

# **Aegis Brands Inc.**

## **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", "we", "us", or "our", or "Aegis Brands" refer to Aegis Brands Inc. 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 the Company's control that may cause the Company's actual results, performance or achievements, or those of the Company's 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 and cannabis products and accessories; the ability to attract qualified franchisees; the location of the Company's cafés and retail cannabis dispensaries; the closure of cafés and stores; loss of key personnel; compliance with government regulations; potential litigation; the ability to exploit and protect the Company's trademarks; changing consumer preferences and discretionary spending patterns including, but not restricted to, the impact of weather and economic conditions on such patterns and the impact of the ongoing COVID-19 pandemic on consumer buying and spending trends and on the business environment; reporting of system sales by franchisees; and the financial performance and financial condition of the Company. The foregoing list of factors is not exhaustive, and investors should refer to the risks described under "Risks and Uncertainties" below and in the Company'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, the Company 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.aegisbrands.ca](http://www.aegisbrands.ca).

### **INTRODUCTION**

The following MD&A has been prepared as of November 9, 2020 and is intended to assist in understanding the financial performance and financial condition of Aegis Brands Inc. ("Aegis Brands" or the "Company") for the 13 weeks (the "Quarter") and 39 weeks ended September 26, 2020, and should be read in conjunction with the Unaudited Condensed Interim Consolidated Financial Statements of the Company for the 13 weeks and 39 weeks ended September 26, 2020 and September 28, 2019, the Audited Consolidated Financial Statements of the Company for the 52 weeks ended December 28, 2019, 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 or stores, 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 and stores, same café and store 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***

Aegis Brands Inc. (the “Company”, “Aegis Brands”, formerly “The Second Cup Ltd.”) is a consolidator of brands in the food, beverage and cannabis spaces with the mission to allow for independent entrepreneurial spirit while providing shared services that encourage unlimited growth. The Company owns and operates the Second Cup Coffee Co.<sup>TM</sup> specialty coffee business as part of a portfolio of brands that also includes Bridgehead Coffee (Bridgehead®), and Hemisphere Cannabis Co.<sup>TM</sup>. The Company owns the trademarks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of these brands in Canada. The retail operating brands hereinafter will be referred to as Second Cup, Bridgehead, and Hemisphere, respectively.

Following shareholder and regulatory approval, the Company changed its name during the third fiscal quarter of 2020 from “The Second Cup Ltd.” to “Aegis Brands Inc.”. As a result of this change, the parent company is now officially “Aegis Brands Inc.”, while its retail brands continue to operate as Second Cup Coffee Co.<sup>TM</sup>, Bridgehead Coffee®, and Hemisphere Cannabis Co.<sup>TM</sup>.

Aegis Brands Inc. is a Canadian public company incorporated under the Business Corporations Act (Ontario) in 2011. The Company relocated to a new registered office in September 2020 located at 5915 Airport Road, Suite 630, Mississauga, ON L4V 1T1. The Company’s website is [www.aegisbrands.ca](http://www.aegisbrands.ca). The Company’s common shares trade under the new name and the new Toronto Stock Exchange ticker symbol “AEG” (previously “SCU”). Each existing certificate reflecting the Company’s prior name will continue to represent a valid certificate until such certificate is transferred, re-registered or otherwise exchanged.

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 2020 consists of 52 weeks.

#### ***Operating Brands***

The Company owns and operates three retail operating brands. There are 231 cafés operating under the trade name Second Cup Coffee Co., out of which 31 are Company-owned and the balance are operated by franchisees. Bridgehead has 19 Company-owned coffeehouses including its flagship roastery, all of which continue to operate under the Bridgehead brand. During the quarter, the Company opened 2 retail cannabis dispensaries which operate under the brand Hemisphere Cannabis Co.

#### ***Strategic Imperatives and Key Performance Drivers***

Aegis Brands was created with the vision of building a portfolio of brands that can grow and flourish by leveraging expertise developed over 40 years in the Canadian retail and foodservice industry. Aegis will continue to focus on its key strategies, which include the growth of the Second Cup brand through non-traditional channels, the pursuit of retail cannabis opportunities and strategic acquisitions. The Company expects to continue strengthening its franchise network, franchise 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 and 2021.

The Company also expects to continue to identify synergies, share best practices, and integrate the operations of support functions between its retail brands, while continuing to ensure that all brands independently operate and preserve their core values.

The Company is actively engaged in a brand strategy review to identify and test new innovations to aggressively grow café and store sales and improve the economic model of its stores, as well as engage in a strategic review to chart the way forward as the economic impacts of COVID-19 continue to resonate through the economy.

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The Company currently has two operating retail cannabis dispensaries and expects to open an additional two locations this year, which will include another location in Toronto, as well as the Company's first store in the City of Ottawa. In fiscal 2021, the Company expects to open three new retail cannabis dispensaries and will continue to explore and pursue other locations across Canada. The Company's retail cannabis stores operate under the trade name Hemisphere Cannabis Co.

### **HIGHLIGHTS OF SIGNIFICANT EVENTS**

#### ***Statement on COVID-19***

The COVID-19 pandemic continues to spread on a global scale, causing companies and various international jurisdictions to impose restrictions, such as quarantines, closures, cancellations and travel restrictions. While the restrictions were gradually eased by governments and businesses during the summer months, the case count is continuing to go up, and restrictions are going back into effect by governments and businesses in certain parts of Canada.

There is uncertainty around how long the pandemic and the associated economic and business consequences will last. There is also uncertainty on how long it will take for a vaccine to be ready for the Canadian public to use, and how long it will take to administer on a national scale.

The Company continues to closely monitor the situation around the pandemic, including the impacts on the business. The Company continues to be engaged in discussions with landlords, both on its own behalf and on behalf of its franchisees, to request abatements and/or deferrals of rent, and, where appropriate, to discuss potential amendments to or the termination of lease agreements for certain underperforming café locations. The Company has applied for the Canada Emergency Wage Subsidy (CEWS), a financial relief measure supported by the Federal Government of Canada as a result of the economic impacts of the COVID-19 pandemic. The CEWS is comprised of a financial subsidy of eligible earnings for eligible employees, up to a specified monetary threshold as determined by the Federal Government. The Company is working with the full network of suppliers to arrange deferred payment terms to provide franchisees with additional flexibility to manage cash and payroll.

The Company continues to actively monitor all aspects of its business and operations and to work closely with its franchisees and other business partners.

#### ***Acquisition of Bridgehead***

On December 5, 2019, the Company announced the acquisition of Ottawa-based Bridgehead Coffee ("Bridgehead"), the Company's first acquisition since it announced its new operating structure and strategy in November. This acquisition closed on January 9, 2020. Bridgehead has 19 coffeehouses in Ottawa, Ontario, including its flagship roastery, all of which continue to operate under the Bridgehead brand.

The base purchase price consisted of cash consideration of \$6.0 million, stock consideration of \$3.3 million, which represents the fair value of the stock as at the valuation date of January 8, 2020, and additional earn out payments of up to \$1.5 million based on the profitability of Bridgehead's existing coffeehouses over the next two years.

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### **CAPABILITIES**

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

#### **The Second Cup Brand**

The brand – Second Cup Coffee Co.<sup>TM</sup> – 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 cafés across Canada, Second Cup Coffee Co.<sup>TM</sup> is a specialty coffee retailer. Second Cup 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.

In January 2018, Second Cup announced a move to Clean Label beverages, with a commitment to eliminate artificial colours and flavours, preservatives and high fructose corn syrup from all beverages on the menu.

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

#### ***The Second Cup Brand - 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.

#### ***The Second Cup Brand - Products***

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<sup>TM</sup> - 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.

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### **The Bridgehead Brand**

The brand - Bridgehead® – reflects a commitment to deliver original and premium Fairtrade coffee brands, with 100% of its coffee certified Fairtrade and 100% of its coffee made from organic certified green coffee. A proud Canadian company, Bridgehead has 19 company-owned coffeehouses in Ottawa, including its flagship roastery, all of which continue to operate under the Bridgehead name.

All Bridgehead coffeehouses serve baked goods and fresh foods made daily in the company's Kitchen and Bakery, using local and seasonal ingredients.

#### ***The Bridgehead Brand – People***

There are a total of 330 team members who continue to work for the Bridgehead brand. Team members range from baristas, managers to support personnel employed at the Company's head office.

#### ***The Bridgehead Brand - Products***

Bridgehead takes pride in leveraging its experience and knowledge of the coffee business to serve fresh and locally roasted coffee prepared to the industry's highest technical standards, including the preparation of espresso to the technical standards of the World Barista Championship.

Bridgehead operates its own Scratch Bakery and sources fresh ingredients from over fifteen different local farmers and suppliers to make delicious foods and products for its customers.

### **The Hemisphere Brand**

The brand – Hemisphere Cannabis Co.™ – reflects a commitment to deliver a premium shopping experience in the recreational retail cannabis market for seasoned users and beginners. Hemisphere opened its first location on July 10, 2020 and its second location on September 11, 2020. Both locations are based in Toronto.

Hemisphere received its retail operator license from the Alcohol and Gaming Commission of Ontario (AGCO). The company has also submitted applications to the AGCO to obtain the retail store authorization for five additional retail cannabis locations to open in the Province of Ontario during the balance of the year, and in fiscal 2021.

#### ***The Hemisphere Brand – People***

Hemisphere employs friendly and knowledgeable budtenders who have been trained to provide a guided selection experience. Hemisphere's store is organized based on need-state to help create a simple to navigate shopping experience.

#### ***The Hemisphere Brand - Products***

Hemisphere is in the business of selling legal recreational cannabis products and accessories, including a diverse selection of cannabis flower, concentrates, and infused beverages and edibles.

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### **Liquidity, capital resources and management of capital**

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 loan of \$176 plus accrued interest was repaid by Mr. Pelton on June 30, 2020 in accordance with the terms of the employment and loan agreement.

On January 9, 2020, the Company completed the acquisition of 100% of the issued and outstanding shares of Ottawa-based Bridgehead Coffee ("Bridgehead"). The base purchase price consisted of cash consideration of \$6.0 million, stock consideration of 2,521,069 shares of Aegis Brands Inc., and 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 fair value of the stock consideration as at the valuation date of January 8, 2020 is \$3.3 million.

### **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**

The Company relies heavily on information technology network infrastructure including point of sale system ("POS") hardware and software in cafés and stores, 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.

During the third quarter of fiscal 2020, the Company entered into an agreement with a third-party supplier to upgrade its POS systems to ensure that all Second Cup and Bridgehead cafés are equipped with state-of-the-art retail POS infrastructure at its locations across Canada. The Company expects to complete this upgrade of POS systems by the end of this fiscal year.

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### **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).

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 specific to the Second Cup brand 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 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.

For the Second Cup brand, 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.

IFRS 16 was adopted for the acquiree, Bridgehead, from the date of its acquisition by Aegis Brands Inc. on January 9, 2020. All leases were recognized on the balance sheet at the acquisition date as identified lease assets acquired and lease liabilities assumed and measured using the model in IFRS 16 as if they were new leases on the acquisition date in accordance with IFRS 3.

### **SEGMENTED INFORMATION AND REPORTING**

The Company's brands, Second Cup, Bridgehead, and Hemisphere operate as independent brands and as separate reportable segments for the Company's internal reporting provided to the Chief Executive Officer. The financial results of the brands are reported on a consolidated basis on these unaudited condensed interim financial statements.

The Company's consolidated operating revenues comprise royalties, the sale of goods from Company-operated cafés, the sale of goods through retail and other ancillary channels, and other service fees.

Management is organized based on the Company's operating brands rather than the specific revenue streams.

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### CONSOLIDATED 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 Unaudited Condensed Interim Financial Statements of the Company for the 13 weeks ended September 26, 2020 and September 28, 2019.

| (In thousands of Canadian dollars, except same café and store sales, number of cafés and stores, per share amounts, and number of common shares.) | 13 weeks ended                  |                                 | 39 weeks ended                  |                                 |
|---|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
|   | September 26, 2020 <sup>2</sup> | September 28, 2019 <sup>3</sup> | September 26, 2020 <sup>2</sup> | September 28, 2019 <sup>3</sup> |
| System sales of cafés and stores <sup>1</sup>   | \$18,758                        | \$32,936                        | \$60,556                        | \$101,625                       |
| Same café and stores sales <sup>1,4</sup>   | (41.8%)                         | (2.9%)                          | (31.5%)                         | (1.3%)                          |
| Number of cafés & stores - end of period  | 252                             | 246                             | 252                             | 246                             |
| Total revenue   | \$6,245                         | \$6,652                         | \$18,574                        | \$19,433                        |
| Operating costs and expenses  | \$6,908                         | \$7,378                         | \$24,674                        | \$21,286                        |
| Operating loss <sup>1</sup>   | (\$663)                         | (\$726)                         | (\$6,100)                       | (\$1,853)                       |
| EBITDA <sup>1</sup>   | \$731                           | \$179                           | (\$2,216)                       | \$746                           |
| Adjusted EBITDA <sup>1</sup>  | \$731                           | \$785                           | (\$1,429)                       | \$1,751                         |
| Net loss and comprehensive loss   | (\$751)                         | (\$933)                         | (\$5,579)                       | (\$1,073)                       |
| Adjusted net loss and comprehensive loss <sup>1</sup>   | (\$751)                         | (\$233)                         | (\$4,673)                       | (\$936)                         |
| Basic and diluted loss per share as reported  | (\$0.03)                        | (\$0.04)                        | (\$0.24)                        | (\$0.05)                        |
| Adjusted basic and diluted loss per share <sup>1</sup>  | (\$0.03)                        | (\$0.01)                        | (\$0.20)                        | (\$0.04)                        |
| Total assets - end of period  | \$115,772                       | \$117,265                       | \$115,772                       | \$117,265                       |
| Number of weighted average common shares issued and outstanding   | 22,916,028                      | 20,366,649                      | 22,814,446                      | 20,049,103                      |

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

<sup>2</sup>Financial results in fiscal 2020 reflect the adoption of IFRS 16 specific to the Bridgehead brand, as a result of its acquisition by the Company on January 9, 2020. See the section "Changes in Accounting Policies" for further analysis.

<sup>3</sup>The Company's comparative, prior year results reflect the consolidated financial results of its Second Cup brand.

<sup>4</sup>Same café & store sales represent the percentage change, on average, in sales at cafés & stores operating system-wide that have been open for more than 12 months.

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### OPERATIONAL REVIEW

#### *Seasonality of system sales of cafés*

The following table shows the percentage of annual system sales of cafés achieved, on average, in each fiscal reporting quarter over the last three years:

| % of Annual system sales of cafés | 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.

The seasonality of system sales of cafes reported above is specific to the Second Cup brand's historical sales and excludes the associated seasonality of the Bridgehead and Hemisphere brands. The Company acquired Bridgehead on January 9, 2020. The seasonality of the system sales of Bridgehead cafés is expected to trend and yield similar returns in future years, with higher system sales of cafes in the fourth quarter during the holiday season.

#### *Store network*

|   | 13 weeks ended     |                    | 39 weeks ended     |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | September 26, 2020 | September 28, 2019 | September 26, 2020 | September 28, 2019 |
| Number of locations - beginning of period | 250                | 252                | 244                | 262                |
| Locations opened                          | 4                  | 2                  | 4                  | 3                  |
| Locations closed                          | (2)                | (8)                | (15)               | (19)               |
| Acquired during the period <sup>1</sup>   | 0                  | -                  | 19                 | -                  |
| Number of locations - end of period       | 252                | 246                | 252                | 246                |

The Company ended the Quarter with 31 (September 28, 2019 – 30) Company-owned Second Cup cafés. Café closures are mainly attributable to leases that are not renewed on expiration, under-performing locations and landlord re-development of specific sites.

<sup>1</sup>The Company acquired Bridgehead on January 9, 2020. The 19 Company-owned coffeehouses under the Bridgehead brand are included above.

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### **Third Quarter – Aegis Brands Inc.**

#### ***System sales of cafés and stores***

System sales of cafés and stores for the 13 weeks ended September 26, 2020 were \$18,758 compared to \$32,936 for the 13 weeks ended September 28, 2019 representing a decrease of \$14,178 or 43%. The year-over-year change is driven by the ongoing impacts of the COVID-19 pandemic, including temporary closures and restrictions on store operations (i.e. closure of dining room space and operations limited to take-out, delivery and drive-thru).

#### ***Same café and store sales***

During the Quarter, same café and store sales decreased 41.8%, compared to 2.9% in the same quarter of 2019, largely driven by the economic consequences of the COVID-19 pandemic.

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

Total revenue for the Quarter was \$6,245 (2019 - \$6,652), consisting of Company-owned stores and product sales inclusive of the Second Cup, Bridgehead and Hemisphere operating brands, royalty revenue, advertising fund contributions, fees, and other revenue.

Company-owned stores and product sales for the Quarter were \$4,435 (2019 - \$2,794), an increase of \$1,641. Sales at Company-owned cafés continued to be negatively impacted by the COVID-19 pandemic. In comparison to the prior year, sales at Company-owned locations are higher due to the inclusion of the Bridgehead sales as well sales at the two newly-opened Hemisphere stores in the Quarter.

Franchise revenue was \$1,810 for the Quarter (2019 - \$3,858), a decrease of \$2,048. The franchise business segment continues to be impacted by the temporary closures of cafés and scaled down nature of operations under the current business environment.

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

Operating costs and expenses include the costs of Company-owned stores and product sales, franchise-related expenses, general and administrative expenses, loss on disposal of assets, and depreciation and amortization. The Canada Emergency Wage Subsidy provided by the government has reduced remuneration expenses in the quarter. In addition, the Company's operating expenses decreased due to a reduced number of operating cafés and a decrease in salaries for Coffee Central staff and elimination of certain Coffee Central positions through temporary and permanent lay-offs, as well as the suspension of compensation for the Board of Directors.

Total operating costs and expenses for the Quarter were \$6,908 (2019 - \$7,378), a decrease of \$470.

Company-owned stores and product related expenses for the Quarter were \$3,296 (2019 - \$2,715), an increase of \$581. Expenses are higher due to the addition of the Bridgehead and Hemisphere locations this year, offset by the decline in costs at Second Cup corporate cafés due to lower sales.

Franchise related expenses for the Quarter were \$852 in the Quarter (2019 - \$2,013), a decrease of \$1,161. Consistent with the decrease in franchise revenue, expenses associated with the franchise business decreased due to the reduced number of operating cafés through the Quarter, lower labor costs as a result of the wage subsidy, and a decrease in advertising fund expenses versus prior year, offset by an additional provision for expected credit loss on leases receivable.

General and administrative expenses were \$1,338 for the Quarter (2019 - \$1,757), a decrease of \$419, driven by reduced labour costs as a result of the wage subsidy, compensation reduction and reduced staff count at Coffee Central.

Depreciation and amortization expense were \$1,394 (2019 - \$905), an increase of \$489. Total amortization of right-of-use assets was \$893 and the amortization on fixed and intangible assets came to \$501.

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#### ***EBITDA***

EBITDA for the Quarter was \$731 (2019 – \$179), an increase of \$552, as a result of lower operating costs due to the wage subsidy and the elimination of Coffee Central positions where possible, through both temporary and permanent layoffs. Business activities in the third quarter benefited, in comparison to the second fiscal quarter in 2020, from the gradual relaxation of COVID-19 restrictions.

#### ***Interest and Financing Costs***

The Company reported net interest and financing costs of \$362, as compared to \$197 in the same Quarter last year, primarily driven by non-cash net interest recorded on the Company's lease obligations and lease receivables, recorded in accordance with IFRS 16. The net interest is higher due to the inclusion of company-owned Bridgehead coffeehouses and Hemisphere retail cannabis dispensaries.

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

The Company reported a net loss for the quarter of \$751 or \$0.03 per share, as compared to net loss in the same Quarter last year of \$933 or \$0.04 per share.

Adjusted net loss was \$751 or \$0.03 per share, as compared to adjusted net loss of \$233 or \$0.01 in the same Quarter last year.

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

## **Aegis Brands Inc.**

### **Management's Discussion and Analysis**

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#### **Year-to-date – Aegis Brands Inc.**

##### ***System sales of cafés and stores***

System sales of cafés and stores for fiscal 2020 were \$60,556 compared to \$101,625 last year representing a decrease of \$41,069 or 40%. The year-over-year change is driven by the ongoing economic impacts of the COVID-19 pandemic, including the temporary closures of franchised and corporately owned cafés and restrictions on store operations (i.e. closure of dining room space and operations limited to take out, delivery, and drive-thru).

##### ***Same café and store sales***

During the year, same café and store sales decreased 31.5%, compared to 1.3% last year, largely driven by the economic consequences of the COVID-19 pandemic.

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

Total revenue to date was \$18,574 (2019 - \$19,433), consisting of Company-owned stores and product sales inclusive of the Second Cup, Bridgehead and Hemisphere operating brands, royalty revenue, advertising fund contributions, other fees and revenue.

Company-owned stores and product sales to date were \$12,556 (2019 - \$8,002), an increase of \$4,554. Sales at Company-owned stores were negatively impacted by the ongoing COVID-19 pandemic. However, sales are higher in comparison to the prior year due to the inclusion of the Bridgehead and Hemisphere stores, partially offset by the decline in sales at Second Cup corporate cafés.

Franchise revenue was \$6,018 to date (2019 - \$11,431), a decrease of \$5,413, as a result of the temporary closures of cafés and restrictions on store operations.

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

Operating costs and expenses include the costs of Company-owned stores and product sales, franchise-related expenses, general and administrative expenses, loss on disposal of assets, and depreciation and amortization. The Company's operating expenses are partially offset by the Canada Emergency Wage Subsidy, the short term reduction of salaries for Coffee Central staff and the Senior Leadership team, the suspension of all compensation for the Board of Directors, and the elimination of certain Coffee Central positions through temporary and permanent lay-offs.

Total operating costs and expenses to date were \$24,674 (2019 - \$21,286), an increase of \$3,388.

Year to date, expenses related to company-owned stores were \$10,769 (2019 - \$7,820), an increase of \$2,949 due to the addition of the Bridgehead and Hemisphere locations in fiscal 2020, partially offset by lower operating costs at Second Cup corporate cafés.

Franchise related expenses to date were \$5,136 to date (2019 - \$5,942), a decrease of \$806. The year-over-year change is due to the reduced number of operating cafés and lower operating costs this year. This was partially offset against: (1) \$1,200 of bad debts provision recorded as a result of the deferral of the collection of accrued royalties and cooperative advertising fund contributions from franchisees for twelve weeks starting February 23 to May 16, and (2) \$944 of additional expected credit loss on leases receivable, a non-cash adjustment which considers forward-looking factors in accordance with IFRS 9.

General and administrative expenses are \$4,155 (2019 - \$4,916), a decrease of \$761, which includes the benefit of the wage subsidy, compensation reduction and reduced staff count at Coffee Central.

Depreciation and amortization expense were \$3,884 (2019 - \$2,599), an increase of \$1,285. Total amortization of right-of-use assets was \$2,473 to date and the amortization on fixed and intangible assets came to \$1,411.

## **Aegis Brands Inc.**

### **Management's Discussion and Analysis**

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Impairment indicators were identified as a result of the economic impacts of the COVID-19 pandemic, which has resulted in the temporary closures of cafés, and scaled down nature of operations of open cafés. Impairment testing was performed over its fixed and right-of-use assets recorded in accordance with IFRS 16, as well as on the Company's intangible assets. The Company has recorded non-cash asset impairment charges of \$787 on a year to date basis to its right-of-use assets.

#### ***EBITDA***

EBITDA to date was a loss of \$2,216 (2019 – \$746), a decrease of \$2,962, driven primarily by the loss of revenue due to the temporary closures of cafés and scaled down operations of open cafés, bad debts expense recorded on the deferral of accrued royalties and cooperative advertising contributions for twelve weeks, the recording of non-cash expected credit losses in accordance with IFRS 9, and the recognition of non-cash asset impairment charges. This was partially offset by the wage subsidy, compensation reduction and reduced staff count.

Adjusted for asset impairment charges, year to date EBIDTA loss was \$1,429.

#### ***Other loss***

Other loss to date was \$450, composed of a decrease in the fair market value of warrants based on the Black-Scholes pricing model.

#### ***Interest and Financing Costs***

The Company reported net interest and financing costs of \$1,062, as compared to \$429 to date last year, primarily driven by non-cash net interest recorded on the Company's lease obligations and lease receivables, recorded in accordance with IFRS 16.

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

The Company reported a net loss of \$5,579 or \$0.24 per share to date, as compared to net loss last year of \$1,073 or \$0.05 per share.

Adjusted for impairment and fair market value adjustments on warrants, net loss to date was \$4,673 or \$0.20 per share, as compared to adjusted net loss last year of \$936 or \$0.04.

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

# Aegis Brands Inc.

## Management's Discussion and Analysis

### CONSOLIDATED SELECTED QUARTERLY INFORMATION

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

|   | <b>Q3 2020</b>             | <b>Q2 2020</b>             | <b>Q1 2020</b>             | <b>Q4 2019<sup>2,3</sup></b> |
|---|----------------------------|----------------------------|----------------------------|------------------------------|
| System sales of cafés <sup>1</sup>                                | \$18,758                   | \$10,910                   | \$30,889                   | \$36,132                     |
| Same café sales <sup>1</sup>                                      | (41.8%)                    | (52.6%)                    | (8.6%)                     | (2.6%)                       |
| Number of cafés & stores - end of period                          | 252                        | 256                        | 261                        | 244                          |
| Total revenue   | \$6,245                    | \$3,536                    | \$8,793                    | \$7,605                      |
| Operating loss <sup>1</sup>                                       | (\$663)                    | (\$2,240)                  | (\$3,197)                  | (\$3,716)                    |
| EBITDA <sup>1</sup>   | \$731                      | (\$687)                    | (\$2,260)                  | (\$2,807)                    |
| Adjusted EBITDA <sup>1</sup>                                      | \$731                      | (\$687)                    | (\$1,473)                  | (\$211)                      |
| Net income loss for the period                                    | (\$751)                    | (\$1,931)                  | (\$2,897)                  | (\$3,601)                    |
| Adjusted net loss for the period <sup>1</sup>                     | (\$751)                    | (\$1,931)                  | (\$1,991)                  | (\$1,018)                    |
| Basic and diluted loss per share                                  | (\$0.03)                   | (\$0.08)                   | (\$0.13)                   | (\$0.18)                     |
| Adjusted basic and diluted loss per share <sup>1</sup>            | (\$0.03)                   | (\$0.08)                   | (\$0.09)                   | (\$0.05)                     |
|   | <b>Q3 2019<sup>3</sup></b> | <b>Q2 2019<sup>3</sup></b> | <b>Q1 2019<sup>3</sup></b> | <b>Q4 2018<sup>2,3</sup></b> |
| System sales of cafés & stores <sup>1</sup>                       | \$32,936                   | \$34,377                   | \$34,312                   | \$38,860                     |
| Same café sales & stores <sup>1</sup>                             | (2.9%)                     | 0.0%                       | (0.9%)                     | (2.0%)                       |
| Number of cafés & stores - end of period                          | 246                        | 252                        | 256                        | 262                          |
| Total revenue   | \$6,652                    | \$6,541                    | \$6,239                    | \$7,176                      |
| Operating income (loss) <sup>1</sup>                              | (\$726)                    | (\$638)                    | (\$489)                    | \$598                        |
| EBITDA <sup>1</sup>   | \$179                      | \$218                      | \$350                      | \$922                        |
| Adjusted EBITDA <sup>1</sup>                                      | \$785                      | \$617                      | \$350                      | \$1,297                      |
| Net (loss) income for the period                                  | (\$933)                    | (\$782)                    | \$642                      | (\$55)                       |
| Adjusted net income (loss) for the period <sup>1</sup>            | (\$233)                    | (\$300)                    | (\$403)                    | \$594                        |
| Basic and diluted (loss) earnings per share                       | (\$0.04)                   | (\$0.04)                   | \$0.03                     | \$0.00                       |
| Adjusted basic and diluted earnings (loss) per share <sup>1</sup> | (\$0.01)                   | (\$0.02)                   | (\$0.02)                   | \$0.03                       |

<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 & stores 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 accounting standards on a modified retrospective basis – IFRS 15 beginning in 2018 and IFRS 16 beginning 2019. The prior periods are on the previous standards. See the section "Changes in Accounting Policies" for further analysis.

# Aegis Brands Inc.

## Management's Discussion and Analysis

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### LIQUIDITY AND CAPITAL RESOURCES

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

#### *Summary of cash flows*

|   | 13 weeks ended        |                       | 39 weeks ended        |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September<br>26, 2020 | September<br>28, 2019 | September<br>26, 2020 | September<br>28, 2019 |
| Cash flows provided (used) by operating activities                        | \$1,164               | (\$308)               | (\$1,450)             | \$722                 |
| Cash flows used in investing activities                                   | (539)                 | (554)                 | (2,020)               | (1,155)               |
| Cash flows used in financing activities                                   | (245)                 | (584)                 | (7,675)               | (2,119)               |
| Net Increase (Decrease) in cash and cash<br>equivalents during the period | 380                   | (\$1,446)             | (11,145)              | (\$2,552)             |

#### **Third Quarter**

Cash provided by operating activities was \$1,164 for the Quarter compared to cash used of \$308 for the same Quarter in 2019, as a result of lower operating loss in the Quarter as compared to last year, adjusted for non-cash allowance and charges.

During the Quarter, cash used by investing activities was \$539 compared to cash used of \$554 for the same Quarter in 2019. The purchases of capital and intangible assets in fiscal 2020 are primarily to support the construction of retail cannabis locations under the trade name Hemisphere Cannabis Co.

Cash used in financing activities of \$245 for the Quarter is composed of the Company's lease payments, which were lower than prior quarters as a result of some abatements and deferrals of rent, offset by proceeds from the repayment of an employee loan.

#### **Year to date**

Cash used in operating activities was \$1,450 to date compared to cash provided of \$722 in 2019. The decrease is primarily driven by a higher operating loss to date compared with last year, adjusted for non-cash allowance and charges.

To date, cash used by investing activities was \$2,020 compared to \$1,155 in 2019. Purchases of capital and intangible assets amounted to \$2,028 in 2020 (2019 - \$1,301), a significant portion of which is due to the build out of retail cannabis locations under the trade name Hemisphere Cannabis Co.

Cash used in financing activities was \$7,675 to date is primarily composed of the cash paid to acquire Bridgehead on January 9, 2020 and the Company's lease payments.

## Aegis Brands Inc.

### Management's Discussion and Analysis

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#### *Working capital as at*

|                              | September 26, 2020 | December 28, 2019 |
|------------------------------|--------------------|-------------------|
| Current assets               | \$ 12,033          | \$ 23,543         |
| Current liabilities          | <u>25,307</u>      | <u>19,423</u>     |
| Working capital (deficiency) | <u>\$ (13,274)</u> | <u>\$ 4,120</u>   |

The Company's net working capital is a negative balance of \$13,274 as at September 26, 2020 compared to a positive working capital balance of \$4,120 at December 28, 2019. The decrease is primarily due to the purchase consideration paid to acquire Bridgehead on January 9, 2020, the non-cash write-down of leases receivable and the inclusion of leases receivable and lease liabilities on adoption of IFRS 16 for Bridgehead from the date of acquisition.

The Company has unrestricted cash and cash equivalents of \$1,627 as at September 26, 2020 (December 28, 2019 - \$11,458).

#### *Financial instruments*

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

| <b>Financial instrument</b>              | <b>Risks</b>                        |
|--|-------------------------------------|
| <i>Financial assets</i>                  |                                     |
| 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 |
| <i>Financial liabilities</i>             |                                     |
| Accounts payable and accrued liabilities | Liquidity, currency and commodity   |
| Gift card liability                      | Liquidity                           |
| Deposits from franchisees                | Liquidity                           |
| Lease liabilities                        | Liquidity                           |
| Long term debt                           | 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 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.

# **Aegis Brands Inc.**

## **Management's Discussion and Analysis**

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The Company has applied IFRS 9's simplified approach and has calculated expected credit loss 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 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.

### ***Contingencies, commitments and guarantees***

#### ***Obligations from Operating Leases***

With the adoption of IFRS 16, operating leases are now reported in the consolidated statement of financial position as lease liabilities along with the associated right-of-use assets and leases receivable.

#### ***Purchase Obligations***

Contracts are in place with third party companies to purchase the coffee that is sold in all cafés. In terms of these supply agreements, there is a guaranteed minimum volume of coffee purchases of \$1,504 (September 28, 2019 - \$1,604) 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 its franchisees and for Company-owned cafés, there is \$127 (September 28, 2019 - \$456) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the Quarter. Construction costs for franchise projects are paid from deposits received from franchisees and for corporate projects from the Company's cash flows.

#### ***Other Obligations***

The Company is involved in litigation and other claims arising in the normal course of business. Judgment must be used to determine whether 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.

# **Aegis Brands Inc.**

## **Management's Discussion and Analysis**

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### **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES**

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

#### ***Disclosure controls and procedures***

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

As at November 9, 2020, the Company's management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the disclosure controls and procedures. Based on this evaluation, the CEO and CFO have concluded that, as at September 26, 2020 the Company's disclosure controls and procedures were appropriately designed.

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

During the 13 weeks ended September 26, 2020 and up to the date of the approval of the Unaudited Condensed Interim Financial Statements and MD&A, there has been no change that has materially affected, or is reasonably likely to materially affect the Company's disclosure controls and procedures.

#### ***Internal controls over financial reporting***

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

As at November 9, 2020, 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 September 26, 2020, the Company's controls over financial reporting were appropriately designed and were operating effectively.

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

During the 13 weeks ended September 26, 2020 and up to the date of the approval of the Unaudited Condensed Interim Financial Statements and MD&A, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

# **Aegis Brands Inc.**

## **Management's Discussion and Analysis**

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### **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. 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.

## **Aegis Brands Inc.**

### **Management's Discussion and Analysis**

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#### *(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.

# Aegis Brands Inc.

## Management's Discussion and Analysis

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### CHANGES IN ACCOUNTING POLICIES

These unaudited condensed interim consolidated financial statements have been prepared using the same accounting policies and methods of computation as the annual consolidated financial statements of the Company for the year ended December 28, 2019.

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 has replaced IAS 17, Leases, and related interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all leases and requires a lessee to recognize (i) right-of-use assets and lease liabilities for leases with terms of more than 12 months, unless the underlying asset is of low value; and (ii) depreciation of lease assets separately from interest on lease liabilities on the Condensed Interim Consolidated Statements of Operations and Comprehensive Income (Loss).

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.

The Company transitioned to IFRS 16 in accordance with the modified retrospective approach from December 30, 2018.

As discussed in the aforementioned section, the Company acquired Bridgehead on January 9, 2020. From January 9, 2020, for leases in which the acquiree is a lessee, right-of-use assets, lease receivables and corresponding lease liabilities were recorded in accordance with IFRS 16. 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.

## **Aegis Brands Inc.**

### **Management's Discussion and Analysis**

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Adjustments recognized on adoption of IFRS 16 for Bridgehead

IFRS 16 was adopted for the acquiree, Bridgehead, from the date of its acquisition on January 9, 2020. Lease liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of January 9, 2020.

For Company-operated cafés and the head office, right-of-use assets were measured at the amount equal to the lease liability.

For its subleased cafés, Bridgehead 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 change in accounting policy affected the following items in the balance sheet on January 9, 2020:

- right-of-use assets – increase by \$8,835
- leases receivable – increase by \$245
- lease liabilities – increase by \$9,080

# **Aegis Brands Inc.**

## **Management's Discussion and Analysis**

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### **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 Aegis Brands Inc. 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 Aegis Brands Inc.'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.

Aegis Brands Inc. 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 the Company 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 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.

The Company, as a market participant in the retail cannabis sector, face risks due to the industry's unique legal status. The Company is subject to risks and uncertainties that could significantly affect its future performance, including, but not limited to, changes to the regulatory environment for the cannabis industry, changes to the business environment for the cannabis industry, and risks and uncertainties posed by the performance and management of its retail cannabis operations. In addition to general risks inherent in a nascent industry, the Company faces additional risks, such as risks in its banking and finance activity, placement of insurance coverage, and risks associated with a tightly-controlled supply chain environment.

The Company 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

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trends and royalty calculations. The stores 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 is set out in the Company's Annual Information Form, which is available at [www.sedar.com](http://www.sedar.com).

#### ***Risks Related to COVID-19***

The COVID-19 pandemic continues to significantly impact global economic activity, including consumer spending patterns at restaurants and retail locations. Further, due to governmental measures and public health recommendations including those relating to physical distancing, public meeting places, including restaurants and other hospitality-related venues, the Company could experience a significant near and potentially long-term decline in customer visits.

The Canadian specialty coffee industry and retail cannabis market is also affected by changes in discretionary spending patterns, which are in turn dependent on consumer confidence, disposable consumer income and general economic conditions. In the event that the Company is unable to mitigate the impacts of the COVID-19 outbreak on operations, the Company may be unable to fulfill product delivery obligations to customers, costs may increase, and revenue and margins could decrease. It is unknown whether and how the Company may be affected if such an epidemic persists for an extended period of time. A widespread health crisis could adversely affect the global economy, resulting in an economic downturn that could impact demand for business. The Company may incur expenses or delays relating to such events outside of our control, which could have a material adverse impact on business, operating results and the overall financial condition.

The Company may also experience temporary shortages of supplies or staff to the extent its work force is impacted and may also continue to experience location closures for undefined periods of time. The Company acts as the "head lessee" under the leases for its Second Cup café locations. Aegis Brands Inc. is currently supporting conversations on behalf of its franchisees with landlords and financial institutions to request deferrals of rent or loan repayments, as required. Defaults by the franchisees under their subleases could result in increased costs and could have a negative impact on the Company's business and results of operations. Further, if multiple franchisees default under their subleases, the Company may be unable to satisfy its corresponding obligations under the corresponding head leases to the extent applicable landlords seek to recover their losses from the Company.

As a result of all of the foregoing, the Company may need to take certain measures in response to the COVID-19 outbreak that may require significant additional costs and management time. The global outbreak of COVID-19 continues to evolve rapidly and could have a significant adverse impact on the business, franchisees and the financial condition, cash flow, results of operation and ability to pay dividends and the extent and duration of such impact are uncertain.

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

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

#### ***System sales of cafés and stores***

System sales of cafés and stores comprise the net revenue reported to Second Cup by franchisees of Second Cup cafés and by Company-owned cafés, as well as net revenue reported by Bridgehead coffeehouses and Hemisphere retail cannabis dispensaries.

This measure is useful in assessing the operating performance of the entire Company network, such as capturing the net change of the overall café and store network. Changes in system sales of cafés and stores result from the number of open locations and same café/store sales.

#### ***Same café and store sales***

Same café and store sales represent the percentage change, on average, in sales at cafés and stores 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 and store sales are changes in customer count and changes in average transaction size.

#### ***Operating income (loss)***

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

#### ***EBITDA and adjusted EBITDA***

EBITDA represents earnings before interest and financing, income taxes, and depreciation and amortization. Adjustments to EBITDA are for items that are not necessarily reflective of the Company's underlying operating performance. As there is no generally accepted method of calculating EBITDA, this measure is not necessarily comparable to similarly titled measures reported by other issuers. EBITDA is presented as management believes it is a useful indicator of the Company's ability to meet debt service and capital expenditure requirements and evaluate liquidity. Management interprets trends in EBITDA as an indicator of relative financial performance. EBITDA should not be considered by an investor as an alternative to net income or cash flows as determined in accordance with IFRS.

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

Adjustments to net earnings (loss) and net earnings (loss) per share are for items that are not necessarily reflective of the Company's underlying operating performance. These measures are not defined under IFRS, although the measures are derived from input figures in accordance with IFRS. Management views these as indicators of financial performance.

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

|                             | 13 weeks ended                     |                       | 39 weeks ended                     |                       |
|-----------------------------|------------------------------------|-----------------------|------------------------------------|-----------------------|
|                             | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 |
| Net loss                    | \$ (751)                           | \$ (933)              | \$ (5,579)                         | \$ (1,073)            |
| Add (deduct):               |                                    |                       |                                    |                       |
| Income tax recovery         | (274)                              | (339)                 | (2,033)                            | (391)                 |
| Interest and financing loss | 362                                | 197                   | 1,062                              | 429                   |
| Other loss (income)         | -                                  | 349                   | 450                                | (818)                 |
| Operating loss              | \$ (663)                           | \$ (726)              | \$ (6,100)                         | \$ (1,853)            |

|   | 13 weeks ended                     |                       | 39 weeks ended                     |                       |
|---|------------------------------------|-----------------------|------------------------------------|-----------------------|
|   | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 |
| Net loss                                  | \$ (751)                           | \$ (933)              | \$ (5,579)                         | \$ (1,073)            |
| Add (deduct):                             |                                    |                       |                                    |                       |
| Income tax recovery                       | (274)                              | (339)                 | (2,033)                            | (391)                 |
| Interest and financing loss               | 362                                | 197                   | 1,062                              | 429                   |
| Other loss (income)                       | -                                  | 349                   | 450                                | (818)                 |
| Depreciation of property<br>and equipment | 434                                | 221                   | 1,168                              | 566                   |
| Amortization of intangible<br>Assets      | 68                                 | 103                   | 243                                | 359                   |
| Amortization of right-of-<br>use assets   | 892                                | 581                   | 2,473                              | 1,674                 |
| EBITDA                                    | \$ 731                             | \$ 179                | \$ (2,216)                         | \$ 746                |
| Add impact of the<br>following:           |                                    |                       |                                    |                       |
| Asset impairment<br>Charges               | -                                  | -                     | 787                                | -                     |
| Other charges                             | -                                  | 606                   | -                                  | 1,005                 |
| Adjusted EBITDA                           | \$ 731                             | \$ 785                | \$ (1,429)                         | \$ 1,751              |

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|                                       | 13 weeks ended                     |                       | 39 weeks ended                     |                       |
|---------------------------------------|------------------------------------|-----------------------|------------------------------------|-----------------------|
|                                       | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 |
| Net loss                              | \$ (751)                           | \$ (933)              | \$ (5,579)                         | \$ (1,073)            |
| Add (deduct) impact of the following: |                                    |                       |                                    |                       |
| After-tax other (income) loss         | -                                  | 256                   | 329                                | (599)                 |
| After-tax asset impairment            | -                                  | -                     | 577                                | -                     |
| After-tax transition costs            | -                                  | 444                   | -                                  | 736                   |
| Adjusted net loss                     | \$ <u>(751)</u>                    | \$ <u>(233)</u>       | \$ <u>(4,673)</u>                  | \$ <u>(936)</u>       |

|   | 13 weeks ended                     |                       | 39 weeks ended                     |                       |
|---|------------------------------------|-----------------------|------------------------------------|-----------------------|
|   | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 | September 26,<br>2020 <sup>1</sup> | September 28,<br>2019 |
| Net loss per share                      | \$ (0.03)                          | \$ (0.04)             | \$ (0.24)                          | \$ (0.05)             |
| Add (deduct) impact of the following:   |                                    |                       |                                    |                       |
| After-tax other (income) loss per share | -                                  | 0.01                  | 0.01                               | (0.03)                |
| After tax asset impairment              | -                                  | -                     | 0.03                               | -                     |
| After-tax transition costs per share    | -                                  | 0.02                  | -                                  | 0.04                  |
| Adjusted net loss per share             | \$ <u>(0.03)</u>                   | \$ <u>(0.01)</u>      | \$ <u>(0.20)</u>                   | \$ <u>(0.04)</u>      |

<sup>1</sup> The Company's interim results in fiscal 2020 reflect the consolidated financial statements of its operating brands including Second Cup, Bridgehead, and Hemisphere. The Company's comparative, prior year results reflect the consolidated financial results of its Second Cup brand.