



**The Second Cup Ltd.**

Unaudited Condensed Interim Financial Statements  
**For the 13 weeks ended March 26, 2016 and March 28, 2015**

**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)

Barbara Mallon  
Chief Financial Officer, The Second Cup Ltd.

May 5<sup>th</sup>, 2016

# The Second Cup Ltd.

## Condensed Interim Statements of Financial Position

(Unaudited, expressed in thousands of Canadian dollars)

	March 26, 2016	December 26, 2015
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 1,598	\$ 3,080
Restricted cash (note 11)	665	840
Trade and other receivables	2,682	3,434
Notes and leases receivable	130	120
Inventories	192	229
Prepaid expenses and other assets	293	427
Income taxes recoverable	687	687
	<u>6,247</u>	<u>8,817</u>
<b>Non-current assets</b>		
Notes and leases receivable	229	268
Property and equipment	4,473	4,761
Intangible assets	32,598	32,639
	<u>37,299</u>	<u>37,678</u>
<b>Total assets</b>	<u>\$ 43,547</u>	<u>\$ 46,485</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 4,354	\$ 5,360
Provisions	1,463	1,655
Other liabilities	470	534
Gift card liability	3,024	3,554
Deposits from franchisees	529	701
Current portion of long-term debt (note 5)	5,984	-
	<u>15,824</u>	<u>11,804</u>
<b>Non-current liabilities</b>		
Provisions	754	982
Other liabilities	306	314
Long-term debt (note 5)	-	5,977
Deferred income taxes	3,327	3,481
	<u>4,387</u>	<u>10,754</u>
<b>Total liabilities</b>	<u>20,211</u>	<u>22,558</u>
<b>SHAREHOLDERS' EQUITY</b>	<u>23,336</u>	<u>23,927</u>
<b>Total liabilities and shareholders' equity</b>	<u>\$ 43,547</u>	<u>\$ 46,485</u>

Contingencies, commitments and guarantees (note 12).

See accompanying notes to the unaudited condensed interim financial statements.

Approved by the Directors May 5<sup>th</sup>, 2016

Michael Bregman, Director

Rael Merson, Director

# The Second Cup Ltd.

## Condensed Interim Statements of Loss and Comprehensive Loss

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

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	<b>13 weeks ended March 26, 2016</b>	<b>13 weeks ended March 28, 2015</b>
<b>Revenue (note 6)</b>		
Company-owned cafés and product sales	\$ 3,929	\$ 5,239
Franchise revenue	3,505	3,775
	<u>7,434</u>	<u>9,014</u>
<b>Operating costs and expenses (note 7)</b>		
Company-owned cafés and cost of product sales	4,357	5,230
Franchise	2,018	1,931
General and administrative	1,382	1,434
Loss (gain) on disposal of assets	4	-
Depreciation and amortization	406	351
	<u>8,167</u>	<u>8,946</u>
<b>Income (loss) from operations</b>	<u>(733)</u>	<u>68</u>
Interest and financing costs (note 8)	27	176
<b>Loss before income taxes</b>	<u>(760)</u>	<u>(108)</u>
Recovery of income taxes	(154)	(32)
<b>Net loss and comprehensive loss for the period</b>	<u>\$ (606)</u>	<u>\$ (76)</u>
<b>Basic and diluted loss per share (note 9)</b>	<u>\$ (0.05)</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)

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	<b>Share Capital</b>	<b>Contributed Surplus</b>	<b>Deficit</b>	<b>Total</b>
<b>Balance - December 27, 2014</b>	\$ 8,652	\$ 61,649	\$ (45,309)	\$ 24,992
Net loss for the period	-	-	(76)	(76)
Stock option plan expense	-	15	-	15
<b>Balance - March 28, 2015</b>	<u>\$ 8,652</u>	<u>\$ 61,664</u>	<u>\$ (45,385)</u>	<u>\$ 24,931</u>
<b>Balance - December 26, 2015</b>	\$ 8,652	\$ 61,736	\$ (46,462)	\$ 23,927
Net loss for the period	-	-	(606)	(606)
Stock option plan expense	-	15	-	15
<b>Balance - March 26, 2016</b>	<u>\$ 8,652</u>	<u>\$ 61,751</u>	<u>\$ (47,068)</u>	<u>\$ 23,336</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 26, 2016	13 weeks ended March 28, 2015
<b>CASH PROVIDED BY (USED IN)</b>		
<b>Operating activities</b>		
Net loss for the period	\$ (606)	\$ (76)
Items not involving cash		
Depreciation of property and equipment	303	273
Amortization of intangible assets	103	78
Share-based compensation expense	15	15
Deferred income taxes	(154)	(32)
Loss (gain) on disposal of capital related items	4	-
Change in fair value of interest rate swap	(23)	76
Other	(12)	(5)
Changes in non-cash working capital	<u>(1,233)</u>	<u>(1,095)</u>
Cash provided by (used in) operating activities	<u>(1,603)</u>	<u>(766)</u>
<b>Investing activities</b>		
Proceeds from disposal of capital related items	2	-
Cash payments for capital expenditures	(19)	(170)
Cash payments for intangible assets	(63)	(324)
Proceeds from repayment of leases receivable	13	5
Proceeds from repayment of notes receivable	13	13
Change in restricted cash	<u>175</u>	<u>-</u>
Cash provided by (used in) investing activities	<u>121</u>	<u>(476)</u>
Cash used in financing activities	<u>-</u>	<u>-</u>
<b>Decrease in cash and cash equivalents during the period</b>	<b>(1,482)</b>	<b>(1,242)</b>
<b>Cash and cash equivalents - Beginning of period</b>	<b><u>3,080</u></b>	<b><u>10,918</u></b>
<b>Cash and cash equivalents - End of period</b>	<b><u>\$ 1,598</u></b>	<b><u>\$ 9,676</u></b>

See accompanying notes to the unaudited condensed interim financial statements. Supplemental cash flow information is provided in note 10.

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 26, 2016 and March 28, 2015

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

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## 1. Organization and nature of business

The Second Cup Ltd. is a Canadian specialty coffee retailer with 307 cafés operating under the trade name, Second Cup™, in Canada, of which 32 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 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](http://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 26, 2016 have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as applicable to condensed interim financial statements 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 26, 2015, which have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board.

# **The Second Cup Ltd.**

## **Notes to the Condensed Interim Financial Statements**

March 26, 2016 and March 28, 2015

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

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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 at May 5, 2016, the date the Board of Directors approved the unaudited condensed interim financial statements.

Second Cup's fiscal year is 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. Fiscal 2016 is a 53-week period (2015 – 52-week period).

### **b. Segmented information and reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Executive Officer. 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.

### **3. Changes in accounting policies**

The accounting policies adopted in the preparation of these condensed interim consolidated financial statements are consistent with those followed in the preparation of the Company's audited financial statements for the year ended December 26, 2015. There were no significant accounting policies adopted during the first quarter of 2016.

### **4. Provisions**

Provisions for café leases are estimates for costs to be incurred by the Company as a result of closure of cafés and franchisee failure to make payment of occupancy costs.

An expense of \$9 (March 28, 2015 – recovery of \$55) was recognized in the 13 weeks ended March 26, 2016 and was reflected in the franchise operating costs and expenses line on the condensed interim statements of operations and comprehensive loss.



# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 26, 2016 and March 28, 2015

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

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### 5. Term debt

	March 26, 2016	December 26, 2015
Face value of borrowings	\$ 6,000	\$ 6,000
Unamortized transaction costs	<u>(16)</u>	<u>(23)</u>
	<u>\$ 5,984</u>	<u>\$ 5,977</u>

The credit facility is comprised of a \$6,000 (December 26, 2015 - \$6,000) non-revolving term loan. The loan is collateralized by substantially all the assets of the Company and matures on January 1, 2017.

The Company amended its term loan in 2015, which included repaying \$5,000, eliminating the credit facility of \$2,000, extending the maturity to 2017 and revising certain financial covenants. Pursuant to the terms of the Company's amended 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 minimum EBITDA amount for each of the four quarters
- a fixed charge coverage ratio; both of which are based on a trailing four-quarter basis

The facility matures on January 1, 2017 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. As at March 26, 2016, the applicable margin pertaining to the aforementioned range is 3.25% (December 26, 2015 - 3.25%).

The Company has an interest rate swap agreement with a notional value of \$6,000 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%.

As at March 26, 2016, there was an interest rate swap liability of \$54 recorded in the Statements of Financial Position (December 26, 2015 - \$77).

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 26, 2016 and March 28, 2015

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

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### 6. Revenue

	13 weeks ended March 26, 2016	13 weeks ended March 28, 2015
<b>Franchise revenue</b>		
Royalties	\$ 2,451	\$ 2,601
Services and other	<u>1,054</u>	<u>1,174</u>
	3,505	3,775
<b>Company-owned cafés and product sales</b>	<u>3,929</u>	<u>5,239</u>
	<u>\$ 7,434</u>	<u>\$ 9,014</u>

#### *Royalties*

Royalty revenue from franchised cafés is based on agreed percentage royalty rates 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.

#### *Services and other*

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

#### *Company-owned cafés and product sales*

Company owned cafés and product sales revenue includes the sale of goods from Company owned cafés, as well as products sold in grocery stores through wholesale distribution channels and third party licensing agreements.

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 26, 2016 and March 28, 2015

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

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### 7. Operating expenses

	13 weeks ended March 26, 2016	13 weeks ended March 28, 2015
<b>Company owned cafés and cost of product sales</b>		
Cost of product sales	\$ 1,528	\$ 2,017
Labour and related expenses	1,423	1,668
Occupancy and other	1,406	1,545
Depreciation of property and equipment	111	134
Loss (gain) on disposal of assets	4	-
	<u>4,472</u>	<u>5,364</u>
<b>Franchise</b>		
Labour and related expenses	1,086	964
Travel and franchisee meetings	294	498
Business development initiatives	-	89
Professional fees and other	638	380
	<u>2,018</u>	<u>1,931</u>
<b>General and administrative</b>		
Labour and related expenses	423	566
Professional fees and other	847	757
Occupancy	112	111
Depreciation and amortization	295	217
	<u>1,677</u>	<u>1,651</u>
	<u>\$ 8,167</u>	<u>\$ 8,946</u>

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 26, 2016 and March 28, 2015

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

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### 8. Interest and financing

	13 weeks ended March 26, 2016	13 weeks ended March 28, 2015
Interest expense	\$ 30	\$ 206
Amortization of deferred financing costs	6	7
Interest income	(9)	(37)
	<u>\$ 27</u>	<u>\$ 176</u>

### 9. 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:

	13 weeks ended March 26, 2016	13 weeks ended March 28, 2015
Net loss	\$ (606)	\$ (76)
Weighted average number of shares issued and outstanding	12,830,945	12,830,945
Basic and diluted loss per share	<u>\$ (0.05)</u>	<u>\$ (0.01)</u>

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 26, 2016 and March 28, 2015

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

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### 10. Supplemental cash flow information

	13 weeks ended March 26, 2016	13 weeks ended March 28, 2015
Changes in non-cash working capital (inflow (outflow)):		
Trade and other receivables	\$ 752	\$ 1,038
Notes and leases receivable	3	17
Inventories	37	(2)
Prepaid expenses and other assets	134	100
Accounts payable and accrued liabilities	(1,006)	(1,193)
Provisions	(410)	(451)
Other liabilities	(41)	(110)
Gift card liability	(530)	(660)
Deposits from franchisees	(172)	166
Income taxes	-	-
	<u>\$ (1,233)</u>	<u>\$ (1,095)</u>

#### Cash payments for capital expenditures

Purchase of property and equipment	\$ (19)	\$ (170)
Purchase of intangible assets	(63)	(324)
	<u>\$ (82)</u>	<u>\$ (494)</u>

#### Supplementary information

Interest paid	\$ 65	\$ 130
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### 11. Restricted cash

The Company has established certain accounts that have been classified restricted cash primarily representing a) deposits from franchisees for the cost of constructing a new café or the renovation of an existing café, and b) funds contributed for use in advertising and promotional programs where the Company is acting as an agent on behalf of the co-operative fund.

# The Second Cup Ltd.

## Notes to the Condensed Interim Financial Statements

March 26, 2016 and March 28, 2015

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

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### 12. 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 head lease commitments, a provision has been recognized. The Company's lease commitments at March 26, 2016 are as follows:

	Head lease commitments	Sublease to franchisees	Net
March 25, 2017	\$ 18,190	\$ 14,944	\$ 3,246
March 31, 2018	15,833	12,771	3,062
March 30, 2019	13,906	10,876	3,030
March 28, 2020	11,371	8,530	2,841
March 27, 2021	9,426	6,817	2,609
Thereafter	23,252	17,458	5,794
	<u>\$ 91,978</u>	<u>\$ 71,396</u>	<u>\$ 20,582</u>

The Company believes it will have sufficient resources to meet the net commitment of \$20,582 over the term of the leases.

The Company is involved in litigation and other claims arising in the normal course of business. Judgment 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 \$1,780 USD (March 28, 2015 – \$3,587 USD) for the subsequent 12 months. The coffee purchase commitment is comprised of two components: unapplied futures commitment contracts and fixed price physical contracts.

Due to the Company acting as the primary coordinator of café construction costs on behalf of its franchisees and for Company-operated cafés, there is \$496 (March 28, 2015 - \$25) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the quarter. Construction costs financed for franchise projects are from deposits received from franchisees and for corporate projects from the Company's cash flows.

### 13. Related parties

Related parties are identified as key management, members of the Board of Directors and shareholders that effectively exercise significant influence over the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties. There were no related party transactions in the reporting period.