The Second Cup Ltd.

Audited Financial Statements

For the 52 weeks ended December 28, 2013 and December 29, 2012

March 7, 2014

Independent Auditor's Report

To the Shareholders of
The Second Cup Ltd.

We have audited the accompanying financial statements of The Second Cup Ltd., which comprise the statements of financial position as at December 28, 2013 and December 29, 2012 and the statements of operations and comprehensive income (loss), statements of changes in equity and statements of cash flows for the two fifty-two week periods then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audit is sufficient and appropriate to provide a basis for our audit opinion.

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"PwC" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of The Second Cup Ltd. as at December 28, 2013 and December 29, 2012 and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

The Second Cup Ltd.

Statements of Financial Position
As at December 28, 2013 and December 29, 2012
(Expressed in thousands of Canadian dollars)

	2013	2012
ASSETS		
Current assets		
Cash and cash equivalents	$ 6,501	$ 3,880
Trade and other receivables (note 7)	4,368	4,616
Notes and leases receivable (note 8)	220	265
Inventories (note 9)	123	137
Prepaid expenses and other assets	190	695
	11,402	9,593
Non-current assets		
Notes and leases receivable (note 8)	701	741
Property and equipment (note 10)	3,507	3,544
Intangible assets (note 11)	61,730	74,802
Total assets	$ 77,340	$ 88,680
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 12)	$ 4,586	$ 3,123
Provisions (note 13)	847	448
Other liabilities (note 14)	717	720
Income tax payable	138	318
Gift card liability	3,895	4,560
Deposits from franchise partners	878	1,480
	11,061	10,649
Non-current liabilities		
Provisions (note 13)	1,380	683
Other liabilities (note 14)	428	421
Long-term debt (note 15)	11,089	11,037
Deferred income taxes	7,418	9,190
Total liabilities	31,376	31,980
SHAREHOLDERS' EQUITY	45,964	56,700
Total liabilities and shareholders' equity	$ 77,340	$ 88,680

Contingencies, commitments and guarantees (note 22) and subsequent event (note 25).
See accompanying notes to financial statements.

Approved by the Directors March 7, 2014

Michael Bregman, Director   Rael Merson, Director

The Second Cup Ltd.

Statements of Operations and Comprehensive Loss
For the periods ended December 28, 2013 and December 29, 2012
(Expressed in thousands of Canadian dollars, except per share amounts)

	2013	2012
Revenue		
Royalties	$ 14,117	$ 14,927
Sale of goods	5,506	4,698
Services	7,565	6,721
	27,188	26,346
Cost of goods sold	4,054	3,523
Gross profit	23,134	22,823
Operating expenses (note 16)	16,704	15,417
Impairment charges (note 17)	13,552	15,656
Operating loss	(7,122)	(8,250)
Interest and financing (note 18)	516	503
Loss before income taxes	(7,638)	(8,753)
Income taxes (recovery) (note 19)	(269)	651
Net loss and comprehensive loss for the period	$ (7,369)	$ (9,404)
Basic and diluted loss per share (note 20)	$ (0.74)	$ (0.95)

See accompanying notes to financial statements.

The Second Cup Ltd.

Statements of Changes in Shareholders' Equity
For the periods ended December 28, 2013 and December 29, 2012
(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 loss for the period	-	-	(9,404)	(9,404)
Dividends to shareholders	-	-	(5,298)	(5,298)
Balance - December 29, 2012	$ 1,000	$ 61,557	$ (5,857)	$ 56,700
Net loss for the period			(7,369)	(7,369)
Dividends to shareholders			(3,367)	(3,367)
Balance - December 28, 2013	$ 1,000	$ 61,557	$ (16,593)	$ 45,964

See accompanying notes to financial statements.

The Second Cup Ltd.

Statements of Cash Flows

For the periods ended December 28, 2013 and December 29, 2012

(Expressed in thousands of Canadian dollars)

CASH PROVIDED BY (USED IN)	2013	2012
Operating activities		
Loss for the period	$ (7,369)	$ (9,404)
Items not involving cash		
Depreciation of property and equipment	749	716
Amortization of intangible assets	502	451
Impairment charges	13,552	15,656
Amortization of deferred financing charges	38	82
Amortization of provisions	(116)	(89)
Amortization of leasehold inducements	69	26
Deferred income taxes	(1,772)	(993)
(Gain) Loss on disposal of capital related items	(197)	70
Movement in fair value of interest rate swap	44	(206)
Changes in non-cash working capital (note 21)	2,178	(1,159)
Cash provided by operating activities	7,678	5,150
Investing activities		
Proceeds from disposal of capital related items	1,240	350
Cash payments for capital expenditures (note 21)	(2,904)	(1,938)
Proceeds from repayment of leases receivable	-	36
Proceeds from repayment of notes receivable	13	185
Investment in notes receivable	(10)	-
Cash used by investing activities	(1,661)	(1,367)
Financing activities		
Dividends paid to shareholders	(3,367)	(5,298)
Repayment of note payable	-	(18)
Deferred financing charges	(29)	(50)
Payments on long-term lease	-	(2)
Cash used by financing activities	(3,396)	(5,368)
Increase (decrease) in cash and cash equivalents during the period	2,621	(1,585)
Cash and cash equivalents - Beginning of the period	3,880	5,465
Cash and cash equivalents - End of the period	$ 6,501	$ 3,880

See accompanying notes to financial statements. Supplemental cash flow information is provided in note 21.

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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 franchisor (as measured by the number of cafés) with 356 cafés operating under the trade name Second Cup™ in Canada, of which ten are Company-operated and the balance are operated by franchise partners.

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, excluding the Territory of Nunavut.

Second Cup is incorporated under the Business Corporations Act (Ontario) in 2011 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. The common shares of the Company are listed on the Toronto Stock Exchange under the symbol "SCU".

2. Summary of significant accounting policies

a. Basis of preparation

The financial statements of Second Cup have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretation Committee ("IFRIC") interpretations. The accounting policies applied in the financial statements are based on IFRS effective for the fiscal year ended December 28, 2013. The Company's functional currency is the Canadian dollar.

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.

Second Cup manages an advertising and co-operative fund (the "Co-op Fund") established to collect and administer funds contributed for use in advertising and promotional programs, and initiatives designed to increase sales and enhance the reputation of the Second Cup brand. Contributions to the Co-op Fund are required to be made from both franchised and Company-operated cafés and are based on a percentage of café sales. The revenue, expenses and cash flows of the Co-op Fund are not consolidated, but netted in the Company's Statements of Operations and Comprehensive Loss in operating expenses when there is a spend deficit, or carried on the balance sheet in accounts payable if there is a spend surplus. The assets and liabilities of the Co-op Fund are included in the assets and liabilities of the Company on the Statements of Financial Position. The policy is established because the contributions to the Co-op Fund are segregated, the contributions are designated for a specific purpose, the Company is acting as an agent, and this accounting treatment is common practice in the Company's industry.

Reclassification

Certain comparable figures have been reclassified to conform to the current period's financial statement presentation. Management determined that reclassification better captures the substance of the balances in conjunction with the Company's accounting policies. The reclassification had no impact on the Statements of Operations and Comprehensive Loss nor current vs. non-current presentation on the Statements of Financial Position. The 2012 Statements of Financial Position was reclassified as follows:

Item in current liabilities	2012 as reported	Reclassification impact	2012 reclassified
Accounts payable and accrued liabilities	$ 3,313	$ (190)	$ 3,123
Provisions	365	83	448
Other liabilities	189	531	720
Deposits from franchise partners	1,904	(424)	1,480

Impairment charges were previously presented showing solely charges related to intangible assets and goodwill. Impairment pertaining to property and equipment was classified under operating expenses. The reclassification captures all impairment charges combined under one line item.

2012 operating expenses and impairment charges were reclassified as follows:

Item in Statements of Operations and Comprehensive Loss	2012 as reported	Reclassification impact	2012 reclassified
Operating expenses	$ 15,779	$ (362)	$ 15,417
Impairment of goodwill and trademarks	15,294	(15,294)	-
Impairment charges	-	15,656	15,656

b. Segmented information and reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The Company substantially operates and is managed as one reportable segment. The Company is structured as a franchisor with all of its operating revenues derived in Canada. Operating revenues comprise 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.

c. Critical accounting estimates and the use of judgements

The preparation of financial statements requires management to make estimates, assumptions, and use judgement in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgements are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. The accounting estimates will, by definition, seldom equal the related actual results.

Estimates

The following are examples of estimates and assumptions the Company makes:

- The allowance for doubtful accounts;
- The allowance for inventory obsolescence;
- The estimated useful lives of assets;
- The recoverability of tangible and intangible assets subject to depreciation, amortization, or with indefinite lives;
- The derivation of income tax assets and liabilities;
- Café lease provisions; and
- Gift card breakage.

Use of judgement

The following discusses the most significant accounting judgements and estimates that the Company has made in the preparation of the financial statements:

(i) Impairment charges

Impairment analysis is an area involving management judgement requiring assessment as to whether the carrying value of assets is recoverable. Fair value less cost to sell is determined by estimating the net present value of future cash flows derived from such assets using cash flow projections that have been discounted at an

appropriate rate and based on a market participant's view. In calculating the net present value of the future cash flows, certain assumptions are required to be made in respect of highly uncertain matters including:

- Growth in total revenue;
- Change and timing of cash flows such as the increase or decrease of expenditures;
- Selection of discount rates to reflect the risks involved; and
- Applying judgement in cash flows specific to cash generating units.

Changing the assumptions selected by management, in particular, the discount rate and the growth rate assumptions used in the cash flow projections, could significantly affect the impairment evaluations and recoverable amounts.

The Company's impairment test includes the key assumptions related to sensitivity in the cash flow projections. Further details are provided in note 17 to the financial statements.

(ii) Deferred income taxes

The timing of reversal of temporary differences and the expected income allocation to various tax jurisdictions within Canada affect the effective income tax rate used to compute the deferred income taxes. Management estimates the reversals and income allocation based on historical and budgeted operating results and income tax laws existing at the Statements of Financial Position dates. In addition, management occasionally estimates the current or future deductibility of certain expenditures, affecting current or deferred income tax balances and expenses.

(iii) Estimated useful lives

Management estimates the useful lives of property and equipment based on the period during which the assets are expected to be available-for-use. The amounts and timing of recorded expenses for depreciation of property and equipment for any period are affected by these estimated useful lives. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's property and equipment in the future.

(iv) Café lease provisions

Café lease provisions require judgement to evaluate the likelihood and measurement of settlements, temporary payouts, or sub-leasing. Management works with landlords and franchise partners to obtain adequate information needed to make applicable judgements.

d. Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the Statements of Financial Position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously. The Company does not use hedge accounting.

In respect to recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

Financial instrument	Categorization	Recognition method
Financial assets		
Cash and cash equivalents	Loans and receivables	Amortized cost
Trade and other receivables	Loans and receivables	Amortized cost
Notes and leases receivable	Loans and receivables	Amortized cost
Financial liabilities		
Interest rate swap	Fair value through profit and loss	Fair value
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Gift card liability	Other financial liabilities	Amortized cost
Deposits from franchise partners	Other financial liabilities	Amortized cost
Term loan	Other financial liabilities	Amortized cost

(i) Cash and cash equivalents, trade and other receivables, and notes and leases receivable: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at the amount expected to be received, and if necessary less a present value discount if collection is to be expected beyond one year. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment, if necessary. Management has selected this classification as the benefit of selecting the available-for-sale classification alternative was not beneficial to the Company.

(ii) Derivative financial instruments: The Company uses derivatives in the form of interest rate swaps to manage risks related to its variable rate long-term debt. Management has selected the fair value through profit or loss classification as such best reflects management's investment and treasury management intentions.

Unrealized fair value gains and losses pertaining to the interest rate swap are included in interest income (expense).

(iii) Transaction costs: The Company accounts for long-term debt initially at fair value, net of any transaction costs incurred and, subsequently, at amortized cost using the effective interest method. Transaction costs pertaining to instruments categorized as fair value through profit and loss are recognized immediately. Transaction costs associated with instruments recognized at amortized cost are amortized over the expected life of the instrument. The Company has selected this classification as it results in better matching of the transaction costs with the periods benefiting from the transaction costs.

e. Cash and cash equivalents

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

f. Leases receivable

The Company has entered into lease agreements acting as the lessor with some franchise partners relating to point of sale systems ("POS"). The lease term is for the major part of the economic life of the POS although the Company does not transfer title. The Company recognizes leases as finance type leases and records a lease receivable at an amount equal to the net investment in the lease. Leases receivable are initially recognized at the amount expected to be received, less a present value discount if collection is to be expected beyond one year. Subsequently, leases receivable are measured at amortized cost using the effective interest method less a provision for impairment.

g. Inventories

Inventories are stated at the lower of cost and net realizable value, with cost being determined on a first-in, first-out ("FIFO") method. Net realizable value is the estimated recoverable amount less applicable selling expenses. If carrying value exceeds net realizable amount, a write-down is recognized. The write-downs are reversed if the circumstances that caused the initial write-down no longer exist.

h. Property and equipment

Property and equipment are stated at cost less accumulated depreciation net of any impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying value or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying value of a replaced asset is removed when replaced. Repairs and maintenance costs are charged to the Statements of Operations and Comprehensive Loss during the period in which they are incurred. Where property and equipment construction projects are of a sufficient size and duration, an amount is capitalized for the costs used to finance construction.

Depreciation is calculated using the straight-line basis as management believes this approach best reflects consumption and benefit patterns pertaining to the asset's use. Depreciation is charged commencing when the asset is available for use. The following rates are based on the expected useful lives of the asset:

Leasehold improvements	lesser of 10 years and the remaining term of the lease
Equipment, furniture, fixtures and other	3 to 7 years
Computer hardware	3 years

i. Goodwill

Goodwill represents the excess of the cost of acquisition over the fair values of assets, liabilities and contingent liabilities acquired. Goodwill is carried at cost less accumulated impairment losses. Goodwill is tested annually for impairment or at any time if an indicator for impairment exists.

j. Intangible assets

Intangible assets consist of trademarks, franchise rights and software, which are amortized or assessed for impairment as follows:

(i) Trademarks
Trademarks consist of trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Second Cup cafés in Canada and are recorded at the historical cost less impairment write-downs. The trademark is an indefinite life intangible asset that is tested annually for impairment or at any time if an indicator for impairment exists. The trademark assets do not have continual renewal requirements nor is there any deterioration incurred due to usage. As a result of the combination of the aforementioned, our trademark assets are considered to have indefinite lives.

(ii) Franchise rights
As a result of the acquisition of The Second Cup Ltd. in 2009 by Second Cup Royalty Income Fund, franchise rights were recognized as an intangible asset. The franchise rights intangible asset is based on the net present value of the discounted future cash flows expected from the existing franchise partners of Second Cup as at the date of acquisition, including royalties and franchise fees. Franchise rights are reviewed for impairment at any time if an indicator of impairment exists. Franchise rights are amortized based on the average remaining term of the existing franchise agreement.

(iii) Software
Purchased software costs are recorded at cost and are amortized commencing when the asset is available for use. Amortization is calculated using the straight-line basis as management believes this approach best reflects consumption and benefit patterns pertaining to the asset's use. The following rate is based on the expected useful lives of the assets:

Software	3 to 7 years

Where software implementation projects are of a sufficient size and duration, an amount is capitalized for the costs used to finance development.

k. Provisions
Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material. The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts. A summary of the provisions to the Company are:

(i) Headlease liabilities
On June 27, 2009, Second Cup Trade-Marks Limited Partnership, on behalf of Second Cup Income Fund, completed the acquisition of all of the outstanding shares of Second Cup. Headlease liabilities represent the provision for lease guarantees provided by Second Cup for franchised operations at the date of acquisition. The liability was recorded at estimated fair value based on the net present value of the future estimated negative cash flows when Second Cup is required to cover rental arrears of its franchise partners, to terminate unfavourable leases or to cover shortfalls if a location is sublet to a third party. This liability is amortized over the average remaining length of these existing lease agreements.

(ii) Café leases
Second Cup has lease commitments since it acts as the head tenant on most café leases. In cases where the lease contract specifies an ongoing or termination fee, or rents due in arrears to the landlord where the

Company believes they are liable, the Company records a provision based on its best estimate of future cash outflows. When ceasing operations under operating leases where the landlord does not allow the Company to prematurely exit the lease, but allows for subleasing, the Company estimates the fair value of sublease income in calculating the provision to the end of the lease term. In other circumstances, the Company will record a provision where onerous arrangements exist as a result of the Company acting as the head tenant on café leases.

(iii) Other

Other provisions may include restructuring related, lawsuit related, and any other provisions.

l. Other liabilities

(i) Deferred revenue

The Company has entered into several supply agreement contracts and receives allowances from certain suppliers in consideration for the café network achieving certain volume thresholds over the term of the supply agreement. Deferred revenue is amortized over the term of the supply agreements based on the proportion of volume thresholds met during the fiscal year.

Deposits from franchise partners for franchise administration fees pertaining to the commencement of a new franchise term or a pending transfer arrangement are accounted as deferred revenue until the revenue recognition criteria are met.

(ii) Leasehold inducements

Leasehold inducements are amortized to rent expense on a straight-line basis over the term of the lease.

m. Income taxes

Income tax comprises current and deferred income taxes. Income taxes are recognized in the Statements of Operations and Comprehensive Loss except to the extent that it relates to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

Current income taxes are the expected taxes payable on the taxable income for the period, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous periods.

Deferred income taxes are recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying values in the financial statements. Deferred income taxes are determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the Statements of Financial Position dates and are expected to apply when the deferred income tax asset or liability is settled. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilized.

n. Gift card liability

Second Cup has a gift card program that allows customers to prepay for future purchases by loading a dollar value onto their gift cards through cash or credit/debit cards in the cafés or online through credit cards, when and as needed. The gift card liability represents liabilities related to unused balances on the Second Cup Café Card net of estimated breakage. These balances are included as sales from franchised cafés, or as revenue of Company-operated cafés, at the time the customer redeems the amount in a café for products.

The gift cards do not have an expiration date and the Company does not deduct non-usage fees from outstanding gift card balances. When the Company determines the likelihood of the gift card being redeemed by the customer is remote and there is not a legal obligation to remit the unredeemed gift cards to a relevant jurisdiction, this amount is recorded as breakage. The determination of the gift card breakage rate is based upon Company-specific historical load and redemption patterns. During 2013, the Company revised its estimated breakage rate from 2% to 3% of gift card sales. Gift card breakage is recognized on a pro rata basis based on historical gift card redemption patterns commencing after a reasonable period from the date of the gift card sale. Breakage is recognized in other operating expenses in the Statements of Operations and Comprehensive Loss and a portion is allocated to the Co-op Fund.

o. Deposits from franchise partners

The development process of a new or to be renovated café requires a deposit from a franchise partner at the outset. Deposits from franchise partners are applied against the cost of constructing a new café or the renovation of an existing café.

p. Revenue recognition

Revenue is recognized when it is probable the economic benefits will flow to the Company and delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other revenue related concessions.

(i) Royalties

Royalty revenue from franchised cafés is recognized as the products are sold based on agreed percentage royalty rates as a function of the franchise location sales. Revenue is recognized on an accrual basis in accordance with the substance of the relevant agreement, provided that it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably.

(ii) Sale of goods

Revenue from the sale of goods from Company-operated cafés and from the sale of products through the e-commerce channel is recognized as the products are delivered to customers.

(iii) Services

Services revenue includes initial franchise fees, renewal fees, transfer fees earned on the sale of cafés from one franchise partner to another, construction administration fees, product licencing revenue, wholesale revenue, purchasing coordination fees, and other ancillary fees (such as IT support and training fees).

Initial franchise fees are recognized as income when substantially all the initial services as required by the franchise agreement have been performed and risks and rewards are transferred to the franchise partner. Recognition generally occurs when the café commences operations. Renewal fees are recognized at the commencement of a new franchise term. Café resale fees are recognized when title transfers on the sale of a café between franchise partners. Construction administration fees are recognized on the completion of a café renovation and re-opening. All fees are recognized as revenue after the franchise agreement has been signed and the Company has performed substantially all services and met all material conditions required by the franchise agreement.

For Second Cup branded products sold by third parties, product licencing or wholesale revenue is recognized when goods are shipped from the distributor or manufacturer.

Purchasing coordination fees are derived from purchases made by franchise partners from approved suppliers and are recognized as the services are rendered or goods delivered and all significant conditions have been met.

q. Cost of goods sold

Cost of goods sold represents the product cost of goods sold in Company-operated cafés and through the e-commerce channel, plus the cost of direct labour to prepare and deliver the goods to the customers in the Company-operated cafés.

r. Operating leases

Operating lease payments are recognized as expense on a straight-line basis over the lease term. Leasehold inducements are amortized to rent expense on a straight-line basis over the lease term. For the purposes of determining the lease term, the Company considers option periods for which failure to renew the lease imposes an economic penalty on the Company of such an amount that the renewal appears to be reasonably assured at the inception of the lease.

s. Long-term incentive plan and Directors' deferred share unit plan

Units granted under the management long-term incentive plan vest over a three-year period and are paid out in cash at the end of the 3 year vesting period or upon termination of the individual. Units are granted based on a weighted average price of the Company's shares prior to the grant date. The fair value of the grant is amortized over the respective vesting period using the graded amortization method. Compensation expense is adjusted for changes in fair value of the Company's share price thereafter. Any dividends paid by the Company during the vesting period will be accrued based on the total number of units granted. Forfeitures are adjusted and accounted in the period incurred. Amounts recognized are recorded in operating expenses.

Units granted under the Directors' deferred share unit plan have graded vesting for each month of service completed over the course of one year. Units are paid out in cash upon the termination of the director. Units are granted based on a weighted average price of the Company's shares prior to the grant date. The fair value of the grants is amortized over the respective vesting period using the graded amortization method. Compensation expense is adjusted for changes in fair value of the Company's share price thereafter. Any dividends paid by the Company during the vesting period will be accrued based on the total number of units granted. Amounts recognized are recorded in operating expenses.

Recorded values of both plans are presented as Accounts payable and accrued liabilities in the Statements of Financial Position.

t. Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired.

The criteria used to determine if there is objective evidence of an impairment loss include:

- significant financial difficulty of the borrower/lessee;
- delinquencies in interest or principal payments; and
- it becomes probable that the borrower/lessee will enter bankruptcy or other financial reorganization.

If such evidence exists, the Company recognizes an impairment loss for assets carried at amortized cost as follows:

The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's effective interest rate. The carrying value of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Notes receivable and leases receivable are assessed for impairment on an individual basis based on the ability of the debtor/lessee to make the required payments and the value of the security. When there is no longer reasonable assurance that a note receivable or lease receivable will be collected, its carrying value is reduced and a charge is recorded in operating expenses.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent years if the amount of the loss decreases and the decrease can be related objectively to an event's occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

u. Impairment of non-financial assets

Property and equipment and intangible assets without indefinite lives are tested for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Assets with indefinite lives are subject to an annual impairment test or any time an impairment indicator exists. The Company has selected December as the mandatory annual test date.

For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash generating units or "CGUs"). The recoverable amount of each particular CGU is the higher of an asset's fair value less costs to sell and value in use. Management has determined its cash generating units are:

- Franchising, distribution, and wholesale; and
- Company-operated cafés. Each Company-operated café is considered a separate CGU.

The impairment analysis involves comparing the carrying value of the CGUs with their estimated recoverable amounts. An impairment loss is recognized for the amount by which the asset's carrying value exceeds its recoverable amount. Impairment losses for CGUs reduce first the carrying value of any goodwill allocated to that CGU. Any remaining impairment loss is charged pro rata to the other assets in the CGU.

The Company evaluates impairment losses, other than goodwill impairment, for potential reversals when events or circumstances warrant such consideration.

v. Related parties

For the purposes of these financial statements, a party is considered related to the Company if such party or the Company has the ability to, directly or indirectly, control or exercise significant influence over the other entity's financial and operating decisions, or if the Company and such party are subject to common influence. Related parties may be individuals or other entities. All transactions with related parties are recorded at fair value.

w. Dividends

Dividends on common shares are recognized in the Company's financial statements in the period in which the dividends are approved by the Board of Directors.

3. Changes in accounting policies

The Company has adopted the following standards effective December 30, 2012, the first day of fiscal 2013, and they had no material effect on financial results:

- IFRS 7, Financial Instruments: Disclosures (amended);
- IFRS 10, Consolidated Financial Statements;
- IFRS 11, Joint Arrangements;
- IFRS 12, Disclosure of Interests in Other Entities;
- IFRS 13, Fair Value Measurement;

Summary of the significant new standards

IFRS 7 was amended to harmonize the disclosure requirements with those of the Financial Accounting Standards Board. The standard sets out objectives to enhance disclosures about offsetting of financial assets and liabilities.

IFRS 10 replaces the consolidation requirements in IAS 27, Consolidated and Separate Financial Statements and SIC-12 Consolidation – Special Purpose Entities. It provides a single model to be applied in the control analysis for all investees.

IFRS 12 integrates the disclosure requirements on interests in other entities and requires a parent company to disclose information about significant judgements and assumptions it has made in determining whether it has control, joint control, or significant influence over another entity and the type of joint arrangement when the arrangement has been structured through a separate vehicle. An entity should also provide these disclosures when changes in facts and circumstances affect the entity's conclusion during the reporting period.

IFRS 13 replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance. The standard clarifies the definition of fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements.

Accounting standards not yet adopted

IFRS 9 replaces the guidance in IAS 39, Financial Instruments: Recognition and Measurement on the classification and measurement of financial assets and financial liabilities. The standard eliminates the current categorization of financial assets. Financial assets will be categorized at inception as measured at amortized cost or measured at fair value. Subsequent re-measurement of assets measured at fair value will be recognized in profit or loss. The mandatory effective date of this standard has been deferred and has not been determined.

The Company is in the process of determining the extent of the impact of these standards on its financial statements.

4. Share capital

Second Cup is authorized to issue an unlimited number of common shares. Common shares are classified as equity and have $nil par value. Incremental costs directly attributable to the issue of new common shares are shown in equity as a deduction, net of tax, from the proceeds.

5. Management of capital

The capital structure of the Company consists of $11,089 (2012 - $11,037) in Long-term debt, an unused but available $2,000 operating credit facility, and $45,964 (2012 - $56,700) in Shareholders' equity, which comprises share capital, contributed surplus, and retained earnings (deficit).

The Company's objectives relating to the management of its capital structure are to:

- safeguard its ability to continue as a going concern;
- maintain financial flexibility in order to preserve its ability to meet financial obligations;
- maintain a capital structure that provides financing options to the Company when the need arises to access capital;
- ensure it has sufficient cash and cash equivalents to pay declared dividends to its shareholders; and
- deploy capital to provide an adequate return to its shareholders.

The Company's primary uses of capital are to finance increases in non-cash working capital and capital expenditures.

The Company determines the appropriate level of long-term debt in the context of its cash flows and overall business risks. The Company has historically generated sufficient cash flows to pay quarterly dividends to its shareholders. In order to maintain or modify the capital structure, Second Cup may adjust the amount of dividends paid to its shareholders.

Under the term loan and operating facility, the Company is required to comply with a number of covenants and restrictions, including the requirements to meet certain financial ratios. These financial ratios are discussed in note 15. To date, the Company has complied with these ratios. There were no changes in the Company's approach to capital management during the period.

6. Financial instruments and financial risk management

Financial instruments

The following summarizes the nature of certain risks applicable to the Company's financial instruments:

Financial instrument	**Risks**
Financial assets	
Cash and cash equivalents	Credit and interest rate
Trade and other receivables	Credit
Notes and leases receivable	Credit
Financial liabilities	
Interest rate swap	Credit, liquidity, and interest rate
Accounts payable and accrued liabilities	Liquidity, currency, and commodity
Gift card liability	Liquidity
Deposits from franchise partners	Liquidity
Term loan	Liquidity and interest rate

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 implicit interest used to discount the base value is considered to be based on an appropriate credit and risk rate pertaining to the debtor.

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 following table summarizes the financial instruments measured at fair value:

		2013		**2012**
Interest rate swap				
Opening fair value	$	(96)	$	(302)
Additions during the period		(159)		-
Realized during the period		96		-
Change in value		19		206
Closing fair value	$	(140)	$	(96)

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 market valuation reports provided by a tier one Canadian bank.

	Level 1	Level 2	Level 3
As at December 29, 2012			
Interest rate swap	$ -	$ (96)	$ -
As at December 28, 2013			
Interest rate swap	$ -	$ (140)	$ -

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

Credit risk

a. Cash and cash equivalents, and interest rate swap

Credit risk associated with cash and cash equivalents, and the interest rate swap is managed by ensuring these assets are placed with institutions of high creditworthiness.

b. Trade and other receivables, notes and leases receivable

The Company's trade and other receivables, notes and lease receivable primarily comprise amounts due from franchise partners. Credit risk associated with these receivables is mitigated as a result of the review and evaluation of franchise partner account balances beyond a particular age. Prior to accepting a franchise partner, the Company undertakes a detailed screening process which includes the requirement that a franchise partner has sufficient financing. The risk is further mitigated due to a broad franchise partner base that is spread across the country which limits the concentration of credit risk.

Other receivables may include amounts owing from large organizations where often those organizations have a simultaneous vendor relationship with the Company's franchise partners. Credit risk is mitigated as a result of the Company directing and maintaining certain controls over the vendor relationship with the franchise partners.

Management accounts for a specific bad debt provision when the expected recovery is less than the actual receivable. The bad debt expense is calculated on a specific identification basis.

An analysis of aging of the Company's trade and other receivables from billing date net of an allowance for doubtful accounts is as follows:

	0-30 Days	31-60 Days	61-90 Days	> 90 Days	Total
2013	$ 4,151	$ 151	$ 38	$ 28	$ 4,368
2012	4,324	138	121	33	4,616

The Company's trade and other receivables included a combined allowance for doubtful accounts of $663 (December 29, 2012 - $223). Trade and other receivables are further discussed in note 7.

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

	< 90 Days	90 Days to < 1 year	1 year to < 2 years	2 years and after	Total
2013	$ 57	$ 163	$ 238	$ 463	$ 921
2012	70	195	229	512	1,006

The Company's notes and leases receivable included a combined allowance for doubtful accounts of $110 (December 29, 2012 - $189). Notes and leases receivable are further discussed in note 8.

Liquidity risk
The Company manages liquidity risk through regular monitoring of dividends, forecast and actual cash flows, monitoring maturity dates of financial assets and liabilities, and also the management of its capital structure and debt leverage ratios as outlined in note 15. The Company's main source of income is royalty receipts from its franchise partners.

Interest rate risk
The Company's financial instruments exposed to interest rate risk earn and bear interest at floating rates. The Company entered into an interest rate swap agreement to minimize risk on its long-term debt.

Interest expense on the term loan was adjusted to include the payments made or received under the interest rate swap agreement.

Currency risk
The Company transacts with a small number of vendors that operate in foreign currencies. The Company believes that due to low volumes of transactions, low number of vendors, and low magnitude of spend, the impact of currency risk is not material.

Commodity risk
The Company is directly and indirectly exposed to commodity market risk. The exposure relates to the changes in coffee commodity prices given it is a material input for the Company's product offerings. The direct risk pertaining to Company-operated cafés is not considered material given that there is a relatively small number of cafés. The direct exposure pertaining to the wholesale business is mitigated given that the Company has the ability to adjust its sales price if commodity prices rise over a threshold level. The indirect risk exists where franchise partner profitability may be impacted, thus potentially resulting in an impeded ability to collect

accounts receivable or the need for other concessions to be made to the franchise partner. The Company mitigates this risk by entering fixed price purchase commitments through coffee commodity brokers and by having the ability to adjust retail selling prices.

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 December 28, 2013, assuming that a reasonably possible change in the relevant risk variable has occurred as at December 28, 2013.

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

	Pre-tax effects on net income (loss) - increase (decrease)		
	Liability amount	**1% decrease in interest rates**	**1% increase in interest rates**
Term loan	$ 11,000	$ 110	$ (110)
Interest rate swap	140	(110)	110
		$ -	$ -

7. Trade and other receivables

	2013	**2012**
Trade and other receivables	$ 5,031	$ 4,839
Less: Allowance for doubtful accounts	(663)	(223)
Trade and other receivables - net	$ 4,368	$ 4,616

During the period, the Company recorded $316 (2012 - $422) as bad debt expense pertaining to trade and other receivables.

8. Notes and leases receivable

		2013		2012
Notes receivable - current	$	229	$	314
Lease receivable - current		45		27
Less: Allowance for doubtful accounts - current		(54)		(76)
Notes and leases receivable - current		220		265
Notes receivable - long-term		421		633
Lease receivable - long-term		308		221
Less: Allowance for doubtful accounts - long-term		(28)		(113)
Notes and leases receivable	$	921	$	1,006

During the period, the Company recorded $nil (2012 - $nil) as bad debt expense pertaining to notes and leases receivable. The Company discounts its notes and leases receivable using an effective discount rate ranging between eight and nine percent.

9. Inventories

		2013		2012
Merchandise held for resale	$	133	$	131
Supplies		21		24
		154		155
Less: Provision for obsolete inventory		(31)		(18)
	$	123	$	137

During the period, the Company recorded $237 (2012 - $287) as inventory write-downs.

10. Property and equipment

	Leasehold improvements	Equipment, furniture, fixtures and other	Computer hardware	Total
Net carrying value				
As at December 31, 2011				
Cost	$ 1,228	$ 3,042	$ 276	$ 4,546
Accumulated depreciation	(431)	(478)	(159)	(1,068)
As at December 31, 2011	797	2,564	117	3,478
Additions	851	857	50	1,758
Disposals - original cost	(177)	(297)	-	(474)
Disposals - accumulated depreciation	20	34	-	54
Capitalized to lease	-	(194)	-	(194)
Impairment charge (note 17)	(345)	(17)	-	(362)
Depreciation	(200)	(446)	(70)	(716)
As at December 29, 2012	946	2,501	97	3,544
Cost	1,902	3,408	326	5,636
Accumulated depreciation	(956)	(907)	(229)	(2,092)
As at December 29, 2012	$ 946	$ 2,501	$ 97	$ 3,544

	Leasehold improvements	Equipment, furniture, fixtures and other	Computer hardware	Total
Net carrying value				
As at December 29, 2012				
Cost	$ 1,902	$ 3,408	$ 326	$ 5,636
Accumulated depreciation	(956)	(907)	(229)	(2,092)
As at December 29, 2012	946	2,501	97	3,544
Additions	882	1,118	117	2,117
Disposals - original cost	(760)	(249)	-	(1,009)
Disposals - accumulated depreciation	29	17	-	46
Capitalized to lease	-	(143)	-	(143)
Impairment charge (note 17)	(299)	-	-	(299)
Depreciation	(150)	(516)	(83)	(749)
As at December 28, 2013	648	2,728	131	3,507
Cost	1,725	4,134	443	6,302
Accumulated depreciation	(1,077)	(1,406)	(312)	(2,795)
As at December 28, 2013	$ 648	$ 2,728	$ 131	$ 3,507

11. Intangible assets

	Trademarks	Franchise rights	Software	Total
Net carrying value				
As at December 31, 2011				
Cost	$ 86,905	$ 1,331	$ 574	$ 88,810
Accumulated amortization	-	(707)	(165)	(872)
As at December 31, 2011	86,905	624	409	87,938
Additions (acquired)	-	-	180	180
Capitalized to lease	-	-	(15)	(15)
Impairment charge (note 17)	(12,850)	-	-	(12,850)
Amortization	-	(283)	(168)	(451)
As at December 29, 2012	$ 74,055	$ 341	$ 406	$ 74,802
Cost	$ 74,055	$ 1,331	$ 739	$ 76,125
Accumulated amortization	-	(990)	(333)	(1,323)
As at December 29, 2012	$ 74,055	$ 341	$ 406	$ 74,802
Net carrying value				
As at December 29, 2012				
Cost	$ 74,055	$ 1,331	$ 739	$ 76,125
Accumulated amortization	-	(990)	(333)	(1,323)
As at December 29, 2012	74,055	341	406	74,802
Additions (acquired)	-	-	787	787
Disposals - original cost	-	-	(123)	(123)
Disposals - accumulated amortization	-	-	41	41
Capitalized to lease	-	-	(22)	(22)
Impairment charge (note 17)	(13,253)	-	-	(13,253)
Amortization	-	(283)	(219)	(502)
As at December 28, 2013	$ 60,802	$ 58	$ 870	$ 61,730
Cost	$ 60,802	$ 1,331	$ 1,381	$ 63,514
Accumulated amortization	-	(1,273)	(511)	(1,784)
As at December 28, 2013	$ 60,802	$ 58	$ 870	$ 61,730

12. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities consist of:

	2013	2012
Accounts payable - trade	$ 1,953	$ 1,280
Accrued salaries, wages, benefits, and incentives	362	577
Sales tax payable	335	235
Accrued liabilities	1,936	1,031
	$ 4,586	$ 3,123

13. Provisions

	Headlease liabilities	Café leases	Other	Total
As at December 31, 2011	$ 255	$ 499	$ -	$ 754
Provisions charged during the period	-	852	-	852
Provisions utilized during the period	(46)	(429)	-	(475)
As at December 29, 2012	$ 209	$ 922	$ -	$ 1,131
Current portion	$ 82	$ 366	$ -	$ 448
Long-term portion	127	556	-	683
As at December 29, 2012	$ 209	$ 922	$ -	$ 1,131
As at December 29, 2012	$ 209	$ 922	$ -	$ 1,131
Provisions charged during the period	-	895	681	1,576
Provisions utilized during the period	(81)	(399)	-	(480)
As at December 28, 2013	$ 128	$ 1,418	$ 681	$ 2,227
Current portion	$ 57	$ 412	$ 378	$ 847
Long-term portion	71	1,006	303	1,380
As at December 28, 2013	$ 128	1,418	681	2,227

The provisions for café leases are dependent on the individual circumstances specific to each lease or arrangement, such as lease settlement terms. Uncertainties exist in the amount of café lease related provisions

where onerous arrangements exist with franchise partners that are continuously being re-evaluated and negotiated by management and thus the amount of provision may increase or decrease. The associated cash outflows pertaining to other provisions are substantially short term in nature and do not extend beyond two years. Headlease liabilities do not have any associated cash outflows.

14. Other liabilities

	2013	2012
Deferred revenue - current	$ 678	$ 681
Leasehold inducements - current	39	39
Other liabilities - current	717	720
Deferred revenue - long-term	47	31
Leasehold inducements - long-term	381	390
Other liabilities	$ 1,145	$ 1,141
Deferred revenue	$ 725	$ 712
Leasehold inducements	420	429
Other liabilities	$ 1,145	$ 1,141

15. Long-term debt

	2013	2012
Face value of long-term debt	$ 11,000	$ 11,000
Fair value of interest rate swap	140	96
Unamortized transaction costs	(51)	(59)
	$ 11,089	$ 11,037

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 are comprised of 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 2013.

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 which 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 periods ended December 28, 2013 and December 29, 2012, the Company was in compliance with all financial and other covenants of the Company's operating credit facility and term loan.

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 December 28, 2013, the applicable margin pertaining to the aforementioned range is 2.75%. As at December 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 December 28, 2013, the applicable margin pertaining to the aforementioned range is 2.75%. As at December 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 December 29, 2012, the balance of $96 was recorded as a liability.

On September 30, 2013, the Company 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, which resulted in a fixed effective interest rate of 4.82%.

16. Operating expenses

	2013	2012
Head office		
Salaries, wages, benefits, and incentives	$ 6,866	$ 6,540
Head office overheads	2,906	2,306
Occupancy and lease costs	1,756	1,614
Professional fees	1,075	1,150
Research and innovation	550	476
Bad debts and other (recovery)	(161)	709
Depreciation of property and equipment	566	506
Amortization of intangible assets	502	451
Restructuring	883	-
	14,943	13,752
Company-operated cafés		
Occupancy and lease costs	1,187	885
Other	588	500
Depreciation of property and equipment	183	210
(Gain) loss on disposal of capital related items	(197)	70
	1,761	1,665
	$ 16,704	$ 15,417

During the period, the Company realized $797 (2012 - $nil) in recoveries as a result of the change in estimate of the gift card breakage rate which is included in bad debts and other (recovery). The effect of such a change in estimate on future periods cannot be reasonably determined. The Company recorded $883 (2012 - $nil) of restructuring costs pertaining to the reconstitution of the board of directors and change in chief executive officers.

17. Impairment charges

a. Impairment of trademarks and goodwill

During the interim quarter ended June 29, 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.

The trademarks and goodwill were allocated fully to the franchising, distribution, and wholesale 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 judgement. This methodology used to test impairment is classified as Level 3 per the hierarchy described in note 6. These key judgements 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.

The Company uses probability weighted cash flow projections based on financial forecasts covering a five-year period. These projections are approved by the board of directors based on management expectations of potential outcomes. 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 where an impairment charge was incurred in the respective period:

	2013	**2012**
Forecast same café sales	-3.1% to 2.0%	-2.0% to 4.0%
Forecast system-wide café sales	-0.8% to 4.8%	-2.0% to 8.0%
Average growth rate used to extrapolate cash flows beyond the forecast period	2.0%	2.0%
Discount rate	11% to 13%	11.5%

The valuation of the franchising, distribution, and wholesale 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 (2012 - $12,850) to trademarks and $nil (2012 - $2,444) to goodwill. The carrying value of goodwill as at December 28, 2013 and December 29, 2012 was $nil with a corresponding accumulated impairment amount of $2,444 respectively.

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

	2013		**2012**	
Key assumption	**Low growth**	**High growth**	**Low growth**	**High growth**
System sales of cafés	-0.8% to 2.0%	-0.1% to 4.8%	0.0% to 2.0%	3.0% to 7.3%
Discount rate	11.0%	13.0%	11.0%	13.0%
Incremental increase (decrease) to impairment charges	$2,130	($7,842)	$1,796	($5,749)

b. Impairment of leasehold improvements, equipment, furniture, fixtures, and other

Impairment indicators were identified when an individual Company-operated café was experiencing poor performance directly impacting cash flows. The Company completes its impairment analysis based on historical and forecasted performance measures for each café with impairment indicators. The asset's recoverable amount has been determined using value in use. The recoverable amount was compared to the net book value of the assets. This methodology used to test impairment is classified as Level 3 per the hierarchy described in note 6. As a result of the impairment test, impairment charges of $299 (2012 - $362) were recorded to assets that were not able to be redeployed to a different CGU as the carrying amount exceeded the recoverable amount. A sensitivity of 2% increase or decrease in sales for each CGU pertaining to the impacted assets would not have had an impact on the impairment recorded. The impacted assets were adjusted to a carrying value of $nil.

c. Summary of impairment charges

	2013	2012
Trademarks	$ 13,253	$ 12,850
Goodwill	-	2,444
Leasehold improvements	299	345
Equipment, furniture, fixtures and other	-	17
	$ 13,552	$ 15,656

18. Interest and financing

	2013	2012
Interest expense	$ 566	$ 482
Amortization of deferred financing costs	38	82
Interest income	(88)	(61)
	$ 516	$ 503

19. Income taxes (recovery)

Income taxes are recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year. Income taxes, 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:

	2013	2012
Loss before income taxes	$ (7,638)	$ (8,753)
Combined Canadian federal and provincial tax rates	26.51%	26.50%
Tax recovery at statutory rate	(2,025)	(2,320)
Increased (reduced) by following differences		
Change in tax rates	(3)	480
Non-deductible permanent differences	1,749	2,363
Other	10	128
Income taxes (recovery)	$ (269)	$ 651

	2013	2012
Current income taxes	$ 1,503	$ 1,644
Deferred income taxes (recovery)	(1,772)	(993)
Income taxes (recovery)	$ (269)	$ 651

The Company's blended weighted average statutory income tax rate is aggregate of the following:

		2013		2012
Basic federal rate	%	15.00	%	15.00
Weighted average provincial rate		11.51		11.50
Combined Canadian federal and provincial tax rates	%	26.51	%	26.50

The movement in deferred income tax (assets) and liabilities during the year is as follows:

	Property and equipment	Trademarks	Intangible assets	Other	Total
As at December 31, 2011	$ 1,147	$ 9,349	$ 158	$ (471)	$ 10,183
Charged (credited) to the income statement	391	(1,294)	(68)	(22)	(993)
As at December 29, 2012	1,538	8,055	90	(493)	9,190
Charged (credited) to the income statement	266	(1,754)	(75)	(209)	(1, 772)
As at December 28, 2013	$ 1,804	$ 6,301	$ 15	$ (702)	$ 7,418

20. Basic and diluted loss per share

Loss per share is based on the weighted average number of shares outstanding during the period. Basic and diluted loss per share is determined as follows:

		2013		2012
Net loss	$	(7,369)	$	(9,404)
Weighted average number of shares issued and outstanding		9,903,045		9,903,045
Basic and diluted loss per share	$	(0.74)	$	(0.95)

21. Supplemental cash flow information

	2013	2012
Changes in non-cash working capital (inflow (outflow)):		
Trade and other receivables	$ 248	$ 722
Notes and leases receivable	248	(400)
Inventories	14	(58)
Prepaid expenses and other assets	505	(501)
Accounts payable and accrued liabilities	1,463	(780)
Provisions	1,212	349
Other liabilities	(65)	46
Gift card liability	(665)	207
Deposits from franchise partners	(602)	447
Income taxes	(180)	(1,191)
	$ 2,178	$ (1,159)
Cash payments for capital expenditures		
Purchase of property and equipment	$ (2,117)	$ (1,758)
Purchase of intangible assets	(787)	(180)
	$ (2,904)	$ (1,938)
Supplementary information		
Interest paid	$ 522	$ 689
Income taxes paid	$ 1,687	$ 2,835

22. Contingencies, commitments and guarantees

Second Cup has lease commitments for Company-operated cafés and acts as the head tenant on most 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 (note 13). The Company's lease commitments at December 28, 2013 are as follows:

	Headlease commitments	Sublease to franchisees	Net
December 28, 2014	$ 19,627	$ 18,144	$ 1,483
December 28, 2015	18,328	17,004	1,324
December 28, 2016	16,254	15,033	1,221
December 28, 2017	14,222	13,030	1,192
December 28, 2018	12,159	11,076	1,083
Thereafter	32,694	29,142	3,552
	$ 113,284	$ 103,429	$ 9,855

The Company believes it will have sufficient resources to meet the net commitment of $9,855.

Second Cup is involved in litigation and other claims arising in the normal course of business. Management must use its judgement 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 $5,621 USD (2012 - $4,421 USD) during fiscal 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 distribution agreement and has partnered with a vendor to wholesale its product through grocery and other retail outlets across Canada. As a result of the distribution agreement, the Company is required to pay a portion of one-time listing fees in the amount of up to $1,050 in 2014.

Second Cup is the primary coordinator of café construction costs on behalf its franchise partners and for Company-operated cafés. As at December 28, 2013, there is $1,433 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.

23. Related parties

The Company has identified related parties as key management, members of the board of directors, and shareholders that effectively exercise significant influence on the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties.

In 2013, the Company incurred a total of $153 in legal expenditures incurred on behalf of shareholders and related companies with respect to the reconstitution of the board of directors. These items were recorded at their exchange amount as restructuring expenses (note 16).

Compensation of key management

Key management is defined as the senior management team and the Board of Directors. The following summarizes the compensation expense of key management personnel and the composition thereof:

		2013		2012
Salaries and short-term employee benefits	$	1,875	$	2,139
Termination costs		681		-
Share-based compensation		185		170
Total compensation	$	2,741	$	2,309

24. Long-term incentive plan and directors' deferred share unit plan

The fair value of the units outstanding is determined based on the market value of the underlying common shares of the Company.

A summary of the status of the Company's long-term incentive plan is presented below:

	Notional units		Recorded value
Notional units outstanding as at December 31, 2011	88,763	$	418
Units forfeited	(3,723)		(19)
Units paid out	(32,682)		(175)
Units granted in lieu of dividends	6,205		41
Change in fair value			(9)
Notional units outstanding as at December 29, 2012	58,563	$	256
Expensed in the period		$	130

	Notional units		Recorded value
Notional units outstanding as at December 29, 2012	58,563	$	256
Units forfeited	(3,770)		(16)
Units paid out	(29,857)		(138)
Units granted in lieu of dividends	4,936		22
Change in fair value			(3)
Notional units outstanding as at December 28, 2013	29,872	$	121
Expensed in the period		$	61

The weighted average price of units granted in lieu of dividends was $4.51 (2012 - $6.83).

A summary of the status of the Company's directors' deferred share unit plan is presented below:

	Notional units		Recorded value
Notional units outstanding as at December 31, 2011	14,398	$	89
Deferred units granted	9,018		55
Units granted in lieu of dividends	1,760		12
Change in fair value			(27)
Notional units outstanding as at December 29, 2012	25,176	$	129
Expensed in the period		$	40

	Notional units		Recorded value
Notional units outstanding as at December 29, 2012	25,176	$	129
Deferred units granted	30,820		157
Units granted in lieu of dividends	2,487		11
Change in fair value			(44)
Notional units outstanding as at December 28, 2013	58,483	$	253
Expensed in the period		$	124

The weighted average price of deferred units granted combined with units granted in lieu of dividends was $5.01 (2012 - $6.22).

25. Subsequent event

On March 7, 2014 the Board of Directors of Second Cup approved a quarterly dividend of $0.085 per common share, payable on March 28, 2014 to shareholders of record at the close of business on March 21, 2014.