



**The Second Cup Ltd.**

Unaudited Condensed Interim Financial Statements  
**For the 13 weeks ended March 30, 2013**

**Notice to Reader**

The management of The Second Cup Ltd. (“Second Cup” or the “Company”) is responsible for the preparation of the accompanying condensed interim financial statements. The condensed interim financial statements have been prepared in accordance with International Financial Reporting Standards, which became the reporting standard for publicly accountable enterprises for years beginning on or after January 1, 2011 and are considered by management to present fairly the financial position, financial performance and cash flows of Second Cup.

These condensed interim financial statements have not been reviewed by an auditor. These condensed interim financial statements are unaudited and include all adjustments, consisting of normal and recurring items that management considers necessary for a fair presentation of the financial position, financial performance and cash flows.

(Signed)

Stacey Mowbray  
President and Chief Executive Officer, The Second Cup Ltd.

(Signed)

Robert Masson  
Chief Financial Officer, The Second Cup Ltd.

May 2, 2012

# The Second Cup Ltd.

## Condensed Interim Statements of Financial Position

(Unaudited, expressed in thousands of Canadian dollars)

	March 30, 2013	December 29, 2012
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 3,575	\$ 3,880
Trade and other receivables	3,111	4,616
Current portion of notes and leases receivable	257	265
Inventories	286	137
Prepaid expenses and other assets	187	695
Income tax recoverable	240	-
	<u>7,656</u>	<u>9,593</u>
<b>Non-current assets</b>		
Notes and leases receivable	706	741
Property and equipment	3,845	3,544
Intangible assets	74,710	74,802
	<u>79,261</u>	<u>79,087</u>
<b>Total assets</b>	<u>\$ 86,917</u>	<u>\$ 88,680</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 2,763	\$ 3,313
Current portion of other long-term liabilities	422	189
Provisions	409	365
Income tax payable	-	318
Gift card liability	3,760	4,560
Deposits from franchise partners	1,629	1,904
	<u>8,983</u>	<u>10,649</u>
<b>Non-current liabilities</b>		
Deferred income tax liabilities	9,230	9,190
Other long-term liabilities	552	421
Provisions	642	683
Fair value of derivative interest rate swap (note 3)	1	96
Term loan and operating facility (note 3)	10,963	10,941
	<u>21,388</u>	<u>21,431</u>
<b>Total liabilities</b>	<u>30,371</u>	<u>31,980</u>
<b>Shareholders' equity</b>	<u>56,546</u>	<u>56,700</u>
<b>Total liabilities and shareholders' equity</b>	<u>\$ 86,917</u>	<u>\$ 88,680</u>

Contingencies, commitments and guarantees (note 5) and subsequent event (note 13).

See accompanying notes to unaudited condensed interim financial statements.

Approved by the Directors

Michael Rosicki, Director

James Anas, Director

# The Second Cup Ltd.

## Condensed Interim Statements of Income and Comprehensive Income

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

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
<b>Revenue</b>		
Royalty	\$ 3,497	\$ 3,678
Sale of goods	1,289	900
Services	1,460	1,430
	<u>6,246</u>	<u>6,008</u>
<b>Cost of goods sold</b>	<u>967</u>	<u>676</u>
<b>Gross profit</b>	5,279	5,332
<b>Operating expenses</b> (note 7)	<u>4,252</u>	<u>3,790</u>
<b>Operating income</b>	1,027	1,542
Interest income	(13)	(22)
Interest expense (note 3)	90	138
<b>Net interest expense</b>	<u>77</u>	<u>116</u>
<b>Income before income taxes</b>	<u>950</u>	<u>1,426</u>
<b>Income taxes</b> (note 4)		
Current	222	351
Deferred	40	43
	<u>262</u>	<u>394</u>
<b>Net income for the period</b>	688	1,032
<b>Other comprehensive income for the period</b>	<u>-</u>	<u>-</u>
<b>Comprehensive income for the period</b>	<u>\$ 688</u>	<u>\$ 1,032</u>
<b>Basic and diluted earnings per share</b> (note 6)	<u>\$ 0.07</u>	<u>\$ 0.10</u>

See accompanying notes to unaudited condensed interim financial statements.

## The Second Cup Ltd.

### Condensed Interim Statements of Changes in Shareholders' Equity

(Unaudited, expressed in thousands of Canadian dollars)

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	Share Capital	Contributed Surplus	Retained Earnings (Deficit)	Total
<b>Balance - December 31, 2011</b>	\$ 1,000	\$ 61,557	\$ 8,845	\$ 71,402
Net income for the period	-	-	1,032	1,032
Dividends to shareholders	<u>          </u>	<u>          </u>	<u>(1,486)</u>	<u>(1,486)</u>
<b>Balance - March 31, 2012</b>	<u>\$ 1,000</u>	<u>\$ 61,557</u>	<u>\$ 8,391</u>	<u>\$ 70,948</u>
<b>Balance - December 29, 2012</b>	\$ 1,000	\$ 61,557	\$ (5,857)	\$ 56,700
Net income for the period	-	-	688	688
Dividends to shareholders	<u>          </u>	<u>          </u>	<u>(842)</u>	<u>(842)</u>
<b>Balance - March 30, 2013</b>	<u>\$ 1,000</u>	<u>\$ 61,557</u>	<u>\$ (6,011)</u>	<u>\$ 56,546</u>

See accompanying notes to unaudited condensed interim financial statements.

# The Second Cup Ltd.

Condensed Interim Statements of Cash Flows  
(Unaudited, expressed in thousands of Canadian dollars)

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net income for the period	\$ 688	\$ 1,032
Items not involving cash		
Amortization of deferred financing charges	22	18
Amortization of intangible assets	117	108
Amortization of leasehold inducements	(10)	(7)
Amortization of property and equipment	183	158
Amortization of provisions	(18)	(22)
Deferred income taxes	40	43
Loss (gain) on disposal of property and equipment	7	(1)
Impairment of property and equipment	-	7
Movement in fair value of derivative interest rate swap	(95)	(65)
Income taxes	(558)	(1,502)
Leasehold inducements	100	-
Changes in non-cash working capital (note 8)	563	(535)
	<u>1,039</u>	<u>(766)</u>
<b>Investing activities</b>		
Investment in notes receivable	(10)	-
Proceeds from disposal of property and equipment	5	25
Proceeds from repayment of leases receivable	11	4
Proceeds from repayment of notes receivable	13	18
Purchase of property and equipment	(496)	(122)
Purchase of software	(25)	(89)
	<u>(502)</u>	<u>(164)</u>
<b>Financing activities</b>		
Dividends paid to shareholders	(842)	(1,486)
Payments on long-term lease	-	(2)
Repayment of note payable	-	(18)
	<u>(842)</u>	<u>(1,506)</u>
<b>(Decrease) in cash and cash equivalents during the period</b>	(305)	(2,436)
<b>Cash and cash equivalents - Beginning of period</b>	<u>3,880</u>	<u>5,465</u>
<b>Cash and cash equivalents - End of period</b>	<u>\$ 3,575</u>	<u>\$ 3,029</u>

See accompanying notes to unaudited condensed interim financial statements

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

**March 30, 2013 and March 31, 2012**

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

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### 1. Organization and Nature of Business

The Second Cup Ltd. (“Second Cup” or “the Company”) is Canada’s largest specialty coffee café franchisor (as measured by the number of cafés) with 361 cafés operating under the trade name, Second Cup™, in Canada, of which ten are Company operated and the balance are operated by franchise partners who are selected and trained to retail Second Cup’s product offering.

Second Cup owns the trademarks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of Second Cup cafés in Canada.

Second Cup is incorporated and domiciled in Canada. The address of its registered office is 6303 Airport Road, 2<sup>nd</sup> Floor, Mississauga, Ontario, L4V 1R8. The Company’s website is [www.secondcup.com](http://www.secondcup.com).

Second Cup’s fiscal year follows the method implemented by many retail entities, such that each quarter will consist of 13 weeks and will end on the Saturday closest to the calendar quarter end. The fiscal year is made up of 52 or 53 week periods ending on the last Saturday of December.

The common shares of the Company are listed on the Toronto Stock Exchange under the symbol “SCU”.

### 2. Basis of Preparation

These unaudited condensed interim financial statements for the 13 weeks ended March 30, 2013 have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as applicable to condensed interim financial reports including International Accounting Standard 34, Interim Financial Reporting (“IAS 34”) and should be read in conjunction with the Company’s audited annual financial statements for the year ended December 29, 2012, which have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board.

The accounting policies applied in these unaudited condensed interim financial statements are consistent with those of the previous financial year, except as described below and are based on IFRS issued and outstanding as of May 2, 2013, the date the Board of Directors approved the unaudited condensed interim financial statements.

#### *Changes in accounting policies*

The Company has adopted IFRS 13, Fair Value Measurement (“IFRS 13”). IFRS 13 provides a single framework for measuring fair value. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. The Company adopted IFRS 13 on December 30, 2012 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at December 30, 2012.

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

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### 3. Term Loan and Operating Facility

On June 12, 2012, the Company renegotiated its term loan and operating credit facilities, including an extension of the maturity of the credit facilities to May 31, 2015 and a decrease in interest rates. The revised credit facilities comprise an \$11,000 non-revolving term credit facility, fully drawn, and an undrawn \$2,000 revolving operating credit facility. The term credit facilities are collateralized by substantially all the assets of the Company.

The \$11,000 non-revolving term credit facility bears interest at the bankers' acceptance rate plus 2.75%. As at March 30, 2013, the full amount of the \$11,000 non-revolving term credit facility was drawn.

The \$2,000 operating credit facility bears interest at the bankers' acceptance rate plus 2.75%. As at March 30, 2013, no advances had been drawn on this facility.

The Company has an interest rate swap agreement with a notional value of \$11,000 maturing on April 1, 2013, which fixes the interest rate on the Company's non-revolving term credit facility at 3.04% per annum plus the margin noted above, which results in a fixed effective interest rate of 5.79%. As at March 30, 2013, the estimated fair value of this contract is a \$1 liability to the Company (December 29, 2012 - \$96), which is recorded as a liability on the Company's Unaudited Condensed Interim Statements of Financial Position and the fair value movement of the interest rate swap has been recorded as a non-cash credit to income on the Company's Unaudited Condensed Interim Statements of Income and Comprehensive Income.

Pursuant to the terms of the Company's operating credit facility 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. During the period ended March 30, 2013, the Company was in compliance with all financial and other covenants of the Company's operating credit facility and term loan.

In accordance with IFRS 7, Financial Instruments: Disclosures ("IFRS 7"), the term loan is presented net of transaction costs. Transaction costs are amortized to the Unaudited Condensed Interim Statements of Income and Comprehensive Income using the effective interest method.

	<b>March 30, 2013</b>	<b>December 29, 2012</b>
Face value of long-term debt	\$ 11,000	\$ 11,000
Unamortized transaction costs	<u>(37)</u>	<u>(59)</u>
	<u>\$ 10,963</u>	<u>\$ 10,941</u>

At maturity on May 31, 2015, the fair value of the term loan will be equal its face value.



# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

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Interest expense consists of the following:

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
Interest on term loan	\$ 111	\$ 131
Interest on derivative interest rate swap	48	48
Movement in fair value of derivative interest rate swap	(95)	(65)
Amortization of deferred financing charges	22	18
Other interest expense	4	6
	<hr/>	<hr/>
	\$ 90	\$ 138

#### 4. Income Taxes

Income tax expense is recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year.

Income tax expense as reported differs from the amount that would be computed by applying the combined Canadian federal and provincial statutory income tax rates to income before income taxes. The reasons for the differences are as follows:

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
Income before income taxes	\$ 950	\$ 1,426
Combined Canadian federal and provincial tax rates	<hr/> 26.50%	<hr/> 26.25%
Tax provision at statutory rate	252	374
Increased by following differences		
Non-deductible permanent differences	3	3
Other	7	17
	<hr/>	<hr/>
Income tax expense	\$ 262	\$ 394

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

### 5. Contingencies, Commitments and Guarantees

Second Cup has lease commitments for Company-operated cafés and acts as the head tenant on leases, which it in turn subleases to franchise partners. To the extent that the Company may be required to make rent payments due to headlease commitments, a provision has been recognized. The Company's lease commitments at March 30, 2013 are as follows:

	Headlease commitments	Sublease to franchisees	Net
March 31, 2014	\$ 19,671	\$ 18,297	\$ 1,374
March 31, 2015	18,571	17,369	1,202
March 31, 2016	16,737	15,551	1,186
March 31, 2017	14,734	13,553	1,181
March 31, 2018	12,657	11,540	1,117
Thereafter	35,976	31,478	4,498
	<u>\$ 118,346</u>	<u>\$ 107,788</u>	<u>\$ 10,558</u>

The Company believes it has sufficient resources to meet the net commitment of \$10,558.

Total occupancy and lease costs expensed in the quarter are as follows:

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
Company head office and franchise café locations	\$ 355	\$ 232
Company operated cafés	288	180
	<u>\$ 643</u>	<u>\$ 412</u>

Second Cup is involved in litigation and other claims arising in the normal course of business. Management must use its judgment to determine whether or not a claim has any merit, the amount of the claims and whether to record a provision, which is dependent on the potential success of the claim. Second Cup believes it will not incur any significant loss or expense with such claims. However, there can be no assurance that unforeseen circumstances will not result in significant costs. The outcome of these actions is not determinable at this time, and adjustments, if any, will be recorded in the period of settlement.

The Coffee "C" contract is the world benchmark for Arabica coffee. The contract prices physical delivery of exchange grade green beans from one of 19 countries of origin in a licensed warehouse to one of several ports in the U.S. and Europe, with stated premiums / discounts for ports and growth. Second Cup sources high altitude Arabica coffee which tends to trade at a premium above the "C" coffee commodity price. Second Cup has a contract with a third party company to purchase and roast the coffee that is sold in all Second Cup cafés by franchise partners. In terms of this supply agreement, Second Cup has guaranteed a minimum volume of coffee purchases amounting to \$5,705 (December 29, 2012 - \$4,421). The coffee purchase commitment represents purchase commitments made up to the end of May 2014. The coffee purchase commitment is comprised of three components: unapplied futures commitment contracts, fixed price physical contracts and flat price physical contracts.

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

Second Cup has entered into a marketing agreement with a third party through 2014 and has committed to spend \$200 per year on advertising placed in various media offered by the third party over the term of the agreement.

### 6. Basic and Diluted Earnings Per Share

Earnings per share are based on the weighted average number of shares outstanding during the period. Basic and diluted earnings per share are determined as follows:

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
Net income	\$ 688	\$ 1,032
Weighted average number of shares issued and outstanding	<u>9,903,045</u>	<u>9,903,045</u>
Basic and diluted earnings per share	<u>\$ 0.07</u>	<u>\$ 0.10</u>

### 7. Operating Expenses

#### Expenses by nature

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
<b>Head office</b>		
Salaries, wages and benefits	\$ 1,924	\$ 2,126
Occupancy and lease costs	355	232
Travel and franchise partner meetings	352	197
Research and innovation	321	34
Head office overheads	215	237
Professional fees	176	147
Amortization of property and equipment	137	123
Advertising and franchise development	135	117
Amortization of intangible assets	117	108
Legal costs	38	87
Inventory markdowns	13	-
Bad debt expense	(1)	65
	<u>3,782</u>	<u>3,473</u>
<b>Company cafés</b>		
Lease costs	288	180
Other operating expenses	89	68
Amortization of property and equipment	46	35
Advertising and local marketing	40	28
Loss (gain) on disposal of property and equipment	7	(1)
Impairment of property and equipment	-	7
	<u>470</u>	<u>317</u>
<b>Operating expenses</b>	<u>\$ 4,252</u>	<u>\$ 3,790</u>

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

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### Salaries, wages and employee benefits

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
Salaries and wages	\$ 1,585	\$ 1,763
Severance costs	192	115
Employee benefits	203	200
Directors' compensation	88	105
Long-term incentive plan ("LTIP")	36	101
Recovery from Co-op Fund	(180)	(158)
	<hr/>	<hr/>
Total head office	\$ 1,924	\$ 2,126

### 8. Supplementary Cash Flow Information

Changes in non-cash working capital items:

	Thirteen weeks ended March 30, 2013	Thirteen weeks ended March 31, 2012
Trade and other receivables	\$ 1,505	\$ 1,142
Notes and leases receivable	29	13
Inventories	(149)	(9)
Prepaid expenses and other assets	508	79
Accounts payable and accrued liabilities	(550)	(869)
Provisions	21	(55)
Other long-term liabilities	274	(28)
Gift card liability	(800)	(813)
Deposits from franchise partners	(275)	5
	<hr/>	<hr/>
Supplementary information	\$ 563	\$ (535)
	<hr/>	<hr/>
Interest paid	\$ 161	\$ 184
Income taxes paid	\$ 780	\$ 1,853

### 9. Financial Instruments and Financial Risk Management

#### *Financial Instruments*

The Company's financial instruments consist of cash and cash equivalents, trade and other receivables, notes and leases receivable, accounts payable and accrued liabilities, gift card liability, other long-term liabilities, term loan and operating facility, the derivative interest rate swap and deposits from franchise partners.

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

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### *Categories of financial instruments*

The Company has designated each of its significant categories of financial instruments outstanding as follows:

	March 30, 2013	December 29, 2012
<b>Financial assets</b>		
Loans and receivables		
Cash and cash equivalents	\$ 3,575	\$ 3,880
Trade and other receivables	3,111	4,616
Leases receivable	233	245
Notes receivable	730	761
<b>Financial liabilities</b>		
Financial liabilities designated as fair value through profit and loss		
Derivative interest rate swap	1	96
Other financial liabilities		
Accounts payable and accrued liabilities	2,763	3,313
Gift card liability	3,760	4,560
Term loan and operating facility	10,963	10,941

### *Financial liabilities designated as fair value through profit and loss*

	March 30, 2013	December 29, 2012
Opening fair value	\$ 96	\$ 302
Additions during the period	-	-
Realized during the period	-	-
Change in value	(95)	(206)
Closing fair value	\$ <u>1</u>	\$ <u>96</u>

### *Fair value of financial instruments*

The fair values of cash and cash equivalents, trade and other receivables, accounts payable and accrued liabilities and gift card liability approximate their carrying values due to their short-term maturity. The fair value of notes and leases receivable approximates their carrying value as the interest charged is considered to be based on market rates.

The fair value of the Company's term loan approximates its carrying value less transaction costs due to the floating interest rate of the term loan.

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

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IFRS 7 requires financial instruments that are measured subsequent to initial recognition at fair value to be grouped in Levels 1 to 3 in the fair value hierarchy, based on the degree to which the fair value is observable. The three levels of the fair value hierarchy are:

- Level 1 - inputs derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices); and
- Level 3 - fair value derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value for the derivative interest rate swap, classified as a Level 2, was derived using a discounted cash flow model that considers various observable inputs including time to maturity, forward interest rates and credit spreads.

As at December 29, 2012	Level 1	Level 2	Level 3
Derivative interest rate swap	\$ <u>-</u>	\$ <u>(96)</u>	\$ <u>-</u>
	\$ <u>-</u>	\$ <u>(96)</u>	\$ <u>-</u>
As at March 30, 2013	Level 1	Level 2	Level 3
Derivative interest rate swap	\$ <u>-</u>	\$ <u>(1)</u>	\$ <u>-</u>
	\$ <u>-</u>	\$ <u>(1)</u>	\$ <u>-</u>

There were no transfers between Level 1 and Level 2 in the period.

The Company's financial instruments are exposed to credit risk, liquidity risk and interest rate risk.

### ***Credit Risk***

The Company's financial instruments exposed to credit risk include cash and cash equivalents, trade and other receivables, leases receivable and notes receivable. The Company places its cash with institutions of high creditworthiness. The Company's trade and other receivables, leases receivable and notes receivable primarily comprise amounts due from franchise partners. Based on experience, management believes its trade and other receivables, leases receivable and notes receivable credit risk exposure is limited. Credit risk from trade and other receivables, leases receivable and notes receivable is minimized as a result of the review and evaluation of franchise partner account balances beyond a particular age. Management accounts for a specific bad debt provision when the expected recovery is less than the actual accounts receivable. The provision relating to past due trade and other receivables as at March 30, 2013 was \$142 (December 29, 2012 - \$223). The provision relating to past due leases receivable and notes receivable as at March 30, 2013 was \$214 (December 29, 2012 - \$189).

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

The maturities of the Company's trade and other receivables as at March 30, 2013 are as follows:

	<b>Maturing in the next 90 days</b>	<b>Maturing between 90 days and less than a year</b>	<b>Maturing between 1 year and less than 2 years</b>	<b>Maturing after 2 years</b>	<b>Total</b>
Total	\$ 3,108	\$ 3	\$ -	\$ -	\$ 3,111

The creditworthiness of new franchise partners is reviewed during the application process. A new franchise partner requires a minimum 30% of their investment in unencumbered cash, written confirmation of financing for the remaining 70% from their bank and a deposit of \$100 to accompany the signed franchise agreement.

The maturities of the Company's notes and leases receivable as at March 30, 2013 are as follows:

	<b>Maturing in the next 90 days</b>	<b>Maturing between 90 days and less than a year</b>	<b>Maturing between 1 year and less than 2 years</b>	<b>Maturing after 2 years</b>	<b>Total</b>
Total	\$ 67	\$ 190	\$ 217	\$ 489	\$ 963

### **Liquidity Risk**

Liquidity risk is the risk the Company will encounter difficulty in meeting obligations as they come due associated with its financial liabilities. The Company manages liquidity risk through regular monitoring of dividends, forecast and actual cash flows, and also the management of its capital structure and senior leverage ratios as outlined in note 18 of the audited annual financial statements of Second Cup for the year ended December 29, 2012. The Company's main source of income is royalty receipts from its franchise partners.

The contractual maturities of the Company's financial liabilities as at March 30, 2013 are as follows:

	<b>Maturing in the next 90 days</b>	<b>Maturing between 90 days and less than a year</b>	<b>Maturing between 1 year and less than 2 years</b>	<b>Maturing after 2 years</b>	<b>Total</b>
Accounts payable and accrued liabilities	\$ 2,335	\$ 337	\$ 91	\$ -	\$ 2,763
Gift card liability	3,760	-	-	-	3,760
Derivative interest rate swap	6	-	-	-	6
Term loan and operating facility	109	328	437	11,076	11,950
Total	\$ 6,210	\$ 665	\$ 528	\$ 11,076	\$ 18,479

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

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### *Interest Rate Risk*

Interest rate risk is the risk the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company is exposed to interest rate risk on its cash and cash equivalents and term loan, which earn and bear interest at floating rates. The Company entered into an interest rate swap agreement to minimize risk.

Interest expense on the long-term debt is adjusted to include the payments made or received under the interest rate swap agreement. The interest rate swap agreement is recognized in the Statements of Financial Position at its estimated fair value. During the period ended March 30, 2013, the Company recorded a net interest recovery of \$94 on the Company's Unaudited Condensed Interim Statements of Income and Comprehensive Income relating to the interest rate swap.

### *Sensitivity Analysis*

IFRS 7 requires disclosure of a sensitivity analysis to illustrate the sensitivity of the Company's financial position and performance to changes in market variables such as interest rates as a result of changes in the fair value of cash flows associated with the Company's financial instruments. The sensitivity analysis provided discloses the effect on net income for the period ended March 30, 2013, assuming that a reasonably possible change in the relevant risk variable has occurred as at March 30, 2013.

The following table shows the Company's exposure to interest rate risk and the pre-tax effects on net income for the period ended March 30, 2013 of a 1% change in interest rates which management believes is reasonably possible:

	<b>Pre-tax effects on net income - increase (decrease)</b>		
	<b>Carrying amount of liability</b>	<b>1% decrease in interest rates</b>	<b>1% increase in interest rates</b>
Term loan	\$ 11,000	\$ (110)	\$ 110
Interest rate swap agreement	1	110	(110)
		<u>\$ -</u>	<u>\$ -</u>



# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 30, 2013 and March 31, 2012

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

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### 10. Long-term Incentive Plan and Directors Deferred Share Unit Plan (“LTIP” and “DSUP”)

Shares granted under the LTIP vest over a three-year period and are paid out in cash on December 15 of each year. Shares are granted based on the weighted average price of the Company’s shares for the 20 trading days prior to the grant date. The fair value of the shares outstanding is determined based on the market value of the underlying shares of the Company.

A summary of the status of the Company’s LTIP is presented below:

	<b>Thirteen weeks ended March 30, 2013</b>	
	<b>Notional shares</b>	<b>Fair value</b>
Notional shares outstanding at December 29, 2012	58,563	\$ 256
Shares granted in lieu of dividends	868	5
Change in fair value		14
	<hr/>	<hr/>
Notional shares outstanding as at March 30, 2013	59,431	\$ 275
	<hr/>	<hr/>
Expensed in current period		\$ 36
		<hr/>

Shares granted under the DSUP vest on the last day of the year in which they are granted and are paid out in cash on the termination of the director. Shares are granted based on the weighted average price of the Company’s shares for the five trading days prior to the grant date. The fair value of the shares outstanding is determined based on the market value of the underlying shares of the Company.

A summary of the status of the Company’s DSUP is presented below:

	<b>Thirteen weeks ended March 30, 2013</b>	
	<b>Notional shares</b>	<b>Fair value</b>
Notional shares outstanding at December 29, 2012	25,176	\$ 129
Deferred share units granted	30,820	157
Shares granted in lieu of dividends	877	5
Change in fair value		4
	<hr/>	<hr/>
Notional shares outstanding at March 30, 2013	56,873	\$ 295
	<hr/>	<hr/>
Expensed in current period		\$ 44
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# **The Second Cup Ltd.**

Notes to the Condensed Interim Financial Statements

**March 30, 2013 and March 31, 2012**

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

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## **11. Segmented Reporting**

The Company's business is classified as one operating segment that is reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The Company is structured as a franchisor with all of its operating revenues derived in Canada. Operating revenues comprise the sale of goods from Company operated cafés and the sale of goods through ancillary channels, royalties and other service fees. Management is organized based on the Company's operations as a whole rather than the specific revenue streams.

## **12. Seasonality of Operations**

The Company's business is seasonal with revenues and operating income generally lower in the first quarter of the fiscal year due in part to post-holiday consumer spending patterns. Historically, revenue has been highest in the fourth quarter, which includes the holiday sales periods of November and December. Because of this seasonality, the results for any quarter are not necessarily indicative of what may be achieved for any other quarter or for the full fiscal year.

## **13. Subsequent Event**

On May 2, 2013 the Board of Directors of Second Cup approved a quarterly dividend of \$0.085 per common share, payable on May 31, 2013 to shareholders of record at the close of business on May 17, 2013.