



THE SECOND CUP LTD.

Annual Information Form

For the year ended December 31, 2011

March 23, 2012

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GLOSSARY OF TERMS

In addition to the other terms defined in this Annual Information Form, the following terms are used frequently and are defined below. Unless the context otherwise requires, any reference in this Annual Information Form to any agreement, instrument, indenture, declaration or other document will be deemed to be a reference to that agreement, instrument, indenture or other document, as amended, supplemented and restated from time to time.

“affiliate” means, in respect of a person or company, another person or company that would be considered to be an “affiliated entity” in respect of such person or company for the purposes of Ontario Securities Commission Rule 45-501, as amended or replaced from time to time.

“Arrangement” means the plan of arrangement under the provisions of section 182 of the OBCA involving the Fund, The Second Cup Ltd. and 2241221 Ontario Inc. effected January 1, 2011 pursuant to which the income trust structure of the Fund was reorganized into the Company.

“associate” has the meaning ascribed to it in the Securities Act.

“Bank” means the Canadian chartered bank affiliate of Scotia Capital Inc.

“EBITDA” means earnings before interest, taxes, depreciation and amortization.

“Fund” means Second Cup Income Fund.

“Gross Revenue” has the meaning ascribed to it in “Business of Second Cup — Franchise Operations — Second Cup Franchise Agreements” as it relates to both company-owned cafés and franchised cafés.

“Licence” means the licence to use the Second Cup Marks (including for the purpose of trade names and domain names) in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years.

“Licence and Royalty Agreement” means the licence and royalty agreement dated November 26, 2004, as amended, or amended and restated from time to time, between a subsidiary of the Fund and Second Cup pursuant to which Second Cup was granted the Licence and agreed to pay a royalty to such subsidiary.

“OBCA” means *Business Corporation Act* (Ontario).

“Operating Loan” means the revolving loan facility in the amount of up to \$2,000,000 established by the Bank in favour of the Company.

“S.C. Coffee Co.” means The Second Cup Coffee Company Inc. (formerly Dinecorp Hospitality Inc.), a private corporation formed under the laws of the Province of Ontario.

“Second Cup” or the **“Company”** means The Second Cup Ltd., the company resulting from the amalgamation of The Second Cup Ltd. and 2241221 Ontario Inc. pursuant to the Arrangement.

“Second Cup cafés” refers to the retail outlets dedicated to the sale of specialty coffee and related products operated by Second Cup or Second Cup franchise partners and identified by the Second Cup Marks.

“Second Cup Marks” means the trade-marks owned by the Company and registered under the *Trade-marks Act* (Canada), and such trade-marks, trade names, operating procedures, methods, systems and other intellectual property and proprietary rights that are used in connection with the operation of Second Cup cafés in Canada and all associated rights.

“Securities Act” means the *Securities Act* (Ontario), as amended.

“**Share**” means a common share in the capital of the Company.

“**Shareholders**” means the holders of Shares.

“**System Sales**” means the Gross Revenue of all Second Cup cafés including (i) the Gross Revenue of the company-owned Second Cup cafés in Canada owned by Second Cup; and (ii) the Gross Revenue reported by Second Cup cafés in the royalty pool which are subject to franchise agreements with Second Cup, without audit or other form of independent assurance.

“**Tax Act**” means the *Income Tax Act* (Canada).

“**Term Loan**” means the term loan in the principal amount of \$11,000,000 by the Bank to the Company due April 1, 2013, any renewal thereof and any replacement thereof by a financial institution carrying on business in Canada as more fully described under “General Development of the Business —Term Loan and Operating Loan”.

“**trustees**” means, at the relevant time, the trustees of the Fund.

“**Unit**” means a trust unit of the Fund, each such unit representing an equal undivided beneficial interest in any of the Fund’s distributions, whether of net income, net realized capital gains or other amounts, and in any distributions by the Fund in the event of the Fund’s termination.

“**Unitholders**” means, at the relevant time, the holders of the Units.

EXPLANATORY NOTES

All information contained in this Annual Information Form is presented as of December 31, 2011 unless otherwise indicated. All dollar amounts are stated in Canadian currency unless otherwise stated. Reference is made to the glossary for the meaning of certain defined terms.

FORWARD-LOOKING STATEMENTS

Certain statements in this Annual Information Form that are not current or historical factual information may constitute forward-looking information within the meaning of applicable securities legislation. Forward-looking information can be identified by words such as “may”, “will”, “should”, “expect”, “anticipate”, “believe”, “plan”, “intend” and other similar words. Forward-looking information reflects current expectations regarding future events and operating performance and speaks only as of the date of this Annual Information Form. It should not be read as a guarantee of future performance or results and will not necessarily be an accurate indication of whether or not those results will be achieved. Forward-looking information is based upon a number of assumptions and is subject to known and unknown risks, uncertainties and other factors, many of which are beyond the Company’s control, that may cause the Company’s actual results, performance or achievements, or those of Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking information. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying forward-looking information: competition; availability of premium quality coffee beans; the ability to attract qualified franchise partners; the location of Second Cup cafés; the closure of Second Cup cafés; loss of key personnel, compliance with government regulation; potential litigation; the ability to exploit and protect the Second Cup Marks; changing consumer preferences and discretionary spending patterns including, but not restricted to, the impact of weather and economic conditions on such patterns; and reporting of Gross Revenue by franchise partners. The foregoing list of factors is not exhaustive, and investors should refer to the risks described under “Risk Factors”.

Although the forward-looking information contained in this Annual Information Form is based upon assumptions, current estimates, expectations and projections, which we believe are reasonable in the circumstances as of the current date, there can be no assurance that actual results will be consistent with this forward-looking information. You should not place undue importance on forward-looking information and should not rely upon this information as of any other date. The Company is providing the forward-oriented financial information and financial outlook set out in this Annual Information Form for the purpose of helping explain the objectives and strategies of the Company. Readers are cautioned that this information may not be appropriate for any other purpose.

Other than as required under securities laws, the Company does not undertake to update any such forward-looking information. Additional information about these assumptions and risks and uncertainties is contained in the Company’s filings with securities regulators. These filings are also available at www.sedar.com

In addition to using financial measures prescribed by International Financial Reporting Standards (“IFRS”), non-IFRS financial measures and other terms are used in this Annual Information Form. These terms include “system sales”, “system sales of cafés in the royalty pool” and “same café sales growth”. These terms are not financial measures recognized by IFRS and do not have any standardized meaning prescribed by IFRS and therefore may not be comparable to similar terms and measures presented by other similar issuers. System sales and same café sales growth are presented in reference to the sales performance of all cafés in Canada. The Company believes

they are useful measures as they provide an indication of the top-line sales. These non-IFRS measures and terms are intended to provide additional information on the Company's performance and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with IFRS.

CORPORATE STRUCTURE

Name, Address and Jurisdiction of Formation

The Company is the successor to Second Cup Income Fund following completion of the reorganization of the income trust structure of the Fund into a corporate structure by way of a court approved plan of arrangement and articles of arrangement under the OBCA on January 1, 2011. Pursuant to the Arrangement, the Fund was dissolved and common shares of the Company were distributed to Unitholders of the Fund on the basis of one common share of the Company for each Unit held. Prior to the Arrangement, The Second Cup Ltd. was an indirect wholly-owned subsidiary of the Fund. From and after completion of the Arrangement, the Company has carried on the entire business previously carried on by the Fund and its subsidiaries. The board of directors of the Company are comprised of the individuals who were formerly members of the board of trustees of the Fund. The Company's Shares are posted and listed for trading on the Toronto Stock Exchange under the symbol "SCU".

GENERAL DEVELOPMENT OF THE BUSINESS

Establishment of the Second Cup Income Fund

Second Cup Income Fund was established on October 22, 2004 and completed an initial public offering on December 2, 2004 raising aggregate proceeds of approximately \$95.8 million. The Fund used the net proceeds of the offering to indirectly acquire the Second Cup Marks and entered into the Licence and Royalty Agreement pursuant to which The Second Cup Ltd. was granted the Licence to use the Second Cup Marks and agreed to pay a royalty to a subsidiary of the Fund. On April 2, 2007, the Fund completed an internal reorganization pursuant to which the subsidiary corporations of the Fund were replaced with a newly formed trust and limited partnership.

Acquisition of Second Cup

On June 27, 2009, the Fund acquired all the issued and outstanding shares of The Second Cup Ltd. Following the closing of the acquisition, The Second Cup Ltd. and its management team continued to operate the Second Cup business as an indirect wholly-owned subsidiary of the Fund. Prior to the acquisition, the Fund derived its revenue through royalty payments indirectly received from The Second Cup Ltd. pursuant to the Licence and Royalty Agreement. Following the acquisition, the business of the Fund and the business of The Second Cup Ltd. previously carried on separately were recombined.

Conversion to a Corporate Structure

On June 2, 2010, the Unitholders of the Fund approved by special resolution the Arrangement providing for the reorganization of the income trust structure of the Fund into a publicly traded corporation named "The Second Cup Ltd.". The Arrangement was approved by the Ontario Superior Court of Justice on April 26, 2010 and became effective on January 1, 2011. Pursuant to the Arrangement, on January 1, 2011, the Fund was dissolved, The Second

Cup Ltd. and 2241221 Ontario Inc. were amalgamated, and the corporation resulting from such amalgamating called “The Second Cup Ltd.” issued to the then Unitholders of the Fund one Share for each Unit held.

The Shares commenced trading on the TSX on January 4, 2011 under the symbol “SCU”. The Units were delisted from the TSX on December 31, 2010.

As a result of the Arrangement, the Company carries on the entire business previously carried on by the Fund and its subsidiaries and is the successor reporting issuer of the Fund in all provinces and territories of Canada, the same jurisdictions as those of the Fund prior to the Arrangement. In addition, as a result of the Arrangement, the Fund ceased to be a reporting issuer.

BUSINESS OF SECOND CUP

General

Second Cup is Canada’s largest franchisor of specialty coffee cafés and second largest retailer of specialty coffee, as measured by number of cafés. Since the opening of its first café in suburban Toronto in 1975, Second Cup’s network has grown to 359 cafés across Canada as at December 31, 2011, of which 352 are franchised and 7 are company-owned. For the 52 weeks ended December 31, 2011, Second Cup’s system sales were \$193,660,000.

Second Cup cafés offer a wide selection of brewed specialty coffees, hot and cold espresso-based beverages, blender drinks, specialty teas and hot chocolates for in-store, take-out and drive-thru consumption. In addition to coffee-based products and other beverages, Second Cup cafés carry a variety of complementary products, including pastries, muffins, cookies, coffee accessories and coffee-related gift items, with some cafés also offering sandwiches.

What is Specialty Coffee?

The term “specialty coffee”, as used in reference to coffee production, refers to coffee produced from specialty grade Arabica coffee beans prepared according to exacting standards. Typically, specialty coffee is sourced from the top 10% of the world’s Arabica coffee bean production and must satisfy stringent grading and sorting standards, which results in a distinct, tangible difference in the taste profile of specialty coffee as compared to premium grade or commodity grade coffee and instant coffee. The term “specialty coffee”, as used in reference to the retail market for coffee products, is increasingly being used as a general term to describe the sector within the coffee market characterized by cafés offering an upscale retail experience and hand-crafted, premium coffee products such as espresso-based beverages, blender drinks and iced coffee beverages.

History

Second Cup opened its first café in a shopping mall in suburban Toronto in 1975. Throughout the late 1970s and 1980s, the chain experienced rapid growth. By 1989, Second Cup had approximately 130 cafés, with shopping malls and office tower locations comprising over two thirds of its café network, and sales consisting mainly of brewed coffee, whole bean coffee and coffee-related merchandise.

Throughout the 1990s and early 2000s, Second Cup focused on extending its core product offering to include espresso-based beverages, iced beverages, blender drinks, and complementary food items such as pastries, muffins and cookies. During this period, Second Cup also continued to expand by opening cafés in street-front locations and power

and strip centres, as well as in non-traditional retail locations such as hospitals, universities, airports, train stations and other transportation venues.

In December 2004, The Second Cup Ltd. sold the Second Cup Marks to the Fund and entered into the Licence and Royalty Agreement in conjunction with the Fund's initial public offering. Second Cup retained a 15% interest in the issued and outstanding Units of the Fund.

On November 14, 2006, Mr. Gabriel Tsampalieros, the Chairman and Chief Executive Officer of The Second Cup Ltd. purchased all of the issued and outstanding shares of The Second Cup Ltd. through S.C. Coffee Co., a corporation controlled by him. The transaction excluded the Fund Units previously held by The Second Cup Ltd. In addition, S.C. Coffee Co. also purchased all the international Second Cup trade-marks which were not transferred to the Fund in connection with the Fund's initial public offering in December 2004.

On June 27, 2009, S.C. Coffee Co. sold all of the issued and outstanding shares of The Second Cup Ltd. to a subsidiary of the Fund recombining the business of the Fund with the business of Second Cup. As a result of the transaction, The Second Cup Ltd. became an indirect wholly-owned subsidiary of the Fund.

On January 1, 2011, the reorganization of the income trust structure of the Fund into a dividend paying publicly traded corporation named "The Second Cup Ltd." pursuant to the Arrangement was completed.

By January 1, 2012, Second Cup had 359 cafés in Canada and system sales of \$193,660,000 for the 52 weeks ended December 31, 2011.

Competitive Conditions

The Canadian specialty coffee market is highly competitive and highly fragmented, with few barriers to entry. Management estimates that independent specialty coffee retailers constitute approximately 50% of specialty coffee cafés in Canada as measured by number of locations. Three specialty coffee retailers have a significant presence in Canada: Second Cup, Starbucks and Timothy's. Starbucks' annual report shows that it operates approximately 1120 locations in Canada (as of October 2, 2011), and Timothy's website states that it operates approximately 100 locations in Canada, (as of February 17, 2012) The remainder of the branded specialty coffee chains in Canada consist of smaller, mainly regional, participants such as A.L. Van Houtte, Blenz, Café Dépôt, Café Suprême, Café Presse and Williams Coffee Pub.

Management is not aware of any reliable third party comparable data on the trends affecting the Canadian specialty coffee market during the year or the performance of Second Cup's competitors in the Canadian specialty coffee market during this period.

In addition to specialty coffee retailers, there are a number of "mainstream" coffee retail chains, such as Tim Horton's, Coffee Time and Country Style, who compete with Second Cup in the Canadian coffee market and a growing number of "quick service restaurants" such as McDonalds who have also added premium and specialty coffee to their service offerings.

With 359 cafés as at December 31, 2011, Second Cup has the second largest number of specialty coffee retail outlets in Canada.

The Second Cup Café System

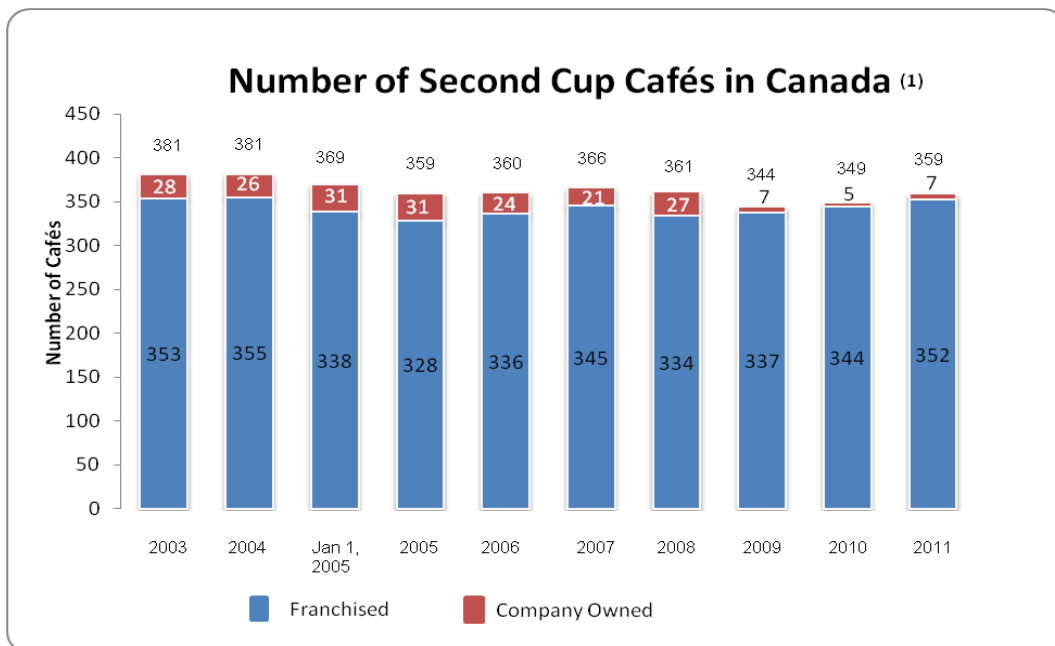
The Second Cup Concept

The Second Cup brand has a high degree of retail visibility, with locations in high-traffic areas in almost every major city in Canada. Second Cup is a franchise-driven business focused on delivering a premium experience to its guests, which includes offering products that are “best in class” and focused on developing innovative, market leading products that make Second Cup cafés a destination of choice for Canadian coffee drinkers. Second Cup is focused on continuing the growth of the Second Cup brand through a combination of growing existing café sales and adding new cafés to the Second Cup network.

Number of Locations

Since 1975, there has been substantial growth in the number of Second Cup cafés in Canada. Following periods of steady expansion in the 1970s and 1980s, Second Cup experienced rapid growth in net new cafés from 1997 to 2000, adding 99 cafes, many of which were in non-traditional retail sites such as “store-in-store”, hospital, airport and other venues.

Following this period of rapid expansion, the number of cafés declined marginally as management focused on enhancing the performance of existing cafés, closing non-performing locations and solidifying the competitive position of Second Cup.



Note:

- (1) All figures are as at the end of the respective fiscal period. For 2003 and 2004, figures are for the 52-week fiscal period ended on the Saturday closest to March 31. For January 1, 2005, figures are for the 40-week period ended January 1, 2005. Second Cup recorded a shortened fiscal period consisting of 40 weeks ended January 1, 2005 as a result of the change in its fiscal year end to coincide with that of

the Fund. For 2005-2008 and 2011, figures are for the 52-week fiscal period ended the last Saturday of December. For 2009 and 2010, figures are for a 12 month period ended December 31.

As illustrated in the chart above, the vast majority of Second Cup cafés are franchised. Although Second Cup is a franchise-driven business, it operates company-owned cafés from time to time as an intermediary measure before transitioning operation to a franchise partner. Second Cup also operates some Company owned cafés as test sites for product and service innovation.

In addition to focusing on identifying locations for new cafés, Second Cup also carefully monitors the performance of its existing network of franchised cafés and closes under performing cafés on a managed basis. By closing under performing cafés and carefully selecting locations for new cafés, Second Cup seeks to strengthen its café network and increase average sales per café.

Second Cup Café Openings and Closings

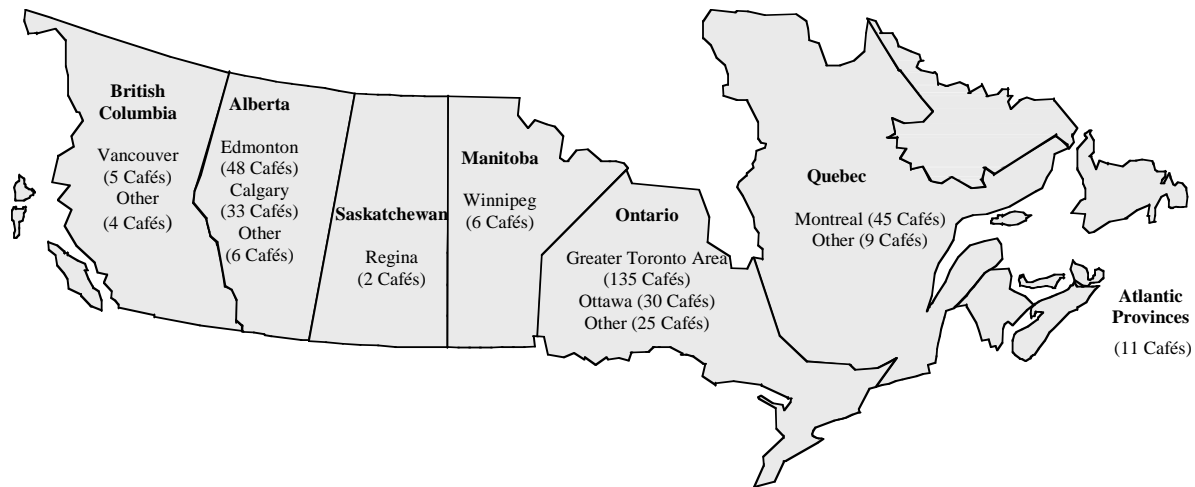
	<u>Mar. 2003</u> ⁽¹⁾	<u>Mar. 2004</u> ⁽¹⁾	<u>Jan. 2005</u> ⁽²⁾	<u>2005</u> ⁽³⁾	<u>2006</u> ⁽³⁾	<u>2007</u> ⁽³⁾	<u>2008</u> ⁽³⁾	<u>2009</u> ⁽⁴⁾	<u>2010</u> ⁽⁴⁾	<u>2011</u> ⁽³⁾
Openings	10	12	7	6	16	14	12	13	13	22
Closings	17	12	19	16	15	8	17	30	8	12

Notes:

- (1) For 2003 and 2004, figures are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) Figures for January, 2005 reflect café openings and closings for the 40-week period ended January 1, 2005. Second Cup recorded a shortened fiscal period consisting of 40 weeks ended January 1, 2005 as a result of the change in its fiscal year to coincide with that of the Fund.
- (3) Figures for 2005-2008 and 2011 are for the 52-week fiscal period ended the last Saturday of December.
- (4) For 2009 and 2010, figures are for a 12 month period ended December 31.

Geographic Presence

Second Cup cafés are geographically dispersed across Canada and are primarily concentrated in large urban centres such as Toronto, Calgary, Montreal, Edmonton, Ottawa and Vancouver. The following map illustrates the geographic distribution of Second Cup cafés in Canada.



Café Types

Second Cup cafés are situated in a wide range of high-traffic, high-visibility locations, consisting of street-fronts, shopping malls, office towers, power and strip centres and non-traditional retail sites such as hospitals, universities, “store-in-store” sites, airports, train stations and other transportation venues. Second Cup café sizes range from 60 square foot cappuccino bars to 2,800 square foot street-front locations with self-contained customer seating areas and outdoor patios.

The following table illustrates the relative mix of location types in the Second Cup café network as at December 31, 2011:

	<u>Number of Cafés</u>	<u>% of Total</u>
Street-Fronts.....	94	26%
Power and Strip Centres	93	26%
Shopping Malls.....	65	18%
Non-Traditional	70	20%
Office Towers	37	10%
Total	<u>359</u>	<u>100%</u>

- *Street-Fronts* — As at January 1, 2012 there were 94 Second Cup cafés operating in street-front locations, representing 26% of all Second Cup cafés in Canada. Street-front cafés average 1,500 square feet and generally contain seating for approximately 15 or more customers, with many also offering external patio seating.
- *Power and Strip Centres* — With the growth of power and strip centres containing “big box” retailers and factory outlet stores, Second Cup has opened an increasing number of cafés in this type of venue. Second Cup currently has 93 cafés operating in power and strip centres, representing 26% of all Second Cup cafés in Canada. Power and strip centre cafés average 1,700 square feet and typically have self-contained seating and external patio areas, with some having drive-thru access as well.
- *Shopping Malls* — There are currently 65 Second Cup cafés operating in shopping malls, representing 18% of all Second Cup cafés in Canada. These cafés average 600 square feet, but can range from 60 square foot cappuccino bars to 1,600 square foot sites.
- *Non-Traditional* — Second Cup has developed a flexible café format that is suitable for non-traditional retail locations, such as hospitals, universities, “store-in-store” sites, airports, train stations and other transportation venues. Second Cup currently operates 70 non-traditional cafés, representing 20% of all Second Cup cafés in Canada, and consisting of 12 cafés located in hospitals, 33 cafés located in educational venues, 10 cafés located in transportation venues and 15 cafés located in “store-in-store” sites, mainly in combination with Harvey’s branded restaurants within Home Depot stores.
- *Office Towers* — Second Cup currently has 37 cafés operating in office towers, representing 10% of all Second Cup cafés in Canada. Office tower cafés average 850 square feet, but can range from 150 square foot cappuccino bars to 1,600 square foot sites. Office tower locations tend to serve a captive customer base of individuals working in the office tower itself.

New Locations

Prior to entering a particular market area, Second Cup conducts a thorough market assessment to determine the optimal number and placement of cafés. Second Cup's location selection process involves a variety of analytical techniques to evaluate factors that impact upon the viability of a proposed location, such as visibility, accessibility and traffic, as well as population density, household income, local competition and the proximity to major activity centres. New lease commitments entered into by Second Cup are carefully screened by management using a projected return on investment analysis. Second Cup believes that careful diligence in evaluating proposed new café locations has contributed to its success and helped minimize the number of under performing cafés in the Second Cup network.

Leases

Almost all Second Cup cafés are operated in leased premises. Second Cup enters into the head lease for each café location and, in turn, enters into a sublease with each of its franchise partners. Second Cup believes that entering into such arrangements allows it to maintain greater control over, and flexibility with respect to, the development process and the ongoing goodwill generated at its cafés. The leases that have been entered into by Second Cup are renewable over a staggered period, with an average of approximately 35 leases coming up for renewal annually over the next 10 years. The staggered nature of the lease renewal periods provides Second Cup with the flexibility to address under performing cafés, and ensures the periodic refreshment of the café network as franchise partners are required to modernize locations upon the renewal of the franchise agreement.

Products

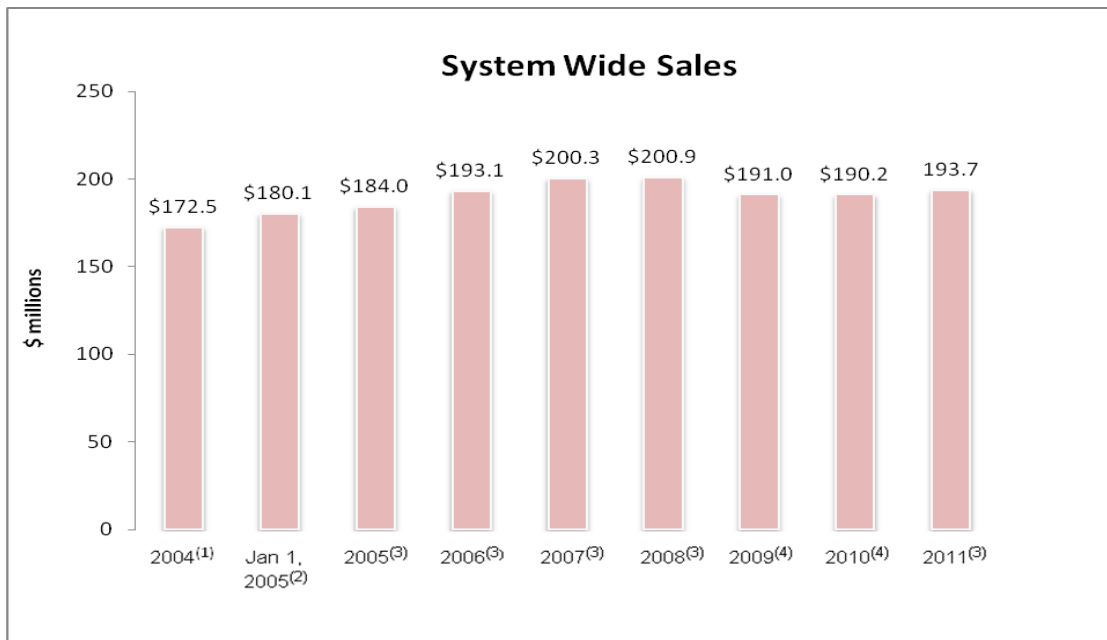
Second Cup's coffee portfolio includes over 25 types of coffee, including a number of single origin estate coffees and a variety of blends exclusive to Second Cup, such as Paradiso[®], Espresso Forte and Second Cup's Holiday Blend. Second Cup has developed a custom five-point roast scale to distinguish each coffee by its degree of roast. Ranging from one to five (with five being the darkest roast), the use of the roast scale permits customers to select the degree of roast that corresponds to their taste preference. Second Cup also offers a wide variety of espresso-based beverages and blender drinks such as espressos, cappuccinos, lattes and iced coffees, and is continually developing variations of these products. Examples of innovative espresso-based beverages and blender drinks developed by Second Cup include the Moccaccino[™], Caramel Corretto[®], Chillatte[®], Frrrozen Hot Chocolate[™] and Icepresso Chiller[™].

During 2008, Second Cup introduced a new fair-trade and organic certified blend of coffee entitled Cuzco and a retail whole bean program in café in sealed valve bags merchandised in free standing racks. In January 2009, Second Cup launched a light-medium roast blend of coffee named Mellow Blend, sourced from Columbia, Costa Rica and Peru. Two new tea lattes named Green Tea Matcha Latte and London Fog Latte, were introduced to the market in April 2009. During the summer of 2009, Second Cup added a Sparkling Green Tea Lemonade made from green tea concentrate and a Vanilla Yogurt Smoothie that is high in pro-biotic fibre to the cold beverage product offerings. During 2010, Second Cup introduced three new lattes; Caramel Apple Latte, Cinnamon Latte and Hazelnut Mocha Latte. In the fall of 2010, Second Cup introduced its limited edition Blend 35 coffee in celebration of its 35th Birthday. Second Cup improved upon the environmental sustainability of its beverages in 2011, with 80% of the coffee portfolio, 100% of its espresso beverages, and 100% of its new, silk sachet tea collection certified by third parties such as the Rainforest Alliance as environmentally sustainable products. The new teas were highlighted during the summer of 2011 by featuring the new Wildberry Brewed Iced Tea and Harvest Berry Tea in Second Cup's product line up. White chocolate chiller beverages were also launched in the summer of 2011 and in the fall, Second Cup's offerings were a Salted Caramel Hot Chocolate, Pumpkin Spice Latte and Pumpkin Spice Chiller.

In addition to coffee-based products and other beverages, Second Cup cafés carry a variety of complementary products, including pastries, muffins, cookies, coffee accessories and coffee-related gift items, with most cafés also offering sandwiches. Second Cup introduced breakfast cookies, snack bars, yogurt parfaits, grilled sandwiches, and hot breakfast sandwiches in order to capitalize on the consumer need for convenience and “one stop shopping” on what it has identified as a trend in customer preference towards snacking occasions as a substitute for traditional meals. Second Cup has also put more focus on developing its cafés as a destination for high quality, seasonal merchandise such as that offered during the holiday season which customers expect from a premium specialty coffee retailer. The breakfast category of food products was broadened in 2009 with the launch of Summer Berry/Sweet Vanilla Oatmeal and Maple Pecan Oatmeal; both products are made with instant oatmeal and designed for “on the go” consumption.

Sales

Since 1995, Second Cup’s system sales have almost tripled, from \$71,400,000 for the 52-week period ended June 24, 1995 to \$193,659,505 for the 52 weeks period ended December 31, 2011. The increase in system sales has been achieved through a combination of growth in the number of cafés, as well as same café sales growth.



Notes:

- (1) 2004 results are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) For January 1, 2005, results shown are for the 52-week period ended January 1, 2005. Second Cup recorded a shortened fiscal period consisting of 40 weeks ended January 1, 2005 as a result of the change in its fiscal year-end to coincide with that of the Fund. Sales for the 40-week period ended January 1, 2005 were \$140,848,000.
- (3) 2005 -2008 and 2011 figures are for the 52-week fiscal period ended the last Saturday of December.
- (4) For 2009 and 2010 figures are for a 12 month period ended December 31.

Same Café Sales Growth and Average Sales per Café

As indicated in the table below, since 2003, annual same café sales growth has averaged approximately 1.6%. Second Cup has achieved such growth by increasing brand awareness and expanding product offerings.

Same Café Sales Growth

2003⁽¹⁾	2004⁽¹⁾⁽²⁾	2005⁽³⁾	2005⁽⁴⁾	2006⁽⁴⁾	2007⁽⁴⁾	2008⁽⁴⁾	2009⁽⁵⁾	2010⁽⁵⁾	2011⁽⁴⁾
-0.3%	-0.7%	5.8%	4.6%	6.2%	3.1%	0.2%	-3.2%	0.0%	-0.1%

Notes:

- (1) For 2003 and 2004, figures are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) Second Cup results were impacted by the power outage that occurred in Ontario in August 2003 and the outbreak of SARS in the Greater Toronto Area in April 2003 through June 2003. The financial results for these periods are reflected in fiscal 2004.
- (3) As a result of a change in its fiscal year-end subsequent to the creation of the Fund, Second Cup changed its year-end from the Saturday closest to March 31 to the Saturday closest to December 31. Same Café Growth of 5.8% represents growth for the 40-week period ended January 1, 2005.
- (4) 2005-2008 and 2011 figures are for the 52-week fiscal period ended the last Saturday of December.
- (5) For 2009-2010 figures are for a 12 month period ended December 31.

Second Cup has increased average sales per café from approximately \$420,000 in 1997 to approximately \$557,000 for the year ended December 31, 2011. With minor exceptions, Second Cup has consistently maintained or improved average sales per café each year.

Average Sales per Café
(thousands)

2003⁽¹⁾	2004⁽¹⁾⁽²⁾	2005⁽³⁾	2005⁽⁴⁾	2006⁽⁴⁾	2007⁽⁴⁾	2008⁽⁴⁾	2009⁽⁵⁾⁽⁶⁾	2010⁽⁶⁾	2011⁽⁴⁾
\$462	\$464	\$489	\$512	\$549	\$565	\$565	\$554	\$563	\$557

Notes:

- (1) For 2003 and 2004, results are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) Second Cup results were impacted by the power outage that occurred in Ontario in August 2003 and the outbreak of SARS in the Greater Toronto Area in April 2003 through June 2003. The financial results for these periods are reflected in fiscal 2004.
- (3) As a result of a change in its fiscal year-end subsequent to the creation of the Fund, Second Cup changed its year-end from the Saturday closest to March 31 to the Saturday closest to December 31. This number represents average sales for cafés reporting at least 50 weeks of sales in the 52-week period ended January 1, 2005.
- (4) For 2005-2008 and 2011, figures are for the 52-week fiscal period ended the last Saturday of December. This number represents average sales figures for cafés reporting at least 50 weeks of sales in the respective 52-week period.
- (5) Second Cup results were impacted by the economic downturn in 2009.
- (6) For 2009-2010, figures are for a 12 month period ended December 31.

Seasonality

The first quarter represents the lowest average system sales quarter for the year due to the seasonality of the business. The final quarter, which includes the holiday sales periods of November and December in the retail industry, generally constitutes the highest average system sales quarter of the fiscal year.

Advertising and Marketing

Second Cup's marketing and advertising initiatives are directed toward enhancing the Second Cup brand, promoting new products and driving traffic into cafés. Second Cup strives to create highly relevant and appealing programs that are consistent with the delivery of the "The Coffee Company That Cares" which our customers have come to expect.

Second Cup's marketing program is funded through contributions made by company-owned and franchised cafés to a national co-operative fund, which is administered by Second Cup. All Second Cup cafés, subject to some exceptions, are required to remit a fixed percentage of their Gross Revenue (typically 3.0%, depending on the type of café) to this fund. These contributions are used to pay for the development and execution of marketing plans, product research and development, training, in-café improvement initiatives and other programs that benefit the Second Cup system as a whole. Examples of such initiatives include print advertising (magazine and newspaper), outdoor advertising (billboard) and internet marketing. The fund is also applied towards other programs such as Café Card administration.

In addition to contributing to the national co-operative fund, as part of the standard franchise agreement, a franchise partner is required to make expenditures on local advertising and promotion of the café in an amount equal to the greater of 2% of the franchise partner's annual Gross Revenue and the amount required to be expended pursuant to the provisions of the relevant lease relating to the premises.

Purchasing and Distribution

In order to differentiate its specialty coffee products on the basis of quality, Second Cup has established exacting standards for the sourcing, roasting, packaging, distribution and blending of Second Cup coffee.

Sourcing

Second Cup uses only Arabica coffee beans, which it seeks to buy from the best growers around the globe. Second Cup's green coffee beans are sourced from a diverse set of suppliers in Central America (Costa Rica and Panama), South America (Colombia, Peru and Brazil), Africa (Kenya and Ethiopia) and Indonesia (Sumatra and Java). Management estimates only 1% to 2% of the world's Arabica coffee beans grown each year meet Second Cup's stringent standards for procurement.

Second Cup has spent years developing and nurturing long-term relationships with farmers, co-operatives and processors in order to secure its supply of high quality coffee. These relationships permit Second Cup to offer many coffees on an exclusive basis. One example is La Minita, an estate coffee from Costa Rica regarded by many in the specialty coffee industry as one of the world's finest. Second Cup continuously aims to strengthen its coffee sourcing programs by visiting coffee growing regions on a regular basis, solidifying relationships with suppliers, sharing best practices with growers and finding additional sources of the highest quality coffee.

Second Cup believes that it has developed relationships with a sufficient number of growers to have a secure source of premium coffee beans. However, Second Cup generally does not enter into long-term or written agreements with its growers. Second Cup also believes that it has established a sufficient number of alternative sources of high quality coffee beans that could be accessed if any coffee currently purchased from existing suppliers became unavailable or economically unviable.

As with all commodities, coffee is subject to fluctuations in price. Second Cup utilizes the services of a major North American coffee & tea company that carries out the purchasing of Second Cup's coffee beans pursuant to a custom coffee processing and distribution agreement described below. Through its agreement with this company, Second Cup typically locks in a portion of its future coffee costs rather than leaving itself exposed to changes in spot prices. By locking in supply costs, Second Cup and its franchise partners can better predict costs and availability of key ingredients.

Roasting, Packaging and Distribution

As part of its commitment to deliver roaster-fresh, quality products to each café, Second Cup combines the purchase of high quality coffee beans with high standards for roasting, packaging and distribution. Second Cup has the benefit of a custom coffee processing and packaging agreement (the "Coffee Processing Agreement") with one of the largest private label coffee and tea manufacturers in North America under which Second Cup has control over the inventory, roasting, and packaging of its coffee products. The Coffee Processing Agreement enables Second Cup to maintain control of its costs and quality standards while leveraging the manufacturing skills of a third party. Second Cup also has a distribution agreement with a national distribution company which provides Second Cup with access to a national system of warehousing and distribution that affords each café continuous availability of freshly roasted coffee and other products. Furthermore, by virtue of these agreements, Second Cup does not have to invest in production facilities, equipment or working capital and can remain focused on the retail aspect of the business.

Quality Control

Second Cup believes that it is essential to maintain quality control standards at every step in the purchasing and distribution process in order to meet customer expectations.

Second Cup's quality control procedures begin upon delivery of green coffee beans, when each shipment is inspected and sampled for compliance with specifications prior to being shipped to Second Cup's roasting facility. Once inspected, Second Cup coffees are roasted using a "batch roasting" method. This method calls for roasting comparatively small amounts of beans at any one time to maximize the taste profile of each roast. Batch roasting allows Second Cup to ensure superior coffee quality because of the ability to determine the exact temperature and length of time for its various roasts. In addition, by using a dedicated roasting facility, Second Cup is able to maintain a consistently high standard of coffee beans free of contamination from beans of lower quality used by other coffee producers.

Second Cup also adheres to a strict packaging policy. As is standard in the specialty coffee industry, coffee is packaged in special one-way valve bags, which allow gases emitted by the freshly roasted coffee to escape while preventing air or moisture from entering the bag and causing the coffee to become stale. This contrasts with the majority of non-specialty coffee, which is packaged in tins or brick packs in which the coffee cannot be packaged until after gases cease emission and the staling process commences.

Second Cup has also established quality control standards for the blending of its coffee. For in-café preparation, coffee must be used within four hours of being ground and must be sold according to Second Cup's exacting standards for freshness.

Franchise Operations

Second Cup is the largest specialty coffee café franchisor in Canada. It views its franchise system as the principal means to successfully enhance and expand the Second Cup brand and café network. As at December 31, 2011, Second Cup had 352 franchise partner developed cafés in operation, owned by a total of approximately 202 different Second Cup franchise partners.

Second Cup's rigorous and systematic franchise partner screening and selection process has been developed to ensure that only candidates with appropriate skill levels, professional experience, financial capital, passion for the business and drive to succeed are selected to become Second Cup franchise partners. Franchise partners go through a pre-screening process that consists of financial and background checks as well as a series of interviews with senior management prior to receiving approval to become a Second Cup franchise partner.

As of December 31, 2011, Second Cup's candidate selection process had yielded a pool of 62 approved candidates to whom Second Cup could offer Second Cup franchises.

Second Cup franchise partners typically invest between \$240,000 and \$400,000 to open a new Second Cup café. They own and operate the Second Cup cafés as independent businesses, licensed under a franchise agreement to use the Second Cup Marks. Second Cup franchise partners are required to devote their full time and attention to the business and to personally play a leadership role in the café's operations.

Second Cup has a proven ability to select, develop, manage and motivate franchise partners to drive long-term growth both within existing cafés and through new café growth. Over the past three decades, Second Cup has developed an operating system that provides each franchise partner with the training, tools and guidance to enable each franchise partner to maximize its business potential. Key components of this system include effective site selection, café design and build out, equipment selection and maintenance programs, "best in class" products and services from suppliers, and innovative product development and category management.

At Second Cup, franchise partners who consistently meet high operational standards are given the opportunity to become franchisees of additional units and are known as "multi-unit" operators. Multi-unit franchising has helped accelerate new café growth and has served as a motivating incentive for single-café franchise partners.

Second Cup Franchise Agreements

The relationship between Second Cup and each of its franchise partners is governed by a franchise agreement. Although the terms of the franchise agreements entered into with Second Cup franchise partners may differ for certain franchise partners (e.g., Cara Operations Limited and certain non-traditional franchise partners, such as hospitals and universities), they are substantially similar and are summarized below.

Upon execution of a franchise agreement, a Second Cup franchise partner must pay certain fees, including an initial non-refundable franchise fee, which is currently \$40,000. In addition to the initial franchise fee, the franchise partner must pay all expenses incurred in order to fully construct or complete all improvements to the premises to ensure that it is in accordance with Second Cup's standards.

Under the standard Second Cup franchise agreement, a franchise partner pays an ongoing royalty of 9% of the café's Gross Revenue. While there are certain cafés which pay a lower royalty rate, the vast majority of these cafés are located in institutions such as hospitals and educational facilities which typically require less franchisor support. As a result, the overall effective average royalty rate for all Second Cup franchise partners is approximately 8.2%. The effective average royalty rate fell from 8.5% in the previous fiscal year as a result of an incentive program that reduced

the royalty rate for new cafés during the two initial years of operation, as well as café specific arrangements in place during the period. Royalties are payable in instalments, on or before the 10th day immediately following the end of a four-week period determined in accordance with Second Cup's accounting system.

"Gross Revenue" is defined generally in the standard Second Cup franchise agreement to mean the total amount of all sales and other income whatsoever, from whatever source (whether it be of a retail, wholesale or other nature), derived from operating a Second Cup café or any other business activity whatsoever at the Second Cup café, or derived from selling any products from any location, whether or not such amounts are collected and whether payment is made by way of cash, credit or otherwise. Without limiting the generality of the foregoing, Gross Revenue includes:

- All sales made pursuant to telephone, electronic communication or other similarly placed orders;
- The amount of all sales assumed to have been lost by the interruption of the operation of a Second Cup café and which is the basis upon which an insurer has or will pay business interruption insurance;
- All sales made in any part of the shopping mall, building, complex or development in which the Second Cup café is located and/or of which it is a part.

The following is not included in calculating Gross Revenue:

- The amount of any tax imposed by the provincial government of the province within Canada in which the Second Cup café is located, directly on retail sales and collected from customers in their presence at the time of the sale, provided that the amount of any such tax is in fact paid by the operator of the Second Cup café to the provincial government;
- The amount of any sales tax imposed by the federal government of Canada, directly on retail sales and collected from customers in their presence at the time of sale, provided the amount of the sales tax is in fact paid by the operator of the Second Cup café to the federal government of Canada.

In calculating Gross Revenue, the following is deducted:

- The amount of any cash refunded to a customer on account of the return of any products, provided that the amount refunded in respect of such products was originally included in calculating Gross Revenue;
- An exchange of products made between the operator of the Second Cup café and a customer, provided that the amount paid for the products by the customer was originally included in calculating Gross Revenue;
- An amount equal to the value of any discount given to a customer on account of the purchase of any products through the use of a coupon or other similar promotions approved by Second Cup, provided the sale upon which the discount is given was recorded at full value in calculating Gross Revenue.

In calculating Gross Revenue, no allowance whatsoever is made for bad debts. Each sale of products made upon instalment or credit is treated as a sale at the full price at the time such products are ordered, irrespective of the time when the operator of the Second Cup café delivers the products or receives payment for such products.

As part of the standard franchise agreement, a franchise partner is also required to make expenditures on local advertising and promotion of the café in an amount equal to the greater of 2 % of the franchise partner's annual Gross

Revenue and the amount required to be expended pursuant to the provisions of the relevant lease relating to the premises. In addition to local advertising and promotion, the majority of franchise partners are required to contribute 3.0% of their annual Gross Revenue to Second Cup's national co-operative fund. This fee is payable to Second Cup at the same time as the royalty fee described above. See "Advertising and Marketing" above.

Second Cup typically enters into the head lease for a café location and, in turn, enters into a sublease with the franchise partner concurrently with the entering into of the franchise agreement. Pursuant to the sublease, the franchise partner agrees to observe and perform all of the terms and conditions contained in the head lease. The franchise partner is generally responsible for paying all rent and other amounts to be paid by Second Cup under the head lease in addition to all amounts payable under the franchise agreement, which are deemed to be additional rent owing under the head lease and sublease, entitling Second Cup to the remedies provided for the non-payment of rent. Any default by the franchise partner under the sublease is deemed to be a default under the franchise agreement, allowing Second Cup to terminate the franchise agreement. Similarly, any default by the franchise partner under the franchise agreement is deemed to be a default under the sublease, allowing Second Cup to terminate the sublease.

Aside from the head lease, Second Cup is not obliged to provide any financial covenants or guarantees in connection with a franchise partner's financial arrangements, including with respect to equipment leases and supply purchases. Further, each franchise partner is required to maintain risk insurance in respect of the leased premises and equipment (to their full replacement value), comprehensive general liability insurance, business interruption insurance, insurance required pursuant to the lease of the premises and such other coverage as Second Cup may require from time to time.

Unless terminated earlier by Second Cup in accordance with its terms, the term of each Second Cup franchise agreement commences on execution of the agreement and terminates at the close of business on the day which is one day prior to the earlier of: (i) the date upon which the specific term of the lease governing the occupancy of the premises at the time of entering into of the franchise agreement expires and (ii) the date on which the lease for the premises is terminated. Upon completion of this term, which is typically 10 years, but without execution of a new franchise agreement, a franchise partner may, with the consent of Second Cup, continue to occupy the premises and carry on business as a franchise partner of Second Cup on a calendar month-to-month basis upon the same terms and conditions set out in the original franchise agreement. The Second Cup franchise agreement does not confer on the franchise partner any right of renewal.

The Second Cup franchise agreement permits transfers of a franchise partner's interest in a Second Cup café, subject to Second Cup's consent. In the case of a transfer, a franchise partner is required to pay to Second Cup 10% of the purchase price to be paid by the purchaser. Prior to the completion of the transfer, the purchaser is subject to the same screening process as other new candidates and is required to successfully complete any training that may be required by Second Cup.

Franchise Reporting

In accordance with their franchise agreements, franchise partners are required to provide a Gross Revenue report as well as a cash report on a weekly basis. Within 10 days of the end of each four-week period, franchise partners are required to submit a statement of Gross Revenue which sets out daily Gross Revenue and total Gross Revenue for such period. Franchise partners are also required to furnish profit and loss statements and various other reports, including completed labour schedules, production reports, purchase records and inventory forms.

In addition to self-reporting by franchise partners, Second Cup's regional managers are required to "score" Second Cup cafés approximately three times per year against an exhaustive list of operational standards to ensure quality and consistency in the chain.

Franchise Support Systems

Second Cup's franchise system is managed by its Vice President Operations, who is supported by two regional directors and 13 regional managers, as well as a number of other employees in customer service, training and other operational functions. Second Cup seeks to provide a variety of support services to its franchise partners to assist them in becoming successful operators, including the following:

- *Franchise Partner Selection and Approval* — Second Cup continuously improves upon its systematic approach to the selection of franchise partners. Potential franchise partners, whether they are acquiring cafés from Second Cup or from existing Second Cup franchise partners, are required to go through a series of checks, interviews and hands-on performance evaluations to ensure that the quality of Second Cup's franchise partner base is continuously improving.
- *Real Estate and Development* — Second Cup's real estate and development teams take a lead role in identifying and securing prime development locations for new cafés. This includes market and site analysis and site-specific financial projections, allowing senior management the opportunity to make informed decisions on potential sites prior to franchise partner selection. In addition, the team negotiates with landlords on all new and renewal lease agreements. Second Cup provides full management services (including design, equipment procurement and construction management services) to franchise partners for both the construction of new cafés, as well as the remodelling and upgrading of existing cafés, to ensure that the cafés conform to current design standards.
- *Second Cup School of Business* — Second Cup strongly believes that coffee knowledge and training represent points of meaningful differentiation in the specialty coffee market. Following the decision to join Second Cup's franchise family, franchise partners enrol in Second Cup's School of Business training program. Over a six-week period, franchise partners are given detailed instruction on the management of a Second Cup café, the fundamentals of coffee and the coffee retailing business. The program includes both classroom sessions and in-café instruction.
- *Training and Development* — In addition to the School of Business, training sessions are conducted periodically throughout the year. Second Cup also provides ongoing guidance for franchise partners through regular visits from regional managers, the holding of periodic seminars, workshops and meetings, and by providing an on-line training program to assist franchise partners in properly training their staff. Additionally, in order to promote a deeply rooted understanding of the coffee industry, each operator is required to make an educational trip to Costa Rica upon entering into the franchise agreement, to experience first hand the growing, harvesting and processing of high quality coffee.
- *Café Opening Support* — Second Cup provides a minimum of 12 to 14 days of full time, in-café support for new café openings. A regional manager provides three days of advance planning and training services to the franchise partner and then remains at the café for a full week following the opening of the café. Furthermore, two one-day follow-up sessions are scheduled 30 and 90 days after the opening of the café to ensure that operating standards are being met.
- *Conventions, Special Events and Franchise Partner Advisory Council* — Second Cup hosts an annual convention at which franchise partners, management and key suppliers interact and participate in educational sessions, workshops and social activities. In addition, regional meetings are held periodically during the year. Furthermore, Second Cup has established a Franchise Partner Advisory Council that provides management with franchise partner feedback and input into key

decision processes. The council is comprised of 11 members elected by the franchise partners and generally meets three times a year to discuss strategy and business objectives with management.

- *I.T. Support Desk* – Second Cup provides technical support services to its franchise partners for cafe cards, debit/credit facilities, cash point of sale systems and wireless internet systems. The Second Cup I.T. help desk currently operates Monday -Friday 8 a.m. - 6 p.m. and Saturday 9 a.m. – 5 p.m. EST. A pilot program is underway to provide 24 hour support to franchise partners for network issues and the intention is to supply this service to all franchise partners.
- *National Marketing and Program Development* — Second Cup is responsible for collecting all contributions from franchise partners to the national co-operative fund, which are then used to advertise the Second Cup brand, promote new and existing products and develop chain-wide programs on behalf of franchise partners.
- *Product Sourcing* — To maintain the quality and consistency of ingredients and products, as well as to ensure that franchise partners obtain favourable pricing, Second Cup establishes product specifications and negotiates supply arrangements with authorized suppliers.
- *Finance and Technology* — Second Cup provides appropriate customized tools and training for franchise partners to manage the financial performance of their cafés and ensure appropriate financial reporting to Second Cup on an ongoing basis. Additional information technology assistance is also provided in the form of standardized point of sale platforms and web-based information systems focused on operational knowledge

The Second Cup Marks

The Second Cup Marks are trade-marks that are registered or the subject of pending applications for registration under the *Trade-marks Act* (Canada), and other unregistered trade-marks used by Second Cup in connection with its business in Canada. The Second Cup Marks also include the methods, systems and procedures for the operation of Second Cup cafés using certain types of equipment, supplies, ingredients, recipes, merchandising and advertising, and business techniques in Canada.

The Second Cup Marks do not include the rights outside of Canada to any trade-marks or trade names used by Second Cup or any affiliated entities in their business, and in particular they do not include the rights outside of Canada to the trade-marks registered or pending registration under the *Trade-marks Act* (Canada).

The following are some of the Second Cup Marks: Amoureux de Choco*lattes[®], Caramel Corretto[®], Chillatte[®], Chiller[®], Chocolat Chaud... Glacé[®], Chocolate Lovers[®], Chocolate Lovers' Lattes[®], Coffee College[®], Corazon[®], Crème Brûlée Ristretto[®], Cuzco[®], Early Edition Blend[®], Encanto[®], Frrrozen Hot Chocolate[®], Fruizzi[®], Icepresso[®], Icepresso Chiller[®], Jumpin' Juice[®], Les Amoureux Du Chocolat[®], Make Second Cup Your Second Home[®], Melange Passion Matin[®], Mocca Mandarino[®], Nouvelles Express[®], Paradiso[®], Passport[®], Profitmaker[®], Rwandan Cup of Hope[®], Second Cup[®], Steamy Monday[®], Take A Second For Yourself[®], The Second Cup[®], The Second Scoop[®], The Ultimate Coffee Experience[®], Tiamo[®], Treat-a-Friend[®], Trebella[®], Veneto Blend[®], What's Brewing[®], Where The World Stops, For Just A Second[®], White Mocca[®], and related design marks.

Employees

As at December 31, 2011, 78 individuals were employed by Second Cup at its head office, as well as an estimated 57 employees in company-owned cafés. Second Cup's employees are not unionized, and Second Cup has never experienced a strike or work stoppage. Second Cup believes that its relations with its employees are very positive.

Government Regulation

Second Cup and its cafés are subject to the laws and regulations that typically apply to a Canadian foodservice operator. For instance, company-owned and franchised Second Cup cafés are subject to regulation by a number of health, sanitation, safety, fire, building and other agencies or governmental authorities in the provinces or municipalities in which cafés are located. Second Cup must also comply with the laws and regulations adopted in the Provinces of Ontario, Alberta, New Brunswick and Prince Edward Island that require certain disclosure to be made with respect to the offer and sale of franchises. These laws require Second Cup to furnish prospective franchise partners located in Ontario, Alberta, New Brunswick and Prince Edward Island, as applicable, with a disclosure document containing information prescribed by these laws. In addition, Second Cup and its franchise partners are subject to provincial labour and employment laws that govern their relationship with employees, such as minimum wage requirements, overtime and working conditions.

Credit Facilities

The Company has outstanding a term loan of \$11,000,000 and an operating loan of \$2,000,000. The Operating Loan is repayable on demand and provides the Fund with working capital from time to time, if required. As at December 31, 2011, there was no balance owing on the Operating Loan.

The indebtedness and liability of the Company under the Term Loan and the Operating Loan are secured by a first ranking security interest in all property of the Company.

Pursuant to the terms of the Operating Loan and Term Loan, the Company is subject to certain financial and other customary covenants, including requirements to maintain a ratio of senior debt to EBITDA and to maintain a trailing four quarter fixed charge coverage ratio. In addition, the Bank may accelerate repayment of the Term Loan and Operating Loan in the case of certain events, including a change in control of the Company or a default by the Company under material agreements or other indebtedness. During the year ended December 31, 2011, the Company was in compliance with all financial and other covenants of the Operating Loan and Term Loan. See "Risk Factors – The Company has outstanding indebtedness".

RISK FACTORS

An investment in the Shares involves a number of risks. In addition to the other information contained in this Annual Information Form, investors and prospective investors should give careful consideration to the following factors.

Risks Related to the Business of Second Cup

The Canadian specialty coffee industry is characterized by intense competition.

The Canadian specialty coffee industry is intensely competitive with respect to price, location and coffee and food quality. In addition to Second Cup, there are two major specialty coffee retailers in Canada, as well as a growing number of smaller, mainly regional, competitors. In addition to competing directly with specialty coffee retailers, Second Cup competes with “mainstream” coffee retailers, as well as, all restaurants and food service outlets that serve coffee and in particular a national quick service food chain has introduced premium and specialty coffee to its menu items. In the whole and ground bean segment of the specialty coffee industry, Second Cup franchise partners will compete against specialty coffee chains as well as supermarkets, many of which have substantially greater financial and other resources than Second Cup franchise partners will have. If Second Cup franchise partners are unable to successfully compete in the Canadian specialty coffee industry, System Sales may be adversely affected.

General economic conditions and a reduction in discretionary revenue/spending could affect the business.

The Canadian specialty coffee industry is also affected by changes in discretionary spending patterns, which in turn are dependent on consumer confidence, disposable consumer income and general economic conditions. Factors such as change in general economic conditions, recessionary or inflationary trends, job security and unemployment, equity market levels, consumer credit availability and overall consumer confidence levels may affect the business. Adverse changes to these factors could reduce customer traffic at Second Cup cafés or impose practical limits on pricing, either of which could reduce System Sales. Because the industry’s revenues are predominantly derived from the sale of coffee and coffee beverages, changes in consumer preferences which result in decreases in coffee consumption would have an adverse effect on the industry, including Second Cup and the Second Cup franchise partners. The coffee business is also affected by changes in demographic trends, traffic and weather patterns and the type, number and proximity of competing cafés. In addition, factors such as inflation, increased ingredient, raw material, labour and benefit costs and the availability of experienced management and hourly employees may adversely affect the Canadian specialty coffee industry in general and therefore potentially affect Second Cup and the Second Cup franchise partners.

A shortage in the supply or an increase in the price of premium quality coffee beans could adversely affect Second Cup.

The success of Second Cup franchise partners to generate System Sales will depend to a large extent upon the availability of premium quality green coffee beans at reasonable prices. The availability and price of premium quality green coffee beans are influenced by several factors that are beyond Second Cup’s and Second Cup franchise partners’ control, including changes in weather patterns and other natural phenomena, political events or disruptions of shipping and port channels. In addition, green coffee bean prices have been affected in the past, and could be affected in the future, by the actions of governments or organizations which have attempted to influence commodity prices of green coffee beans through agreements establishing export quotas or restricting coffee supplies worldwide. Price increases for green coffee beans could result in increases in the retail price of coffee beverages and other coffee products sold in Second Cup cafés, which could adversely affect System Sales. Similarly, a significant reduction in the availability of coffee beans purchased by Second Cup could have a material adverse effect on System Sales.

Second Cup has no long-term or written contracts with coffee bean suppliers and relies upon historical relationships to ensure availability. While there are a number of coffee bean suppliers, there can be no assurance that coffee bean suppliers that have relationships with Second Cup will continue to supply coffee beans at competitive prices.

The growth of the café network is dependent on Second Cup's ability to attract qualified franchise partners.

The growth of the café network is dependent upon the ability of Second Cup to attract qualified franchise partners. The opening and success of Second Cup cafés is dependent on a number of factors, including: availability of suitable sites; negotiations of acceptable leases for new locations; availability, training and retention of management and other employees necessary to staff new Second Cup cafés; adequately supervising construction; and securing suitable financing; among other factors, some of which are beyond the control of Second Cup. Adverse credit markets, such as these currently being experienced, may affect the ability of franchises to obtain new credit or refinance existing credit on economically reasonable terms. Furthermore, Second Cup franchise partners may not have all the business abilities or access to financial resources necessary to successfully develop or operate a Second Cup café. Second Cup provides training and support to its franchise partners, but the quality of franchised operations may be diminished by any number of factors beyond Second Cup's control. There is no assurance that Second Cup franchise partners will successfully operate cafés in a manner consistent with Second Cup's standards and requirements, or hire and train qualified managers and other personnel. If they do not, the image and reputation of Second Cup may suffer, and System Sales and results of operations of the Second Cup cafés could decline.

The ability to locate and secure acceptable Second Cup cafés sites may be limited and Second Cup may be required to contribute to the franchise partner lease obligations.

Second Cup faces competition for café locations and franchise partners from its competitors and from franchisors and operators of other businesses. The success of Second Cup franchise partners is significantly influenced by the location of their cafés. There can be no assurance that current Second Cup café locations will continue to be attractive, or that additional café sites can be located and secured as demographic patterns change. Also, there is no guarantee that the property leases in respect of the Second Cup cafés will be renewed or suitable alternative locations will be obtained and, in such event, one or several cafés could be closed. It is possible that the current locations or economic conditions where Second Cup cafés are located could decline in the future, resulting in potentially reduced sales in those locations, which will have an adverse effect on System Sales. There is no assurance that future sites will produce the same results as past sites. There is also no assurance that a franchise partner will continue to pay its lease obligations in a timely manner which could result in Second Cup being obligated to pay the lease obligations pursuant to its head lease commitment which would adversely affect the profitability of Second Cup's business.

The closure of Second Cup cafés may affect the profitability of the Second Cup business.

The profitability of the Second Cup business will depend on System Sales, which will in turn depend on the number of Second Cup cafés that are operating. Each year, a number of Second Cup cafés may close in the normal course and such closures may result in a decrease in the profitability of the Second Cup business as a result of cafe closing costs, ongoing lease obligations incurred by Second Cup under its head lease and unpaid royalty payments owed by the franchise partner at closing.

Second Cup's ability to generate revenue will depend primarily on the ability of franchise partners to generate Gross Revenue.

The ability of Second Cup to earn royalties will depend primarily on Second Cup franchise partners' ability to generate Gross Revenue and to pay royalties to Second Cup. Failure to achieve adequate levels of collection from Second Cup franchise partners could have an adverse effect on Second Cup's revenue.

Franchise partners report Gross Revenue to Second Cup without audit or other form of independent assurance.

Pursuant to the franchise agreements, franchise partners report Gross Revenue to Second Cup on a weekly basis without audit or other form of independent assurance. Although Second Cup has developed various mechanisms

to seek to verify Gross Revenue reported by its franchise partners, Second Cup does not have a centralized accounting system in place to monitor such Gross Revenue. Second Cup seeks to substantiate Gross Revenue reported by its franchise partners through, among other things, analytical and financial reviews performed by management, on site visits, and analysis of raw material purchases by the cafés. Furthermore, audits are performed at random by an internal audit team on cafés throughout the network. There can be no assurance, however, that Gross Revenue reported by franchise partners is accurate and in accordance with the terms of the franchise agreements.

The loss of key personnel could have a material impact on Second Cup's operations.

The success of Second Cup will depend on the efforts of key personnel to retain and attract appropriate franchise partner candidates and locate new café sites in order to continue to successfully grow Second Cup's business and thereby increase System Sales. The loss of the services of such key personnel could have an adverse effect on the operations of Second Cup. If such key personnel depart Second Cup and subsequently compete with Second Cup or devote significantly more time to other business interests, such activities could have a material adverse effect on Second Cup's ability to conduct its business, maintain existing franchises, generate new franchises and locate new café sites.

The failure to enforce or maintain, or a successful challenge to, the Second Cup Marks may have an adverse impact on the Second Cup business.

The ability of Second Cup to maintain or increase its System Sales will depend on its ability to capitalize on the Second Cup brand. A failure to enforce or maintain any of Second Cup's intellectual property rights may result in Second Cup being unable to capitalize on its efforts to utilize its brand equity. In addition, if any Second Cup Marks are ever successfully challenged, this may have an adverse impact on System Sales.

The Company owns the Second Cup Marks in Canada. It does not own identical or similar trade-marks relating to the Second Cup business in other jurisdictions. Third parties may use such trade-marks in jurisdictions other than Canada in a manner that diminishes the value of such trade-marks. If this occurs, the value of the Second Cup Marks may suffer and System Sales could decline. Similarly, negative publicity or events associated with such trade-marks in jurisdictions outside of Canada may negatively affect the image and reputation of Second Cup cafés in Canada, resulting in a decline in System Sales.

Changes in or failure to comply with government regulation could have an adverse effect on Second Cup.

Second Cup franchise partners will be subject to various federal, provincial and local laws affecting their business. Each Second Cup café is subject to licensing and regulation by a number of governmental authorities, which may regulate among other things, food inspection, health, employee and public safety, zoning, smoking laws and fire prevention. Difficulties in obtaining or failures to obtain the required licences or approvals could delay or prevent the development of a new Second Cup café in a particular area. In addition, changes in laws and regulations to which Second Cup and its franchise partners are currently subject may have an adverse effect on System Sales. The loss of a licence or approval, or a violation of laws, could force the temporary or permanent shut down of a Second Cup café, which could adversely affect System Sales.

Potential litigation and other complaints could adversely affect System Sales.

Second Cup franchise partners may be the subject of complaints or litigation from customers alleging food related illness, injuries suffered on the premises or other food quality, health or operational concerns. Adverse publicity resulting from such allegations may adversely affect the Gross Revenue of Second Cup cafés, regardless of whether such allegations are true or whether Second Cup or the Second Cup franchise partner is ultimately held liable. In addition, due to the nature of its business, Second Cup may from time to time be involved in litigation with past and

existing franchise partners, suppliers and other third parties. Although historically Second Cup's involvement in such litigation has been rare and has not been material to the operation of the business of Second Cup, litigation is expensive, time consuming and may divert management's attention away from the operation of the business. Management cannot be certain that a substantial claim may not arise that would be material to the operations of Second Cup.

Risk Related to the Structure of the Company

Dividends are not guaranteed and will depend on the performance of the Second Cup business.

The dividends paid to Shareholders are not guaranteed and will be dependent on the performance of the Second Cup business. Second Cup collects royalties, franchise fees and other amounts from Second Cup franchise partners and also generates revenues from its company-owned cafés. In the conduct of its business, Second Cup pays expenses and incurs debt and obligations to third parties. These expenses, debts and obligations could impact the ability of the Company to pay dividends. In addition, the growth of the café network is dependant upon investments made by Second Cup to select new locations, enter into new leases and recruit, train and supervise franchises, which may affect amounts available to be paid as dividends.

There can be no assurance that the amount of the dividend paid by the Company will remain at the current level.

The Company has outstanding indebtedness.

The Company has third-party debt service obligations under the Term Loan and the Operating Loan. See "General Development of the Business — Term Loan and Operating Loan". The degree to which the Company is leveraged could have important consequences to the holders of the Shares, including: (i) a portion of the Company's cash flow from operations will be dedicated to the payment of the principal and interest on its indebtedness, thereby reducing funds available for distribution to the Company; and (ii) certain of the Company's borrowings will be at variable rates of interest, which exposes the Company to the risk of increased interest rates. The Company's ability to make scheduled payments of the principal of, or interest on, or to refinance, its indebtedness will depend on the profitability of Second Cup. The Term Loan is due April 1, 2013. The Term Loan and the Operating Loan bear interest at the bankers' acceptances plus 3.5%. The Company has in place an interest rate swap arrangement fixing the interest rate on Term Loan at an estimated effective rate of 6.54%. Current and future borrowings by Second Cup could adversely affect its performance.

The Term Loan and Operating Loan contain numerous restrictive covenants that limit the discretion of the Company with respect to certain business matters. In certain circumstances, these restrictive covenants may restrict the cash available for payment of dividends to Shareholders.

DESCRIPTION OF CAPITAL STRUCTURE

The authorized capital of the Company consists of an unlimited number of Shares. The summary below of the rights, privileges, restrictions and conditions attaching to the Shares is subject to, and qualified in its entirety by reference to, the Company's articles and by-laws which are available on SEDAR at www.sedar.com.

Common Shares

Each Share entitles the holder thereof to one (1) vote at all meetings of Shareholders, except where holders of another class are entitled to vote separately as a class as provided by law or the rules of any applicable stock exchange. Subject to the rights of the holders of any other class of shares ranking senior to the Shares, the holders of Shares are entitled to such dividends as the board of directors may declare from time to time, which dividends are payable in money or property or by issuing fully paid shares of the Company.

Subject to the prior rights of the holders of any other class of shares ranking senior to the Shares, in the event of the liquidation, dissolution or winding-up of the Company, whether voluntary or involuntary, or any other distribution of assets of the Company among its shareholders for the purpose of winding-up its affairs, the holders of Shares are entitled to receive the remaining property and assets of the Company.

DIVIDENDS AND DISTRIBUTIONS

Dividend Policy

The declaration of dividends is subject to the discretion of the board of directors and may vary depending on, among other things, the Company's earnings, financial requirements, debt covenants, the satisfaction of solvency tests imposed by the OBCA for the declaration of dividends and other conditions existing at such time. See "Risk Factors – Risks Relating to the Structure of the Company". The Company's current policy is to pay out a substantial portion of earnings while retaining a sufficient amount to adequately fund organic growth initiatives.

Cash Distributions

As the Fund, the predecessor entity to the Company, was an income trust, it did not pay dividends. The following table sets forth the month of payment, record date, payment date and distribution per Unit paid by the Fund on the Units for each month of the 2009 and 2010 fiscal years and per Share paid by the Company for each quarter of the 2011 fiscal year:

	<u>Period</u>	<u>Record Date</u>	<u>Payment Date</u>	<u>Distribution Per Unit/Share</u>
2009	January 2009	February 25, 2009	February 27, 2009	\$0.0940
	February 2009	March 27, 2009	March 31, 2009	\$0.0940
	March 2009	April 28, 2009	April 30, 2009	\$0.0767
	April 2009	May 27, 2009	May 29, 2009	\$0.0767
	May 2009	June 26, 2009	June 30, 2009	\$0.0767
	June 2009	July 29, 2009	July 31, 2009	\$0.0767
	July 2009	August 28, 2009	August 31, 2009	\$0.0767
	August 2009	September 28, 2009	September 30, 2009	\$0.0767
	September 2009	October 28, 2009	October 30, 2009	\$0.0767
	October 2009	November 26, 2009	November 30, 2009	\$0.0767
	November 2009	December 29, 2009	December 31, 2009	\$0.0767
	December 2009	December 31, 2009	January 29, 2009	\$0.0767
2010	January 2010	February 24, 2010	February 26, 2010	\$0.07667
	February 2010	March 24, 2010	March 26, 2010	\$0.07667
	March 2010	April 28, 2010	April 30, 2010	\$0.07667
	April 2010	May 27, 2010	May 31, 2010	\$0.07667

	May 2010	June 28, 2010	June 30, 2010	\$0.07667
	June 2010	July 28, 2010	July 30, 2010	\$0.07667
	July 2010	August 27, 2010	August 31, 2010	\$0.07667
	August 2010	September 28, 2010	September 30, 2010	\$0.07667
	September 2010	October 27, 2010	October 29, 2010	\$0.07667
	October 2010	November 26, 2010	November 30, 2010	\$0.07667
	November 2010	December 29, 2010	December 31, 2010	\$0.07667
	December 2010	December 31, 2010	January 31, 2011	\$0.07667
2011	Quarter ended April 2, 2011	May 16, 2011	May 30, 2011	\$0.15
	Quarter ended July 2, 2011	August 17, 2011	August 31, 2011	\$0.15
	Quarter ended October 1, 2011	November 16, 2011	November 30, 2011	\$0.15
	Quarter ended December 31, 2011	March 16, 2012	March 30, 2012	\$0.15

DIRECTORS AND OFFICERS

Directors

The current directors of the Company are set forth below.

Name, Municipality and Province of Residence	Director Since
James Anas <i>Burlington, Ontario</i>	June 8, 2009
Bryna Goldberg ⁽²⁾⁽⁵⁾ <i>Toronto, Ontario</i>	June 8, 2009
Raymond Guyatt ⁽¹⁾⁽⁴⁾ <i>Westmount, Quebec</i>	December 1, 2004
Michael Rosicki ⁽¹⁾⁽²⁾⁽³⁾ <i>Oakville, Ontario</i>	December 1, 2004
Peter Saunders ⁽¹⁾⁽²⁾	May 13, 2011

Notes:

- ⁽¹⁾ Member of Audit Committee
- ⁽²⁾ Member of Governance/ Human Resources/ Compensation Committee
- ⁽³⁾ Chair of the Board
- ⁽⁴⁾ Chair of the Audit Committee
- ⁽⁵⁾ Chair of the Governance/ Human Resources/ Compensation Committee

The following is a summary biography of each of the directors of the Company:

James S. Anas

Mr. Anas held the position of Chairman of Second Cup from April 1, 2009 to June 27, 2009. Mr. Anas has held the position of Chairman of S.C. Coffee Co. since April 2009, following his tenure as Executive Vice-Chairman from 2008 to April 2009 and previously as President and Chief Executive Officer from 2001 to 2008. Previously, Mr. Anas held the position of President and Chief Executive Officer and director of the national franchisor, and formerly TSX listed, Jumbo Entertainment Inc. from 1993 to 2001. Mr. Anas is currently Chairman of the Board of Directors of Guardian Capital Group Limited, a TSX listed financial services company.

Bryna Goldberg

Bryna Goldberg is a retired business executive. Until her retirement in 2007, Ms. Goldberg was Executive Vice President, Legal Affairs, General Counsel and Secretary of Shoppers Drug Mart Inc., where she was employed for over 20 years. She played a key role in transitioning Shoppers to a new ownership structure including through a leveraged buy-out transaction and subsequent initial public offering. Ms. Goldberg is a lawyer and a member of the Law Society of Upper Canada.

Raymond Guyatt

Raymond Guyatt is a retired executive. From 1987 to 2000, Mr. Guyatt was the Executive Vice President and Chief Financial Officer of Imasco Limited. He was also a director of both Imasco and CT Financial Services from 1990 to 2000. Mr. Guyatt was a director of Mackenzie Financial Corporation from 2002 to 2005 and was Chairman of the Innovation Council of the Canadian Institute of Chartered Accountants from 2001 to 2003. Mr. Guyatt is a Chartered Accountant and a member of the Institute of Chartered Accountants of Ontario.

Michael Rosicki

Michael Rosicki is a retired business executive. From 1999 to 2004, Mr. Rosicki was Chairman and Chief Executive Officer of Parmalat North America. From 1997 to 1999, Mr. Rosicki was with Mattel, where he began as President of Mattel Canada Inc. and later became President, Mattel Europe, Canada, Middle East, and Africa. Prior to that, he was with Nestlé Canada Inc. for 12 years, culminating in his role as President of the company's Foods Group. Mr. Rosicki is a director of Metro Inc. and Aastra Technologies Ltd. He has held senior positions with various industry and charitable associations, including past member of the Board of the Hospital for Sick Children's Foundation (SickKids Foundation), past Chairman and co-founder of Kids Help Phone, and past Chairman of the Food Products Manufacturers of Canada.

Peter Saunders

Mr. Saunders acts as Director of Canadian Tire Corporation Limited, Director and Chairman of Jack Wills Limited, Lead Director of Godiva Chocolatier Inc. and Director of Retail Services and Systems Inc. (Total Wine & More); Mr. Saunders was previously Chairman (2008-2009) and Chief Executive Officer (2002-2008) of The Body Shop International PLC and Chief Operating Officer of T. Eaton Co. Ltd. (1995-1997).

Officers

The names and municipalities of residence of the persons who are the current executive officers of the Company are as follows:

<u>Name</u>	<u>Position with Second Cup</u>
Stacey Mowbray <i>Toronto, Ontario</i>	President and Chief Executive Officer
Robert Masson <i>Richmond Hill, Ontario</i>	Chief Financial Officer
Cathy Whelan-Molloy <i>Toronto, Ontario</i>	Chief Marketing Officer
Ian M. Baskerville, <i>Milton, Ontario</i>	General Counsel, Vice-President Human Resources and Corporate Secretary
Rita Toporowski..... <i>Oakville, Ontario</i>	Vice-President, Corporate Planning and Development
Wayne C. Vanderhorst..... <i>Grimsby, Ontario</i>	Vice-President, Franchise Development
Tom Zacharias	Vice-President, Operations

The following is a summary biography of each of the members of the senior management team of Second Cup:

Stacey Mowbray — President and Chief Executive Officer

Prior to joining Second Cup, Ms. Mowbray held positions in Molson Canada as Chief Marketing Officer, Cara Operations as President of the Milestone's chain and as SVP Branding and Marketing, Pepsi Canada as Vice President of Marketing and the Weston group where she started her career in sales and marketing over 20 years ago. Ms. Mowbray has a Masters Business Degree from York University and a Bachelor of Business Administration from Wilfrid Laurier University. She has also been a board member of several industry associations over her career.

Robert Masson — Chief Financial Officer

Mr. Masson has held various finance and accounting related positions over the last 14 years and is a designated Chartered Accountant with the Institute of Chartered Accountants of Ontario. Mr. Masson holds a Bachelor of Commerce degree from the University of Kwa-Zulu Natal in South Africa. From 1995 to 1998 Mr. Masson was employed as an auditor with Ernst & Young. From 1999 to 2006, Mr. Masson held positions with

various companies including Deloitte & Touche and IBM Canada. From 2006 to January 2009 Mr. Masson was VP Finance with Manchu Wok Canada Inc. In February 2009, Mr. Masson was appointed Chief Financial Officer of Second Cup and the Fund.

Cathy Whelan-Molloy – Chief Marketing Officer

Ms. Whelan Molloy joined Second Cup as Chief Marketing Officer in September 2011. Prior to joining Second Cup, she was Vice President, Marketing Strategy at Zellers, from October 2010 to March 2011 (Zellers sold to Target in December 2010); Principal, CWM Marketing and Consumer Insights from 2008 until 2010; Executive Vice President, Marketing, at Loblaws from July 2007 until January 2008; Vice President, Marketing and Merchandising, Tim Hortons from June 1994 until July 2007.

Ian Baskerville — General Counsel, Vice-President Human Resources and Corporate Secretary

Mr. Baskerville joined Second Cup as Vice President, Legal Affairs in November 2006 and took on the role of General Counsel, Vice President Human Resources in 2010. Prior to joining Second Cup, Mr. Baskerville was Legal Counsel for Cara Operations Limited from 2003 to November 2006. From 2000 to 2003, Mr. Baskerville specialized in mergers and acquisitions as a lawyer at Cassels Brock & Blackwell LLP. Mr. Baskerville obtained a Bachelor of Arts degree from the University of Victoria and a Bachelor of Laws degree from the University of Western Ontario. Mr. Baskerville is a member of the Law Society of Upper Canada.

Rita Toporowski — Vice-President, Corporate Planning & Development

Ms. Toporowski joined Second Cup as Vice President Corporate Planning & Development in June 2009. Prior to that, Ms. Toporowski was Vice President Corporate Planning & Development for S.C. Coffee Co. from July 2007 to June 2009. Before joining S.C. Coffee Co., she was with Air Canada for over 16 years in numerous senior level positions including Senior Director Six Sigma.

Wayne C. Vanderhorst – Vice-President, Franchise Development

Mr. Vanderhorst joined Second Cup in September 2007 as Vice President, Franchise Development. Prior to joining Second Cup, Mr. Vanderhorst was employed with Mr. Lube Canada LP as Vice President, Real Estate & Development from August 2005 to September 2007 and was previously with Dairy Queen Canada Inc. for over 16 years in numerous positions including Director of Real Estate & Leasing.

Tom Zacharias – Vice-President, Operations

Mr. Zacharias joined Second Cup in August of 2011. Mr. Zacharias previously held the position of Vice President Franchise Operations at Mr. Lube Canada LP., where he worked from February of 2007 until July of 2011. Prior to that Mr. Zacharias was employed by Cara Operations Ltd. from February 1999 until November 2006 in a number of positions most recently as Chief Operating Officer, Air Terminal Restaurants Division.

As of March 23, 2012, the directors and executive officers of the Company held 77,215 Shares, representing approximately 0.8% of the Company's issued and outstanding Shares.

Audit Committee

As required by applicable securities laws, the Company has established an audit committee to monitor the Company's financial reporting, accounting systems and internal controls, and to liaise with the Company's external

auditors. The audit committee is required to consist of at least three directors, each of whom must be “independent” within the meaning of Multilateral Instrument 52-110 — *Audit Committees*, subject to the provisions of such instrument. The Chair of the audit committee receives compensation of \$10,000 per year for such role.

Charter of the Audit Committee

The charter of the audit committee is attached to this Annual Information Form as Schedule A.

Composition of the Audit Committee

Presently, the audit committee consists of Messrs. Guyatt, Rosicki and Saunders and is chaired by Mr. Guyatt. All members of the audit committee are independent and financially literate; as such terms are defined under Multilateral Instrument 52-110 – *Audit Committees*. See “Directors and Officers” for a summary of the education and experience of each member of the audit committee.

Pre-approval Policies and Procedures

There have been no recommendations of the audit committee to nominate or compensate an external auditor which have not been adopted by the board of directors of the Company. In accordance with the Company’s audit committee charter, all non-audit services to be provided to the Company or any of its affiliates by the external auditors or any of their affiliates are subject to pre-approval by the audit committee. The committee may approve policies and procedures for the pre-approval of non-audit services to be rendered by the external auditors, which policies and procedures (i) shall include reasonable detail with respect to the services covered, (ii) shall require that the committee be informed of each non-audit service and (iii) shall not include delegation of the committee’s responsibilities to management.

Audit Fees

PricewaterhouseCoopers LLP served as the Fund’s auditing firm since the Fund’s inception in 2004 and has continued as the auditors of the Company. Fees paid or payable for the 2011 and 2010 fiscal years to PricewaterhouseCoopers LLP are \$221,000 and \$329,000, respectively. These fees are detailed below:

	2011 Fiscal Year	2010 Fiscal Year
Audit fees	\$152,000	\$153,000
Audit-related fees	\$3,000	\$5,000
Tax fees	\$31,000	\$34,000
All other fees	\$35,000	\$137,000
	<hr/> \$221,000	<hr/> \$329,000

The nature of each category of fees is described below.

Audit and audit related fees: Audit fees and audit related fees were paid for professional services rendered for the audit of the Company’s annual financial statements, reading of the Company’s quarterly reporting, and for services that are normally provided in connection with the statutory and regulatory filings or engagements.

Tax Fees: Tax fees were paid for professional services rendered for the preparation of the Company’s annual income tax returns and advice associated therewith.

All other fees: Other fees were paid for professional services rendered with respect to the transition to International Financial Reporting Standards.

Insider Reporting

The following individuals are “insiders” of the Company and, as such, will have reporting obligations as insiders under the securities laws of the various provinces and territories of Canada, including the obligation to file “insider trading reports” under those laws:

- the directors and senior officers of the Company.

MARKET FOR SECURITIES

Trading Price and Volume

The outstanding Shares of the Company are listed and posted for trading on the TSX under the symbol “SCU”. The following table shows the price range and average daily volume traded of the Shares on the TSX for each month of 2011.

Month	Trading Price Range	Average Trading Volume
January 2011	\$7.81 - \$8.66	11,831
February 2011	\$8.20 - \$8.87	12,827
March 2011	\$7.70 - \$8.55	15,426
April 2011	\$7.32 - \$8.00	11,516
May 2011	\$7.35 - \$7.97	9,249
June 2011	\$6.57 - \$7.68	9,409
July 2011	\$6.60 - \$7.00	5,987
August 2011	\$5.93 - \$6.85	13,955
September 2011	\$5.44 - \$6.19	11,062
October 2011	\$5.50 - \$6.59	37,313
November 2011	\$6.05 - \$6.60	7,248
December 2011	\$6.00 - \$6.43	9,889

LEGAL PROCEEDINGS

Neither the Company nor any of its affiliates are involved in any litigation or proceedings which, if determined adversely, would be material to the Company, and no such proceedings are known to the Company to be contemplated. See “Risk Factors” and note 20 to the financial statements of Second Cup for the 52 weeks ended December 31, 2011.

INTERESTS OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

None.

TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for the Shares is Computershare Investor Services Inc, 100 University Avenue, Toronto, Ontario.

MATERIAL CONTRACTS

The material contracts relating to the Company are as follows:

- (a) the loan agreement in respect of the Company as more particularly described under “Business of Second Cup – Credit Facility”.

Copies of the foregoing documents may be examined during normal business hours at the Company’s offices at 6303 Airport Road, 2nd Floor, Mississauga, Ontario L4V 1R8.

EXPERTS

The Company’s auditors are PricewaterhouseCoopers LLP, Chartered Accountants, who have prepared an independent auditors’ report dated March 1, 2012 in respect of the Company’s financial statements with accompanying notes for the 2010 & 2011 fiscal years. PricewaterhouseCoopers LLP has advised that they are independent with respect to the Corporation within the meaning of the Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario.

ADDITIONAL INFORMATION

Additional information relating to the Company may be obtained on request from the administrative office of the Fund at 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8 or may be found on SEDAR at www.sedar.com. Additional information, including with respect to directors’ remuneration and indebtedness and principal holders of the Shares of the Company will be contained in the Company’s information circular for its 2012 annual meeting of Shareholders.

Additional financial information is provided in the financial statements and notes to the financial statements of the Company and Management’s Discussion and Analysis for 2011.

Schedule A – Charter of the Audit Committee

THE SECOND CUP LTD.

AUDIT COMMITTEE CHARTER

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Charter of the Audit Committee

The term “**Corporation**” herein shall refer to The Second Cup Ltd. and the term “**Board**” shall refer to the Board of Directors of the Corporation. “The term “**Management**” herein shall refer to senior management of the Corporation.

PURPOSE

The Audit Committee (the “**Committee**”) is a standing committee appointed by the Board to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting including responsibility to:

- oversee the work of the Corporation’s external auditors engaged for the purpose of preparing or issuing an auditor’s report or performing other audit, review or attest services for the Corporation;¹
- oversee the integrity of the Corporation’s financial statements and financial reporting process, including the audit process and the Corporation’s internal accounting controls and procedures and compliance with related legal and regulatory requirements;
- oversee the work of the Corporation’s internal auditors;
- oversee the qualifications and independence of the external auditors;
- oversee the work of the Corporation’s financial management and external auditors in these areas;² and
- provide an open avenue of communication between the external auditors, the Board and Management.³

In addition, the Committee will review and/or approve any other matter specifically delegated to the Committee by the Board, including a quarterly review to ensure the Corporation is meeting its financial covenants with its lender.

The function of the Committee is oversight. It is not the duty or responsibility of the Committee or its members (i) to plan or conduct audits, (ii) to determine that the Corporation’s financial statements are complete and accurate and are in accordance with generally accepted accounting principles or (iii) to conduct other types of auditing or accounting reviews or similar procedures or investigations. The Committee and its Chair are members of the Board, appointed to the Committee to provide broad oversight of the financial, risk and control related activities of the Corporation and are specifically not accountable or responsible for the day to day operation or performance of such activities.

The Corporation is responsible for the preparation, presentation and integrity of the Corporation’s financial statements. Management is also responsible for maintaining appropriate accounting and financial reporting principles and policies and systems of risk assessment and internal controls and procedures designed to provide

¹ Multilateral Instrument 52-110 (“MI 52-110”) s.2.3(3)

² MI 52-110 s.2.3(3)

³ MI 52-110 s.4.1(c)

reasonable assurance that assets are safeguarded and transactions are properly authorized, recorded and reported and to assure the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with accounting standards and applicable laws and regulations.

The external auditors are responsible for planning and carrying out an audit of the Corporation's annual financial statements in accordance with generally accepted auditing standards to provide reasonable assurance that, among other things, such financial statements are in accordance with generally accepted accounting principles.

AUDIT RESPONSIBILITIES OF THE COMMITTEE

Selection and Oversight of the External Auditors

1. The external auditors are ultimately accountable to the Committee and the Board as the representatives of the Shareholders of the Corporation and shall report directly to the Committee and the Committee shall so instruct the external auditors.⁴ The Committee shall evaluate the performance of the external auditors and make recommendations to the Board on the reappointment or appointment of the external auditors of the Corporation to be proposed in the Corporation's proxy circular for Shareholder approval and shall have authority to terminate the external auditors.⁵ If a change in external auditors is proposed, the Committee shall review the reasons for the change and any other significant issues related to the change, including the response of the incumbent auditors, and enquire on the qualifications of the proposed auditors before making its recommendation to the Board.⁶ The Board is responsible for selecting the external auditor to be proposed in the Corporation's proxy circular for Shareholder approval and appointment.
2. The Committee shall review and recommend to the Board for approval the terms of engagement and the compensation to be paid by the Corporation to the external auditors with respect to the conduct of the annual audit.⁷
3. The Committee shall review the independence of the external auditors and shall make recommendations to the Board on appropriate actions to be taken which the Committee deems necessary to protect and enhance the independence of the external auditors. In connection with such review, the Committee shall:
 - (a) actively engage in a dialogue with the external auditors about all relationships or services that may impact the objectivity and independence of the external auditors;⁸

⁴ MI 52-110 s.2.2

⁵ MI 52-110 s.2.3(2)(a)

⁶ National Instrument 51-102 s.4.11

⁷ MI 52-110 s.2.3(2)(b)

⁸ PCAOB Ethics and Independence Rule 3526 – Communication with Audit Committees Concerning Independence

- (b) require that the external auditors submit to it on a periodic basis, and at least annually, a formal written statement delineating all relationships between the Corporation, on the one hand, and the external auditors and their affiliates on the other hand;⁹
 - (c) require that (i) both the lead audit partner and the partner responsible for performing a second review respecting the audit be rotated at least every seven years and be subject to a five year time out and (ii) all other partners on the audit engagement team who provide more than 10 hours of audit, review or attest services with respect to the Corporation's financial statements or who serve as the lead partner in connection with any audit or review related to financial statements of a subsidiary whose assets or revenues constitute at least 20% of the assets or revenues of the Corporation be rotated at least every seven years and be subject to a two year time out;¹⁰
 - (d) consider whether there should be a regular rotation of the external audit firm itself; and
 - (e) consider the auditor independence standards promulgated by applicable auditing regulatory and professional bodies.
4. The Committee shall prohibit the external auditor and its subsidiaries from providing certain non-audit services to the Corporation. All non-audit services to be provided to the Corporation or any of its affiliates by the external auditors or any of their affiliates shall be subject to pre-approval by the Committee.¹¹ The Committee may approve policies and procedures for the pre-approval of non-audit services to be rendered by the external auditors, which policies and procedures (i) shall include reasonable detail with respect to the services covered, (ii) shall require that the Committee be informed of each non-audit service and (iii) shall not include delegation of the Committee's responsibilities to management.¹²
5. The Committee shall establish and monitor clear policies for the hiring by the Corporation of partners, employees and former partners and employees of the external auditors.¹³
6. The Committee shall require the external auditors to provide to the Committee, and the Committee shall review and discuss with the external auditors, all reports which the external auditors are required to provide to the Committee or the Board under rules, policies or practices of professional or regulatory bodies applicable to the external auditors, and any other reports which the Committee may require. Such reports shall include:
- (a) a description of the external auditors' internal quality-control procedures, any material issues raised by the most recent internal quality-control review, or peer review, of the external auditors, or by any inquiry or investigation by governmental or professional authorities, within the

⁹ CICA Handbook Section 5751.12, .25 - .29 and .32

¹⁰ CICA (Proposed) Independence Standards s.204.4(20)

¹¹ MI 52-110 ss.2.3(4), 2.4 and 2.5

¹² MI 52-110, s.2.6

¹³ Independence Standards Board Independence Standard No. 3; MI 52-110 s.2.3(8)

preceding five years, respecting one or more independent audits carried out by the external auditors, and any steps taken to deal with any such issues;¹⁴ and

- (b) a report describing (i) all critical accounting policies and practices used in the preparation of the Corporation's financial statements, (ii) all alternative treatments of financial information within generally accepted accounting principles related to material items that have been discussed with Management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the external auditors (iii) other material written communication between the external auditors and Management, such as any management letter or schedule of unadjusted differences; and (iv) disagreements between Management and/or the internal auditors and the external auditors regarding financial reporting.
7. The Committee is responsible for resolving disagreements between Management and the external auditors regarding financial reporting.¹⁵

Oversight of Internal Audit Function

8. The Committee shall determine the appropriate internal audit function for the Corporation and oversee its processes, reports and the terms of compensation for any individuals engaged in such function, if any.

Oversight and Monitoring of Audits

9. The Committee shall review with the external auditors and Management the audit function generally, the objectives, staffing, locations, co-ordination, reliance upon Management, any internal audit and general audit approach and scope of proposed audits of the financial statements of the Corporation, the overall audit plans, the responsibilities of Management and the external auditors, the audit procedures to be used and the timing and estimated budgets of the audits.¹⁶
10. The Committee shall discuss with the external auditors any difficulties or disputes that arise with Management or any internal auditors during the course of the audit and the adequacy of Management's responses in correcting audit-related deficiencies.¹⁷
11. The Committee shall review with Management the results of any internal and all external audits.
12. The Committee shall take such other reasonable steps as it may deem necessary to satisfy itself that the audit was conducted in a manner consistent with all applicable legal requirements and auditing standards of applicable professional or regulatory bodies.

¹⁴ CICA Handbook Section 5751.31

¹⁵ MI 52-110 s.2.3(3)

¹⁶ CICA Handbook Section 5751.14; MI 52-110 s.2.3(3)

¹⁷ CICA Handbook Section 5751.23

Oversight and Review of Accounting Principles and Practices¹⁸

13. The Committee shall, as it deems necessary, oversee, review and discuss with Management, the external auditors and any internal auditors:
- (a) the quality, appropriateness and acceptability of the Corporation's accounting principles and practices used in its financial reporting, changes in the Corporation's accounting principles or practices and the application of particular accounting principles and disclosure practices by Management to new transactions or events;
 - (b) all significant financial reporting issues and judgments made in connection with the preparation of the Corporation's financial statements, including the effects of alternative methods within generally accepted accounting principles on the financial statements and any "second opinions" sought by Management from an independent auditor with respect to the accounting treatment of a particular item;
 - (c) disagreements between Management and the external auditors or any internal auditors regarding the application of any accounting principles or practices;
 - (d) any material change to the Corporation's auditing and accounting principles and practices as recommended by Management, the external auditors or any internal auditors or which may result from proposed changes to applicable generally accepted accounting principles;
 - (e) the effect of regulatory and accounting initiatives on the Corporation's financial statements and other financial disclosures;
 - (f) any reserves, accruals, provisions, estimates or management programs and policies, including factors that affect asset and liability carrying values and the timing of revenue and expense recognition, that may have a material effect upon the financial statements of the Corporation;
 - (g) any legal matter, claim or contingency that could have a significant impact on the financial statements, the Corporation's compliance policies and any material reports, inquiries or other correspondence received from regulators or governmental agencies and the manner in which any such legal matter, claim or contingency has been disclosed in the Corporation's financial statements;
 - (h) the treatment for financial reporting purposes of any significant transactions which are not a normal part of the Corporation's operations;
 - (i) the use of any "pro forma" or "adjusted" information not in accordance with generally accepted accounting principles;¹⁹ and
 - (j) Management's determination of goodwill impairment, if any, as required by applicable accounting standards.

¹⁸ CICA Handbook Section 5751.17, .20, .21 and .22

¹⁹ CSA Notice 52-306

14. The Committee will review and resolve disagreements between Management and the external auditors regarding financial reporting²⁰ or the application of any accounting principles or practices.

Oversight and Monitoring of Internal Controls

15. The Committee shall, as it deems necessary, exercise oversight of, review and discuss with Management and the external auditors:
- (a) the adequacy and effectiveness of the Corporation's internal accounting and financial controls based on recommendations of Management and the external auditors for the improvement of accounting practices and internal controls;²¹
 - (b) any material weaknesses in the internal control environment, including with respect to computerized information system controls and security; and
 - (c) Management's compliance with the Corporation's processes, procedures and internal controls.

Communications with Others

16. The Committee shall establish and monitor procedures for the receipt and treatment of complaints received by the Corporation regarding accounting, internal accounting controls or audit matters and the anonymous submission of concerns regarding questionable accounting or auditing matters and review periodically with Management, and senior finance officers of the Corporation responsible for any internal audit function, these procedures and any significant complaints received.²²

Oversight and Monitoring of the Corporation's Financial Disclosures

17. The Committee shall:
- (a) review with the external auditors and Management and recommend to the Board for approval the audited financial statements and the notes and Management's Discussion and Analysis accompanying such financial statements, the Corporation's annual report, the financial information of the Corporation contained in any prospectus or information circular or other disclosure documents or regulatory filings of the Corporation;²³ and
 - (b) review with the external auditors and Management and approve each set of interim financial statements and the notes and Management's Discussion and Analysis accompanying such

²⁰ MI 52-110 s.2.3(3)

²¹ CICA Handbook Section 5751.16

²² MI 52-110 s.2.3(7)

²³ National Instrument 51-102 ss.4.5(1) and 5.5(1); MI 52-110 ss.2.3(5) and 5.1

financial statements and any other disclosure documents or regulatory filings of the Corporation containing or accompanying financial information of the Corporation.²⁴

Such reviews shall be conducted prior to the release of any summary of the financial results or the filing of such reports with applicable regulators.

18. The Committee shall review all financial statements and material change reports prepared for the Corporation.
19. Prior to their distribution and filing, the Committee shall review and discuss earnings press releases, as well as financial information provided to analysts and ratings agencies. The Chair of the Committee may perform this review function, on behalf of the Committee, as is required. Such discussions may, in the discretion of the Committee, be done generally (i.e., by discussing the types of information to be disclosed and the type of presentation to be made) and the Committee need not discuss in advance each instance in which the Corporation discloses financial information if it has reviewed and approved the Corporation's policies and procedures with respect to such matters.²⁵
20. The Committee shall meet with Management to review and assess the process and systems in place for the review of public disclosure documents that contain audited and unaudited financial information and their effectiveness.²⁶
21. As part of the process by which the Committee shall satisfy itself as to the reliability of public disclosure documents that contain audited and unaudited financial information, the Committee shall require each of (i) the President or Chief Executive Officer and (ii) the Chief Financial Officer of the Corporation to provide a certificate addressed to the Committee certifying in respect of each annual and quarterly report the matters such officers are required to certify in connection with the filing of such reports under applicable securities laws.²⁷
22. The Committee shall review the disclosure with respect to its pre-approval of audit and non-audit services provided by the external auditors.

Oversight of Finance Matters

23. The Committee shall meet periodically with Management to review and discuss the Corporation's major financial risk exposures and the policy steps Management has taken to monitor and control such exposures.
24. The Committee shall meet periodically with the Secretary of the Corporation to review issues arising out of compliance activities, as well as assess contingent legal and regulatory risks.

²⁴ National Instrument 51-102 ss. 4.5(2), (3) and 5.5(2) and (3); MI 52-110 s.2.3(5)

²⁵ National Instrument 51-102 s.11.4 and MI 52-110 s.2.3(5); National Policy 51-201 s. 6.4

²⁶ MI 52-110 s.2.3(6)

²⁷ Multilateral Instrument 52-109, Parts 2 and 3

Committee Reporting

25. As required by applicable laws or regulations or stock exchange requirements, the Committee shall review and approve the information required to be reported to Shareholders and others in its Annual Information Form, and for such purposes, each member of the Committee shall provide information respecting that member's education and experience that relate to his or her responsibilities as a Committee member.²⁸

Insider Trading

26. The Committee shall prepare and revise as necessary a policy on insider trading respecting the Corporation's securities. Such policy shall impose trading black-outs, policies and procedures respecting trades in the Corporation's securities.
27. The Committee shall periodically review Management's systems and practices for ensuring that all directors, officers and other reporting insiders of the Corporation who are required to do so file insider reports in connection with any trade of securities of the Corporation or any derivative transaction which results in the effective disposition of the individual's economic interest in a security of the Corporation within the shortest period of time in which such reports are required to be filed.

Additional Responsibilities

28. Each new member of the Committee shall receive such training as may be approved by the Chair of the Committee. Training should cover the requirements and obligations of audit committees, issues of accounting principles, auditing standards, risk management and ethical compliance. Each Committee member should attend refresher training as may be deemed appropriate from time to time.
29. The Committee shall review and/or approve any other matter specifically delegated to the Committee by the Board and undertake on behalf of the Board such other activities as may be necessary or desirable to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting.

THE CHARTER

The Committee shall review and reassess the adequacy of this Charter at least annually and otherwise as it deems appropriate and recommend changes to the Board. The performance of the Committee shall be evaluated with reference to this Charter annually.²⁹

The Committee shall ensure that this Charter or a summary of it which has been approved by the Committee is disclosed in accordance with all applicable securities laws or regulatory requirements in the annual proxy circular or annual report of the Corporation.

²⁸ MI 52-110 s.5.1; Form 52-110F and Companion Policy 52-110CP s. 4.2

²⁹ National Policy 58-201 s.3.18(a)