Well Rested
Well Invested

2018 Annual Report

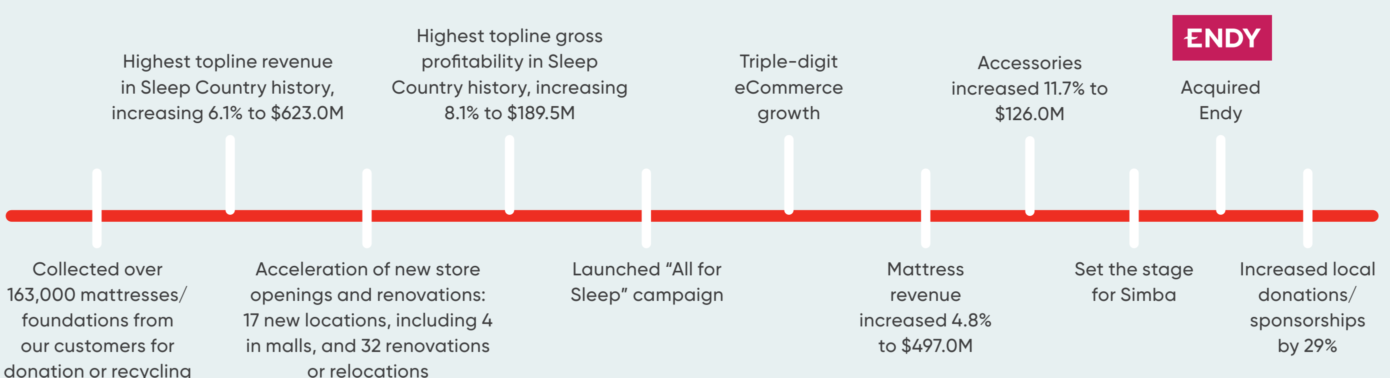
All for Sleep™

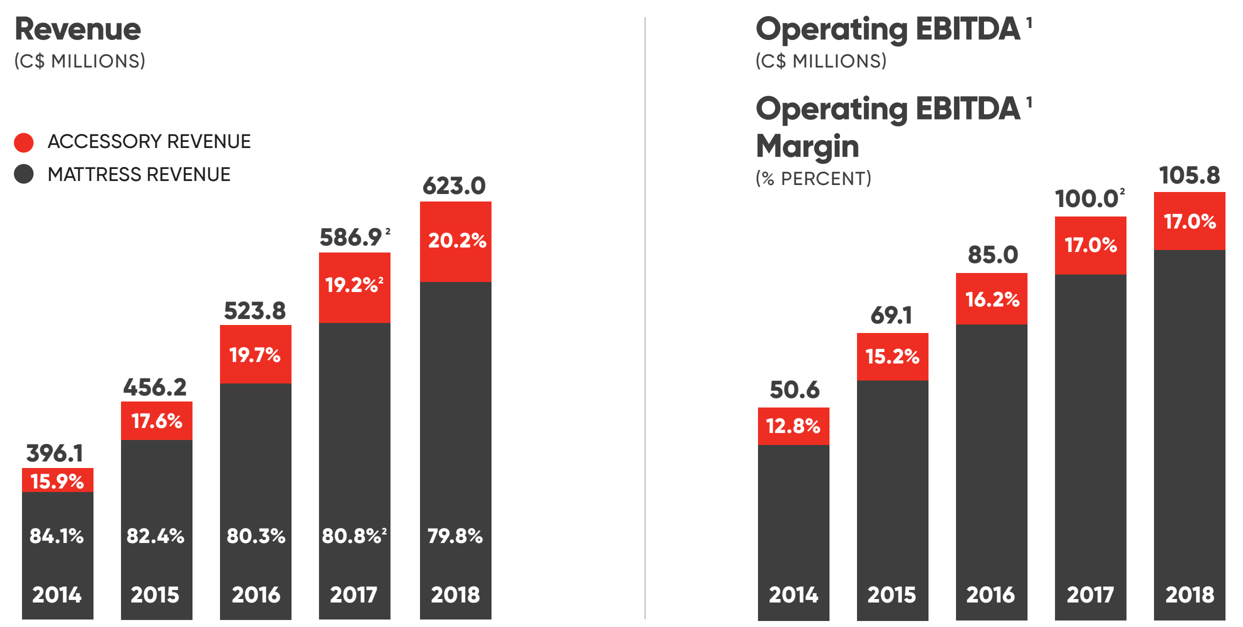
Sleep Country owns sleep.

In 2018, we strengthened our position as Canada's premier sleep retailer. We recorded our company's highest topline revenue and profitability, expanded our gross profit margin to 30.4%, opened, renovated or relocated a record 49 stores, achieved triple-digit growth in our eCommerce platform sales, solidified our partnership with Simba and expanded our family of companies to include Endy.

We are proud of our accomplishments. Looking ahead to 2019, we are poised to accelerate our competitive position in the sleep industry as we celebrate our 25th anniversary.

2018 Highlights



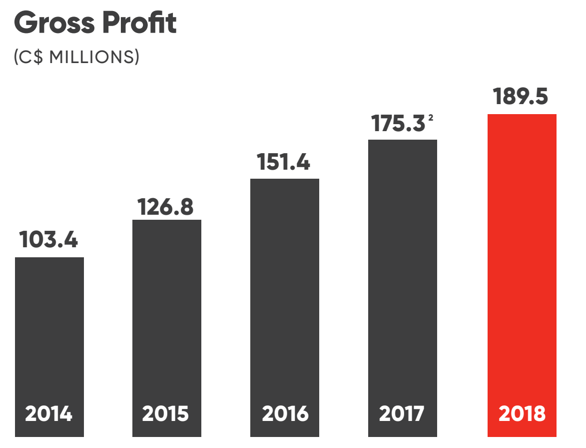


1 See the section in the Management Discussion and Analysis entitled "Non-IFRS Measures" for further details concerning how the company calculates Operating EBITDA, Operating EBITDA Margin and Same Store Sales.

2 On January 1, 2018, the Company adopted IFRS15 and as a result, the Financial Results and Non-IFRS Measures for 2017 have been restated.

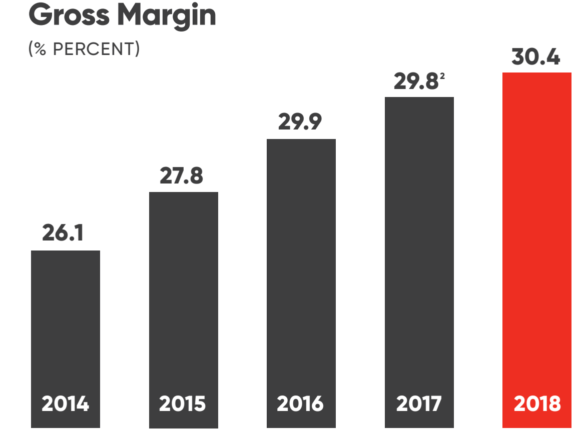
Gross Profit

(C$ MILLIONS)



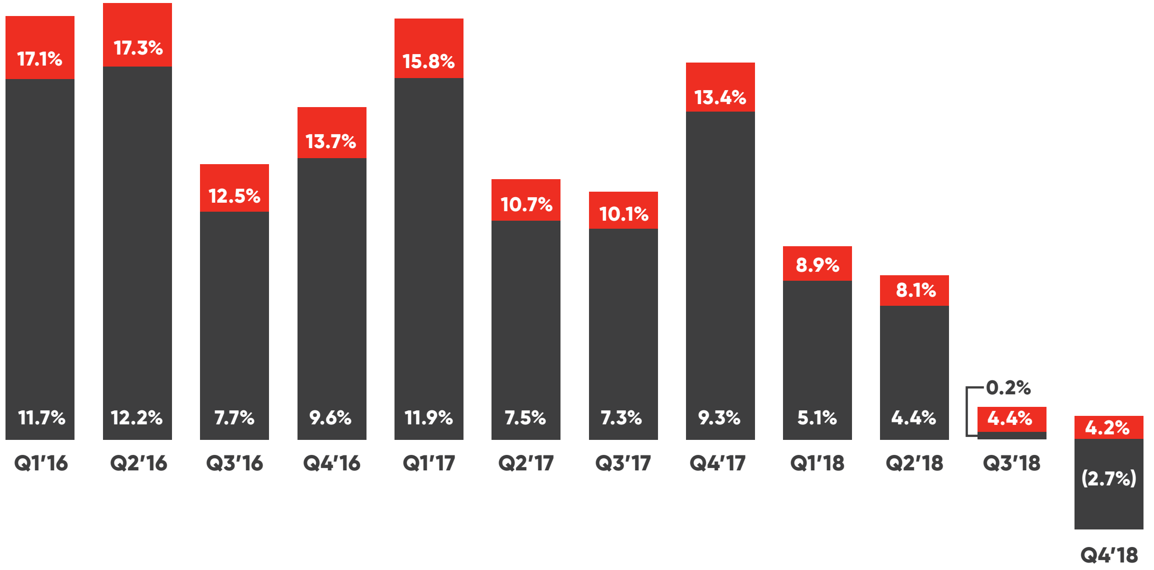
Gross Margin

(% PERCENT)



Total Sales Growth & Same Store Sales Growth

(% PERCENT)

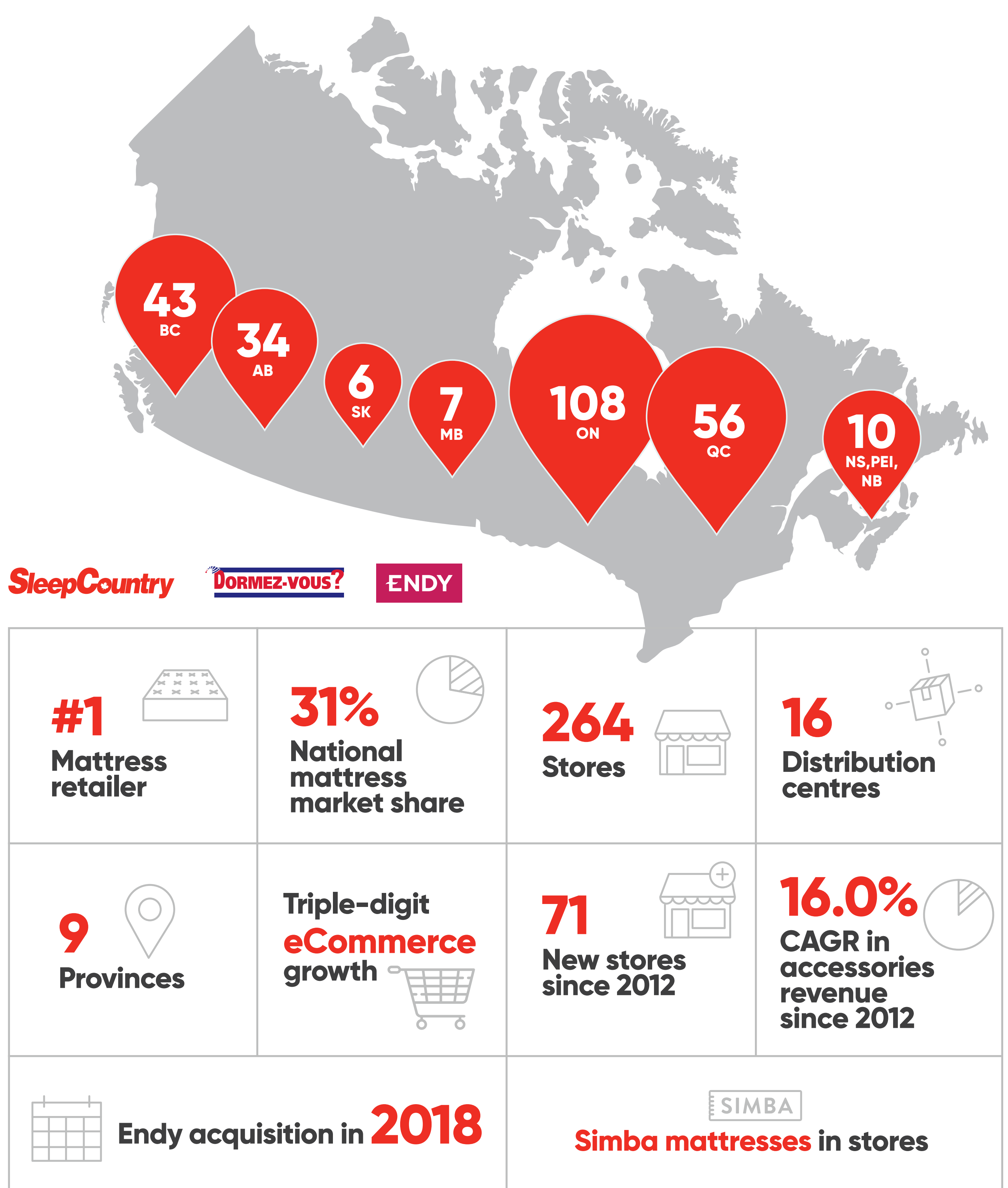


Store Count

(# STORES)

All for Sleep. Coast to coast.

With a national footprint, omnichannel approach and wide product array, Sleep Country is Canada's only total sleep solutions retailer for the whole family – even the furry ones.



2019 Outlook

- Spend $30 million to $40 million on capital expenditure toward the revamped eCommerce platform, a new in-store POS system, a new warehouse management system, a cascaded implementation of a new ERP system, new stores, store renovations and maintenance capital expenditure
- Open eight to 12 stores
- Renovate 25 to 30 stores
- Explore relevant partners to round out our product offering
- Complete diversified strategic partnerships with Walmart and Simba
- Invest in digital and traditional advertising to grow brand awareness and sales for Endy
- Further increase digital marketing spend to promote Bloom™ and Simba mattress-in-a-box brands
- Promote the Simba Hybrid mattress-in-a-box
- Rollout a new cloud-based eCommerce platform to revamp the Sleep Country and Dormez-vous? websites
- Optimize targeted advertising and sales training to grow SSS (See “Non-IFRS Measures”) and aggressively capture more market share
- Continue to invest in our marketing platform as we capitalize upon digital opportunities
- Continue support of charities that focus on helping women, children and families in need

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Management's Discussion and Analysis of Financial Condition and Results of Operations of Sleep Country Canada Holdings Inc.

*The following Management's Discussion and Analysis ("*MD&A*") is prepared as of February 26, 2019 and is intended to assist readers in understanding the financial performance and financial condition of Sleep Country Canada Holdings Inc. ("*SCC*" or "*Sleep Country*" or the "*Company*") for the year ended December 31, 2018 and should be read in conjunction with the audited annual consolidated financial statements of SCC and the accompanying notes for the year ended December 31, 2018 and the audited consolidated financial statements of SCC and accompanying notes for the year ended December 31, 2017 and the related MD&A.*

1. Basis of Presentation

The Company's audited annual consolidated financial statements and accompanying notes 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, except number of stores, per share amounts or unless otherwise indicated.

All references in this MD&A to "**Q4 2018**" are to SCC's fiscal quarter ended December 31, 2018, "**Q4 2017**" are to SCC's fiscal quarter ended December 31, 2017 and to "**Q4 2016**" are to SCC's fiscal quarter ended December 31, 2016. All references in this MD&A to "**2018**" are to SCC's fiscal year ended December 31, 2018, to "**2017**" are to SCC's fiscal year ended December 31, 2017 and to "**2016**" are to SCC's fiscal year ended December 31, 2016.

The audited annual consolidated financial statements of SCC and the accompanying notes for the year ended December 31, 2018 and this MD&A were reviewed by the Company's Audit Committee and were approved by its Board of Directors on February 26, 2019.

2. Forward-looking Information

This MD&A, including, in particular, the sections below entitled "Factors Affecting Our Results of Operations", "Liquidity and Capital Resources", "Outlook" and "Risk Factors", contains forward-looking information and forward-looking statements which reflect the current view of management with respect to the Company's objectives, plans, goals, strategies, outlook, results of operations, financial and operating performance, prospects and opportunities. Wherever used, the words "may", "will", "anticipate", "intend", "estimate", "expect", "plan", "believe" and similar expressions identify forward-looking information and forward-looking statements. Forward-looking information and forward-looking statements should not be read as guarantees of future events, performance or results, and will not necessarily be accurate indications of whether, or the times at which, such events, performance or results will be achieved. All of the information in this MD&A containing forward-looking information or forward-looking statements is qualified by these cautionary statements.

Forward-looking information and forward-looking statements are based on information available to management at the time they are made, underlying estimates, opinions and assumptions made by management and management's current good faith belief with respect to future strategies, prospects, events, performance and results, and are subject to inherent risks and uncertainties surrounding future expectations generally. Such risks and uncertainties include, but are not limited to, those described below under the heading "Risk Factors" and in the Company's 2018 annual information form (the "**AIF**") filed on February 26, 2019. A copy of the AIF can be accessed under the Company's profile on the System for Electronic Document Analysis and Retrieval ("**SEDAR**") at www.sedar.com. Additional risks and uncertainties not presently known to the Company or that the Company currently believes to be less significant may also adversely affect the Company.

SCC cautions that the list of risk factors and uncertainties described in this MD&A and the AIF is not exhaustive and that should certain risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual strategies, prospects, events, performance and results may vary significantly from those expected. There can be no assurance that the

actual strategies, prospects, results, performance, events or activities anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to, or effects on, the Company. Readers are urged to consider the risks, uncertainties and assumptions carefully in evaluating the forward-looking information and forward-looking statements and are cautioned not to place undue reliance on such information and statements. SCC does not undertake to update any such forward-looking information or forward-looking statements, whether as a result of new information, future events or otherwise, except as required by applicable laws.

3. Overview

Sleep Country is Canada's leading mattress retailer and the only specialty mattress retailer with a national footprint. Sleep Country operates under three mattress retail banners (the "**Banners**"): "Sleep Country Canada", the largest mattress retailer in Canada excluding Quebec; "Dormez-vous?" the largest retailer of mattresses in Quebec and "Endy", a leading Canadian online mattress-in-a-box retailer. Sleep Country continues to expand its presence coast-to-coast as well as online. As at December 31, 2018, Sleep Country had 264 stores (2017 - 247 stores) and 16 distribution centres (2017 - 16 distribution centres) across Canada. Sleep Country's stores average approximately 5,000 square feet and offer a large selection of mattresses, box spring bases, metal frames, lifestyle bases and a wide assortment of complementary sleep related products ("**Accessories**"), which include pillows, mattress pads, sheets, duvets, headboards, footboards and platforms. Sleep Country's stores are all corporate-owned, enabling it to develop and maintain a strong culture of customer service, resulting in a consistent and superior in-store and home delivery customer experience. In Q2 2017, the Company also launched its new eCommerce platform and the Bloom™ brand to meet the needs of the consumers looking for the convenience of online shopping. On December 6, 2018, Sleep Country acquired Endy Canada Inc.

Sleep Country Canada

Sleep Country launched its concept in the Vancouver market with four stores in 1994 and has since expanded across Canada with 208 corporately owned stores and 14 distribution centres as at December 31, 2018 in British Columbia, Alberta, Manitoba, Saskatchewan, Ontario, Nova Scotia, New Brunswick and Prince Edward Island. SCC's regional footprint includes the following distribution centres: Victoria, BC; Richmond, BC; Kelowna, BC; Calgary, AB; Edmonton, AB; Winnipeg, MB; Regina, SK; Brampton, ON; London, ON; Ancaster, ON; Cobourg, ON; Ottawa, ON; Moncton, NB and Halifax, NS.

Dormez-vous?

Sleep Country also operates under the Dormez-vous? Banner in Quebec. As of December 31, 2018, the Dormez-vous? Banner had 56 stores with two distribution centres in Montreal and Quebec City.

Endy

Launched in 2015, Endy is one of Canada's leading mattress-in-a-box eCommerce retailers. The brand's award-winning Endy Mattress-in-a-box is engineered to offer the perfect balance of comfort and support. Endy has also expanded its product assortment to include The Endy Pillow, The Endy Sheets, and The Endy Mattress Protector. On December 6, 2018, Sleep Country acquired substantially all the operating assets.

4. Dividends and Share purchases

Dividends:

The Board of Directors of the Company has periodically declared dividends on the Company's common shares as follows:

Date of declaration	Record date	Payment date	Dividend declared (per share)
January 29, 2016	February 16, 2016	February 26, 2016	$ 0.13
May 10, 2016	May 20, 2016	May 30, 2016	$ 0.13
July 28, 2016	August 16, 2016	August 26, 2016	$ 0.15
November 1, 2016	November 18, 2016	November 28, 2016	$ 0.15
January 26, 2017	February 17, 2017	February 27, 2017	$ 0.15
May 9, 2017	May 19, 2017	May 29, 2017	$ 0.165
August 2, 2017	August 18, 2017	August 28, 2017	$ 0.165
November 1, 2017	November 17, 2017	November 27, 2017	$ 0.165
January 26, 2018	February 16, 2018	February 26, 2018	$ 0.165
May 7, 2018	May 22, 2018	May 31, 2018	$ 0.185
August 2, 2018	August 20, 2018	August 30, 2018	$ 0.185
November 1, 2018	November 19, 2018	November, 29, 2018	$ 0.185
February 5, 2019	February 15, 2019	February 26, 2019	$ 0.185

All dividends are designated as "eligible dividends" for Canadian tax purposes.

Share purchases:

In the fourth quarter of 2017, the Company received approval from the Toronto Stock Exchange (the "TSX") to commence a Normal Course Issuer Bid ("NCIB") and purchase on the TSX or through alternative trading systems up to 1,600,000 of the Company's common shares, representing approximately 4.5% of the public float. In accordance with the rules and by-laws of the TSX, the Company was permitted, until one year from the date of approval, to purchase, up to a daily maximum of 21,005 Shares (representing 25% of the average daily trading volume of the Shares on the TSX for the six months prior to commencement of the NCIB), except where such purchases are made in accordance with the "block purchase" exception under the applicable TSX rules and policies.

Since the commencement of the NCIB, the Company had purchased 641,326 Common Shares, for cancellation, at an average price of $34.12 per share, for a total consideration of $21.9 million. Sleep Country's NCIB expired on December 6, 2018 and was not renewed.

5. Factors Affecting Our Results of Operations

Revenues

Revenues are derived primarily from the retail sales of mattress sets, lifestyle bases and Accessories (including pillows, mattress pads, sheets, duvets, headboards, footboards and platforms) and are recognized when the performance obligation is fulfilled. The performance obligation is deemed fulfilled when the control of the products has transferred to the customer and there is no unfulfilled obligation that could affect the customer's acceptance of the products. Provisions for returns relating to the Company's various customer satisfaction programs are accrued based on historical experience. Revenue from sale of third party warranties is recognized based on the net amount of consideration the Company retains after paying the third party the consideration received in exchange for the services to be provided by the third party.

SCC's goal is to build on the market position of its Banners and to grow its revenue by growing Same Store Sales (or "**SSS**"[1]), continuing to add stores in both new and existing markets, increasing its online revenue through its eCommerce platforms and expand and grow its accessories offering and revenue. SCC's revenue is impacted by competition from other retailers that sell similar products and by seasonal patterns.

(1) See "Non-IFRS Measures".

Same Store Sales or SSS (See "Non-IFRS Measures")

SSS is primarily driven by:

- changes in customer traffic through marketing and advertising;
- changes in the conversion rate of converting shoppers into buyers; and
- changes in the average transaction size.

Online Expansion Opportunities

Sleep Country successfully launched its new eCommerce platform in Q2 2017 to address the growing trend of consumers who research and shop online. This has also allowed the Company to reach more customers in existing markets, as well as introduce the Sleep Country brand to customers currently outside the markets it has a store presence in.

In December 2018, Sleep Country acquired Endy with a goal of diversifying the product offering, accelerating the growth of the Company's online business and demonstrating continued focus on providing the customers with the choice to navigate easily between traditional and online channels. The acquisition of Endy, along with Sleep Country's existing eCommerce and Bloom mattress-in-a-box offerings, is expected to complement Sleep Country's national store footprint and diverse selection of sleep products. The Company believes that this acquisition will also position Sleep Country strongly to compete against local and potential U.S. and international entrants to the Canadian market.

Product Expansion Opportunities

SCC's goal is to build on the market position of its Banners and to grow its revenue by continuing to expand its product offering in both the mattress and Accessory categories.

The original Bloom mattress-in-a-box was launched in May 2017 in order to cater to the consumers that are looking for affordability, convenience and trust when buying a new mattress-in-a-box. In June 2018, SCC added to the original Bloom mattress-in box by introducing three new Bloom mattresses-in-box at various price points and thereby extending the mattress-in-a-box offering for every budget and every room.

In May 2018, Sleep Country and Simba, a leading mattress-in-a-box retailer based in UK, announced its strategic partnership to launch the Simba Hybrid Mattress-in-a-box in Canada. This premium mattress-in-box is introduced to the Canadian market exclusively by Sleep Country through its eCommerce platform and network of stores, and complements its existing line up of mattress-in-a-box, offered through the Bloom brand. In Q4 2018, the set up for this launch was completed, and the Simba Hybrid Mattress-in-a-box was successfully launched in January 2019.

In 2018 SCC also launched a number of new accessories such as weighted blankets, silk pillowcases, eye masks, Hotel Collection sheets, throws in a variety of materials from faux cashmere to faux fur, LuxeSilk™ Duvet and Dog beds. SCC intends to continue to expand its product offerings by entering into business partnerships with other mattress and Accessory players that will be featured in its network of stores and on its eCommerce platform and branded websites.

Store Expansion Opportunities

SCC has the ability to add new stores in existing markets (in-fill stores) add new stores in satellite markets and add new stores in new markets. An existing market or in-fill opportunity is a pre-existing built out region in which SCC already has an established store presence serviced by one or more existing distribution centres. A satellite market is a new region that is adjacent or close to a pre-existing built-out region, which benefits from advertising spill and is serviced logistically from the

nearby distribution centre. A new market is a brand new territory in which the Company did not previously operate, requiring incremental advertising and distribution logistics.

Sleep Country has successfully expanded every year since its founding in 1994. This capability to expand its store presence depends on SCC's ability to choose new locations and new markets, to hire and train new employees for its stores and distribution centres and, in the case of expansion into new markets, create top-of-mind brand awareness of its Banners.

Since 2015, Sleep Country has opened seven stores within enclosed malls, four of which were opened in 2018. Stores within enclosed malls represent an additional growth opportunity to service the captive audience that is shopping in these malls and further allows the Company to capitalize on the decline of departmental stores.

SCC's site selection strategy is focused on maximizing sales per store and per region throughout its store network. Prior to identifying and ultimately selecting locations for new stores, management conducts extensive analysis utilizing the following factors: (i) demographics such as population density, household income and population growth rates; (ii) store visibility and accessibility; (iii) lease and advertising economics; (iv) competitive dynamics; (v) overlap with existing stores and distribution footprint; and (vi) potential cannibalization of existing stores. In terms of regional expansion, once a target area has been determined, management focuses on ensuring SCC can successfully incorporate its culture (vision and mission) into the new region. To help accomplish this, SCC has traditionally started by ensuring the core of its new regional team is comprised of existing employees in leadership roles who are willing to relocate. The team is then supplemented with local hires, who have received extensive training including in classroom, in store, and throughout the organization i.e. distribution centres, thereby learning SCC's service model and culture.

The following table summarizes SCC's store count for each of the three-month and fiscal years ended December 31, 2018 and December 31, 2017.

	Q4		Annual	
	2018	**2017**	**2018**	**2017**
Number of stores, beginning of period	**260**	244	**247**	235
Stores newly opened	**4**	3	**17**	12
Number of stores, end of period	**264**	247	**264**	247
Number of stores in new store design, end of period			**155**	106
Stores relocated	**2**	-	**3**	-
Stores renovated	**10**	10	**29**	31

The 17 new stores opened in 2018 are in-fill stores, of which four are stores within enclosed malls.

Enhanced Store Design

An enhanced store design was first introduced in certain existing stores during the second half of 2014. The purpose of the new store design is to enhance the customer shopping experience, especially when they shop for accessories, through enhanced millwork and improved display. As at December 31, 2018, there were 155 stores or 59% of the store network that featured the new store design, of which 54 were new stores, 93 were renovated stores and 8 were relocations of existing stores. Over time, SCC intends to select additional stores to renovate to this new design. The Company will continue to feature the new design in all new stores it opens.

Competition

The retail mattress industry is highly competitive and includes national and regional full-line furniture retailers, departmental retailers, small regional specialty mattress retailers and online mattress-in-a-box retailers. Of the leading retailers in the mattress industry, Sleep Country is the only national specialty mattress retailer. Management believes it can maintain a leading position through its highly differentiated service model that has been unrivalled in execution over the last 24 years and serves as a significant barrier to entry.

Sears Canada, one of the largest competitors of Sleep Country, closed all of their Canadian store locations between October 2017 and January 2018.

Seasonality

The retail mattress industry is affected by seasonal conditions. SCC typically experiences higher sales and a greater proportion of income during the third and fourth quarters due to a concentration of summer season holidays in the third quarter and other seasonal factors. Sales have historically trended lower in the first quarter as consumers tighten their budgets after the holiday season. The cold winter weather in many parts of the country during the first quarter also tends to lower customers' desire to shop. SCC expects these trends to continue for the foreseeable future. The average quarterly share of annual sales over the last three fiscal years is as follows:

First quarter	21%
Second quarter	23%
Third quarter	30%
Fourth quarter	26%
Yearly total	100%

Cost of Sales and Gross Profit

Cost of sales includes product related costs and the costs of SCC's sales and distribution operations net of volume rebates received from suppliers. Cost of sales is impacted by the number of stores, fluctuations in the volume of inventories sold, average unit selling prices ("**AUSP**") and SCC's ability to manage store level occupancy costs.

Product gross margin is affected by changes in sales product mix, suppliers' term discount, freight and inventory management.

The largest component of SCC's sales operational costs are the sales associates' compensation and store occupancy costs. The largest component of SCC's distribution operations are labour costs and delivery expenses.

Volume rebates are driven by the purchase volume of inventory from suppliers. Some suppliers also offer step-ups on higher volume achieved as additional incentives. The rebates are pro-rated between products sold and those still in inventory. Rebates on products sold are recorded as a reduction to cost of sales, while rebates on products in inventory are recorded as a reduction to the carrying value of inventory.

6. Fourth Quarter and Full Year Operational Highlights

		Q4			Annual	
(C$ thousands unless otherwise stated; except store count and earnings per share)	**2018**	2017[2]	**Change**	**2018**	2017[2]	**Change**
Revenues	$ **160,104**	153,620	4.2%	$ **622,977**	586,948	6.1%
SSS[1]	**(2.7%)**	9.3%		**1.4%**	8.8%	
Stores opened	4	*3*		17	*12*	
Stores renovated/relocated	12	*10*		32	*31*	
Gross profit margin	**31.2%**	30.5%		**30.4%**	29.9%	
Operating EBITDA[1]	**25,896**	25,750	0.6%	**105,775**	100,022	5.8%
Operating EBITDA margin %[1]	**16.2%**	16.8%		**17.0%**	17.0%	
Net income	**13,313**	14,849	(10.3%)	**59,641**	59,246	0.7%
Earnings per share – Basic	**0.36**	0.40	(10.0%)	**1.61**	1.58	1.9%
Earnings per share – Diluted	**0.36**	0.39	(7.7%)	**1.59**	1.56	1.9%
Adjusted Net Income[1]	**14,776**	15,900	(7.1%)	**63,861**	62,167	2.7%
Adjusted earnings per share – Basic[1]	$ **0.40**	$ 0.42	(4.8%)	$ **1.72**	$ 1.65	4.2%
Adjusted earnings per share – Diluted[1]	$ **0.40**	$ 0.42	(4.8%)	$ **1.71**	$ 1.64	4.3%

Notes:

1. See the section below entitled "Non-IFRS Measures" for further details concerning how the Company calculates SSS, Operating EBITDA, Operating EBITDA Margin, Adjusted Net Income and Basic and Diluted Adjusted Earnings per Share ("EPS") and for a reconciliation to the most comparable IFRS measure.
2. On January 1, 2018, the Company adopted IFRS 15 and as a result, the financial results and the non-IFRS measures for 2017 have been restated. The adoption has no material impact on the financial results of the Company and has no impact on the EPS. The impact of adoption on Q4 2017 and Annual 2017 is discussed under the heading "Critical Accounting Estimates".

Highlights of Results in Q4 2018

Total revenues increased by 4.2% from Q4 2017. The sales growth was aided by the addition of 17 new stores since December 31, 2017, partially offset by a SSS decrease of 2.7%. The overall traffic and conversion, as well as the mattress units and the mattress AUSP showed positive growth in Q4 2018 compared to Q4 2017. Gross profit margins improved from 31.2% in Q4 2018 compared to 30.5% in Q4 2017.

In December 2018, Sleep Country acquired substantially all of the assets of Endy. Sleep Country paid $63.7 million in cash at closing, $2.3 million payable in working capital adjustment and has agreed to pay up to an additional $25 million in cash in early 2021 based on achieving certain growth and profitability targets in 2020. The transaction was financed through Sleep Country's revolving credit facility, which was upsized by $60 million to $210 million for the transaction. Since the date of acquisition, Endy has generated revenue of $3,467. The post acquisition net income of Endy did not significantly contribute to the consolidated net income of SCC.

Continued focus on media and advertising, which increased by $2.6 million mainly related to its "All for Sleep" campaign that emphasizes how a lack of quality sleep can affect people with a light-hearted, comedic approach. "All for Sleep" is Sleep Country's new positioning statement and is a reflection of how the Company has evolved its focus from mattresses into a total sleep solution provider for the whole family.

The Operating EBITDA increased by 0.6% from $25.8 million in Q4 2017 to $25.9 million in Q4 2018. The Adjusted Net Income for Q4 2018 was $14.8 million (Q4 2017 – $15.9 million) and Basic Adjusted earnings per share declined from $0.42 in Q4 2017 to $0.40 in Q4 2018. See "Non-IFRS Measures". Net income in Q4 2018 decreased by $1.5 million from $14.8 million in Q4 2017 to $13.3 million in Q4 2018 resulting in a lower Basic earnings per share of $0.36 (Q4 2017 - $0.40).

Highlights of Results in 2018

Total revenues increased by 6.1% from 2017 and SSS grew 1.4% on top of SSS of 8.8% in 2017. Sales growth was aided by the addition of 17 new stores since December 31, 2017. Of the 17 stores that opened in 2018, four were enclosed mall stores. The overall traffic and conversion, as well as the mattress units and the mattress AUSP showed positive growth in 2018 compared to 2017.

In June 2018, SCC added to the original Bloom mattress-in-a-box by introducing three new Bloom mattresses-in-box at various price points and thereby extending this product offering for every budget and every room.

Continued focus on media and advertising, which increased by $5.6 million mainly related to its "All for Sleep" campaign that emphasizes how a lack of quality sleep can affect people with a light-hearted, comedic approach. "All for Sleep" is Sleep Country's new positioning statement and is a reflection of how the Company has evolved its focus from mattresses into a total sleep solution provider for the whole family. In addition, there was additional spend on TV infomercials, primarily to support the Accessories business and digital marketing to support the eCommerce website and drive traffic to stores

Operating EBITDA increased by 5.8% which translated into a growth in Adjusted Net Income of 2.7% from $62.2 million in 2017 to $63.9 million in 2018. Net income in 2018 was $59.6 million (2017 - $59.2 million) resulting in Basic earnings per share of $1.61 (2017 - $1.58). Basic Adjusted Earnings per Share increased by 4.2% to $1.72 in 2018 from $1.65 in 2017. See "Non-IFRS Measures".

Outlook

Management believes Sleep Country is well-positioned to continue to grow revenue and profitability and to generate strong cash flow. Key initiatives planned for 2019 include the following:

- opening eight to 12 stores per year;
- renovating 25 to 30 stores to feature the enhanced store design;
- growing SSS (See "Non-IFRS Measures") by optimizing our advertising and investing in sales training;
- implementing specific tactics, including targeted advertising, aimed at aggressively capturing more market share;
- continuing to grow online sales with the Endy brand and revamp the Sleep Country and Dormez-vous? website on a new cloud based eCommerce platform. The revamped Sleep Country and Dormez-vous? website will offer a wider variety of mattresses for sale and will also feature all our accessories for sale;
- further increasing digital marketing spend to promote the Bloom™ and Simba mattresses-in-a-box brands that are offered to customers through our eCommerce website as well as our retail stores;
- continuing to heavily advertise the Endy brand using digital advertising channels but will be enhanced with additional traditional media channels to broaden awareness in all markets in Canada;
- launching and promote the Simba Hybrid Mattress-in-a-box in Canada;
- continuing to expand merchandising opportunities in accessories; and
- spending approximately $30 million to $40 million on capital expenditure driven mainly by an investment in a new cloud based eCommerce platform, a new in-store Point of Sale system, a new warehouse management system and a new ERP system, new stores, store renovations, and maintenance capital expenditures.

Selected Financial Information

The following table sets out selected IFRS and certain non-IFRS financial measures of SCC and should be read in conjunction with the audited annual consolidated financial statements of SCC for 2018 and 2017.

		Q4				Annual				
((C$ thousands unless otherwise stated; except earnings per share))		**2018**		**2017[(2)]**	**Change**		**2018**		**2017[(2)]**	**Change**
Consolidated Income Statement										
Revenues	**$**	**160,104**	$	153,620	4.2%	**$**	**622,977**	$	586,948	6.1%
Cost of sales		**110,164**		106,832	3.1%		**433,432**		411,614	5.3%
Gross profit		**49,940**		46,788	6.7%		**189,545**		175,334	8.1%
General and administrative expenses		**25,640**		22,089	16.1%		**88,123**		78,233	12.6%
Depreciation and amortization		**4,064**		3,306	22.9%		**14,820**		12,384	19.7%
Income before finance related expenses, interest income and other expenses (income) and income taxes		**20,236**		21,393	(5.4%)		**86,602**		84,717	2.2%
Finance related expenses		**1,287**		922	39.6%		**4,475**		3,687	21.4%
Interest income and other expenses (income) – net		**-**		71	(100.0%)		**(89)**		(17)	423.5%
Net Income before provision for income taxes		**18,949**		20,400	(7.1%)		**82,216**		81,047	1.4%
Provision for Income taxes		**5,636**		5,551	1.5%		**22,575**		21,801	3.6%
Net income	**$**	**13,313**	$	14,849	(10.3%)	**$**	**59,641**	$	59,246	0.7%
EBITDA[(1)]	**$**	**24,300**	$	24,699	(1.6%)	**$**	**101,422**	$	97,101	4.5%
Operating EBITDA[(1)]	**$**	**25,896**	$	25,750	0.6%	**$**	**105,775**	$	100,022	5.8%
Operating EBITDA Margin[(1)]		**16.2%**		16.8%			**17.0%**		17.0%	
Adjusted Net Income[(1)]	**$**	**14,776**	$	15,900	(7.1%)	**$**	**63,861**	$	62,167	2.7%
Earnings per share – Basic	**$**	**0.36**	$	0.40	(10.0%)	**$**	**1.61**	$	1.58	1.9%
Earnings per share – Diluted	**$**	**0.36**	$	0.39	(7.7%)	**$**	**1.59**	$	1.56	1.9%
Adjusted earnings per share - Basic[(1)]	**$**	**0.40**	$	0.42	(4.8%)	**$**	**1.72**	$	1.65	4.2%
Adjusted earnings per share - Diluted[(1)]	**$**	**0.40**	$	0.42	(4.8%)	**$**	**1.71**	$	1.64	4.3%
Dividends declared per share	**$**	**0.185**	**$**	0.165	12.1%	**$**	**0.720**	**$**	0.645	10.8%

		31-Dec-18		**31-Dec-17[(2)]**
Total assets	$	**602,106**	$	**482,499**
Long-term debt	$	**170,036**	$	**107,147**

Notes:

1. See the section below entitled "Non-IFRS Measures" for further details concerning how the Company calculates EBITDA, Operating EBITDA, Operating EBITDA Margin, Adjusted Net Income and Basic and Diluted Adjusted EPS and for a reconciliation to the most comparable IFRS measure.
2. On January 1, 2018, the Company adopted IFRS 15 and as a result, the financial results and the non-IFRS measures for 2017 have been restated. The adoption has no material impact on the financial results of the Company and has no impact on the EPS. The impact of adoption on Q4 2017 and 2017 is discussed under the heading "Critical Accounting Estimates".

	Q4			Annual		
((C$ thousands unless otherwise stated; except earnings per share))	**2017(2)**	**2016**	**Change(3)**	**2017(2)**	**2016**	**Change(3)**
Consolidated Income Statement						
Revenues	$ 153,620	$ 135,430	13.4%	$ 586,948	$ 523,787	12.1%
Cost of sales	106,832	96,425	10.8%	411,614	372,389	10.5%
Gross profit	46,788	39,005	20.0%	175,334	151,398	15.8%
General and administrative expenses	22,089	20,360	8.5%	78,233	67,882	15.2%
Depreciation and amortization	3,306	3,335	(0.9%)	12,384	11,869	4.3%
Income before finance related expenses, interest income and other expenses (income) and income taxes	21,393	15,310	39.7%	84,717	71,647	18.2%
Finance related expenses	922	834	10.6%	3,687	4,121	(10.5%)
Interest income and other expenses (income) – net	71	75	(5.3%)	(17)	118	(114.4%)
Net Income before provision for income taxes	20,400	14,401	41.7%	81,047	67,408	20.2%
Provision for Income taxes	5,551	3,224	72.2%	21,801	17,834	22.2%
Net income	$ 14,849	$ 11,177	32.9%	$ 59,246	$ 49,574	19.5%
EBITDA(1)	$ 24,699	$ 18,645	32.5%	$ 97,101	$ 83,516	16.3%
Operating EBITDA(1)	$ 25,750	$ 19,123	34.7%	$ 100,022	$ 85,045	17.6%
Operating EBITDA Margin(1)	16.8%	14.1%		17.0%	16.2%	
Adjusted Net Income(1)	$ 15,900	$ 11,655	36.4%	$ 62,167	$ 51,103	21.7%
Earnings per share – Basic	$ 0.40	$ 0.30	33.3%	$ 1.58	$ 1.32	19.7%
Earnings per share – Diluted	$ 0.39	$ 0.29	34.5%	$ 1.56	$ 1.31	19.1%
Adjusted earnings per share - Basic(1)	$ 0.42	$ 0.31	35.5%	$ 1.65	$ 1.36	21.3%
Adjusted earnings per share - Diluted(1)	$ 0.42	$ 0.31	35.5%	$ 1.64	$ 1.35	21.5%
Dividends declared per share	$ 0.165	$ 0.15	13.3%	$ 0.645	$ 0.56	16.1%
		31-Dec-17(2)			**31-Dec-16**	
Total assets	$	**482,499**		$	**461,008**	
Long-term debt	$	**107,147**		$	**118,751**	

Notes:

1. See the section below entitled "Non-IFRS Measures" for further details concerning how the Company calculates EBITDA, Operating EBITDA, Operating EBITDA Margin, Adjusted Net Income and Basic and Diluted Adjusted EPS and for a reconciliation to the most comparable IFRS measure.
2. On January 1, 2018, the Company adopted IFRS 15 and as a result, the financial results and the non-IFRS measures for 2017 have been restated. The adoption has no material impact on the financial results of the Company and has no impact on the EPS. The impact of adoption on Q4 2017 and 2017 is discussed under the heading "Critical Accounting Estimates".
3. See the Management Discussion and Analysis for year ended December 31, 2017 for discussion related to performance analysis.

7. Fourth Quarter 2018 versus Fourth Quarter 2017[1]

[1]On January 1, 2018, the Company adopted IFRS 15 and as a result, the financial results and the non-IFRS measures for 2017 have been restated. The adoption has no material impact on the financial results of the Company and has no impact on the EPS. The impact of adoption on Q4 2017 and Annual 2017 is discussed under the heading "Critical Accounting Estimates".

Revenues

Revenues increased by 4.2%, from $153.6 million in Q4 2017 to $160.1 million in Q4 2018. Sales growth was aided by the addition of 17 new stores since December 31, 2017 and was partly offset by a SSS decrease of 2.7% in Q4 2018. SSS growth in Q4 2017 was 9.3%. The total traffic as well as the conversion in Q4 2018 increased compared to Q4 2017. See "Non-IFRS Measures".

The increase in total revenue was comprised of an increase in mattress sales and Accessories sales. Mattress revenue increased by 3.1%, from $122.9 million to $126.7 million. The mattress units sold as well as the AUSP in Q4 2018 increased compared to Q4 2017. Accessories revenue increased by 8.7%, from $30.7 million to $33.4 million.

Gross profit

Gross profit was $49.9 million in Q4 2018 compared to $46.8 million in Q4 2017, representing an increase of $3.1 million. Gross profit margin increased by 0.7% to 31.2% for Q4 2018 from 30.5% for Q4 2017 primarily because of the following factors:

- inventory and other directly related expenses, net of volume rebates, decreased as a percentage of revenue from 45.6% to 44.7%, mainly as a result of achieving higher raw product margins and increase in volume rebate income, partly offset by an increase in freight expenses;
- sales and distribution compensation expenses were 14.5% of revenue in Q4 2018 compared to 15.1% of revenue in Q4 2017 mainly as a result of improved efficiencies; and
- store occupancy costs increased as a percentage of revenue to 9.0% compared to 8.2% of revenue in Q4 2017. This was mainly impacted by the decline in SSS and effect of incurring pre-opening occupancy costs for new stores

General and administrative ("**G&A**") expenses

Total G&A expenses increased by $3.5 million, or 16.1%, from $22.1 million in Q4 2017 to $25.6 million in Q4 2018; and, as a percentage of revenue, G&A increased from 14.4% in Q4 2017 to 16.0% in Q4 2018.

							Q4
(C$ millions unless otherwise stated)		**2018**	% of revenue		2017	*% of revenue*	Change
Media and advertising expenses[1]	**$**	**10.9**	**6.8%**	$	8.3	5.3%	$ 2.6
Salaries, wages and benefits[2]		**5.1**	**3.2%**		5.2	3.4%	(0.1)
Credit card and finance charges[3]		**4.0**	**2.5%**		3.4	2.2%	0.6
Rent and other occupancy charges[4]		**2.2**	**1.4%**		1.8	1.2%	0.4
Professional fees[5]		**0.8**	**0.5%**		0.4	0.3%	0.4
Telecommunication and information technology		**1.0**	**0.6%**		0.9	0.6%	0.1
Mattress recycling and Donations		**0.8**	**0.5%**		0.7	0.4%	0.1
Other[6]		**0.8**	**0.6%**		1.4	0.9%	(0.6)
Total G&A expenses	**$**	**25.6**	**16.0%**	$	**22.1**	14.4%	$ 3.5

Notes:

1. Media and advertising expenses increased by $2.6 million mainly due an increase in production spend, primarily around the launch of the 'All for Sleep' campaign and infomercials; and additional digital advertising by Sleep Country and Endy, partly offset by a reduction in traditional media adverting.
2. Salaries, wages and benefits decrease by $0.1 million mainly as a result of a reduction in management bonus, partly offset by additional compensation expense incurred in the regular course of business as a result of merit increases and additional hires to support growth of the business, as well as compensation costs of the newly acquired Endy business.
3. Credit card and finance charges are variable costs. These costs increased as a percentage of revenue over Q4 2017 by 0.3% mainly due to customers' preference towards longer term financing plans and an increase in credit card charges.
4. Rent and other occupancy charges include rent for the distribution centres and office space, which increased by $0.4 million compared to Q4 2017 mainly due to the relocation of a distribution centre in Moncton in Q4 2018.
5. The increase in professional fees is mainly due to fees incurred in relation to the acquisition of Endy.
6. Other G&A expenses decreased mainly due to reduction in travel expenses and the favorable impact of reversal of provision for bad debts.

EBITDA

EBITDA was $24.3 million for Q4 2018 compared to $24.7 million for Q4 2017, representing a decrease of $0.4 million (or 1.6%). See "Non-IFRS Measures". Total revenue increased by $6.5 million or 4.2% and gross profit increased by $3.1 million or 6.7%, however G&A expenses increased by $3.5 million resulting in a decrease of $0.4 million in EBITDA.

Operating EBITDA

Operating EBITDA was $25.9 million for Q4 2018, or 16.2% of revenue, compared to $25.8 million for Q4 2017, or 16.8% of revenue, representing an increase of $0.1 million (or 0.6%). See "Non-IFRS Measures".

Depreciation and amortization expenses

Depreciation and amortization expenses increased by $0.8 million from $3.3 million in Q4 2017 to $4.1 million in Q4 2018 mainly resulting from new store openings and store renovations in the current and prior years.

Finance related expenses

Finance related expenses increased by $0.4 million from $0.9 million in Q4 2017 to $1.3 million in Q4 2018 as a result of a higher effective interest rate of 4.05% in Q4 2018 compared to 3.35% in Q4 2017 and higher average balance outstanding on the senior secured credit facility, mainly to fund the acquisition of Endy.

Income taxes

Net income before income taxes decreased by 7.1% from $20.4 million in Q4 2017 to $18.9 million in Q4 2018, however, the income tax expense for Q4 2018 remained relatively unchanged at $5.6 million in Q4 2018 and Q4 2017.

Net income

The net income for Q4 2018 decreased by $1.5 million and was at $13.3 million in Q4 2018 compared to $14.8 million in Q4 2017 (Q4 2018-$0.36 per share; Q4 2017-$0.40 per share). The decrease was mainly driven by the decrease in EBITDA along with an increase in depreciation and amortization expense and finance related expenses. See "Non-IFRS Measures".

Adjusted Net Income

Adjusted Net Income for Q4 2018 was $14.8 million ($0.40 per share) compared to $15.9 million ($0.42 per share) for Q4

2017, a decrease of $1.1 million (or 7.1%). The decrease was primarily due to higher depreciation and amortization expense and finance related expense, partially offset by an increase in Operating EBITDA. See "Non-IFRS Measures".

8. Annual Financial Results 2018 versus 2017(1)

(1) On January 1, 2018, the Company adopted IFRS 15 and as a result, the financial results and the non-IFRS measures for 2017 have been restated. The adoption has no material impact on the financial results of the Company and has no impact on the EPS. The impact of adoption on Q4 2017 and Annual 2017 is discussed under the heading "Critical Accounting Estimates".

Revenues

Revenues increased by 6.1%, from $586.9 million in 2017 to $623 million in 2018, driven by addition of 17 new stores since December 31, 2017 and a 1.4% increase in SSS in 2018. SSS growth in 2017 was 8.8%. The total traffic as well as the conversion in 2018 increased compared to 2017. See "Non-IFRS Measures".

The increase in total revenue was comprised of an increase in mattress sales and accessories sales. Mattress revenue increased by 4.8%, from $474.1 million to $497 million. The mattress units sold as well as the AUSP in 2018 increased compared to 2017. Accessories revenue increased by 11.7%, from $112.8 million to $126 million.

Gross profit

Gross profit was $189.5 million in 2018 compared to $175.3 million in 2017, representing an increase of $14.2 million. Gross profit margin increased by 0.5% to 30.4% for 2018 from 29.9% in 2017 primarily as a result of the following factors:

- inventory and other directly related expenses net of volume rebates decreased as a percentage of revenue from 45.8% to 45.3% mainly as a result of achieving higher raw product margins and lower inventory provisions, partially offset by an increase in freight expense and third-party logistics delivery expenses;
- sales and distribution compensation expenses were 14.8% of revenue in 2018 compared to 15.2% of revenue in 2017 mainly as a result of improved efficiencies; and
- store occupancy costs, which increased as a percentage of revenue from 8.5% to 8.9%.

General and administrative ("G&A") expenses

Total G&A expenses increased by $9.9 million, or 12.6%, from $78.2 million in 2017 to $88.1 million in 2018; and, as a percentage of revenue, G&A increased from 13.3% in 2017 to 14.1% in 2018.

								Annual
(C$ millions unless otherwise stated)		**2018**	***% of revenue***		**2017**	**% of revenue**		**Change**
Media and advertising expenses(1)	$	**33.8**	**5.4%**	$	28.2	4.8%	$	5.6
Salaries, wages and benefits(2)		**19.9**	**3.2%**		18.2	3.1%		1.7
Credit card and finance charges(3)		**14.8**	**2.4%**		13.3	2.3%		1.5
Rent and other occupancy charges(4)		**8.1**	**1.3%**		8.4	1.4%		(0.3)
Professional fees(5)		**2.2**	**0.4%**		1.4	0.2%		0.8
Telecommunication and information technology		**3.9**	**0.6%**		3.6	0.6%		0.3
Mattress recycling and Donations		**2.3**	**0.4%**		2.2	0.4%		0.1
Other		**3.1**	**0.5%**		2.9	0.5%		0.2
Total G&A expenses	**$**	**88.1**	**14.1%**		**78.2**	13.3%	$	9.9

Notes:

1. Media and advertising expenses increased by $5.6 million mainly due to:
   - a shift in media spend from traditional radio and print media advertising towards digital marketing to support the eCommerce website and drive traffic to stores;
   - additional TV infomercials, primarily to support Accessories, along with additional traditional media advertising on television to provide increased support to the overall business;
   - an increase in production spend, primarily around the launch of the 'All for Sleep' campaign;
   - higher fees and other onboarding costs of the new advertising agency; and
   - Endy advertising spend.
2. Salaries, wages and benefits increased by $1.7 million mainly as a result of a $1 million increase in share-based compensation expense and additional compensation expense incurred in the regular course of business as a result of merit increases and additional hires to support growth of the business.
3. Credit card and finance charges are variable costs. These costs increased as a percentage of revenue over Q4 2017 by 0.1% mainly due to a shift in customers' preference towards longer term financing plans.
4. Rent and other occupancy charges include rent for the distribution centres and office space, which decreased in 2018 by $0.3 million compared to 2017 mainly due to additional costs incurred in 2017 in relation to the relocation of four distribution centers, partly offset by increase in occupancy costs of the new facilities.
5. The increase in professional fees is mainly related to additional one-time fees incurred in relation to the acquisition of Endy and management consulting fees incurred in relation to the ERP project.

EBITDA

EBITDA was $101.4 million for 2018 compared to $97.1 million for 2017, representing an increase of $4.3 million (or 4.5%). See "Non-IFRS Measures". The increase was primarily due to strong revenue growth in 2018 combined with improved gross profit margins, partially offset by an increase in the G&A expenses.

Operating EBITDA

Operating EBITDA was $105.8 million for 2018 compared to $100 million for 2017, representing an increase of $5.8 million (or 5.8%). See "Non-IFRS Measures". The increase was primarily due to strong revenue growth in 2018 combined with improved gross profit margins, partially offset by an increase in G&A expenses.

Depreciation and amortization expenses

Depreciation and amortization increased by $2.4 million from $12.4 million in 2017 to $14.8 million in 2018 primarily due to the impact of new store openings and store renovations in the current year and the impact of relocation of four distribution centres in 2017.

Finance related expenses

Finance related expenses were $4.5 million in 2018 compared to $3.7 million in 2017, representing an increase of $0.8 million mainly as a result of a higher effective interest rate of 3.7% in 2018 compared to 3.03% in 2017.

Income taxes

2018 had an income tax expense of $22.6 million versus $21.8 million for 2017 representing an increase of 3.6% mainly as a result of increased taxable income.

Net income

The net income for 2018 was $59.6 million ($1.61 per share) compared to $59.2 million ($1.58 per share) in 2017 representing an increase of $0.4 million (or 0.7%). The increase was mainly due to an increase in EBITDA partially offset by higher finance related expenses, depreciation and amortization expense and income tax expense. See "Non-IFRS Measures".

Adjusted net income

Adjusted Net Income for 2018 was $63.9 million ($1.72 per share) compared to $62.2 million ($1.65 per share) for 2017, an increase of $1.7 million (or 2.7%). The increase was primarily due to higher Operating EBITDA, partially offset by an increase in depreciation and amortization expense, finance related expense and income tax expense. See "Non-IFRS Measures".

9. Summary of Quarterly Results

Over the past two years, the Company's quarterly revenue and earnings have steadily increased, with the third quarter typically generating the greatest contribution to revenues and earnings, and the first quarter the least. This is largely due to the seasonal nature of revenue and the timing of marketing programs. Accordingly, results of operations for any interim period are not necessarily indicative of the results of operations for the full fiscal year. The following table shows the financial performance of the Company for the last eight quarters and has been prepared in accordance with IFRS, except where indicated.

(C$ thousands unless otherwise stated)	2018 Q4	2018 Q3	2018 Q2	2018 Q1	2018 TOTAL	2017 Q4[2]	2017 Q3[2]	2017 Q2[2]	2017 Q1[2]	2017 TOTAL[2]
Revenues	**$ 160,104**	$ 183,899	$ 143,693	$ 135,281	**$ 622,977**	$ 153,620	$ 176,200	$ 132,922	$ 124,206	$ 586,948
SSS[1]	**(2.7%)**	0.2%	4.4%	5.1%	**1.4%**	9.3%	7.3%	7.5%	11.9%	8.8%
Gross profit	**$ 49,940**	$ 62,171	$ 41,228	$ 36,206	**$ 189,545**	$ 46,788	$ 58,447	$ 37,395	$ 32,704	$ 175,334
Gross profit margin	**31.2%**	33.8%	28.7%	26.8%	**30.4%**	30.5%	33.2%	28.1%	26.3%	29.9%
EBITDA[1]	**$ 24,300**	$ 36,772	$ 21,766	$ 18,584	**$ 101,422**	$ 24,699	$ 35,099	$ 19,556	$ 17,747	$ 97,101
Operating EBITDA[1]	**$ 25,896**	$ 37,693	$ 22,893	$ 19,293	**$ 105,775**	$ 25,750	$ 35,831	$ 20,222	$ 18,219	$ 100,022
Operating EBITDA Margin[1]	**16.2%**	20.5%	15.9%	14.3%	**17.0%**	16.8%	20.3%	15.2%	14.7%	17.0%
Net income	**$ 13,313**	$ 23,729	$ 12,279	$ 10,320	**$ 59,641**	$ 14,849	$ 22,828	$ 11,258	$ 10,311	$ 59,246
Adjusted Net Income[1]	**$ 14,776**	$ 24,650	$ 13,406	$ 11,029	**$ 63,861**	$ 15,900	$ 23,560	$ 11,924	$ 10,783	$ 62,167
Earnings per share – Basic	**$ 0.36**	$ 0.64	$ 0.33	$ 0.28	**$ 1.61**	$ 0.40	$ 0.61	$ 0.30	$ 0.27	$ 1.58
Earnings per share – Diluted	**$ 0.36**	$ 0.63	$ 0.33	$ 0.28	**$ 1.59**	$ 0.39	$ 0.60	$ 0.30	$ 0.27	$ 1.56
Adjusted earnings per share – Basic[1]	**$ 0.40**	$ 0.67	$ 0.36	$ 0.30	**$ 1.72**	$ 0.42	$ 0.63	$ 0.32	$ 0.29	$ 1.65
Adjusted earnings per share – Diluted[1]	**$ 0.40**	$ 0.66	$ 0.36	$ 0.29	**$ 1.71**	$ 0.42	$ 0.62	$ 0.31	$ 0.28	$ 1.64

Notes:

1. See the section below entitled "Non-IFRS Measures" for further details concerning how the Company calculates SSS, EBITDA, Operating EBITDA, Operating EBITDA Margin, Adjusted Net Income and Basic and Diluted Adjusted EPS and for a reconciliation to the most comparable IFRS measure.
2. On January 1, 2018, the Company adopted IFRS 15 and as a result, the financial results and the non-IFRS measures for 2017 have been restated. The adoption has no material impact on the financial results of the Company and has no impact on the EPS. The impact of adoption on Q4 2017 and Annual 2017 is discussed under the heading "Critical Accounting Estimates".

10. Segment Performance

As at December 31, 2018, the Company manages its business on the basis of two operating segments, SCC and Endy, which is consistent with the internal reporting provided to the chief operating decision-maker, the Chief Executive Officer. The Company has only one reportable segment as the operating segments meet the aggregation criteria of IFRS 8. The Company operates in Canada, which is its country of domicile.

11. Liquidity and Capital Resources

Liquidity

SCC's primary sources of cash consist of existing cash balances, operating activities, and available credit facilities. SCC's primary uses of cash are to fund operating expenses, capital expenditures, finance costs, taxation expense, debt principal payments, dividends, business acquisitions and share repurchases. Historically, SCC has experienced lower sales and EBITDA in the first half of the year. Management believes cash generated from operations, together with cash on hand and amounts available under SCC's credit facilities will be sufficient to meet its future cash requirements. However, SCC's ability to fund future cash requirements will depend on its future operating performance, which could be affected by general economic, financial and other factors including factors beyond its control despite the risk management strategies that management puts in place. See the section entitled "Risk Factors" in the AIF for a discussion of the various risks and uncertainties that may affect the Company's ability to fund its future cash requirements.

Management reviews new store opening, acquisition and investment opportunities in the normal course of its business and may, if suitable opportunities arise, realize these opportunities to meet SCC's business strategy. Historically, the funding for any such acquisitions or investments has come from cash flow generated from operating activities and/or additional debt.

A summary of net cash flows by activities is presented below for 2018 and 2017:

(C$ thousands unless otherwise stated)	**2018**	2017
Cash flows from operating activities	**$ 68,100**	$ 92,603
Cash flows used in investing activities	**(93,157)**	(28,118)
Cash flows from/(used in) financing activities	**31,425**	(64,685)
Net increase (decrease) in cash	**6,368**	(200)
Cash at beginning of the year	**23,620**	23,820
Cash at end of the period	**$ 29,988**	$ 23,620

Net cash flows from operating activities

Net cash flows generated by operating activities in 2018 were $68.1 million in 2018 comprised of the positive impact of cash generated from operating activities of $85.8 million offset by $17.7 million of cash used as a result of an increase in non-cash items relating to operating activities ("working capital"). The increase in working capital in 2018 was primarily driven by higher inventories, higher prepaid expenses and deposits, lower trade and other payables, partially offset by higher customer deposits and lower trade and other receivables.

Net cash flows generated by operating activities were $92.6 million in 2017 comprised of the positive impact of cash generated from operating activities of $82.2 million and $10.4 million of cash generated as a result of a decrease in non-cash items relating to operating activities (working capital). The decrease in working capital was primarily driven by higher trade and other payables, higher customer deposits, lower trade and other receivables and lower prepaid expenses and deposits, partially offset by higher inventories.

Net cash flows used in investing activities

Net cash flows used in investing activities were 93.2 million for 2018, consisting primarily of $66 million used in the acquisition of Endy. The remaining change in 2018 mainly related to investments in capital expenditure mainly due to new store openings and store renovations.

Net cash flows used in investing activities in 2017 was $28.1 million of capital expenditure mainly due to new store openings, store renovations and relocation of distribution centres.

Net cash flows from/(used in) financing activities

Net cash flows from financing activities were $31.4 million for 2018, consisting primarily of additional loans taken on the senior secured credit facility $63.6 million, partly offset by dividends on the common shares of $26.7 million, interest payments of $5 million on the senior secured credit facility and finance leases.

Net cash flows used in financing activities were $64.7 million for 2017, consisting primarily of dividends on the common shares of $24.3 million, repurchase of its common shares $21.9 million, net repayment of the senior secured credit facility of $14 million, interest payments of $3.6 million on the senior secured credit facility and finance leases and $0.8 million in finance lease repayments.

Contractual obligations

The following table summarizes the Company's significant contractual obligations and commitments as at December 31, 2018 based on undiscounted cash flow including estimated interest payable as per the terms of the long-term debt:

(C$ thousands unless otherwise stated)	2019	2020	2021	2022	2023	Thereafter	Total
Commitments:							
Operating leases	$ 41,469	$ 39,598	$ 34,479	$ 28,825	$ 22,208	$ 57,763	**$ 224,342**
Financial obligation:							
Trade and other payable	51,411	-	-	-	-	-	**51,411**
Long-term debt:							
Existing credit facility:	6,238	6,238	6,238	6,238	174,274	-	**199,226**
Finance leases	912	881	835	675	369	100	**3,772**
Total contractual obligation	$ 100,030	$ 46,717	$ 41,552	$ 35,738	$ 196,851	$ 57,863	**$ 478,751**

The Company enters into operating leases for stores and distribution centres, passenger vehicles and office equipment with terms up to 15 years.

The existing credit facility represents a senior secured credit facility with a balance outstanding as at December 31, 2018 of $168.6 million (December 31, 2017 - $105 million).

The finance leases are comprised of leases on delivery trucks. As at December 31, 2018, the outstanding principal of the finance leases was $3.1 million (2017 - $3.5 million).

Executive employment agreements allow for total additional payments of approximately $7.1 million if a liquidity event occurs, $3.9 million if all are terminated without cause, $nil if all are terminated with cause and $3.5 million if all are terminated as a result of death.

All directors and/or officers of the Company, and each of its various subsidiary entities, are indemnified by the Company for various items including, but not limited to, all costs to settle lawsuits or actions due to their association with the Company, subject to certain restrictions. The Company has purchased directors' and officers' liability insurance with maximum coverage of $30 million to mitigate the cost of any potential future lawsuits or actions to the directors and officers. The term of the

indemnification is not explicitly defined, but is limited to events for the period during which the indemnified party served as a director or officer of the Company. The maximum amount of any potential future payment required to be made by the Company cannot be reasonably estimated but could have a material adverse effect on the Company.

In the normal course of business, the Company has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with advisors and consultants, leasing contracts, license agreements, information technology agreements and various product and service agreements. These indemnification arrangements may require the Company to compensate counterparties for losses incurred by the counterparties as a result of breaches in representations, covenants and warranties provided by the Company or as a result of litigation or other third party claims or statutory sanctions that may be suffered by the counterparties as a consequence of the relevant transaction. In some instances, the terms of these indemnities are not explicitly defined. The Company, whenever possible, tries to limit this potential liability within the particular agreement or contract, but due to the unpredictability of future events the maximum amount of any potential reimbursement required to be made by the Company or its subsidiary entities cannot be reasonably estimated, but could have a material adverse effect on the Company.

Capital Resources

Senior secured credit facility

On January 1, 2017, SCC held a senior secured credit facility of $150 million, which was scheduled to mature on June 29, 2021.

On August 30, 2017, the senior secured credit agreement was amended and the maturity date was extended to August 30, 2022. On November 29, 2018, in connection with the purchase of substantially all of the operating assets of Endy, the senior secured credit agreement was amended. Pursuant to this amendment, the facility was increased from $150 million to $210 million and the maturity date was extended to November 29, 2023.

The senior secured credit facility is secured by all of the present and after acquired personal property of SCC, SCCI and Endy. As at December 31, 2018, the balance outstanding on the senior secured credit facility was $168.6 million (December 31, 2017 - $105 million).

The senior secured credit facility allows for the debt to be held in Canadian or US dollars as the debt held in US dollars has a lower interest rate. During the twelve-months period ended December 31, 2018, the Company held majority of the debt in US dollars for 328 days. To mitigate the foreign exchange risk, the Company entered into forward foreign exchange contracts to sell US dollars in the equal amount of the debt with an overall impact of $nil recorded in general and administrative expenses in the consolidated statements of income and comprehensive income. As at December 31, 2018, the debt is held in Canadian dollars and no forward foreign exchange contracts were outstanding. Interest on the senior secured credit facility is based on the prime or bankers' acceptance rates plus applicable margins based on the achievement of certain targets, as defined by the amended and restated senior secured credit agreement. As at December 31, 2018, the applicable margin for bankers' acceptances was 200 basis points and the applicable margin for prime rate loans was 100 basis points.

Under the terms of the senior secured credit facility, certain financial and non-financial covenants must be complied with. As at December 31, 2018, SCC was in compliance with all covenants under the senior secured credit facility.

Off-balance sheet arrangements

SCC did not have any material off-balance sheet arrangements as at December 31, 2018 and December 31, 2017, nor did it have any subsequent to December 31, 2018.

Related party transactions

During 2016, Birch Hill Equity Partners Management Inc. (Birch Hill) and its co-investors had voting direction and control over approximately 18.9% of the Company's common shares until May 2016. Birch Hill maintained two nominee directors on the Company's Board of Directors until May 12, 2017. As such, Birch Hill was deemed to be a related party of the Company prior to May 12, 2017.

As at December 31, 2018 and December 31, 2017, there were no balances due from or payable to a related party.

12. Transactions with Key Management Personnel

Key management personnel are those individuals having authority and responsibility for planning, directing and controlling the activities of the Company, including members of the Company's Board of Directors. The Company considers key management to be the Board of Directors and its executive team. SCC incurred the following compensation expenses in relation to key management personnel:

(C$ thousands unless otherwise stated)	**2018**	2017
Salaries and short-term employee benefits	**$ 2,785**	$ 3,683
Share-based compensation	**3,655**	2,368
Directors fees	**669**	651
	$ 7,109	$ 6,702

13. Risk Factors

SCC's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and cash flow and fair value interest risks), credit risk, liquidity risk and capital risk. SCC's overall risk management program and business practices seek to minimize any potential adverse effects on SCC's financial performance.

Risk management is carried out by the senior management team and is reviewed by SCC's Board of Directors.

For an understanding of other potential risks, including non-financial risks, see the section entitled "Risk Factors" in the AIF.

Market Risk

Market risk is the loss that may arise from changes in factors such as interest rates, foreign exchange rates and the impact these factors may have on other counter-parties.

Foreign Exchange Risk

SCC's operating results are reported in Canadian dollars. A portion of the Company's merchandise purchases are denominated in US dollars which results in foreign currency exposure related to fluctuations between the Canadian and US dollars. The Company does not currently use foreign exchange options or forward contracts to hedge its foreign currency risk relating to merchandise purchases. A sudden increase in the US dollar relative to the Canadian dollar could result in higher costs to the Company, which could in turn result in increased prices and reduced sales, decreased profit margins and could negatively impact the Company's business and financial results.

The Company's senior secured credit facility allows the Company to borrow in Canadian and US dollars. To mitigate any foreign exchange risk related to its US dollar denominated debt, the Company enters into forward foreign exchange contracts to sell US dollars in an amount equal to the principal amount of its US dollar denominated borrowings.

Cash Flow and Fair Value Interest Risk

SCC has no significant interest-bearing assets. SCC's income and operating cash flows are substantially independent of changes in market interest rates.

SCC's primary interest rate risk arises from long-term debt. SCC manages its exposure to changes in interest rates by using a combination of fixed and variable rate debt and varying lengths of terms to achieve the desired proportion of variable and fixed rate debt. An increase (or decrease) in interest rates by 1% would result in a $1.7 million increase (or decrease) on annual interest expense on the credit facility. SCC also has a small number of finance leases that carry interest at variable rates.

Credit Risk

Credit risk refers to the risk of losses due to failure of the Company's customers or other counter-parties to meet their payment obligations. Credit risk arises from deposits with banks, as well as credit exposures from mattress vendors for the payment of volume and co-operative advertising rebate amounts and balances owed from third-party financing companies under the various financing plans the Company offers its customers. In accordance with SCC's investment practice, all deposits are held at banks possessing a credit rating of AA- or better. Sales to retail customers are settled in cash, financed by third-party financing companies or by using major credit cards. The Company transfers the credit risk for financing plans to third-party financing companies. The third-party financing company that SCC deals with carries a minimum rating of BBB or better.

There are no significant impaired receivables that have not been provided for in the allowance. There are no amounts considered past due or impaired.

Liquidity Risk

Liquidity risk is the risk SCC will not be able to meet a demand for cash or fund its obligations as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. Prudent liquidity management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities.

Capital Risk

SCC's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for its common shareholders in the form of cash dividends, benefits to other stakeholders and to maintain an optimal capital structure to minimize the cost of capital.

In order to maintain or adjust the capital structure, SCC may issue new shares, purchase its own shares or sell assets to reduce long-term debt.

14. Critical Accounting Estimates

A summary of significant accounting policies is included in Note 3 of SCC's 2018 audited annual consolidated financial statements. The Company's critical accounting estimates are included in Note 4 of SCC's 2018 audited annual consolidated financial statements and are described below. Critical accounting estimates requires management to make certain judgements and estimates, which may differ from actual results. Accounting estimates are based on historical experience and other factors that management believes to be reasonable under the time frame and circumstances. Changes in management's accounting estimates can have a material impact on the financial results of the Company.

Impairment of goodwill and brands

Management is required to use judgment in determining the grouping of assets to identify the Company's cash generating units ("**CGUs**") for the purposes of testing fixed assets for impairment. Judgment is further required to determine appropriate groupings of CGUs in order to determine the level at which goodwill and intangible assets are tested for impairment. In addition, judgment is used to determine whether a triggering event has occurred requiring an impairment test to be completed.

In determining the recoverable amount of a CGU, various estimates are employed. The Company determines fair value less costs of disposal using estimates such as projected future sales, earnings, capital investments and discount rates. Projected future sales and earnings are consistent with strategic plans provided to the Company's Board of Directors. Discount rates are based on an estimate of the Company's weighted average cost of capital taking into account external industry information reflecting the risk associated with the specific cash flows. As at December 31, 2018 and December 31, 2017, impairment reviews were performed on the SCC CGU by comparing the carrying value of goodwill and brands with the recoverable amount of the CGU to which goodwill and brands have been allocated. As at December 31, 2018 impairment review was performed on the Endy CGU by comparing the carrying value of goodwill and brands with the recoverable amount of the CGU to which goodwill has been allocated. Management determined that there had been no impairment on the Endy CGU as of December 31, 2018.

Business combinations

For each business combination, the Company measures the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values. The determination of fair value requires the Company to make assumptions, estimates and judgments regarding future events. The allocation process is inherently subjective and impacts the amounts assigned to individual identifiable assets and liabilities, including the fair value of finished goods inventory, long-lived assets, the recognition and measurement of any identified intangible assets and the final determination of the amount of goodwill or gain on acquisition. The inputs to the exercise of judgments include legal, contractual, business and economic factors. As a result, the purchase price allocation impacts the Company's reported assets and liabilities and future net earnings due to the impact on future cost of goods sold, amortization and impairment tests.

15. Financial Instruments

At December 31, 2018, the financial instruments consisted of cash, trade and other receivables, trade and other payables, customer deposits, senior secured credit facilities and finance leases.

The carrying values of cash, trade and other receivables, trade and other payables and customer deposits approximate their fair values due to the relatively short periods to maturity of these financial instruments. The carrying values of the senior secured credit facility approximate their fair values as the terms and conditions of the borrowing arrangements are comparable to market terms and conditions as at December 31, 2018 and December 31, 2017. The finance leases approximate their fair values as the implicit interest rates used in determining their fair value approximate interest rates as at December 31, 2018 and December 31, 2017. The Company's financial instruments are exposed to certain financial risks, including currency risk, interest rate risk, credit risk and liquidity risk, which are discussed above under the heading "Risk Factors".

Fair values of contingent consideration liability

The fair value of the contingent consideration liability recorded on the consolidated statements of financial position as at December 31, 2018 was $15.1 million. The estimated range of outcomes (undiscounted) for the contingent consideration arrangement is determined based on the formula price and the likelihood of achieving specified earnings levels over the contingency period, and ranges from $nil to a maximum of $25 million. The consideration is contingent on the acquired business achieving certain specified earnings levels during the period commencing on January 1, 2020 and ending on

December 31, 2020. During the year ended December 31, 2018, $nil was paid with reference to such contingent consideration (2017 – $nil).

The inputs to the measurement of the fair value of contingent consideration related to acquisitions are Level 3 inputs. The fair value measurements were made using a discounted cash flow model; significant model inputs were expected future operating cash flows (determined with reference to each specific acquired business) and a discount rate of 15%. The discount rates is attributable to the level of risk related to economic growth factors combined with the length of the contingent payment periods; and the dispersion was driven by unique characteristics of the businesses acquired and the respective terms for these contingent payments. A 1% increase in the weighted average discount rate would reduce the fair value of contingent consideration by $0.3 million

16. Disclosure Controls and Procedures

Disclosure controls and procedures are designed to provide reasonable assurance that material information relating to the Company is made known to the Chief Executive Officer and the Chief Financial Officer (the "Certifying Officers") by others on a timely basis so that appropriate decisions can be made regarding public disclosure within the time periods required by applicable securities laws. The Certifying Officers are responsible for establishing and maintaining the Company's disclosure controls and procedures.

Our system of disclosure controls and procedures includes, but is not limited to, our Disclosure Policy, our Code of Business Conduct, the effective functioning of our Disclosure Committee, procedures in place to systematically identify matters warranting consideration of disclosure by the Disclosure Committee, verification processes for individual financial and non-financial metrics and information contained in annual and interim filings, including the consolidated financial statements, MD&As, AIF, Management Information Circular and other documents and external communications.

Based on an evaluation of the Company's disclosure control and procedures, the Certifying Officers have concluded that these controls are appropriately designed and were operating effectively as of December 31, 2018. Although the Company's disclosure controls and procedures were operating effectively as of December 31, 2018, there can be no assurance that the Company's disclosure controls and procedures will detect or uncover all failures of persons within the Company to disclose material information otherwise required to be set forth in the Company's regulatory filings.

17. Internal Control Over Financial Reporting

Management is also responsible for establishing and maintaining appropriate internal controls over financial reporting ("**ICFR**"). Our ICFR include, but are not limited to, Entity Level Controls, Information Technology General Controls, Information Technology Application and Development Controls, detailed policies and procedures related to financial accounting and reporting and controls over systems that process and summarize transactions. Our procedures for financial reporting also includes the active involvement of qualified financial professionals, senior management, executive management and our Audit Committee.

ICFR is designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements in accordance with IFRS. The Certifying Officers are responsible for establishing and maintaining adequate ICFR for the Company. In designing ICFR, it should be recognized that due to inherent limitations, any controls, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives and cannot provide absolute assurance with respect to the prevention or detection of misstatements. Projections of any evaluations of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Additionally, management is required to use judgment in evaluating ICFR.

The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the

maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company, (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with IFRS, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

A "material weakness" in internal control over financial reporting is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a company's annual or interim financial statements will not be prevented or detected in a timely basis by the company's internal controls.

The Certifying Officers have evaluated the effectiveness of the Company's ICFR as at December 31, 2018 using the framework established in 'Internal Control - Integrated Framework (COSO Framework)' published by The Committee of Sponsoring Organizations of the Treadway Commission (COSO), 2013. Based on that evaluation, the Certifying Officers concluded that the ICFR, as defined by National Instrument 52-109 – *Certification of Disclosure on Issuers' Annual and Interim Filings*, are appropriately designed and were operating effectively as at December 31, 2018 and that no material weaknesses were identified through their evaluation except as noted below.

In accordance with the provisions of National Instrument 52-109 - Certification of Disclosure in Issuers' Annual and Interim Filings, Management, including the CEO and CFO, have limited the scope of their design of the Company's disclosure controls and procedures and internal control over financial reporting to exclude such controls, policies and procedures of Endy.

The Company acquired the business of Overwater Limited, operating under the brand name Endy on December 6, 2018. Endy's results since its acquisition by the Company until the end of the fourth quarter are included in our Consolidated Statements of Income. Since the date of acquisition, Endy has generated revenue of $3,467, which is approximately 0.6% of the Company's consolidated results. The post acquisition net income of Endy did not significantly contribute to the consolidated net income of SCC. For the Consolidated Balance Sheets, Endy constitutes 7% of total current assets, 4% of total assets, 8% of total current liabilities and 7% of total liabilities as at December 31 2018. Further details related to the acquisition of Endy are disclosed in Note 20 of the Company's consolidated financial statements for the fourth quarter of 2018.

The scope limitation is primarily based on the time required to assess Endy's disclosure controls and procedures and internal control over financial reporting in a manner consistent with the Company's other operations.

18. Current and Future Accounting Standards

On January 1, 2018, the Company adopted IFRS 9 and IFRS 15. The impact of this change has been disclosed in Note 3 of the audited annual consolidated financial statements of SCC and the accompanying notes for year-ended December 31, 2018.

The IASB and the International Financial Reporting Interpretation Committee ("**IFRIC**") have issued the following standards that have not been applied in preparing these audited annual consolidated financial statements as their effective dates fall within annual periods beginning subsequent to the current reporting period. The Company is evaluating the impact of these standards.

IFRS 16, Leases

IFRS 16, Leases ("**IFRS 16**"), sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer (lessee) and the supplier (lessor). IFRS 16 will replace IAS 17, Leases, and related interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all lessees and requires a lessee to recognize right-of-use assets and lease liabilities for leases with terms of more than 12 months, unless the underlying asset is of low value, and depreciation of the lease assets is shown separately from interest on lease liabilities in the consolidated statements of income and comprehensive income. Under IFRS 16, the lessor's accounting for operating and finance leases will remain substantially

unchanged. IFRS 16 is effective for annual periods beginning on or after January 1, 2019.

As the Company has significant contractual obligations in the form of operating leases under IAS 17, there will be a material increase to both assets and liabilities on adoption of IFRS 16, and material changes to the timing of recognition of expenses associated with the lease arrangements. At this time, the Company has selected a technology solution to manage the accounting for leases under IFRS 16 upon adoption and is in the process of implementing it. The Company began designing internal controls for IFRS 16 during 2018. The Company will continue to analyze the new standard to finalize its impact on the Company's consolidated statements of financial position and consolidated statements of income and comprehensive income. As at December 31, 2018, the Company expects that upon adoption of the standard, excluding the impact of income taxes, its total assets will increase approximately between $208,000-$255,000, its total liabilities will increase approximately between $217,000-$265,000 and its deficit will increase approximately between $7,000-$11,000.

The Company expects to use the modified retrospective method upon adoption. Further, the Company currently expects to apply the following practical expedients, as described under IFRS 16:

i) grandfather the assessment of which transactions are leases;

ii) recognition exemption of short-term leases; and

iii) recognition exemption leases of low-value items.

IFRIC 23 – Uncertainty over Income Tax Treatments

On June 23, 2017, the IASB issued IFRIC Interpretation 23, Uncertainty over Income Tax Treatments ("**IFRIC 23**"), which clarifies how to apply the recognition and measurement requirements in IAS 12, Income Taxes, when there is uncertainty over income tax treatments. Application of the standard is mandatory for annual reporting periods beginning on or after January 1, 2019, with earlier application permitted. The Company plans to adopt the new interpretation beginning January 1, 2019. Management does not expect the adoption of IFRIC 23 to have a material impact on the Company's results.

19. Outstanding Share Data

As of the date hereof, 37,059,430 common shares and no Class A common shares of the Company are issued and outstanding. As of the date hereof, 845,826 options to purchase an equivalent number of common shares, 167,152 performance share units and 22,901 deferred share units are issued and outstanding. For further details concerning the rights, privileges and restrictions attached to the common shares and the Class A common shares, please refer to the section entitled "Description of Share Capital" in the AIF.

20. Non-IFRS Measures

The Company prepares its financial statements in accordance with IFRS. In order to provide additional insight into the business, to provide investors with supplemental measures of its operating performance and to highlight trends in its business that may not otherwise be apparent when relying solely on IFRS financial measures, the Company has also provided in this MD&A certain non-IFRS measures, including "Same Store Sales" or "SSS", "EBITDA", "Operating EBITDA", "Operating EBITDA Margin", "Adjusted Net Income" and "Basic and Diluted Adjusted EPS" each as defined below. These measures are provided as additional information to complement IFRS measures by providing further understanding of the Company's results of operations from management's perspective. Management also uses non-IFRS measures 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. The Company also believes that securities analysts, investors and other interested parties frequently use non-IFRS measures in the evaluation of issuers.

Readers are cautioned that these non-IFRS measures are not recognized under IFRS and do not have a standardized meaning

prescribed by IFRS. They are therefore unlikely to be comparable to similarly titled measures presented by other publicly traded companies. Accordingly, they should not be considered in isolation nor as a substitute for analysis of the Company's financial information reported under IFRS. See below for further details concerning how the Company calculates these non-IFRS measures and for reconciliations to the most comparable IFRS measures.

Same Store Sales (SSS)

SSS is a non-IFRS measure used in the retail industry to compare sales derived from established stores over a certain period compared to the same period in the prior year. The Company has embarked on an omni-channel approach to engaging with customers. This approach allows customers to shop online for home delivery or purchase in any of our store locations. Due to the customer cross-channel behavior, the Company reports a single comparable sales metrics, inclusive of store and eCommerce channels. SSS calculation excludes sales of excess inventory to third parties. SSS helps to explain what portion of revenue growth can be attributed to growth in established stores and what portion can be attributed to the opening of new stores. SCC calculates SSS as the percentage increase or decrease in sales of stores opened for at least 12 complete months relative to the same period in the prior year.

EBITDA and Operating EBITDA

EBITDA and Operating EBITDA are used by SCC to assess its operating performance.

EBITDA is defined as income (loss) adjusted for:

- finance related expenses;
- income taxes;
- depreciation and amortization; and
- interest and other expenses (income) – net.

Operating EBITDA is defined as EBITDA adjusted for:

- share-based compensation; and
- acquisition costs related to Endy.

Adjusted Net Income

Adjusted Net Income is used by SCC to assess its operating performance. Adjusted Net Income is defined as net income (loss) adjusted for:

- share-based compensation; and
- acquisition costs related to Endy.

Adjusted EPS - Basic

Adjusted EPS - Basic is defined as Adjusted Net Income attributable to the common shareholders of the Company divided by weighted average number of shares issued and outstanding during the period.

Adjusted EPS - Diluted

Adjusted EPS - Diluted is defined as Adjusted Net Income attributable to the common shareholders of the Company divided by weighted average number of shares issued and outstanding during the period adjusted for the effects of dilutive stock options, Performance share units and Deferred share units.

Calculation of Non-IFRS Measures

		Q4		Annual
(C$ thousands unless otherwise stated, except earnings per share)	**2018**	**2017**(1)	**2018**	**2017**(1)
Reconciliation of net income to EBITDA and Operating EBITDA:				
Net income	**$ 13,313**	$ 14,849	**$ 59,641**	$ 59,246
Interest income and other expenses (income) - net	**-**	$ 71	**(89)**	$ (17)
Finance related expenses	**1,287**	$ 922	**4,475**	$ 3,687
Income taxes	**5,636**	$ 5,551	**22,575**	$ 21,801
Depreciation and amortization	**4,064**	$ 3,306	**14,820**	$ 12,384
EBITDA	**24,300**	$ 24,699	**101,422**	$ 97,101
Adjustments to EBITDA:				
Acquisition costs(2)	**502**	-	**502**	-
Share-based compensation(3)	**1094**	$ 1,051	**3,851**	$ 2,921
Total adjustments	**$ 1,596**	$ 1,051	**$ 4,353**	$ 2,921
Operating EBITDA	**$ 25,896**	$ 25,750	**$ 105,775**	$ 100,022
Operating EBITDA margin	**16.2%**	16.8%	**17.0%**	17.0%
Net income	**$ 13,313**	$ 14,849	**$ 59,641**	$ 59,246
Adjustments:				
Acquisition costs(2)	**502**	-	**$ 502**	$ -
Share-based compensation(3)	**1,094**	1,051	**$ 3,851**	$ 2,921
Total adjustments, before income taxes	**$ 1,596**	$ 1,051	**$ 4,353**	$ 2,921
Tax impact of all adjustments	**$ (133)**	-	**$ (133)**	-
Adjusted Net Income	**$ 14,776**	$ 15,900	$ **63,861**	$ 62,167
Weighted average number of shares- Basic	**37,058**	37,499	**37,029**	37,611
Earnings per share - Basic	**$ 0.36**	$ 0.40	**$ 1.61**	$ 1.58
Adjusted earnings per share - Basic	**$ 0.40**	$ 0.42	**$ 1.72**	$ 1.65
Adjusted earnings per share – Diluted(4)	**$ 0.40**	$ 0.42	**$ 1.71**	$ 1.64

Notes:

1. On January 1, 2018, the Company adopted IFRS 15 and as a result, the financial results and the non-IFRS measures for 2017 have been restated. The adoption has no material impact on the financial results of the Company and has no impact on the EPS. The impact of adoption on Q4 2017 and 2017 is discussed under the heading "Critical Accounting Estimates".
2. Adjustment for one-time professional fees incurred in relation to acquisition of business operations of Endy in December 2018.
3. Adjustment for share-based compensation, a non-cash item, and the related payroll tax expense, a cash expense.
4. The weighted average number of diluted shares for Q4 2018 is 37,346; for Q4 2017 is 37,895; for 2018 is 37,409 and for 2017 is 37,953.

21. Additional Information

Additional information relating to the Company, including the Company's annual information form, quarterly and annual reports and supplementary information is available on SEDAR at www.sedar.com. Press releases and other information are also available in the Investor Relations section of the Company's website at www.sleepcountryir.ca.

Independent auditor's report

To the Shareholders of Sleep Country Canada Holdings Inc.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of Sleep Country Canada Holdings Inc. and its subsidiaries (together, the Company) as at December 31, 2018 and 2017, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 31, 2018 and 2017;
- the consolidated statements of income and comprehensive income for the years then ended;
- the consolidated statements of changes in shareholders' equity for the years then ended;
- the consolidated statements of cash flows for the years then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing

to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the

disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Adam Boutros.

Chartered Professional Accountants, Licensed Public Accountants

Oakville, Ontario

February 26, 2019

PricewaterhouseCoopers LLP
PwC Centre, 354 Davis Road, Suite 600, Oakville, Ontario, Canada L6J 0C5
T: +1 905 815 6300, F: +1 905 815 6499

"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

Sleep Country Canada Holdings Inc.

Consolidated Financial Statements
December 31, 2018 and December 31, 2017
(in thousands of Canadian dollars)

Sleep Country Canada Holdings Inc.

Consolidated Statements of Financial Position

As at December 31, 2018 and December 31, 2017

(in thousands of Canadian dollars, except per share amounts)

	2018 $	2017 $ (restated – note 3)
Assets		
Current assets (note 3)		
Cash	29,988	23,620
Trade and other receivables (note 5)	13,120	14,002
Inventories (note 6)	54,729	38,326
Prepaid expenses and deposits (note 12)	5,545	1,833
	103,382	77,781
Property and equipment (note 7)	65,710	52,773
Deferred tax assets (note 12)	3,908	4,166
Intangible assets (note 8)	128,222	105,633
Goodwill (note 8)	300,884	242,146
	602,106	482,499

Approved by the Board of Directors

(Signed) Douglas Bradley Director

(Signed) David Shaw Director

Sleep Country Canada Holdings Inc.
Consolidated Statements of Financial Position …continued
As at December 31, 2018 and December 31, 2017

(in thousands of Canadian dollars, except per share amounts)

	2018 $	2017 $ (restated – note 3)
Liabilities		
Current liabilities (note 3)		
Trade and other payables (note 9)	51,411	52,421
Customer deposits	22,452	19,264
Long-term debt (note 11)	686	662
	74,549	72,347
Other liabilities (note 10)	28,988	11,638
Deferred tax liabilities (note 12)	24,789	24,200
Long-term debt (note 11)	170,036	107,147
	298,362	215,332
Shareholders' Equity (note 3)		
Share capital and other (note 14)	353,188	349,957
Deficit	(49,444)	(82,790)
	303,744	267,167
	602,106	482,499

Contingent liabilities and unrecognized contractual commitments (note 16)

Sleep Country Canada Holdings Inc.

Consolidated Statements of Income and Comprehensive Income

As at December 31, 2018 and December 31, 2017

(in thousands of Canadian dollars, except per share amounts)

	2018 $	2017 $ (restated – note 3)
Revenues (note 3)	622,977	586,948
Cost of sales (notes 3, 6 and 13)	433,432	411,614
Gross profit	189,545	175,334
General and administrative expenses (notes 3 and 13)	88,123	78,233
Depreciation and amortization (notes 7 and 8)	14,820	12,384
Income before finance related expenses, interest income and other expenses and income taxes	86,602	84,717
Finance related expenses (note 11)	4,475	3,687
Interest and other expenses (income) – net	(89)	(17)
	4,386	3,670
Income before provision for income taxes (note 3)	82,216	81,047
Provision for income taxes (note 12)		
Current	21,728	20,982
Deferred	847	819
	22,575	21,801
Net income and comprehensive income for the year (note 3)	59,641	59,246
Earnings per share attributed to common shareholders (notes 3 and 15)		
Basic earnings per share (in dollars)	1.61	1.58
Diluted earnings per share (in dollars)	1.59	1.56

Sleep Country Canada Holdings Inc.

Consolidated Statements of Changes in Shareholders' Equity

As at December 31, 2018 and December 31, 2017

(in thousands of Canadian dollars, except per share amounts)

	Share capital and other				
	Number of shares	**Common shares $**	**Contributed surplus $**	**Deficit $**	**Total equity $**
Balance – January 1, 2017 (restated – note 3)	37,648,349	351,693	1,696	(101,905)	251,484
Net income for the year (note 3)	-	-	-	59,246	59,246
Dividend declared and paid	-	-	-	(24,284)	(24,284)
Shares issued on exercise of share-based compensation option/unit	1,283	19	-	-	19
Share-based compensation (note 18)	-	-	2,591	-	2,591
Share repurchase (note 14)	(641,326)	(21,889)	-	-	(21,889)
Excess of purchase price over average cost	-	15,847	-	(15,847)	-
Balance – December 31, 2017	37,008,306	345,670	4,287	(82,790)	267,167
Balance – January 1, 2018	37,008,306	345,670	4,287	(82,790)	267,167
Net income for the year	-	-	-	59,641	59,641
Dividend declared and paid	-	-	-	(26,665)	(26,665)
Shares issued on exercise of share-based compensation option/unit	51,124	536	(867)	370	39
Share-based compensation (note 18)	-	-	3,562	-	3,562
Balance – December 31, 2018	37,059,430	346,206	6,982	(49,444)	303,744

Sleep Country Canada Holdings Inc.
Consolidated Statements of Cash Flows
As at December 31, 2018 and December 31, 2017

(in thousands of Canadian dollars, except per share amounts)

	2018 $	2017 $ (restated –note 3)
Cash provided by (used in)		
Operating activities		
Net income for the year	59,641	59,246
Items not affecting cash		
Depreciation of property and equipment (note 7)	12,707	10,907
Amortization of intangible assets (note 8)	2,113	1,477
Share-based compensation (note 18)	3,562	2,591
Finance related expenses (note 11)	4,475	3,687
Loss (gain) on disposal of property and equipment	336	(81)
Deferred lease inducements and escalated rent	2,048	3,434
Decommissioning liabilities	57	105
Deferred income taxes (note 12)	847	819
	85,786	82,185
Changes in non-cash items relating to operating activities		
Trade and other receivables	1,065	935
Inventories	(12,255)	(3,732)
Prepaid expenses and deposits	(3,356)	566
Trade and other payables	(6,232)	10,655
Customer deposits	3,092	1,994
	(17,686)	10,418
	68,100	92,603
Investing activities		
Purchase of property and equipment	(24,591)	(25,487)
Purchase of intangible assets	(2,583)	(2,631)
Acquisition of Endy (note 20)	(65,983)	-
	(93,157)	(28,118)

Sleep Country Canada Holdings Inc.

Consolidated Statements of Cash Flows

As at December 31, 2018 and December 31, 2017

(in thousands of Canadian dollars, except per share amounts)

	2018 $	2017 $ (restated –note 3)
Financing activities		
Shares issued	39	19
Shares repurchased (note 14)	-	(21,889)
Increase in loan taken on senior secured credit facility (note 11)	106,600	5,000
Repayment of senior secured credit facility (note 11)	(43,000)	(19,000)
Financing costs on senior secured credit facility	(575)	(212)
Dividends paid on Class A common shares	(26,665)	(24,284)
Interest paid	(4,250)	(3,562)
Repayment of finance lease obligation	(724)	(757)
	31,425	(64,685)
Increase (decrease) in cash during the year	6,368	(200)
Cash – Beginning of year	23,620	23,820
Cash – End of year	29,988	23,620
Supplementary information		
Additions to property and equipment included in trade and other payables	918	669
Additions to property and equipment included in decommissioning liabilities	30	110
Acquisition of property and equipment under finance lease	387	3,387
Additions to property and equipment included in acquisition of Endy	54	-
Additions to intangible assets included in acquisition of Endy	22,119	-

1. Organization

Sleep Country Canada Holdings Inc. (the Company or SCC) was incorporated by articles of incorporation under the Canada Business Corporations Act on May 27, 2015. The Company is authorized to issue an unlimited number of common shares and Class A common shares without par value. The common shares are voting and are entitled to dividends if, as and when declared by the Board of Directors.

As at December 31, 2017, the sole subsidiary of the Company was Sleep Country Canada Inc. (SCCI).

On December 6, 2018, the Company acquired the business of Overwater Limited (note 20), operating under the brand name Endy, an online mattress retailer operating in the Canadian market. The acquisition was made by Endy Canada Inc. (Endy), a newly formed subsidiary of the Company by purchasing a majority of the assets of Overwater Limited, net of designated liabilities assumed.

The Company and its subsidiaries operate in the retail marketplace under three brands, Sleep Country, Dormez-vous? and Endy, offering mattresses and bedding products. The Company operates through its network of 264 stores and its eCommerce platforms. As at December 31, 2018, the Company has two subsidiaries, SCCI and Endy.

The address of its registered office is 7920 Airport Road, Brampton, Ontario.

2. Basis of presentation

The consolidated financial statements of the Company are prepared in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB) and using the accounting policies described herein.

The consolidated financial statements of the Company include the financial results of SCC and its two subsidiaries, SCCI and Endy.

The Company's operations can be affected by seasonal fluctuations due to changes in customer buying habits throughout the year.

The consolidated financial statements were reviewed by the Company's Audit Committee and approved and authorized for issuance by the Board of Directors on February 26, 2019.

3. Significant accounting policies

The significant accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

Financial assets and liabilities

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the financial instrument.

Financial assets are derecognized when the contractual rights to receive cash flows from the financial asset expire and financial liabilities are derecognized when obligations under the contract expire, are discharged or are cancelled. Financial assets upon initial recognition are classified in one of two categories: (1) those to be measured subsequently at fair value (either through OCI or through profit or loss); and (2) those to be measured at amortized cost. The classification depends on the entity's business model for managing the financial assets and the contractual terms of the cash flows. The following

classifications have been applied:

- cash and trade and other receivables are classified as financial assets measured at amortized cost; and
- trade and other payables, customer deposits and long-term debt have been classified as other financial liabilities measured at amortized costs.

Long-term debt is recognized initially at fair value, net of recognized transaction costs, and is subsequently measured at amortized cost, which is the carrying value. Any difference between the carrying value and the redemption value is recognized in the consolidated statements of income and comprehensive income using the effective interest rate method. For debt modifications, a gain or loss is calculated as the difference between the original contractual cash flows and the modified cash flows discounted at the original effective interest rate.

Fees paid on the establishment of senior credit facilities are capitalized and amortized over the period of the facility to which it relates.

The Company assesses on a forward-looking basis the expected credit losses associated with its financial assets. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade and other receivables, the Company applies the simplified approach permitted by IFRS 9, Financial Instruments (IFRS 9) which requires expected lifetime losses to be recognized at the time of initial recognition of the receivables. There was no impact due to this change in accounting policy.

Derivative financial instruments

Forward foreign exchange contracts are periodically used to limit foreign currency risks relating to the Company's senior secured credit facility (note 11) when denominated in US dollars. These contracts are treated as derivative instruments, are not designated as hedges for accounting purposes and are marked-to-market in the period, with changes in fair value recorded in the consolidated statements of income and comprehensive income.

Offsetting financial instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statements of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

Foreign currency translation

- Functional and presentation currency

  Items included in the consolidated financial statements of each of the Company's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The functional currency of the subsidiaries is Canadian dollars. The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency.

- Transactions and balances

  Transactions denominated in a foreign currency are translated into the functional currency at the rate in effect at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency at the exchange rates in effect as at the year-end date and revenues and expenses are translated at

the average rate during the year. Foreign exchange gains and losses are included in the consolidated statements of income and comprehensive income.

Segment information

As at December 31, 2018, the Company manages its business on the basis of two operating segments, SCC and Endy, which is consistent with the internal reporting provided to the chief operating decision-maker, the Chief Executive Officer. The Company has only one reportable segment as the operating segments meet the aggregation criteria of IFRS 8. The Company aggregates these reporting segments because the nature of products, services, methods of distribution and economic characteristics is similar. The Company operates in Canada, which is its country of domicile.

Inventories

Inventories are stated at the lower of their carrying value determined on a specific item on an actual cost basis and net realizable value. Net realizable value is the estimated selling price less applicable selling expenses. Trade discounts and volume rebates earned are deducted in determining the carrying value of inventory purchases.

Property and equipment

Property and equipment are recorded at cost less accumulated depreciation, net of any impairment loss. Depreciation is computed on a straight-line basis at annual rates based on the estimated useful lives of the related assets as follows:

Computer hardware	36 months
Furniture, fixtures and other	48 to 60 months
Leasehold improvements	lesser of the lease term or 120 months
Assets under finance lease	over the term of the lease

Included in furniture, fixtures and other are office equipment depreciated over 60 months and certain vehicles depreciated over 48 months. Assets under finance lease primarily represent the delivery truck fleet.

The Company recognizes in the carrying amount of property and equipment the full purchase price of assets acquired/ constructed as well as the costs incurred that are directly incremental as a result of the construction of a specific asset, when they relate to bringing the asset into working condition.

Estimates of useful lives, residual values and methods of depreciation are reviewed annually. Any changes are accounted for prospectively as a change in accounting estimate.

Goodwill and intangible assets

Intangible assets are assets acquired that lack physical substance and that meet the specified criteria for separate recognition from goodwill.

- Computer software

  Computer software is recorded at cost less accumulated amortization, net of any impairment loss. Amortization is computed on a straight-line basis at annual rates based on the estimated useful life of 36 to 60 months.

- Non-compete contracts

  Non-compete contracts are amortized over an estimated life of four to ten years.

- Brands

  Sleep Country and Dormez-vous? corporate brands are recorded at cost and are not subject to amortization, as they have an indefinite life. The company has determined the brands have an indefinite life because the company has the ability and intention to renew the brand names indefinitely and an analysis of product life cycle studies and market and competitive trends provides evidence that the brands will generate net cash inflows for the group for an indefinite period. They are tested for impairment annually, as at the consolidated statements of financial position dates, or more frequently if events or circumstances indicate they may be impaired.

  The Endy brand was recorded at its fair value at the time of acquisition and is subject to amortization over an estimated life of 20 years.

- Goodwill

  Goodwill is the residual amount that results when the purchase price of an acquired business exceeds the sum of the amounts allocated to the assets acquired, less liabilities assumed. Goodwill is not amortized and management tests goodwill for impairment annually or more frequently if events or changes in circumstances indicate the asset might be impaired.

Impairment of non-financial assets

- *Impairment of goodwill and indefinite life intangible assets*

  Management tests goodwill and brands related to the Sleep Country and Dormez-vous? corporate brands for impairment annually or more frequently if events or changes in circumstances indicate the asset might be impaired. The asset will be written down if the carrying amount of the asset exceeds the higher of its fair value less costs of disposal and its value in use. Value in use is the present value of the future cash flows expected to be derived from the asset.

  For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. Goodwill is allocated to cash generating units (CGUs) or groups of CGUs for the purpose of impairment testing. The allocation is made to those CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which the goodwill arose. The impairment tests are performed by comparing the carrying value of the assets (or asset groups) of these CGUs with their recoverable amount, which is the higher of their fair value less costs of disposal and their value in use (which is the present value of the expected future cash flows of the relevant asset or CGU), as determined by management.

- *Impairment of definite life intangible assets and property and equipment*

  Assets that are subject to amortization are periodically reviewed for indicators of impairment. Whenever events or changes in circumstances indicate the carrying amount may not be recoverable, the asset or CGU is tested for impairment. To the extent the asset or CGU's carrying amount exceeds its recoverable amount, an impairment loss is recognized in the consolidated statements of income and comprehensive income. The recoverable amount of an

asset or a CGU is the higher of its fair value less costs of disposal and its value in use. Value in use is the present value of the future cash flows expected to be derived from an asset or CGU. The fair value is the price that could be received for an asset or CGU in an orderly transaction between market participants at the measurement date, less costs of disposal. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows.

- *Impairment reversals*

  If, in a subsequent period, the amount of recognized impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, a reversal of the previously recognized impairment, except for goodwill, is recognized in the consolidated statements of income and comprehensive income.

Trade and other payables

Trade and other payables are obligations to pay for goods or services that have been acquired or rendered in the ordinary course of business from suppliers and employees. Trade and other payables are classified as current liabilities if payment is due or expected within one year or less. Otherwise, they are presented as non-current liabilities. Trade and other payables are recognized initially at fair value and subsequently are measured at amortized cost.

Customer deposits

Customer deposits represent amounts paid by customers in advance of delivery of product (e.g., mattresses). These deposits can be for all or a portion of the total purchase price of the product. The amounts received representing the customer deposit are unencumbered and can be used for general operating purposes. Once the product is delivered to the customer, therefore fulfilling the performance obligation, the liability is relieved and is recorded in revenue. Over time, some portion of the customer deposits is not redeemed (breakage). The expected breakage amount based on historical actuals are recognized as revenue in proportion to the redemption pattern exercised by the customers.

Decommissioning provisions

These provisions represent the cost of the Company's obligation to rehabilitate its leased premises and is estimated based on the present value of expected future rehabilitation costs and is recognized in the period in which the obligation is incurred. The present value of these costs is added to the cost of the associated asset and is amortized over its useful life, while the corresponding liability will accrete to its future value over the same period.

Share-based compensation

The Company has a share-based compensation plan (the stock option plan), a performance share unit (PSU) plan and a deferred share unit (DSU) plan, all of which are equity settled share-based arrangements.

Equity settled share-based payments to employees are measured at the fair value of the equity instrument granted. An option valuation model (Black-Scholes) is used to fair value stock options issued to employees on the date of grant. The market value of the Company's common shares on the date of the grant is used to determine the fair value of the equity based share units issued to participants.

The Company grants stock options and PSUs to certain employees and key management of the Company, while DSUs are granted only to directors. In general, stock options cliff vest after four years, PSUs cliff vest after three years and DSUs vest

in equal instalments on the last day of each month of the fiscal year immediately following the grant date. The initial fair value of equity settled share-based arrangements is recognized as a compensation expense with a corresponding increase in equity reserves over the related service period provided to the Company. The compensation expense is recognized over the applicable vesting period by increasing contributed surplus based on the number of awards expected to vest. This number is reviewed at least annually, with any change in estimate recognized immediately in compensation expense.

Revenue recognition

Revenue is recognized based on the five-step model outlined in IFRS 15. Revenue is derived from the sale of goods and services and is recognized at a point in time when the performance obligation is fulfilled. The performance obligation is deemed fulfilled when the control of the products has transferred to the customer and there is no unfulfilled obligation that could affect the customer's acceptance of the products. Provisions for returns relating to the Company's various customer satisfaction programs are accrued based on historical experience. Revenue from sale of third party warranties is recognized based on the net amount of consideration the Company retains after paying the third party the consideration received in exchange for the services to be provided by the third party.

Leases

Assets, primarily delivery trucks, held under leases that result in the Company receiving substantially all the risks and rewards of ownership of the asset (finance leases) are capitalized at the lower of the fair value of the property and equipment or the estimated present value of the minimum lease payments. The corresponding finance lease obligation is included within long-term debt. The interest element is amortized using the effective interest rate method.

The Company leases stores and distribution centres. Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. The Company recognizes rental expense incurred and inducements received from landlords on a straight-line basis over the term of the lease. Any difference between the calculated expense and the amounts actually paid is reflected as deferred lease inducements in other liabilities in the Company's consolidated statements of financial position.

Income taxes

Income taxes comprise current and deferred income taxes. Income taxes are recognized in the consolidated statements of income and comprehensive income, except to the extent that they relate to items recognized directly in other comprehensive income or directly in equity, in which case the income tax is recognized directly in other comprehensive income or equity, respectively.

Current income tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustment to tax payable in respect of previous years.Income taxes provided for by the Company and its subsidiaries are accounted for using the liability method. Deferred income taxes arise due to the temporary differences in the financial reporting and tax bases of assets and liabilities. Changes in these temporary differences are reflected in the provision for deferred income taxes using substantively enacted income tax rates and regulations. Deferred income taxes are recognized for all temporary differences except where they arise on goodwill that is not tax deductible, on the initial recognition of an asset or liability that is not a business combination and at the time of the transaction affects neither accounting nor taxable income, and in respect of differences associated with investments in subsidiaries where the group is able to control the timing of their reversal and it is probable that the temporary differences will not reverse in the foreseeable future. Deferred income tax assets are recognized to the extent that the recoverability of deferred income tax assets is considered more likely than not.

Business combinations

Business combinations are accounted for using the acquisition method. The consideration transferred by the Company is measured as the fair value of assets transferred and equity instruments issued at the date of completion of the acquisition. Identifiable assets acquired and liabilities assumed in a business combination are measured initially at fair value at the acquisition date. The excess of the consideration transferred over the fair value of the net assets acquired is recorded as goodwill. If the consideration transferred is less than the net assets acquired, the difference is recognized directly in the consolidated statements of income and comprehensive income as a gain on acquisition. Results of operations of a business acquired are included in the Company's consolidated financial statements from the date of the business acquisition. Acquisition costs incurred are expensed and included in selling and administrative expenses.

The fair value of the contingent consideration is classified as a financial liability and is recorded on the consolidated statements of financial position at the acquisition date and is remeasured at fair value at the end of each period until the end of the contingency period, with fair value adjustments recognized in earnings.

Change in accounting policy

- *IFRS 9, Financial Instruments*

  IFRS 9 replaces the provisions of IAS 39, Financial Instruments – Recognition and Measurement, that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting. On January 1, 2018, the Company adopted IFRS 9 resulting in changes in accounting policies for financial instruments. In accordance with the transition provisions, the Company has adopted the standard rules retrospectively. There were no significant adjustments to the amounts recognized in the consolidated financial statements on adoption of the new standard.

- *IFRS 15, Revenue from Contracts with Customers*

  On January 1, 2018, the Company adopted the new accounting standard IFRS 15, Revenue from Contracts with Customers, and all the related amendments (new revenue standard or IFRS 15) using the full retrospective method. The Company recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening retained earnings as at January 1, 2017. The impact on the opening balance sheet on January 1, 2017 was not material. The comparative information has been restated to reflect the new revenue standard.

  The new revenue standard resulted in a change in the revenue recognition pattern for customer deposits and gift card breakage. The breakage amounts were previously recognized when likelihood of usage was remote and now are recognized as revenue in proportion to the redemption pattern exercised by customers. The Company has updated and disclosed its policies as a result of adopting the new revenue standard.

  The Company has restated its consolidated financial statements from amounts previously reported due to the adoption of IFRS 15. Select consolidated statements of income and comprehensive income line items, which reflect the adoption of IFRS 15, are as follows:

	2017		
	As previously reported	**Adjustments**	**As adjusted**
	$	**$**	**$**
Revenues	588,014	(1,066)	586,948
Cost of sales	413,057	(1,443)	411,614
General and administrative expenses	78,031	202	78,233
Income before provision for income taxes	80,872	175	81,047
Net income and comprehensive income for the year	59,071	175	59,246
Basic earnings per share attributed to common shareholders	1.57		1.58

Select consolidated statements of financial position line items, which reflect the adoption of IFRS 15, are as follows:

	December 31, 2017		
	As previously reported	**Adjustments**	**As adjusted**
	$	**$**	**$**
Assets			
Current assets	77,730	51	77,781
Liabilities and equity			
Current liabilities	72,655	(308)	72,347
Shareholders' equity	266,808	359	267,167

Adoption of IFRS 15 had no impact on net cash from or used in operating, investing or financing activities in the Company's consolidated statements of cash flows.

Accounting standards and amendments issued but not yet adopted

The IASB and International Financial Reporting Interpretations Committee (IFRIC) have issued the following standards that have not been applied in preparing these consolidated financial statements as their effective dates fall within annual periods beginning subsequent to the current reporting period. The Company is evaluating the impact of these standards.

- *IFRS 16, Leases*

  IFRS 16, Leases (IFRS 16), sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer (lessee) and the supplier (lessor). IFRS 16 will replace IAS 17, Leases, and related interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all lessees and requires a lessee to recognize right-of-use assets and lease liabilities for leases with terms of more than 12 months, unless the underlying asset is of low value, and depreciation of the lease assets is shown separately from interest on lease liabilities in the consolidated statements of income and comprehensive income. Under IFRS 16, the lessor's accounting for operating and finance leases will remain substantially unchanged. IFRS 16 is effective for annual periods beginning on or after January 1, 2019.

  As the Company has significant contractual obligations in the form of operating leases under IAS 17, there will be a material increase to both assets and liabilities on adoption of IFRS 16, and material changes to the timing of recognition of expenses associated with the lease arrangements. At this time, the Company has selected a technology solution to manage the accounting for leases under IFRS 16 on adoption and is in the process of implementing it. The Company began designing internal controls for IFRS 16 during 2018. The Company will continue to analyze the new standard to finalize its impact on the Company's consolidated statements of financial position and consolidated statements of income and comprehensive income. As at December 31, 2018, the Company expects that upon adoption of the standard, excluding the impact of income taxes, its total assets will increase approximately between $208,000-$255,000, its total liabilities will increase approximately between $217,000-$265,000 and its deficit will increase approximately between $7,000-$11,000.

  The Company expects to use the modified retrospective method on adoption. Further, the Company currently expects to apply the following practical expedients, as described under IFRS 16:

  i) grandfather the assessment of which transactions are leases;
  ii) recognition exemption of short-term leases; and
  iii) recognition exemption leases of low-value items.

- *IFRIC 23, Uncertainty over Income Tax Treatments*

  On June 23, 2017, the IASB issued IFRIC Interpretation 23, Uncertainty over Income Tax Treatments (IFRIC 23), which clarifies how to apply the recognition and measurement requirements in IAS 12, Income Taxes, when there is uncertainty over income tax treatments. Application of the standard is mandatory for annual reporting periods beginning on or after January 1, 2019, with earlier application permitted. The Company plans to adopt the new interpretation beginning January 1, 2019. Management does not expect the adoption of IFRIC 23 to have a material impact on the Company's results.

4. Critical accounting estimates and judgments

The preparation of consolidated financial statements requires management to make estimates and assumptions using judgments that affect the application of accounting policies and the reported amounts of assets and liabilities, income and expenses during the reporting period. Estimates and other judgments are continually evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Actual results may differ from those estimates.

The following discusses the most significant accounting judgments and estimates the Company has made in the preparation of the consolidated financial statements.

Impairment of goodwill and brands

Management is required to use judgment in determining the grouping of assets to identify their CGUs for the purposes of testing fixed assets for impairment. Judgment is further required to determine appropriate groupings of CGUs in order to determine the level at which goodwill and intangible assets are tested for impairment. In addition, judgment is used to determine whether a triggering event has occurred requiring an impairment test to be completed.

In determining the recoverable amount of a CGU, various estimates are employed. The Company determines fair value less costs of disposal using estimates such as projected future sales, earnings, capital investments and discount rates. Projected future sales and earnings are consistent with strategic plans provided to the Company's Board of Directors. Discount rates are based on an estimate of the Company's weighted average cost of capital taking into account external industry information reflecting the risk associated with the specific cash flows. As at December 31, 2018 and December 31, 2017, impairment reviews were performed by comparing the carrying value of goodwill and brands with the recoverable amount of the CGU to which goodwill and brands have been allocated. Management has determined there had been no impairment as at both of those dates (note 8).

Business combinations

For each business combination, the Company measures the identifiable assets acquired and the liabilities assumed at their acquisition date fair values. The determination of fair value requires the Company to make assumptions, estimates and judgments regarding future events. The allocation process is inherently subjective and impacts the amounts assigned to individual identifiable assets and liabilities, including the fair value of finished goods inventory, long-lived assets, the recognition and measurement of any identified intangible assets and the final determination of the amount of goodwill or gain on acquisition. The inputs to the exercise of judgments include legal, contractual, business and economic factors. As a result, the purchase price allocation impacts the Company's reported assets and liabilities and future net earnings due to the impact on future cost of goods sold, amortization and impairment tests.

5. Trade and other receivables

	2018	**2017**
	$	**$**
Trade and other receivables	13,194	14,105
Provision for doubtful debts	(74)	(103)
	13,120	14,002

The Company's trade and other receivables consist of balances due from vendors related to volume and co-operative advertising rebates and balances due from the third party financing companies. The carrying amounts of the Company's trade and other receivables, which approximate their fair values, are denominated in Canadian dollars.

The maximum exposure to credit risk at the reporting date is the carrying value of the trade and other receivables.

6. Inventories

	2018	**2017**
	$	**$**
Merchandise	57,101	41,198
Provision for obsolescence	(2,372)	(2,872)
	54,729	38,326
Included in cost of sales		
Writedowns (reversals) of inventory due to net realizable value lower than cost	(489)	658
Writeoffs due to damage or shrinkage	1,976	1,825

During the year, the Company reversed previously taken writedowns of $991 (2017 – $nil). All inventory is recorded in cost of sales once sold.

7. Property and equipment

	Computer hardware $	Furniture, fixtures and other $	Leasehold improvements $	Assets under financelease $	Total $
Year ended December 31, 2017					
At January 1, 2017	1,020	3,268	28,784	855	33,927
Additions	1,362	4,328	20,769	3,387	29,846
Depreciation	(799)	(1,651)	(7,700)	(757)	(10,907)
Disposal	(23)	(48)	(22)	-	(93)
At December 31, 2017	1,560	5,897	41,831	3,485	52,773
At December 31, 2017					
Cost	4,139	10,166	74,045	5,396	93,746
Accumulated depreciation	(2,579)	(4,269)	(32,214)	(1,911)	(40,973)
Net book value	1,560	5,897	41,831	3,485	52,773

(in thousands of Canadian dollars, except per share amounts)

Year ended December 31, 2018					
At January 1, 2018	1,560	5,897	41,831	3,485	52,773
Additions	1,844	2,250	21,532	387	26,013
Depreciation	(1,054)	(1,786)	(9,144)	(723)	(12,707)
Disposal	-	(17)	(352)	-	(369)
At December 31, 2018	2,350	6,344	53,867	3,149	65,710
At December 31, 2018					
Cost	5,166	12,083	87,293	5,284	109,826
Accumulated depreciation	(2,816)	(5,739)	(33,426)	(2,135)	(44,116)
Net book value	2,350	6,344	53,867	3,149	65,710

During the year ended December 31, 2018, the Company disposed of assets with an original cost value of $9,933 (2017 – $11,554) and accumulated depreciation of $9,564 (2017 – $11,461).

8. Goodwill and intangible assets

	Intangible assets					
	Brands – indefinite life	**Brands – definite life**	**Non-compete contracts**	**Computer software**	**Total**	**Goodwill**
	$	**$**	**$**	**$**	**$**	**$**
Year ended December 31, 2017						
At January 1, 2017	101,540	-	603	2,355	104,498	242,146
Additions	-	-	-	2,631	2,631	-
Amortization for the year	-	-	(168)	(1,309)	(1,477)	-
Disposal	-	-	-	(19)	(19)	-
At December 31, 2017	101,540	-	435	3,658	105,633	242,146
At December 31, 2017						
Cost	101,540	-	2,804	7,448	111,792	242,146
Accumulated amortization and impairments	-	-	(2,369)	(3,790)	(6,159)	-
Net book value	101,540	-	435	3,658	105,633	242,146
Year ended December 31, 2018						
At January 1, 2018	101,540	-	435	3,658	105,633	242,146
Additions	-	-	-	2,583	2,583	-
Additions – acquisition of Endy (note 20)	-	21,960	145	14	22,119	58,738
Amortization for the year	-	(77)	(169)	(1,867)	(2,113)	-
Disposal	-	-	-	-	-	-
At December 31, 2018	101,540	21,883	411	4,388	128,222	300,884
At December 31, 2018						
Cost	101,540	21,960	2,949	9,140	135,589	300,884
Accumulated amortization and impairments	-	(77)	(2,538)	(4,752)	(7,367)	-
Net book value	101,540	21,883	411	4,388	128,222	300,884

During the year ended December 31, 2018, the Company disposed of assets with an original cost value of $905 (2017 – $2,134) and accumulated depreciation of $905 (2017 – $2,115).

Goodwill of $300,884 (2017 – $242,146) has been allocated to the two CGUs, Sleep Country and Endy.

The Sleep Country and Dormez-vous corporate brands of $101,540 (2017 – $101,540) have been allocated to the Sleep Country operating segment.

Management has determined, using appropriate valuation methodologies, that there was no impairment of its goodwill or brands as at December 31, 2018 or December 31, 2017.

In assessing goodwill and brands for impairment as at December 31, 2018, the Company compared the aggregate recoverable amount of the assets included in the CGUs to their respective carrying amounts as follows:

	2018 $	2017 $
Sleep Country	242,146	242,146
Endy	58,738	-
	300,884	242,146

For the Sleep Country CGU, the recoverable amount has been determined based on the value in use (discounted cash flows) of the CGUs using the 2019 budgets approved by management that made maximum use of observable markets for inputs and outputs. The fair value less cost of disposal is categorized as Level 3 in the fair value hierarchy. For periods beyond the budget period, cash flows were extrapolated using revenue growth rates of 5.0% – 5.7% (2017 – 5.2% – 6.5%) and a terminal growth rate of 2.5% (2017 – 2.5%) that approximate the long-term average for the mattress retailer segment. A discount rate of 8.2% (2017 – 8.2%) was used in the model. As at December 31, 2018 and December 31, 2017, any reasonable changes to the model assumptions would not result in an impairment.

For the Endy CGU, the recoverable amount has been determined based on the value in use (discounted cash flows) of the CGUs using the 2019 budgets approved by management that made maximum use of observable markets for inputs and outputs. The fair value less cost of disposal is categorized as Level 3 in the fair value hierarchy. For periods beyond the budget period, cash flows were extrapolated using revenue growth rates of 5.5% – 45.6% (2017 – n/a) and a terminal growth rate of 3.0% (2017 – n/a) that approximate the long-term average for the online mattress retailer segment. A discount rate of 15.2% (2017 – n/a) was used in the model. As at December 31, 2018, any reasonable changes to the model assumptions would not result in an impairment.

9. Trade and other payables

	2018	2017
	$	$
Trade payables	28,534	23,391
Income taxes payable	883	3,177
Accrued expenses	21,994	25,853
	51,411	52,421

10. Other liabilities

	2018	2017
	$	$
Deferred lease inducements and rent escalation	13,003	10,957
Decommissioning provisions	765	681
Contingent consideration (notes 19 and 20)	15,123	-
Other (note 20)	97	-
	28,988	11,638

11. Long-term debt

	2018	2017
	$	$
Senior secured credit facility (i)	167,573	104,323
Finance lease obligations	3,149	3,486
	170,722	107,809
Less: Current portion of long-term debt	686	662
	170,036	107,147

(i) Represented net of transaction costs of $1,116 as at December 31, 2018 (2017 – $677).

Senior secured credit facility

On January 1, 2017, SCC held a senior secured credit facility of $150,000, which was scheduled to mature on June 29, 2021.

On August 30, 2017, the senior secured credit agreement was amended and the maturity date was extended to August 30, 2022. On November 29, 2018, in connection with the purchase of substantially all of the operating assets of Overwater Limited, a leading online mattress retailer operating under the brand name Endy (note 20), the senior secured credit

agreement was amended. Pursuant to this amendment, the facility was increased from $150,000 to $210,000 and the maturity date was extended to November 29, 2023.

The senior secured credit facility is secured by all of the present and after acquired personal property of SCC, SCCI and Endy. As at December 31, 2018, the balance outstanding on the senior secured credit facility was $168,600 (2017 – $105,000).

The senior secured credit facility allows for the debt to be held in Canadian or US dollars. During the year, the Company held the majority of the debt in US dollars for 328 days as the debt held in US dollars has a lower interest rate. To mitigate the foreign exchange risk, the Company entered into forward foreign exchange contracts to sell US dollars in the equal amount of the debt with an overall impact of $nil recorded in general and administrative expenses in the consolidated statements of income and comprehensive income. As at December 31, 2018, the debt is held in Canadian dollars and no forward foreign exchange contracts were outstanding. Interest on the senior secured credit facility is based on the prime or bankers' acceptance rates plus applicable margins based on the achievement of certain targets, as defined by the amended and restated senior secured credit agreement. As at December 31, 2018, the applicable margin for bankers' acceptances was 200 basis points and the applicable margin for prime rate loans was 100 basis points. The average effective interest rate, including transaction costs and revolver commitment fees, on the facility was 3.70% (2017 – 3.03%).

Under the terms of the senior credit facility, certain financial and non-financial covenants must be complied with. As at December 31, 2018 and December 31, 2017, SCC was in compliance with all covenants under the senior secured credit facility.

Finance related expenses included in the consolidated statements of income and comprehensive income include the following:

	2018	2017
	$	$
Interest on finance lease obligations	270	220
Revolver commitment fees	144	143
Interest expense on senior credit facility	4,061	3,324
	4,475	3,687

12. Income tax

Components of income tax provision

Significant components of the income tax provision are as follows:

	2018	2017
	$	$
Current income tax expense	21,728	20,982
Deferred income tax expense relating to		
Temporary differences	836	689
Deferred income tax rate changes	11	130
	847	819
Provision for income taxes	22,575	21,801

Reconciliation to effective tax rate

The overall income tax provision differs from the amount that would be obtained by applying the combined statutory income tax rate to income due to the following:

	2018	2017
	$	$
Income before provision for income taxes	82,216	80,872
Weighted average Canadian income tax rate	26.50%	26.50%
Income tax expense based on statutory income tax rate	21,785	21,431
Difference between rates applicable to Company and rates applicable to subsidiaries	266	118
Effect of non-deductible expenses and other items	513	123
Deferred tax rate changes	11	130
	22,575	21,801
Effective income tax rate	27.46%	26.96%

Deferred income tax liability

Significant components of the net deferred income tax liability are as follows:

	2018	2017
	$	**$**
Excess of carrying value of intangible assets over tax values	(27,188)	(27,314)
Benefit of share issuance costs and financing fees deductible in future years	1,334	2,465
Loss carry-forwards – net of unrecognized deferred income tax assets	2,195	1,903
Other temporary differences	2,800	2,912
	(20,859)	(20,034)

SCC has recognized a deferred tax asset of $3,908 (2017 – $4,166), which is dependent on future taxable income. The Company expects that it will be able to utilize the deferred tax asset in the future.

Reconciliation of deferred income tax movement:

	2018	2017
	$	**$**
Deferred income tax expense in the consolidated statements of income and comprehensive income	848	819

As at December 31, 2018, the Company has unused capital losses of $19,702 (2017 – $19,702) with no expiry date.

Capital losses may only be used to offset capital gains. No deferred income tax benefit has been set up for these losses as the Company does not expect to realize capital gains in the foreseeable future.

On February 1, 2018, the Canada Revenue Agency (CRA) issued a notice of proposed adjustments for the 2014 taxation year, which also resulted in consequential income adjustments for the 2015 and 2016 taxation years. The proposed adjustments relate to restructuring transactions in the Company's pre-initial public offering (IPO) structure and certain related transactions.

Notices of Reassessment were issued by the CRA related to certain of these issues in June 2018 with an exposure of $3,480, which includes tax and interest. In order to contest the matter, the Company has filed Notices of Objection with the Chief of Appeals, CRA on September 5, 2018. The Company has received an acknowledgement of the receipt of the Notices of Objection by the CRA and is currently awaiting a response to these Notices.

The Company was required to pay a minimum of 50% of the amount issued in the Notices of Reassessment within 30 days of the date of these Notices. Accordingly, a payment of $77 was made on June 28, 2018, $1,701 was made on July 3, 2018 and $1,033 was made on July 31, 2018. In September 2018, pursuant to the Notices of Reassessments issued by the Treasury Board and Finance of Alberta in relation to the CRA audit, the Company has made a payment of $177. All of these payments are included in prepaid expenses and deposits.

The Company expects to receive a Notice of Reassessment under Part III Tax, pursuant to subsection 184(2) of the Income Tax Act on the basis that it paid an excess capital dividend on July 15, 2015. The maximum exposure, including tax, penalty and interest, in this matter is approximately $5,818. In the event the Notice of Reassessment under Part III Tax is received, the Company, with the concurrence of Birch Hill Equity Partners Management Inc. (Birch Hill) and its co-investors, has the ability to file an election under subsection 184(3) to treat the excess amount as a taxable dividend, which is expected to resolve this exposure.

Pursuant to the indemnifications provisions of the pre-IPO share purchase agreement dated July 10, 2015, the Company expects to be indemnified for all of the above matters by Birch Hill and its co-investors, which include some current members of the Company's Board and Company's management. The Company believes it will be able to sustain its tax positions, and consequently no reserve has been made.

13. Expenses by nature

	Cost of sales	
	2018	**2017**
	$	**$**
		(restated – note 3)
Inventory and directly related costs recognized as an expense, including write-downs, writeoffs and reversals	282,165	268,736
Salaries, wages and benefits	92,387	89,349
Rent and other occupancy charges – stores	55,134	49,979
Other	3,746	3,550
	433,432	411,614

	General and administrative	
	2018	**2017**
	$	**$**
		(restated – note 3)
Media and advertising expenses	33,711	28,163
Salaries, wages and benefits	19,885	18,233
Credit card and finance charges	14,805	13,255
Rent and other occupancy charges – warehouses and other	8,134	8,445
Professional fees	2,239	1,419
Telecommunication and information technology	3,948	3,640
Mattress recycling costs and donations	2,315	2,162
Other	3,086	2,916
	88,123	78,233

14. Share capital and other

Authorized share capital

Unlimited common shares

Unlimited Class A common shares

Issued and outstanding, no par value

	2018	2017
	$	$
37,059,430 common shares (2017 – 37,008,306)	622,365	621,829
Reorganization adjustment and other	(276,159)	(276,159)
Contributed surplus	6,982	4,287
	353,188	349,957

Common shares and Class A common shares

The holders of common shares are entitled to receive notice of any meetings of shareholders, to attend and to cast one vote per common share at all such meetings. Holders of common shares do not have cumulative voting rights with respect to the election of directors and, accordingly, holders of a majority of the common shares entitled to vote in any election of directors may elect all directors standing for election. Holders of common shares are entitled to receive on a pro rata basis such dividends, if any, as and when declared by the Board of Directors at its discretion from funds legally available therefor and on liquidation, dissolution or winding up of the Company are entitled to receive on a pro rata basis the net assets of the Company after payment of debts and other liabilities, in each case subject to the rights, privileges, restrictions and conditions attaching to any other series or class of shares ranking senior in priority to or on a pro rata basis with the common shares with respect to dividends or liquidation. The common shares do not carry any pre-emptive, subscription, redemption or conversion rights, nor do they contain any sinking or purchase fund provisions.

Holders of Class A common shares will be entitled to the same rights and privileges as holders of common shares described above and will rank equally with the holders of common shares on liquidation, dissolution or winding up of the Company. The Class A common shares will not carry any pre-emptive or subscription rights, nor will they contain any sinking or purchase fund provisions. Class A common shares are redeemable at the option of the Company on written notice to the holders of the Class A common shares, with the redemption price being equal to the price per common share in the IPO. As at December 31, 2018, there were no outstanding Class A common shares (2017 – nil).

In the fourth quarter of 2017, the Company received approval from the Toronto Stock Exchange (the TSX) to commence, within one year of the approval date, a Normal Course Issuer Bid (NCIB) and purchase on the TSX or through alternative trading systems up to 1,600,000 of the Company's common shares, representing approximately 4.5% of the public float of the Company's common shares issued and outstanding as at November 30, 2017. In accordance with the rules and by-laws of the TSX, the Company was permitted to purchase up to a daily maximum of 21,005 shares (representing 25% of the average daily trading volume of the shares on the TSX for the six months prior to commencement of the NCIB), except where such purchases were made in accordance with the block purchase exception under the applicable TSX rules and policies.

During 2018, the Company did not purchase common shares for cancellation (2017 – 641,326). The purchases of 641, 326 common shares made in 2017 were made at an average price of $34.12, for a total consideration of $21,889. Sleep Country's NCIB expired on December 6, 2018 and was not renewed.

15. Earnings per share (EPS)

Basic EPS amounts are calculated by dividing the net earnings attributable to common shareholders of the Company by the weighted average number of shares outstanding during the year.

Diluted EPS amounts are calculated by dividing the net earnings attributable to common shareholders of the Company by the weighted average number of shares issued during the year, adjusted for the effects of potentially dilutive stock options. For the year ended December 31, 2018, the effects of 459,037 stock options are dilutive and 386,789 stock options are anti-dilutive. All stock options were dilutive in the year ended December 31, 2017. PSUs and DSUs are dilutive in nature.

The following table sets forth the calculation of basic and diluted EPS:

	Attributable to common shareholders		
			2018
	Net earnings **$**	**Weighted average number of shares** (in thousands of shares)	**EPS** **$**
Basic	59,641	37,029	1.61
Diluted	59,641	37,409	1.59

	Attributable to common shareholders		
			2017
	Net earnings **$**	**Weighted average number of shares** (in thousands of shares)	**EPS** **$**
Basic	59,246	37,611	1.58
Diluted	59,246	37,953	1.56

(in thousands of Canadian dollars, except per share amounts)

16. Contingent liabilities and unrecognized contractual commitments

Operating leases

The Company and its subsidiaries conduct all of their operations from leased stores and distribution centres. The Company has entered into operating lease arrangements for leased premises, passenger vehicles and office equipment with terms of up to 15 years. For the year ended December 31, 2018, the total amount paid under these operating leases was $38,971 (2017 – $36,089).

Non-cancellable operating lease rentals are payable as follows:

	2018	2017
	$	$
Less than 1 year	41,469	37,507
Between 1 and 5 years	125,110	114,933
More than 5 years	57,763	52,612
	224,342	205,052

Executive employment agreements allow for total additional payments of approximately $7,054 if a liquidity event occurs, $3,947 if all are terminated without cause, $nil if all are terminated with cause and $3,519 if all are terminated as a result of death.

All directors and/or officers of the Company, and each of its various subsidiary entities, are indemnified by the Company for various items including, but not limited to, all costs to settle lawsuits or actions due to their association with the Company, subject to certain restrictions. The Company has purchased directors' and officers' liability insurance with maximum coverage of $30,000 to mitigate the cost of any potential future lawsuits or actions to the directors and officers. The term of the indemnification is not explicitly defined, but is limited to events for the period during which the indemnified party served as a director or officer of the Company. The maximum amount of any potential future payment required to be made by the Company cannot be reasonably estimated but could have a material adverse effect on the Company.

In the normal course of business, the Company has entered into agreements that include indemnities in favour of third parties, such as purchase and sale agreements, confidentiality agreements, engagement letters with advisers and consultants, leasing contracts, licence agreements, information technology agreements and various product and service agreements. These indemnification arrangements may require the Company to compensate counterparties for losses incurred by the counterparties as a result of breaches in representations, covenants and warranties provided by the Company or as a result of litigation or other third party claims or statutory sanctions that may be suffered by the counterparties as a consequence of the relevant transaction. In some instances, the terms of these indemnities are not explicitly defined. The Company, whenever possible, tries to limit this potential liability within the particular agreement or contract; however, due to the unpredictability of future events, the maximum amount of any potential reimbursement required to be made by the Company or its subsidiary entities cannot be reasonably estimated, but could have a material adverse effect on the Company.

(in thousands of Canadian dollars, except per share amounts)

17. Related party transactions and balances

Key management personnel are those individuals who have the authority and responsibility for planning, directing and controlling the activities of the Company, including members of the Company's Board of Directors. The Company considers key management to be the Board of Directors and its executive team.

During 2016, Birch Hill Equity Partners Management Inc. (Birch Hill) and its co-investors had voting direction and control over approximately 18.9% of the Company's common shares until May 2016. Birch Hill maintained two nominee directors on the Company's Board of Directors until May 12, 2017. As such, Birch Hill was deemed to be a related party of the Company prior to May 12, 2017.

As at December 31, 2018 and December 31, 2017, there were no balances due from or payable to a related party.

SCC incurred the following compensation expenses in relation to key management personnel:

	2018	2017
	$	$
Salaries and short-term employee benefits	2,785	3,683
Share-based compensation	3,655	2,368
Directors' fees	669	651
	7,109	6,702

18. Share-based compensation

On July 16, 2015, the Company established a share-based compensation plan composed of stock options and PSUs. On January 22, 2016, the Company established a share-based compensation plan for its Directors composed of DSUs. The impact of the share-based compensation expense is summarized as follows:

	2018	2017
	$	$
845,826 stock options (2017 – 692,966) (a)	1,402	1,000
167,152 PSUs (2017 – 149,977) (b)	1,820	1,385
22,901 DSUs (2017 – 12,506) (c)	340	206
	3,562	2,591

The stock options, PSUs and DSUs, are equity settled and as such, the expense associated with these instruments is recorded as a share-based compensation expense through the consolidated statements of income and comprehensive income with a corresponding entry made to contributed surplus in share capital and other on the consolidated statements of financial position. During the year, the Company recorded $289 (2017 – $329) in payroll taxes related to share-based compensation.

The maximum number of common shares that may be issued under all security based compensation arrangements implemented by the Company, including the stock option plan, the PSU plan and the DSU plan, may not exceed 10% of the total number of common shares issued and outstanding from time to time. The maximum number of common shares that may be issued under the PSU plan is 4% and under the DSU plan is 1% of the total number of common shares issued and outstanding from time to time.

a) Stock options

The Company has a stock option plan under which options to purchase common shares may be granted to officers and employees of the Company. Options granted under the plan have an exercise price of not less than the weighted average trading price of the common shares where they are listed for the five trading days prior to the date of the grant. Options granted vest on the fourth anniversary of the grant date. All issued options expire after ten years from the date granted.

The Company's stock option transactions during the year were as follows:

	Number of options	**Weighted average exercise price per share**
		$
Balance – January 1, 2017	473,613	18.63
Granted on March 10, 2017	229,472	32.39
Options exercised on April 10, 2017	(1,013)	19.31
Options forfeited on May 12, 2017	(9,106)	17.00
Balance – December 31, 2017	692,966	23.21
Balance – January 1, 2018	692,966	23.21
Granted on March 13, 2018	161,212	36.60
Options forfeited on August 31, 2018	(5,028)	26.94
Options forfeited on November 14, 2018	(1,298)	32.39
Options exercised on November 14, 2018	(2,026)	19.31
Balance – December 31, 2018	845,826	25.73

The vested number of options outstanding as at December 31, 2018 is nil (2017 – 3,324).

The Black-Scholes model was used to estimate the fair value of stock options. The grant date fair value of the options is the same as the weighted average exercise price. In determining the fair value of these employee stock options, the following assumptions were used for the series issued on March 13, 2018. Key assumptions include:

- a risk free interest rate of 2.15%, which is based on a Government of Canada five to ten-year benchmark bond yield at the date of grant;
- expected volatility of 31.2%, which is based on the trading history of the Company;
- an estimated dividend yield of 1.8%;
- a seven-year expected life of the options; and
- a forfeiture rate of 1.19%.

b) PSU plan

The Company has established a PSU plan for employees and officers of the Company. A PSU represents the right to receive a common share settled by the issuance of treasury shares or purchased on the open market. PSUs vest 100% at

the end of the third year after the grant date. The number of units that will vest is determined based on the achievement of certain EBITDA targets established by the Board of Directors. The number of units that vest is determined by multiplying the number of units granted to the participant by the adjustment factor, which ranges from 0.5 to 1.5, depending on the achievement of such targets. Therefore, the number of units that will vest and are paid out may be higher or lower than the number of units originally granted to a participant.

The Company's PSU plan transactions during the year were as follows:

	Number of units (vested and unvested)	**Grant date fair value per unit**
		$
Balance – January 1, 2017	90,603	18.57
Issued as dividend equivalents – February 27, 2017	156	29.80
Granted – March 10, 2017	58,952	32.39
Issued – April 10, 2017	90	19.31
Exercised – April 10, 2017	(270)	19.31
Issued as dividend equivalents – May 29, 2017	160	39.33
Issued as dividend equivalents – August 28, 2017	124	33.91
Granted – November 27, 2017	162	32.61
Balance – December 31, 2017	149,977	24.06
Balance – January 1, 2018	149,977	24.06
Issued as accelerated performance units – January 10, 2018	180	19.31
PSU exercised – January 15, 2018	(873)	24.30
Issued as dividend equivalents – February 28, 2018	156	33.48
Granted – March 13, 2018	50,835	36.60
Granted – May 31, 2018	187	31.78
Issued as accelerated performance units – August 8, 2018	16,075	17.00
PSU exercised – August 8, 2018	(48,225)	17.00
PSU cancelled – August 31, 2018	(1,160)	28.71
Balance – December 31, 2018	167,152	29.21

The vested number of units outstanding as at December 31, 2018 is nil (2017 – 693).

c) DSU plan

The Company has established a DSU plan for Directors of the Company. A DSU represents the right to receive a common share settled by the issuance of treasury shares or purchased on the open market. DSUs granted vest in equal instalments on the last day of each month of the fiscal year immediately following the grant date, and relate to the applicable portion of the Directors' annual retainer.

	Number of units (vested and un-vested)	Grant date fair value per unit
Balance – January 1, 2017	8,920	31.77
Forfeited – May 12, 2017	(1,574)	31.77
Granted – May 18, 2017	5,160	38.76
Balance – December 31, 2017	12,506	34.65
Balance – January 1, 2018	12,506	34.65
Granted – May 17, 2018	9,162	32.74
Granted – August 15, 2018	1,233	31.55
Balance – December 31, 2018	22,901	33.72

The vested number of units outstanding as at December 31, 2018 is 19,128 (2017 – 10,356).

19. Financial instruments and risk management

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange risk and cash flow and fair value interest risks), credit risk and liquidity risk. The Company's overall risk management program and business practices seek to minimize any potential adverse effects on the Company's consolidated financial performance.

Risk management is carried out by the senior management team and is overseen by the Board of Directors.

Market risk

Market risk is the loss that may arise from changes in factors such as interest rates, foreign exchange and the impact these factors may have on other counterparties.

- Foreign exchange risk

  The Company operates in Canada. The exposure related to foreign exchange is limited to US dollar payments to suppliers, which is not significant.

- Cash flow and fair value interest risk

  The Company has no significant interest bearing assets. The Company's income and operating cash flows are substantially independent of changes in market interest rates.

  The Company's primary interest rate risk arises from long-term debt. The Company manages its exposure to changes in interest rates by using a combination of fixed and variable rate debt and utilizing interest rate swaps as necessary to achieve the desired proportion of variable and fixed rate debt. An increase or decrease in interest rates by 1% would result in an increase or a decrease of $1,686 (2017 – $1,050) on interest expense on the credit facilities. There are also a small number of finance leases at variable interest rates.

Credit risk

Credit risk refers to the risk of losses due to failure of the Company's customers or other counterparties to meet their payment obligations. Credit risk arises from deposits with banks, as well as credit exposures from mattress vendors for the payment of volume and co-operative advertising rebate amounts and balances owed from third party financing companies under the various financing plans the Company offers its customers. In accordance with SCC's investment practice, all deposits are held at banks possessing a credit rating of AA- or better. Sales to retail customers are settled in cash, financed by third party financing companies or by using major credit cards. The Company transfers the credit risk for financing plans to third party financing companies. The third party financing companies that SCC deals with carry a minimum rating of BBB or better.

Trade receivables are written off when there is no reasonable expectation of recover. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the group, and a failure to make contractual payments for a period of greater than 120 days past due.

Impairment losses on trade receivables and contract assets are presented as net impairment losses within operating profit. Subsequent recoveries of amounts previously written off are credited against the same line item.

Liquidity risk

Liquidity risk is the risk the Company will not be able to meet a demand for cash or to fund its obligations as they come due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. Prudent liquidity management implies maintaining sufficient cash and the availability of funding through an adequate amount of committed credit facilities.

The table below analyzes the Company's financial liabilities into relevant maturity groupings based on the remaining period from the consolidated statements of financial position dates to the contractual maturity date. The amounts discussed in the table are contractual undiscounted cash flows.

	Within 1 year $	Between 1 and 5 years $	Over 5 years $
At December 31, 2018			
Trade and other payables	51,411	-	-
Long-term debt	7,150	195,748	100
	58,561	195,748	100
At December 31, 2017			
Trade and other payables	52,421	-	-
Long-term debt	5,179	122,886	345
	57,600	122,886	345

Fair value of financial instruments

The different levels used to determine fair values have been defined as follows:

- Level 1 – inputs use quoted prices (unadjusted) in active markets for identical financial assets or financial liabilities

that the Company has the ability to access.

- Level 2 – inputs other than quoted prices included in Level 1 that are observable for the financial asset or financial liability, either directly or indirectly. Level 2 inputs include quoted prices for similar financial assets and financial liabilities in active markets, and inputs other than quoted prices that are observable for the financial liabilities.
- Level 3 – inputs are unobservable inputs for the financial asset or financial liability and include situations where there is little, if any, market activity for the financial asset or financial liabilities.

The following describes the fair value determinations of financial instruments:

The carrying values of cash, trade and other receivables, trade and other payables and customer deposits approximate their fair values due to the relatively short periods to maturity of these financial instruments. The carrying value of the senior secured credit facility approximates its fair value as the terms and conditions of the borrowing arrangements are comparable to market terms and conditions as at December 31, 2018 and December 31, 2017. The finance leases approximate their fair values as the implicit interest rates used in determining their fair value approximate interest rates as at December 31, 2018 and December 31, 2017.

- *Fair values of contingent consideration liability*

  The fair value of the contingent consideration liability recorded on the consolidated statements of financial position as at December 31, 2018 was $15,123 (see note 20). The estimated range of outcomes (undiscounted) for the contingent consideration arrangement is determined based on the formula price and the likelihood of achieving specified earnings levels over the contingency period, and ranges from $nil to a maximum of $25,000. The consideration is contingent on the acquired business achieving certain specified earnings levels during the period commencing on January 1, 2020 and ending on December 31, 2020. During the year ended December 31, 2018, $nil was paid with reference to such contingent consideration (2017 – $nil).

  The inputs to the measurement of the fair value of contingent consideration related to acquisitions are Level 3 inputs. The fair value measurements were made using a discounted cash flow model; significant model inputs were expected future operating cash flows (determined with reference to each specific acquired business) and a discount rate of 15%. The discount rates is attributable to level of risk related to economic growth factors combined with the length of the contingent payment periods; and the dispersion was driven by unique characteristics of the businesses acquired and the respective terms for these contingent payments. A 1% increase in the weighted average discount rate would reduce the fair value of contingent consideration by $260.

	$
Balance – December 31, 2017	-
Amounts recognized on acquisitions	15,123
Fair value adjustments	-
Resolved and settled in cash	-
Other	-
Balance – December 31, 2018	15,123
Less: Current portion	-
Non-current portion	15,123

Capital risk management

The Company's objectives when managing capital are to safeguard its ability to continue as a going concern in order to provide returns for its common shareholders in the form of cash dividends, benefits to other stakeholders and to maintain an optimal capital structure to minimize the cost of capital.

In order to maintain or adjust the capital structure, the Company may issue new shares or sell assets to reduce long-term debt.

20. Business combinations

On December 6, 2018, the Company acquired substantially all of the operating assets of Overwater Limited, a leading online mattress retailer operating under the brand name Endy. Endy generated annual revenue of approximately $47,300 and a net income of approximately $4,650 in 2018 and employed approximately 36 people. The results of operations since December 6, 2018 have been included in these consolidated financial statements. Since the date of acquisition, Endy has generated revenue of $3,467. The post acquisition net income of Endy did not significantly contribute to the consolidated net income of SCC.

This acquisition has been accounted for as a business combination.

The following table summarizes the purchase consideration that is paid or payable at the date of the acquisition and the allocation of the purchase consideration to the identifiable assets acquired and liabilities assumed based on management's estimate of the fair values:

	$
Purchase consideration	
Cash purchase price, including working capital adjustment	66,080
Other liabilities – Contingent consideration (note 10)	15,123
Total purchase consideration	81,203
Allocation of purchase consideration to net assets acquired	
Current assets	
Trade and other receivables (note 5)	184
Inventories (note 6)	4,147
Prepaid expenses and deposits (note 12)	356
	4,687

	$
Current liabilities	
Trade and other payables (note 9)	4,299
Customer deposits	96
	4,395
Net working capital	292
Property and equipment (note 7)	54
Intangible assets (note 8)	22,119
Goodwill (note 8)	58,738
Total net assets acquired	81,203

Acquisition related costs of $502 are included in administrative expenses in profit or loss and in operating cash flows in the consolidated statements of cash flows.

Recognized goodwill reflects the value assigned to expected future synergies and an assembled workforce within the companies and is fully tax deductible.

The vendor, at the time of acquisition, is entitled to receive a contingent consideration payment if the acquired business achieves specified earnings levels during the period commencing on January 1, 2020 and ending on December 31, 2020. The ultimate amount of payment is determined based on a formula, the key inputs to which are (i) a contractually agreed maximum payment; (ii) a contractually specified earnings level and (iii) the actual earnings for the contingency period. If the acquired business does not achieve the specified earnings level, the maximum payment is reduced for any shortfall, potentially to nil.

21. Subsequent events

The Company's dividend policy is at the discretion of the Board of Directors. On February 5, 2019, the Company declared a dividend of $0.185 per common share that will be payable on February 26, 2019 to holders of the common shares of record at the close of business on February 15, 2019.

Shareholder information

Exchange Listing

The Toronto Stock Exchange

Common Shares

Ticker Symbol: ZZZ

Auditor

PricewaterhouseCoopers LLC

PWC Tower

18 York Street, Suite 2600

Toronto, ON M5J 0B2

Banker

TD Securities

TD West Tower, 30th Floor

100 Wellington Street West

Toronto, ON M5K 1A2

Registrar and Transfer Agent

Computershare

100 University Avenue, 8th Floor

Toronto, ON M5J 2Y1

computershare.com

Shareholder Contact

Robert Masson

Chief Financial Officer

Sleep Country Canada

robert.masson@sleepcountry.ca

Annual Meeting of Shareholders

Date: May 7, 2019

Time: 10:00am (EST)

Scotiabank Centre

Scotia Plaza, 2nd Floor

40 King Street West

Toronto, ON M5H 1H1

Board of Directors

Stephen Gunn

Co-Chair

Christine Magee

Co-Chair

David Friesema

Andrew Moor

David Shaw

John Cassaday

Douglas Bradley

Zabeen Hirji

Officers

David Friesema

Chief Executive Officer

Robert Masson

Chief Financial Officer

Stewart Schaefer

Chief Business Development Officer & President, Dormez-vous?

Capital Stock

As at December 31, 2018, there were 37,059,430 common shares outstanding.

All for Sleep™

Sleep Country/Dormez-vous?
7920 Airport Road
Brampton, ON, L6T 4N8
T: 289-748-0206
sleepcountry.ca

Sleep Country