The Second Cup Ltd.

Unaudited Condensed Interim Financial Statements

For the thirteen and thirty-nine weeks ended September 28, 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 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)

Steve Boyack
Chief Financial Officer, The Second Cup Ltd.

October 31, 2013

The Second Cup Ltd.

Condensed Interim Statements of Financial Position

(Unaudited, expressed in thousands of Canadian dollars)

		September 28, 2013		December 29, 2012
Assets				
Current assets				
Cash and cash equivalents	$	5,322	$	3,880
Trade and other receivables		2,598		4,616
Notes and leases receivable		211		265
Inventories		168		137
Prepaid expenses and other assets		106		695
Income tax recoverable		1		-
		8,406		9,593
Non-current assets				
Notes and leases receivable		695		741
Property and equipment		3,684		3,544
Intangible assets		61,477		74,802
Total assets	$	74,262	$	88,680
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities	$	3,331	$	3,118
Provisions		597		482
Other liabilities		792		633
Income tax payable		-		318
Gift card liability		3,185		4,560
Deposits from franchise partners		952		1,538
		8,857		10,649
Non-current liabilities				
Provisions		1,008		683
Other liabilities		441		421
Long-term debt (note 3)		10,942		11,037
Deferred income taxes (note 8)		7,385		9,190
Total liabilities		28,633		31,980
Shareholders' equity		45,629		56,700
Total liabilities and shareholders' equity	$	74,262	$	88,680

Contingencies, commitments and guarantees (note 4) and subsequent events (note 14).
See accompanying notes to the unaudited condensed interim financial statements.

Approved by the Directors Michael Rosicki, Director James Anas, Director

The Second Cup Ltd.

Condensed Interim Statements of Income (Loss) and Comprehensive Income (Loss)

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

	13 weeks ended		39 weeks ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Revenue				
Royalty revenue	$ 3,285	$ 3,532	$ 10,301	$ 10,910
Revenue from sale of goods	1,363	1,235	3,980	3,101
Services revenue	1,620	1,611	4,869	4,550
	6,268	6,378	19,150	18,561
Cost of goods sold	1,042	971	2,965	2,376
Gross profit	5,226	5,407	16,185	16,185
Operating expenses (note 5)	3,865	4,274	11,945	11,447
Impairment of trademarks (note 6)	-	-	13,253	-
Operating income (loss)	1,361	1,133	(9,013)	4,738
Interest and financing (note 7)	90	116	262	375
Income (loss) before income taxes	1,271	1,017	(9,275)	4,363
Income taxes (recovery) (note 8)	353	271	(729)	1,743
Net income (loss) and comprehensive income (loss) for the period	$ 918	$ 746	$ (8,546)	$ 2,620
Basic and diluted earnings (loss) per share (note 9)	$ 0.09	$ 0.08	$ (0.86)	$ 0.26

See accompanying notes to the unaudited condensed interim financial statements.

The Second Cup Ltd.

Condensed Interim Statements of Changes in Shareholders' Equity

(Unaudited, expressed in thousands of Canadian dollars)

	Share Capital	Contributed Surplus	Retained Earnings (Deficit)	Total
Balance - December 31, 2011	$ 1,000	$ 61,557	$ 8,845	$ 71,402
Net income for the period	-	-	2,620	2,620
Dividends to shareholders	-	-	(4,456)	(4,456)
Balance - September 29, 2012	$ 1,000	$ 61,557	$ 7,009	$ 69,566
Balance - December 29, 2012	$ 1,000	$ 61,557	$ (5,857)	$ 56,700
Net loss for the period	-	-	(8,546)	(8,546)
Dividends to shareholders	-	-	(2,525)	(2,525)
Balance - September 28, 2013	$ 1,000	$ 61,557	$ (16,928)	$ 45,629

See accompanying notes to the unaudited condensed interim financial statements.

The Second Cup Ltd.

Condensed Interim Statements of Cash Flows

(Unaudited, expressed in thousands of Canadian dollars)

	13 weeks ended		39 weeks ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Cash provided by (used in)				
Operating activities				
Net income (loss) for the period	$ 918	$ 746	$ (8,546)	$ 2,620
Items not involving cash				
Depreciation of property and equipment	187	191	543	508
Amortization of intangible assets	123	115	360	335
Impairment charges	-	-	13,253	7
Amortization of deferred financing charges	3	22	30	60
Amortization of provisions	(51)	(22)	(87)	(67)
Amortization of leasehold inducements	86	(8)	-	(24)
Deferred income taxes	(86)	(4)	(1,805)	695
(Gain) loss on disposal of property and equipment	-	29	(16)	28
Movement in fair value of interest rate swap	-	(53)	(96)	(159)
Income taxes	57	1	(319)	(1,674)
Changes in non-cash working capital (note 10)	(600)	792	1,596	1,056
	637	1,809	4,913	3,385
Investing activities				
Proceeds from disposal of property and equipment	45	(4)	867	191
Cash payments for capital expenditures (note 10)	(880)	(783)	(1,822)	(1,527)
Proceeds from repayment of leases receivable	14	12	35	21
Proceeds from repayment of notes receivable	-	17	13	169
Investment in notes receivable	-	-	(10)	-
	(821)	(758)	(917)	(1,146)
Financing activities				
Dividends paid to shareholders	(841)	(1,485)	(2,525)	(4,456)
Repayment of note payable	-	-	-	(18)
Deferred financing charges	(29)	(1)	(29)	(48)
Payments on long-term lease	-	-	-	(2)
	(870)	(1,486)	(2,554)	(4,524)
(Decrease) increase in cash and cash equivalents during the period	(1,054)	(435)	1,442	(2,285)
Cash and cash equivalents - Beginning of period	6,376	3,615	3,880	5,465
Cash and cash equivalents - End of period	$ 5,322	$ 3,180	$ 5,322	$ 3,180

See accompanying notes to the unaudited condensed interim financial statements.

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

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 351 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 offerings.

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 only in Canada.

Second Cup is incorporated and domiciled in Canada. The address of its registered office is 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8. The Company’s website is 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 (“Quarter”) and 39 weeks (“Year to Date”) periods ended September 28, 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 in the interim financial statements for the period ended March 30, 2013 pertaining to the adoption of new IFRS. Certain comparable figures have been reclassified to conform to the current year’s financial statement presentation. The accounting policies are based on IFRS issued and outstanding as of October 31, 2013, the date the Board of Directors approved the unaudited condensed interim financial statements.

3. Long-term Debt

Details of long-term debt:

	September 28, 2013	December 29, 2012
Face value of long-term debt	$ 11,000	$ 11,000
Fair value of interest rate swap	-	96
Unamortized transaction costs	(58)	(59)
	$ 10,942	$ 11,037

At maturity on September 30, 2016, the fair value of the term loan will equal its face value. The term loan is presented net of transaction costs. Transaction costs are amortized to the unaudited condensed interim statements of income (loss) and comprehensive income (loss) using the effective interest method.
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. The Company has requirements to maintain:

- a ratio of senior debt to EBITDA ratio ("Leverage Ratio"),
- a fixed charge coverage ratio,

both of the latter are based on a trailing four-quarter basis, and

- a maximum amount of permitted distributions and purchases of the Company's own stock based on a trailing cumulative EBITDA, plus a carry-forward legacy surplus of permitted distributions.

During the period ended September 28, 2013, the Company was in compliance with all financial and other covenants of the Company's operating credit facility and term loan.

On September 26, 2013, the Company renegotiated its term loan and operating credit facilities, including an extension of the maturity of the credit facilities to September 30, 2016. 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. As a result of the renegotiated term loan, the Company recognized an additional $29 pertaining to transaction costs during the third Quarter 2013.

The $11,000 non-revolving term credit facility bears interest at the bankers' acceptance ("BA") rate plus a margin range of 2.25% to 3.25% depending on the Company's Leverage Ratio. As at September 28, 2013, the applicable margin pertaining to the aforementioned range is 2.75%. As at September 28, 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 BA rate plus a range of 2.25% to 3.25% depending on the Company's Leverage Ratio. As at September 28, 2013, the applicable margin pertaining to the aforementioned range is 2.75%. As at September 28, 2013, no advances had been drawn on this facility.

The Company had an interest rate swap agreement with a notional value of $11,000 that expired on April 1, 2013, which fixed the interest rate on the Company's non-revolving term credit facility at 3.04% per annum plus the margin noted above, which resulted in a fixed effective interest rate of 5.79%. As at September 28, 2013, the swap agreement expired. As at December 29, 2012, the balance of $96 was recorded as a liability. The fair value movement of the interest rate swap has been recorded as a non-cash credit to income.

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

4. 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 the Company may be required to make rent payments due to headlease commitments, a provision has been recognized. The Company's lease commitments at September 28, 2013 are as follows:

	Headlease commitments	Sublease to franchisees	Net
September 28, 2014	$ 19,940	$ 18,486	$ 1,454
September 28, 2015	18,525	17,307	1,218
September 28, 2016	16,474	15,254	1,220
September 28, 2017	14,540	13,322	1,218
September 28, 2018	12,419	11,315	1,104
Thereafter	34,646	30,907	3,739
	$ 116,544	$ 106,591	$ 9,953

The Company believes it will have sufficient resources to meet the net commitment of $9,953.

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 claim 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. Second Cup sources high altitude Arabica coffee which tends to trade at a premium above the "C" coffee commodity price. Second Cup has contracts with third party companies to purchase the coffee that is sold in all Second Cup cafés. In terms of these supply agreements, Second Cup has guaranteed a minimum volume of coffee purchases of $5,869 (December 29, 2012 - $4,421). The coffee purchase commitment represents purchase commitments made up to the end of December 2014. The coffee purchase commitment is comprised of three components: unapplied futures commitment contracts, fixed price physical contracts and flat price physical contracts.

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.

Second Cup is the primary coordinator of café construction costs on behalf its franchise partners and for corporate cafés. As at September 28, 2013, there is $2,046 of contractual commitments pertaining to construction costs for new locations and renovations. The Company finances construction costs for franchise projects from deposits received from franchise partners and corporate projects from the Company's cash flows.

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

5. Operating Expenses

Expenses by nature

	13 weeks ended		39 weeks ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Head office				
Salaries, wages, benefits and incentives	$ 1,484	$ 1,680	$ 5,075	$ 5,056
Head office overheads	496	445	1,772	1,729
Occupancy and lease costs	883	694	1,473	1,025
Professional fees	390	272	826	826
Research and innovation	226	140	675	361
Bad debts and other	(379)	320	(55)	627
Depreciation of property and equipment	138	124	411	369
Amortization of intangible assets	123	115	360	335
	3,361	3,790	10,537	10,328
Company cafés				
Occupancy and lease costs	306	237	881	603
Other	149	151	411	349
Depreciation of property and equipment	49	67	132	139
Loss (gain) on disposal of property and equipment	-	29	(16)	28
	504	484	1,408	1,119
Operating expenses	$ 3,865	$ 4,274	$ 11,945	$ 11,447

6. Impairment of Trademarks

During the Quarter ended June 29, 2013 and the Year to Date period ended September 28, 2013, the Company identified impairment indicators, which were primarily a result of the decline in its stock price and a decline in sales in comparison to internal projections.

During the reporting periods presented, the Company had two cash generating units ("CGU") - corporate cafés and the franchise business. The trademarks were allocated fully to the franchise business CGU. The CGU's recoverable amount has been determined using fair value less costs to sell.

Key assumptions

The discounted cash flow methodology uses estimates and assumptions that are sensitive to change and require judgment. This methodology used to test impairment is classified as Level 3 per the hierarchy described in Note 11. These key judgments include estimates of discount rates, forecast growth in system sales and other estimates impacting future cash flows. Changes in these estimates and assumptions may have a significant impact on recoverable amounts. General market uncertainty and the competitive operating environment for the Company and other similar retail entities were also factors taken into account in the analysis. The changes in the market growth rates reflect the current general economic pressures now impacting the national economy.

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

These calculations use cash flow projections based on financial forecasts covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates stated below. The following are key assumptions used in the fair value less costs to sell calculation:

Forecast same café sales	-3.1% to 2.0%
Forecast system-wide café sales	-0.8% to 4.8%
Average growth rate used to extrapolate cash flows beyond the forecast period	2.0%
Discount rate	11% to 13%

The valuation of the franchise business CGU is based on probabilities assigned to forecasted cash flows and includes key assumptions above. The Company recognized an impairment charge of $13,253 to trademarks in the Quarter ended June 29, 2013 and Year to Date period September 28, 2013.

The effect of a change in management's key assumptions is reflected below:

Sensitivity

Key assumption	Low growth	High growth
System-wide café sales	-0.8% to 2%	0.1% to 4.8%
Discount rate	11.0%	13.0%
Impact on impairment loss	Additional impairment loss of $2,130	Reduction to impairment loss of $7,842

7. Interest and Financing

	13 weeks ended		39 weeks ended	
	September 28, 2013	**September 29, 2012**	**September 28, 2013**	**September 29, 2012**
Interest expense	$ 113	$ 106	$ 293	$ 366
Amortization of deferred financing costs	3	22	30	60
Interest income	(26)	(12)	(61)	(51)
	$ 90	$ 116	$ 262	$ 375

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

8. 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:

	13 weeks ended		39 weeks ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Income (loss) before income taxes	$ 1,271	$ 1,017	$ (9,275)	$ 4,363
Combined Canadian federal and provincial tax rates	26.51%	26.44%	26.51%	26.44%
Tax provision at statutory rate	337	269	(2,459)	1,154
Increased (reduced) by following differences				
Change in tax rates	-	-	-	458
Deferred income tax assets and liabilities not previously recognized	-	-	(31)	-
Non-deductible permanent differences	12	3	1,774	9
Other	4	(1)	(13)	122
Income tax expense (recovery)	$ 353	$ 271	$ (729)	$ 1,743
Current income tax expense	$ 439	$ 275	$ 1,076	$ 1,048
Deferred income tax (recovery) expense	(86)	(4)	(1,805)	695
	$ 353	$ 271	$ (729)	$ 1,743

9. Basic and Diluted Earnings (Loss) 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:

	13 weeks ended		39 weeks ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Net income (loss)	$ 918	$ 746	$ (8,546)	$ 2,620
Weighted average number of shares issued and outstanding	9,903,045	9,903,045	9,903,045	9,903,045
Basic and diluted earnings (loss) per share	$ 0.09	$ 0.08	$ (0.86)	$ 0.26

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

10. Supplementary Cash Flow Information

	13 weeks ended		39 weeks ended	
	September 28, 2013	September 29, 2012	September 28, 2013	September 29, 2012
Changes in non-cash working capital (inflow (outflow))				
Trade and other receivables	$ (495)	$ 538	$ 2,018	$ 2,587
Notes and leases receivable	18	(529)	61	(495)
Inventories	37	188	(31)	(73)
Prepaid expenses and other assets	28	105	589	83
Accounts payable and accrued liabilities	385	(235)	213	(1,117)
Provisions	15	203	106	111
Other liabilities	381	80	601	242
Gift card liability	(524)	(112)	(1,375)	(973)
Deposits from franchisees	(445)	554	(586)	691
	$ (600)	$ 792	$ 1,596	$ 1,056
Cash payments for capital expenditures				
Purchase of property and equipment	$ (727)	$ (755)	$ (1,527)	$ (1,371)
Purchase of intangible assets	(153)	(28)	(295)	(156)
	$ (880)	$ (783)	$ (1,822)	$ (1,527)
Supplementary information				
Interest paid	$ 112	$ 159	$ 386	$ 525
Income taxes paid	$ 385	$ 273	$ 1,395	$ 2,721

11. 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 liabilities, term loan, deposits from franchise partners, and the interest rate swap.

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

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

		September 28, 2013		**December 29, 2012**
Financial assets				
Loans and receivables				
Cash and cash equivalents	$	5,322	$	3,880
Trade and other receivables		2,598		4,616
Notes and leases receivable		906		1,006
Financial liabilities				
Financial liabilities designated as fair value through profit and loss				
Interest rate swap	$	-	$	96
Other financial liabilities				
Accounts payable and accrued liabilities		3,331		3,118
Gift card liability		3,185		4,560
Deposits from franchise partners		952		1,538
Term loan		10,942		10,941

Financial liabilities designated as fair value through profit and loss

		September 28, 2013		**December 29, 2012**
Opening fair value	$	96	$	302
Additions during the period		-		-
Realized during the period		-		-
Change in value		(96)		(206)
Closing fair value	$	-	$	96

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.

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

Financial instruments that are measured subsequent to initial recognition at fair value are to be categorized 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 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**
Interest rate swap	$ -	$ (96)	$ -

As at September 28, 2013	**Level 1**	**Level 2**	**Level 3**
Interest rate swap	$ -	$ -	$ -

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.

An analysis of aging of the Company's trade and other receivables from payment due date as at September 28, 2013 net of an allowance for doubtful accounts is as follows:

	0-30 Days	**31-60 Days**	**61-90 Days**	**>90 Days**	**Total**
Total	$ 2,202	$ 166	$ 91	$ 139	$ 2,598

The Company's trade and other receivables included a combined allowance for doubtful accounts of $258 (December 29, 2012 - $223).

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

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 payment maturity dates of the Company's notes and leases receivable from September 28, 2013 net of an allowance for doubtful accounts are as follows:

Maturity	**< 90 Days**	**90 Days to < 1 year**	**1 year to < 2 years**	**2 years and after**	**Total**
Total	$ 54	$ 157	$ 225	$ 470	$ 906

The Company's notes and leases receivable included a combined allowance for doubtful accounts of $102 (December 29, 2012 - $189).

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 3. The Company's main source of income is royalty receipts from its franchise partners.

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, which expired on April 1, 2013.

Interest expense on the term loan was adjusted to include the payments made or received under the interest rate swap agreement. The interest rate swap agreement is recognized in the unaudited condensed interim statements of financial position at its estimated fair value. During the 39 weeks ended September 28, 2013, the Company recorded a net interest recovery of $96 on the Company's unaudited condensed interim statements of income (loss) and comprehensive income (loss) relating to the interest rate swap.

Sensitivity Analysis
The Company completes an assessment of sensitivity of its 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 financial instruments. The sensitivity analysis provided discloses the effect on net income for the period ended September 28, 2013, assuming that a reasonably possible change in the relevant risk variable has occurred as at September 28, 2013.

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

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

	Pre-tax effects on net income - increase (decrease)		
	Gross amount of liability	**1% decrease in interest rates**	**1% increase in interest rates**
Term loan	$ 11,000	$ 110	$ (110)

12. 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 are comprised of royalties, the sale of goods from Company-operated cafés and the sale of goods through ancillary channels, and other service fees. Management is organized based on the Company's operations as a whole rather than the specific revenue streams.

13. 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.

14. Subsequent Events

On September 30, 2013, the Company had entered into an interest rate swap agreement with a notional value of $11,000 that expires on September 30, 2016. The swap fixed the interest rate on the Company's non-revolving term credit facility at 2.07% per annum plus the margin noted above in note 3, which resulted in a fixed effective interest rate of 4.82%.

On October 30, 2013 the Board of Directors of Second Cup approved a quarterly dividend of $0.085 per common share, payable on November 29, 2013 to shareholders of record at the close of business on November 15, 2013.