

# SECOND CUP COFFEE CO.™

## The Second Cup Ltd. Reports Increased Earnings for the Fourth Quarter 2016

MISSISSAUGA, ON, February 27, 2017 /CNW/ - The Second Cup Ltd. (TSX: SCU) reported improved financial results today for the fourth quarter ended December 31, 2016.

### **Highlights:**

- EBITDA of \$667,000 compared with \$555,000 in Q4 2015. EBITDA improved progressively each quarter of 2016.
- Net Income of \$147,000 or \$0.01 per share for the quarter compared with a Net Income of \$94,000 or \$0.01 per share in Q4 of 2015.
- Full year Net Loss of \$975,000 or \$0.08 per share compared with a Net Loss of \$1,153,000 or \$0.09 per share in the prior year.
- Q4 same store sales of -1.0% or +0.3% excluding Alberta.
- Completed \$8 million refinancing with SPE Finance LLC.

“In the fourth quarter, we were pleased to successfully complete our refinancing and deliver another quarter of positive earnings,” says Ms. Alix Box, President and CEO, The Second Cup Ltd. “We remain focused on driving store sales and improving profitability for franchisees. We are testing some exciting ideas in several cafes now and are optimistic about the impact on sales as they are rolled out across the country.”

### **Fourth Quarter 2016**

Same store sales were -1.0 % in Q4 and -1.1% for the full year. Excluding Alberta same store sales rose 0.3% in the quarter and 0.2% for the full year. Ontario, Second Cup’s largest region, recorded positive same store sales in both Q4 and for the full year of 1.8% and 0.8% respectively.

The Q4 net profit was \$147,000 compared to a Q3 net loss of \$75,000. This is a continuation of the quarter over quarter improvement throughout 2016. Net loss for

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the year is \$975,000 or \$0.08 per share compared to a loss of \$1,153,000 or \$0.09 per share in 2015. The company continues to reduce the number of corporate stores through franchising to strong operators and ended the quarter at 22 down from a high of 47.

During the quarter, Second Cup entered into a 4 year, \$8 million secured term loan with SPE Finance LLC, an affiliate of Serruya Private Equity (SPE). Proceeds from the term loan were used in part to repay the company's existing \$6 million credit facility. The balance will be used for general corporate purposes. This term loan carries an interest rate of 10% and includes warrants to purchase up to 600,000 common shares at a strike price of \$2.75 per share. In addition, SPE has designated Mr. Garry MacDonald as its nominee to serve on the Second Cup board of directors. Mr. MacDonald was appointed a director effective February 24<sup>th</sup>, 2017 and will be included on management's proposed slate of directors at the company's next annual general meeting.

### **New Developments**

Second Cup celebrated a key milestone this month with the Rewards program reaching the 300,000 member mark and 25% sales penetration in under two years. Members enjoy free rewards faster by earning points with every dollar spent and through personalized bonus point offers sent by email and on the mobile app. The Rewards program continues to be a strategic priority for Second Cup.

Second Cup has a number of new initiatives in test markets that have encouraging results for sales growth. Based on successful test market results, the company recently launched a new line of "Better For You" products to meet growing customer demand for healthier options. The new menu includes smoothies made with a whole fresh banana and added benefits like flax, protein and greens. Overnight Oats and a healthy breakfast wrap with 10 grams of fat round out the introductory offering. "We are excited by the customer adoption and franchisees are enthusiastic about our plan to continue to expand the line with innovative additions," says Ms. Box.

**About Second Cup Coffee Co.™**

Founded in 1975, The Second Cup Ltd. is the largest Canadian specialty coffee retailer operating over 290 franchised and company owned cafes in Canada. The company's vision is to be the coffee brand most passionately committed to quality and innovation. For more information, please visit [www.secondcup.com](http://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 Financial Statements of the Company for the 53 weeks ended December 31, 2016.

(In thousands of Canadian dollars, except same café sales, number of cafés, per share amounts, and number of common shares.)	<b>14 weeks ended December 31, 2016</b>	<b>13 weeks ended December 26, 2015</b>	<b>53 weeks ended December 31, 2016</b>	<b>52 weeks ended December 26, 2015</b>
System sales of cafés <sup>1</sup>	\$46,743	\$46,900	\$163,738	\$174,866
Same café sales <sup>1</sup>	(1.0%)	0.2%	(1.1%)	(1.4%)
Number of cafés - end of period	294	310	294	310
Total revenue	\$7,500	\$9,636	\$30,351	\$37,341
Operating costs and expenses	\$7,199	\$9,469	\$31,336	\$38,422
Operating income (loss) <sup>1</sup>	\$301	\$167	(\$985)	(\$1,081)
EBITDA <sup>1</sup>	\$667	\$555	\$563	\$384
Net income (loss) and comprehensive income (loss)	\$147	\$94	(\$975)	(\$1,153)
Basic and diluted earnings (loss) per share as reported	\$0.01	\$0.01	(\$0.08)	(\$0.09)
Total assets - end of period	\$45,314	\$46,485	\$45,314	\$46,485
Number of weighted average common shares issued and outstanding	12,830,945	12,830,945	12,830,945	12,830,945

<sup>1</sup>See the section "Definitions and discussion on certain non-GAAP measures" for further analysis.

**SELECTED BALANCE SHEET DATA**

	<u>December 31, 2016</u>	<u>December 26, 2015</u>
Cash and Cash Equivalents	3,004	3,080
Restricted Cash	1,947	840
Total Assets	45,314	46,485
Total Debts	7,181	5,977
Total Liabilities	22,038	22,558
Total Shareholders' Equity	23,276	23,927

**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	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>Average</b>
First Quarter	24.0	24.7	23.9	24.2
Second Quarter	25.1	25.0	24.6	24.9
Third Quarter	23.9	23.5	23.0	23.5
Fourth Quarter	27.0	26.8	28.5	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***

	<b>14 weeks ended December 31, 2016</b>	<b>13 weeks ended December 26, 2015</b>	<b>53 weeks ended December 31, 2016</b>	<b>52 weeks ended December 26, 2015</b>
Number of cafés - beginning of period	298	327	310	347
Cafés opened	2	1	4	3
Cafés closed	(6)	(18)	(20)	(40)
Number of cafés - end of period	294	310	294	310

The Company ended the Year with 22 (2015 – 32) 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.

**Fourth Quarter**

***System sales of cafés***

System sales of cafés for the 14 weeks ended December 31, 2016 were \$46,743 compared to \$46,900 for the 13 weeks ended December 26, 2015 representing a decrease of \$157 or 0.3%. The decrease is attributable to the reduced store count and a decrease in same café sales, offset by inclusion of an extra week of sales.

***Same café sales***

During the Quarter, same café sales decreased by 1.0%, compared to an increase of 0.2% in the comparable Quarter of 2015. Alberta's ongoing economic downturn continued to negatively impact overall same store sales by approximately 1.3% in the Quarter.

***Analysis of revenue***

Total revenue for the Quarter was \$7,500 (2015 - \$9,636) consisting of Company-owned café and product sales, royalty revenue, franchise fees and other revenue.

Company-owned cafés and product sales for the Quarter were \$3,210 (2015 - \$5,506). The decrease in revenue of \$2,296 is attributable to the reduced Company-owned cafés count from 32 last year to 22 this Year and lower Company-branded consumer product sales, offset by inclusion of an extra week of sales.

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Reducing Company-owned cafés is consistent with the Company's strategy of returning to an asset light business model.

Franchise revenue was \$4,290 for the Quarter (2015 - \$4,130). The increase in franchise revenue of \$160 in 2016 is primarily driven by a slightly better blended royalty rate on higher franchise café sales due to an extra week, offset by fewer 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 \$7,199 (2015 - \$9,469), a decrease of \$2,270.

### ***Company-owned cafés and product sales***

Company-owned cafés and product related expenses for the Quarter were \$3,410 (2015 - \$5,678), a decrease of \$2,268. This decrease in costs is attributable to a lower number of Company-owned cafés and lower product sales as compared to 2015.

### ***Franchise***

The Company incurred franchise related expenses of \$2,006 (2015 - \$1,816). Expenses for the same period in 2015 benefited from an adjustment in the provisions for café closure costs.

### ***General and administrative***

General and administrative expenses were \$1,502 for the Quarter (2015 - \$1,565). The \$63 decrease is mainly due to reduced staff-related expenses as a result of a reduction in employee headcount.

### ***Gain and loss on disposal of assets***

A gain on disposal of \$84 was recognized in the Quarter (2015 – loss of \$22). Gain and loss on disposal of assets are primarily related to the franchising of Company-owned cafés to franchise partners.

### ***Depreciation and amortization***

Depreciation and amortization expense was \$365 (2015 - \$388).

### ***EBITDA***

EBITDA for the Quarter was \$667 compared to \$555 in 2015. The increase of \$112 is primarily due to a smaller loss attributed to the Company-owned cafés and product sales segment.

### ***Net income (loss)***

The Company's net income for the Quarter was \$147 or \$0.01 per share, compared to a net income of \$94 or \$0.01 per share in 2015.

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 \$163,738 compared to \$174,866 for 2015, representing a decrease of \$11,128 or 6.4%. The decrease is attributable to decreased same café sales as well as the reduced café count.

***Same café sales***

For the Year, same café sales declined by 1.1% compared to a decline of 1.4% in 2015. Alberta's economic downturn continued to negatively impact overall same store sales by approximately 1.3% for the Year.

***Analysis of revenue***

This analysis of revenue includes the revenue outlined in the quarterly comments above. Total revenue for the Year was \$30,351 (2015 - \$37,341).

Company-owned cafés and product sales were \$14,663 (2015 - \$22,082). The decrease of \$7,419 is attributable to the gradual reduction in the Company-owned cafés count from 32 at the end of 2015 to 22 this Year and lower Company-branded consumer product sales, offset by inclusion of an extra week of sales. Reducing Company-owned cafés is consistent with the Company's strategy of returning to an asset light business model.

Franchise revenue was \$15,688 for the Year (2015 - \$15,259). The increase in revenue of \$429 is primarily driven by a slightly better blended royalty rate on franchise café sales and fee revenue from corporate café resales, offset by fewer franchise café count in 2016.

***Operating costs and expenses***

Operating expenses include the costs outlined in the quarterly comments above. Total operating expenses for the Year were \$31,336 (2015 - \$38,422), a decrease of \$7,086.

***Company-owned cafés and product sales***

Company-owned cafés and product related expenses for the Year were \$15,682 (2015 - \$22,382), a decrease of \$6,700. The decrease in costs is mainly related to lower café operating expenses associated with the reduction of Company-owned cafés.

***Franchise***

Franchise related expenses of \$8,103 were incurred for the Year (2015 - \$8,809). The decrease of \$706 is attributable to rent-related expenses recorded during the third quarter of 2015.

***General and administrative***

General and administrative expenses were \$5,778 for the Year (2015 - \$5,787). Restructuring and severance costs were lower in the Year offset by an increase in technology costs as compared to 2015.

***Gain and loss on disposal of assets***

A loss on disposal of assets of \$225 was recognized for the Year (2015 - \$21 gain). The loss is related to the resale of Company-owned cafés.

***Depreciation and amortization***

Depreciation and amortization expense was \$1,548 (2015 - \$1,465).

***EBITDA***

EBITDA for the Year was \$563, compared to \$384 last year. The increase in 2016 over 2015 is mainly due to the improvement in the franchise business partially offset by lower earnings from Company-branded product sales.

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### Net loss

The Company's net loss for the Year was \$975 or \$0.08 loss per share, compared to a net loss of \$1,153 or \$0.09 loss per share in 2015.

A reconciliation of net loss to adjusted EBITDA is 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)	Q4 2016 <sup>2</sup>	Q3 2016	Q2 2016	Q1 2016
System sales of cafés <sup>1</sup>	\$46,743	\$37,717	\$40,207	\$39,071
Same café sales <sup>1</sup>	(1.0%)	(1.2%)	(1.3%)	(1.1%)
Number of cafés - end of period	294	298	304	307
Total revenue	\$7,500	\$7,656	\$7,761	\$7,434
Operating income (loss) <sup>1</sup>	\$301	(\$25)	(\$528)	(\$733)
EBITDA <sup>1</sup>	\$667	\$357	(\$128)	(\$332)
Net income (loss) for the period	\$147	(\$75)	(\$441)	(\$606)
Basic and diluted earnings (loss) per share	\$0.01	(\$0.01)	(\$0.03)	(\$0.05)
Dividends declared per share	-	-	-	-
	Q4 2015 <sup>2</sup>	Q3 2015	Q2 2015	Q1 2015
System sales of cafés <sup>1</sup>	\$46,900	\$41,087	\$43,715	\$43,174
Same café sales <sup>1</sup>	0.2%	(2.9%)	(3.2%)	(1.1%)
Number of cafés - end of period	310	327	339	344
Total revenue	\$9,636	\$9,270	\$9,421	\$9,014
Operating (loss) income <sup>1</sup>	\$167	(\$1,310)	(\$6)	\$68
EBITDA <sup>1</sup>	\$554	(\$924)	\$334	\$419
Net (loss) income for the period	\$94	(\$1,099)	(\$72)	(\$76)
Basic and diluted (loss) earnings per share	\$0.01	(\$0.09)	(\$0.01)	(\$0.01)
Dividends declared per share	-	-	-	-

<sup>1</sup>See the section "Definitions and discussion on certain non-GAAP financial measures" for further analysis.

<sup>2</sup>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).

## **OUTLOOK**

This section is qualified by the section “Caution Regarding Forward-Looking Statements” at the beginning of this MD&A.

The Company celebrated a key milestone in February 2017 with the Rewards program reaching the 300,000 member mark and 25% sales penetration in under two years. Members enjoy free rewards faster by earning points with every dollar spent and through personalized bonus point offers sent by email and on the mobile app. The Rewards program continues to be a strategic priority for the Company.

The Company has a number of new initiatives in test markets that have encouraging results for sales growth. Based on successful test market results, the Company recently launched a new line of “Better For You” products to meet growing customer demand for healthier options.

## **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, free cash flows, net debt, loyalty sales, operating income (loss), EBITDA, adjusted EBITDA and adjusted earnings 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.

### ***Free cash flow***

Free cash flow is calculated as operating cash flow minus capital expenditures. Free cash flow represents the cash that a company is able to generate after spending the money required to maintain or expand its asset base. Free cash flow is important because it allows the Company to pursue opportunities that enhance shareholder value.

### ***Net Debt***

Net debt refers to the total debt of the Company minus cash and cash equivalents. It does not include cash classified as restricted. Net debt is discussed at times as management believes it is a useful indicator of the Company’s ability to meet debt service and evaluate liquidity.

### ***Loyalty Sales***

Loyalty sales refers to system sales that are transacted in café through or in association with the Company’s loyalty program. Loyalty sales are defined as sales transactions through the Company’s loyalty app or sales transactions that are accompanied by the Company’s loyalty card. Management views this as useful indicator of its loyal customer base.

**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**

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.

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

	<u>14 weeks ended</u>	<u>13 weeks ended</u>	<u>53 weeks ended</u>	<u>52 weeks ended</u>
	<u>December 31, 2016</u>	<u>December 26, 2015</u>	<u>December 31, 2016</u>	<u>December 26, 2015</u>
Net income (loss)	\$ 147	\$ 94	\$ (975)	\$ (1,153)
Interest and financing	96	72	255	457
Income taxes (recovery)	59	-	(265)	(385)
Depreciation of property and equipment	268	284	1,145	1,091
Amortization of intangible assets	97	104	403	374
EBITDA	<u>\$ 667</u>	<u>\$ 554</u>	<u>\$ 563</u>	<u>\$ 384</u>