# ROCKY MOUNTAIN LIQUOR INC

## Ticker: "RUM"

# MANAGEMENT'S DISCUSSION AND ANALYSIS
## For the period ended March 31, 2017

## As at May 23, 2017

**ROCKY MOUNTAIN LIQUOR INC**

# MANAGEMENT'S DISCUSSION AND ANALYSIS

This management discussion and analysis ("MD&A") is dated May 23,2017

The following is a discussion of the consolidated financial condition and operations of Rocky Mountain Liquor Inc. ("RML" or the "Company") for the periods indicated and of certain factors that the Company believes may affect its prospective financial condition, cash flows and results of operations. This discussion and analysis should be read in conjunction with the unaudited consolidated interim financial statements and accompanying notes of the Company for the period ended March 31, 2017. The Company owns 100% of Andersons Liquor Inc. ("Andersons") headquartered in Edmonton Alberta, which owns and operates private liquor stores in that province.

The Company's audited consolidated financial statements and the notes thereto have been prepared in accordance with International Financial Reporting Standards ("IFRS") and are reported in Canadian dollars. References to notes are to notes of the consolidated financial statements unless otherwise stated.

Throughout this MD&A, references are made to "EBITDA", "operating margin", "operating margin before non-recurring items", "operating margin as a percentage of sales", and other "Non-IFRS Measures". A description of these measures and their limitations are discussed below under "Non-IFRS Measures". See also "Risk Factors" discussed below.

Additional information relating to the Company, including all other public filings is available on SEDAR (www.sedar.com) and on the Company's website www.ruminvestor.com.

## FORWARD LOOKING INFORMATION AND STATEMENTS ADVISORY

This management discussion and analysis contains certain forward-looking information and statements within the meaning of applicable securities laws. The use of any of the words "expect", "anticipate", "continue", "estimate", "objective", "ongoing", "may", "will", "project", "should", "believe", "plans", "intends", "might" and similar expressions is intended to identify forward-looking information or statements. In particular, but without limiting the foregoing, this management discussion and analysis contains forward-looking information and statements pertaining to the following: (i) the stability of retail liquor sales; (ii) the ability to acquire additional liquor stores and/or locations; (iii) increased revenues and margins due to tax increase, (iv) the ability to purchase inventory at a discount, (v) ongoing impact from price inflation, (vi) potential exercise of warrants, (vii) equity issuance and (viii) other expectations, beliefs, plans, goals, objectives, assumptions, information and statements about possible future events, conditions, results of operations or performance. All statements other than statements of historical fact contained in this management's discussion and analysis are forward-looking statements, including, without limitation, statements regarding the future financial position, business strategy, proposed or recent acquisitions and the benefits to be derived there from, and plans and objectives of or involving the Company.

The forward-looking information and statements contained in this management discussion and analysis reflect several material factors, expectations and assumptions including, without limitation: (i) demand for adult beverages; (ii) the ability to acquire additional liquor stores and/or locations; (iii) the Company's ability to secure financing to suit its growth strategy; (iv) the integration risk and requirements for the purchase or development of liquor stores; (v) the Company's future operating and financial results; (vi) treatment under governmental regulatory regimes, tax, and other laws; and (vii) the ability to attract and retain employees for the Company.

The forward-looking information and statements included in this MD&A are not guarantees of future performance and should not be unduly relied upon. Forward-looking statements are based on current expectations, estimates and projections that involve a number of risks and uncertainties, which could cause actual results to differ materially from those anticipated and described in the forward-looking statements. Such information and statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward looking information or statements including, without limitation: (i) impact of economic events affecting discretionary consumer spending; (ii) impact from competition in the markets where the Company operates; (iii) the impact of increases in labour costs; (iv) actions by governmental or regulatory authorities including changes in income tax laws and excise taxes; (v) the impact of weather on its effect on consumer demand; (vi) the impact of supplier disruption or delays; (vii) the maintenance of management information systems; (viii) the ability of the Company to retain key personnel; (ix) the availability of financing; (x) the ability of the Company to meet its financial obligations; (xi) the importance of the Company's integrated inventory and distribution systems; (xii) market volatility and share price; (xiii) the impact of a limited trading market; (xiv) importance of cybersecurity; and (xv) the ability to source locations and acquisitions for growth strategy and to complete construction projects.

The Company cautions that the foregoing list of assumptions, risks and uncertainties is not exhaustive. The forward looking information and statements contained in this discussion and analysis speak only as of the date of this management discussion and analysis, and the Company assumes no obligation to publicly update or revise them to reflect new events or circumstances, except as may be required pursuant to applicable laws.

## KEY OPERATING AND FINANCIAL METRICS

Key operational and financial highlights, year over year 3 month comparison:

- Gross margin percentage increased to 24.5% (2016 – 24.1%)
- Sales decreased to $8.8M (2016 - $9.5M)
- EBITDA decreased to a loss of $377,065 (2016 – loss $272,079)
- Net loss is $953,432 (2016 - $625,324)

## RECENT DEVELOPMENTS SINCE PERIOD ENDED MARCH 31, 2017

Subsequent to period end, as part of the previously discussed rebranding strategy, five stores transitioned to the Great Canadian Liquor ("GCL") trade name after renovations, rebranding and implementation of new pricing strategies. These stores held grand openings May 4-7, 2017 and introduced GCL's website, www.greatcanadianliquor.com which details store locations, current flyers and other marketing campaigns.

## OUTLOOK

Unemployment rates continue to rise in Alberta. In April 2017, Alberta's seasonally adjusted unemployment rate was 7.9%, up from the 7.4% rate that was registered a year earlier[1]. Additionally, we have seen many competitors in our markets employing aggressive discounting in response to the economic conditions.

We have identified a number of target stores and are currently implementing a plan to offset current economic challenges and the effects of competitive pressures. We have undertaken store renovations, new pricing strategies and are establishing a consistent brand to address changes in consumer buying preferences. Five locations have been completed, and began operations under the Great Canadian Liquor brand. We have launched a new website and digital advertising platform to support the introduction of the brand. We are planning to transition up to five additional locations during this fiscal year.

While our main focus is on the new initiatives, we are continuing to evaluate new greenfield and acquisition opportunities. We also plan to continue to sell stores in markets that are not compatible with our current business plans, ensuring the most effective use of our capital. We expect this approach will be sustainable in the long term with improvement in the economy and increased consumer spending.

The Alberta government increased the minimum wage to $12.20 on October 1, 2016 and has announced two further increases of $1.40 per hour. Minimum wage will increase to $13.60 in October 2017 and to $15.00 in October 2018. The Company pays its team members in excess of minimum wage, however the increase will continue to cause upward pressure on wage costs across the industry. Management expects to incur increased salary costs in the 2017 and 2018 fiscal years as a result of the increases to minimum wage.

The Company has an available $10 million revolving credit facility of which $529,105 was unused as of May 23, 2017. Management believes this is sufficient for the successful execution of our business plan.

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[1] Government of Alberta, Economic Dashboard – Unemployment Rate Published May 5, 2017 , Retrieved May 15, 2017 from http://economicdashboard.alberta.ca/Unemployment

## OPERATING RESULTS - 3 Months ending March 31, 2017

### *Basis of Comparison*

The retail liquor industry is subject to seasonal variations with respect to sales. Sales are typically lowest early in the year and increase in the latter half. It is key to note that given the changes in the composition of stores of the Company, historical performance does not reflect the annualized results from recently acquired liquor stores, and more recent periods do not include results from stores that have been sold or closed.

The following table shows the operating results of the Company for the three month period ending March 31, 2017 and 2016.

| Period | 3 months ending Mar 2017 | | 3 months ending Mar 2016 | |
|---|---|---|---|---|
| Sales | $ 8,781,529 | 100.00% | $ 9,543,365 | 100.00% |
| Gross margin | 2,152,461 | 24.51% | 2,303,893 | 24.14% |
| Operating and administrative expense | 2,530,931 | 28.82% | 2,579,737 | 27.03% |
| Operating Margin (1) | $ (378,470) | -4.31% | $ (275,844) | -2.89% |
| | | | | |
| Non-recurring Items (1) | - | 0.00% | - | 0.00% |
| Operating Margin before non-Recurring Items (1) | $ (378,470) | -4.31% | $ (275,844) | -2.89% |
| Annual Incentives (2) | - | 0.00% | - | 0.00% |
| Operating Margin before non-Recurring Items (1) and Annual Incentives (2) | $ (378,470) | -4.31% | $ (275,844) | -2.89% |
| Stores at Period End | 41 | | 43 | |

Notes:

(1) *Operating Margin and Operating Margin before non-recurring expenses has been calculated as described under "Non-IFRS Measures"*

(2) *Annual Incentives include bonuses paid to management and executives, and employee share savings plan benefits*

### *Sales*

Sales represent the combination of adult beverages including spirits, beer, and wine, with other ancillary products such as ice, juice, and mix.

Total sales for the three month period ended March 31, 2017 were $8.8 million. Sales are lower than the same quarter in 2016 by $761,836 due to the closure of one store in 2017 and the closure of one store in the prior year. As well, there has also been a slowdown in the economy in Alberta which has affected sales in certain rural markets where energy is the dominant industry.

### *Cost of Goods Sold and Gross Margin*

Margins have increased from 24.1% to 24.5% as compared to this quarter last year as the Company has taken advantage of lower cost products and promotions from suppliers.

### *Operating and Administrative Expenses*

The major expenses included in operating and administrative expenses are salaries, rents, and location costs such as utilities, property taxes, and insurance. Total operating and administrative expenses for the three month period ended March 31, 2017 were $2.53 million, compared to $2.58 million for the same period in 2016. The decrease is due to the closure stores in the current and prior year. As a percentage of sales, wages have increased 2% over the same period last year due to the minimum wage increase, lease and premise costs have decreased 9% as a result of store closures. Stores that closed had higher than average occupancy costs. Other costs have remained constant.

### *Finance Costs*

Interest on the bank loan and convertible debentures increased from $236,229 for the three months ending March 31, 2016 to $257,754 for the same period in 2017. The increase is due to the accretive interest charge as a result of the amended debenture terms. Actual interest paid is lower as the coupon rate on the debenture was reduced under its new terms, as discussed below.

## CONVERTIBLE DEBENTURES

In 2011 the Company issued a $9,200,000 unsecured subordinated convertible debenture ("the Debenture") due on April 30, 2016. On April 1, 2016 the Company announced that holders of the Debenture approved the proposed amendments extending the maturity date to April 30, 2021, reducing the conversion price to $0.25 from $0.50, and reducing the coupon rate to 7.50% from 7.75%.

On June 10, 2016 the Company redeemed $1,211,000 of the outstanding principal amount of the amended Debenture reducing it to $6,865,000.

On the Company's Consolidated Statements of Financial Position the balance of the Debenture at March 31, 2017 is $5,698,697. For accounting purposes the value of the convertible option was calculated and the difference was recorded as equity. The remaining liability for the Debentures will be increased to $6,865,000 over the five year term.

## FINANCING & CREDIT FACILITIES

On March 31, 2017 the Company had a bank agreement with lender, TD for a $10 million uncommitted, revolving demand credit facility. This agreement is not subject to any monitoring ratios. Current utilization of the facility is $9.5 million.

As of March 31, 2017, the Company had $496,991 of cash on hand, and the $10 million Facility was drawn at $9.2M. The Company pays interest at prime plus 1.25% or bankers' acceptances plus 2.75% per annum. At March 31, 2017 the Company has $5.0M of its bank loan in bankers' acceptances.

The interest rate on the convertible debenture is fixed at 7.5%.

The Company manages its interest rate risk through credit facility negotiations and by identifying upcoming credit requirements based on strategic plans.

## OFF BALANCE SHEET ARRANGEMENTS

There were no off-balance sheet arrangements as at March 31, 2017 or May 23, 2017.

## CRITICAL ACCOUNTING JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

There are no updates to the Company's critical accounting judgements, estimates and assumptions. For further discussion, refer to the Company's annual MD&A for the year ended December 31, 2016.

## CHANGES IN ACCOUNTING POLICIES

There were no new accounting standards adopted in the period. See Note 2 of the annual consolidated financial statements for the year ending December 31, 2016 for further information.

## DISCLOSURE CONTROLS AND PROCEDURES AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time periods specified under Canadian securities laws and include controls and procedures designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and the Chief Financial Officer, to allow timely decisions regarding required disclosure.

### Disclosure Controls and Procedures

There have been no changes in the design of the Company`s disclosure controls and procedures or internal control over financial reporting that occurred during period ended March 31, 2017 that have materially affected, or are a reasonably likely to materially affect the Company's disclosure controls and procedures or internal control over financial reporting.

a) The venture issuer is not required to certify the design and evaluation of the issuer's Disclosure Controls Procedures ("DC&P") and Internal Control over Financial Reporting ("ICFR") and has not completed such an evaluation; and

b) Inherent limitations on the ability of the certifying officers to design and implement on a cost effective basis DC&P and ICFR for the issuer may result in additional risks to the quality, reliability, transparency and timeliness of interim and annual filings and other reports provided under securities legislation.

## RISK FACTORS

The Company's results of operations, business prospects, financial condition, and the trading price of the Shares are subject to a number of risks. These risk factors include: impact due to economic conditions; regulated competitive environment; labour costs and labour market; impact from provincial tax increases; weather; supply interruption or delay; importance of information and control systems; reliance on key personnel; available financing; credit facility and financial instrument covenants; importance of inventory and EFC; market volatility and unpredictable share price; active trading market; cybersecurity and acquisition growth strategy and development risks.

For a discussion of these risks and other risks associated with an investment in Shares, see "Risk Factors" detailed in the Company's Management Discussion and Analysis dated April 24, 2017, which is available at www.sedar.com.

## NON-IFRS MEASURES

Operating margin for purposes of disclosure under "Operating Results" has been derived by subtracting Operating and Administrative expenses from Gross Margin. Operating margin as a percentage of sales is calculated by dividing operating margin by sales.

Operating margin before non-recurring items has been derived by adding non-recurring items to operating margin. Non-recurring items include costs incurred and recoveries received by the Company that are not part of on-going operations and that are not expected to recur. Operating margin before non-recurring items as a percentage of sales is calculated by dividing operating margin before non-recurring items by sales.

Operating margin operating margin as a percentage of sales and operating margin before non-recurring items are calculated in tables under sections "Operating Results – 3 Months"

EBITDA is defined as the net income of the Company plus the following: interest expense, provision for income taxes, depreciation, amortization, mark to market adjustments on financial instruments, non-cash items such as stock based compensation expense and issue costs of securities, deferred taxes, write down of goodwill, gain on repurchase of convertible debentures, gain / loss on disposal of stores and property and equipment, and other restructuring charges for store closures. EBITDA is also less any non-recurring extraordinary or one-time gains or losses from any capital asset sales. Management believes that, in addition to income or loss, EBITDA is a useful supplemental measure of performance.

| **Period** | **3 months ended Mar 2017** | **3 months ended Mar 2016** |
|---|---|---|
| Net comprehensive loss | (953,432) | $ (625,324) |
| Interest expense | 257,754 | 236,229 |
| Depreciation | 149,632 | 150,063 |
| Loss on disposal of property and equipment | 79,776 | 7,166 |
| Store closure expenses | 82,961 | - |
| Share based compensation | 6,244 | - |
| Gain on repurchase of convertible debenture | - | (40,213) |
| **EBITDA** | **$ (377,065)** | **$ (272,079)** |

Operating margin, operating margin as a percentage of sales, operating margin before non-recurring items, operating margin before non-recurring items as a percentage of sales and EBITDA are not measures recognized by IFRS and do not have a standardized meaning prescribed by IFRS. Investors are cautioned that operating margin, operating margin as a percentage of sales, and EBITDA should not replace net income or loss (as determined in accordance with IFRS) as an indicator of the Company's performance, of its cash flows from operating, investing and financing activities or as a measure of its liquidity and cash flows. The Company's method of calculating operating margin, operating margin as a percentage of sales, and EBITDA may differ from the methods used by other issuers. Therefore, the Company's operating margin, operating margin as a percentage of sales, and EBITDA may not be comparable to similar measures presented by other issuers.