

# **The Second Cup Ltd.**

## **Management's Discussion and Analysis**

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### **CAUTION REGARDING FORWARD-LOOKING STATEMENTS**

Certain statements in this Management's Discussion and Analysis ("MD&A") may constitute forward-looking statements within the meaning of applicable securities legislation. The terms the "Company", "Second Cup", "we", "us", or "our" refer to The Second Cup Ltd. Forward-looking statements include words such as "may", "will", "should", "expect", "anticipate", "believe", "plan", "intend" and other similar words. These statements reflect current expectations regarding future events and financial performance and speak only as of the date of this MD&A. The MD&A should not be read as a guarantee of future performance or results and will not necessarily be an accurate indication of whether or not those results will be achieved. Forward-looking statements are based on a number of assumptions and are subject to known and unknown risks, uncertainties and other factors, many of which are beyond Second Cup's control that may cause Second Cup's actual results, performance or achievements, or those of Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The following are some of the factors that could cause actual results to differ materially from those expressed in the underlying forward-looking statements: competition; availability of premium quality coffee beans; the ability to attract qualified franchise partners; the location of Second Cup cafés; the closure of Second Cup cafés; loss of key personnel; compliance with government regulations; food safety; potential litigation; the ability to exploit and protect the Second Cup trademarks; changing consumer preferences and discretionary spending patterns including, but not restricted to, the impact of weather and economic conditions on such patterns; reporting of system sales by franchise partners; and the financial performance and financial condition of Second Cup. The foregoing list of factors is not exhaustive, and investors should refer to the risks described under "Risks and Uncertainties" below and in Second Cup's Annual Information Form, which is available at [www.sedar.com](http://www.sedar.com).

Although the forward-looking statements contained in this MD&A are based on what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements and, as a result, the forward-looking statements may prove to be incorrect.

As these forward-looking statements are made as of the date of this MD&A, Second Cup does not undertake to update any such forward-looking statements whether as a result of new information, future events or otherwise. Additional information about these assumptions and risks and uncertainties is contained in the Company's filings with securities regulators. These filings are also available on the Company's website at [www.secondcup.com](http://www.secondcup.com).

### **INTRODUCTION**

The following MD&A has been prepared as of May 6, 2015 and is intended to assist in understanding the financial performance and financial condition of The Second Cup Ltd. ("Second Cup" or the "Company") for the 13 weeks (the "Quarter") ended March 28, 2015, and should be read in conjunction with the Unaudited Condensed Interim Financial Statements of the Company for the 13 weeks ended March 28, 2015, the Audited Financial Statements of the Company for the 52 weeks ended December 27, 2014, and the Annual Information Form, which are available at [www.sedar.com](http://www.sedar.com). Past performance may not be indicative of future performance. All amounts are presented in thousands of Canadian dollars, except number of cafés, per share amounts or unless otherwise indicated and have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Company also reports certain non-IFRS measures such as System sales of cafés, Same café sales, Operating income, EBITDA, Adjusted EBITDA, and Adjusted earnings per share that are discussed in the "Definitions and discussion of certain non-GAAP financial measures" in this MD&A.

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### **CORE BUSINESS, STRATEGY, AND PERFORMANCE DRIVERS**

#### ***Core business***

Second Cup 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 who are selected and trained to retail Second Cup's product offering. Further discussion of the Company's core business was described in the 2014 annual MD&A.

#### ***Strategic imperatives and key performance drivers***

Second Cup's new vision of being the coffee brand most passionately committed to quality and innovation will drive management's strategies and actions going forward. Coffee will be at the core of the offering and the brand will win customers' hearts through more "personalized experiences".

While much remains to be done, our journey continues and our three-year strategic plan is providing solid direction as we reinvigorate the Second Cup brand.

In February, the Company held an annual convention for all franchisees (the first in the past four years) laying out the future direction for Second Cup Coffee Co., which was well received by several hundred franchisees and Coffee Central employees. Our franchisees are optimistic and inspired by the new direction for Second Cup.

The café of the future at the intersection of King & John in Toronto continues to outperform with sales increasing more than 39% in the first quarter of 2015 compared with the prior year. The concept will be rolled out in upcoming renovations with three beginning in Montreal during Q2.

In Ontario and Quebec, Second Cup introduced its premium baked goods to positive reviews from franchisees, customers, media and influencers. The superior quality, natural ingredients and local sourcing, reinforcing our premium positioning, captured positive attention and contributed to much improved café results. The initial introduction covers 65% of Second Cup Coffee Co. cafés. The Company plans to expand the program to 85% of cafés by year-end.

### **CAPABILITIES**

This section documents factors that affect the Company's capabilities to execute strategies, manage key performance drivers and deliver results. This section is qualified by the section "Caution Regarding Forward-Looking Statements" at the beginning of this MD&A.

The Company's capabilities specific to the Second Cup brand, café of the future, our people, product, locations, competition, and technology were discussed in the 2014 annual MD&A.

#### ***Liquidity, capital resources and management of capital***

The Company's objectives relating to the management of its capital structure are discussed in the 2014 MD&A. During the period ended March 28, 2015 the Company was in compliance with all financial and other covenants of the Company's term loan and operating credit facility.

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## Management's Discussion and Analysis

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### FINANCIAL HIGHLIGHTS

The following table sets out selected IFRS and certain non-GAAP financial measures of the Company and should be read in conjunction with the Unaudited Condensed Interim Financial Statements of the Company for the 13 weeks ended March 28, 2015.

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts)	<b>13 weeks ended March 28, 2015</b>	<b>13 weeks ended March 29, 2014</b>
System sales of cafés <sup>1</sup>	\$43,174	\$43,930
Same café sales <sup>1</sup>	(1.1%)	(6.9%)
Number of cafés - end of period	344	357
Total revenue	\$9,014	\$6,623
Gross profit	\$5,248	\$4,745
Operating expenses	\$5,235	\$3,821
Restructuring charges	-	\$559
Provision for café closures	\$(55)	\$139
Operating income	\$68	\$226
Adjusted EBITDA <sup>1</sup>	\$364	\$1,080
Net (loss) income and comprehensive (loss) income	\$(76)	\$56
Basic and diluted (loss) earnings per share as reported	\$(0.01)	\$0.01
Adjusted basic and diluted earnings per share <sup>1</sup>	\$(0.01)	\$0.06
Total Assets - as at end of period	\$51,179	\$76,040
Number of common shares issued and outstanding - end of period	12,830,945	9,903,045

<sup>1</sup>See the section "Definitions and discussion on certain non-GAAP financial measures" for further analysis.

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## Management's Discussion and Analysis

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### OPERATIONAL REVIEW

#### *Seasonality of System sales of cafés*

The following table shows the percentage of annual System sales of cafés achieved, on average, in each fiscal reporting quarter over the last three years:

% of annual System sales of cafés	2012	2013	2014	Average
First quarter	24.2	24.5	24.0	24.2
Second quarter	24.4	24.9	25.1	24.8
Third quarter	23.9	23.5	23.9	23.8
Fourth quarter	27.5	27.1	27.0	27.2
	100.0	100.0	100.0	100.0

Historically, System sales of cafés have been higher in the fourth quarter, which includes the holiday sales periods of November and December. Because of this seasonality, the results for any quarter are not necessarily indicative of what may be achieved for any other quarter or year.

#### *Café network*

	<b>13 weeks ended March 28, 2015</b>	<b>13 weeks ended March 29, 2014</b>
Number of cafés - beginning of period	347	356
Cafés opened	2	5
Cafés closed	(5)	(4)
Number of cafés - end of period	344	357

The Company ended the quarter with forty-one (2014 - eleven) Company-operated cafés.

#### *System sales of cafés*

System sales of cafés for the 13 weeks ended March 28, 2015 were \$43,174 compared to \$43,930 for the 13 weeks ended March 29, 2014, representing a decrease of \$756 or 1.7%. The decrease is attributable to decreased same café sales and to the smaller store network.

#### *Same café sales*

During the quarter, same café sales declined by 1.1%, compared to a decline of 6.9% in the comparable quarter of 2014. While negative, the 1.1% sales decline represents a significant improvement in trend and is the best quarterly result since the 13 weeks ended March 31, 2012.

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### ***Analysis of revenue***

Total revenue for the Quarter was \$9,014 (2014 - \$6,623) and consisted of royalty revenue, revenue from sale of goods, and services and other revenue.

Royalty revenue for the Quarter was \$2,602 (2014 - \$3,195). The reduction in royalty revenue of \$593 is primarily a result of the new royalty incentive introduced in August 2014, lower café sales, and the increase of Company-operated cafés.

Revenue from the sale of goods, which consists of revenue from Company-operated cafés and wholesale revenue was \$5,238 (2014 - \$1,800) for the Quarter. The increase of \$3,438 in revenue from the sale of goods was mainly due to the increased number of Company-operated cafés.

Services and other revenue for the Quarter was \$1,174 (2014 - \$1,628).

### ***Cost of goods sold***

Cost of goods sold represents the product cost of goods sold in Company-operated cafés and wholesale channels, plus the cost of direct labour in the Company-operated cafés. Cost of goods sold was \$3,766 (2014 - \$1,878). The \$1,888 increase in cost of goods sold is mainly due to the increase in Company-operated cafés.

### ***Operating expenses***

Operating expenses include Coffee Central expenses and the overhead expenses of Company-operated cafés. Total operating expenses for the Quarter were \$5,235 (2014 - \$3,821), an increase of \$1,414.

### ***Coffee Central***

Coffee Central expenses for the Quarter were \$3,712 (2014 - \$3,603), an increase of \$109.

### ***Company-operated cafés***

Company-operated café expenses for the Quarter were \$1,523 (2014 - \$218). The \$1,305 increase is attributable to the number of Company-operated cafés.

### ***Interest and financing***

The Company incurred interest and financing expenses of \$176 (2014 - \$156). The increase in interest and financing expenses is due to the fair value adjustments of the interest rate swap, which was partially offset by an increase in interest income.

### ***Income taxes***

Deferred income tax recoveries of \$32 were recorded in the Quarter (2014 - income tax expense of \$14).

### ***Adjusted EBITDA***

Adjusted EBITDA for the Quarter was \$364 (2014 - \$1,080). The decrease of \$716 was primarily due to restructuring and provisions for café closures last year.

### ***Net income***

The Company's net loss for the Quarter was \$76 or \$0.01 per share, compared to net income of \$56 or \$0.01 per share in 2014. The decrease in net income of \$132 or \$0.05 per share was mainly due to decreased royalties and increased expenses relating to Company-operated cafés, offset partially by Coffee Central expense savings due to the FY14 restructuring and retail listing fees incurred during the the same period last year. A reconciliation of Net income to Adjusted EBITDA is provided in the section "Definitions and discussion on certain non-GAAP financial measures".

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### SELECTED QUARTERLY INFORMATION

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts)	Q1 2015 <sup>2</sup>	Q4 2014 <sup>2</sup>	Q3 2014	Q2 2014
System sales of cafés <sup>1</sup>	\$43,174	\$49,427	\$43,596	\$45,829
Same café sales <sup>1</sup>	(1.1%)	(3.9%)	(3.3%)	(5.0%)
Number of cafés - end of period	344	347	349	357
Total revenue	\$9,014	\$8,427	\$6,686	\$6,435
Operating income (loss) <sup>1</sup>	\$68	(\$521)	(\$30,214)	(\$388)
Adjusted EBITDA <sup>1</sup>	\$364	\$1,068	\$1,079	\$1,516
Net income (loss) for the period	(\$76)	(\$469)	(\$26,230)	(\$390)
Basic and diluted earnings (loss) per share	(\$0.01)	(\$0.04)	(\$2.65)	(\$0.04)
Dividends declared per share	-	-	-	-
	Q1 2014	Q4 2013 <sup>2</sup>	Q3 2013	Q2 2013
System sales of cafés <sup>1</sup>	\$43,930	\$51,898	\$44,894	\$47,688
Same café sales <sup>1</sup>	(6.9%)	(4.3%)	(3.7%)	(2.2%)
Number of cafés - end of period	357	356	351	362
Total revenue	\$6,623	\$8,038	\$6,268	\$6,636
Operating (loss) income <sup>1</sup>	\$226	\$1,891	\$1,361	(\$11,401)
Adjusted EBITDA <sup>1</sup>	\$941	\$3,345	\$1,671 <sup>3</sup>	\$2,122
Net (loss) income for the period	\$56	\$1,177	\$918	(\$10,152)
Basic and diluted (loss) earnings per share	\$0.01	\$0.12	\$0.09	(\$1.03)
Dividends declared per share	\$0.085	\$0.085	\$0.085	\$0.085

<sup>1</sup>See the section "Definitions and discussion on certain non-GAAP financial measures" for further analysis.

<sup>2</sup>The Company's fourth quarter System sales of cafés are higher than other quarters due to the seasonality of the business (see "Seasonality of System sales of cafés" above).

<sup>3</sup>The Company amended its definition of Adjusted EBITDA as discussed in the section "Definitions and discussion on certain non-GAAP financial measures" to include provisions for café closures. Comparative amounts were amended in order to provide adequate comparative figures.

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## Management's Discussion and Analysis

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### LIQUIDITY AND CAPITAL RESOURCES

Second Cup collects royalties based on the franchisees' portion of System sales of cafés, franchise fees, and other amounts from its franchisees and also generates revenues from its Company-operated cafés. The performance of Second Cup franchisees and Company-operated cafés could impact the ability of the Company to declare and pay dividends to its shareholders. For a more detailed discussion of the risks and uncertainties affecting the Company's liquidity, see the "Risks and uncertainties" section below.

#### *Summary of cash flows*

	<b>13 weeks ended March 28, 2015</b>	<b>13 weeks ended March 29, 2014</b>
Cash used in operating activities	\$ (766)	\$ 427
Cash used in investing activities	(476)	(671)
Cash used in financing activities	<u>-</u>	<u>(842)</u>
Decrease in cash and cash equivalents during the period	\$ <u>(1,242)</u>	\$ <u>(1,086)</u>

Cash used in operating activities was \$766 for the Quarter compared to cash generated of \$427 for the same Quarter in 2014. The difference is attributable to lower royalty.

During the Quarter, cash used in investing activities was \$476 compared to cash used of \$671 for the same Quarter in 2014. The cash usage was a result of purchases relating to the Loyalty program software and hardware.

We did not have any financing activities for the 13 weeks ended March 28, 2015 (2014 - \$842).

#### *Working capital as at*

	<b>March 28, 2015</b>	<b>December 27, 2014</b>
Current assets	\$ 14,049	\$ 16,430
Current liabilities	<u>10,305</u>	<u>23,684</u>
Working capital (deficiency)	\$ <u>3,744</u>	\$ <u>(7,254)</u>

The Company has working capital of \$3,744 as of March 28, 2015. The working capital surplus is due to an improvement in trade and other receivables and accounts payables and accrued liabilities.

The Company had cash and cash equivalents of \$9,676 at March 28, 2015 (December 27, 2014 - \$10,918). The Company continues to believe it has sufficient financial resources to pay its operating expenses.



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## Management's Discussion and Analysis

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### *Financial instruments*

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

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

### *(i) Credit risk*

#### **Cash and cash equivalents, and interest rate swap**

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

#### **Trade and other receivables, and notes and leases receivable**

Trade and other receivables, and 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.

### *(ii) Liquidity risk*

Liquidity risk is managed through regular monitoring of forecasts and actual cash flows, monitoring maturity dates of financial assets and liabilities, and also the management of capital structure and debt leverage ratios as outlined above. The main source of income is royalty receipts from franchisees.

### *(iii) Interest rate risk*

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.

### *(iv) Currency and commodity risk*

Transactions occur 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.

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 the ability to adjust its sales price as commodity prices change. Risk is mitigated by entering fixed price forward purchase commitments and by adjusting selling prices.

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### Management's Discussion and Analysis

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#### *Contingencies, commitments and guarantees*

Second Cup has lease commitments for Company-operated cafés and also 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.

	<b>Headlease commitments</b>	<b>Sublease to franchisees</b>	<b>Net</b>
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 Company believes it will have 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 for the subsequent 12 months. 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 the second quarter of 2015.

Due to the Company acting as the primary coordinator of café construction costs on behalf its franchisees and for Company-operated cafés, there is \$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.

#### ***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 occurred 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 of product in the ordinary course of business.

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### **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

The Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”) must acknowledge they are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting (“ICFR”) for the Company. The control framework used by the CEO and CFO to design the Company’s ICFR is Internal Control Over Financial Reporting - Guidance for Smaller Public Companies as issued by COSO. In addition, in respect of:

#### ***Disclosure controls and procedures***

The CEO and CFO must certify they have designed the disclosure controls and procedures, or caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company is made known to them in a timely manner and that information required under securities legislation is recorded, processed, summarized and reported in a timely manner.

As at May 6, 2015, the Company’s management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the disclosure controls and procedures. Based on this evaluation, the CEO and CFO have concluded that, as at March 28, 2015, the Company’s disclosure controls and procedures were appropriately designed.

Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls and procedures should not exceed their expected benefits. As such, the Company’s disclosure controls and procedures can only provide reasonable, and not absolute, assurance that the objectives of such controls and procedures are met.

During the 13 weeks ended March 28, 2015 and up to the date of the approval of the Unaudited Condensed Interim Financial Statements and MD&A, there has been no change that has materially affected, or is reasonably likely to materially affect the Company’s disclosure controls and procedures.

#### ***Internal controls over financial reporting***

The CEO and CFO must certify they have designed such internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Unaudited Condensed Interim Financial Statements for external purposes in accordance with IFRS.

As at May 6, 2015, the Company’s management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the controls over financial reporting. No material weaknesses in the design of these controls over financial reporting were identified. Based on this evaluation, the CEO and CFO have concluded that, as at March 28, 2015 the Company’s controls over financial reporting were appropriately designed and were operating effectively.

Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls should not exceed their expected benefits. As such, the Company’s internal controls over financial reporting can only provide reasonable, and not absolute, assurance that the objectives of such controls are met.

During the 13 weeks ended March 28, 2015 and up to the date of the approval of the Unaudited Condensed Interim Financial Statements and MD&A, there has been no change in the Company’s internal control over financial reporting that has materially affected, or is reasonably likely to materially affect the Company’s internal control over financial reporting.

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### **CRITICAL ACCOUNTING ESTIMATES**

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

#### ***Estimates***

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

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

#### ***Use of judgement***

The following discusses the most significant accounting judgements and estimates that the Company has made in the preparation of the Unaudited Condensed Interim Financial Statements:

##### ***(i) Deferred income taxes***

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

##### ***(ii) Estimated useful lives***

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

##### ***(iii) Café lease provisions***

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

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### **RISKS AND UNCERTAINTIES**

This section is qualified by the section "Caution Regarding Forward-Looking Statements" at the beginning of this MD&A.

The performance of Second Cup is primarily dependent on its ability to maintain and increase the sales of existing cafés, add new profitable cafés to the network and redevelop and modernize cafés as their leases come due. System sales of the café network are affected by various external factors that can affect the specialty coffee industry as a whole.

A more detailed discussion of the risks and uncertainties affecting Second Cup is set out in the Company's MD&A for the year ended December 27, 2014 and Second Cup's Annual Information Form, which is available at [www.sedar.com](http://www.sedar.com).

### **OUTLOOK**

This section is qualified by the section "Caution Regarding Forward-Looking Statements" at the beginning of this MD&A.

We believe our renewed dedication to providing the ultimate coffee experience positions us well for creating long-term growth and value creation for our shareholders.

In the second quarter of 2015 we will feature more innovation including; unveiling our new and exciting Cold beverage platform, elements of the new branding in all of our cafes, and the launch of our loyalty program, Second Cup Coffee Co. Rewards.

### **DEFINITIONS AND DISCUSSION ON CERTAIN NON-GAAP FINANCIAL MEASURES**

In this MD&A, the Company reports certain non-IFRS measures such as System sales of cafés, same café sales, operating income (loss), EBITDA, adjusted EBITDA, and adjusted earnings per share.

#### ***System sales of cafés***

System sales of cafés comprise the net revenue reported to Second Cup by franchisees of Second Cup cafés and by Company-operated cafés. This measure is useful in assessing the operating performance of the entire Company network, such as capturing the net change of the overall café network.

Changes in System sales of cafés result from the number of cafés and same café sales (as described below). The primary factors influencing the number of cafés within the network include the availability of quality locations and the availability of qualified franchisees.

#### ***Same café sales***

Same café sales represents the percentage change, on average, in sales at cafés operating system-wide that have been open for more than 12 months, including cafés closed temporarily for renovations / remodelling. The inclusion of cafés temporarily closed is a change in methodology. Since the impact of this revision is inconsequential, the Company will not restate same café sales results for previously reported years. It is one of the key metrics the Company uses to assess its performance as an indicator of appeal to customers. Same café sales provide a useful comparison between periods while also encompassing other matters such as seasonality. The two principal factors that affect same café sales are changes in customer traffic and changes in average transaction size.

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#### ***Operating income (loss)***

Operating income (loss) represents Revenue, less Cost of goods sold, less Operating expenses, and less Impairment charges. This measure is not defined under IFRS, although the measure is derived from input figures in accordance with IFRS. Management views this as an indicator of financial performance that excludes costs pertaining to Interest and financing, and Income taxes.

#### ***EBITDA and Adjusted EBITDA***

EBITDA represents earnings before interest, taxes, depreciation, and amortization. As there is no generally accepted method of calculating EBITDA, this measure is not necessarily comparable to similarly titled measures reported by other issuers. EBITDA is presented as management believes it is a useful indicator of the Company's ability to meet debt service and capital expenditure requirements, and evaluate liquidity. Management interprets trends in EBITDA as an indicator of relative financial performance. EBITDA should not be considered by an investor as an alternative to net income or cash flows as determined in accordance with IFRS.

Impairment charges, if incurred, are a reconciling item in the calculation of adjusted EBITDA as its nature is non-cash and management interprets this measure to be similar in substance to depreciation and amortization. This interpretation by management is consistently applied regardless of whether impairment charges are or are expected to be recurring.

Restructuring charges, if incurred, are a reconciling item in the calculation of adjusted EBITDA as management believes such costs are non-recurring and not an indicative performance measure directly linked to the Company's business operations.

Provision for café closures, if incurred, are a reconciling item in the calculation of adjusted EBITDA as management believes that while such costs may be recurring, they could be larger than normal during this period of transformation of the business and are not an indicative performance measure directly linked to the Company's business operations from ongoing cafés.

## The Second Cup Ltd.

### Management's Discussion and Analysis

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A reconciliation of Net income to EBITDA and Adjusted EBITDA is provided below:

	<b>13 weeks ended March 28, 2015</b>	<b>13 weeks ended March 29, 2014</b>
Net (loss) income	\$ (76)	\$ 56
Net interest and financing	176	156
Income tax (recovery) expense	(32)	14
Depreciation of property and equipment	273	195
Amortization of intangible assets	78	71
Gain on disposal of property and equipment	-	(110)
EBITDA	<u>419</u>	<u>382</u>
Restructuring charges	-	559
Provision for café closures	<u>(55)</u>	<u>139</u>
Adjusted EBITDA	<u>\$ 364</u>	<u>\$ 1,080</u>

#### *Adjusted basic and diluted earnings per share*

Adjusted earnings per share represent earnings per share excluding any impairment charges, provisions for café closures and restructuring charges. Impairment charges are non-cash, but material items that are adjusted as management concluded that this is not a direct measure of the Company's focus on day to day operations, is not indicative of future operating results, and thus better evaluates the underlying business of the Company. Restructuring charges and the provision for café closures are a reconciling item as management believes these costs are non-recurring and not an indicative performance measure directly linked to the focus of the Company's business operations on a per share basis.

A reconciliation of Net income to Adjusted basic and diluted earnings per share is provided below:

	<b>13 weeks ended March 28, 2015</b>	<b>13 weeks ended March 29, 2014</b>
Net (loss) income	\$ (76)	\$ 56
Restructuring charges	-	559
Provision for café closures	(55)	139
Tax effect	<u>15</u>	<u>(185)</u>
Adjusted earnings	(116)	569
Weighted average number of shares issued and outstanding (unrounded)	<u>12,830,945</u>	<u>9,903,045</u>
Adjusted basic and diluted earnings per share	<u>\$ (0.01)</u>	<u>\$ 0.06</u>