Second Cup Royalty Income Fund
TSX: SCU.UN

2007 ANNUAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2007

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Second Cup Royalty Income Fund
LETTER FROM THE CHAIRMAN

On behalf of the Board of Trustees of the Second Cup Royalty Income Fund (the "Fund"), I am pleased to present our Annual Report for the fiscal year ended December 31, 2007. All amounts are expressed in thousands of dollars, except units, unless otherwise indicated.

The Fund indirectly owns the Second Cup trade-marks which it licenses to The Second Cup Ltd. ("Second Cup") in accordance with the terms of a licence and royalty agreement. Second Cup, in turn, franchises and operates cafés across Canada using these trade-marks and pays to the Fund a royalty of 6.5% of the total sales of cafés included in the Royalty Pool. As at January 1, 2008, there were 357 cafés in the Royalty Pool.

HIGHLIGHTS

The Fund's "top line" structure means that its success and growth depends primarily on Second Cup's ability to maintain and increase the overall system sales of Royalty Pool Cafés. Growth in overall system sales is dependent on same café sales growth, and adding net new cafés to the café network. Same café sales growth is of particular importance as it directly correlates to increased cash available for distribution, and is a key indicator of brand health and franchise profitability.

SAME CAFÉ SALES GROWTH

For 2007, the cafés in the Royalty Pool achieved same café sales growth of 3.0% following same café sales growth of 6.2% in 2006. While modest, the same café sales growth of 0.7% in the fourth quarter of 2007 represented the 12th consecutive quarter of positive same café sales growth since the inception of the fund in December of 2004. Same café sales growth has averaged 4.6% during this period. The continued same café sales growth is the direct result of strategic initiatives implemented by Second Cup which have focussed on continuing to deliver a "Neighbourhood Oasis" to its guests.

Overall royalties earned by the fund increased by 3.3% in 2007 as a result of the same café sales growth during the year and the increase in net system sales resulting from the January 1, 2007 adjustment to the Royalty Pool.

COMPLETION OF REORGANIZATION

In April of 2007, we were pleased to announce that the Unitholder-approved reorganization of the structure of the Fund had been completed. As a result of the reorganization, the subsidiary corporations that previously existed have been replaced with a limited partnership which provides the Fund with a "flow-through" structure. This structure will maximize the cash available for distribution by eliminating income taxes payable by the Fund and its subsidiaries until the proposed income tax legislation on income funds becomes applicable in 2011. It is anticipated that the tax savings expected over the next few years resulting from this new structure will more than offset the costs of the restructuring. In 2007 alone, the Fund's current income taxes decreased from $318 in 2006 to $56 in 2007 as a result of the reorganization. Further, had the reorganization not taken place, the Fund's subsidiary corporations would have had current income taxes in excess of the $318 incurred in 2006 due to increased earnings in 2007.

DISTRIBUTABLE CASH

Excluding the impact of changes in non-cash working capital of the Fund and its wholly-owned subsidiaries, costs relating to the reorganization and a one-time recovery of income taxes relating to prior years, distributable cash increased 3.1% to $1.1576 per unit, compared to $1.1229 per unit in 2006.

DISTRIBUTION INCREASES

In 2007, monthly distributions were increased by 5.0% which, annualized, represented an increase from $1.0404 per unit to $1.0920 per unit. In March 2008 we were pleased to announce an additional increase of 3.3% to monthly distributions, resulting in an annualized distribution amount of $1.1280 per unit.

OUTLOOK

Management of Second Cup have informed us that they expect a challenging start to 2008 in terms of same café sales growth, due in large part to the inclement weather experienced in the first few months of the year; a shift in the Easter holiday to the first quarter from the second quarter in 2007; and the comparably strong sales growth from the first quarter of 2007. Same café sales of cafés in the Royalty Pool benefited from the extra day in February as a result of the leap year. As a result of the above noted factors, same café sales for the first quarter ended March 31, 2008 were 1.4%. Management of Second Cup have stated that they are confident that the track record of consecutive quarters of positive same café sales growth will continue and they expect comparable sales growth of 2% to 4% overall for 2008, assuming a stable economy for the balance of the year.

In closing, we would like to take this opportunity to thank our Unitholders for their continued support, and the Second Cup café franchisees, operators and colleagues who, through their ongoing dedication to their guests and Second Cup, continue to deliver positive café sales growth.

David R Bloom

David Bloom
Chairman, Second Cup Royalty Income Fund
on behalf of the Board of Trustees
April 18, 2008

The Second Cup Ltd.

LETTER FROM THE CHAIRMAN AND CEO

On behalf of management and colleagues of The Second Cup Ltd. ("Second Cup"), I am pleased to provide a summary overview of the financial results for Second Cup for our fiscal year ended December 29, 2007. Also included is an outline of the top priorities, key initiatives and outlook for fiscal 2008. Please note that our complete financial statements are included in the 2007 Annual Report of the Second Cup Royalty Income Fund (the "Fund").

2007 HIGHLIGHTS

Fiscal 2007 began with significant promise as the strong momentum in same café sales growth ("SCSG") experienced by Second Cup in the latter part of 2006 continued into 2007. SCSG in the first and second fiscal quarters were 5.8% and 4.7% respectively. SCSG slowed considerably in the second half as lower consumer confidence, rising fuel prices, increasing concerns over the economy and truly inclement weather (particularly in our key Ontario and Quebec markets) during our peak selling season adversely affected traffic counts. As a result SCSG slowed to 1.7% and 1.1% respectively, in the third and fourth quarters. SCSG for 2007 in its entirety was 3.1% compared to 6.2% in 2006. The positive SCSG achievement in the fourth quarter of 2007 represented the 17th consecutive quarter of positive SCSG for Second Cup and 12th consecutive quarter for the Fund since its inception in December 2004.

Other important activities and achievements in 2007 included: the renovation of 40 existing cafés, the highest ever in Second Cup's history; the opening of 14 new cafés, which were offset somewhat by the closure of eight underperforming cafés; the continued expansion of the sandwich program; the introduction in selective markets and cafés of the grilled sandwich program; the introduction of several new espresso based and blender beverages; the roll-out of a new on-line training program for front-line staff; and the revamp of our training program for new franchisees. While not related to the Fund we also established a team focused on the development of the Second Cup brand outside of Canada.

FISCAL 2008 PRIORITIES AND KEY INITIATIVES

Our mission and top priority for 2008 and beyond is the entrenchment of a café unit economic model that consistently delivers sustainable, profitable growth and greater economic returns. To this end, all our efforts and initiatives are simultaneously aimed at increasing SCSG and traffic counts in a meaningful way, and in reducing both input costs and the costs of building new cafés and renovating existing ones.

We have a number of key initiatives in 2008 designed to build sales and increase traffic which include: continuing to expand the successful roll-out of both our regular and grilled sandwich program; introducing a new hot breakfast sandwich program; selectively expanding our food offerings as part of an overall makeover and realignment of the menu to reduce operating complexity and improve quality and consistency; and launching an exciting new line-up of reformulated beverages which will be low in fat (containing 3 grams of fat or less) and contain fewer calories. Leading our team in these initiatives is Stacey Mowbray who joined as President of Second Cup and its parent, The Second Cup Coffee Company Inc., on February 25, 2008. A proven strategist and leader, Stacey brings an acknowledged ability to build brands and develop people and strong teams.

OUTLOOK

Fiscal 2008 will continue to be a challenge as the economy struggles, competitive pressures mount and the cost of commodities and fuel continue to rise or remain high, all of which constrain the consumer's ability to spend. That said, we believe that through a combination of selective price increases and the strength of sales building initiatives, we will be able to achieve SCSG in the range of 2% to 4% and maintain our track record of delivering positive quarterly SCSG. We believe the latter part of the year will be more robust.

On the development front, we remain confident of our ability to deliver on our target of renovating upwards of 40 existing cafés and opening 12 to 18 new cafés. The challenge, as it relates to our café network in 2008, will be the number of closures. Under normal circumstances we anticipate closures to range from 10 to 14. The added dynamic this year revolves around the higher number of cafés which are at the end of their lease terms. The potential exists for landlords to redevelop these locations as they look to rejuvenate their properties and change their tenant portfolios, which in some cases will adversely affect us.

As always, I would like to extend my sincere thanks and gratitude to our franchisees and colleagues for their tireless efforts and commitment to Second Cup, and for making their cafes and Second Cup a "Second Home" for our guests.

I look forward to seeing you at the Fund's Annual Meeting on May 22, 2008.

Gabriel Tsampalieros
Chairman and Chief Executive Officer
The Second Cup Ltd.
April 18, 2008

SECOND CUP ROYALTY INCOME FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion of the results of operations and financial condition of Second Cup Royalty Income Fund (the "Fund") for the year ended December 31, 2007 and should be read in conjunction with the audited consolidated financial statements of the Fund and accompanying notes, which are available at www.sedar.com. The consolidated financial statements of the Fund are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are presented in thousands of Canadian dollars, unless otherwise indicated. This Management's Discussion and Analysis ("MD&A") has been prepared as of March 11, 2008.

BASIS OF PRESENTATION

Effective January 1, 2005, the Fund adopted Accounting Guideline 15 ("AcG-15"), a pronouncement of The Canadian Institute of Chartered Accountants ("CICA") related to variable interest entities ("VIEs"). A VIE is an entity where its equity investment at risk is insufficient to permit the entity to finance its activities without additional subordinated support from others and/or where certain essential characteristics of a controlling financial interest are not met. AcG-15 outlines who should consolidate such entities.

As a result of adopting this standard, the Fund reflects its investment in Second Cup Trade-Marks Limited Partnership ("MarksLP"), in which it holds a 99.99% partnership interest, as an equity-accounted investment. MarksLP is consolidated in the financial statements of The Second Cup Ltd. ("Second Cup"). Prior to the reorganization described below, the Fund had accounted for its wholly owned subsidiary, Second Cup Trade-Marks Inc. ("MarksCo"), as an equity-accounted investment. The consolidated financial statements of the Fund include the accounts of the Fund and its wholly owned subsidiaries Second Cup GP Trust ("GP Trust"), which holds the remaining 0.01% partnership interest in MarksLP, and Second Cup GP Inc. ("GP Inc.").

OVERVIEW AND BUSINESS OF THE FUND

The Fund was created as a limited purpose trust to use the proceeds of an initial public offering to indirectly acquire the trademarks and other intellectual property and associated rights used by Second Cup cafés in Canada (the "Second Cup Marks"). The Second Cup Marks were then licensed to Second Cup in return for a royalty of 6.5% of system sales of certain Second Cup cafés in Canada (the "Royalty Pool"). Units of the Fund trade on the Toronto Stock Exchange under the symbol "SCU.UN". The Fund's fiscal year ends December 31.

As at December 31, 2007, the Fund has 9,708,609 units outstanding, 70,533 of which are owned directly by Second Cup. In January 2008, as a result of the annual adjustment to the Royalty Pool (see "Adjustments to Royalty Pool" below), an additional 176,124 units were issued to Second Cup, bringing the total number of units outstanding to 9,884,733 and Second Cup's holdings to 246,657 units. Also, Mr. Gabriel Tsampalieros, who indirectly owns 100% of the common shares of Second Cup, beneficially owns directly or indirectly a further 751,839 units of the Fund. In total, these 998,496 units represent approximately 10.1% of the outstanding units of the Fund.

REORGANIZATION OF THE FUND

As announced on April 3, 2007, the reorganization of the Fund's structure permits the Fund to maximize the cash available for distribution to unitholders of the Fund ("Unitholders").

Since the creation of the Fund in December 2004, the Fund has owned the Second Cup Marks through intermediary corporate subsidiaries. This structure subjected these subsidiaries to income tax which, in turn, reduced the cash available for distribution to the Fund's Unitholders. On April 2, 2007, as a result of the Unitholder approved reorganization of the structure of the Fund (the "Reorganization"), the Fund replaced its subsidiary corporations, including MarksCo, with a newly formed trust and limited partnership. This latter entity, MarksLP, will be consolidated for reporting purposes with Second Cup as a VIE for the same reasons that MarksCo has historically been consolidated by Second Cup. MarksLP is accounted for in the consolidated financial statements of the Fund as an equity-accounted investment.

As a result of the Reorganization, the Fund negotiated a new term loan of $11,000 (the "Term Loan") with its bankers on similar terms and conditions of MarksCo's term loan. The proceeds of the Term Loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan. Further, the notes receivable amounting to $79,343 as at April 1, 2007 (December 31, 2006 - $78,739) from MarksCo were repaid through an increase in the equity ownership of MarksLP by the Fund and a new note receivable from MarksLP of $9,171 (December 31, 2007 - $300).

Under the new structure, the new wholly owned subsidiaries of the Fund will not be subject to income tax. As a result, a net future income tax liability of $10,668 was reversed and resulted in an increase to the income of the equity-accounted investment in MarksCo on April 2, 2007. This net future income tax liability is comprised of an elimination of future tax assets of $1,408 previously recognized by MarksCo, offset by a $12,076 future income tax liability inherent in the carrying value of the equity-accounted investment that resulted from the step-up to the value of the Second Cup Marks when the Fund originally acquired MarksCo. The Fund has reflected the elimination of this net future income tax liability in these consolidated financial statements as an increase in the equity accounted earnings of MarksCo.

The Licence and Royalty Agreement (the "Agreement") entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to license the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of system sales of cafés in the Royalty Pool will be paid to MarksLP. As a result of the Reorganization, the Fund's earnings are predominantly comprised of distribution income from MarksLP instead of interest and dividend income from MarksCo.

It is important to note that, while the Fund's underlying structure has been changed, essentially the underlying assets and operations of the Fund and its subsidiaries have not changed as a result of the Reorganization.

NEW ACCOUNTING STANDARDS AND ACCOUNTING POLICY CHANGES

As required by the CICA, on January 1, 2007, the Fund adopted CICA Handbook Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments - Recognition and Measurement; Section 3861, Financial Instruments - Disclosure and Presentation; and Section 3865, Hedges. As required by the implementation of these new standards, the comparative consolidated financial statements have not been restated.

These new sections provide standards for recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Handbook Section 1530 also establishes standards for reporting and displaying comprehensive income. Comprehensive income includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign exchange gains and losses arising from translation of self-sustaining foreign operations, and changes in unrealized gains and losses on cash flow hedges. The impact of these changes in accounting policies on the December 31, 2007 consolidated financial statements is not significant.

CICA Handbook Section 1506, Accounting Changes, revised the standards on changes in accounting policy, estimates or errors to require a change in accounting policy to be applied retrospectively, unless doing so is impracticable, changes in estimates to be recorded prospectively, and prior period errors to be corrected retrospectively. Voluntary changes in accounting policy are allowed only when they result in financial statements that provide reliable and more relevant information. In addition, these revised standards call for enhanced disclosures about the effects of changes in accounting policies, estimates and errors in the financial statements. These revised standards became effective for interim and annual financial statements relating to fiscal periods ending on or after January 1, 2007.

Amendments to CICA Handbook Section 1540, Cash Flow Statements, require entities to disclose total cash distributions on financial instruments classified as equity in accordance with a contractual agreement and the extent to which total cash distributions are non-discretionary. This disclosure requirement became effective for interim and annual financial statements relating to fiscal periods ending on or after March 31, 2007. The declaration of distributions from the Fund are at the discretion of the Trustees of the Fund.

New Accounting Standards

The CICA issued three new accounting standards: Handbook Section 1535, Capital Disclosures (Section 1535), Handbook Section 3862, Financial Instruments - Disclosures (Section 3862), and Handbook Section 3863, Financial Instruments - Presentation (Section 3863). These new standards become effective for the Fund on January 1, 2008.

Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The Fund will adopt these new standards effective January 1, 2008, but they are not expected to affect its consolidated results or financial position.

FINANCIAL HIGHLIGHTS

The following table sets out selected financial information and other data of the Fund and its wholly owned subsidiaries, MarksLP and MarksCo, and should be read in conjunction with the audited consolidated financial statements of the Fund.

	THREE MONTHS ENDED		YEAR ENDED	
(IN THOUSANDS OF DOLLARS, EXCEPT NUMBER OF CAFÉS AND PER UNIT AMOUNTS)	DECEMBER 31, 2007	DECEMBER 31, 2006	DECEMBER 31, 2007	DECEMBER 31, 2006
Number of cafés in Royalty Pool (357 cafés post the January 1, 2008 adjustment)	351	352	351	352
Number of active cafés - end of period	342	340	342	340
Same café sales growth(3)	0.7%	7.8%	3.0%	6.2%
System sales of cafés in the Royalty Pool(3)	$ 54,402	$ 53,759	$ 195,750	$ 189,287
Royalty revenues earned by MarksLP and MarksCo(1)	$ 3,593	$ 3,551	$ 12,829	$ 12,421
Earnings before Reorganization expense, non-cash movements in interest rate swap and amortization of deferred financing fees and income taxes(2)	$ 3,225	$ 3,223	$ 11,295	$ 11,141
Reorganization expense	-	$ 40	$ 312	$ 407
Non-cash movement of interest rate swap and amortization of deferred financing fees(1)	$ 191	$ 17	$ 316	$ 86
Current income tax (recovery) expense(1)	$ (450)	$ 171	$ (394)	$ 318
Non-cash future income tax expense (recovery)(1)	$ (2,041)	$ (116)	$ 2,865	$ 187
Net earnings for the period	$ 5,525	$ 3,111	$ 8,196	$ 10,143
Earnings per unit excluding Reorganization costs, recovery of income taxes relating to prior years, non-cash amortization and movements in the interest rate swap and non-cash future income taxes(3)	$ 0.3322	$ 0.3167	$ 1.1576	$ 1.1229
Basic earnings per unit	$ 0.5691	$ 0.3228	$ 0.8442	$ 1.0524
Diluted earnings per unit	$ 0.5672	$ 0.3216	$ 0.8414	$ 1.0485
Distributable cash per unit excluding Reorganization costs, changes in non-cash working capital, and recovery of income taxes relating to prior years(3)	$ 0.3322	$ 0.3167	$ 1.1576	$ 1.1229
Distributable cash per unit(3)	$ 0.3131	$ 0.3091	$ 1.1356	$ 1.0998
Distributions declared per unit	$ 0.2730	$ 0.2601	$ 1.0877	$ 1.0303

(1) "Royalty revenues earned by MarksLP and MarksCo", "Non-cash movement of interest rate swap and amortization of deferred financing fees", "Current income taxes" and "Non-cash future income tax expense (recovery)" represent the combined amounts of the consolidated Fund and its wholly owned subsidiaries, MarksLP and MarksCo, which are consolidated with the statements of Second Cup for reporting purposes in accordance with GAAP. The Fund accounts for the earnings of MarksLP and MarksCo on an equity-accounted basis in its consolidated financial statements, in accordance with GAAP.

(2) "Earnings before Reorganization expense, non-cash movements in interest rate swap and amortization of deferred financing fees and income taxes" is a non-GAAP measure and represents the earnings, before Reorganization costs, non-cash movements in interest rate swap, non-cash amortization of deferred financing fees and all income tax expenses or recoveries, of the consolidated Fund and its wholly owned subsidiaries, MarksLP and MarksCo, which are consolidated with the statements of Second Cup for reporting purposes in accordance with GAAP.

(3) "Same café sales growth", "System sales of cafés in the Royalty Pool", "Earnings per unit excluding Reorganization costs, recovery of income taxes relating to prior years, non-cash amortization and movements in the interest rate swap and non-cash future income taxes", "Distributable cash per unit excluding Reorganization costs and changes in non-cash working capital" and "Distributable cash" are non-GAAP measures.

		AS AT DECEMBER 31, 2007		AS AT DECEMBER 31, 2006
Total assets	$	112,039	$	89,198
Total long-term liabilities	$	24,551		-

SYSTEM SALES

Overview of System Sales

The indirect source of revenue for the Fund is royalty income collected by MarksLP from Second Cup. Royalty income is equal to 6.5% of system sales of Second Cup cafés in the Royalty Pool. MarksLP uses the royalty revenue to pay distributions, interest and principal to the Fund. As a result, same café sales growth is a key performance indicator for the Fund.

System sales comprise the gross revenue reported to Second Cup by franchisees of Second Cup cafés and by cafés owned by Second Cup that are included in the Royalty Pool. Sales are reported by franchisees to Second Cup on a weekly basis without audit or other form of independent assurance. Second Cup substantiates sales reported by its franchisees through analytical and financial reviews performed by management, on-site visits, and analysis of raw material purchases by the cafés.

Increases in system sales result from the addition of new cafés to the Royalty Pool and same café sales growth. System sales from existing cafés are primarily dependent on pricing, product and marketing initiatives undertaken by Second Cup, maintaining operational excellence within the café network and general market conditions, including weather. The primary factors that influence the number of cafés added to the Second Cup café network, and subsequently vended into the Royalty Pool, include the availability and cost of high quality locations, competition from other specialty coffee retailers and other businesses for prime locations and the availability of qualified franchisees.

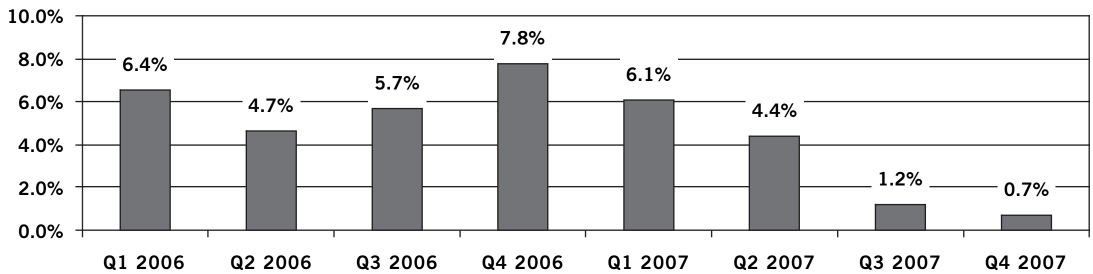
System sales are also affected by the permanent closure of Second Cup cafés already included in the Royalty Pool. Cafés are closed when they cease to be viable or, occasionally, when it is not possible to renew a lease for a particular location or to find an alternative suitable location for the franchisee. Under the Agreement, Second Cup is required to make a monthly make-whole payment to MarksLP to compensate the Fund for the loss of monthly royalty revenue on closed cafés until the next Royalty Pool adjustment date.

Analysis of System Sales and Same Café Sales Growth

System sales for the fourth quarter were $54,402, compared to $53,759 for the fourth quarter for 2006, representing an increase of $643 or 1.2%. The increase was mainly the result of same café sales in the quarter of 0.7%, and the net additional sales from the cafés added on the January 1, 2007 adjustment date.

System sales for the year were $195,750, compared to $189,287 for 2006, representing an increase of $6,463 or 3.4%. This increase was mainly the result of same café sales growth of 3.0% in 2007, and the net additional sales from the cafés added on the January 1, 2007 adjustment date. The following chart depicts the same café sales growth by Second Cup cafés in the Royalty Pool for the eight most recently completed fiscal quarters.

Same Café Sales Growth



Same café sales for the fourth quarter and year-to-date were positively impacted by price increases implemented in 2006 and Second Cup's promotional programs, which continued to shift Second Cup's sales mix to its higher priced blender and espresso-based beverages, and, in turn, resulted in higher average cheque amounts versus 2006. The temporary closure of 10 cafés while under renovation reduced same café sales in the fourth quarter by approximately 0.5%. On a year-to-date basis, same café sales were negatively impacted by approximately 1.0% due to the temporary closure of 40 cafés while under renovation (2006 - 11). The poor weather across Canada in the month of December, compared to a very mild December the year before, also had a negative impact on sales during the most important sales period of the year.

Management is not aware of any reliable third party comparable data on the trends affecting the Canadian specialty coffee market or the performance of Second Cup's competitors in the Canadian specialty coffee market during the year.

Seasonality of System Sales

The first quarter represents the lowest average 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 sales quarter of the fiscal year.

ROYALTY POOL AND CAFÉ NETWORK

During the year, nine cafés in the Royalty Pool were permanently closed, bringing the number of active cafés in the Royalty Pool to 342 as at December 31, 2007. Average annualized system sales of the nine closed cafés were considerably below the average of all Royalty Pool cafés with the total system sales of the nine cafés being approximately $3,513 on an annualized basis. In accordance with the Agreement, Second Cup made monthly "make-whole" payments to the Fund related to sales of the cafés permanently closed. The loss of the royalty revenues from these cafés was more than offset by future royalty income from 15 cafés added to the Royalty Pool on January 1, 2008 (see "Adjustment to the Royalty Pool" below).

OPERATING EXPENSES AND INCOME TAXES

Fourth Quarter

(IN THOUSANDS OF DOLLARS)		THREE MONTHS ENDED DECEMBER 31, 2007		THREE MONTHS ENDED DECEMBER 31, 2006
General and administrative expenses	$	79	$	57
Reorganization expense	$	-	$	40
Interest expense - net	$	148	$	-
Amortization of deferred financing charges	$	13	$	-
Movement in fair value of derivative interest rate swap	$	179	$	-
Income taxes				
Current	$	-	$	3
Future		(2,041)		-
Total income taxes	$	(2,041)	$	3

Operating expenses of the Fund are limited to general and administrative expenses for the administration of the Fund on a consolidated basis. General and administrative expenses consist primarily of professional fees, public entity costs and trustee fees. Excluding costs related to the Reorganization, total operating expenses of the Fund for the fourth quarter were $79 compared to $57 in the fourth quarter of 2006. The increase is primarily due to additional legal and advisory and other general and administrative expenses incurred by the Fund. During the quarter, the Fund incurred costs of $nil (2006 - $40) related to the Reorganization. The Fund recorded net interest expense of $148 related primarily to the term loan and $13 in amortization of financing charges also relating to the term loan. The Fund recorded a non-cash charge of $179 for the movement in the fair value of the interest rate swap. In 2006, the interest expense, amortization of deferred financing charges and movement in fair value of the interest rate swap resided in MarksCo (see "Reorganization of the Fund"). As a result of the Reorganization of the structure of the Fund, the Fund had no current income tax expense in the period compared to $3 in the prior year (also see income tax amounts relating to MarksCo below).

Income from Equity Accounted Investment in MarksCo and MarksLP

The Fund recorded income from its equity accounted investment in MarksLP of $3,807 (MarksCo 2006 income - $805) during the quarter. Royalty income earned by MarksLP from Second Cup in the quarter was $3,593 (2006 - $3,551) on sales of $54,402 (2006 - $53,759) reported by the Second Cup cafés in the Royalty Pool, an increase of 1.2% compared to the fourth quarter in 2006. General and administrative expenses of MarksLP included in income from equity accounted investments in the quarter were $150 (MarksCo 2006 - $123). The increase is primarily due to additional costs incurred for legal and accounting advisory charges, and other general and administrative expenses incurred in the third quarter. During the quarter, MarksLP earned bank interest income of $10 (2006 - $nil). Interest expense relating to the notes payable to the Fund by MarksLP was $97 in the quarter, compared to interest expense paid by MarksCo on its notes to the Fund of $2,406 in 2006. MarksLP recorded $10 in interest income in the fourth quarter of 2007 compared to net interest expense to non-related parties of $148 in the fourth quarter of 2006, primarily relating to interest on MarksCo's term loan which was repaid on April 2, 2007 as part of the Reorganization. In the fourth quarter of 2006, income from equity-accounted investments included income tax expenses of MarksCo amounting to $52, comprised of current income tax expense of $168, future income tax expense of $28 and an increase of $144 in its future income tax assets as a result of the federal government substantively enacting new legislation, which will result in a reduction in federal income tax rates commencing 2008. In the fourth quarter of 2007, as a result of reassessments obtained subsequent to a federal income tax audit, MarksLP recorded a recovery of $450 in current income tax. Excluding this tax recovery, current tax expense for MarksLP was $nil.

New Income Tax Legislation

On December 14, 2007, new legislation was substantively enacted, reducing the income tax rate from 31.5% to 29.5% in 2011, and 28% for 2012 onwards. As a result of this rate reduction, the Fund recorded a non-cash future income tax recovery of $2,059 on December 14, 2007. The Fund also recognized an additional future income tax liability of $18, on December 31, 2007 relating to the timing differences on the final adjustment of the cafés added to the Royalty Pool on January 1, 2007 (see "Adjustment to the Royalty Pool" below).

Net Earnings

Accordingly, net earnings of the Fund were $5,525 or $0.5691 per unit for the period, compared to $3,111, or $0.3228 per unit in 2006. Excluding the non-cash future income tax recovery of $2,041 (2006 - $116) related to the revision to the future income tax liability as a result of the income tax legislation described above; Reorganization costs of $nil (2006 - $40); the current income tax recovery of $450 (2006 - $nil) relating to prior years as described above; and the non-cash movements in the fair value of the interest rate swap and amortization of deferred financing charges of $191 (2006 - $17 in MarksCo), net earnings for the quarter were $3,225 or $0.3322 per unit compared to $3,052 or $0.3167 per unit in 2006, an increase of 4.9% on a per unit basis.

Year-to Date

(IN THOUSANDS OF DOLLARS)		YEAR ENDED DECEMBER 31, 2007		YEAR ENDED DECEMBER 31, 2006
General and administrative expenses	$	469	$	304
Reorganization expense	$	312	$	407
Interest expense - net	$	447	$	-
Amortization of deferred financing charges	$	31	$	-
Loss on movement in fair value of derivative interest rate swap	$	143	$	-
Income taxes				
Current	$	3	$	12
Future		13,504		-
Total income taxes	$	13,507	$	12

Operating expenses of the Fund are limited to general and administrative expenses for the administration of the Fund on a consolidated basis. General and administrative expenses consist primarily of professional fees, public entity costs and trustee fees. Excluding costs related to the Reorganization, total operating expenses of the Fund in 2007 were $469 (2006 - $304). The increase is primarily due to additional legal and advisory and other general and administrative expenses incurred by the Fund in the third quarter. During the year, the Fund incurred costs of $312 (2006 - $407) related to the Reorganization. The Fund recorded net interest expense of $447 related primarily to the term loan and $31 in amortization of financing charges also relating to the term loan. The Fund recorded a non-cash charge of $143 for the movement in the fair value of the interest rate swap. In 2006, the interest expense, amortization of deferred financing charges and movement in fair value of the interest rate swap resided in MarksCo (see "Reorganization of the Fund"). As a result of the Reorganization, current income tax expense for the year decreased to $3, compared to $12 in the prior year (also see income tax amounts relating to MarksCo below).

Income from Equity-accounted Investment in MarksCo and MarksLP

The Fund recorded income from equity-accounted investments of $20,146 (2006 - $1,319). Royalty income earned by MarksLP and MarksCo from Second Cup in the year was $12,829 (2006 - $12,421) on sales of $195,750 (2006 - $189,287) reported by the Second Cup cafés in the Royalty Pool, an increase of 3.4% compared to 2006, in-line with actual system sales growth. Included in the income from equity-accounted investments of $20,146 were earnings of $9,314 in MarksLP and earnings of $164 in MarksCo. MarksCo earnings of $164 included a non-cash writedown of deferred financing charges amounting to $142 (2006 - $86). In addition, the earnings from the equity investment reflect a credit to equity earnings of $10,668 relating to the elimination of a net future income tax liability, both as a result of the Reorganization discussed above. This net liability was comprised of a write-off of future tax assets of $1,408 previously recognized by MarksCo, offset by a $12,076 future income tax liability inherent in the carrying value of the equity-accounted investment that resulted from the step-up to the value of the Second Cup Marks when the Fund originally acquired MarksCo. The increase in the amortization of the deferred financing charges is due to the term loan being paid off by MarksCo as a result of the Reorganization.

General and administrative expenses of MarksLP and MarksCo included in income from equity accounted investments were $496 (MarksCo 2006 - $389). The increase is primarily due to additional costs incurred for external legal and accounting advisory charges in the third quarter, and increases in other general and administrative expenses. MarksLP also earned bank interest income of $22 (2006 - $nil). Interest expense relating to the notes payable to the Fund by MarksLP and MarksCo were $2,959 for the year, compared to $9,547 in 2006. Net interest expense to non-related parties, primarily relating to interest on MarksCo's term loan which was repaid on April 2, 2007 as part of the Reorganization, amounted to $144 for the year, compared to $587 in 2006. For 2006, income from equity-accounted investments included income tax expenses of MarksCo amounting to $493, comprised of current tax expense of $306, future tax expense of $107 and a reduction of $80 in its future income tax asset as a result of the federal government substantively enacting new legislation which will result in a reduction in federal income tax rates commencing 2008. In the fourth quarter of 2007, as a result of reassessments obtained subsequent to a federal income tax audit, MarksLP recorded a recovery of $450 in current income tax. Excluding the future income tax recovery of $10,668 and the current tax recovery of $450 discussed above, other current tax expense in 2007 amounted to $82, comprised of current tax expense of $53 and non-cash future tax expense of $29.

New Income Tax Legislation

On June 12, 2007 new tax legislation was enacted that changed the rules applicable to publicly traded income trusts commencing in 2011. In 2011, income taxes payable will reduce net earnings of the Fund. As the new trust tax legislation has been enacted, the Fund is now required to give accounting recognition to these new rules. Future income taxes are recorded as the difference between the accounting values of balance sheet assets and liabilities and the tax cost basis of these assets and liabilities based on substantively enacted tax laws and rates for differences that are expected to reverse after January 1, 2011. As the Fund will not be liable for taxes until January 1, 2011, on June 12, 2007 the Fund recognized a future non-cash income tax expense amounting to $15,545 arising from those temporary tax differences at December 31, 2007 expected to exist on January 1, 2011 at the tax rate applicable to the Fund. On December 14, 2007, new legislation was substantively enacted, reducing the income tax rate from 31.5% to 29.5% in 2011, and 28% for 2012 onwards. As a result of this rate reduction, the Fund recorded a non-cash future income tax recovery of $2,059 on December 14, 2007. The Fund also recognized an additional future tax liability of $18, on December 31, 2007 relating to the timing differences on the final adjustment of the cafés added to the Royalty Pool on January 1, 2007 (see "Adjustment to the Royalty Pool" below).

Net Earnings

Net earnings of the Fund were $8,196 or $0.8442 per unit for the year, compared to $10,143, or $1.0524 per unit in 2006. Excluding the impact of the $10,668 (2006 - $nil) non-cash future income tax recovery as a result of the Reorganization and non-cash future income tax expense of $29 in MarksCo prior to the Reorganization (2006 - $187) recorded in the equity earnings of MarksCo; the $13,504 non-cash charge to earnings of the Fund related to the set up of a future income tax liability as a result of the income tax legislation described above; Reorganization costs of $312 (2006 - $407); the current income tax recovery of $450 relating to prior years as described above (2006 - $nil); and the non-cash movements in the fair value of the interest rate swap of $143 (2006 - $nil) and amortization of deferred financing charges of $31 (2006 - $nil) in the Fund and $142 in MarksCo (2006 - $86), net earnings for the year-to-date were $11,239 or $1.1576 per unit compared to $10,823 or $1.1229 per unit in 2006, an increase of 3.1% on a per unit basis.

SELECTED QUARTERLY INFORMATION

A discussion of the Fund's previous interim results can be found in the Fund's quarterly Management's Discussion and Analysis reports available at www.sedar.com.

(IN THOUSANDS OF DOLLARS EXCEPT CAFÉS AND PER UNIT AMOUNTS)	Q4 2007(1),(6)	Q3 2007	Q2 2007(5)	Q1 2007(2)
Total number of cafés in Royalty Pool at end of period	351	351	351	351
Number of active cafés in Royalty Pool at end of period	342	344	348	348
Same café sales growth	0.7%	1.2%	4.4%	6.1%
System sales of cafés in the Royalty Pool	$ 54,402	$ 47,202	$ 48,149	$ 45,997
Net earnings for the period	$ 5,525	$ 2,571	$ (2,171)	$ 2,271
Diluted earnings per unit	$ 0.5672	$ 0.2641	$ (0.2236)	$ 0.2326
Distributable cash per unit	$ 0.3131	$ 0.2696	$ 0.2755	$ 0.2774
Distributions declared per unit	$ 0.2730	$ 0.2730	$ 0.2730	$ 0.2687

	Q4 2006(1),(2),(4)	Q3 2006(2)	Q2 2006(2),(3)	Q1 2006(2)
Total number of cafés in Royalty Pool at end of period	352	352	352	352
Number of active cafés in Royalty Pool at end of period	340	345	348	350
Same café sales growth	7.8%	5.7%	4.7%	6.4%
System sales of cafés in the Royalty Pool	$ 53,759	$ 46,343	$ 45,812	$ 43,373
Net earnings for the period	$ 3,111	$ 2,627	$ 2,160	$ 2,245
Diluted earnings per unit	$ 0.3216	$ 0.2715	$ 0.2233	$ 0.2321
Distributable cash per unit	$ 0.3091	$ 0.2783	$ 0.2409	$ 0.2715
Distributions declared per unit	$ 0.2601	$ 0.2601	$ 0.2601	$ 0.2500

(1) The Fund's fourth quarter system sales are significantly higher than other quarters due to the seasonality of the business (see "Seasonality of System Sales" above).

(2) Results for the quarters of 2007 and 2006 are not directly comparable as they include the impact of expenses related to the Reorganization of the Fund (see "Reorganization of the Fund"). Details on expenses related to the Reorganization are set out in the table below.

(3) Results for the second quarter of 2006 include a $224 non-cash tax charge, resulting from a revaluation of MarksCo's future income tax assets as a result of reductions in federal income tax rates that were enacted during the quarter. This resulted in a reduction in basic and diluted earnings per unit of $0.0232. There was no impact to distributable cash per unit from this non-cash item.

(4) Upon the detailed annual review of the tax provision by management of MarksCo, it was determined that the reductions in federal income tax rates that were enacted in the second quarter reduced future income taxes by $80, versus the original estimate of $224. This resulted in a non-cash tax recovery of $144 being recognized in the fourth quarter of 2006. This recovery increased basic and diluted earnings per unit in the fourth quarter by $0.0149. There was no impact to distributable cash per unit from this non-cash item.

(5) Results for the second quarter of 2007 include a non-cash recovery of future income taxes of $10,668 relating to the Reorganization of the Fund, and a non-cash future income tax charge of $15,545 relating to the new tax legislation enacted on June 12, 2007.

(6) Results for the fourth quarter of 2007 include a non-cash recovery of future income taxes of $2,059 relating to reductions in federal income tax rates that were enacted on December 14, 2007, and a current income tax recovery of $450 relating to reassessments received on prior year returns of the predecessor corporation to MarksLP.

Information pertaining to the expenses incurred relating to the Reorganization is below. These costs are included in the quarterly net earnings and distributable cash amounts disclosed above.

	Q4 2007	Q3 2007	Q2 2007	Q1 2007
Expenses related to the Reorganization				
- in thousands of dollars	-	$ 11	-	$ 301
- per unit	-	$ 0.0011	-	$ 0.0310

	Q4 2006	Q3 2006	Q2 2006	Q1 2006
Expenses related to the Reorganization				
- in thousands of dollars	$ 40	$ 10	$ 164	$ 193
- per unit	$ 0.0041	$ 0.0010	$ 0.0171	$ 0.0200

DISTRIBUTIONS

During the fourth quarter, the Fund declared total distributions of $2,650 or $0.2730 per unit, compared to total distributions declared in the fourth quarter of 2006 of $2,507 or $0.2601 per unit. On a per unit basis, this represents a 5.0% increase from the comparable period.

On a year-to-date basis, the Fund declared total distributions of $10,560 or $1.0877 per unit, compared to total distributions declared in the comparable period in 2006 of $9,930 or $1.0303 per unit. On a per unit basis, this represents a 5.6% increase over the comparable year-to-date period.

Distributions for the year-to-date were as follows:

PERIOD	PAYMENT DATE	AMOUNT/UNIT
January 2007	February 28, 2007	$ 0.0867
February 2007	March 30, 2007	$ 0.0910
March 2007	April 30, 2007	$ 0.0910
Total - First Quarter 2007		$ 0.2687
April 2007	May 31, 2007	$ 0.0910
May 2007	June 29, 2007	$ 0.0910
June 2007	July 31, 2007	$ 0.0910
Total - Second Quarter 2007		$ 0.2730
July 2007	August 30, 2007	$ 0.0910
August 2007	September 27, 2007	$ 0.0910
September 2007	October 31, 2007	$ 0.0910
Total - Third Quarter 2007		$ 0.2730
October 2007	November 30, 2007	$ 0.0910
November 2007	December 31, 2007	$ 0.0910
December 2007	January 31, 2008	$ 0.0910
Total - Fourth Quarter 2007		$ 0.2730
Total - Year-to-date 2007		$ 1.0877

On January 31, 2008, the Fund paid the declared distribution for December 2007 of $883, or $0.0910 per unit to holders of record at the close of business on December 31, 2007. On February 29, 2008, the Fund paid distributions for January 2008 of $900 or $0.0910 per unit to holders of record at the close of business on February 27, 2008.

On March 11, 2008, the Fund's Board of Trustees approved a 3.3% increase in the monthly unitholder distribution effective for the February 2008 distribution which will be paid on March 31, 2008 to holders of record at the close of business on March 28, 2008. The change will increase the monthly distribution rate from $0.0910 to $0.0940 per unit, or $1.1280 per unit on an annualized basis from $1.0920 per unit.

DISTRIBUTABLE CASH

In common with other royalty income trusts in Canada, management believes that distributable cash is an appropriate measure of performance of the Fund as the amount of cash available to pay distributions to Unitholders is determined with reference to distributable cash. Management believes that, in addition to net income, distributable cash is a useful supplemental measure in evaluating the Fund's performance as it provides investors with an indication of cash available for distributions. Investors are cautioned, however, that distributable cash should not be construed as an alternative to the consolidated statements of cash flows as a measure of liquidity and cash flows. The method of calculating distributable cash for the purposes of this MD&A may differ from that used by other issuers and, accordingly, distributable cash in this MD&A may not be comparable to distributable cash used by other issuers (see "Non-GAAP Terms").

For purposes of this MD&A, distributable cash is based on cash flows from operating activities, the GAAP measure reported in the Fund's consolidated statements of cash flows. Cash flow from operating activities of the Fund is adjusted to include cash flow from operating activities of its wholly owned subsidiary, MarksLP (and MarksCo prior to the Reorganization).

Fourth Quarter

	THREE MONTHS ENDED DECEMBER 31, 2007	THREE MONTHS ENDED DECEMBER 31, 2006
Cash flow from operating activities of the Fund	$ (297)	$ 2,379
Add:		
Cash flow from operating activities of MarksLP and MarksCo	3,337	600
Distributable cash for the Fund	$ 3,040	$ 2,979
Number of units outstanding	9,708,609	9,638,076
Distributable cash per unit	$ 0.3131	$ 0.3091
Distributions paid	$ 2,650	$ 2,507
Distributions declared	$ 2,650	$ 2,507
Distributions declared per unit	$ 0.2730	$ 0.2601

Distributable cash for the quarter was $3,040, or $0.3131 per unit, as compared to $2,979, or $0.3091 per unit in the fourth quarter of 2006 representing an increase of 1.3% per unit. Non-cash working capital of the Fund for the quarter increased by $166 and non-cash working capital of MarksLP and MarksCo increased by $469 compared to a decrease of $73 in the Fund and an increase of $106 in MarksCo for the comparable period. Changes in non-cash working capital are primarily due to the timing of payments from related parties and payments of income tax amounts. Excluding the impact of changes in non-cash working capital and the Reorganization costs of $nil (2006 - $40) and the $450 (2006 - $nil) recovery of income taxes relating to prior years, distributable cash would have been $3,225, or $0.3322 per unit, compared to $3,052, or $0.3167 per unit for the fourth quarter of 2006, which represents a 4.9% increase in distributable cash per unit.

Year-to-date

	YEAR ENDED DECEMBER 31, 2007	YEAR ENDED DECEMBER 31, 2006
Cash flow from operating activities of the Fund	$ 2,317	$ 8,870
Add:		
Cash flow from operating activities of MarksLP and MarksCo	8,708	1,730
Distributable cash for the Fund	$ 11,025	$ 10,600
Number of units outstanding	9,708,609	9,638,076
Distributable cash per unit	$ 1.1356	$ 1.0998
Distributions paid	$ 10,513	$ 9,894
Distributions declared	$ 10,560	$ 9,930
Distributions declared per unit	$ 1.0877	$ 1.0303

Non-cash working capital of the Fund for the year-to-date decreased by $589 and non-cash working capital of MarksLP and MarksCo increased by $941 compared to a decrease of $46 in the Fund and a decrease of $138 in MarksCo for the comparable period. Changes in non-cash working capital are primarily due to the timing of payments from related parties and payments of income tax amounts. Excluding the impact of changes in non-cash working capital; the Reorganization costs of $312 (2006 - $407); and the $450 (2006 - $nil) recovery of income taxes relating to prior years, distributable cash would have been $11,239, or $1.1576 per unit, compared to $10,823 or $1.1229 per unit in 2006, which represents a 3.1% increase in distributable cash per unit.

Tax Treatment of Distributions

Of the $1.0877 in distributions declared per unit during the year, 15.5% or $0.1685 per unit represented a tax deferred return of capital, 1.9% or $0.0203 per unit represented dividend income and 82.6% or $0.8989 per unit is taxable as other taxable income (equivalent to interest income). For the year ended December 31, 2006, 13.5% or $0.1389 per unit represented a tax deferred return of capital, 11.9% or $0.1224 represented dividend income and 74.6% or $0.7690 per unit was taxable as other taxable income.

LIQUIDITY AND CAPITAL RESOURCES

The Fund is required to remit distributions in arrears to Unitholders, on the last business day of each month. The Fund's distribution policy is to make cash distributions to Unitholders from the distributable cash generated by the Fund and MarksLP, and to make such distributions in equal amounts to Unitholders on a monthly basis in order to smooth out any seasonal fluctuations in the Fund's income. The Fund has no contractual or purchase obligations. The Fund did not have any capital expenditures in 2007 and does not have any plans for capital expenditures in 2008.

The Fund had cash and cash equivalents balances of $1,037 at December 31, 2007 (2006 - $320). This excludes cash and cash equivalents amounts held by MarksLP of $58 at December 31, 2007 (MarksCo 2006 - $802).

The primary source of liquidity for the Fund is the royalty payable to MarksLP by Second Cup. Second Cup collects royalties based on franchisee system sales, franchise fees and other amounts from its franchisees and also generates revenues from its company-owned cafés. The performance of Second Cup franchisees and company-owned cafés could impact the ability of Second Cup to pay the royalty to MarksLP. For a more detailed discussion of the risks and uncertainties affecting the Fund's liquidity, see "Risks and Uncertainties" below.

For the year ended December 31, 2007, the Fund generated cash from operations of $2,317 (2006 - $8,870). The decrease in cash from operating activities is mainly due to the Reorganization, whereby in the prior year the Fund earned interest income from its wholly owned subsidiary, MarksCo. As a result of the Reorganization, which occurred on April 2, 2007, MarksCo was replaced with MarksLP. From April 2, 2007 onwards, the Fund's primary source of cash flows is MarksLP's principal repayments on the notes payable to the Fund, as well as distributions of its earnings through the Fund's 99.99% holdings of MarksLP's limited partnership units and the 0.01% holdings of the Fund's wholly owned subsidiary, GP Trust. Also as a result of the Reorganization, the Fund received $11,000 in cash as a result of the new term loan, and invested it in MarksCo to enable it to repay its term loan on April 2, 2007. The Fund incurred $127 in financing charges related to the new term loan. The Fund also received $8,871 from MarksLP as payment of principal on its notes receivable. The Fund paid distributions to Unitholders of $10,513 (2006 - $9,894) during the year. The increase in distributions paid is due mainly to an increase in the monthly distribution rate over the prior year and an increase in the number of units outstanding.

The Fund continues to believe it has sufficient financial resources to pay ongoing future distributions, operating expenses and income taxes.

Term Loan, Operating Credit Facility and Interest Rate Swap

As a result of the Reorganization, the Fund negotiated a new term loan of $11,000 with its bankers on similar terms and conditions as MarksCo's term loan maturing on December 2, 2009. The credit facilities total $12,000 and are comprised of an $11,000 non-revolving term credit facility and a $1,000 operating credit facility. As at December 31, 2007, the $1,000 operating line of credit was unused and the $11,000 non-revolving term credit facility was fully utilized. The $11,000 non-revolving term credit facility bears interest at prime or base rate plus 0.75% or LIBOR advances or bankers' acceptances plus 1.75%. The $1,000 operating credit facility bears interest at prime or base rate plus 0.50% or LIBOR advances or bankers' acceptances plus 1.50%.

The table below represents payments due by period by the Fund, and relate to credit facilities that have been consolidated in the Fund's consolidated financial statements.

(IN THOUSANDS OF DOLLARS)	TOTAL	LESS THAN 1 YEAR	1 - 3 YEARS	4 - 5 YEARS	AFTER 5 YEARS
Term loan	$ 11,000	-	$ 11,000	-	-

An interest rate swap agreement was entered into by the Fund maturing December 2, 2009, which fixes the interest rate on the Fund's non-revolving credit facility at 4.87% per annum plus the variable margin noted above. As at December 31, 2007, the estimated fair value of this contract is a $143 liability to the Fund (2006 - $nil), and is recorded as a liability on the Fund's consolidated balance sheets and as a non-cash charge to earnings.

OFF-BALANCE SHEET ARRANGEMENTS

The Fund does not have any off-balance sheet arrangements.

RELATED PARTY TRANSACTIONS AND BALANCES

In the second quarter of 2007, the Fund engaged in a number of transactions with related parties to effect the Reorganization as described further above.

During the year, interest income of $535 was earned on the note receivable from MarksLP, of which $22 (2006 - $nil) is receivable at December 31, 2007 and $2,424 (2006 - $9,547) was earned on the notes receivable from MarksCo of which $nil is receivable at December 31, 2007 (2006 - $811). In addition, principal repayments of $8,871 were received from MarksLP (2006 - $nil). The Fund also charged a management fee of $87 (2006 - $nil) to MarksLP for certain general and administrative expenses incurred by the Fund during the year. In addition, during the year, dividend income of $190 (2006 - $1,135) was received from MarksCo.

Included in accounts payable and accrued liabilities is an amount of $nil due to MarksLP (2006 - $69 due to MarksCo) relating to certain general and administrative expenses of the Fund. The amount is non-interest bearing and is due on demand.

On January 1, 2007, the Fund engaged in a number of transactions with MarksCo and Second Cup to effect the adjustments to the Royalty Pool. See "January 1, 2007 Royalty Pool Adjustment" below.

FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash and cash equivalents, notes and interest receivable from MarksLP, accounts payable and accrued liabilities and distributions payable to the Unitholders. All financial assets and derivative financial instruments, except for those financial assets classified as held-to-maturity or loans and receivables, are measured at their fair values. Financial liabilities are measured at their fair values when they are classified as held for trading purposes. Otherwise, they are measured at amortized cost. The Fund classifies its notes receivable from MarksLP as loans receivable carried at amortized cost. All other financial assets and derivatives are measured at fair value. Transaction costs associated with long-term debt are included in the carrying value of the long-term debt and are amortized using the effective interest rate method.

Credit risk

The Fund's financial instruments exposed to credit risk include cash and cash equivalents and the note and interest receivable from MarksLP. The Fund places its cash and cash equivalents with institutions of high creditworthiness. The Fund believes that the credit risk exposure on its note and interest receivable from MarksLP is limited. This is based on the consistency of the royalty income collected by MarksLP, which is its sole source of cash for payment of interest and principal on the note receivable by the Fund.

ADJUSTMENTS TO THE ROYALTY POOL

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount that may be satisfied by additional Fund units or cash, the form of payment being at the option of the Fund. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net system sales, with the balance received when the actual full year performance of the new cafés is known.

January 1, 2007

On January 1, 2007, the actual annual sales of the nine cafés added to the Royalty Pool on January 1, 2006 were $4,421, greater than the original estimate of $4,055. In accordance with the provisions in the Agreement, a final adjustment of $356 was satisfied by MarksCo delivering to Second Cup 35,903 additional units of the Fund. In addition, MarksCo also made a cash payment of $37 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the additional units above had they been issued on January 1, 2006.

On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized sales of these 11 cafés added to the Royalty Pool were estimated at $4,555 offset by $3,815 in sales of the 12 cafés permanently closed from the Royalty Pool during 2006. In accordance with the provisions in the Agreement, the Fund, through MarksCo, was required to make a payment of $315 to Second Cup, representing 80% of the obligation based on forecasted sales. On January 1, 2007, the Fund issued 34,630 units to MarksCo, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue 32,412 additional units to satisfy the remaining obligation of MarksLP on or about January 1, 2008.

In conjunction with this adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. The notes issued by MarksCo to the Fund bore interest at 12.125% and were to mature on January 1, 2017. These notes were repaid as part of the Reorganization discussed above. The common shares were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

January 1, 2008

On January 1, 2008, the actual annual sales of the 11 cafés added to the Royalty Pool on January 1, 2007 for the year ended December 31, 2007 were $4,961, as compared to the original estimate of $4,555. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the provisions in the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the additional 32,412 units above had they been issued on January 1, 2007.

Also, on January 1, 2008, 15 cafés were added to the Royalty Pool of which nine opened in 2006 subsequent to the cut-off date for inclusion in the Royalty Pool at January 1, 2007 along with six cafés opened in 2007 prior to the cut-off date for the January 1, 2008 adjustment. The annualized sales of these 15 cafés added to the Royalty Pool have been estimated at $6,750. These sales were offset by $3,513 in sales of nine cafés permanently closed from the Royalty Pool during the year. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $1,347 to Second Cup, representing 80% of the obligation based on forecasted sales. On January 1, 2008, the Fund issued 143,712 units to MarksLP, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue additional units to satisfy the remaining obligation. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 351 to 357, and Second Cup's ownership increased to 246,657 units.

AMENDED AND RESTATED DECLARATION OF TRUST

The Second Amended and Restated Declaration of Trust dated April 2, 2007 establishing and governing the Fund was further amended and restated on October 22, 2007 to address certain non-material post-Reorganization matters. A copy of the Third Amended and Restated Declaration of Trust dated October 22, 2007 has been filed on www.sedar.com.

OUTSTANDING UNIT AND SHARE DATA

	AS AT DECEMBER 31, 2007	AS AT DECEMBER 31, 2006
Fund - units issued	9,708,609	9,638,076
- amount	$ 88,159	$ 87,488

On January 1, 2008, 176,124 units were issued to Second Cup (see "Adjustment to the Royalty Pool" above) representing approximately 1.8% of the total issued and outstanding units of the Fund.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer and the Chief Financial Officer of GP Inc., as administrator of the Fund, have evaluated, as of December 31, 2007, the effectiveness of the Fund's disclosure controls and procedures within the meaning of Multilateral Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings. They have concluded that the Fund's disclosure controls and procedures provide reasonable assurance that material information relating to the

Fund would have been made known to members of management. As well, the certifying officers are satisfied that the system of internal controls over financial reporting has been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of consolidated financial statements for external purposes.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Fund's management has designed internal controls over financial reporting, as defined under Multilateral Instrument 52-109 of the Canadian Securities Administrators.

The purpose of internal controls over financial reporting is to provide reasonable assurance regarding the reliability of financial reporting, in accordance with GAAP, focusing in particular on controls over information contained in the annual and interim financial statements. The internal controls are not expected to prevent and detect all misstatements due to error or fraud.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

During the most recent period, there were no changes in the Fund's internal controls over financial reporting that have materially affected, or are reasonable likely to materially affect, the Fund's internal controls over financial reporting.

CRITICAL ACCOUNTING ESTIMATES

The Fund, annually, reviews the book value of its primary asset, its investment in MarksLP, which consists of notes receivable and limited partnership units. The review is based on the distributable cash flow of the Fund, which is based on income from the Fund's investment in MarksLP. In turn, MarksLP's cash flows are based on the royalty income earned on licensing the Second Cup Marks to Second Cup. The review also considers the unit price of the Fund, actual and forecast royalty income from Second Cup and actual and forecast distributable cash of the Fund.

RISKS AND UNCERTAINTIES

The performance of the Fund is dependent on the royalties paid to MarksLP by Second Cup on the system sales of Royalty Pool cafés. This is considered to be a key attribute of the Fund and a fund with this structure is commonly referred to as a "top line" fund. The distributions to Unitholders are a function of the system sales of the Royalty Pool cafés less the Fund's expenses and are not directly a function of the profitability of Second Cup or the individual Second Cup cafés. The success of the Fund is determined primarily by the ability of Second Cup to maintain and increase the system sales of Royalty Pool cafés and to add new cafés to the Royalty Pool on an accretive basis.

System sales of Royalty Pool cafés are affected by various external factors that can affect the specialty coffee industry as a whole. Potential risks include the following:

- The specialty coffee industry is characterized by intense competition with respect to price, location, coffee and food quality and numerous factors affecting discretionary consumer spending. Competitors include national and regional chains, all restaurants and food service outlets that serve coffee, and supermarkets that compete in the whole bean segment. If Second Cup cafés are unable to successfully compete in the Canadian specialty coffee industry, system sales may be adversely affected, which, in turn, may reduce the amount of the royalty paid to MarksLP and adversely affect the ability of the Fund to pay distributions.
- Second Cup faces intense competition for high profile retail locations and qualified franchisees, both from specialty coffee chains and competitors from other industries. Growth of the café network depends on Second Cup's ability to secure and build desirable locations and find high calibre, qualified franchisees to operate them.
- A shortage in supply or an increase in the price of premium quality coffee beans could adversely affect Second Cup. Second Cup has no long-term or written contracts with coffee bean suppliers and relies on 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 specialty coffee industry is also affected by changes in discretionary spending patterns, demographic trends, and traffic and weather patterns as well as the type, number and location of competing cafés.
- Second Cup's business could be adversely affected by reduced consumer confidence and increased concerns about food safety in general, or other unusual events.
- Changes in government regulations and other regulatory developments (such as smoking by-laws) could have an adverse impact on system sales and the royalties.
- The loss of key personnel and/or a shortage of experienced management and hourly employees could have an adverse impact on Second Cup's operations and cafés.

On June 12, 2007, new income tax legislation regarding the taxation of income trusts that were publicly traded prior to November 1, 2006 was enacted by the federal government. As a result of the legislation, the Fund will be taxed on earnings before distributions to Unitholders commencing January 1, 2011. On December 14, 2007, new legislation was substantively enacted reducing the income tax rate from 31.5% to 29.5% in 2011 and 28% for 2012 onwards. Under the legislation, certain income earned by these entities will be taxed in a manner similar to income earned by a corporation and distributions or allocations made by these entities to Unitholders will be taxed similar to dividends from taxable Canadian corporations. The deemed dividends will be eligible for the proposed new enhanced dividend tax credit if paid or allocated to a resident of Canada.

A more detailed discussion of the risks and uncertainties affecting the Fund is set out in the Fund's Annual Information Form, which is available at www.sedar.com.

OUTLOOK

The information contained in this "Outlook" is forward-looking information. Please see "Forward-Looking Information" below for a discussion of the risks and uncertainties in connection with forward-looking information.

The Fund's "top line" structure means that its success and growth depend primarily on Second Cup's ability to maintain and increase the overall system sales of cafés in the Royalty Pool. Growth in overall system sales is dependent on same café sales growth and adding new cafés to the café network.

Second Cup has now achieved 17 consecutive quarters of positive same café sales dating back to the fourth quarter of 2003. Subject to stable economic conditions across Second Cup's primary markets, Second Cup expects to achieve same café sales growth of approximately 2% to 4% for the 2008 fiscal year. To achieve this growth, Second Cup has planned a number of growth initiatives to strengthen the long-term success of the Second Cup brand and its franchisees:

- In 2008, Second Cup will put an even stronger focus on operational excellence at the café level, which it believes will yield even better consistency across the chain and in doing so improve the overall guest experience and help drive same café sales growth.
- In an effort to drive loyalty among specialty coffee customers, Second Cup's promotional strategies will focus on targeted branding initiatives leveraging its premium priced specialty beverages, food and merchandise innovations, and value added offers. Second Cup will also selectively enhance the nutritional quality of its grab and go food, and beverage offerings, including the launch of a beverage platform with lower fat and calorie claims in mid-2008.
- Second Cup will continue to improve upon in-café food offerings, and will be launching a premium hot breakfast sandwich in its Ontario and Quebec markets in early 2008.

- Second Cup will also be taking selective price increases on several of its products throughout the year, which is expected to have an impact of 1% to 2% on same café sales growth, depending on the timing and amount of pricing taken.
- Second Cup will continue to develop and build neighbourhood cafés with a focus on expansion in key urban markets utilizing a disciplined café development process, and the delivery of cost savings to franchisees in the build out of their new and renovated cafés.

In terms of network expansion, Second Cup expects to open 12 to 18 new cafés in Canada during the 2008 fiscal year. Second Cup also expects to close 10 to 14 cafés during 2008, the majority of which have sales below the average performance of cafés in the Royalty Pool. Furthermore, Second Cup expects that approximately 35 of its cafés will be renovated during 2008.

Overall, based on the initiatives outlined above and others, the anticipated economic environment and market conditions affecting the specialty coffee industry, the Fund expects a successful year in 2008.

FORWARD-LOOKING INFORMATION

Certain statements in this MD&A 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 MD&A. 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 on 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 MarksLP, 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; reporting of system sales 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 “Risks and Uncertainties” above and in the Fund’s Annual Information Form, which is available at www.sedar.com.

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

As these forward-looking statements are made as of the date of this MD&A, the Fund does not undertake to update any such forward-looking 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 on the Fund’s website at www.secondcupincomefund.com.

NON-GAAP TERMS

In addition to using financial measures prescribed by GAAP, non-GAAP financial measures and other terms are used in this MD&A. These terms include “system sales”, “same café sales growth”, “net earnings for the year excluding Reorganization costs and the impact of the Reorganization and new tax legislation on non-cash future income tax balances”, “basic earnings per unit excluding Reorganization costs and the impact of the Reorganization and new tax legislation on non-cash future income tax balances”, “distributable cash per unit excluding Reorganization costs and changes in non-cash working capital” and “distributable cash”. These terms are not financial measures recognized by

GAAP and do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar terms and measures presented by other similar issuers. These non-GAAP measures and terms are intended to provide additional information on the Fund's performance and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

System sales and same café sales growth are presented in reference to the sales performance of the Royalty Pool Cafés. The Fund believes they are useful measures as they provide an indication of the top-line sales on which the royalty that is the Fund's indirect source of income is based. Distributable cash is presented in reference to the Fund's distribution policy. The Fund believes distributable cash is a useful measure as it provides investors with an indication of cash available for distribution. Management believes, in addition to net income, distributable cash is a useful supplemental measure in evaluating the Fund's performance as it provides investors with an indication of cash available for distributions and working capital needs. Investors are cautioned, however, that distributable cash should not be construed as an alternative to the consolidated statements of cash flows as a measure of liquidity and cash flows. The method of calculating distributable cash for the purposes of this MD&A may differ from that used by other issuers and, accordingly, distributable cash in this MD&A may not be comparable to distributable cash used by other issuers.

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
Chartered Accountants
North American Centre
5700 Yonge Street, Suite 1900
North York, Ontario
Canada M2M 4K7
Telephone +1 416 218 1500
Facsimile +1 416 218 1499

March 11, 2008

Auditors' Report

To the Unitholders of
Second Cup Royalty Income Fund

We have audited the consolidated balance sheets of **Second Cup Royalty Income Fund** (the Fund) as at December 31, 2007 and 2006 and the consolidated statements of earnings and comprehensive income, unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

Second Cup Royalty Income Fund

CONSOLIDATED BALANCE SHEETS

(EXPRESSED IN THOUSANDS OF DOLLARS)

	DECEMBER 31, 2007	DECEMBER 31, 2006
Assets		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,037	$ 320
Interest receivable from equity-accounted investment (note 11)	22	811
Prepaid expenses and other assets	137	2
	1,196	1,133
Notes receivable from equity-accounted investment (notes 2 and 8)	300	78,739
Equity-accounted investment (notes 2 and 8)	110,543	9,326
	$ 112,039	$ 89,198
Liabilities		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (note 11)	$ 147	$ 211
Distributions payable to unitholders	883	836
	1,030	1,047
Future income tax liability (note 12)	13,504	-
Fair value of derivative interest rate swap (note 5)	143	-
Term loan (notes 2 and 5)	10,904	-
	25,581	1,047
UNITHOLDERS' EQUITY	86,458	88,151
	$ 112,039	$ 89,198

Reorganization (note 2)
Subsequent event (note 14)
See accompanying notes to consolidated financial statements.

APPROVED BY THE TRUSTEES

(Signed) David Bloom
Trustee

(Signed) Raymond Guyatt
Trustee

Second Cup Royalty Income Fund

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT PER UNIT AMOUNTS)

	FOR THE YEAR ENDED DECEMBER 31, 2007	FOR THE YEAR ENDED DECEMBER 31, 2006
Earnings from equity-accounted investment (note 8)	$ 20,146	$ 1,319
Interest income from equity-accounted investment (note 11)	2,959	9,547
General and administrative expenses (note 11)	(469)	(304)
Reorganization expense (note 2)	(312)	(407)
Interest expense on term loan - net	(447)	-
Amortization of deferred financing charges	(31)	-
Movement in fair value of derivative interest rate swap (note 5)	(143)	-
Earnings before income taxes	21,703	10,155
Income taxes - current (note 12)	(3)	(12)
Income taxes - future (note 12)	(13,504)	-
Net earnings for the year	8,196	10,143
Other comprehensive income	-	-
Comprehensive income	$ 8,196	$ 10,143
Basic earnings per unit (note 10)	$ 0.8442	$ 1.0524
Diluted earnings per unit (note 10)	$ 0.8414	$ 1.0485

See accompanying notes to consolidated financial statements.

Second Cup Royalty Income Fund

CONSOLIDATED STATEMENTS OF UNITHOLDERS' EQUITY

(EXPRESSED IN THOUSANDS OF DOLLARS)

	INCOME FUND UNITS	ACCUMULATED UNITHOLDERS' EARNINGS	ACCUMULATED DISTRIBUTIONS	REFUNDABLE TAXES	TOTAL
BALANCE - DECEMBER 31, 2005	$ 86,940	$ 10,820	$ (10,370)	$ (1)	$ 87,389
Net earnings for the year	-	10,143	-	-	10,143
Units issued January 1, 2006	548	-	-	-	548
Distributions to unitholders	-	-	(9,930)	-	(9,930)
Refundable taxes incurred	-	-	-	(371)	(371)
Recovery of refundable taxes	-	-	-	372	372
BALANCE - DECEMBER 31, 2006	$ 87,488	$ 20,963	$ (20,300)	$ -	$ 88,151
Net earnings for the year	-	8,196	-	-	8,196
Units issued January 1, 2007	671	-	-	-	671
Distributions to unitholders	-	-	(10,560)	-	(10,560)
Refundable taxes incurred	-	-	-	(64)	(64)
Recovery of refundable taxes	-	-	-	64	64
	88,159	29,159	(30,860)	-	86,458
Accumulated other comprehensive income	-	-	-	-	-
BALANCE - DECEMBER 31, 2007	$ 88,159	$ 29,159	$ (30,860)	$ -	$ 86,458

See accompanying notes to consolidated financial statements.

Second Cup Royalty Income Fund

CONSOLIDATED STATEMENTS OF CASH FLOWS

(EXPRESSED IN THOUSANDS OF DOLLARS)

	FOR THE YEAR ENDED DECEMBER 31, 2007	FOR THE YEAR ENDED DECEMBER 31, 2006
Cash provided by (used in)		
OPERATING ACTIVITIES		
Net earnings for the year	$ 8,196	$ 10,143
Items not involving cash		
Earnings from equity-accounted investment	(20,146)	(1,319)
Amortization of deferred financing charges	31	-
Future income taxes	13,504	-
Movement in fair value of derivative interest rate swap	143	-
Change in non-cash working capital items (note 15)	589	46
	2,317	8,870
INVESTING ACTIVITIES		
Investment in note receivable of Second Cup Trade-Marks Inc.	(604)	(493)
Impact of reorganization (note 2)	(11,021)	-
Dividends from equity-accounted investment	190	1,135
Repayment of loan receivable	8,871	-
Investment in common shares of Second Cup Trade-Marks Inc.	(67)	(55)
	(2,631)	587
FINANCING ACTIVITIES		
Issuance of units	671	548
Distributions paid to unitholders	(10,513)	(9,894)
Deferred financing charges	(127)	-
Increase in term loan	11,000	-
	1,031	(9,346)
INCREASE IN CASH AND CASH EQUIVALENTS DURING THE YEAR	717	111
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	320	209
CASH AND CASH EQUIVALENTS - END OF YEAR	$ 1,037	$ 320

SUPPLEMENTARY CASH FLOW INFORMATION (note 15)

See accompanying notes to consolidated financial statements.

1. BASIS OF PRESENTATION

Second Cup Royalty Income Fund (the "Fund") is an unincorporated open-ended trust established under the laws of the Province of Ontario. An unlimited number of units may be issued pursuant to the Fund's declaration of trust. Units are redeemable by the holder at any time, subject to certain limitations. Income tax obligations related to distributions by the Fund are the responsibility of the Unitholders.

The Fund prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles.

On January 1, 2005, the Fund adopted Accounting Guideline 15, a pronouncement of The Canadian Institute of Chartered Accountants ("CICA") related to variable interest entities ("VIEs"). As a result of adopting this standard, the Fund reflects its investment in Second Cup Trade-Marks Limited Partnership ("MarksLP"), in which it holds a 99.99% partnership interest, as an equity-accounted investment (see note 2 below). MarksLP is consolidated in the financial statements of The Second Cup Ltd. ("Second Cup"). Prior to the reorganization as described in note 2 below, the Fund had accounted for its wholly owned subsidiary, Second Cup Trade-Marks Inc. ("MarksCo"), the predecessor organization to MarksLP, as an equity-accounted investment. The consolidated financial statements of the Fund include the accounts of the Fund and its wholly owned subsidiaries Second Cup GP Trust ("GP Trust"), which holds the remaining 0.01% partnership interest in MarksLP, and Second Cup GP Inc. ("GP Inc."), which entered into an Administration Agreement whereby GP Inc. will provide certain administrative and advisory services in connection with the Fund and the trust units of the Fund.

2. REORGANIZATION

On April 2, 2007, as a result of the Unitholder-approved reorganization of the structure of the Fund (the "Reorganization"), the Fund effectively replaced its subsidiary corporations, including MarksCo, with a newly formed trust and limited partnership. This latter entity, MarksLP, will be consolidated for reporting purposes with Second Cup as a VIE for the same reasons that MarksCo had historically been consolidated by Second Cup. MarksLP is accounted for on the records of the Fund as an equity-accounted investment.

It is important to note that while the Fund's underlying structure has been changed, essentially the underlying assets and operations of the Fund and its subsidiaries have not changed as a result of the Reorganization.

As a result of the Reorganization, the Fund negotiated a new term loan of $11,000 (the "Term Loan") with its bankers on similar terms and conditions of MarksCo's term loan. The proceeds of the Term Loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan. Further, the notes receivable amounting to $79,343 as at April 1, 2007 (December 31, 2006 - $78,739) from MarksCo were repaid through an increase in the equity ownership of MarksLP by the Fund and a new note receivable from MarksLP of $9,171 as at April 2, 2007 (December 31, 2007 - $300).

Under the new structure, the new wholly owned subsidiaries of the Fund will not be subject to income tax. As a result, a net future income tax liability of $10,668 was reversed and resulted in an increase to the income of the equity-accounted investment in MarksCo on April 2, 2007. This net future income tax liability is comprised of an elimination of future income tax assets of $1,408 previously recognized by MarksCo, offset by a $12,076 future income tax liability inherent in the carrying value of the equity-accounted investment that resulted from the step-up to the value of the Second Cup trademarks ("Second Cup Marks") when the Fund originally acquired MarksCo. The Fund has reflected the elimination of this net future income tax liability in these consolidated financial statements as an increase in the equity-accounted earnings of MarksCo.

The Licence and Royalty Agreement (the "Agreement") entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to license the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of system sales of certain Second Cup cafés in Canada (the "Royalty Pool") will be paid to MarksLP. As a result of the Reorganization, the Fund's earnings are predominantly comprised of equity income from its ownership of MarksLP instead of interest and dividend income from MarksCo.

3. NEW ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

Effective January 1, 2007, the Fund has adopted the following sections of the CICA Handbook:

Comprehensive Income, CICA Handbook Section 1530

Section 1530 introduces new standards for reporting and disclosure of comprehensive income. Comprehensive income is the change in equity (net assets) of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. It requires an entity to recognize certain unrealized gains and losses in accumulated other comprehensive income, a new component of Unitholders' Equity. A new statement entitled consolidated statements of earnings and comprehensive income has been added to the Fund's consolidated financial statements.

Comprehensive income is comprised of the Fund's net earnings and other comprehensive income. This category may include unrealized gains and losses on available-for-sale financial assets, foreign currency translation and changes in the fair market value of derivative instruments designated as cash flow hedges, all net of income taxes. As at December 31, 2007, the Fund does not have any other comprehensive income.

Equity, CICA Handbook Section 3251

As a result of implementing Section 1530 as discussed above, accumulated other comprehensive income ("AOCI") is included in the consolidated balance sheets as a separate component of Unitholders' Equity. As at December 31, 2007, the Fund does not have any AOCI.

Financial Instruments - Recognition and Measurement, CICA Handbook Section 3855,
Financial Instruments - Disclosure and Presentation, CICA Handbook Section 3861

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the consolidated balance sheet and at what amount - sometimes using fair value, other times using cost-based measures. Section 3861 specifies how financial instruments and associated gains and losses are to be presented. These standards require that all financial assets be classified as either available-for-sale, held-for-trading, held-to-maturity or loans and receivables. Financial liabilities are classified as either held-for-trading or cost/amortized cost.

Financial assets held to maturity, loans and receivables and financial liabilities other than those held for trading are measured at amortized cost. The Fund classifies its notes receivable from MarksLP as loans receivable carried at amortized cost. All other financial assets and derivatives are measured at fair value. Transaction costs associated with long-term debt are included in the carrying value of the long-term debt and are amortized using the effective interest rate method.

Hedges, CICA Handbook Section 3865

Section 3865 specifies the criteria that must be satisfied in order for hedge accounting to be applied and the accounting for each of the permitted hedging strategies: fair value hedges and cash flow hedges. Hedge accounting is discontinued prospectively when the derivative no longer qualifies as an effective hedge, or the derivative is terminated or sold, or upon the sale or early termination of the hedged item. The Fund's interest rate swap has not been designated as a hedge for accounting purposes. Movements in the fair value of the swap are recorded through net earnings.

New Accounting Standards

The CICA issued three new accounting standards: Handbook Section 1535, Capital Disclosures (Section 1535), Handbook Section 3862, Financial Instruments - Disclosures (Section 3862), and Handbook Section 3863, Financial Instruments - Presentation (Section 3863). These new standards become effective for the Fund on January 1, 2008.

Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

These new accounting standards will impact the Fund's financial statement disclosures but are not expected to affect the consolidated results or financial position.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

a. Cash and cash equivalents

Deposits in banks and short-term investments with original maturities of three months or less are considered cash and cash equivalents. Cash equivalents are carried at cost, which approximates fair market value.

b. Earnings per unit

The earnings per unit are based on the weighted average number of units outstanding during the period. Diluted earnings per unit are calculated to reflect the dilutive effect, if any, of any other commitments or instruments. Units are excluded from the computation of diluted earnings per unit if their effect is anti-dilutive.

c. Income taxes

Prior to June 12, 2007, pursuant to the Income Tax Act as previously enacted, the Fund was not subject to income tax to the extent that its taxable income was distributed to Unitholders.

As a result of new tax legislation proposed by the Minister of Finance (Canada) on October 31, 2006 and substantively enacted on June 12, 2007, the Fund will pay a tax on distributions declared subsequent to January 1, 2011 at substantively enacted income tax rates.

As a result of this change, as further explained in note 12, the Fund has provided for the future tax effect of existing temporary differences between the accounting and tax bases of assets and liabilities that are expected to reverse subsequent to January 1, 2011.

The Fund and its subsidiaries account for income taxes using the liability method. Future income taxes arise due to the temporary differences in the financial reporting and tax bases of assets and liabilities. Changes in these temporary differences are reflected in the provision for future income taxes using substantively enacted income tax rates.

d. Equity-accounted investment

The Fund has significant influence over its investment in MarksLP and uses the equity method to account for this investment. Under the equity method, the cost of the investment is adjusted by the Fund's proportionate share of income and reduced by distributions payable to the Fund.

Management reviews the carrying value of its investment in MarksLP at least annually for impairment taking into consideration any events or circumstances that might have impaired the carrying value. If there is an impairment, the investment is written down to estimated recoverable amount.

e. Variable interest entities

CICA Accounting Guideline 15, "Consolidation of Variable Interest Entities" ("AcG-15"), provides guidance for applying the principles in CICA Handbook Section 1590, "Subsidiaries", to those entities defined as Variable Interest Entities ("VIEs"), in which either the equity at risk is not sufficient to permit that entity to finance its activities without additional subordinated financial support from other parties, or equity investors lack either voting control, an obligation to absorb expected losses, or the right to receive residual returns. AcG-15 requires consolidation of VIEs by the primary beneficiary. The primary beneficiary is defined as the party that has exposure to the majority of a VIE's expected losses and/or residual returns. As disclosed in note 1, the Fund has determined that MarksLP is a VIE whose primary beneficiary is Second Cup Limited. As noted above, the Fund equity accounts for its investment in MarksLP.

f. Distribution to Unitholders

The amount of cash to be distributed annually to Unitholders is determined with reference to distributable cash, which is calculated as net earnings adjusted for future income taxes and amortization expense. Distributions are recorded when declared, made monthly in arrears and are subject to the Fund retaining such reasonable working capital reserves as may be considered appropriate by the trustees of the Fund.

g. Use of estimates

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires the trustees to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The carrying amounts of investments and notes receivable from long-term investments, accounting for VIEs and future income taxes are the more significant areas requiring management judgement and estimation.

h. Financial instruments

Fair values

The Fund's financial instruments consist of cash and cash equivalents, notes and interest receivable from MarksLP, accounts payable and accrued liabilities and distributions payable to Unitholders. The fair values of these instruments approximate their carrying amounts due to their short-term maturity.

Credit risk

The Fund's financial instruments exposed to credit risk include cash and cash equivalents and notes and interest receivable from MarksLP. The Fund places its cash and cash equivalents with institutions of high creditworthiness. The Fund believes the credit risk exposure on its notes and interest receivable from MarksLP is limited. This is based on the consistency of the royalty income collected by MarksLP, which is its sole source of cash for payment of interest and principal to the Fund.

5. TERM LOAN AND OPERATING FACILITY

On December 2, 2004, MarksCo, as borrower, and the Fund and a subsidiary of the Fund, as guarantors, entered into a term credit agreement maturing on December 2, 2007, which was subsequently extended to December 2, 2009. The $12,000 credit facilities were comprised of an $11,000 non-revolving term credit facility and a $1,000 operating credit facility. As a result of the Reorganization, the Fund negotiated new credit facilities of $12,000, also comprised of an $11,000 non-revolving term credit facility and a $1,000 operating facility, with its bankers on similar terms and conditions as MarksCo's facilities. The proceeds of this new loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan.

The $11,000 non-revolving term credit facility bears interest at prime or base rate plus 0.75% or LIBOR advances or bankers' acceptances plus 1.75%. At December 31, 2007, the full amount of the $11,000 non-revolving term credit facility was drawn with an effective interest rate of 6.62% after taking into consideration the interest rate swap described below.

The $1,000 operating credit facility bears interest at prime or base rate plus 0.50% or LIBOR advances or bankers' acceptances plus 1.50%. At December 31, 2007, no advances had been drawn on this facility.

The term credit facilities are collateralized by substantially all the assets of MarksLP and the Fund, including the Agreement, pursuant to which Second Cup has also provided a general security agreement.

An interest rate swap agreement fixes the interest rate on the $11,000 non-revolving term credit facility loan at 4.87% plus the variable margin noted above until December 2, 2009. As at December 31, 2007, the fair value of this interest rate swap agreement is a $143 liability to the Fund (2006 - $nil).

In accordance with the adoption of CICA Handbook Section 3855, the term loan is presented net of transaction costs. Transaction costs are amortized to the consolidated statements of earnings and comprehensive income using the effective interest method. At maturity, December 2, 2009, the balance sheet value of the term loan will be equal to the face value. At December 31, 2007, the net long-term debt is $10,904 (face value is $11,000 net of $96 transaction costs).

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS AND PER UNIT AMOUNTS)

6. SYSTEM SALES

System sales include gross revenue of the pool of Second Cup cafés (Company-owned or franchised) on which Second Cup pays a royalty to MarksLP (the "Royalty Pool") based on information reported by café operators. Gross revenue is self-assessed by each café on a weekly basis and submitted to Second Cup.

	2007	2006
System sales reported by cafés in the Royalty Pool	$ 195,750	$ 189,287

7. JANUARY 1, 2007 ROYALTY POOL ADJUSTMENT

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount that may be satisfied by additional Fund units or cash, the form of payment being at the option of the Fund. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net system sales, with the balance received when the actual full year performance of the new cafés is known.

On January 1, 2007, the actual system sales of the nine cafés added to the Royalty Pool on January 1, 2006 were $4,421, greater than the original estimate of $4,055. In accordance with the provisions in the Agreement, a final adjustment of $356 was satisfied by MarksCo delivering to Second Cup 35,903 additional units of the Fund. In addition, MarksCo also made a cash payment of $37 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the additional units above had they been issued on January 1, 2006.

On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized system sales of the 11 cafés added to the Royalty Pool were estimated at $4,555, offset by $3,815 in system sales of the 12 cafés permanently closed from the Royalty Pool during 2006. In accordance with the provisions in the Agreement, the Fund, through MarksCo, was required to make a payment of $315 to Second Cup, representing 80% of the obligation based on forecast system sales. On January 1, 2007, the Fund issued 34,630 units to MarksCo, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue 32,412 additional units to satisfy the remaining obligation of MarksLP on or about January 1, 2008 (see note 14).

In conjunction with the second adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. These notes were repaid as part of the Reorganization discussed in note 2 above. The common shares were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS AND PER UNIT AMOUNTS)

8. INVESTMENT IN SECOND CUP TRADE-MARKS LIMITED PARTNERSHIP AND IN SECOND CUP TRADE-MARKS INC.

As a result of the Reorganization described in note 2 above, the Fund's equity investment in MarksCo was replaced by a partnership interest in MarksLP.

The following table details the changes in investment in MarksLP and MarksCo:

	2007	2006
Opening balance	$ 9,326	$ 9,087
Income in equity earnings from MarksCo*	164	1,319
Subscription for additional common shares of MarksCo (note 7)	67	55
Dividends received from MarksCo	(190)	(1,135)
Release of future income tax liability on Reorganization* (note 2)	10,668	-
Conversion of debt to LP Units on Reorganization (note 2)	81,194	-
Income in equity earnings from MarksLP*	9,314	-
	$ 110,543	$ 9,326

* Aggregate earnings for 2007 from the equity-accounted investment amount to $20,146 (2006 - $1,319).

The total investment in Marks LP/MarksCo is summarized below:

	2007	2006
Common shares	$ -	$ 8,749
Cumulative equity in earnings of MarksCo	13,120	2,287
Cumulative dividends received from MarksCo	(1,900)	(1,710)
Cumulative equity in earnings of MarksLP	9,314	-
Investment in MarksLP	90,009	-
	110,543	9,326
Note receivable from MarksLP (2006 - MarksCo)	300	78,739
	$ 110,843	$ 88,065

The note receivable of $300 from MarksLP bears interest at 12% and matures on April 1, 2017. Interest only payments are due monthly, in arrears. MarksLP made $8,871 in principal payments on the note to the Fund during the nine months ended December 31, 2007. The former notes receivable from MarksCo that were repaid in the year accrued interest at 12.125% and matured between 2014 and 2016.

9. INCOME FUND UNITS

The declaration of trust of the Fund provides that an unlimited number of units may be issued. Each unit is transferable, and represents an equal undivided beneficial interest in any distribution of the Fund and in the net assets of the Fund. All units have equal rights and privileges. Each unit entitles the holder thereof to participate equally in allocations and distributions and to one vote at all meetings of Unitholders for each whole unit held. The units are not subject to future calls or assessments.

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS AND PER UNIT AMOUNTS)

Units are redeemable at any time at the option of the Unitholder at a price based on market value as defined in the trust agreement, subject to a maximum of $50 in cash redemptions by the Fund in any one month. The limitation may be waived at the discretion of the trustees of the Fund.

Weighted average units outstanding:

	NUMBER OF UNITS	NET PROCEEDS
Issued and outstanding as at December 31, 2005	9,582,760	$ 86,940
Issued on January 1, 2006	55,316	548
Issued on January 1, 2007 (note 7)	70,533	671
Fund units	9,708,609	$ 88,159

Subsequent to December 31, 2007, the Fund issued an additional 176,124 units (note 14).

10. BASIC AND DILUTED EARNINGS PER UNIT

Earnings per unit are based on the weighted average number of units outstanding during the year. Diluted earnings per unit are calculated to reflect the estimated dilutive impact of the additional units of the Fund to be issued to Second Cup on January 1, 2008 as final consideration for the increase in the Royalty Pool on January 1, 2007 (see note 7). Basic and diluted earnings per unit are determined as follows:

	2007	2006
Numerator for basic and diluted earnings per unit - net income	$ 8,196	$ 10,143
Denominator for basic earnings per unit:		
- weighted average number of units issued and outstanding	9,708,609	9,638,076
Denominator for diluted earnings per unit:		
- weighted average number of units issued and outstanding	9,708,609	9,638,076
- impact of additional units to be issued on January 1, 2007 adjustment to Royalty Pool	-	35,903
- impact of additional units to be issued on January 1, 2008 adjustment to Royalty Pool	32,412	-
Denominator for diluted earnings per unit	9,741,021	9,673,979
Basic earnings per unit	$ 0.8442	$ 1.0524
Diluted earnings per unit	$ 0.8414	$ 1.0485

11. RELATED PARTY TRANSACTIONS AND BALANCES

During the year, interest income of $535 (2006 - $nil) was earned on the note receivable from MarksLP, (note 8) of which $22 (2006 - nil) is receivable at December 31, 2007. During the year, interest income of $2,424 (2006 - $9,547) was earned on the note receivable from MarksCo of which $nil is receivable at December 31, 2007 (2006 - $811). In addition, during the year, dividend income of $190 (2006 - $1,135) was received from MarksCo.

The Fund also charged a management fee of $87 (2006 - $nil) to MarksLP for certain general and administrative expenses of which $nil is receivable at December 31, 2007, this fee is netted against general and administrative expenses of the Fund. Included in accounts payable and accrued liabilities is an amount of $nil (2006 - $69) due to MarksCo. This amount arose as a result of MarksCo paying for certain general and administrative expenses of the Fund. The amount is non-interest bearing and is due on demand.

On January 1, 2007, the Fund engaged in a number of transactions with MarksCo and Second Cup to effect the first adjustment to the Royalty Pool. Refer to note 7 above for further details on these transactions.

12. INCOME TAXES

On June 12, 2007 new tax legislation was enacted that changed the rules applicable to publicly traded income trusts commencing in 2011. In 2011, income taxes payable will reduce net earnings of the Fund.

As the new trust tax legislation has been enacted, the Fund is now required to give accounting recognition to these new rules. Future income taxes are recorded as the difference between the accounting values of balance sheet assets and liabilities and the income tax cost basis of these assets and liabilities based on substantively enacted tax laws and rates for differences that are expected to reverse after January 1, 2011.

As the Fund will not be liable for taxes until January 1, 2011, on June 12, 2007 the Fund recognized a future non-cash income tax expense amounting to $15,545 arising from those temporary income tax differences at December 31, 2007 expected to exist on January 1, 2011 at the tax rate applicable to the Fund.

On December 14, 2007, new legislation was substantively enacted, reducing the income tax rate from 31.5% to 29.5% in 2011, and 28% for 2012 onwards. As a result of this rate reduction, the Fund recorded a non-cash future income tax recovery of $2,059 on December 14, 2007. The Fund also recognized an additional future tax liability of $18, on December 31, 2007 relating to the final adjustment (note 15).

For the year ended December 31, 2006 and for the first quarter of 2007, the Fund's indirect subsidiaries were taxable on their income at Canadian statutory rates. Income tax expense as reported differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rates to earnings before income taxes. The reasons for the difference in 2007 were as follows:

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS AND PER UNIT AMOUNTS)

	2007	2006
Earnings before income taxes	$ 21,703	$ 10,155
Combined Canadian federal and provincial tax rates	46.41%	46.41%
Tax provision at statutory rate	10,072	4,713
Reduced by following differences:		
Income distributed or accrued to Unitholders not subject to tax in the Fund	(5,132)	(4,089)
Impact of future tax applicable beginning in 2011	13,504	-
Non-deductible permanent differences	211	-
Earnings from equity-accounted investment in MarksCo	(5,148)	(612)
Provision for income taxes	$ 13,507	$ 12

The principal temporary differences that give rise to the net future income tax liability at December 31, 2007 relate to temporary differences between the accounting and tax basis of MarksLP's intangible assets.

13. ECONOMIC DEPENDENCE

All of the Fund's income is comprised of equity income from its ownership of MarksLP instead of interest and dividend income from MarksCo. In turn, all of MarksLP's income is derived from royalties payable by Second Cup to MarksLP under the Agreement as described in note 2.

14. SUBSEQUENT EVENT

On January 1, 2008, the actual system sales of the 11 cafés added to the Royalty Pool on January 1, 2007 (see note 7) for the year ended December 31, 2007 were $4,961 as compared to the original estimate of $4,555. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the 32,412 additional units above had they been issued on January 1, 2007.

Also, on January 1, 2008, 15 cafés were added to the Royalty Pool. The system sales of these 15 cafés added to the Royalty Pool have been estimated at $6,750 annually. These sales were offset by $3,513 in system sales of nine cafés permanently closed from the Royalty Pool during the year. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $1,347 to Second Cup, representing 80% of the obligation based on forecast system sales. On January 1, 2008, the Fund issued 143,712 units to MarksLP which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue additional units to satisfy the remaining obligation. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 351 to 357.

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS AND PER UNIT AMOUNTS)

15. SUPPLEMENTARY CASH FLOW INFORMATION

Changes in non-cash working capital items:

	2007	2006
Prepaid expenses	$ (137)	$ -
Interest receivable from Second Cup Trade-Marks Inc.	789	(5)
Accounts payable and accrued liabilities	(65)	50
Income taxes recoverable	2	-
Refundable taxes	-	1
	$ 589	$ 46

Supplementary information:		
Interest paid	$ 565	$ -
Income taxes paid	$ 3	$ 12

THE SECOND CUP LTD.

REPORT TO UNITHOLDERS OF SECOND CUP ROYALTY INCOME FUND

December 31, 2006 to December 29, 2007

This report and the consolidated financial statements of The Second Cup Ltd. ("Second Cup" or "the Company") are provided as a supplement to the annual consolidated financial statements and management's discussion and analysis of the Second Cup Royalty Income Fund (the "Fund"). This report is dated March 10, 2008 and should be read in conjunction with the consolidated financial statements of Second Cup for the 52 weeks ended December 29, 2007.

The consolidated financial statements of Second Cup are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are presented in thousands of Canadian dollars, except units, unless otherwise indicated.

BASIS OF PRESENTATION

The Company adopted Accounting Guideline 15 ("AcG-15"), a pronouncement of The Canadian Institute of Chartered Accountants ("CICA") related to variable interest entities ("VIEs") in January 2005. AcG-15 outlines who should consolidate such entities. The Company determined that Second Cup Trade-Marks Limited Partnership ("MarksLP") and Second Cup Trade-Marks Inc. ("MarksCo"), both wholly owned subsidiaries of the Fund, are VIEs. MarksLP, and prior to the reorganization described below, MarksCo, owns the Canadian trademarks and certain other intellectual property and associated rights used by Second Cup in connection with the operation of Second Cup cafés in Canada (excluding the territory of Nunavut) (collectively, the "Second Cup Marks" or the "Marks") and, through the Agreement noted below, has licenced them to the Company, which operates the business activities associated with these trademarks, in exchange for a royalty payment. The activities of MarksCo, MarksLP and Second Cup are closely related and with the guidance provided by AcG-15, management has determined that Second Cup should consolidate the financial results of MarksCo and MarksLP.

A Licence and Royalty Agreement (the "Agreement") exists under which MarksLP licences the use of the Second Cup trademarks (the "Second Cup Marks") to Second Cup for a period of 99 years. In exchange for this licence, Second Cup agreed to pay MarksLP a royalty equal to 6.5% of system sales of a defined number of Second Cup cafés in Canada (the "Royalty Pool"). Prior to the reorganization noted below, Second Cup had paid this royalty to MarksCo.

The adoption of AcG-15 does not change the contractual rights and obligations between Second Cup and MarksLP. It is important to note that MarksLP continues to own the Second Cup Marks and receive royalty revenues from Second Cup and pay its obligations to the Fund. The liabilities of MarksLP, comprising notes payable to the Fund, are obligations of MarksLP, not Second Cup. For further information on the financial results of the Fund, readers are referred to the Fund's annual consolidated financial statements and management's discussion and analysis for the calendar year ended December 31, 2007, which is available at www.sedar.com.

OVERVIEW AND BUSINESS OF SECOND CUP

Second Cup franchises, owns and operates the second largest specialty coffee café chain in Canada, as measured by the number of cafés. Second Cup's revenues are derived from royalties from franchisees, initial and renewal franchise fees, administration fees, sales from Company-owned cafés, coordination fees, and other sources of revenue. The Company's revenues are affected by a number of factors, principally system wide sales, the number of new cafés opened, the number of franchise agreements renewed and sales of Company-owned cafés.

Operating costs and administrative expenses include the compensation, general and administrative costs associated with the operations of Second Cup in providing services to the franchised and the Company-owned Second Cup cafés, costs of maintaining and enhancing the Second Cup brand, costs associated with developing, researching and marketing new products, and costs associated with the establishment of new Second Cup cafés and the refranchising of existing Second Cup cafés. Operating costs also include the cost of operating Company-owned cafés. Pursuant to the Agreement, the Company pays a royalty to MarksLP based on the annual sales of the Second Cup cafés included in the Royalty Pool.

As a result of the application of AcG-15, operating costs and administrative expenses disclosed in the Company's consolidated financial statements include expenses of MarksLP, a wholly owned subsidiary of the Fund.

Second Cup's fiscal year comprises 13 periods of four weeks each, ending on the last Saturday of December. To accommodate this year-end, an additional week (i.e., a 53rd week) is expected to be added approximately every five years. The Company's most recently completed fiscal year was the 52 weeks ended December 29, 2007. The Company's fiscal quarters consist of three 12-week periods and a fourth quarter consisting of 16 weeks.

MarksLP's business is the ownership of the Second Cup Marks. MarksLP uses the royalty revenue earned on the licensing of the trademarks and other intellectual property and associated rights used by Second Cup cafés in Canada to make loan repayments and distributions to the Fund. MarksLP's fiscal year ends December 31.

REORGANIZATION OF THE FUND

On April 2, 2007, the Unitholder-approved reorganization of the structure of the Fund (the "Reorganization") replaced its subsidiary corporations, including MarksCo, with a newly formed trust and limited partnership. This latter entity, MarksLP, has been consolidated for reporting purposes with Second Cup as a VIE for the same reasons that MarksCo had historically been consolidated by Second Cup.

As a result of the Reorganization, the Fund negotiated a new term loan of $11,000 with its bankers on similar terms and conditions as MarksCo's term loan. The proceeds of this new loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan. Further, the notes payable by MarksCo to a subsidiary of the Fund, which amounted to $79,343 as at April 1, 2007 (December 30, 2006 - $78,739), were repaid through an increase in the equity ownership of MarksLP by the Fund and a new note payable by MarksLP to the Fund. The increase in the equity ownership of MarksLP has been recorded as an increase in the non-controlling interest on the Company's consolidated balance sheets.

Under the new structure, the new wholly owned subsidiaries of the Fund are not subject to income tax. As a result, the future income tax liabilities on the consolidated balance sheets of Second Cup prior to the Reorganization relating to MarksCo of $9,966 were credited to consolidated earnings on April 2, 2007 and resulted in an increase in the non-controlling interest on the Company's consolidated balance sheets.

The Agreement entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to licence the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of system sales of cafés in the Royalty Pool are being paid to MarksLP. As a result of the Reorganization, the Fund's earnings are predominantly comprised of distribution income from MarksLP in place of interest and dividend income from MarksCo.

It is important to note that while the Fund's underlying structure has been changed, essentially the underlying assets and operations of the Fund and its subsidiaries have not changed as a result of the Reorganization.

CHANGE IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

Effective January 1, 2007, the Company adopted CICA Handbook Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments - Recognition and Measurement; and Section 3861, Financial Instruments - Disclosure and Presentation. As required by the implementation of these new standards, the comparative consolidated financial statements have not been restated.

These new sections provide standards for recognition, measurement, disclosure and presentation of financial assets, financial liabilities and non-financial derivatives. Handbook Section 1530 also establishes standards for reporting and disclosure of comprehensive income. Comprehensive income includes unrealized gains and losses on financial assets classified as available-for-sale, unrealized foreign exchange gains and losses arising from translation of self-sustaining foreign operations, and changes in unrealized gains and losses on cash flow hedges. The impact of these changes in accounting policies on the Company's December 29, 2007 consolidated financial statements is not significant.

CICA Handbook Section 1506, Accounting Changes, revised the standards on changes in accounting policy, estimates or errors to require a change in accounting policy to be applied retrospectively, unless doing so is impracticable, changes in estimates to be recorded prospectively, and prior period errors to be corrected retrospectively. Voluntary changes in accounting policy are allowed only when they result in financial statements that provide reliable and more relevant information. In addition, these revised standards call for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. This revised standard is effective for interim and annual financial statements relating to fiscal periods ending on or after January 1, 2007.

Advertising and cooperative fund assets and liabilities

The Company manages an advertising and cooperative fund (the "Coop Fund") established to collect and administer funds contributed for use in advertising and promotional programs, national training programs and, among other things, initiatives designed to increase sales and enhance the reputation of the Second Cup Brand. Contributions to the Coop Fund are required to be made from both Company-owned and operated and franchise cafés and are based on a percentage of café sales. The Company accounts for the Coop Fund in accordance with CICA Accounting Guideline 2 "Franchise Fee Revenue" ("AcG-2"). The revenue, expenses, and cash flows of the Coop Fund are not included in the Company's consolidated statements of operations and cash flows because the contributions to this fund are segregated and designated for a specific purpose. Instead, the assets and liabilities of the Coop Fund are identified on the Company's consolidated balance sheets. Previously, the assets and liabilities of the Coop Fund were not included in the consolidated financial statements of the Company. The result of adopting this policy was to restate the December 30, 2006 consolidated balance sheet wherein current assets and current liabilities were increased by $1,140. For December 29, 2007, current assets and current liabilities relating to the Coop Fund amounted to $820. There was no impact on current or prior year's net earnings.

New accounting standards

The CICA issued three new accounting standards: Handbook Section 1535, Capital Disclosures (Section 1535), Handbook Section 3862, Financial Instruments - Disclosures (Section 3862), and Handbook Section 3863, Financial Instruments - Presentation (Section 3863). These new standards become effective for the Company on January 1, 2008.

Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The Company will adopt these new standards effective January 1, 2008, but they are not expected to affect its consolidated results or financial position.

FINANCIAL HIGHLIGHTS

The following tables set out selected consolidated financial information and other data of Second Cup, including the results of MarksLP and MarksCo, and should be read in conjunction with the consolidated financial statements of Second Cup.

	16 WEEKS ENDED		52 WEEKS ENDED	
(IN THOUSANDS OF DOLLARS, EXCEPT NUMBER OF CAFÉS)	DECEMBER 29, 2007	DECEMBER 30, 2006	DECEMBER 29, 2007	DECEMBER 30, 2006
Number of cafés in Canada - end of period	366	360	366	360
System sales - Canadian operations	$ 67,779	$ 66,745	$ 200,271	$ 193,098
Same café sales growth	1.1%	8.3%	3.1%	6.2%
Total revenue	$ 10,326	$ 11,625	$ 33,227	$ 33,707
Operating costs and administrative expenses	$ 5,867	$ 7,422	$ 20,715	$ 22,054
Investment income	$ 59	$ 91	$ 112	$ 1,150
Interest expense, net	$ 55	$ 3,110	$ 3,005	$ 10,106
Net earnings (loss) for the period	$ 151	$ (434)	$ (304)	$ 340

	AS AT DECEMBER 29, 2007	AS AT DECEMBER 30, 2006
Total assets	$ 104,876	$ 103,744
Total long-term liabilities	$ 445	$ 99,839
Non-controlling interest in MarksLP/MarksCo	$ 102,115	$ 1,659

Analysis of system sales

System sales for the 16 weeks ended December 29, 2007 (the "Period") were $67,779, compared to $66,745 for the 16 weeks ended December 30, 2006, representing an increase of 1.5%. This increase resulted from same café sales growth of 1.1% and from more cafés operating in the Period than in the prior year. For the year, system sales were $200,271, up from $193,098 in 2006, representing an increase of 3.7%. Same café sales growth for the year was 3.1%.

Same café sales for the Period and year to date were positively impacted by price increases implemented in 2006 and Second Cup's promotional programs, which continued to shift the Company's sales mix to its higher priced blender and espresso-based beverages, and, in turn, resulted in higher average cheque amounts versus 2006. The temporary closure of 16 cafés while under renovation reduced same café sales in the Period by approximately 0.5% to 1.0%. On a year-to-date basis, same café sales were negatively impacted by approximately 1.0% due to the temporary closure of 40 cafés while under renovation (2006 - 11). The poor weather across Canada in the month of December, compared to a very mild December the year before, also had a negative impact on sales during the most important sales period of the year.

Management is not aware of any reliable third party comparable data on the trends affecting the Canadian specialty coffee market during the year or the performance of Second Cup's competitors in the Canadian market during this period.

16 weeks ended December 29, 2007

Analysis of revenues

Revenues of $10,326 were generated in the Period compared to $11,625 for the 16-week period ended December 30, 2006. The reduction was due mainly to decreased sales from Company-owned cafés in the Period, off-set by increased royalties on higher system sales, and increased other income as discussed further below. Excluding sales from Company-owned cafés, the effective royalty rate was consistent with the comparable period at 8.6% of system sales compared to 8.5% for the comparable Period in the prior year.

Revenues from Company-owned cafés were $2,062 for the Period, versus $4,061 for the 16 weeks ended December 30, 2006, the decrease mainly resulted from operating fewer Company-owned cafés compared to the prior year. Second Cup ended the Period with 21 Company-owned cafés, four of which were operated by franchisees, compared to 24 Company-owned cafés, two of which were operated by franchisees, as at December 30, 2006. During the Period, upon review of its liability relating to the Second Cup Café Cards, an adjustment was made that decreased the sales of Company-owned cafés.

Other income increased to $2,630 for the Period versus $2,203 for the comparable period. Other income includes initial franchise fees, which are recognized as income when a new café is opened; renewal fees, which are recognized when an existing franchisee enters into a new franchise agreement; transfer fees earned on the sale of cafés from one franchisee to another; construction administration fees; purchasing coordination fees earned; and other income earned by Second Cup on the sale of its branded coffee through alternate channels. The increase in other income was generated from coordination fees in line with sales, fees earned on the renewal of franchise agreements, and franchise fees earned on the refranchising of corporate cafés in the Period.

Analysis of net earnings

Operating costs and administrative expenses, including expenses of MarksCo and MarksLP of $178 (2006 - $140) for the Period, were $5,867 versus $7,421 for the comparable period in the prior year. The primary reason for the reduction in operating costs and administrative expenses was the reduction in the number of Company-owned and operated cafés as described above. These savings were offset mainly by planned increases in personnel and related costs as the Company instituted its own procurement, information technology, legal, and accounting departments. In the comparative prior Period, these functions were performed by the Company's former parent, Cara Operations Limited ("Cara"), as part of its centralized service departments at a lower cost. Other administrative costs increased as a result of the Company adding resources to its development departments in mid to late 2006 and in the Period.

Amortization of capital assets amounted to $150 for the Period, in line with the comparative period's amortization of $149.

During the Period, interest expense of $nil was incurred on the notes payable by MarksCo to a subsidiary of the Fund, compared to an expense of $2,930 in 2006. The elimination in interest expense on the notes reflects the extinguishment of the notes in accordance with the Reorganization. Interest expense of $109 (2006 - $nil) was incurred in the period on the notes payable by MarksLP to the Fund. In addition, as a result of the bank term loan payable by MarksCo being repaid as part of the Reorganization, interest expense thereon of $nil was incurred versus $180 in the comparative period. Interest income relating to cash and cash equivalents was $53 in the Period (2006 - $nil).

During the Period, investment income of $59 was earned on units of the Fund owned by Second Cup, compared to income of $91 earned in the comparative period. This decrease was due to the lower number of Fund units owned by Second Cup as a result of a distribution of units to Cara, in November 2006.

An income tax recovery of $325 was recognized in the Period compared to an expense of $217 in the 16-week period ended December 30, 2006. In the fourth quarter of 2007, as a result of reassessments obtained subsequent to a federal income tax audit relating to the predecessor corporation of MarksLP, MarksLP recorded a recovery of $450 in current income taxes. Excluding this tax recovery, current tax expense for MarksLP was $nil.

A non-controlling interest of $4,487 was recorded in the Period (2006 - $896). This reflects the earnings of MarksLP (MarksCo in 2006) attributable to the Fund.

Accordingly, Second Cup generated earnings of $151 for the Period, compared to a net loss of $434 for the 16-week period ended December 30, 2006. Second Cup also recorded an unrealized loss of $45, net of $24 in future income taxes, resulting from the fair market value of its ownership of 70,533 units of the Fund which were valued at $9.44 (see note 9 to the consolidated financial statements) as at December 29, 2007, compared to $10.40 as at September 8, 2007. This unrealized loss was recorded in comprehensive income.

52 weeks ended December 29, 2007

Analysis of revenues

Revenues in 2007 were $33,227, compared to $33,707 for the 52 weeks ended December 30, 2006. Royalty revenue has increased to $16,270 from $15,526, as a result of the year-to-date increase in system sales. Revenue from Company-owned and operated cafés declined from $12,526 to $10,482 as the Company operated, on average, fewer Company-owned cafés compared to the prior year. Excluding sales from Company-owned and operated cafés, the effective royalty rate was also in line with the prior year at 8.7%.

The increase came from coordination fees, driven by the increased sales volumes across the café network; revenues recognized from a new agreement that the Company negotiated with a third party to sell Second Cup branded granola bars in certain grocery stores; increased fees earned on the renewal of franchise agreements; and increased franchise fees earned on the refranchising of Company-owned cafés.

Analysis of net earnings

Operating costs and administrative expenses, including expenses of MarksCo and MarksLP of $494 (2006 - $388), were $20,715 for the 52 weeks ended December 29, 2007, compared to $22,054 for the prior year. The Company experienced a reduction in costs to operate Company-owned cafés resulting from a reduction in the number of Company-owned and operated cafés in the year compared to 2006. This savings was offset mainly by increases in overhead costs due to the Company initiating its own procurement, information technology, legal, and accounting departments. In the prior year, these functions were performed by Cara as described above. Other overhead costs also increased as a result of the Company's planned additional resources to its development departments in mid to late 2006.

Amortization of capital assets amounted to $503 for the year versus $500 for 2006. MarksCo's amortization of its deferred financing charges amounted to $142 for the year compared to $86 for 2006. MarksCo wrote off the balance of its deferred financing charges on April 2, 2007 when the related $11,000 term loan was repaid as part of the Reorganization.

Interest expense of $2,449 was incurred on the notes payable by MarksCo to a subsidiary of the Fund, compared to an expense of $9,521 in 2006. As a result of the Reorganization, the notes payable of $79,343 were effectively replaced by an investment in limited partnership units of MarksLP by the Fund on April 2, 2007 and a note payable of $9,171 by MarksLP to the Fund. Interest expense of $534 was incurred on this note by MarksLP (2006 - $nil). Interest expense of $145 (2006 - $585) was incurred during the year to date on the bank term loan payable by MarksCo. The reduction in interest expense was the result of the repayment of the loan as described above. Interest income relating to cash and cash equivalents was $123 in 2007 (2006 - $nil).

During the year, investment income of $112 was earned on units of the Fund owned by Second Cup, compared to income of $1,150 earned in 2006. This decrease was due to the lower number of Fund units owned by Second Cup following the distribution of units to Cara in November 2006.

The Company recorded a net income tax recovery of $10,108, compared to an expense of $117 in 2006. In the second quarter, as described in "Reorganization of the Fund" above, MarksCo was replaced by MarksLP, a non-taxable limited partnership. As a result, the future income tax liabilities relating to the Marks of $9,966 were eliminated resulting in a corresponding future income tax recovery being recognized in that quarter. Also, in the fourth quarter of 2007, as a result of reassessments obtained subsequent to a federal income tax audit relating to the predecessor corporation of MarksLP, MarksLP recorded a recovery of $450 in current income taxes.

As a result of the receipt of units of the Fund in conjunction with the adjustment to the Royalty Pool, as described in "Adjustment to the Royalty Pool" below, Second Cup realized income for tax purposes of $609 in 2007 (2006 - $671) resulting in a current income tax expense of approximately $110 in 2007 (2006 - $235). For financial reporting purposes, the consideration paid to the Company for net vend-in of cafés to the Royalty Pool is deferred over the term of the Royalty Agreement and recorded as deferred income. This deferred income is eliminated on consolidation of MarksLP with the Company.

A non-controlling interest of $19,386 was recorded in 2007 (2006 - $1,319). This non-controlling interest reflects the earnings of MarksCo and MarksLP attributable to the Fund, which indirectly owns 100% of MarksLP and MarksCo. The elimination of the future income tax liabilities of $9,966 associated with the Marks in the period resulted in a corresponding increase to non-controlling interest. Furthermore, due to the $79,343 notes payable by MarksCo to the Fund effectively being replaced with a note of $9,171 and an investment in limited partnership units by the Fund, interest expense decreased on these combined notes to $2,449 from $9,521 in the prior year, which also increased the collective earnings of MarksLP and MarksCo compared to the prior year.

Accordingly, Second Cup recorded a net loss of $304 for 2007, versus net earnings of $340 for 2006. Second Cup also recorded an unrealized loss of $4, net of a recovery of future income taxes of $2, resulting from the fair market value of its ownership of 70,533 units of the Fund. This unrealized loss was recorded in comprehensive income.

SELECTED QUARTERLY INFORMATION

A discussion of the Company's previous quarterly results since the Fund's inception can be found in the Company's quarterly reports available at www.sedar.com.

(IN THOUSANDS OF DOLLARS EXCEPT CAFÉS)	2007				2006			
	Q4[(1)]	Q3	Q2	Q1	Q4[(1)]	Q3	Q2	Q1
Number of cafés in Canada at end of period	366	361	357	357	360	358	355	357
Same café sales growth	1.1%	1.7%	4.7%	5.8%	8.3%	4.8%	5.0%	5.8%
System sales	$ 67,779	$ 43,758	$ 45,289	$ 43,445	$ 66,745	$ 42,666	$ 42,809	$ 40,878
Net earnings (loss) for the period	$ 151	$ 114	$ 11	$ (580)	$ (434)	$ 120	$ 623	$ 31

(1) The Company's fiscal year consists of three 12-week quarters and a fourth quarter consisting of 16 weeks. As such, the fourth quarter information presented for 2007 and 2006 represents the 16 weeks ended December 29, 2007 and December 30, 2006, respectively, and are not comparable to other quarters.

Seasonality of system sales

The first quarter represents the lowest average 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 sales quarter of the fiscal year.

LIQUIDITY AND CAPITAL RESOURCES

16 weeks ended December 29, 2007

Cash generated by operating activities was $3,584 for the Period compared to $646 for the 16 weeks ended December 30, 2006. Cash generated by operating activities in the Period was impacted mainly by the earnings of MarksLP of $4,487 compared to earnings of MarksCo of $896 in the comparable period. The earnings of MarksLP compared to MarksCo increased as a result of the elimination of the term loan and notes payable to the Fund in the Reorganization, which significantly reduced interest expense in the Period. Cash generated by operating activities in the Period was also impacted by an increase in non-cash working capital of $1,084, due to an increase in accounts payable and accrued liabilities of $2,080 in the period due mainly to an increase in liabilities relating to unused balances on the Second Cup Café card, offset by decreased deposits from franchisees of $1,239 due to renovations completed in the period and an increase in accounts receivable of $1,705 in the period due to the seasonality of sales and coordination fees.

During the Period, investing activities resulted in a cash usage of $89, compared to a cash usage of $1,220 in 2006. The Company generated proceeds of $752 in the Period on the sale and refranchising of Company-owned cafés compared to

$713 in the comparable period. Furthermore, investing activities included the purchase of capital assets of $841 (2006 - $1,385), principally for the construction of new Company-owned cafés, and the modernization and renovation of Company-owned and operated cafés in the Period.

Financing activities resulted in a cash usage of $4,814 during the Period, compared to cash generated of $2,343 in the comparative period. The usage related to MarksLP principal repayments of its notes payable to the Fund amounting to $4,814 in the Period.

52 weeks ended December 29, 2007

Cash generated by operating activities was $9,843 for 2007, compared to $2,210 for 2006. Cash generated by operating activities in the year was impacted mainly by the combined earnings of MarksLP and MarksCo of $9,420, after excluding a non-cash future income tax writedown of $9,966 described above compared to earnings of MarksCo of $1,319 in 2006. Combined earnings of MarksLP and MarksCo increased as a result of the elimination of the term loan and notes payable to the Fund in the Reorganization, which significantly reduced interest expense in the current year. Cash generated by operating activities was also positively impacted by a reduction in non-cash working capital of $189 due to an increase in accounts payable and accrued liabilities of $1,733 due mainly to increases in deposits on Second Cup Café cards offset by an increase in accounts receivable of $1,025 due to the seasonality of sales and coordination fees and the $764 decrease in interest payable to the Fund.

For 2007, investing activities resulted in a cash usage of $1,028 compared to cash usage of $589 for 2006. The Company generated proceeds of $1,296 on the sale and refranchising of Company-owned cafés compared to $1,818 in 2006. Furthermore, investing activities included the purchase of capital assets of $1,653 (2006 - $1,859), principally for the construction of new Company-owned cafés, and the modernization and renovation of Company-owned and operated cafés in the period.

During the year, financing activities resulted in a cash usage of $8,368, compared to cash generated of $50 in 2006. In 2007, the Reorganization resulted in cash proceeds of $11,022 of which $11,000 was used to repay the term loan. MarksLP also made principal repayments of its notes payable to the Fund amounting to $8,871 in the current year (2006 - $nil). Cash used in financing activities also included dividends declared and paid of $190 (2006 - $1,135) by MarksCo to the Fund. MarksCo delivered units of the Fund valued at $671 on January 1, 2007 ($548 on January 1, 2006) to Second Cup (see “Royalty Pool Adjustments”) and financed the purchase of these units by the issuance of $67 in common shares ($55 in 2006) of MarksCo and $604 ($493 in 2006) of notes payable to a subsidiary of the Fund. The common shares were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

OFF-BALANCE SHEET ARRANGEMENTS

Second Cup has lease commitments for Company-owned cafés. In addition, Second Cup is a sublessor under the head lease for all franchised cafés, other than locations franchised to certain corporate franchises and certain hospitals and universities. Should franchisees fail to meet their obligations under the terms of their respective subleases, Second Cup would become liable for the obligations under the related head leases. In the event that a franchisee fails to meet its obligations under the terms of its sublease, Second Cup has the right to take steps to terminate the existing franchise agreement and either operate the location as a Company-owned café or refranchise the location.

The following table sets out anticipated net lease obligations for Second Cup.

	PAYMENTS DUE BY PERIOD					
(IN THOUSANDS OF DOLLARS)	2008	2009	2010	2011	2012	AFTER 2012
Minimum lease obligation	16,095	14,105	11,691	10,347	9,034	25,207
Less: Sublease to franchisees	15,285	13,286	10,927	9,710	8,556	23,850
Net lease obligations	810	819	764	637	478	1,357

RELATED PARTY TRANSACTIONS

Second Cup

For the period ended December 29, 2007, Second Cup earned an administrative fee of $500 from its parent, The Second Cup Coffee Company Inc. (formerly Dinecorp Hospitality Inc.) ("S.C. CoffeeCo"), for services in connection with the administration of S.C. CoffeeCo's international operations. In the prior year, this administrative fee was charged to its former parent, Cara, and amounted to $346. For the period November 14, 2006 through December 30, 2006, an administrative fee of $53 was charged to S.C. CoffeeCo.

At December 29, 2007, the Company had an outstanding payable of $13 (2006 - $53 receivable) to S.C. CoffeeCo, which arose as a result of S.C. CoffeeCo paying for certain reimbursable general and administrative expenses of the Company.

Second Cup earned investment income of $112 during the year (2006 - $1,150) on its investment in units of the Fund.

During the year ended December 30, 2006, dividends of $1,504 were paid by Second Cup to Cara, satisfied by transferring 55,383 units of the Fund, and $950 in cash. In accordance with GAAP, Second Cup recorded the transfer of units at an amount of $554, being the book value of the units on the Company's consolidated financial statements at the time of the transaction.

Second Cup also transferred its remaining investment in the Fund, consisting of 1,437,347 units of the Fund, by way of a return of capital to Cara of $12,950. The return of capital was recorded in the consolidated financial statements of the Company as a reduction in capital stock of $12,950 and a charge to deficit of $1,418, for a total amount of $14,368, being the book value of the units at the time of the transaction.

MarksCo

For the year ended December 29, 2007, interest expense to the Fund of $2,449 (2006 - $9,521) was incurred on the MarksCo notes of $79,343 (December 30, 2006 - $78,739), which were repaid on April 2, 2007 as a result of the Reorganization (2006 - $785 payable). In addition, during the year ended December 29, 2007, dividends of $190 were declared and paid by MarksCo to the Fund (2006 - $1,135).

At December 30, 2006, MarksCo had an outstanding receivable of $69 due from the Fund. This amount arose as a result of MarksCo paying for certain reimbursable general and administrative expenses of the Fund. The amount was non-interest bearing and was due on demand.

On January 1, 2007, Second Cup, MarksCo and the Fund engaged in a number of transactions to effect the adjustments to the Royalty Pool. See "Royalty Pool Adjustment" below for more information.

MarksLP

For the year ended December 29, 2007, interest expense to the Fund of $534 (2006 - $nil) was incurred on the MarksLP notes which were entered into on April 2, 2007 as a result of the Reorganization of which $21 was payable at December 29, 2007. MarksLP made $8,871 in principal payments to the Fund for the period ended December 29, 2007 leaving a balance outstanding of $300 at December 29, 2007.

Subsequent to the year-end and in accordance with the Agreement, on January 1, 2008, Second Cup, MarksLP and the Fund engaged in a number of transactions to effect the adjustments to the Royalty Pool. See "Royalty Pool Adjustment" below for more information.

CRITICAL ACCOUNTING ESTIMATES

The preparation of Second Cup's consolidated financial statements requires management to make estimates and assumptions that affect income and expenses during the reporting periods, in addition to the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the consolidated financial statements.

Intangible assets

Intangible assets consist of goodwill and trademarks. Goodwill is recorded at cost and represents the excess of costs of investments and businesses acquired over the fair value of the net assets acquired. The trademarks are recorded at their historical carrying value.

Management of Second Cup reviews the carrying value of the intangible assets at least annually for impairment. Based on its annual review of the carrying values of goodwill and trademarks carried out in connection with the audited consolidated financial statements of the Company at December 29, 2007, management believes that no impairment exists with respect to either amount, and that there has been no decline in the carrying value of the these assets.

Contingent liabilities

Second Cup is involved in litigation and other claims arising in the normal course of business. Management must use its judgement to determine whether or not a claim has any merit, the amount of the claims and whether to record a provision, which is dependent on the potential success of the claim. Management does not believe that any liability that may arise from current claims will have a material adverse impact on the financial position of Second Cup.

Future income taxes

Second Cup follows the asset and liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that management determines it is more likely than not that the future income tax assets will be realized.

FINANCIAL INSTRUMENTS

Fair values

The Company's financial instruments consist of cash, accounts receivable, advances to related parties, income taxes recoverable, investment in the Fund, advertising and cooperative fund assets and liabilities, accounts payable and accrued liabilities, interest and notes payable to the Fund, income taxes payable, advertising and cooperative fund assets and liabilities and deposits from franchisees. The fair value of the Company's investment in the Fund is recorded at fair value (see note 9 to the consolidated financial statements). The fair values of all other financial instruments approximate their carrying amounts due to their short-term maturity.

Credit risk

The Company's financial instruments exposed to credit risk include cash, accounts receivable and advances to related parties. The Company places its cash with institutions of high creditworthiness. The Company's accounts receivable primarily comprise amounts due from franchises and management believes that its accounts receivable credit risk exposure is limited. Advances to related parties are also believed to have limited risk exposure based on the creditworthiness of the parent company.

RISKS AND UNCERTAINTIES

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

- The specialty coffee industry is characterized by intense competition with respect to price, location, coffee and food quality and numerous factors affecting discretionary consumer spending. Competitors include national and regional chains, all restaurants and food service outlets that serve coffee, and supermarkets that compete in the whole bean segment. If Second Cup cafés are unable to successfully compete in the Canadian specialty coffee industry, system wide sales may decrease.

- Second Cup faces intense competition for high profile retail locations and qualified franchisees, both from specialty coffee chains and competitors from other industries. Growth of the café network depends on Second Cup's ability to secure and build desirable locations and find high calibre, qualified franchisees to operate them.
- A shortage in supply or an increase in the price of premium quality coffee beans could adversely affect Second Cup. Second Cup has no long-term or written contracts with coffee bean suppliers and relies on 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 specialty coffee industry is also affected by changes in discretionary spending patterns, demographic trends, and traffic and weather patterns as well as the type, number and location of competing cafés.
- Second Cup's business could be adversely affected by reduced consumer confidence and increased concerns about food safety in general, or other unusual events.
- Changes in government regulations and other regulatory developments (such as smoking by-laws) could have an adverse impact on system wide sales.
- The loss of key personnel and/or a shortage of experienced management and hourly employees could have an adverse impact on Second Cup's operations and cafés.

A more detailed discussion of these and other risks and uncertainties affecting the Company and the Fund is set out in the Fund's Annual Information Form, which is available at www.sedar.com.

ROYALTY POOL ADJUSTMENT

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount, which may be satisfied by additional Fund units or cash, the form of payment being at the option of the Fund. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net sales of these cafés, with the balance received when the actual full year performance of the new cafés is known.

On January 1, 2007, the actual annual sales of the nine cafés added to the Royalty Pool in the first adjustment on January 1, 2006 were $4,421, greater than the original estimate of $4,055. In accordance with the provisions in the Agreement, a final adjustment of $356 was satisfied by the receipt by the Company of 35,903 additional units of the Fund. In addition, the Company received a cash payment of $37 from MarksCo, representing the cash distributions that would have otherwise been earned by it on these additional units above had they been issued on January 1, 2006.

On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized sales of the 11 cafés added to the Royalty Pool were estimated at $4,555, offset by $3,815 in sales of the 12 cafés permanently closed from the Royalty Pool during 2006. In accordance with the provisions in the Agreement, the Fund, through MarksCo, was required to make a payment of $314 to Second Cup, representing 80% of the obligation based on forecast sales of these cafés. On January 1, 2007, Second Cup received 34,630 units of the Fund to satisfy this obligation.

In conjunction with the second adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. The notes issued by MarksCo to the Fund bore interest at 12.125% and were to mature on January 1, 2017. These notes were repaid as part of the Reorganization. The common shares of MarksCo were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

As a result of these adjustments to the Royalty Pool, MarksCo recognized an intangible asset. This increase and a related deferred gain recognized by Second Cup are eliminated on preparation of the Company's consolidated financial statements.

On January 1, 2008, the actual sales of the 11 cafés added to the Royalty Pool on January 1, 2007 for the year ended December 31, 2007 were $4,961 as compared to the original estimate of $4,555. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the 32,412 additional units above had they been issued on January 1, 2007. Second Cup recorded a deferred gain of $295, a current income tax expense of approximately $103 and a corresponding recovery of future income tax and future income tax assets of approximately $94 relating to this adjustment. The deferred gain, recovery of future income taxes and future income tax assets have been eliminated from these financial statements on consolidation with MarksLP.

A third annual adjustment was made on January 1, 2008 whereby 15 cafés were added to the Royalty Pool. The sales of these 15 cafés added to the Royalty Pool have been estimated at $6,750 annually. These sales were offset by $3,513 in sales of nine cafés permanently closed from the Royalty Pool during the year. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $1,347 to Second Cup, representing 80% of the obligation based on forecasted sales. On January 1, 2008, the Fund issued 143,712 units to MarksLP, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue additional units to satisfy the remaining obligation. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 351 to 357 and Second Cup's holdings of units of the Fund increased to 246,657.

OUTLOOK

The information contained in this "Outlook" is forward-looking information. Please see "Forward-Looking Information" below for a discussion of the risks and uncertainties in connection with forward-looking information.

Second Cup has now achieved 17 consecutive quarters of positive same café sales dating back to the fourth quarter of 2003. Subject to stable economic conditions across the Company's primary markets, Second Cup expects to achieve same café sales growth of approximately 2% to 4% for the 2008 fiscal year. To achieve this growth, Second Cup has planned a number of growth initiatives to strengthen the long-term success of the Second Cup brand and its franchisees:

- In 2008, Second Cup will put an even stronger focus on operational excellence at the café level, which it believes will yield even better consistency across the chain and in doing so improve the overall guest experience and help drive same café sales growth.
- In an effort to drive loyalty among specialty coffee customers, the Company's promotional strategies will focus on targeted branding initiatives leveraging its premium priced specialty beverages, food and merchandise innovations, and value added offers. Second Cup will also selectively enhance the nutritional quality of its grab and go food, and beverage offerings, including the launch of a beverage platform with lower fat and calorie claims in mid-2008.
- Second Cup will continue to enhance its in-café food offerings, and will be launching a premium hot breakfast sandwich in its Ontario and Quebec markets in early 2008.
- Second Cup will also be taking selective price increases on several of its products throughout the year, which is expected to have an impact of 1% to 2% on same café sales growth, depending on the timing and amount of pricing taken.
- Second Cup will continue to develop and build neighbourhood cafés with a focus on expansion in key urban markets utilizing a disciplined café development process, and the delivery of cost savings to franchisees in the build out of their new and renovated cafés.

In terms of network expansion, Second Cup expects to open 12 to 18 new cafés in Canada during the 2008 fiscal year. Second Cup also expects to close 10 to 14 cafés during 2008, the majority of which have sales below the average performance of cafés in the Royalty Pool. Furthermore, Second Cup expects that approximately 35 of its cafés will be renovated during 2008.

Overall, based on the initiatives outlined above and others, the anticipated economic environment and market conditions affecting the specialty coffee industry, the Company expects a successful year in 2008.

FORWARD-LOOKING INFORMATION

Certain statements in this report 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 report. 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 on a number of assumptions and is subject to known and unknown risks, uncertainties and other factors, many of which are beyond the Company's control, that may cause the Company's actual results, performance or achievements, or those of MarksCo, the Fund, MarksLP, 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; reporting of system sales 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 "Risks and Uncertainties" above.

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

As these forward-looking statements are made as of the date of this report, the Company does not undertake to update any such forward-looking 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 on the Fund's website at www.secondcupincomefund.com.

NON-GAAP TERMS

In addition to using financial measures prescribed by GAAP, non-GAAP financial measures and other terms are used in this report. These terms include "system sales" and "same café sales". These terms are not financial measures recognized by GAAP and do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar terms and measures presented by other similar issuers. These non-GAAP measures and terms are intended to provide additional information on the Company's performance and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

PricewaterhouseCoopers LLP
Chartered Accountants
North American Centre
5700 Yonge Street, Suite 1900
North York, Ontario
Canada M2M 4K7
Telephone +1 416 218 1500
Facsimile +1 416 218 1499

March 10, 2008

Auditors' Report

To the Shareholder of
The Second Cup Ltd.

We have audited the consolidated balance sheets of **The Second Cup Ltd.** as at December 29, 2007 and December 30, 2006 and the consolidated statements of operations and comprehensive income, deficit and cash flows for the 52-week periods then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 29, 2007 and December 30, 2006 and the results of its operations and its cash flows for the 52-week periods then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

The Second Cup Ltd.

CONSOLIDATED BALANCE SHEETS

(EXPRESSED IN THOUSANDS OF DOLLARS)

	DECEMBER 29, 2007	DECEMBER 30, 2006 (RESTATED - NOTE 5(p))
Assets		
CURRENT ASSETS		
Cash	$ 2,743	$ 2,296
Accounts receivable	4,612	3,587
Due from related parties (note 17)	-	122
Inventories (note 6)	151	208
Prepaid expenses and sundry assets	160	302
Investment in Second Cup Royalty Income Fund (notes 9 and 19)	665	-
Income taxes recoverable	82	277
Future income taxes (note 13)	68	145
Advertising and cooperative fund assets (note 5(p))	820	1,140
	9,301	8,077
Deferred financing charges (note 7)	-	142
Capital assets (note 8)	2,604	2,570
Trademarks (note 5(h))	88,019	88,019
Goodwill	4,898	4,898
Future income taxes (note 13)	54	38
	$ 104,876	$ 103,744
Liabilities		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities (note 5(m))	$ 7,906	$ 6,173
Due to related parties (note 17)	13	-
Interest payable to Second Cup Royalty Income Fund (note 17)	21	785
Deposits from franchisees	961	1,196
Advertising and cooperative fund liabilities (note 5(p))	820	1,140
	9,721	9,294
Term loan (notes 3 and 11)	-	11,000
Notes payable (note 12)	300	78,739
Future income taxes (note 13)	145	10,100
	10,166	109,133
Non-controlling interest in MarksLP/MarksCo (note 10)	102,115	1,659
	112,281	110,792
SHAREHOLDER'S DEFICIENCY		
Capital stock (note 14)	3,724	3,724
Deficit	(11,125)	(10,772)
Accumulated other comprehensive loss (note 15)	(4)	-
	(7,405)	(7,048)
	$ 104,876	$ 103,744

Contingencies, commitments and guarantees (note 16)
Subsequent event (note 20)
See accompanying notes to consolidated financial statements.

APPROVED BY THE BOARD OF DIRECTORS

(Signed) Gabriel Tsampalieros	(Signed) James Anas
Director	Director

The Second Cup Ltd.

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME

(EXPRESSED IN THOUSANDS OF DOLLARS)

	FOR THE YEAR ENDED DECEMBER 29, 2007	FOR THE YEAR ENDED DECEMBER 30, 2006
SYSTEM SALES - Canada	$ 200,271	$ 193,098
REVENUE		
Royalty revenue	$ 16,270	$ 15,526
Revenue from Company-owned cafés	10,482	12,526
Other income	6,475	5,655
	33,227	33,707
EXPENSES		
Operating costs and administrative expenses	20,715	22,054
Amortization of capital assets	503	500
Amortization of deferred financing charges	142	86
Writedown of capital assets	-	335
Interest expense on notes payable	2,983	9,521
Interest expense on term loan	145	585
	24,488	33,081
	8,739	626
Interest income	123	-
Investment income (note 9)	112	1,150
EARNINGS BEFORE INCOME TAXES AND NON-CONTROLLING INTEREST	8,974	1,776
Income taxes (recovery)		
Current	(216)	531
Future	1,482	(414)
Reversal of future income tax liability	(11,374)	-
	(10,108)	117
EARNINGS BEFORE NON-CONTROLLING INTEREST	19,082	1,659
Non-controlling interest (note 10)	19,386	1,319
Net (loss) earnings for the year	(304)	340
Other comprehensive loss (note 15)	(4)	-
Comprehensive (loss) income	$ (308)	$ 340

See accompanying notes to consolidated financial statements.

The Second Cup Ltd.

CONSOLIDATED STATEMENTS OF DEFICIT

(EXPRESSED IN THOUSANDS OF DOLLARS)

	FOR THE YEAR ENDED DECEMBER 29, 2007	FOR THE YEAR ENDED DECEMBER 30, 2006
DEFICIT - BEGINNING OF YEAR	$ (10,772)	$ (11,240)
Dividends paid (note 17)	-	(1,504)
Reduction of legal stated capital (note 14)	-	3,050
Transfer of investment (note 17)	-	(1,418)
Refundable taxes incurred	(49)	-
Net (loss) earnings for the year	(304)	340
DEFICIT - END OF YEAR	$ (11,125)	$ (10,772)

See accompanying notes to consolidated financial statements.

The Second Cup Ltd.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(EXPRESSED IN THOUSANDS OF DOLLARS)

	FOR THE YEAR ENDED DECEMBER 29, 2007	FOR THE YEAR ENDED DECEMBER 30, 2006
Cash provided by (used in)		
OPERATING ACTIVITIES		
Net (loss) earnings for the year	$ (304)	$ 340
Items not involving cash		
Non-controlling interest	19,386	1,319
Amortization	645	586
Writedown of capital assets	-	335
Future income taxes	(9,892)	(414)
Gain on disposal of capital assets	(181)	(144)
	9,654	2,022
Changes in non-cash working capital items (note 18)	189	188
	9,843	2,210
INVESTING ACTIVITIES		
Purchase of capital assets	(1,653)	(1,859)
Proceeds from disposal of capital assets	1,296	1,818
Purchase of investments in the Fund (note 19)	(671)	(548)
	(1,028)	(589)
FINANCING ACTIVITIES		
Advances from former parent (note 17)	-	1,637
Repayment of notes payable to the Fund	(8,871)	-
Repayment of term loan (note 11)	(11,000)	-
Impact of reorganization (note 3)	11,022	-
Issuance of common shares in MarksCo (note 19)	67	55
Issuance of notes payable (note 19)	604	493
Dividends paid (note 17)	-	(950)
Dividends paid to non-controlling interest (note 17)	(190)	(1,135)
Deferred financing charges	-	(50)
	(8,368)	50
INCREASE IN CASH DURING THE YEAR	447	1,671
CASH - BEGINNING OF YEAR	2,296	625
CASH - END OF YEAR	$ 2,743	$ 2,296

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 29, 2007 AND DECEMBER 30, 2006
(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS)

1. ORGANIZATION AND NATURE OF OPERATIONS

The Second Cup Ltd. ("Second Cup" or the "Company") is a specialty coffee retailer with 366 cafés operating under the trade name Second Cup™ in Canada as of December 29, 2007, of which 17 are Company-owned (December 30, 2006 - 360 cafés, of which 24 were Company-owned). The cafés are predominantly operated by franchisees that are selected and trained to retail the Company's product offering.

Second Cup Trade-Marks Limited Partnership ("MarksLP") is a wholly owned subsidiary of the Second Cup Royalty Income Fund (the "Fund"). The business of MarksLP is the ownership of the Canadian trademarks and certain other intellectual property and associated rights used by Second Cup in connection with the operation of Second Cup cafés in Canada (excluding the territory of Nunavut) (collectively, the "Second Cup Marks", or the "Marks") and, through the Licence and Royalty Agreement (the "Agreement") with Second Cup, the taking of actions to exploit the use of the Second Cup Marks and the collection of the royalty payable under the Agreement. As discussed in note 2 below, MarksLP, while a wholly owned subsidiary of the Fund and not the Company, is consolidated in these financial statements.

On November 14, 2006, Dinecorp Hospitality Inc. (who has since changed its name to The Second Cup Coffee Company ("S.C. Coffee Co"), a Canadian controlled private company, purchased all the issued and outstanding shares of the Company from its former parent, Cara Operations Limited ("Cara").

2. BASIS OF PRESENTATION

Effective January 2, 2005, the Company adopted Accounting Guideline 15 ("AcG-15"), a new pronouncement of The Canadian Institute of Chartered Accountants ("CICA") relating to variable interest entities ("VIEs"). A VIE is an entity where its equity investment at risk is insufficient to permit the entity to finance its activities without additional subordinated support from others and/or where certain essential characteristics of a controlling financial interest are not met. AcG-15 outlines who should consolidate such entities. The Company has identified two significant VIEs related to the Company.

Second Cup Trade-Marks Limited Partnership ("MarksLP")
MarksLP, a wholly owned subsidiary of the Fund, is a VIE that owns the Second Cup Marks. MarksLP has, through the Agreement, licenced these Marks to Second Cup, which operates the business activities associated with these Marks in exchange for a royalty payment. The activities of MarksLP and Second Cup are closely related and, based on the guidance provided in AcG-15, it was determined that although MarksLP is wholly owned by the Fund, Second Cup should consolidate the financial assets and results of MarksLP. As a result, the consolidated financial statements exclude the royalty expense paid to MarksLP, but include the interest expense and dividends declared by MarksCo through April 2, 2007, as well as other expenses of MarksLP. The non-controlling interest represents the equity of MarksLP, which is 100% owned by the Fund.

Franchise entities
The Company also has a variable interest in the franchise entities, which operate Second Cup's franchised cafés. Based on guidance provided by AcG-15, the Company has determined that these franchise entities are not required to be consolidated by Second Cup.

3. REORGANIZATION

On April 2, 2007, the Unitholder-approved reorganization of the structure of the Fund (the "Reorganization") replaced its subsidiary corporations, including Second Cup Trade-Marks Inc. ("MarksCo"), with a newly formed trust and limited partnership. This latter entity, MarksLP, is consolidated with Second Cup in these financial statements as a VIE (see note 2 above) for the same reasons that MarksCo had historically been consolidated by Second Cup.

As a result of the Reorganization, the Fund negotiated a new term loan of $11,000 with its bankers on similar terms and conditions as MarksCo's term loan. The proceeds of this new loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan. Further, the notes payable by MarksCo to a subsidiary of the Fund which amounted to $79,343 as at April 1, 2007 (December 30, 2006 - $78,739), were repaid through an increase in the equity ownership of MarksLP by the Fund and a new note payable by MarksLP to the Fund amounting to $9,171 (December 29, 2007 - $300). The increase in the equity ownership of MarksLP has been recorded as an increase in the non-controlling interest on the Company's consolidated balance sheets.

Under the new structure, the new wholly owned subsidiaries of the Fund will not be subject to income tax. As a result, the future income tax liabilities on the consolidated balance sheets of Second Cup prior to the Reorganization of $9,966 relating to the Second Cup trademarks owned by MarksLP were credited to consolidated earnings on April 2, 2007 and resulted in an increase in the non-controlling interest on the Company's consolidated balance sheets.

The Agreement, entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to license the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of the sales of cafés in the Royalty Pool are payable to MarksLP. As a result of the Reorganization, the Fund's earnings are predominantly comprised of distribution income from MarksLP as a replacement of interest and dividend income from MarksCo.

It is important to note that, while the Fund's underlying structure has been changed, essentially the underlying assets and operations of the Fund and its subsidiaries did not change as a result of the Reorganization.

4. CHANGE IN ACCOUNTING POLICY INCLUDING INITIAL ADOPTION

Effective January 1, 2007, the Company has adopted the following sections of the CICA Handbook:

Accounting Changes, CICA Handbook Section 1506

Section 1506 revised the standards on changes in accounting policy, estimates or errors to require a change in accounting policy to be applied retrospectively, unless doing so is impracticable, changes in estimates to be recorded prospectively, and prior period errors to be corrected retrospectively. Voluntary changes in accounting policy are allowed only when they result in financial statements that provide reliable and more relevant information. In addition, these revised standards call for enhanced disclosures about the effects of changes in accounting policies, estimates and errors in the financial statements. These revised standards are effective for interim and annual financial statements relating to fiscal periods ending on or after January 1, 2007.

Comprehensive Income, CICA Handbook Section 1530

Section 1530 introduces new standards for reporting and disclosure of comprehensive income. Comprehensive income is the change in equity (net assets) of an enterprise during a reporting period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners. It requires an entity to recognize certain unrealized gains and losses in accumulated other comprehensive income, a new component of Shareholder's Equity. A new statement entitled consolidated statement of operations and comprehensive (loss) income has been added to the Company's consolidated financial statements.

The comprehensive loss is comprised of the Company's net loss and other comprehensive losses in the year. This category may include unrealized gains and losses on available-for-sale financial assets, foreign currency translation and changes in the fair market value of derivative instruments designated as cash flow hedges, all net of income taxes.

Equity, CICA Handbook Section 3251

As a result of implementing Section 1530 as discussed above, accumulated other comprehensive income ("AOCI") is included in the consolidated balance sheets as a separate component of shareholder's deficiency.

Financial Instruments - Recognition and Measurement, CICA Handbook Section 3855,
Financial Instruments - Disclosure and Presentation, CICA Handbook Section 3861

Section 3855 prescribes when a financial asset, financial liability, or non-financial derivative is to be recognized on the consolidated balance sheet and at what amount - sometimes using fair value, other times using cost-based measures. Section 3861 specifies how financial instruments and associated gains and losses are to be presented. These standards require that all financial assets be classified as either available-for-sale, held-for-trading, held-to-maturity or loans and receivables. Financial liabilities are classified as either trading or cost/amortized cost.

Financial assets held to maturity, loans and receivables and financial liabilities other than those held for trading are measured at amortized cost. The Company classifies its notes payable to the Fund as loans payable carried at amortized cost. All other financial assets and derivatives are measured at fair value. The Company's investment in units of the Fund are classified as available for sale and measured at fair value. The unrealized gains and losses associated with the Company's investment in units of the Fund are included in other comprehensive income. Transaction costs associated with long-term debt are included in the carrying value of the long-term debt and are amortized using the effective interest rate method.

No adjustments were necessary to opening Shareholder's Equity at January 1, 2007 as a result of adopting Sections 3855 and 3861.

New Accounting Standards

The CICA issued three new accounting standards: Handbook Section 1535, Capital Disclosures (Section 1535), Handbook Section 3862, Financial Instruments - Disclosures (Section 3862), and Handbook Section 3863, Financial Instruments - Presentation (Section 3863). These new standards become effective for the Company on January 1, 2008.

Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The Company will adopt these new standards effective January 1, 2008, but they are not expected to affect its consolidated results or financial position.

5. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Consolidation

These consolidated financial statements include the accounts of the Company and MarksLP, a wholly owned subsidiary of the Fund and have been prepared in accordance with Canadian generally accepted accounting principles.

The Company opens, acquires and closes individual café locations in the normal course of business. Café closures in geographical areas where existing or new cafés continue to serve the same customer base are not reported as discontinued operations.

b. Fiscal year

The Company's fiscal year is made up of 52 or 53-week periods ending on the last Saturday of December.

c. Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the amounts of revenues and expenses for the reporting periods. Actual results could differ from those estimates. The carrying values of accounts receivable and long term assets, accounting for VIEs and estimates of provisions for liabilities are the more significant areas requiring management judgement and estimate.

d. System sales

System sales include gross revenue of all Company-owned and franchised cafés based on information reported by café operators. Gross revenue is self-assessed by each café on a weekly basis and submitted to the Company.

e. Revenue recognition

Royalty revenue from franchised cafés is recognized as the products are sold by the franchisee. Franchise fees are recognized as income when the agreement has been signed and all material conditions have been met. Other income includes purchasing co-ordination fees, café resale fees, renewal fees, construction administration fees and initial franchise fees, which are recognized as income once all significant conditions have been met.

f. Inventories

Inventories are valued at the lower of cost and net realizable value, with cost being determined substantially on a first-in, first-out basis.

g. VIEs

AcG-15 requires consolidation of VIEs by the primary beneficiary. The primary beneficiary is defined as the party that has exposure to the majority of the VIE's expected losses and/or residual returns. Second Cup has evaluated its interests in MarksLP, a wholly owned subsidiary of the Fund, and determined that the Company is the primary beneficiary and should consolidate MarksLP.

h. Trademarks

Trademarks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Second Cup cafés in Canada are recorded at the historical cost to MarksLP. The management of MarksLP reviews the carrying value of the trademarks at least annually for impairment taking into consideration any events or circumstances that might have impaired the carrying value. If there is an impairment, trademarks are written down to their estimated recoverable amount.

i. Goodwill

Goodwill represents the excess of the cost of investments in subsidiaries and businesses acquired over the fair value of the net assets acquired. Goodwill is not amortized, but is tested for impairment at least annually or when events or changes in circumstances indicate that the carrying value may not be recoverable. The measurement of impairment is based on fair value.

j. Capital assets

Capital assets are recorded at cost less accumulated amortization. Amortization is calculated using the straight-line basis at the following rates, which are based on the expected useful life of the asset:

Leasehold improvements	lesser of 10 years and the remaining term of the lease
Equipment, furniture, fixtures and other	7 years
Computer software and hardware	3 years

Capital assets are tested for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. The measurement of impairment is based on estimated fair value.

k. Deferred financing charges

Deferred financing charges represent costs associated with the MarksCo term loan, which was repaid in its entirety as a result of the Reorganization.

l. Future income taxes

Future income taxes are provided for on the asset and liability method whereby future income tax assets are recognized for deductible temporary differences and operating loss carry-forwards, and future income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

m. Gift certificates and Café Cards

Accounts payable and accrued liabilities include $3,583 (2006 - $2,751) of liabilities related to unredeemed gift certificates and unused balances on Second Cup's reloadable payment card ("Second Cup Café Card"). These balances are included as sales of franchised cafés, or as revenue of Company-owned cafés, at the time the customer redeems the amount in a café for products or services.

n. Operating leases

For operating leases, minimum lease payments are recognized as rent expense on a straight-line basis over the lease term. For the purposes of determining the lease term, the Company considers option periods for which failure to renew the lease imposes an economic penalty on the Company of such an amount that the renewal appears to be reasonably assured at the inception of the lease.

o. Financial instruments

Fair values

The Company's financial instruments consist of cash, accounts receivable, advances to related parties, income taxes recoverable, investment in the Fund, accounts payable and accrued liabilities, interest and notes payable to the Fund, income taxes payable, advertising and cooperative fund assets and liabilities, and deposits from franchisees. The fair value of the Company's investment in the Fund is recorded at fair value (see note 9). The fair values of all other financial instruments approximate their carrying amounts due to their short-term maturity.

Credit risk

The Company's financial instruments exposed to credit risk include cash, accounts receivable and advances to related parties. The Company places its cash with institutions of high creditworthiness. The Company's accounts receivable primarily comprise amounts due from franchisees and management believes that its accounts receivable credit risk exposure is limited. Advances to related parties are also believed to have limited risk exposure based on their creditworthiness.

p. Advertising and cooperative fund assets and liabilities

The Company manages an advertising and cooperative fund (the "Coop Fund") established to collect and administer funds contributed for use in advertising and promotional programs, national training programs and, among other things, initiatives designed to increase sales and enhance the reputation of the Second Cup Brand. Contributions to the Coop Fund are required to be made from both Company-owned and operated and franchise cafés and are based on a percentage of café sales. The Company accounts for the Coop Fund in accordance with CICA Accounting Guideline 2 "Franchise Fee Revenue" ("AcG-2"). The revenue, expenses, and cash flows of the Coop Fund are not included in the Company's consolidated statements of operations and cash flows because the contributions to this fund are segregated and designated for a specific purpose. Instead, the assets and liabilities of the Coop Fund are identified on the Company's consolidated balance sheets.

Previously, the assets and liabilities of the Coop Fund were not included in the consolidated financial statements of the Company. The result of adopting this policy was to restate the December 30, 2006 consolidated balance sheet wherein current assets and current liabilities were increased by $1,140. For December 29, 2007, current assets and current liabilities relating to the Coop Fund amounted to $820. There was no impact on current or prior year's net earnings.

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS)

6. INVENTORIES

	2007	2006
Merchandise held for resale	$ 117	$ 161
Supplies	34	47
	$ 151	$ 208

7. DEFERRED FINANCING CHARGES

Deferred charges consist of deferred financing costs related to the MarksCo term loan, which was repaid in its entirety as a result of the Reorganization. As a result, the remaining deferred charges of $142 were fully amortized in the year (2006 amortization - $86).

	2007	2006
Cost	$ 142	$ 327
Less: Accumulated amortization	142	185
	$ -	$ 142

8. CAPITAL ASSETS

	2007		
	COST	ACCUMULATED AMORTIZATION	NET
Leasehold improvements	$ 2,783	$ 1,276	$ 1,507
Equipment, furniture, fixtures and other	1,857	951	906
Computer software and hardware	1,410	1,219	191
	$ 6,050	$ 3,446	$ 2,604

	2006		
	COST	ACCUMULATED AMORTIZATION	NET
Leasehold improvements	$ 2,937	$ 1,359	$ 1,578
Equipment, furniture, fixtures and other	1,906	994	912
Computer software and hardware	1,234	1,154	80
	$ 6,077	$ 3,507	$ 2,570

Amortization of capital assets for the year ended December 29, 2007 was $503 (2006 - $500).

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS)

9. INVESTMENT IN SECOND CUP ROYALTY INCOME FUND

	2007	2006
Investment in units of the Fund (2007 - 70,533 units; 2006 - nil)	$ 665	$ -
Income earned on investment	$ 112	$ 1,150

In accordance with CICA Handbook Section 3855, Financial Instruments - Recognition and Measurement, the investment in units of the Fund has been designated as available-for-sale and is measured at fair value. On December 29, 2007, the fair value of the investment in units of the Fund was $9.44 per unit. An unrealized loss of $6, less applicable future income tax of $2, is recorded in other comprehensive income for the 52 weeks ended December 29, 2007.

10. NON-CONTROLLING INTEREST IN MARKSLP/MARKSCO

The non-controlling interest represents the equity of MarksLP, which is 100% owned by the Fund, and is made of the following:

	2007	2006
Balance - Beginning of year	$ 1,659	$ 1,413
Earnings: Non-controlling interest	19,386	1,319
Issuance of common shares (note 17)	67	55
Impact of Reorganization (note 3)	81,192	-
Less:		
Dividends paid to non-controlling interest	(190)	(1,135)
Change in refundable taxes	1	7
Balance - End of year	$ 102,115	$ 1,659

11. TERM LOAN AND OPERATING FACILITY

On December 2, 2004, MarksCo, as borrower, and the Fund and a subsidiary of the Fund, as guarantors, entered into a term credit agreement maturing on December 2, 2007. The $12,000 credit facilities were comprised of an $11,000 non-revolving term credit facility and a $1,000 operating credit facility. The $11,000 non-revolving term credit facility bore interest at prime or base rate plus 0.75% or LIBOR advances or bankers' acceptances plus 1.75%.

As a result of the Reorganization, the Fund negotiated new credit facilities of $12,000, also comprised of an $11,000 non-revolving term credit facility and a $1,000 operating facility, with its bankers on similar terms and conditions as MarksCo's facilities. The proceeds of this new loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the above-noted MarksCo term loan.

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS)

12. NOTES PAYABLE

The notes payable amount to $300 and are due by MarksLP to the Fund (2006 - $78,739, due by MarksCo). The notes bear interest at 12.125%. As a result of the Reorganization, notes of $78,739 due by MarksCo to the Fund were effectively replaced with a note of $9,171 due by MarksLP to the Fund and an investment in limited partnership units of MarksLP by the Fund resulting in an increase to non-controlling interest in MarksLP by Second Cup (see note 10 above). Interest only payments are due monthly in arrears. MarksLP made principal payments of $8,871 for the 52 weeks ended December 29, 2007.

13. INCOME TAXES

The significant components of future income tax assets and liabilities are as follows:

	2007	2006
Capital assets	$ 54	$ 25
Investment in Fund	(1)	-
Provisions and accrued expenses	65	145
Goodwill	(141)	(240)
Deferred financing charges	-	13
Trademarks	-	(9,860)
Net future income tax liability	$ (23)	$ (9,917)
Classified as		
Current assets	$ 68	$ 145
Long-term assets	54	38
Long-term liabilities	(145)	(10,100)
	$ (23)	$ (9,917)

14. CAPITAL STOCK

AUTHORIZED

An unlimited number of common shares and an unlimited number of preference shares issuable in one or more series

ISSUED COMMON SHARES

	NUMBER OF SHARES	AMOUNT
Balance as at January 1, 2005 and December 31, 2005	19,724	$ 19,724
Reduction in legal stated capital in 2006	-	(3,050)
Return of capital in 2006	-	(12,950)
Balance as at December 30, 2006 and December 29, 2007	19,724	$ 3,724

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS)

A return of capital of $12,950 to its former parent, Cara, was effected on November 13, 2006 (see notes 1 and 17). Also on November 13, 2006, the Company reduced its legal stated capital by $3,050.

15. ACCUMULATED OTHER COMPREHENSIVE LOSS

	2007	2006
Balance - beginning of year	$ -	$ -
Unrealized loss on investments designated as available for sale	(6)	-
Less: Future income tax recovery on unrealized gain	2	-
Balance - end of year	$ (4)	$ -

16. CONTINGENCIES, COMMITMENTS AND GUARANTEES

The Company has lease commitments for Company-owned cafés. The Company also acts as the head tenant on leases, which, it in turn, subleases to franchisees. The Company's lease commitments at December 29, 2007 are as follows:

	LEASE COMMITMENTS	SUBLEASE TO FRANCHISEES	NET
2008	$ 16,095	$ 15,285	$ 810
2009	14,105	13,286	819
2010	11,691	10,927	764
2011	10,347	9,710	637
2012	9,034	8,556	478
Thereafter	25,207	23,850	1,357
	$ 86,479	$ 81,614	$ 4,865

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

Substantially all of the Company's assets have been pledged under a general security agreement as collateral for commitments under the Agreement.

17. RELATED PARTY TRANSACTIONS AND BALANCES

Second Cup

For the year ended December 29, 2007, Second Cup earned an administrative fee of $500 from its parent, The S.C. CoffeeCo, for services related to S.C. CoffeeCo's international operations. In the prior year, this administrative fee was charged to its former parent, Cara, and amounted to $346. For the period November 14, 2006 through December 30, 2006, an administrative fee of $53 was charged to S.C. CoffeeCo.

At December 29, 2007, the Company had an outstanding payable of $13 (2006 - $53 receivable) to S.C. CoffeeCo, which arose as a result of S.C. CoffeeCo paying for certain reimbursable general and administrative expenses of the Company.

Second Cup earned investment income of $112 during the year (2006 - $1,150) on its investment in units of the Fund.

During the year ended December 30, 2006, dividends of $1,504 were paid by Second Cup to Cara, satisfied by transferring 55,383 units of the Fund, and $950 in cash. In accordance with GAAP, Second Cup recorded the transfer of units at an amount of $554, being the book value of the units on the Company's consolidated financial statements at the time of the transaction.

Second Cup also transferred its remaining investment in the Fund, consisting of 1,437,347 units of the Fund, by way of a return of capital to Cara of $12,950. The return of capital was recorded in the consolidated financial statements of the Company as a reduction in capital stock of $12,950 and a charge to deficit of $1,418, for a total amount of $14,368, being the book value of the units at the time of the transaction.

MarksCo

For the year ended December 29, 2007, interest expense of $2,449 (2006 - $9,521) on its notes payable to the Fund was incurred on the MarksCo notes of $79,343 (December 30, 2006 - $78,739), which were repaid as a result of the Reorganization (2006 - $785 payable). In addition, prior to the Reorganization, dividends of $190 were declared and paid by MarksCo to the Fund (2006 - $1,135).

At December 30, 2006, MarksCo had a receivable of $69 due from the Fund. This amount arose as a result of MarksCo paying for certain reimbursable general and administrative expenses of the Fund. The amount was non-interest bearing and due on demand.

On January 1, 2007, Second Cup, MarksCo and the Fund engaged in a number of transactions to effect the adjustments to the Royalty Pool. Refer to note 19 for further details on these transactions.

MarksLP

For the year ended December 29, 2007, interest expense of $534 (2006 - $nil) on notes payable to the Fund was incurred on the MarksLP notes, which arose as a result of the Reorganization of which $21 was payable at December 29, 2007. MarksLP made $8,871 in principal payments to the Fund for the year ended December 29, 2007 leaving a balance outstanding of $300 at December 29, 2007.

Subsequent to the year-end and in accordance with the Agreement, on January 1, 2008, Second Cup, MarksLP and the Fund engaged in a number of transactions to effect the adjustments to the Royalty Pool. Refer to note 19 for further details on these transactions.

(ALL AMOUNTS EXPRESSED IN THOUSANDS OF DOLLARS, EXCEPT UNITS)

18. SUPPLEMENTARY CASH FLOW INFORMATION

Changes in non-cash working capital items:

	2007	2006
Accounts receivable	$ (1,025)	$ (534)
Due (from) to related parties	135	(96)
Inventories	57	64
Prepaid expenses and sundry assets	142	(47)
Income taxes recoverable	195	(70)
Accounts payable and accrued liabilities	1,733	471
Interest payable to the Fund	(764)	(21)
Deposits from franchisees	(235)	414
Refundable income taxes	(49)	7
	$ 189	$ 188
Supplementary information:		
Interest paid	$ 3,890	$ 10,138
Income tax (recovered) paid	$ (347)	$ 647

19. ROYALTY POOL ADJUSTMENT

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount that may be satisfied by additional Fund units or cash, the form of payment being at the option of the Fund. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net sales of these cafés, with the balance received when the actual full year performance of the new cafés is known.

On January 1, 2007, the actual annual sales of the nine cafés added to the Royalty Pool in the first adjustment on January 1, 2006 were $4,421, greater than the original estimate of $4,055. In accordance with the provisions in the Agreement, a final adjustment of $356 was satisfied by the receipt by the Company of 35,903 additional units of the Fund. In addition, the Company received a cash payment of $37 from MarksCo, representing the cash distributions that would have otherwise been earned by it on these additional units above had they been issued on January 1, 2006.

On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized sales of the 11 cafés added to the Royalty Pool were estimated at $4,555, offset by $3,815 in sales of the 12 cafés permanently closed from the Royalty Pool noted above. In accordance with the provisions in the Agreement, the Fund, through MarksCo, was required to make a payment of $314 to Second Cup, representing 80% of the obligation based on forecast sales of these cafés. On January 1, 2007, Second Cup received 34,630 units of the Fund to satisfy this obligation. After a full year of performance of the new cafés, Second Cup expects to receive additional units of the Fund to satisfy the remaining obligation (see note 20).

In conjunction with the second adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. The notes issued by MarksCo to the Fund bore interest at 12.125% and were to mature on January 1, 2017. These notes were repaid as part of the Reorganization. These common shares of MarksCo were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

As a result of these adjustments to the Royalty Pool, MarksCo recognized an intangible asset. This increase and a related deferred gain recorded by Second Cup are eliminated in the Company's consolidated financial statements.

20. SUBSEQUENT EVENT

On January 1, 2008, the actual sales of the 11 cafés added to the Royalty Pool on January 1, 2007 (see note 19) for the year ended December 31, 2007 were $4,961 as compared to the original estimate of $4,555. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on these additional units above had they been issued on January 1, 2007.

Also, on January 1, 2008, 15 cafés were added to the Royalty Pool. The annualized sales of these 15 cafés added to the Royalty Pool have been estimated at $6,750. These sales were offset by $3,513 in sales of nine cafés permanently closed from the Royalty Pool during the year. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $1,347 to Second Cup, representing 80% of the obligation based on forecasted sales. On January 1, 2008, the Fund issued 143,712 units to MarksLP, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue additional units to satisfy the remaining obligation. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 351 to 357 and Second Cup's holdings of units of the Fund increased to 246,657.

Second Cup Royalty Income Fund

UNITHOLDER INFORMATION

CORPORATE HEAD OFFICE
Second Cup GP Inc.
6303 Airport Road
Mississauga, Ontario
Canada L4V 1R8

MAILING ADDRESS
Second Cup Royalty Income Fund
6303 Airport Road
Mississauga, Ontario
Canada L4V 1R8

Registrar and Transfer Agent
Computershare Trust Company of Canada

Auditors
PricewaterhouseCoopers LLP

Market Information
Units Listed: Toronto Stock Exchange
Symbol: **SCU.UN**

Investor Enquiries
Stephen Devito C.A.
Chief Financial Officer
Tel: 905-362-1824
Fax: 905-362-1121
E-mail: investor@secondcup.com

Website:
www.secondcupincomefund.com