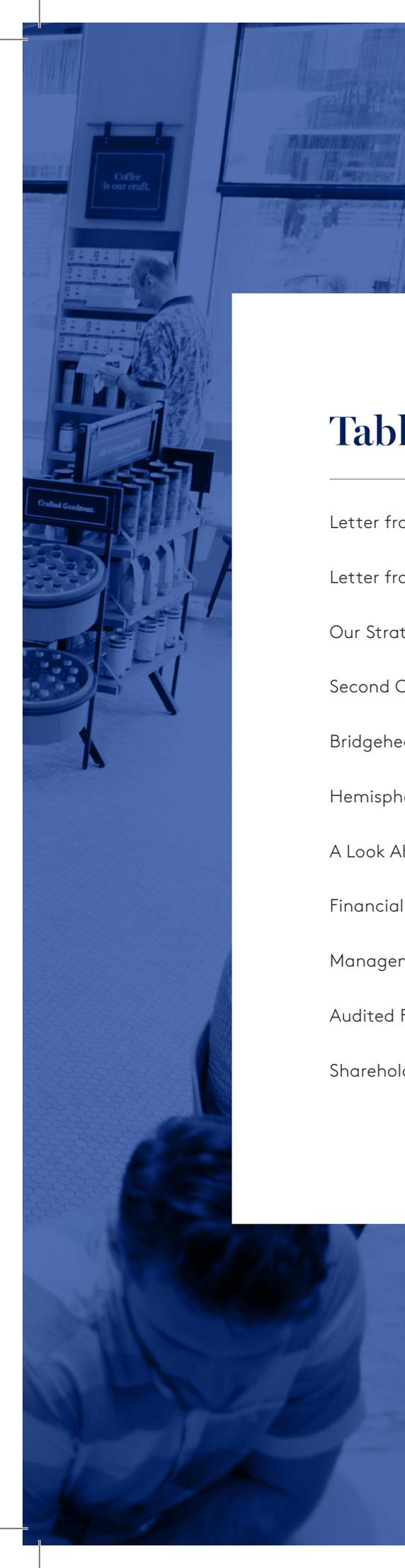


THE SECOND CUP LTD.

# Annual Report 2019







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## Letter from the Chairman

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Early this year, we were all feeling a sense of renewal at Aegis Brands, a new name signifying profound changes at all levels of the organization. Steve Pelton became CEO and a significant shareholder in June 2019 and quickly placed his imprint on the enterprise. The senior management was upgraded and longstanding issues were being resolved decisively and aggressively. The organization was being transformed to become an acquirer of attractive food service brands.

Our first acquisition in early January was Ottawa based Bridgehead Coffee. This iconic brand operates nineteen successful specialty coffee stores in Ottawa supported by its own roastery, baking and food commissary. The early results from this acquisition were very encouraging.

In March, the world abruptly changed with the emergence of the COVID-19 pandemic, which has materially impacted our operations. The pandemic triggered enormous change in the organization. Stores closed, head count was cut, compensation levels were reduced, and government assistance programs were accessed as the company went into survival mode. Now stores have reopened, but at significantly reduced sales levels. Some of the best performing stores were in high traffic office/commuter locations, which are now devoid of people.

I feel very proud at how Steve and his team have responded. From the outset, they were determined not only to survive, but to take steps to emerge from the crisis with strength. Though cost cuts were aggressive, Steve was selective. Fortunately, they continued work on the Hemisphere cannabis

concept, which was intended to re-purpose high quality Second Cup locations.

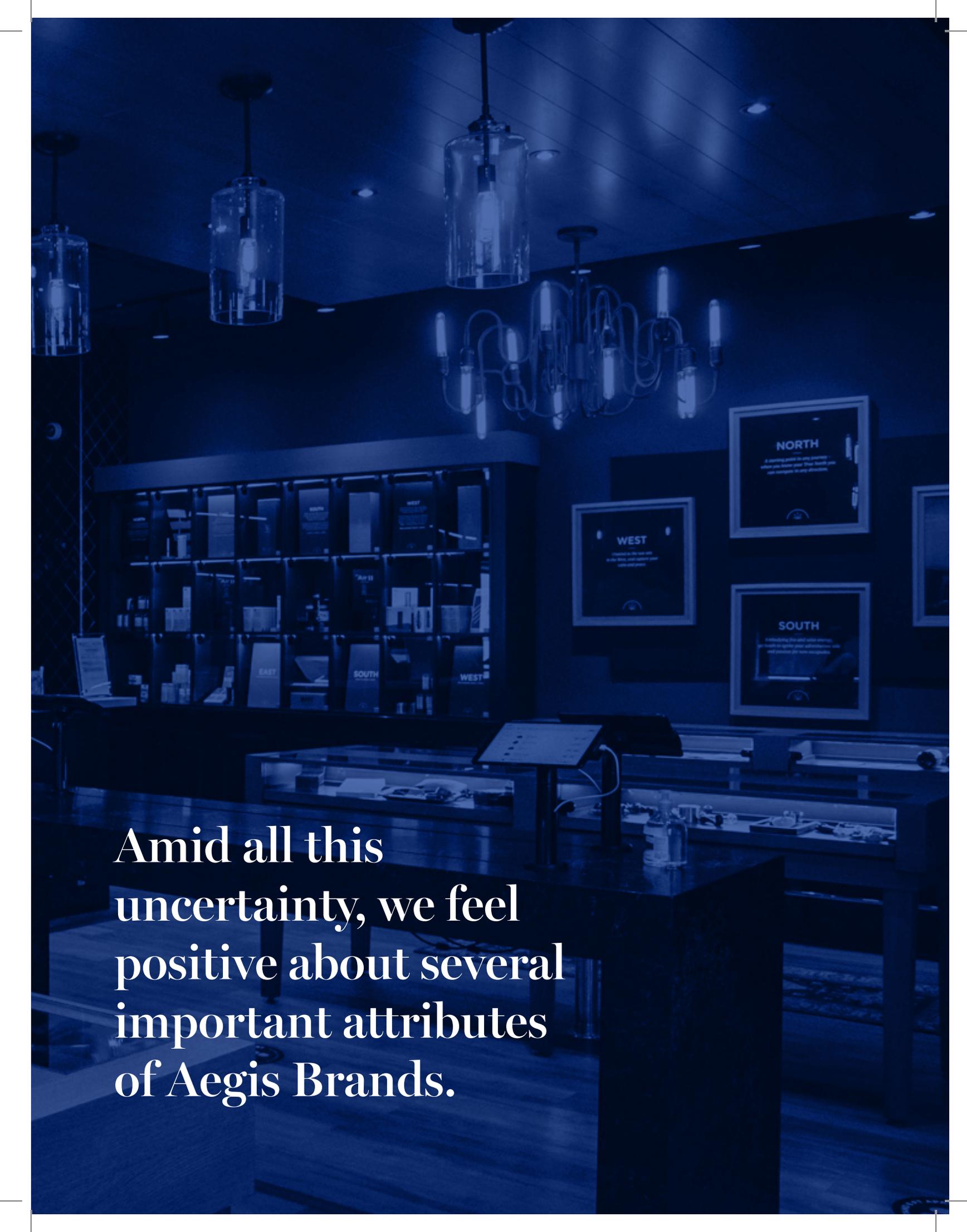
The first Hemisphere store opened in Toronto in July and is performing exceptionally well. Customers are responding enthusiastically and the store is already delivering strong profitability. The second Hemisphere location is planned to open in early September, with several additional sites planned for the next few months.

At this time, there remains uncertainty and lack of clarity about the future. How long will the pandemic related restrictions carry on? Will leases be successfully restructured or terminated? Will franchisees survive? How will government assistance programs evolve? Will sufficient capital be available to fund future plans? Amid all this uncertainty, we feel positive about several important attributes of Aegis Brands. Most important, is the quality of our management team led by Steve Pelton. The balance sheet remains debt free with a return to positive operating cash flow anticipated soon. Though nascent we are very excited about prospects for Hemisphere Cannabis.

The abruptness and depth of challenges is daunting, but we believe that Steve and his team are doing a superb job coping and will continue to do so. As a result, I remain hopeful that Aegis Brands will emerge with strength.

A handwritten signature in black ink, appearing to read 'Michael Bregman'. The signature is stylized and fluid.

**Michael Bregman**  
Chairman of the Board



Amid all this  
uncertainty, we feel  
positive about several  
important attributes  
of Aegis Brands.



## Letter from the President & CEO

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On June 1, 2019, I assumed - with great passion and determination - the role of President and CEO of Second Cup Limited. Second Cup has 45 years of equity as the only Canadian-owned, national specialty coffee retailer in this country. We have a truly exceptional coffee product, some of the best real estate assets in the country, and a network of franchisees that are second-to-none. But it was immediately clear to me that these advantages were being unrealized, and that there was significant unrecognized value in this organization.

As a result, we set out a bold strategic plan to realize the full potential of Second Cup. That plan focused on three key pillars: the growth of Second Cup through non-traditional channels, retail cannabis opportunities and strategic acquisitions.

In the latter half of 2019, we began to realize the fruits of these efforts. In November, we announced a new corporate structure: "The Second Cup Ltd." would rebrand as Aegis Brands Inc., a new parent company that would own and operate the existing Second Cup Coffee Co. specialty coffee business as part of a portfolio of brands.

And in December, we made our first addition to that portfolio with the acquisition of

Bridgehead Coffee, an iconic Ottawa-based brand with massive potential for growth. We were looking ahead to 2020 with incredible enthusiasm about the opportunities that lay in front of us.

It's an understatement, then, to say that 2020 has thrown us some unexpected curveballs. As with every foodservice business in Canada and around the world, the COVID-19 pandemic upended our business in the first half of this year. All 19 Bridgehead coffeehouses in Ottawa and 130 of the 244

Second Cup cafés across Canada closed in mid-March, and cafés that remained open had to reimagine their entire business model, shifting away from being a place of communal gathering to operating largely as take-out and drive-thru operations. We have been working tirelessly with franchisees across the country to provide support in negotiations with landlords, and we collected no royalty or advertising fund payments for four months. We took salary reductions and made layoffs at Coffee Central, and temporarily eliminated all compensation for our Board of Directors.

It is a testament to the commitment, passion and determination of everyone at Aegis, at



Second Cup and Bridgehead that despite these wholly unprecedented challenges, we have continued to make such progress against our strategic plan.

Just last month, we announced that 14 new non-traditional Second Cup locations are scheduled to open in the next 18 months across Canada, including a pilot program with Suncor Energy that will see Second Cup drive-thrus opening at three Petro-Canada locations in Ontario this year. And later this year Second Cup coffee will return to grocery and other retail banners, a channel that has seen dramatic growth during the COVID-19 pandemic, supplementing the new Second Cup e-commerce platform which launched in April.

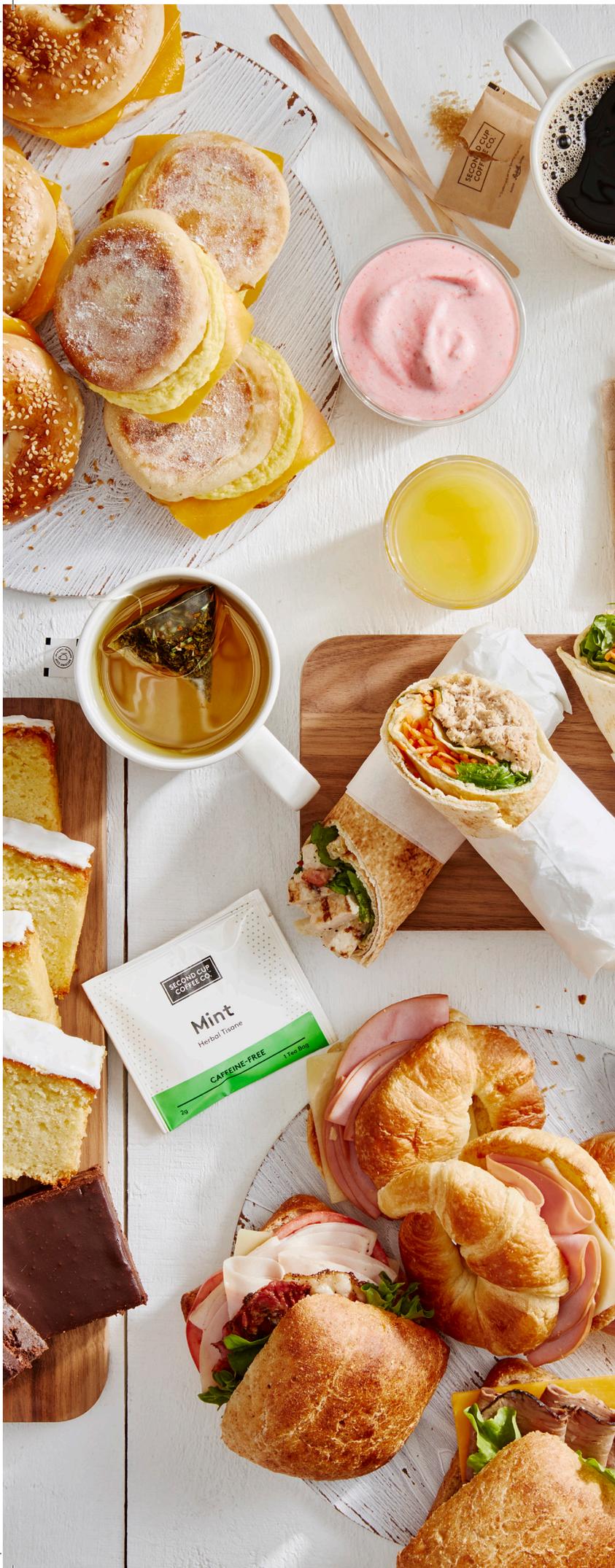
On July 10, 2020, we opened the first location of our retail cannabis brand, Hemisphere Cannabis Co, and six additional Hemisphere locations are preparing to open across Ontario. We're exploring opportunities to co-produce a branded line of cannabis products and - subject to cannabis marketing regulations - are planning to produce THC and CBD beverages featuring Second Cup flavours and branding. Our goal, pending future deregulation of CBD, is to make Second Cup the first national coffee chain to sell CBD beverages in our cafés.

And while Bridgehead's physical locations have seen declines in traffic and sales due to the COVID-19 pandemic, e-commerce sales for Bridgehead have increased 10x over pre-COVID levels and Bridgehead products are newly available for sale at Farm Boy, Costco and Whole Foods.

The last six months have taught us a lot about ourselves, as individuals. And it's taught us a lot about what it means to be Canadian. In these most difficult days, people across the country have come together in a spirit of incredible solidarity, and have demonstrated that innovation isn't hampered by crisis - in many ways, it's driven by it. The same can be said for the last six months at Aegis. We look forward to better days ahead, but we know that with hard work, determination and truly Canadian ingenuity, anything is possible.

A handwritten signature in black ink, appearing to read 'Steven Pelton'.

**Steven Pelton**  
President & CEO



## Our Strategy

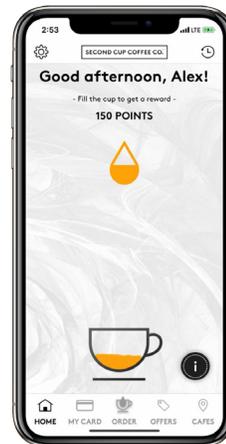
The strategic growth of Aegis will come from three key pillars.

### **THE REVITALIZATION OF SECOND CUP, with a Focus on Non-Traditional Channel Growth**

Non-traditional Second Cup locations - that is to say, cafés in sites such as hospitals, airports and transportation venues - consistently over-index on both sales and profitability. Growing Second Cup therefore means growing these types of locations - work that is already underway through the Suncor Energy pilot program that was announced earlier this year.

But new locations aren't the only ways that we're breathing life into the Second Cup brand. Canadians can expect to see:

- A new food program at Second Cup cafés, designed to bring incremental customers into our stores.
- An improved and expanded Rewards Program, providing an even better Second Cup experience for our most loyal customers.
- New and more convenient ways to enjoy Second Cup coffee, including the return of Second Cup to grocery and other retail banners.



## RETAIL CANNABIS OPPORTUNITIES

We created Aegis with the vision of building a portfolio of amazing brands that could grow and flourish with access to the resources and expertise that we've developed over 40 years in the Canadian foodservice industry, and Hemisphere Cannabis Co is the latest way we're bringing this vision to life.

The ability to leverage our premium real estate across Canada - and to convert Second Cup locations to Hemisphere locations only as licenses are approved, avoiding the need to pay rent on unopened stores - is truly unparalleled. And the fact that we can provide this retail cannabis brand with access to shared services including marketing, HR, real estate and finance - rather than having to build out a head office team from scratch - means that stores can be cash flow and EBITA positive within months of opening.

Finally, our deep understanding of Canadian consumers, and of their retail habits, has helped create an in-store experience that is unique and memorable. Hemisphere

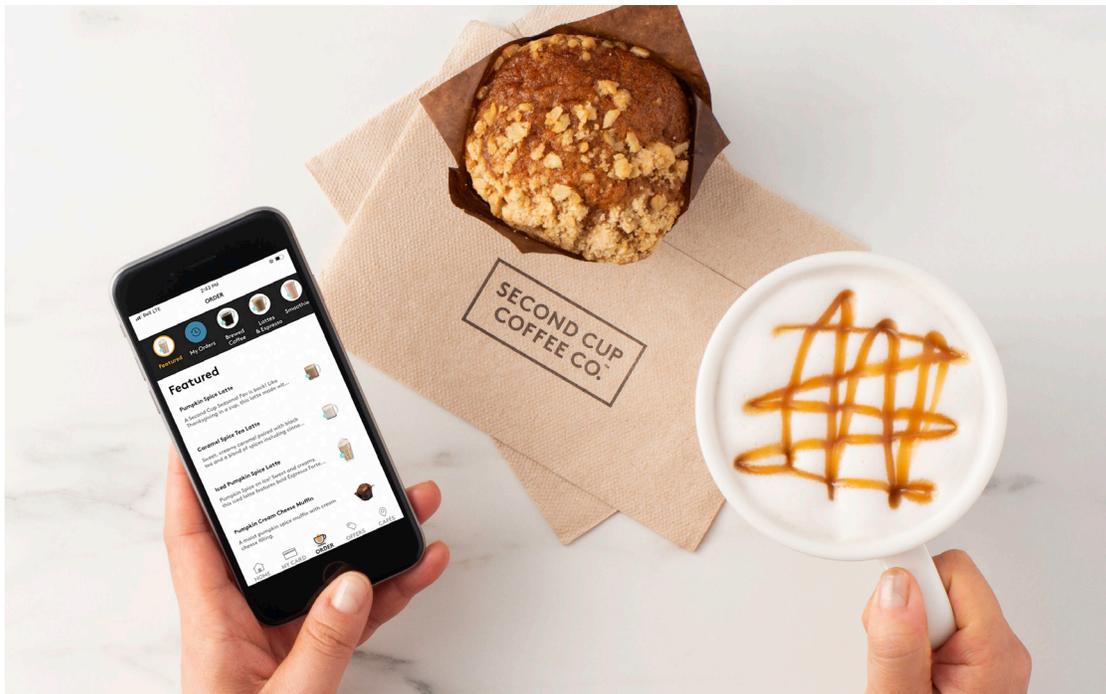
locations are inviting for everyone from the canna-curious to seasoned users. Knowledgeable budtenders are specially trained to provide a guided selection experience for those who need it, and stores are organized based on need-state to help create a simple-to-navigate shopping experience for those who don't.

## STRATEGIC ACQUISITIONS

Finally, we have committed to growing Aegis through the acquisition of other incredible brands in the foodservice, coffee and cannabis space. Our first such acquisition, Bridgehead Coffee, was finalized at the end of 2019.

That said, it's important to highlight that the success of this strategy is not in the acquisitions themselves, but in how we integrate these vibrant, growing brands into the Aegis family and accelerate growth. We are fiercely committed to letting each company under the Aegis umbrella operate as an independent brand, providing them with shared expertise and services to help them thrive, staying true to who they are and what has made them so beloved.





## Second Cup Coffee Co.

### DIGITAL TRANSFORMATION

2019 was the start of the digital transformation of the Second Cup with the introduction of mobile order and pay ahead. Seamlessly integrated into the Rewards program, our improved app gives guests the option to mobile order, pay ahead, and earn and redeem points

Technology has impacted guest experience with many Canadians looking at more flexible options to transact, but one thing that has not changed, is that Canadians love a great cup of coffee. We are on a digital transformation journey to develop new tools with our mission at the core of everything we do, to be the destination for specialty coffee in Canada. We supported our enhanced app through strong marketing communication both in store and on-line, and continue to include a call to action to “download the app for a free coffee” in all our marketing assets going forward.

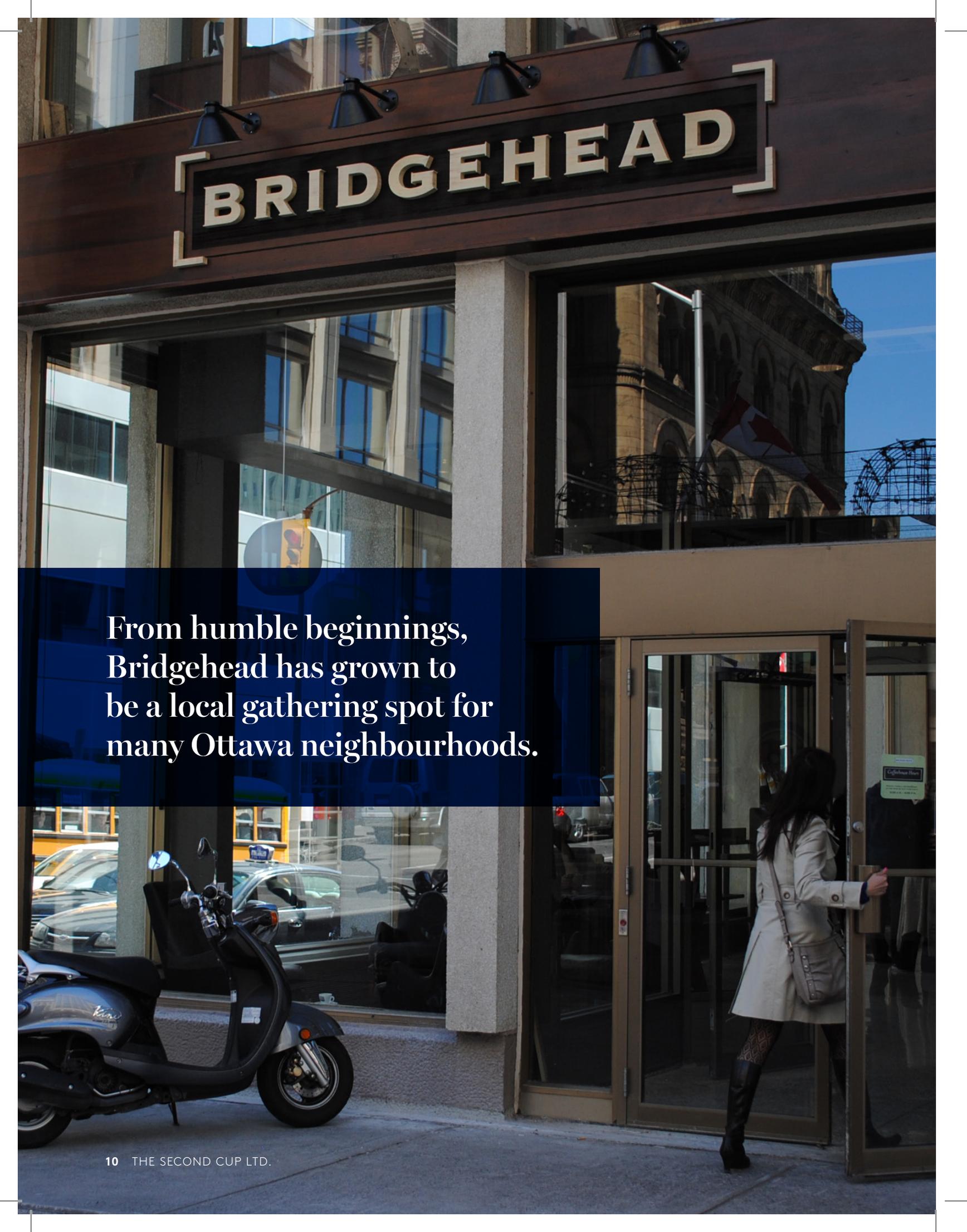
### PRODUCT INNOVATION

In 2019 our beverage menu continued to focus on the clean label initiative that was launched in 2018 and developed memorable new coffee drinks that delighted our guests. We had fusions and blends on our mind and launched a Honey Tea Latte and Tea fusions with great fan fare. Honey Tea Latte was so well received as a limited time offer we made it a permanent fixture on menu moving forward. 2019 was the second annual Barista Championship event. Our winner Billy Taheja from Montreal showcased his barista and latte art skill with a twist.

Pinkberry was large focus for our network with an exciting new campaign that leaned into Hollywood celebrity culture. A much loved brand by the Hollywood elite, the Pinkberry marketing campaign hosted red carpet events, out of home billboards and TMZ styled digital videos.

We are on a digital transformation journey to develop new tools with our mission at the core of everything we do.



The image shows the exterior of a building named 'BRIDGEHEAD'. The name is displayed in large, white, 3D block letters on a dark brown sign above the entrance. The entrance consists of large glass doors and windows. A woman in a light-colored coat and black boots is walking through the glass doors. To the left, a silver scooter is parked on the sidewalk. The building's facade is dark brown with several black spotlights mounted above the sign. The windows reflect the surrounding city street, including a yellow taxi and a traffic light. The sky is a clear, pale blue.

# BRIDGEHEAD

From humble beginnings, Bridgehead has grown to be a local gathering spot for many Ottawa neighbourhoods.

# Bridgehead

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Bridgehead is Ottawa's biggest little Coffee Shop. From humble beginnings, Bridgehead has grown to be a local gathering spot for many Ottawa neighbourhoods. Built on 20 years of history, Bridgehead prides itself on renowned hospitality, quality coffee & fresh food made daily from its own scratch bakery, sustainable environmental practices and community connection. It sources fresh ingredients from as many local suppliers as possible and purchases only Fair trade and Organic coffee from the farmers it works with - 90% of whom Bridgehead has a direct relationship with. Bridgehead cares about great coffee, people and the planet.

Bridgehead has announced a new partnership with the Sprott School of Business at Carleton University which will include a new coffeehouse located in the new business building as well as various other elements including a case study focused on the growth of the local brand. Additionally, a new location at Ottawa's Macdonald-Cartier International Airport (YOW) is also underway. In addition to coffeehouse growth, Bridgehead is focused on expanding into grocery as well as directly to customers through its own e-commerce site.

The focus remains keeping the local community connection while bringing the brand outside of its own backyard.





## Hemisphere Cannabis Co.

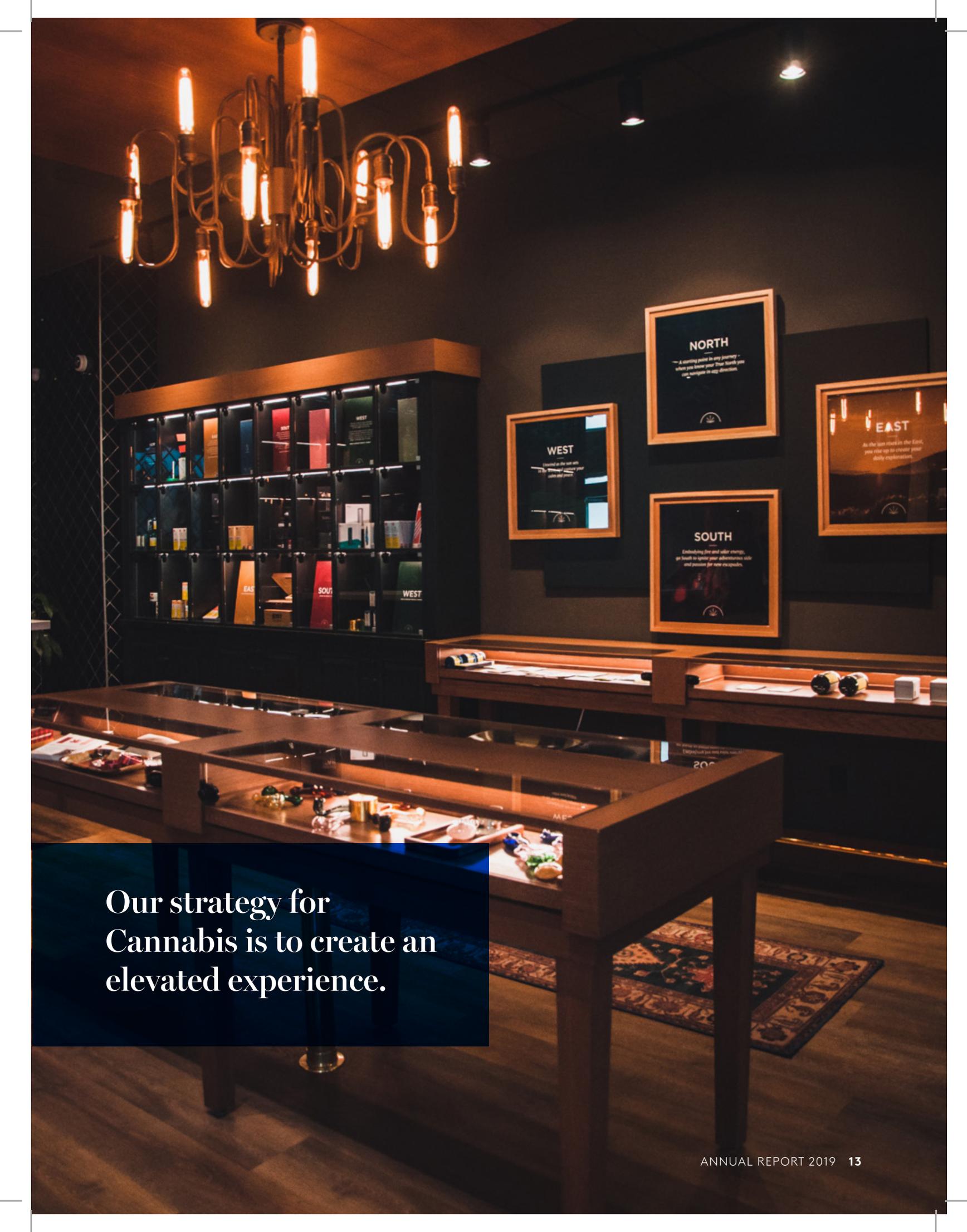
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### LAYING THE GROUNDWORK

In 2019 we started to lay the groundwork to expand into Cannabis. We declared our intent to convert under-utilized Second Cup locations to cannabis dispensaries and applied for our retail license to sell Cannabis.

Our strategy for Cannabis is to create an elevated experience. Armed with our years of hospitality experience, we built Hemisphere Cannabis as a space people would want to be seen in.

2020 will be an exciting year with Hemisphere Cannabis positioned to make a huge splash in the retail landscape.



Our strategy for Cannabis is to create an elevated experience.

# A Look Ahead

---

As we look ahead to 2020 and beyond and the changing consumer landscape, our focus on our three strategic pillars - the growth of Second Cup through non-traditional channels, retail cannabis opportunities and strategic acquisitions - will remain unchanged. The growth and success of our business will be further fuelled through:

## A REVITALIZED SENIOR LEADERSHIP TEAM

In the last 18 months, we have undertaken wholesale change in our senior leadership team and today, we have some of the brightest minds in Canada leading our marketing, operations, human resources and franchise operations. This hand-picked team has been assembled with the specific goal of growing and leading not only Second Cup, but a robust family of Aegis Brands.

## EXPANDED REACH OF SECOND CUP & BRIDGEHEAD

We are looking forward to a number of significant new opportunities for both the Second Cup and Bridgehead brands:

- **Retail sales.** In addition to the reintroduction of Second Cup coffee at retail, we have launched Bridgehead Coffee at both Farm Boy and Whole Foods, and plan to continue to grow the availability of the Bridgehead brand outside of our own cafés.
- **Non-traditional locations.** Like Second Cup, Bridgehead is aggressively pursuing new non-traditional locations. In 2020, new Bridgehead coffee shops are planned for the Ottawa International Airport, Carleton University and on-site at a Farm Boy retail store.
- **Geographic expansion of Bridgehead.** We are thrilled to share plans to bring this beloved Ottawa chain to Toronto before the end of 2021.



## NEW OPPORTUNITIES IN CANNABIS

Cannabis continues to be a critical business priority for Aegis, and we're focused on:

- **Growing our cannabis retail footprint.**

While all cannabis retail locations require government approval, it is our objective to have 30 locations of Hemisphere across the country by the end of 2022. We are confident that our shared services model and deep experience in brand development provide us with unique competitive advantages that will fully bear fruit as the cannabis retail landscape becomes more developed. This will also likely present us with strong opportunities to grow Hemisphere not only through the conversion of existing Second Cup locations, but also through potential future consolidation or acquisition.

- **Product development.** We are in the early stages of securing a cannabis partner to co-produce a branded line of cannabis products, which will be made available for sale in all Hemisphere locations. In addition, and subject to cannabis marketing regulations, we are actively exploring the production of THC and CBD beverages featuring Second Cup flavours and branding.

- **Future opportunities.** When we consider the potential future legalization of consumption lounges, it is clear that there is no company better equipped to offer a "cannabis coffeehouse" experience than Aegis.

## COVID RECOVERY

There is no consideration of what lies ahead for Aegis without reflection on the impact that the COVID-19 pandemic has had - and continues to have - on our business.

While we will likely emerge from this period with a reduced café count, we can state with confidence that those cafés will be healthier businesses than they were before. Everything from our structure at Coffee Central to the food programs in our cafés to our day-to-day processes and operations have been reimagined during this period, and we are better equipped than ever to face any challenges that lie ahead.



THE SECOND CUP LTD.

# Financial Highlights

# Financial Highlights

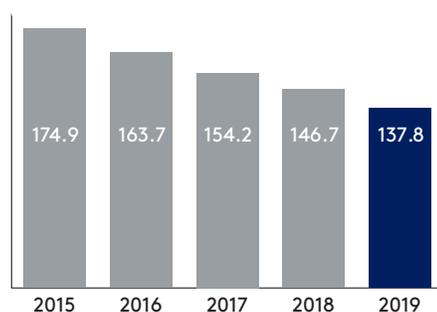
The following table sets out selected IFRS and certain non-IFRS financial measures of the Company and should be read in conjunction with the audited Consolidated Financial Statements of the Company for the 52 weeks ended December 28, 2019.

(In thousands of Canadian dollars, except same café sales, number of cafés, per share amounts, and number of common shares.)	13 weeks ended		52 weeks ended	
	December 28, 2019 <sup>2</sup>	December 29, 2018	December 28, 2019 <sup>2</sup>	December 29, 2018
System sales of cafés <sup>1</sup>	\$36,132	\$38,860	\$137,757	\$146,697
Same café sales <sup>1</sup>	(2.6%)	(2.0%)	(1.6%)	(1.2%)
Number of cafés – end of period	244	262	244	262
Total revenue	\$7,605	\$7,176	\$27,037	\$25,714
Operating costs and expenses	\$11,321	\$6,578	\$32,606	\$24,558
Operating income <sup>1</sup>	(\$3,716)	\$598	(\$5,569)	\$1,156
EBITDA <sup>1</sup>	(\$2,807)	\$922	(\$2,060)	\$2,491
Adjusted EBITDA <sup>1</sup>	(\$211)	\$1,297	\$1,541	\$2,930
Net income (loss) and comprehensive income (loss)	(\$3,601)	(\$55)	(\$4,674)	\$1,151
Adjusted net income (loss) and comprehensive income (loss)	(\$1,018)	\$594	(\$1,954)	\$1,074
Basic and diluted earnings (loss) per share as reported	(\$0.18)	\$0.00	(\$0.23)	\$0.06
Adjusted basic and diluted earnings (loss) per share <sup>1</sup>	(\$0.05)	\$0.03	(\$0.10)	\$0.06
Total assets – end of period	\$113,352	\$56,001	\$113,352	\$56,001
Number of weighted average common shares issued and outstanding	20,394,959	19,940,073	20,135,567	18,920,785

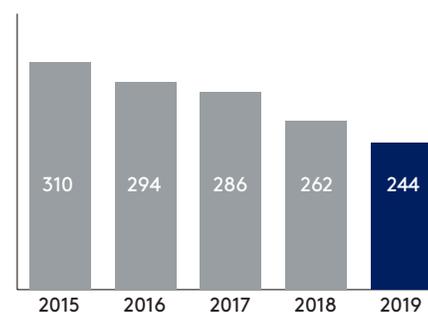
1 See the section “Definitions and Discussion on Certain non-GAAP Financial Measures” for further analysis.

2 Adoption of new standard on a modified retrospective basis – Consolidated financial statements for 2019 are prepared under the new standard whereas the

**System wide sales**  
(in millions of Canadian dollars)



**Number of Second Cup cafés**  
(in Canada)



# Management's Discussion and Analysis

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## 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](http://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](http://www.secondcup.com).

## INTRODUCTION

The following MD&A has been prepared as of March 11, 2020 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 28, 2019, and should be read in conjunction with the audited Consolidated Financial Statements of the Company for the 52 weeks ended December 28, 2019, accompanying notes and the Annual Information Form, which are available at [www.sedar.com](http://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-IFRS 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 244 cafés operating under the trade name Second Cup™ in Canada, of which 32 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](http://www.secondcup.com).

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 2019 consists of 52 weeks.

As at December 28, 2019, the issued share capital consisted of 20,394,959 common shares.

Additional information including the Annual Information Form is on SEDAR at [www.sedar.com](http://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 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.

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.

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 reductions in the number of Company-owned cafés in 2020.

## 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.™ – 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 244 cafés across Canada, Second Cup Coffee Co.™ 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.

On November 8th, 2019, the Company announced a new operating structure in support of its new strategy. Subject to TSX and shareholder approval, the existing public company will change its name to Aegis Brands Inc. ("Aegis" or "Aegis Brands"), which will own and operate the existing Second Cup Coffee Co. specialty coffee business as part of a portfolio of brands.

The Company's name change will not officially take effect until it has been approved by shareholders at the 2020 Annual General and Special Meeting and is subject to TSX approval. As of the date of this report, the Company continues to trade publicly as The Second Cup Ltd. (TSX: SCU).

***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 April 17, 2018, the Company entered into an agreement with the Underwriter, who 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 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 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. During this period, the Company repurchased 60,335 common shares for an aggregate total value of \$115.

On July 3, 2019, in accordance with the terms of the employment agreement with the Company's new President and CEO, the Company issued Mr. Steven Pelton 515,241 common shares in the capital of the Company at \$1.70 per share. Mr. Pelton paid \$200 in cash for 117,647 shares and 397,594 shares were paid with the proceeds of two loans advanced to Mr. Pelton by the Company – a five-year loan of \$500 repayable in June 2024 and a one-year loan of \$176 repayable in June 2020, both loans accruing interest at 4.0% per annum.

### **Competition**

The Canadian specialty coffee market is highly competitive and 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.

## **ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS**

In January 2016, the International Accounting Standards Board ("IASB") issued IFRS 16 Leases ("IFRS 16"). IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer ("lessee") and the supplier ("lessor"). This replaces IAS 17, Leases, and related interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all leases and requires a lessee to recognize (i) right-of-use assets and lease liabilities for leases with terms of more than 12 months, unless the underlying asset is of low value; and (ii) depreciation of lease assets separately from interest on lease liabilities on the consolidated statements of operations and comprehensive income (loss).

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

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

The financial statements reflect the application of IFRS 16 beginning in fiscal 2019, while the financial statements for prior periods were prepared under the guidance of the previous standard.

## 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	2017	2018	2019	Average
First Quarter	24.6	24.5	24.9	24.7
Second Quarter	24.6	24.7	25.0	24.7
Third Quarter	24.0	24.3	23.9	24.1
Fourth Quarter	26.8	26.5	26.2	26.5
	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.

### *Café network*

	13 weeks ended		52 weeks ended	
	December 28, 2019	December 29, 2018	December 28, 2019	December 29, 2018
Number of cafés – beginning of period	246	270	262	286
Cafés opened	2	3	5	7
Cafés closed	(4)	(11)	(23)	(31)
Number of cafés – end of period	244	262	244	262

The Company ended the Year with 32 (2018 - 25) 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 28, 2019 were \$36,132 compared to \$38,860 for the 13 weeks ended December 29, 2018 representing a decrease of \$2,728 or 7.0%. 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 2.6%, compared to a decline of 2.0% in the comparable Quarter of 2018. The decline is primarily due to a reduction in transactions.

### *Analysis of revenue*

Total revenue for the Quarter was \$7,605 (2018 - \$7,176), an increase of \$429, consisting of Company-owned café and product sales, royalty revenue, Co-op Fund contributions, fees and other revenue.

Company-owned cafés and product sales for the Quarter were \$3,284 (2018 - \$2,441), an increase of \$843. The number of Company-owned and operated cafés increased in the Quarter to 32 (2018 - 25), part of the Company's short-term efforts to continue to improve the operation and customer experience by taking back certain

underperforming cafés. The Company maintains its ongoing objective of reducing the number of Company-owned cafés, consistent with the Company's strategy of returning to an asset light business model in the future.

Franchise revenue was \$4,321 for the Quarter (2018 - \$4,735), a decrease of \$414. The decrease in franchise revenue in the Quarter is primarily due to lower franchise café count.

#### **Operating costs and expenses**

Operating costs and expenses primarily include the costs of Company-owned cafés and product sales, franchise-related expenses, general and administrative expenses, depreciation and amortization, and non-cash asset impairment charges. Total operating costs and expenses for the Quarter were \$11,321 (2018 - \$6,578), an increase of \$4,743.

Company-owned cafés and product sales related expenses for the Quarter were \$3,124 (2018 - \$2,852), an increase of \$272. The increase in costs is due to the increase in Company-owned cafés compared to prior year.

Franchise related expenses for the Quarter were \$3,354 (2018 - \$2,021), an increase of \$1,333. The increase in franchise related expenses is primarily driven by an allowance for expected credit losses, in accordance with IFRS 9, recognized during the Quarter for leases receivable on the balance sheet due to the application of IFRS 16. This allowance is a non-cash adjustment recorded in the Quarter.

General and administrative expenses were \$1,539 for the Quarter (2018 - \$1,140), an increase of \$399. This increase in expenses is primarily due to management transition costs and professional fees, partially offset by a decrease in rent expense as a result of a change in accounting for leases IFRS 16.

Depreciation and amortization expenses were \$909 (2018 - \$324), an increase of \$585. Total amortization of right-of-use assets was \$619 in the Quarter under IFRS 16. Prior to adoption, payments made under real estate leases for base rent were charged to rent expense.

The Company recognized non-cash asset impairment charges of \$2,385 (2018 - \$216) as a result of the impairment analysis based on the value in use model for each corporate café or cash generating unit (CGU). With the adoption of IFRS 16 in the beginning of 2019, the value in use model was constructed with different data-points as compared to the models prepared under the previous accounting standards, IAS 17. The recoverable amount was compared to the carrying value of the underlying CGU's or corporate stores' assets, which include leasehold improvements, furniture and equipment (consistent with prior years), and also included the underlying right-of-use assets (recognized on the consolidated statement of financial position in accordance with IFRS 16).

The asset impairment charges for Q4 2018 have been reclassified for consistency with the current period presentation. The reclassification has had no effect on the previously reported net income and comprehensive income for the period.

#### **EBITDA**

EBITDA for the Quarter was a loss of \$2,807 (2018 - income of \$922), a decrease of \$3,729, mainly as a result of lower franchise revenues, management transition costs, the non-cash asset impairment charges, and the non-cash provision for expected credit losses offset by a change in the accounting for leases in accordance with IFRS 16. Adjusted for non-recurring costs, EBITDA was a loss of \$211 (2018 - income of \$1,297).

#### **Other income and expenses**

Other expenses for the Quarter were \$929 (2018 - \$669), composed of the change in fair value of NAC warrants of \$780 and acquisition costs of \$240, partially offset against income from the NAC strategic alliance of \$91.

In entering into the strategic alliance with NAC in 2018, the Company received five million warrants that will expire after five years from the date of issuance. As of December 28, 2019, the fair value of the warrants was \$0.090 versus \$0.246 at the end of the prior Quarter, resulting in a decrease to the fair value of the NAC warrants of \$780. The change in fair value of the NAC warrants will fluctuate in accordance with the trading price of the NAC common shares.

Acquisition costs of \$240 were recognized in the quarter relating to the acquisition by the Company of 100% of the issued and outstanding shares of Ottawa-based Bridgehead Coffee announced in the Quarter.

#### ***Interest and financing income and expenses***

Interest expense for the Quarter was \$189 compared to interest income of \$63 in the same Quarter of 2018 driven primarily by a change in the accounting for leases in accordance with IFRS 16. This change resulted in \$294 in net interest expense, as a result of the interest expense related to the Company's head lease obligations for its franchised and corporate owned locations offset by the interest income on the Company's finance leases to the franchisees. The net interest expense related to leases is a non-cash adjustment based on a change in the recording of lease payments.

#### ***Net loss***

The Company's net loss for the Quarter was \$3,601 or \$0.18 per share, compared to a net loss of \$55 or nil per share in 2018. Adjusted for extraordinary items, net loss for the Quarter was \$1,018 or \$0.05 per share.

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-IFRS Financial Measures".

## **YEAR**

#### ***System sales of cafés***

System sales of cafés for the Year were \$137,757 (2018 - \$146,697), a decrease of \$8,940 or 6.1%. The decrease is primarily due to the reduction in café count.

#### ***Same café sales***

For the Year, same café sales declined by 1.6% compared to a decline of 1.2% in 2018. The decline is primarily due to reduced transactions.

#### ***Analysis of revenue***

Total revenue for the Year was \$27,037 (2018 - \$25,714), an increase of \$1,323, consisting of Company-owned café and product sales, royalty revenue, Co-op Fund contributions, franchise fees and other revenue.

Company-owned cafés and product sales were \$11,285 (2018 - \$7,885), an increase of \$3,400. 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 \$15,752 for the Year (2018 - \$17,829), a decrease of \$2,077. The decrease in franchise revenue in the year is primarily due to lower franchise café count.

#### ***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, depreciation and amortization, and non-cash asset impairment charges. Total operating costs and expenses for the Year were \$32,606 (2018 - \$24,558), an increase of \$8,048.

Company-owned cafés and product related expenses were \$10,944 for the Year (2018 - \$8,954), an increase of \$1,990. The increase in costs is due to the increase in Company-owned cafés compared to prior year.

Franchise related expenses were \$9,296 for the Year (2018 - \$8,961), an increase of \$335. The net increase in franchise related expenses is primarily driven by an allowance for expected credit losses, in accordance with IFRS 9, recognized for leases receivable on the balance sheet due to the application of IFRS 16. This allowance is a non-cash adjustment.

General and administrative expenses were \$6,456 for the Year (2018 - \$5,064), an increase of \$1,392. This increase in expenses is primarily due to management transition costs and professional fees, offset by a decrease in rent expense as a result of a change in accounting for leases IFRS 16.

Depreciation and amortization expense was \$3,509 (2018 - \$1,335), an increase of \$2,174. Total amortization of right-of-use assets was \$2,294 in the year under IFRS 16. Prior to adoption, payments made under real estate leases for base rent were charged to rent expense.

The Company recognized non-cash asset impairment charges of \$2,385 (2018 - \$216) as a result of the impairment analysis based on the value in use model for each corporate café or cash generating unit (CGU). With the adoption of As a result of the adoption of IFRS 16 in the beginning of 2019, the value in use model under IFRS 16 was constructed with different data-points as compared to the models prepared under the previous accounting standards, IAS 17. The recoverable amount was compared to the carrying value of the underlying CGU's or corporate stores' assets, which include leasehold improvements, furniture and equipment (consistent with prior years), and also included the underlying right-of-use assets (recognized on the consolidated statement of financial position in accordance with IFRS 16).

The asset impairment charges for Q4 2018 have been reclassified for consistency with the current period presentation. The reclassification has had no effect on the previously reported net income and comprehensive income for the period.

#### **EBITDA**

EBITDA was a loss of \$2,060 for the Year compared to income of \$2,491 last year. The decrease is primarily driven by higher loss attributed to Company-owned cafes, lower franchise revenue, non-cash asset impairment charges, and management transition costs offset by a change in the accounting for leases in accordance with IFRS 16. Adjusted for non-recurring transaction costs, EBITDA for the Year was \$1,541 compared with \$2,930 last year.

#### **Other income and expenses**

Other loss for the Year of \$111 (2018 - income of \$321), comprised of recognized income from the NAC strategic alliance of \$1,399, offset against the change in fair value of NAC warrants of \$1,270 and acquisition costs of \$240.

As of December 28, 2019, the fair value of the warrants was \$0.090 each versus \$0.344 each at the end of the prior year, resulting in a decrease to the fair value of the NAC warrants of \$1,270 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.

Acquisition costs of \$240 were recognized relating to the acquisition by the Company of 100% of the issued and outstanding shares of Ottawa-based Bridgehead Coffee announced in the Fourth Quarter.

#### **Interest and financing costs**

Net interest expense for the Year was \$619 compared to interest income of \$165 in the 2018. Interest income from investments was \$282 (2018 - \$165). The interest expense, recognized as a result of the adoption of IFRS 16 in fiscal 2019, includes the interest income on the Company's finance leases of \$3,262, offset against interest expense of \$4,163 on the Company's head lease obligations for its franchised and corporate owned locations. The interest expense related to leases is a non-cash adjustment based on a change in the recording of lease payments.

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

The Company's net loss for the Year was \$4,674 or \$0.23 per share, compared to a net income of \$1,151 or \$0.06 per share in 2018. Adjusted for extraordinary items, net loss for the Year was \$1,954 or \$0.10 per share compared to a net income of \$1,074 or \$0.06 per share in 2018.

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-IFRS Financial Measures".

## SELECTED QUARTERLY INFORMATION

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts.)	Q4 2019 <sup>2,3</sup>	Q3 2019 <sup>3,4</sup>	Q2 2019 <sup>3,4</sup>	Q1 2019 <sup>3,4</sup>
System sales of cafés <sup>1</sup>	\$36,132	\$32,936	\$34,377	\$34,312
Same café sales <sup>1</sup>	(2.6%)	(2.9%)	0.0%	(0.9%)
Number of cafés – end of period	244	246	252	256
Total revenue	\$7,605	\$6,652	\$6,541	\$6,239
Operating loss <sup>1</sup>	(\$3,716)	(\$726)	(\$638)	(\$489)
EBITDA <sup>1</sup>	(\$2,807)	\$179	\$218	\$350
Adjusted EBITDA <sup>1</sup>	(\$211)	\$785	\$617	\$350
Net income (loss) for the period	(\$3,601)	(\$933)	(\$782)	\$642
Adjusted net income (loss) for the period <sup>1</sup>	(\$1,018)	(\$233)	(\$300)	(\$403)
Basic and diluted loss per share	(\$0.18)	(\$0.04)	(\$0.04)	\$0.03
Adjusted basic and diluted loss per share <sup>1</sup>	(\$0.05)	(\$0.01)	(\$0.02)	(\$0.02)
	Q4 2018 <sup>2,3</sup>	Q3 2018 <sup>3</sup>	Q2 2018 <sup>3</sup>	Q1 2018 <sup>3</sup>
System sales of cafés <sup>1</sup>	\$38,860	\$35,704	\$36,213	\$35,920
Same café sales <sup>1</sup>	(2.0%)	0.3%	(1.0%)	(2.2%)
Number of cafés – end of period	262	270	275	279
Total revenue	\$7,176	\$6,609	\$6,353	\$5,576
Operating income (loss) <sup>1</sup>	\$598	\$520	\$212	(\$175)
EBITDA <sup>1</sup>	\$922	\$858	\$537	\$174
Adjusted EBITDA <sup>1</sup>	\$1,297	\$880	\$559	\$194
Net income (loss) for the period	(\$55)	\$766	\$577	(\$138)
Adjusted net income (loss) for the period <sup>1</sup>	\$594	\$432	\$186	(\$138)
Basic and diluted (loss) earnings per share	\$0.00	\$0.04	\$0.03	(\$0.01)
Adjusted basic and diluted earnings (loss) per share <sup>1</sup>	\$0.03	\$0.03	\$0.01	(\$0.01)

<sup>1</sup>See the section "Definitions and Discussion on Certain non-IFRS Financial Measures" for further analysis.

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

<sup>3</sup>Adoption of new standard on a modified retrospective basis – Financial statements for 2019 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.

<sup>4</sup>Certain quarterly financial metrics have been revised to reflect the adoption of new standard IFRS 16

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.

### Summary of cash flows

	13 weeks ended		52 weeks ended	
	December 28, 2019	December 29, 2018	December 29, 2018	December 29, 2018
Cash flows provided by operating activities	\$328	\$1,050	\$1,001	\$2,209
Cash flows provided by (used in) investing activities	(709)	(248)	(1,863)	(1,084)
Cash flows provided by (used in) financing activities	(497)	(3)	(2,568)	9,190
Increase in cash and cash equivalents during the period	(\$878)	\$799	(\$3,430)	\$10,315

## FOURTH QUARTER

Cash provided by operating activities was \$328 for the Quarter compared to \$1,050 for the same period last year. The decrease in operating cash of \$722 is mainly driven by an operating loss in the Quarter compared with an operating income last year, adjusted for non-cash allowance and charges and offset by the change in accounting for leases under IFRS 16.

During the Quarter, cash used in investing activities was \$709 compared to cash used of \$248 for the same Quarter in 2018. The increase is mainly due to higher capital expenditures.

Cash used in financing activities was \$497, comprised of lease payments, compared to \$3 for the same period last year.

**YEAR**

Cash provided by operating activities was \$1,001 for the Year compared to \$2,209 for 2018. The decrease is primarily due to by an operating loss for the Year, adjusted for non-cash allowance and charges and offset by the change in accounting leases under IFRS 16.

During the Year, cash used by investing activities was \$1,863 compared to cash used of \$1,084 for 2018. The increase in 2018 is primarily driven by higher payments for capital expenditures in Company-owned cafés to be refranchised.

Cash used by financing activities was \$2,568 for the Year compared to cash provided of \$9,190 in 2018. The Company closed the Offering on May 8, 2018, net of transaction costs. As of the end of fiscal 2018, the Company had repurchased 60,335 common shares under a normal course issuer bid for an aggregate total value of \$115. The settlement for this occurred in fiscal 2019.

**Working capital as at**

	December 28, 2019	December 29, 2018
Current assets	\$23,543	\$20,199
Current liabilities	19,423	11,153
Working capital (deficiency)	\$4,120	\$9,046

The Company's working capital was \$4,120 as at December 28, 2019 compared to a working capital balance of \$9,046 at December 29, 2018. The decrease of \$4,926 is primarily due to the inclusion of the current portions of leases receivable and lease liabilities, respectively, as a result of the implementation of IFRS 16. Gift card liability ended the Year at \$2,106, a decrease of \$221 compared to the end of 2018. 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
<b>Financial assets</b>	
Cash and cash equivalents	Credit and interest rate
Restricted cash	Credit and interest rate
Trade and other receivables	Credit and interest rate
Notes and leases receivable	Credit and interest rate
Warrants	Credit, liquidity, and interest rate
<b>Financial liabilities</b>	
Accounts payable and accrued liabilities	Liquidity, currency and commodity
Gift card liability	Liquidity
Deposits from franchisees	Liquidity
Lease liabilities	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 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 current and long-term employee loan receivable balances are in accordance with the terms of the employment agreement with the Company's President and CEO, Mr. Steven Pelton. This has been further discussed in the section 'Related Parties'.

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

### ***(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.

### ***(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.

### ***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 \$1,543 (2018 - \$1,601) 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 \$122 (2018 - \$211) 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.

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 28, 2019, 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 28, 2019 and up to the date of the approval of the audited Consolidated 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 Condensed Financial Statements for external purposes in accordance with IFRS.

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 28, 2019, the Company's controls over financial reporting were appropriately designed and were operating effectively.

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

During the 13 weeks ended December 28, 2019 and up to the date of the approval of the audited Consolidated 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 credit losses

### *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. For fiscal 2019, the impairment analysis has included the right-of-use assets recorded in line with IFRS 16 accounting standards on the Consolidated Statements of Financial Position. 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) Allowance for credit losses**

In accordance with IFRS 9, Financial Instruments ("IFRS 9"), the Company has recorded an allowance for forward-looking expected credit losses ("ECL") for all loans and other debt financial assets that are not held at fair value through profit and loss.

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, and lease receivables, 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.

**CHANGES IN ACCOUNTING POLICIES**

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

**IFRS 16 Leases**

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

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

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

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

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

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

#### ***Adjustments recognized on adoption of IFRS 16***

The Company transitioned to IFRS 16 in accordance with the modified retrospective approach. The prior year figures for fiscal 2018 were not adjusted. On adoption of IFRS 16, the Company recognized lease liabilities in relation to leases, which had previously been classified as 'operating leases' under the principles of IAS 17, Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of December 30, 2018. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on December 30, 2018 was 6.62%.

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

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

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

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

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

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

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

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

***IFRS 15 Revenue from Contracts with Customers***

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

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

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

**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.

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](http://www.sedar.com).

## OUTLOOK

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

Rejuvenation of the Second Cup brand is an on-going initiative. 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.

The Company will change its name to Aegis Brands Inc. ("Aegis" or "Aegis Brands"), which will own and operate the existing Second Cup Coffee Co. specialty coffee business as part of a portfolio of brands. As of the date of this report, this change is pending shareholder and TSX approval.

On January 9, 2020, the Company completed the acquisition of 100% of the issued and outstanding shares of Ottawa-based Bridgehead Coffee ("Bridgehead") for a purchase price of \$9.5 million at closing, of which \$6.0 million is in cash and \$3.5 million in the Company's common shares, with additional earn out payments of up to \$1.5 million based on the profitability of Bridgehead's existing coffeehouses over the next two years. Bridgehead owns and operates nineteen company-owned coffeehouses in Ottawa, which will continue to operate under the Bridgehead name.

## DEFINITIONS AND DISCUSSION ON CERTAIN NON-GAAP FINANCIAL MEASURES

In this MD&A, the Company reports certain non-IFRS 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-IFRS 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, such as the fair value gain/loss on NAC warrants, impact of amortization of deferred income, and also include asset impairment charges. 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 on the following page:

	13 weeks ended		52 weeks ended	
	December 28, 2019 <sup>1</sup>	December 29, 2018	December 28, 2019 <sup>1</sup>	December 29, 2018
Net income (loss)	\$(3,601)	\$(55)	\$(4,674)	\$1,151
Add (deduct):				
Income taxes (recovery)	(1,233)	47	(1,625)	491
Interest and financing costs (income)	189	(63)	619	(165)
Other loss (income)	929	669	111	(321)
Operating income (loss)	\$(3,716)	\$598	\$(5,569)	\$1,156

	13 weeks ended		52 weeks ended	
	December 28, 2019 <sup>1</sup>	December 29, 2018	December 28, 2019 <sup>1</sup>	December 29, 2018
Net income (loss)	\$(3,601)	\$(55)	\$(4,674)	\$1,151
Income taxes (recovery)	(1,233)	47	(1,625)	491
Interest and financing costs (income)	189	(63)	619	(165)
Other loss (income)	929	669	111	(321)
Depreciation of property and equipment	176	190	742	825
Amortization of intangible assets	114	134	473	510
Amortization of right-of-use assets	619	-	2,294	-
EBITDA	(2,807)	922	(2,060)	2,491
Add impact of the following:				
Asset Impairment charges	2,385	216	2,385	216
Non-recurring costs	211	159	1,216	223
Adjusted EBITDA	\$(211)	\$1,297	\$1,514	\$2,930

	13 weeks ended		52 weeks ended	
	December 28, 2019 <sup>1</sup>	December 29, 2018	December 28, 2019 <sup>1</sup>	December 29, 2018
Net income (loss)	\$(3,601)	\$(55)	\$(4,674)	\$1,151
Add (deduct) impact of the following:				
After-tax other loss (income)	680	491	81	(235)
After-tax asset impairment charges	1,748	158	1,748	158
After-tax non-recurring costs	155	-	891	-
Adjusted net income (loss)	\$(1,018)	\$594	\$(1,954)	\$1,074

	13 weeks ended		52 weeks ended	
	December 28, 2019 <sup>1</sup>	December 29, 2018	December 28, 2019 <sup>1</sup>	December 29, 2018
Net income (loss) per share	\$(0.18)	\$0.00	\$(0.23)	\$0.06
Add (deduct) impact of the following:				
After-tax other loss (income)	0.03	0.02	0.00	0.00
After-tax asset impairment charges	0.09	0.01	0.09	0.00
After-tax transition costs	0.01	-	0.04	-
Adjusted net income (loss) per share	\$(0.05)	\$0.03	\$(0.10)	\$0.06

<sup>1</sup> Adoption of new standard on a modified retrospective basis – Financial statements for 2019 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

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Consolidated Financial Statements for the 52 weeks ended December 28, 2019 and December 29, 2018

## 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 subsidiary (together, the Company) as at December 28, 2019 and December 29, 2018, and its financial performance and its cash flows for the 52 weeks then ended in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS).

### *What we have audited*

The Company's consolidated financial statements comprise:

- the consolidated statements of financial position as at December 28, 2019 and December 29, 2018;
- the consolidated statements of operations and comprehensive income (loss) for the 52 weeks then ended;
- the consolidated statements of changes in shareholders' equity for the 52 weeks then ended;
- the consolidated statements of cash flows for the 52 weeks 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.

## AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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 Donato Lisozzi.

*PricewaterhouseCoopers LLP*

Chartered Professional Accountants, Licensed Public Accountants

Vaughan, Ontario

March 12, 2020

# Consolidated Statements of Financial Position

As at December 28, 2019 and December 29, 2018

(Expressed in thousands of Canadian dollars)

	2019	2018
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$11,458	\$14,888
Restricted cash (note 24)	565	1,750
Trade and other receivables (note 6, 7)	2,314	2,561
Notes and leases receivable (note 8)	8,419	30
Inventories (note 9)	529	525
Prepaid expenses and other assets	258	259
Income tax receivable	-	186
	<b>23,543</b>	<b>20,199</b>
<b>Non-current assets</b>		
Notes and leases receivable (note 8)	42,658	23
Investments in equity securities (note 6,17)	450	1,720
Right-of-use assets (note 10)	12,635	-
Property and equipment (note 10)	2,179	2,044
Intangible assets (note 11)	31,887	32,015
<b>Total assets</b>	<b>\$113,352</b>	<b>\$56,001</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 12)	\$4,436	\$5,251
Provisions (note 13)	359	634
Other liabilities (note 14)	44	130
Gift card liability	2,106	2,327
Lease liabilities (note 13)	11,290	-
Deposits from franchisees	705	769
Deferred income (note 27)	483	2,042
	<b>19,423</b>	<b>11,153</b>
<b>Non-current liabilities</b>		
Provisions (note 13)	200	297
Other liabilities (note 14)	-	157
Lease liabilities (note 13)	56,830	-
Deferred income (note 27)	2,178	2,357
Deferred income taxes (note 21)	3,548	5,591
<b>Total liabilities</b>	<b>82,179</b>	<b>19,555</b>
<b>SHAREHOLDERS' EQUITY</b>	<b>31,173</b>	<b>36,446</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$113,352</b>	<b>\$56,001</b>

Contingencies, commitments and guarantees (note 25). See accompanying notes to consolidated financial statements.

Approved by the Directors March 11, 2020

Michael Bregman, Director

Stephen Kelley, Director

For the 52 weeks ended December 28, 2019 and December 29, 2018

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

# Consolidated Statements of Operations and Comprehensive Income (Loss)

	2018	2018
<b>Revenue (note 15)</b>		
Franchise revenue	\$15,752	17,829
Company-owned cafés and product sales	11,285	7,885
	27,037	25,714
<b>Operating costs and expenses (note 16)</b>		
Company-owned cafés and cost of product sales	10,944	8,954
Franchise expenses	9,296	8,961
General and administrative expenses	6,456	5,064
Loss on disposal of assets	16	28
Depreciation and amortization	3,509	1,335
Asset impairment charges (note 16 and 20)	2,385	216
	32,606	24,558
<b>Income (loss) from operations</b>	(5,569)	1,156
Other income (expenses) (notes 6, 17 and 18)	(111)	
Interest and financing (expenses) income (note 19)	(619)	
<b>Income (loss) before income taxes</b>	(6,299)	1,642
Income taxes (recovery) expense (note 21)	(1,625)	491
<b>Net income (loss) and comprehensive income (loss) for the period</b>	(4,674)	\$1,151
<b>Basic and diluted income (loss) per share (note 22)</b>	\$(0.23)	\$0.06

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Changes in Shareholders' Equity

For the 52 weeks ended December 28, 2019 and December 29, 2018

(Expressed in thousands of Canadian dollars)

	Share Capital	Warrants	Contributed Surplus	Retained Earnings (Deficit)	Total
<b>Balance – December 30, 2017</b>	\$19,271	\$165	\$61,747	(\$52,921)	\$28,262
Adoption of new accounting policy - net of tax (note 3)	\$-	\$-	\$-	(\$2,286)	(\$2,286)
Net income for the period	-	-	-	1,151	1,151
Stock option plan expense (note 28)	-	-	28	-	28
Shares repurchased (note 5)	(87)	-	-	(28)	(115)
Shares issued (note 4)	9,406	-	-	-	9,406
<b>Balance – December 29, 2018</b>	<b>\$28,590</b>	<b>\$165</b>	<b>\$61,775</b>	<b>(\$54,084)</b>	<b>\$36,446</b>
Adoption of new accounting policy - net of tax (note 3)	\$-	\$-	\$-	(\$870)	(\$870)
Net loss for the period	-	-	-	(4,674)	(4,674)
Stock option plan expense (note 28)	-	-	69	-	69
Shares issued (note 5)	200	-	2	-	202
<b>Balance – December 28, 2019</b>	<b>\$28,790</b>	<b>\$165</b>	<b>\$61,846</b>	<b>(\$59,628)</b>	<b>\$31,173</b>

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

For the 52 weeks ended December 28, 2019 and December 29, 2018

(Expressed in thousands of Canadian dollars)

	2019	2018
<b>CASH PROVIDED BY (USED IN)</b>		
<b>Operating activities</b>		
Net income (loss) for the period	\$(4,674)	\$1,151
Items not involving cash		
Depreciation of property and equipment	742	825
Amortization of intangible assets	473	510
Amortization of right-of-use assets (note 10)	2,294	-
Share-based compensation expense	80	18
Deferred income taxes (note 21)	(1,625)	480
Loss on disposal of assets	16	28
Interest income – finance leases (note 19)	(3,262)	-
Interest expense – lease liabilities (note 19)	4,163	-
Gain on disposal of leases	(24)	-
Other income (note 17)	(1,399)	(1,256)
Change in fair value of investments in securities (note 17)	1,270	935
Asset impairment charges (note 10, 20)	2,385	216
Loss allowance for notes and lease receivable (note 8)	627	35
Changes in non-cash working capital and other (note 23)	(65)	(733)
Cash provided by operating activities	1,001	2,209
<b>Investing activities</b>		
Proceeds from disposal of assets	156	304
Cash payments for capital expenditures (note 23)	(1,688)	(1,281)
Cash payments for intangible assets (note 23)	(350)	(157)
Notes receivable repayment	19	50
Cash used in investing activities	(1,863)	(1,084)
<b>Financing activities</b>		
Proceeds from issuance of shares (note 5)	200	10,000
Lease payments	(2,653)	-
Payment for repurchased shares	(115)	-
Transaction costs	-	(810)
Cash provided by (used in) financing activities	(2,568)	9,190
<b>Increase (Decrease) in cash and cash equivalents during the period</b>	<b>(3,430)</b>	<b>10,315</b>
<b>Cash and cash equivalents - Beginning of the period</b>	<b>14,888</b>	<b>4,573</b>
<b>Cash and cash equivalents - End of the period</b>	<b>\$11,458</b>	<b>\$14,888</b>

See accompanying notes to consolidated financial statements. Supplemental cash flow information is provided in note 23. Information on non-cash transactions and supplemental cash flow information are described further in notes 6, and 24.

# Notes to the Consolidated Financial Statements

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*For the 52 weeks ended December 28, 2019 and December 29, 2018*

(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 244 (2018 - 262) cafés operating under the trade name Second Cup™ in Canada, of which 32 (2018 - 25) 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.secondcup.com](http://www.secondcup.com). The common shares of the Company are listed on the Toronto Stock Exchange under the symbol "SCU".

On November 8th, 2019, the Company announced a new operating structure in support of its new strategy. Subject to TSX and shareholder approval, the existing public company will change its name to Aegis Brands Inc. ("Aegis" or "Aegis Brands"), which will own and operate the existing Second Cup Coffee Co. specialty coffee business as part of a portfolio of brands.

The Company's name change will not officially take effect until it has been approved by shareholders at the 2020 Annual General and Special Meeting and is subject to TSX approval. As of the date of this report, the Company continues to trade publicly as The Second Cup Ltd. (TSX: SCU). This has been further discussed in the Subsequent Events section of these consolidated financial statements.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### a. Basis of preparation

The consolidated financial statements (the "financial statements") have been prepared in accordance with and comply with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). The financial statements were approved and authorized for issue by the Board of Directors on March 11, 2020. 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 2019 is a 52-week period (2018 - 52-week period).

In accordance with IFRS 15, Revenue from Contracts with Customers ("IFRS 15"), the revenue, expenses, assets, liabilities and cash flows of the Co-op Fund are consolidated in the Company's Consolidated Statements of Financial Position. The Company manages the Co-op Fund which was 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.

The Company transitioned to IFRS 16, Leases ("IFRS 16"), in 2019, in accordance with the modified retrospective approach. On adoption of this accounting standard, the Company recognized lease liabilities in relation to leases,

which had in prior years been classified under the principles of IAS 17, Leases, as ‘operating lease commitments’. For Company-operated cafés and the head office, right-of-use assets were measured and recognized on the Consolidated Statements of Financial Position in accordance with the accounting standards. For most of the franchise cafés, the Company enters into the head lease for those café locations and, in turn, enters into a sublease on the same terms with its franchisees. Leases receivable for the subleases were measured at the amount equal to the lease liability and recognized 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**

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:

<b>Financial instrument</b>	<b>Recognition method</b>
<b><i>Financial assets</i></b>	
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
<b><i>Financial liabilities</i></b>	
Accounts payable and accrued liabilities	Amortized cost using the effective interest rate method
Deposits from franchisees	Amortized cost using the effective interest rate method
Gift card liabilities	Amortized cost using the effective interest rate method
Lease liabilities	Amortized cost using the effective interest rate method

#### **d. 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 \$243 held as security for cash management services.

#### **e. Leases receivable**

The leases receivable balance for fiscal 2019 relates to (1) head leases the Company has entered into for franchise café's, with a corresponding liability on these leases recorded on the consolidated statement of financial position and (2) point of sale systems ("POS") leased to certain franchisees by the Company. The Company enters into head lease agreements for most of its franchise café locations and, in turn, enters into a sublease on the same terms with its franchisees. IFRS 16 requires the Company, as an intermediate lessor, to classify a sublease by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying property. Lease receivable for the subleases were measured at the amount equal to the lease liability. The Company does not have any cashflows for lease receivables or associated lease liabilities for these subleased café's.

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 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.

The Company records an adjustment to leases receivable for expected credit losses as required by IFRS 9, Financial Instruments. The lease receivable balance as presented on the consolidated statement of financial position is net of these adjustments.

As the Company is considered an intermediate lessor on certain franchise café locations, the leases receivable balance for fiscal 2019 includes the underlying interest income on these locations resulting from the head lease agreements. The interest income does not reflect actual cash the Company will receive from its franchisees, and has been recorded in accordance with IFRS 16 adopted in fiscal 2019.

Lease and other occupancy costs paid by the Company as a result of the head lease agreements, which are due from franchise café's, have been recorded in fiscal 2019 as part of the lease receivables balance, net of loss allowances. In previous years, and prior to the adoption of IFRS 16, this was recorded as part of trade and other receivables.

#### **f. 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.

#### **g. 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.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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:

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

### **h. Right-of-use assets**

IFRS 16 requires the Company, as a lessee for company-operated caf  s and the head office, 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 recognize (ii) depreciation for lease assets separately from interest on lease liabilities on the Consolidated Statements of Operations and Comprehensive Income (Loss).

The Company has performed an analysis of impairment of its right-of-use assets based on the historical performance of each of its company-operated caf  s. The Company has also taken into account certain forward-looking factors including forecasted growth rates, and has embedded other assumptions as part of this impairment analysis. The balance of the Company's right-of-use assets as presented on the consolidated statement of financial position is net of any impairment recorded by the Company. This has been further discussed in the impairment analysis section – note 20.

### **i. Intangible assets**

Intangible assets consist of trademarks and software, which are recorded at cost and subsequently 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 caf  s 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.

In previous years, the Company has performed assessments to identify onerous contracts as they relate to real estate leases, and where applicable, provisions were recorded for such contracts. In applying IFRS 16, the Company

followed practical expedients permitted by the standard, including the reliance on previous assessments on whether leases are onerous. The Company recorded an adjustment to the right-of-use assets at the date of initial application for lease contracts that were onerous, and this has been further discussed in the section 'Changes in Accounting Policies'.

Lease and other occupancy costs not expected to be fully paid by the franchisee are recorded as part of the lease liabilities balance in fiscal 2019, as a result of the adoption of IFRS 16 during the fiscal year. In previous years, these were recognized as part of provisions.

The Company has recognized provisions for restructuring activities through fiscal 2019.

#### **k. 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.

#### **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. In the last two fiscal years of 2018 and 2019, the Company has calculated a breakage rate of 3.59% in line with the underlying redemption analysis of gift card sales. Gift card breakage is recognized on a pro rata basis based on historical gift card redemption patterns.

#### **n. Lease Liabilities**

On adoption of IFRS 16, the Company recognized lease liabilities in relation to leases, which had previously been classified as 'operating leases' under the principles of IAS 17, Leases. For company-operated café's and the head office, the Company has recognized right-of-use assets and a corresponding lease liability on the consolidated statement of financial position. For most of its franchise locations, the company enters into subleases with its franchisees (typically on the same terms as the Company's head lease agreement). For these franchised café locations, leases receivable for the subleases were measured at the amount equal to the lease liability.

Lease liabilities for fiscal 2019 also includes the underlying interest expense calculated on the Company's head lease agreements, and interest expense calculated on the Company's corporate café locations. This interest does not represent actual cash that the Company needs to pay. The interest expense has been recorded in accordance with IFRS 16 adopted in fiscal 2019.

**o. 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.

**p. Revenue recognition**

Revenue is recognized when it is determined that performance obligation has been fulfilled, the sales price is fixed or determinable, and collectability 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 the fiscal years of 2018 and 2019, 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.

**(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).

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 years 2018 and 2019, franchise fees and renewal fees have been recognized over the term of franchise agreements in accordance with IFRS 15.

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.

**q. 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.

**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**

In accordance with IFRS 9, the loss allowance for a financial instrument is 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, intangible assets without indefinite lives, and right-of-use assets (resulting from the Company's corporate owned café's and lease commitments) 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 year end date has been selected as the mandatory annual test date.

As discussed in the section 'Changes in Accounting Policies', the Company adopted IFRS 16 in fiscal 2019. As a result of this change, the Company has recognized right-of-use assets on the Consolidated Statements of Financial Position relating to Company-operated café's. The underlying right-of-use assets have been factored into the Company's assessment of impairment indicators and corresponding analysis.

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. Critical accounting estimates, assumptions and 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; and
- the allowance for credit losses

**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. For fiscal 2019, the impairment analysis has taken into account the right-of-use assets recorded in line with IFRS 16 accounting standards on the Consolidated Statements of Financial Position. 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. Value in use 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 20 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 affects 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 significant changes in the amount of depreciation recorded in respect of the Company's property and equipment in the future.

**(iv) Allowance for credit losses**

In accordance with IFRS 9, Financial Instruments ("IFRS 9"), the Company has recorded an allowance for forward-looking expected credit losses ("ECL") for all loans and other debt financial assets that are not held at fair value through profit and loss.

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, and lease receivables, 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.

### **3. CHANGES IN ACCOUNTING POLICIES**

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

#### **IFRS 16 Leases**

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

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

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

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

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

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

#### ADJUSTMENTS RECOGNIZED ON ADOPTION OF IFRS 16

The Company transitioned to IFRS 16 in accordance with the modified retrospective approach. The prior year figures for fiscal 2018 were not adjusted. On adoption of IFRS 16, the Company recognized lease liabilities in relation to leases, which had previously been classified as 'operating leases' under the principles of IAS 17, Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of December 30, 2018. The weighted average lessee's incremental borrowing rate applied to the lease liabilities on December 30, 2018 was 6.62%.

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

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

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

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

For most of the franchise cafés, the Company enters into the head lease for those café locations and, in turn, enters into a sublease on the same terms with its franchisees. IFRS 16 requires the Company, as an intermediate lessor, to classify a sublease as a finance lease by reference to the right-of-use asset arising from the head lease, rather than by reference to the underlying property. Leases receivable for the subleases were measured at the

amount equal to the lease liability. The Company recorded an adjustment to leases receivable for expected credit losses of \$612 at the date of initial application as required by IFRS 9, Financial Instruments.

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

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

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

#### **IFRS 15 Revenue from Contracts with Customers**

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

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

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

#### **4. 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 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.

On July 3, 2019, in accordance with the terms of the employment agreement with the Company’s new President and CEO, the Company issued Mr. Steven Pelton 515,241 common shares in the capital of the Company at \$1.70 per share.

Shares outstanding at the fiscal year ended December 28, 2019 are 20,394,959 (2018 – 19,940,073). See note 5 for more details.

#### **5. MANAGEMENT OF CAPITAL**

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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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 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. During this period, the Company repurchased 60,335 common shares for an aggregate total value of \$115.

On July 3, 2019, in accordance with the terms of the employment agreement with the Company's new President and CEO, the Company issued Mr. Steven Pelton 515,241 common shares in the capital of the Company at \$1.70 per share. Mr. Pelton paid \$200 in cash for 117,647 shares and 397,594 shares were paid with the proceeds of two loans advanced to Mr. Pelton by the Company – a five-year loan of \$500 repayable in June 2024 and a one-year loan of \$176 repayable in June 2020, both loans accruing interest at 4.0% per annum.

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.

## 6. 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
<b><i>Financial assets</i></b>	
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
<b><i>Financial liabilities</i></b>	
Accounts payable and accrued liabilities	Liquidity, currency, and commodity
Gift card liability	Liquidity
Deposits from franchisees	Liquidity
Lease liabilities	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 both fiscal 2018 and 2019 (see note 17, 18) was 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 stock's volatility was adjusted at year end for industry specific factors and other considerations to determine the fair value of the warrants. The following table summarizes the financial instruments measured at fair value:

	2019	2018
<b>Warrants</b>		
Opening fair value	1,720	\$-
Fair value of warrants received	-	2,655
Change in fair value	(1,270)	(935)
Closing fair value	\$450	\$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 monitored 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. Consistent with the prior fiscal year, the Company has leveraged a provision matrix that is based on the 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 loss allowances are as follows:

	0-30 Days	31-60 Days	61-90 Days	> 90 Days	Total
Gross amount as at December 28, 2019	\$2,013	\$129	\$87	\$2,152	\$4,381
Allowance for doubtful accounts	(33)	(21)	(56)	(1,957)	(2,067)
Net amount 2019	\$1,980	\$108	\$31	\$195	\$2,341
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

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Trade and other receivables include a combined loss allowance of \$2,067 (December 29, 2018 - \$3,565). Credit terms vary by customer in the range of 30 to 90 days. The net amount due of \$195 aged over 90 days has no specific terms of repayment. Trade and other receivables are further discussed in note 7.

The payment maturity dates of the notes receivable as at December 28, 2019, net of loss allowances, are as follows

	< 90 Days	90 Days to < 1 year	1 year to < 2 years	2 years and after	Total
2018	\$20	\$13	\$4	\$0	\$37
2018	\$8	\$22	\$19	\$4	\$53

Notes receivable (on point of sale systems leased to certain franchisees by the Company) includes a combined loss allowance of \$89 (December 29, 2018 - \$90). Notes and leases receivable are further discussed in note 7 and 8.

The Company is considered an intermediate lessor on certain franchise café locations. The following table outlines the contractual undiscounted lease payments towards real estate leases receivable as at December 28, 2019.

	As at December 28, 2019
Year 1	\$12,263
Year 2	10,812
Year 3	9,686
Year 4	8,299
Year 5	7,305
Thereafter	15,395
Less: unearned interest income	(11,651)
Less: expected credit loss allowance	(1,230)
Add: other lease receivable net of loss allowance	161
Total leases receivable	\$51,040

Lease and other occupancy costs paid by the Company as a result of the head lease agreements, which are due from franchise café's, have been recorded in fiscal 2019 as part of the lease receivables balance, net of loss allowances, for a total of \$161.

Leases receivable on the consolidated statement of financial position also includes \$37 relating to leases receivable on point of sale systems ("POS") leased to certain franchisees.

### 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.

## 7. TRADE AND OTHER RECEIVABLES

	2019	2018
Trade and other receivables	\$4,381	\$6,126
Less: Loss Allowance	(2,067)	(3,565)
Net trade and other receivables	\$2,341	\$2,561

During the period, \$303 (2018 - \$1,240 expense) was recorded as a charge pertaining to trade and other receivables recognized as part of the Company's operating costs and expenses. In accordance with IFRS 16, lease and other occupancy costs receivable from franchisees has been recognized as part of the lease receivable balance, net of loss allowances recorded during the year (note 8).

## 8. NOTES AND LEASES RECEIVABLE

	2019	2018
Notes and other lease receivable	\$120	\$107
Lease receivable	11,884	-
Less: Loss Allowance – notes and other lease receivable	(85)	(77)
Less: Loss Allowance	(3,500)	-
Notes and leases receivable – current	8,419	30
Notes and other lease receivable	4	4
Lease receivable	42,917	42,917
Less: Loss Allowance – notes and other lease receivable	(261)	(261)
Less: Loss Allowance	(2)	(2)
Notes and leases receivable – long-term	42,658	23
Notes and leases receivable	\$51,077	\$53

The leases receivable balance for fiscal 2019 is made up of (1) lease receivable on point of sale systems ("POS") leased to certain franchisees by the Company and (2) leases receivables related to head leases the Company has for franchise locations, in accordance with IFRS 16 accounting standards which were adopted in the beginning of fiscal 2019 by the Company.

## 9. INVENTORIES

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

	2019	2018
Merchandise held for resale	\$478	\$474
Supplies	51	51
	\$529	\$525

## 10. PROPERTY, EQUIPMENT, AND RIGHT-OF-USE ASSETS

## a. Property and Equipment

	Leasehold	Equipment, furniture, fixtures and construction in process	Computer hardware	Total
<b>Net carrying value</b>				
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 17)	(14)	(197)	(5)	(216)
Depreciation	(282)	(463)	(80)	(825)
As at December 29, 2018	<b>637</b>	<b>1,393</b>	<b>14</b>	<b>2,044</b>
<b>Net carrying value</b>				
As at December 29, 2018				
Cost	\$2,635	\$5,132	\$883	\$8,650
Accumulated depreciation	(1,998)	(3,639)	(869)	(6,606)
As at December 29, 2018	637	1,393	14	2,044
Additions	806	880	2	1,688
Disposals – original cost	(29)	(308)	–	(337)
Disposals – accumulated depreciation	8	157	5	170
Impairment charge (note 20)	(326)	(318)	–	(644)
Depreciation	(346)	(379)	(17)	(742)
As at December 28, 2019	<b>750</b>	<b>1,425</b>	<b>4</b>	<b>2,179</b>
Cost	<b>3,086</b>	<b>5,337</b>	<b>886</b>	<b>9,309</b>
Accumulated depreciation	<b>(2,336)</b>	<b>(3,912)</b>	<b>(882)</b>	<b>(7,130)</b>
As at December 28, 2019	<b>\$750</b>	<b>\$1,425</b>	<b>\$4</b>	<b>\$2,179</b>

## b. Right-of-use assets

	Right-of-use assets
Balance, December 29, 2018	\$12,252
Amortization	(2,294)
Net additions	4,562
Less: leasehold inducements	(144)
Less: asset impairment charges	(1,741)
As at December 28, 2019	<b>\$12,635</b>

## 11. INTANGIBLE ASSETS

	Trademarks	Software	Total
<b>Net carrying value</b>			
As at December 30, 2017			
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	-	217	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
Additions	-	350	350
Disposals - original cost	-	(9)	(9)
Disposals - accumulated amortization	-	4	4
Amortization	-	(473)	(473)
As at December 28, 2019	\$31,144	\$743	\$31,887
Cost	31,144	3,395	34,539
Accumulated amortization	-	(2,652)	(2,652)
As at December 28, 2019	\$31,144	\$743	\$31,887

## 12. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of:

	2019	2018
Accounts payable - trade	\$1,671	\$1,689
Accrued liabilities	2,016	2,855
Deferred share unit plan liabilities	342	331
Accrued salaries, wages, benefits, and incentives	284	201
Sales tax payable - government remittances payable	123	175
	<b>\$4,436</b>	<b>\$5,251</b>

## 13. PROVISIONS AND LEASE LIABILITIES

## a. Provisions

	Café leases (a)	Other (b)	Total
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
Provisions re-allocated to lease liabilities in accordance with IFRS 16	(634)	-	(634)
Provisions charged during the period	-	901	901
Provisions utilized during the period	(97)	(542)	(639)
As at December 28, 2019	\$200	\$359	\$559
Current portion	\$-	\$359	\$359
Long-term portion	200	-	200
As at December 28, 2019	\$200	\$359	\$559

Lease and other occupancy costs not expected to be fully paid by the franchisee were previously recorded under IAS 17 as a provision as the Company has liability on the café head lease. In accordance with IFRS 16, the Company has recognized the underlying provision in fiscal 2019 as part of lease liabilities on the consolidated statements of financial position.

## b. Lease Liabilities

The following table outlines the total contractual undiscounted real estate lease liabilities as at December 28, 2019:

	As at December 28, 2019
Year 1	\$15,296
Year 2	13,580
Year 3	12,425
Year 4	10,900
Year 5	9,598
Thereafter	21,588
Less: future interest expense – franchise café's	(11,651)
Less: future interest expense – corporate café's	(4,022)
Add: other occupancy liabilities	406
Total leases liabilities	\$68,120

Lease and other occupancy costs not expected to be fully paid by the franchisee are recorded as part of the lease liabilities balance in fiscal 2019, as a result of the adoption of IFRS 16 during the fiscal year. In previous years, these were recognized as part of provisions.

## 14. OTHER LIABILITIES

	2019	2018
Deferred income – current	\$44	\$94
Leasehold inducements – current	-	36
Other liabilities – current	\$44	\$130
Deferred income – long-term	\$-	\$14
Leasehold inducements – long-term	-	143
Other liabilities – long-term	\$-	\$157
Deferred income	\$44	\$108
Leasehold inducements	-	179
Other liabilities	\$44	\$287

In accordance with IFRS 16, lease inducements are recognized on the consolidated statement of financial position as part of the right-of-use assets (previously reported separately as leasehold inducements before the adoption of IFRS 16).

## 15. REVENUE

	2019	2018
<b>Franchise revenue</b>		
Royalties	\$ 8,804	\$9,930
Advertising fund contributions	2,736	3,031
Franchise fees, services and other	4,212	4,868
	15,752	17,829
<b>Company-owned cafés and product sales</b>	11,285	7,885
	\$27,037	\$25,714

### *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 franchised cafés and are based on a percentage of café sales.

### *Franchise fees, services and other*

Franchise fees, services and other fees (as included in the table below) 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)

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

	Deferred income
Balance at December 29, 2018	\$3,000
Franchise fees adjustments to deferred income	(4)
Franchise fees added year to date	381
Franchise fees recognized as income in the year	(716)
Balance at December 28, 2019	\$2,661

### ***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.

## **16. OPERATING COSTS AND EXPENSES**

	2019	2018
<b>Company-owned cafés and cost of product sales</b>		
Cost of product sales	\$4,159	\$3,101
Labour and related expenses	4,424	2,941
Occupancy and other	2,361	2,912
Depreciation of property and equipment	490	361
Amortization of right-of-use asset	2,060	-
Loss on disposal of assets	16	28
	13,510	9,343
<b>Franchise expenses</b>		
Labour and related expenses	3,778	3,768
Advertising fund expenses	2,624	3,022
Travel and franchisee meetings	341	285
Professional fees and other	2,553	1,886
	9,296	8,961
<b>General and administrative expenses</b>		
Labour and related expenses	3,048	1,707
Professional fees and other	3,182	2,879
Occupancy	226	478
	6,456	5,064
<b>Other</b>		
Depreciation and amortization	725	974
Change in fair value of NAC warrants as at end of year	234	-
Acquisition costs	2,385	216
	3,344	1,190
	\$32,606	\$24,558

## 17. OTHER EXPENSES (INCOME)

	2019	2018
Recognition of NAC deferred income	\$(1,399)	\$(1,256)
Change in fair value of NAC warrants as at end of year	1,270	935
Acquisition costs	240	-
	<u>\$111</u>	<u>\$(321)</u>

## 18. 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. 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. The deferred income was recognized into income over the course of the agreement – which commenced on the date of agreement, April 12, 2018, and terminated on October 17, 2019. Included in other income for 2019 is \$1,399 (\$1,256 – 2018) for the amortization of the deferred income (note 17).

The fair value of the warrants was calculated using the Black Scholes model based on a volatility adjusted for industry specific factors and other considerations, including the business performance of the NAC brand. The fair value of the warrants was \$0.09 each (\$0.344 – 2018), resulting in a decrease to the fair value of the warrants of \$1,270 (\$935 – 2018).

## 19. INTEREST AND FINANCING COSTS (INCOME)

	2019	2018
Interest expense – lease liabilities	\$4,163	\$-
Interest (income) – finance leases	(3,262)	-
Interest (income) – short term securities	(282)	(165)
	<u>\$619</u>	<u>\$(165)</u>

## 20. IMPAIRMENT OF ASSETS

### a. Impairment of trademarks

The Company's trademarks are allocated fully to the franchising, distribution and wholesale cash generating unit (CGU). The CGU's recoverable amount has been determined using the higher of (1) Fair value less costs of disposal ("FVLCTD") and (2) Value in use.

The Company has determined that the recoverable amount is \$40,660, which is the fair value based on the market price less estimated costs of disposal. The methodology used to determine the FVLCTD is classified as Level 3 per the hierarchy described in note 6. In determining the FVLCTD, the Company has used the observable market price (using inputs derived from unadjusted quoted prices in active markets) of the Company's share price at year end, adjusted to exclude the impact of the corporate café CGU, and calculated the market capitalization based on the number of shares outstanding at the fiscal year ended December 28, 2019 (note 4).

The impairment analysis performed for fiscal 2019 does not indicate any impairment for the franchising, distribution and wholesale CGU (2018 - \$nil) as the recoverable amount exceeded the carrying value of the CGU.

### b. Corporate cafes - impairment of leasehold improvements, equipment, furniture, fixtures, other fixed assets, and impairment of right-of-use assets

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 recoverable amount has been determined using a value in use model for each corporate café or CGU. The underlying assets for each of the Company's corporate café's, including fixed and right-of-use assets recorded in accordance with IFRS 16, have been assessed for impairment.

As per the discussion in the section 'Changes in Accounting Policies', the Company has recorded \$12,635 of right-of-use assets on the consolidated statement of financial position in connection with IFRS 16 adopted in the beginning of fiscal 2019. Due to this adoption, the carrying amount of assets included in determining the recoverable amount is significantly larger for fiscal 2019, as compared to prior years.

The value in use model under IFRS 16 is constructed with different data-points compared to the models prepared under the previous accounting standards, IAS 17. The key differences included in determining the recoverable amount are summarized below:

- (1) the inclusion of the right-of-use asset in the carrying amount of the CGU
- (2) exclusion of lease liabilities from the carrying amount of the CGU
- (3) use of a discount rate estimated with reference to the weighted average cost of capital that reflects current market assessments
- (4) inclusion of any estimated cash outflows in connection with the termination of leases

The recoverable amount was compared to the carrying value of the underlying CGU's or corporate stores individually. As per IAS 36, an impairment loss shall be recognized for a cash generated unit if the recoverable amount is less than the carrying amount of the CGU. An impairment loss recognised in prior periods for an asset other than goodwill shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised.

As a result of the impairment test, non-cash impairment charges of \$2,385 for the year ended December 28, 2019 (2018 - \$216) were recorded to assets that were not able to be redeployed to a different CGU and to right-of-use assets (recognized in accordance with IFRS 16) as the carrying amount exceeded the recoverable amount. The impacted assets include right-of-use assets (2019 - \$1,741, 2018 - N/A) and leasehold improvements, equipment, furniture and other fixed assets (2019 - \$644, 2018 - \$216).

## 21. 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:

	2019	2018
Income (loss) before income taxes	\$(6,299)	\$1,642
Combined Canadian federal and provincial tax rate	26.72%	26.67%
Tax expense (recovery) at statutory rate	(1,683)	437
Increased (reduced) by following differences		
Change in tax rates	10	6
Non-deductible permanent differences	56	13
Other	(8)	35
Income tax expense	\$(1,625)	\$491
Current income tax expense	\$101	\$11
Deferred income tax expense	(1,726)	480
Income tax expense	\$(1,625)	\$491

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

	2019	2018
Basic federal rate	15.00%	15.00%
Weighted average provincial rate	11.72%	11.67%
Combined Canadian federal and provincial tax rates	26.72%	26.67%

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

	Property and equipment		Warrants	Other	Total
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
Charged to the income statement	(57)	5	(14)	(1,660)	(1,726)
Credited to equity	-	-	-	(317)	(317)
As at December 28, 2019	\$1,961	\$4,778	\$180	\$(3,371)	\$3,548

## 22. 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 to purchase shares are excluded due to anti-dilutive impact. Basic and diluted income (loss) per share is determined as follows:

	2019	2018
Net income (loss)	\$(4,674)	\$1,151
Weighted average number of shares issued and outstanding	20,135,567	18,920,785
Basic and diluted income (loss) per share	\$(0.23)	\$0.06

**23. SUPPLEMENTAL CASH FLOW INFORMATION**

	2019	2018
<b>Changes in non-cash working capital and other inflow (outflow)</b>		
Trade and other receivables	\$ 85	\$1,155
Inventories	(4)	(320)
Prepaid expenses and other assets	1	(53)
Accounts payable and accrued liabilities	(826)	1,171
Provisions and lease liabilities	35	(233)
Other liabilities	(104)	(100)
Deferred income	(338)	(118)
Gift card liability	(221)	(1,106)
Deposits from franchisees & change in restricted cash	1,121	(852)
Income taxes	186	(277)
	<b>\$(65)</b>	<b>\$(733)</b>

**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:

	2019	2018
Development Fund	\$84	\$746
Co-op Fund	238	763
Security Deposit held by bank	243	241
Total Restricted Cash	<b>\$565</b>	<b>\$1,750</b>

**25. CONTINGENCIES, COMMITMENTS AND GUARANTEES**

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 \$1,543 (2018 - \$1,601) for the subsequent 12 months. The coffee purchase commitment is comprised of two components: unapplied futures commitment contracts and fixed price physical contracts.

Due to the Company acting as the primary coordinator of café construction costs on behalf of its franchisees and for Company-operated cafés, there are \$122 (2018 - \$211) 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 over the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties. In 2017, the Company signed a category exclusive licensing agreement with Pinkberry Canada Inc. for the Pinkberry Frozen Yogurt program. The Pinkberry brand is owned by the Serruya family who are significant shareholders in the Company. Michael Serruya and Aaron Serruya are members of the Board of Directors.

On July 3, 2019, in accordance with the terms of the employment agreement with the Company's President and CEO, the Company issued Mr. Steven Pelton 515,241 common shares in the capital of the Company at \$1.70 per share. Mr. Pelton paid \$200 in cash for 117,641 shares and 397,600 shares were paid with the proceeds of two loans advanced to Mr. Pelton by the Company – a five-year loan of \$500 repayable in June 2024 and a one-year loan of \$176 repayable in June 2020, both loans accruing interest at 4.0% per annum.

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

### 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:

	2019	2018
Salaries and short-term employee benefits	\$1,836	\$2,344
Termination costs	473	–
Share-based compensation	80	18
Total compensation	\$2,389	\$2,362

## 27. DEFERRED INCOME

	2019	2018
Deferred income – miscellaneous income	\$–	\$1,399
Deferred income – contract liability	483	643
Current deferred income	\$483	\$2,042
Deferred income – contract liability	2,178	2,357
Long term deferred income	\$2,178	\$2,357
Total deferred income	\$2,661	\$4,399

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, as summarized in the table above.

## 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 \$0.18 granted as of December 28, 2019:

	Assumption
Risk-free interest rate (%)	1.58
Volatility (%)	52.87
Expected term (years)	7.6

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 29, 2018	510,000	\$2.69
Granted	927,098	1.80
Forfeited	(356,000)	2.70
As at December 28, 2019	<b>1,081,098</b>	<b>\$1.92</b>
Stock option plan recovery during the period		<b>\$69</b>

The range of exercise prices for share options outstanding at December 29, 2018 is \$1.60 to \$3.60. Of the share options outstanding, 257,098 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 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	<b>180,943</b>	<b>\$331</b>
Recovery in the period		<b>\$(10)</b>
Notional units outstanding as at December 29, 2018	180,943	\$331
Deferred units granted	37,217	70
Deferred units paid out	(23,536)	(37)
Change in fair value	-	(22)
Notional units outstanding as at December 28, 2019	<b>194,624</b>	<b>\$342</b>
Expense in the period		<b>\$11</b>

The average fair value price of deferred units granted was \$1.87 (2018 - \$2.13).

## 30. RECLASSIFICATION OF PRIOR YEAR PRESENTATION

The impairment expense for fiscal 2018 has been reclassified for consistency with the current period presentation. The reclassification has had no effect on the previously reported net income and comprehensive income for the period.

## 31. SUBSEQUENT EVENTS

As per the note in the section 'Organization and Nature of the Business', the Company will change its name to Aegis Brands Inc. ("Aegis" or "Aegis Brands"), which will own and operate the existing Second Cup Coffee Co. specialty coffee business as part of a portfolio of brands. As of the date of this report, this change is pending shareholder and TSX approval.

On January 9, 2020, the Company completed the acquisition of 100% of the issued and outstanding shares of Ottawa-based Bridgehead Coffee ("Bridgehead") for a purchase price of \$9.5 million at closing, of which \$6.0 million is in cash and \$3.5 million in the Company's common shares, with additional earn out payments of up to \$1.5 million based on the profitability of Bridgehead's existing coffeehouses over the next two years. The acquisition of Bridgehead was announced on December 5, 2019. The Company is still in the process of assessing the fair value of net assets acquired.

# Shareholder Information

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## CORPORATE HEAD OFFICE

The Second Cup Ltd.  
6303 Airport Road, 2nd Floor  
Mississauga, Ontario  
Canada L4V 1R8

## Registrar and Transfer Agent

Computershare Trust  
Company of Canada

## Auditors

PricewaterhouseCoopers LLP

## Market Information

Shares Listed:  
Toronto Stock Exchange  
Symbol: SCU

## Investor Inquiries

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investor@secondcup.com

## Website

www.secondcup.com

## THE SECOND CUP LTD. Board of Directors

Michael Bregman <sup>(1),(2)</sup>  
Chairman

Steven Pelton  
Stephen Kelley <sup>(1)</sup>  
Melinda Lee  
Alton McEwen <sup>(2)</sup>  
Alan Simpson <sup>(2)</sup>  
Michael Serruya <sup>(1)</sup>  
Aaron Serruya

## Committees of the Board

(1) Audit Committee  
(2) Governance, Human  
Resources and  
Compensation Committee

## THE SECOND CUP LTD. Senior Management Team

**Steven Pelton**  
President and  
Chief Executive Officer

**Ba Linh Le**  
Chief Financial Officer

**Paul Pascal**  
Vice President, Operations

**Tara Ramsay**  
Vice President,  
People

**Mangala D'Sa**  
Vice President,  
Marketing & Innovation

**Scott McCannell**  
Vice President,  
Non Traditional Franchising  
& Licensing

**Jenn Juby**  
Vice President,  
Retail

