SECOND CUP ROYALTY INCOME FUND

TSX: SCU.UN

2008 ANNUAL REPORT

FOR THE YEAR ENDED DECEMBER 31, 2008

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Second Cup Royalty Income Fund
LETTER FROM THE CHAIRMAN

On behalf of the Board of Trustees of the Second Cup Royalty Income Fund (the "Fund"), I am pleased to present our Annual Report for the fiscal year ended December 31, 2008. All amounts are expressed in thousands of dollars, except units, unless otherwise indicated.

The Fund indirectly owns the Second Cup trade-marks which it licenses to The Second Cup Ltd. ("Second Cup") in accordance with the terms of a licence and royalty agreement. Second Cup, in turn, franchises and operates cafés across Canada using these trade-marks and pays the Fund a royalty of 6.5% of the total sales of cafés included in the Royalty Pool. As at January 1, 2009, there were 359 cafés in the Royalty Pool.

Highlights

The Fund's "top line" structure means that its success and growth depends primarily on Second Cup's ability to maintain and increase the overall system sales of Royalty Pool cafés. Growth in overall system sales is dependent on same café sales growth and adding net new cafés to the café network. Same café sales growth is of particular importance as it directly correlates to increased cash available for distribution, and is a key indicator of brand health and franchise profitability.

Same Café Sales Growth

For 2008, the cafés in the Royalty Pool achieved same café sales growth of 0.2% following same café sales growth of 3.0% in 2007. Same café sales reflected a decline of 1.4% in the fourth quarter of 2008. As reflected in the same café sales decline for the fourth quarter, a softening of café sales continued across Second Cup's major markets in 2008 resulting from lower customer traffic, which management of Second Cup believes is similar to the trend experienced in retail in general and reflective of the current sharp downturn in the Canadian economy. Offsetting this trend, system sales for the fourth quarter and for the year were positively impacted by (1) a continuing shift in the sales mix towards newly introduced food offerings, such as grilled sandwiches and a premium hot breakfast sandwich in key markets, resulting in a higher average cheque versus 2007; (2) the implementation of some minor price increases on whole beans, ready to drink beverages and some espresso-based beverages; and (3) the introduction of pre-packaged whole coffee beans supported with an in-store merchandise unit.

Overall royalties earned by the Fund increased by 1.3% in 2008 as a result of the same café sales growth during the year and the increase in net system sales resulting from the January 1, 2008 adjustment to the Royalty Pool.

Distributable Cash

Excluding the impact of changes in non-cash working capital of the Fund and its wholly-owned subsidiaries, costs relating to the reorganization and a one-time recovery of income taxes relating to prior years, distributable cash increased 0.3% to $1.1607 per unit, compared to $1.1576 per unit in 2007.

Distributions

In March 2008, monthly distributions were increased from $0.091 to $0.094 per unit, an increase of 3.3% to $1.1280 per unit on an annualized basis. In April 2009 we announced a reduction in the monthly distribution from $0.094 per unit to $0.07667 per unit, a reduction of 18.4% to $0.92 per unit on an annualized basis.

Outlook

Management of Second Cup have informed us that given the uncertainty in the retail and economic environment across Canada and Second Cup's dependence upon consumer discretionary spending, management is not providing specific guidance on same café sales for 2009.

Management of Second Cup have informed us that they have experienced a challenging start to 2009 in terms of same café sales growth as evidenced by the Q1 same stores sales decline of 3%. Management believes that the balance of fiscal 2009 will continue to be challenging and as a result the primary goal is to launch a number of initiatives to strengthen both the short and long term success of the Second Cup brand and its franchisees.

Acquisition of The Second Cup Ltd.

The Fund announced on May 1, 2009 that its wholly-owned subsidiary had entered into an agreement to acquire all of the outstanding shares of Second Cup for nominal consideration effective June 27, 2009. Following closing of the acquisition, Second Cup and its management team will continue to operate the Second Cup business as a wholly-owned subsidiary of the Fund, recombining the business of the Fund with the business of Second Cup. As a result of the recombination, Unitholders will own both the royalty and operating branches of the business.

The acquisition is the result of a review of the structure of the Fund and the Second Cup business, undertaken by the Fund and The Second Cup Coffee Company Inc., the current owner of Second Cup. In connection with its review, the Fund received financial advice from TD Securities Inc., the Fund's exclusive financial advisor. Based on its review and such financial advice, the Board of Trustees of the Fund determined that it was in the best interests of Unitholders to recombine the business of Second Cup with the Fund for a number of reasons, including:

- the recombination simplifies the relationship between the Fund and Second Cup and provides Unitholders with direct oversight over the operation of the Second Cup business through the Fund's Board of Trustees;
- the recombination will enable Unitholders to enjoy the full upside in the business attributable to operational improvements, new café openings, exciting new business opportunities and the eventual strengthening of the Canadian economy;
- the recombination will not impact the Fund's intention to pay distributions at an annual rate of $0.92 as announced on April 20, 2009;
- the recombination will mean that Unitholders will in the future receive the full benefit of net new café openings as there will no longer be a "vend-in" mechanism; and
- the Fund will take on no additional bank debt as a result of the recombination and will have a strong pro forma consolidated balance sheet to support the future growth of the business.

The recombination allows Unitholders to capture the benefit of the long term prospects of Second Cup. Notwithstanding the Fund's current top line royalty structure, Unitholders are exposed to the risk of operating shortfalls at Second Cup in difficult business environments, as experienced in 2008 and as expected for 2009. On a going forward basis, distributions to Unitholders and the value of the Fund's units will be based upon the performance of the Second Cup business as a whole. We are confident in the experienced management team under the leadership of Stacey Mowbray, President, and its focus on strengthening the Second Cup trademark, by delivering superior customer satisfaction, by launching exciting new initiatives and programs to enhance customer loyalty and by profitably growing the café network.

In closing, we would like to take this opportunity to thank our Unitholders for their continued support, the talented Second Cup management team and most importantly our network of very capable franchise partners and their associates who by delivering superior customer satisfaction will ensure that Second Cup maximizes every opportunity to achieve stronger sales results for 2009 and beyond.

David Bloom
Chairman, Second Cup Royalty Income Fund
on behalf of the Board of Trustees
May 6, 2009

The Second Cup Ltd.
LETTER FROM THE CHAIRMAN

It was only a few weeks ago that it was my sad responsibility to announce the death of Gabriel T. Tsampalieros at the age of 61. Gabe was Chairman, CEO and owner of The Second Cup Ltd. ("Second Cup"). For over 12 years, Gabe had been involved with Second Cup, firstly as President and CEO of Cara Operations Limited and then from 2006 as owner. On behalf of management and colleagues of Second Cup, I want to express our thanks to Gabe for his leadership, passion and commitment to our vision, mission and values. Having been a franchisee, he was passionate about the success of franchise partners and cared deeply about all the people with whom he worked. Gabe will be dearly missed but his leadership, influence and spirit will live on for years to come.

Set out below is a summary overview of the financial results for Second Cup for our 52 week fiscal year ended December 27, 2008 and an outline of our top priorities, key initiatives and outlook for fiscal 2009. Please note that our consolidated financial statements are included in the 2008 Annual Report of the Second Cup Royalty Income Fund (the "Fund").

2008 Highlights

Highlights from the 52 week fiscal year ended December 27, 2008 include:

- System Sales of $201 million, up 0.4% from 2007;
- Same café sales were up by 0.2% from the prior year;
- We ended the year with 361 cafés compared to 366 at the start of the year;
- Achieved a consolidated break-even EBITDA after minority interests (excluding non-recurring restructuring costs of $1.26 million); and
- Net sales of six net new cafés of $3.2 million were vended in to the Second Cup Royalty Income Fund on January 1, 2008 for a receipt of its units valued at $1.3 million.

Most notably, a highlight of 2008 was Stacey Mowbray joining us as our new President early in the year. Stacey has built a seasoned and dynamic management team that has set a new vision and mission for Second Cup, including the development of a comprehensive and strategic plan for our future growth and development. I am confident that Stacey and her team, along with our associates and franchise partners, will continue to build on our strong foundation as we move forward to secure our new vision.

Capital expenditures, made primarily for new corporate owned and operated cafés, amounted to $2.1 million and corporate cafés sold generated proceeds of $0.9 million for a net capital outlay of $1.2 million, $0.9 million higher than in 2007. Our new management team instituted a new disciplined capital expenditure policy that now forestalls such expenditures, especially as they relate to new corporate cafés.

Same café system growth ("SCSG") for the first half of 2008 was 0.7%. As the economic decline started to accelerate, our SCSG slowed considerably in the second half as lower consumer confidence and increasing concerns over the economy, particularly during our peak selling season, adversely affected traffic counts. As a result, SCSG slowed in the third and fourth quarters to minus 0.2% and 0.3% respectively. SCSG for 2008 in its entirety was 0.2% compared to 3.1% in 2007.

Other important activities and achievements in 2008 included: the renovation of 27 existing cafés, the opening of 13 new cafés, which was offset by the closure of 16 underperforming cafés; the continued expansion of the grilled sandwich program; the introduction of the new breakfast sandwich program in selective markets and cafés; the launch of the retail bean program; introduction of a new organic, fair trade coffee; and the revamp of our training program for new franchisees.

Priorities and Key Initiatives for 2009

Our mission and top priority for 2009 and beyond continues to focus on a café unit economic model that consistently delivers sustainable, profitable growth and greater economic returns. Accordingly, all our efforts and initiatives are simultaneously aimed at increasing SCSG and traffic counts in a meaningful way, and in reducing both input costs and the costs of building new cafés and renovating existing ones.

We see continuing challenges for 2009, given the uncertainty in the retail and economic environment across Canada. Our management team's strategy therefore includes a number of initiatives to strengthen our long term success. These include continuing commitment to operational excellence in all of our cafés; promotional strategies focused on targeted branding initiatives for our core offerings; and sustained café expansion in our key urban markets.

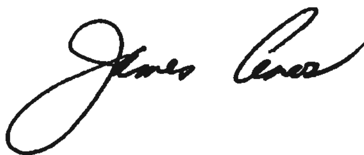
Our key initiatives in 2009 designed to build sales and increase traffic include:

- Complete relaunch of the brewed tea, tea latte and retail tea portfolio;
- Launch of Mellow Blend coffee in January;
- Continued expansion of the food program including bagels and grilled breakfast sandwiches;
- Innovation around cold drink portfolio; and
- National print and direct mail media to support these exciting initiatives.

On the development front, we remain confident of our ability to deliver on our target of renovating upwards of 24 existing cafés and opening 10 to 15 new cafés. The challenge, as it relates to our café network in 2009, will be the number of closures. We anticipate closures to range from 15 to 20 due to a high number of cafés being at the end of their lease term.

I wish to extend my sincere thanks and gratitude to our franchise partners and colleagues for their tireless efforts and commitment to Second Cup, and for making their cafés and Second Cup a "Second Home" for our guests. We also wish to thank the Trustees of the Fund for their loyalty, guidance and assistance during this past year.

I look forward to seeing you at the Fund's upcoming Annual Meeting.



James Anas
Chairman
The Second Cup Ltd.
May 6, 2009

SECOND CUP ROYALTY INCOME FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is a discussion of the results of operations and financial condition of Second Cup Royalty Income Fund (the "Fund") for the year ended December 31, 2008 and should be read in conjunction with the audited consolidated financial statements of the Fund and accompanying notes, which are available at www.sedar.com. The consolidated financial statements of the Fund are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are presented in thousands of Canadian dollars, unless otherwise indicated. This Management's Discussion and Analysis ("MD&A") has been prepared as of March 7, 2009.

BASIS OF PRESENTATION

Effective January 1, 2005, the Fund adopted Accounting Guideline 15 ("AcG-15"), a pronouncement of The Canadian Institute of Chartered Accountants ("CICA") related to variable interest entities ("VIEs"). A VIE is an entity where its equity investment at risk is insufficient to permit the entity to finance its activities without additional subordinated support from others and/or where certain essential characteristics of a controlling financial interest are not met. AcG-15 outlines who should consolidate such entities.

As a result of adopting this standard, the Fund reflects its investment in Second Cup Trade-Marks Limited Partnership ("MarksLP"), in which it holds a 99.99% partnership interest, as an equity-accounted investment. MarksLP is consolidated in the financial statements of The Second Cup Ltd. ("Second Cup"). Prior to the reorganization described below, the Fund had accounted for its wholly owned subsidiary, Second Cup Trade-Marks Inc. ("MarksCo"), as an equity-accounted investment. The consolidated financial statements of the Fund include the accounts of the Fund and its wholly owned subsidiaries Second Cup GP Trust ("GP Trust"), which holds the remaining 0.01% partnership interest in MarksLP and Second Cup GP Inc. ("GP Inc.").

OVERVIEW AND BUSINESS OF THE FUND

The Fund was created as a limited purpose trust to use the proceeds of an initial public offering to indirectly acquire the trademarks and other intellectual property and associated rights used by Second Cup cafés in Canada (the "Second Cup Marks"). The Second Cup Marks were then licensed to Second Cup in return for a royalty of 6.5% of system sales of certain Second Cup cafés in Canada (the "Royalty Pool"). Units of the Fund are traded on the Toronto Stock Exchange under the symbol "SCU.UN". The Fund's fiscal year ends December 31.

As at December 31, 2008, the Fund has 9,884,733 units outstanding, 57,507 of which are owned directly by Second Cup. Subsequently, in January 2009, as a result of the annual adjustment to the Royalty Pool (see "Adjustments to Royalty Pool" below), an additional 18,312 units were issued to Second Cup, bringing the total number of units outstanding to 9,903,045 and Second Cup's holdings to 75,819 units.

REORGANIZATION OF THE FUND IN 2007

As announced on April 3, 2007, the reorganization of the Fund's structure permits the Fund to maximize the cash available for distribution to unitholders of the Fund ("Unitholders").

Since the establishment of the Fund in December 2004 until March 2007 the Fund owned the Second Cup Marks through intermediary corporate subsidiaries. This structure subjected these subsidiaries to income tax which, in turn, reduced the cash available for distribution to the Fund's Unitholders. On April 2, 2007, as a result of the Unitholder approved reorganization of the structure of the Fund (the "Reorganization"), the Fund replaced its subsidiary corporations, including MarksCo, with a newly formed trust and limited partnership. This latter entity, MarksLP, is consolidated for reporting purposes with Second Cup as a VIE for the same reasons that MarksCo had previously been consolidated by Second Cup. MarksLP is accounted for in the consolidated financial statements of the Fund as an equity-accounted investment.

In connection with the Reorganization, the Fund negotiated a new term loan of $11,000 (the "Term Loan") with its bankers on similar terms and conditions of MarksCo's term loan. The proceeds of the Term Loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan. Further, the notes receivable amounting to $79,343 as at April 1, 2007 from MarksCo were repaid through an increase in the equity ownership of MarksLP by the Fund and a new note receivable from MarksLP of $9,171 (December 31, 2008 - $Nil).

Under the new structure, income generated by the new wholly owned subsidiaries of the Fund is not subject to income tax until the new rules regarding the taxation of income trusts come into effect in 2011. As a result, in the second quarter of 2007, a net future income tax liability of $10,668 was reversed and resulted in an increase to the income of the equity-accounted investment in MarksCo on April 2, 2007. The Fund reflected the elimination of this net future income tax liability in these consolidated financial statements as an increase in the equity accounted earnings of MarksCo.

The Licence and Royalty Agreement (the "Agreement") entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to license the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of system sales of cafés in the Royalty Pool are paid to MarksLP. Following the Reorganization, the Fund's earnings are predominantly comprised of income earned by MarksLP instead of interest and dividend income from MarksCo.

It is important to note that, while the Fund's underlying structure was changed, essentially the underlying assets and operations of the Fund and its subsidiaries did not change as a result of the Reorganization.

FINANCIAL HIGHLIGHTS

The following table sets out selected proforma and non-GAAP financial information and other data of the Fund and its wholly owned subsidiaries, and should be read in conjunction with the audited consolidated financial statements of the Fund.

(in thousands of dollars, except number of cafés and per unit amounts)	Three months ended Dec. 31, 2008	Three months ended Dec. 31, 2007	Year ended Dec. 31, 2008	Year ended Dec. 31, 2007
System sales of cafés in the Royalty Pool [3]	$53,562	$54,402	$197,340	$195,750
Number of cafés in Royalty Pool (359 cafés post January, 2009 adjustment)	357	351	357	351
Number of active cafés - end of period	341	342	341	342
Same café sales growth[3]	-1.4%	0.7%	0.2%	3.0%
Royalty revenues earned by MarksLP and MarksCo[1]	$3,574	$3,593	$12,991	$12,829
Earnings before items noted below [2]	$3,127	$3,225	$11,473	$11,239
Reorganization expense	-	-	-	$312
Non-cash impairment charge[1]	$24,349	-	$24,349	-
Non-cash movement in fair value of the derivative interest rate swap and non-cash amortization of deferred financing fees[1]	$188	$191	$319	$316
Recovery of income taxes relating to prior years[1]	-	($450)	-	($450)
Non-cash future income tax expense (recovery) [1]	($3,735)	($2,041)	($3,664)	$2,865
Net earnings (loss) for the period	($17,675)	$5,525	($9,531)	$8,196
Earnings per unit before Reorganization expense, non-cash impairment charge, non-cash movement in fair value of the derivative interest rate swap, non-cash amortization, recovery of income taxes relating to prior years, and non-cash future income taxes[3]	$0.3163	$0.3322	$1.1608	$1.1576
Basic earnings (loss) per unit	($1.7881)	$0.5691	($0.9642)	$0.8442
Diluted earnings (loss) per unit	($1.7881)	$0.5672	($0.9642)	$0.8414
Distributable cash per unit excluding Reorganization costs, changes in non-cash working capital, and recovery of income taxes relating to prior years[3]	$0.3163	$0.3322	$1.1607	$1.1576
Distributable cash per unit[3]	$0.2581	$0.3131	$1.1510	$1.1356
Distributions declared per unit	$0.2820	$0.2730	$1.1250	$1.0877

[1] "Royalty revenues earned by MarksLP and MarksCo", "Non-cash impairment charge", "Non-cash movement in fair value of the derivative interest rate swap and amortization of deferred financing fees", "Recovery of income taxes relating to prior years" and "Non-cash future income tax expense (recovery)" represent the combined amounts of the consolidated Fund and its wholly owned subsidiaries, MarksLP and MarksCo, which are consolidated with the statements of Second Cup for reporting purposes in accordance with GAAP. The Fund accounts for the earnings of MarksLP and MarksCo on an equity-accounted basis in its consolidated financial statements, in accordance with GAAP.

[2] "Earnings before items noted below" is a non-GAAP measure and represents the earnings, before Reorganization expense, non-cash impairment charge, non-cash movements in fair value of the derivative interest rate swap, non-cash amortization of deferred financing fees and non-cash future income taxes and recovery of income taxes relating to prior years, of the consolidated Fund and its wholly owned subsidiaries, MarksLP and MarksCo, which are consolidated with the statements of Second Cup for reporting purposes in accordance with GAAP

[3] "System sales of cafés in the Royalty Pool", "Same café sales growth", "Earnings per unit before Reorganization expense, non-cash impairment charge, non-cash movement in fair value of the derivative interest rate swap, non-cash amortization, recovery of income taxes relating to prior years, and non-cash future income taxes", "Distributable cash per unit excluding Reorganization costs, changes in non-cash working capital, and recovery of income taxes relating to prior years" and "Distributable cash" are non-GAAP measures.

SYSTEM SALES

Overview of System Sales

The indirect source of revenue for the Fund is royalty income collected by MarksLP from Second Cup. Royalty income is equal to 6.5% of system sales of Second Cup cafés in the Royalty Pool. MarksLP uses the royalty revenue to make distributions to the Fund. As a result, same café sales growth is a key performance indicator for the Fund.

System sales comprise the gross revenue reported to Second Cup by franchisees of Second Cup cafés and by cafés owned by Second Cup that are included in the Royalty Pool. Sales are reported by franchisees to Second Cup on a weekly basis without audit or other form of independent assurance. Second Cup's substantiation of sales reported by its franchisees is through analytical and financial reviews performed by management, on-site visits and analyses of raw materials purchased by the cafés from vendors.

Increases in system sales result from the addition of new cafés to the Royalty Pool and same café sales growth. System sales from existing cafés are primarily dependent on pricing, product and marketing initiatives undertaken by Second Cup, maintaining operational excellence within the café network and general market conditions, including weather, disposable consumer income, consumer confidence, recessionary and inflationary trends, job security and unemployment, equity market levels, consumer credit availability and competitive activities. The primary factors that influence the number of cafés added to the Second Cup café network and subsequently vended into the Royalty Pool, include the availability and cost of high quality locations, competition from other specialty coffee retailers and other businesses for prime locations and the availability of qualified franchisees.

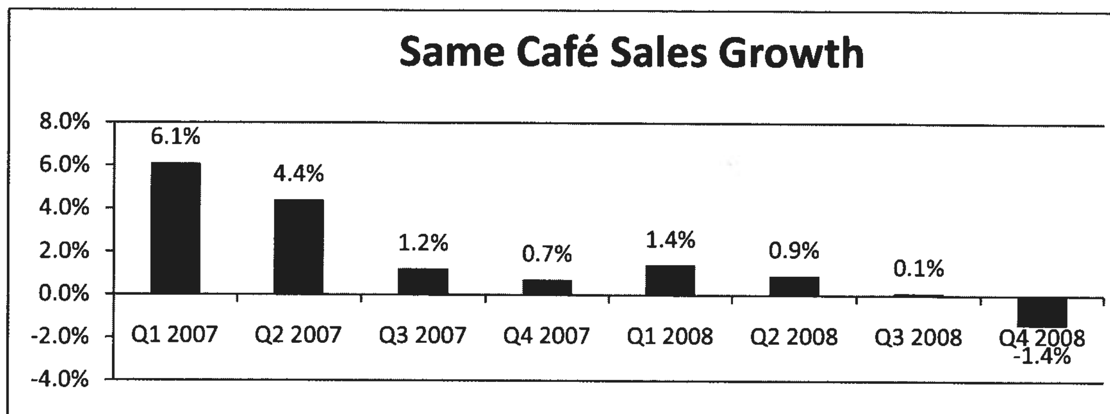
System sales are also affected by the permanent closure of Second Cup cafés already included in the Royalty Pool. Cafés are closed when they cease to be viable or, occasionally, when a renewal of a lease for a particular location is not available or when an alternative suitable location for the franchisee is required. Under the Agreement, Second Cup is required to make a monthly make-whole payment to MarksLP to compensate the Fund for the loss of monthly royalty revenue on closed cafés until future Royalty Pool adjustment dates.

Analysis of System Sales and Same Café Sales Growth

System sales for the fourth quarter were $53,562, compared to $54,402 for the fourth quarter for 2007, representing a decrease of $840 or 1.5%. This was mainly the result of lower same café sales in the quarter of 1.4% and the additional sales from the cafés added on the January 1, 2008 adjustment date, net of the sales lost due to café closures in the year (see "Royalty Pool and Café Network" below).

System sales for the year were $197,340, compared to $195,750 for 2007, representing an increase of $1,590 or 0.8%. This increase was mainly the result of same café sales growth of 0.2% in 2008 related to the additional day due to leap year, and the additional sales from the cafés added on the January 1, 2008 adjustment date, net of the sales lost due to café closures in the year (see "Royalty Pool and Café Network" below).

The following chart depicts the same café sales growth by Second Cup cafés in the Royalty Pool for the eight most recently completed fiscal quarters.



A softening of café sales continued across Second Cup's major markets in 2008 resulting from lower customer traffic, which management of Second Cup believes is similar to the trend experienced in retail in general and reflective of the current sharp downturn in the Canadian economy. Offsetting this trend, system sales for the Fourth Quarter and for the year were positively impacted by (1) a continuing shift in the sales mix towards newly introduced food offerings, like grilled sandwiches and a premium hot breakfast sandwich in key markets, resulting in a higher average cheque versus 2007; (2) the implementation of some minor price increases on whole beans, ready to drink beverages and some espresso-based beverages; and (3) the introduction of a new valve bag, pre-packaged whole coffee beans supported with an in-store merchandise unit.

Management is not aware of any reliable third party comparable data on the trends affecting the Canadian specialty coffee market or the performance of Second Cup's competitors in the Canadian specialty coffee market during the year.

Seasonality of System Sales

The first quarter represents the lowest average sales quarter for the year due to the seasonality of the business. The final quarter, which includes the holiday sales periods of November and December in the retail industry, generally constitutes the highest average sales quarter of the fiscal year.

ROYALTY POOL AND CAFÉ NETWORK

During the year, 16 cafés in the Royalty Pool were permanently closed, bringing the number of active cafés in the Royalty Pool to 341 as at December 31, 2008. Average annualized system sales of the 16 closed cafés were considerably below the average of all Royalty Pool cafés. In accordance with the Agreement, Second Cup made monthly "make-whole" payments to the Fund related to sales of the cafés permanently closed. The loss of the royalty revenues from these cafés was more than offset by future royalty income from 18 cafés added to the Royalty Pool on January 1, 2009 (see "Adjustment to the Royalty Pool" below).

INCOME, OPERATING EXPENSES, INCOME TAXES AND NET EARNINGS

FOURTH QUARTER

Income from Equity Accounted Investment in MarkLP and MarksCo

The Fund recorded income from its equity accounted investment in MarksLP of $3,448 (2007 - $3,806) during the quarter, excluding the impact of the impairment change described below. Royalty income earned by MarksLP from Second Cup in the quarter was $3,574 (2007 - $3,593) on sales of $53,562 (2007 - $54,402) reported by the Second Cup cafés in the Royalty Pool, a decrease of 0.5% compared to the fourth quarter in 2007. During the quarter, MarksLP earned bank interest income of $1 (2007 - $10). General and administrative expenses of MarksLP included in the calculation of income from equity accounted investments in the quarter were $127 ($150 in 2007). As a result of the repayment of the notes payable to

the Fund by MarksLP early in 2008, there was no interest expense related thereto in the fourth quarter of 2008 ($97 in 2007). In the fourth quarter of 2007, as a result of reassessments obtained subsequent to a federal income tax audit, MarksLP recorded a recovery of $450 in current income tax of MarksCo.

Impairment of Investment in Second Cup Trade-Marks Limited Partnership

The Fund equity accounts for MarksLP. Inherent in this equity accounted for investment is a trademark used in connection with the operation of Second Cup cafés in Canada. The trademark is an indefinite life intangible asset that is tested for impairment annually in accordance with Canadian generally accepted accounting principles.

The impairment test performed by management involved comparing the estimated fair value of the trademark with its carrying value. Management considered a number of factors in estimating fair value of the trademark. These included discounted cash flow estimates, comparisons to the Fund's market capitalization, capitalized cash flows methods and earnings multiples. Each of these valuation approaches use estimates and assumptions that are sensitive to change and require management judgement. These key judgments include estimates of discount rates, forecast growth in system sales, market multiples, other estimates impacting future cash flows and control premiums. Changes in these estimates and assumptions may have a significant impact on fair value. General market uncertainty and the recessionary operating environment for the Fund and other similar retail entities were also factors taken into account in the analysis. An increase in the discount rate used in the analysis reflects the current volatility of the Fund's units and market conditions. The changes in the market growth rates reflect the current general economic pressures now impacting the national economy.

The Fund concluded the carrying value of its investment in MarksLP exceeded its fair value as of December 31, 2008. As a result, the Fund recorded a pre-tax non-cash charge for the year ended December 31, 2008 to reduce the investment in MarksLP by $24,349 to $88,500. After taking into account the related recovery of future income taxes, the non-cash after tax charge to income is $20,956 or $2.12 per unit.

Operating expenses

Operating expenses of the Fund are limited to general and administrative expenses for the administration of the Fund on a consolidated basis. General and administrative expenses consist primarily of professional fees, public entity costs and trustee fees. Total operating expenses of the Fund for the fourth quarter were $148 compared to $79 in the fourth quarter of 2007. The increase is primarily due to additional legal and advisory and other general and administrative expenses incurred by the Fund. The Fund recorded net interest expense of $173 (2007-$148) related primarily to the term loan and $12 (2007-$13) in amortization of financing charges also relating to the term loan. The Fund recorded a non-cash charge of $176 (2007-$179) for the movement in the fair value of the interest rate swap

Income Taxes

In the quarter, the Fund recognized a future income tax recovery of $3,735 arising from the impairment charge and from a change in the temporary income tax differences expected to exist on January 1, 2011 at the tax rate applicable to the Fund. In the comparable quarter in 2007, on December 14, 2007, new legislation was substantively enacted, reducing the income tax rate from 31.5% to 29.5% in 2011, and 28% for 2012 onwards. As a result of this rate reduction, the Fund recorded a non-cash future income tax recovery of $2,059 on December 14, 2007. The Fund also recognized an additional future income tax liability of $18, on December 31, 2007, arising from a change in the temporary income tax differences expected to exist on January 1, 2011 at the tax rate applicable to the Fund.

Net Earnings

The Fund's net loss for the quarter was $17,675 or $1.7881 per unit, compared to net income of $5,525, or $0.5691 per unit in 2007. Excluding the non-cash impairment charge of $24,349; future income tax recovery of $3,735 (2007 - non-cash future income tax recovery of $2,041 related to the revision to the future income tax liability as a result of the income tax legislation described above); current income tax recovery of $450 in 2007 relating to prior years as described above; the non-cash movements in the fair value of the derivative interest rate swap; and amortization of deferred financing charges of $188 (2007 - $191), net earnings for the quarter were $3,127 or $0.3163 per unit compared to $3,225 or $0.3322 per unit in 2007, a decrease of 4.8% on a per unit basis.

YEAR ENDED DECEMBER 31, 2008

Income from Equity-accounted Investment in MarksLP and MarksCo

The Fund recorded income during the year from equity-accounted investments of $12,565 (2007 - $20,146), excluding the impact of the impairment charge described below. Royalty income earned by MarksLP from Second Cup in the year was $12,991 (2007 - $12,829 including MarksCo) on sales of $197,340 (2007 - $195,750) reported by the Second Cup cafés in the Royalty Pool, an increase of 1.3% compared to 2007. In 2008, MarksLP earned bank interest income of $5 (2007 - $22). In 2007, net interest expense to non-related parties, primarily relating to interest on MarksCo's term loan which was repaid on April 2, 2007 as part of the Reorganization, amounted to $144 for the year.

General and administrative expenses of MarksLP included in income from equity accounted investments were $429 ($496 in 2007 including MarksCo). Interest expense relating to the notes payable to the Fund by MarksLP was $2 in 2008, compared to $2,959 in 2007 ($534 from MarksLP and $2,425 from MarksCo). In 2007, as a result of income tax reassessments obtained subsequent to a federal income tax audit, MarksLP recorded a recovery of $450 in prior years' income tax of MarksCo.

In 2007, included in the income from equity-accounted investments of $20,146 were earnings of $9,314 in MarksLP and earnings of $164 in MarksCo. MarksCo's earnings of $164 included a non-cash writedown of deferred financing charges amounting to $142 due to the term loan being repaid by MarksCo upon the Reorganization. In addition, the earnings from the equity investment reflect a credit to equity earnings of $10,668 relating to the elimination of a net future income tax liability, both resulting from the Reorganization. This net liability was comprised of a write-off of future tax assets of $1,408 previously recognized by MarksCo, offset by a $12,076 future income tax liability inherent in the carrying value of the equity-accounted investment that resulted from the step-up to the value of the Second Cup Marks when the Fund originally acquired MarksCo. Excluding the future income tax recovery of $10,668 and the current tax recovery of $450 discussed above, other current tax expense of MarksCo in 2007 amounted to $82, comprised of current tax expense of $53 and non-cash future tax expense of $29.

Impairment of Investment in Second Cup Trade-Marks Limited Partnership

As described above, the Fund concluded the carrying value of its investment in MarksLP exceeded its fair value as of December 31, 2008. As a result, the Fund recorded a pre-tax non-cash charge for the year ended December 31, 2008 to reduce the carrying value of the investment in MarksLP by $24,349 to $88,500. After taking into account the related recovery of future income taxes, the non-cash after tax charge to income is $20,956 or $2.12 per unit.

Operating expenses

Operating expenses of the Fund are limited to general and administrative expenses for the administration of the Fund on a consolidated basis. General and administrative expenses consist primarily of professional fees, public entity costs and trustee fees. Total operating expenses of the Fund in 2008 were $411 (2007 - $469, excluding costs related to the Reorganization). In 2007, the Fund incurred costs of $312 related to the Reorganization. The Fund recorded net interest expense of $683 (2007-$447) related primarily to the term loan and $50 (2007-$31) in amortization of related financing charges. The Fund recorded a non-cash charge of $269 (2007-$143) for the movement in the fair value of the derivative interest rate swap. Current income tax expense for 2007 was $3 (also see income tax amounts relating to MarksCo below).

Income Taxes

During the year, the Fund recognized a future income tax recovery of $3,664 arising from the impairment charge and from a change in the temporary income tax differences expected to exist on January 1, 2011 at the tax rate applicable to the Fund.

In 2007, as a result of the Reorganization, a net future income tax liability of $10,668 was reversed and resulted in an increase to the income of the equity accounted investment in MarksCo on April 2, 2007. In addition, on June 12, 2007 new tax legislation was enacted that changed the rules applicable to publicly traded income trusts in 2011. In 2011, income taxes payable will reduce net earnings of the Fund. Prior to June 12, 2007, the Fund's consolidated financial statements did not include provisions for Canadian income

taxes. As the new trust tax legislation was substantively enacted, the Fund was required to give accounting recognition to these new rules. Future income taxes were recorded on the difference between the accounting values of balance sheet assets and liabilities and the tax cost basis of these assets and liabilities based on substantively enacted income tax laws and rates for differences that are expected to reverse after January 1, 2011. On June 12, 2007 the Fund recognized a non-cash future income tax expense amounting to $15,545 arising from those temporary tax differences at December 31, 2007 expected to exist on January 1, 2011. Also, on December 14, 2007, new legislation was substantively enacted, reducing the income tax rate from 31.5% to 29.5% in 2011, and 28% for 2012 onwards. As a result of this rate reduction, the Fund recorded a non-cash future income tax recovery of $2,059 on December 14, 2007. The Fund also recognized an additional future income tax liability of $18, on December 31, 2007 relating to the timing differences on the final adjustment of the cafés added to the Royalty Pool on January 1, 2007 (see "Adjustment to the Royalty Pool" below).

Net Earnings

The Fund recorded a net loss of $9,531 or $0.9642 per unit for 2008, compared to net income of $8,196 or $0.8442 per unit in 2007. In 2008, excluding the impact of the non-cash impairment charge of $24,349, non-cash movements in the fair value of the interest rate swap of $269 and amortization of deferred financing charges of $50, and the non-cash future income tax recovery of $3,664, net earnings for the year were $11,473 or $1.1607 per unit. In 2007, excluding the impact of the $2,865 non-cash future income tax charge, reorganization costs of $312, the current income tax recovery of $450 relating to prior years as described above, and the non-cash movements in the fair value of the interest rate swap of $143 and amortization of deferred financing charges of $173, net earnings for the year were $11,239 or $1.1576 per unit. Using this measure, the Fund's improvement over 2007 was 0.3%.

SELECTED QUARTERLY INFORMATION

A discussion of the Fund's previous interim results can be found in the Fund's quarterly Management's Discussion and Analysis reports available at www.sedar.com.

(in thousands of dollars except cafés and per unit amounts)	*Q4 2008*[1,5]	*Q3 2008*	*Q2 2008*	*Q1 2008*[2]
System sales of cafés in the Royalty Pool	$53,562	$47,315	$49,130	$47,333
Same café sales growth	-1.4%	0.1%	0.9%	1.4%
Total number of cafés in Royalty Pool at end of period	357	357	357	357
Number of active cafés in Royalty Pool at end of period	341	345	350	355
Net earnings (loss) for the period	($17,675)	$2,745	$2,917	$ 2,482
Diluted earnings per unit	($1.7881)	$0.2774	$0.2946	$0.2502
Distributable cash per unit	$0.2581	$0.3213	$0.2902	$0.2813
Distributions declared per unit	$0.2820	$0.2820	$0.2820	$0.2790
	Q4 2007[1,4]	*Q3 2007*	*Q2 2007*[3]	*Q1 2007*[2]
System sales of cafés in the Royalty Pool	$54,402	$47,202	$48,149	$45,997
Same café sales growth	0.7%	1.2%	4.4%	6.1%
Total number of cafés in Royalty Pool at end of period	351	351	351	351
Number of active cafés in Royalty Pool at end of period	342	344	348	348
Net earnings for the period	$5,525	$2,571	($2,171)	$ 2,271
Diluted earnings per unit	$0.5672	$0.2641	($0.2236)	$0.2326
Distributable cash per unit	$0.3131	$0.2696	$0.2755	$0.2774
Distributions declared per unit	$0.2730	$0.2730	$0.2730	$0.2687

[1] The Fund's fourth quarter system sales are higher than other quarters due to the seasonality of the business (see "Seasonality of System Sales" above).
[2] Results for the quarters of 2008 and 2007 are not directly comparable due to the impact of $301 in expenses related to the Reorganization of the Fund in Q1 of 2007 (see "Reorganization of the Fund").
[3] Results for the second quarter of 2007 include a non-cash recovery of future income taxes of $10,668 relating to the Reorganization of the Fund, and a non-cash future income tax charge of $15,545 relating to the new tax legislation enacted on June 12, 2007.
[4] Results for the fourth quarter of 2007 include a non-cash recovery of future income taxes of $2,059 relating to reductions in federal income tax rates that were enacted on December 14, 2007, and a current income tax recovery of $450 relating to reassessments received on prior year returns of the predecessor corporation to MarksLP.
[5] Results for the fourth quarter of 2008 include a non-cash impairment charge of $23,349 and a non-cash recovery of future income taxes relating primarily to this charge.

DISTRIBUTIONS

During the fourth quarter, the Fund declared aggregate distributions of $2,787 or $0.2820 per unit, compared to $2,650 or $0.2730 per unit, respectively in the 2007 fourth quarter. On a per unit basis, this represents a 3.3% increase from the comparable period.

For the year, the Fund declared total distributions of $11,120 or $1.1125 per unit, compared to total distributions declared in the comparable period of 2007 of $10,560 or $1.0877 per unit. On a per unit basis, this represents a 3.4% increase over the prior year.
Monthly distributions for the year were as follows:

Period	Payment Date	Amount/unit
January 2008	February 29, 2008	$0.0910
February 2008	March 31, 2008	$0.0940
March 2008	April 30, 2008	$0.0940
April 2008	May 30, 2008	$0.0940
May 2008	June 30, 2008	$0.0940
June 2008	July 31, 2008	$0.0940
July 2008	August 329, 2008	$0.0940
August 2008	September 30, 2008	$0.0940
September 2008	October 31, 2008	$0.0940
October 2008	November 28, 2008	$0.0940
November 2008	December 31, 2008	$0.0940
December 2008	January 30, 2009	$0.0940
Total for the year		$1.1250

On January 30, 2009, the Fund paid the declared distribution for December 2008 of $929, or $0.0940 per unit, to holders of record at the close of business on December 31, 2008. On February 27, 2009, the Fund paid distributions for January 2009 of $931 or $0.0940 per unit to holders of record at the close of business on February 25, 2009. On March 4, 2009, the Fund's Board of Trustees declared a unitholder distribution of $0.0940 per unit which will be paid on March 31, 2009 to holders of record at the close of business on March 27, 2009.

The determination to declare and make payable distributions from the Fund are at the discretion of the board of Trustees of the Fund and until declared payable, the Fund has no requirement to pay cash distributions to Fund Unitholders. Having regard to current economic conditions and their impact on systems such as described under "System Sales", the Trustee will continually review the level of distributions paid by the Fund and there can be no assurance that distributions will remain at their current levels.

DISTRIBUTABLE CASH

In common with other royalty income trusts in Canada, management believes that distributable cash is an appropriate measure of performance of the Fund as the amount of cash available to pay distributions to Unitholders is determined with reference to distributable cash. Management believes that, in addition to net income, distributable cash is a useful supplemental measure in evaluating the Fund's performance as it provides investors with an indication of cash available for distributions. Investors are cautioned, however, that distributable cash should not be construed as an alternative to the consolidated statements of cash flows as a measure of liquidity and cash flows. The method of calculating distributable cash for the purposes of this MD&A may differ from that used by other issuers and, accordingly, distributable cash in this MD&A may not be comparable to distributable cash used by other issuers (see "Non-GAAP Terms").

For purposes of this MD&A, distributable cash is based on cash flows from operating activities, the GAAP measure reported in the Fund's consolidated statements of cash flows. Cash flow from operating activities of the Fund is adjusted to include cash flow from operating activities of its wholly owned subsidiary, MarksLP (and MarksCo prior to the Reorganization).

Fourth Quarter

		Three months ended December 31, 2008		Three months ended December 31, 2007
Cash flow from operating activities of the Fund	$	2,380	$	(297)
Add (deduct):				
Cash flow from operating activities of MarksLP		2,872		3,337
Distributions paid to Fund by MarksLP		(2,701)		-
Distributable cash for the Fund	$	2,551	$	3,040
Number of units outstanding		9,884,733		9,708,609
Distributable cash per unit	$	0.2581	$	0.3131
Distributions paid	$	2,787	$	2,650
Distributions declared	$	2,787	$	2,650
Distributions declared per unit	$	0.2820	$	0.2730

Distributable cash for the quarter was $2,551, or $0.2581 per unit compared to $3,040, or $0.3131 per unit in the fourth quarter of 2007, a decrease of 17.6% per unit. Non-cash working capital of the Fund for the quarter was unchanged and non-cash working capital of MarksLP increased by $576 compared to an increase of $166 in the Fund and an increase of $469 in MarksLP for the comparable period. Changes in non-cash working capital are primarily due to the timing of payments from related parties. Excluding the impact of changes in non-cash working capital and the 2007 recovery of income taxes of $450 relating to prior years, distributable cash would have been $3,127, or $0.3163 per unit, compared to $3,225, or $0.3322 per unit for the fourth quarter of 2007, a 4.8% decrease in distributable cash per unit.

During the final quarter of 2008 an agreement was reached between MarksLP and Second Cup whereby the payment of certain royalties for 2008 was deferred. This deferral (which is not included in distributable cash) which amounted to $573 ($0.058 per unit in the quarter) was requested by Second Cup to deal with a cash shortfall it experienced resulting from Second Cup's commitment to open new café locations made prior to the slowdown of the economy; the requirement for Second Cup to take back café locations from franchisees that were underperforming; and operational difficulties including restructuring costs encountered as a result of the deterioration of economic conditions and the reduction in consumer spending.

Year ended December 31, 2008

		Year ended December 31, 2008		Year ended December 31, 2007
Cash flow from operating activities of the Fund	$	10,940	$	2,317
Add (deduct):				
Cash flow from operating activities of MarksLP and MarksCo (in 2007)		12,338		8,708
Distributions paid to Fund by MarksLP		(11,901)		-
Distributable cash for the Fund	$	11,377	$	11,025
Number of units outstanding		9,884,733		9,708,609
Distributable cash per unit	$	1.1510	$	1.1356
Distributions paid	$	11,075	$	10,513

		2008		2007
Distributions declared	$	11,120	$	10,560
Distributions declared per unit	$	1.1250	$	1.0877

Non-cash working capital of the Fund for the year decreased by $131 and non-cash working capital of MarksLP increased by $227 compared to a decrease of $589 in the Fund and an increase of $941 in MarksLP and MarksCo for the prior year. Changes in non-cash working capital are primarily due to the timing of payments from related parties and payments of income tax amounts. Excluding the impact of changes in non-cash working capital; the Reorganization costs of $Nil (2007 - $312); and the $Nil (2007- $450 recovery of income taxes relating to prior years, distributable cash would have been $11,473, or $1.1607 per unit, compared to $11,239 or $1.1576 per unit in 2007, which represents a 0.3% increase in distributable cash per unit. As noted above under the Fourth Quarter agreement was reached between MarksLP and Second Cup to defer the payment of $573 ($0.058 per unit) of 2008 royalties.

Tax Treatment of Distributions
Of the $1.1250 in distributions declared per unit during the year, 17.8% or $0.1999 per unit represents a tax deferred return of capital, and 82.2% or $0.9251 per unit is taxable as other taxable income (equivalent to interest income). For the year ended December 31, 2007, 15.5% or $0.1685 per unit represented a tax deferred return of capital, 1.9% or $0.0203 represented dividend income and 82.6% or $0.8989 per unit was taxable as other taxable income.

LIQUIDITY AND CAPITAL RESOURCES

The Fund is required, if declared, to remit distributions in arrears to Unitholders, on the last business day of each month. The Fund's distribution policy is to make cash distributions to Unitholders from the distributable cash generated by the Fund and MarksLP, and to make such distributions in equal amounts to Unitholders on a monthly basis in order to smooth out any seasonal fluctuations in the Fund's income. The Fund has no contractual or purchase obligations. The Fund did not have any capital expenditures in 2008 and does not have any plans for capital expenditures in 2009.

The Fund had cash and cash equivalents balances of $1,202 at December 31, 2008 (2007 - $1,037) exclusive of cash and cash equivalents held by MarksLP of $318 at December 31, 2008 (2007 - $58).

The primary source of liquidity for the Fund is the royalty payable to MarksLP by Second Cup. Second Cup collects royalties based on franchisee system sales, franchise fees and other amounts from its franchisees and also generates revenues from its company-owned cafés. The performance of Second Cup franchisees and company-owned cafés could impact the ability of Second Cup to pay the royalty to MarksLP. As described above, during the final quarter of 2008 an agreement was reached between MarksLP and Second Cup whereby the payment of certain royalties for 2008 was deferred. For a more detailed discussion of the risks and uncertainties affecting the Fund's liquidity, see "Risks and Uncertainties" below.

For the year ended December 31, 2008, the Fund generated cash from operations of $10,940 (2007 - $2,317). The increase in cash from operating activities is mainly due to the Reorganization, whereby in the prior year the Fund earned interest income from its wholly owned subsidiary, MarksCo. From April 2, 2007 onwards, the Fund's primary source of cash flows in 2007 was MarksLP's principal repayments on the notes payable to the Fund, which were fully repaid in January 2008. As a result of the repayment, in 2008 the primary source of cash flows has been distributions from MarksLP. Also the Fund, in 2007, received $11,000 in cash as a result of the new term loan and invested the proceeds in MarksCo to enable it to repay its term loan on April 2, 2007. In 2007 the Fund incurred $127 in financing charges related to the new term loan. In 2007, the Fund also received $8,871 from MarksLP as payment of principal on its notes receivable. The Fund paid distributions to Unitholders of $11,075 (2007 - $10,513) during the year. The increase in distributions paid is due mainly to an increase in the monthly distribution rate over the prior year and an increase in the number of units outstanding.

The Fund continues to believe it has sufficient financial resources to pay future distributions and operating expenses when declared and due.

Term Loan, Operating Credit Facility and Interest Rate Swap

In connection with the Reorganization in 2007, the Fund negotiated a new term loan of $11,000 with its bankers on similar terms and conditions as MarksCo's term loan maturing on December 2, 2009. The credit facilities total $12,000.

The $11,000 non-revolving term credit facility bears interest at prime or base rate plus 0.75% or LIBOR advances or bankers' acceptances plus 1.75%. At December 31, 2008, the full amount of the $11,000 non-revolving term credit facility was drawn with an effective interest rate of 6.62% after taking into consideration the interest rate swap described below.

The $1,000 operating credit facility bears interest at prime or base rate plus 0.50% or LIBOR advances or bankers' acceptances plus 1.50%. At December 31, 2008, no advances had been drawn on this facility.

The term credit facilities are collateralized by substantially all the assets of MarksLP and the Fund, including the Agreement, pursuant to which Second Cup has also provided a general security agreement.

An interest rate swap agreement was entered into by the Fund maturing December 2, 2009, which fixes the interest rate on the Fund's non-revolving credit facility at 4.87% per annum plus the variable margin noted above. At December 31, 2008, the estimated fair value of this contract is a $412 liability to the Fund (2007 - $143) and is recorded as a liability on the Fund's consolidated balance sheet and as a non-cash charge to earnings.

On March 4, 2009 the Fund renegotiated its term loan and operating credit facilities including an extension of the maturity of the credit facilities to January 2, 2011. The revised $12,000 credit facilities are comprised of a fully drawn $11,000 non-revolving term credit facility and an undrawn $1,000 revolving credit facility, bearing interest at prime or base rate plus 2.5% or LIBOR advances or bankers' acceptances plus 3.5%. The derivative interest rate swap was also extended to January 2, 2011. As a result, the effective interest rate as of March 2, 2009 has been reduced from 6.62% to 6.41%.

In accordance with EIC-122, the term loan has been classified as a long term liability even though prior to the renegotiation, it was due to mature in December 2009.

OFF-BALANCE SHEET ARRANGEMENTS

The Fund does not have any off-balance sheet arrangements.

RELATED PARTY TRANSACTIONS AND BALANCES

In the second quarter of 2007, the Fund engaged in a number of transactions with related parties to effect the Reorganization as described further above.

In 2008 interest income of $2 (2007-$535) was earned on the note receivable from MarksLP, which was repaid in January 2008 and in 2007 earned $2,424 on the notes receivable from MarksCo which was fully repaid in 2007. The Fund also charged a management fee of $268 (2007 - $87) to MarksLP for certain general and administrative expenses incurred by the Fund during the year. In addition, during 2007 prior to the Reorganization, dividend income of $190 was received from MarksCo.

In January 2008, the Fund engaged in a number of transactions with MarksCo and Second Cup to effect the adjustments to the Royalty Pool. See "January 1, 2007 Royalty Pool Adjustment" below.

NEW ACCOUNTING STANDARDS AND ACCOUNTING POLICY CHANGES

Effective January 1, 2008, the Fund adopted the following sections of the CICA Handbook:

Capital Disclosures, CICA Handbook Section 1535
Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance. This section relates to disclosure and presentation only and did not have an impact on the Fund's results.

Financial Instruments, CICA Handbook Sections 3862 and 3863
Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. These sections relate to disclosure and presentation only and did not have an impact on the Fund's results.

FUTURE ACCOUNTING STANDARDS

Goodwill, Intangible Assets and Financial Statement Concepts
In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062 Goodwill and Other Intangible Assets. The new section provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the asset definition. It also establishes standards on the recognition, measurement, presentation and disclosure for goodwill and intangible assets subsequent to their initial recognition. The standard requires retroactive application to prior period financial statements. The Fund will adopt this standard for the fiscal year commencing January 1, 2009. The standard is not expected to have a significant impact on the Fund's consolidated financial results.

International Financial Reporting Standards
In February 2008, the Canadian Accounting Standards Board confirmed its plan to converge with International Financial Reporting Standards ("IFRS"). The Fund must prepare its interim and annual consolidated financial statements in accordance with IFRS for the periods beginning on or after January 1, 2011. The Fund has formally established an IFRS project team consisting of members of its finance group and is led by the Fund's Chief Financial Officer. The team will report regularly to the trustees of the Fund. The team will study the impacts of IFRS on the Fund's accounting policies, information systems, internal controls over financial reporting, and contractual arrangements and covenants. The Fund will report on the team's progress on significant items in future communications.

FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash and cash equivalents, accounts payable, notes receivable from MarksLP, accrued liabilities, distributions payable to Unitholders, and the derivative interest rate swap. With the exception of the derivative interest rate swap, the fair values of these instruments approximate their carrying amounts due to their short-term maturity.

Financial assets are classified as either available-for-sale, held-for-trading, held-to-maturity or loans and receivables. Financial liabilities are classified as either held-for-trading or cost/amortized cost. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading are measured at amortized cost. All derivative instruments must be classified as held-for-trading. The Fund classifies its notes receivable from MarksLP as loans receivable carried at amortized cost. The note has been fully repaid as at September 30, 2008. All other financial assets and derivatives are measured at fair value. Transaction costs associated with long-term debt are included in the carrying value of the long-term debt and are amortized using the effective interest rate method.

The Fund's financial instruments are exposed to credit risk, liquidity risk and interest rate risk.

Credit Risk
The Fund's financial instruments exposed to credit risk include cash and cash equivalents. The Fund places its cash and cash equivalents with institutions of high creditworthiness. The Fund is also exposed to credit risk in the event of non-payment of royalties in accordance with the Agreement by Second Cup to MarksLP. The Fund has also obtained a general security on Second Cup's assets pursuant to the Agreement.

Liquidity Risk
Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations as they come due associated with its financial liabilities. The Fund manages liquidity risk through regular monitoring of distribution levels, forecast and actual cash flows and also the management of its capital structure and senior leverage ratios. The Fund's sole sources of income are its equity earnings from MarksLP. MarksLP's cash inflows to service these distributions to the Fund are generated by royalty receipts from Second Cup pursuant to the Agreement. During the year an agreement was reached by MarksLP with Second Cup whereby the payment of $573 in royalties for 2008 were deferred (see "Distributable Cash"). As noted above, the Fund holds a general security interest on Second Cup's assets.

Interest Rate Risk
The Fund is exposed to interest rate risk on its Term Loan and Operating Facility and, to a minor extent, on its interest bearing investments in cash and cash equivalents. The Fund's Term Loan bears interest at prime or base rate plus 0.75% or LIBOR advances or bankers' acceptances plus 1.75%. The $1,000 operating credit facility bears interest at prime or base rate plus 0.50% or LIBOR advances or bankers' acceptances plus 1.50%. At December 31, 2008, no advances had been drawn on this facility. An interest rate swap agreement fixes the interest rate on the Term Loan at 4.87% plus the variable margin noted above until December 2, 2009. Management assesses that the interest rate risk exposure is not significant given the interest rate swap above, which fixes the interest rate through December 2, 2009.

As part of managing liquidity risk, capital resources and interest rate risk, Management recognizes that the Fund's Term Loan matures on December 2, 2009 and intends to continue to utilize long-term debt as part of its capital structure.

As noted above, on March 4, 2009 the Fund renegotiated its term loan and operating credit facilities including an extension of the maturity of the credit facilities to January 2, 2011.

MANAGEMENT OF CAPITAL

The capital structure of the Fund consists of long-term debt and Unitholders' equity, which is comprised of issued units and accumulated earnings, less accumulated cash distributions. The Fund's objectives when managing capital are to safeguard its ability to continue as a going concern and ensure it has sufficient cash and cash equivalents to pay distributions to its Unitholders. The Fund has no capital expenditure requirements.

The Fund determines the appropriate level of long-term debt in the context of its cash flow and overall business risks. The Fund has historically generated sufficient cash flow to pay monthly distributions to its Unitholders. In order to maintain or modify the capital structure, the Fund may adjust the amount of distributions paid to its Unitholders.

Under the Term Loan and Operating Facility, the Fund is required to comply with a number of covenants and restrictions, including the requirements to meet certain financial ratios. These financial ratios include a senior leverage ratio and ratios pertaining to earnings before interest, depreciation, taxes and amortization. To date, the Fund has complied with these ratios.

The Fund will become subject to Canadian corporate income taxes beginning in 2011. This may result in changes to the capital structure of the Fund or the nature of the Fund itself.

There were no changes in the Fund's approach to capital management during the Period.

ADJUSTMENTS TO THE ROYALTY POOL

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount that may be satisfied by additional Fund units or cash, the form of payment being at the option of the Fund. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net system sales, with the balance received when the actual full year performance of the new cafés is known.

January 1, 2007

On January 1, 2007, the actual annual sales of the nine cafés added to the Royalty Pool on January 1, 2006 were greater than the original estimate. In accordance with the provisions in the Agreement, a final adjustment of $356 was satisfied by MarksCo delivering to Second Cup 35,903 additional units of the Fund. In addition, MarksCo also made a cash payment of $37 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the additional units above had they been issued on January 1, 2006.

On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized sales of these 11 cafés added to the Royalty Pool were estimated at $4,555 offset by $3,815 in sales of the 12 cafés permanently closed from the Royalty Pool during 2006. In accordance with the provisions in the Agreement, MarksCo was required to make a payment of $315 to Second Cup, representing 80% of the obligation based on forecasted sales. In January 2007, the Fund issued 34,630 units to MarksCo, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expected to issue 32,412 additional units to satisfy the remaining obligation of MarksLP on or about January 1, 2008.

In conjunction with this adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. The notes issued by MarksCo to the Fund bore interest at 12.125% and were to mature on January 1, 2017. These notes were repaid as part of the Reorganization discussed above. The common shares were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

January 1, 2008

On January 1, 2008, the actual annual sales of the 11 cafés added to the Royalty Pool on January 1, 2007 for the year ended December 31, 2007 were greater than the original estimate. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the provisions in the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the additional 32,412 units above had they been issued on January 1, 2007.

Also, on January 1, 2008, 15 cafés were added to the Royalty Pool of which nine opened in 2006 subsequent to the cut-off date for inclusion in the Royalty Pool at January 1, 2007 along with six cafés opened in 2007 prior to the cut-off date for the January 1, 2008 adjustment. The annualized sales of these 15 cafés added to the Royalty Pool have been estimated at $6,750. These sales were offset by $3,513 in sales of nine cafés permanently closed from the Royalty Pool during the year. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $1,346 to Second Cup, representing 80% of the obligation based on forecasted sales. In January 2008, the Fund issued 143,712 units to MarksLP, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expected to issue additional units to satisfy the remaining obligation. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 351 to 357, and Second Cup's ownership increased to 246,657 units.

January 1, 2009

On January 1, 2009, the actual sales of the 15 cafés added to the Royalty Pool on January 1, 2008 for the year ended December 31, 2008 were less than the original estimate. After adjusting for this, a final adjustment of $172 was satisfied by MarksLP purchasing and delivering 18,312 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $21 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the 18,312 additional units above had they been issued January 2008.

Also, on January 1, 2009, 18 cafés were added to the Royalty Pool. The system sales of these 18 cafés added to the Royalty Pool have been estimated at $7,209 annually. These sales were offset by $6,194 in sales of 16 cafés permanently closed from the Royalty Pool during 2008. As a result of this adjustment to the Royalty Pool, MarksLP was required to make a payment of $190 to Second Cup, representing 80% of the obligation based on forecast system sales. In January, 2009, the MarksLP satisfied this obligation by a cash payment to Second Cup of $190. After a full year of performance of the new cafés, MarksLP expects to satisfy the remaining obligation by an additional payment. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 357 to 359.

OUTSTANDING UNIT AND SHARE DATA

	As at December 31, 2008	As at December 31, 2007
Fund - units issued	9,884,733	9,708,609
- amount	$89,800	$88,159

On January 1, 2009, 18,312 units were issued to Second Cup (see "Adjustment to the Royalty Pool" above) representing approximately 0.2% of the total issued and outstanding units of the Fund.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of GP Inc., managing general partner of the Partnership, administrator of the Fund, on a timely basis so that appropriate decisions can be made regarding public disclosure. In accordance with National Instrument 52-109 Certification of Disclosure in Issuers' Annual and Interim Filings, the CEO and CFO have evaluated the effectiveness of the Fund's disclosure controls and procedures as of the year ended December 31, 2008. Based on that evaluation, the CEO and CFO have concluded that the disclosure control procedures are effective and provide reasonable assurance that: (a) information required to be disclosed by the Fund in its annual filings or other reports filed and submitted under applicable securities legislation is recorded, processed, summarized and reported within the prescribed time periods and (b) material information regarding the Fund is accumulated and communicated to management, including its CEO and CFO in a timely manner.

EVALUATION OF INTERNAL CONTROLS OVER FINANCIAL REPORTING

There were no changes made in the Fund's internal controls over financial reporting during the year ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect the Fund's internal controls over financial reporting.

As of December 31, 2008, the Fund's management has assessed the effectiveness of the Fund's internal control over financial reporting using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control – Integrated Framework. Based on this assessment management has determined that the Fund's internal control over financial reporting was effective as of December 31, 2008.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires the trustees to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The carrying amounts of investments and notes receivable from long-term investments, accounting for VIEs and future income taxes are the more significant areas requiring management judgement and estimation.

Management performs an annual test for impairment on the book value of its investment in MarksLP, which consists of limited partnership units. This impairment test requires a comparison of the estimated fair value of the investment to its carrying value and examines the distributable cash flow to the Fund, which is based on income from the Fund's investment in MarksLP. MarksLP's cash flows are based on the royalty income earned on licensing the Second Cup Marks to Second Cup.

RISKS AND UNCERTAINTIES

The performance of the Fund is dependent on the royalties paid to MarksLP by Second Cup on the system sales of Royalty Pool cafés. This is considered to be a key attribute of the Fund and a fund with this structure is commonly referred to as a "top line" fund. The distributions to Unitholders are a function of the system sales of the Royalty Pool cafés less the Fund's expenses and are indirectly a function of the profitability of Second Cup and the individual Second Cup cafés. The success of the Fund is determined primarily by the ability of Second Cup to add new cafés to the Royalty Pool on an accretive basis, and meet its obligations to MarksLP as they come due. In addition, the growth of the café network is dependant on investments made by Second Cup to open new locations, enter into new leases and recruit, train and supervise franchises.

The amount of royalties agreed to be deferred in the Fourth Quarter of 2008 from Second Cup to MarksLP are subject to the general security held by the Fund on Second Cup's assets noted in Credit Risk section of the report.

System sales of Royalty Pool cafés 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, all restaurants and food service outlets that serve coffee, and supermarkets that compete in the whole bean segment. If Second Cup cafés are unable to successfully compete in the Canadian specialty coffee industry, system sales may be adversely affected, which, in turn, may reduce the amount of the royalty paid to MarksLP and adversely affect the ability of the Fund to pay distributions.

Second Cup faces intense competition for high profile retail locations and qualified franchisees, both from specialty coffee chains and competitors from other industries. 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. Adverse credit markets, such as those currently being experienced, may affect the ability of franchises to obtain new credit or refinance existing credit on economically reasonable terms.

A shortage in supply or an increase in the price of premium quality coffee beans could adversely affect Second Cup. Second Cup has no long-term or written contracts with coffee bean suppliers and relies on historical relationships to ensure availability. While there are a number of coffee bean suppliers, there can be no assurance that coffee bean suppliers that have relationships with Second Cup will continue to supply coffee beans at competitive prices.

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 a change 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, and traffic and weather patterns as well as the type, number and location of competing cafés.

Second Cup's business could be adversely affected by increased concerns about food safety in general, or other unusual events.

Changes in government regulations and other regulatory developments (such as smoking by-laws) could have an adverse impact on system sales and the royalties.

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

On June 12, 2007, new income tax legislation regarding the taxation of income trusts that were publicly traded prior to November 1, 2006 was enacted by the federal government. As a result of the legislation, the Fund will be taxed on earnings before distributions to Unitholders commencing January 1, 2011. On December 14, 2007, new legislation was substantively enacted reducing the income tax rate from 31.5% to 29.5% in 2011 and 28% for 2012 onwards. Under the legislation, certain income earned by these entities will be taxed in a manner similar to income earned by a corporation and distributions or allocations made by these entities to Unitholders will be taxed similar to dividends from taxable Canadian corporations. The deemed dividends will be eligible for the proposed new enhanced dividend tax credit if paid or allocated to a resident of Canada.

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

OUTLOOK

The information contained in this "Outlook" is forward-looking information. Please see "Forward-Looking Information" below for a discussion of the risks and uncertainties in connection with forward-looking information.

The Fund's "top line" structure means that its success and growth depend primarily on Second Cup's ability to maintain and increase the overall system sales of cafés in the Royalty Pool. Growth in overall system sales is dependent on same café sales growth and adding new cafés to the café network.

Given the uncertainty in the retail and economic environment across Canada and Second Cup's dependence upon consumer discretionary spending, management is not providing specific guidance on same café sales for 2009. Management believes fiscal 2009 will be challenging and therefore, a number of initiatives are planned to strengthen the long term success of the Second Cup brand and its franchisees.

- Second Cup will continue its focus on operational excellence at the café level, which it believes will yield increasing consistency across the chain and improve the overall guest experience.
- In an effort to drive loyalty among specialty coffee customers, Second Cup's promotional strategies will focus on targeted branding initiatives promoting and innovating around its premium priced specialty beverages, brewed coffees, tea, food and merchandise. Value added offers will also be a core part of the promotional calendar.
- Second Cup will also be taking selective price increases on several of its products during the year.
- Second Cup will continue to develop and build neighbourhood cafés with a focus on expansion in key urban markets utilizing a disciplined café development process, and continuing its concentration on the delivery of cost savings to franchisees.

In terms of 2009 network expansion, Second Cup expects: (1) to open 10 to 15 new cafés in Canada; (2) to close 15 to 20 cafés during 2009, the majority of which have sales below the average performance of cafés in the Royalty Pool; and (3) approximately 24 of its cafés will be renovated.

FORWARD-LOOKING INFORMATION

Certain statements in this MD&A may constitute forward-looking information within the meaning of applicable securities legislation. Forward-looking information can be identified by words such as "may", "will", "should", "expect", "anticipate", "believe", "plan", "intend" and other similar words. Forward-looking information reflects current expectations regarding future events and operating performance and speaks only as of the date of this MD&A. It 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 information is based on a number of assumptions and is subject to known and unknown risks, uncertainties and other factors, many of which are beyond the Fund's control, that may cause the Fund's actual results, performance or achievements, or those of MarksLP, Second Cup, Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking information. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying forward-looking information: competition; availability of premium quality coffee beans; the ability to attract qualified franchisees; the location of Second Cup cafés; the closure of Second Cup cafes; loss of key personnel; compliance with government regulation; potential litigation; the ability to exploit and protect the Second Cup Marks; 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 results of operations 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" above and in the Fund's Annual Information Form, which is available at www.sedar.com.

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

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

NON-GAAP TERMS

In addition to using financial measures prescribed by GAAP, non-GAAP financial measures and other terms are used in this MD&A. These terms include "system sales", "same café sales growth", "net earnings for the year excluding Reorganization costs and the impact of the Reorganization and new tax legislation on non-cash future income tax balances", "basic earnings per unit excluding Reorganization costs and the impact of the Reorganization and new tax legislation on non-cash future income tax balances", "distributable cash per unit excluding Reorganization costs and changes in non-cash working capital" and "distributable cash". These terms are not financial measures recognized by GAAP and do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar terms and measures presented by other similar issuers. These non-GAAP measures and terms are intended to provide additional information on the Fund's performance and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

System sales and same café sales growth are presented in reference to the sales performance of the Royalty Pool Cafés. The Fund believes they are useful measures as they provide an indication of the top-line sales on which the royalty that is the Fund's indirect source of income is based. Distributable cash is presented in reference to the Fund's distribution policy. The Fund believes distributable cash is a useful measure as it provides investors with an indication of cash available for distribution. Management believes, in addition to net income, distributable cash is a useful supplemental measure in evaluating the Fund's performance as it provides investors with an indication of cash available for distributions and working capital needs. Investors are cautioned, however, that distributable cash should not be construed as an alternative to the consolidated statements of cash flows as a measure of liquidity and cash flows. The method of calculating distributable cash for the purposes of this MD&A may differ from that used by other issuers and,

accordingly, distributable cash in this MD&A may not be comparable to distributable cash used by other issuers.

Additional information relating to the Fund, including the Fund's Annual Information Form, is on SEDAR at www.sedar.com.

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March 7, 2009

Auditors' Report

To the Unitholders of
Second Cup Royalty Income Fund

We have audited the consolidated balance sheets of **Second Cup Royalty Income Fund** (the Fund) as at December 31, 2008 and 2007 and the consolidated statements of earnings (loss) and comprehensive income (loss), unitholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

Second Cup Royalty Income Fund

Consolidated Balance Sheets

(Expressed in thousands of dollars)

As at December 31, 2008 and 2007

	2008	2007
Assets		
Current assets		
Cash and cash equivalents	$ 1,202	$ 1,037
Interest receivable from equity-accounted investment (note 13)	-	22
Prepaid expenses and other assets	46	137
	1,248	1,196
Notes receivable from equity-accounted investment (note 2)	-	300
Equity-accounted investment (notes 2, 9 and 10)	88,500	110,543
	$ 89,748	$ 112,039
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	$ 165	$ 147
Fair value of derivative interest rate swap (note 6)	412	-
Distributions payable to Unitholders	929	883
	1,506	1,030
Future income tax liability (note 14)	9,840	13,504
Fair value of derivative interest rate swap (note 6)	-	143
Term loan (notes 2 and 6)	10,954	10,904
	22,300	25,581
Unitholders' Equity	67,448	86,458
	$ 89,748	$ 112,039

Reorganization (note 2)

Subsequent event (note 16)

See accompanying notes to consolidated financial statements.

Approved by the Trustees

(Signed) David Bloom, Trustee

(Signed) Raymond Guyatt, Trustee

Second Cup Royalty Income Fund

Consolidated Statements of Earnings (Loss) and Comprehensive Income (Loss)

For the years ended December 31, 2008 and 2007

(Expressed in thousands of dollars, except per unit amounts)

		2008		2007
Earnings from equity-accounted investment (note 10)	$	12,565	$	20,146
Interest income from equity-accounted investment (note 13)		2		2,959
Impairment of equity-accounted investment (note 9)		(24,349)		-
General and administrative expenses (note 13)		(411)		(469)
Reorganization expense (note 2)		-		(312)
Interest expense on term loan - net		(683)		(447)
Amortization of deferred financing charges		(50)		(31)
Movement in fair value of derivative interest rate swap (note 6)		(269)		(143)
Earnings (loss) before income taxes		(13,195)		21,703
Income taxes - current (note 14)		-		(3)
Income taxes - future (note 14)		3,664		(13,504)
Net earnings (loss) for the year		(9,531)		8,196
Other comprehensive income		-		-
Comprehensive income (loss)	$	(9,531)	$	8,196
Basic earnings (loss) per unit (note 12)	$	(0.9642)	$	0.8442
Diluted earnings (loss) per unit (note 12)	$	(0.9642)	$	0.8414

See accompanying notes to consolidated financial statements.

Second Cup Royalty Income Fund

Consolidated Statements of Unitholders' Equity

(Expressed in thousands of dollars)

	Income Fund Units	Accumulated Unitholders' Earnings	Accumulated Distributions	Refundable Taxes	Total
Balance - December 31, 2006	$ 87,488	$ 20,963	$ (20,300)	$ -	$ 88,151
Net earnings for the year	-	8,196	-	-	8,196
Units issued January, 2007	671	-	-	-	671
Distributions to Unitholders	-	-	(10,560)	-	(10,560)
Refundable taxes incurred	-	-	-	(64)	(64)
Recovery of refundable taxes	-	-	-	64	64
Balance - December 31, 2007	$ 88,159	$ 29,159	$ (30,860)	$ -	$ 86,458
Net earnings (loss) for the year	-	(9,531)	-	-	(9,531)
Units issued January, 2008	1,641	-	-	-	1,641
Distributions to Unitholders	-	-	(11,120)	-	(11,120)
	89,800	19,628	(41,980)	-	67,448
Accumulated other comprehensive income	-	-	-	-	-
Balance - December 31, 2008	$ 89,800	$ 19,628	$ (41,980)	$ -	$ 67,448

See accompanying notes to consolidated financial statements.

Second Cup Royalty Income Fund

Consolidated Statements of Cash Flows

December 31, 2008 and December 31, 2007

(Expressed in thousands of dollars)

	2008	2007
Cash provided by (used in)		
Operating activities		
Net earnings (loss) for the year	$ (9,531)	$ 8,196
Items not involving cash		
Earnings from equity-accounted investment	(12,565)	(20,146)
Impairment of equity-accounted investment	24,349	-
Amortization of deferred financing charges	50	31
Future income taxes (recovery)	(3,664)	13,504
Movement in fair value of derivative interest rate swap	269	143
Distributions received from MarksLP	11,901	-
Change in non-cash working capital items (note 17)	131	589
	10,940	2,317
Investing activities		
Investment in MarksLP.	-	-
Investment in note receivable of MarksCo.	-	(604)
Impact of reorganization (note 2)	-	(11,021)
Dividends from equity-accounted investment	-	190
Repayment of loan receivable	300	8,871
Investment in common shares of Second Cup Trade-Marks Inc.	-	(67)
	300	(2,631)
Financing activities		
Issuance of units	-	671
Distributions paid to Unitholders	(11,075)	(10,513)
Deferred financing charges	-	(127)
Increase in term loan	-	11,000
	(11,075)	1,031
Increase in cash and cash equivalents during the year	165	717
Cash and cash equivalents - beginning of year	1,037	320
Cash and cash equivalents - end of year	$ 1,202	$ 1,037

Supplementary cash flow information (note 17)

See accompanying notes to consolidated financial statements.

1 Basis of Presentation

Second Cup Royalty Income Fund (the "Fund") is an unincorporated open-ended trust established under the laws of the Province of Ontario. An unlimited number of units may be issued pursuant to the Fund's declaration of trust. Units are redeemable by the holder at any time, subject to certain limitations. Income tax obligations related to distributions by the Fund are the responsibility of the Unitholders.

The Fund prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles.

On January 1, 2005, the Fund adopted Accounting Guideline 15, a pronouncement of The Canadian Institute of Chartered Accountants ("CICA") related to variable interest entities ("VIEs"). As a result of adopting this standard, the Fund reflects its investment in Second Cup Trade-Marks Limited Partnership ("MarksLP"), in which it holds a 99.99% partnership interest, as an equity-accounted investment (see note 2 below). MarksLP is consolidated in the financial statements of The Second Cup Ltd. ("Second Cup"). Prior to the reorganization as described in note 2 below, the Fund had accounted for its wholly owned subsidiary, Second Cup Trade-Marks Inc. ("MarksCo"), the predecessor organization to MarksLP, as an equity-accounted investment. The consolidated financial statements of the Fund include the accounts of the Fund and its wholly owned subsidiaries Second Cup GP Trust ("GP Trust"), which holds the remaining 0.01% partnership interest in MarksLP, and Second Cup GP Inc. ("GP Inc."), which entered into an Administration Agreement whereby GP Inc. provides certain administrative and advisory services in connection with the Fund and the trust units of the Fund.

2 Reorganization in 2007

On April 2, 2007, as a result of the Unitholder-approved reorganization of the structure of the Fund (the "Reorganization"), the Fund effectively replaced its subsidiary corporations, including MarksCo, with a newly formed trust and limited partnership. This latter entity, MarksLP, is consolidated for reporting purposes with Second Cup as a VIE for the same reasons that MarksCo had historically been consolidated with Second Cup. MarksLP is accounted for on the records of the Fund as an equity-accounted investment.

It is important to note that while the Fund's underlying structure was changed, essentially the underlying assets and operations of the Fund and its subsidiaries did not change as a result of the Reorganization.

In connection with the Reorganization, the Fund negotiated a new term loan of $11,000 (the "Term Loan") with its bankers on similar terms and conditions of MarksCo's term loan. The proceeds of the Term Loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan. Further, the notes receivable amounting to $79,343 as at April 1, 2007 from MarksCo were repaid through an increase in the Fund's equity ownership of MarksLP.

Under the new structure, the new wholly owned subsidiaries of the Fund are not subject to income tax until the new rules regarding the taxation of income trusts come into effect in 2011.

The Licence and Royalty Agreement (the "Agreement") entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to license the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a

period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of system sales of certain Second Cup cafés in Canada (the "Royalty Pool") are paid to MarksLP. Following the Reorganization, the Fund's earnings are predominantly comprised of equity income from its ownership of MarksLP instead of interest and dividend income from MarksCo.

3 New Accounting Policies Including Initial Adoption

Effective January 1, 2008, the Fund has adopted the following sections of the CICA Handbook:

Capital Disclosures, CICA Handbook Section 1535
Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital quantitative data about what the entity regards as capital, whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance. This new disclosure is provided in note 18. This section relates to disclosure and presentation only and did not have an impact on the Fund's results.

Financial Instruments, CICA Handbook Sections 3862 and 3863
Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Additional quantitative and qualitative information regarding the Fund's financial instruments and the associated risks is provided in note 19. This section relates to disclosure and presentation only and did not have an impact on the Fund's results.

4 Future Accounting Standards

Goodwill and Intangible Assets:
In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062 Goodwill and Other Intangible Assets. The new Section provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the asset definition. It also establishes standards on the recognition, measurement, presentation and disclosure for goodwill and intangible assets subsequent to their initial recognition. The standard requires retroactive application to prior period financial statements. The Fund will adopt this standard for the fiscal year commencing January 1, 2009. The standard is not expected to have a significant impact on the Fund's consolidated financial results.

5 Summary of Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

a) Cash and cash equivalents

Deposits in banks and short-term investments with original maturities of three months or less are considered cash and cash equivalents. Cash equivalents are carried at cost, which approximates fair market value.

b) Earnings per unit

The earnings per unit are based on the weighted average number of units outstanding during the period. Diluted earnings per unit are calculated to reflect the dilutive effect, if any, of any other commitments or instruments. Units are excluded from the computation of diluted earnings per unit if their effect is anti-dilutive.

c) Income taxes

Prior to June 12, 2007, pursuant to the Income Tax Act as previously enacted, the Fund was not subject to income tax to the extent that its taxable income was distributed to Unitholders. As a result of new tax legislation proposed by the Minister of Finance (Canada) on October 31, 2006 and substantively enacted on June 12, 2007, the Fund will pay a tax on distributions declared subsequent to January 1, 2011 at substantively enacted income tax rates. As a result of this change, as further explained in note 14, the Fund has provided for the future tax effect of existing temporary differences between the accounting and tax bases of assets and liabilities that are expected to reverse subsequent to January 1, 2011.

The Fund and its subsidiaries account for income taxes using the liability method. Future income taxes arise due to the temporary differences in the financial reporting and tax bases of assets and liabilities. Changes in these temporary differences are reflected in the provision for future income taxes using substantively enacted income tax rates.

d) Equity-accounted investment

The Fund has significant influence over its investment in MarksLP and uses the equity method to account for this investment. Under the equity method, the cost of the investment is adjusted by the Fund's proportionate share of income and reduced by distributions payable to the Fund.

Management performs an annual test for impairment on the book value of its investment in MarksLP, which consists of limited partnership units. This impairment test requires a comparison of the estimated fair value of the investment to its carrying value and examines the distributable cash flow to the Fund, which is based on income from the Fund's investment in MarksLP. MarksLP's cash flows are based on the royalty income earned on licensing the Second Cup Marks to Second Cup.

e) Variable interest entities

CICA Accounting Guideline 15, "Consolidation of Variable Interest Entities" ("AcG-15"), provides guidance for applying the principles in CICA Handbook Section 1590, "Subsidiaries", to those entities defined as Variable Interest Entities ("VIEs"), in which either the equity at risk is not sufficient to permit that entity to finance its activities without additional subordinated financial support from other parties, or equity investors lack either voting control, an obligation to absorb expected losses, or the right to receive residual returns. AcG-15 requires consolidation of VIEs by the primary beneficiary. The primary beneficiary is defined as the party that has exposure to the majority of a VIE's expected losses and/or residual returns. As disclosed in note 1, the Fund has determined that MarksLP is a VIE whose primary beneficiary is Second Cup. As noted above, the Fund equity accounts for its investment in MarksLP.

f) Distribution to Unitholders

The amount of cash to be distributed annually to Unitholders is determined with reference to distributable cash, which is calculated as net earnings adjusted for future income taxes, non-cash changes in derivative interest rate swaps, and amortization expense. Distributions are recorded when declared, made monthly in

arrears and are subject to the Fund retaining such reasonable working capital reserves as may be considered appropriate by the trustees of the Fund.

g) Use of estimates
The preparation of the consolidated financial statements in conformity with Canadian generally accepted accounting principles requires the trustees to make estimates and assumptions that affect the reported amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The carrying amounts of investments and notes receivable from long-term investments, accounting for VIEs and future income taxes are the more significant areas requiring management judgement and estimation.

h) Financial instruments
Fair values
The Fund's financial instruments consist of cash and cash equivalents, accounts payable and accrued liabilities and distributions payable to Unitholders. The fair values of these instruments approximate their carrying amounts due to their short-term maturity. The Fund's term loan is also a financial instrument whose fair value approximates carrying value. The Fund also has an interest rate swap contract that is a financial instrument. Details on the fair value of this instrument are provided in note 6.

6 Term Loan and Operating Facility

On December 2, 2004, MarksCo, as borrower, and the Fund and a subsidiary of the Fund, as guarantors, entered into a term credit agreement maturing on December 2, 2007, which was subsequently extended to December 2, 2009. The $12,000 credit facilities were comprised of an $11,000 non-revolving term credit facility and a $1,000 operating credit facility. As a result of the Reorganization, the Fund negotiated new credit facilities of $12,000, also comprised of an $11,000 non-revolving term credit facility and a $1,000 operating facility, with its bankers on similar terms and conditions as MarksCo's facilities. The proceeds of this new loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan.

The $11,000 non-revolving term credit facility bears interest at prime or base rate plus 0.75% or LIBOR advances or bankers' acceptances plus 1.75%. At December 31, 2008, the full amount of the $11,000 non-revolving term credit facility was drawn with an effective interest rate of 6.62% after taking into consideration the interest rate swap described below.

The $1,000 operating credit facility bears interest at prime or base rate plus 0.50% or LIBOR advances or bankers' acceptances plus 1.50%. At December 31, 2008, no advances had been drawn on this facility.

The term credit facilities are collateralized by substantially all the assets of MarksLP and the Fund, including the Agreement, pursuant to which Second Cup has also provided a general security agreement.

An interest rate swap agreement was entered into by the Fund maturing December 2, 2009, which fixes the interest rate on the Fund's non-revolving credit facility at 4.87% per annum plus the variable margin noted above. At December 31, 2008, the estimated fair value of this contract is a $412 liability to the Fund (2007 - $143) and is recorded as a liability on the Fund's consolidated balance sheet and as a non-cash charge to earnings.

Pursuant to the terms of the Fund Operating Loan and Fund Term Loan, MarksLP is subject to certain financial and other customary covenants, including requirements to maintain a ratio of senior debt to EBITDA of less than 1.25:1.0 and to maintain trailing four quarter EBITDA in excess of $9,000,000. In addition, the Bank may accelerate repayment of the Fund Term Loan and Fund Operating Loan in the case of certain events, including a change in control of MarksLP or a default by MarksLP under material agreements or other indebtedness. During the year ended December 31, 2008, MarksLP was in compliance with all financial and other covenants of the Fund Operating Loan and Fund Term Loan.

In accordance with the adoption of CICA Handbook Section 3855, the term loan is presented net of transaction costs. Transaction costs are amortized to the consolidated statements of earnings and comprehensive income using the effective interest method. At maturity, December 2, 2009, the balance sheet value of the term loan will be equal to the face value. At December 31, 2008, the net long-term debt is $10,954 (face value is $11,000 net of $46 transaction costs).

On March 4, 2009, the Fund renegotiated its term loan and operating credit facilities including an extension of the maturity of the credit facilities to January 2, 2011. The revised $12,000 credit facilities are comprised of an $11,000 non-revolving term credit facility, fully drawn, and an undrawn $1,000 revolving credit facility, bearing interest at prime or base rate plus 2.5% or LIBOR advances or bankers' acceptances plus 3.5%. The derivative interest rate swap was also extended to January 2, 2011. As a result, the effective interest rate has been reduced from 6.62% to 6.41%.

In accordance with EIC-122, the term loan has been classified as a long term liability even though prior to the renegotiation, it was due to mature in December 2009.

7 System Sales

System sales include gross revenue of the pool of Second Cup cafés (Company-owned or franchised) on which Second Cup pays a royalty to MarksLP (the "Royalty Pool") based on information reported by café operators. Gross revenue is self-assessed by each café on a weekly basis and submitted to Second Cup. System sales reported by cafés in the Royalty Pool were $197,340 in 2008 and $195,750 in 2007.

8 Royalty Pool Adjustments

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount that may be satisfied by additional Fund units or cash, the form of payment being at the option of MarksLP or, prior to the Reorganization, MarksCo. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net sales, with the balance received when the actual full year performance of the new cafés is known.

On January 1, 2007, the actual sales of the nine cafés added to the Royalty Pool on January 1, 2006 were greater than the original estimate. In accordance with the provisions in the Agreement, a final adjustment of

$356 was satisfied by MarksCo delivering to Second Cup 35,903 additional units of the Fund. In addition, MarksCo also made a cash payment of $37 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the additional units above had they been issued on January 1, 2006.

January 1, 2007
On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized sales of the 11 cafés added to the Royalty Pool were estimated at $4,555, offset by $3,815 in system sales of the 12 cafés permanently closed from the Royalty Pool during 2006. In accordance with the provisions in the Agreement, the Fund, through MarksCo, was required to make a payment of $315 to Second Cup, representing 80% of the obligation based on forecast sales. In January 2007, the Fund issued 34,630 units to MarksCo, which were then delivered to Second Cup to satisfy this obligation.

In conjunction with the second adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. These notes were repaid as part of the Reorganization discussed in note 2 above. The common shares were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

January 1, 2008
On January 1, 2008, the actual sales of the 11 cafés added to the Royalty Pool on January 1, 2007 for the year ended December 31, 2007 were determined to be greater than the original estimate. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on these additional units above had they been issued in January 2007.

Also on January 1, 2008, 15 cafés were added to the Royalty Pool. The annualized sales of these 15 cafés added to the Royalty Pool were estimated at $6,750. These sales were offset by $3,513 in sales of nine cafés permanently closed from the Royalty Pool during 2007. As a result of this adjustment to the Royalty Pool, MarksLP was required to make a payment of $1,346 to Second Cup, representing 80% of the obligation based on forecasted sales. On January 1, 2008, the Fund issued 143,712 units to MarksLP, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue 18,312 additional units to satisfy the remaining obligation. The total number of cafés in the Royalty Pool increased from 351 to 357.

In conjunction with the adjustment to the Royalty Pool, the Fund acquired units of MarksLP for total cash consideration of $1,641. The units were accounted for in the consolidated financial statements as an increase in the equity investment in MarksLP.

9 Impairment of Investment in Second Cup Trade-Marks Limited Partnership

The Fund equity accounts for MarksLP. Inherent in this equity accounted for investment is a trademark used in connection with the operation of Second Cup cafés in Canada. The trademark is an indefinite life

intangible asset that is tested for impairment annually in accordance with Canadian generally accepted accounting principles.

The impairment test performed by management involved comparing the estimated fair value of the trademark with its carrying value. Management considered a number of factors in estimating fair value of the trademark. These included discounted cash flow estimates, comparisons to the Fund's market capitalization, capitalized cash flow methods and earnings multiples. Each of these valuation approaches use estimates and assumptions that are sensitive to change and require management judgement. These key judgments include estimates of discount rates, forecast growth in system sales, market multiples, other estimates impacting future cash flows and control premiums. Changes in these estimates and assumptions may have a significant impact on fair value. General market uncertainty and the recessionary operating environment for the Fund and other similar retail entities were also factors taken into account in the analysis. An increase in the discount rate used in the analysis reflects the current volatility of the Fund's units and market conditions. The changes in the market growth rates reflect the current general economic pressures now impacting the national economy.

The Fund concluded the carrying value of its investment in MarksLP exceeded its fair value as of December 31, 2008. As a result, the Fund recorded a pre-tax non-cash charge for the year ended December 31, 2008 to reduce the investment in MarksLP by $24,349 to $88,500. After taking into account the related recovery of future income taxes, the non-cash after tax charge to income is $20,956 or $2.12 per unit.

10 Investment in Second Cup Trade-Marks Limited Partnership and in Second Cup Trade-Marks Inc.

As a result of the Reorganization described in note 2 above, the Fund's equity investment in MarksCo was replaced by a partnership interest in MarksLP. The following table details the changes in investment in MarksLP and MarksCo.

		2008		**2007**
Opening balance	$	110,543	$	9,326
Income in equity earnings from MarksLP*		12,565		9,314
Distributions received from MarksLP		(11,901)		-
Additional investment in MarksLP		1,642		-
Impairment of equity-accounted investment (note 9)		(24,349)		-
Income in equity earnings from MarksCo*		-		164
Subscription for additional common shares of MarksCo (note 8)		-		67
Dividends received from MarksCo		-		(190)
Release of future income tax liability on Reorganization* (note 2)		-		10,668
Conversion of debt to LP Units on Reorganization (note 2)		-		81,194
	$	88,500	$	110,543

* Excluding the impact of the impairment described in Note 9, aggregate earnings for 2008 from the equity accounted investment amounted to $12,565 (2007 - $20,146)

The total investment in Marks LP/MarksCo consists of the following:

		2008		2007
Cumulative equity in earnings of MarksCo	$	13,120	$	13,120
Cumulative dividends received from MarksCo		(1,900)		(1,900)
Cumulative equity in earnings of MarksLP		21,879		9,314
Cumulative distributions received from MarksLP		(11,900)		-
Impairment of equity-accounted investment (note 9)		(24,349)		-
Investment in MarksLP		91,650		90,009
	$	88,500	$	110,543

11 Income Fund Units

The declaration of trust of the Fund provides that an unlimited number of units may be issued. Each unit is transferable, and represents an equal undivided beneficial interest in any distribution of the Fund and in the net assets of the Fund. All units have equal rights and privileges. Each unit entitles the holder thereof to participate equally in allocations and distributions and to one vote at all meetings of Unitholders for each whole unit held. The units are not subject to future calls or assessments.

Units are redeemable at any time at the option of the Unitholder at a price based on market value as defined in the trust agreement, subject to a maximum of $50 in cash redemptions by the Fund in any one month. The limitation may be waived at the discretion of the trustees of the Fund.

	Number of units		Net proceeds
Balance, December 31, 2006	9,638,076	$	87,488
Issued January, 2007 (note 8)	70,533		671
Balance, December 31, 2007	9,708,609		88,159
Issued January, 2008 (note 8)	176,124		1,641
Balance, December 31, 2008	9,884,733	$	89,800

Subsequent to December 31, 2008, the Fund issued an additional 18,312 units (note 16).

12 Basic and Diluted Earnings Per Unit

Earnings per unit are based on the weighted average number of units outstanding during the year. Diluted earnings per unit are calculated to reflect the estimated dilutive impact of the additional units of the Fund to be issued to Second Cup as final consideration for the increase in the Royalty Pool. (see note 8). Basic and diluted earnings per unit are determined as follows:

	2008	2007
Numerator for basic and diluted earnings per unit – net income	($9,531)	$8,196
Denominator for basic earnings per unit:		
- weighted average number of units issued and outstanding	9,884,733	9,708,609
Denominator for diluted earnings per unit:		
- weighted average number of units issued and outstanding	9,884,733	9,708,609
- impact of additional units to be issued on January 1, 2008 adjustment to Royalty Pool	-	32,412
- impact of additional units to be issued on January 1, 2009 adjustment to Royalty Pool	18,312	-
Denominator for diluted earnings per unit	9,903,045	9,741,021
Basic earnings (loss) per unit	($0.9642)	$0.8442
Diluted earnings (loss) per unit (*)	($0.9642)	$0.8414

* The impact of additional units to be issued on January 1, 2009 adjustment to the Royalty Pool has been excluded from the computation of diluted loss per unit as its impact is anti-dilutive.

13 Related Party Transactions and Balances

During the year, interest income of $2 (2007 - $535) was earned on the note receivable from MarksLP (note 10). In 2007, interest income of $2,424 was earned on the note receivable from MarksCo. In addition, dividend income of $190 was received from MarksCo.

The Fund also charged a management fee of $268 (2007 - $87) to MarksLP for certain general and administrative expenses. This fee is netted against general and administrative expenses of the Fund.

In January, 2008, the Fund engaged in a number of transactions with MarksLP to effect the second adjustment to the Royalty Pool with Second Cup. Refer to note 8 above for further details on these transactions.

14 Income Taxes

On June 12, 2007 new tax legislation was enacted changing the rules applicable to publicly traded income trusts commencing in 2011. In 2011, income taxes payable will reduce net earnings of the Fund.

As a result of the enactment of the new trust tax legislation, the Fund is now required to give accounting recognition to these new rules. Future income taxes are recorded as the difference between the accounting values of balance sheet assets and liabilities and the income tax cost basis of these assets and liabilities based on substantively enacted tax laws and rates for differences that are expected to reverse after January 1, 2011.

In 2008 the Fund recognized a future non-cash income tax recovery amounting to $3,664 (2007 – expense of $13,504) arising primarily from the impairment charge (note 9) and also from a change in the temporary income tax differences expected to exist on January 1, 2011 at the tax rate applicable to the Fund.

Income tax expense as reported differs from the amount that would be computed by applying the combined federal and provincial statutory income tax rates to earnings before income taxes. The reasons for the differences are as follows:

	2008	2007
Earnings (loss) before income taxes	$ (13,195)	$ 21,703
Combined Canadian federal and provincial tax rates	46.41%	46.41%
Tax provision at statutory rate	(6,124)	10,072
Reduced by following differences:		
Income distributed or accrued to Unitholders not subject to tax in the Fund	(5,335)	(5,132)
Impact of future tax applicable beginning in 2011	(3,664)	(13,504)
Impact of impairment of equity accounted investment	11,300	-
Non-deductible permanent differences	159	211
Earnings from equity-accounted investment in MarksCo	-	(5,148)
Provision for income taxes (recovery)	$ (3,664)	$ 13,507

The principal temporary differences that give rise to the net future income tax liability at December 31, 2008 and 2007 relate to temporary differences between the accounting and tax basis of MarksLP's intangible assets.

15 Economic Dependence

All of the Fund's income is comprised of equity income from its ownership of MarksLP. In turn, all of MarksLP's income is derived from royalties payable by Second Cup to MarksLP under the Agreement as described in note 2.

16 Subsequent Events

a) January 1, 2009 Royalty Pool Adjustment
On January 1, 2009, the actual sales of the 15 cafés added to the Royalty Pool on January 1, 2008 (see note 8) for the year ended December 31, 2008 were greater than the original estimate. As a result, a final adjustment of $172 was satisfied by MarksLP purchasing and delivering 18,312 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $21 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the 18,312 additional units above had they been issued on January 1, 2008.

Also, on January 1, 2009, 18 cafés were added to the Royalty Pool. The system sales of these 18 cafés added to the Royalty Pool have been estimated at $7,209 annually. These sales were offset by $6,194 in sales of 16 cafés permanently closed from the Royalty Pool during 2008. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $190 to Second Cup, representing 80% of the obligation based on forecast system sales. In January, 2009, the MarksLP satisfied this obligation by a cash payment to Second Cup. After a full year of performance of the new cafés, MarksLP expects to satisfy the remaining obligation by an additional payment. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 357 to 359.

b) Extension of Credit Facilities, including Interest Rate Swap Agreement, until January 2, 2011
On March 4, 2009, the Fund renegotiated its term loan and operating credit facilities including an extension of the maturity of the credit facilities to January 2, 2011. The revised $12,000 credit facilities are comprised of an $11,000 non-revolving term credit facility, fully drawn, and an undrawn $1,000 revolving credit facility, bearing interest at prime or base rate plus 2.5% or LIBOR advances or bankers' acceptances plus 3.5%. The derivative interest rate swap was also extended to January 2, 2011. As a result, the effective interest rate as of March 2, 2009 has been reduced from 6.62% to 6.41%.

17 Supplementary Cash Flow Information

Cash and cash equivalents include $Nil (2007 - $900) in a Bankers Acceptance issued by a Canadian chartered bank.

Changes in non-cash working capital items excluding:

		2008		2007
Prepaid expenses	$	91	$	(137)
Interest receivable from Second Cup Trade-Marks Inc.		22		789
Accounts payable and accrued liabilities		18		(65)
Income taxes recoverable		-		2
	$	131	$	589

Supplementary information:

		2008		2007
Interest paid	$	649	$	565
Income taxes paid	$	-	$	3

18 Management of Capital

The capital structure of the Fund consists of long-term debt and Unitholders' equity, which is comprised of issued units and accumulated earnings, less accumulated cash distributions. The Fund's objectives when managing capital are to safeguard its ability to continue as a going concern and ensure it has sufficient cash and cash equivalents to pay distributions to its Unitholders. The Fund has no capital expenditure requirements.

The determination to declare and make payable distributions from the Fund are at the discretion of the Trustees of the Fund and until declared payable, the Fund has no requirement to pay cash distributions to its Unitholders. Distributions paid in the year to unitholders amounted to $11,075.

The Fund determines the appropriate level of long-term debt in the context of its cash flow and overall business risks. The Fund has historically generated sufficient cash flow to pay monthly distributions to its Unitholders. In order to maintain or modify the capital structure, the Fund may adjust the amount of distributions paid to its Unitholders.

Under the Term Loan and Operating Facility, the Fund is required to comply with a number of covenants and restrictions, including the requirements to meet certain financial ratios. These financial ratios include a senior leverage ratio and ratios pertaining to earnings before interest, depreciation, taxes and amortization. To date, the Fund has complied with these ratios.

The Fund will become subject to Canadian corporate income taxes beginning in 2011. This may result in changes to the capital structure of the Fund or the nature of the Fund itself.

There were no changes in the Fund's approach to capital management during the period.

19 Financial Instruments and Financial Risk Management

Financial Instruments

The Fund's financial instruments consist of cash and cash equivalents, accounts payable, accrued liabilities, distributions payable to Unitholders, term loan, and the derivative interest rate swap. As described in Note 16, the Fund has negotiated new terms and conditions for its credit facilities until 2011. The fair values of these instruments approximate their carrying amounts due to their short-term maturity.

Financial assets are classified as either available-for-sale, held-for-trading, held-to-maturity or loans and receivables. Financial liabilities are classified as either held-for-trading or cost/amortized cost. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading are measured at amortized cost. All derivative instruments must be classified as held-for-trading. All other financial assets and derivatives are measured at fair value. Transaction costs associated with long-term debt are included in the carrying value of the long-term debt and are amortized using the effective interest rate method.

The Fund's financial instruments are exposed to credit risk, liquidity risk and interest rate risk.

Credit Risk
The Fund's financial instruments exposed to credit risk include cash and cash equivalents. The Fund places its cash and cash equivalents with institutions of high creditworthiness. The Fund is also exposed to credit risk in the event of non-payment of royalties in accordance with the Agreement by Second Cup to MarksLP. The Fund has also obtained a general security on Second Cup's assets pursuant to the Agreement to mitigate this risk.

Liquidity Risk
Liquidity risk is the risk that the Fund will encounter difficulty in meeting obligations as they come due associated with its financial liabilities. The Fund manages liquidity risk through regular monitoring of distribution levels, forecast and actual cash flows, and also the management of its capital structure and senior leverage ratios as outlined in Note 18. The Fund's sole source of income are distributions from MarksLP. MarksLP's cash inflows to service these distributions to the Fund are generated by royalty receipts from Second Cup pursuant to the Agreement as described in note 2.

Interest Rate Risk
The Fund is exposed to interest rate risk on its term loan and operating facility and, to a lesser extent, on its interest bearing investments in cash and cash equivalents. The Fund's term loan bears interest at prime or base rate plus 0.75% or LIBOR advances or bankers' acceptances plus 1.75%. The $1,000 operating credit facility bears interest at prime or base rate plus 0.50% or LIBOR advances or bankers' acceptances plus 1.50%. At December 31, 2008, no advances had been drawn on this facility. An interest rate swap agreement fixes the interest rate on the Term Loan at 4.87% plus the variable margin noted above until December 2, 2009. Management assesses that the interest rate risk exposure is not significant given the interest rate swap above, which fixes the interest rate through December 2, 2009. Net earnings for 2008 would have changed by approximately $110 annually if the prime rate changed by 1%.

As part of managing liquidity risk, capital resources and interest rate risk, Management recognizes that the Fund's Term Loan matures on December 2, 2009 and intends to continue to utilize long-term debt as part of its capital structure. See note 16 relating to the extension of the credit facilities, including the interest rate swap agreement, to January 2, 2011.

Sensitivity analysis
Section 3862 requires disclosure of a sensitivity analysis to illustrate the sensitivity of the Fund's financial position and performance to changes in market variables (foreign exchange rates and interest rates) as a result of changes in the fair value of cash flows associated with the Fund's financial instruments. The sensitivity analysis provided discloses the effect on net earnings at December 31, 2008, assuming that a reasonably possible change in the relevant risk variable has occurred at December 31, 2008

A 100 basis points difference in the market interest rates from those applicable at December 31, 2008 with all other variables remaining constant would not have a material impact on the Fund's income due to the fact that the interest rate exposure is fully hedged by the interest rate swap as described in note 6.

THE SECOND CUP LTD.

Report to Unitholders of Second Cup Royalty Income Fund
December 29, 2007 to December 27, 2008

This report and the consolidated financial statements of The Second Cup Ltd. ("Second Cup" or "the Company") are provided as a supplement to the annual consolidated financial statements and management's discussion and analysis of the Second Cup Royalty Income Fund (the "Fund"). This report is dated March 7, 2009 and should be read in conjunction with the consolidated financial statements of Second Cup for the 52 weeks ended December 27, 2008.

The consolidated financial statements of Second Cup are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are presented in thousands of Canadian dollars, except units, unless otherwise indicated.

BASIS OF PRESENTATION

The Company adopted Accounting Guideline 15 ("AcG-15"), a pronouncement of The Canadian Institute of Chartered Accountants ("CICA") related to variable interest entities ("VIEs") in January 2005. AcG-15 outlines who should consolidate such entities. The Company determined that Second Cup Trade-Marks Limited Partnership ("MarksLP") and Second Cup Trade-Marks Inc. ("MarksCo"), both wholly owned subsidiaries of the Fund, are VIEs. MarksLP, and prior to the reorganization described below, MarksCo, owns the Canadian trademarks and certain other intellectual property and associated rights used by Second Cup in connection with the operation of Second Cup cafés in Canada (excluding the territory of Nunavut) (collectively, the "Second Cup Marks" or the "Marks") and, through the Agreement noted below, has licenced them to the Company, which operates the business activities associated with these trademarks, in exchange for a royalty payment. The activities of MarksCo, MarksLP and Second Cup are closely related and with the guidance provided by AcG-15, management has determined that Second Cup should consolidate the financial results of MarksCo and MarksLP.

A Licence and Royalty Agreement (the "Agreement") exists under which MarksLP licences the use of the Second Cup trademarks (the "Second Cup Marks") to Second Cup for a period of 99 years. In exchange for this licence, Second Cup agreed to pay MarksLP a royalty equal to 6.5% of system sales of a defined number of Second Cup cafés in Canada (the "Royalty Pool"). Prior to the reorganization noted below, Second Cup had paid this royalty to MarksCo.

The adoption of AcG-15 does not change the contractual rights and obligations between Second Cup and MarksLP. It is important to note that MarksLP continues to own the Second Cup Marks and receive royalty revenues from Second Cup and pay its obligations to the Fund. The liabilities of MarksLP, comprising notes payable to the Fund, are obligations of MarksLP, not Second Cup. For further information on the financial results of the Fund, readers are referred to the Fund's annual consolidated financial statements and management's discussion and analysis for the calendar year ended December 31, 2007, which is available at www.sedar.com.

OVERVIEW AND BUSINESS OF SECOND CUP

Second Cup franchises, owns and operates the second largest specialty coffee café chain in Canada, as measured by the number of cafés. Second Cup's revenues are derived from royalties from franchisees, initial and renewal franchise fees, administration fees, sales from Company-owned cafés, coordination fees, and other sources of revenue. The Company's revenues are affected by a number of factors, principally system wide sales, the net number of new cafés opened, the number of franchise agreements renewed and sales of Company-owned cafés.

Operating costs and administrative expenses include the compensation, general and administrative costs associated with the operations of Second Cup in providing services to the franchised and the Company-owned Second Cup cafés, costs of maintaining and enhancing the Second Cup brand, costs associated with

developing, researching and marketing new products, and costs associated with the establishment of new Second Cup cafés and the refranchising of existing Second Cup cafés. Operating costs also include the cost of operating Company-owned cafés. Pursuant to the Agreement, the Company pays a royalty to MarksLP based on the annual sales of the Second Cup cafés included in the Royalty Pool.

As a result of the application of AcG-15, operating costs and administrative expenses disclosed in the Company's consolidated financial statements include expenses of MarksLP, a wholly owned subsidiary of the Fund.

Second Cup's fiscal year comprises 13 periods of four weeks each, ending on the last Saturday of December. To accommodate this year-end, an additional week (i.e., a 53rd week) is expected to be added approximately every five years. The Company's fiscal quarters consist of three 12-week periods and a fourth quarter consisting of 16 weeks. The Company's most recently completed fiscal year was the 52 weeks ended December 27, 2008.

MarksLP's business is the ownership of the Second Cup Marks. MarksLP uses the royalty revenue earned on the licensing of the trademarks and other intellectual property and associated rights used by Second Cup cafés in Canada to make distributions and loan repayments, if any, to the Fund. MarksLP's fiscal year ends December 31.

REORGANIZATION OF THE FUND IN 2007

On April 2, 2007, the Unitholder-approved reorganization of the structure of the Fund (the "Reorganization") replaced its subsidiary corporations, including MarksCo, with a newly formed trust and limited partnership. This latter entity, MarksLP, has been consolidated for reporting purposes with Second Cup as a VIE for the same reasons that MarksCo had historically been consolidated by Second Cup.

As a result of the Reorganization, the Fund negotiated a new term loan of $11,000 with its bankers on similar terms and conditions as MarksCo's term loan. The proceeds of this new loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay MarksCo's term loan. Further, the notes payable by MarksCo to a subsidiary of the Fund, which amounted to $79,343 as at April 1, 2007, were repaid through an increase in the equity ownership of MarksLP by the Fund and a new note payable by MarksLP to the Fund. The increase in the equity ownership of MarksLP was recorded as an increase in the non-controlling interest on the Company's consolidated balance sheets.

Under the new structure, the new wholly owned subsidiaries of the Fund are not subject to income tax. As a result, the future income tax liabilities on the consolidated balance sheets of Second Cup prior to the Reorganization relating to MarksCo of $9,966 were credited to consolidated earnings on April 2, 2007 and resulted in an increase in the non-controlling interest on the Company's consolidated balance sheets.

The Agreement entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to licence the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of system sales of cafés in the Royalty Pool are payable to MarksLP. As a result of the Reorganization, the Fund's earnings are predominantly comprised of distribution income from MarksLP in place of interest and dividend income from MarksCo.

It is important to note that while the Fund's underlying structure was changed, essentially the underlying assets and operations of the Fund and its subsidiaries did not change as a result of the Reorganization.

FINANCIAL HIGHLIGHTS

The following tables set out selected consolidated financial information and other data of Second Cup, including the results of MarksLP and MarksCo, and should be read in conjunction with the consolidated financial statements of Second Cup.

(in thousands of dollars, except number of cafés)	16 weeks ended December 27, 2008	16 weeks ended December 29, 2007	52 weeks ended December 27, 2008	52 weeks ended December 29, 2007
Number of cafés in Canada – end of period	361	366	361	366
System sales - Canadian operations	$66,837	$67,779	$200,979	$200,271
Same café sales growth	(0.3%)	1.1%	0.2%	3.1%
Total revenue	$10,381	$10,302	$30,924	$33,046
Operating costs and administrative expenses	$5,769	$5,867	$18,446	$20,715
Restructuring costs	609	-	1,258	-
Investment income	$42	$59	$201	$112
Interest (income) expense, net	($4)	$56	($58)	$3,005
Net (loss) earnings for the period	($329)	$151	($1,626)	($304)

	As at December 27, 2008	As at December 29, 2007
Total assets	$102,428	$104,254
Total long-term liabilities	$157	$445
Non-controlling interest in MarksLP/MarksCo	$104,341	$102,115

Analysis of system sales

System sales for the 16 weeks ended December 27, 2008 (the "Period") were $66,837, compared to $67,779 for the 16 weeks ended December 29, 2007, a decrease of 1.4%. For the year, system sales were $200,979, up from $200,271 in 2007, an increase of 0.4%. Same café sales growth for the year was 0.2%.

A softening of café sales continued across its major markets in 2008 resulting from lower customer traffic, which management of Second Cup believes is similar to the trend experienced in retail in general and reflective of the current dramatic downturn in the Canadian economy. Offsetting this trend, system sales for the Fourth Quarter and for the year were positively impacted by (1) a continuing shift in the sales mix towards newly introduced food offerings, such as grilled sandwiches and a premium hot breakfast sandwich in key markets, resulting in a higher average cheque versus 2007; (2) the implementation of some minor price increases on whole beans, ready to drink beverages and some espresso-based beverages; and (3) the introduction of a new valve bag, pre-packaged whole coffee beans supported with an in-store merchandise unit.

Management is not aware of any reliable third party comparable data on the trends affecting the Canadian specialty coffee market during the year or the performance of Second Cup's competitors in the Canadian market during this period.

16 weeks ended December 27, 2008

Analysis of revenues

Revenues of $10,381 were generated in the Period compared to $10,302 for the 16-week period ended December 29, 2007. The increase was due mainly to increased sales from Company-owned cafés in the Period, offset by reduced royalties on lower system sales and a decrease in other income as discussed further below. Excluding sales from Company-owned cafés, the effective royalty rate was consistent with the comparable period at 8.6% of system sales.

Revenues from Company-owned cafés were $3,028 for the Period, up from $2,062 for the 16 weeks ended December 29, 2007, due mainly from operating more Company-owned cafés compared to the prior year. Second Cup ended the Period with 27 Company-owned cafés, four of which were operated by franchisees. In the 2007 Period there were 21 Company-owned cafés, four of which were operated by franchisees.

Other income decreased to $1,864 for the Period versus $2,606 for the comparable period. Other income includes initial franchise fees, which are recognized as income when a new cafés are opened; renewal fees, which are recognized when an existing franchisee enters into a new franchise agreement; transfer fees earned on the sale of cafés from one franchisee to another; construction administration fees; purchasing coordination fees earned; and other income earned by Second Cup on the sale of its branded coffee through alternate channels. The decrease in other income compared to last year was due to reduced fees in all of the above channels given the decrease in activity in the Period.

Analysis of net earnings

Operating costs and administrative expenses, including expenses of MarksLP of $147 (2007 - $169) for the Period, were $5,769 versus $5,867 for the comparable period in the prior year. Primarily, the reduction occurred in lower administrative costs due to lower legal expenses and other overheads. These savings were offset mainly by the increased costs of operating Company-owned cafés as discussed in "Analysis of revenues" above.

During the year, the Company approved a plan to realign personnel and its management structure. The costs associated with this restructuring were $609 in the Period.

Amortization of capital assets amounted to $172 for the Period (2007 - $150) due to six additional corporate cafés and amortization of head office computer equipment. The company also recorded a $230 (2007 - $nil) writedown of two corporate cafés to fair values, one of which was closed in January 2009.

During the Period, the Company sold six corporate cafés (2007 - five) resulting in a gain on disposal of $30 (2007 - $24).

As the notes payable by MarksLP to the Fund had been previously repaid, no interest expense was recorded in the Period compared to an expense of $109 in 2007. Interest income relating to cash and cash equivalents was $4 in the Period (2007 - $53).

During the Period, investment income of $42 was earned on units of the Fund owned by Second Cup, compared to income of $59 earned in the comparative period. This decrease was due to the lower number of Fund units owned by Second Cup as a result of the sale of Fund units during the Period (see "Related Party Transactions" below).

An income tax recovery of $120 was recognized in the Period compared to a recovery of $325 in the 16-week period ended December 29, 2007. In the fourth quarter of 2007, as a result of reassessments obtained subsequent to a federal income tax audit relating to the predecessor corporation of MarksLP, MarksLP recorded a recovery of $450 in current income taxes.

A non-controlling interest of $4,126 was recorded in the Period (2007 - $4,487), reflecting the earnings of MarksLP attributable to the Fund.

Second Cup recorded a loss of $329 for the Period, compared to net earnings of $151 for the 16-week period ended December 29, 2007. Second Cup also recorded an unrealized loss of $158 resulting from a decrease in the fair market value of its ownership of 57,507 (September 6, 2008 - 132,657) units of the Fund. These units were valued at $4.75 as at December 27, 2008 compared to $7.50 as at September 6, 2008. This unrealized loss was recorded in other comprehensive loss. As a result of the sale of 75,150 units to a related party at fair market value in the Period (see "Related Party Transactions" below), the Company recorded losses amounting to $190 on the sale of these units by crediting other comprehensive income and a corresponding charge to its Deficit in accordance with CICA Handbook Section 3840 - Related Party Transactions. These transactions resulted in a net loss of $15 (2007 - $45), net of $16 in a recovery of future income taxes (2007 - $24), in other comprehensive loss.

The decrease in earnings compared to the Period in the prior year is principally due to the increasingly weaker general economic conditions in Canada.

52 weeks ended December 27, 2008

Analysis of revenues

Revenues in 2008 were $30,924, compared to $33,046 for the 52 weeks ended December 29, 2007. Royalty revenue has increased to $16,573 from $16,270, as a result of the 1.2% increase in system sales excluding corporate cafés. Revenue from Company-owned and operated cafés declined from $10,482 to $8,868 as the Company operated a different mix of Company-owned cafés compared to the prior year. Year over year sales of Company-owned cafés are not directly comparable as the mix of Company-owned cafés changes as Second Cup refranchises, takes over and builds Company-owned cafés throughout the year. Also, the prior year included five Company-owned cafés which had significantly higher volumes than system-wide average cafés, two of which were sold in the first half of the year and three of which were sold later in the year. Excluding sales from Company-owned and operated cafés, the effective royalty rate was 8.6% or 0.1% higher than the prior year.

Other income decreased to $5,843 from $6,294 for the year-to-date and was due to reduced fees in all channels described above.

Analysis of net earnings

Operating costs and administrative expenses, including expenses of MarksLP of $423 (2007 - $496, incurred by MarksLP and MarksCo), were $18,446 for the 52 weeks ended December 27, 2008, compared to $20,715 for the prior year. The reduction in operating costs and administrative expenses was mainly due to reduced legal expenses, annual convention costs in 2007 and savings in other overheads. The Company experienced a decline in operating costs of Company-owned cafés although costs are not directly comparable as discussed in "Analysis of revenues" above.

During the year, the Company approved a plan to realign personnel and its management structure. The costs associated with this restructuring were $1,258 in 2008.

Amortization of capital assets amounted to $519 for the year versus $503 for 2007. In the prior year MarksCo's amortization of its deferred financing charges amounted to $142. MarksCo wrote off the balance of its deferred financing charges on April 2, 2007 when the related $11,000 term loan was repaid as part of the Reorganization. The company also had a $230 (2007 - $nil) writedown of two corporate cafés, one of which was closed in early January 2009.

The Company sold ten corporate cafés (2007 - 12) resulting in a loss on disposal of $10 (2007- gain $181).

In 2007 MarksCo incurred interest expense of $2,449 on the notes payable to a subsidiary of the Fund. In connection with the Reorganization, the notes payable of $79,343 were effectively replaced by the Fund's investment in limited partnership units of MarksLP and a note payable of $9,171 by MarksLP to the Fund. Interest expense of $4 (2007 - $534) was incurred on this note by MarksLP. In addition, as a result of the bank

term loan payable by MarksCo being repaid as part of the Reorganization, it incurred interest expense of $145 in 2007. Interest income relating to cash and cash equivalents was $62 in 2008 (2007 - $123).

During the year, Second Cup earned investment income of $201 on its units of the Fund, compared to income of $112 earned in 2007. This increase was due to the increased number of Fund units owned by Second Cup (see "Royalty Pool Adjustments" and "Related Party Transactions" below) and from the increase in monthly distributions by the Fund.

The Company recorded a net income tax recovery of $140, compared to a recovery of $10,108 in 2007. As a result of the Reorganization, MarksCo was replaced by MarksLP, a non-taxable limited partnership. Therefore, the future income tax liabilities of $9,966 relating to the Marks were eliminated in 2007. Also, in the fourth quarter of 2007, as noted above, MarksLP recorded a recovery of $450 in current income taxes.

As a result of the receipt of units of the Fund in conjunction with the adjustment to the Royalty Pool, as described in "Adjustment to the Royalty Pool" below, Second Cup realized income for tax purposes of $1,518 in 2008 (2007 - $609) resulting in a current income tax expense of approximately $245 in 2008 (2007 - $110). For financial reporting purposes, the consideration paid to the Company for net vend-in of cafés to the Royalty Pool is deferred over the term of the Royalty Agreement and recorded as deferred income. As of December 27, 2008, Second Cup has recorded cumulative deferred revenue arising from these transactions in the amount of $2,984 (December 29, 2007 - $1,495). This deferred income is eliminated on consolidation of MarksLP with the Company.

A non-controlling interest of $12,486 was recorded in 2008 (2007 - $19,386), reflecting the non-controlling interest in the earnings of MarksLP and MarksCo attributable to the Fund, which indirectly owns 100% of MarksLP/MarksCo. The elimination of the future income tax liabilities in 2007 of $9,966 associated with the Marks in the period resulted in a corresponding increase to non-controlling interest. Furthermore, due to the $79,343 notes payable by MarksCo to the Fund effectively being replaced with a note of $9,171 and an investment in limited partnership units by the Fund, interest expense decreased on these combined notes to $4 from $2,983 in the prior year, also increasing the earnings of MarksLP compared to the prior year.

Accordingly, Second Cup recorded a net loss of $1,626 for 2008, versus a net loss of $304 for 2007. Second Cup also recorded an unrealized loss of $235 (2007 - $4), net of a recovery of future income taxes of $62 (2007 - $2), resulting from a decrease in the fair market value of its ownership of 57,507 (2007 – 70,533) units of the Fund. These units were valued at $4.75 as at December 27, 2008 compared to $9.44 as at December 29, 2007. This unrealized loss was recorded in other comprehensive loss. The unrealized loss of $235 is net of the realization of $324 in losses credited to other comprehensive income and charged to Deficit as a result of the sale of 189,150 units (see "Related Party Transactions" below).

The decrease in earnings for 2008 compared to 2007 is principally due to the increasingly weaker general economic conditions in Canada starting mid way through the year.

SELECTED QUARTERLY INFORMATION

A discussion of the Company's previous quarterly results since the Fund's inception can be found in the Company's quarterly reports available at www.sedar.com.

	2008				2007			
(in thousands of dollars except cafés)	Q4[1]	Q3	Q2	Q1	Q4[1]	Q3	Q2	Q1
Number of cafés at end of period	361	364	363	363	366	361	357	357
Same café sales growth	(0.3%)	(0.2%)	0.6%	0.8%	1.1%	1.7%	4.7%	5.8%
System sales	$66,837	$43,848	$46,022	$44,272	$67,779	$43,758	$45,289	$43,445
Net earnings (loss) for the period	($329)	($386)	($365)	($546)	$151	$114	$11	($580)

[1] The Company's fiscal year consists of three 12-week quarters and a fourth quarter consisting of 16 weeks. As such, the fourth quarter information presented for 2008 and 2007 represents the 16 weeks ended December 27, 2008 and December 29, 2007, respectively, and are not comparable to other quarters.

Seasonality of system sales
The first quarter represents the lowest average sales quarter for the year due to the seasonality of the business. The final quarter, which includes the holiday sales periods of November and December in the retail industry, generally constitutes the highest average sales quarter of the fiscal year.

LIQUIDITY AND CAPITAL RESOURCES

16 weeks ended December 27, 2008
Cash generated by operating activities was $2,998 for the Period compared to $3,584 for the 16 weeks ended December 29, 2007. Cash generated by operating activities in the Period was impacted mainly by the operating loss after accounting for items not involving cash. Cash generated by operating activities in the Period was impacted by an increase in non-cash working capital of $1,114, due to an increase in accounts payable and accrued liabilities of $1,262 in the period related mainly to the seasonal increase in liabilities relating to unused balances on the Second Cup Café card, offset by decreased deposits from franchisees of $393 due to renovations completed in the period and an increase in accounts receivable of $2,006 in the period due to the seasonality of sales and coordination fees.

During the Period, cash generated by investing activities was $809 compared to cash usage of $89 in 2007. The Company sold six Company-owned cafés during the Period generating proceeds of $494 compared to five cafés sold in the comparative Period generating proceeds of $752. The Company generated proceeds of $500 on the sale of Fund units (see "Related Party Transactions" below). Furthermore, investing activities included the purchase of capital assets of $184 (2007 - $841), principally for the construction of new Company-owned cafés, and the modernization and renovation of Company-owned and operated cafés in the Period.

Financing activities resulted in a cash usage of $3,901 during the Period, compared to $4,814 in the comparative period. The current Period activities included MarksLP distributions of $3,901 to the Fund. In the prior year, MarksLP made principal repayments of its notes payable to the Fund amounting to $4,814.

52 weeks ended December 27, 2008
Cash generated by operating activities was $10,383 for 2008, compared to $9,843 for 2007. Cash generated by operating activities in the year was impacted mainly by the combined earnings of MarksLP of $12,486 compared to combined earnings of MarksLP and MarksCo of $9,420, after excluding a non-cash future income tax writedown of $9,966 described above. The current year earnings of MarksLP compared to the prior year combined earnings of MarksLP and MarksCo increased as a result of the elimination of the term

loan and notes payable to the Fund in the Reorganization, significantly reducing interest expense in the current year. As a result of the Reorganization, this interest expense has effectively been replaced by the distribution of earnings on units of MarksLP to its parent, the Fund. Cash generated by operating activities was also impacted by an increase in non-cash working capital of $1,233 due to a decrease in accounts payable and accrued liabilities of $1,070 and a decrease in deposits from franchisees of $423 due to completed renovations.

For 2008, investing activities resulted in a generated cash of $201 compared to cash usage of $1,028 for 2007. The Company generated proceeds of $848 on the sale and refranchising of ten Company-owned cafés compared to $1,296 in 2007 on the sale of 12 cafés. The Company generated proceeds of $1,412 on the sale of Fund units (see "Related Party Transactions" below). Furthermore, investing activities included the purchase of capital assets of $2,059 (2007 - $1,653), principally for the construction of new Company-owned cafés, and the modernization and renovation of Company-owned and operated cafés in the period. As discussed further below, in the prior year, 70,533 units of the Fund were purchased for $671 by MarksCo (see "Royalty Pool Adjustments" below).

During the year, financing activities resulted in a cash usage of $12,201 compared to $8,368 in the prior year. MarksLP fully repaid the notes payable to the Fund in 2008 amounting to $300 (2007 - $8,871) and made distributions of $11,901 to the Fund. In 2007, the Reorganization resulted in cash proceeds of $11,022 of which $11,000 was used to repay the term loan. Cash used in financing activities also included dividends declared and paid of $190 by MarksCo to the Fund. MarksCo delivered units of the Fund valued at $671 on January 1, 2007 to Second Cup (see "Royalty Pool Adjustments") and financed the purchase of these units by the issuance of $67 in common shares and $604 of notes payable to a subsidiary of the Fund. The common shares were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

OFF-BALANCE SHEET ARRANGEMENTS

Second Cup has lease commitments for Company-owned cafés. In addition, Second Cup is a sublessor under the head lease for all franchised cafés, other than locations franchised to certain corporate franchises and certain hospitals and universities. Should franchisees fail to meet their obligations under the terms of their respective subleases, Second Cup would become liable for the obligations under the related head leases. In the event that a franchisee fails to meet its obligations under the terms of its sublease, Second Cup has the right to take steps to terminate the existing franchise agreement and either operate the location as a Company-owned café or refranchise the location.

The following table sets out anticipated net lease obligations for Second Cup.

	Payments Due by Period					
(in thousands of dollars)	2009	2010	2011	2012	2013	After 2013
Minimum lease obligation	14,657	12,339	11429	10,329	9,327	25,816
Less: Sublease to franchisees	13,430	11,255	10,391	9,444	8,556	23,595
Net lease obligations	1,227	1,084	1,038	885	771	2,221

RELATED PARTY TRANSACTIONS

Second Cup

For the period ended December 27, 2008, Second Cup earned an administrative fee of $300 ($500 in 2007) from its parent, The Second Cup Coffee Company Inc. ("S.C. CoffeeCo"), for management and other services.

At December 27, 2008, the Company had an outstanding receivable of $47 (2007 - $13 payable) due from S.C. CoffeeCo, which arose as a result of the Company paying for certain reimbursable general and administrative expenses plus the unpaid balance of the administrative fee noted above.

Second Cup earned investment income of $201 during the year (2007 - $112) on its investment in units of the Fund.

On June 23, 2008, Second Cup sold 50,000 units of the Fund for proceeds of $417, on August 8, 2008, sold 64,000 units of the Fund for proceeds of $495 and on September 30, 2008, sold 75,150 units of the Fund for proceeds of $500 to the 100% beneficial owner of the Company. The selling price of the units was determined as the weighted average price at which the units traded on the Toronto Stock Exchange for the 20 consecutive trading days prior to the transaction. A loss of $324 was recorded on these sales and had previously been booked to other comprehensive loss. In accordance with CICA Handbook Section 3840, Related Party Transactions, this loss was removed from other comprehensive loss and charged to Deficit.

MarksLP
For the year ended December 27, 2008, interest expense of $4 (2007 - $534) was incurred on notes payable to the Fund which arose as a result of the Reorganization and had been fully repaid (2007 - $21) as at December 27, 2008. MarksLP made $300 (2007 - $8,871) in principal payments to the Fund during the year. In addition, distributions of $11,901 (2007 - $nil) were approved and paid by MarksLP to the Fund for the year ended December 27, 2008.

Included in operating costs and administrative expenses is a charge of $264 (2007 - $87) relating to a management fee charged by the Fund for certain general and administrative expenses.

Subsequent to the year-end and in accordance with the Agreement, Second Cup, MarksLP and the Fund engaged in a number of transactions to effect the adjustments to the Royalty Pool (see "Royalty Pool Adjustments" below).

MarksCo
For the year ended December 29, 2007, interest expense to the Fund of $2,449 was incurred on the MarksCo notes of $79,343 which were repaid on April 2, 2007 as a result of the Reorganization. In addition, during the year ended December 29, 2007, dividends of $190 were declared and paid by MarksCo to the Fund.

CRITICAL ACCOUNTING ESTIMATES

The preparation of Second Cup's consolidated financial statements requires management to make estimates and assumptions that affect income and expenses during the reporting periods, in addition to the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the consolidated financial statements.

Intangible assets
Intangible assets consist of goodwill and trademarks. Goodwill is recorded at cost and represents the excess of costs of investments and businesses acquired over the fair value of the net assets acquired. The trademarks are recorded at their historical carrying value.

Management of Second Cup reviews the carrying value of the intangible assets at least annually for impairment. Based on its annual review of the carrying values of goodwill and trademarks carried out in connection with the audited consolidated financial statements of the Company at December 27, 2008, management believes that no impairment exists with respect to either amount, and that there has been no decline in the carrying value of the these assets.

Contingent liabilities
Second Cup is involved in litigation and other claims arising in the normal course of business. Management must use its judgment to determine whether or not a claim has any merit, the amount of the claims and whether to record a provision, which is dependent on the potential success of the claim. Management does not believe that any liability that may arise from current claims will have a material adverse impact on the financial position of Second Cup.

Future income taxes
Second Cup follows the asset and liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that management determines it is more likely than not that the future income tax assets will be realized.

CHANGE IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

New accounting standards
The Company adopted, on December 30, 2007, three new accounting standards: CICA Handbook Sections 1535, 3862 and 3863 dealing with Capital Disclosures, Financial Instruments – Disclosures, and Financial Instruments – Presentation, respectively.

Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether the entity has complied with any capital requirements; and if it has not complied, the consequences of such non-compliance.

Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

FUTURE ACCOUNTING STANDARDS

The CICA has issued the following Handbook sections, which apply commencing with the Company's 2009 fiscal year.

Goodwill, Intangible Assets and Financial Statement Concepts
In February 2008, the CICA issued Section 3064 Goodwill and Intangible Assets, replacing Section 3062 Goodwill and Other Intangible Assets. The new Section establishes standards on the recognition, measurement, presentation and disclosure of goodwill and intangible assets subsequent to their initial recognition. The standard requires retroactive application to prior period consolidated financial statements. The Company will adopt this new standard effective December 28, 2008 but it is not expected to affect its consolidated results or financial position.

MANAGEMENT OF CAPITAL

Second Cup
The capital structure of Second Cup consists of shareholder's equity, deferred revenue that arose from units of the Fund received on the annual Royalty Pool Adjustments and elements of current liabilities that have, historically, been maintained at a minimum amount to be considered part of capital. The deferred revenue is eliminated upon consolidation in these consolidated financial statements (see "Royalty Pool Adjustments" below). Second Cup's primary uses of capital are to finance increases in non-cash working capital and capital expenditures. Second Cup currently funds these requirements from cash, sales of its investment holdings and the ongoing sale of Company-owned cafés included in capital assets and the agreed-to deferment of the payment of Royalties to MarksLP when advisable. Second Cup does not have any secured or long-term debt on its balance sheet, nor does it have a credit facility in place. Second Cup has provided a general security agreement to the Fund's term credit facilities.

Second Cup's objectives relating to the management of its capital structure are to:

1. Maintain a capital structure that provides financing options to the Company when the need arises to access capital.
2. Maintain financial flexibility in order to preserve its ability to meet financial obligations, including the payment of royalties to the Fund under the terms of the Agreement.
3. Deploy capital to provide an adequate return to its shareholder.

Second Cup maintains financial policies; manages its liquidity and capital structure; makes adjustments to it in light of changes to economic conditions, the underlying risks inherent in its operations and capital requirement to maintain and grow its operations.

Second Cup is not subject to any statutory capital requirements and has no commitments to sell or otherwise issue shares. Under the Agreement with MarksLP and the Fund, Second Cup is limited in its ability to raise secured debt without the written consent of the aforementioned parties.

There were no changes in Second Cup's approach to capital management during the year.

MarksLP
The capital structure of MarksLP consists of the partnership interests held by the Fund, which are comprised of original cash investments, accumulated earnings less accumulated cash distributions to the Fund. MarksLP's objectives when managing capital are to safeguard its ability to continue as a going concern and ensure it has sufficient cash and cash equivalents to pay distributions to its limited partner after satisfaction of its obligations.

MarksLP has no debt on its balance sheet and has historically generated sufficient cash flow to pay distributions to the Fund on a monthly basis.

The decrease of the equity component of capital is mainly based on the income of the business less the distributions paid.

The Fund will become subject to Canadian corporate income taxes beginning 2011. This may result in changes to the capital structure of the Fund and/or MarksLP or the nature of the Fund itself.

There were no changes in MarksLP's approach to capital management during the year

During the final quarter of 2008 an agreement was reached between MarksLP and Second Cup whereby the payment of certain royalties amounting to $573 for 2008 was deferred. This deferral, which is eliminated in the Company's consolidated financial statements, was requested by the Company to deal with a cash shortfall it experienced resulting from Second Cup's commitment to open new café locations made prior to the slowdown of the economy; its requirement to take back café locations from franchisees that were underperforming; and operational difficulties including restructuring costs encountered as a result of the deterioration of economic conditions and the reduction in consumer spending.

FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Fair values
The Company's financial instruments consist of cash, accounts receivable, advances to related parties, income taxes recoverable, investment in the Fund, accounts payable and accrued liabilities, deposits from franchisees and advertising and cooperative fund assets and liabilities. The Company's investment in the Fund is recorded at fair value (see note 8 to the consolidated financial statements). The fair values of all other financial instruments approximate their carrying amounts due to their short-term maturity.

Financial assets held to maturity, loans and receivables and financial liabilities other than those held for trading are measured at amortized cost. All other financial assets and derivatives are measured at fair value. The Company's investment in units of the Fund is classified as available-for-sale. The unrealized gains and losses associated with the Company's investment in units of the Fund are included in other comprehensive loss.

The Company's financial instruments are exposed to credit risk and liquidity risk.

Credit risk
The Company's financial instruments exposed to credit risk include cash, accounts receivable and advances to related parties. The Company places its cash with institutions of high creditworthiness. The Company's

accounts receivable primarily comprise amounts due from franchises and management believes that its accounts receivable credit risk exposure is limited. Credit risk from accounts receivable is minimized as a result of the review and evaluation of franchisee account balances beyond a particular age, and accounts for a specific bad debt provision when management considers the expected recovery is less than the actual accounts receivable. Advances to related parties are also believed to have limited risk exposure based on their creditworthiness.

Liquidity risk
Liquidity risk is the risk that the Company will encounter difficulty in meeting its financial obligations as they come due. The Company manages liquidity risk through regular monitoring of cash flows and also through the management of its capital structure. To manage liquidity and to fund new corporate café expansion, management can generate additional cash flow through the strategic sale of its holdings of corporate cafés, the sale of its investment holdings and the deferral of certain royalty payments to MarksLP as referred to above.

RISKS AND UNCERTAINTIES

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 Second Cup's café network is 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, all restaurants and food service outlets that serve coffee, and supermarkets that compete in the whole bean segment. If Second Cup cafés are unable to successfully compete in the Canadian specialty coffee industry, system sales may be adversely affected.
- Second Cup faces intense competition for high profile retail locations and qualified franchisees, both from specialty coffee chains and competitors from other industries. 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. Adverse credit markets, such as those currently being experienced, may affect the ability of franchises to obtain new credit or refinance existing credit on economically reasonable terms.
- A shortage in supply or an increase in the price of premium quality coffee beans could adversely affect Second Cup. Second Cup has no long-term or written contracts with coffee bean suppliers and relies on historical relationships to ensure availability. While there are a number of coffee bean suppliers, there can be no assurance that coffee bean suppliers that have relationships with Second Cup will continue to supply coffee beans at competitive prices.
- 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 a change 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, and traffic and weather patterns as well as the type, number and location of competing cafés.
- Second Cup's business could be adversely affected by increased concerns about food safety in general, or other unusual events.
- Changes in government regulations and other regulatory developments (such as smoking by-laws) could have an adverse impact on system wide sales.
- The loss of key personnel and/or a shortage of experienced management and hourly employees could have an adverse impact on Second Cup's operations and cafés.

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

ROYALTY POOL ADJUSTMENTS

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount that may be satisfied by additional Fund units or cash, the form of payment being at the option of the Fund. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net sales of these cafés, with the balance received when the actual full year performance of the new cafés is known.

January 1, 2007
On January 1, 2007, the actual annual sales of the nine cafés added to the Royalty Pool in the first adjustment on January 1, 2006 were greater than the original estimate. In accordance with the provisions in the Agreement, a final adjustment of $356 was satisfied by the receipt by the Company of 35,903 additional units of the Fund. In addition, the Company received a cash payment of $37 from MarksCo, representing the cash distributions that would have otherwise been earned by it on these additional units above had they been issued on January 1, 2006.

On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized sales of the 11 cafés added to the Royalty Pool were estimated at $4,555, offset by $3,815 in sales of the 12 cafés permanently closed from the Royalty Pool noted above. In accordance with the provisions in the Agreement, the Fund, through MarksCo, was required to make a payment of $315 to Second Cup, representing 80% of the obligation based on forecast sales of these cafés. In January 2007, Second Cup received 34,630 units of the Fund to satisfy this obligation.

In conjunction with the second adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. The notes were repaid as part of the Reorganization. These common shares of MarksCo were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

January 1, 2008
On January 1, 2008, the actual sales of the 11 cafés added to the Royalty Pool on January 1, 2007 for the year ended December 31, 2007 were greater than the original estimate. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on these additional units above had they been issued on January 1, 2007.

Also, on January 1, 2008, 15 cafés were added to the Royalty Pool. The annualized sales of these 15 cafés added to the Royalty Pool were estimated at $6,750, offset by $3,513 in sales of nine cafés permanently closed from the Royalty Pool during 2007. In accordance with the provisions in the Agreement, the Fund, through MarksLP, was required to make a payment of $1,346 to Second Cup, representing 80% of the obligation based on forecast sales. In January 2008, the Fund issued 143,712 units to MarksLP, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue 18,312 additional units to satisfy the remaining obligation. The total number of cafés in the Royalty Pool increased from 351 to 357.

In conjunction with the adjustments to the Royalty Pool on January 1, 2008, the Fund acquired additional partnership units of MarksLP in the amount of $1,641. The issuance of the 1,640,800 limited partnership units by MarksLP to the Fund and 164 general partnership units by MarksLP to Second Cup GP Trust ("GP Trust") were accounted were accounted for in these consolidated financial statements as an increase in the non-controlling interest

As a result of these adjustments to the Royalty Pool, MarksLP recognized an intangible asset. This increase and a related deferred gain recorded by Second Cup are eliminated in the Company's consolidated financial statements. As of December 27, 2008, Second Cup has recorded cumulative deferred revenue arising from these transactions in the amount of $2,984 (December 29, 2007 - $1,495).

Subsequent to the end of the 2008 year, on January 1, 2009, the actual sales of the 15 cafés added to the Royalty Pool on January 1, 2008 for the year ended December 31, 2008 were lower than the original estimate. The final adjustment of $172 was satisfied by MarksLP purchasing and delivering 18,312 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $21 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on these additional units above had they been issued on January 1, 2008. Second Cup's holdings of units of the Fund increased to 75,819.

Also, on January 1, 2009, 18 cafés were added to the Royalty Pool. The annualized sales of these 18 cafés added to the Royalty Pool have been estimated at $7,209 and were offset by $6,194 in sales of 16 cafés permanently closed from the Royalty Pool during the year. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $190 to Second Cup, representing 80% of the obligation based on forecasted sales. In January 2009, MarksLP paid Second Cup $190 to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to pay an additional amount to satisfy the remaining obligation. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 357 to 359.

OUTLOOK

The information contained in this "Outlook" is forward-looking information. Please see "Forward-Looking Information" below for a discussion of the risks and uncertainties in connection with forward-looking information.

Given the uncertainty in the retail and economic environment across Canada and Second Cup's dependence upon consumer discretionary spending, management is not providing specific guidance on same café sales for 2009. Management believes fiscal 2009 will be challenging and therefore, a number of initiatives are planned to strengthen the long term success of the Second Cup brand and its franchisees.

- Second Cup will continue its focus on operational excellence at the café level, which it believes will yield increasing consistency across the chain and improve the overall guest experience.
- In an effort to drive loyalty among specialty coffee customers, Second Cup's promotional strategies will focus on targeted branding initiatives promoting and innovating around its premium priced specialty beverages, brewed coffees, tea, food and merchandise. Value added offers will also be a core part of the promotional calendar.
- Second Cup will also be taking selective price increases on several of its products throughout the year.
- Second Cup will continue to develop and build neighbourhood cafés with a focus on expansion in key urban markets utilizing a disciplined café development process, and continuing its concentration on the delivery of cost savings to franchisees.

In terms of 2009 network expansion, Second Cup expects: (1) to open 10 to 15 new cafés in Canada; (2) to close 15 to 20 cafés during 2009, the majority of which have sales below the average performance of cafés in the Royalty Pool; and (3) approximately 24 of its cafés will be renovated.

FORWARD-LOOKING INFORMATION

Certain statements in this report may constitute forward-looking information within the meaning of applicable securities legislation. Forward-looking information can be identified by words such as "may", "will", "should", "expect", "anticipate", "believe", "plan", "intend" and other similar words. Forward-looking information reflects current expectations regarding future events and operating performance and speaks only as of the date of this report. It 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 information is based on a number of assumptions and is subject to known and unknown risks, uncertainties and other factors, many of which are beyond the Company's control, that may cause the Company's actual results, performance or achievements, or those of the Fund, MarksLP, Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking information. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying forward-looking information: 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 regulation; potential litigation; the ability to exploit and protect the Second Cup Marks; 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 results of operations 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" above.

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

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

NON-GAAP TERMS

In addition to using financial measures prescribed by GAAP, non-GAAP financial measures and other terms are used in this report. These terms include "system sales" and "same café sales". These terms are not financial measures recognized by GAAP and do not have any standardized meaning prescribed by GAAP and therefore may not be comparable to similar terms and measures presented by other similar issuers. These non-GAAP measures and terms are intended to provide additional information on the Company's performance and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

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March 7, 2009

Auditors' Report

To the Shareholder of
The Second Cup Ltd.

We have audited the consolidated balance sheets of **The Second Cup Ltd.** as at December 27, 2008 and December 29, 2007 and the consolidated statements of earnings and comprehensive income, shareholder's equity and cash flows for the 52-week period then ended. These financial statements are the responsibility of the Company's management. 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 plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 27, 2008 and December 29, 2007 and the results of its operations and its cash flows for the 52-week period then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP, an Ontario limited liability partnership, or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity.

The Second Cup Ltd.

Consolidated Balance Sheets
As at December 27, 2008 and December 29, 2007
(Expressed in thousands of dollars)

	2008	2007
Assets		
Current assets		
Cash	$ 1,126	$ 2,743
Accounts receivable	4,414	4,612
Due from related parties (note 15)	47	-
Inventories (note 6)	200	151
Prepaid expenses and sundry assets	96	358
Investment in Second Cup Royalty Income Fund (notes 8 and 20)	273	665
Income taxes recoverable	96	82
Future income taxes (note 11)	57	68
	6,309	8,679
Capital assets (note 7)	3,056	2,604
Trademarks (note 5(h))	88,019	88,019
Goodwill	4,898	4,898
Future income taxes (note 11)	146	54
	$ 102,428	$ 104,254
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities (note 5(m))	$ 6,945	$ 8,015
Due to related parties (note 15)	-	13
Interest payable to Second Cup Royalty Income Fund (note 15)	-	21
Deposits from franchisees	627	1,050
Future income taxes (note 11)	4	-
	7,576	9,099
Notes payable (note 10)	-	300
Future income taxes (note 11)	157	145
	7,733	9,544
Non-controlling interest in MarksLP (note 9)	104,341	102,115
	112,074	111,659
Shareholder's Deficiency		
Capital stock (note 12)	3,724	3,724
Deficit	(13,131)	(11,125)
Accumulated other comprehensive loss (note 13)	(239)	(4)
	(9,646)	(7,405)
	$ 102,428	$ 104,254

Contingencies, commitments and guarantees (note 14)
Subsequent events (note 21)

Approved by the Board of Directors

(Signed) Gabriel Tsampalieros, Director

See accompanying notes to consolidated financial statements

The Second Cup Ltd.

Consolidated Statements of Operations and Comprehensive Loss

For the years ended December 27, 2008 and December 29, 2007

(Expressed in thousands of dollars)

		2008		2007
System sales - Canada	$	200,979	$	200,271
Revenue				
Royalty revenue	$	16,573	$	16,270
Revenue from Company-owned cafés		8,868		10,482
Other income		5,483		6,294
		30,924		33,046
Expenses				
Operating costs and administrative expenses		19,704		20,715
Loss (gain) on disposal of capital assets		10		(181)
Amortization of capital assets		519		503
Amortization of deferred financing charges		-		142
Writedown of capital assets		230		-
Interest expense on notes payable		4		2,983
Interest expense on term loan		-		145
		20,467		24,307
		10,457		8,739
Interest income		62		123
Investment income (note 8)		201		112
Earnings before income taxes and non-controlling interest		10,720		8,974
Income taxes (recovery)				
Current year		(67)		(216)
Prior year		(70)		-
Future		(3)		1,482
Reversal of future income tax liability		-		(11,374)
		(140)		(10,108)
Earnings before non-controlling interest		10,860		19,082
Non-controlling interest (note 9)		12,486		19,386
Net loss for the year		(1,626)		(304)
Other comprehensive loss (note 13)		(235)		(4)
Comprehensive loss	$	(1,861)	$	(308)

See accompanying notes to consolidated financial statements.

The Second Cup Ltd.

Consolidated Statements of Deficit

For the years ended December 27, 2008 and December 29, 2007

(Expressed in thousands of dollars)

		2008		2007
Deficit - Beginning of year	$	(11,125)	$	(10,772)
Refundable taxes incurred		(56)		(49)
Loss on disposal of Fund units (note 8)		(324)		-
Net loss for the year		(1,626)		(304)
Deficit - End of year	$	(13,131)	$	(11,125)

See accompanying notes to consolidated financial statements.

The Second Cup Ltd.

Consolidated Statements of Cash Flows

For the years ended December 27, 2008 and December 29, 2007

(Expressed in thousands of dollars)

	2008	2007
Cash provided by (used in)		
Operating activities		
Net loss for the year	$ (1,626)	$ (304)
Items not involving cash		
Non-controlling interest	12,486	19,386
Amortization	519	645
Writedown of capital assets	230	-
Future income taxes	(3)	(9,892)
Loss (gain) on disposal of capital assets	10	(181)
	11,616	9,654
Changes in non-cash working capital items (note 16)	(1,233)	189
	10,383	9,843
Investing activities		
Purchase of capital assets	(2,059)	(1,653)
Proceeds from disposal of capital assets	848	1,296
Proceeds from disposal of Fund units (note 15)	1,412	-
Purchase of investments in the Fund (note 20)	-	(671)
	201	(1,028)
Financing activities		
Repayment of notes payable to the Fund	(300)	(8,871)
Repayment of term loan (note 3)	-	(11,000)
Impact of reorganization (note 3)	-	11,022
Issuance of common shares in MarksCo (note 20)	-	67
Issuance of notes payable (note 20)	-	604
Distributions/dividends paid to non-controlling interest (notes 9 and 15)	(11,901)	(190)
	(12,201)	(8,368)
(Decrease) increase in cash during the year	(1,617)	447
Cash - Beginning of year	2,743	2,296
Cash - End of year	$ 1,126	$ 2,743

See accompanying notes to consolidated financial statements.

1 Organization and Nature of Operations

The Second Cup Ltd. ("Second Cup" or the "Company") is a specialty coffee franchisor and retailer with 361 cafés operating under the trade name Second Cup™ in Canada as of December 27, 2008, of which 27 are Company-owned (December 29, 2007 - 366 cafés, of which 21 were Company-owned). The cafés are predominantly operated by franchisees that are selected and trained to retail the Company's product offering.

Second Cup Trade-Marks Limited Partnership ("MarksLP") is a wholly owned subsidiary of the Second Cup Royalty Income Fund (the "Fund"). The business of MarksLP is the ownership of the Canadian trademarks and certain other intellectual property and associated rights used by Second Cup in connection with the operation of Second Cup cafés in Canada (excluding the territory of Nunavut) (collectively, the "Second Cup Marks", or the "Marks") and, through the Licence and Royalty Agreement (the "Agreement") with Second Cup, the taking of actions to exploit the use of the Second Cup Marks and the collection of the royalty payable under the Agreement. As discussed in note 2 below, MarksLP, while a wholly owned subsidiary of the Fund and not the Company, is consolidated in these financial statements.

2 Basis of Presentation

Effective January 2, 2005, the Company adopted Accounting Guideline 15 ("AcG-15"), a new pronouncement of The Canadian Institute of Chartered Accountants ("CICA") relating to variable interest entities ("VIEs"). A VIE is an entity where its equity investment at risk is insufficient to permit the entity to finance its activities without additional subordinated support from others and/or where certain essential characteristics of a controlling financial interest are not met. AcG-15 outlines who should consolidate such entities. The Company has identified two significant VIEs related to the Company.

Second Cup Trade-Marks Limited Partnership ("MarksLP")
MarksLP, a wholly owned subsidiary of the Fund, is a VIE that owns the Second Cup Marks. MarksLP has, through the Agreement, licenced these Marks to Second Cup, which operates the business activities associated with these Marks in exchange for a royalty payment. The activities of MarksLP and Second Cup are closely related and, based on the guidance provided in AcG-15, it was determined that, although MarksLP is wholly owned by the Fund, Second Cup should consolidate the financial assets and results of MarksLP. As a result, the consolidated financial statements exclude the royalty expense paid to MarksLP, but include the interest expense and dividends declared by MarksCo through April 2, 2007, distributions declared and paid by MarksLP as well as other expenses of MarksLP. The non-controlling interest represents the equity of MarksLP, which is 100% owned by the Fund.

Franchise Entities
The Company also has a variable interest in the franchise entities, which operate Second Cup's franchised cafés. Based on guidance provided by AcG-15, the Company has determined that these franchise entities are not required to be consolidated by Second Cup.

3 Reorganization in 2007

On April 2, 2007, the Unitholder-approved reorganization of the structure of the Fund (the "Reorganization") replaced its subsidiary corporations, including Second Cup Trade-Marks Inc. ("MarksCo"), with a newly formed trust and limited partnership. This latter entity, MarksLP, is consolidated with Second Cup in these consolidated financial statements as a VIE (see note 2 above) for the same reasons that MarksCo had historically been consolidated by Second Cup.

As a result of the Reorganization, the Fund negotiated a new term loan of $11,000 with its bankers on similar terms and conditions as MarksCo's term loan. The proceeds of this new loan were invested by the Fund in its ownership of MarksLP and, consequently, used to repay the MarksCo term loan. Further, the notes payable by MarksCo to a subsidiary of the Fund, which amounted to $79,343 as at April 1, 2007, were repaid through an increase in the equity ownership of MarksLP by the Fund and a new note payable by MarksLP to the Fund amounting to $9,171, which was fully repaid as at December 27, 2008 (December 29, 2007 - $300). The increase in the equity ownership of MarksLP was recorded as an increase in the non-controlling interest on the Company's consolidated balance sheets.

Under the new structure, the new wholly owned subsidiaries of the Fund are not subject to income tax. As a result, the future income tax liabilities on the consolidated balance sheets of Second Cup prior to the Reorganization of $9,966 relating to the Second Cup trademarks owned by MarksLP were credited to consolidated earnings on April 2, 2007 and resulted in an increase in the non-controlling interest on the Company's 2007 consolidated balance sheet.

The Agreement, entered into in connection with the December 2, 2004 initial public offering of the Fund under which MarksCo agreed to license the use of the Second Cup Marks to Second Cup in all provinces and territories of Canada, excluding the territory of Nunavut, for a period of 99 years, was assigned by MarksCo to MarksLP. Commencing April 2, 2007, payments under the Agreement by Second Cup for royalties equal to 6.5% of the sales of cafés in the Royalty Pool are payable to MarksLP. As a result of the Reorganization, the Fund's earnings are predominantly comprised of its equity ownership of the income earned by MarksLP as a replacement of interest and dividend income from MarksCo.

It is important to note that, while the Fund's underlying structure has been changed, essentially the underlying assets and operations of the Fund and its subsidiaries did not change as a result of the Reorganization.

4 Changes in Accounting Policy Including Initial Adoption

Effective December 30, 2007, the Company adopted the following sections of the CICA Handbook:

Capital Disclosures, CICA Handbook Section 1535
Section 1535 specifies the disclosure of an entity's objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance. This new disclosure is provided in note 17. This section relates to disclosure and presentation only and did not have an impact on the Company's results.

Inventories, CICA Handbook Section 3031
Section 3031 provides new guidance for accounting for inventories and revises and enhances the requirements for assigning costs to inventories. It requires inventory to be measured at the lower of cost and net realizable value, and also provides guidance on the costs that can be capitalized. The adoption of this section did not have an impact on the Company's results.

Financial Instruments, CICA Handbook Sections 3862 and 3863
Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. Additional quantitative and qualitative information regarding the Fund's financial instruments and the associated risks is provided in note 19. These sections relate to disclosure and presentation only and did not have an impact on the Company's results.

Future Accounting Standards

The CICA has issued the following Handbook sections, which apply commencing with the Company's 2009 fiscal year.

In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets. The new Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets subsequent to their initial recognition. The standard requires retroactive application to prior period consolidated financial statements. The Company will adopt this standard for the fiscal year commencing December 28, 2008. It is not expected that adopting Section 3064 will have a material impact on the Company's consolidated financial position or results of operations.

5 Summary of Significant Accounting Policies

a) Consolidation

These consolidated financial statements include the accounts of the Company and MarksLP, a wholly owned subsidiary of the Fund and have been prepared in accordance with Canadian generally accepted accounting principles.

The Company opens, acquires and closes individual café locations in the normal course of business. Café closures in geographical areas where existing or new cafés continue to serve the same customer base are not reported as discontinued operations.

b) VIEs

AcG-15 requires consolidation of VIEs by the primary beneficiary. The primary beneficiary is defined as the party that has exposure to the majority of the VIE's expected losses and/or residual returns. Second Cup has evaluated its interests in MarksLP, a wholly owned subsidiary of the Fund, and determined that the Company is the primary beneficiary and should consolidate MarksLP.

c) Fiscal year

The Company's fiscal year is made up of 52 or 53-week periods ending on the last Saturday of December.

d) Use of estimates
The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the amounts of revenues and expenses for the reporting periods. Actual results could differ from those estimates. The carrying values of accounts receivable and long-term assets, accounting for VIEs and estimates of provisions for liabilities are the more significant areas requiring management judgment and estimates.

e) System sales
System sales include gross revenue of all franchised and Company-owned cafés based on information reported by café operators. Gross revenue is self-assessed by each café on a weekly basis and submitted to the Company.

f) Revenue recognition
Royalty revenue from franchised cafés is recognized as the products are sold by the franchisee. Franchise fees are recognized as income when the agreement has been signed and all material conditions have been met. Other income includes initial franchise fees, café resale fees, renewal fees, construction administration fees and purchasing co-ordination fees, which are recognized as income once all significant conditions have been met.

g) Inventories
Inventories are valued at the lower of cost and net realizable value, with cost being determined substantially on a first-in, first-out basis.

h) Trademarks
Trademarks, trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Second Cup cafés in Canada are recorded at the historical cost to MarksLP. The trademark is an indefinite life intangible asset that is tested annually in accordance with Canadian generally accepted accounting principles.

The impairment test performed by management of MarksLP involved comparing the estimated fair value of the trademark with its carrying value. Management of MarksLP considered a number of factors in estimating fair value of the trademark. These included discounted cash flow estimates, comparisons to the Fund's market capitalization, capitalized cash flow methods and earnings multiples. Each of these valuation approaches use estimates and assumptions that are sensitive to change and require management judgment. These key judgments include estimates of discount rates, forecast growth in system sales, market multiples, other estimates impacting future cash flows and control premiums. Changes in these estimates and assumptions may have a significant impact on fair value. General market uncertainty and the recessionary operating environment for the Fund and other similar retail entities were also factors taken into account in the analysis. An increase in the discount rate used in the analysis reflects the current volatility of the Fund's units and market conditions. The changes in the market growth rates reflect the current general economic pressures now impacting the national economy.

Management of MarksLP concluded the estimated fair value of its trademark exceeded its carrying value as of December 27, 2008 and that the trademark was not impaired.

i) Goodwill
Goodwill represents the excess of the cost of investments in businesses acquired over the fair value of the net assets acquired by Second Cup. Goodwill is not amortized, but is tested for impairment based on fair value at least annually or when events or changes in circumstances indicate that the carrying value may not be

recoverable. The goodwill impairment test requires a comparison of the estimated fair value of the Company to the carrying value that is recorded on the Company's consolidated balance sheets.

The current estimated fair value of the Company is based on discounted cash flows. The valuation approaches use key judgments and assumptions that are sensitive to change, which include appropriate system sales growth rates, café openings and closures, the contribution from corporate cafés and weighted average costs of capital (WACC). When developing these key judgments and assumptions, the Company considers economic, operational and market conditions that could impact the estimated fair value of the Company. However, estimates are inherently uncertain and represent only management's reasonable expectations regarding future developments. These estimates and the key judgments and assumptions upon which the estimates are based will, in all likelihood, differ in some respects from actual future results. For example, should a significant or prolonged deterioration in economic conditions occur, key judgments and assumptions could be impacted. Generally, a moderate decline in estimated operating income or an increase in WACC or a decline in market conditions could result in an additional indication of impairment.

During its annual review of the carrying value of Goodwill, the Company performed the first step of its goodwill impairment test in accordance with with CICA Handbook statement 3064. Management determined that as of December 27, 2008 the estimated fair value of the Company exceeded its carrying value and that goodwill was not impaired.

j) Capital assets

Capital assets are recorded at cost less accumulated amortization. Amortization is calculated using the straight-line basis at the following rates, which are based on the expected useful life of the asset:

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

Capital assets are tested for impairment based on estimated fair value when events or changes in circumstances indicate that the carrying value may not be recoverable.

k) Deferred financing charges

Deferred financing charges in 2007 represented costs associated with the MarksCo term loan, which was repaid in its entirety as a result of the Reorganization.

l) Future income taxes

Future income taxes are provided for on the asset and liability method whereby future income tax assets are recognized for deductible temporary differences and operating loss carry-forwards, and future income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Future income tax assets are recognized only to the extent that management determines that it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of substantive enactment.

m) Café Cards

Accounts payable and accrued liabilities include $3,745 (2007 - $3,583) of liabilities related to unused balances on Second Cup's reloadable payment card ("Second Cup Café Card"). These balances are included as sales of franchised cafés, or as revenue of Company-owned cafés, at the time their customer redeems the amount in a café for products or services.

n) Advertising and cooperative fund assets and liabilities
The Company manages an advertising and cooperative fund (the "Coop Fund") established to collect and administer funds contributed for use in advertising and promotional programs, national training programs and, among other things, initiatives designed to increase sales and enhance the reputation of the Second Cup Brand. Contributions to the Coop Fund are required to be made from both franchised and Company-owned and operated cafés and are based on a percentage of café sales. The Company accounts for the Coop Fund in accordance with CICA Accounting Guideline 2, Franchise Fee Revenue ("AcG-2"). The revenue, expenses, and cash flows of the Coop Fund are not included in the Company's consolidated statements of operations and cash flows because the contributions to this fund are segregated and designated for a specific purpose. At the year end, if the Coop Fund is in a deficit position then the deficit amount is not recognized as an asset and is shown as an expense of the Company. At the year end, if the Coop Fund is in a surplus position then the surplus amount is recognized as a liability of the Company.

As at December 27, 2008, the Coop Fund was in a net deficit position of $13 (2007 - $34).

o) Operating leases
For operating leases, minimum lease payments are recognized as rent expense on a straight-line basis over the lease term. For the purposes of determining the lease term, the Company considers option periods 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.

p) Financial instruments

Fair values
The Company's financial instruments consist of cash, accounts receivable, due (from) to related parties, income taxes recoverable and payable, investments in the Fund, accounts payable and accrued liabilities, deposits from franchisees and interest and notes payable to the Fund. The Company's investment in the Fund is recorded at fair value (see note 8). The fair values of all other financial instruments approximate their carrying amounts due to their short-term maturity.

Credit risk
The Company's financial instruments exposed to credit risk include cash, accounts receivable and due from related parties. The Company places its cash with institutions of high creditworthiness. The Company's accounts receivable primarily comprise amounts due from franchisees and management believes that its accounts receivable credit risk exposure is limited. Amounts due from related parties are also believed to have limited risk exposure based on their creditworthiness.

6 Inventories

	2008	2007
Merchandise held for resale	$ 154	$ 117
Supplies	46	34
	$ 200	$ 151

7 Capital Assets

	2008		
	Cost	Accumulated amortization	Net
Leasehold improvements	$ 2,832	$ 1,247	$ 1,585
Equipment, furniture, fixtures and other	2,157	1,008	1,149
Computer software and hardware	1,635	1,313	322
	$ 6,624	$ 3,568	$ 3,056

	2007		
	Cost	Accumulated amortization	Net
Leasehold improvements	$ 2,783	$ 1,276	$ 1,507
Equipment, furniture, fixtures and other	1,857	951	906
Computer software and hardware	1,410	1,219	191
	$ 6,050	$ 3,446	$ 2,604

Amortization of capital assets for the year ended December 27, 2008 was $519 (2007 - $503).

8 Investment in Second Cup Royalty Income Fund

	2008	2007
Investment in units of the Fund (2008 - 57,507 units; 2007 - 70,533 units)	$ 273	$ 665
Income earned on investment	$ 201	$ 112

In accordance with CICA Handbook Section 3855, Financial Instruments - Recognition and Measurement, the investment in units of the Fund has been designated as available-for-sale and is measured at fair value. On December 27, 2008, the fair value of the investment in units of the Fund was $4.75 per unit compared to $9.44 as at December 29, 2007. This unrealized loss was recorded in other comprehensive loss. As a result of the sale of 189,150 units to a related party during the year (Related Party Transactions note 15), Second Cup recorded losses amounting to $324 on the sale of these units by crediting other comprehensive loss and a corresponding charge to deficit in accordance with CICA Handbook Section 3840, Related Party Transactions. Accordingly, an unrealized loss of $297 (2007 - $6), less applicable future income tax recovery of $62 (2007 - $2), is recorded in other comprehensive loss for the 52 weeks ended December 27, 2008.

9 Non-controlling Interest in MarksLP

The non-controlling interest represents the equity of MarksLP, which is 100% owned by the Fund, and is made of the following:

	2008	2007
Balance - Beginning of year	$ 102,115	$ 1,659
Earnings: Non-controlling interest	12,486	19,386
Issuance of units (note 20)	1,641	-
Issuance of common shares (note 20)	-	67
Impact of Reorganization (note 3)	-	81,192
Less:		
Distributions declared to non-controlling interest	(11,901)	-
Dividends paid to non-controlling interest	-	(190)
Change in refundable taxes	-	1
Balance - End of year	$ 104,341	$ 102,115

10 Notes Payable

The notes payable of $300 due by MarksLP to the Fund as at December 29, 2007, bearing interest at 12.125%, were repaid during 2008.

11 Income Taxes

The significant components of future income tax assets and liabilities are as follows:

	2008	2007
Capital assets	$ 51	$ 54
Investment in Fund	96	(1)
Provisions and accrued expenses	45	65
Goodwill	(157)	(141)
Donations	12	-
Due to related parties	(5)	-
Net future income tax asset (liability)	$ 42	$ (23)
Classified as		
Current assets	$ 57	$ 68
Long-term assets	146	54
Current liabilities	(4)	-
Long-term liabilities	(157)	(145)
	$ 42	$ (23)

12 Capital Stock

Authorized

An unlimited number of common shares and an unlimited number of preference shares issuable in one or more series

Issued common shares

	Number of shares		Amount
Balance as at December 29, 2007 and December 27, 2008	19,724	$	3,724

13 Accumulated other comprehensive loss

		2008		2007
Balance - beginning of year	$	(4)	$	-
Unrealized loss on investments designated as available-for-sale		(297)		(6)
Less: Future income tax recovery on unrealized gain		62		2
Balance - end of year	$	(239)	$	(4)

14 Contingencies, Commitments and Guarantees

The Company has lease commitments for Company-owned cafés and also acts as the head tenant on leases, which it, in turn, subleases to franchisees. The Company's lease commitments at December 27, 2008 are as follows:

		Lease commitments		Sublease to franchisees		Net
2009	$	14,657	$	13,430	$	1,227
2010		12,339		11,255		1,084
2011		11,429		10,391		1,038
2012		10,329		9,444		885
2013		9,327		8,556		771
Thereafter		25,816		23,595		2,221
	$	83,897	$	76,671	$	7,226

The Company is involved in litigation and other claims arising in the normal course of business. Management must use its judgment to determine whether or not a claim has any merit, the amount of the claims and whether to record a provision, which is dependent on the potential success of the claim. The Company believes that it will not incur any significant loss or expense 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.

Substantially all of the Company's assets have been pledged under a general security agreement as collateral for commitments under the Agreement.

15 Related Party Transactions and Balances

Second Cup

For the year ended December 27, 2008, Second Cup earned an administrative fee of $300 (2007 - $500) from its parent, The Second Cup Coffee Company Inc. ("S.C. CoffeeCo") for management and other services. At December 27, 2008, the Company had an outstanding receivable of $47 (2007 - $13 payable) due from S.C. CoffeeCo, which arose as a result of the Company paying for certain reimbursable general and administrative expenses plus the unpaid balance of the administrative fee noted above.

Second Cup earned investment income of $201 (2007 - $112) during the year on its investment in units of the Fund.

On June 23, 2008, Second Cup sold 50,000 units of the Fund for proceeds of $417, on August 8, 2008, sold 64,000 units of the Fund for proceeds of $495 and on September 30, 2008, sold 75,150 units of the Fund for proceeds of $500 to the 100% beneficial owner of the Company. The selling price of the units was determined as the weighted average price at which the units traded on the Toronto Stock Exchange for the 20 consecutive trading days prior to the transaction. The recording of the loss of $324 is described in note 8 above.

MarksLP

For the year ended December 27, 2008, interest expense of $4 (2007 - $534) was incurred on notes payable to the Fund, which arose as a result of the Reorganization (note 3) and had been fully repaid (2007 - $21) as at December 27, 2008. MarksLP made $300 (2007 - $8,871) in principal payments to the Fund during the year. In addition, distributions of $11,901 (2007 - $nil) were approved and paid by MarksLP to the Fund for the year ended December 27, 2008.

Included in operating costs and administrative expenses is a charge of $264 for the year ended December 27, 2008 (2007 - $87) relating to a management fee charged by the Fund for certain general and administrative expenses.

On January 1, 2009, Second Cup, MarksLP and the Fund engaged in a number of transactions to effect the adjustments to the Royalty Pool (see note 21).

16 Supplementary Cash Flow Information

Changes in non-cash working capital items:

	2008	2007
Accounts receivable	$ 198	$ (1,025)
Due (from) to related parties	(60)	135
Inventories	(49)	57
Prepaid expenses and sundry assets	262	(56)
Income taxes recoverable	(14)	195
Accounts payable and accrued liabilities	(1,070)	1,842
Interest payable to the Fund	(21)	(764)
Deposits from franchisees	(423)	(146)
Refundable income taxes	(56)	(49)
	$ (1,233)	$ 189
Supplementary information:		
Interest paid	$ 25	$ 3,890
Income tax recovered	$ (160)	$ (347)

17 Management of Capital

Second Cup

The capital structure of Second Cup consists of shareholder's equity, deferred revenue that arose from units of the Fund received on the annual Royalty Pool Adjustments and elements of current liabilities that have, historically, been maintained at a minimum amount to be considered part of capital. This deferred revenue is eliminated upon consolidation in these consolidated financial statements (Royalty Pool Adjustments, note 20). Second Cup's primary uses of capital are to finance increases in non-cash working capital and capital expenditures.

Second Cup currently funds its requirements from cash, sales of its investment holdings, the ongoing sale of Company-owned cafés included in capital assets and deferment of the payment of royalties to Marks LP when advisable, subject to the agreement of the General Partner of MarksLP. Second Cup does not have any secured or long-term debt on its consolidated balance sheets, nor does it have a credit facility in place. Second Cup has provided a general security agreement to the Fund's term credit facilities.

Second Cup's objectives relating to the management of its capital structure are to:

1. maintain a capital structure that provides financing options to the Company when the need arises to access capital.
2. maintain financial flexibility in order to preserve its ability to meet financial obligations, including the payment of royalties to the Fund under the terms of the Agreement; and
3. deploy capital to provide an adequate return to its shareholder.

Second Cup maintains financial policies, manages its liquidity and capital structure, makes adjustments to it in light of changes to economic conditions, the underlying risks inherent in its operations and capital requirement to maintain and grow its operations.

Second Cup is not subject to any statutory capital requirements and has no commitments to sell or otherwise issue shares. Under the Agreement with MarksLP and the Fund, Second Cup is limited in its ability to raise secured debt without the written consent of the aforementioned parties.

There were no changes in Second Cup's approach to capital management during the year.

MarksLP
The capital structure of MarksLP consists of the partnership interests held by the Fund, which are comprised of original cash investments, accumulated earnings less accumulated cash distributions to the Fund. MarksLP's objectives when managing capital are to safeguard its ability to continue as a going concern and ensure it has sufficient cash and cash equivalents to pay distributions to its limited partner after satisfaction of its obligations.

MarksLP has no debt on its balance sheet and has historically generated sufficient cash flow to pay distributions to the Fund on a monthly basis. The changes of the equity component of capital are mainly the result of the income of the business less the distributions paid. The Fund will become subject to Canadian corporate income taxes beginning in 2011. This may result in changes to the capital structure of the Fund and/or MarksLP or the nature of the Fund itself.

There were no changes in MarksLP's approach to capital management during the year.

18 Royalty payable to Second Cup Trade-Marks Limited Partnership

During the final quarter of 2008 an agreement was reached between MarksLP and Second Cup whereby the payment of certain royalties amounting to $573 for 2008 was deferred. This deferral, which is eliminated in the Company's consolidated financial statements, was requested by the Company to deal with a cash shortfall it experienced resulting from Second Cup's commitment to open new café locations made prior to the slowdown of the economy; its requirement to take back café locations from franchisees that were underperforming; and operational difficulties including restructuring costs encountered as a result of the deterioration of economic conditions and the reduction in consumer spending.

19 Financial Instruments and Financial Risk Management

Financial Instruments
The Company's financial instruments consist of cash, accounts receivable, advances to related parties, income taxes recoverable, investment in the Fund, accounts payable and accrued liabilities and deposits from franchisees. The Company's investment in the Fund is recorded at fair value (see note 8). The fair values of all other financial instruments approximate their carrying amounts due to their short-term maturity.

Financial assets held to maturity, loans and receivables and financial liabilities other than those held-for-trading are measured at amortized cost. All other financial assets and derivatives are measured at fair value. The Company's investment in units of the Fund is classified as available-for-sale. The unrealized gains and losses associated with the Company's investment in units of the Fund are included in other comprehensive income.

The Company's financial instruments are exposed to credit risk and liquidity risk.

Credit Risk
The Company's financial instruments exposed to credit risk include cash, accounts receivable and advances to related parties. The Company places its cash with institutions of high creditworthiness. The Company's accounts receivable primarily comprise amounts due from franchisees and management believes that its accounts receivable credit risk exposure is limited. Credit risk from accounts receivable is minimized as a result of the review and evaluation of franchisee account balances beyond a particular age, and accounts for a specific bad debt provision when management considers the expected recovery is less than the actual accounts receivable. Advances to related parties are also believed to have limited risk exposure based on their creditworthiness.

Liquidity Risk
Liquidity risk is the risk that the Company will encounter difficulty in meeting its financial obligations as they come due. The Company manages liquidity risk through regular monitoring of cash flows, and also through the management of its capital structure as outlined in note 17. To manage liquidity and to fund new corporate café expansion, management can generate additional cash flow through the strategic sale of its holdings of Company-owned cafés, the deferral of certain royalties and the sale of its investment holdings as outlined in note 17.

Sensitivity Analysis
Section 3862 requires disclosure of a sensitivity analysis to illustrate the sensitivity of the Company's financial position and performance to changes in market variables (foreign exchange rates and interest rates) as a result of changes in the fair value of cash flows associated with the Company's financial instruments. The Company's financial instruments are non-interest bearing and are denominated in Canadian dollars. As a result, a reasonably possible change in the relevant risk variable at December 27, 2008 will not have a significant effect on net earnings at December 27, 2008.

20 Royalty Pool Adjustments

Annually, commencing January 1, 2006, the Royalty Pool is adjusted to include new Second Cup cafés opened on or before September 2 of the prior year, and to exclude any Second Cup cafés that were in the Royalty Pool and permanently closed during the year. In return for adding cafés to the Royalty Pool, Second Cup is entitled to be paid an amount that may be satisfied by additional Fund units or cash, the form of payment being at the option of the Fund. The amount to be paid is calculated as 92.5% of the royalty revenue added to the Royalty Pool, divided by the yield of the Fund units over a 20-day trading period specified in the Agreement. Second Cup initially receives 80% of the amount based on forecast net sales of these cafés, with the balance received when the actual full year performance of the new cafés is known.

January 1, 2007
On January 1, 2007, the actual annual sales of the nine cafés added to the Royalty Pool in the first adjustment in January 2006 were greater than the original estimate. In accordance with the provisions in the Agreement, a final adjustment of $356 was satisfied by the receipt of 35,903 additional units of the Fund. In addition, the Company received a cash payment of $37 from MarksCo, representing the cash distributions that would have otherwise been earned by it on these additional units above had they been issued on January 1, 2006.

On January 1, 2007, a second adjustment to the Royalty Pool took place, whereby 11 cafés were added to the Royalty Pool. After taking into account these additional cafés and the 12 cafés permanently closed in 2006, the total number of cafés in the Royalty Pool decreased from 352 to 351. The annualized sales of the 11 cafés added to the Royalty Pool were estimated at $4,555, offset by $3,815 in sales of the 12 cafés permanently closed from

the Royalty Pool noted above. In accordance with the provisions in the Agreement, MarksCo was required to make a payment of $315 to Second Cup, representing 80% of the obligation based on forecast sales of these cafés. In January 2007, Second Cup received 34,630 units of the Fund to satisfy this obligation.

In conjunction with the second adjustment to the Royalty Pool, the Fund acquired notes of MarksCo in the amount of $604 and common shares of MarksCo in the amount of $67, for total cash consideration of $671. These notes were repaid as part of the Reorganization. These common shares of MarksCo were accounted for in the consolidated financial statements as an increase in the non-controlling interest prior to the Reorganization.

January 1, 2008

On January 1, 2008, the actual sales of the 11 cafés added to the Royalty Pool on January 1, 2007 for the year ended December 31, 2007 were greater than the original estimate. As a result, a final adjustment of $295 was satisfied by MarksLP purchasing and delivering 32,412 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $35 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on these additional units above had they been issued on January 1, 2007.

Also, on January 1, 2008, 15 cafés were added to the Royalty Pool. The annualized sales of these 15 cafés added to the Royalty Pool were estimated at $6,750, offset by $3,513 in sales of nine cafés permanently closed from the Royalty Pool during 2007. In accordance with the provisions in the Agreement, MarksLP was required to make a payment of $1,346 to Second Cup, representing 80% of the obligation based on forecast sales. In January 2008, the Fund issued 143,712 units to MarksLP, which were then delivered to Second Cup to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to issue 18,312 additional units to satisfy the remaining obligation (see note 21). The total number of cafés in the Royalty Pool increased from 351 to 357.

In conjunction with the adjustments to the Royalty Pool on January 1, 2008, the Fund acquired additional partnership units of MarksLP in the amount of $1,641. The issuance of the 1,640,800 limited partnership units by MarksLP to the Fund and 164 general partnership units to Second Cup GP Trust were accounted for in these interim consolidated financial statements as an increase in the non-controlling interest.

As a result of these adjustments to the Royalty Pool, MarksLP recognized an intangible asset. This increase and a related deferred gain recorded by Second Cup are eliminated in the Company's consolidated financial statements. As of December 27, 2008, Second Cup has recorded cumulative deferred revenue arising from these transactions in the amount of $2,984 (December 29, 2007 - $1,495).

21 Subsequent Events

On January 1, 2009, the actual sales of the 15 cafés added to the Royalty Pool on January 1, 2008 (see note 20) for the year ended December 31, 2008 were greater than the original estimate. As a result, a final adjustment of $172 was satisfied by MarksLP purchasing and delivering 18,312 additional units of the Fund to Second Cup. In accordance with the Agreement, MarksLP also made a cash payment of $21 to Second Cup, representing the cash distributions that would have otherwise been earned by Second Cup on the 18,312 additional units above had they been issued on January 1, 2008.

Also, on January 1, 2009, 18 cafés were added to the Royalty Pool. The annualized sales of these 18 cafés added to the Royalty Pool have been estimated at $7,209 and were offset by $6,194 in sales of 16 cafés permanently closed from the Royalty Pool during the year. As a result of this adjustment to the Royalty Pool, the Fund, through MarksLP, was required to make a payment of $190 to Second Cup, representing 80% of the obligation based on forecasted sales. In January 2009, MarksLP paid to Second Cup $190 to satisfy this obligation. After a full year of performance of the new cafés, the Fund expects to pay an additional amount to satisfy the remaining obligation. As a result of this adjustment, the total number of cafés in the Royalty Pool increased from 357 to 359.

22 Comparative Figures

Certain of the prior year comparative figures have been reclassified to conform with current period presentation.

Second Cup Royalty Income Fund

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Committees of the Board
(1)Audit Committee
(2)Governance Committee

Registrar and Transfer Agent

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