used, the margins range from 100 bps at less than 2.0x senior leverage ratio, to 225 bps at greater than or equal to 3.5x senior leverage ratio; and (ii) where the LIBOR rate or bankers’ acceptances rate is used, the margins range from 200 bps at less than 2.0x senior leverage ratio, to 325 bps at greater than or equal to 3.5x senior leverage ratio (the “**Trailing Leverage Multiple**”).

The Company has financial and non-financial covenants under the Credit Facilities. The key financial covenants include covenants for senior secured debt to Adjusted EBITDA ratio, total debt to Adjusted EBITDA ratio, and fixed charge coverage ratio. As at the end of Q2 2018, the Company was in compliance with all such covenants.

The following table sets out the mandatory repayment of the Credit Facilities over the next five years:

CAD \$000s	Term Credit Facility	Revolving Credit Facility
Within 1 year.....	4,984	—
Within 1 - 2 years.....	4,984	—
Within 2 - 3 years.....	4,984	—
Within 3 - 4 years.....	4,984	—
Within 4 - 5 years.....	64,756	30,000
<b>Total.....</b>	<b>84,692</b>	<b>30,000</b>

### Contractual Obligations and Off-Balance Sheet Arrangements

The following table summarizes our significant contractual obligations and other obligations as well as our off-balance sheet arrangements as at August 4, 2018:

CAD\$000s	Remainder of						Total
	FY 2018	FY 2019	FY 2020	FY 2021	FY 2022	Thereafter	
Revolving Credit Facility <sup>(1)</sup> .....	—	—	—	—	30,000	—	30,000
Term Credit Facility <sup>(1)</sup> .....	2,492	4,984	4,984	4,984	67,248	—	84,692
Interest commitments relating to long-term debt <sup>(2)</sup> .....	1,736	3,318	3,112	2,906	1,599	—	12,671
Operating leases <sup>(3)</sup> .....	13,108	24,647	21,814	18,798	16,474	54,714	149,555
Finance leases.....	169	338	153	25	9	—	694
Inventory purchase commitments <sup>(4)</sup> .....	67,180	10,318	—	—	—	—	77,498
<b>Total commitments and obligations.....</b>	<b>84,685</b>	<b>43,605</b>	<b>30,063</b>	<b>26,713</b>	<b>115,330</b>	<b>54,714</b>	<b>355,110</b>

Notes:

- (1) The repayment of the Term Credit Facility may occur prior to the mandatory repayment time if certain events occur and/or at the discretion of the Company.
- (2) Based on the interest rate in effect as at August 4, 2018, and assuming no prepayments are made to the Term Credit Facility.
- (3) Operating leases for certain of our premises include renewal options, rent escalation clauses, variable rent, and rent-free periods. The operating lease commitment reflects minimum annual commitments for our operating leases on those premises, excluding renewal options and variable rent.
- (4) Inventory purchase commitments reflect the cost of outstanding inventory purchases ordered from our vendors and expected to be received within the period. Inventory purchases are part of the normal course of our business and will be primarily funded through sales in our DTC segment.

Due to the seasonal fluctuations of our retail business (see “Seasonality”), our cash position may be lower during the first two fiscal quarters when working capital requirements peak and will generally increase in the third and fourth quarters. Historically, contractual obligations and commitments during the first two fiscal quarters were funded primarily through draws on our Revolving Credit Facility (see “Indebtedness”), and, to a lesser extent, sales generated from our operations and our management of working capital. In the third and fourth fiscal quarters, we have historically generated sufficient cash flow from operations to fund our remaining contractual obligations and commitments and to repay any draws on our Revolving Credit Facility during the first two fiscal quarters. We will continue to fund our upcoming commitments and obligations through the use of our Revolving Credit Facility and cash flow from operations. We believe that

we will continue to generate sufficient cash flow from operations over the course of a fiscal year to fund our contractual obligations and commitments and the cost of our growth and development activities incurred during such fiscal year.

## **Financial Instruments**

Commencing in Fiscal 2017, we have designated foreign currency forward contracts as a cash flow hedge to manage our exposure to certain U.S. dollar denominated purchases. At the inception of a hedging relationship, the Company designates and formally documents the relationship between the hedging instrument and the hedged item, the risk management objective, and the strategy in undertaking the hedge transaction. At inception and each fiscal quarter-end thereafter, the Company formally assesses the effectiveness of the cash flow hedges.

To the extent the hedging relationship is assessed as effective, the change in the fair value of the foreign currency forward contracts, net of taxes, is recognized in other comprehensive income (loss) and presented in accumulated other comprehensive income (loss). Any ineffective portion of changes in the fair value of the foreign currency forward contracts are recognized immediately in net income (loss).

The fair value of foreign currency forward contracts is determined using a valuation technique that employs the use of market observable inputs and based on the differences between the contract rate and the market rates as at the period-end date, taking into consideration discounting to reflect the time value of money.

As of August 4, 2018, the Company has recorded a derivative asset of \$1,676, representing foreign currency forward contracts to buy U.S. \$48,890 at an average rate of 1.26. As at August 4, 2018, the exchange rate was 1.30.

All other financial assets and financial liabilities are measured at amortized cost using the effective interest method.

## **Share Information - Prior to Completion of the IPO**

Prior to the completion of the IPO, we were authorized to issue an unlimited number of Class A, B and C Shares, with no par value. The Class A, B and C Shares were identical, except that the aggregate number of votes attached to the Class B Shares, as a class, could at no times exceed 15% of the votes cast at a meeting of shareholders (allocated proportionately among all holders of Class B Shares) and the Class C Shares did not contain voting rights. The Class A, B and C Shares ranked *pari passu* in all respects, including the right to receive dividends and with respect to any distribution of our assets.

Prior to completion of the IPO, there were 156,845,150 Class A Shares, 39,148,787 Class B Shares, and no Class C Shares issued and outstanding. In addition there were 14,069,635 options and 74,627 RSUs, each representing a right to acquire one Class C Share, issued and outstanding.

### Pre-Closing Capital Changes

In connection with and immediately prior to closing of the IPO, all outstanding Class A Shares, Class B Shares, options and RSUs were effectively consolidated on a 0.214193-to-one basis into Shares or securities exercisable for Shares.

## Current Share Information

During year-to-date 2018, the Company granted 122,333 time-based options and 44,039 RSUs under the Omnibus Incentive Plan (the “**Omnibus Plan**”). In addition, 139,731 Shares were issued, through the exercise of 139,731 stock options granted under the Legacy Equity Incentive Plan.

As at August 4, 2018, there were 42,120,231 Shares and no preferred shares issued and outstanding. In addition, there were 3,261,944 options and 58,924 RSUs outstanding under the Company’s Legacy Equity Incentive Plan, Legacy Employee Option Plan, and Omnibus Plan. 185,767 options and 15,985 RSUs were vested as of such date. Each option and RSU is, or will become, exercisable for one Share.

During year-to-date 2018, the Company also granted 15,005 DSUs under the DSU Plan. As of August 4, 2018, there were 15,005 DSUs outstanding under the Company’s DSU Plan. No Shares will be issued upon the settlement of DSUs.

## Related Party Transactions

The Company’s related parties include key management personnel and key shareholders of the Company, including other entities under common control. Investment funds managed by Searchlight beneficially own approximately 47.5% of the total outstanding Shares and the Founders beneficially own approximately 12.0% of the total outstanding Shares. All transactions as described below are in the normal course of business and have been accounted for at their exchange value.

As at August 4, 2018, we have incurred the following costs in connection with transactions entered into with related parties:

CAD \$000s	Q2 2018	Q2 2017	YTD 2018	YTD 2017
Rent <sup>(1)</sup> .....	198	196	396	393
Consulting Fees <sup>(2)</sup> .....	–	100	–	200
Reimbursements <sup>(2)</sup> .....	5	13	22	19
Monitoring Fees <sup>(3)</sup> .....	–	506	–	506

### Notes:

- (1) Our distribution facility and leather factory are each owned by entities controlled by the Founders and certain of their family members. We have entered into lease arrangements in respect of these premises. The leather factory lease terminates on November 30, 2018, with a right to extend the term for two further periods of five years each, and has an annual rent of \$250. The distribution facility lease terminates on November 30, 2018, with a right to extend the term for one further period of one year. Annual rent in respect of the distribution facility is \$535.
- (2) Pursuant to consulting agreements dated December 1, 2015 between the Company and the Founders and certain of the Founders’ family members (the “**Consulting Agreements**”), the Founders and certain of their family members are provided with consulting fees, clothing allowances and reimbursement for certain travel, meals and phone expenses. The Consulting Agreements terminated upon completion of the IPO. Accordingly, the Company is no longer required to pay consulting fees or reimbursements of expenses as previously incurred, with exception to agreed-upon clothing allowances.
- (3) In accordance with a Unanimous Shareholder Agreement in existence prior to, and terminated upon completion of the IPO, the Company was required to pay Searchlight a monitoring fee and reimburses Searchlight for certain out-of-pocket expenses incurred during the year in connection with matters regarding the Company. In connection with the IPO, the Unanimous Shareholder Agreement and, therefore, the monitoring fee and expense reimbursement payable thereunder, terminated upon completion of the IPO.

In February 2016, a member of the Company's executive team purchased the equivalent of 214,193 Shares from Searchlight at a price of \$4.67 per Share. The purchase was paid for using \$500 in cash and a \$500 loan from the Company. The \$500 loan from the Company is to be repaid at the earlier of six years from the loan date and upon a liquidity sale of the Company. Interest accrues at a rate of 4% per annum and will be payable at the start of each calendar year following the date of the loan. Unpaid interest may be deemed paid by increasing the principal amount outstanding. As at August 4, 2018, the outstanding balance on the loan and accrued interest was \$541 (February 3, 2018 – \$541).

## **Financial Outlook**

### ***Fiscal 2019 Targets***

Through the remainder of fiscal 2018, while negative store traffic trends are a concern in Q3, we will continue with our foundation-building work to best position Roots for long-term success. Looking to fiscal 2019, we expect our financial results to be within our previously stated target range:

- annual sales between \$410,000 and \$450,000;
- annual Adjusted EBITDA between \$61,000 to \$68,000; and
- annual Adjusted Net Income between \$35,000 and \$40,000.

The aforementioned description of growth expectations is based on management's current strategies, our assumptions and expectations concerning our growth outlook and opportunities, and our assessment of the outlook and opportunities for the business and the retail industry as a whole and may be considered to be forward-looking information for purposes of applicable securities laws in Canada. Readers are cautioned that actual results may vary from those described above. See below and "Forward-Looking Information" and "Risks and Uncertainties" in this MD&A and "Risk Factors" in our AIF for a description of the assumptions underlying the forward-looking information and of the risks and uncertainties that impact our business and that could cause actual results to vary.

Implicit in such forward-looking information is certain current assumptions, relating to, among others: achieving average annual comparable sales growth in line with or above Fiscal 2016, notwithstanding quarterly variations; growing our e-commerce business; the opening of new corporate stores in Canada and the United States; the renovation or expansion of existing corporate stores; the opening of new international partner-operated stores; establishing a presence in new international markets with new international operating partners; increasing investment in marketing initiatives; strategic expansion of our existing product offering in leather and footwear; inflation rates remaining consistent with historical levels; taxation rates remaining consistent with historical levels; and debt repayments remaining consistent with the terms set out in this MD&A. These current assumptions, although considered reasonable by us at the time of preparation, may prove to be incorrect. Readers are cautioned that actual future operating results and economic performance of the Company, including with respect to our anticipated annual sales, annual Adjusted EBITDA and annual Adjusted Net Income, are subject to a number of risks and uncertainties, including among others those set forth under "Risks and Uncertainties" in this MD&A and "Risk Factors" in our AIF.

## **Risks and Uncertainties**

For a detailed description of risk factors relating to the Company, please refer to the “Risk Factors” section of our AIF, which is available on SEDAR at [www.sedar.com](http://www.sedar.com).

In addition, we are exposed to a variety of financial risks in the normal course of our business, including foreign currency exchange, interest rate, credit and liquidity risk, as summarized below. Our overall risk management program and business practices seek to minimize any potential adverse effects on our consolidated financial performance.

Financial risk management is carried out under practices approved by our Board. This includes identifying, evaluating and hedging financial risks based on the requirements of our organization. Our Board provides guidance for overall risk management, covering many areas of risk including foreign currency exchange risk, interest rate risk, credit risk, and liquidity risk.

### ***Foreign Currency Exchange Risk***

Our consolidated financial statements are expressed in Canadian dollars. However, a portion of our operations are denominated in U.S. dollars. Sales and expenses of all foreign operations are translated into Canadian dollars at the foreign currency exchange rates that approximate the rates in effect at the dates which such items are recognized. Appreciating foreign currencies relative to the Canadian dollar in respect of sales will positively impact operating income and net income (loss) associated with our foreign operations by increasing our sales and vice versa.

We are also exposed to fluctuations in the prices of U.S. dollar denominated purchases resulting from changes in U.S. dollar exchange rates. A depreciating Canadian dollar relative to the U.S. dollar will have a negative impact on year-over-year changes in reported operating income and net income (loss) by increasing the cost of finished goods and raw materials and vice versa. As described above, we enter into certain qualifying foreign currency forward contracts that are designated as cash flow hedges.

### ***Interest Rate Risk***

We are exposed to changes in interest rates on our cash and long-term debt. Debt issued at variable rates exposes us to cash flow interest rate risk. Debt issued at fixed rates exposes us to fair value interest rate risk. As of August 4, 2018, we only have variable interest rate debt. Based on the outstanding borrowings as discussed under “Indebtedness”, a one percentage point change in the average interest rate on our borrowings would have changed interest expense by \$266 in Q2 2018 and \$492 in YTD 2018. The impact of future interest rate expense resulting from future changes in interest rates will depend largely on the gross amount of our borrowings at such time.

### ***Credit Risk***

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Company’s financial instruments that are exposed to concentrations of credit risk are primarily cash, loan receivable, and accounts receivable. The Company limits its exposure to credit risk with respect to cash by dealing with Canadian financial institutions. The Company’s accounts receivable consist primarily of receivables from our business partners from the Partners and Other segment, which are settled in the following fiscal quarter.

## **Liquidity Risk**

Liquidity risk is the risk that we cannot meet a demand for cash or fund our obligations as they come due. We manage liquidity risk by continuously monitoring actual and projected cash flows, taking into account the seasonality of our sales, income and working capital needs. The Revolving Credit Facility is also used to maintain liquidity.

## **Disclosure Controls and Internal Controls over Financial Reporting**

Disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by the Company in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the Company's management, including its certifying officers, namely the CEO and CFO, as appropriate to allow timely decisions regarding public disclosure.

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with IFRS. Management is responsible for establishing adequate internal control over financial reporting for the Company.

## **Changes in Disclosure Controls and Internal Controls over Financial Reporting**

There were no changes in our disclosure controls and internal controls over financial reporting in Q2 2018 that materially affected, or are likely to materially affect the reliability of our financial reporting and preparation of our financial statements.

## **Critical Accounting Estimates and Judgments**

There were no changes to our critical accounting estimates and judgments since Fiscal 2017. See "Critical Accounting Estimates and Judgments" section within the Fiscal 2017 MD&A.

## **New Accounting Standards Adopted in the Year**

- In 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers ("**IFRS 15**"), replacing IAS 18, Revenue; IAS 11, Construction Contracts; and related interpretations. The new standard provides a comprehensive framework for the recognition, measurement and disclosure of revenue from contracts with customers, excluding contracts within the scope of the accounting standards on leases, insurance contracts and financial instruments. IFRS 15 is effective for annual periods beginning on or after January 1, 2018.

The Company adopted IFRS 15 on February 4, 2018. The adoption of IFRS 15 did not require any changes to the Company's revenue recognition approach and did not result in any measurement adjustments. As a result, there were no changes required to the Company's interim condensed consolidated financial statements.

## **New Accounting Standards and Interpretations Not Yet Adopted**

Certain new standards, amendments, and interpretations to existing IFRS standards have been published but are not yet effective and have not been adopted early by the Company. Management anticipates that all of the pronouncements will be adopted in the Company's accounting policy for the first period beginning after the effective date of the pronouncement. Information on new standards, amendments, and interpretation is provided below.

- In 2016, the IASB issued IFRS 16, *Leases* ("**IFRS 16**"), replacing IAS 17, *Leases*, and related interpretations. The standard introduces a single on-balance sheet recognition and measurement model for lessees, eliminating the distinction between operating and finance leases. Lessors continue to classify leases as finance and operating leases. IFRS 16 becomes effective for annual periods beginning on or after January 1, 2019. Early adoption is permitted if IFRS 15 has been adopted. The Company is currently working on the assessment of the standard and expects a significant impact on its consolidated statement of financial position along with a change to the recognition, measurement and presentation of lease expense on its consolidated statement of net income (loss).

## **Additional Information**

Additional information relating to the Company, including the AIF, is available on SEDAR at [www.sedar.com](http://www.sedar.com). The Company's Shares are listed for trading on the TSX under the symbol "ROOT".