

The Second Cup Ltd.

Management's Discussion and Analysis

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Management's Discussion and Analysis ("MD&A") 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 MD&A. The MD&A 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 following are some of the factors that could cause actual results to differ materially from those expressed in the underlying forward-looking statements: competition; availability of premium quality coffee beans; the ability to attract qualified franchisees; the location of Second Cup cafés; the closure of Second Cup cafés; loss of key personnel; compliance with government regulations; potential litigation; the ability to exploit and protect the Second Cup trademarks; changing consumer preferences and discretionary spending patterns including, but not restricted to, the impact of weather and economic conditions on such patterns; reporting of system sales by franchisees; and the financial performance and financial condition of Second Cup. The foregoing list of factors is not exhaustive, and investors should refer to the risks described under "Risks and Uncertainties" below and in Second Cup's Annual Information Form, which is available at www.sedar.com.

Although the forward-looking statements contained in this MD&A 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 MD&A, 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.

INTRODUCTION

The following MD&A has been prepared as of November 2, 2018 and is intended to assist in understanding the financial performance and financial condition of The Second Cup Ltd. ("Second Cup" or the "Company") for the 13 weeks (the "Quarter") and 39 weeks ended September 29, 2018, and should be read in conjunction with the Unaudited Condensed Interim Financial Statements of the Company for the 13 weeks and 39 weeks ended September 29, 2018 and September 30, 2017, the Audited Financial Statements of the Company for the 52 weeks ended December 30, 2017, and the Annual Information Form, which are available at www.sedar.com. Past performance may not be indicative of future performance. All amounts are presented in thousands of Canadian dollars, except number of cafés, per share amounts or unless otherwise indicated and have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Company also reports certain non-IFRS 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 that are discussed in the "Definitions and Discussion of Certain non-GAAP Financial Measures" in this MD&A.

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CORE BUSINESS, STRATEGIC IMPERATIVES, AND KEY PERFORMANCE DRIVERS

Core business

Second Cup is a Canadian specialty coffee retailer with 270 cafés operating under the trade name Second Cup™ in Canada, of which 24 are Company owned and the balance are operated by franchisees. Further discussion of the Company's core business was described in the 2017 annual MD&A.

Strategic imperatives and key performance drivers

Second Cup's vision of being the coffee brand most passionately committed to quality and innovation will drive management's strategies and actions going forward. Coffee will be at the core of the offering supported by ongoing food and beverage innovation.

As the Canadian specialty coffee company, bringing the best coffees in the world to customers is at the core of the brand and fundamental to redefining Second Cup as the coffee brand most passionately committed to quality and innovation. In January 2018, Second Cup announced a move to Clean Label beverages, with a commitment to eliminate artificial colours and flavours, preservatives and high fructose corn syrup from all beverages on the menu.

On April 12, 2018, the Company and National Access Cannabis Corp. ("NAC") established a strategic alliance to develop and operate a network of NAC-branded recreational cannabis dispensaries initially across Western Canada, expanding to include additional provinces where legally permissible. NAC will apply for licences to dispense cannabis products and upon receipt, work with Second Cup and applicable franchisees to leverage Second Cup's extensive Canadian retail footprint to construct retail stores carrying leading cannabis products.

In September 2017, Second Cup obtained category exclusive licence right from Pinkberry Canada Inc. and began rolling out the Pinkberry Frozen Yogurt program in Second Cup cafés.

The Company is encouraged by its progress in franchising corporate stores to strong operators, returning to an asset light business model, and expects to make further reductions in the number of Company-owned cafés in 2018.

CAPABILITIES

This section documents factors that affect the Company's capabilities to execute strategies, manage key performance drivers and deliver results. This section is qualified by the section "Caution Regarding Forward-Looking Statements" at the beginning of this MD&A.

The Company's capabilities specific to the Second Cup brand, café of the future, our people, product, locations, competition and technology were discussed in the 2017 annual MD&A.

Liquidity, capital resources and management of capital

On April 17, 2018, the Company entered into an agreement with Clarus Securities Inc. (the "Underwriter"), pursuant to which the Underwriter agreed to purchase, on a "bought deal" basis, 2,898,600 common shares of the Company at a price of \$3.45 per share for aggregate gross proceeds to the Company of \$10,000 (the "Offering"). The Offering closed on May 8, 2018, with the Company receiving aggregate gross proceeds of \$10,000.

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On August 10, 2017, the Company issued 4,210,528 common shares and 300,000 warrants of Second Cup to the four shareholders of SPE Finance LLC ("SPE"), an affiliate of Serruya Private Equity. The Company also extinguished its \$8,000 debt to SPE and cancelled 600,000 old warrants. These transactions resulted in one-time, non-cash financing charges of \$3,290. 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.

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 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 obligations under franchise agreements include a franchise licence 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 had been performed, which generally occurred when the franchised café opened. On the Transition Date, the Company recognized an increase of \$3,118 to deferred revenue, a decrease to deferred income taxes of \$832 and a decrease to the retained earnings (deficit) of \$2,286. For the 13 and 39 weeks ended September 29, 2018, an increase of \$138 and an increase of \$183, respectively, in franchise revenue was recognized compared to the previous standards.

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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 Unaudited Condensed Interim Financial Statements of the Company for the 13 and 39 weeks ended September 29, 2018 and September 30, 2017.

(In thousands of Canadian dollars, except same café sales, number of cafés, per share amounts, and number of common shares.)	13 weeks ended		39 weeks ended	
	September 29, 2018 ²	September 30, 2017	September 29, 2018 ²	September 30, 2017
System sales of cafés ¹	\$35,704	\$37,014	\$107,837	\$112,827
Same café sales ¹	0.3%	0.0%	(0.9%)	0.1%
Number of cafés – end of period	270	289	270	289
Total revenue	\$5,937	\$5,339	\$16,461	\$17,551
Operating costs and expenses	\$5,417	\$4,903	\$15,903	\$17,568
Operating income (loss) ¹	\$520	\$436	\$558	(\$17)
EBITDA ¹	\$858	\$805	\$1,569	\$1,095
Adjusted EBITDA ¹	\$858	\$805	\$1,569	\$1,382
Net income (loss) and comprehensive income (loss)	\$766	(\$2,962)	\$1,205	(\$3,752)
Adjusted net income (loss) and comprehensive income (loss)	\$766	\$245	\$1,205	(\$545)
Basic and diluted earnings (loss) per share as reported	\$0.04	(\$0.19)	\$0.06	(\$0.28)
Adjusted basic and diluted earnings (loss) per share as reported	\$0.04	\$0.02	\$0.06	(\$0.04)
Total assets – end of period	\$55,272	\$42,631	\$55,272	\$42,631
Number of weighted average common shares issued and outstanding	19,940,073	15,236,961	18,581,022	13,632,950

¹See the section “Definitions and Discussion on Certain non-GAAP Financial Measures” for further analysis.

²Adoption 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.

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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		39 weeks ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Number of cafés – beginning of period	275	291	286	294
Cafés opened	1	1	4	2
Cafés closed	(6)	(3)	(20)	(7)
Number of cafés – end of period	270	289	270	289

The Company ended the Quarter with 24 (September 30, 2017 – 15) 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.

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Third Quarter

System sales of cafés

System sales of cafés for the 13 weeks ended September 29, 2018 were \$35,704 compared to \$37,014 for the 13 weeks ended September 30, 2017 representing a decrease of \$1,310 or 3.5%. 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 increased by 0.3%, compared to flat in the same Quarter of 2017. The improvement in same café sales is driven by the success of the Company's fruit smoothies program and Pinkberry, offset by the reduction in transactions.

Analysis of revenue

Total revenue for the Quarter was \$5,937 (2017 – \$5,339), an increase of \$598, 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 \$2,186 (2017 – \$1,692), an increase of \$494. The number of Company-owned cafés increased by four 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 cafés, consistent with the Company's strategy of returning to an asset light business model.

Franchise revenue was \$3,751 for the Quarter (2017 – \$3,647), an increase of \$104. Franchise revenue in the Quarter includes the recognition of deferred revenue as required by IFRS 15, net impact of \$138 higher 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, gain/loss on disposal of assets, and depreciation and amortization. Total operating costs and expenses for the Quarter were \$5,417 (2017 – \$4,903), an increase of \$514.

Company-owned cafés and product related expenses for the Quarter were \$2,552 (2017 – \$1,902), an increase of \$650. The increase in costs is driven by the higher average number of Company-owned cafés this year.

Franchise related expenses for the Quarter were \$1,380 in the Quarter (2017 – \$1,131), an increase of \$249. The increase in franchise related expenses in the Quarter is primarily driven by an increase in provisions for rent arrears of \$82, bad debts of \$66 and construction related expenses of \$61.

General and administrative expenses were \$1,147 for the Quarter (2017 – \$1,504), a decrease of \$357. This decrease in expenses is primarily due to reductions in remunerations, directors' fees and IT related expenses.

No gain or on disposal of assets was recognized in the Quarter (2017 – gain of \$3). Gain and loss on disposal of assets are related to the franchising of Company-owned cafés to franchise partners.

Depreciation and amortization expense was \$338 (2017 – \$369), a decrease of \$31.

EBITDA

EBITDA for the Quarter was \$858 (2017 – \$805), an increase of \$53.

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Other income

Other income for the Quarter was \$436. 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) was recognized in deferred revenue and is being recognized as other income over the life of the agreement which is 18 months.

Gain on fair value of investments in equity securities

The gain on fair value of NAC warrants was \$20. As of September 29, 2018, the NAC stock price was \$0.98 resulting in an increase to the fair value of the NAC warrants. The change in fair value of the NAC warrants will fluctuate in accordance with the trading price of the NAC common shares.

Interest and financing income (costs)

Interest income for the Quarter was \$61 compared to interest and financing costs of \$3,394 in the same Quarter of 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 Quarter was \$766 or \$0.04 per share, compared to a net loss of \$2,962 or \$0.19 per share in 2017. Adjusted for the after-tax fair value difference on shares issued and other costs of \$3,207 (\$0.21 per share) in 2017, adjusted net income was \$766 or \$0.04 per share compared to an adjusted net income of \$245 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 39 weeks ended September 29, 2018 were \$107,837 compared to \$112,827 for the 39 weeks ended September 30, 2017 representing a decrease of \$4,990 or 4.4%. The decrease is primarily due to the reduction in store count.

Same café sales

Year to date same café sales decreased by 0.9%, compared to an increase of 0.1% in the same period of 2017. The decline is primarily due to reduced transactions.

Analysis of revenue

Year to date total revenue was \$16,461 (September 30, 2017 – \$17,551) 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 \$5,444 (September 30, 2017 – \$6,849). The decrease in revenue of \$1,405 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.

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Year to date franchise revenue was \$11,017 (September 30, 2017 – \$10,702). The increase in franchise revenue of \$315 includes a net positive impact of \$183 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 \$15,903 (September 30, 2017 – \$17,568), a decrease of \$1,665.

Year to date, Company-owned cafés and product related expenses were \$6,174 (September 30, 2017 – \$7,531), a decrease of \$1,357. 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 \$4,767 (September 30, 2017 – \$4,023), an increase of \$744. This increase in expenses is primarily driven by an increase in provisions for bad debts of \$471 and remuneration of \$325.

General and administrative expenses were \$3,948 year to date (September 30, 2017 – \$4,803), a decrease of \$855. 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.

Year to date, a loss on disposal of \$3 was recognized (September 30, 2017 – loss of \$99). Gain and loss on disposal of assets are primarily related to the franchising of Company-owned cafés to franchisees.

Depreciation and amortization expense was \$1,011 (September 30, 2017 – \$1,112), a decrease of \$101.

EBITDA

EBITDA for the year to date was \$1,569 compared to \$1,095 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 \$1,569 compared to \$1,382 in the same period of 2017. The increase in adjusted EBITDA of \$187 is primarily driven by operational efficiencies.

Other income

Year to date, other income was \$819 from the amortization of deferred revenue from the NAC agreement.

Gain on fair value of investments in equity securities

The gain on fair value of NAC warrants was \$170. As of September 29, 2018, the NAC stock price was \$0.98 resulting in an increase to the fair value of the NAC warrants. The change in fair value of the NAC warrants will fluctuate in accordance with the trading price of the NAC common shares.

Interest and financing income (costs)

Interest income for the year to date was \$102 compared to interest and financing costs of \$3,902, in the same period 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.

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Net income (loss)

The Company's net income year to date was \$1,205 or \$0.06 per share, compared to a net loss of \$3,752 or \$0.28 per share in 2017. Adjusted for the after-tax fair value difference on shares issued and other costs of \$3,207 (\$0.24 per share) in 2017, adjusted net income was \$1,205 or \$0.06 per share compared to an adjusted net loss of \$545 or \$0.04 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".

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SELECTED QUARTERLY INFORMATION

(in thousands of Canadian dollars, except
Number of cafés, Same café sales, and per
share amounts)

	Q3 2018 ³	Q2 2018 ³	Q1 2018 ³	Q4 2017 ²
System sales of cafés ¹	\$35,704	\$36,213	\$35,920	\$41,326
Same café sales ¹	0.3%	(1.0%)	(2.2%)	(1.1%)
Number of cafés – end of period	270	275	279	286
Total revenue	\$5,937	\$5,627	\$4,897	\$6,085
Operating income (loss) ¹	\$520	\$213	(\$175)	\$993
EBITDA ¹	\$858	\$537	\$174	\$1,339
Adjusted EBITDA ¹	\$858	\$537	\$174	\$1,339
Net income (loss) for the period	\$766	\$577	(\$138)	\$655
Adjusted net income (loss) for the period ¹	\$766	\$577	(\$138)	\$655
Basic and diluted earnings (loss) per share	\$0.04	\$0.03	(\$0.01)	\$0.04
Adjusted basic and diluted earnings (loss) per share ¹	\$0.04	\$0.03	(\$0.01)	\$0.04
	Q3 2017	Q2 2017	Q1 2017	Q4 2016 ²
System sales of cafés ¹	\$37,014	\$37,898	\$37,915	\$46,743
Same café sales ¹	0.0%	0.7%	(0.2%)	(1.0%)
Number of cafés – end of period	289	291	293	294
Total revenue	\$5,339	\$6,237	\$5,975	\$7,500
Operating income (loss) ¹	\$436	(\$138)	(\$315)	\$301
EBITDA ¹	\$805	\$230	\$60	\$667
Adjusted EBITDA ¹	\$805	\$517	\$60	\$667
Net income(loss) for the period	(\$2,962)	(\$315)	(\$475)	\$147
Adjusted net income (loss) for the period ¹	\$245	(\$315)	(\$475)	\$147
Basic and diluted earnings (loss) per share	(\$0.19)	(\$0.02)	(\$0.04)	\$0.01
Adjusted basic and diluted earnings (loss) per share ¹	\$0.02	(\$0.02)	(\$0.04)	\$0.01

¹See the section “Definitions and Discussion on Certain non-GAAP Financial Measures” for further analysis.

²The 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).

³Adoption 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.

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The system sales decreases quarter over quarter are primarily related to the reduction in total network café count and to a lesser extent to the changes in same café sales.

Seasonal factors and the timing of holidays cause the Company's revenue to fluctuate from quarter to quarter. Revenue changes quarter over quarter are primarily related to the average number of Company-owned cafés count and a reduction in café count.

LIQUIDITY AND CAPITAL RESOURCES

Second Cup collects royalties based on the franchisees' portion of System sales of cafés, franchise fees, and other amounts from its franchisees and also generates revenues from its Company-owned cafés. For a more detailed discussion of the risks and uncertainties affecting the Company's liquidity, see the general risks outlined below and the "Capabilities" section above.

Summary of cash flows

	13 weeks ended		39 weeks ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Cash flows provided by operating activities	\$925	\$515	\$1,159	\$279
Cash flows provided by (used in) investing activities	(645)	(20)	(836)	154
Cash flows provided by (used in) financing activities	(8)	(141)	9,193	(173)
Increase in cash and cash equivalents during the period	\$272	\$354	\$9,516	\$260

Third Quarter

Cash provided by operating activities was \$925 for the Quarter compared to \$515 for the same Quarter in 2017. The increase of \$410 is primarily driven by the reduction in interest and financing costs and an increase in interest income.

During the Quarter, cash used in investing activities was \$645 compared to cash used of \$20 for the same Quarter in 2017. The increase of \$625 is primarily driven by higher payments for capital expenditures and intangible assets.

Cash used in financing activities was \$8 for the Quarter compared to \$141 for the same Quarter in 2017. In 2017, the Company incurred transaction costs related to the shares issued in the third quarter of 2017.

Year to date

Cash provided by operating activities was \$1,159 for the year to date compared to \$279 for the same period in 2017. The change of \$880 is primarily driven by the reduction in interest and financing costs and an increase in interest income.

Year to date, cash used in investing activities was \$836 compared to cash provided of \$154 for the same period in 2017 is primarily driven by higher payments for capital expenditures and intangible assets.

Cash provided by financing activities was \$9,193 for the year to date compared to cash used of \$173 for the same period in 2017. The Company closed the Offering on May 8, 2018, net of transaction costs.

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Working capital as at

	September 29, 2018	December 30, 2017
Current assets	\$ 18,038	\$ 10,122
Current liabilities	<u>10,376</u>	<u>9,869</u>
Working capital	<u>\$ 7,662</u>	<u>\$ 253</u>

The Company's working capital as at September 29, 2018 was \$7,662 compared to a working capital balance of \$253 at December 30, 2017. The Offering closed on May 8, 2018 with the Company receiving net proceeds of \$9,201, leading to an increase in cash balance. Gift card liability ended the Quarter at \$2,830, a decrease of \$602 compared to the end of 2017. Based on the historical redemption patterns, the Company believes that it has sufficient financial resources to cover the gift card liability.

The Company had cash and cash equivalents of \$14,089 as at September 29, 2018 (December 30, 2017 – \$4,573). The Company continues to believe it has sufficient financial resources to meet its obligations as they come due.

Financial instruments

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

Financial instrument	Risks
<i>Financial assets</i>	
Cash and cash equivalents	Credit and interest rate
Restricted cash	Credit and interest rate
Trade and other receivables	Credit
Notes and leases receivable	Credit
<i>Financial liabilities</i>	
Accounts payable and accrued liabilities	Liquidity, currency and commodity
Gift card liability	Liquidity
Deposits from franchisees	Liquidity

(i) Credit risk

Cash and cash equivalents and restricted cash

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

Trade and other receivables, and notes and leases receivable

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

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

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(ii) Liquidity risk

Liquidity risk is managed through regular monitoring of forecasts and actual cash flows, monitoring maturity dates of financial assets and liabilities, and also the management of capital structure and debt covenants as outlined above. The main source of income is royalty receipts from franchisees.

(iii) Currency and commodity risk

Transactions occur with a small number of vendors that operate in foreign currencies. The Company believes that due to low volumes of transactions, low number of vendors, and low magnitude of spend, the impact of currency risk is not material.

The Company is directly and indirectly exposed to changes in coffee commodity prices given it is a material input for the Company's product offerings. The direct exposure is mitigated given the ability to adjust its sales price as commodity prices change. Risk is mitigated by entering fixed price forward purchase commitments and by adjusting selling prices.

Contingencies, commitments and guarantees

Contractual Obligations	Payments Due by Period				
	Total	1 year	2 – 3 years	4 – 5 years	After 5 years
Obligations from Operating Leases	\$12,971	\$2,296	\$3,659	\$3,056	\$3,960
Purchase Obligations	1,921	1,921	Nil	Nil	Nil
Total Contractual Obligations	\$14,892	\$4,217	\$3,659	\$3,056	\$3,960

Obligations from Operating Leases

Second Cup has lease commitments for Company-owned cafés and also acts as the head tenant on most leases, which in turn it subleases to franchisees. To the extent the Company may be required to make rent payments due to head lease commitments, a provision has been recognized.

	Head lease commitments	Sublease to franchisees	Net
September 28, 2019	\$ 16,972	\$ 14,676	\$ 2,296
September 26, 2020	14,585	12,626	1,959
September 25, 2021	12,546	10,846	1,700
September 24, 2022	11,287	9,711	1,576
September 23, 2023	9,743	8,263	1,480
Thereafter	22,476	18,516	3,960
	<u>\$ 87,609</u>	<u>\$ 74,638</u>	<u>\$ 12,971</u>

The Company believes it has sufficient resources to meet the net commitment of \$12,971 over the term of the leases.

Purchase Obligations

Contracts are in place with third party companies to purchase the coffee that is sold in all cafés. In terms of these supply agreements, there is a guaranteed minimum volume of coffee purchases of \$1,921 (September 30, 2017 – \$2,417) for the subsequent 12 months. The coffee purchase commitment is comprised of two components: unapplied futures commitment contracts and fixed price physical contracts.

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Due to the Company acting as the primary coordinator of café construction costs on behalf its franchisees and for Company-owned cafés, there is \$409 (September 30, 2017 – \$554) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the Quarter. Construction costs for franchise projects are paid from deposits received from franchisees and for corporate projects from the Company's cash flows.

Other Obligations

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

Related parties

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

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") must acknowledge they are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting ("ICFR") for the Company. The control framework used by the CEO and CFO to design the Company's ICFR is Internal Control over Financial Reporting – Guidance for Smaller Public Companies as issued by COSO. In addition, in respect of:

Disclosure controls and procedures

The CEO and CFO must certify they have designed the disclosure controls and procedures, or caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Company is made known to them in a timely manner and that information required under securities legislation is recorded, processed, summarized and reported in a timely manner.

As at November 2, 2018, the Company's management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the disclosure controls and procedures. Based on this evaluation, the CEO and CFO have concluded that, as at September 29, 2018, the Company's disclosure controls and procedures were appropriately designed.

Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls and procedures should not exceed their expected benefits. As such, the Company's disclosure controls and procedures can only provide reasonable, and not absolute, assurance that the objectives of such controls and procedures are met.

During the 13 weeks ended September 29, 2018 and up to the date of the approval of the Unaudited Condensed Interim Financial Statements and MD&A, there has been no change that has materially affected, or is reasonably likely to materially affect the Company's disclosure controls and procedures.

Internal controls over financial reporting

The CEO and CFO must certify they have designed such internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Unaudited Condensed Interim Financial Statements for external purposes in accordance with IFRS.

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As at November 2, 2018, the Company's management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the controls over financial reporting. No material weaknesses in the design of these controls over financial reporting were identified. Based on this evaluation, the CEO and CFO have concluded that, as at November 2, 2018, the Company's controls over financial reporting were appropriately designed and were operating effectively.

Consistent with the concept of reasonable assurance, the Company recognizes that the relative cost of maintaining these controls should not exceed their expected benefits. As such, the Company's internal controls over financial reporting can only provide reasonable, and not absolute, assurance that the objectives of such controls are met.

During the 13 weeks ended September 29, 2018 and up to the date of the approval of the Unaudited Condensed Interim Financial Statements and MD&A, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

CRITICAL ACCOUNTING ESTIMATES

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

Estimates

The following are examples of estimates and assumptions the Company makes:

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

Use of judgment

The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of the Audited Financial Statements:

(i) Impairment charges

Management is required to use judgment in determining the grouping of assets to identify their cash generating units ("CGUs") for the purposes of testing intangible assets and property and equipment for impairment. In addition, management uses judgment to determine whether a triggering event has occurred requiring an impairment test to be completed. In determining the net recoverable amount of a CGU, the Company uses a fair value less costs to sell model using assumptions such as projected future sales, earnings, capital investments and discount rates. These assumptions are highly uncertain at the time the estimate is made. Changing the assumptions selected by management, in particular the discount rate and the growth rate assumptions used in the cash flow projections, could significantly affect the impairment evaluations and recoverable amounts. Projected future sales and earnings are consistent with the strategic plans provided to and approved by the Company's Board of Directors.

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(ii) Deferred income taxes

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

(iii) Estimated useful lives

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

(iv) Café lease provisions

Café lease provisions require judgment to evaluate the likelihood and measurement of settlements, temporary payouts or subleasing. Management works with landlords and franchises and uses previous experience to obtain adequate information needed to make applicable judgments.

(v) Allowance for doubtful accounts

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

RISKS AND UNCERTAINTIES

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

The performance of Second Cup is primarily dependent on its ability to maintain and increase the sales of existing cafés, add new profitable cafés to the network and redevelop and modernize cafés as their leases come due. System sales of the café network are affected by various external factors that can affect the specialty coffee industry as a whole.

A more detailed discussion of the risks and uncertainties affecting Second Cup is set out in the Company's MD&A for the year ended December 30, 2017 and Second Cup's 2017 Annual Information Form, which is available at www.sedar.com.

CHANGES IN ACCOUNTING POLICIES

Except as described below, the accounting policies adopted in the preparation of these unaudited condensed interim financial statements are consistent with those followed in the preparation of the Company's audited financial statements for the year ended December 30, 2017.

In May, 2014, the IASB issued IFRS 15 a new comprehensive model for entities to use accounting for revenue arising from contracts with customers. On 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.

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Franchise revenue consists of royalties, as well as initial and renewal of franchise fees, and other fees. Our performance obligations under franchise agreements include a franchise licence 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 had been performed, which generally occurred when the franchised café opened. On the Transition Date, the Company recognized an increase of \$3,118 to deferred revenue, a decrease to deferred income taxes of \$832 and a decrease to the retained earnings (deficit) of \$2,286. For the 13 and 39 weeks ended September 29, 2018, an increase of \$138 and an increase of \$183, respectively, in franchise revenue was recognized compared to the previous standards.

After completing the analysis on the Co-op Fund under the guidance of IFRS 15, the Company continues to report the Co-op Fund on a net basis in our unaudited condensed interim statements of financial position.

Under IFRS 15, the Company recognizes the estimated breakage income on gift cards as they are utilized. Previously, the Company recognized the estimated breakage income on a pro rata basis based on the historical gift card redemption patterns. The application of IFRS 15 to the estimated breakage income on gift cards had no impact to the opening retained earnings (deficit) and to the 13 and 39 weeks ended September 29, 2018.

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. The application of IFRS 9 had no impact to the opening retained earnings (deficit) and to the 13 and 39 weeks ended September 29, 2018.

Recent accounting pronouncements not yet effective

IFRS 16, Leases (“IFRS 16”) sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer (“lessee”) and the supplier (“lessor”). This will replace IAS 17, Leases, and related interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all leases and requires a lessee to recognize (i) right-of-use assets and lease liabilities for leases with terms of more than 12 months, unless the underlying asset is of low value; and (ii) depreciation of lease assets separately from interest on lease liabilities on the unaudited condensed interim statements of income and comprehensive income.

Under IFRS 16, lessor accounting for operating and finance leases will remain substantially unchanged. IFRS 16 is effective for annual periods beginning on or after January 1, 2019, with earlier application permitted for entities that apply IFRS 15. The guidance allows for either a full retrospective or modified retrospective transition method. The Company currently expects to apply the modified retrospective transition method. Further, the Company currently expects to apply the practical expedients to (i) grandfather the assessment of which transactions are leases; (ii) recognition exemption of short-term leases; and (iii) recognition exemption leases of low-value items.

The Company has completed a preliminary assessment of the potential impact on its financial statements, but has not yet completed its detailed assessment. So far, the most significant impact identified is that the Company will recognize new assets and liabilities for its franchisee subleases, operating leases of its head office and corporate cafés.

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OUTLOOK

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

NAC and Second Cup announced their strategic alliance in April 2018, through which the two companies will develop a network of NAC-branded (Meta) and operated recreational cannabis stores in provinces where legally permissible. Two conversions are underway in Alberta. While the guidelines are not yet finalized, many more locations in Ontario have been identified as attractive candidates for conversion to cannabis dispensaries.

While the Board remains focused on operational excellence in the Second Cup network, it recognizes the need for the Company's strategy to continue to evolve and has begun a strategic review process for the overall company. The balance sheet has been strengthened and now has the capacity to support a broader range of strategic alternatives to create shareholder value. There is no guarantee this strategic review will result in any avenues being pursued.

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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.

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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		39 weeks ended	
	September 29, 2018 ¹	September 30, 2017	September 29, 2018 ¹	September 30, 2017
Net income (loss)	\$ 766	\$ (2,962)	\$ 1,205	\$ (3,752)
Income taxes	271	4	444	(167)
Interest and financing (income) costs	(61)	3,394	(102)	3,902
Gain on fair value of investments in equity securities	(20)	-	(170)	-
Other income	(436)	-	(819)	-
Operating income (loss)	<u>\$ 520</u>	<u>\$ 436</u>	<u>\$ 558</u>	<u>\$ (17)</u>

	13 weeks ended		39 weeks ended	
	September 29, 2018 ¹	September 30, 2017	September 29, 2018 ¹	September 30, 2017
Net income (loss)	\$ 766	\$ (2,962)	\$ 1,205	\$ (3,752)
Income taxes	271	4	444	(167)
Interest and financing (income) costs	(61)	3,394	(102)	3,902
Gain on fair value of investments in equity securities	(20)	-	(170)	-
Other income	(436)	-	(819)	-
Depreciation of property and equipment	212	255	635	774
Amortization of intangible assets	126	114	376	338
EBITDA	<u>858</u>	<u>805</u>	<u>1,569</u>	<u>1,095</u>
Add (deduct) impact of the following:				
One-time transition costs	-	-	-	287
Adjusted EBITDA	<u>\$ 858</u>	<u>\$ 805</u>	<u>\$ 1,569</u>	<u>\$ 1,382</u>

¹Adoption 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.

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	13 weeks ended		39 weeks ended	
	September 29, 2018 ¹	September 30, 2017	September 29, 2018 ¹	September 30, 2017
Net income (loss)	\$ 766	\$ (2,962)	\$ 1,205	\$ (3,752)
Add (deduct) impact of the following:				
After-tax fair value difference on shares issued and other costs	-	3,207	-	3,207
Adjusted net income (loss)	\$ <u>766</u>	\$ <u>245</u>	\$ <u>1,205</u>	\$ <u>(545)</u>

	13 weeks ended		39 weeks ended	
	September 29, 2018 ¹	September 30, 2017	September 29, 2018 ¹	September 30, 2017
Net income (loss) per share	\$ 0.04	\$ (0.19)	\$ 0.06	\$ (0.28)
Add (deduct) impact of the following:				
After-tax fair value difference on shares issued and other costs	-	0.21	-	0.24
Adjusted net income (loss) per share	\$ <u>0.04</u>	\$ <u>0.02</u>	\$ <u>0.06</u>	\$ <u>(0.04)</u>

¹Adoption 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.