



The Second Cup Ltd.

Unaudited Condensed Interim Consolidated Financial Statements
For the 13 and 39 weeks ended September 28, 2019, and September 29, 2018

Notice to Reader

The management of The Second Cup Ltd. (“Second Cup” or the “Company”) is responsible for the preparation of the accompanying condensed interim consolidated financial statements. The condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards and are considered by management to present fairly the financial position, financial performance and cash flows of Second Cup.

These condensed interim consolidated financial statements have not been reviewed by an auditor. These condensed interim consolidated financial statements are unaudited and include all adjustments, consisting of normal and recurring items that management considers necessary for a fair presentation of the financial position, financial performance and cash flows.

(Signed)

Steven Pelton
President and Chief Executive Officer, The Second Cup Ltd.

(Signed)

Ba Linh Le
Chief Financial Officer, The Second Cup Ltd.

November 7, 2019

The Second Cup Ltd.

Condensed Interim Consolidated Statements of Financial Position

(Unaudited, expressed in thousands of Canadian dollars)

	September 28, 2019	December 29, 2018
ASSETS		
Current assets		
Cash and cash equivalents	\$ 12,336	\$ 14,888
Restricted cash (note 9)	841	1,750
Trade and other receivables	1,485	2,561
Notes and leases receivable (note 3)	11,499	30
Inventories	512	525
Prepaid expenses and other assets	416	259
Income tax receivable	112	186
	<u>27,201</u>	<u>20,199</u>
Non-current assets		
Notes and leases receivable (note 3)	40,981	23
Investments in equity securities	1,230	1,720
Right-of-use assets (note 3)	13,562	-
Property and equipment	2,441	2,044
Intangible assets	31,850	32,015
	<u>89,064</u>	<u>66,812</u>
Total assets	<u>\$ 117,265</u>	<u>\$ 56,001</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	\$ 3,819	\$ 5,251
Provisions	778	634
Other liabilities	86	130
Gift card liability	1,644	2,327
Lease liabilities (note 3)	12,990	-
Deposits from franchisees	719	769
Deferred income (note 4)	638	2,042
	<u>20,674</u>	<u>11,153</u>
Non-current liabilities		
Provisions	200	297
Other liabilities	116	157
Lease liabilities (note 3)	53,167	-
Deferred income (note 4)	2,182	2,357
Deferred income taxes	5,045	5,591
	<u>58,710</u>	<u>8,402</u>
Total liabilities	<u>81,384</u>	<u>19,555</u>
SHAREHOLDERS' EQUITY	<u>35,881</u>	<u>36,446</u>
Total liabilities and shareholders' equity	<u>\$ 117,265</u>	<u>\$ 56,001</u>

See accompanying notes to the unaudited condensed interim consolidated financial statements.

Approved by the Directors on November 7, 2019

Michael Bregman, Director

Stephen Kelley, Director

The Second Cup Ltd.

Condensed Interim Consolidated Statements of Operations and Comprehensive Income (Loss)

(Unaudited, expressed in thousands of Canadian dollars, except per share amounts)

	13 weeks ended		39 weeks ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Revenue (note 4)				
Company-owned cafés and product sales	\$ 2,794	\$ 2,186	\$ 8,002	\$ 5,444
Franchise revenue	3,858	4,423	11,431	13,094
	<u>6,652</u>	<u>6,609</u>	<u>19,433</u>	<u>18,538</u>
Operating costs and expenses (note 5)				
Company-owned cafés and cost of product sales	2,715	2,541	7,820	6,102
Franchise expenses	2,013	2,087	5,942	6,940
General and administrative expenses	1,757	1,123	4,916	3,924
(Gain) loss on disposal of assets	(12)	-	9	3
Depreciation and amortization	905	338	2,599	1,011
	<u>7,378</u>	<u>6,089</u>	<u>21,286</u>	<u>17,980</u>
Income (loss) from operations	<u>(726)</u>	<u>520</u>	<u>(1,853)</u>	<u>558</u>
Other income (loss)	(349)	456	818	989
Interest and financing income (note 6)	36	61	177	102
	<u>(1,039)</u>	<u>1,037</u>	<u>(858)</u>	<u>1,649</u>
Income (loss) before income taxes	<u>(1,039)</u>	<u>1,037</u>	<u>(858)</u>	<u>1,649</u>
Income taxes (recovery)	(277)	271	(229)	444
	<u>(762)</u>	<u>766</u>	<u>(629)</u>	<u>1,205</u>
Net income (loss) and comprehensive income (loss) for the period	<u>\$ (762)</u>	<u>\$ 766</u>	<u>\$ (629)</u>	<u>\$ 1,205</u>
Basic and diluted earnings (loss) per share (notes 7, 11)	<u>\$ (0.04)</u>	<u>\$ 0.04</u>	<u>\$ (0.03)</u>	<u>\$ 0.06</u>

See accompanying notes to the unaudited condensed interim financial statements.

The Second Cup Ltd.

Condensed Interim Consolidated Statements of Changes in Shareholders' Equity

(Unaudited, expressed in thousands of Canadian dollars)

	Share Capital	Warrants	Contributed Surplus	Retained Earnings (Deficit)	Total
Balance - December 30, 2017	\$ <u>19,271</u>	\$ <u>165</u>	\$ <u>61,747</u>	\$ <u>(52,921)</u>	\$ <u>28,262</u>
Adoption of new accounting policy - net of tax (note 3)	-	-	-	(2,286)	(2,286)
Net income for the period	-	-	-	1,205	1,205
Stock option plan expense	-	-	20	-	20
Shares Issued	<u>9,406</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>9,406</u>
Balance – September 29, 2018	\$ <u>28,677</u>	\$ <u>165</u>	\$ <u>61,767</u>	\$ <u>(54,002)</u>	\$ <u>36,607</u>
Balance - December 29, 2018	\$ <u>28,590</u>	\$ <u>165</u>	\$ <u>61,775</u>	\$ <u>(54,084)</u>	\$ <u>36,446</u>
Adoption of new accounting policy - net of tax (note 3)	-	-	-	(870)	(870)
Net income for the period	-	-	-	(629)	(629)
Stock option plan expense	-	-	58	-	58
Shares Issues	<u>845</u>	<u>-</u>	<u>31</u>	<u>-</u>	<u>876</u>
Balance – September 28, 2019	\$ <u>29,435</u>	\$ <u>165</u>	\$ <u>61,864</u>	\$ <u>(55,583)</u>	\$ <u>35,881</u>

See accompanying notes to the unaudited condensed interim consolidated financial statements.

The Second Cup Ltd.

Condensed Interim Consolidated Statements of Cash Flows

(Unaudited, expressed in thousands of Canadian dollars)

	13 weeks ended		39 weeks ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
CASH PROVIDED BY (USED IN)				
Operating activities				
Net income (loss) for the period	\$ (762)	\$ 766	\$ (629)	\$ 1,205
Items not involving cash				
Depreciation of property and equipment	221	212	567	635
Amortization of intangible assets	103	126	359	376
Amortization of right-of-use asset (note 3)	581	-	1,674	-
Share-based compensation expense	(61)	63	(2)	203
Deferred income taxes	(277)	287	(229)	432
(Gain) loss on disposal of assets	(12)	-	9	3
(Gain) loss on disposal of leases	(56)	-	(95)	-
Other income	(436)	(436)	(1,308)	(819)
Change in fair value of investments in securities	785	(20)	490	(170)
Bad debt expense for notes receivable	4	5	(3)	32
Changes in non-cash working capital & other (note 8)	(398)	(78)	(111)	(738)
Cash provided by (used in) operating activities	(308)	925	722	1,159
Investing activities				
Proceeds from disposal of assets	45	134	133	147
Cash payments for capital expenditures (note 8)	(408)	(696)	(1,097)	(930)
Cash payments for intangible assets (note 8)	(197)	(101)	(204)	(101)
Notes receivable repayment	6	18	13	48
Cash provided by (used in) investing activities	(554)	(645)	(1,155)	(836)
Financing activities				
Proceeds from issuance of shares (note 8)	200	-	200	10,000
Operating lease payments	(784)	-	(2,204)	-
Payment for repurchased shares	-	-	(115)	-
Transaction costs (note 8)	-	(8)	-	(807)
Cash provided by (used in) financing activities	(584)	(8)	(2,119)	9,193
Increase (decrease) in cash and cash equivalents during the period	(1,446)	272	(2,552)	9,516
Cash and cash equivalents - Beginning of the period	13,782	13,817	14,888	4,573
Cash and cash equivalents - End of the period	\$ 12,336	\$ 14,089	\$ 12,336	\$ 14,089

See accompanying notes to the unaudited condensed interim financial statements.
Supplemental cash flow information is provided in note 9.

The Second Cup Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 28, 2019 and September 29, 2018

(Unaudited, expressed in thousands of Canadian dollars, except per share amounts)

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1. Organization and nature of business

The Second Cup Ltd. (the “Company”) is a Canadian specialty coffee retailer with 246 cafés operating under the trade name, Second Cup™, in Canada, of which 30 are Company-operated and the balance is operated by franchisees.

Second Cup owns the trademarks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of Second Cup cafés in Canada.

Second Cup was incorporated under the Business Corporations Act (Ontario) in 2011 and is domiciled in Canada. The address of its registered office is 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8. The Company hereinafter refers to its head office activities as “Coffee Central”. The Company’s website is www.secondcup.com. The common shares of the Company are listed on the Toronto Stock Exchange under the symbol “SCU”.

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2. Summary of significant accounting policies

a. Basis of preparation

These unaudited condensed interim consolidated financial statements for the 13 weeks and 39 weeks ended September 28, 2019 and September 29, 2018 have been prepared in accordance with International Financial Reporting Standards (“IFRS”), as applicable to condensed interim consolidated financial reports including International Accounting Standard (IAS) 34, Interim consolidated financial Reporting (“IAS 34”), and should be read in conjunction with the Company’s audited annual financial statements for the year ended December 29, 2018, which have been prepared in accordance with IFRS, as issued by the International Accounting Standards Board (“IASB”).

The accounting policies applied in these unaudited condensed interim consolidated financial statements are consistent with those of the previous financial year, except for the adoption of the new accounting policies as described in note 3. The accounting policies are based on IFRS issued and outstanding as at November 7, 2019, the date the Board of Directors approved the unaudited condensed interim consolidated financial statements.

Second Cup’s fiscal year is such that each quarter will consist of 13 weeks and will end on the Saturday closest to the calendar quarter-end. The fiscal year is made up of 52 or 53-week periods ending on the last Saturday of December. Fiscal 2019 is a 52-week period (2018 – 52-week period).

These consolidated financial statements include the advertising and co-operative fund (the “Co-op Fund”). The Company manages the Co-op Fund established to collect and administer funds contributed for use in advertising and promotional programs, and initiatives designed to increase sales and enhance the reputation of the Second Cup brand. Contributions to the Co-op Fund are required to be made from both franchised and Company-operated cafés and are based on a percentage of café sales. In accordance with the guidance of IFRS 15, Revenue from Contracts with Customers (“IFRS 15”), the revenue, expenses and cash flows of the Co-op Fund are consolidated in the Condensed Interim Consolidated Statements of Financial Position. The assets and liabilities of the Co-op Fund are included in the assets and liabilities of the Company on the Consolidated Statements of Financial Position.

b. Segmented information and reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the Chief Executive Officer. The Company substantially operates and is managed as one reportable segment. Operating revenues are comprised of royalties, the sale of goods from Company-operated cafés, the sale of goods through retail and other ancillary channels, and other service fees.

3. Changes in accounting policies

These unaudited condensed interim consolidated financial statements have been prepared using the same accounting policies and methods of computation as the annual consolidated financial statements of the Company for the year ended December 29, 2018 other than the changes noted below.

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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 replaces 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 Condensed Interim Consolidated Statements of Operations and Comprehensive Income (Loss).

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 has selected to apply the modified retrospective transition method. Further, the Company has selected 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.

From December 30, 2018, leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Company. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The right-of-use asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis. Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of the following lease payments:

- fixed payments (including in-substance fixed payments), less any lease incentives receivable;
- variable lease payments that are based on an index or a rate;
- amounts expected to be payable by the lessee under residual value guarantees;
- the exercise price of a purchase option if the lessee is reasonably certain to exercise that option; and
- payments of penalties for terminating the lease, if the lease term reflects the lessee exercising that option.

The lease payments are discounted using the interest rate implicit in the lease. If that rate cannot be determined, the lessee's incremental borrowing rate is used, being the rate that the lessee would have to pay to borrow the funds necessary to obtain an asset of similar value in a similar economic environment with similar terms and conditions. Right-of-use assets are measured at cost comprising the following:

- the amount of the initial measurement of lease liability;
- any lease payments made at or before the commencement date less any lease incentives received;
- any initial direct costs; and
- restoration costs.

Adjustments recognized on adoption of IFRS 16

The Company transitioned to IFRS 16 in accordance with the modified retrospective approach. The prior year figures were not adjusted. On adoption of IFRS 16, the Company recognized lease liabilities in relation to leases, which had previously been classified as ‘operating leases’ under the principles of IAS 17, Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental

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borrowing rate as of December 30, 2018. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on December 30, 2018 was 6.62%.

	<u>2019</u>
Operating lease commitments disclosed as at December 29, 2018	\$ 96,875
Less: adjustments for changes in terminations and rent rates	(3,192)
Discounted using incremental borrowing rates at the date of initial application	<u>(18,172)</u>
Lease liabilities recognized as at December 30, 2018	<u>\$ 75,511</u>

In applying IFRS 16 for the first time, the Company has used the following practical expedients permitted by the standard:

- the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- reliance on previous assessments on whether leases are onerous; and
- the exclusion of initial direct costs for the measurement of the right-of-use asset at the date of initial application.

For Company-operated cafés and the head office, right-of-use assets were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the balance sheet as at December 29, 2018. The Company also recorded an adjustment to the right-of-use assets of \$852 at the date of initial application for lease contracts that were onerous.

For most of the franchise cafés, the Company enters into the head lease for those café locations and, in turn, enters into a sublease on the same terms with its franchisees. IFRS 16 requires the Company, as an intermediate lessor, to classify a sublease as a finance lease by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying property. Leases receivable for the subleases were measured at the amount equal to the lease liability. The Company recorded an adjustment to leases receivable for expected credit losses of \$612 at the date of initial application as required by IFRS 9, Financial Instruments.

The change in accounting policy affected the following items in the balance sheet on December 30, 2018:

- right-of-use assets – increase by \$12,252
- leases receivable – increase by \$61,795
- deferred income tax liabilities – decrease by \$317
- provisions – decrease by \$277
- lease liabilities – increase by \$75,511.

The net impact on retained earnings on December 30, 2018 was a decrease of \$870.

On December 31, 2017, the Company applied IFRS 15 using the modified retrospective transition method. Beginning in 2018, the consolidated financial statements reflect the application of IFRS 15 while the financial statements for previous periods were prepared under the guidance of the previous standard.

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As required under the new guidance, the Company defers the initial franchise and licensing fees and recognizes revenue over the term of the related agreement. Previously, the Company recognized initial franchise fees when all material obligations and services had been performed, which generally occurred when the franchised café opened. The transition to IFRS 15 requires the consolidation of the Co-op Fund contributions and related expenses on a gross basis.

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

4. Revenue

	13 weeks ended		39 weeks ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2019
Franchise Revenue				
Royalties	\$ 2,182	\$ 2,418	\$ 6,601	\$ 7,338
Advertising fund contributions	599	720	1,862	2,176
Franchise fees, services and other	1,077	1,285	2,968	3,580
	<u>3,858</u>	<u>4,423</u>	<u>11,431</u>	<u>13,094</u>
Company-owned cafés and product sales	<u>2,794</u>	<u>2,186</u>	<u>8,002</u>	<u>5,444</u>
	<u>\$ 6,652</u>	<u>\$ 6,609</u>	<u>\$ 19,433</u>	<u>\$ 18,538</u>

Royalties

Royalty revenue from franchised cafés is based on agreed percentage royalty rates of the franchise location sales. Revenue is recognized on an accrual basis in accordance with the substance of the relevant agreement, provided that it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably.

Advertising fund contributions

Contributions to the Co-op Fund are required to be made from both franchised and Company-operated cafés and are based on a percentage of café sales. In 2018, the Company adopted IFRS 15 accounting as it relates to the Co-op Fund using the modified retrospective transition method. The transition to IFRS 15 requires the presentation of the Co-op Fund contributions and related expenses on a gross basis.

Franchise fees, services and other

Franchise fees, services and other consist of initial franchise fees, renewal fees, transfer fees earned on the sale of cafés from one franchisee to another, construction administration fees, purchasing coordination fees, licensing fees and other ancillary fees (such as IT support and training fees).

		Deferred income
Balance at December 29, 2018	\$	3,000
Franchise fees adjustments to deferred income		(4)

The Second Cup Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

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(Unaudited, expressed in thousands of Canadian dollars, except per share amounts)

Franchise fees added year to date		246
Franchise fees recognized as income year to date		<u>(513)</u>
Balance at September 28, 2019	\$	<u>2,729</u>

Company-owned cafés and product sales

Company-owned cafés and product sales revenue includes the sale of goods from Company-owned cafés, as well as products sold in grocery stores through wholesale distribution channels and third party licensing agreements.

5. Operating costs and expenses

	13 weeks ended		39 weeks ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Company-owned cafés and cost of product sales				
Cost of product sales	\$ 1,037	\$ 838	\$ 2,976	\$ 2,124
Labour and related expenses	1,083	842	3,177	1,965
Occupancy and other	595	861	1,667	2,013
Depreciation and amortization	684	91	1,865	261
(Gain) loss on disposal of assets	(12)	-	9	3
	<u>3,387</u>	<u>2,632</u>	<u>9,694</u>	<u>6,366</u>
Franchise				
Labour and related expenses	935	907	2,924	3,161
Advertising fund expense	613	707	1,870	2,173
Travel and franchisee meetings	90	40	238	172
Professional fees and other	375	433	910	1,434
	<u>2,013</u>	<u>2,087</u>	<u>5,942</u>	<u>6,940</u>
General and administrative				
Labour and related expenses	937	280	2,361	1,237
Professional fees and other	764	750	2,387	2,332
Occupancy	56	93	168	355
	<u>1,757</u>	<u>1,123</u>	<u>4,916</u>	<u>3,924</u>
Other				
Depreciation and amortization	221	247	734	750
	<u>221</u>	<u>247</u>	<u>734</u>	<u>750</u>
	<u>\$ 7,378</u>	<u>\$ 6,089</u>	<u>\$ 21,286</u>	<u>\$ 17,980</u>

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Notes to the Condensed Interim Consolidated Financial Statements

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(Unaudited, expressed in thousands of Canadian dollars, except per share amounts)

6. Interest and financing costs

	13 weeks ended		39 weeks ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Interest expense – operating leases	\$ (24)	\$ -	\$ (42)	\$ -
Interest income	60	61	219	102
	<u>\$ 36</u>	<u>\$ 61</u>	<u>\$ 177</u>	<u>\$ 102</u>

7. Basic and diluted income (loss) per share

Income (loss) per share is based on the weighted average number of shares outstanding during the period. Basic and diluted income (loss) per share is determined as follows:

	13 weeks ended		39 weeks ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Net income (loss)	\$ (762)	\$ 766	\$ (629)	\$ 1,205
Weighted average number of shares issued and outstanding	<u>20,366,649</u>	<u>19,940,073</u>	<u>20,049,103</u>	<u>18,581,022</u>
Basic and diluted earnings (loss) per share	<u>\$ (0.04)</u>	<u>\$ 0.04</u>	<u>\$ (0.03)</u>	<u>\$ 0.06</u>

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8. Supplemental cash flow information

	13 weeks ended		39 weeks ended	
	September 28, 2019	September 29, 2018	September 28, 2019	September 29, 2018
Changes in non-cash working capital & other (inflow (outflow)):				
Trade and other receivables	\$ 171	\$ (129)	\$ 1,076	\$ 1,655
Inventories	23	47	13	(269)
Prepaid expenses and other assets	217	58	(157)	76
Accounts payable and accrued liabilities	(1,486)	542	(1,259)	(68)
Provisions	416	(161)	320	(306)
Other liabilities	11	(1)	(85)	(361)
Gift card liability	(148)	(42)	(683)	(602)
Deferred income	(73)	(128)	(269)	(148)
Deposits from franchisees and restricted cash	397	(264)	859	(438)
Income taxes	74	-	74	(277)
	<u>\$ (398)</u>	<u>\$ (78)</u>	<u>\$ (111)</u>	<u>\$ (738)</u>
Cash payments for capital expenditures				
Cash payments for capital expenditures	\$ (408)	\$ (696)	\$ (1,097)	\$ (930)
Cash payments for intangible assets	(197)	(101)	(204)	(101)
	<u>\$ (605)</u>	<u>\$ (797)</u>	<u>\$ (1,301)</u>	<u>\$ (1,031)</u>
Supplementary information				
Interest paid -	\$ -	\$ -	\$ -	\$ -
Interest paid – operating leases	24	-	42	-
	<u>24</u>	<u>-</u>	<u>42</u>	<u>-</u>

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Notes to the Condensed Interim Consolidated Financial Statements

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9. Restricted cash

The Company has established certain accounts that have been classified as restricted cash primarily representing: a) deposits from franchisees for the cost of constructing a new café or the renovation of an existing café, b) funds contributed for use in advertising and promotional programs where the Company is acting as an agent on behalf of the Co-op Fund, and c) a deposit held by the Company's bank as security for cash management services.

	September 28, 2019	December 29, 2018
Development Fund	\$ 330	\$ 746
Co-op Fund	268	763
Security Deposit held by bank	<u>243</u>	<u>241</u>
Total Restricted Cash	<u>\$ 841</u>	<u>\$ 1,750</u>

10. Contingencies, commitments and guarantees

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.

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 \$1,604 (September 29, 2018 - \$1,921) for the subsequent 12 months. The coffee purchase commitment is comprised of two components: unapplied futures commitment contracts and fixed price physical contracts.

Due to the Company acting as the primary coordinator of café construction costs on behalf of its franchisees and for Company-operated cafés, there are \$456 (September 29, 2018 - \$409) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the quarter. Construction costs financed for franchise projects are from deposits received from franchisees and for corporate projects from the Company's cash flows.

11. Related parties

Related parties are identified as key management, members of the Board of Directors and shareholders that effectively exercise significant influence over the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties. In 2017, the Company signed a category exclusive licensing agreement with Pinkberry Canada Inc. for the Pinkberry Frozen Yogurt program. The Pinkberry brand is owned by the Serruya family who are significant shareholders in the Company. Michael Serruya and Aaron Serruya are members of the Board of Directors.

The Second Cup Ltd.

Notes to the Condensed Interim Consolidated Financial Statements

September 28, 2019 and September 29, 2018

(Unaudited, expressed in thousands of Canadian dollars, except per share amounts)

On July 5, 2019, in accordance with the terms of the employment agreement with the Company's new President and CEO, the Company issued Mr. Steven Pelton 515,241 common shares in the capital of the Company at \$1.70 per share. Mr. Pelton paid \$200 in cash for 117,641 shares and 397,600 shares were paid with the proceeds of two loans advanced to Mr. Pelton by the Company – a five-year loan of \$500 repayable in June 2024 and a one-year loan of \$176 repayable in June 2020, both loans accruing interest at 4.0% per annum.

Effective August 1, 2019, Melinda Lee is assisting management with strategic acquisitions under a consulting arrangement and as a result has stepped down as Audit Committee Chairman and committee member.