The Second Cup Ltd. Reports Improved Second Quarter Results

MISSISSAUGA, ON, August 3, 2018 /CNW/ - The Second Cup Ltd. ("Second Cup" or the "Company") (TSX: SCU) today reported continued improvement in financial results for the second quarter ended June 30, 2018.

Highlights:

- Net Income of $577,000 or $0.03 per share for the quarter compared with a Net Loss of $315,000 or $0.02 per share in the prior year.
- EBITDA of $537,000 compared with $230,000 in Q2 2017.
- Entered into a strategic alliance with National Access Cannabis Corp. ("NAC") to develop a network of NAC-branded recreational cannabis dispensaries initially in Western Canada, expanding to include additional provinces where legally permissible.
- Closed the short form prospectus offering, on a bought deal basis, for aggregate gross proceeds of $10,000,170.

Second Quarter 2018

EBITDA of $537,000 represents a continuing trend of positive EBITDA results for Second Cup. Q2 2018 net income includes $383,000 of contract income related to the NAC strategic agreement and $150,000 gain in fair value of the warrants to purchase 5 million NAC common shares that were issued to Second Cup as part of the NAC strategic alliance. The change in fair value of the NAC warrants will fluctuate in accordance with the trading price of the NAC common shares.

Same store sales declined by 1.0 % in Q2. The expansion of Pinkberry in Second Cup cafés across the country continues and Pinkberry is now in 77 cafes. Pinkberry continues to be a strong contributor to overall sales.

Garry Macdonald, Second Cup President & CEO said, "The continued improvement in profitability is encouraging. I am pleased with the Pinkberry roll-out, now in one third of the available locations in the chain. Growing same store sales remains a key priority and new initiatives recently introduced including UberEats have demonstrated strong potential to deliver incremental sales."

The Second Cup Coffee Co. Rewards program achieved a new milestone in May, surpassing 400,000 registered members. The popular loyalty program awards points to members for every dollar spent which can then be redeemed for free beverages and coffee beans or pods for at home brewing.

New Developments

This fall, Second Cup's Clean Label beverage menu will be extended to include the Canadian seasonal favourite line of Pumpkin Spice beverages – Latte, White Hot Chocolate and Flash Cold Brew. At the start of the year Second Cup led the Canadian coffee market with a move to Clean Label beverages which now represent approximately 85% of the beverage menu. Clean Label products contain no artificial colours, flavours, preservatives or high fructose corn syrup.

Second Cup has been assisting NAC in its applications for recreational cannabis dispensary licenses in Alberta in respect of select locations that are currently occupied by Second Cup cafés. A number of applications are currently in process in that province. In addition, Second Cup is awaiting a formal announcement from the Ontario government on any changes to the legislation governing the recreational cannabis market in Ontario. At that time, the Company will be able to assess the potential implications to its strategic alliance with NAC.

The net proceeds received by the Company from the short form prospectus offering were $9,201,000. The Company has allocated $2,100,000 of the offering proceeds to fund the Company's estimated share of conversion costs to implement the NAC strategic agreement. In addition, from time to time Second Cup is presented with potential acquisition opportunities that may complement and/or expand the existing Second Cup coffee business. The Company has allocated approximately $7,100,000 of the offering proceeds to potential future acquisitions. At this time, the Company cannot precisely estimate how much of the proceeds will be used towards such acquisitions, if any. There is no assurance that the Company will be able to identify business acquisition opportunities that meet its strategic objectives, or to the extent such opportunities are identified, that it will be able to negotiate acquisition terms that are acceptable to it.

ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

In May, 2014, the International Accounting Standards Board ("IASB") issued IFRS 15, a new comprehensive model for entities to use accounting for revenue arising from contracts with customers ("IFRS 15"). On December 31, 2017, ("Transition Date") the Company applied IFRS 15 using the modified retrospective transition method. The financial statements reflect the application of IFRS 15 beginning in 2018, while the financial statements for previous periods were prepared under the guidance of the previous standard. The details and quantitative impact of the changes are disclosed below.

Franchise revenue consists of royalties, as well as initial and renewal of franchise fees, and other fees. Our performance obligation under franchise agreements include a franchise license as well as pre-opening services including training. These obligations are highly interrelated and 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 have been performed, which generally occurred when the franchised café opened. On the Transition Date, the Company recognized an increase of $2,684 to deferred revenue, a decrease to deferred income taxes of $717 and a decrease to the retained earnings (deficit) of $1,967. For the 13 and 26 weeks ended June 30, 2018, a decrease of $48 and an increase of $45, respectively, in franchise revenue was recognized compared to the previous standards.

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 Unaudited Condensed Interim Financial Statements of the Company for the 13 and 26 weeks ended June 30, 2018 and July 1, 2017.

(In thousands of Canadian dollars, except same café sales, number of cafés, per share amounts, and number of common shares.)	**13 weeks ended**		**26 weeks ended**	
	June 30, 2018[2]	**July 1, 2017**	**June 30, 2018[2]**	**July 1, 2017**
System sales of cafés[1]	$36,213	$37,898	$72,133	$75,813
Same café sales[1]	(1.0%)	0.7%	(1.5%)	0.2%
Number of cafés - end of period	275	291	275	291
Total revenue	$5,627	$6,237	$10,524	$12,212
Operating costs and expenses	$5,414	$6,375	$10,486	$12,665
Operating income (loss)[1]	$213	($138)	$38	($453)
EBITDA[1]	$537	$230	$711	$290
Adjusted EBITDA[1]	$537	$517	$711	$577
Net income (loss) and comprehensive income (loss)	$577	($315)	$439	($790)
Basic and diluted earnings (loss) per share as reported	$0.03	($0.02)	$0.02	($0.06)
Total assets - end of period	$54,653	$43,294	$54,653	$43,294
Number of weighted average common shares issued and outstanding	18,761,522	12,830,945	17,901,497	12,830,945

[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 – 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.

OPERATIONAL REVIEW

Seasonality of system sales of cafés

The following table shows the percentage of annual system sales of cafés achieved, on average, in each fiscal reporting quarter over the last three years:

% of annual system sales of cafés	2015	2016	2017	Average
First Quarter	24.7	23.9	24.6	24.4
Second Quarter	25.0	24.6	24.6	24.7
Third Quarter	23.5	23.0	24.0	23.5
Fourth Quarter	26.8	28.5	26.8	27.4
	100.0	100.0	100.0	100.0

Historically, system sales of cafés have been higher in the fourth quarter, which includes the holiday sales periods of November and December. In 2016, Fourth Quarter contains one extra week, for a total of 14 weeks.

Café network

	13 weeks ended		26 weeks ended	
	June 30, 2018	**July 1, 2017**	**June 30, 2018**	**July 1, 2017**
Number of cafés - beginning of period	279	293	286	294
Cafés opened	3	1	3	1
Cafés closed	(7)	(3)	(14)	(4)
Number of cafés - end of period	275	291	275	291

The Company ended the Quarter with 20 (July 1, 2017 – 19) Company-owned cafés. Café closures are mainly attributable to leases that are not renewed on expiration, under-performing locations and landlord re-development of specific sites.

Second Quarter

System sales of cafés

System sales of cafés for the 13 weeks ended June 30, 2018 were $36,213 compared to $37,898 for the 13 weeks ended July 1, 2017 representing a decrease of $1,685 or 4.4%. The decrease in system sales of cafés is primarily due to the reduction in café count.

Same café sales

During the Quarter, same café sales decreased by 1.0%, compared to an increase of 0.7% in the same Quarter of 2017. The decline is primarily due to reduced transactions.

Analysis of revenue

Total revenue for the Quarter was $5,627 (2017 - $6,237), a decrease of $610, consisting of Company-owned café and product sales, royalty revenue, advertising revenue, fees and other revenue.

Company-owned cafés and product sales for the Quarter were $1,967 (2017 - $2,566), a decrease of $599. The number of Company-owned cafés increased by five in the Quarter, part of the Company's short-term effort to improve the operation and customer experience at certain cafés. The Company maintains its on-going objective of reducing the number of Company-owned café's, consistent with the Company's strategy of returning to an asset light business model.

Franchise revenue was $3,660 for the Quarter (2017 - $3,671), a decrease of $11. Franchise revenue in the Quarter includes the recognition of deferred revenue as required by IFRS 15, net impact of $48 lower than under previous standards.

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 Quarter were $5,414 (2017 - $6,375), a decrease of $961.

Company-owned cafés and product related expenses for the Quarter were $2,114 (2017 - $2,733), a decrease of $619. The decrease in costs is due to the lower average number of Company-owned cafés this year.

Franchise related expenses for the Quarter were $1,619 in the Quarter (2017 - $1,356), an increase of $263. The increase in franchise related expenses in the Quarter is primarily driven by an increase in provisions for bad debts of $136 and incentives of $111.

General and administrative expenses were $1,354 for the Quarter (2017 - $1,842), a decrease of $488. This decrease in expenses is primarily due to a reduction in director fees and other public entity costs and one-time transition costs in 2017.

A loss on disposal of assets of $3 was recognized in the Quarter (2017 - loss of $76). 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 - $368), a decrease of $44.

EBITDA

EBITDA for the Quarter was $537 (2017 - $230), an increase of $307. Adjusted for one-time transition costs of $287 incurred in the second quarter of 2017, adjusted EBITDA was $537 compared to $517.

Contract income

Contract income for the Quarter was $383. The Company entered into a strategic alliance to develop and operate a network of NAC-branded recreational cannabis dispensaries and received five million warrants that will expire after five years. The Black-Scholes fair value of the warrants received ($2,655) is being recognized as contract income over the life of the agreement which is 18 months.

Gain on fair value of warrants

The gain on fair value of warrants was $150. As of June 30, 2018, the NAC stock price was $0.96 resulting in an increase to the fair value of the warrants.

Interest and financing income (costs)

Interest income for the Quarter was $36 compared to interest and financing costs of $250 in the same Quarter of 2017. The Company became debt-free in the third quarter of 2017.

Net income (loss)
The Company's net income for the Quarter was $577 or $0.03 per share, compared to a net loss of $315 or $0.02 per share in 2017.

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

Year to date

System sales of cafés
System sales of cafés for the 26 weeks ended June 30, 2018 were $72,133 compared to $75,813 for the 26 weeks ended July 1, 2017 representing a decrease of $3,680 or 4.9%. The decrease is primarily due to the reduction in store count.

Same café sales
Year to date same café sales decreased by 1.5%, compared to an increase of 0.2% in the same period of 2017. The decline is primarily due to reduced transactions.

Analysis of revenue
Year to date total revenue was $10,524 (July 1, 2017 - $12,212) consisting of Company-owned café and product sales, royalty revenue, franchise fees and other revenue.

Year to date Company-owned cafés and product sales were $3,258 (July 1, 2017 - $5,157). The decrease in revenue of $1,899 is primarily due to the lower average number of Company-owned cafés during the period as compared to last year. 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.

Year to date franchise revenue was $7,266 (July 1, 2017 - $7,055). The increase in franchise revenue of $211 includes a net positive impact of $45 due to the application of the new revenue recognition standards.

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. Year to date total operating costs and expenses were $10,486 (July 1, 2017 - $12,665), a decrease of $2,179.

Year to date, Company-owned cafés and product related expenses were $3,622 (July 1, 2017 - $5,629), a decrease of $2,007. This decrease in costs is due to the lower average number of Company-owned cafés during the period as compared to last year.

The Company incurred franchise related expenses year to date of $3,387 (July 1, 2017 - $2,892), an increase of $495. This increase in expenses is primarily driven by an increase in provisions for bad debts of $321 and incentives of $265, offset by operational savings.

General and administrative expenses were $2,801 year to date (July 1, 2017 - $3,299), a decrease of $498. This decrease in expenses is primarily due to the one-time transition costs in 2017 and a reduction in professional fees.

Year to date, a loss on disposal of $3 was recognized (July 1, 2017 – loss of $102). Gain and loss on disposal of assets are primarily related to the franchising of Company-owned cafés to franchisees.

Depreciation and amortization expense was $673 (July 1, 2017 - $743), a decrease of $70.

EBITDA

EBITDA for the year to date was $711 compared to $290 in the same period of last year. Adjusted for one-time transition costs of $287 incurred in the second quarter of 2017, adjusted EBITDA was $711 compared to $577 in the same period of 2017. The increase in adjusted EBITDA of $134 is primarily due to improved results of Company-owned cafés.

Contract income

Year to date, contract income was $383. The Company entered into a strategic alliance to develop and operate a network of NAC-branded recreational cannabis dispensaries and received five million warrants that will expire after five years. The Black-Scholes fair value of the warrants received ($2,655) is being recognized as contract income over the life of the agreement which is 18 months.

Gain on fair value of warrants

The gain on fair value of warrants was $150. As of June 30, 2018, the NAC stock price was $0.96 resulting in an increase to the fair value of the warrants.

Interest and financing income (costs)

Interest income for the year to date was $41 compared to interest and financing costs of $508 in the same period in 2017. The Company became debt-free in the third quarter of 2017.

Net income (loss)

The Company's net income year to date was $439 or $0.02 per share, compared to a net loss of $790 or $0.06 per share in 2017.

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

SELECTED QUARTERLY INFORMATION

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts)	Q2 2018[3]	Q1 2018[3]	Q4 2017[2]	Q3 2017
System sales of cafés[1]	$36,213	$35,920	$41,326	$37,014
Same café sales[1]	(1.0%)	(2.2%)	(1.1%)	0.0%
Number of cafés - end of period	275	279	286	289
Total revenue	$5,627	$4,897	$6,085	$5,339
Operating income (loss)[1]	$213	($175)	$993	$436
EBITDA[1]	$537	$174	$1,339	$805
Adjusted EBITDA[1]	$537	$174	$1,339	$805
Net income (loss) for the period	$577	($138)	$655	($2,962)
Adjusted net income (loss) for the period[1]	$577	($138)	$655	$245
Basic and diluted earnings (loss) per share	$0.03	($0.01)	$0.04	($0.19)
Adjusted basic and diluted earnings (loss) per share[1]	$0.03	($0.01)	$0.04	$0.02
	Q2 2017	**Q1 2017**	**Q4 2016[2]**	**Q3 2016**
System sales of cafés[1]	$37,898	$37,915	$46,743	$37,717
Same café sales[1]	0.7%	(0.2%)	(1.0%)	(1.2%)
Number of cafés - end of period	291	293	294	298
Total revenue	$6,237	$5,975	$7,500	$7,656
Operating income (loss)[1]	($138)	($315)	$302	($25)
EBITDA[1]	$230	$60	$667	$357
Adjusted EBITDA[1]	$517	$60	$667	$357
Net income(loss) for the period	($315)	($475)	$147	($75)
Adjusted net income (loss) for the period[1]	($315)	($475)	$147	($75)
Basic and diluted earnings (loss) per share	($0.02)	($0.04)	$0.01	($0.01)
Adjusted basic and diluted earnings (loss) per share[1]	($0.02)	($0.04)	$0.01	($0.01)

[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]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.

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. 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 and adjusted EBITDA are provided below:

	13 weeks ended		26 weeks ended	
	June 30, 2018[1]	July 1, 2017	June 30, 2018[1]	July 1, 2017
Net income (loss)	$ 577	$ (315)	$ 439	$ (790)
Income taxes	205	(73)	173	(171)
Interest and financing (income) costs	(36)	250	(41)	508
Gain on fair value of warrants	(150)	-	(150)	-
Contract income	(383)	-	(383)	-
Operating income (loss)	$ 213	$ (138)	$ 38	$ (453)

	13 weeks ended		26 weeks ended	
	June 30, 2018[1]	July 1, 2017	June 30, 2018[1]	July 1, 2017
Net income (loss)	$ 577	$ (315)	$ 439	$ (790)
Income taxes	205	(73)	173	(171)
Interest and financing (income) costs	(36)	250	(41)	508
Gain on fair value of warrants	(150)	-	(150)	-
Contract income	(383)	-	(383)	-
Depreciation of property and equipment	200	248	423	519
Amortization of intangible assets	124	120	250	224
EBITDA	537	230	711	290
Add (deduct) impact of the following:				
One-time transition costs	-	287	-	287
Adjusted EBITDA	$ 537	$ 517	$ 711	$ 577

[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.

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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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.