SECOND CUP COFFEE CO.™

The Second Cup Ltd.

Audited Financial Statements

For the 53 weeks ended December 31, 2016
and 52 weeks ended December 26, 2015

February 24, 2017

Independent Auditor's Report

To the Shareholders of
The Second Cup Ltd.

We have audited the accompanying financial statements of The Second Cup Ltd., which comprise the statements of financial position as at December 31, 2016 and December 26, 2015 and the statements of operations and comprehensive loss, statements of changes in shareholders' equity and statements of cash flows for the fifty-three and fifty-two week periods then ended, respectively, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (IFRS), and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements present fairly, in all material respects, the financial position of The Second Cup Ltd. as at December 31, 2016 and December 26, 2015 and its financial performance and its cash flows for the fifty-three and fifty-two week periods then ended, respectively, in accordance with International Financial Reporting Standards.

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Chartered Professional Accountants, Licensed Public Accountants

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The Second Cup Ltd.

Statements of Financial Position
As at December 31, 2016 and December 26, 2015
(Expressed in thousands of Canadian dollars)

		2016		2015
ASSETS				
Current assets				
Cash and cash equivalents	$	3,004	$	3,080
Restricted cash (note 22)		1,947		840
Trade and other receivables (note 6)		3,023		3,434
Notes and leases receivable (note 7)		139		120
Inventories (note 8)		200		229
Prepaid expenses and other assets		251		427
Income tax receivable		532		687
		9,096		8,817
Non-current assets				
Notes and leases receivable (note 7)		173		268
Property and equipment (note 9)		3,434		4,761
Intangible assets (note 10)		32,611		32,639
Total assets	$	45,314	$	46,485
LIABILITIES				
Current liabilities				
Accounts payable and accrued liabilities (note 11)	$	3,700	$	5,360
Provisions (note 12)		1,598		1,655
Other liabilities (note 13)		217		534
Gift card liability		3,484		3,554
Deposits from franchisees		1,243		701
		10,242		11,804
Non-current liabilities				
Provisions (note 12)		530		982
Other liabilities (note 13)		267		314
Long-term debt (note 14)		7,181		5,977
Deferred income taxes (note 19)		3,818		3,481
Total liabilities		22,038		22,558
SHAREHOLDERS' EQUITY		23,276		23,927
Total liabilities and shareholders' equity	$	45,314	$	46,485

Contingencies, commitments and guarantees (note 23)
See accompanying notes to financial statements.

Approved by the Directors February 24, 2017

Michael Bregman, Director Rael Merson, Director

The Second Cup Ltd.

Statements of Operations and Comprehensive Loss
For the periods ended December 31, 2016 and December 26, 2015
(Expressed in thousands of Canadian dollars, except per share amounts)

		2016		2015
Revenue (note 15)				
Company-owned cafés and product sales	$	14,663	$	22,082
Franchise revenue		15,688		15,259
		30,351		37,341
Operating costs and expenses (note 16)				
Company-owned cafés and cost of product sales		15,681		22,382
Franchise		8,103		8,809
General and administrative		5,779		5,787
Loss (gain) on disposal of assets		225		(21)
Depreciation and amortization		1,548		1,465
		31,336		38,422
Loss from operations		(985)		(1,081)
Interest and financing (note 18)		255		457
Loss before income taxes		(1,240)		(1,538)
Recovery of income taxes (note 19)		(265)		(385)
Net loss and comprehensive loss for the period	$	(975)	$	(1,153)
Basic and diluted loss per share (note 20)	$	(0.08)	$	(0.09)

See accompanying notes to financial statements.

The Second Cup Ltd.

Statements of Changes in Shareholders' Equity
For the periods ended December 31, 2016 and December 26, 2015
(Expressed in thousands of Canadian dollars)

	Share Capital	Warrants	Contributed Surplus	Retained Earnings (Deficit)	Total
Balance - December 27, 2014	$ 8,652	$ -	$ 61,650	$ (45,308)	$ 24,994
Net loss for the period	-	-	-	(1,153)	(1,153)
Stock option plan expense (note 24)	-	-	86	-	86
Balance - December 26, 2015	$ 8,652	$ -	$ 61,736	$ (46,461)	$ 23,927
Net loss for the period	-	-	-	(975)	(975)
Stock option plan expense (note 24)	-	-	53	-	53
Issuance of warrants (note 14)	-	271	-	-	271
Balance - December 31, 2016	$ 8,652	$ 271	$ 61,789	$ (47,436)	$ 23,276

See accompanying notes to financial statements.

The Second Cup Ltd.

Statements of Cash Flows

For the periods ended December 31, 2016 and December 26, 2015

(Expressed in thousands of Canadian dollars)

	2016	2015
CASH PROVIDED BY (USED IN)		
Operating activities		
Net loss for the period	$ (975)	$ (1,153)
Items not involving cash		
Depreciation of property and equipment	1,168	1,091
Amortization of intangible assets	403	374
Share-based compensation expense	53	86
Deferred income taxes (note 19)	238	211
Loss (gain) on disposal of capital related items	225	(21)
Change in fair value of interest rate swap (note 5)	(77)	4
Changes in non-cash working capital & other (note 21)	(2,288)	(1,177)
Cash used in (provided by) operating activities	(1,253)	(585)
Investing activities		
Proceeds from disposal of capital related items	334	497
Cash payments for capital expenditures (note 21)	(382)	(1,942)
Cash payments for intangible assets (note 21)	(393)	(733)
Notes receivable repayment (issuance)	76	(5)
Cash used in investing activities	(365)	(2,183)
Financing activities		
Repayment of term loan (note 14)	(6,000)	(5,000)
Repayment of swap (note 5)	-	(70)
Proceeds from new term loan	8,000	-
Transaction costs	(458)	-
Cash provided by (used in) financing activities	1,542	(5,070)
Increase (decrease) in cash and cash equivalents during the period	(76)	(7,838)
Cash and cash equivalents - Beginning of the period	3,080	10,918
Cash and cash equivalents - End of the period	$ 3,004	$ 3,080

See accompanying notes to financial statements. Supplemental cash flow information is provided in note 21.

Information on non-cash transactions and supplemental cash flow information are described further in notes 5, 14 and 21, respectively.

1. Organization and nature of business

The Second Cup Ltd. ("Second Cup" or "the Company") is a Canadian specialty coffee retailer with 294 (2015 - 310) cafés operating under the trade name Second Cup™ in Canada, of which 22 (2015 - 32) are Company-operated and the balance operated by franchisees.

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

The Company was incorporated under the Business Corporations Act (Ontario) in 2011 and is domiciled in Canada. The address of its registered office and principal place of business is 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8. The Company hereafter 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

The financial statements (the "financial statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The financial statements have been prepared on the historical cost basis except for certain financial instruments that are measured at fair values at the end of each reporting period. The Company's functional currency is the Canadian dollar.

The Company's fiscal year follows the method implemented by many retail entities, such that each quarter will consist of 13 weeks and will end on the Saturday closest to the calendar quarter end. The fiscal year is made up of 52 or 53-week periods ending on the last Saturday of December. Fiscal 2016 is a 53-week period (2015 - 52 weeks).

The Company manages an advertising and co-operative fund (the "Co-op Fund") established to collect and administer funds contributed for use in advertising and promotional programs, and initiatives designed to increase sales and enhance the reputation of the Second Cup brand. Contributions to the Co-op Fund are required to be made from both franchised and Company-operated cafés and are based on a percentage of café sales. The revenue, expenses and cash flows of the Co-op Fund are not consolidated, but are netted on the Statement of Financial Position in accounts payable if there is a surplus, or in accounts receivable if there is a deficit to the extent that the Company will recover the deficit from franchisees. The assets and liabilities of the Co-op Fund are included in the assets and liabilities of the Company on the Statements of Financial Position. The policy is established because the contributions to the Co-op Fund are segregated, designated for a specific purpose and the Company is acting as an agent. Since the decisions as to the content and nature of the marketing campaigns are made solely by a body made up of six franchisees elected by their peers and includes representation from each region of our network (the "Advisory Council") and fulfilled by third parties, the Company does not have the primary responsibility for completing marketing campaigns using the Co-op Fund contributions provided by each franchisee.

2. Summary of significant accounting policies (continued)

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 cafes, the sale of goods through retail and other ancillary channels, and other service fees.

Management is organized based on the Company's operations as a whole rather than the specific revenue streams.

c. Critical accounting estimates, assumptions and the use of judgement

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

Estimates

The following are examples of critical estimates, assumptions and judgements the Company makes in determining the amounts reported in the financial statements:

- the determination of the recoverable amounts of tangible and intangible assets subject to depreciation, amortization, or with indefinite lives;
- the derivation of income tax assets and liabilities;
- the estimated useful lives of assets;
- café lease provisions and restructuring charges; and
- the allowance for doubtful accounts.

Use of judgement

The following discusses the critical judgements and accounting estimates that the Company has made in the preparation of the financial statements:

(i) Impairment charges

Impairment analysis is an area involving management judgement in determining the recoverable amount of an asset. The recoverable amount of a cash generating unit ("CGU") is calculated as the higher of the fair value less costs of disposal, and its value in use. Fair value is determined by estimating the net present value of future cash flows derived from such assets using cash flow projections that have been discounted at an appropriate rate and based on a market participant's view. In calculating the net present value of the future cash flows, certain assumptions are required to be made in respect of highly uncertain matters including:

- growth in total revenue;
- change and timing of cash flows such as the increase or decrease of expenditures;
- selection of discount rates to reflect the risks involved; and
- applying judgement in cash flows specific to CGUs.

2. Summary of significant accounting policies (continued)

c. Critical accounting estimates, assumptions and the use of judgement (continued)

(i) Impairment charges (continued)

Changing the assumptions selected by management, in particular the discount rate and the growth rate used in the cash flow projections, could significantly affect the impairment evaluations and recoverable amounts.

The Company's impairment tests include key assumptions related to the scenarios discussed above. Further details are provided in note 17 to the financial statements.

(ii) Deferred income taxes

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

(iii) Estimated useful lives

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

(iv) Café lease provisions

Café lease provisions are based on the evaluation of the likelihood and measurement of settlements, temporary payouts, or sub-leasing. Management works with landlords, franchisees and uses previous experience to obtain adequate information needed to make these assessments.

(v) Allowance for doubtful accounts

The allowance for impairment of trade and other receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivable. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in expenses in the statement of operations and comprehensive loss. When an account is deemed uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are recognized as a recovery in expenses in the statement of operations and comprehensive loss.

d. Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when obligations are discharged, cancelled or they expire.

Financial assets and liabilities are offset and the net amount reported in the Statements of Financial Position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. Hedge accounting is not used.

2. Summary of significant accounting policies (continued)

d. Financial instruments (continued)

On recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

Financial instrument	Categorization	Recognition method
Financial assets		
Cash and cash equivalents	Loans and receivables	Amortized cost
Restricted cash	Loans and receivables	Amortized cost
Trade and other receivables	Loans and receivables	Amortized cost
Notes and leases receivable	Loans and receivables	Amortized cost
Financial liabilities		
Interest rate swap	Fair value through profit and loss	Fair value
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Gift card liability	Other financial liabilities	Amortized cost
Deposits from franchisees	Other financial liabilities	Amortized cost
Term credit facility	Other financial liabilities	Amortized cost

(i) Cash and cash equivalents, restricted cash, trade and other receivables, and notes and leases receivable: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at the amount expected to be received, and if necessary, less a present value discount if collection is to be expected beyond one year. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment, if necessary.

(ii) Derivative financial instruments: derivatives are used in the form of interest rate swaps to manage risks related to its variable rate long-term debt. Unrealized fair value gains and losses pertaining to the interest rate swap are included in interest income (expense).

(iii) Transaction costs: Long-term debt is accounted for at fair value, net of any transaction costs incurred and, subsequently, at amortized cost using the effective interest method. Transaction costs associated with instruments recognized at amortized cost are amortized over the expected life of the instrument. This classification has been selected as it results in better matching of the transaction costs with the periods benefiting from the transaction costs.

e. Cash and cash equivalents and restricted cash

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less. Restricted cash represents cash on deposit with banks that are held in trust of the Co-op Fund and Development Fund as well as $240 held as security for cash management services.

2. Summary of significant accounting policies (continued)

f. Leases receivable

The Company has entered into lease agreements acting as the lessor with certain franchisees relating to point of sale systems (“POS”). The lease term is for the major part of the economic life of the POS although the title is not transferred. Leases are recognized as finance type leases and recorded as leases receivable at an amount equal to the net investment in the lease. Leases receivable are initially recognized at the amount expected to be received, less a present value discount if collection is to be expected beyond one year. Subsequently, leases receivable are measured at amortized cost using the effective interest method less a provision for impairment.

g. Inventories

Inventories are stated at the lower of cost and net realizable value, with cost being determined on an average cost basis. Net realizable value is the estimated recoverable amount less applicable selling expenses. If carrying value exceeds net realizable amount, a write-down is recognized. The write-downs are reversed if the circumstances that caused the initial write-down no longer exist.

h. Property and equipment

Property and equipment are stated at cost less accumulated depreciation net of any impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset’s carrying value or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying value of a replaced asset is removed when replaced. Repairs and maintenance costs are charged to the Statements of Operations and Comprehensive Loss during the period in which they are incurred. Where property and equipment construction projects are of a sufficient size and duration, an amount is capitalized for the costs used to finance construction.

Depreciation is calculated using the straight-line basis as this approach best reflects consumption and benefit patterns pertaining to the asset’s use. Depreciation is charged commencing when the asset is available for use. The following rates are based on the expected useful lives of the assets:

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

i. Intangible assets

Intangible assets consist of trademarks and software, which are amortized or assessed for impairment as follows:

(i) Trademarks

Trademarks consist of trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Second Cup cafés in Canada and are recorded at the historical cost less impairment write-downs. The trademark is an indefinite life intangible asset that is tested annually for impairment or at any time an indicator for impairment exists. The trademark assets do not have continual renewal requirements nor is there any deterioration incurred due to usage. As a result of the combination of the aforementioned, the trademark assets are considered to have indefinite lives.

2. Summary of significant accounting policies (continued)

i. Intangible assets (continued)

(ii) Software

Purchased software costs are recorded at cost and are amortized commencing when the asset is available for use. Amortization is calculated using the straight-line basis as management believes this approach best reflects consumption and benefit patterns pertaining to the asset's use. The following rate is based on the expected useful life of the asset:

Software	3 to 7 years

Where software implementation projects are of a sufficient size and duration, an amount is capitalized for the costs used to finance development.

j. Provisions

Provisions are recognized when there is a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material. Evaluations are performed to identify onerous contracts and, where applicable, provisions are recorded for such contracts.

Provisions for café closures are estimates for costs expected to be incurred by the Company for operational franchise-owned cafés. Lease and other occupancy costs not expected to be fully paid by the franchisee are recorded as the Company has liability on the café head lease.

k. Other liabilities

(i) Deferred revenue

The Company has entered into several supply agreement contracts and receives allowances from certain suppliers in consideration for the café network achieving certain volume thresholds over the term of the supply agreement. Deferred revenue is amortized over the term of the supply agreements based on the proportion of volume thresholds met during the fiscal year or other rational basis.

Cash received from franchisees for the commencement of a new franchise term or a pending transfer arrangement are deferred as deposits from franchisees until the revenue recognition criteria are met.

(ii) Leasehold inducements

Leasehold inducements are amortized to rent expense on a straight-line basis over the term of the lease.

l. Income taxes

Income taxes comprise current and deferred income taxes. Income taxes are recognized in the Statements of Operations and Comprehensive Loss except to the extent that they relate to items recognized directly in equity, in which case the income tax is also recognized directly in equity. Current income taxes are the expected taxes payable on the taxable income for the period, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous periods.

2. Summary of significant accounting policies (continued)

l. Income taxes (continued)

Deferred income taxes are recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying values in the financial statements. Deferred income taxes are determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the Statements of Financial Position dates, and are expected to apply when the deferred income tax asset or liability is settled. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilized.

m. Gift card liability

The gift card program allows customers to prepay for future purchases by loading a dollar value onto their gift cards through cash or credit/debit cards in the cafés or online through credit cards, when and as needed. The gift card liability represents liabilities related to unused balances on the card net of estimated breakage. These balances are included as sales from franchised cafés, or as revenue of Company-operated cafés, at the time the customer redeems the amount in a café for products. Gift cards do not have an expiration date and outstanding unused balances are not depleted.

When it is determined the likelihood of the remaining balance of a gift card being redeemed by the customer is remote, the amount is recorded as breakage. The determination of the gift card breakage rate is based upon Company-specific historical load and redemption patterns. The 2016 analysis determined that a breakage rate of 3% was applicable to gift card sales, which is consistent with 2015 experience. Gift card breakage is recognized on a pro rata basis based on historical gift card redemption patterns. Breakage income is fully allocated to the Co-op Fund and not recorded in earnings.

n. Deposits from franchisees

The development process of a new or to be renovated café requires a deposit from a franchisee at the outset. Deposits from franchisees are applied against the cost of constructing a new café or the renovation of an existing café.

o. Revenue recognition

Revenue is recognized when it is probable that economic benefits will flow to the Company and delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other revenue related concessions.

(i) 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.

2. Summary of significant accounting policies (continued)

o. Revenue recognition (continued)

(ii) Services and other

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

(iii) 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.

p. Operating costs and expenses

(i) Company-owned cafés and cost of product sales

Company-owned cafés and cost of product sales represents the product cost of goods sold in Company-operated cafés and through the wholesale grocery channel, plus the cost of direct labour to prepare and deliver the goods to the customers in the Company-operated cafés and any occupancy related costs.

(ii) Franchise

Franchise costs represent the cost of direct labour to support the network, travel and franchisee meetings, business development initiatives as well as professional fees directly related to franchise operations.

(iii) General and administrative

General and administrative costs include labour and related expenses for head office, professional fees not directly attributable to franchise operations and occupancy costs.

q. Operating leases

Operating lease payments are recognized as an expense on a straight-line basis over the lease term. Leasehold inducements are amortized to rent expense on a straight-line basis over the lease term. For the purposes of determining the lease term, option periods are considered 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.

r. Directors' deferred share unit plan

Units granted under the Directors' deferred share unit plan have graded vesting for each month of service completed over the course of one year. Units are paid out in cash upon the termination of the director. Units are granted based on a weighted average price of the Company's shares on the five most recent days preceding the grant date. The fair value of the grants is amortized over the respective vesting period using the graded amortization method. Compensation expense is adjusted for changes in fair value of the Company's share price thereafter. Any dividends paid during the vesting period will be accrued based on the total number of units granted. Amounts recognized are recorded in general and administrative expenses.

Recorded values of the plan are presented as accounts payable and accrued liabilities in the Statements of Financial Position.

2. Summary of significant accounting policies (continued)

s. Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired.

The criteria used to determine if there is objective evidence of an impairment loss include:

- significant financial difficulty of the borrower/lessee;
- delinquencies in interest or principal payments; and
- it becomes probable that the borrower/lessee will enter bankruptcy or other financial reorganization.

If such evidence exists, an impairment loss is recognized for assets carried at amortized cost as follows:

The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's effective interest rate. The carrying value of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Notes receivable and leases receivable are assessed for impairment on an individual basis based on the ability of the debtor/lessee to make the required payments and the value of the security. When there is no longer reasonable assurance that a note receivable or lease receivable will be collected, its carrying value is reduced and a charge is recorded in operating expenses.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent years if the amount of the loss decreases and the decrease can be related objectively to an event's occurring after the impairment was recognized.

t. Impairment of non-financial assets

Property and equipment and intangible assets without indefinite lives are tested for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Assets with indefinite lives are subject to an annual impairment test or any time an impairment indicator exists. The yearend date has been selected as the mandatory annual test date.

For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of the cash inflows from their assets or group of assets, which represent a cash generating unit (CGU). The recoverable amount of each particular CGU is the higher of an asset's fair value less costs of disposal and value in use. CGUs have been determined to be as follows:

- franchising, distribution, and wholesale; and
- Company-operated cafés; each Company-operated café is considered a separate CGU.

The impairment analysis involves comparing the carrying value of the CGUs with their estimated recoverable amounts. An impairment loss is recognized for the amount by which the CGU's carrying value exceeds its recoverable amount. Impairment losses for a CGU reduce first the carrying value of any goodwill allocated to that CGU. Any remaining impairment loss is charged pro rata to the other assets in the CGU.

2. Summary of significant accounting policies (continued)

t. Impairment of non-financial assets (continued)

Impairment losses, other than goodwill impairment, are evaluated for potential reversals when events or circumstances warrant such consideration.

u. Related parties

For the purposes of these financial statements, a party is considered related to the Company if such party or the Company has the ability to, directly or indirectly, control or exercise significant influence over the other entity's financial and operating decisions, or if the Company and such party are subject to common influence. Related parties may be individuals or other entities and include members of key management of the Company. All transactions with related parties are recorded at fair value.

v. Share-based compensation

For share option awards granted as part of the stock option plan, a fair value is determined at the date of grant and that fair value is recognized in the financial statements over the vesting period. Proceeds arising from the exercise of share option awards are credited to share capital, as are the recognized grant-date fair values of the exercised share option awards. Share option awards which are determined to be settled on a net-equity basis are accounted for as equity instruments. Share option awards which are determined to be settled on a net-cash settlement basis are accounted as liability instruments. The stock option plan was introduced in May 2014 and is further discussed in note 25.

w. 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.

x. Changes in accounting policies

Recent accounting pronouncements not yet effective

- *IFRS 15, Revenue from contracts with customers ("IFRS 15")*

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

  Application of IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2018 and is to be applied using the retrospective or the modified transition approach.

2. Summary of significant accounting policies (continued)

x. Changes in accounting policies (continued)

- *IFRS 16, Leases ("IFRS 16")*

IFRS 16, Leases ("IFRS 16"), sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer ('lessee') and the supplier ('lessor'). This will replace IAS 17, Leases ("IAS 17"), and related Interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all lessees and requires a lessee to recognize right-of-use assets and lease liabilities for leases with terms of more than 12 months, unless the underlying asset is of low value, and depreciation of lease assets separately from interest on lease liabilities in the income statement.
Under IFRS 16, lessor accounting for operating and finance leases will remain substantially unchanged. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier application permitted for entities that apply IFRS 15, Revenue from Contracts with Customers. As the Company has contractual obligations in the form of operating leases under IAS 17, there may be a material increase to both assets and liabilities upon adoption of IFRS 16, and material changes to the timing of recognition of expenses associated with the lease arrangements.

The Company expects to report more detailed information including estimated quantitative effect in the Company's 2017 financial statements and is not in a position to make a reliable estimate of the impact, if any, due to the new standard in the financial statements.

3. Share capital

The Company is authorized to issue an unlimited number of common shares. Common shares are classified as equity and have no par value. Incremental costs directly attributable to the issue of new common shares are shown in equity as a deduction, net of tax, from the proceeds.

Shares outstanding at the fiscal year ended December 31, 2016 are 12,830,945 (2015 - 12,830,945).

4. Management of capital

On December 2, 2016, the Company entered into a new credit facility which replaced its facility with the Bank of Nova Scotia ("BNS"). As part of the agreement, the Company issued 600,000 warrants that granted the lender the right to purchase, in respect of each warrant, one Common Share in the capital of the Company, at a purchase price of $2.75 per Common Share, at any time up to December 2, 2020. The revised capital structure of the Company now consists of an $8,000 (2015 - $6,000) non-revolving long-term loan and $23,276 (2015 - $23,927) in Shareholders' equity, which comprises share capital, warrants, contributed surplus, and retained earnings (deficit).

The Company's objectives relating to the management of its capital structure are to:

- safeguard its ability to continue as a going concern;
- maintain financial flexibility in order to preserve its ability to meet financial obligations;

4. Management of capital (continued)

- maintain a capital structure that provides financing options to the Company when the need arises to access capital; and
- deploy capital to provide an adequate return to its shareholders.

The Company's primary uses of capital are to finance increases in non-cash working capital and capital expenditures.

5. Financial instruments and financial risk management

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

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

Fair value of financial instruments
The fair values of cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities, provisions, other liabilities and gift card liability approximate their carrying values due to their short-term maturity. The fair value of notes and leases receivable approximates their carrying value as the implicit interest used to discount the base value is considered to be based on an appropriate credit and risk rate pertaining to the debtor. The fair value of the term loan approximates its carrying value less transaction costs due to the floating interest rate of the term loan. The following table summarizes the financial instruments measured at fair value:

	2016	**2015**
Interest rate swap		
Opening fair value	$ (77)	$ (143)
Repaid during the year	-	70
Change in fair value	77	(4)
Closing fair value	$ -	$ (77)

5. Financial instruments and financial risk management (continued)

Financial instruments that are measured subsequent to initial recognition at fair value are to be categorized in Levels 1 to 3 of the fair value hierarchy, based on the degree to which the fair value is observable. The three levels of the fair value hierarchy are:

- Level 1 - inputs derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 - fair value derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value for the interest rate swap, classified as Level 2, was derived using market valuation reports provided by a tier one Canadian bank and had a fair value loss of $77 at December 26, 2015.

There were no changes between levels in the period ended December 31, 2016 versus the period ended December 26, 2015.

Credit risk

a. Cash and cash equivalents, restricted cash and interest rate swap

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

b. Trade and other receivables, notes and leases receivable

Trade and other receivables and notes and lease receivable primarily comprise amounts due from franchisees. Credit risk associated with these receivables is mitigated as a result of the review and evaluation of franchisee account balances beyond a particular age. Prior to accepting a franchisee, the Company undertakes a detailed screening process which includes the requirement that a franchisee has sufficient financing. The risk is further mitigated due to a broad franchisee base that is spread across the country, which limits the concentration of credit risk.

Other receivables may include amounts owing from large organizations where often those organizations have a simultaneous vendor relationship with the Company's franchisees. Credit risk is mitigated as a result of the Company directing and maintaining certain controls over the vendor relationship with the franchisees.

Specific bad debt provisions are accounted for when the expected recovery is less than the actual receivable.

An analysis of aging of trade and other receivables from the billing date net of an allowance for doubtful accounts is as follows:

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

5. Financial instruments and financial risk management (continued)

b. Trade and other receivables, notes and leases receivable (continued)

	0-30 Days	31-60 Days	61-90 Days	> 90 Days	Total
Gross amount as at December 31, 2016	$ 2,630	$ 173	$ 247	$ 2,163	$ 5,213
Allowance for doubtful accounts	(38)	(67)	(112)	(1,973)	(2,190)
Net amount 2016	$ 2,592	$ 106	$ 135	$ 190	$ 3,023
Gross amount as at December 26, 2015	$ 3,056	$ 169	$ 134	$ 1,809	$ 5,168
Allowance for doubtful accounts	(74)	(77)	(85)	(1,498)	(1,734)
Net amount 2015	$ 2,982	$ 92	$ 49	$ 311	$ 3,434

Trade and other receivables include a combined allowance for doubtful accounts of $2,190 (December 26, 2015 - $1,734). Credit terms vary by customer in the range of 30 to 90 days. The net amount due of $190 aged over 90 days has no specific terms of repayment. Trade and other receivables are further discussed in note 6.

The payment maturity dates of the notes and leases receivable as at December 31, 2016, net of an allowance for doubtful accounts, are as follows:

	< 90 Days	90 Days to < 1 year	1 year to < 2 years	2 years and after	Total
2016	$ 32	$ 107	$ 105	$ 68	$ 312
2015	$ 32	$ 88	$ 103	$ 165	$ 388

Notes and leases receivable included a combined allowance for doubtful accounts of $12 (December 26, 2015 - $12). Notes and leases receivable are further discussed in note 7.

Liquidity risk
Liquidity risk is managed through regular monitoring of forecast and actual cash flows, monitoring maturity dates of financial assets and liabilities, and also the management of the Company's capital structure and debt leverage ratios as outlined in note 14. The Company's main source of income is royalty receipts from its franchisees, corporate café sales, and sales from goods and services.

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

5. Financial instruments and financial risk management (continued)

b. Trade and other receivables, notes and leases receivable (continued)

Commodity and currency risk
The Company purchases certain products, such as coffee, in U.S. dollars, thereby exposing the company to risks associated with fluctuations in currency exchange rates. The Company is also directly and indirectly exposed to commodity market risk. The exposure relates to the changes in coffee commodity prices given it is a material input for product offerings. The direct exposure pertaining to the wholesale business is mitigated given that the Company has the ability to adjust its sales price if commodity prices rise over a threshold level. The indirect risk exists where franchisee profitability may be impacted, thus potentially resulting in an impeded ability to collect accounts receivable or the need for other concessions to be made to the franchisee. This risk is mitigated by entering fixed price purchase commitments through coffee commodity brokers and by having the ability to adjust retail selling prices.

6. Trade and other receivables

	2016	2015
Trade and other receivables	$ 5,213	$ 5,168
Less: Allowance for doubtful accounts	(2,190)	(1,734)
Trade and other receivables - net	$ 3,023	$ 3,434

During the period, $576 (2015 - $352 expense) was recorded as a charge pertaining to trade and other receivables.

7. Notes and leases receivable

	2016	2015
Notes receivable - current	$ 71	$ 67
Lease receivable - current	70	65
Less: Allowance for doubtful accounts - current	(2)	(12)
Notes and leases receivable - current	139	120
Notes receivable - long-term	32	33
Lease receivable - long-term	151	235
Less: Allowance for doubtful accounts - long-term	(10)	-
Notes and leases receivable - long-term	173	268
Notes and leases receivable	$ 312	$ 388

Notes and leases receivable are discounted using an effective discount rate ranging between eight and nine percent.

8. Inventories

Inventories relate to goods held for resale at the corporate cafés and are comprised of the following:

		2016		2015
Merchandise held for resale	$	161	$	181
Supplies		39		48
		200		229

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

9. Property and equipment

	Leasehold improvements	Equipment, furniture, fixtures and construction in process	Computer hardware	Total
Net carrying value				
As at December 27, 2014				
Cost	$ 2,440	$ 4,662	$ 709	$ 7,811
Accumulated depreciation	(1,106)	(1,914)	(411)	(3,431)
As at December 27, 2014	1,334	2,748	298	4,380
Additions from operations	183	1,628	131	1,942
Additions from franchise stores reacquired	-	-	-	-
Disposals - original cost	(227)	(446)	(5)	(678)
Disposals - accumulated depreciation	118	106	2	226
Capitalized to lease	-	(18)	-	(18)
Depreciation	(309)	(659)	(123)	(1,091)
As at December 26, 2015 Net carrying value	$ 1,099	3,359	303	4,761
Net carrying value				
As at December 26, 2015				
Cost	$ 2,396	$ 5,826	$ 835	$ 9,057
Accumulated depreciation	(1,297)	(2,467)	(532)	(4,296)
As at December 26, 2015	1,099	3,359	303	4,761
Additions from operations	76	236	50	362
Additions from franchise stores reacquired	-	20	-	20
Reclass of transfers from construction in process	635	(635)	-	-
Disposals - original cost	(585)	(769)	(4)	(1,358)
Disposals - accumulated depreciation	469	344	3	816
Depreciation	(336)	(689)	(142)	(1,167)
As at December 31, 2016	1,358	1,866	210	3,434
Cost	2,522	4,677	881	8,080
Accumulated depreciation	(1,164)	(2,811)	(671)	(4,646)
As at December 31, 2016	$ 1,358	$ 1,866	$ 210	$ 3,434

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

10. Intangible assets

	Trademarks	Software	Total
Net carrying value			
As at December 27, 2014			
Cost	$ 31,144	$ 1,939	$ 33,083
Accumulated amortization	-	(746)	(746)
As at December 27, 2014	31,144	1,193	32,337
Additions (acquired)	-	733	733
Disposals - original cost	-	(53)	(53)
Capitalized to lease	-	(4)	(4)
Amortization	-	(374)	(374)
As at December 26, 2015	$ 31,144	$ 1,495	$ 32,639
Cost	$ 31,144	$ 2,615	$ 33,759
Accumulated amortization	-	(1,120)	(1,120)
As at December 26, 2015	$ 31,144	$ 1,495	$ 32,639
Net carrying value			
As at December 27, 2014			
Cost	$ 31,144	$ 2,615	$ 33,759
Accumulated amortization	-	(1,120)	(1,120)
As at December 26, 2015	31,144	1,495	32,639
Additions (acquired)	-	393	393
Disposals - original cost	-	(29)	(29)
Disposals - accumulated amortization	-	11	11
Amortization	-	(403)	(403)
As at December 31, 2016	$ 31,144	$ 1,467	$ 32,611
Cost	$ 31,144	$ 2,979	$ 34,123
Accumulated amortization	-	(1,512)	(1,512)
As at December 31, 2016	$ 31,144	$ 1,467	$ 32,611

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

11. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities consist of:

		2016		2015
Accounts payable - trade	$	1,825	$	2,695
Accrued liabilities		1,492		2,241
Accrued salaries, wages, benefits, and incentives		127		199
Sales tax payable - government remittances payable		256		225
	$	3,700	$	5,360

12. Provisions

		Headlease liabilities		Café leases (a)		Other (b)		Total
As at December 27, 2014	$	72	$	2,559	$	439	$	3,070
Provisions charged during the period		-		1,422		538		1,960
Provisions utilized during the period		(46)		(1,560)		(787)		(2,393)
As at December 26, 2015	$	26	$	2,421	$	190	$	2,637
Current portion	$	26	$	1,439	$	190	$	1,655
Long-term portion		-		982		-		982
As at December 26, 2015	$	26	$	2,421	$	190	$	2,637
Provisions charged during the period		-		794		186		980
Provisions utilized during the period		(26)		(1,113)		(350)		(1,489)
As at December 31, 2016	$	-	$	2,102	$	26	$	2,128
Current portion	$	-	$	1,572	$	26	$	1,598
Long-term portion		-		530		-		530
As at December 31, 2016	$	-	$	2,102	$	26	$	2,128

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

12. Provisions (continued)

a. Café leases

Provisions for café leases are estimates for costs to be incurred by the Company as a result of the following circumstances: a) closure of cafés, and b) franchisee failure to make payment of occupancy costs at an operational café.

Provisions for café closures of $794 (2015 - $1,422) were charged in the year and are reflected in the franchise line on the Statements of Operations and Comprehensive Loss.

b. Other

Provisions for other items of $186 (2015 - $538) were charged in the year. The remaining provision will be settled throughout the course of 2017.

13. Other liabilities

		2016		2015
Deferred revenue – current	$	181	$	418
Leasehold inducements - current		36		39
Interest rate swap		-		77
Other liabilities – current		217		534
Deferred revenue – long term		52		-
Leasehold inducements - long-term		215		314
Other liabilities - long-term	$	267	$	314
Deferred revenue	$	233	$	418
Leasehold inducements		251		353
Interest rate swap		-		77
Other liabilities	$	484	$	848

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

14. Long-term debt

	2016	2015
Face value of long-term debt	$ 8,000	$ 6,000
Unamortized transaction costs	(819)	(23)
	$ 7,181	$ 5,977

On December 2, 2016, the Company replaced its previous credit facility with a new facility. The new facility has a face value of $8,000, matures on December 2, 2020 (with no principal payments prior to December 2, 2020) and new financial covenants. Pursuant to the terms of the Company's new 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 December 31, 2016.

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 (2015 - $6,000) 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 new 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 unamortized 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.

15. Revenue

	2016	2015
Franchise revenue		
Royalties	$ 10,509	$ 10,553
Services and other	5,179	4,706
	15,688	15,259
Company-owned cafés and product sales	14,663	22,082
	$ 30,351	$ 37,341

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

16. Operating expenses

	2016	2015
Company-owned cafés and cost of product sales		
Cost of product sales	$ 5,795	$ 8,560
Labour and related expenses	4,873	6,869
Occupancy and other	5,013	6,953
Depreciation of property and equipment	394	474
Loss (gain) on disposal of assets	225	(21)
	16,300	22,835
Franchise		
Labour and related expenses	4,330	4,069
Travel and franchisee meetings	670	868
Business development initiatives	-	653
Professional fees and other	3,103	3,219
	8,103	8,809
General and administrative		
Labour and related expenses	2,003	1,954
Professional fees and other	3,322	3,400
Occupancy	454	433
Depreciation and amortization	1,154	991
	6,933	6,778
	$ 31,336	$ 38,422

17. Impairment of assets

a. Impairment of Trademarks

The Company's trademarks are allocated fully to the franchising, distribution, and wholesale CGU. The CGU's recoverable amount has been determined using fair value less costs of disposal.

Key assumptions

The Company uses a discounted cash flow methodology, which includes the use of estimates and assumptions that are sensitive to change and require judgement. This methodology used to test impairment is classified as Level 3 per the hierarchy described in note 5. These key judgements include estimates of discount rates, forecast growth in system sales and other estimates impacting future cash flows. Changes in these estimates and assumptions may have a significant impact on recoverable amounts. General market uncertainty and the competitive operating environment for the Company and other similar retail entities were also factors taken into account in the analysis. The changes in the market growth rates reflect the current general economic pressures now impacting the national economy.

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

Probability weighted cash flow projections are used based on financial forecasts covering a three-year period. These projections are approved by the Board of Directors based on management's expectations of potential outcomes. Cash flows beyond the three-year period are extrapolated using the estimated growth rates as stated in the table below. The valuation of the franchising, distribution, and wholesale business CGU is based on various probabilities assigned to each forecasted cash flows. The analysis performed as at December 31, 2016 does not indicate any impairment (2015 - $nil). The following are key assumptions used in the fair value less costs of disposal calculation as well as a sensitivity analysis for the various range of assumptions used and the related impact.

	2016		**2015**	
	Low growth	**High growth**	**Low growth**	**High growth**
Discount rate	12.0%	16.0%	12.0%	16.0%
Forecast same café sales avg. growth rate	-1.0%	2.5% - 4%	-1.0%	6.0-9.3%
Avg. growth rate used to extrapolate cash flows beyond the forecast period	0.0%	0.0%	0.0%	3.2%
Amount by which recoverable amount exceeds carrying amount	$4,500	$28,400	$(4,273)	$23,814

b. Corporate cafes - Impairment of leasehold improvements, equipment, furniture, fixtures, and other

Impairment indicators include when an individual Company-operated café experiences poor performance directly impacting cash flows. The impairment analysis is based on historical and forecasted performance measures for each café with impairment indicators. The asset's recoverable amount has been determined using value in use. The recoverable amount was compared to the net book value of the assets. This methodology used to test impairment is classified as Level 3 per the hierarchy described in note 5. As a result of the impairment test, impairment charges of $nil for the year ended December 31, 2016 (2015 - $nil) were recorded to assets that were not able to be redeployed to a different CGU as the carrying amount exceeded the recoverable amount. A sensitivity of 2% increase or decrease in sales for each CGU pertaining to the impacted assets would not have had an impact on the impairment recorded.

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

18. Interest and financing

	2016	2015
Interest expense	$ 259	$ 559
Amortization of deferred financing costs	31	21
Interest income	(35)	(123)
	$ 255	$ 457

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

19. Income taxes

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

		2016		**2015**
Loss before income taxes	$	(1,240)	$	(1,538)
Combined Canadian federal and provincial tax rate		26.68%		26.44%
Tax recovery at statutory rate		(331)		(407)
Increased (reduced) by following differences				
Change in tax rates		22		-
Non-deductible permanent differences		19		19
Other		25		3
Income tax recovery	$	(265)	$	(385)
Current income tax recovery	$	(503)	$	(596)
Deferred income tax expense (recovery)		238		211
Income tax recovery	$	(265)	$	(385)

The blended weighted average statutory income tax rate is an aggregate of the following:

		2016		**2015**
Basic federal rate	%	15.00	%	15.00
Weighted average provincial rate		11.68		11.44
Combined Canadian federal and provincial tax rates	%	26.68	%	26.44

The movement in deferred income tax (assets) and liabilities during the year is as follows:

		Property and equipment		**Trademarks**		**Warrants**		**Other**		**Total**
As at December 27, 2014	$	1,791		2,368		-		(889)		3,270
Charged (credited) to the income statement		153		(4)		-		62		211
As at December 26, 2015		1,944	$	2,364	$	-	$	(827)	$	3,481
Charged (credited) to the income statement		67		21		-		150		238
Charged (credited) to equity		-		-		99		-		99
As at December 31, 2016	$	2,011	$	2,385	$	99	$	(677)	$	3,818

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

20. Basic and diluted loss per share

Loss per share is based on the weighted average number of shares outstanding during the period. Share option awards and warrants to purchase shares are excluded due to anti-dilutive impact. Basic and diluted loss per share is determined as follows:

		2016		2015
Net loss	$	(975)	$	(1,153)
Weighted average number of shares issued and outstanding		12,830,945		12,830,945
Basic and diluted loss per share	$	(0.08)	$	(0.09)

21. Supplemental cash flow information

		2016		2015
Changes in non-cash working capital & other (inflow (outflow)):				
Trade and other receivables	$	411	$	592
Inventories		29		(8)
Prepaid expenses and other assets		176		58
Accounts payable and accrued liabilities		(1,658)		(651)
Provisions		(483)		(388)
Other liabilities		(282)		(103)
Gift card liability		(70)		(172)
Deposits from franchisees & change in restricted cash		(566)		(517)
Income taxes		155		12
	$	(2,288)	$	(1,177)
Cash payments for capital expenditures				
Cash payments for capital expenditures	$	(382)	$	(1,942)
Cash payments for intangible assets		(393)		(733)
	$	(775)	$	(2,675)
Supplementary information				
Interest paid	$	318	$	523
Income taxes paid	$	-	$	-

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

22. 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.

		2016		2015
Development Fund	$	1,220	$	521
Co-op Fund		487		319
Security Deposit held by bank		240		-
Total Restricted Cash	$	1,947	$	840

A summary of activities in 2016 and 2015 in the Co-op Fund is provided as follows:

		2016		2015
Co-op Fund – opening balance	$	319	$	61
Amounts contributed by franchisees		2,728		3,438
Amounts contributed by Company for Company-owned cafés		280		376
Amounts paid to third party suppliers for goods and services		(2,486)		(3,556)
Amounts repaid to Company in respect of promissory notes		(354)		-
Co-op Fund – closing balance	$	487	$	319

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

23. 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 headlease commitments, a provision has been recognized (note 12). The lease commitments, over the term of the leases, as at December 31, 2016 are as follows:

	Headlease commitments	Sublease to franchisees	Net
December 30, 2017	$ 17,792	$ 15,793	$ 1,999
December 29, 2018	15,960	13,970	1,990
December 28, 2018	13,994	12,089	1,905
December 26, 2020	11,584	9,927	1,657
December 25, 2021	9,822	8,348	1,474
Thereafter	27,423	22,545	4,878
	$ 96,575	$ 82,672	$ 13,903

The Company believes it has sufficient resources to meet the net commitment of $13,903 over the term of the leases.

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

Contracts are in place with third party companies to purchase the coffee that is sold in all cafés. In terms of these supply agreements, there is a guaranteed minimum value of coffee purchases of $849 USD (2015 - $2,464 USD) for the 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 $241 (2015 - $265) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the fiscal year. Construction costs financed for franchise projects are from deposits received from franchisees and for corporate projects from the Company's cash flows.

24. Related parties

Related parties are identified as key management, members of the Board of Directors and shareholders that effectively exercise significant influence on the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties.

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

Compensation of key management

Key management is defined as the senior management team and the Board of Directors. The following summarizes the compensation expense of key management personnel and the composition thereof:

	2016	2015
Salaries and short-term employee benefits	$ 2,455	$ 2,364
Termination costs	-	142
Share-based compensation	73	36
Total compensation	$ 2,528	$ 2,542

25. Share-based compensation

Stock option plan

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

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

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

The following weighted average assumptions have been used to estimate the weighted average fair value per award of $0.41 granted as of December 31, 2016:

	Assumption
Risk-free interest rate (%)	1.71
Volatility (%)	32.17
Expected term (years)	7.8

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

The table below summarizes all activity for the year ended December 31, 2016:

	Number of share options outstanding		**Weighted average share option price**
As at December 26, 2015	715,000	$	4.09
Granted	60,000		3.21
Forfeited	(105,000)		3.65
As at December 31, 2016	670,000	$	4.08
Stock option plan expense during the 52-week period		$	53

The range of exercise prices for share options outstanding at December 31, 2016 is $3.13 to $4.54. Of the share options outstanding, 204,000 share options are exercisable. The weighted average years to expiration are approximately eight years. Share award options are able to be exercised upon vesting.

26. Directors' deferred share unit plan

A summary of the status of the Company's directors' deferred share unit plan is presented below:

	Notional units		**Recorded value**
Notional units outstanding as at December 27, 2014	39,354	$	120
Deferred units granted	36,049		110
Change in fair value	-		(11)
Notional units outstanding as at December 26, 2015	75,403	$	219
Expensed in the period		$	99

	Notional units		**Recorded value**
Notional units outstanding as at December 26, 2015	75,403	$	219
Deferred units granted	36,878		110
Change in fair value	-		(90)
Notional units outstanding as at December 31, 2016	112,281	$	239
Expensed in the period		$	20

The fair value price of deferred units granted was $2.98 (2015 - $3.05).