Second Cup Reports 2014 Results, Completes Year of Restructuring and Successfully Launches Café of the Future

MISSISSAUGA, ON, March 9, 2015 /CNW/ - The Second Cup Ltd. (TSX: SCU) reported financial results today for the fourth quarter and year ended December 27, 2014.

Highlights:

- Opened "café of the future" with strong early results.
- Successfully completed major restructuring initiatives and adopted 3 year strategic plan.
- Same store sales were -3.9% for the fourth quarter and -4.7% for the full year. For the first nine weeks of 2015, same store sales improved to -1.2%.
- Net loss of $0.5 million or $0.04 per share for the quarter and $27.0 million or $2.66 per share for the year.
- Adjusted quarterly earnings of $0.3 million or $0.03 per share and $2.0 million or $0.20 per share for the year.
- Completed $8.1 million equity offering.
- Acquired 18 Toronto-area cafés from franchisees.

"As planned, 2014 was a year of transformation and great change for Second Cup as we rebuilt the foundation for long-term growth," says Ms. Alix Box, President and CEO, The Second Cup Ltd. "I am encouraged by our accomplishments. We completed all that we set out to do this past year. We streamlined the infrastructure, assembled a talented new leadership team, improved franchisee profitability, restored a collaborative and transparent relationship with franchisees, opened our café of the future and completed our three-year strategic plan to position Second Cup as the best specialty coffee company in Canada. After excluding one-time costs and write downs, the company still delivered positive cash flow. Now, with the strong support of our Board

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and our Franchisees, our revolution is poised to gain ground in 2015. We are beginning to see progress, and we look forward to building on this momentum as more Canadians fall in love with Second Cup all over again."

In early December, the company launched its innovative café of the future in Toronto featuring its new premium branding. The reaction has been very positive, instilling a new sense of excitement for Second Cup's future. Sales for the first 12 weeks have increased more than 30% compared with the prior year. Second Cup is honing the concept and then will aggressively roll it out in new and renovated stores.

An important step in the company's strategic growth plan is the introduction of greatly improved premium baked goods that are handcrafted in local bakeries. With a focus on superior quality natural ingredients, these delicacies highlight classic recipes with a contemporary twist. The new food program has been a success in test stores and is currently being rolled out in cafés across Ontario and Quebec. The new food offering will be available in 85% of the cafés by year end.

In February, several hundred Second Cup franchisees and the Coffee Central team assembled for the company's annual convention. The feedback was extremely favourable and the new direction for the company was enthusiastically endorsed. "There is a renewed spirit and we feel inspired and optimistic about the future of Second Cup," says Harry Sidhu, a long standing Second Cup franchisee and member of the Advisory Council. "The strategic plan addresses everything that we need to do. We look forward to breathing new life into our amazing locations."

"We are very excited about 2015 and are already seeing positive results from our hard work during the last year," says Ms. Box. "For the first nine weeks of 2015, same store sales have improved to -1.2%. This is the best level in several years and we aim for further improvement. Much remains to be done. With more coffee innovation and excellence on brew, plus the upcoming launch of our loyalty program, we are on track to reinvigorate this iconic Canadian brand to once again be the best-in-class specialty coffee leader."

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FINANCIAL HIGHLIGHTS

The following table sets out selected IFRS and certain non-GAAP financial measures of the Company and should be read in conjunction with the Audited Financial Statements of the Company for the 52 weeks ended December 27, 2014.

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts)	13 weeks ended December 27, 2014	13 weeks ended December 28, 2013	52 weeks ended December 27, 2014	52 weeks ended December 28, 2013
System sales of cafés[1]	$49,427	$51,898	$182,782	$191,434
Same café sales[1]	(3.9%)	(4.3%)	(4.7%)	(3.6%)
Number of cafés - end of period	347	356	347	356
Total revenue	$8,427	$8,038	$28,172	$27,188
Gross profit	$5,647	$6,949	$20,493	$23,134
Operating expenses	$5,085	$3,771	$17,194	$15,342
Restructuring charges	-	$883	$2,166	$883
Provision for café closures	$391	$105	$1,630	$479
Impairment charges	-	$299	$29,708	$13,552
Acquisition of certain franchise cafés	$692	-	$692	-
Operating (loss) income [1]	($521)	$1,891	($30,897)	($7,122)
Adjusted EBITDA[1]	$1,068	$3,345	$4,605	$8,846
Net (loss) income and comprehensive (loss) income	($469)	$1,177	($27,032)	($7,369)
Basic and diluted earnings (loss) per share as reported[2]	($0.04)	$0.12	($2.66)	($0.74)
Adjusted basic and diluted earnings per share[1]	$0.03	$0.22	$0.20	$0.54
Total Assets - end of period	$53,449	$77,340	$53,449	$77,340
Number of weighted average common shares issued and outstanding	10,879,012	9,903,045	10,151,716	9,903,045

[1]See the section "Definitions and discussion on certain non-GAAP measures" for further analysis.
[2]Earnings per share is calculated using the weighted average number of common shares outstanding

Café network

	13 weeks ended		52 weeks ended	
	December 27, 2014	December 28, 2013	December 27, 2014	December 28, 2013
Number of cafés - beginning of period	349	351	356	360
Cafés opened	1	6	9	15
Cafés closed	(3)	(1)	(18)	(19)
Number of cafés - end of period	347	356	347	356

The Company ended the Year with thirty five (2013 - ten) Company-operated cafés.

Fourth Quarter

System sales of cafés
System sales of cafés for the 13 weeks ended December 27, 2014 were $49,427 compared to $51,898 for the 13 weeks ended December 28, 2013 representing a decrease of $2,471 or 4.8%. The decrease is attributable to decreased same café sales and to the reduced store count.

Same café sales
During the Quarter, same café sales declined by 3.9%, compared to a decline of 4.3% in the comparable Quarter of 2013. The decrease in sales is the result of a decrease in customer transactions.

Analysis of revenue
Total revenue for the Quarter was $8,427 (2013 - $8,038) and consisted of royalty revenue, revenue from sale of goods, and services and other revenue.

Royalty revenue for the Quarter was $3,067 (2013 - $3,816). The reduction in royalty revenue of $750 is primarily a result of the new royalty incentive introduced in August, as well as lower café sales, and the increased mix of corporately owned cafés. The new royalty incentive rewards cafés that display exceptional operational standards and performance with a reduced royalty charge.

Revenue from the sale of goods, which consists of revenue from Company-operated cafés and from wholesale revenue was $3,619 (2013 - $1,526). The increase of $2,093 was due to the increased number of Company-operated cafés, and to sales of branded coffee in grocery channels. The latter revenue stream commenced in January 2014 and was expanded late in the third quarter, with the launch of two new K-Cup compatible skus.

Services and other revenue for the Quarter was $1,741 (2013 - $2,696). The decrease of $955 in services and other revenue was primarily due to reduced levels of new store openings and store ownership changes. The decrease was partly offset with increased licensing revenue from the sale of Second Cup branded TASSIMO T-Discs.

Cost of goods sold
Cost of goods sold represents the product cost of goods sold in Company-operated cafés and wholesale channels, plus the cost of direct labour in the Company-operated cafés. Cost of goods sold was $2,781 (2013 - $1,089). This increase of $1,692 is due to the higher number of Company-operated cafés and the costs associated with wholesale coffee that did not exist in the prior year.

Operating expenses
Operating expenses include Coffee Central expenses and the overhead expenses of Company-operated cafés. Total operating expenses for the Quarter were $5,085 (2013 - $3,876), an increase of $1,209.

Coffee Central
Coffee Central expenses for the Quarter were $3,862 (2013 - $3,523). The $339 increase was due to more overhead expenses, mainly as a result of one-time transformation projects, depreciation, and operational provisions.

Company-operated cafés
Company-operated café expenses for the Quarter were $1,223 (2013 - $353). The $870 increase is due to the greater number of Company-operated cafés in comparison to the prior period, as well as a loss on acquisition of cafés acquired.

Provisions for café closures
Provisions for café closures were $391 (2013 - $105). The Company recorded provisions for eleven underperforming cafés for estimated lease exit costs and severances. Additional provisions were recorded in the fourth quarter relating to three underperforming cafés for estimated lease exit costs and severances. Four of these cafés were closed in 2014.

Restructuring
Restructuring charges of $nil (2013 - $883) were primarily related to severance costs in the prior year.

Impairment charges
The Company recognized $nil impairment charges in the quarter (2013 - $299).

Acquisition of certain franchise cafés
The Company acquired franchise cafés in the Quarter which resulted in a loss of $692.

Interest and financing
The Company incurred interest and financing expenses of $106 (2013 - $254). The decrease in interest and financing expenses relates to costs realized at renewal of the interest rate swap in the fourth quarter of 2013.

Income taxes (recovery)
Current income tax recovery of $201 (2013 – expense of $427) and deferred income tax expense of $42 (2013 - expense of $33) were recorded in the Quarter. Current income tax recovery relates to the loss incurred in the year.

Adjusted EBITDA
Adjusted EBITDA for the Quarter was $1,068 (2013 - $3,345). The decrease of $2,277 was caused mainly by a reduction in royalty revenue, as well as operational provisions.

Net income (loss)
The Company's net loss for the Quarter was $469 or $0.04 loss per share, compared to a net income of $1,177 or $0.12 per share in 2013. The decrease in net income of $1,646 or $0.16 per share was mainly due to closed café and operational provisions taken in the quarter as well as losses on disposal of corporate cafés vs. a gain in the prior year.

A reconciliation of net income (loss) to Adjusted EBITDA is provided in the section "Definitions and discussion of certain non-GAAP financial measures".

Year

System sales of cafés
System sales of cafés for the Year were $182,782 compared to $191,434 for 2013, representing a decrease of $8,652 or 4.5%. The decrease is attributable to decreased same café sales and to the reduced store count.

Same café sales
For the year, there was a decline of 4.7% compared to a decline of 3.6% in 2013. The nature of the decrease is consistent to what was discussed above in the Quarter.

Analysis of revenue
Total revenues for the Year were $28,172 (2013 - $27,188).

Royalty revenue for the Year was $12,350 (2013 - $14,117). The reduction in royalty revenue of $1,767 was mainly a result of the new royalty incentive introduced in the third quarter, as well as lower café sales, and the mix of corporately owned cafés (35 corporately-owned this year vs. 10 last year).

Revenue from the sale of goods was $9,287 (2013 - $5,506) for the Year. The increase in revenue from the sale of goods was mainly due to the new revenue stream from branded coffee in grocery channels. The increase was also attributable to the increased number of Company-operated cafés.

Services and other revenue for the year was $6,535 (2013 - $7,565). The $1,030 decrease in services and other revenue was primarily due to lower revenues from cafe network activity as discussed above in the quarterly comments.

Cost of goods sold

Cost of goods sold was $7,679 (2013 - $4,054). The $3,625 increase relates to product costs pertaining to wholesale coffee sold in grocery channel, and the greater number of Company-operated cafés active during the period.

Operating expenses

Total operating expenses for the year were $17,194 (2013 - $15,342), an increase of $1,852.

Coffee Central
Coffee Central expenses for the year were $14,307 (2013 - $13,581). The $726 increase relates mainly to provisions for operational expenses.

Company-operated cafés
Company-operated café expenses for the year were $2,887 (2013 - $1,761). The increase is due to the larger number of Company-operated cafés, as well as a loss on acquisition of cafés in the fourth quarter.

Restructuring
Restructuring charges of $2,166 (2013 - $883) were primarily related to severance costs during the first half of the fiscal year.

Provision for café closures
Provisions for café closures were $1,630 (2013 - $479). The Company recorded provisions for eleven underperforming cafés for estimated lease exit costs and severances. Four of these cafés were closed in the period.

Impairment charges
The Company incurred impairment charges of $29,708 (2013 - $13,552). During the third quarter of 2014 the Company recognized an impairment charge of $29,658 to its trademark assets. The impairment charge had no impact on the Company's liquidity, cash flow, borrowing capability or operations. The remaining $50 related to an impairment of property and equipment.

Acquisition of certain franchise cafés
The Company acquired franchise cafés which resulted in a loss of $692, as discussed for the Quarter.

Interest and financing
The Company incurred interest and financing expenses of $478 (2013 - $516). The decrease in interest and financing expenses was discussed above in the Quarter.

Income taxes (recovery)
Current income taxes recovery of $339 (2013 – expense of $1,503) and deferred income tax recoveries of $4,004 (2013 - $1,772) were recorded in the Year. The decline in current taxes is consistent with the discussion above in the Quarter. The income tax recoveries pertaining to deferred income taxes were driven by the impairment charges discussed above.

Adjusted EBITDA
Adjusted EBITDA for the Year was $4,605 (2013 - $8,846). The decrease of $4,241 was driven mostly by a decrease in royalty revenue, as well as retail listing fees incurred and provisions for operational expenses.

Net loss
The Company's net loss for the Year was $27,032 or $2.66 loss per share, compared to net loss of $7,369 or $0.74 loss per share in 2013. The unfavorable change in net loss of $19,663 or $1.92 per share was mainly due to impairment charges, restructuring charges, retail listing fees incurred, and reduced royalty revenue. This was offset partially by the margin realized in the current year from the wholesale of coffee in the grocery channel.

A reconciliation of net loss to adjusted EBITDA is provided in the section "Definitions and discussion of certain non-GAAP financial measures".

Dividend
As Second Cup transforms towards a new era of growth in sales and profitability, the Company is seeing the emergence of attractive opportunities to invest capital. Accordingly, the Company believes it is prudent to retain available cash resources for redeployment into investments that will maximize long-term growth in share value. Given this renewed focus on growth, the Board of Directors decided to continue the dividend suspension announced with the release of the second quarter 2014 results.

SELECTED QUARTERLY INFORMATION

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts)	Q4 2014[2]	Q3 2014	Q2 2014	Q1 2014
System sales of cafés[1]	$49,427	$43,596	$45,829	$43,930
Same café sales[1]	(3.9%)	(3.3%)	(5.0%)	(6.9%)
Number of cafés - end of period	347	349	357	357
Total revenue	$8,427	$6,686	$6,435	$6,624
Operating income (loss)[1]	($521)	($30,214)	($388)	$226
Adjusted EBITDA[1]	$1,068	$1,079	$1,516	$941
Net income (loss) for the period	($469)	($26,230)	($390)	$56
Basic and diluted earnings (loss) per share	($0.04)	($2.65)	($0.04)	$0.01
Dividends declared per share	-	-	-	$0.085
	Q4 2013[2]	**Q3 2013**	**Q2 2013**	**Q1 2013**
System sales of cafés[1]	$51,898	$44,894	$47,688	$46,954
Same café sales[1]	(4.3%)	(3.7%)	(2.2%)	(3.3%)
Number of cafés - end of period	356	351	362	361
Total revenue	$8,038	$6,268	$6,636	$6,246
Operating (loss) income[1]	$1,891	$1,361	($11,401)	$1,027
Adjusted EBITDA[1]	$3,345	$1,671[3]	$2,122	$1,334
Net (loss) income for the period	$1,177	$918	($10,152)	$688
Basic and diluted (loss) earnings per share	$0.12	$0.09	($1.03)	$0.07
Dividends declared per share	$0.085	$0.085	$0.085	$0.085

[1]See the section “Definitions and discussion on certain non-GAAP financial measures” for further analysis.
[2]The Company’s fourth quarter System sales of cafés are higher than other quarters due to the seasonality of the business (see “Seasonality of system sales of cafés” above).
[3]The Company amended its definition of Adjusted EBITDA as discussed in the section “Definitions and discussion on certain non-GAAP financial measures” to include provisions for café closures. Comparative amounts were amended in order to provide adequate comparative figures.

OUTLOOK

This section is qualified by the section “Caution Regarding Forward-Looking Statements” in this press release.

2014 was a year of transformation and great change for Second Cup. Major initiatives set out in May at the Annual General Meeting, specifically: the restructuring of Coffee Central, improvements to the franchise model, the launch of the new café of the future including new branding, and the development of the three-year plan, have been completed. Much remains to be done, but the foundation has been set and the Company is poised to gain ground in 2015.

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this news release may constitute forward looking statements within the meaning of applicable securities legislation. The terms the "company", "Second Cup", "we", "us", or "our" refer to The Second Cup Ltd. Forward looking statements include words such as "may", "will", "should", "expect", "anticipate", "believe", "plan", "intend" and other similar words. These statements reflect current expectations regarding future events and financial performance and speak only as of the date of this news release. 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 statements are based on a number of assumptions and are subject to known and unknown risks, uncertainties and other factors, many of which are beyond Second Cup's control that may cause Second Cup's actual results, performance or achievements, or those of Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The foregoing list of factors is not exhaustive, and investors should refer to the risks described under "Risks and Uncertainties" in Second Cup's Management's Discussion and Analysis ("MD&A") and Annual Information Form, which is available at www.sedar.com.

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

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

DEFINITIONS AND DISCUSSION ON CERTAIN NON-GAAP FINANCIAL MEASURES

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

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

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

Same café sales

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

Operating income (loss)

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

EBITDA and Adjusted EBITDA

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

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

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

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

A reconciliation of net income (loss) to EBITDA and Adjusted EBITDA is provided below:

	13 weeks ended		52 weeks ended	
	December 27, 2014	December 28, 2013	December 27, 2014	December 28, 2013
Net income (loss)	$ (469)	$ 1,177	$ (27,032)	$ (7,369)
Interest and financing	106	254	478	516
Income taxes (recovery)	(159)	460	(4,343)	(269)
Depreciation of property and equipment	288	206	933	749
Amortization of intangible assets	95	142	339	502
Loss (gain) on disposal of property and equipment	124	(181)	34	(197)
EBITDA	(15)	2,058	(29,591)	(6,068)
Impairment charges	-	299	29,708	13,552
Provision for café closures	391	105	1,630	479
Restructuring charges	-	883	2,166	883
Acquisition of certain franchise cafés	692	-	692	-
Adjusted EBITDA	$ 1,068	$ 3,345	$ 4,605	$ 8,846

[1]As a result of the reclassification of impairment charges discussed in note 2a of the Audited Financial Statements, adjusted earnings per share for comparative amounts were amended in order to provide adequate comparative figures.

Adjusted basic and diluted earnings per share

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

A reconciliation of adjusted basic and diluted earnings per share is provided below:

	13 weeks ended		52 weeks ended	
	December 27, 2014	December 28, 2013	December 27, 2014	December 28, 2013
Net income (loss)	$ (469)	$ 1,177	$ (27,032)	$ (7,369)
Restructuring charges	-	883	2,166	883
Provision for café closures	391	105	1,630	479
Impairment charges	-	299	29,708	13,552
Acquisition of certain franchise cafés	692	-	692	-
Tax effect of adjusting items	(287)	(302)	(5,124)	(2,157)
Adjusted earnings	327	2,162	2,040	5,388
Weighted average number of shares issued and outstanding (unrounded)	10,879,012	9,903,045	10,151,716	9,903,045
Adjusted basic and diluted earnings per share	$ 0.03	$ 0.22	$ 0.20	$ 0.54

For the 13 and 52 weeks ended December 27, 2014, there were 535,000 outstanding share option awards (13 and 52 weeks ended December 28, 2013 - nil).

About Second Cup

Founded in 1975, The Second Cup Ltd. is a Canadian specialty coffee retailer operating over 345 franchised and company owned cafes serving more than 1 million customers each week. All of the approximately 4,000 Second Cup baristas are trained coffee experts, who are committed to ensuring excellence in every cup and the very best customer experience possible. For more information, please visit www.secondcup.com or find the company on Facebook and Twitter.

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