ARITZIA

Aritzia Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS
First Quarter Ended May 31, 2020

July 9, 2020

The following Management's Discussion and Analysis ("MD&A") dated July 9, 2020 is intended to assist readers in understanding the business environment, strategies and performance and risk factors of Aritzia Inc. (together with its consolidated subsidiaries, referred to herein as "Aritzia", the "Company", "we", "us" 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 thirteen-week period ended May 31, 2020. This MD&A should be read in conjunction with the Company's unaudited condensed interim consolidated financial statements and accompanying notes for Q1 2021 (as hereinafter defined) and the Company's audited consolidated financial statements and accompanying notes for Fiscal 2020 (as hereinafter defined) and the related Management's Discussion and Analysis.

Basis of Presentation

Our audited annual consolidated financial statements and unaudited condensed interim consolidated financial statements (together, the "consolidated 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 therein. All amounts are presented in thousands of Canadian dollars unless otherwise indicated. We manage our business on the basis of one operating and reportable segment.

All references in this MD&A to "Q1 2021" are to our 13-week period ended May 31, 2020 and to "Q1 2020" are to our 13-week period ended June 2, 2019. All references in this MD&A to "Fiscal 2021" are to our 52-week period ending February 28, 2021 and to "Fiscal 2020" are to our 52-week period ended March 1, 2020.

The unaudited condensed interim consolidated financial statements and accompanying notes for Q1 2021 and this MD&A were authorized for issue by the Company's Board of Directors.

Non-IFRS Measures Including Retail Industry Metrics

This MD&A makes reference to certain non-IFRS measures including certain retail industry metrics. These measures are not recognized measures under IFRS, do not have a standardized meaning prescribed by IFRS and are therefore unlikely to 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 should not be considered in isolation or as a substitute for analysis of our financial information reported under IFRS. We use non-IFRS measures including "EBITDA", "Adjusted EBITDA", "Adjusted Net Income", "Adjusted Net Income per diluted share", "free cash flow" and "gross profit margin". This MD&A also makes reference to "comparable sales growth", which is a commonly used operating metric in the retail industry but may be calculated differently compared to other retailers. Our comparable sales growth calculation excludes the impact of foreign currency fluctuations. These non-IFRS measures, including retail industry metrics, are used to provide investors with supplemental measures of our operating performance and thus highlight trends in our core business that may not otherwise be apparent when relying solely on IFRS measures. We believe that securities analysts, investors and other interested parties frequently use non-IFRS measures, including retail industry metrics, in the evaluation of issuers. Our management also uses non-IFRS measures, including retail industry metrics, in order to facilitate operating performance comparisons from period to period, to prepare annual operating budgets and forecasts and to determine components of management compensation. For definitions and reconciliations of these non-IFRS measures to the relevant reported measures, please see the "How We Assess the Performance of Our Business" and "Selected Consolidated Financial Information" sections of this MD&A.

Forward-Looking Information

Certain statements made in this MD&A may constitute forward-looking information under applicable securities laws. These statements may relate to our future financial outlook, the shift toward eCommerce across the retail landscape and our ability to benefit from such migration, the ability to capitalize on real estate opportunities, and anticipated events or results and include, but are not limited to, expectations regarding our expectations relating to our growth through a challenging retail environment, our ability to scale inventory in order to meet demand and our financial performance through the balance of the fiscal year, an extended ramp up to a new normal with respect to boutique performance, additional labour and operating expenses of approximately $4 million per quarter to implement stringent protocols for its boutiques, distribution centre and support offices and capital expenditures for fiscal 2021 of approximately $30 to $35 million. Particularly, information regarding our expectations of future results, targets, performance achievements, prospects or opportunities is forward-looking information. As the context requires, this may include certain targets as disclosed in the prospectus for our initial public offering, which are based on the factors and assumptions, and subject to the risks, as set out therein and herein. Often but not always, forward-looking statements can be identified by the use of forward-looking terminology such as “may”, “will”, “expect”, “believe”, “estimate”, “plan”, “could”, “should”, “would”, “outlook”, “forecast”, “anticipate”, “foresee”, “continue” or the negative of these terms or variations of them or similar terminology.

Given this unprecedented period of uncertainty, there can be no assurances regarding: (a) the limitations or restrictions that may be placed on servicing our clients in reopened boutiques or potential re-closing of boutiques; (b) the COVID-19-related impacts on our business, operations, supply chain performance and growth strategies, (c) our ability to mitigate such impacts, including ongoing measures to enhance short-term liquidity, contain costs and safeguard the business; (d) our ability to open five to six new boutiques, two exclusive pop-ups and repositioning of three existing locations during the remainder of fiscal 2021; (e) general economic conditions related to COVID-19 and impacts to consumer discretionary spending and shopping habits; (f) credit, market, currency, interest rates, operational, and liquidity risks generally; and (g) other risks inherent to our business and/or factors beyond its control which could have a material adverse effect on the Company.

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 statements, including, without limitation, the factors discussed in the “Risk Factors” section of this MD&A and in the Company’s annual information form dated May 28, 2020 for Fiscal 2020 (the “AIF”). A copy of the AIF and the Company’s other publicly filed documents can be accessed under the Company’s profile on the System for Electronic Document Analysis and Retrieval (“SEDAR”) at www.sedar.com.

The Company cautions that the list of risk factors and uncertainties described in the AIF is not exhaustive and other factors could also adversely affect its results. Readers are urged to consider the risks, uncertainties and assumptions carefully in evaluating the forward-looking information and are cautioned not to place undue reliance on such information. The forward-looking information contained in this MD&A represents our expectations as of the date of this MD&A (or as the date they are otherwise stated to be made), and are subject to change after such date. However, we disclaim any intention or obligation or undertaking to update or revise any forward-looking information whether as a result of new information, future events or otherwise, except as required under applicable securities laws.

Overview

Aritzia is an innovative design house and fashion boutique. We conceive, create, develop and retail fashion brands with a depth of design and quality that provides compelling value. Each of our exclusive brands has its own vision and distinct aesthetic point of view. As a group, they are united by an unwavering commitment to superior fabrics, meticulous construction and relevant, effortless design.

Founded in Vancouver in 1984, Aritzia now has more than 95 locations in select cities across North America, including Vancouver, Toronto, Montreal, New York, Los Angeles, San Francisco and Chicago. We pride ourselves on creating immersive, human and highly personal shopping experiences, both in our boutiques and on *aritzia.com* — with a focus on delivering Everyday Luxury.

We connect our clients to the energy of our culture through the products we sell and the environments we create. As of the date of this MD&A, we operate 68 boutiques in Canada and 29 boutiques in the United States, averaging approximately 6,000 square feet, all of which are in premier locations within top-tier shopping destinations. We sell our products through our boutiques and *aritzia.com*, giving us complete control of the presentation of our brand and the relationships with our clients. This strategy allows us to present our brand in a consistent manner, including pricing, marketing and product merchandising. We strive to offer our clients an aspirational omni-channel shopping experience and exceptional service at every interaction. Our culture is highly focused on the client, and our style advisors are trained to provide shopping experiences that are personalized to exceed our clients' wants and needs.

Financial Highlights

We refer the reader to the section entitled "How We Assess the Performance of Our Business" of this MD&A for the definition of the items discussed below and, when applicable, to the section entitled "Selected Consolidated Financial Information" for reconciliations of non-IFRS measures with the most directly comparable IFRS measure.

Q1 2021 Compared to Q1 2020

Select highlights include the following:

- We experienced a significant decline in sales during the first two weeks of March.
- We temporarily closed all of our 96 boutiques on March 16, 2020 due to COVID-19.
- eCommerce revenue growth was in excess of 150% from boutique closures to the end of the quarter.
- A phased reopening of our boutiques commenced on May 7, 2020 with 30 boutiques reopened by the end of the quarter.
- Net revenue decreased by 43.4% to $111.4 million from $196.7 million in Q1 2020.
- Gross profit margin(1) decreased to 11.7% from 43.5% in Q1 2020, due to the significant deleveraging of occupancy, warehousing and distribution costs from the loss of retail revenue, including higher markdowns as we moved swiftly to decrease our inventory exposure in anticipation of prolonged boutique closures.
- Adjusted EBITDA(1) decreased to $(25.2) million from $35.4 million in Q1 2020.
- Net loss was $(26.5) million compared to net income of $16.2 million in Q1 2020.
- Adjusted Net Loss(1) was $(24.9) million compared to Adjusted Net Income of $18.5 million in Q1 2020.
- Adjusted Net Loss per diluted share(1) was $(0.23) compared to Adjusted Net Income per diluted share(1) of $0.17 in Q1 2020.
- Cash and cash equivalents at the end of Q1 2021 totaled $224.3 million, compared to $35.8 million at the end of Q1 2020.
- Inventory at end of Q1 2021 was $114.6 million, compared to $109.1 million at the end of Q1 2020. Notably, seasonal inventory decreased to $11.0 million this year compared to $26.0 million last year.

COVID-19 and Other Developments

As previously announced in May, we undertook prudent measures to enhance our short-term liquidity and protect our cash position.

Recent developments and ongoing efforts include:

- **89 boutiques have been reopened** as of July 9th, 2020, with initial sales exceeding expectations;
- **eCommerce revenue growth remains strong,** although the trend has moderated since boutique reopenings;
- **Inventory well-positioned for Fall/Winter** with lower initial buy and flexibility to reorder to meet demand;
- **Continuing to leverage applicable government business support programs,** when qualified, for COVID-19;

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(1) See the sections below entitled "How We Assess the Performance of our Business" and "Selected Consolidated Financial Information" for further details concerning comparable sales growth, Adjusted EBITDA, Adjusted Net Income and Adjusted Net Income per diluted share and for a reconciliation to the most comparable IFRS measure.

- **Drove additional cost reductions** by minimizing non-essential operating costs and ongoing negotiations with suppliers and landlords for concessions;
- **Extended payment terms** where possible;
- **Recommenced capital expenditures on boutique construction;** and
- **Increased access to work at Aritzia's Support Office in British Columbia** to select employees on June 1, 2020 under stringent health precautions on a voluntary basis.

In addition, we undertook several initiatives in support of our people and communities:

- **Paid $20 million through the Aritzia Community™ Relief Fund** to ensure financial continuity for our people during boutique closures and to enable seamless boutique reopenings;
- **Gifted 100,000 Aritzia Community™ clothing packages** to frontline healthcare heroes in Canada and the United States;
- **Investing $1 million towards internal Diversity and Inclusion initiatives;** and
- **Donated $100,000 to Black Lives Matter and the NAACP**.

Summary of Factors Affecting Performance

Since the outbreak of COVID-19 and the resulting emergency measures put in place by federal, provincial, state and local governments across North America, we have seen, and expect to continue to see, a direct, material adverse impact to many of the factors affecting our performance. The extent of the impact of such emergency measures, will depend on future developments, including the duration and severity of COVID-19 in the local markets in which we operate, which are uncertain and cannot be predicted.

We generally 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 are discussed below. See also the "Risk Factors" section of this MD&A and in our AIF.

Our Brand

We are a vertically integrated, innovative design house of exclusive fashion brands offering Everyday Luxury, that has been thoughtfully conceived, created and developed, in our boutiques and online. Each of our exclusive brands has its own vision and distinct aesthetic point of view. As a group, they are united by an unwavering commitment to superior fabrics, meticulous construction and relevant, effortless design. Our portfolio of exclusive brands enables us to appeal to our clients across multiple aspects of their lifestyles and life stages, producing strong and enduring client loyalty.

Product Innovation and Merchandise Planning Strategy

Each of our exclusive brands is treated as an independent label and is supported by our own dedicated in-house design team focused on creating beautiful, quality products that align with the unique positioning, look and feel of each brand. In addition to creating new exclusive brands, we continue to innovate our products by broadening our assortment across categories and styles – some examples include the development of leather, denim, intimates and extended sizing opportunities. Our demand-driven merchandise planning, buying and inventory strategies have been developed and refined for more than three decades, and are designed to ensure that we have the right product, at the right time, at the right price, in the right quantity and in the right place.

Boutique Network Expansion and Enhancement

We have developed our boutique network in a measured and disciplined manner. We have a portfolio of boutiques situated in premier real estate locations in high performing retail malls and high streets in North America. In addition to opening new Aritzia and exclusive brand boutiques (e.g. Wilfred, Babaton and TNA), we have generated attractive returns on capital by enhancing elements of our existing boutiques (including footprint, layout and assortment) through carefully considered boutique expansions and repositions. As a result of our disciplined real estate selection process and compelling boutique economics, we have never permanently closed an Aritzia boutique in our 35-year history.

We believe that we have a meaningful opportunity to continue to grow our boutique network, particularly in the United States. To maintain the overall look and feel of the Aritzia brand and support our compelling boutique economics, we are selective in evaluating boutique locations, with a focus on securing premier locations in high performing retail malls and high streets.

See also “COVID-19 and Other Developments” section of this MD&A.

The following table summarizes the change in our boutique count for the periods indicated.

	Q1 2021	Q1 2020	Fiscal 2020	Fiscal 2019
Number of boutiques, beginning of period	96	91	91	85
New boutiques	1	1	5	7
Boutique repositioned into a flagship boutique[(2)]	-	-	-	(1)
Number of boutiques, end of period	97	92	96	91
Boutiques expanded or repositioned	-	1	3	4

[(2)] Fiscal 2019 includes the reposition of one of our banner locations into the flagship boutique located on the same street.

eCommerce Growth

Our clients shop both online and in-boutiques, and we believe there are synergies between our boutique network and *aritzia.com*, with the success of each channel benefitting the other through increased brand awareness and affinity.

We believe the following strategies will support the net revenue growth objectives of *aritzia.com*:

- *Drive our omni-channel growth and capabilities* – Our clients shop both online and in our boutiques, and we believe there are synergies between our boutique network and *aritzia.com*, with the success of each channel benefiting the other through increased brand awareness and affinity. We are currently piloting digital selling tools in our stores as well as new Aritzia Concierge capabilities that will enhance client interactions. We will seek to integrate these capabilities with the *aritzia.com* experience.
- *Capitalize on digital marketing channels to drive client acquisition and retention* – We are directing resources with a renewed focus on digital marketing, including programs centred on search engine optimization enhancements, refinement of our email marketing, and further leveraging our social media. We made numerous technical enhancements to improve our search engine optimization results, including navigation bread crumbs, improved product descriptions, and data driven category naming. We are pleased with the positive impact this has had on new client visits.
- *Deliver personalized experiences* - We are in the early phases of leveraging advanced business intelligence and behaviour analytics to further enhance our understanding of our clients. This includes optimizing our online operations to enhance personalization, which we believe will drive higher conversion and client loyalty. Our goal is to use personalization techniques to customize product and content recommendations to clients based on where they are and how they shop.
- *Improve the digital experience to enhance the shopping experience online* – We are focused on improving the digital experience across all devices (e.g. desktop, mobile, tablet) to work towards making shopping frictionless. We have implemented a number of core optimizations including user reviews and fit guides, enhancing site search functionality, landing page templates, and numerous checkout improvements to reduce client friction. The core areas of our client’s digital journey including content, evaluating, discovery, and purchase are continuously improved resulting in increased conversion rate and average order value.
- *Elevate the brand online* – We see our multi-brand strategy as an asset, and we want to leverage it to create emotional connections with our clients. We are mobilizing resources to focus on developing enhancements to our brand shops and building intuitive tools to allow our clients to easily shop collections of products. We believe this will help improve conversion rates and drive repeat purchases.

See also “COVID-19 and Other Developments” and “Summary of Factors Affecting Performance” sections of this MD&A.

Sourcing and Production

We contract and maintain direct relationships with a diversified base of independent suppliers and manufacturers for our exclusive brands, which provide us with the flexibility to source high quality materials and products at competitive costs. We source the majority of our raw materials directly from suppliers and manufacturers, located primarily in China, Japan, Italy, South Korea and France, which we believe to be best-in-class that uphold our standards for quality, lead time and cost. Our finished goods are sourced from manufacturers located primarily in China, Vietnam, India, Romania, Sri Lanka and Cambodia. Capacity planning with our manufacturers is done at the beginning of the season to ensure flexibility. We believe that our approach of sourcing a majority of our raw materials and working directly with suppliers and manufacturers enhances our ability to create beautiful and high-quality products in a timely manner. We engage third parties to inspect our manufacturers' factories to ensure quality control. We engage independent expert service providers to conduct factory audits for compliance with local laws and regulations and global standards.

See also "COVID-19 and Other Developments" section of this MD&A.

Infrastructure Investments

We continue to strategically invest in infrastructure to safeguard and maximize our existing business, as well as support our growth.

In Fiscal 2018, we successfully completed the implementation of our new point-of-sale ("POS") system in all of our boutiques and our client care centre. This new POS system provides us with a robust platform on which to build and evolve the services and experience we offer to our clients. It has provided us with world class infrastructure, labour efficiencies, greater access to more reliable data and specifically, a foundation to evolve our omni-channel and clienteling capabilities. The new POS system provides near real-time visibility to inventory and sales data. This has already allowed us to respond more nimbly in managing our inventory to maximize sales, as well as begin providing true omni-channel capabilities to give clients even more flexibility in how they shop and receive Aritzia products. In Fiscal 2019, we implemented verified eCommerce returns and integrated payments, which allows us to further enhance our clients' experience.

In August 2018, we relocated and expanded our Greater Vancouver distribution centre from 83,000 square feet into a new 223,000 square foot facility with an upgraded warehouse-management system. The new distribution centre primarily services the west coast and serves as a hub for the rest of our network. During Q2 2020, we completed the expansion of both of our third-party distribution centres in Mississauga, Ontario and Columbus, Ohio. In total, we added 177,000 square feet of space, representing an approximately 80% increase in size for these facilities. These expansions support both our retail and eCommerce businesses with added capacity to handle higher levels of throughput.

Our digital marketing strategy contemplates our eCommerce business as an extension of our boutique experience. This allows us to not only communicate with our clients, but also to interact with and drive engagement.

As we look to further elevate our client experience, we are continuing to develop our Customer Program, which is a multi-year initiative comprised of four projects that are expected to be implemented in phases. The program is designed to build on our world class client experience by providing a seamless, consistent and personalized approach towards how we engage and service our clients. Through advanced business intelligence and behavior analytics, our goal is to be able to tailor unique shopping experiences both in our boutiques and online while driving revenue and client loyalty:

- *Customer 360* – Launched in Fiscal 2020, this tool enables us to store, view and edit client information from all of our front end systems. This gives us an enhanced, real-time view of our clients including their attributes, past purchases and preferences.
- *Marketing Communications Platform* – This platform builds on Customer 360's data repository, which is expected to allow us to personalize our communications by creating campaigns that cater to our clients' attributes and preferences. We expect that a more personalized approach to marketing communications will enhance our top-line growth. The first phase was completed in Fiscal 2020.
- *Concierge* – Launched in Fiscal 2020, this new, integrated solution is expected to not only allow us to enhance our client experience throughout the lifecycle of their purchase, it is also expected to represent a revenue generating opportunity as we personalize each client interaction through our concierge centres.

- *Digital Selling Tools* – This project is expected to be implemented in multiple phases. In the form of a mobile app, the digital selling tool is designed to provide enriched client information and product data to improve the productivity of our style advisors.

Our Product Lifecycle Management ("PLM") system is another foundational technology we are in the process of implementing. The PLM system will manage all of the data to support all of the processes necessary to bring a product to market. The application is designed to provide visibility into our raw materials and enable us to focus on innovation, drive quality, reduce speed to market and optimize costs in our manufacturing processes.

We also continue to expand our talent pool across the organization. We are continuing to find key talent at all levels to support our business and our growth strategies.

Our focus on building our digital infrastructure impacts everything we do. In our view, digital is about more than just our technology and eCommerce business, it runs through the business all the way from design to the service we deliver in boutiques. These strategic investments in systems, infrastructure and people are expected to keep us on the forefront of providing the exceptional client service and an aspirational shopping experience for which we are well-known.

See also "COVID-19 and Other Developments" section of this MD&A.

Consumer Trends

The women's apparel industry is subject to shifts in consumer trends, preferences and consumer spending and our revenue and operating results depend, in part, on our ability to respond to such changes in a timely manner. Our differentiated multi-brand strategy gives us control over our products and provides us with the flexibility to optimize our brand mix as needed to address changes in consumer demand and fashion preferences, which has been a critical driver of the consistency of our growth. Our diversified mix of exclusive brands satisfies a broad range of fashion needs, which allows us to attract a wide client base and increases our addressable market. Our revenue is also impacted by discretionary spending by consumers, which is affected by many factors that are beyond our control, including, but not limited to, general economic conditions, consumer disposable income levels, consumer confidence levels, consumer debt, the cost of basic necessities and other goods and the effects of weather, natural disasters or global pandemics. We believe that our track record demonstrates the success of our exclusive brand strategy at responding to changes in fashion demands through all stages of economic cycles.

Seasonality

Our business is seasonal, with a higher proportion of net revenue and operating cash flows generated during the second half of the fiscal year, which includes the back-to-school and holiday seasons. We also have higher working capital requirements in the periods preceding the launch of new seasons as we receive and pay for new inventory. We manage our working capital needs through cash flow from operations and our revolving credit facility ("Revolving Credit Facility").

Average quarterly share of annual net revenue over the last three completed fiscal years is as follows:

First fiscal quarter	20%
Second fiscal quarter	24%
Third fiscal quarter	27%
Fourth fiscal quarter	29%
Yearly total	100%

Weather

Extreme weather conditions in the areas in which our boutiques are located could adversely affect our business and financial results. For example, frequent or unusually heavy snowfall, ice storms, rainstorms or other extreme weather conditions over a prolonged period could make it difficult for our clients to travel to our boutiques and thereby reduce our revenue and profitability. This is potentially mitigated by our clients' ability to buy our products through *aritzia.com*. Our business is also susceptible to unseasonable weather conditions. For example, extended periods of unseasonably warm temperatures during the winter season or cool weather during the summer season could render a portion of our inventory incompatible with those unseasonable conditions, which could adversely affect sales of these seasonal items.

Competition

We operate in the women's apparel industry, primarily within the North American market. We compete on the basis of several factors that include our strategic mix of exclusive brands, offering high quality products at an attainable price point, our proven and sophisticated merchandise planning strategy, our focus on providing exceptional client service, our premier real estate portfolio and our market positioning. We believe the industry is evolving to benefit players like us that have the scale needed to leverage their infrastructure and capabilities in areas such as brand equity creation, real estate selection, boutique design, supply chain and eCommerce.

Foreign Exchange

The majority of our net revenue is derived in Canadian dollars while the vast majority of our cost of goods sold is denominated in U.S. dollars. Fluctuations in the exchange rate of the Canadian dollar versus the U.S. dollar could materially affect our gross profit margins and operating results. From time to time, we use foreign currency forward contracts to mitigate risks associated with forecasted U.S. dollar merchandise purchases sold in Canada, but there can be no assurances that such strategies will prove to be successful. See "Financial Instruments" and "Risk Factors" sections of this MD&A.

How We Assess the Performance of Our Business

In assessing the performance of our business, we consider a variety of financial and operating measures that affect our operating results.

Net Revenue

Net revenue reflects our sale of merchandise, less returns and discounts. Retail revenue at point-of-sale is measured at the fair value of the consideration received at the time the sale is made to the customer, net of discounts and estimated allowance for returns. For merchandise that is ordered and paid in a boutique and subsequently picked up by or delivered to the customer, revenue is deferred until control of the merchandise has been transferred to the customer. eCommerce revenue is recognized at the date control has been transferred to the customer, and measured at the fair value of consideration received, net of discounts and an estimated allowance for returns. Revenues are reported net of sales taxes collected for various governmental agencies.

Comparable Sales Growth

Comparable sales growth is a retail industry metric used to compare the percentage change in sales derived from established boutiques of a certain period as compared to the sales from the same boutiques in the same period in the prior year. Comparable sales growth helps to explain our revenue growth in established boutiques and eCommerce. Comparable sales is calculated based on revenue (net of sales tax, returns and discounts) from boutiques that have been opened for at least 56 weeks including eCommerce revenue (net of sales tax, returns and discounts), and excludes boutiques that were expanded or repositioned, boutiques in centres where we opened a new additional boutique and boutiques significantly impacted by nearby construction and other similar disruptions during this period and week 53 net revenue, if applicable. Our comparable sales growth calculation excludes the impact of foreign currency fluctuations. We apply the prior year's average quarterly exchange rate to both current year and prior year comparable sales to achieve a consistent basis for comparison (i.e. on a constant currency basis).

Comparable sales growth is typically a useful operating metric in assessing the performance of our business. However, as the temporary boutique closures from COVID-19 have resulted in all boutiques being removed from our comparable store base, we believe comparable sales growth is not currently representative of our business and therefore we have not included this metric in this MD&A.

Gross Profit

Gross profit reflects our net revenue less cost of goods sold. Cost of goods sold includes inventory and product-related costs, variable lease payments and other occupancy-related expenses, as well as depreciation expense for our boutique and distribution centre assets. Our cost of goods sold may include different costs compared to other retailers. Gross profit margin is impacted by the components of cost of goods sold, product mix and markdowns. We define gross profit margin as our gross profit divided by our net revenue.

Selling, General and Administrative ("SG&A") Expenses

Our SG&A expenses consist of selling expenses that are generally variable with net revenue and general and administrative operating expenses that are primarily fixed. Our SG&A expenses also include depreciation and amortization expenses for all support office assets and intangible assets. We expect our SG&A expenses to increase as we continue to open new boutiques, grow our eCommerce business, increase brand awareness and invest in our infrastructure and people.

SG&A expenses as a percentage of net revenue, excluding strategic investments in technology and infrastructure, are usually higher in the lower-volume first and second quarters, and lower in the higher-volume third and fourth quarters because a portion of these costs are relatively fixed. Our SG&A expenses may include different expenses compared to other retailers.

EBITDA

We define EBITDA as consolidated net income before depreciation and amortization, finance expense and income tax expense.

Adjusted EBITDA

We believe Adjusted EBITDA is a useful measure of operating performance, as it provides a more relevant picture of operating results in that it excludes the effects of financing and investing activities by removing the effects of interest, depreciation and amortization expenses that are not reflective of underlying business performance and other one-time or non-recurring expenses. We use Adjusted EBITDA to facilitate a comparison of our operating performance on a consistent basis from period-to-period and to provide for a more complete understanding of factors and trends affecting our business. We define Adjusted EBITDA as consolidated net income before depreciation and amortization, finance expense and income tax expense, adjusted for the impact of certain items, including non-cash items such as stock-based compensation expense, unrealized gains or losses on equity derivative and forward contracts, an estimate of the rent expense related to the adoption of IFRS 16, Leases and other items we consider non-recurring and not representative of our ongoing operating performance. Because Adjusted EBITDA excludes certain non-cash items, we believe that it is less susceptible to variances in actual performance resulting from depreciation and amortization and other non-cash charges.

Adjusted Net Income (per diluted share)

We believe Adjusted Net Income (per diluted share) is a useful measure of performance, as it provides a more relevant picture of results by excluding the effects of expenses that are not reflective of underlying business performance and other one-time or non-recurring expenses. We use Adjusted Net Income to facilitate a comparison of our performance on a consistent basis from period-to-period and to provide for a more complete understanding of factors and trends affecting our business. We define Adjusted Net Income as consolidated net income, adjusted for the impact of certain items, including non-cash items such as stock-based compensation expense, unrealized gains or losses on equity derivative and forward contracts and other items we consider non-recurring and not representative of our ongoing operating performance, net of related tax effects. We define Adjusted Net Income per diluted share by dividing Adjusted Net Income by the weighted average number of diluted shares outstanding.

Free Cash Flow

Free cash flow is a non-GAAP measure we consider to be an important metric because it is an indicator of how much cash is available for debt repayment, share repurchases, re-investment in the Company and other financing activities. Our sustained ability to generate free cash flow is an indicator of the financial strength of our business, as we require regular capital expenditures to build and maintain boutiques and purchase new equipment to improve our business and infrastructure. We define free cash flow as net cash generated from operating activities excluding interest paid, less net cash used in investing activities and repayments of principal on lease liabilities.

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 unaudited condensed interim consolidated financial statements and related notes.

(in thousands of Canadian dollars, unless otherwise noted)	Q1 2021 13 weeks	Q1 2020 13 weeks
Consolidated Statements of Operations:		
Net revenue	$ 111,389	$ 196,699
Cost of goods sold	98,328	111,138
Gross profit	13,061	85,561
Operating expenses		
Selling, general and administrative	43,511	54,429
Stock-based compensation expense	979	2,374
(Loss) Income from operations	(31,429)	28,758
Finance expense	7,390	7,227
Other income	(1,218)	(1,279)
(Loss) Income before income taxes	(37,601)	22,810
Income tax (recovery) expense	(11,130)	6,654
Net (loss) income	$ (26,471)	$ 16,156
Percentage of Net Revenue:		
Net revenue	100.0%	100.0%
Cost of goods sold	88.3%	56.5%
Gross profit	11.7%	43.5%
Operating expenses		
Selling, general and administrative	39.1%	27.7%
Stock-based compensation expense	0.9%	1.2%
(Loss) Income from operations	(28.2%)	14.6%
Finance expense	6.6%	3.7%
Other income	(1.1%)	(0.7%)
(Loss) Income before income taxes	(33.8%)	11.6%
Income tax (recovery) expense	(10.0%)	3.4%
Net (loss) income	(23.8%)	8.2%
Other Performance Measures:		
Year-over-year net revenue (decline) growth	(43.4%)	17.8%
Comparable sales growth[3]	n/a	7.9%
Free cash flow	$ 8,055	$ 16,917
Capital cash expenditures (excluding proceeds from leasehold inducements)	$ 13,880	$ 10,166
Number of boutiques, end of period	97	92
New boutiques added	1	1
Boutiques expanded or repositioned	-	1

[3] Please see the “Comparable Sales Growth” subsection of “How we assess the performance of our Business” section of this MD&A.

The following table provides a reconciliation of net income to EBITDA, Adjusted EBITDA and Adjusted Net (Loss) Income, Adjusted Net (Loss) Income per diluted share and Comparable Sales to Net Revenue for the periods indicated.

(in thousands of Canadian dollars, unless otherwise noted)	Q1 2021 13 weeks	Q1 2020 13 weeks
Reconciliation of Net (Loss) Income to EBITDA and Adjusted EBITDA:		
Net (loss) income	$ (26,471)	$ 16,156
Depreciation and amortization	25,813	23,198
Finance expense	7,390	7,227
Income tax (recovery) expense	(11,130)	6,654
EBITDA	(4,398)	53,235
Adjustments to EBITDA:		
Stock-based compensation expense	979	2,374
Rent impact from IFRS 16, Leases[4]	(22,609)	(20,230)
Unrealized loss on equity derivative contracts	796	-
Adjusted EBITDA	$ (25,232)	$ 35,379
Adjusted EBITDA as a Percentage of Net Revenue	(22.7%)	18.0%
Reconciliation of Net (Loss) Income to Adjusted Net (Loss) Income:		
Net (loss) income	$ (26,471)	$ 16,156
Adjustments to net income:		
Stock-based compensation expense	979	2,374
Unrealized loss on equity derivative contracts	796	-
Related tax effects	(176)	(46)
Adjusted Net (Loss) Income	$ (24,872)	$ 18,484
Adjusted Net (Loss) Income as a Percentage of Net Revenue	(22.3%)	9.4%
Weighted Average Number of Diluted Shares Outstanding (thousands)	109,353	111,851
Adjusted Net (Loss) Income per Diluted Share	$ (0.23)	$ 0.17

Note (4) **Rent Impact from IFRS 16, Leases**	**Q1 2021 13 weeks**	**Q1 2020 13 weeks**
Depreciation and amortization of right-of-use assets	(16,448)	(14,254)
Finance expense, related to leases	(6,161)	(5,976)
Rent impact from IFRS 16, Leases	$ (22,609)	$ (20,230)

(in thousands of Canadian dollars, unless otherwise noted)	Q1 2021 13 weeks	Q1 2020 13 weeks
Reconciliation of Comparable Sales to Net Revenue:	*(not applicable)*[6]	
Comparable sales[5]		$ 161,294
Non-comparable sales		35,405
Net revenue		$ 196,699

(5) The comparable sales for a given period represents revenue (net of sales tax, returns and discounts) from boutiques that have been opened for at least 56 weeks including eCommerce revenue (net of sales tax, returns and discounts) within that given period. This information is provided to give context for comparable sales in such given period as compared to net revenue reported in our financial statements. Our comparable sales growth calculation excludes the impact of foreign currency fluctuations. For more details, please see the "Comparable Sales Growth" subsection of the "How We Assess the Performance of Our Business" section of this MD&A.

(6) Please see the "Comparable Sales Growth" section of this MD&A for more details.

The following table provides selected financial position data for the periods indicated.

		As at May 31, 2020		As at March 1, 2020
Selected Consolidated Financial Position Data:				
Total assets	$	1,190,399	$	1,036,715
Total non-current liabilities		545,485		550,807

Results of Operations

Analysis of Results for Q1 2021 to Q1 2020

The following section provides an overview of our financial performance during Q1 2021 compared to Q1 2020.

Net Revenue

Net revenue decreased by 43.4% to $111.4 million compared to $196.7 million in Q1 2020. The decrease in net revenue was the result of temporary boutique closures due to COVID-19 for the majority of Q1 2021, partially offset by eCommerce revenue growth in excess of 150% from the beginning of boutique closures, driven primarily by an increase in traffic and conversion.

Gross Profit

Gross profit decreased to $13.1 million compared to $85.6 million in Q1 2020. Gross profit margin was 11.7% compared to 43.5% in Q1 2020. The decrease in gross profit margin was primarily due to occupancy, warehousing and distribution centre cost deleverage from the significantly reduced retail revenue, along with higher markdowns from successful sales events that drove our eCommerce revenue during boutique closures. Starting in April, we suspended rent payments for a vast majority of our closed boutiques, however, for accounting purposes we accrued all occupancy costs. We remain in active and ongoing discussions with our landlords.

SG&A Expenses

SG&A expenses decreased by 20.1% to $43.5 million, compared to $54.4 million in the first quarter last year. SG&A expenses were 39.1% of net revenue compared to 27.7% of net revenue in Q1 2020. To-date, we have not laid off or furloughed any of our employees due to COVID-19 and have continued to pay our retail employees their full salaries. This was offset by $13.8 million of government payroll subsidies recognized during Q1 2021. Deleverage in SG&A expenses during Q1 2021 was primarily due to the loss of revenue from the boutique closures.

Other Income

Other income was $1.2 million in Q1 2021, compared to other income of $1.3 million in Q1 2020.

Other income of $1.2 million in Q1 2021 primarily relates to:

- unrealized and realized operational foreign exchange gains of $1.6 million and
- interest income of $0.3 million; partially offset by
- unrealized (losses) on equity derivative contracts of $(0.8) million.

Other income of $1.3 million in Q1 2020 primarily related to:

- unrealized and realized operational foreign exchange gains of $1.1 million and
- interest income of $0.1 million.

Adjusted EBITDA

Adjusted EBITDA was $(25.2) million, or (22.7%) of net revenue in Q1 2021, compared to $35.4 million, or 18.0% of net revenue in Q1 2020. The Adjusted EBITDA loss is primarily the result of a 43.4% decrease in net revenue from the temporary boutique closures and the deleverage of expenses.

Stock-Based Compensation Expense

Stock-based compensation expense was $1.0 million in Q1 2021, compared to $2.4 million in Q1 2020.

Included in Q1 2021 is $0.9 million in expenses primarily related to the accounting for options under our new option plan, $0.2 million in expenses related to the accounting for options under our legacy option plan, partially offset by $0.1 million in recoveries related to the accounting for our deferred and restricted share units.

Included in Q1 2020 is $1.6 million in expenses primarily related to the accounting for options under our new option plan, $0.6 million in expenses related to the accounting for options under our legacy option plan and $0.2 million in expenses related to the accounting for our deferred and restricted share units.

Finance Expense

Finance expense increased by $0.2 million to $7.4 million in Q1 2021, compared to $7.2 million in Q1 2020.

Income Tax (Recovery) Expense

Income tax expense is recognized based on management's best estimate of the weighted average annual income tax rate expected for the full fiscal year. To the extent that forecasts differ from actual results, adjustments are recognized in subsequent periods. The statutory income tax rates for Q1 2021 and Q1 2020 were 26.7% and 26.9%, respectively.

Income tax recovery was $(11.1) million in Q1 2021, compared to expense of $6.7 million in Q1 2020 and the effective tax rates for Q1 2021 and Q1 2020 were 29.6% and 29.2%, respectively. The income tax recovery is primarily due to a loss from operations in Q1 2021.

Net (Loss) Income

Net Loss was $(26.5) million in Q1 2021, compared to net income of $16.2 million in Q1 2020. The net loss is primarily the result of a 43.4% decrease in net revenue from the temporary boutique closures due to COVID-19 and the deleverage of expenses.

Adjusted Net (Loss) Income

Adjusted Net Loss was $(24.9) million compared to $18.5 million in Q1 2020, primarily due to the factors discussed above.

Adjusted Net Loss per diluted share was $(0.23) compared to Adjusted Net Income per diluted share of $0.17 in Q1 2020.

Cash and cash equivalents

Cash and cash equivalents at the end of Q1 2021 totaled $224.3 million, compared to $35.8 million at the end of Q1 2020. The cash position at the end of Q1 2021 reflects the full drawdown of our Revolving Credit Facility of $100.0 million and the reduction and suspension of certain of our cash expenses.

Summary of Consolidated Quarterly Results and Certain Performance Measures

The following table summarizes the results of our operations for the last eight most recently completed quarters. This unaudited quarterly information, other than Adjusted EBITDA, Adjusted Net (Loss) Income and 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.

	Fiscal 2021	Fiscal 2020				Fiscal 2019		
	Q1 13 weeks	Q4 13 weeks	Q3 13 weeks	Q2 13 weeks	Q1 13 weeks	Q4 14 weeks	Q3 13 weeks	Q2 13 weeks
	(in thousands of Canadian dollars, unless otherwise noted)							
Consolidated Statements of Operations:								
Net revenue	$ 111,389	$ 275,430	$ 267,282	$ 241,178	$ 196,699	$ 259,050	$ 242,876	$ 205,359
Gross profit	13,061	102,841	119,595	95,427	85,561	93,847	104,789	76,734
SG&A	43,511	64,331	64,035	60,567	54,429	59,349	56,554	52,401
(Loss) Income from operations	(31,429)	36,099	54,497	32,918	28,758	31,902	45,339	21,681
Adjusted EBITDA (7)	(25,232)	42,375	58,446	36,372	35,379	42,568	57,093	33,032
Net (loss) income	(26,471)	21,715	34,803	17,920	16,156	18,723	32,600	15,115
Adjusted Net (Loss) Income(7)	(24,872)	23,428	35,719	19,757	18,484	25,072	35,933	18,295
Percentage of Net Revenue:								
Net revenue	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Gross profit	11.7%	37.3%	44.7%	39.6%	43.5%	36.2%	43.1%	37.4%
SG&A	39.1%	23.4%	24.0%	25.1%	27.7%	22.9%	23.3%	25.5%
(Loss) Income from operations	(28.2%)	13.1%	20.4%	13.6%	14.6%	12.3%	18.7%	10.6%
Adjusted EBITDA (7)	(22.7%)	15.4%	21.9%	15.1%	18.0%	16.4%	23.5%	16.1%
Net (loss) income	(23.8%)	7.9%	13.0%	7.4%	8.2%	7.2%	13.4%	7.4%
Adjusted Net (Loss) Income(7)	(22.3%)	8.5%	13.4%	8.2%	9.4%	9.7%	14.8%	8.9%
Weighted average number of diluted shares (in thousands)	109,353	113,120	111,898	111,537	111,851	117,488	117,681	117,410
Adjusted Net (Loss) Income per Diluted Share	$ (0.23)	$ 0.21	$ 0.32	$ 0.18	$ 0.17	$ 0.21	$ 0.31	$ 0.16
Growth:								
Net revenue (decline) growth	(43.4%)	6.3%	10.0%	17.4%	17.8%	17.9%	18.8%	18.0%
Comparable sales growth(7)	n/a	8.9%	5.1%	8.4%	7.9%	5.5%	12.9%	11.5%
Boutiques:								
Number of boutiques, beginning of period	96	94	93	92	91	92	90	87
New boutiques added	1	2	1	1	1	-	2	3
Boutique repositioned into a flagship boutique(8)	-	-	-	-	-	(1)	-	-
Number of boutiques, end of period	97	96	94	93	92	91	92	90
Boutiques expanded or repositioned	-	-	2	-	1	1	-	1

Note:

(7) See "How We Assess the Performance of Our Business" for definitions of Adjusted EBITDA, Adjusted Net (Loss) Income and Comparable Sales Growth, which are non-IFRS measures including Retail Industry Metrics. See also "Non-IFRS Measures".

(8) Q4 2019 includes the reposition of one of our banner locations into the flagship boutique located on the same street.

Liquidity and Capital Resources

Overview

Our principal uses of funds are for operating expenses, capital expenditures and debt service requirements. We believe that cash generated from operations, together with amounts available under our Credit Facilities (as hereinafter defined), are expected to be sufficient to meet our future operating expenses, capital expenditures and future debt service requirements. 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 “Summary of Factors Affecting Performance” and “Risk Factors” of this MD&A for additional information. We review investment opportunities in the normal course of our business and may make select investments to implement our business strategy when suitable opportunities arise. Historically, the funding for any such investments has come from cash flows from operating activities and/or our Credit Facilities.

Credit Facilities

We have a term loan (“Term Loan”) and Revolving Credit Facility (collectively the “Credit Facilities”) with our syndicate of lenders.

As at March 1, 2020, the aggregate amount outstanding under our Term Loan was $75.0 million. The Term Loan matures on May 22, 2022 and has no scheduled principal repayments prior to maturity. The Term Loan requires mandatory loan prepayments by us of principal and interest if certain events occur.

A $100.0 million Revolving Credit Facility is also available as part of the Credit Facilities. As at May 31, 2020, $100.0 million was drawn on the Revolving Credit Facility. See “Contractual Obligations – Off-Balance Sheet Arrangements and Commitments” for letters of credit issued. See “COVID-19 and Other Developments” section for more information.

In addition, we also have letters of credit facilities of $75.0 million, secured *pari passu* with the Credit Facilities. The interest rate for the letters of credit is between 1.00% and 2.50%.

The credit agreement contains restrictive covenants customary for credit facilities of this nature, including restrictions on us and each credit facility guarantor, subject to certain exceptions, to incur indebtedness, grant liens, merge, amalgamate or consolidate with other companies, transfer, lease or otherwise dispose of all or substantially all of its assets, liquidate or dissolve, engage in any material business other than the fashion retail business, make investments, acquisitions, loans, advances or guarantees, make any restricted payments, enter into transactions with affiliates, repay indebtedness, enter into restrictive agreements, enter into sale-leaseback transactions, ensure pension plan compliance, sell or discount receivables, enter into agreements with unconditional purchase obligations, issue shares, create or acquire a subsidiary or make any hostile acquisitions.

Cash Flows

The following table presents cash flows for the periods indicated.

	Q1 2021 13 weeks	Q1 2020 13 weeks
	(in thousands of Canadian dollars)	
Net cash generated from operating activities	$ 23,979	$ 40,679
Net cash generated from (used in) financing activities	96,309	(95,999)
Net cash used in investing activities	(13,880)	(10,166)
Effect of exchange rate changes on cash and cash equivalents	155	346
Increase (decrease) in cash and cash equivalents	$ 106,563	$ (65,140)

Analysis of Cash Flows for the First Quarter

Cash Flows Generated from Operating Activities

For Q1 2021, cash flows generated from operating activities totaled $24.0 million, compared to $40.7 million in Q1 2020. This change was primarily attributable to a decrease in Adjusted EBITDA, lower use of working capital primarily due to the extension of payment terms for payables and qualifying deferral of Canadian income tax payments, duty and sales tax remittances that would have otherwise been paid during Q1 2021 to subsequent quarters of Fiscal 2021.

Cash Flows Generated From (Used In) Financing Activities

For Q1 2021, cash flows generated from financing activities totaled $96.3 million, compared to $96.0 million used in Q1 2020. The change was primarily due to activities undertaken in Q1 2021 to enhance our short-term liquidity during the COVID-19 pandemic, including the drawdown of $100.0 million on the Revolving Credit Facility and lower repayments on lease obligations by $11.5 million. In addition, we repurchased $107.0 million of subordinate voting shares for cancellation in Q1 2020.

Cash Flows Used in Investing Activities

For Q1 2021, cash flows used in investing activities totaled $13.9 million, compared to $10.2 million in Q1 2020. Investing activities in Q1 2021 primarily relate to new boutiques and boutique expansions and repositions.

Free Cash Flow

The following table reconciles net cash generated from operating activities to free cash flow for the periods indicated.

	Q1 2021 13 weeks	Q1 2020 13 weeks
	(in thousands of Canadian dollars)	
Net cash generated from operating activities	$ 23,979	$ 40,679
Interest paid	1,295	1,218
Net cash used in investing activities	(13,880)	(10,166)
Repayments of principal on lease liabilities	(3,339)	(14,814)
Free cash flow	$ 8,055	$ 16,917

Contractual Obligations

The following table summarizes our significant undiscounted maturities of our contractual obligations and commitments as at May 31, 2020.

	Less than 1 year	1 to 5 years	More than 5 years	Total
	(in thousands of Canadian dollars)			
Revolving Credit Facility[10]	100,000	-	-	100,000
Accounts payable and accrued liabilities	116,906	-	-	116,906
Assumed interest on Term Loan[9]	1,536	1,507	-	3,043
Term Loan[10]	-	75,000	-	75,000
Total contractual obligations	$ 218,442	$ 76,507	$ -	$ 294,949

Notes:

(9) Based on interest rate in effect as at May 31, 2020, and assuming no unscheduled principal payments are made prior to maturity.

(10) The Credit Facilities require mandatory loan prepayments by Aritzia of principal and interest if certain events occur. The Credit Facilities mature on May 22, 2022 and have no scheduled principal payments prior to maturity. The repayment of the Revolving Credit Facility may occur prior to the mandatory maturity date at the discretion of the Company.

Off-Balance Sheet Arrangements and Commitments

Our third party manufacturers purchase raw materials on our behalf to be used for future production. As at May 31, 2020, we had purchase obligations of $36.5 million, which represent commitments for fabric to be used during upcoming seasons, made in the normal course of business.

We enter into trade letters of credit to facilitate the international purchase of inventory. We also enter into standby letters of credit to secure certain of our obligations, including leases and duties related to import purchases. As at May 31, 2020, letters of credit totaling $38.9 million have been issued.

Other than those items disclosed here and elsewhere in this MD&A and our consolidated financial statements, we do not have any material off-balance sheet arrangements or commitments as at May 31, 2020.

Financial Instruments

From time to time, we use foreign currency forward contracts to manage our exposure to fluctuations with respect to the U.S. dollar for U.S. dollar merchandise purchases sold in Canada. The fair value of the forward contracts is included in prepaid expenses and other current assets or in accounts payable and accrued liabilities, depending on whether they represent assets or liabilities to us. Changes in the fair value of foreign currency forward contracts are recorded in net income. As at May 31, 2020, we did not have any outstanding foreign currency forward contracts.

We use equity derivative contracts to hedge the share price exposure on our cash-settled DSUs and RSUs. These contracts are not designated as hedging instruments for accounting purposes. Changes in the fair value of equity derivative contracts are recorded in net income. As at May 31, 2020, the equity derivative contracts had a negative fair value of $0.1 million.

Related Party Transactions

During Q1 2021, we made payments of $0.6 million (June 2, 2019 - $1.0 million) for a lease of premises and management services and $nil (June 2, 2019 - $0.3 million) for the use of an asset wholly or partially owned by companies that are owned by a director and officer of the Company. At May 31, 2020, $0.1 million was included in accounts payable and accrued liabilities (March 1, 2020 - $0.2 million).

Transactions with Key Management

Key management includes our directors and executive team. Compensation awarded to key management includes:

	Q1 2021 13 weeks	Q1 2020 13 weeks
	(in thousands of Canadian dollars)	
Salaries, directors' fees and short-term benefits	$ 1,096	$ 922
Stock-based compensation expense	89	596
	$ 1,185	$ 1,518

Critical Accounting Estimates and Judgments

The preparation of consolidated financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Estimates and assumptions are continuously evaluated and are based on management's best judgments and experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. Actual results may differ from these estimates.

The following discusses the most significant accounting judgments and estimates made by management in preparation of the consolidated financial statements:

Valuation of Finished Goods Inventory

Inventory, consisting of finished goods, is stated at the lower of cost and net realizable value. Cost is determined using weighted average costs. Cost of inventories includes the cost of merchandise and all costs incurred to deliver the inventory to our distribution centres including freight and duty.

We periodically review our inventories and make provisions as necessary to appropriately value obsolete or damaged goods. In addition, as part of inventory valuations, we accrue for inventory shrinkage for lost or stolen items based on historical trends from actual physical inventory counts. As a result of this analysis, we did not recognize any additional inventory provisions in Q1 2021 due to COVID-19.

Impairment of Assets

Goodwill and intangible assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment or more frequently if events or changes in circumstances indicate that they might be impaired.

Other assets are tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs of disposal and value in use. The recoverable value is determined using discounted future cash flow models, which incorporate assumptions regarding future events, specifically future cash flows, growth rates and discount rates.

For the purposes of assessing impairment, assets are grouped at the lowest levels where there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets ("cash-generating unit"). Non-financial assets, other than goodwill, that suffered an impairment are reviewed for possible reversal of the impairment at the end of each reporting period.

The temporary boutique closures as a result of COVID-19 and the associated reduction in revenue during Q1 2021 are considered to be an indicator of impairment. We performed a recoverability assessment for our property and equipment, definite life intangible assets and right of use assets and determined that that there was no impairment.

We also performed an impairment test over goodwill and indefinite life intangible assets and determined that there was no impairment.

Leases

We exercise judgment in determining the appropriate lease term on a lease by lease basis and consider all facts and circumstances that create an economic incentive to exercise a renewal or termination option. The periods covered by renewal options are included in the lease term only if we are reasonably certain we will exercise such renewal options.

We use the lessee's incremental borrowing rate when determining the carrying amount of right-of-use assets and lease liabilities, as the interest rates implicit in the lease agreements are not readily available. We determine the incremental borrowing rate of each leased asset as the rate of interest that we would have to pay to borrow, over a similar term with a similar security, the funds necessary to obtain an asset of similar value to the right-of-use asset in a similar economic environment.

In May 2020, the IASB issued guidance in relation to accounting for lease concessions resulting from COVID-19. We have elected to apply the issued guidance for Fiscal 2021. No significant rent concessions have yet been confirmed and we are actively negotiating with our landlords.

Stock-Based Compensation Expense

Stock-based compensation expense requires the use of estimates in the Black-Scholes option pricing model, including stock price volatility and the expected life of options.

Gift Card Breakage

Recognition of gift card breakage requires the use of judgment in defining our average gift card breakage rate, based on historical redemption rates. The resulting revenue from breakage is recognized in proportion to actual gift card redemptions.

Return Allowances

Recognizing provisions for sales return allowances requires judgement in determining the return rate of merchandise based on historical patterns of returns.

As a result of our boutique closures due to COVID-19, we temporarily extended our return policies for purchases made online and in-boutiques. Our sales return allowance at Q1 2021 reflects the extended policy.

Income Tax Expense

Income tax expense requires judgment to determine when tax losses, credits and provisions are recognized based on tax rules in various jurisdictions.

Outlook

Net revenue for the first five weeks of the second quarter was down approximately 25% to 30% compared to last year. As of July 9, 2020, 89 of the 96 boutiques have reopened and are trending, on average, at 55% to 65% of last year's productivity levels. While we anticipate boutique performance to improve sequentially, we continue to expect an extended ramp up to a new normal. To-date, eCommerce revenue growth in the second quarter has moderated with the reopening of the majority of our boutiques and is currently trending 50% to 100% higher than last year, varying by region based on store reopenings and the extent of impact by COVID-19.

In order to ensure the health and safety of our people and clients, we have implemented stringent protocols for our boutiques, distribution centre and support offices. These incremental measures are expected to add additional labour and operating expenses of approximately $4 million per quarter for the foreseeable future.

We expect capital expenditures for Fiscal 2021 to be approximately $30 to $35 million. In addition to the opening of McArthur Glen in British Columbia on May 27, 2020, we currently anticipate opening another five to six new boutiques, two exclusive pop-ups and repositioning three existing locations during the remainder of Fiscal 2021. Approximately 50% of these new leases reflect compelling post-COVID financial terms.

Given the ongoing uncertainty related to COVID-19, we will not be providing guidance for the second quarter and full year Fiscal 2021 financial results.

Risk Factors

For a detailed description of risk factors associated with the Company, refer to the "Risk Factors" section of the Company's AIF, which is available on SEDAR at *www.sedar.com*.

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

Risk management is carried out under practices approved by our Audit Committee. This includes reviewing and making recommendations to the Board of Directors on the adequacy of our risk management policies and procedures with regard to identifying the Company's principal risks and implementing appropriate systems and controls to manage these risks. Risk management covers many areas of risk including, but not limited to, foreign exchange risk, interest rate risk, credit risk, liquidity risk and equity price risk.

Foreign Exchange Risk

We source the majority of our raw materials and merchandise from various suppliers in Asia and Europe with the vast majority of purchases denominated in U.S. dollars. Our foreign exchange risk is primarily with respect to the U.S. dollar but we have limited exposure to other currencies as well. We may use foreign exchange forward contracts to mitigate risks associated with forecasted U.S. dollar merchandise purchases sold in Canada.

Interest Rate Risk

We are exposed to changes in interest rates on our cash and cash equivalents, and 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. During the period, we had only variable interest rate debt.

Credit Risk

Credit risk refers to the possibility that we can suffer financial losses due to the failure of our counterparties to meet their payment obligations. We are exposed to minimal credit risk. We do not extend credit to clients, but do have some receivable exposure in relation to tenant improvement allowances. To reduce this risk, we enter into leases with landlords with established credit history, and for certain leases, we may offset rent payments until accounts receivable are fully satisfied. We deposit our cash and cash equivalents with major financial institutions that have been assigned high credit ratings by internationally recognized credit rating agencies. We only enter into derivative contracts with major financial institutions, as described above, for the purchase of foreign currency forward contracts.

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 revenue, income and working capital needs. The Revolving Credit Facility is used to maintain liquidity.

Equity Price Risk

We are exposed to risk arising from the cash settlement of our deferred and restricted share units, as an appreciating subordinate voting share price increases the potential cash outflow. We record a liability for the potential future settlement of our deferred and restricted share units by reference to the fair value of the liability. We may use equity derivative contracts to offset our cash flow variability of the expected payment associated with our deferred and restricted share units. We only enter into equity derivative contracts with major financial institutions.

Disclosure Controls and Internal Control over Financial Reporting

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 to senior management on a timely basis so that appropriate decisions can be made regarding public disclosure.

Management is also responsible for establishing and maintaining adequate internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial reports for external purposes in accordance with IFRS. In designing such controls, it should be recognized that due to inherent limitations, any control, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and may not prevent or detect misstatements. Additionally, management is required to use judgment in evaluating controls and procedures.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting in Q1 2021 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

Current Share Information

On July 11, 2019, we announced the commencement of a normal course issuer bid (“NCIB”) to purchase and cancel up to 3,624,915 subordinate voting shares, representing approximately 5% of the public float, over the 12-month period commencing July 16, 2019 and ending July 15, 2020. All repurchases are made through the facilities of the Toronto Stock Exchange and are done at market prices.

On August 30, 2019, we entered into an automatic share purchase plan (“ASPP”) with a designated broker for the purpose of permitting us to purchase our subordinate voting shares under the NCIB during self-imposed blackout periods. The volume of purchases is determined by the broker in its sole discretion based on purchase price and maximum volume parameters established by us under the ASPP. All purchases made under the ASPP will be included in computing the number of subordinate voting shares purchased under the NCIB. During Q1 2021, we repurchased 38,664 subordinate voting shares for cancellation at an average price of $13.51 per subordinate voting share, for total cash consideration of $0.5 million, under the terms of the ASPP.

On March 17, 2020, we amended the ASPP under the NCIB such that the then authorized trading window ended March 17, 2020. On May 28, 2020, we further amended the ASPP such that no additional trading windows will be authorized, which effectively terminated any further purchases under the ASPP.

As of July 8, 2020, an aggregate of 84,833,728 subordinate voting shares, 24,537,349 multiple voting shares and no preferred shares are issued and outstanding. All of the issued and outstanding multiple voting shares are, directly or indirectly, held or controlled by the principal shareholders. As of July 8, 2020, an aggregate of 7,745,891 options to acquire subordinate voting shares are outstanding.

Additional Information

Additional information relating to the Company, including the Company's AIF, is available on SEDAR at *www.sedar.com*. The Company's subordinate voting shares are listed for trading on the Toronto Stock Exchange ("TSX") under the symbol "ATZ".