The Second Cup Ltd.

Unaudited Condensed Interim Financial Statements

For the 13 weeks ended April 1, 2017 and March 26, 2016

Notice to Reader

The management of The Second Cup Ltd. ("Second Cup" or the "Company") is responsible for the preparation of the accompanying condensed interim financial statements. The condensed interim financial statements have been prepared in accordance with International Financial Reporting Standards and are considered by management to present fairly the financial position, financial performance and cash flows of Second Cup.

These condensed interim financial statements have not been reviewed by an auditor. These condensed interim financial statements are unaudited and include all adjustments, consisting of normal and recurring items that management considers necessary for a fair presentation of the financial position, financial performance and cash flows.

(Signed)

Garry Macdonald
Interim President and Chief Executive Officer, The Second Cup Ltd.

(Signed)

Barbara Mallon
Chief Financial Officer, The Second Cup Ltd.

May 11, 2017

The Second Cup Ltd.

Condensed Interim Statements of Financial Position

(Unaudited, expressed in thousands of Canadian dollars)

	April 1, 2017	December 31, 2016
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,348	$ 3,004
Restricted cash (note 11)	1,901	1,947
Trade and other receivables	2,159	3,023
Notes and leases receivable	102	139
Inventories	190	200
Prepaid expenses and other assets	675	251
Income tax receivable	487	532
	7,862	9,096
Non-current assets		
Notes and leases receivable	118	173
Property and equipment	3,168	3,434
Intangible assets	32,642	32,611
Total assets	$ 43,790	$ 45,314
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$ 4,327	$ 3,700
Provisions	1,069	1,598
Other liabilities	276	217
Gift card liability	2,974	3,484
Deposits from franchisees	831	1,243
	9,477	10,242
Non-current liabilities		
Provisions	384	530
Other liabilities	234	267
Long-term debt (note 5)	7,210	7,181
Deferred income taxes	3,676	3,818
Total liabilities	20,981	22,038
SHAREHOLDERS' EQUITY	22,809	23,276
Total liabilities and shareholders' equity	$ 43,790	$ 45,314

Contingencies, commitments and guarantees (note 12).

See accompanying notes to the unaudited condensed interim financial statements.

Approved by the Directors on May 11, 2017

Michael Bregman, Director   Rael Merson, Director

The Second Cup Ltd.

Condensed Interim Statements of Loss and Comprehensive Loss

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

	13 weeks ended April 1, 2017	13 weeks ended March 26, 2016
Revenue (note 6)		
Company-owned cafés and product sales	$ 2,591	$ 3,929
Franchise revenue	3,384	3,505
	5,975	7,434
Operating costs and expenses (note 7)		
Company-owned cafés and cost of product sales	2,896	4,362
Franchise	1,536	2,018
General and administrative	1,457	1,382
Loss on disposal of assets	26	4
Depreciation and amortization	375	401
	6,290	8,167
Loss from operations	(315)	(733)
Interest and financing costs (note 8)	258	27
Loss before income taxes	(573)	(760)
Recovery of income taxes	(98)	(154)
Net loss and comprehensive loss for the period	$ (475)	$ (606)
Basic and diluted loss per share (note 9)	$ (0.04)	$ (0.05)

See accompanying notes to the unaudited condensed interim financial statements.

The Second Cup Ltd.

Condensed Interim Statements of Changes in Shareholders' Equity

(Unaudited, expressed in thousands of Canadian dollars)

		Share Capital		Warrants		Contributed Surplus		Retained Earnings (Deficit)		Total
Balance - December 26, 2015	$	8,652	$	-	$	61,736	$	(46,461)	$	23,927
Net loss for the period		-		-		-		(606)		(606)
Stock option plan expense		-		-		15		-		15
Balance – March 26, 2016	$	8,652	$	-	$	61,751	$	(47,067)	$	23,336
Balance - December 31, 2016	$	8,652	$	271	$	61,789	$	(47,436)	$	23,276
Net loss for the period		-		-		-		(475)		(475)
Stock option plan expense		-		-		8		-		8
Balance – April 1, 2017	$	8,652	$	271	$	61,797	$	(47,911)	$	22,809

See accompanying notes to the unaudited condensed interim financial statements.

The Second Cup Ltd.

Condensed Interim Statements of Cash Flows

(Unaudited, expressed in thousands of Canadian dollars)

	13 week ended April 1, 2017	13 week ended March 26, 2016
CASH PROVIDED BY (USED IN)		
Operating activities		
Net loss for the period	$ (475)	$ (606)
Items not involving cash		
Depreciation of property and equipment	272	303
Amortization of intangible assets	109	103
Share-based compensation expense	8	15
Deferred income taxes	(142)	(154)
Loss on disposal of capital related items	26	4
Change in fair value of interest rate swap	-	(23)
Changes in non-cash working capital & other (note 10)	(341)	(1,073)
Cash used in operating activities	(543)	(1,431)
Investing activities		
Proceeds from disposal of capital related items	-	2
Cash payments for capital expenditures (note 10)	(33)	(19)
Cash payments for intangible assets (note 10)	(140)	(63)
Notes receivable repayment (issuance)	92	29
Cash used in investing activities	(81)	(51)
Financing activities		
Transaction costs	(32)	-
Cash used in financing activities	(32)	-
Decrease in cash and cash equivalents during the period	(656)	(1,482)
Cash and cash equivalents - Beginning of the period	3,004	3,080
Cash and cash equivalents - End of the period	$ 2,348	$ 1,598

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

Table of Contents

1. Organization and nature of business

The Second Cup Ltd. is a Canadian specialty coffee retailer with 293 cafés operating under the trade name, Second Cup™, in Canada, of which 24 are Company-operated and the balance are operated by franchisees.

Second Cup owns the trademarks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of Second Cup cafés in Canada.

Second Cup was incorporated under the Business Corporations Act (Ontario) in 2011 and is domiciled in Canada. The address of its registered office is 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8. The Company hereinafter refers to its head office activities as “Coffee Central”. The Company’s website is www.secondcup.com. The common shares of the Company are listed on the Toronto Stock Exchange under the symbol “SCU”.

2. Summary of significant accounting policies

a. Basis of preparation

These unaudited condensed interim financial statements for the 13 weeks ended April 1, 2017 and March 26, 2016 have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as applicable to condensed interim financial reports including International Accounting Standard (IAS) 34, Interim Financial Reporting (“IAS 34”), and should be read in conjunction with the Company’s audited annual financial statements for the year ended December 31, 2016, which have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board.

The accounting policies applied in these unaudited condensed interim financial statements are consistent with those of the previous financial year. The accounting policies are based on IFRS issued and outstanding as at May 11, 2017, the date the Board of Directors approved the unaudited condensed interim financial statements.

Second Cup's fiscal year is such that each quarter will consist of 13 weeks and will end on the Saturday closest to the calendar quarter end. The fiscal year is made up of 52 or 53-week periods ending on the last Saturday of December. Fiscal 2017 is a 52-week period (2016 – 53-week period).

b. Segmented information and reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Executive Officer. The Company substantially operates and is managed as one reportable segment. Operating revenues are comprised of royalties, the sale of goods from Company-operated cafés, the sale of goods through retail and other ancillary channels, and other service fees.

c. Reclassification

Certain comparable figures have been reclassified to conform to the current period's financial statement presentation. The change in the restricted cash balance in the previous year cash flow has been reclassified from investing activities to operating activities. This reclassification has been made to enhance the presentation of the company's activities and the financial statements.

3. Changes in accounting policies

The accounting policies adopted in the preparation of these unaudited condensed interim consolidated financial statements are consistent with those followed in the preparation of the Company's audited financial statements for the year ended December 31, 2016. There were no significant accounting policies adopted during the first quarter of 2017.

4. Provisions

Provisions for café leases are estimates for costs to be incurred by the Company as a result of closure of cafés and franchisee failure to make payment of occupancy costs.

An expense of $33 (March 26, 2016 – expense of $9) was recognized in the 13 weeks ended April 1, 2017 and was reflected in the franchise operating costs and expenses line on the unaudited condensed interim statements of loss and comprehensive loss.

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

5. Term debt

		April 1, 2017		December 31, 2016
Face value of borrowings	$	8,000	$	8,000
Unamortized transaction costs		(790)		(819)
	$	7,210	$	7,181

On December 2, 2016, the Company replaced its previous credit facility with another facility. The facility matures on December 2, 2020 (with no principal payments prior to December 2, 2020) and has a face value of $8,000 and stipulated financial covenants. Pursuant to the terms of the Company's term loan, the Company is subject to certain financial and other customary covenants. The Company is required to maintain certain covenants which are defined in the agreement:

- The Company shall not have negative EBITDA for (a) any trailing four fiscal quarter period (calculated quarterly) or (b) any two consecutive fiscal quarters (calculated quarterly); and
- The Company shall at all times maintain trade accounts payables average age no longer than 30% above the trade accounts payables average age as at September 30, 2016, approximately 28 days (calculated quarterly).

The Company was in compliance with these covenants at April 1, 2017.

The facility bears interest at the Base Rate, as defined in the agreement, which is set at 10.0% per annum. The credit facility is comprised of an $8,000 (December 31, 2016 - $8,000) non-revolving term loan. The loan is collateralized by substantially all the assets of the Company and matures on December 2, 2020.

In conjunction with the credit facility, the Company granted the lender 600,000 warrants to purchase the equivalent number of common shares at a price of $2.75. These warrants expire on December 2, 2020 and have been assigned a fair value of $0.62 using the Black-Scholes model and have been included in the transaction costs. Key assumptions in the calculation of fair value include volatility of 41%, interest rate of 1.06% and dividend rate of nil. The warrants have been recorded at fair value net of deferred income tax of $99 to account for the temporary difference between accounting and tax treatment for the warrants.

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

6. Revenue

	13 weeks ended April 1, 2017	13 weeks ended March 26, 2016
Franchise revenue		
Royalties	$ 2,490	$ 2,451
Services and other	894	1,054
	3,384	3,505
Company-owned cafés and product sales	2,591	3,929
	$ 5,975	$ 7,434

Royalties

Royalty revenue from franchised cafés is based on agreed percentage royalty rates of the franchise location sales. Revenue is recognized on an accrual basis in accordance with the substance of the relevant agreement, provided that it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably.

Services and other

Services and other consist of initial franchise fees, renewal fees, transfer fees earned on the sale of cafés from one franchisee to another, construction administration fees, purchasing coordination fees, and other ancillary fees (such as IT support and training fees).

Company-owned cafés and product sales

Company owned cafés and product sales revenue includes the sale of goods from Company-owned cafés, as well as products sold in grocery stores through wholesale distribution channels and third party licensing agreements.

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

7. Operating costs and expenses

	13 weeks ended April 1, 2017	13 weeks ended March 26, 2016
Company owned cafés and cost of product sales		
Cost of product sales	$ 974	$ 1,530
Labour and related expenses	933	1,424
Occupancy and other	989	1,408
Depreciation of property and equipment	85	106
Loss on disposal of assets	26	4
	3,007	4,472
Franchise		
Labour and related expenses	1,050	1,086
Travel and franchisee meetings	104	294
Professional fees and other	382	638
	1,536	2,018
General and administrative		
Labour and related expenses	503	423
Professional fees and other	835	847
Occupancy	119	112
Depreciation and amortization	290	295
	1,747	1,677
	$ 6,290	$ 8,167

8. Interest and financing

	13 weeks ended April 1, 2017	13 weeks ended March 26, 2016
Interest expense	$ 207	$ 30
Amortization of deferred financing costs	62	6
Interest income	(11)	(9)
	$ 258	$ 27

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

9. Basic and diluted loss per share

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

	13 weeks ended April 1, 2017	13 weeks ended March 26, 2016
Net loss	$ (475)	$ (606)
Weighted average number of shares issued and outstanding	12,830,945	12,830,945
Basic and diluted loss per share	$ (0.04)	$ (0.05)

10. Supplemental cash flow information

Changes in non-cash working capital & other (inflow (outflow)):	13 weeks ended April 1, 2017	13 weeks ended March 26, 2016
Trade and other receivables	$ 864	$ 752
Inventories	10	37
Prepaid expenses and other assets	(424)	134
Accounts payable and accrued liabilities	627	(1,006)
Provisions	(675)	(410)
Other liabilities	88	(53)
Gift card liability	(510)	(530)
Deposits from franchisees and restricted cash	(366)	3
Income taxes	45	-
	$ (341)	$ (1,073)
Cash payments for capital expenditures		
Cash payments for capital expenditures	$ (33)	$ (19)
Cash payments for intangible assets	(140)	(63)
	$ (173)	$ (82)
Supplementary information		
Interest paid	$ 206	$ 65

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

11. Restricted cash

The Company has established certain accounts that have been classified as restricted cash primarily representing: a) deposits from franchisees for the cost of constructing a new café or the renovation of an existing café, b) funds contributed for use in advertising and promotional programs where the Company is acting as an agent on behalf of the Co-op Fund, and c) a deposit held by the Company's bank as security for cash management services.

		April 1, 2017		**December 31, 2016**
Development Fund	$	1,359	$	1,220
Co-op Fund		302		487
Security Deposit held by bank		240		240
Total Restricted Cash	$	1,901	$	1,947

A summary of activities in the Co-op Fund is provided as follows:

		13 weeks ended April 1, 2017		**13 weeks ended March 26, 2016**
Co-op Fund – opening balance	$	487	$	319
Contributions by franchisees		586		526
Contributions by Company for Company-owned cafés		106		40
Payments to third party suppliers for goods and services		(877)		(760)
Repayments to Company in respect of promissory notes		-		(89)
Co-op Fund – closing balance	$	302	$	36

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

12. Contingencies, commitments and guarantees

The Company has lease commitments for Company-operated cafés and acts as the head tenant on most leases, which it in turn subleases to franchisees. To the extent the Company may be required to make rent payments due to head lease commitments, a provision has been recognized. The Company's lease commitments as at April 1, 2017 are as follows:

	Head lease commitments	Sublease to franchisees	Net
March 31, 2018	$ 18,309	$ 16,008	$ 2,301
March 30, 2019	16,629	14,376	2,253
March 28, 2020	14,671	12,551	2,120
March 27, 2021	12,428	10,545	1,883
March 26, 2022	10,783	9,039	1,744
Thereafter	30,535	25,136	5,399
	$ 103,355	$ 87,655	$ 15,700

The Company believes it will have sufficient resources to meet the net commitment of $15,700 over the term of the leases.

The Company is involved in litigation and other claims arising in the normal course of business. Judgment must be used to determine whether or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent on the potential success of the claim. It is believed that no significant losses or expenses will be incurred with such claims. However, there can be no assurance that unforeseen circumstances will not result in significant costs. The outcome of these actions is not determinable at this time, and adjustments, if any, will be recorded in the period of settlement.

Contracts are in place with third party companies to purchase the coffee that is sold in all cafés. In terms of these supply agreements, there is a guaranteed minimum volume of coffee purchases of $1,136 USD (March 26, 2016 - $1,780 USD) for the subsequent 12 months. The coffee purchase commitment is comprised of two components: unapplied futures commitment contracts and fixed price physical contracts.

Due to the Company acting as the primary coordinator of café construction costs on behalf of its franchisees and for Company-operated cafés, there is $648 (March 26, 2016 - $496) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the quarter. Construction costs financed for franchise projects are from deposits received from franchisees and for corporate projects from the Company's cash flows.

13. Related parties

Related parties are identified as key management, members of the Board of Directors and shareholders that effectively exercise significant influence over the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties. There were no related party transactions in the reporting period.