



THE SECOND CUP LTD.

ANNUAL REPORT 2018

THE NATIONAL CANADIAN SPECIALTY COFFEE COMPANY

VISION

To be the Canadian specialty coffee brand of choice across Canada, committed to superior quality, innovation and profitable growth.

BRAND PURPOSE

Second Cup Coffee Co.™ ignites customers' passion for the ultimate coffee experience.

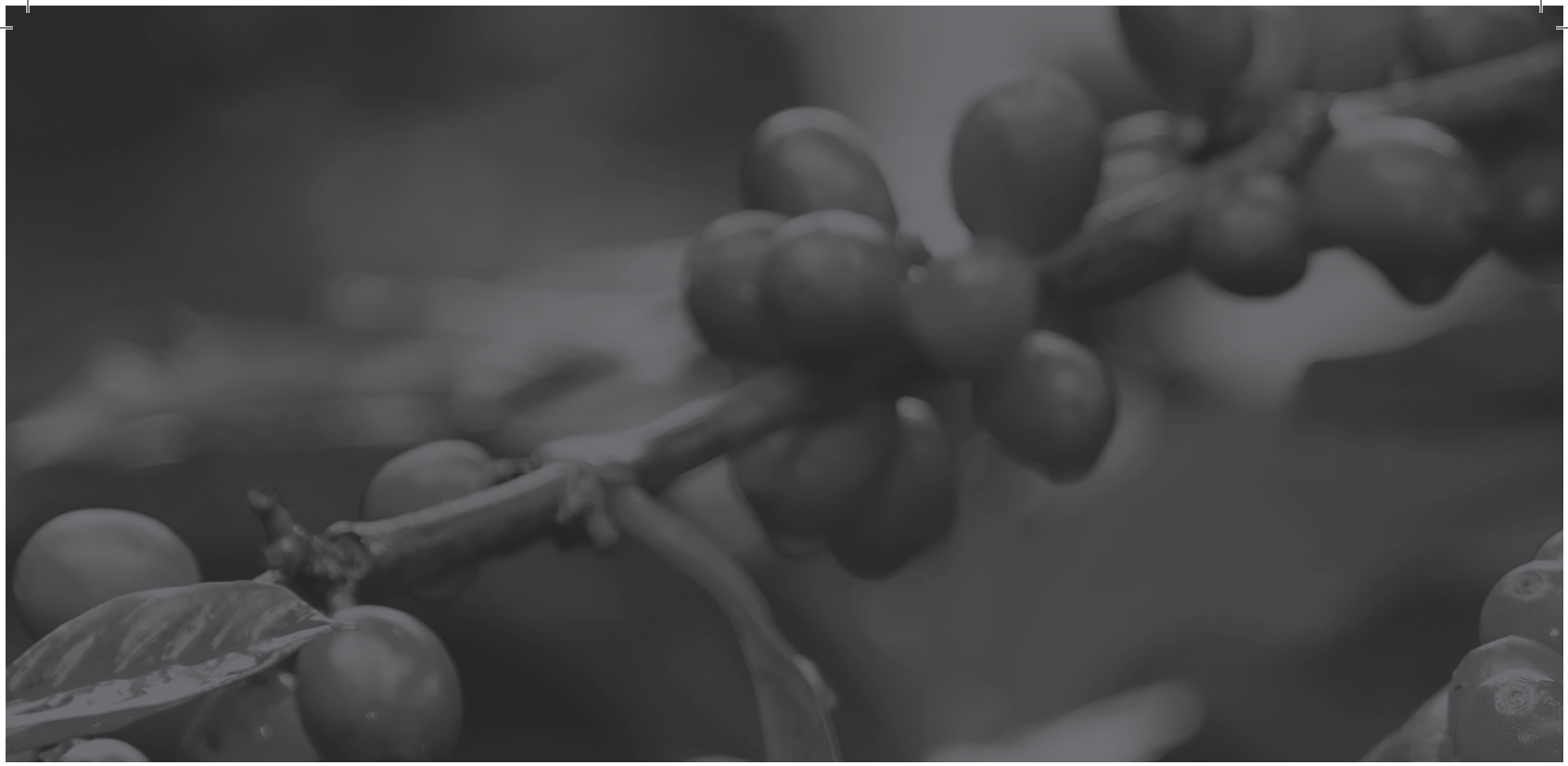
VALUES

Authentic
Superior Quality
Competitive Spirit

Coffee Passion
Innovative
Community Minded

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Letter from the Chairman

From its one time pinnacle as Canada's leading and largest specialty coffee retailer, Second Cup lost its way and its market position eroded over many years. Recent improvements have restored stability and now we need to accelerate the rate of progress. For Second Cup to flourish as a company, we must attract more customers to our stores and we need to improve store economics for our franchisees.

There is a unified sense of urgency for the need to improve. A comprehensive project is underway to reshape the future of Second Cup. Management, franchisees, directors and customers are being drawn upon. Our collective aim is to restore Second Cup to operate best in class coffee stores. While this is a long-term project, we expect to see clear positive signs of improvement in the coming months.

Our aim is to create material value for shareholders. While working to build the core business, we need to pursue additional value creation opportunities. Accordingly, we have embarked on a strategic process whereby we are examining a range of options to create

shareholder value. While there is no assurance of a particular outcome, this strategic process is a priority.

Second Cup's financial foundation has been materially strengthened. The company generated positive cash flow and issued new equity in 2018. At year end, Second Cup was debt free with close to \$15 million cash. There are ample financial resources to support future plans.

We recognize that we have not created value in recent years and this is not acceptable. As a public company we must prioritize value creation for our stakeholders including shareholders, franchisees and employees. We remain optimistic about Second Cup's future and now is the time to pursue the most attractive strategic options available.

Sincerely,

Michael Bregman
Chairman of the Board



Letter from the President & CEO

In 2018, Second Cup achieved its highest profit in four years. We continue to deliver improvement in profitability and our focus remains on growing café sales as well as enhancing our customer experience.

We introduced a number of initiatives throughout the year that have demonstrated strong potential to build sales for 2019 in particular, Pinkberry frozen yogurt, now in over 35% of our cafés, and delivery services like UberEats and Skip The Dishes. We led the Canadian coffee market with the introduction of Clean Label beverages and the “Better For You” category introduced in 2017 continues to gain momentum.

In addition to product innovation, we continued our focus on delivering a truly “handcrafted” coffee experience to our customers with expanded training programs and tools for all cafés and baristas. Our national Latte Art Championship in the fall created excitement among our baristas. Our barista Champion, from Edmonton joined us on our annual coffee expedition to one of our coffee farms in Costa Rica alongside many Second Cup franchisees and Coffee Central staff.

The Second Cup Rewards program continues to grow, representing one quarter

of café sales at year end. Further program enhancements are planned for 2019 including Mobile Order & Pay Ahead.

Upgrading and expanding the Second Cup network is a key part of our strategy. Forty percent of our cafés have been upgraded and new cafés continue to open in traditional and non-traditional formats.

While progress has been made in elevating the brand, we are actively engaged in a brand strategy review to identify and test new innovations to aggressively grow café sales and improve the café economic model which remain top priorities.

My sincere thanks goes to the committed and passionate members of our franchise community, my management team and Coffee Central staff. I also greatly appreciate the support of our dedicated Board of Directors.

Garry Macdonald
President & CEO





2018

Championnat
LATTE ART
Championship

SECOND CUP COFFEE CO.™ CAFÉ & Cie™





— This is Handcrafted

COFFEE INNOVATION

In January 2018, Second Cup led the Canadian coffee market with a move to Clean Label beverages—which now represent over 85% of the beverage menu. Clean Label products contain no artificial colours or flavours, no preservatives and no high-fructose corn syrup.

Canadian consumers are making more informed choices. They care about what is in their food and drinks, and they are looking for options they can feel good about. We are on a continual mission at Second Cup to provide the most premium and innovative coffee experience in the country - and we believe that this is an important step in that journey. Marketing supported this initiative throughout the year, with each new campaign highlighting the Clean Label commitment and benefit for all new beverages and customer faves in our beverage categories including Flash Cold Brew, FroChos, Frappes, Smoothies, brewed coffees and lattes – even our

Pumpkin Spice! The campaign kicked off with a significant investment in outdoor billboards across the country, followed by a cross-Canada sampling tour with the Flash Cold Brew coffee bikes.

In 2018, while we continued to enhance our coffee offering, we also continued our focus on delivering a truly “handcrafted” coffee experience to our customers. We expanded our training programs and tools for all cafés and Baristas, and created excitement among our Baristas with a national Latte Art Championship. Our very best Baristas were flown into Toronto from across the country to compete in a final showdown in Yorkdale Shopping Centre’s Centre Court. Customers across the country have been treated to wonderfully handcrafted coffee beverages topped off with latte art, while our Barista Champion, So-Young Lee from Edmonton enjoyed an all-expenses paid trip for two to one of our coffee farms in Costa Rica alongside many Second Cup franchisees.

SECOND CUP COFFEE CO.™

featuring
 **pinkberry®**
Frozen yogurt



Pinkberry

Second Cup entered into a category exclusive licensing agreement with Pinkberry Canada Inc. in 2017, and since then have rolled out the Pinkberry Frozen Yogurt Brand and program in over one third of Second Cup Coffee Co. cafés across the country. Results

in this first full year have been positive, peaking during the summer months and making Pinkberry our fastest growing new category. Additionally, Pinkberry is driving incremental transactions and positively impacting same store sales.





— This is Handcrafted

BETTER FOR YOU

The “Better For You” category was introduced in 2017 and continued to gain momentum in 2018. This program offers our customers healthier options and is anchored by the Smoothie category—a line of delicious clean label smoothies made with a whole banana and protein boosts like whey. The breakfast cookie made with 10 grams of protein is the top selling bakery item.

Working with best in class bakeries and food partners across the country continues to provide a competitive advantage. We work collaboratively with our partners to develop delicious, regionally relevant items that are made locally and delivered fresh to our cafés.





*Handmade locally.
Baked with fresh ingredients.
Delivered fresh to our cafés.*

This is Handcrafted

FOOD INNOVATION DRIVING GROWTH

Expanding Second Cup's premium, fresh, local food offering in the lunch day part drove growth in food category sales in 2018. Cheese Melts and the Bagel

program launched in 2017 continue to be customer favourites along with new introductions like savoury chicken and meat pies and premium quality soups.









Now Delivered With Uber Eats & **SKIP^{THE} DISHES[™]**

Second Cup has partnered with Uber Eats and Skip the Dishes, giving Canadians the flexibility to have their favourite Second Cup menu items delivered to them wherever they are.

"The feedback I hear most often from Canadians is that they love Second Cup - but that they wish there was a café closer to their home or work," says Garry Macdonald, President and CEO of Second

Cup. "Our new partnership with Uber Eats and Skip the Dishes gives Canadians the flexibility to enjoy our premium coffee and food offerings anywhere that is convenient to them - not just anywhere we have a café."

The program continues to roll out across the country in all delivery accessible locations, and has proven to drive incremental sales for cafés.

Café Upgrades & New Locations

Over 40% of our Second Cup cafés have been modernized to reflect the new design. We continue to work on enhancing the experience while delivering cost efficiency. The Pinkberry Frozen Yogurt concept has been integrated into the café design and is a standard offering.

Growing points of access for

customers continues to be a focus including non-traditional channels. New cafés opened in 2018 including University of Toronto, University of Guelph, Ottawa National Art Gallery, Canadian Museum of History & Indigo (New Brunswick). Tests in new channels are underway.

“Second Cup has been on campus for over 20 years serving our students, faculty, staff and visitors, as well as being a responsible and collaborative tenant in our buildings. One of the goals of our Food Service operation is to support the work of local suppliers, so working with a Canadian coffee brand like Second Cup feels great.”

Anne Macdonald

*Assistant Vice-President Ancillary Services
University of Toronto St. George Campus*

HEALTHY QUICK SERVICE
RESTAURANT FRANCHISES

CELEBRATING
WOMEN'S DAY



SPECIAL FOCUS ON RETAIL
FRANCHISES ACROSS CANADA

FRANCHISE CANADA



Canadian
Franchise
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REIMAGINING THE COFFEE SHOP

Iconic Canadian brand Second Cup
Coffee Co.'s vision for the future

MARCH | APRIL 2019

PN 41043018 \$4.99

0 74470 94981 7 04

Display in business until Apr. 30, 2019

Order & Pay Ahead!

COMING SOON



A Look at 2019

Reinventing the Second Cup brand to offer the most premium and innovative coffee experience in Canada is an on-going effort. In the coming year, we will continue to enhance the experience at every touch point – including an updated café design. At the same time, expanding Second Cup points of distribution with new cafés and more non-traditional locations continues to be a focus.

Delivering a best-in-class experience and product innovation to drive same store sales growth remains our priority. Mobile Order and Pay Ahead will be introduced this year bringing the in-café experience into a new digital dimension – providing the customer with added

convenience by allowing them to skip the line and avoid wait times.

The Rewards program grew by 68,000 in 2018, ending the year with a total of 438,000 members. The Rewards members are our best customers and the loyalty program is key to our growth – our members come more often and spend more than non-members. The integration of Mobile Order & Pay Ahead into the Rewards Program will aid in the acceleration of member growth and enhance member loyalty.

Growing Pinkberry awareness and trial will be a key marketing priority – we know that once a customer tastes Pinkberry, they love it! Expect to see new items added to the “Better For You” menu as well.





Financial Highlights

Financial Highlights

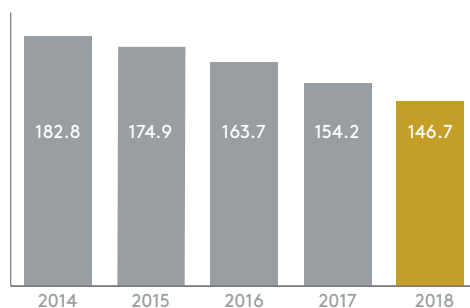
The following table sets out selected IFRS and certain non-GAAP financial measures of the Company and should be read in conjunction with the Audited Consolidated Financial Statements of the Company for the 52 weeks ended December 29, 2018.

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

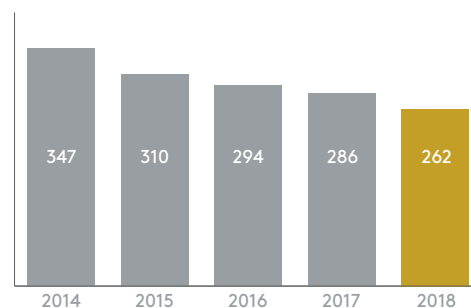
1 See the section "Definitions and Discussion on Certain non-GAAP Financial Measures" for further analysis.

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

System wide sales
(in millions of Canadian dollars)



Number of Second Cup cafés
(in Canada)



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 March 1, 2019 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 52 weeks (the "Year") ended December 29, 2018, and should be read in conjunction with the Audited Financial Statements of the Company for the 52 weeks ended December 29, 2018, accompanying notes 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 262 cafés operating under the trade name Second Cup™ in Canada, of which 25 are Company-owned and the balance are 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, excluding the Territory of Nunavut.

The Company was incorporated under the Business Corporations Act (Ontario) in 2011. The address of its registered office is 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8. The website is www.secondcup.com. The common shares are listed on the Toronto Stock Exchange under the symbol "SCU".

The fiscal year follows the method, 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 year 2018 consists of 52 weeks.

As at December 29, 2018, the issued share capital consisted of 19,940,073 common shares.

Additional information including the Annual Information Form is on SEDAR at www.sedar.com.

As a franchisor, Second Cup opens, acquires, closes and refranchises individual café locations in the normal course of business.

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.

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

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.

The Company has been assisting NAC in its applications for recreational cannabis dispensary licenses in Alberta in respect of select locations that are currently occupied by Second Cup cafés. Of the five applications submitted for the City of Calgary, there are two locations – where a development permit by the City has been granted – that the joint venture are in the various stages of negotiations with the respective landlords and franchisees to convert to a cannabis dispensary. In November 2018, the Alberta Gaming, Liquor and Cannabis (the "AGLC") announced a moratorium on new dispensary licences due to logistics issues, cannabis shortages and high demand. The Company will continue to work with NAC and other parties towards conversion of these two cafés when the moratorium is lifted by the AGLC.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Company continues to focus on strengthening its franchise network, franchising corporate stores to strong operators to follow an asset light business model, and expects to make further reductions in the number of Company-owned cafés in 2019.

CAPABILITIES

This section documents factors that affect the Company's ability 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 Second Cup brand

The brand – Second Cup Coffee Co.TM – reflects an independent spirit, a commitment to deliver the world's finest coffee, and the Company's vision to be the coffee brand most passionately committed to quality and innovation. A proud Canadian company since 1975 with 262 cafés across Canada, Second Cup Coffee Co.TM is a specialty coffee retailer. The Company maintains its commitment to the communities it operates in, celebrating the franchisees' local ownership and their focus on providing quality and friendly service to each customer in every café.

The people

The franchise network consists of approximately 3,000 team members. Team members range from baristas, managers and franchisees at the cafés to support personnel employed at Coffee Central (head office). Baristas and franchisees complete extensive training and certification to deliver a quality product to our customers. Franchisees and baristas are subject to operational quality checks to monitor performance.

Product

As of today, 85% of Second Cup's beverage menu is Clean Label. Clean Label beverages contain no artificial colours or flavours, no preservatives and no high fructose corn syrup. Second Cup will continue to reformulate other menu items to meet the Clean Label standard.

The Company has a strategic partnership with an independent roaster of coffees. The Company has also partnered with Swiss Water Decaffeinated Coffee Company Inc. to decaffeinate its coffee. This process is 100% chemical-free, unlike other decaffeination methods that use methylene chloride or ethyl acetate to remove the caffeine. This decaffeination process gently removes 99.9% of the caffeine while maintaining the unique taste characteristics of the coffee. The process reflects Second Cup's commitment to natural and healthy products.

Second Cup prides itself that all of its coffee and espresso beverages are certified by third parties such as Rainforest Alliance™ - certification that the coffee is grown and processed in a socially and environmentally responsible manner. The Company offers a fair-trade and organic certified blend of coffee called Cuzco®.

Second Cup has introduced a line of Better For You products that continues to grow. This includes smoothies made with a whole banana and added protein boosts and its best-selling breakfast cookie with 10 grams of protein.

In addition to coffee-based products and other beverages, cafés carry a variety of complementary products, including Pinkberry, pastries, sandwiches, muffins, cookies, coffee accessories and coffee-related gift items.

The Pinkberry brand is the leading premium brand in the frozen yogurt category. Launched in California in 2005, Pinkberry has developed a cult-like following and is made with high-quality fresh ingredients, fresh hand-cut fruit and premium toppings.

Liquidity, capital resources and management of capital

The Company's objectives relating to the management of its capital structure are to:

- safeguard its ability to continue as a going concern;
- maintain financial flexibility in order to preserve its ability to meet financial obligations; and
- deploy capital to provide an adequate return to its shareholders.

The Company's primary uses of capital are to finance increases in non-cash working capital, capital expenditures, and other corporate purposes.

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 of old warrants.

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 and net proceeds of \$9,190.

On December 18, 2018, the Company announced that the Toronto Stock Exchange (the "TSX") had approved its notice of intention to make a normal course issuer bid for a portion of its common shares. Pursuant to the normal course issuer bid, the Company intends to acquire up to 1,000,000 Common Shares, representing approximately 7.4% of its public float of 13,463,184 common Shares, in the 12-month period commencing December 20, 2018 and ending on December 19, 2019 or such earlier time that the Company completes its purchases pursuant to the normal course issuer bid or provides notice of termination. Under the normal course issuer bid, the Company may purchase up to 12,071 common shares on the TSX during any trading day. As of December 29, 2018, the Company had repurchased 60,335 common shares for an aggregate total value of \$115.

Competition

The Canadian specialty coffee market is highly competitive and highly fragmented, with few barriers to entry. There are national, regional and local coffee retailers who are specialty coffee providers or quick serve restaurants with broad menus.

Technology

Second Cup relies heavily on information technology network infrastructure including point of sale system ("POS") hardware and software in cafés, gift and loyalty card transactions, and head office financial and administrative functions. The ability to manage operations effectively and efficiently depends on the reliability and capacity of these technology systems, most of which are administered by third party suppliers. The Company has made significant investments in POS systems across its store network as it relies on the POS system to help analysis for both marketing initiatives and royalty calculations.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS

The following table sets out selected IFRS and certain non-GAAP financial measures of the Company and should be read in conjunction with the Audited Consolidated Financial Statements of the Company for the 52 weeks ended December 29, 2018.

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Number of weighted average common shares issued and outstanding	19,940,073	17,041,473	18,920,785	14,485,081

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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	2016	2017	2018	Average
First Quarter	23.9	24.6	24.5	24.3
Second Quarter	24.6	24.6	24.7	24.6
Third Quarter	23.0	24.0	24.3	23.8
Fourth Quarter	28.5	26.8	26.5	27.3
	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		52 weeks ended	
	December 29, 2018	December 30, 2017	December 29, 2018	December 30, 2017
Number of cafés – beginning of period	270	289	286	294
Cafés opened	3	2	7	4
Cafés closed	(11)	(5)	(31)	(12)
Number of cafés – end of period	262	286	262	286

The Company ended the Year with 25 (2017 - 12) 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 13 weeks ended December 29, 2018 were \$38,860 compared to \$41,326 for the 13 weeks ended December 30, 2017 representing a decrease of \$2,466 or 6.0%. The decrease in system sales of cafés is primarily due to the reduction in café count and lower transactions.

Same café sales

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

Analysis of revenue

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

Operating costs and expenses

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

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

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

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

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

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

EBITDA

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

Other expenses

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

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

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

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

Interest and financing income

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

Net income (loss)

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

The consolidated financial statements for 2018 reflect the consolidation of the Co-op Fund under IFRS 15 whereas the condensed interim financial statements for the previous three quarters were prepared under the guidance of the previous standard. See the section "Changes in Accounting Policies" for further analysis.

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

YEAR

System sales of cafés

System sales of cafés for the Year were \$146,697 (2017 - \$154,153), a decrease of \$7,456 or 4.8%. The decrease is primarily due to the reduction in café count.

Same café sales

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

Analysis of revenue

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

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

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

Operating costs and expenses

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

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

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

EBITDA

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

Other income and expenses

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

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

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

Interest and financing costs

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

Net income (loss)

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

The consolidated financial statements for 2018 reflect the consolidation of the Co-op Fund under IFRS 15 whereas the condensed interim financial statements for the previous three quarters were prepared under the guidance of the previous standard. See the section "Changes in Accounting Policies" for further analysis

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

SELECTED QUARTERLY INFORMATION

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts.)	Q4 2018 ^{2,3}	Q3 2018 ³	Q2 2018 ³	Q1 2018 ³
System sales of cafés ¹	\$38,860	\$35,704	\$36,213	\$35,920
Same café sales ¹	(2.0%)	0.3%	(1.0%)	(2.2%)
Number of cafés – end of period	262	270	275	279
Total revenue	\$7,176	\$5,937	\$5,627	\$4,897
Operating income (loss) ¹	\$814	\$520	\$212	(\$175)
EBITDA ¹	\$1,138	\$858	\$537	\$174
Adjusted EBITDA ¹	\$1,297	\$880	\$559	\$194
Net income (loss) for the period	(\$55)	\$766	\$577	(\$138)
Adjusted net income (loss) for the period ¹	\$594	\$432	\$186	(\$138)
Basic and diluted earnings (loss) per share	\$0.00	\$0.04	\$0.03	(\$0.01)
Adjusted basic diluted earnings (loss) per share ¹	\$0.03	\$0.03	\$0.01	(\$0.01)
	Q4 2017 ²	Q3 2017	Q2 2017	Q1 2017
System sales of cafés ¹	\$41,326	\$37,014	\$37,898	\$37,915
Same café sales ¹	(1.1%)	0.0%	0.7%	(0.2%)
Number of cafés – end of period	286	289	291	293
Total revenue	\$6,085	\$5,339	\$6,237	\$5,975
Operating (loss) income ¹	\$993	\$436	(\$138)	(\$315)
EBITDA ¹	\$1,339	\$805	\$230	\$60
Adjusted EBITDA ¹	\$1,339	\$805	\$517	\$60
Net (loss) income for the period	\$655	(\$2,962)	(\$315)	(\$475)
Adjusted net income (loss) for the period ¹	\$655	\$245	(\$315)	(\$475)
Basic and diluted (loss) earnings per share	\$0.04	(\$0.19)	(\$0.02)	(\$0.04)
Adjusted basic diluted earnings (loss) per share ¹	\$0.04	\$0.02	(\$0.02)	(\$0.04)

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

2 The Company's fourth quarter System sales of cafés are higher than other quarters due to the seasonality of the business (see "Seasonality of system sales of cafés" above).

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

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 and product sales. 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Summary of cash flows

	13 weeks ended		52 weeks ended	
	December 29, 2018	December 30 2017	December 29, 2018	December 30, 2017
Cash flows provided by operating activities	\$1,050	\$1,583	\$2,209	\$1,862
Cash flows provided by (used in) investing activities	(248)	(150)	(1,084)	4
Cash flows provided by (used in) financing activities	(3)	(124)	9,190	(297)
Increase in cash and cash equivalents during the period	\$799	\$1,309	\$10,315	\$1,569

FOURTH QUARTER

Cash provided by operating activities was \$1,050 for the Quarter compared to \$1,583 for the same period last year. The decrease in operating cash of \$533 is mainly due to changes in share-based compensation and other non-cash working capital items.

During the Quarter, cash used in investing activities was \$248 compared to cash used of \$150 for the same Quarter in 2017. The increase is mainly due to higher capital expenditures.

Cash used in financing activities was (\$3) for the Quarter compared to \$124 last year. In the Quarter, the Company repurchased 60,335 common shares under a normal course issuer bid for an aggregate total value of \$115 with settlement in 2019.

YEAR

Cash provided by operating activities was \$2,209 for the Year compared to \$1,862 for 2017. The increase in operating cash of \$347 is primarily due to a reduction in interest and financing costs and an increase in interest income offset by changes in non-cash working capital.

During the Year, cash used by investing activities was \$1,084 compared to cash provided of \$4 for 2017. The increase in 2017 is primarily driven by higher payments for capital expenditures in Company-owned cafés to be refranchised.

Cash provided by financing activities was \$9,190 for the Year compared to cash used of \$297 in 2017. The Company closed the Offering on May 8, 2018, net of transaction costs. As of December 29, 2018, the Company had repurchased 60,335 common shares under a normal course issuer bid for an aggregate total value of \$115 with settlement in 2019.

Working capital as at

	December 29, 2018	December 30, 2017
Current assets	\$20,199	\$10,122
Current liabilities	11,153	9,869
Working capital (deficiency)	\$9,046	\$253

The Company's working capital was \$9,128 as at December 29, 2018 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 \$9,190, leading to an increase in cash balance. The increase in current liabilities in 2018 is primarily due to the unamortized income related to the NAC strategic alliance. Gift card liability ended the Year at \$2,327, a decrease of \$1,107 compared to the end of 2017. The application of IFRS 15 accounting on gift card balances outstanding at December 31, 2017 is reflected as a \$927 decrease in gift card liability and a \$927 increase in accrued liabilities. Based on the historical redemption patterns, the Company believes that it has sufficient financial resources to cover the gift card liability.

Financial instruments

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

Financial instrument	Risks
Financial assets	
Cash and cash equivalents	Credit and interest rate
Restricted cash	Credit and interest rate
Trade and other receivables	Credit
Notes and leases receivable	Credit
Warrants	Credit, liquidity, and interest rate
Financial liabilities	
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 lease 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 has 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.

(ii) Liquidity risk

Liquidity risk is managed through regular monitoring of forecast and actual cash flows, monitoring maturity dates of financial assets and liabilities, and also the management of the Company's capital structure and debt leverage. The Company's main source of income is royalty receipts from its franchisees, corporate café sales, and sales from goods and services.

MANAGEMENT'S DISCUSSION AND ANALYSIS

(iii) Currency and commodity risk

The Company purchases certain products, such as coffee, in U.S. dollars, thereby exposing the company to risks associated with fluctuations in currency exchange rates. The Company is also directly and indirectly exposed to commodity market risk. The exposure relates to the changes in coffee commodity prices given it is a material input for the Company's product offerings. The direct exposure is mitigated given that the Company has the ability to adjust its sales price as commodity prices change. The indirect risk exists where franchisee profitability may be impacted, thus potentially resulting in an impeded ability to collect accounts receivable or the need for other concessions to be made to the franchisee. This risk is mitigated by entering fixed price forward purchase commitments through coffee commodity brokers and by having the ability to adjust retail selling prices.

Contingencies, commitments and guarantees

	Total	Payments Due by Period			
		1 year	2 – 3 years	4 – 5 years	After 5 years
Contractual Obligations					
Obligations from Operating Leases	\$16,681	\$2,451	\$4,409	\$3,934	\$5,887
Purchase Obligations	1,812	1,812	Nil	Nil	Nil
Total Contractual Obligations	\$18,493	\$4,263	\$4,409	\$3,934	\$5,887

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
December 28, 2019	\$16,929	\$14,478	\$2,451
December 26, 2020	15,286	12,978	2,308
December 25, 2021	13,679	11,578	2,101
December 31, 2022	12,519	10,492	2,027
December 30, 2023	10,750	8,843	1,907
Thereafter	27,712	21,825	5,887
	\$96,875	\$80,194	\$16,681

The Company believes it has sufficient resources to meet the net commitment of \$16,681 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 value of coffee purchases of \$1,601 (2017 - \$1,392) 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 is \$211 (2017 - \$894) of contractual commitments pertaining to construction costs for new locations and renovations as at the end the Year. Construction costs are financed from deposits received from franchisees for franchise projects and from the Company's cash flows for corporate projects.

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 March 1, 2019, 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 December 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 December 29, 2018 and up to the date of the approval of the Audited 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.

As at March 1, 2019, 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 December 29, 2018, the Company's controls over financial reporting were appropriately designed and were operating effectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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 December 29, 2018 and up to the date of the approval of the Audited 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 Consolidated Financial Statements requires management to make estimates, assumptions, and use judgement in applying its accounting policies and assumptions about the future. Estimates and other judgements 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 in determining the amounts reported in the consolidated financial statements:

- the determination of the recoverable amounts 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 judgement

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

(i) Impairment charges

Impairment analysis is an area involving management judgement in determining the recoverable amount of an asset. The recoverable amount of a cash generating unit ("CGU") is calculated as the higher of the fair value less costs of disposal, and its value in use. Fair value is determined by estimating the net present value of future cash flows derived from such assets using cash flow projections that have been discounted at an appropriate rate and based on a market participant's view. In calculating the net present value of the future cash flows, certain assumptions are required to be made in respect of highly uncertain matters including:

- growth in total revenue;
- change and timing of cash flows such as the increase or decrease of expenditures;
- selection of discount rates to reflect the risks involved; and
- applying judgement in cash flows specific to CGUs.

Changing the assumptions selected by management, in particular the discount rate and the growth rate used in the cash flow projections, could significantly affect the impairment evaluations and recoverable amounts.

The Company's impairment tests include key assumptions related to the scenarios discussed above.

(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 allocations based on historical and budgeted operating results and income tax laws existing at the reporting 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 judgement 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 judgements.

(v) Allowance for doubtful accounts

The adoption of IFRS 9 has changed the accounting for impairment losses, with respect to financial assets, by replacing IAS 39's incurred loss approach with a forward-looking expected credit loss ("ECL") approach. For the Company, it is not expected that impairment losses will be materially different under IFRS 9, as compared to the incurred loss approach. IFRS 9 requires the Company to record an allowance for expected credit losses ("ECLs") for all loans and other debt financial assets that are not held at fair value through profit and loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Company expects to receive. The shortfall is then discounted at an approximation to the asset's original effective interest rate.

The Company notes that its cash equivalents and short-term investments are high-grade investments that are held with reputable financial institutions. As such, these assets are considered to be low credit risk investments.

For trade and other receivables, the Company has applied the standard's simplified approach and has calculated ECLs based on lifetime expected credit losses. The Company has established a provision matrix that is based on the Company's historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment. The adoption of the ECL requirements of IFRS 9 resulted in no changes to impairment allowances of the Company's financial assets. As such, there were no retrospective adjustments made upon transition.

CHANGES IN ACCOUNTING POLICIES

In May, 2014, the IASB issued IFRS 15, Revenue from Contracts with Customers ("IFRS 15") a new comprehensive model for entities to use accounting for revenue arising from contracts with customers. On December 31, 2017, ("Transition Date") the Company applied IFRS 15 using the modified retrospective transition method. The consolidated financial statements 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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 income, a decrease to deferred income taxes of \$832 and a decrease to the retained earnings (deficit) of \$2,286.

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

Under IFRS 15, the Company recognizes gift card breakage income proportionately as gift cards are redeemed using an estimated breakage rate based on our historical experience. Previously, the Company recognized the estimated breakage income on gift card sales on a pro rata basis based on an estimate breakage rate. The application of IFRS 15 accounting on gift card balances outstanding at December 31, 2017 is reflected as a \$927 decrease in gift card liability and a \$927 increase in other accrued liabilities.

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 material impact to the opening retained earnings (deficit) and to the fiscal year ended December 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 is in the process of completing its analysis but the most significant impact will be in the area of accounting for its franchisee subleases and the operating leases of its head office and corporate cafés.

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. Potential risks include the following:

The specialty coffee industry is characterized by intense competition with respect to price, location, coffee and food quality, and numerous factors affecting discretionary consumer spending. Competitors include national and regional chains, independent cafés, all restaurants and food service outlets that serve coffee, and supermarkets that compete in the whole bean and roast and ground segments.

Growth of the café network depends on Second Cup's ability to secure and build desirable locations and find high calibre, qualified franchisees to operate them. Credit markets may affect the ability of franchisees to obtain new credit or refinance existing credit on economically reasonable terms.

Second Cup faces competition for café locations and franchisees from its competitors and from franchisors and operators of other businesses. The success of franchisees is significantly influenced by the location of their cafés. There can be no assurance that current café locations will continue to be attractive, or that additional café sites can be located and secured as demographic and traffic patterns change. Also, there is no guarantee that the property leases in respect of the cafés will be renewed or suitable alternative locations will be obtained and, in such event, cafés could be closed. It is possible that the current locations or economic conditions where cafés are located could decline in the future, resulting in reduced sales in those locations. There is no assurance that future sites will produce the same results as past sites. There is also no assurance that a franchisee will continue to pay rental obligations in a timely manner, which could result in Second Cup being obligated to pay the rental obligations pursuant to its head lease commitment, which would adversely affect the profitability of the business.

The Canadian specialty coffee industry is also affected by changes in discretionary spending patterns, which are in turn dependent on consumer confidence, disposable consumer income and general economic conditions. Factors such as changes in general economic conditions, recessionary or inflationary trends, job security and unemployment, equity market levels, consumer credit availability and overall consumer confidence levels may affect their business. The specialty coffee industry is also affected by demographic trends, traffic and weather patterns, as well as competing cafés.

Business could be adversely affected by increased concerns about food safety in general or other unusual events. On May 28, 2015, the government of Ontario enacted the Making Healthy Choices Act, 2015. The Act came into force on January 1, 2017. Restaurant chains and other food service providers with 20 or more locations operating under the same (or substantially the same) name in Ontario have made changes to the information they display on menus, menu boards and displays.

Second Cup relies heavily on information technology (IT) network infrastructure. The ability to manage operations effectively and efficiently depends on the reliability and capacity of these IT systems, most of which are administered by third party suppliers. The Company relies on POS for system sales for both marketing trends and royalty calculations. Cafés rely on IT network infrastructure to order goods and process credit, debit and café card transactions. Coffee Central financial and administrative functions rely on IT infrastructure for accurate and reliable information. The failure of these systems to operate effectively, or problems with upgrading or replacing systems, could cause a material negative financial result. The Company is continually reviewing its systems and procedures to minimize risk.

The company's cash flow can also be impacted by underperformance of its franchise network through reduced royalties, higher lease exit provisions or the increase in the number of corporate stores. Reduced earnings could impact the company's ability to comply with its credit facility covenants.

The loss of key personnel and/or a shortage of experienced management and hourly employees could have an adverse impact on operations and cafés.

MANAGEMENT'S DISCUSSION AND ANALYSIS

A more detailed discussion of the risks and uncertainties affecting Second Cup is set out in the Second Cup's Annual Information Form, which is available at www.sedar.com.

OUTLOOK

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

Earlier in the year, following the strengthening of the balance sheet, Second Cup initiated a strategic review to examine alternatives to create shareholder value. This review is ongoing.

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

DEFINITIONS AND DISCUSSION ON CERTAIN NON-GAAP FINANCIAL MEASURES

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

System sales of cafés

System sales of cafés comprise the net revenue reported to Second Cup by franchisees of Second Cup cafés and by Company-owned cafés. This measure is useful in assessing the operating performance of the entire Company network, such as capturing the net change of the overall café network.

Changes in system sales of cafés result from the number of cafés and same café sales (as described below). The primary factors influencing the number of cafés within the network include the availability of quality locations and the availability of qualified franchisees.

Same café sales

Same café sales represent the percentage change, on average, in sales at cafés operating system-wide that have been open for more than 12 months. It is one of the key metrics the Company uses to assess its performance as an indicator of appeal to customers. Two principal factors that affect same café sales are changes in customer count and changes in average transaction size.

Operating income (loss)

Operating income (loss) represents revenue, less cost of goods sold, less operating expenses, and less impairment charges. This measure is not defined under IFRS, although the measure is derived from input figures in accordance with IFRS. Management views this as an indicator of financial performance that excludes costs pertaining to interest and financing, and income taxes.

EBITDA and adjusted EBITDA

EBITDA represents earnings before interest and financing, income taxes, and depreciation and amortization. Adjustments to EBITDA are for items that are not necessarily reflective of the Company's underlying operating performance. As there is no generally accepted method of calculating EBITDA, this measure is not necessarily comparable to similarly titled measures reported by other issuers. EBITDA is presented as management believes

it is a useful indicator of the Company's ability to meet debt service and capital expenditure requirements, and evaluate liquidity. Management interprets trends in EBITDA as an indicator of relative financial performance. EBITDA should not be considered by an investor as an alternative to net income or cash flows as determined in accordance with IFRS.

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

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

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

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

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

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

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

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

Audited Consolidated Financial Statements

For the 52 weeks ended December 29, 2018 and December 30, 2017

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of The Second Cup Ltd.

Our opinion

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of The Second Cup Ltd. and its subsidiaries (together, the Company) as at December 29, 2018 and December 30, 2017, and its financial performance and its cash flows for the 52-week periods then ended in accordance with International Financial Reporting Standards (IFRS).

What we have audited

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 29, 2018 and December 30, 2017;
- the consolidated statements of operations and comprehensive income (loss) for the 52-week periods then ended;
- the consolidated statements of changes in shareholders' equity for the 52-week periods then ended;
- the consolidated statements of cash flows for the 52-week periods then ended; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

Basis for opinion

We conducted our audit in accordance with Canadian generally accepted auditing standards. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the consolidated financial statements section of our report.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Canada. We have fulfilled our other ethical responsibilities in accordance with these requirements.

Other information

Management is responsible for the other information. The other information comprises the Management's Discussion and Analysis, which we obtained prior to the date of this auditor's report and the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, which is expected to be made available to us after that date.

Our opinion on the consolidated financial statements does not cover the other information and we do not and will not express an opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard. When we read the information, other than the consolidated financial statements and our auditor's report thereon, included in the annual report, if we conclude

that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor's responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Canadian generally accepted auditing standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with Canadian generally accepted auditing standards, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

The engagement partner on the audit resulting in this independent auditor's report is Aneil Manji.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

Toronto, Ontario

March 1, 2019

Consolidated Statements of Financial Position

As at December 29, 2018 and December 30, 2017

(Expressed in thousands of Canadian dollars)

	2018	2017
ASSETS		
Current assets		
Cash and cash equivalents	\$14,888	\$4,573
Restricted cash (note 24)	1,750	1,359
Trade and other receivables (note 6)	2,561	3,716
Notes and leases receivable (note 7)	30	64
Inventories (note 8)	525	205
Prepaid expenses and other assets	259	206
Income tax receivable	186	-
	20,199	10,123
Non-current assets		
Notes and leases receivable (note 7)	23	74
Investments in equity securities (note 16)	1,720	-
Property and equipment (note 9)	2,044	2,132
Intangible assets (note 10)	32,015	32,372
Total assets	\$56,001	\$44,701
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 11)	\$5,251	\$3,974
Provisions (note 12)	634	934
Other liabilities (note 13)	130	208
Gift card liability	2,327	3,433
Deposits from franchisees	769	1,230
Deferred income (note 27)	2,042	-
Income tax payable	-	91
	11,153	9,870
Non-current liabilities		
Provisions (note 12)	297	230
Other liabilities (note 13)	157	179
Deferred income (note 27)	2,357	-
Deferred income taxes (note 20)	5,591	6,160
Total liabilities	19,555	16,439
SHAREHOLDERS' EQUITY	36,446	28,262
Total liabilities and shareholders' equity	\$56,001	\$44,701

Contingencies, commitments and guarantees (note 25)

See accompanying notes to consolidated financial statements.

Approved by the Directors March 1, 2019



Michael Bregman, Director



Melinda Lee, Director

Consolidated Statements of Operations and Comprehensive Income (Loss)

For the periods ended December 29, 2018 and December 30, 2017

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

	2018	2017
Revenue (note 14)		
Company-owned cafés and product sales	7,885	\$8,562
Franchise revenue	17,829	15,074
	25,714	23,636
Operating costs and expenses (note 15)		
Company-owned cafés and cost of product sales	8,954	9,303
Franchise expenses	8,961	5,693
General and administrative expenses	5,064	6,009
Loss on disposal of assets	28	197
Depreciation and amortization	1,335	1,458
	24,342	22,660
Income from operations	1,372	976
Other income (notes 5, 16, 17 and 19)	(105)	-
Interest and financing costs (income)(note 18)	(165)	3,897
Income (loss) before income taxes	1,642	(2,921)
Income taxes (note 20)	491	176
Net income (loss) and comprehensive income (loss) for the period	\$1,151	(\$3,097)
Basic and diluted income (loss) per share (note 21)	\$0.06	(\$0.21)

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

For the periods ended December 29, 2018 and December 30, 2017

(Expressed in thousands of Canadian dollars)

	Share Capital	Warrants	Contributed Surplus	Retained Earnings (Deficit)	Total
Balance – December 31, 2016	\$8,652	\$271	\$61,789	(\$49,824)	\$20,888
Net loss for the period	\$–	\$–	\$–	\$(3,097)	\$(3,097)
Stock option plan recovery	–	–	(42)	–	(42)
Warrants extinguished (note 3)	–	(271)	–	–	(271)
Warrants issued (note 3)	–	165	–	–	165
Shares issued (note 3)	10,619	–	–	–	10,619
Balance – December 30, 2017	\$19,271	\$165	\$61,747	(\$52,921)	\$28,262
Adoption of new accounting policy - net of tax (note 2(x))	\$–	\$–	\$–	(\$2,286)	(\$2,286)
Net income for the period	–	–	–	1,151	1,151
Stock option plan expense (note 28)	–	–	28	–	28
Shares repurchased (note 4)	(87)	–	–	(28)	(115)
Shares issued net of tax (note 4)	9,406	–	–	–	9,406
Balance – December 29, 2018	\$28,590	\$165	\$61,775	(\$54,084)	\$36,446

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows

For the periods ended December 29, 2018 and December 30, 2017

(Expressed in thousands of Canadian dollars)

	2018	2017
CASH PROVIDED BY (USED IN)		
Operating activities		
Net income (loss) for the period	\$1,151	(\$3,097)
Items not involving cash		
Depreciation of property and equipment	825	1,018
Amortization of intangible assets	510	456
Amortization of deferred financing costs	–	139
Share-based compensation expense	18	60
Deferred income taxes (note 20)	480	30
Loss on disposal of property related items	28	197
Other income	(1,256)	–
Change in fair value of investments in securities	935	–
Asset impairment charges	216	–
Fair value of difference on shares issued and other cost	–	3,290
Bad debt expense for notes and leases receivable	35	43
Changes in non-cash working capital & other (note 21)	(733)	(274)
Cash provided by (used in) operating activities	2,209	1,862
Investing activities		
Proceeds from disposal of assets	304	473
Cash payments for capital expenditures (note 22)	(1,281)	(383)
Cash payments for intangible assets (note 22)	(157)	(217)
Notes receivable repayment	50	131
Cash (used in) provided by investing activities	(1,084)	4
Financing activities		
Proceeds from issuance of shares	10,000	–
Transaction costs	(810)	(297)
Cash (used in) provided by financing activities	9,190	(297)
Increase in cash and cash equivalents during the period	10,315	1,569
Cash and cash equivalents – Beginning of the period	4,573	3,004
Cash and cash equivalents – End of the period	\$14,888	\$4,573

See accompanying notes to consolidated financial statements. Supplemental cash flow information is provided in note 22. Information on non-cash transactions and supplemental cash flow information are described further in notes 5, 23, and 24.

Notes to the Consolidated Financial Statements

For the periods ended December 29, 2018 and December 30, 2017

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

1. ORGANIZATION AND NATURE OF BUSINESS

The Second Cup Ltd. ("Second Cup" or "the Company") is a Canadian specialty coffee retailer with 262 (2017 - 286) cafés operating under the trade name Second Cup™ in Canada, of which 25 (2017 - 12) are Company-operated and the balance operated by franchisees.

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of preparation

The consolidated financial statements (the "financial statements") have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The consolidated financial statements have been prepared on the historical cost basis except for certain financial instruments that are measured at fair value at the end of each reporting period. The Company's functional currency is the Canadian dollar.

The Company's fiscal year follows the method implemented by many retail entities, such that each quarter consists of 13 weeks and ends 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 2018 is a 52-week period (2017 - 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 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 cafes, the sale of goods through retail and other ancillary channels and other service fees.

Management is organized based on the Company's operations as a whole rather than the specific revenue streams.

c. Critical accounting estimates, assumptions and the use of judgement

The preparation of consolidated financial statements requires management to make estimates and assumptions and use judgement in applying its accounting policies and in determining estimates and assumptions about the future. Estimates and other judgements 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 critical estimates, assumptions and judgements the Company makes in determining the amounts reported in the consolidated financial statements:

- the determination of the recoverable amounts 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 judgement

The following discusses the critical judgements and accounting estimates that the Company has made in the preparation of the consolidated financial statements:

(i) Impairment charges

Impairment analysis is an area involving management judgement in determining the recoverable amount of an asset. The recoverable amount of a cash generating unit ("CGU") is calculated as the higher of the fair value less costs of disposal, and its value in use. Fair value is determined by estimating the net present value of future cash flows derived from such assets using cash flow projections that have been discounted at an appropriate rate and based on a market participant's view. In calculating the net present value of the future cash flows, certain assumptions are required to be made in respect of highly uncertain matters including:

- growth in total revenue;
- change and timing of cash flows such as the increase or decrease of expenditures;
- selection of discount rates to reflect the risks involved; and
- applying judgement in cash flows specific to CGUs.

Changing the assumptions selected by management, in particular the discount rate and the growth rate used in the cash flow projections, could significantly affect the impairment evaluations and recoverable amounts.

The Company's impairment tests include key assumptions related to the scenarios discussed above. Further details are provided in note 19 to the consolidated financial statements.

(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 allocations based on historical and budgeted operating results and income tax laws existing at the reporting 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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

significant changes in the amount of depreciation recorded in respect of the Company's property and equipment in the future.

(iv) Café lease provisions

Café lease provisions are based on the evaluation of the likelihood and measurement of settlements, temporary payouts, or sub-leasing. Management works with landlords, franchisees and uses previous experience to obtain adequate information needed to make these assessments.

(v) Allowance for doubtful accounts

The adoption of IFRS 9, Financial Instruments ("IFRS 9") has changed the accounting for impairment losses, with respect to financial assets, by replacing International Accounting Standard 39, Financial Instruments: Recognition and Measurement ("IAS 39")'s incurred loss approach with a forward-looking expected credit loss ("ECL") approach. For the Company, it is not expected that impairment losses will be materially different under IFRS 9, as compared to the incurred loss approach. IFRS 9 requires the Company to record an allowance for ECLs for all loans and other debt financial assets that are not held at fair value through profit and loss. ECLs are based on the difference between the contractual cash flows due in accordance with the contract and all the cash flows that the Company expects to receive. The shortfall is then discounted at an approximation to the asset's original effective interest rate.

The Company notes that its cash equivalents and short-term investments are high-grade investments that are held with reputable financial institutions. As such, these assets are considered to be low credit risk investments.

For trade and other receivables, the Company has applied the standard's simplified approach and has calculated ECLs based on lifetime expected credit losses. The Company has established a provision matrix that is based on the Company's historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment. The adoption of the ECL requirements of IFRS 9 resulted in no changes to impairment allowances of the Company's financial assets. As such, there were no retrospective adjustments made upon transition.

d. Financial instruments

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when obligations are discharged, cancelled or they expire.

Financial assets and liabilities are offset and the net amount reported in the Consolidated Statements of Financial Position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis or realize the asset and settle the liability simultaneously. Hedge accounting is not used.

Financial assets classified as fair value through profit and loss ("FVPL") are measured at fair value with any resultant gain or loss recognized in profit or loss. Financial assets classified as fair value through other comprehensive income ("FVOCI") are measured at fair value with any subsequent remeasurement recognized in other comprehensive income. When FVOCI financial assets are derecognized, the cumulative gain or loss previously recognized directly in equity is recognized in profit or loss. Financial assets classified as loans and receivables and held to maturity are measured at amortized cost using the effective interest rate method. Transaction costs associated with FVPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset. All financial liabilities are recognized initially at fair value plus, in the case of loans and borrowings, directly attributable transaction costs. Financial liabilities are classified as other financial liabilities, and are subsequently measured at amortized cost using the effective interest rate method. The Company has classified its financial instruments as follows:

Financial instrument	Recognition method
Financial assets	
Cash and cash equivalents	Amortized cost
Restricted cash	Amortized cost
Trade and other receivables	Amortized cost
Notes and leases receivable	Amortized cost
Warrants	Fair value through profit and loss
Financial liabilities	
Accounts payable and accrued liabilities	Amortized cost using the effective interest rate method
Deposits from franchisees	Amortized cost using the effective interest rate method
Term credit facility	Amortized cost using the effective interest rate method

e. Cash and cash equivalents and restricted cash

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less. Restricted cash represents cash on deposit with banks that are held in trust of the Co-op Fund and Development Fund as well as \$241 held as security for cash management services.

f. Leases receivable

The Company has entered into lease agreements acting as the lessor with certain franchisees relating to point of sale systems ("POS"). The lease term is for the major part of the economic life of the POS although the title is not transferred. Leases are recognized as finance type leases and recorded as leases receivable at an amount equal to the net investment in the lease. Leases receivable are initially recognized at the amount expected to be received, less a present value discount if collection is to be expected beyond one year. Subsequently, leases receivable are measured at amortized cost using the effective interest method less a provision for impairment.

g. Inventories

Inventories are stated at the lower of cost and net realizable value, with cost being determined on an average cost basis for items that are interchangeable. For inventory items that are not interchangeable, specific costs are attributed to the specific individual items. Net realizable value is the estimated recoverable amount less applicable selling expenses. If carrying value exceeds net realizable amount, a write-down is recognized. The write-downs are reversed if the circumstances that caused the initial write-down no longer exist.

h. Property and equipment

Property and equipment are stated at cost less accumulated depreciation net of any impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying value or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying value of a replaced asset is removed when replaced. Repairs and maintenance costs are charged to the Consolidated Statements of Operations and Comprehensive Loss during the period in which they are incurred. Where property and equipment construction projects are of a sufficient size and duration, an amount is capitalized for the costs used to finance construction.

Depreciation is calculated using the straight-line basis as this approach best reflects consumption and benefit patterns pertaining to the asset's use. Depreciation is charged commencing when the asset is available for use. The following rates are based on the expected useful lives of the assets:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Leasehold improvements	lesser of 10 years and the remaining term of the lease
Equipment, furniture, fixtures and other	3 to 7 years
Computer hardware	3 years

i. Intangible assets

Intangible assets consist of trademarks and software, which are amortized or assessed for impairment as follows:

(i) Trademarks

Trademarks consist of trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Second Cup cafés in Canada and are recorded at the historical cost less impairment write-downs. The trademark is an indefinite life intangible asset that is tested annually for impairment or at any time an indicator for impairment exists. The trademark assets do not have continual renewal requirements nor is there any deterioration incurred due to usage. As a result of the combination of the aforementioned, the trademark assets are considered to have indefinite lives.

(ii) Software

Purchased software costs are recorded at cost and are amortized commencing when the asset is available for use. Amortization is calculated using the straight-line basis as management believes this approach best reflects consumption and benefit patterns pertaining to the asset's use. The following rate is based on the expected useful life of the asset:

Software	3 to 7 years
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Where software implementation projects are of a sufficient size and duration, an amount is capitalized for the costs used to finance development.

j. Provisions

Provisions are recognized when there is a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material. Evaluations are performed to identify onerous contracts and, where applicable, provisions are recorded for such contracts.

Provisions for café closures are estimates for costs expected to be incurred by the Company for operational franchise-owned cafés. Lease and other occupancy costs not expected to be fully paid by the franchisee are recorded as the Company has liability on the café head lease.

k. Other liabilities

(i) Deferred income

The Company has entered into several supply agreement contracts and receives allowances from certain suppliers in consideration for the café network achieving certain volume thresholds over the term of the supply agreement. Deferred income is amortized over the term of the supply agreements based on the proportion of volume thresholds met during the fiscal year or on other rational basis.

Cash received from franchisees for the commencement of a new franchise term, licensing fees, construction management or a pending transfer arrangement are deferred until the revenue recognition criteria are met.

(ii) Leasehold inducements

Leasehold inducements are amortized to rent expense on a straight-line basis over the term of the lease.

l. Income taxes

Income taxes comprise current and deferred income taxes. Income taxes are recognized in the Consolidated Statements of Operations and Comprehensive Income (Loss) except to the extent that they relate to items recognized directly in equity, in which case the income tax is also recognized directly in equity. Current income taxes are the expected taxes payable on the taxable income for the period, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous periods.

Deferred income taxes are recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying values in the consolidated financial statements. Deferred income taxes are determined on a non-discounted basis using tax rates and laws that have been enacted or substantively enacted at the Consolidated Statements of Financial Position dates, and are expected to apply when the deferred income tax asset or liability is recovered or settled. Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the deductible temporary differences can be utilized.

m. Gift card liability

The gift card program allows customers to prepay for future purchases by loading a dollar value onto their gift cards through cash or credit/debit cards in the cafés or online through credit cards, when and as needed. The gift card liability represents liabilities related to unused balances on the card net of estimated breakage. These balances are included as sales from franchised cafés, or as revenue of Company-operated cafés, at the time the customer redeems the amount in a café for products. Gift cards do not have an expiration date and outstanding unused balances are not depleted.

The determination of the gift card breakage rate is based upon Company-specific historical load and redemption patterns. As part of the process of adopting IFRS 15, the 2018 redemption analysis determined that a breakage rate of 3.59% was applicable to gift card sales. Gift card breakage is recognized on a pro rata basis based on historical gift card redemption patterns. Breakage income is allocated to the Co-op Fund. See note 2(x) for more information.

n. Deposits from franchisees

The development process of a new or to be renovated café requires a deposit from a franchisee at the outset. Deposits from franchisees are applied against the cost of constructing a new café or the renovation of an existing café.

o. Revenue recognition

Revenue is recognized when it is determined that performance obligation has been fulfilled and the associated economic benefits will flow to the Company, the sales price is fixed or determinable, and collectibility is reasonably assured. Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other revenue related concessions.

(i) Royalties

For 2017 and 2018, royalty revenue from franchised cafés is based on agreed percentage royalty rates of the franchise location sales as they happen. 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.

(ii) Services and other

Services and other consists of initial franchise fees, renewal fees, transfer fees earned on the sale of cafes from one franchisee to another, Co-op Fund contributions, construction administration fees, purchasing coordination fees, and other ancillary fees (such as IT support and training fees).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Under a franchise agreement, the Company provides the franchisee with (i) a franchise license to use the Company's intellectual property and advertising and promotion management, (ii) pre-opening services, such as training and inspections, and (iii) ongoing services, such as development of training materials, menu items and café monitoring and inspections. The services provided are highly interrelated and constitute the Company's performance obligations under the term of franchise agreement. For fiscal 2018, franchise fees and renewal fees are recognized over the term of franchise agreements (note 2(x)). For fiscal 2017, under the previous accounting standard, franchise fees were recorded in revenue when performance obligations were satisfied, usually when the café opened.

The Company receives food and beverage, and product and service coordination fees relating to agreements with vendors. Fees are generally earned based on the value of purchases during the period. Agreements that contain an initial upfront fee, in addition to ongoing fees are generally recorded to income over the term of the respective agreement.

(iii) 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. Revenue is recognized at a point in time when the services are rendered and the product is sold to the end consumer. Payment is collected at the time of sale and the consideration received is unconditional.

p. Operating costs and expenses

(i) Company-owned cafés and cost of product sales

Company-owned cafés and cost of product sales represents the product cost of goods sold in Company-operated cafés and through the wholesale grocery channel, plus the cost of direct labour to prepare and deliver the goods to the customers in the Company-operated cafés and any occupancy related costs.

(ii) Franchise expenses

Franchise costs represent the cost of direct labour to support the network, Co-op Fund expenses, travel and franchisee meetings, business development initiatives as well as professional fees directly related to franchise operations.

(iii) General and administrative expenses

General and administrative costs include labour and related expenses for head office, professional fees not directly attributable to franchise operations and occupancy costs.

q. Operating leases

Operating lease payments are recognized as an expense on a straight-line basis over the lease term. Leasehold inducements are amortized to rent expense on a straight-line basis over the lease term. For the purposes of determining the lease term, option periods are considered for which failure to renew the lease imposes an economic penalty on the Company of such an amount that the renewal appears to be reasonably assured at the inception of the lease.

r. Directors' deferred share unit plan

Units granted under the Directors' deferred share unit plan have graded vesting for each month of service completed over the course of one year. Units are paid out in cash upon the termination of the director. Units are granted based on a weighted average price of the Company's shares on the five most recent days preceding the grant date. The fair value of the grants is amortized over the respective vesting period using the graded amortization method. Compensation expense is adjusted for changes in fair value of the Company's share price thereafter. Any dividends paid during the vesting period will be accrued based on the total number of units granted. Amounts recognized are recorded in general and administrative expenses.

Recorded values of the plan are presented as accounts payable and accrued liabilities in the Consolidated Statements of Financial Position.

s. Impairment of financial assets

At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired.

IFRS 9 replaces the provisions of IAS 39 that relate to the recognition, classification and measurement of financial assets and financial liabilities, derecognition of financial instruments, impairment of financial assets and hedge accounting.

The adoption of IFRS 9 Financial Instruments from January 1, 2018 resulted in changes in accounting policies and adjustments to the amounts recognized in the consolidated financial statements. The new accounting policies are set out below. In accordance with the transitional provisions in IFRS 9, comparative figures have not been restated.

The adoption of IFRS 9 had no impact on the Company's classification of financial assets and financial liabilities that continue to be measured on the same basis as was previously applied under IAS 39. IFRS 9 replaces the incurred loss model of IAS 39 with a model based on expected credit losses. Under the new standard, the loss allowance for a financial instrument will be calculated at an amount equal to 12-month expected credit losses, or lifetime expected credit losses if there has been a significant increase in the credit risk on the instrument.

t. Impairment of non-financial assets

Property and equipment and intangible assets without indefinite lives are tested for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Assets with indefinite lives are subject to an annual impairment test or any time an impairment indicator exists. The yearend date has been selected as the mandatory annual test date.

For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows that are largely independent of the cash inflows from their assets or group of assets, which represent a CGU. The recoverable amount of each particular CGU is the higher of an asset's fair value less costs of disposal and value in use. CGUs have been determined to be as follows:

- franchising, distribution, and wholesale; and
- Company-operated cafés; each Company-operated café is considered a separate CGU.

The impairment analysis involves comparing the carrying value of the CGUs with their estimated recoverable amounts. An impairment loss is recognized for the amount by which the CGU's carrying value exceeds its recoverable amount. Impairment losses for a CGU reduce first the carrying value of any goodwill allocated to that CGU. Any remaining impairment loss is charged pro rata to the other assets in the CGU.

Impairment losses, other than goodwill impairment, are evaluated for potential reversals when events or circumstances warrant such consideration.

u. Related parties

For the purposes of these consolidated financial statements, a party is considered related to the Company if such party or the Company has the ability to, directly or indirectly, control or exercise significant influence over the other entity's financial and operating decisions, or if the Company and such party are subject to common influence. Related parties may be individuals or other entities and include members of key management of the Company. All transactions with related parties are recorded at fair value.

v. Share-based compensation

For share option awards granted as part of the stock option plan, a fair value is determined at the date of grant and that fair value is recognized in the consolidated financial statements over the vesting period. Proceeds arising from the exercise of share option awards are credited to share capital, as are the recognized grant-date fair values of the exercised share option awards. Share option awards that are determined to be settled on a net-equity basis are accounted for as equity instruments. Share option awards that are determined to be settled on a net-cash settlement basis are accounted as liability instruments. The stock option plan was introduced in May 2014 and is further discussed in note 28.

w. Reclassification

Certain comparable figures have been reclassified to conform to the current period's consolidated financial statement presentation. The reclassification has been made to enhance the presentation of the Company's activities and the consolidated financial statements. This reclassification has been made to enhance the presentation of the Company's activities and the consolidated financial statements.

x. Changes in accounting policies

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 December 31, 2017, ("Transition Date") the Company applied IFRS 15 using the modified retrospective transition method. The consolidated 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 income, a decrease to deferred income taxes of \$832 and a decrease to the retained earnings (deficit) of \$2,286.

The transition to IFRS 15 requires the consolidation of the Co-op Fund contributions and related expenses on a gross basis. See note 14 for more details. The adoption of IFRS 15 had no net impact on the Company's cash provided by operating activities, cash used in investing activities or cash provided by financing activities during the year.

Under IFRS 15, the Company recognizes gift card breakage income proportionately as gift cards are redeemed using an estimated breakage rate based on our historical experience. Previously, the Company recognized the estimated breakage income on gift card sales on a pro rata basis based on an estimate breakage rate. The application of IFRS 15 accounting on gift card balances outstanding at December 31, 2017 is reflected as a \$927 decrease in gift card liability and a \$927 increase in other accrued liabilities.

IFRS 9 replaced the incurred loss model under IAS 39 with a model based on expected credit losses. Under the new standard, expected credit losses are recorded. The application of IFRS 9 had no material impact to the opening retained earnings (deficit) and to the fiscal year ended December 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 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 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 is in the process of completing its analysis but the most significant impact will be in the area of accounting for its franchisee subleases and the operating leases of its head office and corporate cafés.

3. SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares. Common shares are classified as equity and have no par value. Incremental costs directly attributable to the issue of new common shares are shown in equity as a deduction, net of tax, from the proceeds.

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.

On May 8, 2018, the Company issued 2,898,600 common shares of Second Cup as a result of an agreement with Clarus Securities Inc. (the "Underwriter") on a "bought deal" basis.

See note 4 for more details.

Shares outstanding at the fiscal year ended December 29, 2018 are 19,940,073 (2017 – 17,041,473).

4. MANAGEMENT OF CAPITAL

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, an affiliate of Serruya Private Equity. The Company also extinguished its \$8,000 debt to SPE and cancelled 600,000 old warrants.

On April 17, 2018, the Company entered into an agreement with 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 and net proceeds of \$9,190.

On December 18, 2018, the Company announced that the Toronto Stock Exchange (the "TSX") had approved its notice of intention to make a normal course issuer bid for a portion of its common shares. Pursuant to the normal course issuer bid, the Company intends to acquire up to 1,000,000 common shares, representing approximately 7.4% of its public float of 13,463,184 common Shares, in the 12-month period commencing December 20, 2018 and ending on December 19, 2019 or such earlier time that the Company completes its purchases pursuant to the normal course issuer bid or provides notice of termination. Under the normal course issuer bid, the Company may purchase up to 12,071 common shares on the TSX during any trading day. As of December 29, 2018, the Company had repurchased 60,335 common shares for an aggregate total value of \$115.

The Company's objectives relating to the management of its capital structure are to:

- safeguard its ability to continue as a going concern;
- maintain financial flexibility in order to preserve its ability to meet financial obligations; and
- deploy capital to provide an adequate return to its shareholders.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The Company's primary uses of capital are to finance increases in non-cash working capital, capital expenditures, and other corporate purposes.

5. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

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
Warrants	Credit, liquidity, and interest rate
<i>Financial liabilities</i>	
Accounts payable and accrued liabilities	Liquidity, currency, and commodity
Gift card liability	Liquidity
Deposits from franchisees	Liquidity

Fair value of financial instruments

The fair values of cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities, provisions, other liabilities and gift card liability approximate their carrying values due to their short-term maturity. The fair value of notes and leases receivable approximates their carrying value as the implicit interest used to discount the base value is considered to be based on an appropriate credit and risk rate pertaining to the debtor. The fair value of warrants received in 2018 (see note 17) is determined using the Black-Scholes pricing model. This valuation model requires five input variables: the exercise price of the warrants, the current price of the underlying stock, the time to expiration, the risk-free interest rate, and the stock's volatility. The following table summarizes the financial instruments measured at fair value:

	2018	2017
Warrants		
Opening fair value	\$–	\$–
Fair value of warrants received	2,655	–
Change in fair value	(935)	–
Closing fair value	\$1,720	\$–

Financial instruments that are measured subsequent to initial recognition at fair value are to be categorized in Levels 1 to 3 of the fair value hierarchy, based on the degree to which the fair value is observable. The three levels of the fair value hierarchy are:

- Level 1 - inputs derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 - fair value derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

Credit risk

a. 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.

b. Trade and other receivables, notes and leases receivable

Trade and other receivables and notes and lease 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 that includes the requirement that a franchisee has sufficient 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.

The Company has applied IFRS 9's simplified approach and has calculated ECLs based on lifetime expected credit losses. The Company has established a provision matrix that is based on the Company's historical credit loss experience, adjusted for forward-looking factors specific to the debtors and the economic environment.

An analysis of aging of trade and other receivables from the billing date net of an allowance for doubtful accounts is as follows:

	0-30 Days	31-60 Days	61-90 Days	> 90 Days	Total
Gross amount as at December 29, 2018	\$2,252	\$285	\$238	\$3,351	\$6,126
Allowance for doubtful accounts	(69)	(121)	(137)	(3,238)	(3,565)
Net amount 2018	\$2,183	\$164	\$101	\$113	\$2,561
Gross amount as at December 30, 2017	\$3,452	\$158	\$109	\$2,322	\$6,041
Allowance for doubtful accounts	(18)	(60)	(40)	(2,207)	(2,325)
Net amount 2017	\$3,434	\$98	\$69	\$115	\$3,716

Trade and other receivables include a combined allowance for doubtful accounts of \$3,565 (December 30, 2017 - \$2,325). Credit terms vary by customer in the range of 30 to 90 days. The net amount due of \$113 aged over 90 days has no specific terms of repayment. Trade and other receivables are further discussed in note 6.

The payment maturity dates of the notes and leases receivable as at December 29, 2018, net of an allowance for doubtful accounts, are as follows:

	< 90 Days	90 Days to < 1 year	1 year to < 2 years	2 years and after	Total
2018	\$8	\$22	\$19	\$4	\$53
2017	\$22	\$42	\$42	\$32	\$138

Notes and leases receivable included a combined allowance for doubtful accounts of \$90 (December 30, 2017 - \$55). Notes and leases receivable are further discussed in note 7.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Liquidity risk

Liquidity risk is managed through regular monitoring of forecast and actual cash flows, monitoring maturity dates of financial assets and liabilities, and also the management of the Company's capital structure and debt leverage. The Company's main source of income is royalty receipts from its franchisees, corporate café sales, and sales from goods and services.

Commodity and currency risk

The Company purchases certain products, such as coffee, in U.S. dollars, thereby exposing the company to risks associated with fluctuations in currency exchange rates. The Company is also directly and indirectly exposed to commodity market risk. The exposure relates to the changes in coffee commodity prices given it is a material input for product offerings. The direct exposure pertaining to the wholesale business is mitigated given that the Company has the ability to adjust its sales price if commodity prices rise over a threshold level. The indirect risk exists where franchisee profitability may be impacted, thus potentially resulting in an impeded ability to collect accounts receivable or the need for other concessions to be made to the franchisee. This risk is mitigated by entering fixed price purchase commitments through coffee commodity brokers and by having the ability to adjust retail selling prices.

6. TRADE AND OTHER RECEIVABLES

	2018	2017
Trade and other receivables	\$6,126	\$6,041
Less: Allowance for doubtful accounts	(3,565)	(2,325)
Net trade and other receivables	\$2,561	\$3,716

During the period, \$1,240 (2017 - \$464 expense) was recorded as a charge pertaining to trade and other receivables.

7. NOTES AND LEASES RECEIVABLE

	2018	2017
Notes receivable – current	\$41	\$26
Lease receivable – current	66	75
Less: Allowance for doubtful accounts – current	(77)	(37)
Notes and leases receivable – current	30	64
Notes receivable – long-term	4	18
Lease receivable – long-term	32	74
Less: Allowance for doubtful accounts – long-term	(13)	(18)
Notes and leases receivable – long-term	23	74
Notes and leases receivable	53	\$138

Notes and leases receivable are discounted using an effective discount rate ranging between eight and nine percent.

8. INVENTORIES

Inventories relate to goods held for resale, at the corporate cafés, and equipment for construction, and are comprised of the following:

	2018	2017
Merchandise held for resale	\$474	\$180
Supplies	51	25
	\$525	\$205

9. PROPERTY AND EQUIPMENT

	Leasehold improvements	Equipment, furniture, fixtures and construction in process	Computer hardware	Total
Net carrying value				
As at December 31, 2016				
Cost	\$2,522	\$4,677	\$881	\$8,080
Accumulated depreciation	(1,164)	(2,811)	(671)	(4,646)
As at December 31, 2016	1,358	1,866	210	3,433
Additions	43	338	2	383
Reclass of transfers from construction in process	2	(2)	–	–
Disposals – original cost	(403)	(389)	(1)	(793)
Disposals – accumulated depreciation	55	70	1	126
Depreciation	(296)	(608)	(114)	(1,018)
As at December 30, 2017	759	1,275	96	2,132
Net carrying value				
As at December 30, 2017				
Cost	\$2,462	\$4,613	\$881	\$7,956
Accumulated depreciation	(1,703)	(3,338)	(783)	(5,824)
As at December 30, 2017	759	1,275	98	2,132
Additions	281	999	1	1,281
Disposals – original cost	(107)	(227)	–	(334)
Disposals – accumulated depreciation	–	6	–	6
Impairment charge (note 19)	(14)	(197)	(5)	(216)
Depreciation	(282)	(463)	(80)	(825)
As at December 29, 2018	637	1,393	14	2,044
Cost	2,619	5,010	853	8,482
Accumulated depreciation	(1,982)	(3,617)	(839)	(6,438)
As at December 29, 2018	\$637	\$1,393	\$14	\$2,044

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

10. INTANGIBLE ASSETS

	Trademarks	Software	Total
Net carrying value			
As at December 31, 2016			
Cost	\$31,144	\$2,979	\$34,123
Accumulated amortization	–	(1,512)	(1,512)
As at December 31, 2016	31,144	1,467	\$32,611
Additions	–	217	217
Amortization	–	(456)	(456)
As at December 30, 2017	\$31,144	\$1,228	\$32,372
Cost	\$31,144	\$3,194	34,338
Accumulated amortization	–	(1,966)	(1,966)
As at December 30, 2017	\$31,144	\$1,228	\$32,372
Additions	–	157	157
Disposals – original cost	–	(298)	(298)
Disposals – accumulated amortization	–	294	294
Amortization	–	(510)	(510)
As at December 29, 2018	\$31,144	\$871	\$32,015
Cost	31,144	3,053	34,197
Accumulated amortization	–	(2,182)	(2,182)
As at December 29, 2018	\$31,144	\$871	\$32,015

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of:

	2018	2017
Accounts payable – trade	\$1,689	\$959
Accrued liabilities	2,855	1,834
Accrued salaries, wages, benefits, and incentives	532	916
Sales tax payable – government remittances payable	175	265
	\$5,251	\$3,974

12. PROVISIONS

	Café leases (a)	Other (b)	Total
As at December 31, 2016	\$2,102	\$26	\$2,128
Provisions charged during the period	239	480	719
Provisions utilized during the period	(1,274)	(409)	(1,683)
As at December 30, 2017	\$1,067	\$97	\$1,164
Current portion	\$837	\$97	\$934
Long-term portion	230	–	230
As at December 30, 2017	\$1,067	\$97	\$1,164
Provisions charged during the period	40	14	54
Provisions utilized during the period	(176)	(111)	(287)
As at December 29, 2018	\$931	\$–	\$931
Current portion	\$634	\$–	\$634
Long-term portion	297	–	297
As at December 29, 2018	\$931	\$–	\$931

a. Café leases

Provisions for café leases are estimates for costs to be incurred by the Company as a result of the following circumstances: i) closure of cafés, and ii) franchisee failure to make payment of occupancy costs at an operational café.

Provisions for café leases of \$40 (2017 - \$239) were charged in the year and are reflected in the franchise expenses line on the Consolidated Statements of Operations and Comprehensive Income (Loss).

b. Other

Provisions for other items of \$14 (2017 - \$480) were charged in the year.

13. OTHER LIABILITIES

	2018	2017
Deferred revenue – current	\$94	\$172
Leasehold inducements – current	36	36
Other liabilities – current	\$130	\$208
Deferred revenue – long-term	\$14	\$–
Leasehold inducements – long-term	143	179
Other liabilities – long-term	\$157	\$179
Deferred revenue	\$108	\$172
Leasehold inducements	179	215
Other liabilities	\$287	\$387

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

14. REVENUE

	2018	2017
Franchise revenue		
Royalties	\$9,930	\$10,299
Advertising fund contributions	3,031	–
Services and other	4,868	4,775
	17,829	15,074
Company-owned cafés and product sales	7,885	8,562
	\$25,714	\$23,636

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. The Company has adopted IFRS 15 accounting as it relates to the Co-op Fund using the modified retrospective transition method. The consolidated 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 transition to IFRS 15 requires the presentation of the Co-op Fund contributions and related expenses on a gross basis. As a result, franchise revenue includes Co-op Fund contributions of \$3,031 in 2018. For 2017, applying the new standard would result in an increase of \$3,033 in franchise revenue due to the consolidation of the Co-op Fund.

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 31, 2017	\$3,118
Franchise fees additions to deferred income	875
Franchise fees recognized as income in the year	(993)
Balance at December 29, 2018	\$3,000

For 2017, applying IFRS 15 would result in a decrease of \$454 to the franchise fees previously reported.

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. Revenue is recognized at a point in time when the services are rendered and the product is sold to the end consumer. Payment is collected at the time of sale and the consideration received is unconditional.

15. OPERATING COSTS AND EXPENSES

	2018	2017
Company-owned cafés and cost of product sales		
Cost of product sales	\$3,101	\$3,270
Labour and related expenses	2,941	2,966
Occupancy and other	2,912	3,067
Depreciation of property and equipment	361	308
Loss on disposal of assets	28	197
	9,343	9,808
Franchise expenses		
Labour and related expenses	3,768	3,939
Advertising fund expenses	3,022	–
Travel and franchisee meetings	285	345
Professional fees and other	1,886	1,409
	8,961	5,693
General and administrative expenses		
Labour and related expenses	1,707	2,045
Professional fees and other	2,879	3,503
Occupancy	478	461
	5,064	6,009
Other		
Depreciation and amortization	974	1,150
	\$24,342	\$22,660

The Company has adopted IFRS 15 accounting as it relates to the Co-op Fund using the modified retrospective transition method. The consolidated 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 transition to IFRS 15 requires the presentation of the Co-op Fund contributions and related expenses on a gross basis. As a result, franchise expenses includes Co-op Fund expenses of \$3,022 in 2018. For 2017, applying the new standard would result in an increase of \$2,737 in franchise expenses and a decrease of \$151 in Company-owned café expenses.

16. OTHER EXPENSE (INCOME)

	2018	2017
Recognition of NAC deferred income	\$(1,256)	\$–
Change in fair value of NAC warrants as at end of year	935	–
Asset impairment charges	216	–
	\$(105)	\$–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

17. WARRANTS

On April 12, 2018, the Company established a strategic alliance with National Access Cannabis Corp. ("NAC") 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. As consideration, the Company received 5,000,000 warrants to purchase common shares of NAC at a strike price of \$0.91 at any time during the period of five years following the issuance date. As at the date of issuance, the fair value of \$2,655, (\$0.531 each) of warrants was recorded as an asset with a corresponding entry to deferred income. As of December 29, 2018, the fair value was \$0.344 each, resulting in a decrease to the fair value of the warrants of \$935.

The deferred income is recognized over the term of the agreement with NAC, which commenced on the date of agreement, April 12, 2018, and terminates on the twelve-month anniversary of the coming into force of the Cannabis Act, which is October 17, 2019. Included in other income for 2018 is \$1,256 for the amortization of the deferred income.

18. INTEREST AND FINANCING COSTS (INCOME)

	2018	2017
Fair value difference on shares issued and other costs	\$–	\$3,290
Interest expense	–	505
Amortization of deferred financing costs	–	139
Interest income	(165)	(37)
	\$(165)	\$3,897

19. IMPAIRMENT OF ASSETS

a. Impairment of trademarks

The Company's trademarks are allocated fully to the franchising, distribution and wholesale CGU. The CGU's recoverable amount has been determined using fair value less costs of disposal.

Key assumptions

The Company uses a discounted cash flow methodology, which includes the use of estimates and assumptions that are sensitive to change and require judgement. This methodology used to test impairment is classified as Level 3 per the hierarchy described in note 5. These key judgements include estimates of discount rates, forecast growth in system sales and other estimates impacting future cash flows. Changes in these estimates and assumptions may have a significant impact on recoverable amounts. General market uncertainty and the competitive operating environment for the Company and other similar retail entities were also factors taken into account in the analysis. The changes in the market growth rates reflect the current general economic pressures now impacting the national economy.

Probability weighted cash flow projections are used based on financial forecasts covering a three-year period. These projections are approved by the Board of Directors based on management's expectations of potential outcomes. Cash flows beyond the three-year period are extrapolated using the estimated growth rates as stated in the table below. The valuation of the franchising, distribution and wholesale business CGU is based on various probabilities assigned to each forecasted cash flows. The analysis performed as at December 29, 2018 does not indicate any

impairment (2017 - \$nil). The following are key assumptions used in the fair value less costs of disposal calculation as well as a sensitivity analysis for the various range of assumptions used and the related impact:

	2018	2017
Discount rate	12.0%	12.0%
Forecast same café sales avg. growth rate	-1.0%	0.0%
Avg. growth rate used to extrapolate cash flows beyond the forecast period	0.0%	0.0%
Amount by which recoverable amount exceeds carrying amount	\$9,000	\$6,500

b. Corporate cafes – Impairment of leasehold improvements, equipment, furniture, fixtures, and other

Impairment indicators include when an individual Company-operated café experiences poor performance directly impacting cash flows. The impairment analysis is based on historical and forecasted performance measures for each café with impairment indicators. The asset's recoverable amount has been determined using value in use. The recoverable amount was compared to the net book value of the assets. This methodology used to test impairment is classified as Level 3 per the hierarchy described in note 5. As a result of the impairment test, impairment charges of \$216 for the year ended December 29, 2018 (2017 - \$nil) were recorded to assets that were not able to be redeployed to a different CGU as the carrying amount exceeded the recoverable amount. The impacted assets were adjusted to a carrying value of \$nil.

20. INCOME TAXES

Income taxes, as reported, differ from the amount that would be computed by applying the combined Canadian federal and provincial statutory income tax rate to income before income taxes. The reasons for the differences are as follows:

	2018	2017
Income (loss) before income taxes	\$1,642	(\$2,922)
Combined Canadian federal and provincial tax rate	26.67%	26.70%
Tax expense (recovery) at statutory rate	437	(780)
Increased (reduced) by following differences		
Change in tax rates	6	19
Non-deductible permanent differences	13	786
Other	35	151
Income tax expense	\$491	\$176
Current income tax expense	\$11	\$146
Deferred income tax expense	480	30
Income tax expense	\$491	\$176

The blended weighted average statutory income tax rate is an aggregate of the following:

	2018	2017
Basic federal rate	15.00%	15.00%
Weighted average provincial rate	11.67%	11.70%
Combined Canadian federal and provincial tax rates	26.67%	26.70%

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

The movement in deferred income tax (assets) and liabilities during the year is as follows:

	Property and equipment	Trademarks	Warrants	Other	Total
As at December 31, 2016	2,011	4,773	99	(677)	6,206
Charged (credited) to the income statement	(21)	–	–	51	30
Credited to equity	–	–	(39)	(37)	(76)
As at December 30, 2017	1,990	4,773	60	(663)	6,160
Charged to the income statement	28	–	134	318	480
Credited to equity	–	–	–	(1,049)	(1,049)
As at December 29, 2018	\$2,018	\$4,773	\$194	\$(1,394)	\$5,591

21. BASIC AND DILUTED INCOME (LOSS) PER SHARE

Income (loss) per share is based on the weighted average number of shares outstanding during the period. Share option awards and warrants to purchase shares are excluded due to anti-dilutive impact. Basic and diluted income (loss) per share is determined as follows:

	2018	2017
Net income (loss)	\$1,151	(\$3,097)
Weighted average number of shares issued and outstanding	18,920,785	14,485,081
Basic and diluted income (loss) per share	\$0.06	(\$0.21)

22. SUPPLEMENTAL CASH FLOW INFORMATION

	2018	2017
Changes in non-cash working capital and other inflow (outflow)		
Trade and other receivables	\$1,155	(\$693)
Inventories	(320)	(5)
Prepaid expenses and other assets	(53)	46
Accounts payable and accrued liabilities	1,171	293
Provisions	(233)	(964)
Other liabilities	(100)	154
Deferred income	(118)	
Gift card liability	(1,106)	(52)
Deposits from franchisees & change in restricted cash	(852)	324
Income taxes	(277)	623
	\$(733)	(\$274)
Cash payments for capital expenditures		
Cash payments for capital expenditures	\$(1,281)	(\$383)
Cash payments for intangible assets	(157)	(217)
	\$(1,438)	(\$600)
Supplementary information		
Interest paid	\$–	\$505
Income taxes paid	\$11	\$–

23. MOVEMENT OF NON-CASH FINANCING ACTIVITIES

In 2017, the Company recognized the following non-cash financing activities as a result of the changes as described in Note 4 Management of Capital: i) a decrease of \$7,146 in long-term debt; ii) an increase of \$10,760 in share capital; and iii) a net decrease of \$106 in warrants.

24. RESTRICTED CASH

The Company has established certain accounts that have been classified as restricted cash primarily representing: i) deposits from franchisees for the cost of constructing a new café or the renovation of an existing café, ii) 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 iii) a deposit held by the Company's bank as security for cash management services:

	2018	2017
Development Fund	\$746	\$408
Co-op Fund	763	711
Security Deposit held by bank	241	240
Total Restricted Cash	\$1,750	\$1,359

25. CONTINGENCIES, COMMITMENTS AND GUARANTEES

The Company has lease commitments for Company-operated cafés and acts as the head tenant on most leases, which it in turn 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 (note 12). The Company's lease commitments as at December 29, 2018 are as follows::

	Head lease commitments	Sublease to franchisees	Net
December 28, 2019	\$16,929	\$14,478	\$2,451
December 26, 2020	15,286	12,978	2,308
December 25, 2021	13,679	11,578	2,101
December 31, 2022	12,519	10,492	2,027
December 30, 2023	10,750	8,843	1,907
Thereafter	27,712	21,825	5,887
	\$96,875	\$80,194	\$16,681

The Company believes it has sufficient resources to meet the net commitment of \$16,681 over the term of the leases.

The Company is involved in litigation and other claims arising in the normal course of business. Judgement 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 value of coffee purchases of \$1,601 (2017 - \$1,392) for

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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 is \$211 (2017 - \$894) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the fiscal year. Construction costs are financed from deposits received from franchisees for franchise projects and from the Company's cash flows for corporate projects.

26. 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.

Compensation of key management

Key management is defined as the senior management team and the Board of Directors. The following summarizes the compensation expense of key management personnel and the composition thereof:

	2018	2017
Salaries and short-term employee benefits	\$2,344	\$2,236
Termination costs	–	247
Share-based compensation	18	60
Total compensation	\$2,362	\$2,543

27. DEFERRED INCOME

	2018	2017
Deferred income – miscellaneous income	\$1,399	\$ –
Deferred income – contract liability	643	–
Current deferred income	\$2,042	\$ –
Deferred income – miscellaneous income	–	–
Deferred income – contract liability	2,357	–
Long term deferred income	\$2,357	\$ –
Total deferred income	\$4,399	\$ –

28. SHARE-BASED COMPENSATION

Stock option plan

The stock option plan was introduced in May 2014 to advance the interests of the Company by:

- providing eligible persons with incentives;
- encouraging share ownership by participants;
- increasing the proprietary interest of participants in the success of the Company;
- encouraging participants to remain with the Company or its affiliates; and
- attracting new directors and employees.

Stock options are to be settled on a net-equity basis. Compensation expense/gain for stock awards is recognized using the fair value when the stock awards are granted using the Black-Scholes option pricing model. All options vest in tranches and are amortized over the awards' vesting period using the accelerated expense attribution method. Recognition of the expense/gain is recorded as a charge to operating expenses with a corresponding increase/decrease to contributed surplus.

The following weighted average assumptions have been used to estimate the weighted average fair value per award of \$0.23 granted as of December 29, 2018:

	Assumption
Risk-free interest rate (%)	1.66
Volatility (%)	40.67
Expected term (years)	8.1

The table below summarizes all activities for the year ended December 29, 2018:

	Number of share options outstanding	Weighted average share option price
As at December 30, 2017	260,000	\$3.30
Granted	300,000	2.23
Forfeited	(50,000)	3.13
As at December 29, 2018	510,000	\$2.69
Stock option plan recovery during the period		\$28

The range of exercise prices for share options outstanding at December 29, 2018 is \$1.60 to \$4.54. Of the share options outstanding, 108,000 share options are exercisable. The weighted average years to expiration are approximately eight years. Share award options are able to be exercised upon vesting.

29. DIRECTORS' DEFERRED SHARE UNIT PLAN

A summary of the status of the Company's directors' deferred share unit plan is presented below:

	Notional units	Recorded value
Notional units outstanding as at December 31, 2016	112,281	\$239
Deferred units granted	45,047	98
Change in fair value	–	4
Notional units outstanding as at December 30, 2017	157,328	\$341
Expensed in the period		\$102
	Notional units	Recorded value
Notional units outstanding as at December 30, 2017	157,328	\$341
Deferred units granted	37,504	80
Deferred units paid out	(13,889)	(42)
Change in fair value	–	(48)
Notional units outstanding as at December 29, 2018	180,943	\$331
Recovery in the period		\$(10)

The average fair value price of deferred units granted was \$2.13 (2017 - \$2.18).

Shareholder Information

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Canada L4V 1R8

Registrar and Transfer Agent
Computershare Trust
Company of Canada

Auditors
PricewaterhouseCoopers LLP

Market Information
Shares Listed:
Toronto Stock Exchange
Symbol: SCU

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THE SECOND CUP LTD. Board of Directors

Michael Bregman ^{(1),(2)}
Chairman

Melinda Lee ⁽¹⁾
Garry Macdonald
Alton McEwen ⁽²⁾
Paul W. Phelan
Michael Serruya ⁽¹⁾
Aaron Serruya
Alan Simpson ⁽²⁾

Committees of the Board
(1) Audit Committee
(2) Governance, Human
Resources and
Compensation Committee

THE SECOND CUP LTD. Senior Management Team

Garry Macdonald
President and
Chief Executive Officer

Ba Linh Le
Vice President, Finance
and Chief Financial Officer

Vanda Provato
Vice President,
Marketing and Category

Chris Sonnen
Vice President,
Coffee Experience

Audra Wosik
Vice President, Franchising &
Construction

Ted Tai
Vice President, Operations

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