PET VALU HOLDINGS LTD.

Consolidated Financial Statements

For the 52-week periods ended December 31, 2022 and January 1, 2022

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Pet Valu Holdings Ltd.,

Opinion

We have audited the consolidated financial statements of Pet Valu Holdings Ltd. and its subsidiaries (the Company), which comprise the consolidated statements of financial position as at December 31, 2022 and January 1, 2022, and the consolidated statements of income and comprehensive income, consolidated statements of shareholders' equity (deficit) and consolidated statements of cash flows for the periods then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as at December 31, 2022 and January 1, 2022, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards ["IFRS"].

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 are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada, and we have fulfilled our ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matter

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our auditor's opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the consolidated financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the consolidated financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the accompanying consolidated financial statements.

Key audit matter	How our audit addressed the key audit matter
Goodwill and indefinite life intangible assets impairment assessment	
As disclosed in Note 8, the company has goodwill and indefinite life intangible assets of $97.6M and $42.5M, respectively. Goodwill and indefinite life intangible assets must be tested for impairment at least annually, at the cash generating unit (CGU) or group of CGUs level. The determination of recoverable amount, being the value-in-use, requires the use of valuation models and significant judgement on the part of management. Recoverable amounts are based on management's view of variables and market conditions such as future cash flows and the most appropriate discount and growth rates. This matter has been considered as a key audit matter due to the level of judgment required to estimate the future cash flows, growth rates, and discount rates used in management's impairment assessment model.	To test the estimated recoverable amount, our audit procedures included, among others, assessing the valuation methodology and evaluating significant assumptions and the accuracy of underlying data used by management in its analysis. With the assistance of our valuation specialists, we evaluated the Company's model, valuation methodology, and significant assumptions, including the discount rate. We assessed the selection and application of the discount rate by evaluating the inputs and mathematical accuracy of the calculation. We assessed the historical accuracy of management's estimates on cash flow projections and growth rate by comparing management's past projections to actual and historical performance. We performed sensitivity analyses on the significant assumptions, including growth rate and discount rate, to evaluate changes in the recoverable amount that would result from changes in the assumptions.

Other information

Management is responsible for the other information. The other information comprises:

- Management's Discussion & Analysis
- The information, other than the consolidated financial statements and our auditor's report thereon, in the Annual Report.

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

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information 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.

We obtained Management's Discussion & Analysis prior to the date of the auditor's report. If, based on the work we have performed, 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.

The Annual Report is expected to be made available to us after the date of the auditor's report. If based on the work we will perform on this other information, we conclude there is a material misstatement of other information, we are required to report that fact 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.

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.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Stephanie Lamont, CPA, CA.

Ernst & Young LLP

Chartered Professional Accountants
Licensed Public Accountants

March 6, 2023
Toronto, Canada

PET VALU HOLDINGS LTD.

Consolidated Statements of Financial Position
(Expressed in thousands of Canadian dollars)

	Note	As at December 31, 2022	As at January 1, 2022
Assets			
Current assets:			
Cash		$ 63,034	$ 50,068
Accounts and other receivables	9	22,965	14,398
Inventories, net	10	118,410	91,699
Prepaid expenses and other assets		22,262	10,432
Current portion of lease receivables	5	29,827	26,621
Total current assets		256,498	193,218
Non-current assets:			
Long-term lease receivables	5	141,187	121,936
Right-of-use assets, net	5	82,242	80,757
Property and equipment, net	7	91,774	62,067
Intangible assets, net	8	52,280	37,359
Goodwill	6, 8	97,574	92,938
Deferred tax assets	14	6,652	5,601
Investment in associate	20, 21	4,708	2,179
Other assets		7,261	3,118
Total non-current assets		483,678	405,955
Total assets		$ 740,176	$ 599,173
Liabilities and Shareholders' Equity (Deficit)			
Current liabilities:			
Accounts payable and accrued liabilities	11	$ 103,782	$ 86,977
Income taxes payable	14	15,141	13,553
Current portion of deferred franchise fees	4	1,197	1,032
Current portion of lease liabilities	5	51,335	41,960
Current portion of long-term debt	12	17,750	8,875
Total current liabilities		189,205	152,397
Non-current liabilities:			
Long-term deferred franchise fees	4	4,017	3,183
Long-term lease liabilities	5	215,966	196,954
Long-term debt	12	320,063	336,621
Deferred tax liabilities	14	8,250	4,540
Other liabilities		2,299	—
Total non-current liabilities		550,595	541,298
Total liabilities		739,800	693,695
Shareholders' equity (deficit):			
Common shares	15	316,208	307,497
Contributed surplus		4,107	1,779
Deficit		(319,780)	(403,619)
Currency translation reserve		(159)	(179)
Total shareholders' equity (deficit)		376	(94,522)
Total liabilities and shareholders' equity		$ 740,176	$ 599,173

Commitments, contingencies and guarantees (Note 24)
Subsequent events (Note 26)

On behalf of the Board of Directors: *Anthony Truesdale (signed)*, Director

The accompanying notes are an integral part of these consolidated financial statements.

PET VALU HOLDINGS LTD.

Consolidated Statements of Income and Comprehensive Income
(Expressed in thousands of Canadian dollars, except per share amounts)

		Periods ended	
	Note	December 31, 2022	January 1, 2022 (Note 2(b))
Revenue:			
Retail sales	4	$ 402,586	$ 347,305
Franchise and other revenues	4	549,111	428,708
Total revenue		951,697	776,013
Cost of sales	17	599,400	488,834
Gross profit		352,297	287,179
Selling, general and administrative expenses	18	192,105	157,773
Total operating income		160,192	129,406
Interest expenses, net	13	20,478	46,873
Loss (gain) on foreign exchange	12	1,111	(42,560)
Other (income) loss	20	(68)	8
Income before income taxes		138,671	125,085
Income taxes expense	14	37,905	26,292
Net income		100,766	98,793
Less:			
Net income attributable to non-controlling interests	15	—	3,430
Net income attributable to the shareholders of the Company		100,766	95,363
Other comprehensive income, net of tax:			
Currency translation adjustments reclassified to net income	12	—	(29,665)
Currency translation adjustments that may be reclassified to net income, net of tax		20	21,082
Comprehensive income for the period attributable to the shareholders of the Company		$ 100,786	$ 86,780
Basic net income per share attributable to the common shareholders	16	$ 1.43	$ 1.36
Diluted net income per share attributable to the common shareholders	16	$ 1.40	$ 1.33

The accompanying notes are an integral part of these consolidated financial statements.

PET VALU HOLDINGS LTD.

Consolidated Statements of Shareholders' Equity (Deficit)
(Expressed in thousands of Canadian dollars)

For the period ended December 31, 2022	Common shares	Contributed surplus	Deficit	Currency translation reserve	Total
Balance, January 1, 2022	$ 307,497	$ 1,779	$ (403,619)	$ (179)	$ (94,522)
Net income	—	—	100,766	—	100,766
Exercise of share options (Note 15, 19)	8,711	(649)	—	—	8,062
Share-based compensation on option plans (Note 19)	—	2,977	—	—	2,977
Foreign currency translation	—	—	—	20	20
Dividends on common shares (Note 15)	—	—	(16,927)	—	(16,927)
Balance, December 31, 2022	$ 316,208	$ 4,107	$ (319,780)	$ (159)	$ 376

For the period ended January 1, 2022 (Note 2(b))	Common shares	Contributed surplus	Deficit	Currency translation reserve	Group's net investment	Non-controlling interests	Total
Balance, January 2, 2021	$ —	$ —	$ —	$ —	$ (588,530)	$ 118,986	$ (469,544)
Net income	—	—	51,090	—	44,273	3,430	98,793
Net distributions (Note 25)	—	—	—	—	(16,983)	—	(16,983)
Foreign currency translation	—	—	—	12	(8,595)	—	(8,583)
Capital reorganization (Note 15)	6,781	—	(454,009)	(191)	569,835	(122,416)	—
Issuance of common shares, net of issuance costs (Note 15)	300,653	—	—	—	—	—	300,653
Exercise of share options (Note 15)	63	—	—	—	—	—	63
Share-based compensation on option plans (Note 19)	—	1,779	—	—	—	—	1,779
Dividends on common shares (Note 15)	—	—	(700)	—	—	—	(700)
Balance, January 1, 2022	$ 307,497	$ 1,779	$ (403,619)	$ (179)	$ —	$ —	$ (94,522)

The accompanying notes are an integral part of these consolidated financial statements.

PET VALU HOLDINGS LTD.

Consolidated Statements of Cash Flows
(Expressed in thousands of Canadian dollars)

	Note	Periods ended December 31, 2022	January 1, 2022 (Note 2(b))
Cash provided by (used in):			
Operating activities:			
Net income for the period		$ 100,766	$ 98,793
Adjustments for items not affecting cash:			
Depreciation and amortization	5, 7, 8	38,073	33,714
Impairment of right-of-use assets	5	448	17
Deferred franchise fees		420	849
Gain on disposal of property and equipment		(1,561)	(1,016)
Loss on sale of right-of-use assets	5	793	117
Loss (gain) on foreign exchange	12	1,111	(42,560)
Gain on financial instruments	20, 21	(551)	—
Share-based compensation expense	19	6,248	2,199
Share of loss from associate	20	483	8
Interest expenses, net	13	20,478	46,873
Income taxes expense	14	37,905	26,292
Income taxes paid		(36,673)	(13,117)
Security deposits paid	24	(5,073)	—
Change in non-cash operating working capital:			
Accounts receivable		(6,834)	(1,181)
Inventories		(26,133)	(13,687)
Prepaid expenses		(8,194)	277
Accounts payable and accrued liabilities		1,818	581
Net cash provided by operating activities		123,524	138,159
Financing activities:			
Issuance of common shares, net of transaction costs	15	—	295,210
Proceeds from exercise of share options	15	8,062	63
Dividends paid on common shares	15	(16,927)	(700)
Proceeds of 2021 Term Facility	12	—	355,000
Repayment of 2021 Term Facility	12	(8,875)	(4,438)
Proceeds of 2021 Revolving Credit Facility	12	—	40,000
Repayment of 2021 Revolving Credit Facility	12	—	(40,000)
Repayment of 2016 Term Loans	12	—	(680,424)
Interest paid on long-term debt		(18,626)	(41,290)
Repayment of principal on lease liabilities	5	(43,212)	(46,640)
Interest paid on lease liabilities	5, 13	(11,853)	(11,557)
Financing costs	12	—	(6,589)
Standby letter of credit commitment fees	13, 14	(1,373)	(4,994)
Net distributions	25	—	(16,983)
Net cash used in financing activities		(92,804)	(163,342)
Investing activities:			
Business acquisition, net of cash acquired	6	(12,538)	—
Purchases of property and equipment	7	(38,833)	(23,787)
Purchase of intangible assets	8	(3,424)	(2,399)
Proceeds on disposal of property and equipment		3,643	5,167
Right-of-use asset initial direct costs		(2,157)	(2,275)
Tenant allowances		1,459	744
Notes receivable		950	(2,348)
Lease receivables	5	27,050	24,089
Interest received on lease receivables and other		8,703	6,974
Investment in associate	20	(2,178)	(2,174)
Net cash (used in) provided by investing activities		(17,325)	3,991
Effect of exchange rate on cash		(429)	(221)
Net increase (decrease) in cash		12,966	(21,413)
Cash, beginning of period		50,068	71,481
Cash, end of period		$ 63,034	$ 50,068

The accompanying notes are an integral part of these consolidated financial statements.

1. Description of business:

Pet Valu Holdings Ltd. and its subsidiaries (collectively referred to as the "Company") is a specialty retailer and wholesaler of pet food and pet-related supplies. As of December 31, 2022, the Company operates 225 corporate-owned stores (January 1, 2022 — 227) and has 519 franchise stores (January 1, 2022 — 406) in ten provinces in Canada.

The Company is incorporated under the *Business Corporations Act* (British Columbia). The Company's head office is located at 130 Royal Crest Court, Markham, Ontario, Canada.

The Company's common shares are listed on the Toronto Stock Exchange under the symbol “PET”.

2. Basis of presentation:

(a) Basis of presentation:

These consolidated financial statements ("financial statements") refer to the financial statements of the Company and include the accounts of the Company and its subsidiaries with intercompany transactions and balances eliminated. The Company has the following wholly-owned subsidiaries:

Subsidiaries
Pet Valu Canada Holding Corporation
Pet Holdings ULC
Pet Valu Canada Inc.
Les Franchises Chico Inc. (Note 6)
9353-0145 Quebec Inc. (Note 6)
Pet Retail Brands North America Holdings ULC
Pet Valu Management Services Inc.
Pet Retail Brands US Holdings LLC

(b) Carve-out:

On June 30, 2021, the Company completed an initial public offering of 15,812,500 common shares (the “Offering”), including 2,062,500 common shares issued pursuant to the exercise in full by the underwriters of the over-allotment option granted by the Company. The offering price of $20.00 per common share resulted in net proceeds to the Company of $299,647 after underwriting commissions of $16,603. The Company also incurred $4,437 of other incremental expenses directly associated to the Offering. The total net proceeds after underwriting fees and incremental expenses were $295,210. See Note 15 for further details on the impact to the Company’s share capital.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

2. Basis of presentation (continued):

Prior to the Offering, the Company was not operating as a stand-alone entity and as a result, the financial information for periods prior to June 30, 2021 are presented on a carve-out basis that includes only legal entities representing the Canadian operations of Pet Valu Holdings Ltd. (referred to as the “Group”, prior to the distribution of its U.S. operations to its shareholder).

These legal entities included in the Group are as follows:

Canadian Operations	U.S. Operations
Pet Valu Holdings Ltd.	Pet Retail Brands, Inc.
Pet Valu Canada Holding Corporation	Pet Valu, Inc.
Pet Holdings ULC	Pet Supermarket, Inc.
Pet Valu Canada Inc.	Pet Super Partners, LLC
Pet Valu Canada Franchising Inc.	West Pet Spa, LLC
Pet Retail Brands North America Holdings ULC	
Pet Valu Management Services Inc.	
Pet Retail Brands US Holdings LLC	

As the periods prior to June 30, 2021 represent a portion of the business of Pet Valu Holdings Ltd. that was not organized in a single legal entity, the net assets of the Company have been reflected as the Group’s net investment and non-controlling interests. Non-controlling interests represent perpetual preferred shares of a subsidiary of the Company issued to former common equity holders as a result of a group reorganization in 2016 (Note 15(a)). Transactions and balances between the Company and the Group are reflected as related party transactions within these financial statements. All intercompany balances and transactions within the Company have been eliminated.

These financial statements include the assets, liabilities, revenues, and costs that are directly associated with the business activities of the Company. In addition, for the periods prior to June 30, 2021, all of the Group’s U.S. dollar denominated Term Loans (Note 12) have been allocated to the Company from the Group’s U.S. dollar functional currency subsidiary, resulting in the majority of the currency translation adjustments being included in other comprehensive income. The Group's U.S. dollar denominated Term Loans were fully repaid on closing of the Offering.

Management believes the assumptions and the allocations in the financial statements for the periods prior to June 30, 2021 are reasonable. However, the amounts recorded for these transactions and allocations are not necessarily representative of the amount that would have been reflected in the financial statements had the Company operated independently of the Group. Accordingly, these financial statements may not be indicative of what the consolidated results of operations, consolidated financial position, or consolidated cash flows would have been had the Company been a stand-alone entity.

2. Basis of presentation (continued):

Immediately prior to the closing of the Offering, the Company distributed its U.S. operations to its shareholder, and as a result, the Company has no economic interest in the former subsidiaries with U.S. operations and any related indebtedness was extinguished.

The term “Company” is used through the financial statements and applies to either the entity pre-Offering or post-Offering.

All references to “$” or “dollars” are to the currency of Canada unless otherwise indicated.

(c) Fiscal period:

The Company operates under a 52- or 53-week fiscal year ending on the Saturday nearest to December 31. The 2022 and 2021 fiscal years are for the 52-week periods from January 2, 2022 to December 31, 2022 and January 3, 2021 to January 1, 2022, respectively.

(d) Statement of compliance:

These financial statements have been prepared by management in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”). The policies set out below have been consistently applied to all periods presented unless otherwise noted.

These financial statements were approved and authorized for issuance by the Board of Directors of the Company on March 6, 2023.

(e) Basis of measurement:

These financial statements have been prepared on a historical cost basis, unless otherwise stated.

The significant accounting policies set out below have been applied consistently in the preparation of the financial statements for the periods presented.

(f) Presentation currency:

The financial statements are presented in Canadian dollars, the Company’s functional currency, unless otherwise stated. All financial information presented in Canadian dollars has been rounded to the nearest thousand, unless otherwise stated.

2. Basis of presentation (continued):

(g) Use of estimates and judgments:

The preparation of the financial statements requires management to make various judgments and estimates in applying the Company's accounting policies that affect the reported amounts and disclosures made in the financial statements and accompanying notes.

These judgments and estimates are based on management's historical experience, knowledge of current events and conditions and other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Significant judgments and estimates made by management in the process of applying accounting policies and that have the most significant effect on the amounts recognized in the financial statements include the following:

(i) Inventory valuation:

Merchandise inventories are carried at the lower of cost and net realizable value. The estimation of net realizable value is based on the most reliable evidence available of the amount the merchandise inventories are expected to realize. If carrying value exceeds net realizable amount, a write-down is recognized. Additionally, estimation is required for inventory provisions due to shrinkage and obsolescence.

(ii) Impairment of non-financial assets:

The Company is required to use judgment in determining the grouping of assets to identify its cash-generating units ("CGUs") for the purpose of testing store related property and equipment, and right-of-use ("ROU") assets. Judgment is further required to determine appropriate groupings of CGUs for the level at which non-store related assets are tested for impairment, including intangible assets and goodwill. Furthermore, on a quarterly basis, judgment has been used in determining whether there has been an indication of impairment, which would require the completion of a quarterly impairment test, in addition to the annual requirement for goodwill and indefinite-life intangible assets.

The Company's estimate of a CGU's or group of CGUs' recoverable amount is based on value in use ("VIU") and involves estimating future cash flows.

VIU is determined based on the Company's assumptions regarding future events, future cash flow projections, growth rates and discount rates.

2. Basis of presentation (continued):

(iii) Share-based compensation:

The Company measures the value of equity-settled transactions with employees by reference to the fair value of the equity instruments at the date on which they are granted. Estimating fair value for share-based compensation requires determining the most appropriate valuation model for a grant of equity instruments, which is dependent on the terms and conditions of the grant. The Company is also required to determine the most appropriate inputs to the valuation model, including estimates and assumptions with respect to expected life, risk-free interest rate, volatility, distribution yield, and forfeiture rate.

The Company makes estimates to determine the fair value of performance based cash-settled awards. These significant estimates include the estimation of the Company's share price, volatility, expected market conditions and future financial performance of the Company.

(iv) Leases:

The Company has applied judgment to determine the lease term for lease contracts that include renewal or termination options. The assessment of whether the Company is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and ROU assets recognized (Note 5).

The Company is required to estimate the incremental borrowing rates used to discount lease liabilities if the interest rate implicit in the lease is not readily determined. In determining the incremental borrowing rates, management considers the Company’s creditworthiness, the term of the leased asset and Canadian corporate bond yields for companies of a similar credit rating as the Company (Note 5).

(v) Provisions:

The Company reviews provisions at each reporting date using judgments to determine the probability that an outflow of economic resources will result from the legal or constructive obligation and an estimate of the associated obligation. Due to the judgmental nature of these items, future settlements may differ from amounts recognized.

(vi) Income taxes:

In calculating current and deferred income and other taxes, the Company uses judgment when interpreting the tax rules in jurisdictions where the Company operates. The Company also uses judgment in classifying transactions and assessing probable outcomes of claimed deductions, which considers expectations of future operating results, the timing and reversal of temporary differences and possible audits of income tax and other tax filings by tax authorities (Note 14).

2. Basis of presentation (continued):

(vii) Control, joint control, or level of influence:

When determining the appropriate basis of accounting for the Company's interest in affiliates, the Company makes judgments about the degree of influence that it exerts directly or through an arrangement over the investees' relevant activities (Note 20).

(viii) Business combinations:

The Company uses judgment in applying the acquisition method of accounting for business combinations and estimates to value identifiable assets and liabilities at the acquisition date. The Company may engage independent third parties to determine the fair value of inventory, property and equipment and intangible assets. Assumptions and estimates are used to determine cash flow projections, including the period of future benefit, future growth and discount rates, among other factors. The values placed on the acquired assets and liabilities assumed affect the amount of goodwill recorded on an acquisition.

(ix) Fair value measurements:

Certain financial assets are measured at fair value. In estimating fair value, the Company uses market-observable data to the extent it is available. In certain cases where market-observable data is not available, the Company will engage third-party qualified valuation specialists to perform the valuation. Information about the valuation techniques and inputs used in determining the fair value of financial instruments is disclosed in Note 21.

3. Significant accounting policies:

(a) Principles of consolidation:

The financial statements incorporate the financial statements of the Company and legal entities controlled by the Company and its subsidiaries. The Company determines control based on its ability to exercise power that significantly affects the entities’ relevant day-to-day activities. Control is also determined by the Company’s exposure to the variability in returns on investment in the entity, whether favourable or unfavourable. Furthermore, control is defined by the Company's ability to direct the decisions made by the entity that ultimately impact return on investment. The existence and effect of substantive voting rights are considered when assessing whether the Company controls another entity. Subsidiaries are fully consolidated from the date on which control is determined, and they are unconsolidated from the date on which control is deemed to have ceased. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies. All intercompany balances, transactions, unrealized gains and losses resulting from intercompany transactions and dividends are eliminated in full.

3. Significant accounting policies (continued):

(b) Foreign currency:

Each of the Company's operating subsidiaries maintains its accounting records in its functional currency.

(i) Foreign currency transactions:

Transactions carried out in foreign currencies are translated into functional currency using the exchange rate prevailing at the transaction date. Monetary assets and liabilities denominated in a foreign currency at the reporting date are translated at the exchange rate at that date. Foreign currency denominated non-monetary assets and liabilities are measured at the historical exchange rate prevailing at the transaction date. Realized and unrealized foreign currency gains or losses are recognized as income or expense for the period, specifically as (gain) loss on foreign exchange in the consolidated statements of income and comprehensive income.

(ii) Foreign currency translation:

If the functional currency of an entity included in these financial statements is not Canadian dollars, their financial statements are translated into Canadian dollars using the current rate method. Assets and liabilities are translated using the end-of-period exchange rates. Income and expenses are translated at the average exchange rates for each period. Equity accounts are translated at historical foreign exchange rates. Foreign currency differences on translation are reported as a component of shareholders' equity in the financial statements.

(c) Business combinations:

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, which is measured at acquisition date fair value, and the amount of any non-controlling interests in the acquiree. 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 financial statements from the date of the business acquisition. Acquisition-related costs are expensed as incurred and included in selling, general and administrative expenses.

When the Company acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

3. Significant accounting policies (continued):

The purchase price allocation may be provisional during a measurement period of up to one year to provide reasonable time to obtain the information necessary to identify and measure the assets acquired and liabilities assumed. Measurement period adjustments are recognized in the period in which the adjustment amount is determined and adjustments to fair values and allocations are retrospectively adjusted.

When the consideration transferred by the Company in a business combination includes liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition date fair value and included as part of the consideration transferred in a business combination. Contingent consideration that is classified as a liability is remeasured at subsequent reporting dates at fair value with the corresponding gain or loss being recognized in the consolidated statements of income and comprehensive income.

(d) Investment in associates:

Associates are entities over which the Company has significant influence. Significant influence is assumed when the Company has 20%-49% ownership interest, unless qualitative factors overcome this assumption. In addition, potential voting rights that are currently exercisable are taken into account.

Investments in associates are accounted for under the equity method and initially recognized at cost including transaction costs. After initial recognition, the financial statements include the Company’s share of the profit or loss and other comprehensive income of the associate, after aligning with the accounting policies of the Company, until the date on which significant influence ceases.

The entire carrying amount of the investment is assessed for indicators of impairment at each reporting date. An impairment test is performed when there is objective evidence of impairment, such as significant adverse changes in the environment in which the associate operates or a significant or prolonged decline in the fair value of the investment below its carrying amount. An impairment loss is recorded when the recoverable amount becomes lower than the carrying amount.

(e) Inventories and cost of sales:

Inventories are valued at the lower of cost and net realizable value as determined by the first-in, first-out basis and consist of merchandising inventories. Net realizable value is the estimated selling price of inventory during the normal course of business less estimated selling expenses.

If carrying value exceeds net realizable amount, a write-down is recognized. The write-downs are reversed if the circumstances that caused the initial write-down no longer exist. In addition, as part of inventory valuations, the Company accrues for inventory shrinkage for lost or stolen items based on historical trends, and obsolescence as applicable.

3. Significant accounting policies (continued):

Cost of sales reflects the direct cost of merchandise plus purchasing, warehousing, distribution, depreciation expense for store ROU assets and distribution centre assets and occupancy costs related to store operations, such as variable lease payments and general store maintenance.

(f) Property and equipment:

The Company's property and equipment are measured at cost less accumulated depreciation and impairment losses, with the exception of land, which is held at historical cost.

The cost of an item of property and equipment includes expenditures that are directly attributable to the acquisition or construction of the asset. During their construction, items of property and equipment are classified as construction-in-progress. When the asset is available for use, it is transferred from construction-in-progress to the appropriate category of property and equipment and depreciation on the item commences.

Depreciation is recorded on a straight-line basis over the estimated useful lives as outlined below:

Category	Useful life
Buildings	Up to 25 years
Leasehold improvements	Shorter of remaining lease term or estimated useful life of improvement
Furniture, fixtures and equipment	3 – 10 years

The Company assesses an asset's residual value, useful life and depreciation method on an annual basis and adjusts if appropriate.

Gains and losses on disposal of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of the property and equipment and are recognized in the consolidated statement of income and comprehensive income.

(g) Leases:

At inception of a contract, the Company assesses whether a contract is, or contains, a lease based on whether the contract conveys the right of control for the use of an identified asset for a period of time in exchange for consideration. The Company recognizes an ROU asset and a lease liability at the lease commencement date, which is the date the leased asset is available for use. The ROU asset is primarily composed of leased premises for corporate-owned stores, office space, and distribution centres, as well as leased vehicles, and material handling equipment. The ROU asset is initially measured based on the initial amount of the lease liability. The lease liabilities include the net present value of the following lease payments:

3. Significant accounting policies (continued):

(i) fixed payments (including any in-substance fixed payments, less any lease incentives receivable);

(ii) variable lease payments that are based on an index or a rate;

(iii) amounts expected to be payable by the lessee under residual value guarantees; and

(iv) exercise price of any purchase option if the Company is reasonably certain to exercise that option.

The ROU assets are depreciated to the earlier of the end of the useful life of the ROU asset or the lease term using the straight-line method as this most closely reflects the expected pattern of the consumption of the future economic benefits.

The lease term includes periods covered by an option to extend if the Company is reasonably certain to exercise that option. In addition, the ROU asset can be periodically reduced by impairment losses, if any, and adjusted for certain remeasurement of the lease liability.

Lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the Company's incremental borrowing rate, which is the rate the Company would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions.

ROU assets are measured at cost, comprising the amount of the initial measurement of the lease liability, plus any lease payments made at or before the commencement date less any lease incentives received, plus any initial direct costs, and restoration costs.

The lease liability is classified and accounted for at amortized cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate, if there is a change in the Company's estimate of the amount expected to be payable under a residual value guarantee, or if the Company changes its assessment of whether it will exercise a purchase, extension or termination option. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the ROU asset unless it has been reduced to zero. Any further reduction in the lease liability is then recognized in profit or loss.

A lease modification will be accounted for as a separate lease if the modification increases the scope of the lease by adding the right to use one or more underlying assets and if the consideration for the lease increases by an amount commensurate with the stand-alone price for the increase in scope. For a modification that is not a separate lease or where the increase in consideration is not commensurate, the Company remeasures the lease liability with a corresponding adjustment to the ROU asset.

3. Significant accounting policies (continued):

The Company enters into head lease agreements for most of its franchise store locations and, in turn, enters into a sublease with its franchisees. The Company, as an intermediate lessor, classifies a sublease by reference to the ROU asset arising from the head lease, rather than by reference to the underlying asset.

To classify each lease, the Company makes an overall assessment of whether the lease transfers substantially all of the risks and rewards incidental to ownership of the ROU asset. If this is the case, then the lease is accounted for as a net investment in finance lease. If not, then it is an operating lease. As part of this assessment the Company considers certain indicators such as whether the lease is for the major part of the economic life of the ROU asset.

The Company has assessed its subleases to franchisees as a net investment in finance lease, which are included in lease receivables on the consolidated statements of financial position.

When the Company enters into a sublease, the Company:

(i) derecognizes the ROU asset relating to the head lease that it transfers to the sublessee and recognizes the lease receivable;

(ii) recognizes any difference between the ROU asset and the lease receivable in profit or loss; and

(iii) retains the lease liability relating to the head lease in its consolidated statements of financial position, which represents the lease payments owed to the head lessor.

The Company recognizes finance income on the lease receivables using the effective interest method.

Lease receivables for the franchise store subleases were measured at the present value of the lease payments from the franchisee discounted using the incremental borrowing rate on the head lease.

(h) Intangible assets and goodwill:

Intangible assets acquired are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortization and accumulated impairment losses.

3. Significant accounting policies (continued):

The useful lives of intangible assets are assessed as either finite or indefinite. Intangible assets with indefinite useful lives consist of trade names, which are not amortized, but are tested for impairment annually at the CGU level. The assessment of indefinite life is reviewed annually to determine whether the indefinite life continues to be supportable. The Company currently plans to continue operating under the Pet Valu and Chico (Note 6) trade names, and therefore these assets are assessed as having an indefinite useful life. If not, the change in useful life from indefinite to finite is made on a prospective basis.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Company's share of the identifiable assets acquired and liabilities assumed in a business combination. Goodwill is measured at cost less any accumulated impairment and is not amortized.

Intangible assets with finite lives consist of the franchise agreements, software, and other intellectual property including trade names and non-compete agreements. These assets are amortized on a straight-line basis over their useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed on an annual basis. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are considered to modify the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in the consolidated statements of income and comprehensive income in selling, general and administrative expenses.

Estimated useful lives are as follows:

Category	Useful life
Franchise agreements	9 – 10 years
Software	3 – 10 years
Other (trade names and non-compete agreements)	3 – 10 years
Pet Valu and Chico trade name	Indefinite
Goodwill	Indefinite

An intangible asset is derecognized upon disposal (i.e., at the date the recipient obtains control) or when no future economic benefits are expected from its use or disposal. Any gain or loss arising upon derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the consolidated statements of income and comprehensive income.

3. Significant accounting policies (continued):

(i) Impairment of non-financial assets:

Non-financial assets with finite lives are tested for impairment at each reporting date whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Goodwill and indefinite-life intangible assets are tested for impairment at least annually in the fourth quarter of the year, and whenever there is an indication that the asset may be impaired.

The Company considers indicators that include, but are not limited to: a history of operating losses at the individual store level; expected future cash flows from a retail location that are not expected to recover the remaining carrying value of the assets of the location; significant negative industry or economic trends; knowledge of transactions involving the sale of similar assets at amounts below their carrying value; and expectations to dispose of non-financial assets before the end of their estimated useful lives.

An impairment loss is immediately recognized in profit or loss by the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is based on the greater of the CGU's fair value less cost to sell ("FVLCS") and its VIU. The VIU is the present value of estimated future cash flows, using an after-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. The FVLCS is the amount for which an asset or CGU can be sold in a transaction under normal market conditions between knowledgeable and willing contracting parties, less costs to sell.

For purposes of measuring recoverable amounts, store assets that include store property and equipment and ROU assets, are grouped at the lowest levels for which there are largely independent cash inflows, which is referred to as a CGU. For the Company, that is at the individual store level.

The Company's non-store related assets, which include goodwill and intangible assets do not generate separate cash inflows. If there is an indication that a non-store related asset may be impaired, then the recoverable amount is determined at the corporate level which is the lowest level that these assets are monitored for internal management purposes.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the lesser of the revised estimate of recoverable amount and the carrying amount that would have been recorded had no impairment loss been recognized previously. An impairment loss in respect of goodwill is not reversed.

3. Significant accounting policies (continued):

(j) Income taxes:

Income taxes have been recorded at statutory rates based on income reported in these financial statements. Income taxes payable in respect of the components that were not historically separate tax-paying legal entities have been included in income taxes payable. In addition, deferred taxes have been recognized to the extent that they would have been realized if the company were a separate tax-paying entity as represented in these financial statements.

Income taxes expense (recovery) comprises current and deferred income taxes. Current income taxes and deferred income taxes are recognized in net income for the period, except for items recognized directly in equity or in other comprehensive income.

Current income tax is the expected tax payable on the taxable income or net income for the period, using tax rates enacted or substantively enacted at the reporting date.

Deferred income tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred income tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred income tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

(k) Financial instruments:

Financial assets and financial liabilities are recognized when the Company becomes a party to the contractual provisions of the instruments. All financial instruments are initially measured at fair value.

3. Significant accounting policies (continued):

Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss ("FVTPL")) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at FVTPL are recognized immediately in net income on the consolidated statements of income and comprehensive income.

(i) Financial assets:

On initial recognition, a financial asset is classified as measured at amortized cost, fair value through other comprehensive income (“FVOCI”), or FVTPL. The classification of financial assets is based on the business model in which a financial asset is managed and its contractual cash flow characteristics.

A financial asset is measured at amortized cost if it meets both of the following conditions and is not designated as at FVTPL:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A financial asset (unless it is a trade receivable without a significant financing component that is initially measured at the transaction price) is initially measured at fair value plus, for an item not at FVTPL, transaction costs that are directly attributable to its acquisition.

The following accounting policies apply to the subsequent measurement of financial assets.

Financial assets classified as FVTPL are measured at fair value with any resultant gain or loss recognized in profit or loss. Financial assets classified as FVOCI are measured at fair value with any subsequent remeasurement recognized in other comprehensive income. When FVOCI financial assets that are not considered equity investments are derecognized, the cumulative gain or loss previously recognized directly in equity is recognized in profit or loss. Financial assets not designated at FVTPL and held to maturity are measured at amortized cost using the effective interest rate method.

(ii) Financial liabilities:

The Company classifies its financial liabilities as either financial liabilities at FVTPL or amortized cost. Subsequent to initial recognition, other liabilities are measured at amortized cost using the effective interest method. Financial liabilities at FVTPL are stated at fair value with changes being recognized in profit or loss.

3. Significant accounting policies (continued):

(iii) Classification of financial instruments:

The Company classifies its financial assets and liabilities depending on the purpose for which the financial instruments were acquired, their characteristics and management intent as outlined below:

	Classification
Financial assets:	
Cash	Amortized cost
Accounts and other receivables	Amortized cost
Notes receivable	Amortized cost
Lease receivables	Amortized cost
Call option	FVTPL
Financial liabilities:	
Accounts payable and accrued liabilities	Amortized cost
Lease liabilities	Amortized cost
Long-term debt	Amortized cost

(iv) Impairment of financial assets:

At the end of each reporting period, the Company applies the expected credit loss ("ECL") model to assess for impairment of financial assets measured at amortized cost. The Company’s financial assets measured at amortized cost and subject to the ECL model consist primarily of franchise receivables, trade and other receivables, notes receivable, and lease receivables. The Company applies the simplified approach to impairment for franchise receivables, trade and other receivables, and lease receivables by recognizing lifetime expected losses. Lifetime ECL represents the ECL that will result from all probable default events over the expected life of a financial asset. The allowance for ECLs is recorded against the financial assets and the net change in the allowance for ECLs is recorded in net income. For notes receivable, the Company has applied the general ECL model. Under this model, when credit risk is assessed as being low or when there has not been a significant increase in credit risk since initial recognition, the ECL is determined based on the expected losses over the expected life arising from loss events that could occur during the 12 months following the reporting date. If a significant increase in credit risk has occurred throughout a reporting period, impairment is based on lifetime ECL.

3. Significant accounting policies (continued):

For franchise receivables, trade and other receivables, notes receivable, and lease receivables, the Company has established a provision matrix that considers the probability of default based on historical credit loss experience, adjusted for forward-looking factors specific to franchisees, vendors, landlords, and macroeconomic conditions. Additionally, the probability of default on franchise receivables, notes receivable, and lease receivables is assessed through regular monitoring of store performance and review of franchisee payment history. In assessing ECL, the Company also considers the expected loss given default including the available collateral such as leasehold improvements, ROU assets, store inventory and personal guarantees, where applicable, that are pledged in the franchise and sub-lease agreements.

Franchise receivables, trade and other receivables, notes receivable, and lease receivables are considered in default when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a franchisee, vendor, or landlord to engage in a repayment plan with the Company, a failure to make payments for a period of greater than 180 days past due, and no remaining vendor payments or head lease payments to offset against the trade or other receivables. On this basis, the Company has assessed the risk of default to be minimal.

(v) Derecognition:

A financial asset is derecognized when the contractual rights to the cash flows from the asset expire or when the Company transfers the financial asset to another party without retaining control or substantially all the risks and rewards of ownership of the asset. Any interest in transferred financial assets created or retained by the Company is recognized as a separate asset or liability.

A financial liability is derecognized when its contractual obligations are discharged, cancelled, or expire.

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

(l) Revenue recognition:

(i) Retail sales:

The Company’s retail sales include corporate-owned store retail and e-commerce merchandise sales as well as in-store grooming services.

Revenue is recognized for corporate-owned store sales when control passes, which occurs at a point in time when the customer completes a transaction in the store and receives the merchandise.

3. Significant accounting policies (continued):

The Company’s e-commerce operation recognizes revenue when delivery has been completed to the customer.

The Company recognizes revenue for in-store pet grooming services once the service is completed, as this is when the customer has the ability to direct the use of and obtain the benefits of the service.

Retail sales are presented net of indirect tax collected from the customer on behalf of government authorities. Payment terms for all retail sales are at the point of sale.

Retail sales revenue is recognized net of sales discounts and net of an estimated sales return reserve. The Company’s sales return policy is generally limited to 30 days and historically has been immaterial. The sales return reserve reflects an estimate of sales returns based on projected merchandise returns determined using historical average return percentages.

The Company administers frequent buyer loyalty programs. These loyalty programs represent a material right to the customer that may be redeemed on future products and services. A portion of revenue from products or services sold that have an associated free-unit loyalty program is deferred based on an estimate of the amount to be earned and the likelihood of the customer reaching the threshold of earning the associated reward (a free product). For certain vendor-supported free-unit loyalty programs, the Company receives reimbursement from the vendor for the cost of the free-unit redeemed by the customer. A portion of the costs from products sold that have an associated vendor-supported free-unit loyalty program is deferred based on an estimate of the amount to be earned and the likelihood of the customer reaching the threshold of earning the associated reward. The expected redemption percentage for all frequent buyer loyalty programs is based on historical redemption patterns and incorporates current information or trends. The revenue previously deferred is recognized when the points or free-unit rewards are redeemed or expire. Depending on the loyalty program type, free-unit rewards expire between 12 and 36 months from the date of issuance.

The Company administers gift card programs. Customer purchases of gift cards are recorded as liabilities and revenue is recognized when the gift card is redeemed through merchandise purchases. If redemption occurs at a franchisee owned store, the gift card funds are remitted to the franchisee. Gift cards do not carry an expiration date; therefore, customers can redeem their gift cards for merchandise indefinitely. Management reviews unredeemed gift cards and recognizes revenue for these amounts when it is determined the likelihood of redemption is remote.

(ii) Franchise revenues:

Franchise revenues include both one-time and ongoing amounts, consisting mostly of initial and renewal franchise fees, royalties, percentage rent and common area maintenance and realty tax revenues from properties subleased to franchisees, wholesale sales, promotion fees, and fees for services.

3. Significant accounting policies (continued):

Franchise agreements grant individual franchisees the exclusive right to operate a franchise store within a designated territory. The franchise agreements typically provide for a 10-year initial term, with an opportunity to enter into one or more renewal franchise agreements subject to certain conditions. The franchise agreement requires the Company to perform various activities to support the brand and/or franchisees and these activities represent a single performance obligation.

Initial franchise fees for the licence to operate a franchise store are paid in advance at signing and are deferred as a contract liability and recognized as revenue on a straight-line basis over the applicable franchise agreement term as the Company satisfies its performance obligation per the terms of such franchise agreement.

Franchise royalties are variable consideration based on a percentage of the franchisees' retail sales, which are recognized in the period the franchisees' underlying sales occur and are not included in the initial franchise fee.

Percentage rent is calculated based on a percentage of the franchisees' retail sales that exceeds base rent collected on the lease receivable and is included in royalties and sub-lease revenues (Note 4).

Wholesale sales represent sales of merchandise from the Company's warehouses to franchisees and are recognized at the time of delivery, as title has passed and the Company has transferred possession to the franchisee. Canadian franchisees purchase most of their wholesale inventory from the Company.

Promotion fees represent charges to franchisees to fund system-wide or regional advertising campaigns, under the terms of the franchise agreements. These fees are variable consideration based on a percentage of the franchisees' retail sales and are recognized in the period the franchisees' underlying sales occur and are not included in the initial franchise fee.

Fees for services provided by the Company to a franchisee are recognized when the service has been performed as this is when the franchisee has the ability to direct the use of and obtain the benefits of the service. Fees collected in advance are deferred until earned.

On the sale of an existing corporate-owned store to a franchisee, costs relating to the sale of the store are charged to expense as incurred and proceeds (excluding fees) in excess of the net book value of store assets sold to the franchisee are recorded as a gain on the date of sale and are included in selling, general and administrative expenses.

The Company does not incur a significant amount of contract acquisition costs in conducting its franchising activities. The Company's franchising arrangements do not contain a significant financing component.

3. Significant accounting policies (continued):

(m) Share capital:

The Company's common shares are classified as shareholders' equity. Incremental costs directly attributable to the issuance of common shares are shown in equity as a deduction, net of tax, from the proceeds of the issuance. When common shares are re-purchased for cancellation, the amount of consideration paid, which includes directly attributable costs, net of tax, is recognized as a deduction from equity. The excess of the purchase price over the carrying amount of the shares is charged to deficit or retained earnings.

(n) Dividends:

Dividends declared and payable to the Company's common shareholders are recognized as a liability in the consolidated statements of financial position in the period in which the dividends are approved by the Company's Board of Directors.

(o) Share-based compensation:

(i) Amended and Restated Share Option Plan and long-term incentive plan:

The Company has an Amended and Restated Share Option Plan (formerly referred to as the Legacy Option Plan or the Legacy Plan) pursuant to which it has granted share options to current and former directors and employees. Concurrent with the Offering, the Company amended and restated the Amended and Restated Share Option Plan so that no additional awards could be made under this plan, but share options previously granted under the this plan continue to remain outstanding in accordance with their terms and will continue to be governed by the provisions of the Amended and Restated Share Option Plan.

Following the amendment of the Amended and Restated Share Option Plan, the Company adopted a long-term incentive plan (the "LTIP") pursuant to which it can grant awards of share options, restricted share units ("RSUs"), and performance share units ("PSUs") to eligible participants. Share options are accounted for as equity-settled share-based awards at the option of the Company. RSUs and PSUs are accounted for as cash-settled awards.

Equity-settled awards:

The Black-Scholes option pricing model is used to value share options, which requires the use of subjective assumptions. These assumptions include the estimated length of time employees will retain their share options before exercising (the "expected term"), the expected volatility of the Company's common share price over the expected term, the risk-free interest rate, the forfeiture rate, and the dividend yield. Share-based compensation cost for service awards with multiple vesting provisions is recognized over the employee's requisite service period on a graded vesting basis. Share-based compensation expense is recognized in selling, general and administrative expenses with a corresponding increase in contributed surplus. Any consideration paid by plan participants on the exercise of share options is credited to common share capital.

Upon the exercise of share options, the corresponding amounts previously credited to contributed surplus are transferred to share capital.

3. Significant accounting policies (continued):

Cash-settled awards:

RSUs and PSUs are grants of notional common shares that are redeemable for cash based on the market value of the Company's common shares and are non-dilutive to common shareholders. RSUs and PSUs are initially measured based on the market value of the Company's common shares at the date of grant and if applicable, consider the expected achievement of performance conditions. The grant-date fair value is recognized as share-based compensation expense with a corresponding increase recorded in other liabilities for the proportion of the service that has been rendered at that date. RSUs and PSUs are remeasured at each reporting date based on the market value of the Company's common shares and if applicable, consider the expected achievement of performance conditions, with changes in fair value recognized as share-based compensation expense for the proportion of the service that has been rendered at that date.

(ii) Deferred share unit plan:

In connection with the Offering, the Company adopted a deferred share unit plan (the "DSU Plan") for non-employee board members. Each eligible director receives a portion of his or her annual director retainer in deferred share units ("DSUs"). The cash portion of the retainer is paid on a quarterly basis. The DSU portion of the retainer is granted on an annual basis based on the market price of the Company's common shares on the date of such grant and vests in four equal installments on a quarterly basis. DSUs may only be redeemed when a director ceases to be a member of the Board. DSUs issued by the Company under the DSU Plan are settled in cash and are accounted for as cash-settled awards. The cost of the service received as consideration is initially measured based on the market price of the Company's common shares at the date of grant. Deferred share units are remeasured at each reporting date based on the market price of the Company's common shares with changes in fair value recognized as share-based compensation expense for the proportion of the service that has been rendered at that date.

(p) Provisions:

Provisions are recognized when there is a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense.

3. Significant accounting policies (continued):

(q) Advertising and promotion fund:

Pursuant to the franchise agreements, the Company and its franchisees typically contribute 2.5% of their weekly store merchandise sales to a promotion fund. This fund is used to carry out marketing and advertising activities. Advertising contributions received from franchisees are included in franchise and other revenues, and advertising expenses are included in selling, general and administrative expenses in the consolidated statements of income and comprehensive income.

(r) Other comprehensive income:

Other comprehensive income refers to revenue, expenses, gains and losses that are included in comprehensive income, but are excluded from net income as these amounts are recorded directly as an adjustment to shareholders' equity. Other comprehensive income comprises unrealized gains and losses on foreign currency translation adjustments.

(s) Net income per share:

Basic net income per share is calculated by dividing the net income for the period attributable to shareholders of the Company by the weighted average number of common shares outstanding during the period.

Diluted net income per share is calculated by dividing the net income, adjusted for the effects of dilutive options and share units if applicable, for the period attributable to shareholders of the Company by the weighted average number of common shares outstanding during the period, plus the weighted average number of common shares that would be issued on exercise of dilutive options and share units granted, as calculated under the treasury stock method.

(t) New standards and interpretations adopted in the period:

In May 2020, the IASB issued the package of narrow-scope amendments to three standards (IFRS 3, *Business Combinations*, IAS 16, *Property, Plant and Equipment*, and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*) as well as the IASB's Annual Improvements 2018 - 2020, which are changes that clarify the wording or correct minor consequences, oversights or conflicts between requirements in the standards. These amendments are effective for annual periods beginning on or after January 1, 2022. These amendments had no impact on the financial statements of the Company.

In May 2021, the IASB amended IAS 12, *Income Taxes.* The narrow-scope amendments specify treatment of the initial recognition exception under IAS 12, *Income Taxes*, so that it no longer applies to transactions that give rise to equal taxable and deductible temporary differences. The amendments are effective for annual reporting periods beginning on or after January 1, 2023. The Company has early adopted the amendments for the period ended December 31, 2022 and this had no significant impact on the financial statements of the Company.

3. Significant accounting policies (continued):

(u) New standards and interpretations not yet adopted:

In January 2020, IASB issued *Classification of Liabilities as Current or Non-current*, which amends IAS 1, *Presentation of Financial Statements*. The narrow-scope amendments affect only the presentation of liabilities in the statement of financial position and not the amount or timing of its recognition. It clarifies that the classification of liabilities as current or non-current is based on rights that are in existence at the end of the reporting period and specifies that classification is unaffected by expectations about whether an entity will exercise its right to defer settlement of a liability. It also introduces a definition of “settlement” to make clear that settlement refers to the transfer to the counterparty of cash, equity instruments, other assets or services. In October 2022, the IASB issued further amendments to IAS 1, *Presentation of Financial Statements*, that aim to improve the information companies provide about long-term debt with covenants. The amendments to IAS 1 specify that covenants to be complied with after the reporting date do not affect the classification of debt as current or non-current at the reporting date. Instead, the amendments require a company to disclose information about these covenants in the notes to the financial statements. The amendments are effective for annual reporting periods beginning on or after January 1, 2024. Earlier application is permitted. The Company is currently assessing the potential impact of these amendments.

In February 2021, the IASB amended IAS 1, *Presentation of Financial Statements* and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The narrow-scope amendments will help improve accounting policy disclosure and distinguish changes in accounting estimates from changes in accounting policies. The amendments are effective for annual reporting periods beginning on or after January 1, 2023. Earlier application is permitted. These amendments are not expected to have an impact on the Company’s financial statements

In September 2022, the IASB issued *Lease Liability in a Sale and Leaseback*, which amends IFRS 16, *Leases.* The narrow scope amendments add to requirements explaining how to account for a sale and leaseback after the date of the transaction. These amendments will not change the accounting for leases other than those arising in a sale and leaseback transaction. The amendments are effective for annual reporting periods beginning on or after January 1, 2024. Earlier application is permitted. These amendments are not expected to have an impact on the Company’s financial statements.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

4. Revenue:

The following table disaggregates the Company's retail sales and franchise revenue by category for the periods ended December 31, 2022 and January 1, 2022:

	December 31, 2022	January 1, 2022
Retail sales:		
Merchandise sales	$ 398,117	$ 343,730
In-store services	4,469	3,575
Total retail sales	402,586	347,305
Franchise and other revenues:		
Wholesale merchandise sales	432,089	339,167
Royalties and sub-lease revenues	88,608	69,885
Franchise contributions for advertising and other services	28,414	19,656
Total franchise and other revenues	549,111	428,708
Total revenue	$ 951,697	$ 776,013

The changes in the Company's contract liabilities for the period ended December 31, 2022 are as follows:

	Beginning balance	Acquired through business acquisition (Note 6)	Recognition of revenue included in beginning balance (1)	Contract liability, net of revenue, recognized during the period (2)	Ending balance
Franchise fees	$ 4,215	$ 418	$ (1,129)	$ 1,710	$ 5,214
Loyalty programs (Note 11)	6,780	—	(6,780)	8,050	8,050
Gift cards (Note 11)	1,648	—	(488)	617	1,777

(1) Includes franchise fees recognized in revenue, redemptions of loyalty rewards and gift cards, and estimated gift card breakage.

(2) Includes franchise fees on new or renewed franchise agreements, issuances of loyalty rewards, and activation of gift cards.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

4. Revenue (continued):

The balance of franchise fees as of December 31, 2022 that are expected to be recognized in revenue are as follows:

2023	$	1,197
2024		872
2025		829
2026		639
2027		438
Thereafter		1,239
Total	$	5,214

5. Leases:

(a) Right-of-use ("ROU") assets:

The following tables reconcile the changes in ROU assets for the period ended December 31, 2022 and January 1, 2022:

	Leased premises	Other	Total
Balance, January 1, 2022	$ 76,637	$ 4,120	$ 80,757
Net additions	20,380	891	21,271
Acquired through business acquisition (Note 6)	528	—	528
Depreciation	(18,565)	(1,301)	(19,866)
Impairment	(448)	—	(448)
Balance, December 31, 2022	$ 78,532	$ 3,710	$ 82,242

	Leased premises	Other	Total
Balance, January 2, 2021	$ 79,900	$ 5,050	$ 84,950
Net additions	14,487	408	14,895
Depreciation	(17,733)	(1,338)	(19,071)
Impairment	(17)	—	(17)
Balance, January 1, 2022	$ 76,637	$ 4,120	$ 80,757

(Expressed in thousands of Canadian dollars, unless otherwise stated)

5. Leases (continued):

Depreciation is included in cost of sales and selling, general and administrative expenses in the consolidated statements of income and comprehensive income for the period ended December 31, 2022 in the amounts of $19,157 and $709, respectively (January 1, 2022 — $18,375 and $696, respectively). Loss on sale of ROU assets of $793 and $117 were recognized on the sale of corporate-owned stores to franchisees for the periods ended December 31, 2022 and January 1, 2022, respectively. Impairment charges against ROU assets of $448 and $17 were incurred as a result of closing or relocating corporate-owned stores during the periods ended December 31, 2022 and January 1, 2022, respectively.

(b) Lease liabilities

The following tables reconcile the changes in lease liabilities for the period ended December 31, 2022 and January 1, 2022:

	Leased premises	Other	Total
Balance, January 1, 2022	$ 234,683	$ 4,231	$ 238,914
Additions	70,104	904	71,008
Acquired through business acquisition (Note 6)	528	—	528
Interest expense on lease liabilities	11,577	276	11,853
Deferred lease payments	63	—	63
Repayment of interest and principal	(53,608)	(1,457)	(55,065)
Balance, December 31, 2022	$ 263,347	$ 3,954	$ 267,301
Current portion of lease liabilities	$ 50,060	$ 1,275	$ 51,335
Long-term lease liabilities	213,287	2,679	215,966
Total lease liabilities	$ 263,347	$ 3,954	$ 267,301

	Leased premises	Other	Total
Balance, January 2, 2021	$ 211,540	$ 5,119	$ 216,659
Additions	65,885	395	66,280
Interest expense on lease liabilities	11,216	341	11,557
Deferred lease payments	2,615	—	2,615
Repayment of interest and principal	(56,573)	(1,624)	(58,197)
Balance, January 1, 2022	$ 234,683	$ 4,231	$ 238,914
Current portion of lease liabilities	$ 40,898	$ 1,062	$ 41,960
Long-term lease liabilities	193,785	3,169	196,954
Total lease liabilities	$ 234,683	$ 4,231	$ 238,914

(Expressed in thousands of Canadian dollars, unless otherwise stated)

5. Leases (continued):

The Company makes variable lease payments for common area maintenance, property tax, security, and utilities on leased premises. The Company also has certain retail store leases where portions of the lease payments are contingent on a percentage of sales earned in the retail store. Expenses for variable lease components are included in cost of sales and selling, general and administrative expenses in the consolidated statements of income and comprehensive income. Expenses for variable lease components included in cost of sales and selling, general and administrative expenses for the the period ended December 31, 2022 were $26,553 and $169, respectively (January 1, 2022 — $23,529 and $189, respectively).

The following is a summary of the Company's future undiscounted contractual lease payments:

2023	$	62,809
2024		58,025
2025		53,622
2026		39,666
2027		29,204
Thereafter		66,427
Total	$	309,753

(c) Lease receivables:

The Company is considered an intermediate lessor related to head leases the Company has for franchise store locations. As of December 31, 2022 and January 1, 2022, the Company had lease receivables as follows:

		December 31, 2022		**January 1, 2022**
Current portion of lease receivables	$	29,827	$	26,621
Long-term lease receivables		141,187		121,936
Total lease receivables	$	171,014	$	148,557

Finance income on lease receivables for the period ended December 31, 2022 was $7,418 (January 1, 2022 — $6,692). Franchisees make variable lease payments primarily for common area maintenance, property tax, and a percentage of sales earned in their retail store. Revenue from variable lease components included in franchise sales and other revenue in the consolidated statements of income and comprehensive income for the period ended December 31, 2022 was $41,159 (January 1, 2022 — $32,847).

(Expressed in thousands of Canadian dollars, unless otherwise stated)

5. Leases (continued):

The Company assesses the collectability of all lease receivables on an ongoing basis by considering its historical credit loss experience, current and forward-looking macroeconomic conditions, and other relevant factors (Note 3(k)(iv)). Based on this analysis, the expected credit loss is less than 1.0% of the lease receivables as of December 31, 2022 and January 1, 2022, respectively.

The following table presents the contractual undiscounted cash inflows for lease receivables:

2023	$	37,327
2024		34,848
2025		32,716
2026		27,541
2027		21,176
Thereafter		44,806
Total undiscounted lease receivables		198,414
Unearned interest income		(27,400)
Total lease receivables	$	171,014

6. Business acquisitions:

On February 25, 2022, the Company acquired all of the issued and outstanding shares of Les Franchises Chico Inc. and 9353-0145 Quebec Inc. (collectively referred to as "Chico"), a franchisor of pet specialty stores in Quebec, Canada. The purpose of the acquisition was to expand the Company's presence into the Quebec market.

The following table summarizes the final purchase consideration that was paid:

Cash paid	$	14,016
Contingent consideration		3,000
Net purchase price		17,016
Less: cash acquired and contingent consideration		(4,478)
Net consideration paid/cash outflow[1]	$	12,538

[1] Includes $2,100 in holdbacks paid to escrow, with a term of 18 months from the acquisition date, for indemnity purposes.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

6. Business acquisitions (continued):

The final purchase price allocation is as follows:

		Final allocation
Cash	$	1,478
Accounts and other receivables, net		1,493
Inventories, net		578
Prepaid expenses and other assets		35
Current assets acquired		3,584
Right-of-use assets		528
Property and equipment		220
Intangible assets		13,597
Goodwill		4,735
Total assets acquired		22,664
Accounts payable and accrued liabilities		1,609
Income taxes payable		658
Current portion of deferred franchise fees		45
Current portion of lease liabilities		158
Current liabilities assumed		2,470
Long-term deferred franchise fees		373
Long-term lease liabilities		370
Deferred tax liabilities		2,435
Total liabilities assumed		5,648
Net assets acquired	$	17,016

Intangible assets consist of trade names, franchise and non-compete agreements. Recognized goodwill reflects how the acquisition will impact the Company's ability to generate future profits in excess of existing profits. The consideration paid mostly relates to expected future synergies and revenue growth. The goodwill is not deductible for tax purposes.

Acquisition related costs of $462, incurred during the period ended December 31, 2022, are included in selling, general and administrative expenses in the consolidated statements of income and comprehensive income and in operating activities in the consolidated statements of cash flows.

The sellers of the shares, at the time of acquisition, are also entitled to receive a contingent consideration payment of up to $3,000 based on Chico achieving certain performance milestones on the 12-month anniversary of the acquisition date.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

7. Property and equipment:

The Company's property and equipment include the following:

	Land	Building	Furniture and fixtures	Equipment	Leasehold improvements	Construction-in-progress	Total
Cost							
January 1, 2022	$ 120	$ 497	$ 56,614	$ 2,414	$ 83,712	$ —	$ 143,357
Additions	—	—	12,821	236	17,000	17,387	47,444
Acquired through business acquisition (Note 6)	—	—	79	86	55	—	220
Disposal/retirement	—	—	(2,256)	(97)	(3,527)	—	(5,880)
December 31, 2022	120	497	67,258	2,639	97,240	17,387	185,141
Accumulated depreciation							
January 1, 2022	—	(245)	(31,811)	(482)	(48,752)	—	(81,290)
Depreciation	—	(36)	(7,298)	(296)	(8,477)	—	(16,107)
Disposal/retirement	—	—	1,702	83	2,245	—	4,030
December 31, 2022	—	(281)	(37,407)	(695)	(54,984)	—	(93,367)
Net book value, December 31, 2022	$ 120	$ 216	$ 29,851	$ 1,944	$ 42,256	$ 17,387	$ 91,774

	Land	Building	Furniture and fixtures	Equipment	Leasehold improvements	Total
Cost						
January 2, 2021	$ 120	$ 497	$ 47,793	$ 902	$ 77,788	$ 127,100
Additions	—	—	11,054	1,613	11,120	23,787
Disposal/retirement	—	—	(2,233)	(101)	(5,196)	(7,530)
January 1, 2022	120	497	56,614	2,414	83,712	143,357
Accumulated depreciation						
January 2, 2021	—	(225)	(26,819)	(421)	(43,897)	(71,362)
Depreciation	—	(20)	(6,057)	(145)	(7,313)	(13,535)
Disposal/retirement	—	—	1,065	84	2,458	3,607
January 1, 2022	—	(245)	(31,811)	(482)	(48,752)	(81,290)
Net book value, January 1, 2022	$ 120	$ 252	$ 24,803	$ 1,932	$ 34,960	$ 62,067

For the period ended December 31, 2022, construction-in-progress includes costs for the new distribution centre in the Greater Toronto Area (Note 24(a)).

(Expressed in thousands of Canadian dollars, unless otherwise stated)

8. Intangible assets and goodwill:

The Company's intangible assets include the following:

	Franchise agreements	Software	Definite-life trade name	Non-compete agreements	Indefinite-life trade name	Total
Cost						
January 1, 2022	$ 32,400	$ 22,322	$ 2,815	$ 760	$ 30,500	$ 88,797
Additions	—	3,424	—	—	—	3,424
Acquired through business acquisition (Note 6)	1,501	34	—	93	11,969	13,597
Disposal/retirement	—	(7)	—	—	—	(7)
December 31, 2022	33,901	25,773	2,815	853	42,469	105,811
Accumulated amortization						
January 1, 2022	(32,400)	(15,897)	(2,381)	(760)	—	(51,438)
Amortization	(125)	(1,853)	(108)	(14)	—	(2,100)
Disposal/retirement	—	7	—	—	—	7
December 31, 2022	(32,525)	(17,743)	(2,489)	(774)	—	(53,531)
Net book value, December 31, 2022	$ 1,376	$ 8,030	$ 326	$ 79	$ 42,469	$ 52,280

	Franchise agreements	Software	Definite-life trade name	Non-compete agreements	Indefinite-life trade name	Total
Cost						
January 2, 2021	$ 32,400	$ 19,937	$ 2,815	$ 760	$ 30,500	$ 86,412
Additions	—	2,399	—	—	—	2,399
Disposal/retirement	—	(14)	—	—	—	(14)
January 1, 2022	32,400	22,322	2,815	760	30,500	88,797
Accumulated amortization						
January 2, 2021	(32,400)	(14,909)	(2,273)	(758)	—	(50,340)
Amortization	—	(998)	(108)	(2)	—	(1,108)
Disposal/retirement	—	10	—	—	—	10
January 1, 2022	(32,400)	(15,897)	(2,381)	(760)	—	(51,438)
Net book value, January 1, 2022	$ —	$ 6,425	$ 434	$ —	$ 30,500	$ 37,359

(Expressed in thousands of Canadian dollars, unless otherwise stated)

8. Intangible assets and goodwill (continued):

Goodwill changed during the periods as follows:

	Periods ended	
	December 31, 2022	January 1, 2022
Beginning balance	$ 92,938	$ 93,276
Net change in goodwill during the period	4,636	(338)
Ending balance	$ 97,574	$ 92,938

For the period ended December 31, 2022, included in the net change in goodwill during the period are $4,735 of additions (January 1, 2022 — $nil) to the goodwill balances due to the acquisition described in Note 6, which are net of reductions to goodwill balances of $99 (January 1, 2022 — $338) due to the sale of corporate-owned stores to franchisees.

During the fourth quarter of the periods ended December 31, 2022 and January 1, 2022, the Company performed an impairment test, and the recoverable amount of the CGUs for each year was determined to be higher than their carrying value, and as such, no impairment was recorded.

The VIU for goodwill and the indefinite-life trade name was calculated using key assumptions including discounted cash flows over five years based on management's budget projections. Other assumptions used in the Company's annual impairment assessment as at December 31, 2022 include:

- Terminal growth rate of 2.0% (January 1, 2022 — 2.0%)
- After-tax discount rate of 6.4% (January 1, 2022 — 7.3%)

A reasonable change in these assumptions would not have resulted in an impairment.

9. Accounts and other receivables:

The Company's accounts and other receivables include the following:

	December 31, 2022	January 1, 2022
Franchise receivables	$ 12,221	$ 5,967
Trade accounts receivable	6,724	5,639
Other	4,020	2,792
	$ 22,965	$ 14,398

The Company's accounts and other receivables are aged no more than 90 days and 70% are aged less than 30 days. The Company's franchise receivables consist primarily of franchise billings from the last few days of the fiscal year, which are settled within the first days of the next fiscal year. The Company's trade accounts receivable primarily consist of balances due from vendors related to volume and co-operative advertising rebates. The other receivables primarily consist of tenant allowances from landlords.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

9. Accounts and other receivables (continued):

The maximum exposure to credit risk at the reporting date is the carrying value of the accounts and other receivables. The Company assesses the collectability of all receivables on an ongoing basis by considering its historical credit loss experience, current and forward-looking macroeconomic conditions, and other relevant factors (Note 3(k)(iv)). Historically, the Company has not experienced defaults on receivables from franchisees, vendors and landlords. Based on this analysis, the expected credit loss is less than 1% of the accounts and other receivables as of December 31, 2022 and January 1, 2022, respectively.

10. Inventories:

The Company's inventories comprise the following:

		December 31, 2022		January 1, 2022
Merchandise	$	120,503	$	93,507
Provision for obsolescence and shrinkage		(2,093)		(1,808)
	$	118,410	$	91,699

Included in cost of sales are write-downs due to obsolescence, shrinkage and damage of $4,806 and $4,891, for the periods ended December 31, 2022 and January 1, 2022, respectively.

11. Accounts payable and accrued liabilities:

The Company's accounts payable and accrued liabilities include the following:

		December 31, 2022		January 1, 2022
Trade payables	$	33,787	$	35,402
Accrued liabilities		37,317		21,690
Accrued salaries, wages, benefits and incentives		19,061		17,068
Loyalty program liabilities (Note 4)		8,050		6,780
Gift card liabilities (Note 4)		1,777		1,648
Sales taxes payable		3,790		4,389
	$	103,782	$	86,977

(Expressed in thousands of Canadian dollars, unless otherwise stated)

12. Long-term debt:

Total long-term debt, net of deferred financing costs, as of December 31, 2022 and January 1, 2022 consist of the following:

		December 31, 2022		January 1, 2022
Term loans:				
2021 Term Facility (a)	$	341,687	$	350,562
Deferred financing costs (c)		(3,874)		(5,066)
		337,813		345,496
Less current portion of long-term debt		(17,750)		(8,875)
Total long-term debt	$	320,063	$	336,621

(a) 2021 Credit Agreement:

In connection with the Offering, the Company entered into a credit agreement with a syndicate of lenders (the “2021 Credit Agreement”), which provides for (i) a $355,000 term facility (the “2021 Term Facility”) and (ii) a $130,000 revolving credit facility (the "2021 Revolving Facility"), a portion of which not in excess of $20,000 shall be available for the issuance of letters of credit in Canadian or U.S. dollars (collectively referred to as the “2021 Credit Facilities”).

The 2021 Credit Facilities mature on June 30, 2026. The 2021 Term Facility is repayable in quarterly instalments and contains mandatory prepayment provisions with respect to non-ordinary course asset sales, excess cash flow and issuances of debt obligations (excluding debt permitted to be incurred under the 2021 Credit Agreement) by the Company and its subsidiaries (in each case, subject to customary thresholds, qualifications and exceptions set forth in the 2021 Credit Agreement).

Borrowings under the 2021 Credit Facilities will bear interest, according to the type of borrowing advanced, at short-term floating rates (based on a reference rate of U.S. base rate, the Canadian prime rate, the LIBOR rate or bankers’ acceptance rate, as applicable), plus a margin per annum depending on the Company’s net total leverage ratio. As of December 31, 2022, the effective interest rate on the 2021 Credit Facilities was 6.87% (January 1, 2022 — 2.52%).

The obligations under the 2021 Credit Agreement are unconditionally guaranteed by the Company and are secured by a charge over substantially all of the property and assets of the Company.

The 2021 Credit Agreement contains affirmative and negative covenants customary for credit facilities of this nature, subject to certain exceptions set forth in the 2021 Credit Agreement. The 2021 Credit Agreement also contains certain financial covenants over the term of the 2021 Credit Facilities, which include a net leverage ratio and an interest coverage ratio. As of December 31, 2022 and January 1, 2022, the Company was in compliance with all of its covenants.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

12. Long-term debt (continued):

As of December 31, 2022, mandatory long-term debt repayments are as follows:

2023	$	17,750
2024		17,750
2025		17,750
2026		288,437
		341,687
Less current portion of long-term debt		(17,750)
Total long-term debt	$	323,937

Voluntary prepayments of the 2021 Term Facility are permitted at any time (subject to minimum repayment amounts and customary notice periods set forth in the 2021 Credit Agreement) without premium or penalty (other than customary “breakage” costs, if applicable) and will reduce the scheduled principal repayments. The 2021 Credit Agreement provides that amounts under the 2021 Revolving Facility may be borrowed, repaid and re-borrowed.

The Company had unused borrowing capacity available under the 2021 Revolving Facility of $130,000 as of December 31, 2022 and January 1, 2022, respectively.

(b) 2016 Credit Agreement:

On July 5, 2016, the Company entered into a US$605,000 credit agreement with a consortium of lenders (the “2016 Credit Agreement”), which provides for (i) a term loan with a principal amount of US$545,000 under a secured term loan facility (“2016 Term Loan”); (ii) a revolving credit facility for up to US$20,000 (“2016 Revolving Credit Facility”); and (iii) a delayed draw term loan of US$40,000 (“2016 Delayed Draw Term Loan”) (collectively referred to as the “2016 Credit Facilities”). As part of the Offering, the Company terminated the 2016 Credit Agreement and entered into the 2021 Credit Agreement. As such, on June 30, 2021, all outstanding debt on the 2016 Credit Facilities was repaid.

In order to mitigate the foreign currency risk on the repayment of the 2016 Credit Facilities, on June 9, 2021, the Company entered into a foreign exchange forward contract to purchase US$550,000 in exchange for Canadian dollars to be settled on the closing of the Offering. The Company settled the foreign exchange forward contract on June 30, 2021, and recognized a foreign currency gain of $13,459.

In addition, as all of the 2016 Credit Facilities were allocated to the Company from the Group’s U.S. dollar functional currency subsidiary, upon extinguishment of the facilities, the accumulated foreign currency translation adjustments of $29,665 were reclassified to gain on foreign exchange from currency translation reserve within the Group's net investment.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

12. Long-term debt (continued):

(c) Deferred financing costs:

In connection with the 2021 Credit Agreement, deferred financing costs of $5,668 were incurred. The total unamortized deferred financing costs were $3,874 as of December 31, 2022 (January 1, 2022 — $5,066) and are being amortized using the effective interest rate method. Amortization of deferred financing costs for the period ended January 1, 2022 include amortization in relation to the 2016 Credit Agreement.

As a result of the extinguishment of the 2016 Credit Agreement, the unamortized balance of the deferred financing costs on the 2016 Credit Facilities of $5,729 were written off as debt extinguishment costs during the 13-week period ended July 3, 2021. These amounts were included as interest expense in consolidated statements of income and comprehensive income.

13. Interest expense:

Interest expenses, net consist of the following:

	Periods ended	
	December 31, 2022	**January 1, 2022**
2016 Credit Agreement	$ —	$ 22,717
2021 Credit Agreement	15,025	5,394
Amortization of deferred financing costs	1,192	3,312
Debt extinguishment costs	—	5,729
Interest on lease liabilities	11,853	11,557
Interest income on lease receivables	(7,418)	(6,692)
Standby letter of credit commitment fees	1,377	4,994
Other interest income	(1,551)	(138)
Interest expenses, net	$ 20,478	$ 46,873

(Expressed in thousands of Canadian dollars, unless otherwise stated)

14. Income taxes:

Significant components of income taxes expense consist of the following for the periods ended:

	December 31, 2022	January 1, 2022
Current tax expense:		
Current periods	$ 37,633	$ 24,746
Adjustments with respect to prior periods	49	966
	37,682	25,712
Deferred tax expense (recovery):		
Origination and reversal of temporary differences	166	630
Adjustments with respect to prior periods	57	(50)
	223	580
Income taxes expense	$ 37,905	$ 26,292

The Company's income taxes expense differs from that calculated by applying the combined substantively enacted Canadian federal and provincial statutory income tax rates for the periods ended December 31, 2022 and January 1, 2022 of 26.5%, respectively, as follows:

	December 31, 2022	January 1, 2022
Income before income taxes	$ 138,671	$ 125,085
Expected income taxes expense	$ 36,748	$ 33,148
Increase (decrease) in income taxes resulting from:		
Change in deferred tax asset recognition	(182)	—
Non-deductible expenditures	900	911
Non-taxable currency translation adjustments	—	(7,861)
Capital gain benefit on foreign exchange forward contract (Note 12)	—	(1,676)
Imputed income from former foreign affiliates	—	1,404
Other	439	366
Income taxes expense	$ 37,905	$ 26,292

(Expressed in thousands of Canadian dollars, unless otherwise stated)

14. Income taxes (continued):

The tax effects of the significant temporary differences that comprise deferred tax assets and liabilities as at December 31, 2022 and January 1, 2022 are as follows:

	December 31, 2022	January 1, 2022
Deferred tax assets:		
Ordinary loss carryforwards	$ 8,958	$ 7,759
Capital loss carryforwards	$ 9,191	$ 9,178
IFRS 16, *Leases*	69,647	63,350
Financing fees	3,352	4,504
Reserves and accruals	2,824	1,506
Deferred franchise fees	1,228	1,115
Capital lease obligation	1,048	1,120
Other	944	1,337
	$ 97,192	$ 89,869
Deferred tax liabilities:		
Intangible assets and property fair value increments on business acquisition	$ 10,854	$ 8,187
IFRS 16, *Leases*	65,994	59,595
Property and equipment	5,855	4,837
Other	148	302
	$ 82,851	$ 72,921
Value of deferred tax assets not recognized in the current period	(15,939)	(15,887)
Net deferred tax (liabilities) assets	$ (1,598)	$ 1,061

As of December 31, 2022, the Company had approximately $8,958 of tax effected ordinary loss carryforwards available (January 1, 2022 — $7,759). The total U.S. federal losses as of December 31, 2022 were $6,696 (January 1, 2022 - $6,708) and have no expiry date. No deferred tax asset has been recognized with respect to these losses. The Canadian losses which expire between 2039 and 2042 as of December 31, 2022 were $2,262 (January 1, 2022 - $1,051). A deferred tax asset has been recognized on these Canadian losses as the Company expects to have taxable income available to utilize these losses. As of December 31, 2022, the Company had approximately $9,191 of tax effected capital loss carryforwards available, which have no expiry date (January 1, 2022 — $9,178). No income tax benefit has been recognized in respect of those losses.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

14. Income taxes (continued):

The net change in deferred income tax assets and liabilities is recorded as follows:

	December 31, 2022	January 1, 2022
Deferred tax expense recorded in net income	$ (223)	$ (580)
Deferred tax expense recorded through current tax payable	(1)	87
Deferred tax expense recorded in retained earnings	—	5,836
Deferred tax recorded from business acquisition (Note 6)	(2,435)	—
	$ (2,659)	$ 5,343

The Company is subject to routine audits of its tax filing positions by the Canada Revenue Agency (“CRA”) on an ongoing basis. The CRA is currently examining the Company’s tax filings for the 2016 and subsequent taxation years and, in connection with such audit, is reviewing the transaction pursuant to which the Company indirectly acquired its former interest in Pet Supermarket, Inc. To date, the CRA has not proposed any reassessment of the Company's tax liability as a consequence of such audit. The Company and its tax advisors continue to believe that the Company's tax filing positions are appropriate, and accordingly no amounts have been accrued in the financial statements in respect of any such potential reassessment. If the CRA were to reassess the Company, the Company would expect to vigorously oppose any such reassessment. The Company has tax insurance against the risk of the Company ultimately being unsuccessful in opposing any such reassessment that it believes might be proposed by the CRA, although there can be no assurance that such insurance would fully cover the amount of tax which may ultimately be imposed. If the CRA were to issue such a reassessment, the Company would be required to pay the amount owing or provide acceptable security to the CRA with respect to the amount under appeal, pending resolution of the reassessment. On February 26, 2021, the Company incurred costs of $3,690 to obtain a commitment for a standby letter of credit facility that would be available to provide such security in respect of any such reassessment that it believes might be proposed by the CRA. These costs were reported as interest expense in the consolidated statements of income and comprehensive income. The Company will incur ongoing commitment fees of $1,250 annually to the extent that such standby letter of credit facility remains unused. If the Company were to use that facility to provide security to the CRA as discussed above, it would incur additional interest costs estimated not to exceed $3,000 annually, although there can be no assurance that such costs would not exceed this amount or that the facility will fully cover any reassessment.

15. Share capital:

(a) Capital reorganization:

Prior to the capital reorganization on June 30, 2021, the Company was authorized to issue (i) an unlimited number of Class X common shares, (ii) an unlimited number of Class Y common shares, (iii) an unlimited number of Class A preferred shares, (iv) an unlimited number of Class B preferred shares, and (v) an unlimited number of Class C preferred shares, in each case without nominal or par value. All three classes of preferred shares were entitled to cumulative dividends at a rate of 8.6%. They also had a liquidation value of US$1,000 per share plus any unpaid dividends less any previous distributions on the shares.

15. Share capital (continued):

Prior to the capital reorganization, non-controlling interests represented issued perpetual preferred shares and accumulated but unpaid dividends of a subsidiary of the Company. These shares earned a stated cumulative dividend of 8.6% per annum, and did not have redemption features. They also had a liquidation value of US$1,000 per share plus any unpaid dividends less any previous distributions on the shares. As such, these non-controlling interests were classified as equity.

As of June 30, 2021, the date of the capital reorganization, (i) 31,195,059 Class X common shares, (ii) 16,011,583 Class Y common shares, (iii) 58,555 Class A preferred shares, (iv) 39,155 Class B preferred shares, and (v) 31,821 Class C preferred shares were issued and outstanding. These common and preferred shares were included in Group's net investment prior to June 30, 2021.

Immediately prior to the closing of the Offering, all of the Company’s outstanding Class X common shares, Class Y common shares, Class A preferred shares, Class B preferred shares, and Class C preferred shares were exchanged for common shares in the Company. The Class X common shares and Class Y common shares of the Company were exchanged on a one-for-one basis for common shares, and all of the outstanding options to acquire Class X common shares under the Company's legacy share option plan (as amended and restated on closing of the Offering, the "Amended and Restated Share Option Plan") became options to acquire common shares (Note 19(a)). The Class A preferred shares, Class B preferred shares and Class C preferred shares of the Company were exchanged based on their liquidation value plus accrued but unpaid dividends divided by the fair market value of the Company’s common shares ($20.00 per common share) at the closing of the Offering. In addition, as part of the capital reorganization, non-controlling interests were redeemed for nominal consideration.

Following the foregoing share exchanges, all of the Company’s issued and outstanding common shares were consolidated on a one-to-0.928 basis. Options to acquire common shares under the Amended and Restated Share Option Plan were also consolidated on a one-to-0.928 basis at a post-consolidated exercise price converted to Canadian dollars such that the in-the-money value of such options remained unchanged (Note 19(a)).

Following the share consolidation and immediately prior to the closing of the Offering, the Company issued 61,434 common shares to key management personnel based on prior service and achievement of critical business initiatives. The Company recorded share-based compensation expense in relation to the awards of $1,229, which was included in selling, general and administrative expenses for the period ended January 1, 2022. The share-based compensation expense in relation to the awards is recorded in net distributions on a carve-out basis in the consolidated statements of shareholders' equity and consolidated statements of cash flows for the period ended January 1, 2022.

The Company’s authorized share capital following the capital reorganization consists of an unlimited number of common shares and an unlimited number of preferred shares, issuable in series.

15. Share capital (continued):

The holders of common shares are entitled to receive dividends as declared from time to time by the Board of Directors. Shareholders are entitled to one vote per common share at shareholder meetings of the Company.

Preferred shares of each series, if and when issued, will, with respect to the payment of dividends, be entitled to preference over common shares. Except as provided in any special rights or restrictions attaching to any series of preferred shares issued from time to time, the holders of preferred shares will not be entitled to vote at any shareholder meetings of the Company.

(b) Issuance of common shares and secondary offering:

Following the capital reorganization, the Company completed the Offering of 15,812,500 common shares from treasury, including 2,062,500 common shares issued pursuant to the exercise in full by the underwriters of the over-allotment option granted by the Company, at an offering price of $20.00, which resulted in net proceeds to the Company of $299,647 after underwriting commissions of $16,603. The Company incurred $4,437 of other incremental expenses directly associated to the Offering. The total net proceeds after underwriting fees and incremental expenses were $295,210. Income tax recovery of $5,443 related to the underwriting commissions and other transaction costs was recorded as an increase to common shares for the period ended January 1, 2022.

All costs that were incremental and directly attributable to the issuance of common shares from treasury were recorded as a reduction to share capital. All other costs incurred in relation to preparing the Company to operate and report as a publicly listed entity were included in selling, general and administrative expenses.

On September 28, 2021, a secondary offering (the “2021 Secondary Offering”) of the Company's common shares was completed by its principal shareholders on a bought deal basis. The 2021 Secondary Offering of 7,000,000 common shares at an offering price of $32.25 per common share raised gross proceeds of $225,750 for the principal shareholders. The Company did not issue additional common shares or receive any of the proceeds from the 2021 Secondary Offering. Underwriting fees were paid by the principal shareholders, and other expenses related to the 2021 Secondary Offering of approximately $355 were paid by the Company and included in selling, general and administrative expenses for the period ended January 1, 2022.

On November 17, 2022, a secondary offering (the “2022 Secondary Offering”) of the Company's common shares was completed by its principal shareholders on a bought deal basis. The 2022 Secondary Offering of 5,175,000 common shares at an offering price of $37.40 per common share raised gross proceeds of $193,500 for the principal shareholders. The Company did not issue additional common shares or receive any of the proceeds from the 2022 Secondary Offering. Underwriting fees were paid by the principal shareholders, and other expenses related to the 2022 Secondary Offering of approximately $414 were paid by the Company and included in selling, general and administrative expenses for the period ended December 31, 2022.

As of December 31, 2022, there were 70,976,471 common shares and no preferred shares issued and outstanding.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

15. Share capital (continued):

The following table provides a summary of changes to the Company's share capital:

	Common shares outstanding		Amount
Balance, January 2, 2021	—	$	—
Capital reorganization from Group's net investment	54,161,413		6,781
Issuance of common shares, net of issuance costs	15,812,500		300,653
Exercise of share options	110,076		63
Balance, January 1, 2022	70,083,989	$	307,497
Exercise of share options	892,482		8,711
Balance, December 31, 2022	70,976,471	$	316,208

(c) Dividends:

The Company's dividend policy is at the discretion of the Board of Directors. For the period ended December 31, 2022, the Company paid $16,927 in dividends to holders of common shares (January 1, 2022 — $700) or $0.24 per common share (January 1, 2022 — $0.01).

16. Net income per share:

(a) Basic net income per share:

Basic net income per share is calculated by dividing the net income attributable to shareholders of the Company by the weighted average number of common shares outstanding during the period.

		December 31, 2022		January 1, 2022
Net income attributable to shareholders of the Company	$	100,766	$	95,363
Weighted average number of common shares outstanding during the period *(thousands)*		70,450		69,987
Basic net income per share attributable to the common shareholders	$	1.43	$	1.36

16. Net income per share (continued):

(b) Diluted net income per share:

Diluted net income per share is calculated by dividing the income attributable to shareholders of the Company by the weighted average number of common shares outstanding during the period adjusted for the effects of potentially dilutive share options and share units.

	December 31, 2022	January 1, 2022
Net income attributable to shareholders of the Company	$ 100,766	$ 95,363
Weighted average number of common shares outstanding during the period *(thousands)*	72,130	71,659
Diluted net income per share attributable to the common shareholders	$ 1.40	$ 1.33

The following table provides a reconciliation from the basic weighted average number of common shares outstanding to the diluted weighted average number of common shares outstanding (number of shares in thousands):

	December 31, 2022	January 1, 2022
Basic weighted average number of common shares	70,450	69,987
Dilutive effect of share options in the Amended and Restated Share Option	1,566	1,575
Dilutive effect of share options in the LTIP	114	97
Diluted weighted average number of common shares	72,130	71,659

For the period ended December 31, 2022, 319,557 performance-based share options granted pursuant to the Amended and Restated Share Option Plan were not included in the calculation of diluted net income per share, as the vesting conditions required to convert these options to common shares were not met (January 1, 2022 — 596,433).

(Expressed in thousands of Canadian dollars, unless otherwise stated)

17. Cost of sales:

	Periods ended			
		December 31, 2022		January 1, 2022
Merchandise costs	$	479,015	$	389,709
Store occupancy costs		46,481		42,293
Distribution costs		73,904		56,832
	$	599,400	$	488,834

18. Selling, general and administrative expenses:

	Periods ended			
		December 31, 2022		January 1, 2022
Salaries, wages and benefits	$	105,298	$	85,580
Depreciation and amortization		16,263		13,294
Advertising		25,243		21,338
Technology and telecommunication		19,939		13,142
Professional fees		11,052		14,106
Other store expenses		6,161		4,920
Other selling, general and administrative expenses		8,149		5,393
	$	192,105	$	157,773

19. Share-based compensation:

(a) Amended and Restated Share Option Plan:

The Company has an Amended and Restated Share Option Plan (formerly referred to as the Legacy Option Plan or the Legacy Plan) pursuant to which it has granted share options to current and former directors and employees. Prior to the Offering, this plan was administered by the Group, and as a result of the carve-out process, for periods prior to June 30, 2021, the Company was allocated the proportionate share of this plan associated with the Company's employees and directors.

Concurrent with the Offering, the Company amended and restated the Amended and Restated Share Option Plan so that no additional awards could be made under this plan, but share options previously granted under this plan continue to remain outstanding in accordance with their terms and will continue to be governed by the provisions of the Amended and Restated Share Option Plan.

In connection with the Offering, options to acquire Class X common shares became options to acquire common shares in the Company on a one-to-0.928 basis at a post-consolidated exercise price converted to Canadian dollars such that the in-the-money value of such options to the holder remained unchanged.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

19. Share-based compensation (continued):

Amended and Restated Share Option Plan option awards were granted at an exercise price determined by the Company's Board of Directors, which was not less than the fair market value of the underlying share on the date the option was granted. The Amended and Restated Share Option Plan option awards generally vest equally from the date of grant over five years and generally contain an equal number of service-based and performance-based awards. The share options can generally be exercised up to five years after the five-year vesting period and, therefore, the contractual term of each option granted is typically ten years. The Company accounts for the Amended and Restated Share Option Plan as an equity-settled plan.

The fair value of each option award was calculated on the date of grant using the Black-Scholes option pricing model. Expected volatilities were based on the historical volatility of comparable publicly traded companies operating in the Company's industry. The expected life of options granted was based on management's best estimate using the mid-point between the vesting date and the maturity date for each tranche. The risk-free rate for periods within the expected life of the option was based on the U.S. Treasury yield curve in effect at the time of grant.

The tables below summarize the option activity under the Amended and Restated Share Option Plan:

	Options	Weighted average exercise price
Outstanding, January 2, 2021	3,904,398	US$7.08
Granted	465,000	US$8.95
Exercised	(444,797)	US$2.63
Forfeited	(886,948)	US$6.24
Outstanding, June 30, 2021	3,037,653	US$8.27
Options converted concurrent with the Offering[1]	2,819,041	$8.97
Exercised	(110,076)	$0.57
Forfeited	(5,568)	$9.73
Outstanding, January 1, 2022	2,703,397	$9.31
Exercised	(892,482)	$9.03
Forfeited	(43,616)	$9.73
Outstanding, December 31, 2022	1,767,299	$9.44

[1] Reflects the options and weighted average exercise price after the one-to-0.928 share consolidation and conversion to Canadian dollars.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

19. Share-based compensation (continued):

	Options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value
Outstanding, December 31, 2022	1,767,299	$ 9.44	6.36	$ 52,480
Vested and expected to vest	1,767,299	$ 9.44	6.36	$ 52,480
Exercisable, December 31, 2022	913,479	$ 9.16	6.08	$ 27,378

During the period ended December 31, 2022, the Company recorded share-based compensation expense in relation to the Amended and Restated Share Option Plan of $1,862 (January 1, 2022 — $2,654), which was included in selling, general and administrative expenses. The share-based compensation expense incurred for the period ended January 1, 2022 was allocated between pre-Offering and post-Offering in the amount of $1,305 and $1,349, respectively. The share-based compensation expense for the pre-Offering period was recorded in net distributions on a carve-out basis in the consolidated statements of shareholders' equity and consolidated statements of cash flows.

(b) LTIP:

In connection with the Offering, the Company adopted the LTIP, pursuant to which it can grant awards of share options, stock appreciation rights, tandem stock appreciation rights, RSUs, PSUs and restricted stock to eligible participants. Any individual employed by the Company, including a service provider, who in the opinion of the Board of Directors is in a position to contribute to the success of the Company shall be eligible to receive awards under the LTIP. The number of common shares that can be issued under the LTIP, combined with all other security-based compensation arrangements of the Company, shall not exceed 10% of the aggregate number of issued and outstanding common shares, from time to time.

The number and the timing of the awards granted to eligible participants is determined by the Board of Directors. The exercise price per share with respect to each share option is also determined by the Board of Directors but cannot be less than the Market Price (as defined in the LTIP) of the common shares on the day on which the share option is granted. Share options typically vest over a period of three or four years. Share options granted under the plan may be exercised during a period not exceeding ten years from the grant date subject to earlier termination due to employment termination, death or disability. The Company uses the Black-Scholes option pricing model to calculate the fair value of options at the date of grant.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

19. Share-based compensation (continued):

RSUs and PSUs issued by the Company under the LTIP are settled in cash and are accounted for as cash-settled awards. The Company is required to record a liability for the potential future settlement of the vested RSUs and PSUs at each reporting date by reference to the fair value of the liability. The RSUs and PSUs cliff vest in three years following the grant date. The performance based component of PSUs is based 50% on operating income growth before share-based compensation expense and 50% on total return to the Company's shareholders relative to the total return of companies comprising a blend of the S&P/TSX Completion Index, S&P/TSX Capped Consumer Discretionary, and the S&P/TSX Capped Consumer Staples. The number of PSUs that vest is determined by multiplying the number of units granted to the participant by the adjustment factor, which ranges from 0 to 2.0, depending on the achievement of such targets. Additional RSUs and PSUs issued in lieu of cash dividends vest at the same time and are subject to the same conditions as the RSUs and PSUs to which they are attributable.

(i) Share options:

The tables below summarize the share option activity under the LTIP:

	Options	Weighted average exercise price
Outstanding, January 2, 2021	—	$ —
Granted	276,490	$ 20.00
Outstanding, January 1, 2022	276,490	$ 20.00
Granted	304,764	$ 30.92
Forfeited	(49,111)	$ 25.10
Outstanding, December 31, 2022	532,143	$ 25.78

	Options	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value
Outstanding, December 31, 2022	532,143	$ 25.78	8.82	$ 7,102
Vested and expected to vest	503,976	$ 25.50	8.79	$ 6,871
Exercisable, December 31, 2022	7,433	$ 20.00	0.25	$ 142

(Expressed in thousands of Canadian dollars, unless otherwise stated)

19. Share-based compensation (continued):

The weighted-average assumptions used in the model for options granted during the periods ended December 31, 2022 and January 1, 2022 are as follows:

	December 31, 2022	January 1, 2022
Weighted-average risk-free interest rate	2.50 %	1.11 %
Expected life (years)	5.50 — 7.00	6.00 — 6.50
Expected dividend yield	0.79 %	0.20 %
Expected volatility	26.16 %	24.00 %
Forfeiture rate	10.00 %	— %
Weighted-average fair value per option granted	$ 8.77	$ 5.09

During the period ended December 31, 2022, the Company recorded share-based compensation expense in relation to the LTIP share options of $1,115 (January 1, 2022 — $430), which was included in selling, general and administrative expenses.

(ii) RSUs:

The table below summarizes the RSU activity as of December 31, 2022:

	Number of RSUs
Outstanding, January 1, 2022	—
Granted	101,719
Forfeited	(8,138)
Additional units issued in lieu of cash dividends	678
Outstanding, December 31, 2022	94,259

The fair market value of future RSU cash-settlement obligations was $943 at December 31, 2022 (January 1, 2022 – $nil). During the period ended December 31, 2022, the Company incurred share-based compensation expense for RSU cash-settlement obligations of $943 (January 1, 2022 — $nil).

(iii) PSUs:

The table below summarizes the PSU activity as of December 31, 2022:

	Number of PSUs
Outstanding, January 1, 2022	—
Granted	86,811
Forfeited	(8,351)
Additional units issued in lieu of cash dividends	627
Outstanding, December 31, 2022	79,087

(Expressed in thousands of Canadian dollars, unless otherwise stated)

19. Share-based compensation (continued):

The expectation of the adjustment factor for the performance target linked to the total return to the Company's shareholders relative to the total return of companies comprising a blend of the S&P/TSX Completion Index, S&P/TSX Capped Consumer Discretionary, and the S&P/TSX Capped Consumer Staples is measured based on the Monte Carlo simulation method.

The key inputs used in the measurement of the fair value of the PSUs are as follows:

Share price as of grant date	$	28.04
Share price as of valuation date	$	39.13
Risk-free interest rate		4.49 %
Expected life (years)		2.00
Expected volatility		36.88 %

The fair market value of future PSU cash-settlement obligations was $1,103 at December 31, 2022 (January 1, 2022 — $nil). During the period ended December 31, 2022, the Company incurred share-based compensation expense for PSU cash-settlement obligations of $1,103 (January 1, 2022 — $nil).

(c) Deferred share unit plan:

In connection with the Offering, the Company adopted a deferred share unit plan for non-employee board members. Each eligible director receives a portion of his or her annual director retainer in deferred share units ("DSUs"). The DSU portion of the retainer is granted on an annual basis based on the market price of the Company's common shares on the date of such grant. DSUs may only be redeemed when a director ceases to be a member of the Board. DSUs issued by the Company under the DSU Plan are settled in cash and are accounted for as cash-settled awards.

The Company is required to record a liability for the potential future settlement of the vested DSUs at each reporting date by reference to the fair value of the liability. The DSUs vest in four equal installments on the last day of each fiscal quarter during the one-year period following the grant date. Additional DSUs issued in lieu of cash dividends vest at the same time and are subject to the same conditions as the DSUs to which they are attributable.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

19. Share-based compensation (continued):

The following is a summary of the Company's DSU Plan activity:

	Number of DSUs
Outstanding, January 2, 2021	—
Granted	30,493
Forfeited	(5,000)
Additional units issued in lieu of cash dividends	8
Outstanding, January 1, 2022	25,501
Granted	26,110
Additional units issued in lieu of cash dividends	282
Outstanding, December 31, 2022	51,893

The fair market value of future DSU cash-settlement obligations was $1,645 at December 31, 2022 (January 1, 2022 — $420). During the period ended December 31, 2022, the Company incurred share-based compensation expense for DSU cash-settlement obligations of $1,225 (January 1, 2022 — $420).

20. Investment in associate:

The Company has a 19.9% ownership interest in HAFTAL LLC (“HAFTAL”). This ownership interest and other rights give the Company significant influence over HAFTAL, and the Company is accounting for its investment using the equity method. HAFTAL is a Delaware-based company formed for the purposes of developing an elevated experience for tracking pet health and lifestyle statistics.

In connection with the investment, the Company has a call option to purchase the remaining interest in HAFTAL (the "Call Option"). The Call Option has a term of five years following the date of the initial investment and is exercisable after April 1, 2023. The Call Option is accounted for at fair value through profit or loss and is included in the investment in associate in the Company's consolidated statements of financial position (Note 21).

The Company's share of loss from associate and the gain on the fair value of the Call Option is included in other income in the consolidated statements of income and comprehensive income.

During the period ended December 31, 2022, the Company made additional investments in HAFTAL of $2,178 (US$1,700). Following these investments, the Company's ownership interest in HAFTAL remains unchanged.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

20. Investment in associate (continued):

The following table reconciles the change in the investment in associate for the period ended December 31, 2022:

	Investment	Call Option	Total
Balance, January 1, 2022	$ 1,505	$ 674	$ 2,179
Additional investment	2,178	—	2,178
Share of loss from associate	(483)	—	(483)
Unrealized gain on fair value	—	551	551
Currency translation adjustments	217	66	283
Balance, December 31, 2022	$ 3,417	$ 1,291	$ 4,708

21. Financial instruments and risk management:

(a) Credit risk:

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's cash and cash equivalents, accounts and other receivables and lease receivables. The risk on cash and cash equivalents is mitigated by the fact that its deposits are with various high-quality financial institutions. The Company has receivables from the Company's suppliers and from the Company's franchise operators. The credit risk on its receivables from suppliers is managed by the ability to offset any monies owed by the supplier against amounts owed to the suppliers. The management of credit risk on the Company's franchisee accounts receivable and lease receivable is maintained by having short settlement terms on these receivables, and prior to accepting a franchisee, the Company undertakes a detailed screening process that includes the requirement that a franchisee has sufficient financing.

(b) Liquidity risk:

Liquidity risk is the risk the Company will not be able to meet its financial obligations as they come due. The Company mitigates liquidity risk by management of working capital, cash flows, and by maintaining various financing sources, including bank debt and finance leases. Adequate availability is maintained on the operating loan component of its credit facility to minimize this risk (Note 12). The Company's trade and other payables are all due within 12 months from the date of these financial statements.

21. Financial instruments and risk management (continued):

(c) Market risk:

Market risk is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises two types of risk: foreign currency risk and interest rate risk.

(i) Foreign currency risk:

The Company is exposed to currency risk related to some of its purchases. Specifically, the Company sources some of its merchandise in U.S. dollars. Inventory purchases sourced outside Canada and primarily denominated in U.S. dollars represented approximately 30% and 31% for the periods ended December 31, 2022 and January 1, 2022, respectively.

The Company is also exposed to currency risk on financial assets and liabilities denominated in foreign currencies. These assets and liabilities are of a short-term nature and management does not believe they represent a significant risk to the Company. A five percentage point change in the Canadian dollar against the U.S. dollar, assuming that all other variables are constant, would have changed income before income taxes for the period ended December 31, 2022 by $354 (January 1, 2022 — $487), as a result of the revaluation on these financial assets and liabilities.

(ii) Interest rate risk:

Interest rate risk is the risk the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The 2021 Credit Facilities and 2016 Credit Facilities (Note 12) are at variable interest rates. Changes in the banks' prime lending rates, the LIBOR rate or bankers' acceptance rate can cause fluctuations in interest payments and cash flows.

A one percentage point change in the applicable interest rate on the 2021 Credit Agreement based on the debt outstanding as at December 31, 2022 would have changed income before taxes for the period ended December 31, 2022 by $3,417 (January 1, 2022 — $3,506).

(Expressed in thousands of Canadian dollars, unless otherwise stated)

21. Financial instruments and risk management (continued):

(d) Fair values:

Financial instruments that are measured subsequent to initial recognition at fair value are to be categorized in Levels 1 to 3 of the fair value hierarchy, based on the degree to which the fair value is observable. The three levels of the fair value hierarchy are:

- Level 1 – inputs that are quoted market prices (unadjusted) in active markets for identical instruments;
- Level 2 – inputs other than quoted market prices included within Level 1 that are observable either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using: quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques in which all significant inputs are directly or indirectly observable from market data; and
- Level 3 – inputs that are unobservable. This category includes all instruments for which the valuation technique includes inputs that are not observable, and the unobservable inputs have a significant effect on the instrument's valuation. This category includes instruments that are valued based on quoted prices for similar instruments for which significant unobservable adjustments or assumptions are required to reflect the difference between the instruments.

There were no transfers between levels of the fair value hierarchy for the periods ended December 31, 2022 and January 1, 2022.

The carrying values of cash, accounts and other receivables, and accounts payable and accrued liabilities approximate fair values due to the short-term maturity of these financial instruments.

The carrying amounts and fair values of the Call Option, contingent consideration, and long-term debt are as follows:

		December 31, 2022		January 1, 2022	
		Carrying value	Fair value	Carrying value	Fair value
Assets:					
Call Option (Note 20)	(Level 3)	$ 1,291	$ 1,291	$ 674	$ 674
Liabilities:					
Contingent consideration related to the acquisition of Chico (Note 6)	(Level 3)	$ 3,000	$ 3,000	$ —	$ —
Long-term debt, including current portion[(1)]	(Level 2)	$ 337,813	$ 341,687	$ 345,496	$ 350,562

[(1)] Carrying value is net of deferred financing fees.

The Company used the Black-Scholes option pricing model to determine the fair value of the Call Option.

22. Capital management:

The Company's capital management objectives are to maintain prudent financial flexibility and strength in order to pursue its strategy of growth and to provide stakeholder value creation. The Company defines capital as the aggregate of its shareholders' equity and long-term debt.

In order to maintain or adjust its capital structure, the Company may elect to issue or repay financial liabilities, issue shares, repurchase shares, pay dividends or undertake any other activities as deemed appropriate under the specific circumstances.

The Company is subject to financial and customary affirmative and negative covenants pursuant to the 2021 Credit Agreement presented in Note 12.

23. Operating segments:

The Company defines an operating segment on the same basis that it uses to evaluate performance internally and to allocate resources by the Chief Operating Decision Maker (the "CODM"). The Company has determined that the Chief Executive Officer is its CODM and there is one operating segment. Operating revenues are primarily composed of retail sales and franchise revenues (Note 4).

24. Commitments, contingencies and guarantees:

(a) Distribution centre commitments:

On March 31, 2022, the Company entered into lease and construction agreements for a new distribution centre in the Greater Toronto Area. The lease is for an initial term of 10 years commencing August 1, 2023. The Company expects future undiscounted contractual lease payments of $102,236 over the term of the lease. The Company estimates that $8,957 is required to complete leasehold improvements which is expected to be paid within 12 to 18 months. Additionally, during the period ended December 31, 2022, the Company entered into an agreement to procure certain material handling systems with commitments totaling approximately $9,569 to be paid in fiscal years 2023 and 2024. During the period ended December 31, 2022, the Company paid $5,073 in security deposits in relation to the distribution centre lease agreement. These security deposits are included in other assets in the Company's consolidated statements of financial position.

(b) Guarantees of indebtedness:

The Company has provided the following guarantees as of December 31, 2022:

(i) Guarantee of certain lease obligations for a former subsidiary of the Company. The lease obligations expire on February 27, 2023. As of December 31, 2022, the future lease commitment is $82 (US$60) (January 1, 2022 — $831 (US$655)).

24. Commitments, contingencies and guarantees (continued):

(c) Bank comfort letters:

The Company has provided comfort letters to certain financial institutions at their request when these financial institutions provide financing to new franchisees. In the comfort letters, the Company has agreed that for three years from the date of the letter, if the bank is forced to realize on its security, including inventory held by the franchisee, the Company will repurchase the inventory previously sold to the franchisee at a stated discount of 15%, provided that such inventory can be sold by the bank to the Company free and clear of any and all liens, charges and encumbrances or rights of others.

Standard practice is for the Company to realize its rights under the franchise agreement prior to the franchisee reaching default under their finance arrangement; therefore, the risk associated with being required to repurchase inventory under these comfort letters is considered remote. Accordingly, no amount has been provided for in the accompanying financial statements.

(d) Other:

The Company may, from time to time, be named as a defendant in legal proceedings that arise from its normal course of business. Although the amount of any liability that could arise with respect to any pending claims cannot be estimated, the Company believes that any such liability is not reasonably likely to have a material adverse effect on its financial position, operating results or liquidity.

25. Related party transactions:

(a) Transactions with related parties:

Prior to the Offering, the Company was a party to a management agreement with an affiliated entity, which provided management services. The Company incurred management fees and expenses for the period ended December 31, 2022 of $nil (January 1, 2022 — $679), which is included in selling, general and administrative expenses. The balance due was $nil at December 31, 2022 and January 1, 2022, respectively. Concurrent with the closing of the Offering, the Company terminated the management agreement with the affiliated entity.

On May 1, 2021, the Company entered into a transition services agreement with its former subsidiaries, pursuant to which the parties provides to each other certain information technology, real estate and human resources and benefits services on a no cost or at cost basis. The transition services agreement had an initial term of 18 months from the closing of the Offering and was renewed until May 1, 2023. The Company charged the former subsidiaries $114 under the transition services agreement for the the period ended December 31, 2022 (January 1, 2022 — $931). Prior to the transition services agreement, the Company provided services to these subsidiaries from January 3, 2021 to April 30, 2021 and charged $550 to the subsidiaries during that period.

(Expressed in thousands of Canadian dollars, unless otherwise stated)

25. Related party transactions (continued):

In connection with the Offering, the Company entered into a product sourcing and brand license agreement with a former subsidiary, pursuant to which the Company sources certain pet food and pet supply products licensed under the Company's proprietary brands in consideration of a sourcing fee. The original product sourcing and brand license agreement had an initial term of 18 months that was automatically renewable for successive 18-month terms unless earlier terminated upon notice. This agreement was amended and restated on August 10, 2022, and includes an initial term of five years, terminating on August 9, 2027, which automatically renews for successive 18-month periods unless earlier terminated. The Company earned sourcing fees of $899 under the product sourcing and brand license agreement for the period ended December 31, 2022 (January 1, 2022 — $757).

During the period ended December 28, 2019, the Company received a promissory note related to the exercise of options by an employee. This promissory note had a balance outstanding of $504 (US$372) as of December 31, 2022 (January 1, 2022 — $634 (US$500)).

Net distributions represent the net distributions related to funding between the Company and the Group and net distributions to the shareholders of the Group. Net distributions to the Group were $nil for the period ended December 31, 2022 (January 1, 2022 — $3,921). Net distributions to the shareholders of the Group were nil for the period ended December 31, 2022 (January 1, 2022 - $13,062).

All of the related party transactions noted above were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

(b) Compensation of key management personnel:

Key management personnel include the Board of Directors as well as senior executives and officers of the Company that are responsible for planning, directing and controlling the Company's business activities.

Key management personnel remuneration includes the following:

	Periods ended	
	December 31, 2022	**January 1, 2022**
Salaries and benefits	$ 9,091	$ 10,992
Share-based compensation	4,898	4,701
Termination benefits	704	—
Directors' fees	401	636
	$ 15,094	$ 16,329

The compensation amounts noted in the above table are recognized in selling, general and administrative expenses during the reporting periods.

26. Subsequent events:

On March 6, 2023, the Board of Directors of the Company declared a dividend of $0.10 per common share payable on April 17, 2023 to holders of common shares of record as at the close of business on March 31, 2023.