



**SECOND CUP ROYALTY INCOME FUND**

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**Annual Information Form**

For the year ended December 31, 2005

**March 30, 2006**

## TABLE OF CONTENTS

<b>GLOSSARY OF TERMS</b> .....	<b>1</b>
<b>FORWARD-LOOKING STATEMENTS</b> .....	<b>5</b>
<b>GENERAL</b> .....	<b>6</b>
<b>FUND STRUCTURE</b> .....	<b>6</b>
Name, Address and Jurisdiction of Formation.....	6
Intercorporate Relationships .....	7
<b>GENERAL DEVELOPMENT OF THE BUSINESS</b> .....	<b>8</b>
Establishment of the Fund .....	8
Business of the Fund .....	8
Business of AcquisitionCo.....	9
Business of MarksCo .....	9
MarksCo Term Loan and Operating Loan.....	9
<b>LICENCE AND ROYALTY AGREEMENT</b> .....	<b>10</b>
The Licence.....	10
The Royalty.....	10
Security for the Royalty .....	11
Operating Covenants of Second Cup in the Licence and Royalty Agreement.....	14
Adjustments to the Royalty Pool and Payments Made Under the Licence and Royalty Agreement .....	15
New Trade-Marks .....	17
<b>MANAGEMENT AND CORPORATE GOVERNANCE OF MARKSCO</b> .....	<b>18</b>
Directors .....	18
Insider Reporting .....	20
Restrictive Covenants .....	21
Right of First Offer .....	21
The Second Cup Marks.....	23
<b>BUSINESS OF SECOND CUP</b> .....	<b>23</b>
General.....	23
What is Specialty Coffee?.....	24
History .....	24
Competitive Conditions .....	25
The Second Cup Café System.....	25
Products .....	29
Sales .....	31
Advertising and Marketing .....	33
Purchasing and Distribution.....	33
Franchise Operations .....	35
Employees.....	39
Management.....	40
Government Regulation .....	42
Relationship with Cara.....	42
<b>RISK FACTORS</b> .....	<b>43</b>
Risks Related to the Business of Second Cup.....	43
Risk Related to the Structure of the Fund .....	46

<b>DESCRIPTION OF THE FUND</b> .....	<b>50</b>
Declaration of Trust .....	50
Activities of the Fund.....	50
Description of Units.....	51
Issuance of Units.....	51
Pre-Emptive Right .....	52
Trustees.....	52
Cash Distributions.....	55
Redemption Right.....	57
Meetings of Unitholders .....	59
Limitation on Non-Resident Ownership .....	60
Amendments to the Declaration of Trust .....	61
Term of the Fund .....	61
Take-over Bids.....	62
Exercise of Certain Voting Rights Attached to Certain Securities.....	62
Information and Reports .....	62
Book-Entry Only System.....	63
Fund Administration .....	64
<b>GOVERNANCE AND SHARE AND LOAN CAPITAL OF ACQUISITIONCO</b> .....	<b>65</b>
Directors .....	65
Share Capital of AcquisitionCo .....	65
Distribution Policy .....	65
AcquisitionCo Notes.....	66
<b>SHARE AND LOAN CAPITAL OF MARKSCO</b> .....	<b>68</b>
Share Capital of MarksCo.....	68
Distribution Policy .....	68
MarksCo Notes .....	69
<b>MARKET FOR SECURITIES</b> .....	<b>71</b>
Trading Price and Volume .....	71
<b>PROMOTER</b> .....	<b>71</b>
<b>LEGAL PROCEEDINGS</b> .....	<b>71</b>
<b>INTERESTS OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS</b> .....	<b>71</b>
<b>TRANSFER AGENT AND REGISTRAR</b> .....	<b>72</b>
<b>MATERIAL CONTRACTS</b> .....	<b>72</b>
<b>EXPERTS</b> .....	<b>73</b>
<b>ADDITIONAL INFORMATION</b> .....	<b>73</b>

## GLOSSARY OF TERMS

*In addition to the other terms defined in this Annual Information Form, the following terms are used frequently and are defined below. Unless the context otherwise requires, any reference in this Annual Information Form to any agreement, instrument, indenture, declaration or other document will be deemed to be a reference to that agreement, instrument, indenture or other document, as amended, supplemented and restated from time to time.*

**“Acquisition Agreement”** means the acquisition agreement entered into on the Closing Date by Cara, Second Cup and AcquisitionCo pursuant to which AcquisitionCo acquired all the issued and outstanding MarksCo Common Shares.

**“AcquisitionCo”** means 1636433 Ontario Inc., a wholly-owned subsidiary of the Fund that acquired all the issued and outstanding MarksCo Common Shares from Cara.

**“AcquisitionCo Common Shares”** means the common shares in the capital of AcquisitionCo.

**“AcquisitionCo Note Indenture”** has the meaning ascribed to it under “Governance and Share and Loan Capital of AcquisitionCo — AcquisitionCo Notes”.

**“AcquisitionCo Notes”** means the unsecured subordinated debt obligations of AcquisitionCo issuable in series from time to time under the AcquisitionCo Note Indenture.

**“Additional Cafés”** means Second Cup cafés in Canada which, on November 1 of the previous calendar year, had been open for at least 60 days and which were not previously included in the Royalty Pool.

**“Adjustment Date”** means January 1 of each year from 2006 onwards.

**“Administration Agreement”** means the administration agreement entered into on the Closing Date among MarksCo, AcquisitionCo and the Fund pursuant to which MarksCo agreed to provide or arrange for the provision of services required for the administration of the Fund and AcquisitionCo.

**“affiliate”** means, in respect of a person or company, another person or company that would be considered to be an “affiliated entity” in respect of such person or company for the purposes of Ontario Securities Commission Rule 45-501, as amended or replaced from time to time.

**“associate”** has the meaning ascribed to it in the Securities Act.

**“Bank”** means the Canadian chartered bank affiliate of Scotia Capital Inc.

**“Book-Entry Only System”** means the book-based system administered by CDS for registration of interest in and transfer of the Units.

**“Cara”** means Cara Operations Limited, a private corporation formed under the laws of the Province of Ontario.

**“CDS”** means The Canadian Depository for Securities Limited.

**“CDS Participant”** means a participant in the CDS depository service.

**“Closed Café”** means, in any year, a Second Cup café that was included in the Royalty Pool at the beginning of the year but was Permanently Closed during that year.

**“Closing”** means the completion of the initial public offering of the Fund and the transactions to complete the offering as described in the prospectus.

**“Closing Date”** means December 2, 2004, the date of completion of the initial public offering of the Fund.

**“Current Market Price of the Units”** means, as at any date or for any period, the weighted average price at which the Units have traded on a Stock Exchange during the period of 20 consecutive trading days ending on the fifth trading day before such date or the end of such period, as the case may be.

**“Declaration of Trust”** means the amended and restated declaration of trust dated December 1, 2004 establishing and governing Second Cup Royalty Income Fund.

**“Deferred Income Plans”** means registered retirement savings plans, registered retirement income funds and deferred profit sharing plans.

**“EBITDA”** means earnings before interest, taxes, depreciation and amortization.

**“Fund”** means Second Cup Royalty Income Fund.

**“GAAP”** means Canadian generally accepted accounting principles.

**“General Security Agreement”** means the general security agreement between Second Cup and MarksCo pursuant to which Second Cup granted MarksCo a security interest over all the present and after-acquired property and assets of Second Cup as security for the payment of the Royalty and the performance of all other obligations of Second Cup under the Licence and Royalty Agreement.

**“Governance Agreement”** means the governance agreement entered into on the Closing Date among Second Cup, Cara, MarksCo, AcquisitionCo and the Fund providing for, among other matters, the governance of MarksCo.

**“Gross Revenue”** has the meaning ascribed to it in “Business of Second Cup — Franchise Operations — Second Cup Franchise Agreements” as it relates to both company-owned cafés and franchised cafés.

**“Initial Cafés”** means the 351 Second Cup cafés in Canada included in the Royalty Pool as of the Closing Date.

**“Licence”** means the licence to use the Second Cup Marks (including for the purpose of trade names and domain names) in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years.

**“Licence and Royalty Agreement”** means the licence and royalty agreement dated November 26, 2004 between MarksCo and Second Cup pursuant to which Second Cup was granted the Licence and agreed to pay the Royalty to MarksCo.

**“MarksCo”** means Second Cup Trade-Marks Inc., a wholly-owned subsidiary of AcquisitionCo that holds the Second Cup Marks and is a party to the Licence and Royalty Agreement.

**“MarksCo Common Shares”** means the common shares in the capital of MarksCo.

**“MarksCo Note Indenture”** has the meaning ascribed to it under “Share and Loan Capital of MarksCo — MarksCo Notes”.

**“MarksCo Notes”** means the unsecured subordinated debt obligations of MarksCo issuable in series from time to time under the MarksCo Note Indenture.

**“MarksCo Term Loan”** means the term loan in the principal amount of \$11.0 million made on the Closing Date by the Bank to a predecessor corporation of MarksCo, any renewal thereof and any replacement thereof by a financial institution carrying on business in Canada as more fully described under “General Development of the Business — MarksCo Term Loan and Operating Loan”.

**“Noteholders’ Extraordinary Resolution”** means a resolution passed by the holders of not less than 66 <sup>2</sup>/<sub>3</sub>% of the principal amount of notes represented either in person or by proxy, at a meeting of holders of notes called for the purpose of approving such resolution, or approval in writing by the holders of not less than 66 <sup>2</sup>/<sub>3</sub>% of the principal amount of notes then outstanding.

**“Operating Loan”** means the revolving loan facility in the amount of up to \$1.0 million established by the Bank in favour of MarksCo on the Closing Date.

**“Payment Period”** means each month in a calendar year, except in respect of the first payment of the Royalty by Second Cup, in which case the Payment Period was the period from the Closing Date to December 31, 2004.

**“Permanently Closed”** means a Second Cup Café (i) if operated under a franchise agreement or other permitted licence agreement, for which the franchise agreement or other permitted licence agreement has expired, has been terminated by Second Cup, or that has permanently closed or (ii) if owned and operated by Second Cup or a subsidiary of Second Cup, has permanently closed. A Second Cup Café shall not be considered permanently closed if it is closed due to a strike, lock-out, renovations, fire, natural calamity or is closed seasonally in the ordinary course (a **“Temporarily Closed Café”**), provided that in the case of fire or natural calamity, appropriate plans are made within 30 days of the fire or calamity, by the operator to repair the damage and re-open the Second Cup Café as soon as reasonably possible. A Second Cup Café other than a Temporarily Closed Café shall be deemed to be Permanently Closed if it is closed for a continuous period of 90 days for any reason, or for 90 days in any 365 day period. A Temporarily Closed Café shall be deemed to be permanently closed if it remains closed for a continuous period of 180 days for any reason, or for 180 days in any 365 day period.

**“Redemption Price”** has the meaning ascribed thereto under “Description of the Fund — Redemption Right”.

**“Royalty”** means the royalty for each Payment Period to be paid pursuant to the Licence and Royalty Agreement by Second Cup to MarksCo for the Licence in an amount equal to 6.5% of System Sales for all Second Cup cafés in the Royalty Pool during such Payment Period.

**“Royalty Pool”** means, initially, the Initial Cafés, and subsequently consists of the most recently adjusted number of Second Cup cafés to be used for determining System Sales for a particular Payment Period.

**“Second Cup”** means The Second Cup Ltd., the operating company that carries on the business of franchising Second Cup cafés and operating company-owned cafés in Canada.

**“Second Cup cafés”** refers to the retail outlets dedicated to the sale of specialty coffee and related products operated by Second Cup, or Second Cup franchisees and identified by the Second Cup Marks.

“**Second Cup Marks**” means the trade-marks owned by MarksCo and registered under the *Trade-marks Act* (Canada), and such trade-marks, trade names, operating procedures, methods, systems and other intellectual property and proprietary rights that are used in connection with the operation of Second Cup cafés in Canada and all associated rights.

“**Securities Act**” means the *Securities Act* (Ontario), as amended.

“**Series 1 AcquisitionCo Notes**” means the unsecured subordinated debt obligations of AcquisitionCo designated as Series 1 AcquisitionCo Notes that will be issued from time to time in accordance with the AcquisitionCo Note Indenture.

“**Series 2 AcquisitionCo Notes**” means the unsecured subordinated debt obligations of AcquisitionCo designated as Series 2 AcquisitionCo Notes to be issuable in accordance with the AcquisitionCo Note Indenture exclusively to unitholders as full or partial payment of the Redemption Price for Units in connection with an *in specie* payment of the Redemption Price for Units redeemed by a unitholder.

“**Stock Exchange**” means a stock exchange recognized by the Ontario Securities Commission for such purposes, and where the Units have traded on more than one Stock Exchange during the relevant period, “**Stock Exchange**” means the Stock Exchange where the greatest volume of Units traded during the relevant period.

“**Subscription Agreement**” means the subscription agreement among the Fund, AcquisitionCo, MarksCo and Second Cup pursuant to which, among other things, the Fund will ensure that MarksCo is able to deliver Units to Second Cup if required to do so under the Licence and Royalty Agreement.

“**System Sales**” is the basis on which the Royalty is payable; it means the Gross Revenue of all Second Cup cafés in the Royalty Pool, including (i) the Gross Revenue of the company-owned Second Cup cafés in Canada owned by Second Cup; and (ii) the Gross Revenue reported by Second Cup cafés in the Royalty Pool which are subject to franchise agreements with Second Cup, without audit or other form of independent assurance.

“**Tax Act**” means the *Income Tax Act* (Canada).

“**trustees**” means, at the relevant time, the trustees of the Fund.

“**Underwriting Agreement**” means the underwriting agreement dated November 22, 2004 among Cara, Second Cup, the Fund and a syndicate of underwriters (the “**Underwriters**”) pursuant to which the Fund agreed to sell and the Underwriters severally agreed to purchase a total of 8,145,346 Units.

“**Unit**” means a trust unit of the Fund, each such unit representing an equal undivided beneficial interest in any of the Fund’s distributions, whether of net income, net realized capital gains or other amounts, and in any distributions by the Fund in the event of the Fund’s termination.

“**Unit Yield**” as of an Adjustment Date means the amount of the cash distributions paid by the Fund to unitholders for each Unit held during the year ended immediately prior to such date divided by the Current Market Price of a Unit on such date.

“**unitholders**” means, at the relevant time, the holders of the Units.

**“Unitholders’ Special Resolution”** means a resolution passed by a majority of not less than 66<sup>2</sup>/<sub>3</sub>% of the votes cast, either in person or by proxy, at a meeting of unitholders, called for the purpose of approving such resolution, or approved in writing by the holders of not less than 66<sup>2</sup>/<sub>3</sub>% of the Units entitled to be voted on such resolution.

## **FORWARD-LOOKING STATEMENTS**

Certain statements in this Annual Information Form may constitute forward-looking information within the meaning of applicable securities legislation. Forward-looking information can be identified by words such as “may”, “will”, “should”, “expect”, “anticipate”, “believe”, “plan”, “intend” and other similar words. Forward-looking information reflects current expectations regarding future events and operating performance and speaks only as of the date of this Annual Information Form. It 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 information is based upon a number of assumptions and is subject to known and unknown risks, uncertainties and other factors, many of which are beyond the Fund’s control, that may cause the Fund’s actual results, performance or achievements, or those of MarksCo, Second Cup, Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking information. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying forward-looking information: competition; availability of premium quality coffee beans; the ability to attract qualified franchisees; the location of Second Cup cafés; the ability to exploit and protect the Second Cup Marks; changing consumer preferences and discretionary spending patterns including, but not restricted to, the impact of weather on such patterns; reporting of Gross Revenue by franchisees; and the results of operations and financial condition of Second Cup. The foregoing list of factors is not exhaustive, and investors should refer to the risks described under “Risk Factors”.

Although the forward-looking information contained in this Annual Information Form is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with this forward-looking information. Certain assumptions made in preparing forward-looking information include the assumption that the Canadian economy will remain stable or expand at a moderate price in 2006 and that inflation will remain relatively low. The Fund has also assumed interest rates will gradually increase in 2006 and that demand for specialty coffee will be comparable with demand in 2006.

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



## GENERAL

All information contained in this Annual Information Form is presented as of December 31, 2005 unless otherwise indicated. All dollar amounts are stated in Canadian currency unless otherwise stated. Reference is made to the glossary for the meaning of certain defined terms.

## FUND STRUCTURE

### *Name, Address and Jurisdiction of Formation*

#### **Second Cup Royalty Income Fund**

Second Cup Royalty Income Fund (“the Fund”) is an open-ended trust established under the laws of the Province of Ontario and governed by the Declaration of Trust. The Fund’s principal and head office is located at 6303 Airport Road, Mississauga, Ontario L4V 1R8.

#### **1636433 Ontario Inc.**

1636433 Ontario Inc. (“AcquisitionCo”) is a wholly-owned subsidiary of the Fund, incorporated under the laws of the Province of Ontario. The company’s principal and head office is located at 6303 Airport Road, Mississauga, Ontario L4V 1R8.

#### **Second Cup Trade-Marks Inc.**

Second Cup Trade-Marks Inc. (“MarksCo”), is a wholly-owned subsidiary of AcquisitionCo, amalgamated under the laws of the Province of Ontario. The company’s principal and head office is located at 6303 Airport Road, Mississauga, Ontario L4V 1R8.

#### **The Second Cup Ltd.**

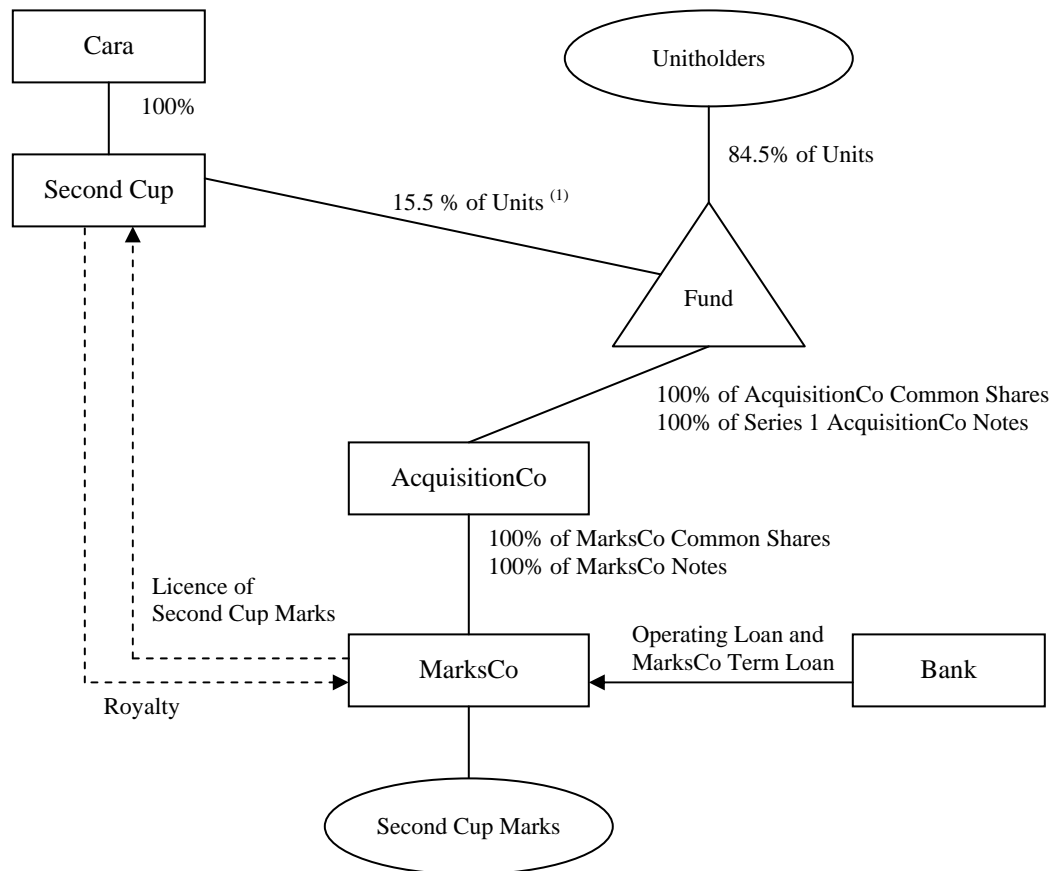
The Second Cup Ltd. (“Second Cup”) is a wholly-owned subsidiary of Cara Operations Limited, incorporated under the laws of the Province of Ontario. The company’s principal and head office is located at 6303 Airport Road, Mississauga, Ontario L4V 1R8.

#### **Cara Operations Limited**

Cara Operations Limited (“Cara”) was amalgamated under the laws of the Province of Ontario. The company’s principal and head office is located at 6303 Airport Road, Mississauga, Ontario L4V 1R8.

***Intercorporate Relationships***

The following diagram illustrates the Fund's organizational structure.



(1) Reflects the issuance of 55,316 Units of the Fund to Second Cup on January 1, 2006 in connection with the annual adjustment to the Royalty Pool (see "Licence and Royalty Agreement — January 1, 2006 Adjustment to the Royalty Pool").

## **GENERAL DEVELOPMENT OF THE BUSINESS**

### ***Establishment of the Fund***

The Fund was established on October 22, 2004 and completed an initial public offering of 8,145,346 Units on December 2, 2004 at \$10.00 per Unit for aggregate proceeds of \$81,453,460 before cash issuance costs of \$8,887,208. The Units commenced trading on the Toronto Stock Exchange (the “TSX”) on December 2, 2004. In addition, the Fund issued 1,437,414 Units to Second Cup on the Closing Date at \$10.00 per Unit for aggregate proceeds of \$14,374,414. The Fund did not carry on any business prior to that date.

The Fund used the proceeds of its initial public offering (net of fees payable to the Underwriters of the offering and offering expenses) plus the proceeds of Second Cup’s subscription for Units, to subscribe for \$78,246,353 aggregate principal amount of Series 1 AcquisitionCo Notes and 8,694,039 AcquisitionCo Common Shares. AcquisitionCo, in turn, acquired from Cara all of the issued and outstanding MarksCo Common Shares for a purchase price of \$86,940,392 pursuant to the Acquisition Agreement. The purchase price was satisfied by AcquisitionCo using the cash from the Fund’s subscription for Series 1 AcquisitionCo Notes and AcquisitionCo Common Shares. AcquisitionCo transferred the MarksCo Common Shares to a wholly-owned subsidiary of AcquisitionCo in exchange for 8,694,039 common shares and notes in the aggregate principal amount of \$78,246,353 of the subsidiary (which became the MarksCo Notes). The subsidiary of AcquisitionCo amalgamated with MarksCo to form a corporation continuing under the name “Second Cup Trade-Marks Inc.”. As a result of these and other transactions, MarksCo became a wholly-owned subsidiary of AcquisitionCo, a party to the Licence and Royalty Agreement and the borrower under a term loan in the amount of \$11.0 million obtained from the Bank (the “MarksCo Term Loan”). The Fund indirectly acquired the Second Cup Marks through the indirect acquisition of MarksCo.

Pursuant to the Licence and Royalty Agreement, Second Cup pays MarksCo a royalty equal to 6.5% of System Sales of the Second Cup cafes included in the Royalty Pool from time to time, in consideration for Second Cup having a 99-year licence to use the Second Cup Marks in Canada. The Royalty Pool initially consisted of 351 Second Cup cafes.

The first annual adjustment to the Royalty Pool was made on January 1, 2006. In connection with the addition of Second Cup cafés to the Royalty Pool, the Fund issued an additional 55,316 Units to MarksCo, which in turn delivered those Units to Second Cup. See “Licence and Royalty Agreement — January 1, 2006 Adjustment to Royalty Pool”. As a result of this issuance, the total number of Units outstanding of the Fund is 9,638,076 as of the date of this Annual Information Form.

### ***Business of the Fund***

The Fund has been created primarily to invest in the securities of AcquisitionCo, including AcquisitionCo Common Shares and AcquisitionCo Notes. The Fund makes cash distributions to unitholders of amounts received as interest paid upon the AcquisitionCo Notes and dividends on the AcquisitionCo Common Shares less estimated amounts required for the payment of expenses, any cash redemptions of Units and other amounts. See “Description of the Fund — Cash Distributions”. The Fund carries on no active business of its own and has no employees.

### ***Business of AcquisitionCo***

AcquisitionCo has been created primarily to invest in the securities of MarksCo, including MarksCo Common Shares and MarksCo Notes. AcquisitionCo carries on no active business of its own and has no employees.

### ***Business of MarksCo***

The business of MarksCo is the ownership of the Second Cup Marks, the taking of actions consistent with the Licence and Royalty Agreement to exploit, to the fullest extent possible, the use of the Second Cup Marks by Second Cup and others, the collection of the Royalty payable to MarksCo under the Licence and Royalty Agreement and the administration of the Fund and AcquisitionCo pursuant to the Administration Agreement. See “Licence and Royalty Agreement”, “Management and Corporate Governance of MarksCo” and “Share and Loan Capital of MarksCo”. MarksCo does not operate the Second Cup business. For the financial year ended December 31, 2005, 100% of the revenue of MarksCo was derived from the Royalty. MarksCo has one employee, the responsibilities of whom include financial reporting, continuous disclosure and related matters for the Fund.

Under the Licence and Royalty Agreement, MarksCo has the contractual right to control the character and quality of the wares produced or services delivered by Second Cup and its franchisees or sublicensees, and to require that the Second Cup Marks be used by Second Cup and its franchisees or sublicensees in a manner that enhances the reputation of the Second Cup Marks. Under the Licence and Royalty Agreement, MarksCo is entitled to:

- inspect the use of the Second Cup Marks by Second Cup and its franchisees or sublicensees to ensure that Second Cup and its franchisees or sublicensees are protecting and enhancing the reputation associated with the Second Cup Marks;
- obtain, on a quarterly basis, a certificate from an officer of Second Cup to the effect that Second Cup is using the Second Cup Marks in accordance with the Licence and Royalty Agreement;
- require Second Cup to submit a report, on a quarterly basis, detailing the use of the Second Cup Marks by Second Cup and its franchisees or sublicensees in the quarter, including details of all licences of the Second Cup Marks granted by Second Cup to franchisees or sublicensees during the quarter; and
- establish the standards governing the character and quality of the wares produced or services delivered, and the manner of use of the Second Cup Marks, by Second Cup and its franchisees and sublicensees.

Second Cup is required to submit to MarksCo for prior written approval any proposed use of the Second Cup Marks not expressly permitted at the time the Licence and Royalty Agreement was entered into.

### ***MarksCo Term Loan and Operating Loan***

On the Closing Date, a predecessor of MarksCo obtained from the Bank the MarksCo Term Loan. As a result of the amalgamation forming MarksCo, MarksCo assumed the MarksCo Term Loan. The net proceeds of the MarksCo Term Loan were distributed to Cara as a return of capital. In addition, MarksCo entered into the Operating Loan with the Bank in the amount of up to \$1.0 million. MarksCo pays fees for the MarksCo Term Loan and the Operating Loan

to the Bank in amounts usual for loans of this nature. The MarksCo Term Loan and the Operating Loan bear interest at floating rates, including rates based on the Canadian dollar prime rate and Canadian dollar bankers' acceptances, plus an applicable margin. MarksCo entered into a swap agreement after the Closing Date to fix the rate on the MarksCo Term Loan. The MarksCo Term Loan is due on December 2, 2007. The Operating Loan is repayable on demand and provides MarksCo with working capital from time to time, if required. As at December 31, 2005, there was no balance owing by MarksCo on the Operating Loan.

The indebtedness and liability of MarksCo under the MarksCo Term Loan and the Operating Loan are secured by a first ranking security interest in all property of MarksCo, including the Second Cup Marks and the rights and interest of MarksCo in the General Security Agreement and Licence and Royalty Agreement. The indebtedness secured by the Bank's security interest (including the MarksCo Term Loan, the Operating Loan and any interest rate hedging facility) ranks senior to all other indebtedness of MarksCo (including the MarksCo Notes).

Pursuant to the terms of the Operating Loan and MarksCo Term Loan, MarksCo is subject to certain financial and other customary covenants, including requirements to maintain a ratio of senior debt to EBITDA of less than 1.25:1.0 and to maintain trailing four quarter EBITDA in excess of \$9 million. In addition, the Bank may accelerate repayment of the MarksCo Term Loan and Operating Loan in the case of certain events, including a change in control of MarksCo or a default by MarksCo under material agreements or other indebtedness. During the year ended December 31, 2005, MarksCo was in compliance with all financial and other covenants of the Operating Loan and MarksCo Term Loan. See "Risk Factors – MarksCo has outstanding indebtedness".

The Fund and AcquisitionCo guarantee the liability of MarksCo under the MarksCo Term Loan and Operating Loan, which guarantees are secured by all of their respective assets, including a pledge of the AcquisitionCo Common Shares and the AcquisitionCo Notes and a pledge of the MarksCo Common Shares and the MarksCo Notes. As well, payments under the AcquisitionCo Notes and under the MarksCo Notes are subordinated to payments to the Bank.

## **LICENCE AND ROYALTY AGREEMENT**

### ***The Licence***

The Licence and Royalty Agreement provides Second Cup with a licence to use and a further right to sublicense the right to use the Second Cup Marks (including for the purpose of trade names and domain names) in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years from the date of the agreement (November 26, 2004). See "Management and Corporate Governance of MarksCo — The Second Cup Marks". MarksCo will retain and defend ownership of the Second Cup Marks. Subject to certain exceptions, MarksCo has a right of first refusal over any intended use of the Second Cup Marks by Second Cup in association with any ware or service, or any intended licence to a third party for use of the Second Cup Marks in Canada in connection with any ware or service. Second Cup has agreed not to use, or license the Second Cup Marks for use, outside of Canada or for certain purposes designated under the Licence and Royalty Agreement, which generally includes uses that are inconsistent with the use of the Second Cup Marks under the Licence and Royalty Agreement or that may diminish the value of the Licence to MarksCo.

### ***The Royalty***

In consideration of the Licence, Second Cup is required to pay MarksCo the Royalty for each Payment Period in an amount equal to 6.5% of System Sales for all Second Cup cafés in the Royalty Pool during such Payment Period. The Royalty Pool initially consisted of the Initial Cafés, and subsequently consists of the most recently adjusted

number of Second Cup cafés to be used for determining System Sales for a particular Payment Period. See “— Adjustments to the Royalty Pool and Payments Made Under the Licence and Royalty Agreement” below. As of December 31, 2005, there were 359 Second Cup cafés operating in Canada, 343 of which were included in the Royalty Pool. On January 1, 2006, subsequent to the Royalty Pool adjustment, there were 352 cafés in the Royalty Pool. See “— January 1, 2006 Adjustment to the Royalty Pool”.

The amount of the Royalty will be determined at the end of each Payment Period and will be payable within 21 days following the end of the Payment Period, except in respect of the first Royalty payment and, if applicable, the final Royalty payment in connection with the termination of the Fund. The amount of the Royalty and the terms of the Licence and Royalty Agreement were determined by negotiation between Cara, Second Cup, the Fund on behalf of MarksCo and the Underwriters.

Each time Second Cup pays the Royalty to MarksCo, Second Cup provides MarksCo with a statement of the Royalty for the relevant Payment Period, certified as correct by the senior financial officer of Second Cup. In addition, MarksCo will be entitled at any time to inspect the books and records of Second Cup (at MarksCo’s expense) in order to review Second Cup’s determination of the amount of the Royalty.

Second Cup will provide MarksCo and the Fund with Second Cup’s unaudited quarterly financial statements within 40 days of the end of each quarterly accounting period of Second Cup (other than the fourth quarterly accounting period) and audited annual consolidated financial statements within 85 days of the end of each fiscal year of Second Cup. These financial statements are required to be prepared in accordance with GAAP and will also include a statement of System Sales for the relevant period.

Second Cup will be required to deliver to MarksCo and the Fund, as soon as practicable and in any event within 30 days after the end of each accounting period, selected unaudited consolidated financial information of Second Cup (including sales, EBITDA, net income and a forecast for such items for the balance of the year) in summary form in respect of such accounting period.

All payments of the Royalty (and all financial covenants in the Licence and Royalty Agreement) are based on GAAP as applied by Second Cup and in effect on the Closing. In the event of any changes to GAAP, each of the applicable parties has agreed to make the appropriate adjustments to any contractual arrangements to account for changes to GAAP.

### ***Security for the Royalty***

Payment of the Royalty and all other obligations of Second Cup under the Licence and Royalty Agreement are secured by a first ranking security interest in all property of Second Cup (subject to customary permitted liens and certain other exceptions as described below), including all amounts payable to Second Cup by the Second Cup franchisees operating Second Cup cafés in Canada. The security interest was granted pursuant to the General Security Agreement. Although it is not currently contemplated that Second Cup will have any subsidiaries, in the event that Second Cup transfers any portion of its business or property to a subsidiary, a guarantee and general security agreement will also be provided by that subsidiary to further secure the obligations of Second Cup under the Licence and Royalty Agreement.

Under the General Security Agreement, MarksCo is entitled, in the case of an uncured event of default by Second Cup, to appoint a receiver of Second Cup with the power to carry on the business of Second Cup and, in the event of a material default by Second Cup, to require Second Cup to prepay the amount of the Royalty for 52 weeks.

All amounts realized by the receiver, after costs, will be applied to the costs of operating the business of Second Cup and to the payment to MarksCo of amounts due under the Licence and Royalty Agreement.

No agreements or consents in respect of the security interest granted by Second Cup to MarksCo have been nor will be obtained. As a result, due to the nature of the security interest provided by Second Cup and the fact that no agreements or consents were sought, the security interest granted by Second Cup may not attach to leases relating to certain Second Cup cafés. In addition, where a security interest is created, the rights granted by Second Cup to MarksCo will be subject to the rights of the landlords under the leases. The appointment of a receiver may trigger cross-default provisions in other agreements, including many of the leases relating to Second Cup cafés. Landlords may also have rights in respect of the non-payment of rent that may rank in priority to the rights of MarksCo.

#### *Negative Covenants in General Security Agreement*

Second Cup has covenant in the General Security Agreement, among other things, that it will not (and will not permit any of its subsidiaries to), without the prior written consent of MarksCo:

1. assume, incur or permit to exist or otherwise become liable upon any indebtedness or obligation for or in respect of borrowed money (including letters of credit, bankers' acceptances, guarantees, capital leases and the unpaid purchase price of property purchased by Second Cup), except indebtedness ("Permitted Indebtedness"):
  - (i) in an aggregate principal amount outstanding at any time of not more than the dollar amount which is equal to 2.5 multiplied by Second Cup's EBITDA (for this purpose, capital leases, but not operating leases, shall be treated as debt and, for greater certainty, guarantees shall be treated as debt as provided in paragraph 3 below) for the most recently completed four quarterly accounting periods of Second Cup and/or its predecessor (excluding the impact of any sale of the Units during such period); and
  - (ii) in respect of a security interest referred to in paragraph 2 below;
2. assume, create, grant or permit to exist, without the prior written consent of MarksCo, any security interest on any of the property of Second Cup (other than on certain excluded assets of Second Cup) or any of its subsidiaries that ranks equal or prior to the security interest granted to MarksCo, other than:
  - (i) purchase money security interests limited to the property purchased;
  - (ii) security interests existing as at the completion of the initial public offering and security interests created in connection with the construction, renovation, equipping, fixturing, furnishing and opening of a Second Cup café;
  - (iii) leases in respect of furniture, fixtures, equipment and similar items up to \$350,000 per lease, to be adjusted upward in accordance with the Consumer Price Index;
  - (iv) security interests on any assets of Second Cup to secure indebtedness or obligations permitted under paragraph 1 above; and
  - (v) a security interest on the Units held by Second Cup so long as
    - (A) recourse in respect of such indebtedness is limited to the Units securing such indebtedness and proceeds thereof, and

(B) the provisions of the Governance Agreement are complied with;

3. guarantee or otherwise become liable in respect of the obligations of another person, other than a Second Cup franchisee with respect to the franchisee's obligations (including rent) to its landlord; provided that the aggregate amount of such guarantee shall form part of and be included (without double counting) in the calculation of Permitted Indebtedness described under paragraph 1 above;
4. pay any dividends or redeem or repurchase any of its shares or otherwise make, directly or indirectly, any distribution (whether by dividend, distribution of property, repurchase of shares, bonus or other payment of any kind whatsoever, other than regular compensation) to any of its direct or indirect shareholders unless at the time of such payment, redemption, repurchase or other distribution, all amounts of the Royalty that are due and payable at the time of such payment, redemption, repurchase or other distribution have been paid, except distributions paid by a wholly-owned direct or indirect subsidiary of Second Cup to its parent corporation;
5. make any investment in a business or the property of another person carrying on business, other than:  
(a) repurchases of economic interests in a direct or indirect wholly-owned subsidiary of Second Cup that has granted a security interest in all of its present and after-acquired property to MarksCo as contemplated herein and that is related to specialty coffee cafés that are, or may at MarksCo's option, become part of the Royalty Pool, provided, in each case, that all amounts of the Royalty and all interest payments that are due and payable at the time of such investment have been paid, or (b) cash equivalent (money market) investments;
6. except as permitted under the Governance Agreement or the Licence and Royalty Agreement, directly or indirectly, consolidate, amalgamate or merge with, or sell, lease or otherwise dispose of all or substantially all of its assets (whether now owned or hereafter), or enter into any arrangement or reorganization having a similar effect, except internal reorganizations, provided that such internal reorganizations would not reasonably be expected to have a material adverse effect on Second Cup or its ability to meet its obligations to pay the Royalty;
7. enter into any sublicense agreement with any other person other than a Second Cup franchisee or a wholly-owned subsidiary of Second Cup which has provided a guarantee to further secure the obligations of Second Cup under the Licence and Royalty Agreement; or
8. dispose of the shares or other interests in any subsidiary that owns a Second Cup café in Canada or that has granted a security interest in all of its property to MarksCo, except to Second Cup or another wholly-owned subsidiary of Second Cup that has granted a security interest in all of its property to MarksCo.

MarksCo has agreed to subordinate its security interest under the General Security Agreement to any security interest permitted by paragraph 2 above.

#### *Certain Remedies*

Upon the occurrence and continuance (after agreed cure periods) of an event of default by Second Cup under the Licence and Royalty Agreement or the General Security Agreement, including the failure to pay the Royalty, MarksCo is entitled to a number of remedies, both at law and under those agreements. The principal remedies are as follows:



- MarksCo could commence legal proceedings against Second Cup to collect the amount of the Royalty and other amounts then due;
- MarksCo could give notice to the Second Cup franchisees operating a Second Cup café in Canada of the assignment to MarksCo of the amounts payable under the franchise agreements with Second Cup and require those Second Cup franchisees to pay these amounts to MarksCo;
- MarksCo could terminate the Licence and Royalty Agreement and, in so doing, would be required to provide for reasonable transition arrangements; and
- MarksCo could appoint, or apply to the court for the appointment of, a receiver to take possession of the assets of Second Cup over which MarksCo has a security interest and carry on the business of Second Cup until the payments, or other arrangements satisfactory to MarksCo, are made. The receiver could, if the payments are not made, sell the assets of Second Cup over which MarksCo has a security interest.

In the event of a material default by Second Cup, the Licence and Royalty Agreement requires Second Cup to immediately pay to MarksCo, as additional security, an amount equal to the Royalty payable to MarksCo by Second Cup for 12 months. In the event of the bankruptcy or insolvency of Second Cup, the Licence and Royalty Agreement provides that Second Cup is required to prepay the Royalty by paying MarksCo as liquidated damages the present value at that time of the Royalty calculated for the remaining term of the Licence and Royalty Agreement.

Until the Royalty is brought into good standing, or MarksCo agrees to other arrangements, and subject to applicable law (including laws governing bankruptcies and reorganizations) and rights in agreements with third parties in the case of a default, a receiver appointed by MarksCo or by the court could continue to operate the business of Second Cup and its affiliated entities over which MarksCo has a security interest.

The exercise of these remedies would be subject to the rights of third party franchisees and parties having prior ranking claims.

The foregoing is a summary only of the remedies available to MarksCo in the event of a default by Second Cup under the Licence and Royalty Agreement and General Security Agreement. Reference should be made to the Licence and Royalty Agreement and the General Security Agreement for the full text of these remedies. See “Material Contracts”.

### ***Operating Covenants of Second Cup in the Licence and Royalty Agreement***

Under the Licence and Royalty Agreement, Second Cup is obligated to, among other things:

- operate and conduct its business (and cause the Second Cup franchisees to conduct business) in at least the manner and to at least the standards that Second Cup’s business is presently conducted and operated;
- use reasonable commercial efforts to collect all fees and other amounts payable to Second Cup under franchise agreements with Second Cup franchisees in Canada;
- monitor the compliance of Second Cup franchisees in Canada with the trade-mark and character and quality standards set under Second Cup franchise or similar agreements;
- enforce the observance and performance of franchise agreements by Second Cup franchisees in Canada in a manner that is consistent with good and prudent business practices; and

- not, without the consent of the board of directors of MarksCo, which will not be unreasonably withheld or delayed, amend the terms of any Second Cup franchise agreement in Canada such that:
  - royalty revenues under a franchise agreement are calculated in a manner that is inconsistent with the present practices of Second Cup including, without limitation, by reducing the percentage of revenues that are payable by Second Cup franchisees; or
  - franchisees are obligated to carry on business in a manner that is materially inconsistent with historical Second Cup practice.

### ***Adjustments to the Royalty Pool and Payments Made Under the Licence and Royalty Agreement***

Second Cup intends to continue to expand the number of Second Cup cafés in Canada that will be included in the Royalty Pool. At the same time, management expects that certain Second Cup cafés will be closed from time to time, in accordance with historical practice. Pursuant to the Licence and Royalty Agreement, the Royalty Pool will be adjusted annually in order to account for the opening and closing of Second Cup cafés.

As described below, an increase in the number of Second Cup cafés in the Royalty Pool may result in the payment by MarksCo to Second Cup of an additional amount meant to reflect the value to MarksCo of the increase in System Sales and the corresponding increase in the Royalty. Conversely, a reduction in the number of Second Cup cafés in the Royalty Pool may result in the payment by Second Cup to MarksCo of an amount meant to reflect the reduction in System Sales and the corresponding decrease in the Royalty.

The following is a summary only of the manner in which these adjustments are to be calculated and implemented. Reference should be made to the Licence and Royalty Agreement for the full text of these adjustment provisions. See “Material Contracts”.

#### *Adjustments to the Royalty Pool*

As of December 31, 2005, 343 Second Cup cafes were included in the Royalty Pool. The Royalty Pool is adjusted annually, on January 1 of each year (the “Adjustment Date”), commencing January 1, 2006, to include Second Cup cafés that, on November 1 of the previous year, had been open for at least 60 days and which were not previously included in the Royalty Pool (“Additional Cafés”). At the same time, the Royalty Pool is adjusted to remove Closed Cafés. Following the Adjustment Date, for the purposes of calculating the Royalty, System Sales will be determined based on Second Cup cafés included in the Royalty Pool following such adjustment. See “— January 1, 2006 Adjustment to Royalty Pool”.

#### *Adjustments if there are Additional Cafés but no Closed Cafés*

If System Sales increase due to the inclusion of Additional Cafés in the Royalty Pool, the amount of the annual Royalty payable to MarksCo thereafter will be expected to increase. As a result, on an Adjustment Date, if Additional Cafés are added to the Royalty Pool and there are no Closed Cafés, MarksCo will pay to Second Cup an amount meant to reflect the value to MarksCo of that future increase in System Sales (as defined below) and the corresponding increase in the Royalty. This amount is used as a basis for calculating the Determined Amount. The Determined Amount is equal to 92.5% of the amount of the additional System Sales for the 52-week period commencing on the Adjustment Date resulting from the inclusion of the Additional Cafés to the Royalty Pool (the “Additional System Sales”) multiplied by the Royalty rate divided by the Unit Yield.

$$\text{Determined Amount} = 92.5\% \times \left[ \frac{\text{Additional System Sales of Additional Cafés} \times \text{Royalty rate}}{\text{Unit Yield}} \right]$$

*Adjustments and Make-Whole Payments if there are Closed Cafés*

If there are Closed Cafés, the amount of the Royalty payable to MarksCo by Second Cup can be expected to decrease both in the year in which the permanent closure of the café occurred and in subsequent years. As a result, the Licence and Royalty Agreement provides for the following adjustments to be made.

First, an amount reflecting the reduction in the Royalty resulting from the decrease in System Sales will be paid by Second Cup to MarksCo (the “Make-Whole Payment”) commencing from the month immediately following the date of permanent closure of a Closed Café. Such amount will be calculated based on the System Sales generated by the Closed Café for the first 52-week period in which the Closed Café was included in the Royalty Pool multiplied by the Royalty rate. In the event that a Closed Café was not operating for a full 52-week period while in the Royalty Pool, the Make-Whole Payment amount will be calculated based on estimated system sales for a full 52-week period forecasted by management of Second Cup on the basis of assumptions considered reasonable by the Governance Committee of MarksCo. One-twelfth of the Make-Whole Payment will be paid every month for the remainder of the year in which the permanent closure occurred, up to the next Adjustment Date (pro rated for partial months).

Subsequently, on each Adjustment Date, the Make-Whole Payment will be taken into account in calculating the adjustment to be made to the Royalty Pool on that Adjustment Date. If Additional System Sales of the Additional Cafés to be added to the Royalty Pool are sufficient to offset the lost System Sales from the Closed Cafés for the first 52-week period in which the Closed Cafés were included in the Royalty Pool, MarksCo will be required to pay the applicable Determined Amount to Second Cup, although the amount of the Determined Amount will be reduced to account for the Closed Cafés. If the System Sales generated by the Closed Cafés for the first 52-week period in which the Closed Cafés were included in the Royalty Pool exceed the Additional System Sales of Additional Cafés to be added to the Royalty Pool, the Make-Whole Payment will be carried over, and continue to be paid for subsequent years, until on an Adjustment Date, Additional System Sales of Additional Cafés are sufficient to offset the System Sales attributable to all Closed Cafés. In these circumstances, the amount of the Make-Whole Payment will be reduced to account for any expected increase in the Royalty related to the Additional System Sales of Additional Cafés to be added to the Royalty Pool as at such Adjustment Date.

The following formula reflects the manner in which payments to be made by MarksCo to Second Cup will be determined where there are both Additional Cafés and Closed Cafés as of an Adjustment Date:

$$\text{Determined Amount} = 92.5\% \times \left[ \frac{(\text{Additional System Sales of Additional Cafés} - \text{System Sales of Closed Cafés}) \times \text{Royalty rate}}{\text{Unit Yield}} \right]$$

*Payment of the Determined Amount*

Payments by MarksCo to Second Cup of the Determined Amount may, at MarksCo’s election, be satisfied: (i) by the transfer of newly-issued Units based on the Current Market Price of such Units as at the Adjustment Date on which the first instalment (referred to below) is paid, or (ii) in cash. If MarksCo elects to pay the Determined Amount in cash, any Units that may be issued by the Fund for the purpose of financing, or refinancing, directly or indirectly, this cash payment will be subject to Second Cup’s pre-emptive right to purchase Units issued by the Fund. See “Description of the Fund — Pre-Emptive Right”.

If the Current Market Price of the Units is less than \$10.00 and MarksCo elects to pay the Determined Amount in cash, MarksCo may require Second Cup to subscribe for Units (at a per Unit subscription price equal to the then Current Market Price of the Units) for an aggregate subscription price equal to the Determined Amount.

MarksCo will pay the Determined Amount in two instalments, each payable on an Adjustment Date. For the first instalment, Second Cup will forecast the expected Additional System Sales that will be generated for the first 52-week period that the Additional Cafés are included in the Royalty Pool (the "Forecast Additional System Sales of Additional Cafés"). MarksCo will pay, on the Adjustment Date, 80% of the estimated Determined Amount calculated using such forecast in accordance with the formulas described above. On the following Adjustment Date, the actual Determined Amount will be calculated for the previous 52-week period and will be compared to the estimated Determined Amount. If actual Additional System Sales of the Additional Cafés exceed 80% of Forecast Additional System Sales of Additional Cafés, MarksCo will be required to pay the second instalment on such Adjustment Date. In addition, MarksCo will be required to pay to Second Cup the amount of any distributions or other amounts that would have been received by Second Cup or interest that would have been earned by Second Cup had the second instalment been paid on the same date as the first instalment. If, however, actual Additional System Sales of Additional Cafés are less than 80% of Forecast Additional System Sales of Additional Cafés, Second Cup will have received, by virtue of the first instalment, an overpayment of the Determined Amount. Although it is not expected to be a frequent occurrence, if Second Cup receives an overpayment of the Determined Amount, it will refund the amount of the overpayment to MarksCo as well as distributions or other amounts received by Second Cup from the Fund or interest earned by Second Cup in respect of such overpayment.

MarksCo, AcquisitionCo, the Fund and Second Cup have entered into the Subscription Agreement to ensure that MarksCo has the Units and/or cash necessary to fund its obligations in respect of the inclusion of Additional Cafés in the Royalty Pool under the Licence and Royalty Agreement.

#### *January 1, 2006 Adjustment to Royalty Pool*

On January 1, 2006, nine new Second Cup cafés were added to the Royalty Pool. The Additional System Sales of these nine Additional Cafés have been estimated to be \$4.06 million annually. These Additional System Sales were offset by \$2.91 million in lost System Sales of eight Closed Cafés. As a result of this adjustment, the total number of Second Cup cafés in the Royalty Pool increased from 351 to 352 on January 1, 2006.

The Unit Yield for the purposes of this adjustment was 10.08%, using a Current Market Price of \$9.90 per Unit. The Current Market Price was calculated based on the market price of units traded on the TSX during the twenty consecutive trading days ending on the fifth trading day before January 1, 2006.

In order to permit MarksCo to pay the first instalment of the Determined Amount of \$547,868, the Fund issued 55,316 Units to MarksCo, which delivered those Units to Second Cup pursuant to the Licence and Royalty Agreement. Such Units represent approximately 0.5% of the issued and outstanding units of the Fund on a fully diluted basis. The Fund used the proceeds from the issuance of the Units to invest in additional AcquisitionCo Notes and AcquisitionCo Common Shares. AcquisitionCo, in turn, used the proceeds received from the Fund to invest in additional MarksCo Notes and MarksCo Common Shares.

#### ***New Trade-Marks***

Second Cup from time to time develops additional trade-marks for use in Canada. Those trade-marks that are related to the Second Cup Marks or are for use in connection with Second Cup cafés in Canada are assigned to

MarksCo for no additional cost and become part of the Second Cup Marks. As a result, the Licence permits Second Cup to use any or all of such trade-marks (including for the purpose of trade names and domain names) in accordance with the terms and conditions of the Licence and Royalty Agreement. See “Management and Corporate Governance — The Second Cup Marks”.

## **MANAGEMENT AND CORPORATE GOVERNANCE OF MARKSCO**

The business of MarksCo is managed and supervised by its board of directors. Although the Fund owns all of the MarksCo Common Shares indirectly through AcquisitionCo, the Fund has no active day-to-day role in MarksCo’s management. On Closing, the Fund, MarksCo, Second Cup, AcquisitionCo and Cara entered into the Governance Agreement which provides for various matters relating to MarksCo, including those described below.

### ***Directors***

The board of directors of MarksCo currently consists of five individuals. Pursuant to the provisions of the Governance Agreement, Second Cup is entitled to nominate two directors and the Fund is entitled to nominate three directors. Each director of MarksCo nominated by the Fund must be “independent” of Second Cup within the meaning of Multilateral Instrument 52-110 — *Audit Committees*. Second Cup’s entitlement to nominate two directors of MarksCo is subject to Second Cup or any of its affiliates holding 10% or more of the Units or securities convertible or exchangeable into Units. As at March 30, 2006, Second Cup held 1,492,730 Units, representing approximately 15.5% of the Fund’s issued and outstanding Units.

The name, municipality of residence, position with MarksCo, principal occupation and period of service of the Fund’s three nominees as directors of MarksCo are set out below. Each of the Fund’s nominees is presently a trustee of the Fund.

<u>Name and</u>			
<u>Municipality of Residence</u>	<u>Position(s) with MarksCo</u>	<u>Principal Occupation</u>	<u>Service as Director/Officer</u>
David Bloom..... <i>Toronto, Ontario, Canada</i>	Director and Chairman of the Board of Directors	President, DGRB Consultants Inc.	Since December 2, 2004
Michael Rosicki..... <i>Oakville, Ontario, Canada</i>	Director	President, Wexford Group Inc.	Since December 2, 2004
Raymond Guyatt..... <i>Westmount, Québec, Canada</i>	Director	Retired Businessman	Since December 2, 2004

The name, municipality of residence, position with MarksCo, principal occupation, and period of service of each of Second Cup’s nominees as directors of MarksCo are set out below.

<u>Name and Municipality of Residence</u>	<u>Position(s) with MarksCo</u>	<u>Principal Occupation</u>	<u>Service as Director/Officer</u>
Gabriel Tsampalieros..... <i>Markham, Ontario, Canada</i>	Director	Chief Executive Officer of Second Cup	Since December 2, 2004
J. Bruce Elliot..... <i>Toronto, Ontario, Canada</i>	Director	President of Second Cup	Since December 2, 2004

The following is a summary biography of each of the directors of MarksCo other than Gabriel Tsampalieros and Bruce Elliot, whose biographies appear under “Business of Second Cup — Management”.

*David Bloom*

David Bloom is the President and a director of DGRB Consultants Inc. From 1986 to 2001, he was the Chairman and Chief Executive Officer of Shoppers Drug Mart Inc. Mr. Bloom is a founder of the Canadian Association of Chain Drug Stores and a former Chairman of the Retail Council of Canada. He is a director of Sleep Country Canada Inc. and a trustee of Sleep Country Canada Income Fund, as well as a director of Swiss Herbal Remedies Limited and Sterling Centrecorp Inc. Mr. Bloom is also a member of the board of trustees of the Hospital for Sick Children and the board of directors and audit committee of the Toronto International Film Festival. Mr. Bloom holds a Bachelors degree (BSc) in Pharmacy from the University of Toronto.

*Michael Rosicki*

Michael Rosicki is the President of Wexford Group Inc. From 1999 to 2004, Mr. Rosicki was Chairman and Chief Executive Officer of Parmalat North America. From 1997 to 1999, Mr. Rosicki was with Mattel, where he began as the President of Mattel Canada Inc. and later became President, Mattel Europe, Canada, Middle East and Africa. Prior to that, he was with Nestlé Canada Inc. for 12 years, where he held progressively senior management positions culminating in his role as President of the company’s Foods Group. Mr. Rosicki is a director of the Hospital for Sick Children’s Foundation and has held senior positions with various industry and charitable associations, including as past Chairman of the Food & Consumer Products Manufacturers of Canada, past Chairman of The Canadian Children’s Foundation and Kids Help Phone, as Founding Chair of National Kids Day and past President of the Ontario Grocery Industry Foundation.

*Raymond Guyatt*

Raymond Guyatt is a retired executive. From 1987 to 2000, Mr. Guyatt was the Executive Vice President and Chief Financial Officer of Imasco Limited. He was also a director of both Imasco and CT Financial Services from 1990 to 2000. Mr. Guyatt was a director of Mackenzie Financial Corporation from 2002 to 2005 and was Chairman of the Innovation Council of the Canadian Institute of Chartered Accountants from 2001 to 2003. Mr. Guyatt is a Chartered Accountant and a member of the Institute of Chartered Accountants of Ontario.

### *Governance Committee*

The board of directors of MarksCo have established a Governance Committee consisting of members of the board of directors of MarksCo who are “independent” within the meaning of Multilateral Instrument 52-110 — *Audit Committees*. The Governance Committee consists of Messrs. Bloom, Guyatt and Rosicki. The role of the Governance Committee involves:

- overseeing the operations of MarksCo, including the payments to be made by Second Cup to MarksCo under the Licence and Royalty Agreement;
- considering and providing a recommendation on any matter involving a material conflict of interest between Second Cup, Cara, AcquisitionCo, MarksCo and the Fund (including any matter involving the Acquisition Agreement, the Governance Agreement, the Licence and Royalty Agreement, the Subscription Agreement, the Administration Agreement, the General Security Agreement and the Second Cup Marks) before any such matter is approved by the board of directors of MarksCo;
- annually reviewing: (i) the operations of Second Cup, including its business plans and prospects for the ensuing year, (ii) the performance of management of Second Cup with reference to their commitments and responsibilities under the Licence and Royalty Agreement, and (iii) adjustments to the Royalty to be made pursuant to the Licence and Royalty Agreement;
- developing MarksCo’s approach to corporate governance issues and compliance with applicable laws, regulations, rules, policies and orders with respect to such issues;
- advising the board of MarksCo in filling vacancies on the board; and
- periodically reviewing the composition and effectiveness of the board and the trustees of the Fund and the contribution of individual directors and trustees of the Fund.

### *Insider Reporting*

Based upon an analysis of the structure of the Fund and applicable law, the following individuals are “insiders” of the Fund and, as such, will have reporting obligations as insiders under the securities laws of the various provinces and territories of Canada, including the obligation to file “insider trading reports” under those laws:

- the trustees of the Fund;
- the directors and senior officers of MarksCo and AcquisitionCo; and
- Second Cup, Cara, and their respective directors and senior officers.

### ***Restrictive Covenants***

Cara has agreed in the Governance Agreement that, for so long as Cara continues to hold securities representing not less than 5% of the votes of Second Cup, Cara will not own or operate or otherwise be interested in any specialty coffee business in Canada during the period of the Licence, except through ownership of Units and as permitted by the Licence and Royalty Agreement.

### ***Right of First Offer***

Pursuant to the Governance Agreement, the Fund has a right of first offer in respect of certain transactions involving the sale of the business of Second Cup, as more particularly described below. Pursuant to this right, neither Cara, Second Cup nor parties related to them will enter into any agreement for a transaction (a “Change of Control Transaction”) which, if completed, would result in a Change of Control (as defined below) of Second Cup unless the Fund or MarksCo is first provided with the opportunity to acquire, directly or indirectly through one or more subsidiaries, the assets and undertaking and/or the shares, as the case may be, of Second Cup (the “Second Cup Business”) held directly or indirectly by Cara. The acquisition opportunity will be offered for consideration and on terms to be set forth in a written notice (the “Right of First Offer Notice”) by Second Cup to the Fund and MarksCo. A Right of First Offer Notice must set forth a summary of the Change of Control Transaction and details of its material terms, including the amount of the purchase price to be paid by the Fund or MarksCo for the Second Cup Business.

The right of first offer will expire if:

- the Fund or MarksCo does not inform Second Cup in writing within 30 days after the receipt of the Right of First Offer Notice that it desires to purchase the Second Cup Business; or
- the Fund or MarksCo does not enter into an agreement with Second Cup, Cara or the relevant related party for the purchase of the Second Cup Business within 30 days after the Fund or MarksCo informs Second Cup in writing that it desires to purchase the Second Cup Business.

However, Cara, Second Cup or the related party may only enter into an agreement in respect of a Change of Control Transaction if:

- the amounts that would be received by Second Cup, Cara or the related party upon completion of the Change of Control Transaction, after taking into account the amount of income taxes that would be payable under the Tax Act by Second Cup, Cara or the related party if the consideration payable in respect of the Change of Control Transaction were immediately distributed to, or paid to, Second Cup, Cara or the related party, is at least equal to the purchase price to be paid by the Fund or MarksCo, as set forth in the Right of First Offer Notice;
- the terms of the transaction as contained in such agreement, when considered as a whole in a commercially reasonable manner, having regard to the nature of the transaction and the summary of the proposed transaction, as contained in the Right of First Offer Notice, are not materially more favourable to the purchaser than the summary of the terms of the proposed transaction contained in the Right of First Offer Notice; and



- in the case of an agreement to purchase the Second Cup Business, on or before the completion of the transaction, the purchaser (including a “Successor Corporation” as defined below) enters into an agreement with the Fund or MarksCo agreeing to assume the obligations of Second Cup under all agreements with the Fund or MarksCo, including the Governance Agreement and the Licence and Royalty Agreement.

If Cara, Second Cup or the related party does not enter into such an agreement within 210 days after the date the Right of First Offer Notice was given to the Fund or MarksCo in respect of such transaction, or a Change of Control Transaction permitted by the foregoing is not completed by the first anniversary of the date upon which such Right of First Offer Notice was first given, neither Cara, Second Cup nor the relevant related party may enter into an agreement that, if completed, would result in a Change of Control, unless the Fund or MarksCo is again provided with the opportunity to acquire the Second Cup Business in accordance with the foregoing.

A Change of Control is defined in the Governance Agreement as:

- the direct or indirect acquisition by a person or persons, acting jointly or in concert, of beneficial ownership (“acting jointly or in concert” and “beneficial ownership” are to be as defined in the Securities Act in existence as of the Closing Date) of 50% or more of Second Cup’s then outstanding voting securities; or
- the approval by the shareholder or shareholders of Second Cup of (a) an amalgamation involving Second Cup; or (b) a complete liquidation or dissolution of Second Cup or the sale or other disposition of all or substantially all of the assets of Second Cup.

Notwithstanding the foregoing, a Change of Control will be deemed to not occur if, following the completion of the proposed transaction:

- Cara would own, directly or indirectly, more than 50% of the combined voting power of the then outstanding voting securities of the corporation or other entity (each a “Successor Corporation”) (a) that has acquired 50% or more of the combined voting power of Second Cup’s then outstanding voting securities, (b) resulting from an amalgamation involving Second Cup, or (c) that acquires (including by virtue of a liquidation distribution) the assets and undertaking previously owned by Second Cup, provided that, in the case of (a) or (c), the Successor Corporation assumes all of the obligations of Second Cup under all agreements between Second Cup and the Fund and its subsidiaries;
- 50% or more of the combined voting power of the outstanding voting securities of Second Cup (or, as the case may be, a Successor Corporation) are held directly or indirectly by persons who are employees of Second Cup (or, as the case may be, a Successor Corporation) or its affiliates, provided that, in the case of a sale of the assets and undertaking of Second Cup, the Successor Corporation assumes all of the obligations of Second Cup under all agreements between Second Cup and the Fund and its subsidiaries; or
- following a transaction that involves the transfer of shares of Second Cup or an amalgamation of Second Cup, 50% or more of the combined voting power of Second Cup’s then outstanding securities (or of a Successor Corporation, in the case of an amalgamation) are held by Cara, or by a trustee or other fiduciary holding securities solely for the benefit of Cara, or by employees of Second Cup or its affiliates, provided that in all cases, any such transferee of shares from Cara agrees to be bound by the terms of the right of first offer.

The right of first offer provisions do not apply to a Change of Control resulting from or related to pledges of shares of Second Cup to (or indirectly held by) a bank or other financial institution or to the direct or indirect realization on such pledge by the bank or other financial institution, including any related voting trust arrangements. However, if the bank or other financial institution realizes on any pledge and such realization would otherwise have resulted in a Change of Control, the Fund will have the right, exercisable for 60 days, to acquire the Second Cup Business at its agreed or arbitrated fair market value for the consideration and on the terms set forth in a Right of First Offer Notice by the bank or other financial institution to the Fund.

### ***The Second Cup Marks***

MarksCo currently owns the Second Cup Marks, which are trade-marks that are registered or the subject of pending applications for registration under the *Trade-marks Act* (Canada), and other unregistered trade-marks used by Second Cup in connection with its business in Canada. The Second Cup Marks also include the methods, systems and procedures for the operation of Second Cup cafés using certain types of equipment, supplies, ingredients, recipes, merchandising and advertising, and business techniques in Canada.

Pursuant to the Licence and Royalty Agreement, Second Cup has the Licence to use the Second Cup Marks in all provinces and territories of Canada excluding the territory of Nunavut, for a period of 99 years from the date of the Licence and Royalty Agreement (November 26, 2004). Second Cup may from time to time develop additional trade-marks. If these trade-marks are related to the Second Cup Marks or are for use in connection with the Second Cup cafés in Canada, they will be assigned to MarksCo for no additional cost and will become part of the Second Cup Marks, and Second Cup will be free to use any or all of such trade-marks (including for the purpose of trade names and domain names) in accordance with the terms and conditions of the Licence and Royalty Agreement.

The Second Cup Marks do not include the rights outside of Canada to any trade-marks or trade names used by Second Cup or any affiliated entities in their business, and in particular they do not include the rights outside of Canada to the trade-marks registered or pending registration under the *Trade-marks Act* (Canada).

The following are some of the Second Cup Marks that are held by MarksCo: Second Cup, The Second Cup<sup>®</sup>, Second Cup Coffee Co., Second Cup Café Inc., Coffee College<sup>®</sup>, The Ultimate Coffee Experience<sup>®</sup>, Caramel Corretto<sup>®</sup>, Chillatte<sup>®</sup>, Chiller<sup>®</sup>, Fruizzi<sup>®</sup>, Tiamo<sup>®</sup>, First Thing, Ma Matière Première, Nouvelles Express<sup>®</sup>, Passport<sup>®</sup>, Profitmaker<sup>®</sup>, Steamy Monday<sup>®</sup>, Take A Second For Yourself<sup>®</sup>, The Second Scoop<sup>®</sup>, Treat-a-Friend<sup>®</sup>, What's Brewing<sup>®</sup>, Where The World Stops, For Just a Second<sup>®</sup>, Chocolate Lovers' Lattes<sup>®</sup>, Chocolate Lovers<sup>®</sup>, Crème Brûlée Ristretto<sup>®</sup>, Early Edition Blend<sup>®</sup>, Encanto<sup>®</sup>, Icepresso<sup>®</sup>, Jumpin' Juice<sup>®</sup>, Les Amoureux Du Chocolat<sup>®</sup>, Mocca Mandarino<sup>®</sup>, Paradiso<sup>®</sup>, White Mocca<sup>®</sup>, Amoureux de Choco\*lattes<sup>®</sup>, Icepresso Chiller<sup>®</sup>, Veneto Blend<sup>®</sup> and related design marks.

## **BUSINESS OF SECOND CUP**

### ***General***

Second Cup is Canada's largest specialty coffee café franchisor and second largest retailer of specialty coffee, as measured by number of cafés. Since the opening of its first café in suburban Toronto in 1975, Second Cup's network has grown to 359 cafés across Canada as at December 31, 2005, of which 328 are franchised and 31 are company-owned. For the 52-week period ended December 31, 2005, Second Cup's system sales were \$184.0 million.

Second Cup cafés offer a wide selection of brewed specialty coffees, hot and cold espresso-based beverages, blender drinks, specialty teas and hot chocolates for in-store, take-out and drive-thru consumption. In addition to coffee-based products and other beverages, Second Cup cafés carry a variety of complementary products, including pastries, muffins, cookies, coffee accessories and coffee-related gift items, with some cafés also offering sandwiches and salads.

### ***What is Specialty Coffee?***

The term “specialty coffee”, as used in reference to coffee production, refers to coffee produced from premium quality Arabica coffee beans prepared according to exacting standards. Typically, specialty coffee is sourced from the top 10% of the world’s Arabica coffee bean production and must satisfy stringent grading and sorting standards, which results in a distinct, tangible difference in the taste profile of specialty coffee as compared to commodity ground coffee and instant coffee. The term “specialty coffee”, as used in reference to the retail market for coffee products, is increasingly being used as a general term to describe the sector within the coffee market characterized by cafés offering an upscale retail experience and premium coffee products such as espresso-based beverages, blender drinks and iced coffee beverages.

### ***History***

Second Cup opened its first café in a shopping mall in suburban Toronto in 1975. Throughout the late 1970s and 1980s, the chain experienced rapid growth. By 1989, Second Cup had approximately 130 cafés, with shopping malls and office tower locations comprising over two thirds of its café network, and sales consisting mainly of brewed coffee, whole bean coffee and coffee-related merchandise.

Throughout the 1990s and early 2000s, Second Cup focused on extending its core product offering to include espresso-based beverages, iced beverages, blender drinks, and complementary food items such as pastries, muffins and cookies. During this period, Second Cup also continued to expand by opening cafés in street-front locations and power and strip centres, as well as in non-traditional retail locations such as hospitals, universities, airports, train stations and other transportation venues. In 1993, Second Cup completed an initial public offering, which resulted in Second Cup’s common shares being listed on the TSX, and in 1996, Cara acquired approximately 36% of the then outstanding shares of Second Cup. Beginning in 2000, Second Cup embarked on a number of new initiatives to improve its competitive position, which resulted in fewer new cafés being opened and the closing of underperforming locations. In 2002, Cara acquired the remaining outstanding shares of Second Cup, and as a result, Second Cup became a wholly-owned subsidiary of Cara and Second Cup’s common shares were subsequently delisted from the Toronto Stock Exchange. The inclusion of Second Cup in the Cara family of companies has provided Second Cup with further access to Cara’s extensive experience and resources in the foodservice industry.

By December 31, 2005, Second Cup had grown to 359 cafés in Canada and had system sales of \$184.0 million for the 52-week period ended December 31, 2005.

In December 2004, Second Cup sold the Second Cup Marks to MarksCo and entered into the License and Royalty Agreement with MarksCo. Second Cup retained a 15% interest in the issued and outstanding units of the Fund. Following the adjustment to the Royalty Pool on January 1, 2006, Second Cup’s interest in the outstanding Units of the Fund increased to approximately 15.5%. See “Licence and Royalty Agreement — January 1, 2006 Adjustment to the Royalty Pool”).

## ***Competitive Conditions***

The Canadian specialty coffee market is highly competitive and highly fragmented, with few barriers to entry. Management estimates that independent specialty coffee retailers constitute approximately 50% of specialty coffee cafés in Canada as measured by number of locations. Three specialty coffee retailers have a significant presence in Canada: Second Cup, Starbucks and Timothy's, which are estimated to account for approximately 13%, 21% and 5%, respectively, of the specialty coffee retail locations in Canada based on information obtained from the websites of these retailers. The remainder of the branded specialty coffee chains in Canada represent in the aggregate approximately 10% of the specialty coffee retail locations, and consist of smaller, mainly regional, participants such as A.L. Van Houtte, Blenz, Café Dépôt, Café Suprême, Café Presse and Williams Coffee Pub.

In addition to specialty coffee retailers, there are a number of "mainstream" coffee retail chains, such as Tim Horton's, Coffee Time and Country Style, that compete with Second Cup in the Canadian coffee market.

With 359 cafés as at December 31, 2005, Second Cup has the second largest number of specialty coffee retail outlets in Canada.

## ***The Second Cup Café System***

### *The Second Cup Concept*

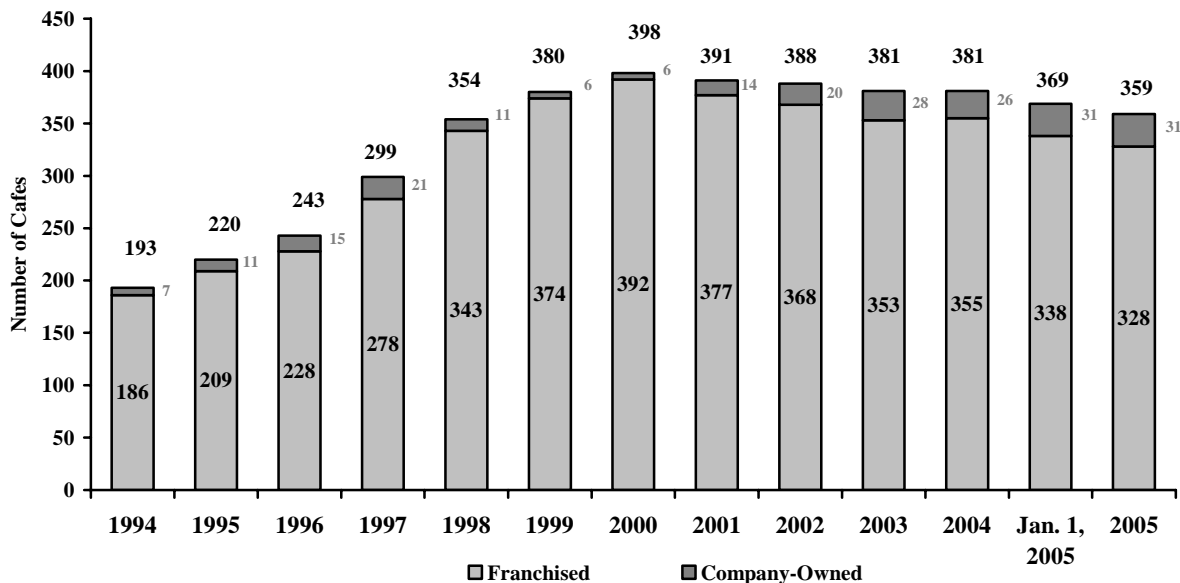
The Second Cup brand has a high degree of retail visibility, with locations in high-traffic areas in almost every major city in Canada. Second Cup is a franchise-driven business focused on delivering an "Oasis Experience" to its customers, which includes offering products that are "best in class" and focusing on developing innovative, market leading products that make Second Cup cafés a destination of choice for Canadian coffee drinkers. Second Cup is focused on continuing the growth of the Second Cup brand through a combination of growing same café sales and adding new cafés to the Second Cup network.

### *Number of Locations*

Since 1975, there has been substantial growth in the number of Second Cup cafés in Canada. Following periods of steady expansion in the 1970s and 1980s, Second Cup experienced rapid growth in net new cafés from 1997 to 2000, due in part to Cara's initial investment in Second Cup in 1996. Following this investment, Cara and Second Cup entered into a strategic partnership pursuant to which Cara agreed to develop Second Cup cafés in non-traditional retail sites such as "store-in-store", hospital, airport and other venues where Cara or its subsidiaries carried on business. Furthermore, Second Cup was testing this concept in other non-traditional "store-in-store" sites through partnerships with other retailers. Between 1997 and 2000, 87 of these locations were developed (72 by Cara), resulting in a higher level of development than had occurred in previous years. During the same period, 25 of these locations were closed (15 by Cara).

Following this period of rapid expansion, the number of cafés declined marginally as management focused on enhancing the performance of existing cafés, closing non-performing locations and solidifying the competitive position of Second Cup.

### Number of Second Cup Cafés in Canada <sup>(1)</sup>



Note:

- (1) All figures are as at the end of the respective fiscal period. For 1993 to 2001, figures are for the 52- or 53-week fiscal period ended on the last Saturday in June. In 2002, Second Cup recorded a shortened fiscal period consisting of the 39 weeks ended March 30, 2002, as a result of a change in its fiscal year-end subsequent to the acquisition of Second Cup by Cara. For 2003 and 2004, figures are for the 52-week fiscal period ended on the Saturday closest to March 31. For January 1, 2005, figures are for the 40-week period ended January 1, 2005. Second Cup recorded a shortened fiscal period consisting of 40 weeks ended January 1, 2005 as a result of the change in its fiscal year end to coincide with that of the Fund. For 2005, figures are for the 52-week fiscal period ended Saturday, December 31.

As illustrated in the chart above, the vast majority of Second Cup cafés are franchised. Although Second Cup is a franchise-driven business, company-owned cafés play an important role for Second Cup by providing it with the flexibility to test new products and initiatives, and to train new management and franchisees. Operating company-owned cafés also provides Second Cup with a platform to acquire and remediate under performing franchises and to take advantage of expansion opportunities on a timely basis. These company-owned cafés often will subsequently become franchised.

In addition to focusing on identifying locations for new cafés, Second Cup also carefully monitors the performance of its existing network of franchised cafés and closes under performing cafés on a managed basis. By closing under performing cafés and carefully selecting locations for new cafés, Second Cup seeks to strengthen its café network and increase average sales per café.

## Second Cup Café Openings and Closings<sup>(1)</sup>

	<u>1994</u>	<u>1995</u>	<u>1996<sup>(2)</sup></u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001<sup>(2)</sup></u>	<u>2002</u>	<u>2003</u>	<u>Mar.</u> <u>2004</u>	<u>Jan.</u> <u>2005<sup>(3)</sup></u>	<u>2005<sup>(4)</sup></u>
Openings .....	18	34	29	61	76	56	50	18	7	10	12	7	6
Closings .....	7	7	6	5	21	30	32	25	10	17	12	19	16

**Notes:**

- (1) For 1993 to 2001, figures are for the 52- or 53-week fiscal period ended on the last Saturday in June. In 2002, Second Cup recorded a shortened fiscal period consisting of the 39 weeks ended March 30, 2002, as a result of a change in its fiscal year-end subsequent to the acquisition of Second Cup by Cara. However, this table reflects café openings and closings for the 52-week period ended March 30, 2002. For 2003 and 2004, figures are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) 1996 and 2001 were 53-week fiscal periods.
- (3) Figures for January, 2005 reflect café openings and closings for the 40-week period ended January 1, 2005. Second Cup recorded a shortened fiscal period consisting of 40 weeks ended January 1, 2005 as a result of the change in its fiscal year to coincide with that of the Fund.
- (4) Figures for 2005 reflect café openings and closings for the 52-week period ended December 31, 2005.

### *Geographic Presence*

Second Cup cafés are geographically dispersed across Canada and are primarily concentrated in large urban centres such as Toronto, Calgary, Montreal, Edmonton, Ottawa and Vancouver. The following map illustrates the geographic distribution of Second Cup cafés in Canada.



As at December 31, 2005, Second Cup also operates a number of cafés in the Middle East through master franchise agreements with partners based in Kuwait and the United Arab Emirates. These cafés are not operated by Second Cup and do not form part of the Royalty Pool.

### Café Types

Second Cup cafés are situated in a wide range of high-traffic, high-visibility locations, consisting of street-fronts, shopping malls, office towers, power and strip centres and non-traditional retail sites such as hospitals, universities, “store-in-store” sites, airports, train stations and other transportation venues. Second Cup café sizes range from 60 square foot cappuccino bars to 2,800 square foot street-front locations with self-contained customer seating areas and outdoor patios.

The following table illustrates the relative mix of location types in the Second Cup café network as at December 31, 2005:

	<b>Number of Cafés</b>	<b>% of Total</b>	<b>Average Sales per Café<sup>(1)</sup></b> (thousands)
Street-Fronts.....	102	28%	\$573
Power and Strip Centres .....	74	21%	\$548
Shopping Malls .....	73	20%	\$553
Non-Traditional .....	73	20%	\$358
Office Towers .....	37	11%	\$486
Total .....	<u>359</u>	<u>100%</u>	<u>\$512</u>

Note:

(1) Includes only cafés that have reported at least 50 weeks of sales during the 52-week period ended December 31, 2005.

- *Street-Fronts* — As at December 31, 2005 there were 102 Second Cup cafés operating in street-front locations, representing 28% of all Second Cup cafés in Canada. Street-front cafés average 1,500 square feet and generally contain seating for approximately 15 or more guests, with many also offering external patio seating.
- *Power and Strip Centres* — With the growth of power and strip centres containing “big box” retailers and factory outlet stores, Second Cup has opened an increasing number of cafés in this type of venue. Second Cup currently has 74 cafés operating in power and strip centres, representing 21% of all Second Cup cafés in Canada. Power and strip centre cafés average 1,700 square feet and typically have self-contained seating and external patio areas, with some having drive-thru access as well.
- *Shopping Malls* — There are currently 73 Second Cup cafés operating in shopping malls, representing 20% of all Second Cup cafés in Canada. These cafés average 600 square feet, but can range from 60 square foot cappuccino bars to 1,600 square foot sites.
- *Non-Traditional* — Second Cup has developed a flexible café format that is suitable for non-traditional retail locations, such as hospitals, universities, “store-in-store” sites, airports, train stations and other transportation venues. Second Cup currently operates 73 non-traditional cafés, representing 20% of all Second Cup cafés in Canada, and consisting of 15 cafés located in hospitals,

14 cafés located in educational venues, 17 cafés located in transportation venues and 27 cafés located in “store-in-store” sites, mainly in combination with Harvey’s within Home Depot stores.

- *Office Towers* — Second Cup currently has 37 cafés operating in office towers, representing 11% of all Second Cup cafés in Canada. Office tower cafés average 850 square feet, but can range from 150 square foot cappuccino bars to 1,600 square foot sites. Office tower locations tend to serve a captive customer base of individuals working in the office tower itself.

### *New Locations*

Prior to entering a particular market area, Second Cup conducts a thorough market assessment to determine the optimal number and placement of cafés. Second Cup’s location selection process involves a variety of analytical techniques to evaluate factors that impact upon the viability of a proposed location, such as visibility, accessibility and traffic, as well as population density, household income, local competition and the proximity to major activity centres. New lease commitments entered into by Second Cup are carefully screened by management using a projected return on investment analysis. Second Cup believes that careful diligence in evaluating proposed new café locations has contributed to its success and helped minimize the number of under performing cafés in the Second Cup network.

### *Leases*

Almost all Second Cup cafés are operated in leased premises. Second Cup enters into the head lease for each café location and, in turn, enters into a sublease with each of its franchisees. Second Cup believes that entering into such arrangements allows it to maintain greater control over, and flexibility with respect to, the development process and the ongoing goodwill generated at its cafés. The leases that have been entered into by Second Cup are renewable over a staggered period, with an average of approximately 36 leases coming up for renewal annually over the next 10 years. The staggered nature of the lease renewal periods provides Second Cup with the flexibility to address under performing cafés, and ensures the periodic refreshment of the café network as franchisees are required to modernize locations upon the renewal of the franchise agreement.

### ***Products***

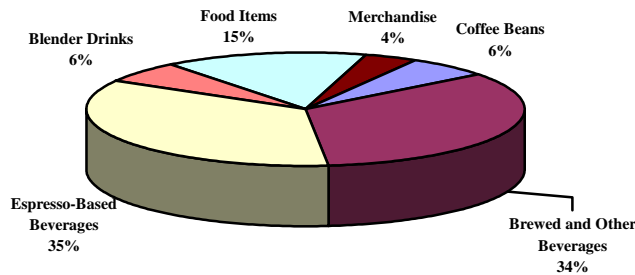
Second Cup’s coffee portfolio includes over 40 types of coffee, including a number of estate coffees, single-origin coffees and a variety of blends exclusive to Second Cup, such as Soho Blend, Paradiso®, Espresso Forte and Second Cup’s Holiday Blend. Second Cup has developed a custom five-point roast scale to distinguish each coffee by its degree of roast. Ranging from one to five (with five being the darkest roast), the use of the roast scale permits customers to select the degree of roast that corresponds to their taste preference. Second Cup also offers a wide variety of espresso-based beverages and blender drinks such as espressos, cappuccinos, lattes and iced coffees, and is continually developing variations of these products. Examples of innovative espresso-based beverages and blender drinks developed by Second Cup include the Moccaccino™, Caramel Corretto®, Chillatte®, Frrrozen Hot Chocolate™, Tiamo® and Icepresso Chiller™.

During 2005, Second Cup launched its reformulated latte, made using a revised recipe for the Canadian consumer following extensive consumer research. The new Second Cup latte was launched with major print advertising and media campaign.



In addition to coffee-based products and other beverages, Second Cup cafés carry a variety of complementary products, including pastries, muffins, cookies, coffee accessories and coffee-related gift items, with some cafés also offering sandwiches and salads. Second Cup recently introduced breakfast cookies, snack bars and yogurt parfaits in order to capitalize on what it has identified as a trend in customer preference towards snacking occasions as a substitute for traditional meals. Second Cup has also put more focus on developing its cafés as a destination for high quality, seasonal merchandise such as that offered during the winter 2005 holiday season.

**Product Mix — 2005<sup>(1)</sup>**



Notes:

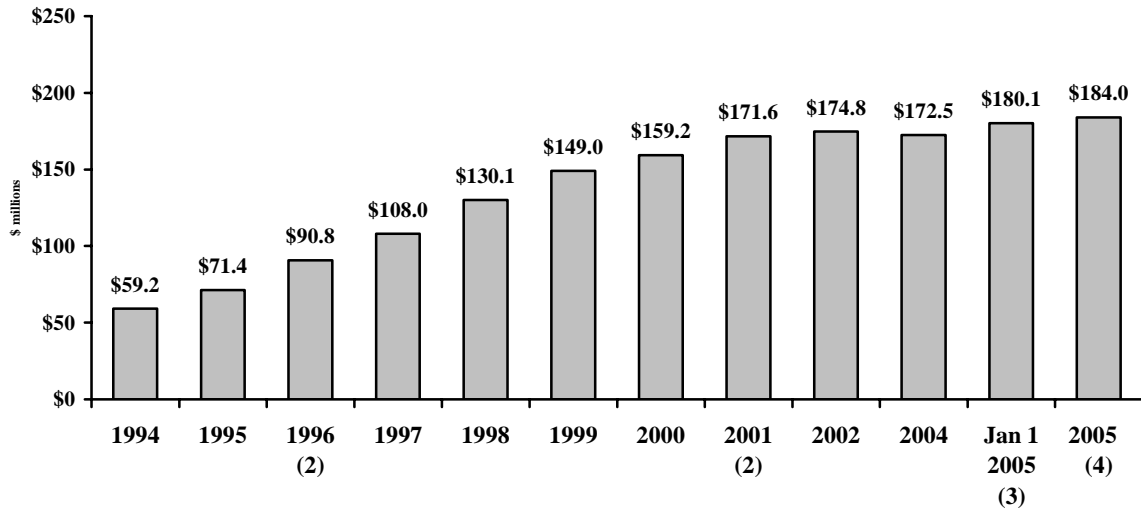
(1) For the 52 weeks ended December 31, 2005. Based on a representative sample of sales mix information reported by Second Cup by franchisees without audit or other form of independent assurance.

During the fourth quarter of 2005, Second Cup introduced a reloadable payment card (the “Second Cup Café Card”) across its major Canadian markets. Customers are able to use the card for purchases at participating Second Cup cafés, as well as other food service brands in the Cara family including Swiss Chalet, Harvey’s, Kelsey’s Neighbourhood Bar & Grill, Milestone’s Grill & Bar and Montana’s Cookhouse.

## Sales

Since 1994, Second Cup's system sales have more than tripled, from \$59.2 million for the 52-week period ended June 26, 1993 to \$184.0 million for the 52-week period ended December 31, 2005. The increase in system sales has been achieved through a combination of growth in the number of cafés, as well as same café sales growth.

### System Wide Sales<sup>(1)</sup>



Notes:

- (1) For 1994 to 2001, results are for the 52- or 53-week fiscal period ended on the last Saturday in June. In 2002, Second Cup recorded a shortened fiscal period consisting of the 39 weeks ended March 30, 2002 as a result of a change in its fiscal year-end subsequent to the acquisition of Second Cup by Cara. However, this graph reflects system sales for the 52-week period ended March 30, 2002. For 2003 and 2004, results are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) 1996 and 2001 were 53-week fiscal periods.
- (3) For January 1, 2005, results shown are for the 52-week period ended January 1, 2005. Second Cup recorded a shortened fiscal period consisting of 40 weeks ended January 1, 2005 as a result of the change in its fiscal year-end to coincide with that of the Fund. Sales for the 40-week period ended January 1, 2005 were \$140.8 million.
- (4) For 2005, sales are for the 52 weeks ended December 31, 2005.

*Same Café Sales Growth and Average Sales per Café*

As indicated in the table below, since 1994, annual same café sales growth has averaged 3.8%. Second Cup has achieved such growth by increasing brand awareness and expanding product offerings.

**Same Café Sales Growth<sup>(1)</sup>**

<u>1994</u>	<u>1995</u>	<u>1996<sup>(2)</sup></u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001<sup>(2)</sup></u>	<u>2002</u>	<u>2003</u>	<u>2004<sup>(3)</sup></u>	<u>40 weeks ended January 1, 2005<sup>(4)</sup></u>	<u>2005<sup>(5)</sup></u>
2.5%	10.8%	6.1%	6.7%	4.7%	5.5%	0.8%	0.6%	3.0%	-0.3%	-0.7%	5.8%	4.6%

Notes:

- (1) For 1994 to 2001, figures are for the 52- or 53-week fiscal period ended on the last Saturday in June. In 2002, Second Cup recorded a shortened fiscal period consisting of the 39 weeks ended March 30, 2002 as a result of a change in its fiscal year-end subsequent to the acquisition of Second Cup by Cara. However, this table reflects same café sales growth for the 52-week period ended March 30, 2002. For 2003 and 2004, figures are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) 1996 and 2001 were 53-week fiscal periods.
- (3) Second Cup results were significantly impacted by the power outage that occurred in Ontario in August 2003 and the outbreak of SARS in the Greater Toronto Area in April 2003 through June 2003. The financial results for these periods are reflected in fiscal 2004.
- (4) As a result of a change in its fiscal year-end subsequent to the creation of the Fund, Second Cup changed its year-end from the Saturday closest to March 31 to the Saturday closest to December 31. Same Café Growth of 5.8% represents growth for the 40-week period ended January 1, 2005.
- (5) For 2005, figures are for the 52 weeks ended December 31, 2005

As a result of achieving positive same café sales growth and focusing on replacing under performing cafés, Second Cup has steadily increased average sales per café from approximately \$385,000 in the 52-week period ended June 29, 1996 to approximately \$512,000 for the 52-week period ended December 31, 2005.

**Average Sales per Café<sup>(1)</sup>**  
(thousands)

<u>1996<sup>(2)</sup></u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001<sup>(2)</sup></u>	<u>2002</u>	<u>2003</u>	<u>2004<sup>(3)</sup></u>	<u>January 1, 2005<sup>(4)</sup></u>	<u>2005<sup>(5)</sup></u>
\$385	\$420	\$438	\$440	\$435	\$442	\$462	\$462	\$464	\$489	\$512

Notes:

- (1) For 1996 to 2001, results are for the 52- or 53-week fiscal period ended on the last Saturday in June. In 2002, Second Cup recorded a shortened fiscal period consisting of the 39 weeks ended March 30, 2002 as a result of a change in its fiscal year-end subsequent to the acquisition of Second Cup by Cara. However, this table reflects average sales per café for the 52-week period ended March 30, 2002. For 2003 and 2004, results are for the 52-week fiscal period ended on the Saturday closest to March 31.
- (2) 1996 and 2001 were 53-week fiscal periods.
- (3) Second Cup results were significantly impacted by the power outage that occurred in Ontario in August 2003 and the outbreak of SARS in the Greater Toronto Area in April 2003 through June 2003. The financial results for these periods are reflected in fiscal 2004.

- (4) As a result of a change in its fiscal year-end subsequent to the creation of the Fund, Second Cup changed its year-end from the Saturday closest to March 31 to the Saturday closest to December 31. This number represents average sales for cafés reporting at least 50 weeks of sales in the 52-week period ended January 1, 2005.
- (5) For 2005, figures are for the 52 weeks ended December 31, 2005. This number represents average sales figures for cafés reporting at least 50 weeks of sales in the 52-week period ended December 31, 2005.

### *Seasonality*

The first quarter represents the lowest average system sales quarter for the year due to the seasonality of the business. The final quarter, which includes the holiday sales periods of November and December in the retail industry, generally constitutes the highest average system sales quarter of the fiscal year.

### ***Advertising and Marketing***

Second Cup's marketing and advertising initiatives are directed toward enhancing the Second Cup brand as well as promoting new products. Second Cup strives to create highly relevant and appealing campaigns that are consistent with the delivery of an "Oasis Experience" provided in its cafés.

Second Cup's marketing program is funded through contributions made by company-owned and franchised cafés to a national co-operative fund, which is administered by Second Cup. All Second Cup cafés are required to remit a fixed percentage of their Gross Revenue (typically between 1.5% and 3.0%, depending on the type of café) to this fund. These contributions are used to pay for the development and execution of strategic plans, product research and development, training, in-café improvement initiatives and other programs that benefit the Second Cup system as a whole. Examples of such initiatives include print advertising (magazine and newspaper), outdoor advertising (billboard) and internet marketing. The fund is also applied towards other programs such as Café Card administration and marketing, and Guest Satisfaction. Second Cup's proprietary Guest Satisfaction program allows guests to rate their experience at a Second Cup café on an internet website. Site information can be accessed by franchisees to measure the performance of their café.

In addition to contributing to the national co-operative fund, as part of the standard franchise agreement, a franchisee is required to make expenditures on local advertising and promotion of the café in an amount equal to the greater of 2% of the franchisee's annual Gross Revenue and the amount required to be expended pursuant to the provisions of the relevant lease relating to the premises.

### ***Purchasing and Distribution***

In order to differentiate its specialty coffee products on the basis of quality, Second Cup has established exacting standards for the sourcing, roasting, packaging, distribution and blending of Second Cup coffee.

### *Sourcing*

Second Cup uses only Arabica coffee beans, which it seeks to buy from the best growers around the globe. Second Cup's green coffee beans are sourced from a diverse set of suppliers in Central America (Costa Rica and Guatemala), North America (Mexico), South America (Colombia and Brazil), Africa (Kenya and Ethiopia) and Indonesia (Sumatra and Java). Management estimates only 1% to 2% of the world's Arabica coffee beans grown each year meet Second Cup's stringent standards for procurement.

Second Cup has spent years developing and nurturing long-term relationships with farmers, co-operatives and processors in order to secure its supply of high quality coffee. These relationships permit Second Cup to offer many coffees on an exclusive basis. One example is La Minita, an estate coffee from Costa Rica regarded by many in the specialty coffee industry as one of the world's finest. Second Cup continuously aims to strengthen its coffee sourcing programs by visiting coffee growing regions on a regular basis, solidifying relationships with suppliers, sharing best practices with growers and finding additional sources of the highest quality coffee.

Second Cup believes that it has developed relationships with a sufficient number of growers to have a secure source of premium coffee beans. However, Second Cup does not enter into long-term or written agreements with its growers. Second Cup also believes that it has established a sufficient number of alternative sources of high quality coffee beans that could be accessed if any coffee currently purchased from existing suppliers became unavailable or economically unviable.

As with all commodities, coffee is subject to fluctuations in price. Second Cup utilizes the services of a major multi-national food company that carries out the purchasing of Second Cup's coffee beans pursuant to a custom coffee processing and distribution agreement described below. Through its agreement with this company, Second Cup typically locks in a portion of its future coffee costs rather than leaving itself exposed to changes in spot prices. By locking in supply costs, Second Cup and its franchisees can better predict costs and availability of key ingredients.

#### *Roasting, Packaging and Distribution*

As part of its commitment to deliver roaster-fresh, quality products to each café, Second Cup combines the purchase of high quality coffee beans with high standards for roasting, packaging and distribution. Second Cup has a custom coffee processing and distribution agreement (the "Coffee Processing Agreement") with a major multi-national food company (the "Roaster") under which Second Cup has control over the inventory, roasting, packaging and distribution of its products. The Coffee Processing Agreement enables Second Cup to maintain control of its costs and quality standards while leveraging the manufacturing skills of a third party. It also provides Second Cup with access to a national system of warehousing and distribution that affords each café continuous availability of freshly roasted coffee. Furthermore, by virtue of the agreement, Second Cup does not have to invest in production facilities, equipment or working capital and can remain focused on the retail aspect of the business.

Under the Coffee Processing Agreement, franchisees pay a price based on the "all-in" cost of production (including a fixed profit margin to the Roaster). The initial term of the Coffee Processing Agreement is 10 years (ending in 2007), with four five-year renewal options exercisable by Second Cup. If Second Cup elects to renew the Coffee Processing Agreement at the end of the initial term or any renewal term, the Roaster may decline such renewal within a prescribed time frame, in which case Second Cup has the option to extend the Coffee Processing Agreement for a period of up to 12 months. The Coffee Processing Agreement is cancellable by either party after reasonable notice and, in most circumstances, after a compensatory fee has been paid. Second Cup believes that if the Coffee Processing Agreement were terminated, alternative arrangements could be entered into with a number of other suppliers with minimal disruption to its operations.

#### *Quality Control*

Second Cup believes that it is essential to maintain quality control standards at every step in the purchasing and distribution process in order to meet customer expectations.

Second Cup's quality control procedures begin upon delivery of green coffee beans, when each shipment is inspected and sampled for compliance with specifications prior to being shipped to Second Cup's dedicated roasting

facility. Once inspected, Second Cup coffees are roasted using a “batch roasting” method. This method calls for roasting comparatively small amounts of beans at any one time to maximize the taste profile of each roast. Batch roasting allows Second Cup to ensure superior coffee quality because of the ability to determine the exact temperature and length of time for its various roasts. In addition, by using a dedicated roasting facility, Second Cup is able to maintain a consistently high standard of coffee beans free of contamination from beans of lower quality used by other coffee producers.

Second Cup also adheres to a strict packaging policy. As is standard in the specialty coffee industry, coffee is packaged in special one-way valve bags, which allow gases emitted by the freshly roasted coffee to escape while preventing air or moisture from entering the bag and causing the coffee to become stale. This contrasts with the majority of non-specialty coffee, which is packaged in tins or brick packs in which the coffee cannot be packaged until after gases cease emission and the staling process commences.

Second Cup has also established quality control standards for the blending of its coffee. For in-café preparation, coffee must be used within four hours of being ground and must be sold according to Second Cup’s exacting standards for freshness.

### ***Franchise Operations***

Second Cup is the largest specialty coffee café franchisor in Canada. It views its franchise system as the principal means to successfully enhance and expand the Second Cup brand and café network. As at December 31, 2005, Second Cup had 328 franchisee developed cafés in operation, owned by a total of approximately 279 different Second Cup franchisees. Thirty-eight of these franchised cafés are operated pursuant to a master franchise agreement with Cara.

Second Cup’s rigorous and systematic franchisee screening and selection process has been developed to ensure that only franchisees with appropriate skill levels, professional experience, financial capital, passion for the business and drive to succeed are selected to become Second Cup franchisees. Franchisees go through a pre-screening process that consists of financial and background checks as well as a series of interviews with senior management prior to receiving approval to become a Second Cup franchisee.

Second Cup franchisees typically invest between \$225,000 and \$350,000 to open a new Second Cup café. They own and operate the Second Cup cafés as independent businesses, licensed under a franchise agreement to use the Second Cup Marks. Second Cup franchisees are required to devote their full time and attention to the business and to personally play a leadership role in the café’s operations.

Second Cup has a proven ability to select, develop, manage and motivate franchisees to drive long-term growth both within existing cafés and through new café growth. Over the past three decades, Second Cup has developed an operating system that provides each franchisee with the training, tools and guidance to enable each franchisee to maximize its business potential. Key components of this system include effective site selection, café design and build out, equipment selection and maintenance programs, “best in class” products and services from suppliers, and innovative product development and category management.

At Second Cup, franchisees who consistently meet high operational standards are given the opportunity to become franchisees of additional units and are known as “multi-unit” operators. Multi-unit franchising has helped accelerate new café growth and has served as a motivating incentive for single-café franchisees.

## *Second Cup Franchise Agreements*

The relationship between Second Cup and each of its franchisees is governed by a franchise agreement. Although the terms of the franchise agreements entered into with Second Cup franchisees may differ for certain franchisees (e.g., Cara and certain non-traditional franchisees, such as hospitals and universities), they are substantially similar and are summarized below.

Upon execution of a franchise agreement, a Second Cup franchisee must pay certain fees, including an initial non-refundable franchise fee, which is currently \$25,000. In addition to the initial franchise fee, the franchisee must pay all expenses incurred in order to fully construct or complete all improvements to the premises to ensure that it is in accordance with Second Cup's standards. As part of this requirement, a non-refundable amount of \$12,000 is charged for construction administration.

Under the standard Second Cup franchise agreement, a franchisee pays an ongoing royalty of 9% of the café's Gross Revenue. While there are certain cafés which pay a lower royalty rate, the vast majority of these cafés are located in institutions such as hospitals and educational facilities, or are cafés operated by Cara, which typically require less franchisor support. As a result, the overall effective average royalty rate for all Second Cup franchisees is approximately 8.5%. Royalties are payable in instalments, on or before the 10<sup>th</sup> day immediately following the end of a four-week period determined in accordance with Second Cup's accounting system.

"Gross Revenue" is defined generally in the standard Second Cup franchise agreement to mean the total amount of all sales and other income whatsoever, from whatever source (whether it be of a retail, wholesale or other nature), derived from operating a Second Cup café or any other business activity whatsoever at the Second Cup café, or derived from selling any products from any location, whether or not such amounts are collected and whether payment is made by way of cash, credit or otherwise. Without limiting the generality of the foregoing, Gross Revenue includes:

- All sales made pursuant to telephone, electronic communication or other similarly placed orders;
- The amount of all sales assumed to have been lost by the interruption of the operation of a Second Cup café and which is the basis upon which an insurer has or will pay business interruption insurance;
- All sales made in any part of the shopping mall, building, complex or development in which the Second Cup café is located and/or of which it is a part.

The following is not included in calculating Gross Revenue:

- The amount of any tax imposed by the provincial government of the province within Canada in which the Second Cup café is located, directly on retail sales and collected from customers in their presence at the time of the sale, provided that the amount of any such tax is in fact paid by the operator of the Second Cup café to the provincial government;
- The amount of any sales tax imposed by the federal government of Canada, directly on retail sales and collected from customers in their presence at the time of sale, provided the amount of the sales tax is in fact paid by the operator of the Second Cup café to the federal government of Canada.

In calculating Gross Revenue, the following is deducted:

- The amount of any cash refunded to a customer on account of the return of any products, provided that the amount refunded in respect of such products was originally included in calculating Gross Revenue;
- An exchange of products made between the operator of the Second Cup café and a customer, provided that the amount paid for the products by the customer was originally included in calculating Gross Revenue;
- An amount equal to the value of any discount given to a customer on account of the purchase of any products through the use of a coupon or other similar promotions approved by Second Cup, provided the sale upon which the discount is given was recorded at full value in calculating Gross Revenue.

In calculating Gross Revenue, no allowance whatsoever is made for bad debts. Each sale of products made upon instalment or credit is treated as a sale at the full price at the time such products are ordered, irrespective of the time when the operator of the Second Cup café delivers the products or receives payment for such products.

As part of the standard franchise agreement, a franchisee is also required to make expenditures on local advertising and promotion of the café in an amount equal to the greater of 2% of the franchisee's annual Gross Revenue and the amount required to be expended pursuant to the provisions of the relevant lease relating to the premises. In addition to local advertising and promotion, the majority of franchisees are required to contribute between 1.5% and 3.0% of their annual Gross Revenue to Second Cup's national co-operative fund. This fee is payable to Second Cup at the same time as the royalty fee described above. See "— Advertising and Marketing" above.

Second Cup typically enters into the head lease for a café location and, in turn, enters into a sublease with the franchisee concurrently with the entering into of the franchise agreement. Pursuant to the sublease, the franchisee agrees to observe and perform all of the terms and conditions contained in the head lease. The franchisee is generally responsible for paying all rent and other amounts to be paid by Second Cup under the head lease in addition to all amounts payable under the franchise agreement, which are deemed to be additional rent owing under the head lease and sublease, entitling Second Cup to the remedies provided for the non-payment of rent. Any default by the franchisee under the sublease is deemed to be a default under the franchise agreement, allowing Second Cup to terminate the franchise agreement. Similarly, any default by the franchisee under the franchise agreement is deemed to be a default under the sublease, allowing Second Cup to terminate the sublease.

Aside from the head lease, Second Cup is not obliged to provide any financial covenants or guarantees in connection with a franchisee's financial arrangements, including with respect to equipment leases and supply purchases. Further, each franchisee is required to maintain risk insurance in respect of the leased premises and equipment (to their full replacement value), comprehensive general liability insurance, business interruption insurance, insurance required pursuant to the lease of the premises and such other coverage as Second Cup may require from time to time.

Unless terminated earlier by Second Cup in accordance with its terms, the term of each Second Cup franchise agreement commences on execution of the agreement and terminates at the close of business on the day which is one day prior to the earlier of: (i) the date upon which the specific term of the lease governing the occupancy of the premises at the time of entering into of the franchise agreement expires and (ii) the date on which the lease for the premises is terminated. Upon completion of this term, which is typically 10 years, but without execution of a new franchise agreement, a franchisee may, with the consent of Second Cup, continue to occupy the premises and carry on



business as a franchisee of Second Cup on a calendar month-to-month basis upon the same terms and conditions set out in the original franchise agreement. The Second Cup franchise agreement does not confer on the franchisee any right of renewal. If the café has been well managed and other criteria for success are present, a new term may be granted. A franchise agreement will not be renewed if Second Cup management believes that, as a result of shifts in demographics or other criteria key to a successful café, the economic probability for success is low.

The Second Cup franchise agreement permits transfers of a franchisee's interest in a Second Cup café, subject to Second Cup's consent. In the case of a transfer, a franchisee is required to pay to Second Cup 10% of the purchase price to be paid by the purchaser. Prior to the completion of the transfer, the purchaser is subject to the same screening process as other new candidates and is required to successfully complete any training that may be required by Second Cup.

### *Franchise Reporting*

In accordance with their franchise agreements, franchisees are required to provide a Gross Revenue report as well as a cash report on a weekly basis. Within 10 days of the end of each four-week period, franchisees are required to submit a statement of Gross Revenue which sets out daily Gross Revenue and total Gross Revenue for such period. Franchisees are also required to furnish profit and loss statements and various other reports, including completed labour schedules, production reports, purchase records and inventory forms.

In addition to self-reporting by franchisees, Second Cup's territory managers are required to "score" Second Cup cafés three times per year against an exhaustive list of operational standards to ensure quality and consistency in the chain.

### *Franchise Support Systems*

Second Cup's franchise system is managed by its Vice-President, Operations, who is supported by three regional directors and 12 territory managers, as well as a number of other employees in customer service, training and other operational functions. Second Cup seeks to provide a variety of support services to its franchisees to assist them in becoming successful operators, including the following:

- *Franchisee Selection and Approval* — Second Cup continuously improves upon its systematic approach to the selection of franchisees. Potential franchisees, whether they are acquiring cafés from Second Cup or from existing Second Cup franchisees, are required to go through a series of checks, interviews and hands-on performance evaluations to ensure that the quality of Second Cup's franchisee base is continuously improving.
- *Real Estate and Development* — Second Cup's real estate and development teams take a lead role in identifying and securing prime development locations for new cafés. This includes market and site analysis and site-specific financial projections, allowing senior management the opportunity to make informed decisions on potential sites prior to franchisee selection. In addition, the team negotiates with landlords on all new and renewal lease agreements. Second Cup provides full management services (including design, equipment procurement and construction management services) to franchisees for both the construction of new cafés, as well as the remodelling and upgrading of existing cafés, to ensure that the cafés conform to current design standards.
- *Second Cup School of Business* — Second Cup strongly believes that coffee knowledge and training represent points of meaningful differentiation in the specialty coffee market. Following the decision to join Second Cup's franchise family, franchisees enrol in Second Cup's School of Business

training program. Over a three-week period, franchisees are given detailed instruction on the management of a Second Cup café, the fundamentals of coffee and the coffee retailing business. The program includes both classroom sessions and in-café instruction.

- *Training and Development* — In addition to the School of Business, training sessions are conducted periodically throughout the year. Second Cup also provides ongoing guidance for franchisees through regular visits from territory managers, the holding of periodic seminars, workshops and meetings, and by providing a CD-ROM-based training program to assist franchisees in properly training their staff. Additionally, in order to promote a deeply rooted understanding of the coffee industry, each operator is required to make an educational trip to Costa Rica upon entering into the franchise agreement, to experience first hand the growing, harvesting and processing of high quality coffee.
- *Café Opening Support* — Second Cup provides a minimum of 12 to 14 days of full time, in-café support for new café openings. A territory manager provides three days of advance planning and training services to the franchisee and then remains at the café for a full week following the opening of the café. Furthermore, two one-day follow-up sessions are scheduled 30 and 90 days after the opening of the café to ensure that operating standards are being met.
- *Conventions, Special Events and Franchisee Advisory Council* — Second Cup hosts an annual convention at which franchisees, management and key suppliers interact and participate in educational sessions, workshops and social activities. In addition, regional meetings are held periodically during the year. Furthermore, Second Cup has established a Franchisee Advisory Council that provides management with franchisee feedback and input into key decision processes. The council is comprised of 12 members elected by the franchisees and generally meets three times a year to discuss strategy and business objectives with management.
- *National Marketing and Program Development* — Second Cup is responsible for collecting all contributions from franchisees to the national co-operative fund, which are then used to advertise the Second Cup brand, promote new and existing products and develop chain-wide programs on behalf of franchisees.
- *Product Sourcing* — To maintain the quality and consistency of ingredients and products, as well as to ensure that franchisees obtain favourable pricing, Second Cup establishes product specifications and negotiates supply arrangements with authorized suppliers.
- *Finance and Technology* — Second Cup provides appropriate customized tools and training for franchisees to manage the financial performance of their cafés and ensure appropriate financial reporting to Second Cup on an ongoing basis. Second Cup also recently introduced robust and formalised business planning tools to assist franchisees achieve long-term financial success. Additional information technology assistance is also provided in the form of standardized point of sale platforms and web-based information systems focused on operational knowledge.

## ***Employees***

As at December 31, 2005, 48 individuals were employed by Second Cup at its head office, as well as an estimated 380 employees in company-owned cafés. Second Cup's employees are not unionized, and Second Cup has

never experienced a strike or work stoppage. Second Cup believes that its relations with its employees are very positive.

***Management***

The continued success of Second Cup will, in part, be determined by its ability to attract and retain top quality management personnel. The names and municipalities of residence of the persons who are the executive officers of Second Cup are as follows:

<u>Name</u>	<u>Position with Second Cup</u>
Gabriel Tsampalieros..... <i>Markham, Ontario</i>	Chairman of the Board
J. Bruce Elliot..... <i>Toronto, Ontario</i>	President
Michael Forsayeth..... <i>Toronto, Ontario</i>	Chief Financial Officer
John Delutis ..... <i>Pickering, Ontario</i>	Vice-President, Operations
Ian Wilkie..... <i>Mississauga, Ontario</i>	Secretary
Stephen A. Devito..... <i>Richmond Hill, Ontario</i>	Director of Finance and Administration
Marla Copeland ..... <i>Toronto, Ontario</i>	Director of Marketing and New Product Development
Chris Tarrant ..... <i>Barrie, Ontario</i>	Director of Real Estate and Development
Derek Taylor ..... <i>Milton, Ontario</i>	Director of Franchising

The following is a summary biography of each of the members of the senior management team of Second Cup:

*Gabriel Tsampalieros — Chairman*

Mr. Tsampalieros has been involved in all aspects of the foodservice industry for over 20 years. In October 1995, Mr. Tsampalieros became the President and Chief Operating Officer of Cara. From 1997 to February 2006, Mr. Tsampalieros was the President and Chief Executive Officer of Cara. He became a director of Second Cup in May 1996 and its Chairman in 2002.

*J. Bruce Elliot — President*

Mr. Elliot became Second Cup's President in August 2004. Mr. Elliot has been involved in many aspects of the food and beverage industries since the late 1970s. Prior to joining Second Cup, Mr. Elliot was at Labatt Breweries of Canada, where he spent over 25 years in progressively senior management roles. From 1977 through 1992, he held various senior marketing and sales management positions with the company and from 1992 until 1995 he was its Vice-President, Marketing and Sales. From 1995 until 1998, Mr. Elliot was the President of Labatt Atlantic; from 1998 until 2000, he was the President of Labatt Breweries of Ontario; and from 2000 until 2003, he was the President of Labatt Breweries of Canada.

*Michael Forsayeth — Chief Financial Officer*

Mr. Forsayeth is a designated Chartered Accountant with the Institute of Chartered Accountants and has been Senior Vice-President and Chief Financial Officer of Cara since 1999. Prior to joining Cara, Mr. Forsayeth spent 11 years in progressively senior management positions with Laidlaw Inc., including President of their Transit and Tour operations, and with Derlan Industries Limited, as Chief Financial Officer.

*John Delutis — Vice-President, Operations*

Mr. Delutis has been Vice President, Operations since 2005 and has held various positions with Second Cup since joining in 1997 including Director of Regional Operations, a position he held for five year prior to taking on his current role. Mr. Delutis has over 20 years experience in the Canadian food industry and spent 10 years with the TDL Group Ltd. (Tim Hortons) in various operational positions.

*Ian Wilkie — Secretary*

Mr. Wilkie has held various legal and senior management positions with Cara since 1988. He is currently Cara's Senior Vice President, General Counsel and Corporate Secretary. Prior to joining Cara, Mr. Wilkie spent 11 years in progressively senior management positions, including as Vice President Legal and Corporate Affairs, with Wardair International Ltd., then a publicly traded corporation and Canada's third largest international airline.

*Stephen A. Devito — Director of Finance and Administration*

Mr. Devito has held various finance and accounting related positions since 1995 and is a designated Chartered Accountant with the Institute of Chartered Accountants of Ontario. From 1998 to 2000, Mr. Devito was employed as an auditor with PricewaterhouseCoopers LLP. From 2000 to 2001, Mr. Devito held the position of Controller for DWL Incorporated, a worldwide software developer. Mr. Devito joined Second Cup's senior management team in 2001 as Director of Finance.

*Marla Copeland — Director of Marketing and New Product Development*

Ms. Copeland has worked in the food and beverage industry since 1990 in a marketing and new product development capacity. Ms. Copeland joined Second Cup in 2001 as Director of New Product Development, and assumed full responsibility for Second Cup's marketing function in November 2003. Prior to joining Second Cup, Ms. Copeland worked at General Mills Canada, Kellogg Australia and Nabisco Canada in various marketing roles. Ms. Copeland also held a senior management role at George Patterson Bates Australia, a major Australian advertising agency, where she consulted with leading food and beverage clients on new product launches and brand strategy.

*Chris Tarrant — Director of Real Estate and Development*

Mr. Tarrant has over 20 years experience in various real estate positions in the food service industry. He most recently held the position of Vice President of Real Estate and Development for KremeKo Inc., the Canadian Area Developer for Krispy Kreme Doughnuts. He held this position from 2001 to 2005. For the seven years prior to that, Mr. Tarrant held various development positions with McDonald's Restaurants of Canada, responsible for development and construction in various parts of Canada. Previously, he was also a full partner in Tipase Management Leasing, a full service retail consulting company whose clients included Il Fornello Restaurants. Mr. Tarrant joined Second Cup's senior management team in 2005 as Director of Real Estate and Development.

*Derek Taylor – Director of Franchising*

Mr. Taylor has held various franchising positions since 2002 with Cara and subsequently, Second Cup. He has 25 years experience in the food service industry, covering both franchising and finance functions. Prior to joining Cara, Mr. Taylor managed an independent franchising consultancy since 1993. From 1989 to 1993 he held the position of Director of Finance with Prime Restaurant Systems Inc, a Canadian franchisor in the food service sector.

***Government Regulation***

Second Cup and its cafés are subject to the laws and regulations that typically apply to a Canadian foodservice operator. For instance, company-owned and franchised Second Cup cafés are subject to regulation by a number of health, sanitation, safety, fire, building and other agencies or governmental authorities in the provinces or municipalities in which cafés are located. Second Cup must also comply with the laws and regulations adopted in the Provinces of Ontario and Alberta that require certain disclosure to be made with respect to the offer and sale of franchises. These laws require Second Cup to furnish prospective franchisees located in Ontario or Alberta, as applicable, with a disclosure document containing information prescribed by these laws. In addition, Second Cup and its franchisees are subject to provincial labour and employment laws that govern their relationship with employees, such as minimum wage requirements, overtime and working conditions.

***Relationship with Cara***

Second Cup is a wholly-owned subsidiary of Cara. Cara is the leading Canadian integrated restaurant company, and the largest operator of full-service restaurants in the country as measured by sales and number of restaurants. Cara's foodservice activities are focused on preparing, serving and distributing a variety of products through six branded restaurant chains, catering programs and integrated food distribution operations. In addition to Second Cup, Cara's brands include Swiss Chalet, Kelsey's Neighbourhood Bar & Grill, Montana's Cookhouse, Milestone's Grill & Bar and Harvey's. Cara became a privately-held company in February 2004.

Second Cup believes that its inclusion in the Cara family of companies provides synergistic value and positions Second Cup to be innovative in its product and service offerings. In addition, Second Cup benefits from a number of administrative services provided by Cara. These services enable Second Cup to dedicate personnel and other resources to effectively managing and growing its business. Administrative services provided by Cara to Second Cup include: (i) office space and support services; (ii) legal services, including franchising, leasing, trade-mark and litigation support; (iii) purchasing services, pursuant to which Cara manages supplier arrangements other than those relating to green coffee bean sourcing and roasting; (iv) human resource management; (v) general accounting;

(vi) information technology; and (vii) internal audit services. Second Cup pays an administrative fee to Cara for these services.

Cara is also a franchisee of Second Cup, with 38 cafés currently operating under a master franchise agreement entered into with Second Cup in 1996. In addition, Cara is the owner of the international operations of Second Cup (see “ – The Second Cup Café System – Geographic Presence”). Second Cup manages these operations in return for an administrative fee charged to Cara.

## **RISK FACTORS**

An investment in the Units involves a number of risks. In addition to the other information contained in this Annual Information Form, investors and prospective investors should give careful consideration to the following factors.

### ***Risks Related to the Business of Second Cup***

**The Canadian specialty coffee industry is characterized by intense competition and limited diversification and depends on numerous factors affecting discretionary consumer spending.**

The Fund’s performance is dependent upon the Royalty received by MarksCo from Second Cup. The amount of the Royalty will be dependent upon System Sales, which are subject to a number of factors that affect the Canadian specialty coffee industry. The Canadian specialty coffee industry is intensely competitive with respect to price, location and coffee and food quality. In addition to Second Cup there are two major specialty coffee retailers in Canada, as well as a growing number of smaller, mainly regional, competitors. In addition to competing directly with specialty coffee retailers, Second Cup competes with “mainstream” coffee retailers as well as all restaurants and food service outlets that serve coffee. In the whole and ground bean segment of the specialty coffee industry, Second Cup franchisees will compete against specialty coffee chains as well as supermarkets, many of which have substantially greater financial and other resources than Second Cup franchisees will have. If Second Cup franchisees are unable to successfully compete in the Canadian specialty coffee industry, System Sales may be adversely affected, the amount of the Royalty may be reduced and the ability of the Fund to pay distributions will be adversely affected.

The Canadian specialty coffee industry is also affected by changes in discretionary spending patterns, which in turn are dependent on consumer confidence, disposable consumer income and general economic conditions. Adverse changes to these factors could reduce customer traffic at Second Cup cafés or impose practical limits on pricing, either of which could reduce System Sales and the Royalty received by MarksCo. Because the industry’s revenues are predominantly derived from the sale of coffee and coffee beverages, changes in consumer preferences which result in decreases in coffee consumption would have an adverse effect on the industry, including Second Cup and the Second Cup franchisees. The coffee business is also affected by changes in demographic trends, traffic and weather patterns and the type, number and proximity of competing cafés. In addition, factors such as inflation, increased ingredient, raw material, labour and benefit costs and the availability of experienced management and hourly employees may adversely affect the Canadian specialty coffee industry in general and therefore potentially affect Second Cup and the Second Cup franchisees.

**A shortage in the supply or an increase in the price of premium quality coffee beans could adversely affect Second Cup.**

The success of Second Cup franchisees to generate System Sales will depend to a large extent upon the availability of premium quality green coffee beans at reasonable prices. The availability and price of premium quality green coffee beans are influenced by several factors that are beyond Second Cup's and Second Cup franchisees' control, including changes in weather patterns and other natural phenomena, political events or disruptions of shipping and port channels. In addition, green coffee bean prices have been affected in the past, and could be affected in the future, by the actions of governments or organizations which have attempted to influence commodity prices of green coffee beans through agreements establishing export quotas or restricting coffee supplies worldwide. Price increases for green coffee beans could result in increases in the retail price of coffee beverages and other coffee products sold in Second Cup cafés, which could adversely affect System Sales and reduce the Royalty. Similarly, a significant reduction in the availability of coffee beans purchased by Second Cup could have a material adverse effect on System Sales and the Royalty received by MarksCo.

Second Cup has no long-term or written contracts with coffee bean suppliers and relies upon historical relationships to ensure availability. While there are a number of coffee bean suppliers, there can be no assurance that coffee bean suppliers that have relationships with Second Cup will continue to supply coffee beans at competitive prices.

**The growth of the café network is dependent on Second Cup's ability to attract qualified franchisees.**

The growth of the café network is dependent upon the ability of Second Cup to attract qualified franchisees. The opening and success of Second Cup cafés is dependent on a number of factors, including: availability of suitable sites; negotiations of acceptable leases for new locations; availability, training and retention of management and other employees necessary to staff new Second Cup cafés; adequately supervising construction; and securing suitable financing; among other factors, some of which are beyond the control of Second Cup. Furthermore, Second Cup franchisees may not have all the business abilities or access to financial resources necessary to successfully develop or operate a Second Cup café. Second Cup provides training and support to its franchisees, but the quality of franchised operations may be diminished by any number of factors beyond Second Cup's control. There is no assurance that Second Cup franchisees will successfully operate cafés in a manner consistent with Second Cup's standards and requirements, or hire and train qualified managers and other personnel. If they do not, the image and reputation of Second Cup may suffer, and System Sales and results of operations of the Second Cup cafés could decline.

**The ability to locate and secure acceptable Second Cup cafés sites may be limited.**

Second Cup faces competition for café locations and franchisees from its competitors and from franchisors and operators of other businesses. The success of Second Cup franchisees is significantly influenced by the location of their cafés. There can be no assurance that current Second Cup café locations will continue to be attractive, or that additional café sites can be located and secured as demographic patterns change. Also, there is no guarantee that the property leases in respect of the Second Cup cafés will be renewed or suitable alternative locations will be obtained and, in such event, one or several cafés could be closed. It is possible that the current locations or economic conditions where Second Cup cafés are located could decline in the future, resulting in potentially reduced sales in those locations, which will have an adverse effect on System Sales and the ability of Second Cup to pay the Royalty. There is also no assurance that future sites will produce the same results as past sites.

**The closure of Second Cup cafés may affect the amount of the Royalty.**

The amount of the Royalty payable to MarksCo by Second Cup will depend on System Sales, which will in turn depend on the number of Second Cup cafés that are included in the Royalty Pool and the System Sales of these Second Cup cafés. Each year, a number of Second Cup cafés may close in the normal course and, while Second Cup will be required to replace the System Sales that are lost as a result of the closure of Second Cup cafés with the System Sales from new Second Cup cafés or pay the Make-Whole Payment, there is no assurance that Second Cup will be able to open sufficient new Second Cup cafés to replace the System Sales of the Second Cup cafés that have closed, or will have the financial resources to make the Make-Whole Payment.

**Second Cup's ability to pay the Royalty will depend primarily on the ability of franchisees to generate Gross Revenue.**

The ability of Second Cup to pay the Royalty will depend primarily on Second Cup franchisees' ability to generate Gross Revenue and to pay royalties to Second Cup. Failure to achieve adequate levels of collection from Second Cup franchisees could have an adverse effect on the ability of Second Cup to pay the Royalty.

**Franchisees report Gross Revenue to Second Cup without audit or other form of independent assurance.**

Pursuant to the franchise agreements, franchisees report Gross Revenue to Second Cup on a weekly basis without audit or other form of independent assurance. Although Second Cup has developed various mechanisms to seek to verify Gross Revenue reported by its franchisees, Second Cup does not have a centralized accounting system in place to monitor such Gross Revenue. Second Cup seeks to substantiate Gross Revenue reported by its franchisees through, among other things, analytical and financial reviews performed by management, on site visits, and analysis of raw material purchases by the cafés. Furthermore, audits are performed at random by an internal audit team on cafés throughout the network. There can be no assurance, however, that Gross Revenue reported by franchisees is accurate and in accordance with the terms of the franchise agreements.

**The loss of key personnel could have a material impact on Second Cup's operations.**

The success of Second Cup will depend on the efforts of key personnel to retain and attract appropriate franchisee candidates and locate new café sites in order to continue to successfully grow Second Cup's business and thereby increase System Sales. The loss of the services of such key personnel could have an adverse effect on the operations of Second Cup. If such key personnel depart Second Cup and subsequently compete with Second Cup or devote significantly more time to other business interests, such activities could have a material adverse effect on Second Cup's ability to conduct its business, maintain existing franchises, generate new franchises and locate new café sites and this in turn could affect the Royalty paid to MarksCo.

**The failure to enforce or maintain, or a successful challenge to, the Second Cup Marks may have an adverse impact on the Royalty.**

The ability of Second Cup to maintain or increase its System Sales will depend on its ability to capitalize on the Second Cup brand through the use of the Second Cup Marks licensed from MarksCo. If MarksCo fails to enforce or maintain any of its intellectual property rights, Second Cup may be unable to capitalize on its efforts to utilize its brand equity. In addition, if any Second Cup Marks are ever successfully challenged, this may have an adverse impact on System Sales and therefore on the Royalty.

MarksCo will own the Second Cup Marks in Canada. It will not own identical or similar trade-marks relating to the Second Cup business in other jurisdictions. Third parties may use such trade-marks in jurisdictions other than



Canada in a manner that diminishes the value of such trade-marks. If this occurs, the value of the Second Cup Marks may suffer and System Sales could decline. Similarly, negative publicity or events associated with such trade-marks in jurisdictions outside of Canada may negatively affect the image and reputation of Second Cup cafés in Canada, resulting in a decline in System Sales.

**Changes in or failure to comply with government regulation could have an adverse effect on Second Cup.**

Second Cup franchisees will be subject to various federal, provincial and local laws affecting their business. Each Second Cup café is subject to licensing and regulation by a number of governmental authorities, which may regulate among other things, food inspection, health, employee and public safety, zoning, smoking laws and fire prevention. Difficulties in obtaining or failures to obtain the required licences or approvals could delay or prevent the development of a new Second Cup café in a particular area. In addition, changes in laws and regulations to which Second Cup and its franchisees are currently subject may have an adverse effect on System Sales. The loss of a licence or approval, or a violation of laws, could force the temporary or permanent shut down of a Second Cup café, which could adversely affect System Sales.

**Potential litigation and other complaints could adversely affect System Sales.**

Second Cup franchisees may be the subject of complaints or litigation from customers alleging food related illness, injuries suffered on the premises or other food quality, health or operational concerns. Adverse publicity resulting from such allegations may adversely affect the Gross Revenue of Second Cup cafés, regardless of whether such allegations are true or whether Second Cup or the Second Cup franchisee is ultimately held liable. In addition, due to the nature of its business, Second Cup may from time to time be involved in litigation with past and existing franchisees, suppliers and other third parties. Although historically Second Cup's involvement in such litigation has been rare and has not been material to the operation of the business of Second Cup, litigation is expensive, time consuming and may divert management's attention away from the operation of the business. Management cannot be certain that a substantial claim may not arise that would be material to the operations of Second Cup.

***Risk Related to the Structure of the Fund***

**The cash distributions to unitholders are not guaranteed and will depend on AcquisitionCo's ability to make dividend and interest payments to the Fund.**

The cash distributions made to unitholders are not guaranteed and will be dependent on the ability of AcquisitionCo to pay its interest obligations under the AcquisitionCo Notes and to pay dividends or other amounts on the AcquisitionCo Common Shares. Payments by AcquisitionCo depend, in turn, on the ability of MarksCo to pay the interest obligations on the MarksCo Notes and dividends on the MarksCo Common Shares held by AcquisitionCo. Payments by AcquisitionCo and MarksCo will be after provisions for administrative expenses and other obligations and liabilities (including taxes, if any) and other amounts. See "Governance and Share and Loan Capital of AcquisitionCo — Distribution Policy" and "Share and Loan Capital of MarksCo — Distribution Policy".

**MarksCo is dependent on Second Cup to pay the Royalty to it.**

The primary source of revenue of MarksCo is the Royalty payable to it by Second Cup. Second Cup collects royalties, franchise fees and other amounts from Second Cup franchisees and also generates revenues from its company-owned cafés. In the conduct of its business, Second Cup pays expenses and incurs debt and obligations to third parties. These expenses, debts and obligations could impact the ability of Second Cup to pay the Royalty to MarksCo.

MarksCo depends on the operations and assets of Second Cup to pay the Royalty and any Make-Whole Payment to it, and is subject to the risks encountered by Second Cup in the operation of its business, including the risks relating to the Canadian specialty coffee industry referred to above and the results of operations and financial condition of Second Cup.

**The Units do not represent a direct investment in AcquisitionCo or MarksCo.**

Securities such as the Units are hybrids in that they share certain attributes common to both equity securities and debt instruments. The Units do not represent a direct investment in AcquisitionCo or MarksCo and should not be viewed by investors as units in AcquisitionCo or MarksCo. As holders of Units, unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring “oppression” or “derivative” actions. The Units represent a fractional interest in the Fund. The Fund’s primary assets will be the AcquisitionCo Notes and the AcquisitionCo Common Shares. The price per Unit will be a function of anticipated distributable cash.

**The security interest granted by Second Cup to MarksCo may not attach to leases relating to certain Second Cup cafés.**

No agreements or consents in respect of the security interest granted by Second Cup to MarksCo will be obtained from landlords of Second Cup. As a result, due to the nature of the security interest provided by Second Cup and the fact that no agreements or consents are being sought, the security interest granted by Second Cup may not attach to leases relating to certain Second Cup cafés. In addition, where a security interest is created, the rights granted by Second Cup to MarksCo will be subject to the rights of the landlords under the leases. If there is an event of default under the Licence and Royalty Agreement or the General Security Agreement, and MarksCo seeks to realize on its security, there is a risk that, in certain circumstances, the leases for certain Second Cup cafés may be terminated. The appointment of a receiver may trigger cross-default provisions in other agreements, including many of the leases relating to Second Cup cafés. Landlords may also have rights in respect of the non-payment of rent that may rank in priority to the rights of MarksCo.

**The Fund may issue additional Units diluting existing unitholders’ interests.**

The Declaration of Trust authorizes the Fund to issue an unlimited number of Units for such consideration and on such terms and conditions as shall be established by the Fund’s trustees without the approval of any unitholders. Any subsequent issuances of Units by the Fund may dilute the interests of existing unitholders.

**An investment in Units is subject to certain income tax considerations.**

Although the Fund is of the view, and AcquisitionCo and MarksCo are of the view, that all expenses to be claimed by the Fund, AcquisitionCo or MarksCo in the determination of their respective incomes under the Tax Act will be reasonable and deductible in accordance with the applicable provisions of the Tax Act, there can be no assurance that the Tax Act or the interpretation of the Tax Act will not change, or that the Canada Revenue Agency will agree with the expenses claimed.

There can be no assurance that Canadian federal income tax laws respecting the treatment of mutual fund trusts will not be changed in a manner which adversely affects the holders of Units.

Further, interest on the notes accrues at the Fund level for income tax purposes whether or not actually paid. The Declaration of Trust provides that an amount equal to the Fund’s taxable income will be distributed each year to

unitholders in order to reduce the Fund's taxable income to zero. Where interest payments on the notes are due but not paid in whole or in part such that there is insufficient cash for distributions, the Declaration of Trust provides that additional Units must be distributed to unitholders in lieu of cash distributions.

Where Units are issued to unitholders in lieu of cash distributions, including in the circumstances set out above, unitholders will generally be required to include an amount equal to the fair market value of those Units into their taxable income, in circumstances when they do not directly receive a cash distribution.

**Proposed amendments to the Tax Act, if adopted, may cause the Fund to lose its status as a mutual fund trust in certain circumstances.**

Currently, a trust will not be considered to be a mutual fund trust if it is established or maintained primarily for the benefit of non-residents unless all or substantially all of its property is property other than taxable Canadian property as defined in the Tax Act. On September 16, 2004, the Minister of Finance (Canada) released draft amendments to the Tax Act. Under the draft amendments, a trust would lose its status as a mutual fund trust if the aggregate fair market value of all units issued by the trust held by one or more non-resident persons or partnerships that are not Canadian partnerships is more than 50% of the aggregate fair market value of all the units issued by the trust where more than 10% (based on fair market value) of the trust's property is taxable Canadian property or certain other types of property. If the draft amendments are enacted as proposed, and if, at any time, more than 50% of the aggregate fair market value of units of the Fund were held by non-residents and partnerships other than Canadian partnerships, the Fund would thereafter cease to be a mutual fund trust. The draft amendments do not currently provide any means of rectifying a loss of mutual fund trust status. The December 6, 2004 Notice of Ways and Means Motion to implement the tax proposals contained in the 2004 Federal Budget does not contain this proposal and the Department of Finance indicated in a concurrent release that further discussions would be pursued with the private sector in this regard.

**There is no assurance of the Units' continued investment eligibility.**

There can be no assurance that the Units will continue to be qualified investments for Deferred Income Plans and registered education savings plans under the Tax Act. The Tax Act imposes penalties for the acquisition or holding of non-qualified or ineligible investments.

**Distribution of securities on redemption of Units or termination of the Fund may result in unitholders holding illiquid securities.**

Upon a redemption of Units or termination of the Fund, the trustees may distribute the AcquisitionCo Notes or AcquisitionCo Common Shares held by the Fund or the Fund's other assets directly to the unitholders, subject to obtaining all required regulatory approvals. There is currently no market for the AcquisitionCo Notes or AcquisitionCo Common Shares. In addition, the AcquisitionCo Notes and AcquisitionCo Common Shares are not freely tradable and are not currently listed on any stock exchange. Securities of AcquisitionCo so distributed may not be qualified investments for trusts governed by Deferred Income Plans and registered education savings plans, depending upon the circumstances at the time.

**MarksCo has outstanding indebtedness.**

MarksCo will have third-party debt service obligations under the MarksCo Term Loan and the Operating Loan. See “General Development of the Business — MarksCo Term Loan and Operating Loan”. The degree to which MarksCo is leveraged could have important consequences to the holders of the Units, including: (i) a portion of MarksCo’s cash flow from operations will be dedicated to the payment of the principal and interest on its indebtedness, thereby reducing funds available for distribution to AcquisitionCo (and therefore for distribution by AcquisitionCo to the Fund); and (ii) certain of MarksCo’s borrowings will be at variable rates of interest, which exposes MarksCo to the risk of increased interest rates. MarksCo’s ability to make scheduled payments of the principal of, or interest on, or to refinance, its indebtedness will depend on the payment of the Royalty by Second Cup. The MarksCo Term Loan is due three years from the Closing Date. In the event that MarksCo is unable to refinance such loan upon its maturity on terms at least as favourable as the current terms, or at all, the cash available for distribution and payment of interest by MarksCo to AcquisitionCo (and therefore the cash ultimately available for distribution by the Fund to unitholders) may be reduced, and distributions by the Fund may in turn be reduced or suspended until such time as the loan is fully repaid or alternative financing arrangements are made.

The MarksCo Term Loan and Operating Loan contain numerous restrictive covenants that limit the discretion of MarksCo with respect to certain business matters. In certain circumstances, these restrictive covenants may restrict the cash available for distribution and payment of interest by MarksCo to AcquisitionCo (and therefore the cash ultimately available for distribution to unitholders).

Current and future borrowings by Second Cup could adversely affect Second Cup’s ability to pay the Royalty and the Make-Whole Payments.

**MarksCo has contingent liabilities.**

As part of the restructuring of the business of Second Cup prior to the closing of the offering, all of the assets and liabilities relating to Second Cup’s Canadian business, including contractual obligations of Second Cup, but excluding the Second Cup Marks, have been assigned and transferred to Second Cup.

Cara and Second Cup jointly and severally provided in the Acquisition Agreement an absolute, dollar-for-dollar indemnity in respect of any liabilities existing in respect of the assets and liabilities transferred to Second Cup, including the contractual obligations assigned, such that MarksCo will have full recourse to Cara and Second Cup in the event of any liabilities in connection with those assets. However, there is no guarantee that Cara or Second Cup will be financially capable of meeting their obligations pursuant to the indemnity and MarksCo may find itself without recourse to Cara or Second Cup with respect to any liabilities that may arise in respect of the transferred assets.

**There is a remote risk that a unitholder could be personally responsible for the Fund’s obligations.**

The Declaration of Trust provides that no unitholder will be subject to any liability whatsoever to any person in connection with a holding of Units. However, there remains a risk, which is considered to be remote in the circumstances, that a unitholder could be personally liable despite such statement in the Declaration of Trust for the Fund’s obligations to the extent that claims are not satisfied out of the Fund’s assets. It is intended that the Fund’s affairs will be conducted to seek to minimize such risk wherever possible.

## DESCRIPTION OF THE FUND

### *Declaration of Trust*

The Fund is an open-ended trust established under the laws of the Province of Ontario pursuant to the Declaration of Trust. The Fund currently qualifies as a mutual fund trust for the purposes of the Tax Act. The following is a summary of the material attributes and characteristics of the Units and certain provisions of the Declaration of Trust, which does not purport to be complete. Reference is made to the Declaration of Trust for a complete description of the Units and the full text of its provisions. See “Material Contracts”.

### *Activities of the Fund*

The Declaration of Trust provides that the Fund is restricted to:

- (a) investing in or acquiring or disposing of securities, including those issued by AcquisitionCo and MarksCo and their affiliated entities;
- (b) temporarily holding cash in interest-bearing accounts, short-term government debt or investment grade corporate debt for the purposes of paying the Fund’s expenses, paying amounts payable by the Fund in connection with the redemption of any Units and making distributions to unitholders;
- (c) issuing Units (or rights, warrants, convertible or exchangeable securities, subscription receipts or options in respect thereof) pursuant to the Declaration of Trust;
- (d) issuing debt securities or borrowing funds (including by way of letters of credit, bank guarantees and bankers’ acceptances);
- (e) guaranteeing (including as guarantor, surety or co-obligor) the payment or performance of any indebtedness, liability or other obligation of AcquisitionCo, MarksCo or their wholly-owned affiliated entities including with respect to the MarksCo Term Loan and Operating Loan and granting security interests in or otherwise encumbering, pledging (provided that doing so would not affect the redemption rights of unitholders), mortgaging or charging any or all of the Fund’s assets for those obligations, and where considered appropriate, postponing or subordinating its rights under indebtedness or other obligations;
- (f) issuing or redeeming rights to acquire Units pursuant to any unitholder rights plan adopted by the Fund;
- (g) redeeming or repurchasing securities of the Fund;
- (h) entering into and performing its obligations under the Administration Agreement, the Governance Agreement, the Subscription Agreement and the Underwriting Agreement; and
- (i) undertaking such other activities, or taking such actions, including investing in securities, as are related to or in connection with the foregoing or as are contemplated by the Declaration of Trust or as may otherwise be approved by the trustees of the Fund from time to time,

provided that the Fund will not undertake any activity, take any action, or make any investment which would result in the Fund not being considered a “mutual fund trust” for purposes of the Tax Act or which would result in the Units being “foreign property” for the purposes of the Tax Act.

As at the date of this Annual Information Form, the Fund does not intend to hold securities of entities other than AcquisitionCo and MarksCo, other than cash equivalents referred to in (b) above.

### ***Description of Units***

The beneficial interests in the Fund are designated as “Units”, which are entitled to the rights and subject to the limitations, restrictions and conditions set out in the Declaration of Trust, the terms of which are summarized below.

An unlimited number of Units may be created and issued pursuant to the Declaration of Trust. Each Unit is transferable and represents an equal undivided beneficial interest in any of the Fund’s distributions, whether of net income, net realized capital gains or other amounts, and in the Fund’s net assets in the event of the Fund’s termination or winding-up.

All Units have equal rights and privileges and are not subject to future calls or assessments. Except as set out under “ - Redemption Right” below, the Units have no conversion, retraction, redemption or pre-emptive rights.

On December 16, 2004, the *Trust Beneficiaries’ Liabilities Act, 2004* (Ontario) came into force. This statute provides that holders of units of a trust are not, as beneficiaries, liable for any act, default, obligation or liability of the trust if, when the act or default occurs or the liability arises, (i) the trust is a reporting issuer under the Securities Act, and (ii) the trust is governed by the laws of Ontario. The Fund is a reporting issuer under the Securities Act and is governed by the laws of Ontario by virtue of the provisions of its declaration of trust.

No certificates will be issued for fractional Units and fractional Units will not entitle holders to vote in respect of those fractional Units. The Units are not “deposits” within the meaning of the *Canada Deposit Insurance Corporation Act* (Canada) and are not insured under the provisions of such act or any other legislation. Furthermore, the Fund is not a trust company, and accordingly, the Fund is not registered under any trust and loan company legislation as it does not carry on or intend to carry on the business of a trust company.

### ***Issuance of Units***

The Declaration of Trust provides that the Units or rights to acquire Units may be allotted and issued at the times, to the persons, for the consideration and on the terms and conditions that the trustees of the Fund determine. Units may be issued in satisfaction of any non-cash distribution by the Fund to unitholders on a *pro rata* basis (subject to possible escrow and resale arrangements for non-Canadian residents). The Declaration of Trust also provides that, immediately after any *pro rata* distribution of Units to all unitholders in satisfaction of any non-cash distribution, the number of outstanding Units will be consolidated such that each Canadian resident unitholder will hold after the consolidation the same number of Units as the unitholder held before the non-cash distribution. In this case, each Unit certificate representing a number of Units prior to the non-cash distribution will be deemed to represent the same number of Units after the non-cash distribution and the consolidation. Non-Canadian resident unitholders will also have their Units consolidated but may be subject to withholding tax.

### ***Pre-Emptive Right***

The Governance Agreement provides Second Cup with a pre-emptive right pursuant to which the Fund will not issue, or agree to issue, any Units, or any securities which are convertible, exercisable or exchangeable for or into Units, to any person unless an offer is made to Second Cup to issue to it that number of Units or securities, at the same price per Unit or security as the trustees propose to issue the other Units or securities, necessary to maintain the percentage of the outstanding voting interest in the Fund held by Second Cup and any of its affiliates at the date of the offer. Any Units not taken up by Second Cup may be issued to any person within 48 hours (excluding Saturdays, Sundays or holidays) of the date of such offer at not less than the price offered to Second Cup. Second Cup waived its pre-emptive right in connection with the Fund's initial public offering.

### ***Trustees***

The Fund may have a minimum of three trustees and a maximum of 10 trustees. The Declaration of Trust prohibits a non-resident of Canada (as that term is defined in the Tax Act) from acting as a trustee. The trustees of the Fund are to supervise the Fund's activities and manage the Fund's affairs.

The Fund currently has three trustees, each of whom also serves as a director of AcquisitionCo and MarksCo. See "Management and Corporate Governance of MarksCo — Directors" for the principal occupations and biographies of David Bloom, Michael Rosicki and Raymond Guyatt, the trustees of the Fund. Trustees are to be appointed at each annual meeting of unitholders to hold office for a term expiring at the close of the next annual meeting. A majority of trustees of the Fund are required at all times to be "independent" within the meaning of Multilateral Instrument 52-110 — *Audit Committees*. Messrs. Bloom, Rosicki and Guyatt are considered by the Fund to be "independent" within the meaning of such instrument.

Any one or more of the trustees may resign upon prior written notice and may be removed by a resolution passed by a majority of the unitholders. Any vacancy created by such removal or resignation must be filled at the same meeting, failing which it may be filled by the remaining trustees of the Fund.

A quorum of trustees, being a majority of trustees then holding office, may fill a vacancy in the board of trustees, except a vacancy resulting from an increase in the maximum number of trustees beyond the limit described below or from a failure of the unitholders to appoint the minimum number of trustees at a meeting of the unitholders called for such purpose. In the absence of a quorum of trustees or if the vacancy has arisen from a failure of the unitholders to appoint the minimum number of trustees at a meeting of the unitholders called for such purpose, the trustees then holding office will be required to call forthwith a special meeting of the unitholders to fill the vacancy. If the trustees fail to call such meeting or if there are not any trustees then in office, any unitholder may call such a special meeting. If a meeting of unitholders fails to appoint the minimum number of trustees by reason of the disqualification or death of any nominee, the trustees appointed at the meeting may exercise all of the powers of the trustees if the appointed number of trustees constitutes a quorum.

The trustees of the Fund may, between annual meetings of unitholders, appoint one or more additional trustees to serve until the next annual meeting of unitholders, but the number of additional trustees will not at any time exceed one third of the number of trustees who held office at the expiration of the immediately preceding annual meeting of unitholders.

The Declaration of Trust provides that, subject to the terms and conditions thereof, the trustees may, in respect of the assets of the Fund, exercise any and all rights, powers and privileges that could be exercised by a legal and beneficial owner of those assets. The role of the trustees includes, among other things:

- acting for the Fund, voting on the Fund's behalf and representing the Fund as a shareholder and noteholder of AcquisitionCo, including voting for the election of directors of AcquisitionCo;
- maintaining records and providing reports to unitholders;
- supervising the activities of the Fund, including the investments of the Fund; and
- effecting payments of distributions from the Fund to unitholders.

The trustees will also supervise the application of the Fund's written corporate disclosure and insider trading policies. These policies will, among other things:

- articulate the legal obligations of the Fund, its affiliates and their respective trustees, directors, officers and employees with respect to confidential information;
- identify spokespersons of the Fund who are authorized to communicate with third parties such as analysts, the media and investors;
- provide guidelines on the disclosure of forward-looking information;
- require advance review of any disclosure of financial information with a view to ensuring that selective disclosure of material information does not occur; and
- establish "black-out" periods immediately prior to and following the disclosure of quarterly and annual financial results during which the Fund, its affiliates and their respective trustees, directors, officers and certain other persons may not purchase or sell Units in the market.

The Declaration of Trust provides that the trustees of the Fund will act honestly and in good faith with a view to the best interests of the Fund and in connection therewith will exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. The duties and standard of care of the trustees are intended to be similar to, and not any greater than, those imposed on a director of a corporation governed by the *Business Corporations Act* (Ontario). The Declaration of Trust provides that the trustees will be entitled to indemnification from the Fund in respect of the exercise of their powers and the discharge of their duties provided that they acted honestly and in good faith with a view to the best interests of the Fund. In the case of a criminal or administrative action or proceeding that is enforced by a monetary penalty, a trustee will be entitled to indemnification from the Fund provided that he or she had reasonable grounds for believing that his or her conduct was lawful.

The trustees and executive officers of the Fund and its subsidiaries as a group beneficially own, directly or indirectly, or exercise control or direction over, an aggregate of 144,600 Units of the Fund, representing 1.50 % of the issued and outstanding Units.



## *Audit Committee*

As required by applicable securities laws, the Fund has established an audit committee to monitor the Fund's financial reporting, accounting systems and internal controls, and to liaise with the Fund's external auditors. The audit committee is required to consist of at least three trustees, each of whom must be "independent" within the meaning of Multilateral Instrument 52-110 — *Audit Committees*, subject to the provisions of such instrument. The Chair of the audit committee receives compensation of \$3,000 per year for such role.

### *Charter of the Audit Committee*

The charter of the audit committee is attached to this Annual Information Form as Schedule A.

### *Composition of the Audit Committee*

Presently, the audit committee consists of Messrs. Bloom, Guyatt and Rosicki and is chaired by Mr. Guyatt. All members of the audit committee are independent and financially literate, as such terms are defined under Multilateral Instrument 52-110 — *Audit Committees*.

### *Relevant Education and Experience of the Audit Committee Members*

The following is a brief summary of the education and experience of each member of the audit committee, including any education or experience that is relevant to the performance of his responsibilities as an audit committee member:

1. David Bloom is the President and a director of DGRB Consultants Inc. From 1986 to 2001, he was the Chairman and Chief Executive Officer of Shoppers Drug Mart Inc. Mr. Bloom is a founder of the Canadian Association of Chain Drug Stores and a former Chairman of the Retail Council of Canada. He is a director of Sleep Country Canada Inc. and a trustee of Sleep Country Canada Income Fund, as well as a director of Swiss Herbal Remedies Limited and Sterling Centrecorp Inc. Mr. Bloom is also a member of the board of trustees of the Hospital for Sick Children and the board of directors and Audit Committee of the Toronto International Film Festival. Mr. Bloom holds a Bachelors degree (BSc) in Pharmacy from the University of Toronto.
2. Michael Rosicki is the President of Wexford Group Inc. From 1999 to 2004, Mr. Rosicki was Chairman and Chief Executive Officer of Parmalat North America. From 1997 to 1999, Mr. Rosicki was with Mattel, where he began as the President of Mattel Canada Inc. and later became President, Mattel Europe, Canada, Middle East and Africa. Prior to that, he was with Nestlé Canada Inc. for 12 years, where he held progressively senior management positions culminating in his role as President of the company's Foods Group. Mr. Rosicki is a director of the Hospital for Sick Children's Foundation and has held senior positions with various industry and charitable associations, including as past Chairman of the Food & Consumer Products Manufacturers of Canada, past Chairman of The Canadian Children's Foundation and Kids Help Phone, as Founding Chair of National Kids Day and past President of the Ontario Grocery Industry Foundation.
3. Raymond Guyatt is a retired executive. From 1987 to 2000, Mr. Guyatt was the Executive Vice President and Chief Financial Officer of Imasco Limited. He was also a director of both Imasco and CT Financial Services from 1990 to 2000. Mr. Guyatt was a director of Mackenzie Financial Corporation from 2002 to 2005 and was Chairman of the Innovation Council of the Canadian Institute of Chartered Accountants from 2001 to 2003. Mr. Guyatt is a Chartered Accountant and a member of the Institute of Chartered Accountants of Ontario.

### *Pre-approval Policies and Procedures*

There have been no recommendations of the audit committee to nominate or compensate an external auditor which have not been adopted by the board of trustees of the Fund. In accordance with the Fund's audit committee charter, all non-audit services to be provided to the Fund or any of its affiliates by the external auditors or any of their affiliates shall be subject to pre-approval by the audit committee. The committee may approve policies and procedures for the pre-approval of non-audit services to be rendered by the external auditors, which policies and procedures (i) shall include reasonable detail with respect to the services covered, (ii) shall require that the committee be informed of each non-audit service and (iii) shall not include delegation of the committee's responsibilities to management of MarksCo.

### *Audit Fees*

PricewaterhouseCoopers LLP has served as the Fund's auditing firm since the Fund's inception in 2004. Fees paid or payable for the years ended December 31, 2005 and December 31, 2004 to PricewaterhouseCoopers LLP are \$64,500 and \$573,000 respectively. These fees are detailed below:

	<b>Year ended December 31, 2005</b>	<b>Year ended December 31, 2004</b>
Audit fees	\$ 37,500	\$ 35,000
Audit-related fees	Nil	Nil
Tax fees	Nil	Nil
All other fees	\$ 27,000	538,000
	<b>\$ 64,500</b>	<b>\$ 573,000</b>

The nature of each category of fees is described below.

Audit fees: Audit fees were paid for professional services rendered for the audit of the Fund's annual financial statements, review of the Fund's quarterly reporting, and for services that are normally provided in connection with the statutory and regulatory filings or engagements.

All other fees: Other fees were paid for professional services rendered with respect to assistance with compliance with new accounting standards effective in fiscal 2005. In fiscal 2004, other fees were paid for professional services rendered in relation to the initial public offering of the Fund, including the preparation and review of the long form prospectus, review of financial statements of Second Cup for periods prior to the Closing Date and tax services related to the initial public offering.

### *Cash Distributions*

The amount of cash to be distributed per month per Unit to the unitholders of the Fund will be equal to a *pro rata* share of interest and (if applicable) principal repayments on the Series 1 AcquisitionCo Notes and dividends or other amounts on or in respect of the AcquisitionCo Common Shares owned by the Fund, less amounts which are paid, payable, incurred or provided for in such period in connection with:

- the Fund's administrative expenses and other obligations and liabilities;

- amounts which may be paid by the Fund in connection with any cash redemptions of Units;
- satisfaction of the Fund's debt service obligations, if any; and
- such reasonable reserves as may be established by the trustees of the Fund in their sole discretion, which are currently expected to be nominal.

The trustees may authorize increased or decreased distributions in excess of or below the aforementioned distributions from time to time or suspend distributions entirely, as they see fit, in their sole discretion.

The Fund intends to make distributions each month of amounts determined by the trustees in their sole discretion to be available for distribution by the Fund for such month. If declared, distributions in respect of each month are expected to be paid on the last day of the immediately following month to unitholders of record as of record dates to be specified (except in respect of the month of December, for which the record date will be the last day of December). Substantially all distributions will be considered income of the unitholder for Canadian tax purposes.

The following table sets forth the month of payment, record date, payment date and distribution per Unit paid by the Fund on the Units for each month of the 2004 and 2005 fiscal years:

	<u>Period</u>	<u>Payment Date</u>	<u>Distribution Per Unit</u>
2004	December 2004 <sup>(1)</sup>	January 31, 2005	\$0.0821
2005	January 2005	February 28, 2005	\$0.0833
	February 2005	March 31, 2005	\$0.0833
	March 2005	April 29, 2005	\$0.0833
	April 2005	May 31, 2005	\$0.0833
	May 2005	June 30, 2005	\$0.0833
	June 2005	July 29, 2005	\$0.0835
	July 2005	August 31, 2005	\$0.0833
	August 2005	September 30, 2005	\$0.0833
	September 2005	October 31, 2005	\$0.0833
	October 2005	November 30, 2005	\$0.0833
	November 2005	December 30, 2005	\$0.0833
	December 2005	January 31, 2005	\$0.0835

(1) The Fund made its initial cash distribution on January 31, 2004 for the period from December 2, 2004 (the Closing Date) to December 31, 2004

In addition to monthly distributions, it is provided in the Declaration of Trust that the Fund will make a final year-end distribution each year payable in cash or Units to unitholders of the Fund of record on December 31, in the amount by which the Fund's income (including net taxable capital gains, if any, but excluding capital gains arising on a distribution *in specie* of Series 2 AcquisitionCo Notes on redemption of Units which are designated by the Fund to redeeming unitholders and capital gains, the tax paid or made payable on which may be offset by capital losses carried forward from prior years or is recoverable by the Fund) for the purposes of the Tax Act (plus the non-taxable portion of capital gains, if any) for the year would otherwise exceed distributions already paid or payable to unitholders of the Fund in that year. The unitholders will have a legal right to enforce such payment on December 31. Such year-end distribution is expected to be paid to such unitholders of the Fund on or before the immediately following January 31.

For the year-ended December 31, 2005, no such year-end distribution was required due to significant tax deductions available to the Fund resulting from expenses incurred in connection with the Fund's initial public offering.

To the extent that cash of the Fund is used to redeem Units or is otherwise unavailable to satisfy distributions, the Fund will satisfy distributions to unitholders in the form of additional Units. Such additional Units are expected to be issued pursuant to available exemptions under applicable securities laws, discretionary exemptions granted by applicable securities regulatory authorities or a prospectus or similar filing.

Unitholders who are non-residents of Canada (as that term is defined in the Tax Act) may be subject to withholding taxes payable in respect of distributions by the Fund, whether such distributions are in the form of cash or additional Units. Non-residents should consult their own tax advisors regarding the tax consequences of investing in the Units. Additional Units otherwise issuable to non-residents of Canada may in certain cases also be escrowed and resold on their behalf.

### ***Redemption Right***

Units are redeemable at any time on demand by their holders. As the Units will only be issued in book-entry form, a unitholder who wishes to exercise the redemption right will be required to obtain a redemption notice form from the unitholder's investment dealer, and cause the dealer to deliver the completed redemption notice form to CDS. Upon the Fund's receipt of the redemption notice, all rights to and under the Units tendered for redemption will be surrendered and the holder thereof will be entitled to receive a price per unit (the "Redemption Price") equal to the lesser of:

- 90% of the Market Price (as defined below) of the Units on the principal marketplace on which they are traded during the 10 trading day period immediately preceding the date on which the applicable Units were surrendered for redemption (the "Unit Redemption Date"); and
- 100% of the Closing Market Price (as defined below) of the Units on the principal marketplace on which they are traded on the Unit Redemption Date.

For the purposes of these calculations, the "Market Price" will be the amount equal to the weighted average of all reported trading prices of the Units on the applicable marketplace for each of the trading days on which there was a trade during the specified trading day period; provided that if there was trading in the Units on the applicable marketplace for fewer than five of the trading days during the specified trading day period, the "Market Price" will be the weighted average of the following prices established for each of the trading days during the specified trading period: (a) the average of the last bid and asking prices of the Units for each trading day on which there was no trading and (b) the weighted average reported trading prices of the Units for each trading day that there was trading.

For the purposes of these calculations, the "Closing Market Price" will be: (a) an amount equal to the closing price of the Units on the applicable marketplace if there was a trade on the specified date and the applicable marketplace provides a closing price; (b) an amount equal to the average of the highest and lowest prices of Units on the applicable marketplace if there was trading on the specified date and the applicable marketplace provides only the highest and lowest trading prices of Units on a particular day; or (c) the average of the last bid and last asking prices on the applicable marketplace if there was no trading on the specified date.

The aggregate Redemption Price payable by the Fund in respect of any Units surrendered for redemption during any calendar month will, except in the circumstances described below, be satisfied by way of a cash payment

by the Fund. This cash payment will be made no later than the last day of the month following the month in which the Units were tendered for redemption. Unitholders will not be entitled to receive cash upon the redemption of their Units if:

- the total amount payable by the Fund in respect of such Units and all other Units tendered for redemption in the same calendar month exceeds \$50,000 (the “Monthly Limit”), provided that the trustees may, in their sole discretion, waive this limitation in respect of all Units tendered for redemption in any calendar month;
- at the time such Units are tendered for redemption, the outstanding Units are not listed or quoted for trading on the Toronto Stock Exchange or another stock exchange or organized market which the trustees consider to be, in their sole discretion, one which provides representative fair market value prices for the Units; or
- the normal trading of Units is suspended or halted on any stock exchange or organized market on which the Units are listed or quoted for trading on the Unit Redemption Date or for more than five trading days during the 10-day trading period commencing immediately after the Unit Redemption Date.

If a unitholder is not entitled to receive cash upon the redemption of Units as a result of the last two limitations above, the redemption price will be equal to the fair market value of the Units as determined by the trustees in their sole discretion, and the redemption price for each Unit tendered for redemption will, subject to obtaining all applicable regulatory approvals, be paid and satisfied by way of a distribution *in specie* by the Fund of Series 2 AcquisitionCo Notes. In these circumstances, Series 1 AcquisitionCo Notes held by the Fund having a value equal to the aggregate redemption price will be redeemed by AcquisitionCo in consideration for the issuance to the Fund of Series 2 AcquisitionCo Notes. The Series 2 AcquisitionCo Notes will then be distributed to the redeeming unitholder in full satisfaction of the redemption price. The aggregate principal amount of these Series 2 AcquisitionCo Notes will be equal to the product of the redemption price per Unit payable by the Fund and the number of Units tendered. However, no Series 2 AcquisitionCo Notes in a principal amount of less than \$10 will be distributed and, where the principal amount of Series 2 AcquisitionCo Notes to be received by the former unitholder upon redemption *in specie* would otherwise include a principal amount of less than a multiple of \$10, the principal amount will be rounded down to the next lowest multiple of \$10 and the excess will be paid by the Fund in cash. The term of the Series 2 AcquisitionCo Notes will be 10 years, less a day, subject to earlier redemption at the Fund’s option, and they will bear interest at a market rate determined by the directors of AcquisitionCo at the time of issuance of such Series 2 AcquisitionCo Notes. Interest on the Series 2 AcquisitionCo Notes will be payable on the 30<sup>th</sup> day of each calendar month that such Series 2 AcquisitionCo Notes are outstanding.

If a unitholder is not entitled to receive cash upon the redemption of Units as a result of the first limitation described above, the unitholder will receive a cash payment equal to such unitholder’s *pro rata* share of the Monthly Limit based on the aggregate number of Units tendered for redemption in the applicable calendar month and, subject to obtaining all applicable regulatory approvals, the balance in Series 2 AcquisitionCo Notes determined in accordance with the procedures described above.

It is anticipated that the redemption right described above will not be the primary mechanism for unitholders to dispose of their Units. Series 2 AcquisitionCo Notes which may be distributed *in specie* to unitholders in connection with a redemption will not be listed on any stock exchange, no market is expected to develop for those notes and they may be subject to an indefinite “hold period” or other resale restrictions under applicable securities laws. Series 2 AcquisitionCo Notes so distributed may be qualified investments for Deferred Income Plans and registered education savings plans, depending upon the circumstances at the time.

The Fund will be allowed, from time to time, to purchase Units for cancellation in accordance with applicable securities laws and the rules prescribed under applicable stock exchanges or regulatory policies.

### ***Meetings of Unitholders***

Each Unit entitles the holder thereof to one vote at all meetings of the unitholders. Meetings of unitholders will be called and held annually for (i) the election of trustees; (ii) the appointment of auditors of the Fund for the ensuing year, (iii) generally, any other matter that requires a resolution of unitholders and (iv) transacting such other business as the trustees may determine or as may be properly brought before the meeting. The Declaration of Trust provides that the unitholders will be entitled to pass resolutions that will bind the Fund only with respect to (and that such actions may not occur without the passing of such resolutions):

- the election or removal of trustees of the Fund;
- the appointment or removal of the auditors of the Fund;
- the appointment of an inspector to investigate the performance by the trustees of their responsibilities and duties;
- the approval of amendments to the Declaration of Trust (except as described under “— Amendments to the Declaration of Trust” below);
- the sale, lease or exchange of all or substantially all of the Fund’s assets, except in conjunction with an internal reorganization or an *in specie* redemption of Units by the Fund;
- any amalgamation, arrangement, other merger or capital reorganization of the Fund with any other entity, except in conjunction with an internal reorganization;
- the exercise of certain voting rights attached to the securities of AcquisitionCo and MarksCo held directly or indirectly by the Fund;
- the termination, winding-up or dissolution of the Fund prior to the end of its term; and
- such other business as the trustees may determine or as may be properly brought before a meeting.

A resolution appointing or removing the trustees or the auditors of the Fund must be passed by a simple majority of the votes cast by the unitholders. All other matters must be approved by a Unitholders’ Special Resolution.

A meeting of unitholders may be convened at any time and for any purpose by the trustees and must be convened if requisitioned by the holders of not less than 10% of the Units then outstanding by a written requisition. A requisition must state in reasonable detail the business proposed to be transacted at the meeting.

Unitholders may attend and vote at all meetings of unitholders of the Fund either in person or by proxy and a proxy holder need not be a unitholder. Two persons present in person or represented by proxy and representing in the aggregate at least 10% of the votes attached to all outstanding Units will constitute a quorum for the transaction of

business at all such meetings. The Declaration of Trust contains provisions as to the notice required and other procedures with respect to the calling and holding of meetings of unitholders. If no quorum is present, the meeting may (unless it was a requisitioned meeting) be adjourned to a date that is not less than seven days later by notice given by news release and at the adjourned meeting all those unitholders of the Fund present will constitute a quorum.

### ***Limitation on Non-Resident Ownership***

In order for the Fund to maintain its status as a mutual fund trust under the Tax Act, the Fund must not be established or maintained primarily for the benefit of non-residents of Canada within the meaning of the Tax Act and pursuant to certain proposed amendments to the Tax Act, not more than 50% of the fair market value of the Units may be held by non-residents of Canada and/or partnerships (other than Canadian partnerships as defined in the Tax Act). Accordingly, the Declaration of Trust provides that at no time may non-residents of Canada and/or partnerships other than Canadian partnerships be the beneficial owners of more than 40% of the Units. The trustees may require declarations as to the jurisdictions in which beneficial owners of Units are resident or as to their status as Canadian partnerships.

If the trustees become aware that the beneficial owners of 40% of the Units then outstanding are or may be non-residents and/or partnerships other than Canadian partnerships or that such a situation is imminent, the trustees may direct the transfer agent and registrar to make a public announcement thereof and will not accept a subscription for Units from or issue or register a transfer of Units to any person unless the person provides a declaration that he or she is not a non-resident or a partnership other than a Canadian partnership. If, notwithstanding the foregoing, the trustees determine that more than 40% of the Units are held by non-residents and/or partnerships other than Canadian partnerships, they may direct the transfer agent of the Units to send a notice to such holders of Units, chosen in inverse order to the order of acquisition or registration or in such manner as the trustees may consider equitable and practicable, requiring them to sell their Units or a portion thereof within a specified period determined by the trustees. If the unitholders receiving such notice have not sold the specified number of Units or provided the trustees with satisfactory evidence that they are not non-residents or a partnership other than a Canadian partnership within such period, the trustees may direct the transfer agent to sell such Units on behalf of such unitholders, and in the interim, the voting and distribution rights attached to such Units will be suspended. Upon such sale, the affected holders will cease to be holders of the Units and their rights will be limited to receiving the net proceeds of such sale.

On September 16, 2004, the Minister of Finance (Canada) released draft amendments to the Tax Act relating to the circumstances under which the ownership of units of a trust by non-resident persons and partnerships other than Canadian partnerships would cause the trust to lose its status as a mutual fund trust. Under the draft amendments, a trust would lose its status as a mutual fund trust if the aggregate fair market value of all units issued by the trust held by one or more non-resident persons or partnerships that are not Canadian partnerships is more than 50% of the aggregate fair market value of all the units issued by the trust. The draft amendments do not currently provide any means of rectifying a loss of mutual fund trust status such that if, at any time, the Fund were to lose its mutual fund trust status as a result of the application of the draft amendments, the Fund would permanently cease to be a mutual fund trust. The December 6, 2004 Notice of Ways and Means Motion to implement the tax proposals contained in the 2004 Federal Budget does not contain this proposal and the Department of Finance indicated in a concurrent release that further discussions would be pursued with the private sector in this regard. Depending on the final form of the draft amendments as enacted, it may be necessary to amend the Declaration of Trust to take into account these new restrictions. This amendment may be made without unitholder approval.

### ***Amendments to the Declaration of Trust***

The Declaration of Trust may be amended or altered from time to time by a Unitholders' Special Resolution. The trustees of the Fund may, without the approval of the unitholders, make certain amendments to the Declaration of Trust, including amendments:

- for the purpose of ensuring continuing compliance with applicable laws, regulations, requirements or policies of any governmental authority having jurisdiction over the trustees or over the assets of the Fund or its subsidiary entities, or any stock exchange or other organized market on which the Units are listed or quoted for trading;
- which, in the opinion of the trustees, provide additional benefits or protection for unitholders of the Fund;
- to remove any conflicts or inconsistencies in the Declaration of Trust or to make minor corrections which, in the opinion of the trustees, are necessary or desirable and not prejudicial to the unitholders of the Fund;
- which, in the opinion of the trustees, are necessary or desirable as a result of changes in Canadian taxation laws or policies of any governmental authority having jurisdiction over the trustees or the Fund; and
- for the purpose of ensuring that the Fund continues to qualify as a mutual fund trust and the Units do not constitute "foreign property", in each case, under the Tax Act.

### ***Term of the Fund***

The Fund has been established for an indefinite term. However, unitholders may, by a Unitholders' Special Resolution, require the trustees to commence to wind up the affairs of the Fund.

The Declaration of Trust provides that, upon being required to commence to wind up the affairs of the Fund, the trustees will give notice thereof to unitholders, which notice will designate the time or times at which unitholders must surrender their Units for cancellation and the date at which the register of Units will be closed. After the date the register is closed, the trustees will proceed to wind up the affairs of the Fund as soon as may be reasonably practicable and, for such purpose, will, subject to any direction to the contrary in respect of a termination authorized by a resolution of the unitholders, sell and convert into money all of the assets comprising the Fund, including if applicable the AcquisitionCo Notes and AcquisitionCo Common Shares, and all of the other assets of the Fund in one transaction or in a series of transactions at public or private sales and do all other acts appropriate to liquidate the Fund. After paying, retiring, discharging or making provision for the payment, retirement or discharge of all of the Fund's known liabilities and obligations and providing for indemnity against any other outstanding liabilities and obligations, the trustees will distribute the remaining part of the proceeds of the sale of the assets comprising the Fund, together with any cash forming part of the assets of the Fund, among the unitholders in accordance with their *pro rata* interests, against delivery of Units. If the trustees are unable to sell all or any of the assets which comprise part of the Fund by the date set for termination, they may distribute such assets *in specie* directly to the unitholders in accordance with their *pro rata* interests, subject to obtaining all required regulatory approvals.



### ***Take-over Bids***

The Declaration of Trust contains provisions to the effect that, if a take-over bid is made for all of the issued and outstanding Units, and not less than 90% of the Units on a fully-diluted basis (including any Units issuable upon the exchange of any securities exchangeable into Units but not including any Units held at the date of the take-over bid by or on behalf of the offeror or associates or affiliates of the offeror) are taken up and paid for by the offeror, the offeror will be entitled to acquire the Units held by unitholders and holders of securities exchangeable for Units who did not accept the take-over bid on the terms offered by the offeror.

### ***Exercise of Certain Voting Rights Attached to Certain Securities***

The Declaration of Trust provides that the Fund will not vote any securities held by it including AcquisitionCo Common Shares and Series 1 AcquisitionCo Notes, and will cause AcquisitionCo not to vote its MarksCo Common Shares and MarksCo Notes, to authorize, among other things:

- any sale, lease or other disposition of all or substantially all of the direct or indirect assets of AcquisitionCo or MarksCo except in conjunction with an internal reorganization or a permitted charge, pledge or lien or pursuant to any guarantee of any obligation of AcquisitionCo or MarksCo;
- any amalgamation, arrangement or other merger of AcquisitionCo or MarksCo with any other entity except in conjunction with an internal reorganization or in conjunction with the acquisition by AcquisitionCo or MarksCo of the securities or assets of another entity;
- any material amendment to the AcquisitionCo Note Indenture or the MarksCo Note Indenture other than in contemplation of a further issue of notes by AcquisitionCo or MarksCo, whether of the same series or another series; and
- any material amendment to AcquisitionCo's or MarksCo's constituting documents to change the authorized share capital in a way which would reasonably be expected to be prejudicial to the Fund,

without the authorization of the unitholders by a Unitholders' Special Resolution.

### ***Information and Reports***

The Fund will furnish to unitholders, in accordance with and subject to applicable securities laws, such consolidated financial statements (including quarterly and annual consolidated financial statements) and other reports as are from time to time required by applicable law, including prescribed forms needed for the completion of unitholders' tax returns under the Tax Act and equivalent provincial legislation.

Prior to each meeting of the unitholders of the Fund, the trustees will provide the unitholders with notice of the meeting and all such information as is required by applicable law and the Declaration of Trust to be provided to such holders.

The Fund has undertaken to applicable securities regulatory authorities that, for as long as the Fund is a reporting issuer, (i) in complying with its reporting issuer obligations, MarksCo will be treated as a subsidiary of Second Cup, (ii) it will provide unitholders with separate financial statements for Second Cup and (iii) it will annually certify that it has complied with such undertaking, and file the certificate on SEDAR concurrently with the filing of its annual financial statements.

Second Cup has undertaken to provide the Fund with Second Cup's unaudited financial statements within 40 days of the end of each quarterly accounting period of Second Cup, other than the fourth quarterly accounting period, and audited annual consolidated financial statements within 85 days of the end of each fiscal year of Second Cup. These financial statements are required to be prepared in accordance with GAAP and will also include a statement of System Sales for the relevant period.

The quarterly and annual financial statements of Second Cup which the Fund receives from Second Cup will be required to be filed on [www.sedar.com](http://www.sedar.com) as a supplement to the quarterly and annual financial statements of the Fund.

Second Cup will be required to deliver to the Fund all financial statements and material change reports to be filed by Second Cup pursuant to undertakings to applicable securities regulatory authorities and, from time to time, such additional information regarding the financial position or business of Second Cup as the Fund may reasonably request in order to comply with any continuous disclosure or other disclosure requirements which now, or in the future, may apply to the Fund under applicable securities legislation or other legislation or in order to include in any disclosure document which the Fund is required, or chooses, to deliver to unitholders or is required to file or deliver to securities regulatory authorities or applicable stock exchanges or marketplaces.

In addition, Second Cup and MarksCo have undertaken to applicable securities regulatory authorities that, for as long as the Fund is a reporting issuer, Second Cup and MarksCo, respectively, will require each person who would be an "insider" of Second Cup and MarksCo, respectively, if they were reporting issuers, to file insider reports about trades in units of the Fund (including securities exchangeable into units of the Fund) and comply with statutory prohibitions against insider trading in accordance with applicable Canadian securities legislation.

### ***Book-Entry Only System***

Registration of interests in and transfers of the Units will be made only through a book-based system (the "Book-Entry Only System") administered by CDS. At Closing, the Fund delivered to CDS certificates evidencing the aggregate number of Units subscribed for under the initial public offering. Pursuant to the Book-Entry Only System, Units must be purchased, transferred and surrendered for redemption through a CDS Participant. All rights of beneficial unitholders must be exercised through, and all payments or other property to which such unitholder is entitled will be made or delivered by, CDS or the CDS Participant through which the unitholder holds such Units. Upon purchase of any Units, the unitholders will receive only a customer confirmation from the registered dealer which is a CDS Participant and from or through which the Units are purchased.

References in this Annual Information Form to a "unitholder" means, unless the context otherwise requires, the owner of the beneficial interest in such Units.

The ability of a beneficial owner of Units to pledge those Units or otherwise take action with respect to the unitholder's interest in those Units (other than through a CDS Participant) may be limited due to the lack of a physical certificate.

The Fund has the option to terminate registration of the Units through the Book-Entry Only System, in which case certificates for the Units in fully registered form would be issued to beneficial owners of Units or their nominees.

The Fund, the trustees of the Fund and the transfer agent and registrar for the Units will not have any liability for (a) records maintained by CDS relating to the beneficial interests in the Units or the book-entry accounts maintained by CDS; (b) maintaining, supervising or reviewing any records relating to those beneficial interests; or (c) any advice or representation made or given by CDS and made or given with respect to the rules and regulations of CDS, or any action taken or not taken by CDS or the CDS participants.

### ***Fund Administration***

Except as expressly prohibited by law, the trustees may grant or delegate certain of their authority to effect the actual administration of their duties under the Declaration of Trust. The trustees may grant broad discretion to a third party to administer and manage the Fund's day-to-day operations and to make executive decisions which conform to the general policies and principles set forth in the Declaration of Trust or otherwise established by the trustees from time to time.

On the Closing Date, the Fund and AcquisitionCo entered into the Administration Agreement with MarksCo whereby MarksCo agreed to provide or arranged for the provision of services required in the Fund's and AcquisitionCo's administration, including those necessary to: (i) effect the Fund's compliance with continuous disclosure obligations under applicable securities legislation, including the preparation of financial statements; (ii) provide investor relations services; (iii) provide or cause to be provided to unitholders all information to which unitholders are entitled under the Declaration of Trust, including relevant information with respect to income taxes; (iv) call and hold meetings of unitholders and distribute required materials, including notices of meetings and information circulars, in respect of all such meetings; (v) provide for the calculation of distributions to unitholders; (vi) attend to all administrative and other matters arising in connection with any redemptions of Units; (vii) effect compliance with limitations on non-resident ownership; and (viii) provide general accounting, bookkeeping and administrative services. The Administration Agreement may be terminated by the Fund and AcquisitionCo upon payment to MarksCo of all costs and expenses incurred by MarksCo in terminating contracts entered into by it with third parties (provided such contracts were approved by the Fund or AcquisitionCo, as the case may be), with the Fund's and AcquisitionCo's approval for the performance by MarksCo of its duties under the Administration Agreement.

MarksCo will pay all expenses incurred by it and attributable to the exercise of its duties in the administration of the Fund. The Fund will reimburse all the expenses incurred by MarksCo on the Fund's behalf and will pay MarksCo an annual fee not to exceed \$25,000.

## **GOVERNANCE AND SHARE AND LOAN CAPITAL OF ACQUISITIONCO**

The business of AcquisitionCo is managed and supervised by its board of directors. Although the Fund owns all of the AcquisitionCo Common Shares, the Fund has no active day-to-day role in its management.

### ***Directors***

The directors of AcquisitionCo are David Bloom, Michael Rosicki and Raymond Guyatt, each of whom is a trustee of the Fund and a nominee of the Fund to the board of directors of MarksCo.

### ***Share Capital of AcquisitionCo***

The authorized share capital of AcquisitionCo consists of an unlimited number of common shares each without a par value. 8,748,826 AcquisitionCo Common Shares are currently issued and outstanding, all of which are owned by the Fund. Each AcquisitionCo Common Share entitles the holder thereof to receive notice of and to attend all meetings of shareholders of AcquisitionCo and to one vote per share at such meeting (other than meetings of another class of shares of AcquisitionCo). The AcquisitionCo Common Shares entitle the holders thereof to receive in any year dividends as and when declared payable by the board of directors of AcquisitionCo on the AcquisitionCo Common Shares. In the event of the liquidation, dissolution or winding-up of AcquisitionCo, holders of the AcquisitionCo Common Shares, after payment of or other proper provision for all of the liabilities of AcquisitionCo, will be entitled to share rateably in all remaining assets of AcquisitionCo.

### ***Distribution Policy***

It is the Fund's understanding that the board of directors of AcquisitionCo will adopt a policy to distribute all of its available cash, subject to applicable law, by way of dividends or other amounts on or in respect of the AcquisitionCo Common Shares, after:

- satisfaction of its debt service obligations, including principal and interest and other expense obligations;
- provisions for its administrative expenses and other obligations and liabilities (including taxes, if any);
- making any principal repayments in respect of the AcquisitionCo Notes considered advisable by the board of directors of AcquisitionCo, with the Fund's consent and the consent of the holders of the AcquisitionCo Notes by Noteholders' Extraordinary Resolution;
- provisions for any additional amounts that may become payable pursuant to the Subscription Agreement; and
- such reasonable working capital reserves as may be considered appropriate by its board of directors.

## *AcquisitionCo Notes*

The following is a summary of the material attributes and characteristics of the AcquisitionCo Notes that were issued under the AcquisitionCo Note Indenture providing for the issuance of the AcquisitionCo Notes. The AcquisitionCo Note Indenture was dated the Closing Date and was made between AcquisitionCo and Computershare Trust Company of Canada, as trustee (the “AcquisitionCo Note Trustee”). This summary is qualified in its entirety by reference to the provisions of the AcquisitionCo Note Indenture, which contains a complete statement of the attributes and characteristics described below. See “Material Contracts”.

The number of AcquisitionCo Notes is unlimited. Two series of AcquisitionCo Notes were initially authorized for issuance under the AcquisitionCo Note Indenture. Only Series 1 AcquisitionCo Notes are currently issued and outstanding, all of which are held by the Fund. \$493,081 aggregate principal amount of Series 1 AcquisitionCo Notes were issued in conjunction with the adjustment to the Royalty Pool. Additional Series 1 AcquisitionCo Notes may be issued by AcquisitionCo from time to time. \$78,739,434 aggregate principal amount of Series 1 AcquisitionCo Notes are currently issued and outstanding. Series 2 AcquisitionCo Notes will be reserved by AcquisitionCo to be issued exclusively to the Fund and to be delivered to holders of Units as full or partial payment of the redemption price for Units in connection with an *in specie* payment of the redemption price for Units redeemed by a unitholder.

### *Interest and Maturity*

The Series 1 AcquisitionCo Notes were issued at Closing and at each subsequent Adjustment Date and will mature on the 10<sup>th</sup> anniversary of the date of issuance and bear interest at a rate of 12.0% per annum, calculated and payable monthly in arrears, on or prior to the 21<sup>st</sup> day after the end of each calendar month that such Series 1 AcquisitionCo Note is outstanding. Each Series 1 AcquisitionCo Note issued subsequent to Closing, will mature on a date which is the 10<sup>th</sup> anniversary of the date of issuance thereof and will bear interest at a rate to be determined by the board of directors of AcquisitionCo at the time of issuance thereof, calculated and payable monthly in arrears, on or prior to the 21<sup>st</sup> day after the end of each calendar month that such Series 1 AcquisitionCo Note is outstanding.

The term of each Series 2 AcquisitionCo Note will be 10 years, less a day, subject to earlier redemption at the Fund’s option. Each Series 2 AcquisitionCo Note will bear interest at a market rate to be determined by the board of directors of AcquisitionCo at the time of issuance thereof and be payable, unless otherwise determined by AcquisitionCo, on or prior to the 21<sup>st</sup> day after the end of each calendar month that such Series 2 AcquisitionCo Note is outstanding.

The AcquisitionCo Notes will be issued only as fully registered notes in a minimum denomination of \$100.00.

### *Payment Upon Maturity*

On maturity, AcquisitionCo will repay the indebtedness represented by the AcquisitionCo Notes by paying to the AcquisitionCo Note Trustee, on behalf of the holders, an amount equal to the principal amount of the outstanding AcquisitionCo Notes, together with accrued and unpaid interest thereon. Payment to the holders will be made upon presentation and surrender of the AcquisitionCo Notes by the holders to the AcquisitionCo Note Trustee on the maturity date. Upon payment of the principal amount together with any accrued and unpaid interest, the AcquisitionCo Notes shall be cancelled by the AcquisitionCo Note Trustee.

### *Redemption*

From time to time, the board of directors of AcquisitionCo will review the status of AcquisitionCo's assets, the status of the Royalty and the financial condition of MarksCo. If this review, in the opinion of the board of directors of AcquisitionCo, indicates that it is unlikely that the indebtedness of AcquisitionCo evidenced by the AcquisitionCo Notes could be refinanced on the same terms and conditions upon maturity of such AcquisitionCo Notes, AcquisitionCo may, subject to the consent of the Fund and the consent of the holders of the AcquisitionCo Notes by a Noteholders' Extraordinary Resolution, commence principal repayments on the AcquisitionCo Notes such that, in the opinion of the board of directors of AcquisitionCo, the AcquisitionCo Notes will be fully repaid upon maturity. In that event, the available after-tax cash of AcquisitionCo will be utilized to the extent required to fund such repayments in lieu of dividends on the AcquisitionCo Common Shares. In addition, if AcquisitionCo has available cash, but is prohibited from declaring or paying a dividend or reducing its stated capital under applicable laws, the board of directors of AcquisitionCo may make principal repayments on the AcquisitionCo Notes to the extent of such available cash.

In addition, Series 1 AcquisitionCo Notes may be redeemed in connection with the issuance of Series 2 AcquisitionCo Notes in satisfaction of a redemption *in specie* of Units by the Fund. See "Description of the Fund — Redemption Right".

### *Ranking*

All AcquisitionCo Notes will rank equally with each other. The payment of the principal of and interest on the AcquisitionCo Notes and all other amounts payable pursuant to the AcquisitionCo Note Indenture will be unsecured debt obligations of AcquisitionCo and will be expressly subordinated in right of payment to all AcquisitionCo Senior Indebtedness. "AcquisitionCo Senior Indebtedness" will be defined in the AcquisitionCo Note Indenture as all indebtedness and liabilities of AcquisitionCo, including the principal of, and premium, if any, and interest on, indebtedness of AcquisitionCo that by the terms of the instrument or agreement creating, evidencing or governing the same, is expressed to rank in right of payment in priority to the indebtedness evidenced by the notes or the AcquisitionCo Note Indenture. The guarantees in favour of the Bank in connection with the MarksCo Term Loan and Operating Loan will be AcquisitionCo Senior Indebtedness.

### *Default*

The AcquisitionCo Note Indenture provides that any of the following will constitute an Event of Default (as defined in the AcquisitionCo Note Indenture):

- default in repayment of the principal amount of the AcquisitionCo Notes when the same becomes due;
- subject to the terms of any AcquisitionCo Senior Indebtedness, the failure to pay the interest obligations on the AcquisitionCo Notes when the same becomes due, for a period of six months;
- the occurrence of an event of default on any AcquisitionCo Senior Indebtedness so that an amount in excess of \$1,000,000 is or becomes due and payable;
- certain events of winding-up, liquidation, bankruptcy, insolvency or receivership;
- the taking of possession by an encumbrancer, in the opinion of the AcquisitionCo Note Trustee, of all or substantially all of the property of AcquisitionCo;

- AcquisitionCo ceasing to own all of the issued and outstanding MarksCo Common Shares;
- AcquisitionCo or any of its material subsidiaries ceasing to carry on its business or a substantial part thereof; or
- default in the observance or performance of any other covenant or condition of the AcquisitionCo Note Indenture and the continuance of such default for a period of not less than 30 days after notice in writing has been given by the AcquisitionCo Note Trustee to AcquisitionCo specifying such default and requiring AcquisitionCo to rectify the same.

The AcquisitionCo Note Indenture also provides that the AcquisitionCo Note Trustee shall not take steps or actions with respect to an Event of Default without the prior consent of the Fund so long as the Fund holds, directly or indirectly, at least 25% of the aggregate principal amount of the outstanding AcquisitionCo Notes.

## **SHARE AND LOAN CAPITAL OF MARKSCO**

### ***Share Capital of MarksCo***

The authorized share capital of MarksCo consists of an unlimited number of common shares each without a par value. 8,748,826 MarksCo Common Shares are currently issued and outstanding, all of which are owned by AcquisitionCo. Each MarksCo Common Share will entitle the holder thereof to receive notice of and to attend all meetings of shareholders of MarksCo and to one vote per share at such meeting (other than meetings of another class of shares of MarksCo). The MarksCo Common Shares will entitle the holders thereof to receive in any year dividends as and when declared payable by the board of directors of MarksCo on the MarksCo Common Shares. In the event of the liquidation, dissolution or winding-up of MarksCo, holders of the MarksCo Common Shares, after payment of or other proper provision for all of the liabilities of MarksCo, will be entitled to share rateably in all remaining assets of MarksCo.

### ***Distribution Policy***

It is the Fund's understanding that the board of directors of MarksCo will adopt a policy to distribute all of its available cash, subject to applicable law, by way of dividends or other amounts on or in respect of the MarksCo Common Shares, after:

- satisfaction of its debt service obligations, including principal and interest and other expense obligations;
- provisions for its administrative expenses and other obligations and liabilities (including taxes, if any);
- provisions for any additional amounts which may become payable to Second Cup pursuant to the Licence and Royalty Agreement in the event that Additional Cafés are added to the Royalty Pool;
- making any principal repayments in respect of the MarksCo Notes considered advisable by the board of directors of MarksCo, with the consent of the Fund and the consent of the holders of the MarksCo Notes by Noteholders' Extraordinary Resolution; and
- such reasonable working capital reserves as may be considered appropriate by its board of directors.

## *MarksCo Notes*

The following is a summary of the material attributes and characteristics of the MarksCo Notes that were issued under the MarksCo Note Indenture providing for the issuance of the MarksCo Notes. The MarksCo Note Indenture was dated the Closing Date and was made between MarksCo and Computershare Trust Company of Canada, as trustee (the “MarksCo Note Trustee”). This summary is qualified in its entirety by reference to the provisions of the MarksCo Note Indenture, which contains a complete statement of the attributes and characteristics described below. See “Material Contracts.”

The number of MarksCo Notes are unlimited. Two series of MarksCo Notes were initially authorized for issuance under the MarksCo Note Indenture. All of the issued and outstanding MarksCo Notes are held by the Fund. \$493,081 aggregate principal amount of MarksCo Notes were issued in conjunction with the adjustment to the Royalty Pool. \$78,739,434 aggregate principal amount of MarksCo Notes are currently issued and outstanding. Additional MarksCo Notes may be issued by MarksCo from time to time.

### *Interest and Maturity*

The MarksCo Notes were issued at Closing and at each subsequent Adjustment Date and will mature on the 10<sup>th</sup> anniversary of the date of issuance and will bear interest at a rate of 12.125% per annum, calculated and payable monthly in arrears, on or prior to the 21<sup>st</sup> day after the end of each calendar month that such MarksCo Note is outstanding. Each MarksCo Note issued subsequent to Closing, will mature on a date which is the 10<sup>th</sup> anniversary of the date of issuance thereof and will bear interest at a rate to be determined by the board of directors of MarksCo at the time of issuance thereof, calculated and payable monthly in arrears, on or prior to the 21<sup>st</sup> day after the end of each calendar month that such MarksCo Note is outstanding.

The MarksCo Notes will be issued only as fully registered notes in a minimum denomination of \$100.00.

### *Payment Upon Maturity*

On maturity, MarksCo will repay the indebtedness represented by the MarksCo Notes by paying to the MarksCo Note Trustee, on behalf of the holders, an amount equal to the principal amount of the outstanding MarksCo Notes, together with accrued and unpaid interest thereon. Payment to the holders will be made upon presentation and surrender of the MarksCo Notes by the holders to the MarksCo Note Trustee on the maturity date. Upon payment of the principal amount together with any accrued and unpaid interest, the MarksCo Notes shall be cancelled by the MarksCo Note Trustee.

### *Redemption*

From time to time, the board of directors of MarksCo will review the status of MarksCo’s assets, the status of the Royalty and the financial condition of Second Cup. If this review, in the opinion of the board of directors of MarksCo, indicates that it is unlikely that the indebtedness of MarksCo evidenced by the MarksCo Notes could be refinanced on the same terms and conditions upon maturity of such MarksCo Notes, MarksCo may, subject to the Fund’s consent and the consent of the holders of the MarksCo Notes by a Noteholders’ Extraordinary Resolution, commence principal repayments on the MarksCo Notes such that, in the opinion of the board of directors of MarksCo, the MarksCo Notes will be fully repaid upon maturity. In that event, the available after-tax cash of MarksCo will be utilized to the extent required to fund such repayments in lieu of dividends on the MarksCo Common Shares. In



addition, if MarksCo has available cash, but is prohibited from declaring or paying a dividend or reducing its stated capital under applicable laws, the board of directors of MarksCo may make principal repayments on the MarksCo Notes to the extent of such available cash.

### *Ranking*

All MarksCo Notes are ranked equally with each other. The payment of the principal of and interest on the MarksCo Notes and all other amounts payable pursuant to the MarksCo Note Indenture are unsecured debt obligations of MarksCo and are expressly subordinated in right of payment to all MarksCo Senior Indebtedness. "MarksCo Senior Indebtedness" is defined in the MarksCo Note Indenture as all indebtedness and liabilities of MarksCo, including the principal of, and premium, if any, and interest on, indebtedness of MarksCo, which by the terms of the instrument or agreement creating, evidencing or governing the same, is expressed to rank in right of payment in priority to the indebtedness evidenced by the MarksCo Notes or the MarksCo Note Indenture. The MarksCo Term Loan and Operating Loan are MarksCo Senior Indebtedness.

### *Default*

The MarksCo Note Indenture provides that any of the following will constitute an Event of Default (as defined in the MarksCo Note Indenture):

- default in repayment of the principal amount of the MarksCo Notes when the same becomes due;
- subject to the terms of any MarksCo Senior Indebtedness, the failure to pay the interest obligations on the notes when the same becomes due, for a period of six months;
- the occurrence of an event of default on any MarksCo Senior Indebtedness so that an amount in excess of \$1,000,000 is or becomes due and payable;
- certain events of winding-up, liquidation, bankruptcy, insolvency or receivership;
- the taking of possession by an encumbrance, in the opinion of the MarksCo Note Trustee, of all or substantially all of the property of MarksCo;
- MarksCo ceasing to own the Second Cup Marks;
- MarksCo or any of its material subsidiaries ceasing to carry on its business or a substantial part thereof; or
- default in the observance or performance of any other covenant or condition of the MarksCo Note Indenture and the continuance of such default for a period of not less than 30 days after notice in writing has been given by the MarksCo Note Trustee to MarksCo specifying such default and requiring MarksCo to rectify the same.

The MarksCo Note Indenture also provides that the MarksCo Note Trustee shall not take steps or actions with respect to an Event of Default without the Fund's prior consent so long as the Fund holds, directly or indirectly, at least 25% of the aggregate principal amount of the outstanding MarksCo Notes.

## MARKET FOR SECURITIES

### *Trading Price and Volume*

The outstanding Units of the Fund are listed and posted for trading on the TSX under the symbol “SCU.UN”. The following table shows the price range and average volume traded on the TSX for each month of 2005.

Month	Trading Price Range	Average Trading Volume
January 2005	\$10.92 to \$11.80	41,650
February 2005	\$10.67 to \$11.70	48,465
March 2005	\$10.02 to \$11.44	18,577
April 2005	\$10.06 to \$10.73	11,213
May 2005	\$10.50 to \$11.00	18,937
June 2005	\$10.55 to \$11.05	15,443
July 2005	\$10.61 to \$11.75	19,604
August 2005	\$10.76 to \$11.85	21,249
September 2005	\$10.10 to \$11.29	26,845
October 2005	\$8.40 to \$10.29	23,200
November 2005	\$8.70 to \$10.25	20,658
December 2005	\$9.50 to \$10.23	14,867

## PROMOTER

Cara may be considered to be the promoter of the Fund for the purposes of applicable securities legislation by reason of its initiative in founding and organizing the Fund. Cara, through its wholly-owned subsidiary, Second Cup, owns 1,492,730 Units, representing approximately 15.5% of the issued and outstanding Units.

As part of the transactions relating to the Fund’s Initial Public Offering, AcquisitionCo acquired from Cara all of the then-issued and outstanding MarksCo Common Shares on December 2, 2004. The purchase price for the MarksCo Common Shares was \$86,940,392. Such purchase price and the terms of the Acquisition Agreement were determined by negotiation between Cara, Second Cup, the Fund on behalf of AcquisitionCo and the Underwriters.

## LEGAL PROCEEDINGS

Neither the Fund nor Second Cup are involved in any litigation or proceedings which, if determined adversely, would be material to any of the Fund or Second Cup, and no such proceedings are known to the Fund or Second Cup to be contemplated. See “Risk Factors” and note 15 to the consolidated financial statements of Second Cup for the year ended December 31, 2005.

## INTERESTS OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

Cara sold the MarksCo Common Shares to AcquisitionCo for the consideration set forth under “Funding and Acquisition of the Second Cup Marks” and was paid the purchase price for those shares. Second Cup and MarksCo

are parties to the Licence and Royalty Agreement pursuant to which Second Cup pays the Royalty to MarksCo and is entitled to payments of the Determined Amount from MarksCo. See “Licence and Royalty Agreement”.

In addition, Second Cup has granted security for its obligations under the Licence and Royalty Agreement and is entitled to the rights under the Governance Agreement.

## **TRANSFER AGENT AND REGISTRAR**

The transfer agent and registrar for the Units is Computershare Investor Services Inc, 100 University Avenue, Toronto, Ontario.

## **MATERIAL CONTRACTS**

The only material contracts entered into by the Fund, AcquisitionCo or MarksCo during the past two years other than in the ordinary course of business, are as follows:

- (a) the Acquisition Agreement referred to under “General Development of the Business — Establishment of the Fund”;
- (b) the Licence and Royalty Agreement referred to under “Licence and Royalty Agreement”, as amended from time to time;
- (c) the Governance Agreement referred to under “Management and Corporate Governance of MarksCo”;
- (d) the Declaration of Trust referred to under “Description of the Fund”;
- (e) the loan agreement in respect of each of the MarksCo Term Loan and the Operating Loan;
- (f) the General Security Agreement referred to under “Licence and Royalty Agreement”;
- (g) the AcquisitionCo Note Indenture referred to under “Governance and Share and Loan Capital of AcquisitionCo”;
- (h) the MarksCo Note Indenture referred to under “Share and Loan Capital of MarksCo”;
- (i) the Administration Agreement referred to under “Description of the Fund”; and

- (j) the Underwriting Agreement, which provided that the Fund would pay to the Underwriters an aggregate fee of approximately \$4.9 million in respect of all of the Units offered or \$0.06 per Unit. The Fund agreed to indemnify the Underwriters and their directors, officers, employees, shareholders and agents against certain liabilities pursuant to the underwriting agreement, including liabilities under Canadian securities legislation.

Copies of the foregoing documents may be examined during normal business hours at the Fund's offices at 6303 Airport Road, Mississauga, Ontario L4V 1R8.

## **EXPERTS**

The Fund's consolidated financial statements have been audited by PricewaterhouseCoopers LLP, Chartered Accountants, Toronto, Ontario, which are also the auditors of AcquisitionCo, MarksCo and Second Cup. Such firm is independent in accordance with the firm's rules of professional conduct in Ontario. To the knowledge of the Trustees, none of the partners of PricewaterhouseCoopers LLP owned one percent or more of the Units at the time of the preparation of the Fund's consolidated financial statements or Annual Information Form respectively.

## **ADDITIONAL INFORMATION**

Additional information relating to the Fund may be obtained on request from the administrative office of the Fund at 6303 Airport Road, Mississauga, Ontario, L4V 1R8 or may be found at the Fund's website at [www.secondcupincomefund.com](http://www.secondcupincomefund.com) or on SEDAR at [www.sedar.com](http://www.sedar.com). Additional information, including with respect to trustees' remuneration and indebtedness and principal holders of the units of the Fund will be contained in the Fund's information circular for its 2006 annual meeting of Unitholders.

Additional financial information is provided in the consolidated financial statements and notes to the consolidated financial statements of the Fund and Management's Discussion and Analysis for 2005.

## Schedule A – Charter of the Audit Committee

The term “Fund” herein shall refer to Second Cup Royalty Income Fund and the term “Board” shall refer to the Board of Trustees of the Fund. “Second Cup Royalty Group” means, collectively, the Fund, Second Cup Trade-Marks Inc. (“MarksCo”) and AcquisitionCo. The term “Management” herein shall refer to senior management of MarksCo.

### PURPOSE

The Audit Committee (the “Committee”) is a standing committee appointed by the Board to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting including responsibility to:

- oversee the work of the Fund’s external auditors engaged for the purpose of preparing or issuing an auditor’s report or performing other audit, review or attest services for the Fund;<sup>1</sup>
- oversee the integrity of the Fund’s financial statements and financial reporting process, including the audit process and the Fund’s internal accounting controls and procedures and compliance with related legal and regulatory requirements;
- oversee the qualifications and independence of the external auditors;
- oversee the work of the Fund’s financial management and external auditors in these areas;<sup>2</sup> and
- provide an open avenue of communication between the external auditors, the Board and Management.<sup>3</sup>

In addition, the Committee will review and/or approve any other matter specifically delegated to the Committee by the Board.

The function of the Committee is oversight. It is not the duty or responsibility of the Committee or its members (i) to plan or conduct audits, (ii) to determine that the Fund’s financial statements are complete and accurate and are in accordance with generally accepted accounting principles or (iii) to conduct other types of auditing or accounting reviews or similar procedures or investigations. The Committee and its Chair are members of the Board, appointed to the Committee to provide broad oversight of the financial, risk and control related activities of the fund and are specifically not accountable or responsible for the day to day operation or performance of such activities.

MarksCo is responsible for the preparation, presentation and integrity of the Fund’s financial statements. Management is also responsible for maintaining appropriate accounting and financial reporting principles and policies and systems of risk assessment and internal controls and procedures designed to provide reasonable assurance that assets are safeguarded and transactions are properly authorized, recorded and reported and to assure the effectiveness and efficiency of operations, the reliability of financial reporting and compliance with accounting standards and applicable laws and regulations. The external auditors are responsible for planning and carrying out an audit of the Fund’s annual financial statements in accordance with generally accepted auditing standards to

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<sup>1</sup> Multilateral Instrument 52-110 (“MI 52-110”) s.2.3(3)

<sup>2</sup> MI 52-110 s.2.3(3)

<sup>3</sup> MI 52-110 s.4.1(c)

provide reasonable assurance that, among other things, such financial statements are in accordance with generally accepted accounting principles.

## **AUDIT RESPONSIBILITIES OF THE COMMITTEE**

### **Selection and Oversight of the External Auditors**

1. The external auditors are ultimately accountable to the Committee and the Board as the representatives of the unitholders of the Fund and shall report directly to the Committee and the Committee shall so instruct the external auditors.<sup>4</sup> The Committee shall evaluate the performance of the external auditors and make recommendations to the Board on the reappointment or appointment of the external auditors of the Fund to be proposed in the Fund's proxy circular for unitholder approval and shall have authority to terminate the external auditors.<sup>5</sup> If a change in external auditors is proposed, the Committee shall review the reasons for the change and any other significant issues related to the change, including the response of the incumbent auditors, and enquire on the qualifications of the proposed auditors before making its recommendation to the Board.<sup>6</sup> The Board is responsible for selecting the external auditor to be proposed in the Fund's proxy circular for unitholder approval and appointment.
2. The Committee shall review and recommend to the Board for approval the terms of engagement and the compensation to be paid by the Fund to the external auditors with respect to the conduct of the annual audit.<sup>7</sup>
3. The Committee shall review the independence of the external auditors and shall make recommendations to the Board on appropriate actions to be taken which the Committee deems necessary to protect and enhance the independence of the external auditors. In connection with such review, the Committee shall:
  - (a) actively engage in a dialogue with the external auditors about all relationships or services that may impact the objectivity and independence of the external auditors;<sup>8</sup>
  - (b) require that the external auditors submit to it on a periodic basis, and at least annually, a formal written statement delineating all relationships between the Fund and Second Cup Royalty Group, on the one hand, and the external auditors and their affiliates on the other hand;<sup>9</sup>
  - (c) require that (i) both the lead audit partner and the partner responsible for performing a second review respecting the audit be rotated at least every five years and be subject to a five year time out and (ii) all other partners on the audit engagement team who provide more than 10 hours of audit, review or attest services with respect to the Fund's consolidated financial statements or who serve as the lead partner in connection with any audit or review related to financial statements of a

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<sup>4</sup> MI 52-110 s.2.2

<sup>5</sup> MI 52-110 s.2.3(2)(a)

<sup>6</sup> National Instrument 51-102 s.4.11

<sup>7</sup> MI 52-110 s.2.3(2)(b)

<sup>8</sup> Independence Standards Board Independence Standard No. 1

<sup>9</sup> CICA Handbook Section 5751.12, .25 - .29 and .32

subsidiary whose assets or revenues constitute at least 20% of the consolidated assets or revenues of the Fund be rotated at least every seven years and be subject to a two year time out;<sup>10</sup>

- (d) consider whether there should be a regular rotation of the external audit firm itself; and
  - (e) consider the auditor independence standards promulgated by applicable auditing regulatory and professional bodies.
4. The Committee shall prohibit the external auditor and its subsidiaries from providing certain non-audit services to the Fund. All non-audit services to be provided to the Fund or any of its affiliates by the external auditors or any of their affiliates shall be subject to pre-approval by the Committee.<sup>11</sup> The Committee may approve policies and procedures for the pre-approval of non-audit services to be rendered by the external auditors, which policies and procedures (i) shall include reasonable detail with respect to the services covered, (ii) shall require that the Committee be informed of each non-audit service and (iii) shall not include delegation of the Committee's responsibilities to management of MarksCo.<sup>12</sup>
5. The Committee shall establish and monitor clear policies for the hiring by Second Cup Royalty Group of partners, employees and former partners and employees of the external auditors.<sup>13</sup>
6. The Committee shall require the external auditors to provide to the Committee, and the Committee shall review and discuss with the external auditors, all reports which the external auditors are required to provide to the Committee or the Board under rules, policies or practices of professional or regulatory bodies applicable to the external auditors, and any other reports which the Committee may require. Such reports shall include:
- (a) a description of the external auditors' internal quality-control procedures, any material issues raised by the most recent internal quality-control review, or peer review, of the external auditors, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the external auditors, and any steps taken to deal with any such issues;<sup>14</sup> and
  - (b) a report describing (i) all critical accounting policies and practices used in the preparation of the Fund's financial statements, (ii) all alternative treatments of financial information within generally accepted accounting principles related to material items that have been discussed with Management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the external auditors (iii) other material written communication between the external auditors and Management, such as any management letter or schedule of unadjusted differences; and (iv) disagreements between Management and/or the internal auditors and the external auditors regarding financial reporting.

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<sup>10</sup> CICA Proposed Independence Standards s.204.4(20)

<sup>11</sup> MI 52-110 ss.2.3(4), 2.4 and 2.5

<sup>12</sup> MI 52-110, s.2.6

<sup>13</sup> Independence Standards Board Independence Standard No. 3; MI 52-110 s.2.3(8)

<sup>14</sup> CICA Handbook Section 5751.31

7. The Committee is responsible for resolving disagreements between Management and the external auditors regarding financial reporting.<sup>15</sup>

#### **Oversight of Internal Audit Function**

8. The Committee shall determine the appropriate internal audit function for the Fund and oversee its processes, reports and the terms of compensation for any individuals engaged in such function, if any.

#### **Oversight and Monitoring of Audits**

9. The Committee shall review with the external auditors and Management the audit function generally, the objectives, staffing, locations, co-ordination, reliance upon Management, any internal audit and general audit approach and scope of proposed audits of the financial statements of the Fund, the overall audit plans, the responsibilities of Management and the external auditors, the audit procedures to be used and the timing and estimated budgets of the audits.<sup>16</sup>
10. The Committee shall discuss with the external auditors any difficulties or disputes that arise with Management or any internal auditors during the course of the audit and the adequacy of Management's responses in correcting audit-related deficiencies.<sup>17</sup>
11. The Committee shall review with Management the results of any internal and all external audits.
12. The Committee shall take such other reasonable steps as it may deem necessary to satisfy itself that the audit was conducted in a manner consistent with all applicable legal requirements and auditing standards of applicable professional or regulatory bodies.

#### **Oversight and Review of Accounting Principles and Practices<sup>18</sup>**

13. The Committee shall, as it deems necessary, oversee, review and discuss with Management, the external auditors and any internal auditors:
  - (a) the quality, appropriateness and acceptability of the Fund's accounting principles and practices used in its financial reporting, changes in the Fund's accounting principles or practices and the application of particular accounting principles and disclosure practices by Management to new transactions or events;
  - (b) all significant financial reporting issues and judgments made in connection with the preparation of the Fund's financial statements, including the effects of alternative methods within generally accepted accounting principles on the financial statements and any "second opinions" sought by Management from an independent auditor with respect to the accounting treatment of a particular item;

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<sup>15</sup> MI 52-110 s.2.3(3)

<sup>16</sup> CICA Handbook Section 5751.14; MI 52-110 s.2.3(3)

<sup>17</sup> CICA Handbook Section 5751.23

<sup>18</sup> CICA Handbook Section 5751.17, .20, .21 and .22



- (c) disagreements between Management and the external auditors or any internal auditors regarding the application of any accounting principles or practices;
  - (d) any material change to the Fund’s auditing and accounting principles and practices as recommended by Management, the external auditors or any internal auditors or which may result from proposed changes to applicable generally accepted accounting principles;
  - (e) the effect of regulatory and accounting initiatives on the Fund’s financial statements and other financial disclosures;
  - (f) any reserves, accruals, provisions, estimates or management programs and policies, including factors that affect asset and liability carrying values and the timing of revenue and expense recognition, that may have a material effect upon the financial statements of the Fund;
  - (g) the use of special purpose entities and the business purpose and economic effect of off-balance sheet transactions, arrangements, obligations, guarantees and other relationships of Second Cup Royalty Group and their impact on the reported financial results of the Fund;
  - (h) any legal matter, claim or contingency that could have a significant impact on the financial statements, the Fund’s compliance policies and any material reports, inquiries or other correspondence received from regulators or governmental agencies and the manner in which any such legal matter, claim or contingency has been disclosed in the Fund’s financial statements;
  - (i) the treatment for financial reporting purposes of any significant transactions which are not a normal part of the Fund’s operations;
  - (j) the use of any “pro forma” or “adjusted” information not in accordance with generally accepted accounting principles;<sup>19</sup> and
  - (k) Management’s determination of goodwill impairment, if any, as required by applicable accounting standards.
14. The Committee will review and resolve disagreements between Management and the external auditors regarding financial reporting<sup>20</sup> or the application of any accounting principles or practices.

**Oversight and Monitoring of Internal Controls**

15. The Committee shall, as it deems necessary, exercise oversight of, review and discuss with Management and the external auditors:
- (a) the adequacy and effectiveness of the Fund’s internal accounting and financial controls based on recommendations of Management and the external auditors for the improvement of accounting practices and internal controls;<sup>21</sup>

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<sup>19</sup> CSA Notice 52-306

<sup>20</sup> MI 52-110 s.2.3(3)

<sup>21</sup> CICA Handbook Section 5751.16

- (b) any material weaknesses in the internal control environment, including with respect to computerized information system controls and security; and
- (c) Management's compliance with the Fund's processes, procedures and internal controls.

### **Communications with Others**

16. The Committee shall establish and monitor procedures for the receipt and treatment of complaints received by the Fund regarding accounting, internal accounting controls or audit matters and the anonymous submission by employees of concerns regarding questionable accounting or auditing matters and review periodically with Management, and senior finance officers of Second Cup Royalty Group responsible for any internal audit function, these procedures and any significant complaints received.<sup>22</sup>

### **Oversight and Monitoring of the Fund's Financial Disclosures**

17. The Committee shall:
- (a) review with the external auditors and Management and recommend to the Board for approval the audited financial statements and the notes and Management's Discussion and Analysis accompanying such financial statements, the Fund's annual report, the financial information of the Fund contained in any prospectus or information circular or other disclosure documents or regulatory filings of the Fund;<sup>23</sup> and
  - (b) review with the external auditors and Management and approve each set of interim financial statements and the notes and Management's Discussion and Analysis accompanying such financial statements and any other disclosure documents or regulatory filings of the Fund containing or accompanying financial information of the Fund.<sup>24</sup>

Such reviews shall be conducted prior to the release of any summary of the financial results or the filing of such reports with applicable regulators.

18. The Committee shall review all financial statements and material change reports provided to the Fund by MarksCo and New Second Cup. The Committee shall oversee the inclusion of New Second Cup's quarterly and annual financial statements as a supplement to the Funds financial statements filed on SEDAR.
19. The Committee shall review such additional information regarding the business of New Second Cup as the Fund may reasonably request to comply with any continuous disclosure or other disclosure requirements.
20. Prior to their distribution and filing, the Committee shall review and discuss earnings press releases, as well as financial information provided to analysts and ratings agencies. The Chair of the Committee may perform this review function, on behalf of the Committee, as is required. Such discussions may, in the discretion of the Committee, be done generally (i.e., by discussing the types of information to be disclosed and the type of presentation to be made) and the Committee need not discuss in advance each instance in

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<sup>22</sup> MI 52-110 s.2.3(7)

<sup>23</sup> National Instrument 51-102 ss.4.5(1) and 5.5(1); MI 52-110 ss.2.3(5) and 5.1; OSC Rule 52-501

<sup>24</sup> National Instrument 51-102 ss. 4.5(2), (3) and 5.5(2) and (3); MI 52-110 s.2.3(5); OSC Rule 52-501

which the Fund discloses financial information if it has reviewed and approved the Fund's policies and procedures with respect to such matters.<sup>25</sup>

21. The Committee shall meet with Management to review and assess the process and systems in place for the review of public disclosure documents that contain audited and unaudited financial information and their effectiveness.<sup>26</sup>
22. As part of the process by which the Committee shall satisfy itself as to the reliability of public disclosure documents that contain audited and unaudited financial information, the Committee shall require each of the Chief Executive Officer and the Chief Financial Officer of MarksCo to provide a certificate addressed to the Committee certifying in respect of each annual and quarterly report the matters such officers are required to certify in connection with the filing of such reports under applicable securities laws.<sup>27</sup> The Committee shall oversee the inclusion of such a certificate in respect of each annual and quarterly financial statement that New Second Cup provides to the Fund as a supplement to the Fund's financial statement filings.
23. The Committee shall review the disclosure with respect to its pre-approval of audit and non-audit services provided by the external auditors.

#### **Oversight of Finance Matters**

24. The Committee shall meet periodically with Management to review and discuss the Fund's major financial risk exposures and the policy steps Management has taken to monitor and control such exposures.
25. The Committee shall meet periodically with the Company Secretary of MarksCo to review issues arising out of compliance activities, as well as assess contingent legal and regulatory risks.
26. The Committee shall receive and review the financial statements, material charge reports and other financial information of members of New Second Cup and MarksCo and any auditor recommendations concerning such entities as they relate to the ownership, licensing, maintenance and control of the Second Cup Marks.

#### **Committee Reporting**

27. As required by applicable laws or regulations or stock exchange requirements, the Committee shall review and approve the information required to be reported to unitholders and others in its Annual Information Form, and for such purposes, each member of the Committee shall provide information respecting that member's education and experience that relate to his or her responsibilities as a Committee member.<sup>28</sup>

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<sup>25</sup> National Instrument 51-102 s.11.4 and MI 52-110 s.2.3(5); National Policy 51-201 s. 6.4

<sup>26</sup> MI 52-110 s.2.3(6)

<sup>27</sup> Multilateral Instrument 52-109, Parts 2 and 3

<sup>28</sup> MI 52-110 s.5.1; Form 52-110F and Companion Policy 52-110CP s. 4.2

### **Insider Trading**

28. The Committee shall prepare and revise as necessary a policy on insider trading respecting the Fund's securities. Such policy shall impose trading black-outs, policies and procedures respecting trades in the Fund's securities.
29. The Committee shall periodically review Management's systems and practices for ensuring that all trustees, directors, officers and other reporting insiders of the Fund who are required to do so file insider reports in connection with any trade of securities of the Fund or any derivative transaction which results in the effective disposition of the individual's economic interest in a security of the Fund within the shortest period of time in which such reports are required to be filed.

### **Additional Responsibilities**

30. Each new member of the Committee shall receive such training as may be approved by the Chair of the Committee. Training should cover the requirements and obligations of audit committees, issues of accounting principles, auditing standards, risk management and ethical compliance. Each Committee member should attend refresher training annually.
31. The Committee shall review and/or approve any other matter specifically delegated to the Committee by the Board and undertake on behalf of the Board such other activities as may be necessary or desirable to assist the Board in fulfilling its oversight responsibilities with respect to financial reporting.

### **THE CHARTER**

The Committee shall review and reassess the adequacy of this Charter at least annually and otherwise as it deems appropriate and recommend changes to the Board. The performance of the Committee shall be evaluated with reference to this Charter annually.<sup>29</sup>

The Committee shall ensure that this Charter or a summary of it which has been approved by the Committee is disclosed in accordance with all applicable securities laws or regulatory requirements in the annual proxy circular or annual report of the Fund.

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<sup>29</sup> National Policy 58-201 s.3.18(a)