



The Second Cup Ltd.

Unaudited Condensed Interim Financial Statements
For the 13 weeks ended March 28, 2015 and March 29, 2014

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)

Alix Box
President and Chief Executive Officer, The Second Cup Ltd.

(Signed)

Sandra Clarke
Interim Vice President, Finance, and Chief Financial Officer, The Second Cup Ltd.

May 6, 2015

The Second Cup Ltd.

Condensed Interim Statements of Financial Position (Unaudited, expressed in thousands of Canadian dollars)

	March 28, 2015	December 27, 2014
ASSETS		
Current assets		
Cash and cash equivalents	\$ 9,676	\$ 10,918
Trade and other receivables	2,988	4,026
Notes and leases receivable	78	81
Inventories	223	221
Prepaid expenses and other assets	385	485
Income tax recoverable	699	699
	<u>14,049</u>	<u>16,430</u>
Non-current assets		
Notes and leases receivable	270	302
Property and equipment	4,277	4,380
Intangible assets	32,583	32,337
	<u>37,130</u>	<u>37,019</u>
Total assets	<u>\$ 51,179</u>	<u>\$ 53,449</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 4,818	\$ 6,011
Provisions	1,454	1,937
Other liabilities	422	512
Gift card liability	3,067	3,727
Deposits from franchisees	544	378
Current portion of long-term debt	-	11,119
	<u>10,305</u>	<u>23,684</u>
Non-current liabilities		
Provisions	1,154	1,133
Other liabilities	359	368
Long-term debt (note 5)	11,192	-
Deferred income taxes	3,238	3,270
	<u>16,943</u>	<u>5,771</u>
Total liabilities	<u>26,248</u>	<u>28,455</u>
SHAREHOLDERS' EQUITY	<u>24,931</u>	<u>24,994</u>
Total liabilities and shareholders' equity	<u>\$ 51,179</u>	<u>\$ 53,449</u>

Contingencies, commitments and guarantees (note 10).

See accompanying notes to the unaudited condensed interim financial statements.

Approved by the Directors May 6, 2015

Michael Bregman, Director

Rael Merson, 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 March 28, 2015	13 weeks ended March 29, 2014
Revenue		
Royalties	\$ 2,602	\$ 3,195
Sale of goods	5,238	1,800
Services and other	1,174	1,628
	<u>9,014</u>	<u>6,623</u>
Cost of services	<u>3,766</u>	<u>1,878</u>
Gross profit	5,248	4,745
Operating expenses (note 6)	<u>5,235</u>	<u>3,821</u>
Income before following:	13	924
Restructuring and other charges	-	559
Provisions for café closures (note 4)	<u>(55)</u>	<u>139</u>
Income before interest and financing expenses	68	226
Interest and financing (note 7)	<u>176</u>	<u>156</u>
(Loss) income before income taxes	(108)	70
Income tax (recovery) expense	<u>(32)</u>	<u>14</u>
Net (loss) income and comprehensive (loss) income for the period	<u>\$ (76)</u>	<u>\$ 56</u>
Basic and diluted (loss) earnings per share (note 8)	<u>\$ (0.01)</u>	<u>\$ 0.01</u>

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	Deficit	Total
Balance - December 28, 2013	\$ 1,000	\$ 61,557	\$ (16,593)	\$ 45,964
Net income for the period	-	-	56	56
Dividends to shareholders	-	-	(842)	(842)
Balance - March 29, 2014	<u>\$ 1,000</u>	<u>\$ 61,557</u>	<u>\$ (17,379)</u>	<u>\$ 45,178</u>
Balance - December 27, 2014	\$ 8,652	\$ 61,649	\$ (45,309)	\$ 24,992
Net loss for the period	-	-	(76)	(76)
Stock option plan expense	-	15	-	15
Balance - March 28, 2015	<u>\$ 8,652</u>	<u>\$ 61,664</u>	<u>\$ (45,385)</u>	<u>\$ 24,931</u>

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 March 28, 2015	13 weeks ended March 29, 2014
CASH PROVIDED BY (USED IN)		
Operating activities		
Net (loss) income for the period	\$ (76)	\$ 56
Items not involving cash		
Depreciation of property and equipment	273	195
Amortization of intangible assets	78	71
Share-based compensation expense	15	-
Deferred income taxes	(32)	14
Gain on disposal of capital related items	-	(110)
Movement in fair value of interest rate swap	76	42
Other	(5)	(7)
Changes in non-cash working capital	<u>(1,095)</u>	<u>166</u>
Cash (used in) provided by operating activities	<u>(766)</u>	<u>427</u>
Investing activities		
Proceeds from disposal of capital related items	-	169
Cash payments for capital expenditures (note 9)	(170)	(840)
Cash payments for intangible assets	(324)	-
Proceeds from repayment of notes receivable	5	-
Proceeds from repayment of leases receivable	<u>13</u>	<u>-</u>
Cash used in investing activities	<u>(476)</u>	<u>(671)</u>
Financing activities		
Dividends paid to shareholders	-	(842)
Cash used in financing activities	<u>-</u>	<u>(842)</u>
Decrease in cash and cash equivalents during the period	(1,242)	(1,086)
Cash and cash equivalents - Beginning of the period	<u>10,918</u>	<u>6,501</u>
Cash and cash equivalents - End of the period	\$ <u>9,676</u>	\$ <u>5,415</u>

See accompanying notes to the unaudited condensed interim financial statements. Supplemental cash flow information is provided in note 9.

The Second Cup Ltd.

Notes to the Condensed Interim Financial Statements

March 28, 2015 and March 29, 2014

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

Table of Contents

Note to the Condensed Interim Financial Statements	Page
GENERAL APPLICATION	
1. Organization and nature of business	5
2. Summary of significant accounting policies	5
3. Changes in accounting policies	6
STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOCUSED	
4. Provisions	6
5. Borrowings	7
6. Operating expenses	8
7. Interest and financing	8
OTHER	
8. Basic and diluted earnings per share	8
9. Supplemental cash flow information	9
10. Contingencies, commitments and guarantees	9
11. Related parties	10

1. Organization and nature of business

The Second Cup Ltd. (“Second Cup” or “the Company”) is a Canadian specialty coffee retailer with 344 cafés operating under the trade name, Second Cup™, in Canada, of which 41 are Company-operated and the balance are operated by franchisees.

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 was incorporated under the Business Corporations Act (Ontario) in 2011 and is domiciled in Canada. The address of its registered office is 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8. The Company hereinafter refers to its head office activities as “Coffee Central”. 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

These unaudited condensed interim financial statements for the 13 weeks ended March 28, 2015 have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as applicable to condensed interim financial reports including International Accounting Standard (IAS) 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 27, 2014, which have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board (“IASB”).

The Second Cup Ltd.

Notes to the Condensed Interim Financial Statements

March 28, 2015 and March 29, 2014

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

The accounting policies applied in these unaudited condensed interim financial statements are consistent with those of the previous financial year. The accounting policies are based on IFRS issued and outstanding as of May 6, 2015, the date the Board of Directors approved the unaudited condensed interim financial statements.

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.

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. Operating revenues are comprised of royalties, the sale of goods from Company-operated cafés, the sale of goods through retail and other ancillary channels, and other service fees.

c. Comparative figures

Certain comparative 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. Provision for café closures was separately presented on the face of the Condensed Interim Statements of Income (Loss) and Comprehensive Income (Loss). Previous presentation had these costs recorded as operating expenses.

3. Changes in accounting policies

There were no new significant accounting policies adopted during the first quarter of 2015.

4. Provisions

Provisions for cafe leases are estimates for costs to be incurred by the Company as a result of the following circumstances; a) closure of cafes, and b) franchisee failure to make payment of occupancy costs at an operational café.

A recovery of \$55 (2014 – expense of \$139), was recognized in the 13 weeks ended March 28, 2015 and reflected in the Provisions for café closures line on the Statement of Operations and Comprehensive Loss. These amounts comprise an adjustment on the estimated lease exit costs and severances relating to the closure of underperforming cafes in the prior year.

The Second Cup Ltd.

Notes to the Condensed Interim Financial Statements

March 28, 2015 and March 29, 2014

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

5. Borrowings

	March 28, 2015	December 27, 2014
Face value of borrowings	\$ 11,000	\$ 11,000
Fair value of interest rate swap	219	143
Unamortized transaction costs	(27)	(24)
	<u>\$ 11,192</u>	<u>\$ 11,119</u>

The credit facilities comprise 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. The credit facilities mature on September 30, 2016.

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 is required to maintain certain covenants, which are defined in the agreements:

- 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.

In 2014, as a result of the Company's restructuring, certain one-time costs and the decision to take back a number of cafes, the fixed coverage and leverage ratios were negatively impacted resulting in non-compliance with these covenants. As a result, the debt was classified as current as at December 27, 2014.

Subsequently, the Company received a waiver of this non-compliance from its lender as well as an amendment to its banking agreement, which reset certain covenants for the next twelve months.

Under the amendment, the Company must maintain a Leverage ratio, adjusted for permitted cash balances up to \$5 million, maintained on account with the lender, of less than 1.75 to 1 and also a fixed charge ratio of greater than 1 for fiscal 2015. After which time, the covenants revert back to the original covenants of a Leverage ratio of less than 1.75 to 1 and a fixed charge ratio of greater than 1.5.

The facility under the amendment, (assuming continued compliance with revised covenants) continues to mature on September 30, 2016 and bears interest at the bankers' acceptance ("BA") plus a margin range of 2.25% to 3.25% based on the Company's leverage ratio. The unused operating facility of \$2,000 also continues to be in place.

As at March 28, 2015, the applicable margin pertaining to the aforementioned range is 3.25% (December 27, 2014 – 3.25%).

The Company has an interest rate swap agreement with a notional value of \$11,000 that expires on September 30, 2016. The swap fixes the interest rate on the Company's non-revolving term credit facility at 2.07% per annum plus the margin noted above, which results in a fixed effective interest rate of 5.32%.

The Second Cup Ltd.

Notes to the Condensed Interim Financial Statements

March 28, 2015 and March 29, 2014

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

As at March 28, 2015, there was an interest rate swap liability of \$219 recorded in the Condensed Interim Statements of Financial Position (December 27, 2014 - \$143).

6. Operating expenses

	13 weeks ended March 28, 2015	13 weeks ended March 29, 2014
Coffee Central		
Salaries, wages, benefits, and incentives	\$ 1,761	\$ 1,819
Coffee Central overheads	1,714	1,554
Depreciation of property and equipment	159	159
Amortization of intangible assets	78	71
	<u>3,712</u>	<u>3,603</u>
Company-operated cafés		
Occupancy / lease costs and other	1,409	292
Depreciation of property and equipment	114	36
Gain on disposal of capital related items	-	(110)
	<u>1,523</u>	<u>218</u>
	<u>\$ 5,235</u>	<u>\$ 3,821</u>

7. Interest and financing

	13 weeks ended March 28, 2015	13 weeks ended March 29, 2014
Interest expense	\$ 206	\$ 177
Amortization of deferred financing costs	7	7
Interest income	(37)	(28)
	<u>\$ 176</u>	<u>\$ 156</u>

8. Basic and diluted earnings per share

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

	13 weeks ended March 28, 2015	13 weeks ended March 29, 2014
Net (loss) income	\$ (76)	\$ 56
Weighted average number of shares issued and outstanding	<u>12,830,945</u>	<u>9,903,045</u>
Basic and diluted (loss) earnings per share	<u>\$ (0.01)</u>	<u>\$ 0.01</u>

The Second Cup Ltd.

Notes to the Condensed Interim Financial Statements

March 28, 2015 and March 29, 2014

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

9. Supplemental cash flow information

	13 weeks ended March 28, 2015	13 weeks ended March 29, 2014
Changes in non-cash working capital (inflow (outflow)):		
Trade and other receivables	\$ 1,038	\$ 992
Notes and leases receivable	17	38
Inventories	(2)	31
Prepaid expenses and other assets	100	29
Accounts payable and accrued liabilities	(1,193)	509
Provisions	(451)	(435)
Other liabilities	(110)	36
Gift card liability	(660)	(766)
Deposits from franchisees	166	231
Income tax recovery	-	(499)
	<u>\$ (1,095)</u>	<u>\$ 166</u>

Cash payments for capital expenditures

Cash payments for capital expenditures	\$ (170)	\$ (304)
Cash payments for intangible assets	(324)	(536)
	<u>\$ (494)</u>	<u>\$ (840)</u>

Supplementary information

Interest paid	\$ 130	\$ 135
Income taxes paid	-	498

10. Contingencies, commitments and guarantees

The Company has lease commitments for Company-operated cafés and acts as the head tenant on most leases, which it in turn subleases to franchisees. 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 March 28, 2015 are as follows:

	Headlease commitments	Sublease to franchisees	Net
March 26, 2016	\$ 19,614	\$ 16,683	\$ 2,931
March 25, 2017	17,395	14,720	2,675
March 31, 2018	15,490	13,173	2,317
March 30, 2019	13,527	11,489	2,038
March 28, 2020	11,481	9,591	1,890
Thereafter	27,503	22,011	5,492
	<u>\$ 105,010</u>	<u>\$ 87,667</u>	<u>\$ 17,343</u>

The Second Cup Ltd.

Notes to the Condensed Interim Financial Statements

March 28, 2015 and March 29, 2014

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

The Company believes it has sufficient resources to meet the net commitment of \$17,343.

The Company is involved in litigation and other claims arising in the normal course of business. Judgement must be used 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. It is believed that no significant losses or expenses will be incurred 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.

Contracts are in place with third party companies to purchase the coffee that is sold in all cafés. In terms of these supply agreements, there is a guaranteed minimum volume of coffee purchases of \$3,587 USD (March 28, 2014 – \$6,250 USD). The coffee purchase commitment comprises three components: unapplied futures commitment contracts, fixed price physical contracts and flat price physical contracts.

The Company 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, there is a requirement to pay a portion of one-time listing fees in the amount of up to \$708 in 2015.

Due to the Company acting as the primary coordinator of café construction costs on behalf its franchisees and for Company-operated cafés, as at March 28, 2015, there is \$25 (March 29, 2014 - \$ 618) of contractual commitments pertaining to construction costs for new locations and renovations. Construction costs financed for franchise projects are from deposits received from franchisees and for corporate projects from the Company's cash flows.

11. Related parties

Related parties are identified 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.

Certain transactions occur between a Company controlled by a board member, and one of the Company's vendors. For the 13 weeks ended March 28, 2015, the said vendor purchased \$594 (2014-\$607) of product in the ordinary course of business.