The Second Cup Ltd.

Condensed Interim Financial Statements
(Unaudited)
For the 13 and 39 weeks ended September 27, 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)

Steve Boyack
Chief Financial Officer, The Second Cup Ltd.

October 31, 2014

The Second Cup Ltd.

Condensed Interim Statements of Financial Position

(Unaudited, expressed in thousands of Canadian dollars)

		September 27, 2014		December 28, 2013
ASSETS				
Current assets				
Cash and cash equivalents	$	3,485	$	6,501
Trade and other receivables		3,369		4,368
Notes and leases receivable		308		220
Inventories		126		123
Prepaid expenses and other assets		382		190
Income tax recoverable		574		-
		8,244		11,402
Non-current assets				
Notes and leases receivable		548		701
Property and equipment		3,370		3,507
Intangible assets		32,416		61,730
Total assets	$	44,578	$	77,340
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities	$	4,479	$	4,586
Provisions		2,709		847
Other liabilities		639		717
Income taxes payable		-		138
Gift card liability		2,850		3,895
Deposits from franchisees		448		878
		11,125		11,061
Non-current liabilities				
Provisions		800		1,380
Other liabilities		384		428
Long-term debt (note 4)		11,124		11,089
Deferred income taxes		3,372		7,418
Total liabilities		26,805		31,376
SHAREHOLDERS' EQUITY		17,773		45,964
Total liabilities and shareholders' equity	$	44,578	$	77,340

Contingencies, commitments and guarantees (note 13).
See the accompanying notes to the Condensed Interim Financial Statements.

Approved by the Directors, October 31, 2014.

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		39 weeks ended	
	September 27, 2014	September28, 2013	September 27, 2014	September28, 2013
Revenue				
Royalties	$ 2,805	$ 3,285	$ 9,283	$ 10,301
Sale of goods	2,406	1,363	6,728	3,980
Services and other	1,484	1,620	4,794	4,869
	6,695	6,268	20,805	19,150
Cost of goods sold	1,849	1,042	4,899	2,965
Gross profit	4,846	5,226	15,906	16,185
Operating expenses (note 5)	4,113	3,634	13,169	11,571
Restructuring charges	-	-	2,166	-
Provision for café closures (note 6)	1,239	231	1,239	374
Impairment charges (note 7)	29,708	-	29,708	13,253
Operating income (loss)	(30,214)	1,361	(30,376)	(9,013)
Interest and financing (note 8)	116	90	372	262
Income (loss) before income taxes	(30,330)	1,271	(30,748)	(9,275)
Income taxes (recovery) (note 9)	(4,100)	353	(4,184)	(729)
Net income (loss) and comprehensive income (loss) for the period	$ (26,230)	$ 918	$ (26,564)	$ (8,546)
Basic and diluted income (loss) per share (note 10)	$ (2.65)	$ 0.09	$ (2.68)	$ (0.86)

See the accompanying notes to the 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 29, 2012	$ 1,000	$ 61,557	$ (5,857)	$ 56,700
Net loss for the period	-	-	(8,546)	(8,546)
Dividends to shareholders	-	-	(2,525)	(2,525)
Stock option plan expense (note 11)	-	-	-	-
Balance - September 28, 2013	$ 1,000	$ 61,557	$ (16,928)	$ 45,629
Balance - December 28, 2013	$ 1,000	$ 61,557	$ (16,593)	$ 45,964
Net loss for the period	-	-	(26,564)	(26,564)
Dividends to shareholders	-	-	(1,684)	(1,684)
Stock option plan expense (note 11)	-	57	-	57
Balance – September 27, 2014	$ 1,000	$ 61,614	$ (44,841)	$ 17,773

See the accompanying notes to the Condensed Interim Financial Statements.

The Second Cup Ltd.

Condensed Interim Statements of Cash Flows

(Unaudited, expressed in thousands of Canadian dollars)

	13 weeks ended		39 weeks ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
CASH PROVIDED BY (USED IN)				
Operating activities				
Net income (loss) for the period	$ (26,230)	$ 918	$ (26,564)	$ (8,546)
Items not involving cash				
Depreciation of property and equipment	254	187	645	543
Amortization of intangible assets	94	123	244	360
Amortization of deferred financing charges	6	3	20	30
Amortization of leasehold inducements and lease provisions	(14)	35	(43)	(87)
Share-based compensation expense (note 11)	37	-	57	-
Deferred income taxes	(4,100)	(86)	(4,046)	(1,805)
Gain on disposal of capital related items	(2)	-	(90)	(16)
Movement in fair value of interest rate swap	(9)	-	15	(96)
Impairment charges	29,708	-	29,708	13,253
Changes in non-cash working capital (note 12)	(531)	(543)	(223)	1,277
Cash (used in) provided by operating activities	(787)	637	(277)	4,913
Investing activities				
Proceeds from disposal of capital related items	87	45	312	867
Cash payments for capital expenditures (note 12)	(194)	(880)	(1,367)	(1,822)
Proceeds from repayment of leases receivable	-	14	-	35
Proceeds from repayment of notes receivable	-	-	-	13
Investment in notes receivable	-	-	-	(10)
Cash used in investing activities	(107)	(821)	(1,055)	(917)
Financing activities				
Dividends paid to shareholders	-	(841)	(1,684)	(2,525)
Deferred financing charges	-	(29)	-	(29)
Cash used in financing activities	-	(870)	(1,684)	(2,554)
Increase (decrease) in cash and cash equivalents during the period	(894)	(1,054)	(3,016)	1,442
Cash and cash equivalents - Beginning of period	4,379	6,376	6,501	3,880
Cash and cash equivalents - End of period	$ 3,485	$ 5,322	$ 3,485	$ 5,322

See the accompanying notes to the Condensed Interim Financial Statements. Supplemental cash flow information is provided in note 12.

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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 349 cafés operating under the trade name, Second Cup™, in Canada, of which 17 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. The common shares of the company are listed on the Toronto Stock Exchange under the symbol “SCU”.

2. Basis of preparation

These Condensed Interim Financial Statements for the 13 and 39 weeks ended September 27, 2014 have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as applicable to condensed interim financial reports including International Accounting Standard 34, Interim Financial Reporting (“IAS 34”) and should be read in conjunction with the company’s annual Audited Financial Statements for the year ended December 28, 2013, which have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board.

The accounting policies are based on IFRS issued and outstanding as at October 31, 2014, the date the Board of Directors approved the unaudited Condensed Interim Financial Statements.

2. Basis of preparation (continued)

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.

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.

The accounting policies applied in these Condensed Interim Financial Statements are consistent with those of the previous financial year except for the following:

Share-based compensation

Share option awards

For share option awards granted as part of the stock option plan, a fair value is determined at the date of grant and that fair value is recognized in the financial statements. Proceeds arising from the exercise of share option awards are credited to share capital, as are the recognized grant-date fair values of the exercised share option awards. Share option awards which are determined to be settled on a net-equity basis are accounted for as equity instruments. Share option awards which are determined to be settled on a net-cash settlement basis are accounted for as liability instruments.

The stock option plan was introduced in May 2014 and is further discussed in note 11.

New accounting standards

New accounting standards, amendments and interpretations

Effective December 29, 2013, the company elected to early adopt the following new standards, amendments and IFRIC interpretations, each with an effective date of January 1, 2014:

- *IAS 32, Financial instruments: Presentation ("IAS 32")*

  The amendments to IAS 32 clarify the requirements for offsetting a financial asset and liability in the financial statements. The implementation of these amendments did not have a significant impact on the company.

- *IAS 36, Impairment of assets ("IAS 36")*

  The amendments to IAS 36 clarify the requirement to disclose information about the recoverable amount of assets for which an impairment loss has been recognized or reversed. The implementation of these amendments has been reflected in Note 7.

2. Basis of preparation (continued)

New accounting standards (continued)

New accounting standards, amendments and interpretations (continued)

During the 13 weeks ended September 27, 2014 the company adopted the following amendments resulting from the Annual Improvements to IFRS:

- *IFRS 2, Share-based payment ("IFRS 2")*

  The amendments to IFRS 2 clarify the definition of vesting conditions, and are effective for share-based payment transactions for which the grant date is on/after July 1, 2014. The implementation of these amendments did not have a significant impact on the company.

- *IFRS 3, Business combinations ("IFRS 3")*

  The amendments to IFRS 3 clarify the treatment of contingent consideration in a business combination, and are effective for business combinations where the acquisition date is on/after July 1, 2014. The implementation of these amendments did not have a significant impact on the company.

Recent accounting pronouncements not yet effective

- *IFRS 15, Revenue ("IFRS 15")*

  In May, 2014, the IASB issued IFRS 15. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. IFRS 15 will also result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively and improve guidance for multiple-element arrangements. The standard will also address accounting for loyalty programs, warranties and breakage.

  Application of IFRS 15 is effective for annual reporting periods beginning on/after January 1, 2017 and is to be applied using the retrospective or the modified transition approach. Early adoption is permitted. Management is currently assessing the impact of this standard.

- *IFRS 9, Financial instruments ("IFRS 9")*

  In July 2014, the IASB issued the final publication of IFRS 9 superseding the current version of IAS 39. This standard establishes principles for the financial reporting of financial assets and financial liabilities that will present relevant and useful information to users of financial statements for their assessment of the amounts, timing and uncertainty of an entity's future cash flows. This new standard also includes a new general hedge accounting standard which will align hedge accounting more closely with risk management.

  Application of IFRS 9 is effective for annual reporting periods beginning on/after January 1, 2018 and is to be applied retrospectively. Early adoption is permitted. Management is currently assessing the impact of this standard.

2. Basis of preparation (continued)

New accounting standards (continued)

Recent accounting pronouncements not yet effective (continued)

- *IFRS 8, Operating segments ("IFRS 8")*

  The annual improvements to IFRS include amendments to IFRS 8 that require additional operating segment disclosures. The amendments are effective for years beginning on/after July 1, 2014. Management is currently assessing the impact of this standard.

- *IAS 24, Related party transactions ("IAS 24")*

  The annual improvements to IFRS include an amendment to the definition of 'related party' in IAS 24 and further amendments that clarify related disclosure requirements. The amendments are effective for years beginning on/after July 1, 2014. Management is currently assessing the impact of this standard.

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. Restructuring charges and provisions for café closures were separately presented on the face of the Statements of Income (Loss) and Comprehensive Income (Loss). Previous presentation had these costs recorded as operating expenses.

3. 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 franchisees	Liquidity
term credit facility	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.

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.

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

3. Financial instruments and financial risk management (continued)

		Level 1		Level 2		Level 3
As at December 28, 2013						
Interest rate swap	$	-	$	(140)	$	-
As at September 27, 2014						
Interest rate swap	$	-	$	(155)	$	-

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

Credit risk

a. Cash and cash equivalents, and interest rate swap

The 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 leases receivable primarily comprise amounts due from franchisees. Credit risk associated with these receivables is mitigated as a result of the review and evaluation of franchisee account balances beyond a particular age. Prior to accepting a franchisee, the company undertakes a detailed screening process which includes the requirement that a franchisee have sufficient capital and financing. The risk is further mitigated due to a broad franchisee 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 franchisees. Credit risk is mitigated as a result of the company directing and maintaining certain controls over the vendor relationship with the franchisees.

Management records a bad debt provision when the expected recovery is less than the actual receivable. The bad debt expense is calculated on a specific identification basis based on historical information, trends and reasons for accounts being past due.

An analysis of aging of the company's trade and other receivables from the billing date as at September 27, 2014 net of an allowance for doubtful accounts is as follows:

		0 - 30 Days		31 - 60 Days		61 - 90 Days		> 90 Days		Total
September 27, 2014	$	2,872	$	271	$	-	$	226	$	3,369
December 28, 2013		4,151		151		38		28		4,368

The company's trade and other receivables included a combined allowance for doubtful accounts of $1,061 (December 28, 2013 - $663).

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

3. Financial instruments and financial risk management (continued)

The payment maturity dates of the company's notes and leases receivable from September 27, 2014 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
September 27, 2014	$ 142	$ 166	$ 236	$ 312	$ 856
December 28, 2013	57	163	238	463	921

The company's notes and leases receivable included a combined allowance for doubtful accounts of $36 (December 28, 2013 - $110).

Liquidity risk
The company manages liquidity risk through regular monitoring of forecasts 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 4. The company's main source of income is royalty receipts from its franchisees.

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 changes in coffee commodity prices given it is a material input for the company's product offerings. The direct exposure is mitigated given that the company has the ability to adjust its sales price as commodity prices change. The company mitigates risk by entering fixed price forward purchase commitments and by adjusting 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 September 27, 2014, assuming that a reasonably possible change in the relevant risk variable has occurred as at September 27, 2014.

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

3. Financial instruments and financial risk management (continued)

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

		Pre-tax effects on net income - increase (decrease)	
	Liability amount	**1% decrease in interest rates**	**1% increase in interest rates**
Term loan	$ 11,000	$ 110	$ (110)
Interest rate swap	155	(110)	110
		$ -	$ -

4. Long-term debt

	September 27, 2014	**December 28, 2013**
Face value of long-term debt	$ 11,000	$ 11,000
Fair value of interest rate swap	155	140
Unamortized transaction costs	(31)	(51)
	$ 11,124	$ 11,089

The company's term loan and operating credit facilities mature on September 30, 2016. The 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.

Pursuant to the terms of the company's term loan and operating credit facility, 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.

As at September 27, 2014, the company was in compliance with all financial and other covenants of the company's term loan and operating credit facility.

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

4. Long-term debt (continued)

The $11,000 non-revolving term credit facility bears interest at the bankers' acceptance ("BA") rate plus a margin range of 2.25% to 3.25% depending on the company's Leverage Ratio. As at September 27, 2014, the applicable margin pertaining to the aforementioned range is 2.75%. As at September 27, 2014, 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 margin range of 2.25% to 3.25% depending on the company's Leverage Ratio. As at September 27, 2014, the applicable margin pertaining to the aforementioned range is 2.75%. As at September 27, 2014, no advances had been drawn on this facility.

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%.

5. Operating expenses

	13 weeks ended		39 weeks ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Coffee Central				
Salaries, wages, benefits, and incentives	$ 1,506	$ 1,484	$ 5,222	$ 5,075
Coffee Central overheads	1,587	1,385	4,440	4,317
Retail listing fees	10	-	1,060	-
Depreciation of property and equipment	218	138	539	411
Amortization of intangible assets	94	123	244	360
	3,415	3,130	11,505	10,163
Company-operated cafés				
Occupancy / lease costs and other	664	455	1,648	1,292
Depreciation of property and equipment	36	49	106	132
Loss (gain) on disposal of capital related items	(2)	-	(90)	(16)
	698	504	1,664	1,408
	$ 4,113	$ 3,634	$ 13,169	$ 11,571

6. Provision for café closures

During the 13 and 39 weeks ended September 27, 2014, the company recorded provisions for the closure of eight underperforming cafés totalling $1,239 (2013 - $231 for the 13 weeks and $374 for the 39 weeks ended September 28, 2013, respectively) for estimated lease exit costs and severances. Two of the eight cafés were closed during the third quarter and the remainder are expected to be closed during the fourth quarter. Asset impairments on corporate-operated cafes had been taken in previous fiscal years before 2013.

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

7. Impairment charges

a. Impairment of trademarks

During the 13 and 39 weeks ended September 27, 2014, the company identified impairment indicators, which were primarily a result of the decline in its stock price.

The trademarks were allocated fully to the franchising, distribution, and wholesale business cash generating unit ("CGU"). The CGU's recoverable amount has been determined using fair value less costs to sell.

Key assumptions

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

The company uses probability weighted cash flow projections based on financial forecasts covering a three-year period. These projections are approved by the board of directors based on management expectations of potential outcomes. Cash flows beyond the three-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:

	2014	**2013**
Forecast same café sales	-6.0% to 6.6%	-3.1% to 2.0%
Forecast system-wide café sales	-9.5% to 17.3%	-0.8% to 4.8%
Average growth rate used to extrapolate cash flows beyond the forecast period	-0.9% to 7.9%%	2.0%
Discount rate	13% to 17%	11% to 13%

The valuation of the franchising, distribution, and wholesale business CGU is based on probabilities assigned to forecasted cash flows and includes the key assumptions above. The company recognized an impairment charge of $29,658 for the 13 and 39 weeks ended September 27, 2014 (2013 – $nil for the 13 weeks and $13,253 for the 39 weeks ended September 28, 2013, respectively) to trademarks. The sensitivity analysis of a change in management's key assumptions is reflected below:

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

7. Impairment charges (continued)

a. Impairment of trademarks (continued)

Key assumptions (continued)

	2014		2013	
Key assumption	**Low growth**	**High growth**	**Low growth**	**High growth**
System sales of cafés	-9.5% to 0.1%	-0.7% to 17.3%	-0.8% to 2.0%	-0.1% to 4.8%
Discount rate	13.0%	17.0%	11.0%	13.0%
Incremental increase (decrease) to impairment charges	$6,943	$(30,159)	$2,130	$(7,842)

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 3. As a result of the impairment test, impairment charges of $50 for the 13 and 39 weeks ended September 27, 2014 (2013 - $nil for the 13 and 39 weeks ended September 28, 2013) 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.

8. Interest and financing

	13 weeks ended		39 weeks ended	
	September 27, 2014	**September 28, 2013**	**September 27, 2014**	**September 28, 2014**
Interest expense	$ 125	$ 113	$ 421	$ 293
Amortization of deferred financing costs	6	3	20	30
Interest income	(15)	(26)	(69)	(61)
	$ 116	$ 90	$ 372	$ 262

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

9. 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, differ from the amount that would be computed by applying the combined Canadian federal and provincial statutory income tax rates to income before income taxes. The reasons for the differences are as follows:

	13 weeks ended		39 weeks ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Income (loss) before income taxes	$ (30,330)	$ 1,271	$ (30,748)	$ (9,275)
Combined Canadian federal and provincial tax rates	26.53%	26.51%	26.53%	26.51%
Tax provision (recovery) at statutory rate	(8,047)	337	(8,157)	(2,459)
Increased (reduced) by the following differences				
Change in tax rates	-	-	6	-
Deferred income tax assets and liabilities not previously recognized	-	-	-	(31)
Non-deductible permanent differences	3,947	12	3,939	1,774
Other	-	4	28	(13)
Income taxes (recovery)	$ (4,100)	$ 353	$ (4,184)	$ (729)
Current income taxes	$ (249)	$ 439	$ (387)	$ 1,076
Deferred income taxes	(3,851)	(86)	(3,797)	(1,805)
Income taxes (recovery)	$ (4,100)	$ 353	$ (4,184)	$ (729)

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

10. Basic and diluted income (loss) per share

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

	13 weeks ended		39 weeks ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Net income (loss)	$ (26,230)	$ 918	$ (26,564)	$ (8,546)
Weighted average number of shares issued and outstanding	9,903,045	9,903,045	9,903,045	9,903,045
Basic and diluted income (loss) per share	$ (2.65)	$ 0.09	$ (2.68)	$ (0.86)

For the 13 and 39 weeks ended September 27, 2014, there were 500,000 outstanding share option awards (13 and 39 weeks ended September 28, 2013 - nil) that were not included in the determination of diluted loss per share because they are non-dilutive for the periods presented.

11. Share-based compensation

Stock option plan

The stock option plan was introduced in May 2014 to advance the interests of the company by:

- providing eligible persons with incentives;
- encouraging share ownership by participants;
- increasing the proprietary interest of participants in the success of the company;
- encouraging participants to remain with the company or its affiliates; and
- attracting new directors and employees.

The company has determined that its stock options are to be settled on a net-equity basis. Compensation expense for stock awards is recognized using the fair value when the stock awards are granted using the Black-Scholes option pricing model. All options vest in tranches and are amortized over the awards' vesting period using the accelerated expense attribution method. Recognition of the expense is recorded as a charge to operating expenses with a corresponding increase to contributed surplus.

The company used the following weighted average assumptions to estimate the weighted average fair value per award of $0.50 granted for the 13 and 39 weeks ended September 27, 2014:

	Assumption
Risk-free interest rate (%)	1.95
Volatility (%)	31.36
Expected term (years)	6.5

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

11. Share-based compensation (continued)

The following table below summarizes all activity for the 13 and 39 weeks ended September 27, 2014:

	Number of share options outstanding		Weighted average share option price
As at December 28, 2013	-	$	-
Granted	500,000		4.34
As at September 27, 2014	500,000	$	4.34
Stock option plan expense during the 39 week period		$	57

The range of exercise prices for share options outstanding at the end of the period is $4.32 to $4.54. There were nil share options exercisable at the end of the period. As at September 27, 2014, the weighted average years to expiration are ten years.

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

12. Supplemental cash flow information

	13 weeks ended		39 weeks ended	
	September 27, 2014	September 28, 2013	September 27, 2014	September 28, 2013
Changes in non-cash working capital (inflow (outflow)):				
Trade and other receivables	$ (690)	$ (495)	$ 999	$ 2,018
Notes and leases receivable	(48)	18	65	61
Inventories	(11)	37	(3)	(31)
Prepaid expenses and other assets	(229)	28	(192)	589
Accounts payable and accrued liabilities	506	385	(107)	213
Provisions	490	15	1,325	106
Other liabilities	(66)	381	(123)	601
Gift card liability	(180)	(524)	(1,045)	(1,375)
Deposits from franchisees	(296)	(445)	(430)	(586)
Income taxes	(7)	57	(712)	(319)
	$ (531)	$ (543)	$ (223)	$ 1,277
Cash payments for capital expenditures				
Purchase of property and equipment	$ (159)	$ (727)	$ (650)	$ (1,527)
Purchase of intangible assets	(35)	(153)	(717)	(295)
	$ (194)	$ (880)	$ (1,367)	$ (1,822)
Supplementary information				
Interest paid	$ 136	$ 112	$ 406	$ 386
Income taxes paid	7	385	666	1,395

13. 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 franchisees. A provision has been recognized to the extent the company may be required to make rent payments due to headlease commitments. The company’s lease commitments at September 27, 2014 are as follows:

	Headlease commitments	Sublease to franchisees	Net
September 27, 2015	$ 20,220	$ 18,691	$ 1,529
September 27, 2016	18,466	16,853	1,613
September 27, 2017	16,391	14,896	1,495
September 27, 2018	14,304	13,004	1,300
September 27, 2019	12,585	11,362	1,223
Thereafter	30,719	27,661	3,058
	$ 112,685	$ 102,467	$ 10,218

13. Contingencies, commitments and guarantees (continued)

The company believes it will have sufficient resources to meet the net commitment of $10,218.

Second Cup is involved in litigation and other claims arising in the normal course of business. Management must use its judgment to determine whether or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent on the potential success of the claim. Second Cup believes it will not incur any significant loss or expense with such claims. However, there can be no assurance that unforeseen circumstances will not result in significant costs. The outcome of these actions is not determinable at this time, and adjustments, if any, will be recorded in the period of settlement.

The Coffee “C” contract is the world benchmark for Arabica coffee. The contract prices physical delivery of exchange grade green beans from one of 19 countries of origin in a licensed warehouse to one of several ports in the U.S. and Europe, with stated premiums/discounts. Second Cup sources high quality 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 as at September 27, 2014, Second Cup has guaranteed a minimum volume of coffee purchases of $5,093 for the subsequent 12 months. These coffee purchase commitments, along with stock on hand, account for approximately 100% of needs for a year. The commitments are comprised of three components: unapplied futures commitment contracts, fixed price physical contracts and flat price physical contracts.

Second Cup is the primary coordinator of café construction on behalf its franchisees and for company-operated cafés. As at September 27, 2014, there is $1,591 of contractual commitments pertaining to construction for new locations and renovations. The company manages franchisee construction projects from deposits received and finances corporate projects from the company’s cash flows.

14. Related parties

The company has identified related parties as key management, members of the Board of Directors, and shareholders who effectively exercise significant influence over the company. Such related parties include any entities acting with or on behalf of the aforementioned parties.

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For the 13 and 39 weeks ended September 27, 2014, one of the company’s vendors purchased $874 and $2,635 respectively of product in the ordinary course of business, on behalf of the company and its franchisees from a related party.

15. Subsequent event

On October 17, 2014, the company announced that it will acquire 17 Second Cup cafés located in the Toronto area.