SECOND CUP COFFEE CO.™

THE SECOND CUP LTD.

Annual Report 2017

Vision

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

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Letter from the Chairman

Second Cup strengthened significantly during 2017. Garry Macdonald became CEO mid-year and has brought stability to the organization. The company's capital structure improved materially and at year end was debt free with $4.5 million of cash.

The year saw a successful return to Second Cup's asset light business model. The year ended with 12 corporate stores compared with a peak of 47 in 2015. Product innovation stepped up, highlighted by the successful introduction of Pinkberry frozen yogurt in a number of test stores. Pinkberry has proven to be a highly complementary addition to Second Cup's core offering, resulting in growth in store sales and profitability. The Pinkberry program is now being rolled out across the country.

As a result of the debt exchange last August, the shareholders of Serruya Private Equity became Second Cup's largest shareholders. Michael and Aaron Serruya joined the Second Cup Board of Directors. The Serruya family has a long track record of value creation in businesses similar to Second Cup. We expect the company to generate positive cash flow in the future. With a solid financial foundation, Second Cup may now actively consider new opportunities to create value for shareholders.

There is much additional opportunity for improvement at Second Cup, but today the company is stronger than it has been in many years. For this I thank our management team, franchisees, directors and shareholders.

Michael Bregman
Chairman

Letter from the President & CEO

Last May when I assumed the leadership role at Second Cup, I was thrilled to join the iconic Canadian brand and excited by the growth potential. As I reflect on the past twelve months, I am pleased with the significant improvement in profitability and the innovation that will further enhance our brand presence, and create added value and returns for our franchisee partners and shareholders.

We ended 2017 with an incredible 383% growth in EBITDA (adjusted) and in Q4 it was more than double compared to the same quarter in the prior year. Growing same store sales remains a priority. We ended the year at -0.2%, an improvement from -1.1% in 2016.

There were numerous product innovations in 2017 with a focus on differentiated, premium offerings that have mass appeal. These included a new Better For You menu, our unparalleled Flash Cold Brew and new fresh food offerings including Bagels and Cheese Melts. We will continue to drive sales and profit improvement through innovation and differentiation in our new product development including enhancements to breakfast, lunch and snack programs.

Our Rewards program membership grew by 30% and continues to be valued by customers and franchisee partners. We know from our research that it is the number one driver of brand choice among coffee drinkers and Rewards members spend more per transaction. We have plans to further enhance the Rewards member experience this year.

The most promising new product introduction is Pinkberry frozen yogurt - recognized as the premium brand leader in the frozen yogurt category. The roll out began late last year and response to this complimentary, premium offering has been very favourable, attracting new customers to our cafés and driving incremental sales. We are aggressively working to launch Pinkberry in more cafés across the network in time for the peak frozen yogurt season.

Second Cup has great real estate locations. In 2017 many more of our cafés were renovated to reflect the modernized brand with improvements in costs. We will continue to focus on expanding our traditional café model in carefully selected, high profile locations, as well as our concept upgrades and renovations while restoring our asset light business model. We ended the year with 12 corporately-owned cafés, which is down from a peak of 47 stores in 2015.

One of our priorities in 2018 will be to expand the Second Cup footprint nanionally to add brand value and access. In support of this initiative, we have developed a new non-traditional format program and a new co-brand licensing format, offering our premium quality Second Cup branded/ signature products in smaller footprint venues with a lower capital cost profile. Partnering examples in the non-traditional sector may include compatible QSR chains, entertainment venues, institutional, petroleum, convenience, etc.

Second Cup is an incredible brand. The company is in a much stronger position today and I wish to thank the dedicated management team, staff at Coffee Central and our committed franchisee partners. I am very appreciative of the support of our Board of Directors.

I look forward to a year of accelerated growth to help Second Cup realize its full potential.

Garry Macdonald
President & CEO

SECOND CUP COFFEE CO.™

featuring

pinkberry® frozen yogurt

Pinkberry

Second Cup entered into a category exclusive licensing agreement with Pinkberry Canada Inc., and in Q4 2017 we began rolling out the Pinkberry Frozen Yogurt program in Second Cup cafés across the country. Early results have been very positive with Pinkberry contributing significantly to sales and profitability as well as attracting new customers.

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.

This licensing agreement brings together two great brands and provides Canadians with an opportunity to experience the best in frozen yogurt and the best specialty coffee.

"Pinkberry is a delicious product that has been well-received by my customers. It has brought in new customers that I have never seen in the nearly five years we've been open. Customers are coming in exclusively for Pinkberry. Canadians like frozen yogurt at any time of the year. I can't wait for the summer and expect to see my patio filled with Pinkberry fans!"

—

Tamara Belamy
Second Cup Franchisee Partner and Advisory Council Member

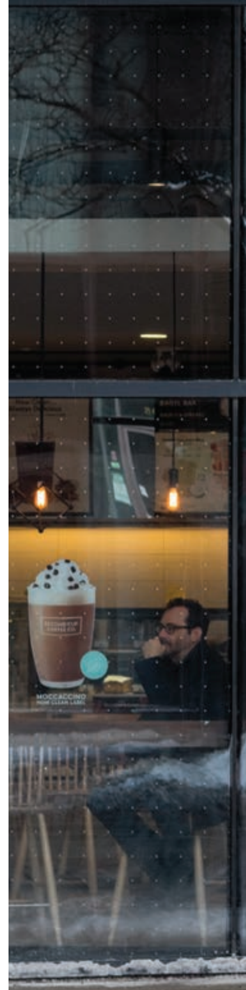
pinkberry

SECOND CUP COFFEE CO.
pinkberry
We now serve
Pinkberry
Frozen yogurt

Café Revitalization Continues

In 2017 we continued to modernize our Second Cup cafés to reflect the updated brand design in new and existing locations. We continue to work on enhancing the experience while delivering cost efficiency. The Pinkberry frozen yogurt concept has now been integrated into the café design and is a standard offering.

We have designated one of our downtown Toronto cafés as an innovation centre for testing new ideas to drive sales and profitability that we then rapidly roll-out across the system.



"I have a very loyal customer base and they love the new design of the café. It's bright and airy and has reenergized my staff. The new merchandising displays really show off our premium food and beverage products. With Pinkberry, we now have another reason for customers to visit more often and to bring in new customers."

—
Jeetesh Jogie
Second Cup Franchisee Partner
Toronto, ON

INTRODUCING

FLASH

COLD ✷ BREW

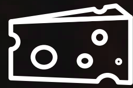
Full flavour, extra smooth.

Mocca

Classic Black

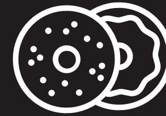
Vanilla Bean

Rethink the cold.



CHEESE MELTS

Comfort classics made better.



BAGEL BAR

Fresh, toasted bagels & spreads.

Driving Innovation

Second Cup significantly advanced its food and beverage offerings last year with numerous introductions and a focus on products that are differentiated and have mass appeal to drive incremental sales.

FLASH COLD BREW

Second Cup has made uncompromising improvements to every aspect of our coffee process, from farm to cup, to ensure we're delivering the best tasting coffee. Flash Cold Brew was introduced last spring and has resulted in significant growth in our cold coffee category, the fastest growing segment in the coffee market. The result of this specialized, Flash Brew method is a superior coffee taste profile that's full flavour and extra smooth.

FRESH FOOD

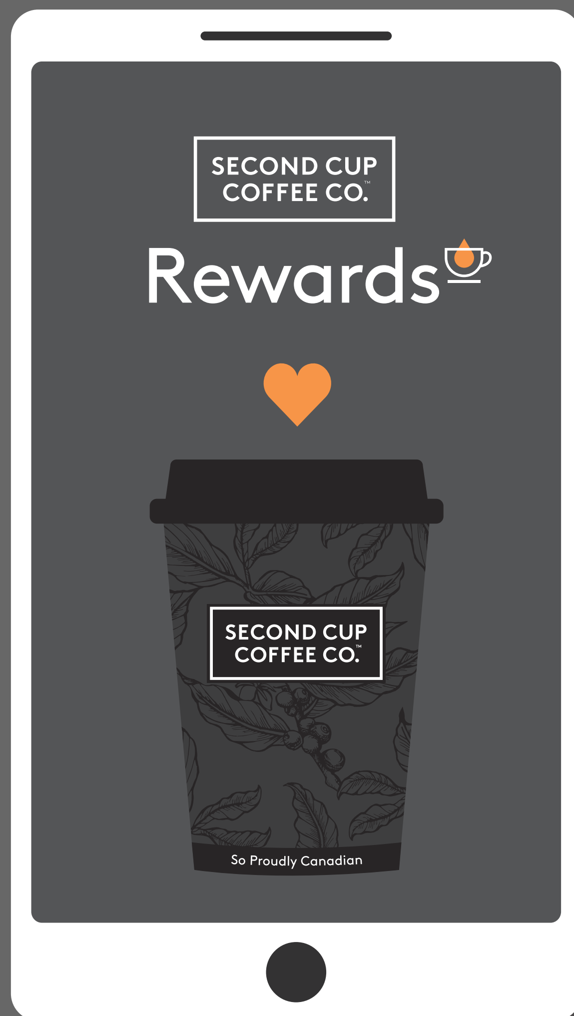
Expanding Second Cup's premium, fresh, local food offering in the breakfast and lunch dayparts is a key strategy for café sales growth. In 2017 major advancements were made with the launch of a fresh Bagel and Spreads program and a line of premium Cheese Melt sandwiches – a classic, remastered.

BETTER FOR YOU MENU

In the first quarter of last year we launched a Better For You menu to meet the growing customer demand for healthier options. A line of smoothies is at the core of the program and opened the door to a whole new group of customers for our cafés. Additional low calorie and high-protein bakery and sandwich menu items compliment the offer. This program will be expanded with new menu innovation underway.

Simply Rewarding

Members earn **FREE** coffee!



SECOND CUP COFFEE CO. REWARDS

A free Rewards program remains a top driver of brand choice for coffee consumers and continues to be a customer favourite. In 2017 our loyalty member base grew by 30% and members' average transaction is significantly higher than the average. With Second Cup Coffee Co. Rewards, members earn points for every dollar they spend and through personalized bonus point offers sent by email and on the mobile app.

DOWNLOAD THE APP

Second Cup Coffee Co.™ Rewards Program available at participating Second Cup Coffee Co.™ Cafés in Canada. ™Trademark of The Second Cup Ltd. See secondcup.com/rewards for full program details, terms and conditions.

Always Delicious NOW CLEAN LABEL!

Fresh is our secret ingredient

Made with non-fat milk
and hand-cut fresh fruit.

Going Clean... Always Delicious

NO Preservatives

NO Artificial Colours

NO Artificial Flavours

NO High-Fructose Corn Syrup

Committed to
Clean Label beverages.

A look at 2018

Second Cup's dramatic improvement in our profitability last year sets the stage for an accelerated growth plan in 2018. The focus is on driving same store sales with innovation led by the expansion of Pinkberry, as well as upgrading and expanding Second Cup in traditional and non-traditional formats. You can expect more exciting fresh food, beverage and Rewards innovation this year.

Leading the Canadian coffee market with Clean Label beverages

In January, Second Cup led the Canadian coffee market with a move to Clean Label beverages which now represent over 70% of the beverage menu.

Clean Label products contain no artificial colours, flavours, preservatives or high fructose corn syrup. Canadian consumers are making more informed food choices. They care about what's in their food and drinks, and they're looking for options they can feel good about.

"At Second Cup, we're on a continual mission to provide the most innovative premium coffee experience in the country - and we believe that our Clean Label commitment is another important step in that journey."

—

Garry Macdonald
President & CEO

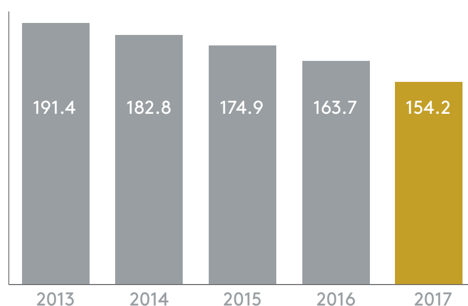
SECOND CUP
COFFEE CO.™
SECOND CUP COFFEE CO.

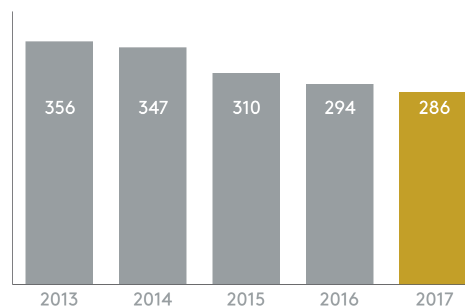
Financial Highlights

The following table sets out selected IFRS and certain non-GAAP financial measures of the Company and should be read in conjunction with the Audited Financial Statements of the Company for the 52 weeks ended December 30, 2017.

(In thousands of Canadian dollars, except same café sales, number of cafés, per share amounts, and number of common shares.)	13 weeks ended December 30, 2017	14 weeks ended December 31, 2016	52 weeks ended December 30, 2017	53 weeks ended December 31, 2016
System sales of cafés[1]	**$41,326**	$46,743	**$154,153**	$163,738
Same café sales[1]	**(1.1%)**	(1.0%)	**(0.2%)**	(1.1%)
Number of cafés – end of period	**286**	294	**286**	294
Total revenue	**$6,085**	$7,500	**$23,636**	$30,351
Operating costs and expenses	**$5,092**	$7,199	**$22,660**	$31,336
Operating income (loss)[1]	**$993**	$302	**$976**	($985)
EBITDA[1]	**$1,339**	$667	**$2,434**	$563
Adjusted EBITDA[1]	**$1,339**	$667	**$2,721**	$563
Net income (loss) and comprehensive income (loss)	**$655**	$147	**($3,097)**	($975)
Adjusted net income (loss) and comprehensive income (loss)[1]	**$655**	$147	**$110**	($975)
Basic and diluted earnings (loss) per share as reported	**$0.04**	$0.01	**($0.21)**	($0.08)
Adjusted basic and diluted earnings (loss) per share[1]	**$0.04**	$0.01	**$0.01**	($0.08)
Total assets – end of period	**$44,700**	$45,314	**$44,700**	$45,314
Number of weighted average common shares issued and outstanding	**17,041,473**	12,830,945	**14,485,081**	12,830,945

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





Management's Discussion and Analysis

CAUTION REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this Management's Discussion and Analysis ("MD&A") may constitute forward-looking statements within the meaning of applicable securities legislation. The terms the "Company", "Second Cup", "we", "us", or "our" refer to The Second Cup Ltd. Forward-looking statements include words such as "may", "will", "should", "expect", "anticipate", "believe", "plan", "intend" and other similar words. These statements reflect current expectations regarding future events and financial performance and speak only as of the date of this MD&A. The MD&A should not be read as a guarantee of future performance or results and will not necessarily be an accurate indication of whether or not those results will be achieved. Forward-looking statements are based on a number of assumptions and are subject to known and unknown risks, uncertainties and other factors, many of which are beyond Second Cup's control that may cause Second Cup's actual results, performance or achievements, or those of Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The following are some of the factors that could cause actual results to differ materially from those expressed in the underlying forward-looking statements: competition; availability of premium quality coffee beans; the ability to attract qualified franchisees; the location of Second Cup cafés; the closure of Second Cup cafés; loss of key personnel; compliance with government regulations; potential litigation; the ability to exploit and protect the Second Cup trademarks; changing consumer preferences and discretionary spending patterns including, but not restricted to, the impact of weather and economic conditions on such patterns; reporting of system sales by franchisees; and the financial performance and financial condition of Second Cup. The foregoing list of factors is not exhaustive, and investors should refer to the risks described under "Risks and Uncertainties" below and in Second Cup's Annual Information Form, which is available at www.sedar.com.

Although the forward-looking statements contained in this MD&A are based on what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward-looking statements and, as a result, the forward-looking statements may prove to be incorrect.

As these forward-looking statements are made as of the date of this MD&A, Second Cup does not undertake to update any such forward-looking statements whether as a result of new information, future events or otherwise. Additional information about these assumptions and risks and uncertainties is contained in the Company's filings with securities regulators. These filings are also available on the Company's website at www.secondcup.com.

INTRODUCTION

The following MD&A has been prepared as of February 23, 2018 and is intended to assist in understanding the financial performance and financial condition of The Second Cup Ltd. ("Second Cup" or the "Company") for the 13 weeks (the "Quarter") and 52 weeks (the "Year") ended December 30, 2017, and should be read in conjunction with the Audited Financial Statements of the Company for the 52 weeks ended December 30, 2017, accompanying notes and the Annual Information Form, which are available at www.sedar.com. Past performance may not be indicative of future performance. All amounts are presented in thousands of Canadian dollars, except number of cafés, per share amounts or unless otherwise indicated and have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The Company also reports certain non-IFRS measures such as system sales of cafés, same café sales, operating income (loss), EBITDA, adjusted EBITDA, adjusted net income (loss) and adjusted net income (loss) per share that are discussed in the "Definitions and Discussion of Certain non-GAAP Financial Measures" in this MD&A.

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CORE BUSINESS, STRATEGIC IMPERATIVES, AND KEY PERFORMANCE DRIVERS

Core business

Second Cup is a Canadian specialty coffee retailer with 286 cafés operating under the trade name Second Cup™ in Canada, of which 12 are Company-owned and the balance is operated by franchisees.

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

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

The fiscal year follows the method, such that each quarter will consist of 13 weeks and will end on the Saturday closest to the calendar quarter-end. The fiscal year is made up of 52 or 53-week periods ending on the last Saturday of December. Fiscal year 2017 consists of 52 weeks.

As at December 30, 2017, the issued share capital consisted of 17,041,473 common shares.

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

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

Strategic imperatives and key performance drivers

Second Cup's vision of being the coffee brand most passionately committed to quality and innovation will drive management's strategies and actions going forward. Coffee will be at the core of the offering supported by ongoing food and beverage innovation.

As the Canadian specialty coffee company, bringing the best coffees in the world to customers is at the core of the brand and fundamental to redefining Second Cup as the coffee brand most passionately committed to quality and innovation. In January 2018, Second Cup announced a move to Clean Label beverages, with a commitment to eliminate artificial colours and flavours, preservatives and high fructose corn syrup from all beverages on the menu.

In September 2017, Second Cup obtained category exclusive license right from Pinkberry Canada Inc. and began rolling out the Pinkberry Frozen Yogurt program in Second Cup cafés. As at December 30, 2017, Pinkberry was being served at 24 cafés across Canada.

The Company is encouraged by its progress in franchising corporate stores to strong operators, returning to an asset light business model, and expects to make further reductions in the number of Company-owned cafés in 2018.

CAPABILITIES

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

The Second Cup brand

The brand – Second Cup Coffee Co.™ – reflects an independent spirit, a commitment to deliver the world's finest coffee, and the Company's vision to be the coffee brand most passionately committed to quality and innovation. A proud Canadian company since 1975 with 286 cafés across Canada, Second Cup Coffee Co.™ is a specialty coffee retailer. The Company maintains its commitment to the communities it operates in, celebrating the franchisees' local ownership and their focus on providing quality and friendly service to each customer in every café.

The people

The franchise network consists of approximately 3,500 team members. Team members range from baristas, managers and franchisees at the cafés to support personnel employed at Coffee Central (head office). Baristas and franchisees complete extensive training and certification to deliver a quality product to our customers. Franchisees and baristas are subject to operational quality checks to monitor performance.

Product

As of today, 27 beverages achieve the Clean Label standard, representing 70% of Second Cup's beverage menu. Clean Label beverages contain no artificial colours or flavours, no preservatives and no high fructose corn syrup. Second Cup will continue to reformulate other menu items to meet the Clean Label standard.

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

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

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

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

Liquidity, capital resources and management of capital

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

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

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

On August 10, 2017 ("Issuance Date"), the Company issued 4,210,528 common shares and 300,000 warrants of Second Cup to the four shareholders of SPE Finance LLC (SPE), an affiliate of Serruya Private Equity. The Company also extinguished its $8,000 debt to SPE, cancelled 600,000 of old warrants and became debt-free. These transactions resulted in one-time, non-cash financing charges of $3,290. These charges consist of the difference between the share price of $2.60 on the Issuance Date and the agreed-to share price of $1.90, and the write-off of the unamortized portion of deferred transaction costs related to the debt.

Competition

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

Technology

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

FINANCIAL HIGHLIGHTS

The following table sets out selected IFRS and certain non-GAAP financial measures of the Company and should be read in conjunction with the Audited Financial Statements of the Company for the 52 weeks ended December 30, 2017.

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Adjusted net income (loss) and comprehensive income (loss)[1]	**$655**	$147	**$110**	($975)
Basic and diluted earnings (loss) per share as reported	**$0.04**	$0.01	**($0.21)**	($0.08)
Adjusted basic and diluted earnings (loss) per share[1]	**$0.04**	$0.01	**$0.01**	($0.08)
Total assets – end of period	**$44,700**	$45,314	**$44,700**	$45,314
Number of weighted average common shares issued and outstanding	**17,041,473**	12,830,945	**14,485,081**	12,830,945

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

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	2015	2016	2017	Average
First Quarter	24.7	23.9	**24.6**	24.4
Second Quarter	25.0	24.6	**24.6**	24.7
Third Quarter	23.5	23.0	**24.0**	23.5
Fourth Quarter	26.8	28.5	**26.8**	27.4
	100.0	100.0	**100.0**	100.0

Historically, system sales of cafés have been higher in the fourth quarter, which includes the holiday sales periods of November and December. In 2016, Fourth Quarter contains one extra week, for a total of 14 weeks. The Company's comparative results take into account the inclusion of the additional selling week in 2016.

Café network

	13 weeks ended	14 weeks ended	52 weeks ended	53 weeks ended
	December 30, 2017	December 31, 2016	December 30, 2017	December 31, 2016
Number of cafés – beginning of period	**289**	298	**294**	310
Cafés opened	**2**	2	**4**	4
Cafés closed	**(5)**	(6)	**(12)**	(20)
Number of cafés – end of period	**286**	294	**286**	294

The Company ended the Year with 12 (2016 - 22) Company-owned cafés. Café closures are mainly attributable to leases that are not renewed on expiration, under-performing locations and landlord re-development of specific sites.

Fourth Quarter

Inclusion of an additional week in 2016 has a direct impact on the following analysis of the Fourth Quarter results.

System sales of cafés

System sales of cafés for the 13 weeks ended December 30, 2017 were $41,326 compared to $46,743 for the 14 weeks ended December 31, 2016 representing a decrease of $5,417 or 11.6%. The decrease in system sales of cafés is primarily due to the reduction in café count.

Same café sales

During the Quarter, same café sales declined 1.1%, compared to a decline of 1.0% in the comparable Quarter of 2016. The decline is primarily due to reduced transactions.

Analysis of revenue

Total revenue for the Quarter was $6,085 (2016 - $7,500), a decrease of $1,415, consisting of Company-owned café and product sales, royalty revenue, fees and other revenue.

Company-owned cafés and product sales were $1,713 (2016 - $3,210), a decrease of $1,497. The decrease in revenue is primarily due to the reduced Company-owned café count from 22 last year to 12 this Quarter. Reducing Company-owned cafés is consistent with the Company's strategy of returning to an asset light business model.

Franchise revenue was $4,372 for the Quarter (2016 - $4,290), an increase of $82. The increase in franchise revenue in the Quarter is primarily driven by an increase in franchising fees, partially offset by a decrease in royalties and coordination fees.

Operating costs and expenses

Operating costs and expenses include the costs of Company-owned cafés and product sales, franchise-related expenses, general and administrative expenses, loss/gain on disposal of assets, and depreciation and amortization. Total operating costs and expenses for the Quarter were $5,092 (2016 - $7,199), a decrease of $2,107.

Company-owned cafés and product sales related expenses for the Quarter were $1,772 (2016 - $3,410), a decrease of $1,638. The decrease in costs is due to the reduction in store count of Company-owned cafés and lower product sales as compared to the Quarter in 2016.

Franchise related expenses for the Quarter were $1,670 (2016 - $2,006), a decrease of $336. The decrease in franchise related expenses is primarily due to a lower provision for café leases and enhanced operating efficiencies.

General and administrative expenses were $1,206 for the Quarter (2016 - $1,502), a decrease of $296. This decrease in expenses is primarily due to a reduction in remunerations and directors' fees.

A loss on disposal of $98 was recognized in the Quarter (2016 - gain of $84). Gain and loss on disposal of assets are related to the franchising of Company-owned cafés to franchise partners.

Depreciation and amortization expense was $346 (2016 - $365), a decrease of $19.

EBITDA

EBITDA for the Quarter was $1,339 (2016 - $667), an increase of $672. The increase is primarily driven by the reduction in franchise related expenses and the increase in franchise revenue, as described.

Interest and financing costs

Interest and financing income for the Quarter was $5 compared to interest and financing costs of $96 in the same Quarter of 2016. The Company became debt-free in the third quarter this year.

Net income (loss)

The Company's net income for the Quarter was $655 or $0.04 per share, compared to a net income of $147 or $0.01 per share in 2016.

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-GAAP Financial Measures".

Year

Inclusion of an additional week in 2016 has a direct impact on the following analysis of the Year.

System sales of cafés

System sales of cafés for the Year were $154,153 (2016 - $163,738), a decrease of $9,585 or 5.9%. The decrease is primarily due to the reduction in café count.

Same café sales

For the Year, same café sales declined by 0.2% compared to a decline of 1.1% in 2016. The decline in the Year was primarily due to the decline in the fourth quarter same café sales as described above.

Analysis of revenue

Total revenue for the Year was $23,636 (2016 - $30,351), a decrease of $6,715, consisting of Company-owned café and product sales, royalty revenue, fees and other revenue.

Company-owned cafés and product sales were $8,562 (2016 - $14,663), a decrease of $6,101. The decrease is due to the reduction of Company-owned café count from 22 to 12 this Year. Reducing Company-owned cafés count is consistent with the Company's strategy of returning to an asset light business model.

Franchise revenue was $15,074 for the Year (2016 - $15,688), a decrease of $614. The decrease in franchise revenue is primarily due to lower royalties and coordination fees as a result of lower café count.

Operating costs and expenses

Operating costs and expenses include the costs of Company-owned cafés and product sales, franchise-related expenses, general and administrative expenses, loss/gain on disposal of assets, and depreciation and amortization. Total operating costs and expenses for the Year were $22,660 (2016 - $31,336), a decrease of $8,676.

Company-owned cafés and product related expenses were $9,303 for the Year (2016 - $15,681), a decrease of $6,378. The decrease in costs is attributable to the reduction of Company-owned café count and lower product sales as compared to 2016.

Franchise related expenses were $5,693 for the Year (2016 - $8,103), a decrease of $2,410. This decrease in expenses is primarily due to a reduction in remuneration, an improvement in operational effectiveness and moving from a national franchisee convention format to regional meetings with franchisees this year.

General and administrative expenses were $6,009 for the Year (2016 - $5,779), an increase of $230. This increase is driven by higher professional fees related to legal matters and one-time transition costs, partially offset by a reduction in general and administrative remuneration.

A loss on disposal of assets of $197 was recognized for the Year (2016 - $225 loss). Gain and loss on disposal of assets are primarily related to the franchising of Company-owned cafés to franchise partners.

Depreciation and amortization expense was $1,458 (2016 - $1,548), a decrease of $90.

EBITDA

EBITDA was $2,434 for the Year (2016 - $563), an increase of $1,871. Adjusted for one-time transition costs of $287 incurred in the second quarter of 2017, adjusted EBITDA was $2,721 compared to an adjusted EBITDA of $563 in 2016. The increase of $2,158 is primarily driven by the reduction in franchise related expenses, lower corporate café operating loss, and lower provision for café leases, partially offset by the decrease in franchise revenue.

Interest and financing costs

Interest and financing costs was $3,897 for the Year (2016 - $255), an increase of $3,642. The increase is primarily driven by one-time, non-cash financing charges of $3,290. These charges consist of the difference between the share price of $2.60 on the Issuance Date and the agreed-to share price of $1.90, and the write-off of the unamortized portion of deferred transaction costs related to the debt.

Net loss

The Company's net loss for the Year was $3,097 or $0.21 loss per share, compared to a net loss of $975 or $0.08 loss per share in 2016. Adjusted for the after-tax expense on fair market value difference on issuance of shares of $3,207 ($0.22 per share), adjusted net income was $110 or $0.01 per share compared to an adjusted net loss of $975 or $0.08 loss per share in 2016.

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

SELECTED QUARTERLY INFORMATION

(in thousands of Canadian dollars, except Number of cafés, Same café sales, and per share amounts.)	Q4 2017[2]	Q3 2017	Q2 2017	Q1 2017
System sales of cafés[1]	$41,326	$37,014	$37,898	$ 37,915
Same café sales[1]	(1.1%)	0.0%	0.7%	(0.2%)
Number of cafés – end of period	286	289	291	293
Total revenue	$6,085	$5,339	$6,237	$5,975
Operating income (loss)[1]	$993	$436	($138)	($315)
EBITDA[1]	$1,339	$805	$230	$60
Adjusted EBITDA[1]	$1,339	$805	$517	$60
Net income (loss) for the period	$655	($2,962)	($315)	($475)
Adjusted net income (loss) for the period[1]	$655	$245	($315)	($475)
Basic and diluted earnings (loss) per share	$0.04	($0.19)	($0.02)	($0.04)
Adjusted basic diluted earnings (loss) per share[1]	$0.04	$0.02	($0.02)	($0.04)
	Q4 2016[2]	Q3 2016	Q2 2016	Q1 2016
System sales of cafés[1]	$46,743	$37,717	$40,207	$39,071
Same café sales[1]	(1.0%)	(1.2%)	(1.3%)	(1.1%)
Number of cafés – end of period	294	298	304	307
Total revenue	$7,500	$7,656	$7,761	$7,434
Operating (loss) income[1]	$302	($25)	($528)	($733)
EBITDA[1]	$667	$357	($128)	($332)
Adjusted EBITDA[1]	$667	$357	($128)	($332)
Net (loss) income for the period	$147	($75)	($441)	($606)
Adjusted net income (loss) for the period[1]	$147	($75)	($441)	($606)
Basic and diluted (loss) earnings per share	$0.01	($0.01)	($0.03)	($0.05)
Adjusted basic diluted earnings (loss) per share[1]	$0.01	($0.01)	($0.03)	($0.05)

1 See the section "Definitions and Discussion on Certain non-GAAP Financial Measures" for further analysis.
2 The Company's fourth quarter System sales of cafés are higher than other quarters due to the seasonality of the business (see "Seasonality of system sales of cafés" above).

The system sales decreases quarter over quarter are primarily related to the reduction in total network café count and to a lesser extent to the changes in the same café sales.

Seasonal factors and the timing of holidays cause the Company's revenue to fluctuate from quarter to quarter. Revenue decreases quarter over quarter are primarily related to the reduction of Company-owned cafés count and reduction in café count.

LIQUIDITY AND CAPITAL RESOURCES

Second Cup collects royalties based on the franchisees' portion of System sales of cafés, fees, and other amounts from its franchisees and also generates revenues from its Company-owned cafés and product sales. The performance of Second Cup franchisees and Company-owned cafés could impact the ability of the Company to declare and pay dividends to its shareholders. For a more detailed discussion of the risks and uncertainties affecting the Company's liquidity, see the "Risks and uncertainties" section below.

Summary of cash flows

	13 weeks ended	14 weeks ended	52 weeks ended	53 weeks ended
	December 30 2017	December 31, 2016	December 30, 2017	December 31, 2016
Cash flows provided by (used in) operating activities	**$1,583**	($498)	**$1,862**	($1,253)
Cash flows provided by (used in) investing activities	**(150)**	-	**4**	(365)
Cash flows provided by (used in) financing activities	**(124)**	1,542	**(297)**	1,542
Increase (decrease) in cash and cash equivalents during the period	**$1,309**	$1,044	**$1,569**	($76)

Fourth Quarter

Cash provided by operating activities was $1,583 for the Quarter compared to cash used of $498 for the same Quarter in 2016. The increase in cash of $2,081 is primarily due to changes in non-cash working capital and higher profit.

During the Quarter, cash used in investing activities was $150 compared to cash used of nil for the same Quarter in 2016 due to purchases of capital expenditures and intangible assets in 2017.

Cash used in financing activities was $124 for the Quarter compared to cash provided by financing activities of $1,542 for the same Quarter in 2016. In 2016, the Company received net cash of $2,000 due to the new term loan. In 2017, the Company paid financing charges related to the issuance of shares.

Year

Cash provided by operating activities was $1,862 for the Year compared to cash used in operating activities of $1,253 for 2016. The increase in cash of $3,115 was primarily due to changes in non-cash working capital and higher profit.

During the Year, cash provided by investing activities was $4 compared to cash used of $365 for 2016. The change of $369 in cash was primarily due to lower payments for intangible assets and higher proceeds from disposal of capital items.

Cash used in financing activities was $297 for the Year compared to cash provided by financing activities of $1,542 in 2016. In 2016, the Company received net cash of $2,000 due to the new term loan. In 2017, the Company paid financing charges related to the issuance of shares.

Working capital as at

	December 30, 2017	December 31, 2016
Current assets	**$10,122**	$9,096
Current liabilities	**9,869**	10,242
Working capital (deficiency)	**$253**	($1,146)

The Company's working capital was $253 as at December 30, 2017 improved by $1,399 from December 31, 2016, primarily as a result of an increase in cash and cash equivalents and a reduction in accounts payable and accrued liabilities at the end of the Year. Gift card liability ended the Year at $3,432, a decrease of $52 compared to the end of 2016. Based on the historical redemption patterns, the Company believes that it has sufficient financial resources to cover the gift card liability. The Company operates in the franchise industry, in which a working capital deficit is considered normal.

Financial instruments

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

Financial instrument	Risks
Financial assets	
Cash and cash equivalents	Credit and interest rate
Restricted cash	Credit and interest rate
Trade and other receivables	Credit
Notes and leases receivable	Credit
Financial liabilities	
Accounts payable and accrued liabilities	Liquidity, currency and commodity
Gift card liability	Liquidity
Deposits from franchisees	Liquidity
Term credit facility	Liquidity and interest rate

(i) Credit risk

Cash and cash equivalents, restricted cash and interest rate swap

Credit risk associated with cash and cash equivalents, restricted cash and the interest rate swap 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 leases receivable primarily comprise amounts due from franchisees. Credit risk associated with these receivables is mitigated as a result of the review and evaluation of franchisee account balances beyond a particular age. Prior to accepting a franchisee, the Company undertakes a detailed screening

process which includes the requirement that a franchisee has sufficient 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.

Specific bad debt provisions are accounted for when the expected recovery is less than the actual receivable.

(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. 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

					Payments Due by Period
Contractual Obligations	Total	1 year	2 – 3 years	4 – 5 years	After 5 years
Obligations from Operating Leases	$8,878	$1,488	$2,637	$2,128	$2,625
Purchase Obligations	2,286	2,286	Nil	Nil	Nil
Total Contractual Obligations	$11,164	$3,774	$2,637	$2,128	$2,625

Obligations from operating leases

Second Cup has lease commitments for Company-owned cafés and also acts as the head tenant on most leases, which in turn it subleases to franchisees. To the extent the Company may be required to make rent payments due to head lease commitments, a provision has been recognized.

	Head lease commitments	Sublease to franchisees	Net
December 29, 2018	$17,954	$16,466	$1,488
December 28, 2019	16,158	14,736	1,422
December 26, 2020	13,907	12,692	1,215
December 25, 2021	12,034	10,938	1,096
December 31, 2023	10,835	9,803	1,032
Thereafter	27,637	25,012	2,625
	$98,525	$89,647	$8,878

The Company believes it has sufficient resources to meet the net commitment of $8,878 over the term of the leases.

Purchase obligations

Contracts are in place with third party companies to purchase the coffee that is sold in all cafés. In terms of these supply agreements, there is a guaranteed minimum value of coffee purchases of $1,392 (2016 - $1,140) for the subsequent 12 months. The coffee purchase commitment is comprised of two components: unapplied futures commitment contracts and fixed price physical contracts.

Due to the Company acting as the primary coordinator of café construction costs on behalf of its franchisees and for Company-operated cafés, there is $894 (2016 - $241) of contractual commitments pertaining to construction costs for new locations and renovations as at the end the Year. Construction costs financed for franchise projects are 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 or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent on the potential success of the claim. It is believed that no significant losses or expenses will be incurred with such claims. However, there can be no assurance that unforeseen circumstances will not result in significant costs. The outcome of these actions is not determinable at this time, and adjustments, if any, will be recorded in the period of settlement.

Related parties

Related parties are identified as key management, members of the Board of Directors, and shareholders that effectively exercise significant influence on the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

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

Disclosure controls and procedures

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

As at February 23, 2018, the Company's management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the disclosure controls and procedures. Based on this evaluation, the CEO and CFO have concluded that, as at December 30, 2017, the Company's disclosure controls and procedures were appropriately designed.

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

During the 13 weeks ended December 30, 2017 and up to the date of the approval of the Audited Financial Statements and MD&A, there has been no change that has materially affected, or is reasonably likely to materially affect the Company's disclosure controls and procedures.

Internal controls over financial reporting

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

As at February 23, 2018, the Company's management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the controls over financial reporting. No material weaknesses in the design of these controls over financial reporting were identified. Based on this evaluation, the CEO and CFO have concluded that, as at December 30, 2017, the Company's controls over financial reporting were appropriately designed and were operating effectively.

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

During the 13 weeks ended December 30, 2017 and up to the date of the approval of the Audited Financial Statements and MD&A, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect the Company's internal control over financial reporting.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Audited Financial Statements requires management to make estimates, assumptions, and use judgement in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgements are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. The accounting estimates will, by definition, seldom equal the related actual results.

Estimates

The following are examples of estimates and assumptions the Company makes:

- the recoverability of tangible and intangible assets subject to depreciation, amortization, or with indefinite lives;
- the derivation of income tax assets and liabilities;
- the estimated useful lives of assets;
- café lease provisions and restructuring charges; and
- the allowance for doubtful accounts.

Use of judgement

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

(i) Impairment charges

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

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

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

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

(ii) Deferred income taxes

The timing of reversal of temporary differences and the expected income allocation to various tax jurisdictions within Canada affect the effective income tax rate used to compute the deferred income taxes. Management estimates the reversals and income allocation based on historical and budgeted operating results and income tax laws existing at the Statements of Financial Position dates. In addition, management occasionally estimates the current or future deductibility of certain expenditures, affecting current or deferred income tax balances and expenses.

(iii) Estimated useful lives

Estimates for the useful lives of property and equipment are based on the period during which the assets are expected to be available-for-use. The amounts and timing of recorded expenses for depreciation of property and equipment for any period are affected by these estimated useful lives. It is possible that changes in these factors may cause significant changes in the estimated useful lives of property and equipment in the future.

(iv) Café lease provisions

Café lease provisions require judgement to evaluate the likelihood and measurement of settlements, temporary payouts or subleasing. Management works with landlords and franchises and uses previous experience to obtain adequate information needed to make applicable judgements.

(v) Allowance for doubtful accounts

The allowance for impairment of trade and other receivables is established when there is objective evidence that the Company will not be able to collect all amount due according to the original terms of the receivable. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in expenses in the statement of income. When an account is deemed uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are recognized as a recovery in expenses in the statement of income.

CHANGES IN ACCOUNTING POLICIES

In accordance with the IFRS Interpretations Committee ("IFRIC") agenda decision addressing the expected manner of recovery of an intangible asset with an indefinite useful life for the purposes of measuring deferred tax in accordance with IAS 12, Income Taxes ("IAS 12"), the IFRIC noted that an intangible asset with an indefinite useful life does not mean infinite life, nor does it mean the expected manner of recovery of the carrying amount would result solely through sale. Therefore, in applying IAS 12, an entity must determine its expected manner of recovery of the carrying value of the intangible asset with an indefinite life and should reflect the tax consequences that follow from that expected manner of recovery. Previously, the Company measured deferred taxes on temporary differences arising from certain indefinite life intangible assets using capital gains rates on the basis that the assets will be recovered through its disposition. As a result of the IFRIC agenda decision, the Company has changed its accounting policy to measure deferred taxes at the income tax rate applicable to ordinary taxable income expected to apply in the years in which the temporary differences are expected to be recovered or settled. The Company adopted this change on a retrospective basis as an accounting policy change in accordance with IAS 8, "Accounting Policies, Changes to Accounting Estimates and Errors" and the impact on the financial statements was an increase to deferred tax liabilities at December 27, 2015 of $2,388, a corresponding adjustment to retained earnings (deficit) of $2,388.

Recent accounting pronouncements not yet effective

In May 2014, the IASB issued IFRS 15, a new comprehensive model for entities to use accounting for revenue arising from contracts with customers. In September 2015, the IASB deferred adoption of the new standard by one year. Several updates have been issued since then to clarify the implementation guidance. The new guidance supersedes the most current revenue recognition guidance, including industry-specific guidance, enhances revenue recognition disclosures, and is now effective commencing in 2018. The guidance allows for either a full retrospective or modified retrospective transition method. We currently expect to apply the modified retrospective transition method.

Under current accounting guidance, we recognize initial franchise fees when we have performed all material obligations and services, which generally occurs when the franchised café opens. As required under the new guidance, we anticipate deferring the initial franchise fees and recognizing revenue over the term of the related franchise agreement (generally ten years).

We anticipate an increase in deficit as at December 31, 2017, the date of initial adoption and a corresponding increase in deferred revenue reflecting initial franchise fees previously recognized that are now recorded over the term.

We anticipate that the new guidance will also change our reporting of the Co-op Fund contributions from franchisees and the related advertising and promotional expenditures, which are currently reported on a net basis in our Statements of Financial Position. Under the new guidance, Co-op Fund contributions from franchisees and advertising and promotional expenditures will be reported on a gross basis.

In addition, we anticipate that the estimated breakage income on gift cards will be recognized as gift cards are utilized instead of our current policy of recognizing on a pro rata basis based on historical gift card redemption patterns.

We do not believe this guidance will materially impact our recognition of revenue from Company-owned cafes and product sales or our recognition of franchise royalties revenue.

IFRS 9 replaces the incurred loss model under IAS 39 with a model on expected credit losses. Under the new standard, expected credit losses will need to be recorded. Under our current accounting, losses are recognized when probable. We are currently assessing the impact of the new standard, however, the new standard will likely increase our allowance for doubtful account provision.

IFRS 16, Leases, sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer ('lessee') and the supplier ('lessor'). This will replace IAS 17, Leases, and related Interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all leases and requires a lessee to recognize 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 depreciation of lease assets separately from interest on lease liabilities on the Statements of Operations and Comprehensive Loss.

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

The Company has completed a preliminary assessment of the potential impact on its financial statements, but has not yet completed its detailed assessment. So far, the most significant impact identified is that the Company will recognize new assets and liabilities for its subleases, operating leases of its head office and corporate cafés.

RISKS AND UNCERTAINTIES

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

The performance of Second Cup is primarily dependent on its ability to maintain and increase the sales of existing cafés, add new profitable cafés to the network and redevelop and modernize cafés as their leases come due. System sales of the café network are affected by various external factors that can affect the specialty coffee industry as a whole. Potential risks include the following:

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

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

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

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

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

Second Cup relies heavily on information technology (IT) network infrastructure. The ability to manage operations effectively and efficiently depends on the reliability and capacity of these IT systems, most of which are administered by third party suppliers. The Company relies on POS for system sales for both marketing trends and royalty calculations. Cafés rely on IT network infrastructure to order goods and process credit, debit and café card

transactions. Coffee Central financial and administrative functions rely on IT infrastructure for accurate and reliable information. The failure of these systems to operate effectively, or problems with upgrading or replacing systems, could cause a material negative financial result. The Company is continually reviewing its systems and procedures to minimize risk.

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

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

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

OUTLOOK

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

Second Cup continues to rollout Pinkberry premium frozen yogurt which is now in 30 cafés across the country. Response to this complimentary, premium offering has been very favourable with new customers attracted to the cafés, driving incremental sales. Pinkberry will be introduced to more cafés across the network in time for the peak frozen yogurt season.

In January, Second Cup led the Canadian coffee market with a move to Clean Label beverages which now represent over 70% of the beverage menu. Clean Label products contain no artificial colours, flavours, preservatives or high fructose corn syrup.

DEFINITIONS AND DISCUSSION ON CERTAIN NON-GAAP FINANCIAL MEASURES

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

System sales of cafés

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

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

Same café sales

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

Operating income (loss)

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

EBITDA and adjusted EBITDA

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

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

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

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

	13 weeks ended December 30, 2017	14 weeks ended December 31, 2016	52 weeks ended December 30, 2017	53 weeks ended December 31, 2016
Net income (loss)	$655	$147	($3,097)	($975)
Income taxes (recovery)	343	59	176	(265)
Interest and financing costs	(5)	96	3,897	255
Operating income (loss)	$993	$302	$976	($985)

	13 weeks ended December 30, 2017	14 weeks ended December 31, 2016	52 weeks ended December 30, 2017	53 weeks ended December 31, 2016
Net income (loss)	$655	$147	($3,097)	($975)
Income taxes (recovery)	343	59	176	(265)
Interest and financing costs	(5)	96	3,897	255
Depreciation of property and equipment	228	291	1,002	1,168
Amortization of intangible assets	118	74	456	380
EBITDA	1,339	$667	2,434	563
Add (deduct) impact of the following: One-time transition costs	-	-	287	-
Adjusted EBITDA	$1,339	$667	$2,721	$563

	13 weeks ended December 30, 2017	14 weeks ended December 31, 2016	52 weeks ended December 30, 2017	53 weeks ended December 31, 2016
Net income (loss)	$655	$147	($3,097)	($975)
Add impact of the following: After-tax fair value difference on shares issued and other costs	-	-	3,207	-
Adjusted net income (loss)	$655	$147	$110	($975)

	13 weeks ended December 30, 2017	14 weeks ended December 31, 2016	52 weeks ended December 30, 2017	53 weeks ended December 31, 2016
Net income (loss) per share	$0.04	$0.01	($0.21)	($0.08)
Add impact of the following: After-tax fair value difference on shares issued and other costs	-	-	0.22	-
Adjusted net income (loss) per share	$0.04	$0.01	$0.01	($0.08)

Audited Financial Statements

For the 52 weeks ended December 30, 2017 and 53 weeks ended December 31, 2016

INDEPENDENT AUDITOR'S REPORT

February 23, 2018

To the Shareholders of
The Second Cup Ltd.

We have audited the accompanying financial statements of The Second Cup Ltd., which comprise the statements of financial position as at December 30, 2017 and December 31, 2016 and the statements of operations and comprehensive loss, statements of changes in shareholders' equity and statements of cash flows for the fifty-two and fifty-three week periods then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of The Second Cup Ltd. as at December 30, 2017 and December 31, 2016 and its financial performance and its cash flows for the fifty-two and fifty-three week periods then ended, respectively, in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants

Statements of Financial Position

As at December 30, 2017 and December 31, 2016
(Expressed in thousands of Canadian dollars)

	2017	2016
ASSETS		
Current assets		
Cash and cash equivalents	$4,573	$3,004
Restricted cash (note 23)	1,359	1,947
Trade and other receivables (note 6)	3,716	3,023
Notes and leases receivable (note 7)	64	139
Inventories (note 8)	205	200
Prepaid expenses and other assets	205	251
Income tax receivable	-	532
	10,122	9,096
Non-current assets		
Notes and leases receivable (note 7)	74	173
Property and equipment (note 9)	2,132	3,434
Intangible assets (note 10)	32,372	32,611
Total assets	$44,700	$45,314
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 11)	$3,974	$3,700
Provisions (note 12)	934	1,598
Other liabilities (note 13)	459	217
Gift card liability	3,432	3,484
Deposits from franchisees	979	1,243
Income tax payable	91	-
	9,869	10,242
Non-current liabilities		
Provisions (note 12)	230	530
Other liabilities (note 13)	179	267
Long-term debt (note 14)	-	7,181
Deferred income taxes (note 19)	6,160	6,206
Total liabilities	16,438	24,426
SHAREHOLDERS' EQUITY	28,262	20,888
Total liabilities and shareholders' equity	$44,700	$45,314

Contingencies, commitments and guarantees (note 24)
See accompanying notes to financial statements.

Approved by the Directors February 23, 2018

Michael Bregman, Director   Rael Merson, Director

Statements of Operations and Comprehensive Loss

For the periods ended December 30, 2017 and December 31, 2016

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

	2017	2016
Revenue (note 15)		
Company-owned cafés and product sales	$8,562	$14,663
Franchise revenue	15,074	15,688
	22,636	30,351
Operating costs and expenses (note 16)		
Company-owned cafés and cost of product sales	9,303	15,681
Franchise	5,693	8,103
General and administrative	6,009	5,779
Loss on disposal of assets	197	225
Depreciation and amortization	1,458	1,548
	22,660	31,336
Income (loss) from operations	976	(985)
Interest and financing costs (notes 14 and 18)	3,897	255
Loss before income taxes	(2,921)	(1,240)
Income taxes (note 19)	176	(265)
Net loss and comprehensive loss for the period	($3,097)	($975)
Basic and diluted loss per share (note 20)	($0.21)	($0.08)

See accompanying notes to financial statements.

Statements of Changes in Shareholders' Equity

For the periods ended December 30, 2017 and December 31, 2016
(Expressed in thousands of Canadian dollars)

	Share Capital	Warrants	Contributed Surplus	Retained Earnings (Deficit)	Total
Balance – December 26, 2015 (note 2.x)	$8,652	$–	$61,736	($48,849)	$21,539
Net loss for the period	–	–	–	(975)	(975)
Stock option plan expense (note 26)	–	–	53	–	53
Issuance of warrants (note 14)	–	271	–	–	271
Balance – December 31, 2016	$8,652	$271	$61,789	($49,824)	$20,888
Net loss for the period	$–	$–	$–	($3,097)	($3,097)
Stock option plan recovery (note 26)	–	–	(42)	–	(42)
Warrants extinguished (note 14)	–	(271)	–	–	(271)
Warrants issued (note 14)	–	165	–	–	165
Shares issued (note 3)	10,619	–	–	–	10,619
Balance – December 30, 2017	**$19,271**	**$165**	**$61,747**	**($52,921)**	**$28,262**

See accompanying notes to financial statements.

Statements of Cash Flows

For the periods ended December 30, 2017 and December 31, 2016

(Expressed in thousands of Canadian dollars)

	2017	2016
CASH PROVIDED BY (USED IN)		
Operating activities		
Net loss for the period	($3,097)	($975)
Items not involving cash		
Depreciation of property and equipment	1,018	1,168
Amortization of intangible assets	456	403
Amortization of deferred financing costs	139	—
Share-based compensation expense	60	53
Deferred income taxes (note 19)	30	238
Loss on disposal of capital related items	197	225
Fair value difference on shares issued and other costs (note 4)	3,290	—
Bad debt expense for notes and leases receivable	43	—
Change in fair value of interest rate swap (note 5)	—	(77)
Changes in non-cash working capital & other (note 21)	(274)	(2,288)
Cash provided by (used in) operating activities	1,862	(1,253)
Investing activities		
Proceeds from disposal of capital related items	473	334
Cash payments for capital expenditures (note 21)	(383)	(382)
Cash payments for intangible assets (note 21)	(217)	(393)
Notes receivable repayment	131	76
Cash provided by (used in) investing activities	4	(365)
Financing activities		
Repayment of term loan (note 14)	—	(6,000)
Proceeds from new term loan	—	8,000
Transaction costs	(297)	(458)
Cash (used in) provided by financing activities	(297)	1,542
Increase (decrease) in cash and cash equivalents during the period	1,569	(76)
Cash and cash equivalents – Beginning of the period	3,004	3,080
Cash and cash equivalents – End of the period	$4,573	$3,004

See accompanying notes to financial statements. Supplemental cash flow information is provided in note 21.
Information on non-cash transactions and supplemental cash flow information are described further in notes 5, 14, 21, and 22.

Notes to the Financial Statements

For the periods ended December 30, 2017 and December 31, 2016
(Expressed in thousands of Canadian dollars, except per share amounts)

1. ORGANIZATION AND NATURE OF BUSINESS

The Second Cup Ltd. ("Second Cup" or "the Company") is a Canadian specialty coffee retailer with 286 (2016 - 294) cafés operating under the trade name Second Cup™ in Canada, of which 12 (2016 - 22) are Company-operated and the balance operated by franchisees.

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

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

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Basis of preparation

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

The Company's fiscal year follows the method implemented by many retail entities, such that each quarter 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 2017 is a 52-week period (2016 - 53 weeks).

The Company manages an advertising and co-operative fund (the "Co-op Fund") established to collect and administer funds contributed for use in advertising and promotional programs, and initiatives designed to increase sales and enhance the reputation of the Second Cup brand. Contributions to the Co-op Fund are required to be made from both franchised and Company-operated cafés and are based on a percentage of café sales. The revenue, expenses and cash flows of the Co-op Fund are not consolidated, but are netted on the Statement of Financial Position in accounts payable if there is a surplus, or in accounts receivable if there is a deficit to the extent that the Company will recover the deficit from franchisees. The assets and liabilities of the Co-op Fund are included in the assets and liabilities of the Company on the Statements of Financial Position. The policy is established because the contributions to the Co-op Fund are segregated, designated for a specific purpose and the Company is acting as an agent. Since the decisions as to the content and nature of the marketing campaigns are made solely by a body made up of six franchisees elected by their peers and includes representation from each region of our network (the "Advisory Council") and fulfilled by third parties, the Company does not have the primary responsibility for completing marketing campaigns using the Co-op Fund contributions provided by each franchisee.

b. Segmented information and reporting

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

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

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

The preparation of financial statements requires management to make estimates, assumptions, and use judgement in applying its accounting policies and in determining estimates and assumptions about the future. Estimates and other judgements are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected. The accounting estimates will, by definition, seldom equal the related actual results.

Estimates

The following are examples of critical estimates, assumptions and judgements the Company makes in determining the amounts reported in the financial statements:

- the determination of the recoverable amounts of tangible and intangible assets subject to depreciation, amortization, or with indefinite lives;
- the derivation of income tax assets and liabilities;
- the estimated useful lives of assets;
- café lease provisions and restructuring charges; and
- the allowance for doubtful accounts.

Use of judgement

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

(i) Impairment charges

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

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

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

The Company's impairment tests include key assumptions related to the scenarios discussed above. Further details are provided in note 17 to the financial statements.

(ii) Deferred income taxes

The timing of reversal of temporary differences and the expected income allocation to various tax jurisdictions within Canada affect the effective income tax rate used to compute the deferred income taxes. Management estimates the reversals based on historical and budgeted operating results and income tax laws existing at the reporting dates. In addition, management occasionally estimates the current or future deductibility of certain expenditures, affecting current or deferred income tax balances and expenses.

(iii) Estimated useful lives

The useful lives of property and equipment are based on the period during which the assets are expected to be available-for-use. The amounts and timing of recorded expenses for depreciation of property and equipment for any period are affected by these estimated useful lives. It is possible that changes in these factors may cause significant changes in the amount of depreciation recorded in respect of the Company's property and equipment in the future.

(iv) Café lease provisions

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

(v) Allowance for doubtful accounts

The allowance for impairment of trade and other receivables is established when there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivable. The carrying amount of the asset is reduced through the use of an allowance account, and the amount of the loss is recognized in expenses in the statement of operations and comprehensive loss. When an account is deemed uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are recognized as a recovery in expenses in the statement of operations and comprehensive loss.

d. Financial instruments

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

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

On recognition, the Company classifies its financial instruments in the following categories depending on the purpose for which the instruments were acquired:

Financial instrument	Categorization	Recognition method
Financial assets		
Cash and cash equivalents	Loans and receivables	Amortized cost
Restricted cash	Loans and receivables	Amortized cost
Trade and other receivables	Loans and receivables	Amortized cost
Notes and leases receivable	Loans and receivables	Amortized cost
Financial liabilities		
Accounts payable and accrued liabilities	Other financial liabilities	Amortized cost
Gift card liability	Other financial liabilities	Amortized cost
Deposits from franchisees	Other financial liabilities	Amortized cost
Term credit facility	Other financial liabilities	Amortized cost

(i) Cash and cash equivalents, restricted cash, trade and other receivables, and notes and leases receivable: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are initially recognized at the amount expected to be received, and if necessary, less a present value discount if collection is to be expected beyond one year. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment, if necessary.

(ii) Transaction costs: Long-term debt and share capital are accounted for at fair value, net of any transaction costs incurred. Long-term debt, subsequently, is accounted for at amortized cost using the effective interest method. Transaction costs associated with instruments recognized at amortized cost are amortized over the expected life of the instrument. This classification has been selected as it results in better matching of the transaction costs with the periods benefiting from the transaction costs.

e. Cash and cash equivalents and restricted cash

Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less. Restricted cash represents cash on deposit with banks that are held in trust of the Co-op Fund and Development Fund as well as $240 held as security for cash management services.

f. Leases receivable

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

g. Inventories

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

h. Property and equipment

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

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

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

i. Intangible assets

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

(i) Trademarks

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

(ii) Software

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

Software	3 to 7 years

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

j. Provisions

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

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

k. Other liabilities

(i) Deferred revenue

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

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

(ii) Leasehold inducements

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

l. Income taxes

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

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

m. Gift card liability

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

When it is determined the likelihood of the remaining balance of a gift card being redeemed by the customer is remote, the amount is recorded as breakage. The determination of the gift card breakage rate is based upon Company-specific historical load and redemption patterns. The 2017 analysis determined that a breakage rate of 3% was applicable to gift card sales, which is consistent with 2016 experience. Gift card breakage is recognized on a pro rata basis based on historical gift card redemption patterns. Breakage income is fully allocated to the Co-op Fund and not recorded in earnings.

n. Deposits from franchisees

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

o. Revenue recognition

Revenue is recognized when it is probable that economic benefits will flow to the Company and delivery has occurred, the sales price is fixed or determinable, and collectability is reasonably assured. Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other revenue related concessions.

(i) Royalties

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

(ii) Services and other

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

(iii) Company-owned cafés and product sales

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

p. Operating costs and expenses

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

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

(ii) Franchise

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

(iii) General and administrative

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

q. Operating leases

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

r. Directors' deferred share unit plan

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

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

s. Impairment of financial assets

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

The criteria used to determine if there is objective evidence of an impairment loss include:

- significant financial difficulty of the borrower/lessee;
- delinquencies in interest or principal payments; and
- it becomes probable that the borrower/lessee will enter bankruptcy or other financial reorganization.

If such evidence exists, an impairment loss is recognized for assets carried at amortized cost as follows:

The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's effective interest rate. The carrying value of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Notes receivable and leases receivable are assessed for impairment on an individual basis based on the ability of the debtor/lessee to make the required payments and the value of the security. When there is no longer reasonable assurance that a note receivable or lease receivable will be collected, its carrying value is reduced and a charge is recorded in operating expenses.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent years if the amount of the loss decreases and the decrease can be related objectively to an event's occurring after the impairment was recognized.

t. Impairment of non-financial assets

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

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

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

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

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

u. Related parties

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

v. Share-based compensation

For share option awards granted as part of the stock option plan, a fair value is determined at the date of grant and that fair value is recognized in the financial statements over the vesting period. Proceeds arising from the exercise of share option awards are credited to share capital, as are the recognized grant-date fair values of the exercised share option awards. Share option awards which are determined to be settled on a net-equity basis are accounted for as equity instruments. Share option awards which are determined to be settled on a net-cash settlement basis are accounted as liability instruments. The stock option plan was introduced in May 2014 and is further discussed in note 26.

w. Reclassification

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

x. Changes in accounting policies

In accordance with the IFRS Interpretations Committee ("IFRIC") agenda decision addressing the expected manner of recovery of an intangible asset with an indefinite useful life for the purposes of measuring deferred tax in accordance with IAS 12, Income Taxes ("IAS 12"), the IFRIC noted that an intangible asset with an indefinite useful life does not mean infinite life, nor does it mean the expected manner of recovery of the carrying amount would result solely through sale. Previously, the Company measured deferred taxes on temporary differences arising from certain indefinite life intangible assets using capital gains rates on the basis that the assets will be recovered through its disposition. As a result of the IFRIC agenda decision, the Company has changed its accounting policy to measure deferred taxes at the income tax rate applicable to ordinary taxable income expected to apply in the years in which the temporary differences are expected to be recovered or settled. The Company adopted this change on a retrospective basis as an accounting policy change in accordance with IAS 8, "Accounting Policies, Changes to Accounting Estimates and Errors" and the impact on the financial statements was an increase to deferred tax liabilities at December 27, 2015 of $2,388 and a corresponding adjustment to retained earnings (deficit) of $2,388.

Recent accounting pronouncements not yet effective

In May 2014, the IASB issued IFRS 15, a new comprehensive model for entities to use accounting for revenue arising from contracts with customers. In September 2015, the IASB deferred adoption of the new standard by one year. Several updates have been issued since to clarify the implementation guidance. The new guidance supersedes the most current revenue recognition guidance, including industry-specific guidance, enhances revenue recognition disclosures, and is now effective commencing in 2018. The guidance allows for either a full retrospective or modified retrospective transition method. We currently expect to apply the modified retrospective transition method.

Under current accounting guidance, we recognize initial franchise fees when we have performed all material obligations and services, which generally occurs when the franchised café opens. As required under the new guidance, we anticipate deferring the initial franchise fees and recognizing revenue over the term of the related franchise agreement (generally ten years).

We anticipate an increase in deficit as at December 31, 2017, the date of initial adoption and a corresponding increase in deferred revenue reflecting initial franchise fees previously recognized that are now recorded over the term.

We anticipate that the new guidance will also change our reporting of the Co-op Fund contributions from franchisees and the related advertising and promotional expenditures, which are currently reported on a net basis in our Statements of Financial Position. Under the new guidance, Co-op Fund contributions from franchisees and advertising and promotional expenditures will be reported on a gross basis.

In addition, we anticipate that the estimated breakage income on gift cards will be recognized as gift cards are utilized instead of our current policy of recognizing on a pro rata basis based on historical gift card redemption patterns.

We do not believe this guidance will materially impact our recognition of revenue from Company-owned cafes and product sales or our recognition of franchise royalties revenue.

IFRS 9 replaces the incurred loss model under IAS 39 with a model on expected credit losses. Under the new standard, expected credit losses will need to be recorded. Under our current accounting, losses are recognized when probable. We are currently assessing the impact of the new standard and expect the new standard will likely increase our allowance for doubtful account provision.

IFRS 16, Leases, sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, the customer ('lessee') and the supplier ('lessor'). This will replace IAS 17, Leases, and related Interpretations. IFRS 16 provides revised guidance on identifying a lease and for separating lease and non-lease components of a contract. IFRS 16 introduces a single accounting model for all leases and requires a lessee to recognize 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 depreciation of lease assets separately from interest on lease liabilities on the Statements of Operations and Comprehensive Loss.

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

The Company has completed a preliminary assessment of the potential impact on its financial statements, but has not yet completed its detailed assessment. So far, the most significant impact identified is that the Company will recognize new assets and liabilities for its subleases, operating leases of its head office and corporate cafés.

3. SHARE CAPITAL

The Company is authorized to issue an unlimited number of common shares. Common shares are classified as equity and have no par value. Incremental costs directly attributable to the issue of new common shares are shown in equity as a deduction, net of tax, from the proceeds. On August 10, 2017, the Company issued 4,210,528 common shares and 300,000 warrants of Second Cup to the four shareholders of SPE Finance LLC (SPE), an affiliate of Serruya Private Equity. See note 4 Management of Capital for further details.

Shares outstanding at the fiscal year ended December 30, 2017 are 17,041,473 (2016 - 12,830,945).

4. MANAGEMENT OF CAPITAL

On August 10, 2017, the Company issued 4,210,528 common shares and 300,000 warrants of Second Cup to the four shareholders of SPE Finance LLC (SPE), an affiliate of Serruya Private Equity. The Company also extinguished its $8,000 debt to SPE and cancelled 600,000 of old warrants. These transactions resulted in one-time, non-cash financing charges of $3,290. These charges consist of the difference between the share price of $2.60 on the issuance date and the agreed-to share price of $1.90, and the write-off of the unamortized portion of deferred transaction costs related to the debt.

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

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

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

5. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Financial instruments

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

Financial instrument	Risks
Financial assets	
Cash and cash equivalents	Credit and interest rate
Restricted cash	Credit and interest rate
Trade and other receivables	Credit
Notes and leases receivable	Credit
Financial liabilities	
Interest rate swap	Credit, liquidity, and interest rate
Accounts payable and accrued liabilities	Liquidity, currency, and commodity
Gift card liability	Liquidity
Deposits from franchisees	Liquidity
Term credit facility	Liquidity and interest rate

Fair value of financial instruments

The fair values of cash and cash equivalents, restricted cash, trade and other receivables, accounts payable and accrued liabilities, provisions, other liabilities and gift card liability approximate their carrying values due to their short-term maturity. The fair value of notes and leases receivable approximates their carrying value as the implicit interest used to discount the base value is considered to be based on an appropriate credit and risk rate pertaining to the debtor. The following table summarizes the financial instruments measured at fair value:

	2017	2016
Interest rate swap		
Opening fair value	$–	($77)
Repaid during the year	–	–
Change in fair value	–	77
Closing fair value	$–	$–

The interest rate swap expired in the third quarter of 2016.

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

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

At December 30, 2017, there were no financial instruments classified as Level 2.

There were no changes between levels in the period ended December 30, 2017 versus the period ended December 31, 2016.

Credit risk

a. Cash and cash equivalents, restricted cash and interest rate swap

Credit risk associated with cash and cash equivalents, restricted cash and the interest rate swap is managed by ensuring these assets are placed with institutions of high creditworthiness.

b. Trade and other receivables, notes and leases receivable

Trade and other receivables and notes and lease receivable primarily comprise amounts due from franchisees. Credit risk associated with these receivables is mitigated as a result of the review and evaluation of franchisee account balances beyond a particular age. Prior to accepting a franchisee, the Company undertakes a detailed screening process which 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.

Specific bad debt provisions are accounted for when the expected recovery is less than the actual receivable.

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

	0-30 Days	31-60 Days	61-90 Days	> 90 Days	Total
Gross amount as at December 30, 2017	**$3,452**	**$158**	**$109**	**$2,322**	**$6,041**
Allowance for doubtful accounts	**(18)**	**(60)**	**(40)**	**(2,207)**	**(2,325)**
Net amount 2017	**$3,434**	**$98**	**$69**	**$115**	**$3,716**
Gross amount as at December 31, 2016	$2,630	$173	$247	$2,163	$5,213
Allowance for doubtful accounts	(38)	(67)	(112)	(1,973)	(2,190)
Net amount 2016	$2,592	$106	$135	$190	$3,023

Trade and other receivables include a combined allowance for doubtful accounts of $2,325 (December 31, 2016 - $2,190). Credit terms vary by customer in the range of 30 to 90 days. The net amount due of $115 aged over 90 days has no specific terms of repayment. Trade and other receivables are further discussed in note 6.

The payment maturity dates of the notes and leases receivable as at December 30, 2017, net of an allowance for doubtful accounts, are as follows:

	< 90 Days	90 Days to < 1 year	1 year to < 2 years	2 years and after	Total
2017	**$22**	**$42**	**$42**	**$32**	**$138**
2016	$32	$107	$105	$68	$312

Notes and leases receivable included a combined allowance for doubtful accounts of $55 (December 31, 2016 - $12). Notes and leases receivable are further discussed in note 7.

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 as outlined in note 14. The Company's main source of income is royalty receipts from its franchisees, corporate café sales, and sales from goods and services.

Commodity and currency risk

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

6. TRADE AND OTHER RECEIVABLES

	2017	2016
Trade and other receivables	$6,041	$5,213
Less: Allowance for doubtful accounts	(2,325)	(2,190)
Net trade and other receivables	$3,716	$3,023

During the period, $464 (2016 - $576 expense) was recorded as a charge pertaining to trade and other receivables.

7. NOTES AND LEASES RECEIVABLE

	2017	2016
Notes receivable – current	$26	$71
Lease receivable – current	75	70
Less: Allowance for doubtful accounts – current	(37)	(2)
Notes and leases receivable – current	64	139
Notes receivable – long-term	18	32
Lease receivable – long-term	74	151
Less: Allowance for doubtful accounts – long-term	(18)	(10)
Notes and leases receivable – long-term	74	173
Notes and leases receivable	$138	$312

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

8. INVENTORIES

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

	2017	2016
Merchandise held for resale	**$180**	$161
Supplies	**25**	39
	$205	$200

9. PROPERTY AND EQUIPMENT

	Leasehold improvements	Equipment, furniture, fixtures and construction in process	Computer hardware	Total
Net carrying value				
As at December 26, 2015				
Cost	$2,396	$5,826	$835	$9,057
Accumulated depreciation	(1,297)	(2,467)	(532)	(4,296)
As at December 26, 2015	1,099	3,359	303	4,761
Additions from operations	76	236	50	362
Additions from franchise stores reacquired	–	20	–	20
Reclass of transfers from construction in process	635	(635)	–	–
Disposals – original cost	(585)	(769)	(4)	(1,358)
Disposals – accumulated depreciation	469	344	3	816
Depreciation	(336)	(689)	(142)	(1,167)
As at December 31, 2016	$1,358	$1,866	$210	$3,434
Net carrying value				
As at December 31, 2016				
Cost	$2,522	$4,677	$881	$8,080
Accumulated depreciation	(1,164)	(2,811)	(671)	(4,646)
As at December 31, 2016	1,358	1,866	210	3,434
Additions from operations	43	324	2	369
Additions from franchise stores reacquired	–	14	–	14
Reclass of transfers from construction in process	2	(2)	–	–
Disposals – original cost	(403)	(389)	(1)	(793)
Disposals – accumulated depreciation	55	70	1	126
Depreciation	(296)	(608)	(114)	(1,018)
As at December 30, 2017	**759**	**1,275**	**98**	**2,132**
Cost	**2,462**	**4,613**	**881**	**7,956**
Accumulated depreciation	**(1,703)**	**(3,338)**	**(783)**	**(5,824)**
As at December 30, 2017	**$759**	**$1,275**	**$98**	**$2,132**

10. INTANGIBLE ASSETS

	Trademarks	Software	Total
Net carrying value			
As at December 26, 2015			
Cost	$31,144	$2,615	$33,759
Accumulated amortization	–	(1,120)	(1,120)
As at December 26, 2015	31,144	1,495	32,639
Additions	–	393	393
Disposals – original cost	–	(29)	(29)
Disposals – accumulated amortization	–	11	11
Amortization	–	(403)	(403)
As at December 31, 2016	$31,144	$1,467	$32,611
Cost	$31,144	$2,979	$34,123
Accumulated amortization	–	(1,512)	(1,512)
As at December 31, 2016	31,144	1,467	32,611
Additions	–	217	217
Amortization	–	(456)	(456)
As at December 30, 2017	**31,144**	**1,228**	**32,372**
Cost	**31,144**	**3,194**	**34,338**
Accumulated amortization	**–**	**(1,966)**	**(1,966)**
As at December 30, 2017	**$31,144**	**$1,228**	**$32,372**

11. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of:

	2017	2016
Accounts payable – trade	**$2,247**	$1,825
Accrued liabilities	**848**	1,492
Accrued salaries, wages, benefits, and incentives	**574**	127
Sales tax payable – government remittances payable	**305**	256
	$3,974	$3,700

12. PROVISIONS

	Head lease liabilities	Café leases (a)	Other (b)	Total
As at December 26, 2015	$26	$2,421	$190	$2,637
Provisions charged during the period	–	794	186	980
Provisions utilized during the period	(26)	(1,113)	(350)	(1,489)
As at December 31, 2016	$–	$2,102	$26	$2,128
Current portion	$–	$1,572	$26	$1,598
Long-term portion	–	530	–	530
As at December 31, 2016	$–	$2,102	$26	$2,128
Provisions charged during the period	–	239	480	719
Provisions utilized during the period	–	(1,274)	(409)	(1,683)
As at December 30, 2017	**$–**	**$1,067**	**$97**	**$1,164**
Current portion	**$–**	**$837**	**$97**	**$934**
Long-term portion	**–**	**230**	**–**	**230**
As at December 30, 2017	**$–**	**$1,067**	**$97**	**$1,164**

a. Café leases

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

Provisions for café closures of $239 (2016 - $794) were charged in the year and are reflected in the franchise line on the Statements of Operations and Comprehensive Loss.

b. Other

Provisions for other items of $480 (2016 - $186) were charged in the year. The remaining provision will be settled throughout the course of 2018.

13. OTHER LIABILITIES

	2017	2016
Deferred revenue – current	**$423**	$181
Leasehold inducements – current	**36**	36
Other liabilities – current	**459**	217
Deferred revenue – long-term	**–**	52
Leasehold inducements – long-term	**179**	215
Other liabilities – long-term	**$179**	$267
Deferred revenue	**$423**	$233
Leasehold inducements	**215**	251
Other liabilities	**$638**	$484

14. LONG-TERM DEBT

	2017	2016
Face value of long-term debt	$–	$8,000
Unamortized transaction costs	–	(819)
	$–	$7,181

On August 10, 2017, the Company issued 4,210,528 common shares and 300,000 warrants of Second Cup to the four shareholders of SPE Finance LLC (SPE), an affiliate of Serruya Private Equity. The Company also extinguished its $8,000 debt to SPE and cancelled 600,000 of old warrants. These transactions resulted in one-time, non-cash financing charges of $3,290. These charges consist of the difference between the share price of $2.60 on the issuance date and the agreed-to share price of $1.90, and the write-off of the unamortized portion of deferred transaction costs related to the debt.

15. REVENUE

	2017	2016
Franchise revenue		
Royalties	**$10,299**	$10,509
Services and other	**4,775**	5,179
	15,074	15,688
Company-owned cafés and product sales	**8,562**	14,663
	$23,636	$30,351

16. OPERATING COSTS AND EXPENSES

	2017	2016
Company-owned cafés and cost of product sales		
Cost of product sales	$3,270	$5,795
Labour and related expenses	2,966	4,873
Occupancy and other	3,067	5,013
Depreciation of property and equipment	308	394
Loss on disposal of assets	197	225
	9,808	16,300
Franchise		
Labour and related expenses	3,939	4,330
Travel and franchisee meetings	345	670
Professional fees and other	1,409	3,103
	5,693	8,103
General and administrative		
Labour and related expenses	2,045	2,003
Professional fees and other	3,503	3,322
Occupancy	461	454
	6,009	5,779
Other		
Depreciation and amortization	1,150	1,154
	$22,660	$31,336

17. IMPAIRMENT OF ASSETS

a. Impairment of trademarks

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

Key assumptions

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

Probability weighted cash flow projections are used based on financial forecasts covering a three-year period. These projections are approved by the Board of Directors based on management's expectations of potential outcomes. Cash flows beyond the three-year period are extrapolated using the estimated growth rates as stated in the table below. The valuation of the franchising, distribution, and wholesale business CGU is based on various probabilities assigned to each forecasted cash flows. The analysis performed as at December 30, 2017 does not indicate any impairment (2016 - $nil). The following are key assumptions used in the fair value less costs of disposal calculation as well as a sensitivity analysis for the various range of assumptions used and the related impact.

	2017		2016	
	Low growth	High growth	Low growth	High growth
Discount rate	**12.0%**	**16.0%**	12.0%	16.0%
Forecast same café sales avg. growth rate	**0.0%**	**4.5% – 5.5%**	(1.0%)	2.5% – 4.0%
Avg. growth rate used to extrapolate cash flows beyond the forecast period	**0.0%**	**0.0%**	0.0%	0.0%
Amount by which recoverable amount exceeds carrying amount	**$6,500**	**$5,300**	$4,500	$28,400

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

Impairment indicators include when an individual Company-operated café experiences poor performance directly impacting cash flows. The impairment analysis is based on historical and forecasted performance measures for each café with impairment indicators. The asset's recoverable amount has been determined using value in use. The recoverable amount was compared to the net book value of the assets. This methodology used to test impairment is classified as Level 3 per the hierarchy described in note 5. As a result of the impairment test, impairment charges of $nil for the year ended December 30, 2017 (2016 - $nil) were recorded to assets that were not able to be redeployed to a different CGU as the carrying amount exceeded the recoverable amount. A sensitivity of 2% increase or decrease in sales for each CGU pertaining to the impacted assets would not have had an impact on the impairment recorded.

18. INTEREST AND FINANCING COSTS

	2017	2016
Fair value difference on shares issued and other costs	**$3,290**	$–
Interest expense	**505**	259
Amortization of deferred financing costs	**139**	31
Interest income	**(37)**	(35)
	$3,897	$255

19. INCOME TAXES

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

	2017	2016
Loss before income taxes	**($2,922)**	($1,240)
Combined Canadian federal and provincial tax rate	**26.70%**	26.68%
Tax recovery at statutory rate	**(780)**	(331)
Increased (reduced) by following differences		
Change in tax rates	**19**	22
Non-deductible permanent differences	**786**	19
Other	**151**	25
Income tax expense (recovery)	**$176**	($265)
Current income tax expense (recovery)	**$146**	($503)
Deferred income tax expense (recovery)	**30**	238
Income tax expense (recovery)	**$176**	($265)

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

	2017	2016
Basic federal rate	**15.00%**	15.00%
Weighted average provincial rate	**11.70%**	11.68%
Combined Canadian federal and provincial tax rates	**26.70%**	26.68%

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

	Property and equipment	Trademarks	Warrants	Other	Total
As at December 26, 2015 (Note 2.x)	$1,944	$4,752	$–	($827)	$5,869
Charged (credited) to the income statement	67	21	–	150	238
Charged to equity	–	–	99	–	99
As at December 31, 2016	2,011	4,773	99	(677)	6,206
Charged (credited) to the income statement	(21)	–	–	51	30
Charged to equity	–	–	(39)	(37)	(76)
As at December 30, 2017	**$1,990**	**$4,773**	**$60**	**($663)**	**$6,160**

20. BASIC AND DILUTED LOSS PER SHARE

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

	2017	2016
Net loss	($3,097)	($975)
Weighted average number of shares issued and outstanding	14,485,081	12,830,945
Basic and diluted loss per share	($0.21)	($0.08)

21. SUPPLEMENTAL CASH FLOW INFORMATION

	2017	2016
Changes in non-cash working capital & other (inflow (outflow)):		
Trade and other receivables	($693)	$411
Inventories	(5)	29
Prepaid expenses and other assets	46	176
Accounts payable and accrued liabilities	293	(1,658)
Provisions	(964)	(483)
Other liabilities	154	(282)
Gift card liability	(52)	(70)
Deposits from franchisees & change in restricted cash	324	(566)
Income taxes	623	155
	($274)	($2,288)
Cash payments for capital expenditures		
Cash payments for capital expenditures	($383)	($382)
Cash payments for intangible assets	(217)	(393)
	($600)	($775)
Supplementary information		
Interest paid	$505	$318
Income taxes paid	$–	$–

22. MOVEMENT OF NON-CASH FINANCING ACTIVITIES

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

23. RESTRICTED CASH

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

	2017	2016
Development Fund	**$408**	$1,220
Co-op Fund	**711**	487
Security Deposit held by bank	**240**	240
Total Restricted Cash	**$1,359**	$1,947

A summary of activities in 2017 and 2016 in the Co-op Fund is provided as follows:

	2017	2016
Co-op Fund – opening balance	**$487**	$319
Contributions by franchisees	**2,586**	2,728
Contributions by Company for Company-owned cafés	**290**	238
Other contributions by Company	**–**	150
Payments to third party suppliers for goods and services	**(2,652)**	(2,594)
Repayments to Company in respect of promissory notes	**–**	(354)
Co-op Fund – closing balance	**$711**	$487

24. CONTINGENCIES, COMMITMENTS AND GUARANTEES

The Company has lease commitments for Company-operated cafés and acts as the head tenant on most leases, which it in turn subleases to franchisees. To the extent the Company may be required to make rent payments due to head lease commitments, a provision has been recognized (note 12). The Company's lease commitments as at December 30, 2017 are as follows:

	Head lease commitments	Sublease to franchisees	Net
December 29, 2018	$17,954	$16,466	$1,488
December 28, 2019	16,158	14,736	1,422
December 26, 2020	13,907	12,692	1,215
December 25, 2021	12,034	10,938	1,096
December 31, 2022	10,835	9,803	1,032
Thereafter	27,637	25,012	2,625
	$98,525	$89,647	$8,878

The Company believes it has sufficient resources to meet the net commitment of $8,878 over the term of the leases.

The Company is involved in litigation and other claims arising in the normal course of business. Judgement must be used to determine whether or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent on the potential success of the claim. It is believed that no significant losses or expenses will be incurred with such claims. However, there can be no assurance that unforeseen circumstances will not result in significant costs. The outcome of these actions is not determinable at this time, and adjustments, if any, will be recorded in the period of settlement.

Contracts are in place with third party companies to purchase the coffee that is sold in all cafés. In terms of these supply agreements, there is a guaranteed minimum value of coffee purchases of $1,392 (2016 - $1,140) for the subsequent 12 months. The coffee purchase commitment is comprised of two components: unapplied futures commitment contracts and fixed price physical contracts.

Due to the Company acting as the primary coordinator of café construction costs on behalf of its franchisees and for Company-operated cafés, there is $894 (2016 - $241) of contractual commitments pertaining to construction costs for new locations and renovations as at the end of the fiscal year. Construction costs are financed for franchise projects from deposits received from franchisees and for corporate projects from the Company's cash flows.

25. RELATED PARTIES

Related parties are identified as key management, members of the Board of Directors and shareholders that effectively exercise significant influence on the Company. Such related parties include any entities acting with or on behalf of the aforementioned parties.

Compensation of key management

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

	2017	2016
Salaries and short-term employee benefits	$2,236	$2,455
Termination costs	247	–
Share-based compensation	60	73
Total compensation	$2,543	$2,528

26. SHARE-BASED COMPENSATION

Stock option plan

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

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

Stock options are to be settled on a net-equity basis. Compensation expense/gain for stock awards is recognized using the fair value when the stock awards are granted using the Black-Scholes option pricing model. All options vest in tranches and are amortized over the awards' vesting period using the accelerated expense attribution method.

Recognition of the expense/gain is recorded as a charge to operating expenses with a corresponding increase/ decrease to contributed surplus.

The following weighted average assumptions have been used to estimate the weighted average fair value per award of $0.39 granted as of December 30, 2017:

	Assumption
Risk-free interest rate (%)	1.63
Volatility (%)	32.63
Expected term (years)	7.8

The table below summarizes all activity for the year ended December 30, 2017:

	Number of share options outstanding	Weighted average share option price
As at December 31, 2016	670,000	$4.08
Granted	50,000	1.60
Forfeited	(460,000)	4.25
As at December 30, 2017	**260,000**	**$3.30**
Stock option plan recovery during the period		**$42**

The range of exercise prices for share options outstanding at December 30, 2017 is $1.60 to $4.54. Of the share options outstanding, 76,000 share options are exercisable. The weighted average years to expiration are approximately eight years. Share award options are able to be exercised upon vesting.

27. DIRECTORS' DEFERRED SHARE UNIT PLAN

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

	Notional units	Recorded value
Notional units outstanding as at December 26, 2015	75,403	$219
Deferred units granted	36,878	110
Change in fair value	–	(90)
Notional units outstanding as at December 31, 2016	112,281	$239
Expensed in the period		$20
	Notional units	**Recorded value**
Notional units outstanding as at December 31, 2016	112,281	$239
Deferred units granted	45,047	98
Change in fair value	–	4
Notional units outstanding as at December 30, 2017	**157,328**	**$341**
Expensed in the period		**$102**

The average fair value price of deferred units granted was $2.18 (2016 - $2.98).

Shareholder Information

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Computershare Trust
Company of Canada

Auditors
PricewaterhouseCoopers LLP

Market Information
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Symbol: SCU

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THE SECOND CUP LTD.
Board of Directors

Michael Bregman [(1),(2)]
Chairman

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

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

THE SECOND CUP LTD.
Senior Management Team

Garry Macdonald
President and
Chief Executive Officer

Ba Linh Le
Vice President, Finance
and Chief Financial Officer

Vanda Provato
Vice President,
Marketing and Category

Chris Sonnen
Vice President,
Coffee Experience

Audra Wosik
Vice President, Franchising

Ted Tai
Vice President, Operations

John Kazmierowski
Vice President,
Development-Leasing
& Construction

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