Second Cup Reports Highest Full Year Profit in Four Years

MISSISSAUGA, ON, March 4, 2019 /CNW/ - The Second Cup Ltd. (TSX: SCU) today reported financial results for the fourth quarter ended December 29, 2018.

Highlights:

- 2018 Adjusted Net Income grew to $1,074,000 or $0.06 per share compared with $110,000 or $0.01 per share in 2017.
- Fiscal year Adjusted EBITDA was $2,930,000 compared with $2,721,000 one year ago.
- Q4 Adjusted Net Income was $594,000 or $0.03 per share compared with $655,000 or $0.04 per share in the prior year.
- Q4 Adjusted EBITDA was $1,297,000 compared with $1,339,000 last year.
- Normal course issuer bid initiated in the fourth quarter.

Fourth Quarter 2018

Same store sales declined 2.0% in Q4 and 1.2% for the full year. Adjusted EBITDA and Adjusted Net Income in the quarter were down slightly versus year ago mainly due to a reduction in café count. Full year results compared favourably with prior year – Adjusted EBITDA for the full year improved by $209,000 while Adjusted Net Income improved by $964,000 or $0.05 per share.

The company commenced a normal course issuer bid beginning December 20, 2018. Earlier in the year, following the strengthening of the balance sheet, Second Cup initiated a strategic review to examine alternatives to create shareholder value. This review is ongoing.

Garry Macdonald, Second Cup President & CEO said, "We introduced a number of initiatives throughout 2018 that have demonstrated strong potential to build sales this year including Pinkberry frozen yogurt, now in over 35% of our cafes, and delivery services like UberEats and Skip The Dishes. Additionally, 40% of our cafes have been upgraded over the last four years and Second Cup expansion continues in traditional and non-traditional formats. We continue to deliver improvement in profitability and our focus remains on growing café sales as well as enhancing our customer experience."

The Second Cup Rewards program continues to grow, representing one quarter of cafes sales at year end. Further program enhancements are planned for 2019.

New Developments

Reinventing the Second Cup brand is an on-going initiative. While progress has been made in elevating the brand, the company is actively engaged in a brand strategy review to identify and test new innovations to aggressively grow cafe sales and improve the café economic model which remain top priorities.

About Second Cup Coffee Co.™

Founded in 1975, The Second Cup Ltd. is a Canadian specialty coffee retailer operating franchised and company owned cafes across Canada. The company's vision is to be the Canadian specialty coffee brand of choice across Canada, committed to superior quality, innovation and profitable growth. For more information, please visit www.secondcup.com or find the company on Facebook and Twitter.

SOURCE The Second Cup Ltd.

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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 Consolidated Financial Statements of the Company for the 52 weeks ended December 29, 2018.

(In thousands of Canadian dollars, except same café sales, number of cafés, per share amounts, and number of common shares.)	**13 weeks ended**		**52 weeks ended**	
	December 29, 2018[2]	**December 30, 2017**	**December 29, 2018**[2]	**December 30, 2017**
System sales of cafés[1]	$38,860	$41,326	$146,697	$154,153
Same café sales[1]	(2.0%)	(1.1%)	(1.2%)	(0.2%)
Number of cafés – end of period	262	286	262	286
Total revenue	$7,176	$6,085	$25,714	$23,636
Operating costs and expenses	$6,362	$5,092	$24,342	$22,660
Operating income [1]	$814	$993	$1,372	$976
EBITDA[1]	$1,138	$1,339	$2,707	$2,434
Adjusted EBITDA[1]	$1,297	$1,339	$2,930	$2,721
Net income (loss) and comprehensive income (loss)	($55)	$655	$1,151	($3,097)
Adjusted net income (loss) and comprehensive income (loss)	$594	$655	$1,074	$110
Basic and diluted earnings (loss) per share as reported	$0.00	$0.04	$0.06	($0.21)
Adjusted basic and diluted earnings (loss) per share as reported	$0.03	$0.04	$0.06	$0.01
Total assets – end of period	$56,001	$44,700	$56,001	$44,700
Number of weighted average common shares issued and outstanding	19,940,073	17,041,473	18,920,785	14,485,081

[1]See the section "Definitions and Discussion on Certain non-GAAP Financial Measures" for further analysis.
[2]Adoption of new standard on a modified retrospective basis – Consolidated financial statements for 2018 are prepared under the new standard whereas the previous periods are on the old standard.

Fourth Quarter

System sales of cafés

System sales of cafés for the 13 weeks ended December 29, 2018 were $38,860 compared to $41,326 for the 13 weeks ended December 30, 2017 representing a decrease of $2,466 or 6.0%. The decrease in system sales of cafés is primarily due to the reduction in café count and lower transactions.

Same café sales

During the Quarter, same café sales declined 2.0%, compared to a decline of 1.1% in the comparable Quarter of 2017. The decline is primarily due to a reduction in transactions.

Analysis of revenue

Total revenue for the Quarter was $7,176 (2017 - $6,085), an increase of $1,091, consisting of Company-owned café and product sales, royalty revenue, Co-op Fund contributions, fees and other revenue. The transition to IFRS 15 on a modified retrospective basis in 2018 requires the presentation of the Co-op Fund contributions and related expenses on a gross basis. As a result, revenue for the Quarter includes Co-op Fund contributions of $855.

Company-owned cafés and product sales for the Quarter were $2,441 (2017 - $1,713), an increase of $728. The number of Company-owned cafés increased in the Quarter to 25 (2017 – 12), part of the Company's short-term effort to improve the operation and customer experience by taking back certain underperforming cafés. The Company maintains its on-going objective of reducing the number of Company-owned cafés, consistent with the Company's strategy of returning to an asset light business model.

Franchise revenue was $4,735 for the Quarter (2017 - $4,372), an increase of $363. The increase is due to the consolidation of Co-op Fund contributions of $855, offset by lower royalties and coordination fees as a result of a lower number of franchise cafés.

Operating costs and expenses

Operating costs and expenses include the costs of Company-owned cafés and product sales, franchise-related expenses, general and administrative expenses, loss/gain on disposal of assets, and depreciation and amortization. Total operating costs and expenses for the Quarter were $6,362 (2017 - $5,092), an increase of $1,269, including Co-op Fund expenses of $849.

Company-owned cafés and product sales related expenses for the Quarter were $2,852 (2017 - $1,772), an increase of $1,080. The increase in costs is due to the increase in Company-owned cafés compared to prior year.

Franchise related expenses for the Quarter were $2,021 (2017 - $1,670), an increase of $351. The increase in franchise related expenses is primarily due to the consolidation of Co-op Fund expenses of $849, offset by lower remuneration.

General and administrative expenses were $1,140 for the Quarter (2017 - $1,206), a decrease of $66. This decrease in expenses is primarily due to a reduction in remunerations and directors' fees expenses.

A loss on disposal of $25 was recognized in the Quarter (2017 - loss of $98). Gain and loss on disposal of assets are related to the franchising of Company-owned cafés to franchise partners.

Depreciation and amortization expense was $324 (2017 - $346), a decrease of $22.

EBITDA

EBITDA for the Quarter was $1,138 (2017 - $1,339), a decrease of $201. The savings in franchise and corporate expenses offset the lower franchise revenue and higher operating losses attributed to Company-owned cafés. Adjusted for non-recurring transaction costs, EBITDA for the Quarter was $1,297.

Other expenses
Other expenses for the Quarter were $885, comprised of a change in fair value of NAC warrants of $1,105 and asset impairment charges of $216, offsetting recognized income from the NAC strategic alliance of $436.

In entering into the strategic alliance with NAC, the Company received five million warrants that will expire after five years from the date of issuance. The Black-Scholes fair value of the warrants received ($2,655) was recorded in deferred income and is being recognized as other income over the life of the agreement which is 18 months.

As of December 29, 2018, the fair value of the warrants was $0.344 versus $0.565 at the end of the third quarter, resulting in a decrease to the fair value of the NAC warrants of $1,105. The change in fair value of the NAC warrants will fluctuate in accordance with the trading price of the NAC common shares.

The Company incurred impairment charges of $216 (2017 - $nil) related to an impairment of property and equipment of some Company-owned cafés.

Interest and financing income
Interest income for the Quarter was $63 compared to interest income of $5 in the same Quarter of 2017.

Net income (loss)
The Company's net loss for the Quarter was $55 or $nil per share, compared to a net income of $655 or $0.04 per share in 2017. Adjusted for extraordinary items, net income for the Quarter was $594 or $0.03 per share.

The consolidated financial statements for 2018 reflect the consolidation of the Co-op Fund under IFRS 15 whereas the condensed interim financial statements for the previous three quarters were prepared under the guidance of the previous standard.

Reconciliations of net income (loss) to EBITDA, adjusted EBITDA, adjusted net income (loss) and adjusted net income (loss) per share are provide 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 $146,697 (2017 - $154,153), a decrease of $7,456 or 4.8%. The decrease is primarily due to the reduction in café count.

Same café sales
For the Year, same café sales declined by 1.2% compared to a decline of 0.2% in 2017. The decline is primarily due to reduced transactions.

Analysis of revenue
Total revenue for the Year was $25,714 (2017 - $23,636), an increase of $2,078, consisting of Company-owned café and product sales, royalty revenue, Co-op Fund contributions, franchise fees and other revenue. The transition to IFRS 15 on a modified retrospective basis in 2018 requires the presentation of the Co-op Fund contributions and related expenses on a gross basis. As a result, revenue for the Year includes Co-op Fund contributions of $3,031.

Company-owned cafés and product sales were $7,885 (2017 - $8,562), a decrease of $677. While the Company maintains its on-going objective of reducing the number of Company-owned cafés, consistent with the Company's strategy of returning to an asset light business model, the Company took back a number of low-performing franchise cafés during the year as part of its effort to improve café operation and customer experience.

Franchise revenue was $17,829 for the Year (2017 - $15,074), an increase of $2,755. The increase is primarily due to the consolidation of Co-op Fund contributions of $3,031, offset by lower royalties and coordination fees as a result of a lower number of franchise cafés. There was also a net positive impact of $118 due to the application of the new revenue recognition standard IFRS 15.

Operating costs and expenses

Operating costs and expenses include the costs of Company-owned cafés and product sales, franchise-related expenses, general and administrative expenses, loss on disposal of assets, and depreciation and amortization. Total operating costs and expenses for the Year were $24,342 (2017 - $22,660), an increase of $1,682.

Company-owned cafés and product related expenses were $8,954 for the Year (2017 - $9,303), a decrease of $349. The decrease in costs is attributable to lower sales as compared to 2017.

Franchise related expenses were $8,961 for the Year (2017 - $5,693), an increase of $3,268. This increase in expenses is primarily driven by the inclusion of Co-op Fund expenses of $3,022, an increase in provisions for bad debts of $653 offset by savings in remuneration and other operating expenses.

General and administrative expenses were $5,064 for the Year (2017 - $6,009), a decrease of $945. This decrease in expenses is primarily due to the one-time transition costs in 2017 and reductions in remuneration, directors' fees, and IT related expenses.

A loss on disposal of assets of $28 was recognized for the Year (2017 - $197 loss). Gain and loss on disposal of assets are primarily related to the franchising of Company-owned cafés to franchise partners.

Depreciation and amortization expense was $1,335 (2016 - $1,458), a decrease of $123.

EBITDA

EBITDA was $2,707 for the Year (2017 - $2,434), an increase of $273. The increase is primarily driven by corporate expense savings offset by higher Company-owned café operating loss and bad debts. Adjusted for non-recurring transaction costs, EBITDA for the Year was $2,950 compared with $2,721 last year.

Other income and expenses

Other income for the Year was $105 (2017 - $nil), comprised of recognized income from the NAC strategic alliance of $1,256 offset by a change in fair value of NAC warrants of $935 and asset impairment charges of $216.

As of December 29, 2018, the fair value of the warrants was $0.344 each versus $0.531 each at issuance on April 12, 2018, resulting in a decrease to the fair value of the NAC warrants of $935 for the Year. The change in fair value of the NAC warrants will fluctuate in accordance with the trading price of the NAC common shares.

The Company incurred impairment charges of $216 (2017 - $nil) related to an impairment of property and equipment of some Company-owned cafés.

Interest and financing costs

Interest income was $165 for the Year compared to interest and financing costs of $3,897 in 2017. In the third quarter of 2017, one-time, non-cash financing charges of $3,290 was recognized. These charges consist of the difference between the share price of $2.60 on the Issuance Date and the agreed-to share price of $1.90, and the write-off of the unamortized portion of deferred transaction costs related to the debt.

Net income (loss)

The Company's net income for the Year was $1,151 or $0.06 per share, compared to a net loss of $3,097 or $0.21 per share in 2017. Adjusted for extraordinary items, net income for the Year was $1,074 or $0.06 per share compared to a net income of $110 or $0.01 per share in 2017.

The consolidated financial statements for 2018 reflect the consolidation of the Co-op Fund under IFRS 15 whereas the condensed interim financial statements for the previous three quarters were prepared under the guidance of the previous standard.

Reconciliations of net income (loss) to EBITDA, adjusted EBITDA, adjusted net income (loss) and adjusted net income (loss) per share are provide in the section "Definitions and Discussion of Certain non-GAAP Financial Measures".

ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

In May, 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers ("IFRS 15") a new comprehensive model for entities to use accounting for revenue arising from contracts with customers. On December 31, 2017, ("Transition Date") the Company applied IFRS 15 using the modified retrospective transition method. The consolidated financial statements for fiscal year 2018 reflect the application of IFRS 15, while the financial statements for previous periods were prepared under the guidance of the previous standard.

Franchise revenue consists of royalties, as well as initial and renewal of franchise fees, and other fees. As required under the new guidance, the Company defers the initial franchise and licensing fees and recognizes revenue over the term of the related agreement. Previously, the Company recognized initial franchise fees when all material obligations and services had been performed, which generally occurred when the franchised café opened.

The transition to IFRS 15 requires the consolidation of the Co-op Fund contributions and related expenses on a gross basis. The adoption of IFRS 15 had no net impact on the Company's cash provided by operating activities, cash used in investing activities or cash provided by financing activities during the year.

Under IFRS 15, the Company recognizes gift card breakage income proportionately as gift cards are redeemed using an estimated breakage rate based on our historical experience. Previously, the Company recognized the estimated breakage income on gift card sales on a pro rata basis based on an estimate breakage rate.

IFRS 9, Financial Instruments ("IFRS 9") replaced the incurred loss model under IAS 39 with a model on expected credit losses. Under the new standard, expected credit losses are recorded.

For further details, refer to the Audited Consolidated Financial Statements for the 52 weeks ended December 29, 2018.

DEFINITIONS AND DISCUSSION ON CERTAIN NON-GAAP FINANCIAL MEASURES

In this MD&A, the Company reports certain non-GAAP financial measures such as system sales of cafés, same café sales, operating income (loss), EBITDA, adjusted EBITDA, adjusted net income (loss) and adjusted net income (loss) per share. Non-GAAP measures are not defined under IFRS and are not necessarily comparable to similarly titled measures reported by other issuers.

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-owned 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 represent the percentage change, on average, in sales at cafés operating system-wide that have been open for more than 12 months. It is one of the key metrics the Company uses to assess its performance as an indicator of appeal to customers. Two principal factors that affect same café sales are changes in customer count 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 and financing, income taxes, and depreciation and amortization. Adjustments to EBITDA are for items that are not necessarily reflective of the Company's underlying operating performance. 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.

Adjusted net income (loss) and adjusted net income (loss) per share

Adjustments to net earnings (loss) and net earnings (loss) per share are for items that are not necessarily reflective of the Company's underlying operating performance – fair value gain/loss on NAC warrants, impact of amortization of deferred income, and asset impairments in 2018 and fair value difference on debt exchange in 2017. These measures are not defined under IFRS, although the measures are derived from input figures in accordance with IFRS. Management views these as indicators of financial performance.

Reconciliations of net income (loss) to operating income (loss), EBITDA, adjusted EBITDA, adjusted net income (loss) and adjusted net income (loss) per share are provided below:

	13 weeks ended		52 weeks ended	
	December 29, 2018[1]	December 30, 2017	December 29, 2018[1]	December 30, 2017
Net income (loss)	$ (55)	$ 655	$ 1,151	$ (3,097)
Income taxes	47	343	491	176
Interest and financing (income) costs	(63)	(5)	(165)	3,897
Other loss (income)	885	-	(105)	-
Operating income (loss)	$ 814	$ 993	$ 1,372	$ 976

	13 weeks ended		52 weeks ended	
	December 29, 2018[1]	December 30, 2017	December 29, 2018[1]	December 30, 2017
Net income (loss)	$ (55)	$ 655	$ 1,151	$ (3,097)
Income taxes	47	343	491	176
Interest and financing (income) costs	(63)	(5)	(165)	3,897
Other loss (income)	885	-	(105)	-
Depreciation of property and equipment	190	228	825	1,002
Amortization of intangible assets	134	118	510	456
EBITDA	1,138	1,339	2,707	2,434
Add impact of the following:				
Transition costs	-	-	-	287
Transaction costs and other	159	-	223	-
Adjusted EBITDA	$ 1,297	$ 1,339	$ 2,930	$ 2,721

	13 weeks ended		52 weeks ended	
	December 29, 2018[1]	December 30, 2017	December 29, 2018[1]	December 30, 2017
Net income (loss)	$ (55)	$ 655	$ 1,151	$ (3,097)
Add impact of the following:				
After-tax fair value difference on shares issued and other costs	-	-	-	3,207
After-tax other loss (income)	649	-	(77)	-
Adjusted net income (loss)	$ 594	$ 655	$ 1,074	$ 110

	13 weeks ended		52 weeks ended	
	December 29, 2018[1]	December 30, 2017	December 29, 2018[1]	December 30, 2017
Net income (loss) per share	$ 0.00	$ 0.04	$ 0.06	$ (0.21)
Add impact of the following:				
After-tax fair value difference on shares issued and other costs	-	-	-	0.22
After-tax other loss (income)	0.03	-	0.00	-
Adjusted net income (loss) per share	$ 0.03	$ 0.04	$ 0.06	$ 0.01

[1]Adoption of new standard on a modified retrospective basis – Financial statements for 2018 are prepared under the new standard whereas the previous periods are on the old standard. See the section "Changes in Accounting Policies" for further analysis.

Forward-looking information

This news release may contain forward-looking statements (within the meaning of applicable securities laws) relating to the business of the Company and the environment in which it operates. Forward-looking statements are identified by words such as "believe", "anticipate", "expect," "intend", "plan", "will", "may" and other similar expressions. These statements are based on the Company's expectations, estimates, forecasts and projections and include, without limitation, statements regarding the benefits of the debt exchange and the impact of the debt exchange on the Company's strategic plan and transformation. The forward-looking statements in this news release are based on certain assumptions, including that the Company will be able to execute its plan, including store growth in traditional and non-traditional channels. They are not guarantees of future performance and involve risks and uncertainties that are difficult to control or predict. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements, including, but not limited to, the factors discussed under the heading "Risk Factors" in the Company's annual information form available at www.sedar.com. There can be no assurance that forward-looking statements will prove to be accurate as actual outcomes and results may differ materially from those expressed in these forward-looking statements. Readers, therefore, should not place undue reliance on any such forward-looking statements. Further, a forward-looking statement speaks only as of the date on which such statement is made. The Company undertakes no obligation to publicly update any such statement or to reflect new information or the occurrence of future events or circumstances.