The Second Cup Ltd.

Unaudited Condensed Interim Financial Statements

For the 13 and 26 weeks ended June 27, 2015 and June 28, 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)

Barbara Mallon
Chief Financial Officer, The Second Cup Ltd.

July 31st, 2015

The Second Cup Ltd.

Condensed Interim Statements of Financial Position

(Unaudited, expressed in thousands of Canadian dollars)

	June 27, 2015	December 27, 2014
ASSETS		
Current assets		
Cash and cash equivalents	$ 9,508	$ 10,918
Restricted cash (note 11)	746	-
Trade and other receivables	2,264	4,026
Notes and leases receivable	83	81
Inventories	266	221
Prepaid expenses and other assets	303	485
Income tax recoverable	92	699
	13,262	16,430
Non-current assets		
Notes and leases receivable	262	302
Property and equipment	4,245	4,380
Intangible assets	32,688	32,337
Total assets	$ 50,457	$ 53,449
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 4,680	$ 6,012
Provisions	1,169	1,937
Other liabilities	665	512
Gift card liability	3,020	3,727
Deposits from franchisees	527	378
Current portion of long-term debt	-	11,119
	10,061	23,685
Non-current liabilities		
Provisions	840	1,133
Other liabilities	341	368
Long-term debt (note 5)	11,158	-
Deferred income taxes	3,175	3,270
Total liabilities	25,575	28,456
SHAREHOLDERS' EQUITY	24,882	24,993
Total liabilities and shareholders' equity	$ 50,457	$ 53,449

Contingencies, commitments and guarantees (note 12).
See accompanying notes to the unaudited condensed interim financial statements.

Approved by the Directors July 31, 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		26 weeks ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Revenue (note 6)				
Company-owned cafes and product sales	$ 5,634	$ 1,745	$ 10,873	$ 3,814
Franchise revenue	3,786	4,690	7,561	9,245
	9,420	6,435	18,434	13,059
Operating Costs and Expenses (note 7)				
Company-owned cafes and cost of product sales	5,622	1,927	10,845	4,404
Franchise	1,968	1,413	3,905	3,152
General and administrative	1,584	3,187	3,019	5,211
Loss (gain) on disposal of assets	(88)	21	(88)	(88)
Depreciation and amortization	341	276	691	542
	9,427	6,824	18,372	13,221
Income (loss) from Operations	(7)	(389)	62	(162)
Interest and financing (note 8)	71	99	248	256
Loss before income taxes	(78)	(488)	(186)	(418)
Recovery of income taxes	(6)	(98)	(38)	(84)
Net loss and comprehensive loss for the period	$ (72)	$ (390)	$ (148)	$ (334)
Basic and diluted loss per share (note 9)	$ (0.01)	$ (0.04)	$ (0.01)	$ (0.03)

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 loss for the period	-	-	(334)	(334)
Dividends to shareholders	-	-	(1,684)	(1,684)
Stock Option Expense	-	20	-	20
Balance – June 28, 2014	$ 1,000	$ 61,577	$ (18,611)	$ 43,966
Balance - December 27, 2014	$ 8,652	$ 61,649	$ (45,308)	$ 24,993
Net loss for the period	-	-	(148)	(148)
Stock option plan expense	-	37	-	37
Balance – June 27, 2015	$ 8,652	$ 61,686	$ (45,456)	$ 24,882

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		26 weeks ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
CASH PROVIDED BY (USED IN)				
Operating activities				
Net loss for the period	$ (72)	$ (390)	$ (148)	$ (334)
Items not involving cash				
Depreciation of property and equipment	267	196	540	391
Amortization of intangible assets	73	79	151	150
Share-based compensation expense	22	20	37	20
Deferred income taxes	(63)	40	(95)	54
Gain on disposal of capital related items	(88)	22	(88)	(88)
Movement in fair value of interest rate swap	(39)	(18)	37	24
Impairment charges	-	-	-	-
Other	(34)	(8)	(39)	(15)
Changes in non-cash working capital	818	142	(277)	308
Cash provided by (used in) operating activities	884	83	118	510
Investing activities				
Proceeds from disposal of capital related items	228	56	228	225
Cash payments for capital expenditures	(463)	(187)	(633)	(491)
Cash payments for intangible assets	(90)	(146)	(414)	(682)
Proceeds from repayment of leases receivable	17	-	30	-
Proceeds from repayment of notes receivable	2	-	7	-
Cash used in investing activities	(306)	(277)	(782)	(948)
Financing activities				
Dividends paid to shareholders	-	(842)	-	(1,684)
Cash used in financing activities	-	(842)	-	(1,684)
Increase (decrease) in cash and cash equivalents during the period	578	(1,036)	(664)	(2,122)
Cash and cash equivalents - Beginning of period	9,676	5,415	10,918	6,501
Cash and cash equivalents - End of period	$ 10,254	$ 4,379	$ 10,254	$ 4,379
Restricted cash	$ 746	$ -	$ 746	$ -
Cash and cash equivalents	$ 9,508	$ 4,379	$ 9,508	$ 4,379

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

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1. Organization and nature of business

The Second Cup Ltd. (“Second Cup” or “the Company”) is a Canadian specialty coffee retailer with 337 cafés operating under the trade name, Second Cup™, in Canada, of which 47 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 and 26 weeks ended June 27, 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 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 July 31, 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 Executive Officer. The Company substantially operates and is managed as one reportable segment. Operating revenues are comprised of royalties, other service fees, the sale of goods from Company-operated cafés, the sale of goods through retail and other ancillary channels.

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.

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 27, 2014. There was no significant impact on the Company's condensed interim consolidated financial statements as a result of new standards that became effective during fiscal 2015.

4. Provisions

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

Reflected in the Franchise operating costs and expenses, a recovery of $227 (2014 – expense of $47) was recognized in the 26 weeks ended June 27, 2015. These amounts comprise an adjustment on the estimated lease exit costs.

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

5. Borrowings

	June 27, 2015	December 27, 2014
Face value of borrowings	$ 11,000	$ 11,000
Fair value of interest rate swap	180	143
Unamortized transaction costs	(22)	(24)
	$ 11,158	$ 11,119

The credit facilities comprise an $11,000 non-revolving term credit facility, fully drawn, and an undrawn $2,000 revolving operating credit facility. The term credit facilities are collateralized by substantially all the assets of the Company. The 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 acquire a number of cafés, 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. As at June 27, 2015, the applicable margin pertaining to the aforementioned range is 3.25%. The unused operating facility of $2,000 continues to be in place.

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%.

As at June 27, 2015, there was an interest rate swap liability of $180 recorded in the Condensed Interim Statements of Financial Position.

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

6. Revenue

	13 weeks ended		26 weeks ended	
	June 27, 2015	**June 28, 2014**	**June 27, 2015**	**June 28, 2014**
Franchise Revenue				
Royalties	$ 2,605	$ 3,282	$ 5,207	$ 6,477
Services and other	1,181	1,408	2,354	2,768
	3,786	4,690	7,561	9,245
Company-owned cafes and product sales	5,634	1,745	10,873	3,814
	$ 9,420	$ 6,435	$ 18,434	$ 13,059

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
Franchise fees and other consists of initial franchise fees, renewal fees, transfer fees earned on the sale of cafés from one franchisee to another, 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 sale of goods from Company owned cafés, as well as products sold in grocery stores through wholesale distribution channels and third party licensing agreements.

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

7. Operating expenses

	13 weeks ended June 27, 2015	13 weeks ended June 28, 2014	26 weeks ended June 27, 2015	26 weeks ended June 28, 2014
Company owned cafés and cost of product sales				
Cost of product sales	$ 2,087	$ 590	$ 4,104	$ 2,011
Labour and related expenses	1,895	605	3,644	1,083
Occupancy and other	1,640	732	3,097	1,310
Depreciation of property and equipment	93	36	207	72
(Gain) loss on disposal of capital related items	(88)	21	(88)	(88)
	5,627	1,984	10,964	4,388
Franchise				
Labour and related expenses	965	822	1,933	1,700
Travel and franchisee meetings	125	119	624	323
Business development initiatives	453	(7)	542	88
Professional fees and other	425	479	806	1,041
	1,968	1,413	3,905	3,152
General and administrative				
Labour and related expenses	915	2,502	1,565	3,827
Professional fees and other	559	575	1,233	1,164
Occupancy	110	109	221	219
Depreciation and amortization	248	241	484	471
	1,832	3,427	3,503	5,681
	$ 9,427	$ 6,824	$ 18,372	$ 13,221

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

8. Interest and financing

	13 weeks ended		26 weeks ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Interest expense	$ 104	$ 117	$ 311	$ 295
Amortization of deferred financing costs	5	7	12	14
Interest income	(38)	(25)	(75)	(53)
	$ 71	$ 99	$ 248	$ 256

9. 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		26 weeks ended	
	June 27, 2015	June 28, 2014	June 27, 2015	June 28, 2014
Net loss	$ (72)	$ (390)	$ (148)	$ (334)
Weighted average number of shares issued and outstanding	12,830,945	9,903,045	12,830,945	9,903,045
Basic and diluted loss per share	$ (0.01)	$ (0.04)	$ (0.01)	$ (0.03)

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

10. Supplemental cash flow information

	13 weeks ended		26 weeks ended	
	June 27, 2015	**June 28, 2014**	**June 27, 2015**	**June 28, 2014**
Changes in non-cash working capital (inflow (outflow)):				
Trade and other receivables	$ 725	$ 697	$ 1,762	$ 1,689
Notes and leases receivable	(15)	75	1	113
Inventories	(43)	(23)	(45)	8
Prepaid expenses and other assets	82	8	182	37
Accounts payable and accrued liabilities	(138)	(1,122)	(1,331)	(613)
Provisions	(588)	1,270	(1,039)	835
Other liabilities	252	(93)	144	(57)
Gift card liability	(47)	(99)	(707)	(865)
Deposits from franchisees	(17)	(365)	149	(134)
Income taxes	607	(206)	607	(705)
	$ 818	$ 142	$ (277)	$ 308
Cash payments for capital expenditures				
Purchase of property and equipment	$ (463)	$ (187)	$ (633)	$ (491)
Purchase of intangible assets	(90)	(146)	(414)	(682)
	$ (553)	$ (333)	$ (1,047)	$ (1,173)
Supplementary information				
Interest paid	$ 144	$ 135	$ 274	270
Income taxes paid	$ -	$ 161	$ -	659

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 “Co-op Fund”).

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

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 headlease commitments, a provision has been recognized. The Company's lease commitments at June 27, 2015 are as follows:

		Headlease commitments		Sublease to franchisees		Net
June 25, 2016	$	19,515	$	15,799	$	3,716
June 24, 2017		17,391		14,135		3,256
June 30, 2018		15,473		12,507		2,966
June 29, 2019		13,786		10,974		2,812
June 27, 2020		11,432		8,846		2,586
Thereafter		28,361		20,808		7,553
	$	105,958	$	83,069	$	22,889

The Company believes it will have sufficient resources to meet the net commitment of $22,889.

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 $3,307 USD (June 28, 2014 – $5,500 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 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 $206 in 2015.

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 $770 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 on the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties.

For the 13 and 26 weeks ended June 27, 2015, one of the company's vendors purchased $416 and $1,010, respectively, of product in the ordinary course of business, on behalf of the company and its franchisees from a company controlled by a board member.