



SECOND CUP LTD.

Annual Report 2016



**SECOND CUP
COFFEE CO.™**

VISION

To be the coffee brand most passionately committed to quality and innovation.



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Letter from the Chairman



Over the past three years, Second Cup has vastly improved as a company. After taking necessary bold action to repair serious structural issues, the company's foundation is much more secure. Second Cup has invested heavily to improve franchisee profitability. Successful franchisees are the lifeblood of Second Cup.

While much damage has been repaired, the company has struggled to resume its growth trajectory. We aim to see improvement in key measures including average sales per store, same store sales growth, store count and store profitability. When Second Cup stores deliver an outstanding experience for customers, everything falls into place. Sales and profitability grow, franchisees earn better returns, company profitability rises and growth will resume.

It is no easy task to fix a long ailing specialty retailer, but we have some important advantages. The quality of Second Cup's real estate is exceptional. The capital structure has been strengthened and there is a shared commitment to create value. To date, we have not succeeded in creating value, and alternatives will be considered if Second Cup is unable to maximize value independently.

There is a level of shared impatience among shareholders, directors and management. I regard this as healthy, as our commitment to maximize long term value is not subject to compromise.

We are grateful for your support as Second Cup pursues its journey, committed to realize its full potential success.

Michael Bregman

A handwritten signature in black ink, appearing to read 'Michael Bregman'. The signature is stylized and fluid, with a long horizontal line extending to the right.

Chairman

Letter from the President & CEO

In 2016 we focused on our strategic priorities and we addressed major structural issues in the company. The related costs are largely behind us. With fewer distractions and a solid foundation, we are focused on building sales and profitability. While we are not satisfied with our performance, we are encouraged by our quarter over quarter improvement in our earnings throughout the year. We are pleased by positive same store sales growth in our largest market of Ontario, and the continued optimism and support from our franchisees.

We reduced our corporate store count from 32 at the beginning of the year to 22 by year end. We will continue to pursue opportunities to further decrease corporate stores as we return to an asset-light model.

Bringing the best coffees in the world to our customers is at the core of our brand and 2016 was a year of coffee enhancements. We took our coffee quality to even higher levels of excellence by examining and improving every step of the coffee process from farm to cup, engaging the talents of some of the world's most knowledgeable coffee aficionados. We created a new and unique blend called Batch⁴⁹ that has resonated well with our customers.

The modernization of our fleet of stores continues with close to 30 new and renovated locations in Ontario, Quebec and Alberta. Each café reflects the local community while delivering on our commitment to superior quality and innovation. We continue to make enhancements to the concept. Each renovation and new store re-energizes the franchisees, their staff and customers and the overall Second Cup brand.

We aim for more aggressive growth in the next three years.

Second Cup's Rewards program, a strategic priority for the company and important business driver continued to gain members, recently achieving a key milestone of 300,000 members and 25% sales penetration in under two years.

In December we completed a successful re-financing with Serruya Private Equity, retiring our bank debt. We expect to benefit from the Serruya family as they have tremendous experience with franchised concepts.

Our top priorities for 2017 are increasing sales and profitability for both our franchisees and the company. Innovation is critical to our success. We have streamlined our approach to food and beverage innovation and are set on delivering three major sales building initiatives this year. In January we launched our **Better for You** line of healthy products including smoothies. This spring will mark the debut of Flash Cold Brew, a superior tasting cold coffee offering that will be the best in the market. We have exciting fresh food and lunch ideas in test as well.

As I have observed in past years, challenges remain and we must continue to be uncompromising in our commitment to excellence. We are seeing some encouraging signs and we remain focused on getting the business to improve. The progress we have made in improving our financial results, and the progress we have made to focus our business practices and to enhance the store experience for our customers, makes us optimistic for 2017.



The Board of Directors continues to be supportive and I thank them for their guidance and encouragement. I also want to thank our incredibly hard-working franchisees, whose dedication to our transformation has been invaluable.

Finally, I want to thank my management team, and all the support staff at Coffee Central, for the passion they bring to our business every day.

Alix Box

President & CEO

Revitalizing the network

The roll out of the new café concept continues with close to 30 locations in the primary regions of Ontario, Alberta and Quebec. We are continuously working to evolve the builds, taking a customized approach for each location to reflect the local community while delivering on our commitment to superior quality and innovation. Each renovation and new build re-energizes the brand as well as the franchisees, their staff and customers.

SECOND CUP COFFEE CO.™

*Proudly Operated by
Alvaro Carbonell*

— Since 2015 —

"The transformation of my café after the renovation has been dramatic – for customers, for staff, for sales!"

"It's always been a great location in a vibrant downtown community but the design was tired. The physical changes in colour and design immediately changed the vibe of the café from quiet solitude to social and energetic. The staff and regulars love coming here, it makes them happy. The contemporary design has attracted a new premium quality customer too. We're so proud of the café and excited to show it off to customers and friends. It's exactly what Second Cup needed and I'm excited about the future."

—
Lisa Tirkalas,
Second Cup Franchisee

*324 Bloor Street West,
Toronto, Ontario*





"The new café concept has completely re-energized our business, our staff and our customers."

"We are seeing significant growth in all areas of the business since last year and growth week over week. The Second Cup development team negotiated the best spot in the mall for our relocation and the new design is so eye-catching that people can't help but stop and come in. When our existing customers saw the new café they said "wow", and we've attracted many new and younger customers—the design is very appealing to everyone. The design of the café really reflects the superior quality of the brand, the products, the service, and our staff is so proud to come to work every day."

—
Martine Desbiens & Charles Carrier,
Second Cup Franchisees

*Fairview Pointe Claire,
Montreal, Quebec*





Driving Innovation

Driving innovation is fundamental to the transformation strategy. A number of key initiatives in coffee, food and Rewards were furthered in 2016 to deliver the ultimate coffee experience to customers. Second Cup has always been known for excellent coffee, and in 2016 we took our coffee obsession to even higher levels of excellence by examining and improving every step of the coffee process from farm to cup. A new premium quality breakfast program was introduced and the Rewards program experienced significant member and sales penetration growth. The advancements made in 2016 set the stage for exciting and significant sales growth opportunities in 2017.





SECOND CUP
COFFEE CO.™

2016: The Year of Coffee

We made uncompromising improvements to sourcing, blending, roasting and tasting to create truly exceptional coffees that are Second to None.

THE BEST SOURCING

Second Cup only selects from the top 2% of the world's production of coffee – the highest quality 100% Specialty Grade Arabica beans.

THE BEST ROASTING

Second Cup is now working with an award-winning Canadian artisanal roaster that develops and enhances the flavour notes of every bean, and every roast is tasted and tested by Second Cup Coffee Expert, Chris Sonnen.

THE BEST PEOPLE

There is an entire team of coffee lovers behind every Second Cup coffee including two of the best Coffee Experts in the business: Alton McEwen – a long-time leader in the specialty coffee sector – and Chris Sonnen who brings an unrivalled passion for the ultimate brew to Second Cup.

Our Coffee is Second to None

"I don't know where you can get a better cup of coffee than Second Cup. I've had the privilege of working with Chris Sonnen at Second Cup who has been working to ensure that Second Cup is incorporating every new advancement in sourcing, roasting and production to maximize quality."

Alton McEwen

Member of the Board,
Second Cup

30 years of specialty coffee
business experience, 25 years
with Second Cup.





**OUR COFFEE IS
SECOND TO NONE.™**

Better. Not bitter.

Chris Sonne

Chris Sonnen,
Second Cup's Coffee Expert



Batch 49[™]

Being a Canadian company makes us proud. We wanted to do something in a unique way that reflects our position as the only Canadian specialty coffee retailer. Early in 2016 we introduced our new signature blend – Batch⁴⁹ – denoting the position of Canada on the 49th parallel.

Perfect hot or cold, we believe no other coffee comes close to it. It is unparalleled in terms of taste and quality. Our customers and franchisees loved it so much we made it a permanent coffee offering.



Better Breakfast Better Day



Premium quality food is an important part of the ultimate coffee experience. Eating occasions outside the home are growing and breakfast in particular is 'on the go'. Second Cup's strategic focus on premium quality food innovation advanced in 2016 with the introduction of the new breakfast program featuring a line of premium quality sandwiches including healthier choices like the egg white and spinach on naan bread. These premium quality sandwiches are made fresh through local vendors across the country. Breakfast sandwich sales doubled in 2016 and more innovation is planned for 2017.



Rewards

One of the biggest successes in the transformation has been the Rewards program which continues to grow. In February 2017 the program achieved a key milestone reaching the 300,000 member mark and 25% sales penetration in under two years. Members enjoy free rewards faster by earning points with every dollar spent and through personalized bonus point offers sent by email and on the mobile app. Franchisees recognize the program's ability to drive incremental visits and sales. The Rewards program continues to be a strategic priority for Second Cup.

"The Rewards program was one of the key drivers of our significant sales growth in 2016. Customers love when they earn a free Reward; they get excited and will come back to visit more often."

Ed Grant, Second Cup Franchisee

Halifax Shopping Centre, Halifax, Nova Scotia

ReWard Yourself



Members earn **FREE** coffee faster!

A Look at 2017

With a strong foundation set in 2016, our product and marketing innovation is focused on differentiated products with mass appeal and superior quality that have the ability to drive meaningful incremental sales. With a new test and learn approach, we will confidently and boldly roll out our new ideas.



Our franchisees are very proud of Second Cup's Canadian heritage. To celebrate Canada 150 we created a new beautifully designed cup, illustrated by world famous Canadian artist John Coburn, that reflects our community brand pillar depicting iconic Canadian landmarks and valued traditions from coast to coast.

Better For You Menu



The first big initiative launched in January is the Better for You menu - a new line of "Better For You" products to meet growing customer demand for healthier options. The new menu includes smoothies made with a whole fresh banana and added benefits like flax, protein and greens and a healthy breakfast wrap with 10 grams of fat. Marketing support is focused on driving trial. We are excited by the customer adoption and franchisees are enthusiastic about our plan to continue to expand the line with innovative additions.

"In today's market the consumer is looking for healthier choices. Since we have introduced the Better For You products our smoothie and yogurt sales have significantly increased compared to last year. We are receiving positive feedback from our existing customers and attracting new customers. They are looking for better quality ingredients, better taste and without the calories."

Tom & Joanne Kastias,
Second Cup Franchisees
Hyatt Hotel, Toronto Ontario





Lunch Innovation.

A CLASSIC REMASTERED – CHEESE MELTS

Lunch is the fastest growing daypart in the market and with the introduction of Cheese Melts, we have a fresh, premium quality sandwich to offer our customers. Regional roll out began in March 2017.

ReThink the Cold.

FLASH COLD BREW

In April, Second Cup introduces Canadians to the ultimate cold coffee experience – Flash Cold Brew. The cold coffee category is experiencing tremendous growth. With the flash brewing method and using our popular Batch⁴⁹ coffee, customers will enjoy full coffee flavour and a smoother taste. Brewed directly over ice, we believe the flash cold brew method delivers the best cold coffee experience – an aromatic, smoother, cleaner, brighter taste.



“The innovation in 2016 helped us to strengthen our superior quality position in coffee and food and the Rewards program continues to drive customer loyalty and sales. I value the collaborative approach with Second Cup and know franchisees are very optimistic about the future with new product innovations like the Better for You program.”

Steven Craig, Second Cup Franchisee and member of the Franchisee Advisory Council.



Shareholder Information

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 Enquiries

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THE SECOND CUP LTD.

Board of Directors

Michael Bregman ⁽¹⁾ ⁽²⁾
Chairman

Alix Box

Stephen Kelley ⁽¹⁾

Garry Macdonald

Alton McEwen ⁽²⁾

Rael Merson ⁽¹⁾

Alan Simpson ⁽²⁾

Committees of the Board

(1) Audit Committee

(2) Governance, Human

Resources and

Compensation Committee

THE SECOND CUP LTD.

Senior Management Team

Alix Box

President and
Chief Executive Officer

Barbara Mallon

Vice President, Finance
and Chief Financial Officer

Vanda Provato

Vice President,
Marketing and Category

Chris Sonnen

Vice President,
Coffee Experience

Audra Wosik

Vice President, Franchising

Ted Tai

Vice President, Operations

John Kazmierowski

Vice President, Development-
Leasing & Construction

**SECOND CUP
COFFEE CO.™**