There's a little love in every cup.™

The Second Cup Ltd. Annual Report 2011

Rainforest Alliance Certified

Fair Trade Certified

OCIA Certified Organic

Printed on environmentally-responsible paper that contains FSC certified 50% post-consumer and 50% virgin fiber.

ANNUAL REPORT 2011 THE SECOND CUP LTD.

The Second Cup Ltd. ANNUAL REPORT *2011*

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SECOND CUP
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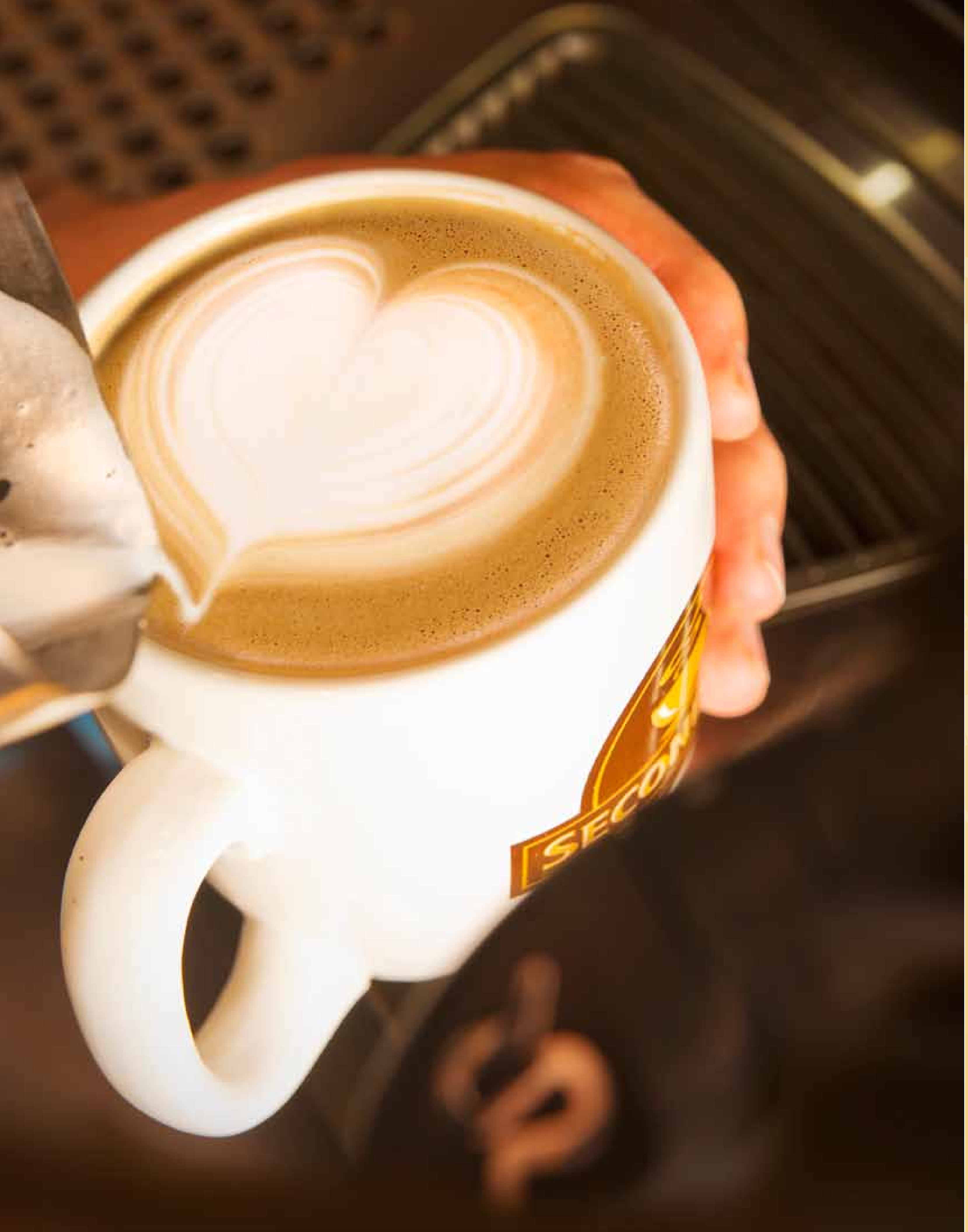
SECOND CUP



Contents

There's a little love in every cup.™

Letter from the Chairman
of The Second Cup Ltd.

On behalf of the Board of Directors of The Second Cup Ltd. ("Second Cup"), I am pleased to present our Annual Report for the fiscal year ended December 31, 2011. All amounts are expressed in thousands of Canadian dollars, except shares, unless otherwise indicated.

CONVERSION OF SECOND CUP INCOME FUND

On January 1, 2011 we completed our planned conversion from Second Cup Income Fund to Second Cup. The common shares of Second Cup commenced trading on the Toronto Stock Exchange on January 4, 2011 under the symbol "SCU." As a result of the Conversion, Second Cup is now subject to corporate income tax and, therefore, the results for 2011 will not be directly comparable to 2010.

HIGHLIGHTS

While corporate revenues were in line with the previous year, earnings before interest, tax, depreciation and amortization declined marginally from $10.7 million in 2010 to $10.6 million in 2011 reflecting a satisfactory profitability level. Adjusted net earnings per share for the year were $0.64 compared to $1.00 in 2010. The decline of $0.36 per share was mainly due to Second Cup's new tax status, as discussed above.

BOARD OF DIRECTORS

There have been some and will be more changes on the Board of Directors. In 2011, we were pleased to welcome Peter Saunders to our Board of Directors. Peter brings with him a wealth of retail experience, which has been a great addition to Second Cup. We wish to announce the planned retirement from the Board of Ray Guyatt, our Audit Committee Chair. Ray has been a board member since November 2004 and we thank him for his tremendous contribution for all these years.

We are proposing to nominate Bryan Held for election as a new director at our 2012 Annual General Meeting. Bryan comes with a diverse financial, business and international management experience. All of us on the Board are looking forward to the wisdom he will bring.

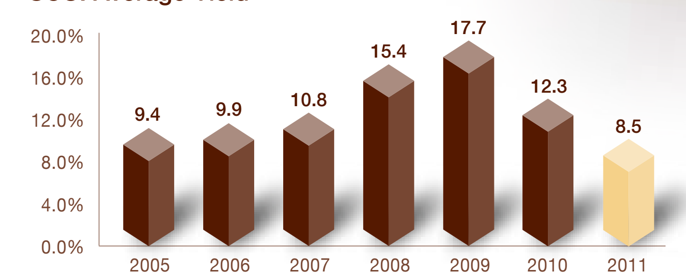
EACH WEEK, OVER 5,000 OF OUR TRUSTED COFFEE EXPERTS HANDCRAFT AND SERVE OVER ONE MILLION COFFEES AND TEAS TO CHERISHED GUESTS AT OUR 359 CAFÉS ACROSS CANADA.

Michael Rosicki
Chairman

DIVIDENDS

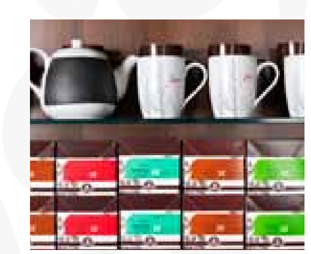
The Second Cup Board of Directors has approved a current dividend policy whereby Second Cup will pay a quarterly dividend at a rate of $0.15 per common share. Based on our current stock price, this represents a yield of 8.5%. This dividend policy is based on a continuation of our desire to pay out a substantial portion of earnings to our shareholders while retaining a sufficient amount to adequately fund organic growth initiatives.

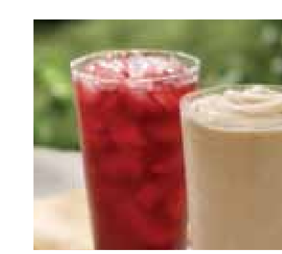
SCU: Average Yield



In closing, we would like to take this opportunity to thank our shareholders for their continued support, the talented Second Cup management team and my fellow directors. Most importantly, we thank our network of very capable Franchise Partners and their associates, who by delivering a superior customer experience everyday, will ensure that Second Cup optimizes every opportunity to achieve stronger sales and earnings results for 2012 and beyond.

Michael Rosicki
Chairman, The Second Cup Ltd.
on behalf of the Board of Directors
April 5, 2012





Letter from the President and CEO
of The Second Cup Ltd.

OVERALL, OUR SYSTEM SALES GREW 1.8% FOR THE YEAR AND WE SUCCESSFULLY OPENED 22 NEW CAFÉS, GIVING US NET GROWTH OF 10 TO COMPLETE THE YEAR AT 359 CAFÉS.

It is my pleasure to share with you our financial results for 2011 and our growth plans for 2012.

AT SECOND CUP, WE ARE PROUD TO MAINTAIN OUR UNIQUE POSITION IN THE MARKET AS THE COFFEE COMPANY THAT CARES.

Our commitment to caring is demonstrated by our passion for coffee excellence at every step of the process, our promise of delivering an exceptional café experience, and our dedication to ethical buying practices and certification.

In 2011, our focus was on regaining growth of our topline sales through investments in the Second Cup brand and through continued growth in new café units.

Overall, our system sales grew 1.8% for the year and we successfully opened 22 new cafés, giving us net growth of 10 to complete the year at 359 cafés.

2011 HIGHLIGHTS

We were very proud to announce that as of April 2011, 80% of our coffee portfolio and 100% of our espresso beverages are Rainforest Alliance, Fair Trade or Organic certified. In the fall, we relaunched our teas and tisanes as whole leaf in silken pyramid bags – all of which are also 100% Rainforest Alliance certified. Our commitment to quality and sustainability through third-party certifications upholds our "caring promise" to our café guests and gives us a unique point of difference, as well as leadership in this area.

In 2011, we opened 22 new cafés in a variety of formats and locations, including drive thrus, university campuses, community centres, street fronts and malls. We made a significant investment of $3 million into management information systems that will provide data for improved business building and cost management at both the café level and the

Stacey Mowbray
President and CEO

national level. In addition, we strengthened our management team by hiring Cathy Whelan Molloy, a veteran retail marketer, as our Chief Marketing Officer and Tom Zacharias as Vice President of Operations, who brings his vast retail and franchise experience.

2012 OUTLOOK

Our business continues to operate in a highly competitive market and a challenging consumer environment.

For 2012, our goal is to regain growth with positive same café sales and the addition of net new cafés. In terms of network expansion, we plan to open 30 new cafés and close 15 cafés, the majority of which have below average sales performance. Our plans also call for the renovation of approximately 20 cafés.

Our primary focus will be on driving traffic into our cafés through media, featuring product news and strategic offers like our successful Latte Tuesdays. Inside the café, our focus will be on operational excellence, training and promoting our brand's quality credentials as "The Coffee Company That Cares."

We recently retrained all of our baristas to perform "latte art" on all of our hero latte beverages. It is a great way to showcase the skills and talents of our trusted coffee experts, who take pride in handcrafting the perfect latte.

I want to extend a heartfelt thanks to everyone who has a hand in strengthening our brand—from our coffee farmers and local food partners to our franchise partners and trusted coffee experts. Most of all, we thank our millions of guests who frequent our cafés every day.

By putting a personal, handcrafted touch into everything we do for our café guests, ensuring a warm, welcoming café experience, and upholding our promise to work in harmony with both the environment and the people who provide us the best quality coffee beans, we're building a brand with heart.

With all that we do at Second Cup, we can proudly claim: *There's a little love in every cup.*™

Stacey Mowbray
President and CEO, The Second Cup Ltd.
April 5, 2012

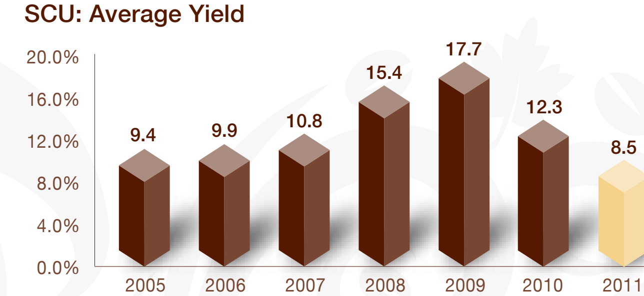
The Second Cup Ltd. (formerly Second Cup Income Fund)

Financial Highlights

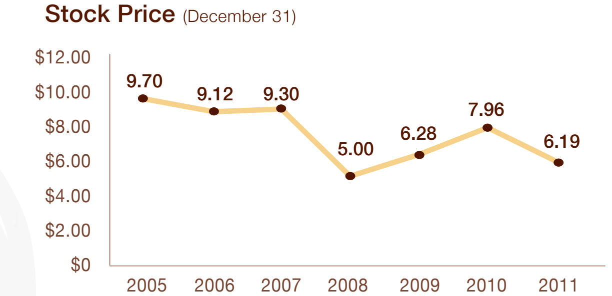
(in thousands of dollars, except number of cafés and per share/unit amounts)

	13 weeks ended December 31, 2011	3 months ended December 31, 2010	52 weeks ended December 31, 2011	12 months ended December 31, 2010
System sales of cafés[1]	$54,404	$52,921	$193,660	$190,197
Number of cafés – end of period	359	349	359	349
Same café sales growth[1]	1.2%	(1.5%)	(0.1%)	0.0%
Total revenue	$7,363	$6,490	$25,001	$25,171
Gross profit	$6,603	$5,918	$22,778	$22,547
Operating expenses	$3,393	$3,228	$13,176	$12,446
Operating income	$3,210	$2,690	$9,602	$10,101
Income Before Interest, Tax, Depreciation and Amortization ("EBITDA")[1]	$3,647	$2,881	$10,600	$10,681
Income before income taxes	$3,116	$2,583	$8,887	$9,160
Net income for the period	$2,352	$2,611	$13,301	$9,310
Adjusted net income[1]	$2,116	$2,859	$6,358	$9,873
Basic and diluted earnings per share/unit as reported	$0.23	$0.26	$1.34	$0.94
Adjusted basic and diluted earnings per share/unit[1]	$0.21	$0.29	$0.64	$1.00
Total assets	$105,554	$104,014	$105,554	$104,014

SCU: Average Yield



Stock Price (December 31)



1 "System sales of cafés," "Same café sales growth," "EBITDA," "Adjusted net income" and "Adjusted basic and diluted earnings per share/unit" are not recognized performance measures under IFRS and, accordingly, may not be comparable to similar computations as reported by other issuers.

Management's Discussion and Analysis

The following is a discussion of the results of operations and financial condition of The Second Cup Ltd. ("Second Cup" or the "Company") for year ended December 31, 2011 and should be read in conjunction with the audited financial statements of the Company (formerly Second Cup Income Fund) (the "Fund") and accompanying notes, which are available at www.sedar.com. 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 1, 2012.

OVERVIEW AND BUSINESS OF THE FUND

Second Cup is Canada's largest specialty coffee café franchisor and retailer (as measured by the number of cafés) with 359 cafés operating under the trade name Second Cup™ in Canada, of which seven are Company-operated and the balance are operated by franchise partners who are selected and trained to retail Second Cup's product offering.

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

Second Cup is incorporated and domiciled in Canada. The address of its registered office is 6303 Airport Road, 2nd Floor, Mississauga, Ontario L4V 1R8.

In 2010, the Fund's quarter and year-end followed the calendar method. In 2011, Second Cup implemented the method followed by many retail entities, such that each quarter will consist of 13 weeks and will end on the Saturday closest to the calendar quarter-end. The effect of this change in the current quarter is that the fourth quarter of 2011 consisted of 91 days compared to 92 days in the comparable quarter in 2010.

Prior to January 1, 2011, the Fund was an unincorporated open-ended trust established under the laws of the Province of Ontario. An unlimited number of units could have been issued pursuant to the Fund's declaration of trust. Units were redeemable by the holder at any time, subject to certain limitations.

Conversion of Second Cup Income Fund

At the annual and special meeting of unitholders held on June 2, 2010, unitholders of the Fund approved the proposed conversion from an income trust structure to a public corporation (the "Conversion"). The Conversion was completed on January 1, 2011 when unitholders of the Fund received, for each unit of the Fund held, one common share of Second Cup. Upon Conversion, the Fund was dissolved with its assets and liabilities assumed by Second Cup. The common shares of Second Cup commenced trading on the Toronto Stock Exchange on January 4, 2011 under the symbol "SCU."

The exchange of the units of the Fund into shares of the Company was recorded at the carrying values of the Fund's assets and liabilities on January 1, 2011 in accordance with the continuity of interest method of accounting, as the Company is considered to be a continuation of the Fund.

As a result of the Conversion, unitholders' capital of $89,972 was reclassified to share capital on the Statements of Financial Position.

As a result of the Conversion, Second Cup is now subject to corporate income tax and therefore, the results of 2011 will not be directly comparable to 2010.

As at December 31, 2011, the Company has 9,903,045 shares outstanding.

BASIS OF PRESENTATION

Second Cup prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of The Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS"), and to require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, these are the Company's first annual financial statements prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB"). In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

The financial statements have been prepared in accordance with IFRS. Subject to certain transition elections and exceptions disclosed in Note 5 of the audited financial statements, the Company has consistently applied the same accounting policies used in the preparation of its opening IFRS Statement of Financial Position at January 1, 2010 (the "Transition date") throughout all periods presented, as if these policies had always been in effect. Note 5 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP.

The accounting policies applied in the financial statements are based on IFRS effective for the year ended December 31, 2011, as issued and outstanding as of March 1, 2012, the date the board of directors approved the statements.

Prior to the Conversion, the consolidated financial statements included the accounts of the Fund and its wholly owned subsidiaries Second Cup Trade-Marks Limited Partnership ("MarksLP"), Second Cup GP Trust ("GP Trust"), Second Cup GP Inc. ("GP Inc.") and Second Cup. As a result of the Conversion, the financial statements will consist only of Second Cup.

The Company's business is classified as one operating segment that is reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The Company is structured as a franchisor with all of its operating revenues derived in Canada. Operating revenues comprise the sale of goods from Company-operated cafés and the sale of goods through ancillary channels, royalties and other service fees. Management is organized based on the Company's operations as a whole rather than the specific revenue streams. The comparative period information is based on the single operating structure of the Fund.

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

FINANCIAL HIGHLIGHTS

The following table sets out selected IFRS financial information and other data of the Company and should be read in conjunction with the audited financial statements of the Company.

(in thousands of Canadian dollars, except number of cafés and per share/unit amounts)	13 weeks ended December 31, 2011	3 months ended December 31, 2010	52 weeks ended December 31, 2011	12 months ended December 31, 2010
System sales of cafés[1]	$54,404	$52,921	$193,660	$190,197
Number of cafés – end of period	359	349	359	349
Same café sales growth[1]	1.2%	(1.5%)	(0.1%)	0.0%
Total revenue	$7,363	$6,490	$25,001	$25,171
Gross profit	$6,603	$5,918	$22,778	$22,547
Operating expenses	$3,393	$3,228	$13,176	$12,446
Operating income	$3,210	$2,690	$9,602	$10,101
Amortization of property and equipment and intangible assets	336	127	881	488
Loss on disposal of property and equipment	20	64	36	92
Impairment of property and equipment	81	-	81	-
Income Before Interest, Tax, Depreciation and Amortization ("EBITDA")[1]	$3,647	$2,881	$10,600	$10,681
Income before income taxes	$3,116	$2,583	$8,887	$9,160
Current income tax (charge) recovery	(894)	-	(1,527)	83
Deferred income tax (charge) recovery excluding Conversion	(106)	28	(1,002)	67
Deferred income tax recovery due to Conversion	236	-	6,943	-
Net income for the period	$2,352	$2,611	$13,301	$9,310
Deferred income tax recovery due to Conversion	(236)	-	(6,943)	-
Conversion costs	-	248	-	563
Adjusted net income[1]	$2,116	$2,859	$6,358	$9,873
Basic and diluted earnings per share/unit as reported	$0.23	$0.26	$1.34	$0.94
Adjusted basic and diluted earnings per share/unit[1]	$0.21	$0.29	$0.64	$1.00
Total assets	$105,554	$104,014	$105,554	$104,014

1 "System sales of cafés," "Same café sales growth," "EBITDA," "Adjusted net income" and "Adjusted basic and diluted earnings per share/unit" are not recognized performance measures under IFRS and, accordingly, may not be comparable to similar computations as reported by other issuers.

SYSTEM SALES

Overview of System Sales

System sales comprise the gross revenue reported to Second Cup by franchisees of Second Cup cafés and by cafés owned by Second Cup. 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 as reported by authorized vendors.

Increases in system sales result from the addition of new cafés 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 influencing the number of cafés added to the Second Cup café network 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. 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, more preferable location is available.

Analysis of System Sales and Same Café Sales Growth

System sales for the 13 weeks ended December 31, 2011 were $54,404 compared to $52,921 for the three months ended December 31, 2010, representing an increase of $1,483 or 2.8%. The total number of cafés at the end of the quarter was 359 compared to 349 cafés at the end of the fourth quarter of 2010. Same café sales increased by 1.2% in the quarter.

System sales for the 52 weeks ended December 31, 2011 were $193,660, compared to $190,197 for the twelve months ended December 31, 2010, representing an increase of $3,463 or 1.8%, primarily due to the net growth in the number of cafés from 349 to 359 at the end of 2011. Same café sales decline was 0.1% for the full year.

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

As discussed above, in 2011 Second Cup implemented the method followed by many retail outlets and each quarter will consist of 13 weeks (2010 - three months). The following table shows the percentage of annual system sales achieved, on average, in each fiscal reporting quarter over the last three fiscal years:

% of Annual System Sales	2009	2010	2011	Average
First quarter	23.6	23.8	23.5	23.7
Second quarter	24.4	24.4	24.4	24.4
Third quarter	24.0	24.0	24.0	24.0
Fourth quarter	28.0	27.8	28.1	27.9
	100.0	100.0	100.0	100.0

The Company's business is seasonal, with revenues and operating income generally lower in the first quarter of the fiscal year due in part to post-holiday consumer spending patterns. Historically, results have been higher in the fourth quarter, which include the holiday sales periods of November and December. Because of this seasonality, the results for any quarter are not necessarily indicative of what may be achieved for any other quarter or for the full fiscal year.

CAFÉ NETWORK

In order to accelerate the growth of new cafés, Second Cup introduced a revised royalty structure for new cafés that opened in 2011. New cafés that opened in 2011 are permitted to pay a royalty rate of 3% in the first year, a rate of 6% in the second year and, thereafter, a rate of 9%.

During the quarter, six cafés were renovated (2010 - six), there were seven café openings (2010 - five) and seven café closures (2010 - one) with 359 cafés open at December 31, 2011. For the year, 25 cafés (2010 - 33) were renovated; there were 22 café openings (2010 - 13) and twelve café closures (2010 - eight).

INCOME, OPERATING EXPENSES, INCOME TAXES AND NET EARNINGS

Fourth Quarter

Analysis of revenues

Total revenues for the quarter were $7,363 (2010 - $6,490) and consisted of royalty revenue, revenue from sale of goods and services revenue.

Royalty revenue for the quarter was $4,346 (2010 - $4,397). The reduction in royalty revenue of $51 was mainly due to a reduction in the effective royalty rate (excluding sales from Company-operated cafés) from 8.4% in 2010 to 8.1% in the current quarter as a result of the revised royalty structure for new cafés as well as café specific arrangements in place during the period.

Revenue from the sale of goods, which includes revenue from Company-operated cafés and the sale of coffee through wholesale and retail channels, was $1,042, compared to $782 for the three months ended December 31, 2010. The increase in revenue from the sale of goods was mainly due to operating five Company-operated cafés in 2010 compared to nine for most of the fourth quarter in 2011. The Company franchised two cafés late in the quarter, ending the quarter with seven Company-operated cafés.

Services revenue for the quarter was $1,975 (2010 - $1,311). Services revenue includes initial franchise fees, renewal fees, transfer fees earned on the sale of cafés from one franchise partner to another, purchasing coordination fees and other ancillary fees (IT support and training fees). The $664 increase in services revenue is mainly due to an increase in purchasing coordination fees, initial franchise fees and other ancillary fees.

Cost of Goods Sold

Cost of goods sold represents the product cost of goods sold in corporate cafés and through retail and wholesale channels plus the cost of direct labour to prepare and deliver the goods to the customers in the cafés. Cost of goods sold as a percentage of revenue from the sale of goods was 73% in the current quarter, unchanged from the three months ended December 31, 2010.

Operating Expenses

Operating expenses include the head office expenses of Second Cup and the overhead expenses of Company-operated cafés. Total operating expenses amounted to $3,393 (2010 - $3,228), an increase of $165.

Head Office Operating Expenses

Head office expenses of Second Cup decreased by $124 (4.2%) from $2,981 in 2010 to $2,857. Salaries, wages and benefits decreased by $218. Occupancy and lease costs increased by $606 compared to the prior year. In 2010 occupancy and lease costs included a $124 one time recovery of occupancy costs previously written off, $165 gain on assignment of a lease and a $136 reversal of a provision for a vacant property successfully sublet. Occupancy and lease costs in 2011 included a charge to increase the provision for vacant properties of $204, a $65 recovery of occupancy costs previously written off and a $61 increase in the accrual for rent arrears. In 2010 the Fund expensed $248 in conversion costs relating to the Conversion discussed above. Advertising and franchise development costs decreased $83 to $76 from $159. Professional fees decreased $219 to $84 from $303 primarily due to a reduction in consulting. In 2010 consulting included one-time costs for the July 1, 2010 HST implementation, developing new training modules, designing an e-commerce platform, recruiting costs and additional costs associated with LEEDS compliancy. Amortization of property, equipment and intangibles increased $105 primarily due to the purchase of POS hardware and software discussed above.

Corporate Café Operating Expenses

The overhead expenses in Company-operated cafés increased by $289 from $247 in 2010 to $536. Lease costs increased $119 primarily due to an increase in the number of Company-operated cafés and a reduction in the amortization of liabilities arising from the 2009 acquisition of the Company by the Fund. Amortization of property and equipment increased $102 and the Company recorded a loss of $81 on the impairment of a Company-operated café.

Other Income and Expenses

The Company incurred interest expense of $177 (2010 - $180), and $18 (2010 - $48) in amortization of financing charges relating to the term loan. The Company also recorded a non-cash credit of $86 (2010 - $118) for the movement in the fair value of the derivative interest rate swap that fixes the interest rate on the Company's term loan. The Company earned other interest income of $20 (2010 - $10) primarily due to interest earned from short-term highly liquid bank investments with original maturities of three months or less and from notes receivable.

Income Taxes

Current income taxes of $894 (2010 - $nil) were recorded in the quarter. A deferred tax recovery of $130 (2010 - $28) was recorded in the quarter. As previously stated, Second Cup is subject to corporate income tax as of January 1, 2011.

EBITDA

EBITDA for the quarter was $3,647 (2010 - $2,881). The increase in EBITDA was due to an increase in gross profit of $685 offset by an increase in operating expenses of $165 as discussed above.

Net Income

The Company's net income for the quarter was $2,352 or $0.23 per share, compared to $2,611 or $0.26 per unit in 2010. The reduction in net income of $259 was mainly due to income taxes of $764 in 2011 offset by an increase in operating income.

Full Year

Analysis of Revenues

Revenues were $25,001 compared to $25,171 in 2010 and consisted of royalty revenue, revenue from sale of goods and services revenue.

Royalty revenue was $15,631 (2010 - $15,874). The reduction in royalty revenue of $243 was mainly due to a reduction in the effective royalty rate (excluding sales from Company-operated cafés) from 8.5% in 2010 to 8.2% as a result of the revised royalty structure for new cafés as well as café specific arrangements in place during the period.

Revenue from the sale of goods, which includes revenue from Company-operated cafés and the sale of coffee through wholesale and retail channels, was $3,006 compared to $3,489 for the 12 months ended December 31, 2010. The reduction in revenue from the sale of goods was mainly due to a reduction in the weighted average number of Company-operated cafés from eight in 2010 to six for 2011. The Company ended the year with seven (2010 – five) Company-operated cafés.

Services revenue was $6,364 (2010 - $5,808). Services revenue includes initial franchise fees, renewal fees, transfer fees earned on the sale of cafés from one franchise partner to another, purchasing coordination fees and other ancillary fees (IT support and training fees). The $556 increase in services revenue is due to an increase in initial franchise fees of $285, increases in transfer fees of $128 and increases in other ancillary fees of $405, a decrease in purchasing coordination fees of $71 and a decrease in renewal fees of $197.

Cost of Goods Sold

Cost of goods sold as a percentage of revenue from the sale of goods was 74% compared to 75% for the twelve months ended December 31, 2010.

Operating Expenses

Total operating expenses amounted to $13,176 (2010 - $12,446), an increase of $730.

Head Office Operating Expenses

Head office expenses of Second Cup increased by $423 (3.7%) from $11,585 in 2010 to $12,008. Salaries, wages and benefits increased $340 primarily due to an increase in severance costs of $426, offset by a reduction in long term incentive plan costs of $99. Occupancy and lease costs increased by $442 compared to the prior year. This was mainly due to occupancy cost recoveries, a gain on lease assignment and a reversal of a vacant property lease provision in 2010 which were not repeated in 2011. In 2010, the Fund expensed $563 in Conversion costs relating to the Conversion discussed above. Head office overheads increased $108 due to increases in IT costs related to POS and increases in recruitment fees. Bad debt expense increased by $131 compared to 2010. Amortization of property, equipment and intangibles increased by $262 compared to 2010 due to POS hardware and software as discussed above.

Corporate Café Operating Expenses

The overhead expenses in Company-operated cafés increased by $307 from $861 in 2010 to $1,168. Lease costs increased $179 primarily due to an increase in the number of Company-operated cafés and a reduction in the amortization of liabilities arising from the 2009 acquisition of the Company by the Fund. Amortization of property and equipment increased by $131. The loss on disposal of assets was $36 compared to $92 in 2010 and the Company recorded a loss of $81 on the impairment of a Company-operated café.

Other Income and Expenses

The Company incurred interest expense of $717 (2010 - $718), and $72 (2010 - $185) in amortization of financing charges relating to the term loan. The Company also recorded a non-cash credit of $29 (2010 – charge of $33) for the movement in the fair value of the derivative interest rate swap that fixes the interest rate on the Company's term loan. The Company earned other interest income of $67 (2010 - $26) primarily due to interest earned from short-term, highly liquid bank investments with original maturities of three months or less and from notes receivable.

Income Taxes

The income tax recovery of $4,414 (2010 - $150) consists of:

- recovery of $6,943 due to the Conversion;
- current tax expense of $1,527 (2010 - $83 recovery); and
- deferred tax expense of $1,002 (2010 - $67 recovery), excluding the impact of the Conversion.

Prior to the Conversion in 2011, the Fund was an unincorporated open-ended trust and was not subject to income taxes to the extent that its taxable income was distributed to unitholders. As a result of new tax legislation substantively enacted on June 12, 2007, the Fund would have paid tax on distributions declared subsequent to January 1, 2011. As a result of this legislation, the Fund had provided for the future tax effect of existing temporary differences between the accounting and tax bases of assets and liabilities that were expected to reverse subsequent to January 1, 2011 at the specified investment flow through ("SIFT") entity tax rates under Canadian GAAP. Under IFRS, the taxation rate to apply to temporary differences of the Fund that were expected to reverse after 2010 was the highest marginal tax rate of 46.41% rather than the lower SIFT tax rate used previously of 28.25%. On the IFRS Transition Date, this IFRS adjustment resulted in an increase of $7,495 to the deferred tax liability and a corresponding decrease to equity. As a corporation, the deferred tax liability is measured using the corporate tax rate of 28.16% and resulted in a reduction in the deferred tax liability of $6,943 and a corresponding non-cash credit to income in the first quarter.

EBITDA

EBITDA was $10,600 (2010 - $10,681). The decline in EBITDA was due to an increase in operating expenses of $730 as discussed above offset by an increase in gross profit of $231.

Net Income

The Company's net income was $13,301 or $1.34 per share, compared to $9,310 or $0.94 per unit in 2010. Excluding the deferred income tax recovery of $6,943 referred to above and Conversion costs of $563 in 2010, adjusted net income was $6,358 (2010 - $9,873). The reduction in adjusted net income of $3,515 was mainly due to an increase in gross profit of $231, an increase in operating expenses of $730 (including an increase in severance costs of $426) as well as the fact that Second Cup is now subject to corporate income tax, which resulted in a deferred tax expense of $1,002, excluding the impact of the Conversion (2010 - $563) and a current tax expense of $1,527 (2010 - $83 recovery).

Capital Expenditure

In January 2011, the board of directors approved capital expenditure of $2,100 for the implementation of a new café technology platform, which includes new point of sale systems ("POS") to be distributed to the majority of cafés. The implementation is expected to be completed in early 2012 and will provide improved management information, improved customer service and will simplify administration. The franchise partners will pay a monthly fee to cover the support and maintenance of the system.

Dividend

On March 1, 2012, the board of directors of Second Cup approved a dividend of $0.15 per common share, payable on March 30, 2012 to shareholders of record at the close of business on March 16, 2012. The dividend will be considered an eligible dividend for income tax purposes. The Company's dividend policy is to continue to pay out a substantial portion of earnings while retaining a sufficient amount to adequately fund organic growth initiatives. The determination to declare and make payable dividends from Second Cup is at the discretion of the board of directors of Second Cup and, until declared payable, Second Cup has no requirement to pay cash dividends to shareholders. Taking into account current economic conditions and their impact on the profitability of Second Cup, the board of directors will continually review the level of dividends paid by the Company and there can be no assurance that the amount of the dividend will remain at the current level.

Annual General Meeting of Shareholders

The board of directors has set a record date of April 2, 2012 for the Annual General Meeting of shareholders. The Annual General Meeting will be held at 2:00 p.m. on Thursday, May 3, 2012 at the offices of Stikeman Elliott LLP, 53rd Floor, 5300 Commerce Court West, 199 Bay Street, Toronto, Ontario.

SELECTED QUARTERLY INFORMATION

A discussion of the Company's previous interim results can be found in the Company's quarterly MD&A reports available at www.sedar.com.

(in thousands of dollars, except number cafés and per share/unit amounts)	Q4 2011[1]	Q3 2011	Q2 2011	Q1 2011
System sales of cafés[2]	$54,404	$46,369	$47,294	$45,593
Same café sales growth[2]	1.2%	(0.1%)	0.3%	(2.3%)
Number of cafés at end of period	359	359	350	352
Total revenue	$7,363	$6,138	$6,072	$5,428
Operating income for the period	$3,210	$2,362	$2,506	$1,524
Amortization of property and equipment and intangible assets	336	219	185	141
Loss on disposal of property and equipment	20	9	-	7
Impairment of property and equipment	81	-	-	-
EBITDA[2]	$3,647	$2,590	$2,691	$1,672
Net income before income taxes	$3,116	$2,095	$2,283	$1,393
Current income tax charge (recovery)	894	511	122	-
Deferred income tax (recovery) charge	(130)	(68)	616	(6,359)
Net income for the period	$2,352	$1,652	$1,545	$7,752
Basic/diluted earnings per share	$0.23	$0.17	$0.16	$0.78
Dividends declared per share	$0.15	$0.15	$0.15	$0.00

(in thousands of dollars, except number cafés and per share/unit amounts)	Q4 2010[1,3]	Q3 2010[3]	Q2 2010[3]	Q1 2010
System sales of cafés[2]	$52,921	$45,583	$46,353	$45,340
Same café sales growth[2]	(1.5%)	0.3%	0.2%	1.1%
Number of cafés at end of period	349	345	342	342
Total revenue	$6,490	$6,687	$6,065	$5,929
Operating income for the period	$2,690	$2,910	$2,382	$2,119
Amortization of property and equipment and intangible assets	127	121	119	121
Loss (gain) on disposal of property and equipment	64	29	12	(13)
EBITDA[2]	$2,881	$3,060	$2,513	$2,227
Net income before income taxes	$2,583	$2,642	$2,020	$1,915
Current income tax recovery	-	-	(83)	-
Deferred income tax charge (recovery)	(28)	37	37	(113)
Net income for the period	$2,611	$2,605	$2,066	$2,028
Basic/diluted earnings per unit	$0.26	$0.26	$0.21	$0.21
Distributions declared per unit	$0.23	$0.23	$0.23	$0.23

[1] The Company's fourth quarter system sales are higher than other quarters due to the seasonality of the business (see "Seasonality of System Sales" above).
[2] "System sales of cafés," "Same café sales growth" and "EBITDA" are not recognized performance measures under IFRS and, accordingly may not be comparable to similar computations as reported by other issuers.
[3] Results for 2010 include conversion costs of $248, $3 and $312 in the fourth, third and second quarters respectively relating to the conversion to a public corporation from an income trust structure.

LIQUIDITY AND CAPITAL RESOURCES

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

Fourth quarter

Cash generated by operating activities was $3,581 for the quarter compared to $3,567 for the same quarter last year. The slight increase is the result of increases in non-cash working capital including income taxes and an increase in gross profit.

During the quarter, cash used in investing activities was $983 (2010 - $1,247). The Company purchased $974 (2010 - $1,162) of property and equipment and $64 (2010 - $145) of software primarily for POS. The Company received proceeds of $29 (2010 - $170) on the disposal of property and equipment. During the quarter, the Company agreed to finance certain franchisees $8 (2010 - $134) to enable them to purchase certain equipment, furniture and fixtures all of which are owned by the Company as the underlying security. The Company received proceeds of $28 (2010 - $24) on the repayment of leases and promissory notes.

Financing activities resulted in cash usage of $1,513 (2010 - $1,973). Second Cup paid the second quarter dividend totalling $1,485 compared to distributions of $2,279 in 2010. The Company repaid $25 (2010 - $25) on a note payable to a previous landlord and made payments of $3 (2010 - $3) on a long-term lease. In 2010 the Fund incurred $87 in financing charges related to the lender's consent to the Conversion discussed above and the Fund received proceeds of $421 from the sale of treasury units.

Full Year

Year to date, the Company generated cash from operations of $8,305 compared to $11,137 in 2010. The decrease is primarily the result of increases in non-cash working capital due to the timing of paying for the purchase of POS acquired at the end of December 2010.

Year to date, cash used by investing activities was $2,925 (2010 - $1,608). Second Cup purchased $2,731 (2010 - $1,420) of property and equipment primarily for POS, head office computer upgrades and leasehold improvements. In addition, $312 (2010 - $186) of software primarily for POS was purchased. The Company agreed to finance certain franchisees $50 (2010 - $163) to enable them to purchase certain equipment, furniture and fixtures all of which are owned by the Company as the underlying security. During 2010, the Fund settled the early termination of a café lease with a landlord. The café was leased jointly with a third party and after the Fund paid its 50% obligation to the landlord, the Fund issued a promissory note for $200 to the landlord for the third party's 50% share. The Fund then took back a promissory note for $200 from the third party secured by a general security agreement as collateral. Second Cup collected $91 (2010 - $66) on the repayment of promissory notes. Second Cup collected $6 (2010 - $nil) relating to POS leases receivable from franchise partners. Second Cup received proceeds of $49 on the disposal of property and equipment compared to proceeds of $295 in 2010 from the sale of café assets. The Company also received proceeds of $313 from the disposal of assets held for sale.

Financing activities resulted in cash usage of $5,328 in 2011, compared to $8,678 in 2010. Second Cup paid dividends totalling $4,456 and the December 2010 distribution to unitholders in the amount of $759 compared to distributions of $9,077 in 2010. As noted above, the Fund settled a lawsuit with a previous landlord by agreeing to a $200 note payable bearing interest at 5% maturing February 2012. The Company repaid $101 (2010 - $81) on the note payable and made payments of $12 (2010 - $12) on a long-term lease. In 2010, the Fund incurred $189 in financing charges related to the extension of the term loan to April 1, 2013 and received proceeds of $481 from the disposal of treasury units.

The Company had cash and cash equivalents of $5,465 at December 31, 2011 (December 31, 2010 - $5,413).

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

Term Loan, Operating Credit Facility and Interest Rate Swap

On March 31, 2010, the Fund renegotiated its term loan and operating credit facilities including an extension of the credit facilities to April 1, 2013. The revised $13,000 credit facilities are comprised of an $11,000 non-revolving term credit facility, fully drawn, and an undrawn $2,000 revolving credit facility. As a result of the refinancing, the Fund capitalized loan extension fees of $102 plus an additional $87 of fees related to the lender's consent to the Conversion in 2010.

The $11,000 non-revolving term credit facility bears interest at the bankers' acceptance rate plus 3.50%. At December 31, 2011, the full amount of the $11,000 non-revolving term credit facility was drawn.

The $2,000 operating credit facility bears interest at the bankers' acceptance rate plus 3.50%. At December 31, 2011, no advances had been drawn on this facility.

The term credit facilities are collateralized by substantially all the assets of the Company.

An interest rate swap agreement was entered into by the Company, maturing on April 1, 2013, which fixes the interest rate on the Company's non-revolving credit facility at 3.04% per annum plus the margin noted above, which results in a fixed effective interest rate of 6.54%. At December 31, 2011, the estimated fair value of this contract is a $302 liability to the Company (December 31, 2010 - $331), is recorded as a liability on the Company's Statements of Financial Position, and the fair value movement of the interest rate swap has been recorded as a non-cash charge to earnings on the Company's Statements of Income and Comprehensive Income.

Pursuant to the terms of the Company's operating loan and term loan, the Company is subject to certain financial and other customary covenants, including requirements to maintain a ratio of senior debt to EBITDA and to maintain a trailing four quarter fixed charge coverage ratio. During the year ended December 31, 2011, the Company was in compliance with all financial and other covenants of the Company's operating loan and term loan.

In accordance with IFRS 7, Financial Instruments – Disclosures, the term loan is presented net of transaction costs. Transaction costs are amortized to the Statements of Income and Comprehensive Income using the effective interest method.

OFF-BALANCE SHEET ARRANGEMENTS

Second Cup has lease commitments for Company-operated cafés and also acts as the head tenant on leases, which it, in turn, subleases to franchise partners. The Company's lease commitments at December 31, 2011 are as follows:

	Headlease commitments	Sublease to franchisees	Net
December 31, 2012	$ 18,491	$ 17,755	$ 736
December 31, 2013	17,445	16,948	497
December 31, 2014	16,282	15,776	506
December 31, 2015	14,784	14,275	509
December 31, 2016	12,515	12,004	511
Thereafter	32,999	31,144	1,855
	$ 112,516	$ 107,902	$ 4,614

The Company believes it has sufficient resources to meet the net commitment of $4,614.

Total occupancy and lease costs expensed in the quarter are as follows:

	December 31, 2011	December 31, 2010
Company head office and franchise café locations	$ 882	$ 440
Company-operated cafés	504	325
	$ 1,386	$ 765

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 claim and whether to record a provision, which is dependent on the potential success of the claim. Second Cup 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.

Second Cup has a contract with a third party company to purchase and roast the coffee that is sold in all Second Cup cafés by franchise partners. In terms of this supply agreement, Second Cup has guaranteed a minimum volume of coffee purchases amounting to $9,462 (2010 - $3,648). The coffee purchase commitment represents purchase commitments made up to the end of December 2012.

FUTURE ACCOUNTING STANDARDS

Financial Instruments – Recognition and Measurement

IFRS 9, Financial Instruments ("IFRS 9"), was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39") for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39 except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

IFRS 13, Fair Value Measurement ("IFRS 13"), is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

IFRS 9 and IFRS 13 are effective for annual periods beginning on or after January 1, 2015 and January 1, 2013 respectively with earlier adoption permitted. The Company has not yet assessed the impact of these standards or determined whether it will early adopt them.

MANAGEMENT OF CAPITAL

The capital structure of the Company consists of $10,909 (2010 - $10,837) in long-term debt and $71,402 (2010 - $62,557) in shareholders' equity, which comprises issued shares and accumulated earnings, less accumulated cash distributions.

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

- safeguard its ability to continue as a going concern;
- ensure it has sufficient cash and cash equivalents to pay declared dividends to its shareholders;
- maintain a capital structure that provides financing options to the Company when the need arises to access capital;
- maintain financial flexibility in order to preserve its ability to meet financial obligations; and
- deploy capital to provide an adequate return to its shareholders.

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

The Company determines the appropriate level of long-term debt in the context of its cash flow and overall business risks. The Company has historically generated sufficient cash flows to pay monthly dividends to its shareholders. In order to maintain or modify the capital structure, Second Cup may adjust the amount of dividends paid to its shareholders. The current level of capital is considered adequate in the context of current operations.

Under the term loan and operating facility, the Company 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 a fixed charge coverage ratio. To date, the Company has complied with these ratios.

There were no changes in the Company's approach to capital management during the quarter.

OUTSTANDING UNIT AND SHARE DATA

	Income Fund Units		Share Capital	
	#	$	#	$
Balance January 1, 2010	9,903,045	89,972	-	-
Balance December 31, 2010	9,903,045	89,972	-	-
Conversion January 1, 2011	(9,903,045)	(89,972)	9,903,045	89,972
Reduction in stated capital January 1, 2011	-	-	-	(88,972)
Balance December 31, 2011	-	-	9,903,045	1,000

At the annual and special meeting of unitholders held on June 2, 2010, the unitholders approved the Conversion to be undertaken on January 1, 2011. Included as part of the Conversion was a reduction in the stated capital from $89,972 to $1,000, resulting in a reduction of the deficit by $27,575 and an increase in contributed surplus of $61,397. The Conversion and the associated reduction in share capital were approved by court orders dated June 11, 2010 and December 17, 2010.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Multilateral Instrument 52-109 ("MI 52-109") requires the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") to make certain certifications related to the information contained in the Company's annual filings. Specifically, the CEO and CFO must acknowledge that they are responsible for establishing and maintaining disclosure controls and procedures and internal control over financial reporting for the Company. In addition, in respect of:

(a) Disclosure Controls and Procedures

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

As at December 31, 2011, the Company's management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the disclosure controls and procedures. Based on this evaluation, the CEO and CFO have concluded that, as at December 31, 2011, the Company's disclosure controls and procedures were appropriately designed.

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

(b) Internal Controls over Financial Reporting

The CEO and CFO must certify that they have designed such internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

As at December 31, 2011, the Company's management, under the supervision of, and with the participation of, the CEO and CFO, evaluated the design of the controls over financial reporting. No material weaknesses in the design of these controls over financial reporting were identified. Based on this evaluation, the CEO and CFO have concluded that, as at December 31, 2011, the Company's controls over financial reporting were appropriately designed and are operating effectively.

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

During the 52 weeks ended December 31, 2011, there has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements requires management to use judgment in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgments are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of the financial statements:

Impairment analysis
Impairment analysis is an area involving management judgement requiring assessment as to whether the carrying value of assets is recoverable. Fair value less cost to sell is determined by estimating the net present value of future cash flows derived from such assets using cash flow projections which have been discounted at an appropriate rate. In calculating the net present value of the future cash flows, certain assumptions are required to be made in respect of highly uncertain matters including:

a) Growth in total revenue
b) Growth in EBITDA, calculated as adjusted operating profit before depreciation and amortization,
c) Long term growth rates
d) Selection of discount rates to reflect the risks involved.

Management has estimated cash flows based on expected future operations.

The discount rate is based upon a weighted average cost of capital derived from the benchmark analysis from similar retail or franchise businesses in Canada and the United States.

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

The Company's review includes the key assumptions related to sensitivity in the cash flow projections. Further details are provided in Note 14 to the financial statements.

Recoverable amount and Cash Generating Units (CGUs)
A CGU is defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.

Goodwill is not amortized but tested for impairment at least once a year or more frequently when there is an indication that it may be impaired.

An impairment test is performed at the level of each CGU within each operating segment. This allocation is reviewed if the Company changes the level at which it monitors return on investment for goodwill testing purposes.

An impairment loss is recognized when the carrying value of the assets and liabilities of the franchise business CGU is lower than its recoverable amount. The recoverable amount of the franchise business CGU was estimated based on fair value less costs to sell as this was determined to be higher than the value-in-use. Fair value less costs to sell is the best estimate of the amount obtainable from the sale of a CGU in an arm's length transaction between knowledgeable, willing parties, less costs to sell. This estimate is determined on December 31, on the basis of available market information to arrive at the discounted present value of future cash flows over a five-year period, plus a terminal value.

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

Fair value of derivative
Second Cup's over-the-counter derivative consists of an interest rate swap used to economically hedge exposure to variable cash flows associated with interest payments on the Company's borrowings. Management estimates the fair value of this derivative as the present value of expected future cash flows to be received or paid, based on available market data, which includes market yields and counterparty credit spreads.

Estimated useful lives
Management estimates the useful lives of property and equipment based on the period during which the assets are expected to be available-for-use. The amounts and timing of recorded expenses for amortization of property and equipment for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of physical wear and tear, technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's property and equipment in the future.

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 the Second Cup café network are affected by various external factors that can affect the specialty coffee industry as a whole. Potential risks include the following:

The specialty coffee industry is characterized by intense competition with respect to price, location, coffee and food quality and numerous factors affecting discretionary consumer spending. Competitors include national and regional chains, 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 adversely affect the ability of Second Cup to pay dividends.

Growth of the café network depends on Second Cup's ability to secure and build desirable locations and find high calibre, qualified franchise partners to operate them. Adverse credit markets, such as those currently being experienced, may affect the ability of franchise partners to obtain new credit or refinance existing credit on economically reasonable terms.

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

A shortage in supply or an increase in the price of premium quality coffee beans could adversely affect Second Cup. Second Cup has no material long-term 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.

As a Franchisor, Second Cup guarantees the lease of its franchise partners for most of its franchised cafés.

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

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

OUTLOOK

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 Second Cup business continues to operate in a highly competitive marketplace and a challenging consumer environment. For 2012, management is targeting to regain growth with positive same café sales, and the addition of net new cafés. The focus will be on driving traffic into cafés through external messaging, sampling and product news. In café, the focus will be on operational excellence, training and promotion of the brand's quality credentials as The Coffee Company That Cares.

In terms of 2012 network expansion Second Cup has targeted to open 30 new cafés. In addition, Second Cup expects to close approximately 15 cafés, the majority of which have sales below the average performance of its cafés and to renovate approximately 20 of its cafés.

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 Second Cup's control, that may cause Second Cup's actual results, performance or achievements, or those of Second Cup cafés, or industry results to be materially different from any future results, performance or achievements expressed or implied by such forward-looking 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 franchise partners; the location of Second Cup cafés; the closure of Second Cup cafés; loss of key personnel; compliance with government regulations; potential litigation; the ability to exploit and protect the Second Cup 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 franchise partners; 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 Second Cup'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, Second Cup 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 Company's filings with securities regulators. These filings are also available on the Company's website at www.secondcup.com.

NON-IFRS TERMS

In addition to using financial measures prescribed by IFRS, non-IFRS financial measures and other terms are used in this MD&A. These terms include "system sales of cafés," "same café sales growth," "EBITDA," "adjusted net income" and "adjusted basic and diluted earnings per share/unit". These terms are not financial measures recognized by IFRS and do not have any standardized meaning prescribed by IFRS and, therefore, may not be comparable to similar terms and measures presented by other similar issuers. These non-IFRS 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 IFRS.

System sales of cafés and same café sales growth are presented in reference to the sales performance of all cafés in Canada. The Company believes they are useful measures as they provide an indication of the top-line sales on which the royalty that is Second Cup's direct source of income is based.

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

The Second Cup Ltd. (formerly Second Cup Income Fund)

Audited Financial Statements

For the years ended December 31, 2011 and 2010 pwc

March 8, 2012

To the Shareholders of
The Second Cup Ltd.

We have audited the accompanying financial statements of The Second Cup Ltd., which comprise the statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010 and the statements of income and comprehensive income, statements of changes in equity and statements of cash flows for the years ended December 31 2011 and December 31, 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of The Second Cup Ltd. as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with IFRS.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

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The Second Cup Ltd. (formerly Second Cup Income Fund)

Statements of Financial Position

As at December 31, 2011, December 31, 2010 and January 1, 2010

(Expressed in thousands of Canadian dollars)

	December 31, 2011	December 31, 2010	January 1, 2010
ASSETS			
Current assets			
Cash and cash equivalents (note 7)	$ 5,465	$ 5,413	$ 4,562
Trade and other receivables (note 8)	5,338	5,843	4,558
Current portion of notes and leases receivable (note 10)	149	85	-
Inventories (note 9)	79	49	83
Prepaid expenses and other assets	194	361	92
Income tax recoverable	-	75	53
	11,225	11,826	9,348
Non-current assets			
Notes and leases receivable (note 10)	469	228	-
Property and equipment (note 11)	3,478	1,491	600
Goodwill (note 12)	2,444	2,444	2,444
Intangible assets (note 13)	87,938	88,025	88,185
Total assets	$ 105,554	$ 104,014	$ 100,577
LIABILITIES			
Current liabilities			
Accounts payable and accrued liabilities	$ 4,093	$ 6,443	$ 3,874
Current portion of other long-term liabilities (note 19)	166	288	72
Provisions (note 15)	447	570	532
Income tax payable	1,509	-	-
Gift card liability	4,353	4,167	3,992
Distributions payable to unitholders	-	759	759
Deposits from franchise partners	1,457	1,448	1,375
	12,025	13,675	10,604
Non-current liabilities			
Deferred income taxes (notes 16 and 17)	10,183	16,124	16,191
Other long-term liabilities (note 19)	392	55	39
Provisions (note 15)	341	435	761
Fair value of derivative interest rate swap (note 18)	302	331	298
Term loan (note 18)	10,909	10,837	10,841
Total liabilities	34,152	41,457	38,734
Shareholders'/Unitholders' Equity (note 1)	71,402	62,557	61,843
Total liabilities and equity	$ 105,554	$ 104,014	$ 100,577

Contingencies, commitments and guarantees (note 20) and subsequent event (note 29).
See accompanying notes to financial statements.

Approved by the Directors March 1, 2012

Michael Rosicki, Director Raymond Guyatt, Director

The Second Cup Ltd. (formerly Second Cup Income Fund)

Statements of Income and Comprehensive Income

For the years ended December 31, 2011 and 2010

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

	2011	2010
Revenue		
Royalty revenue	$ 15,631	$ 15,874
Revenue from sale of goods	3,006	3,489
Services revenue	6,364	5,808
	25,001	25,171
Cost of goods sold	2,223	2,624
Gross profit	22,778	22,547
Operating expenses (note 22)	13,176	12,446
Operating income	9,602	10,101
Interest income	(67)	(26)
Interest expense (note 18)	782	967
Net interest expense	715	941
Income before income taxes	8,887	9,160
Income taxes (recovery) (note 16)		
Current	1,527	(83)
Deferred	(5,941)	(67)
	(4,414)	(150)
Net income for the year	13,301	9,310
Other comprehensive income	-	-
Comprehensive income	$ 13,301	$ 9,310
Basic and diluted earnings per share/unit (note 21)	$ 1.34	$ 0.94

See accompanying notes to financial statements.

The Second Cup Ltd. (formerly Second Cup Income Fund)

Statements of Changes in Equity

(Expressed in thousands of dollars)

	Share Capital (*see below)	Contributed Surplus	Accumulated Other Comprehensive Income	(Deficit) Retained Earnings	Total
Balance - January 1, 2010	$ 89,972	$ -	$ -	$ (28,129)	$ 61,843
Treasury units	-	-	-	321	321
Gain on disposal of treasury units	-	160	-	-	160
Net income for the year	-	-	-	9,310	9,310
Distributions to unitholders	-	-	-	(9,077)	(9,077)
Balance - December 31, 2010	$ 89,972	$ 160	$ -	$ (27,575)	$ 62,557
Reduction in share capital	(88,972)	61,397	-	27,575	-
Net income for the year	-	-	-	13,301	13,301
Dividends to shareholders	-	-	-	(4,456)	(4,456)
Balance - December 31, 2011	$ 1,000	$ 61,557	$ -	$ 8,845	$ 71,402

* Prior to the Conversion (notes 1 and 6) Share Capital was referred to as Income Fund Units.
See accompanying notes to financial statements.

The Second Cup Ltd. (formerly Second Cup Income Fund)

Statements of Cash Flows

For the years ended December 31, 2011 and 2010

(Expressed in thousands of Canadian dollars)

	2011	2010
CASH PROVIDED BY (used in)		
Operating Activities		
Net income for the year	$ 13,301	$ 9,310
Items not involving cash		
Amortization of provisions (note 3(l))	(112)	(169)
Amortization of property and equipment (note 3(h))	489	142
Amortization of intangible assets (note 3(j))	392	346
Loss on disposal of property and equipment	36	92
Impairment of property and equipment	81	-
Amortization of deferred financing charges (note 3(n))	72	185
Deferred income taxes	(5,941)	(67)
Movement in fair value of derivative interest rate swap	(29)	33
Income taxes	1,584	(22)
Leasehold inducement	403	-
Changes in non-cash working capital (note 24)	(1,971)	1,287
	8,305	11,137
Investing activities		
Purchase of property and equipment	(2,731)	(1,420)
Purchase of assets held for sale	(291)	-
Purchase of software	(312)	(186)
Proceeds from disposal of property and equipment	49	295
Proceeds from disposal of assets held for sale	313	-
Investment in promissory notes	(50)	(363)
Proceeds from repayment of promissory notes	91	66
Proceeds from repayment of leases receivable	6	-
	(2,925)	(1,608)
Financing activities		
Distributions paid to unitholders	(759)	(9,077)
Dividends paid to shareholders	(4,456)	-
Payments on long-term lease	(12)	(12)
Issuance of note payable	-	200
Repayment of note payable	(101)	(81)
Proceeds from disposal of treasury units	-	481
Deferred financing charges	-	(189)
	(5,328)	(8,678)
Increase in cash and cash equivalents during the year	52	851
Cash and cash equivalents - Beginning of year	5,413	4,562
Cash and cash equivalents - End of year	$ 5,465	$ 5,413

See accompanying notes to financial statements.

The Second Cup Ltd. (formerly Second Cup Income Fund)

Notes to the Financial Statements

For the years ended December 31, 2011 and 2010

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

1. ORGANIZATION AND NATURE OF BUSINESS

The Second Cup Ltd. ("Second Cup" or "the Company") is Canada's largest specialty coffee café franchisor (as measured by the number of cafés) with 359 cafés operating under the trade name Second Cup™ in Canada, of which seven are Company operated and the balance are operated by franchise partners who are selected and trained to retail Second Cup's product offering.

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

Second Cup is incorporated and domiciled in Canada. The address of its registered office is 6303 Airport Road, 2nd Floor, Mississauga, Ontario, L4V 1R8.

In 2010, Second Cup Income Fund's (the "Fund") quarters and year-end followed the calendar method. In 2011, Second Cup implemented the method followed by many retail entities, such that each quarter will consist of 13 weeks and will end on the Saturday closest to the calendar quarter end. The effect of this change in the current quarter is that the fourth quarter of 2011 consisted of 91 days compared to 92 days in the comparable quarter in 2010.

Prior to January 1, 2011, the Fund was an unincorporated open-ended trust established under the laws of the Province of Ontario. An unlimited number of units could have been issued pursuant to the Fund's declaration of trust. Units were redeemable by the holder at any time, subject to certain limitations.

Conversion of Second Cup Income Fund

At the annual and special meeting of unitholders held on June 2, 2010, unitholders of the Fund approved the proposed conversion from an income trust structure to a public corporation ("Conversion"). The Conversion was completed on January 1, 2011. Under the plan of arrangement, unitholders of the Fund received, for each unit of the Fund held, one common share of Second Cup. As a result of this Conversion, the Fund was dissolved with its assets and liabilities assumed by Second Cup. The common shares of Second Cup commenced trading on the Toronto Stock Exchange on January 4, 2011 under the symbol "SCU."

The exchange of the units of the Fund into shares of the Company was recorded at the carrying values of the Fund's assets and liabilities on January 1, 2011 in accordance with the continuity of interest method of accounting, as the Company is considered to be a continuation of the Fund.

As a result of the Conversion, unitholders' capital of $89,972 was reclassified to share capital. Included as part of the Conversion was a reduction in the stated capital from $89,972 to $1,000, resulting in a reduction of the deficit by $25,575 and an increase in contributed surplus of $61,397. The Conversion and the associated reduction in share capital were approved by court orders dated June 11, 2010 and December 17, 2010.

2. BASIS OF PREPARATION AND ADOPTION OF IFRS

Second Cup prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of The Canadian Institute of Chartered Accountants ("CICA Handbook"). In 2010, the CICA Handbook was revised to incorporate International Financial Reporting Standards ("IFRS") and to require publicly accountable enterprises to apply such standards effective for years beginning on or after January 1, 2011. Accordingly, these are the Company's first annual financial statements prepared in accordance with IFRS as issued by the International Accounting Standards Board ("IASB"). In these financial statements, the term "Canadian GAAP" refers to Canadian GAAP before the adoption of IFRS.

The financial statements have been prepared in accordance with IFRS. Subject to certain transition elections and exceptions disclosed in note 5, the Company has consistently applied the same accounting policies used in the preparation of its opening IFRS Statement of Financial Position at January 1, 2010 (the "Transition date") throughout all periods presented, as if these policies had always been in effect. Note 5 discloses the impact of the transition to IFRS on the Company's reported financial position, financial performance and cash flows, including the nature and effect of significant changes in accounting policies from those used in the Company's consolidated financial statements for the year ended December 31, 2010 prepared under Canadian GAAP.

These financial statements were approved by the Board of Directors for issue on March 1, 2012.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of measurement
The financial statements have been prepared under the historical cost convention, except for certain financial instruments that are measured at fair values, as explained in the accounting policies below. Historical cost is generally based on the fair value of the consideration given in exchange for assets.

(b) Consolidation
Prior to the Conversion, the consolidated financial statements included the accounts of the Fund and its wholly owned subsidiaries Second Cup Trade-Marks Limited Partnership ("MarksLP"), Second Cup GP Trust ("GP Trust"), Second Cup GP Inc. ("GP Inc.") and Second Cup. As a result of the Conversion, the financial statements consist only of Second Cup.

(c) Segmented information
Second Cup operates within Canada which is considered to be its sole operating segment. As a franchisor, Second Cup opens, acquires, closes and refranchises individual café locations in the normal course of business.

(d) Cash and cash equivalents
Cash and cash equivalents include cash on hand, deposits held with banks and other short-term highly liquid investments with original maturities of three months or less.

(e) Financial instruments
Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount reported in the Statements of Financial Position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

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

(i) Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term. Derivatives are also included in this category unless they are designated as hedges. The only instruments held by the Company classified in this category are interest rate swaps (see (v) below). The Company fair values the swap at the end of each quarter with the change in fair value accounted through profit or loss.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the Statements of Income and Comprehensive Income. Gains and losses arising from changes in fair value are presented in the Statements of Income and Comprehensive Income within other gains and losses in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the Statements of Financial Position date, which is classified as non-current.

(ii) Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise trade receivables, notes receivable and cash and cash equivalents, and are included in current assets due to their short-term nature except for the portion expected to be realized beyond 12 months of the Statements of Financial Position date. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment, if necessary.

(iii) Leases: The Company has entered into lease agreements with some franchise partners relating to point of sale systems ("POS"). The lease term is for the major part of the economic life of the POS although the Company does not transfer title. The Company recognizes leases as finance type leases and records a lease receivable at an amount equal to the net investment in the lease. The Company's leases receivable are included in current assets due to their short-term nature except for the portion expected to be realized beyond 12 months of the Statements of Financial Position date. Leases receivable are initially recognized at the amount expected to be received, less, when material, a discount to reduce the leases receivable to fair value. Subsequently, leases receivable are measured at amortized cost using the effective interest method less a provision for impairment.

(iv) Financial liabilities at amortized cost: Financial liabilities at amortized cost include trade payables, deposits from franchise partners, gift card liability, bank debt and long-term debt. Trade payables are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value. Subsequently, trade payables are measured at amortized cost using the effective interest method.

The sale process of a new café requires a deposit from a franchise partner at the outset, including an amount for franchise fees, which is recognized as revenue when the café opens. Deposits from franchise partners are applied against the cost of constructing a new café or the renovation of an existing café. Gift card liability represents liabilities related to unused balances on Second Cup's reloadable payment card ("Second Cup Café Card") net of estimated breakage. These balances are included as sales from franchised cafés, or as revenue of Company operated cafés at the time the customer redeems the amount in a café for products or services. Breakage represents management's estimate of balances outstanding relating to gift cards that may never be redeemed. Bank debt and long-term debt are recognized initially at fair value, net of any transaction costs incurred, and subsequently at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within 12 months. Otherwise, they are presented as non-current liabilities.

(v) Derivative financial instruments: The Company uses derivatives in the form of interest rate swaps to manage risks related to its variable rate debt. All derivatives have been classified as fair value through profit or loss, are included on the Statements of Financial Position within other liabilities and are classified as current or non-current based on the contractual terms specific to the instrument.

Gains and losses on remeasurement are included in interest income (expense).

(vi) Classification as debt or equity: Debt and equity instruments issued by the Company are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

(f) Impairment of financial assets
At each reporting date, the Company assesses whether there is objective evidence that a financial asset is impaired.

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

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

If such evidence exists, the Company recognizes an impairment loss, as follows:

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

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

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

(g) Inventories
Inventories are stated at the lower of cost and net realizable value, with cost being determined on a first-in, first-out ("FIFO") method. Net realizable value is the estimated selling price less applicable selling expenses. If carrying value exceeds net realizable amount, a write down is recognized. The write down may be reversed in a subsequent period if the circumstances which caused it no longer exist.

(h) Property and equipment
Property and equipment are stated at cost less accumulated amortization and accumulated impairment losses. Cost includes expenditures that are directly attributable to the acquisition of the asset. Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the Statements of Income during the period in which they are incurred.

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	3 to 7 years
Computer hardware	3 years

Property and equipment are reviewed for impairment annually or at any time if an indicator of impairment exists (refer to note 3(k)).

(i) Goodwill
Goodwill represents the excess of the cost of acquisition over the fair values of assets, liabilities and contingent liabilities acquired. Goodwill is carried at cost less accumulated impairment losses.

Goodwill is reviewed for impairment annually or at any time if an indicator of impairment exists (refer to note 3(k)).

(j) Intangible assets
Intangible assets consist of trademarks, franchise rights and software, which are amortized or assessed for impairment (refer to note 3(k)) as follows:

(i) Trademarks
Trademarks consist of trade names, operating procedures and systems and other intellectual property used in connection with the operation of the Second Cup cafés in Canada and are recorded at the historical cost less impairment write-downs. The trademark is an indefinite life intangible asset that is tested annually for impairment.

Management believes the trademarks related to Second Cup are very well established in the marketplace and will continue to provide benefits indefinitely into the future.

(ii) Franchise rights
As a result of the acquisition of Second Cup in 2009, franchise rights were recognized as an intangible asset. The franchise rights intangible asset is based on the net present value of the discounted future net cash flows expected from the existing franchise partners of Second Cup as at the date of acquisition, including royalties and franchise fees.

(iii) Software
Purchased software costs are recorded at cost and are amortized commencing when the asset is available for use.

Amortization is calculated at the following rates, which are based on the expected useful life of the asset:

Franchise rights	average remaining term of the existing franchise agreement
Software	3 to 7 years

(k) Impairment of non-financial assets
Property and equipment and intangible assets are tested for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. Long-lived assets that are not amortized are subject to an annual impairment test.

For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows (cash generating units or "CGUs"). The recoverable amount of each particular CGU is the higher of an asset's fair value less costs to sell and value in use. For the purposes of the impairment test, the Company estimates the fair value less costs to sell of the individual cash generating units.

The impairment analysis involves comparing the carrying amount of the cash generating units with their estimated recoverable amounts based on fair value less costs to sell values. Management considers a number of factors in estimating the recoverable value of each CGU. These factors are included in the discounted cash flow estimates, capitalized cash flow methods and earnings multiples, each of these valuation methods use estimates and assumptions that are sensitive to change and require 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 recoverable amounts. Costs to sell are estimated based on the most recent transactions in the retail and franchise business.

An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. Impairment losses for CGUs reduce first the carrying amount of any goodwill allocated to that CGU. Any remaining impairment loss is charged pro rata to the other assets in the CGU.

The Company evaluates impairment losses, other than goodwill impairment, for potential reversals when events or circumstances warrant such consideration.

(l) Provisions
Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount can be reliably estimated. Provisions are measured at management's best estimate of the expenditure required to settle the obligation at the end of the reporting period and are discounted to present value where the effect is material. The Company performs evaluations to identify onerous contracts and, where applicable, records provisions for such contracts.

(i) Headlease liabilities
On June 27, 2009, MarksLP, on behalf of the Fund, completed the acquisition of all of the outstanding shares of Second Cup. Headlease liabilities represent the provision for lease guarantees provided by Second Cup for franchised operations at the date of acquisition, June 27, 2009. The liability was recorded at estimated fair value based on the net present value of the future estimated negative cash flows when Second Cup is required to cover rental arrears of its franchise partners, to terminate unfavourable leases or to cover shortfalls if a location is sublet to a third party. This liability is amortized over the average remaining length of these existing lease agreements.

(ii) Café lease agreements
The Company café lease liability is based on the net present value of the difference between the market related rental rates and the contract lease rates paid by Second Cup from the date of the acquisition until the end of each respective lease agreement. The café lease agreement liability is amortized over the average remaining length of these Company café leases.

(m) Other long-term liabilities

(i) Leasehold inducement
The Company extended its head office lease contract to March 31, 2024. The landlord provided a tenant allowance which is amortized over the full lease term.

(n) Deferred financing charges
Deferred financing charges represent costs associated with the Company's term loan, and are offset against the term loan and expensed to the Statement of Income using the effective interest rate method.

(o) Income tax
Income tax comprises current and deferred income tax. Income tax is recognized in the Statements of Income except to the extent that it relates to items recognized directly in equity, in which case the income tax is also recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted, or substantively enacted, at the end of the reporting period, and any adjustment to tax payable in respect of previous years.

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

Deferred income tax assets and liabilities are presented as non-current.

Prior to its Conversion in 2011, the Fund was an unincorporated open-ended trust and was not subject to income tax to the extent that its taxable income was distributed to unitholders. As a result of new tax legislation substantively enacted on June 12, 2007, the Fund would have paid a tax on distributions declared subsequent to January 1, 2011. As a result of this legislation, the Fund had provided for the future tax effect of existing temporary differences between the accounting and tax bases of assets and liabilities that were expected to reverse subsequent to January 1, 2011. On January 1, 2011, the Fund completed its conversion to a corporation, therefore Second Cup will be subject to corporate income tax.

(p) Advertising and cooperative fund assets and liabilities
Second Cup 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 revenue, expenses and cash flows of the Coop Fund are not included in the Company's Statements of Income and Cash Flows because the contributions to this fund are segregated and designated for a specific purpose. The assets and liabilities of the Coop Fund are included in the assets and liabilities of the Company.

(q) Gift card liability
Second Cup has a gift card program that allows customers to prepay for future purchases by reloading a dollar value onto their gift cards through cash or credit/debit card in the cafés or on-line through credit cards, when and as needed. The purpose of the gift card program is to expand the Second Cup brand through increased exposure as well as to increase sales. Gift card liability represents liabilities related to unused balances on the Second Cup Café Card net of estimated breakage. These balances are included as sales from franchised cafés, or as revenue of Company operated cafés, at the time the customer redeems the amount in a café for products or services. Breakage represents management's estimates of balances outstanding relating to gift cards that may never be redeemed. This breakage factor is estimated based on historical experience and is reviewed quarterly by management.

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

Royalty revenue from franchised cafés is recognized as the products are sold as reported by the franchise partner.

Revenue from the sale of goods from Company operated cafés, from the sale of products through wholesale and e-commerce channels are recognized as the products are sold to customers.

Services revenue includes initial franchise fees, renewal fees, café resale fees, construction administration fees and purchasing coordination fees.

Initial franchise fees are recognized as income when the café commences operations, renewal fees are recognized at the commencement of a new franchise term, café resale fees are recognized when title transfers on the sale of a café between franchise partners and construction administration fees are recognized upon the completion of a café renovation and re-opening. All fees are recognized as revenue after the franchise agreement has been signed and the Company has performed substantially all services and met all material conditions required by the franchise agreement.

Purchasing coordination fees are for franchise partners and other customers and are recognized as the services are rendered and all significant conditions have been met.

(s) Cost of goods sold
Cost of goods sold represents the product cost of goods sold in corporate cafés and through retail and wholesale channels plus the cost of direct labour to prepare and deliver the goods to the customers in the cafés.

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

(u) Long-term incentive plan and Directors deferred share unit plan
In December 2009, Second Cup implemented a long-term incentive plan ("LTIP") as described in note 27. Under IFRS 2, Share-based Payment, the fair value of each tranche of the grants is amortized over their respective vesting period using the graded amortization method. Compensation expense is measured at the grant date at fair value and recognized over the service period based on the vesting period and is adjusted for any changes in fair value of the Company's share price. In terms of the LTIP, any dividends paid by the Company during the vesting period will be accrued based on the total number of shares granted.

In January 2011, the Company implemented a Directors deferred share unit plan ("DSUP") as described in note 27. Compensation expense is measured at the grant date (beginning of year) at fair value vesting on the last day of the year in which the shares are granted and is adjusted for any changes in fair value of the Company's share price. In terms of the DSUP, any dividends paid by the Company during the vesting period will be accrued based on the total number of shares granted.

(v) Earnings per share
Basic earnings per share ("EPS") is calculated by dividing the net income for the period attributable to equity owners of the Company by the weighted average number of common shares outstanding during the period.

Diluted EPS is calculated by adjusting the weighted average number of common shares outstanding for dilutive instruments. The number of shares included with respect to options, warrants and similar instruments is computed using the treasury stock method.

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

(x) Dividends
Dividends on common shares are recognized in the Company's financial statements in the period in which the dividends are approved by the Board of Directors.

(y) Future changes in accounting policies
IFRS 9, Financial Instruments ("IFRS 9"), was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39") for debt instruments with a new mixed measurement model having only two categories: amortized cost and fair value through profit and loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39 except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

IFRS 13, Fair Value Measurement ("IFRS 13"), is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

IFRS 9 and IFRS 13 are effective for annual periods beginning on or after January 1, 2015 and January 1, 2013 respectively with earlier adoption permitted. The Company has not yet assessed the impact of these standards or determined whether it will early adopt them.

4. CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements requires management to use judgment in applying its accounting policies and estimates and assumptions about the future. Estimates and other judgments are continuously evaluated and are based on management's experience and other factors, including expectations about future events that are believed to be reasonable under the circumstances. Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

The following discusses the most significant accounting judgments and estimates that the Company has made in the preparation of the financial statements:

Impairment analysis
Impairment analysis is an area involving management judgement requiring assessment as to whether the carrying value of assets is recoverable. Fair value less cost to sell is determined by estimating the net present value of future cash flows derived from such assets using cash flow projections which have been discounted at an appropriate rate. In calculating the net present value of the future cash flows, certain assumptions are required to be made in respect of highly uncertain matters including:

a) Growth in total revenue
b) Growth in EBITDA, calculated as adjusted operating profit before depreciation and amortization,
c) Long term growth rates
d) Selection of discount rates to reflect the risks involved.

Management has estimated cash flows based on expected future operations.

The discount rate is based upon a weighted average cost of capital derived from the benchmark analysis from similar retail or franchise businesses in Canada and the United States.

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

The Company's review includes the key assumptions related to sensitivity in the cash flow projections. Further details are provided in note 14 to the financial statements.

Recoverable amount and Cash Generating Units (CGUs)
A CGU is defined as the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets.

Goodwill is not amortized but tested for impairment at least once a year or more frequently when there is an indication that it may be impaired.

An impairment test is performed at the level of each CGU within each operating segment. This allocation is reviewed if the Company changes the level at which it monitors return on investment for goodwill testing purposes.

An impairment loss is recognized when the carrying value of the assets and liabilities of the franchise business CGU is lower than its recoverable amount. The recoverable amount of the franchise business CGU was estimated based on fair value less costs to sell as this was determined to be higher than the value-in-use. Fair value less costs to sell is the best estimate of the amount obtainable from the sale of a CGU in an arm's length transaction between knowledgeable, willing parties, less costs to sell. This estimate is determined on December 31, on the basis of available market information to arrive at the discounted present value of future cash flows over a five-year period, plus a terminal value.

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

Fair value of derivative
Second Cup's over-the-counter derivative consists of an interest rate swap used to economically hedge exposure to variable cash flows associated with interest payments on the Company's borrowings. Management estimates the fair value of this derivative as the present value of expected future cash flows to be received or paid, based on available market data, which includes market yields and counterparty credit spreads.

Estimated useful lives
Management estimates the useful lives of property and equipment based on the period during which the assets are expected to be available-for-use. The amounts and timing of recorded expenses for amortization of property and equipment for any period are affected by these estimated useful lives. The estimates are reviewed at least annually and are updated if expectations change as a result of physical wear and tear, technical or commercial obsolescence and legal or other limits to use. It is possible that changes in these factors may cause significant changes in the estimated useful lives of the Company's property and equipment in the future.

5. TRANSITION TO IFRS

The effect of the Company's transition to IFRS, described in note 2, is summarized in this note as follows:

a) Transition elections
b) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS
c) Explanatory notes
d) Adjustments to the Statements of Cash Flows

(a) Transition elections
The Company has applied the following transition exceptions and exemptions to full retrospective application of IFRS:

i. In accordance with IFRS transitional provisions, the Company elected to apply IFRS relating to business combinations prospectively from January 1, 2010. As such, Canadian GAAP balances relating to business combinations entered into before that date, including goodwill, have been carried forward without any adjustment.

ii. In accordance with IFRS transitional provisions, the Company applied mandatory exception from full retrospective application of IFRS relating to estimates. Therefore the estimates made and presented in these financial statements as of January 1, 2010 are consistent with estimates made under Canadian GAAP.

(b) Reconciliation of equity and comprehensive income as previously reported under Canadian GAAP to IFRS

Equity

	December 31, 2011	January 1, 2010
Equity as reported under Canadian GAAP	$70,045	$ 69,338
IFRS adjustments increase (decrease)		
LTIP (note 27)	(27)	-
Deferred income tax	(7,461)	(7,495)
Equity as reported under IFRS	$62,557	$ 61,843

Comprehensive income

	Year ended December 31, 2010
Comprehensive income as reported under Canadian GAAP$	9,303
IFRS adjustments increase (decrease)	
LTIP	(27)
Deferred income tax	34
Net income	9,310
Other comprehensive income	-
Comprehensive income as reported under IFRS	$ 9,310

(c) Explanatory notes
LTIP
Under IFRS 2, Share-based Payment, the fair value of each tranche of the grants will be amortized over their respective vesting period using the graded amortization method rather than on a straight-line basis as permitted under Canadian GAAP. Under Canadian GAAP, forfeitures can be accounted for when they occur, whereas under IFRS, the number of rights that would ultimately vest is estimated and amortized over their vesting period. As a result of the above noted changes, the LTIP liability (included in accounts payable and accrued liabilities) increased by $27 as at December 31, 2010.

As at January 1, 2010, there was no material difference between Canadian GAAP and IFRS with respect to the LTIP liability under IFRS 2.

Deferred income taxes
Under Canadian GAAP income trusts record temporary differences that are expected to reverse after 2010 based on specified investment flow through ("SIFT") entity tax rate. Income trusts were not subject to income tax to the extent that their taxable income was distributed to unitholders, which resulted in the temporary differences being recorded at the corporate tax rate of 28.25%. Under IAS 12 the rate to apply to temporary differences existing on January 1, 2010 that are expected to reverse after 2010 would be the highest marginal tax rate of 46.41% rather than the corporate tax rate. The result of IAS 12 is that the income trusts cannot take the benefit of the fact that the income trust will also get a deduction for future distributions. The highest marginal tax rate is the rate at which tax would be payable by the income trust should distributions not be declared. After the Conversion, the tax rate will be at the corporate tax rate and the future tax adjustment will reverse (note 16).

(d) Adjustments to the Statements of Cash Flows
The transition from Canadian GAAP to IFRS had no significant impact on cash flows generated by the Company.

6. SHARE CAPITAL

Second Cup is authorized to issue an unlimited number of common shares.

	Income Fund Units		Share Capital	
	#	$	#	$
Balance January 1, 2010	9,903,045	89,972	-	-
Balance December 31, 2010	9,903,045	89,972	-	-
Conversion January 1, 2011	(9,903,045)	(89,972)	9,903,045	89,972
Reduction in stated capital January 1, 2011	-	-	-	(88,972)
Balance December 31, 2011	-	-	9,903,045	1,000

At the annual and special meeting of unitholders held June 2, 2010, the unitholders approved the Conversion to be undertaken on January 1, 2011. Included as part of the Conversion was a reduction in the stated capital from $89,972 to $1,000, resulting in a reduction of the deficit by $27,575 and an increase in contributed surplus of $61,397. The Conversion and the associated reduction in share capital were approved by court orders dated June 11, 2010 and December 17, 2010.

7. CASH AND CASH EQUIVALENTS

	December 31, 2011	December 31, 2010	January 1, 2010
Cash	$ 3,040	$ 4,413	$ 3,662
Cash equivalents	2,425	1,000	900
Cash and cash equivalents	$ 5,465	$ 5,413	$ 4,562
Interest rate per annum	1.10%	0.52%	0.65%

The cash equivalent represents short term savings with maturity less than three months since December 31.

8. TRADE AND OTHER RECEIVABLES

	December 31, 2011	December 31, 2010	January 1, 2010
Trade and other receivables	$ 5,449	$ 5,917	$ 4,674
Less: allowance for doubtful accounts	(111)	(74)	(116)
Trade and other receivables - net	$ 5,338	$ 5,843	$ 4,558

9. INVENTORIES

	December 31, 2011	December 31, 2010	January 1, 2010
Merchandise held for resale	$ 67	$ 39	$ 66
Supplies	12	10	17
	$ 79	$ 49	$ 83

10. NOTES AND LEASES RECEIVABLE

	December 31, 2011	December 31, 2010	January 1, 2010
Notes and leases receivables due in 1 year	$ 162	$ 85	$ -
Notes and leases receivables due after 1 year, but before 5 years	543	184	-
Notes and leases receivables due after 5 years	50	44	-
	755	313	-
Less: allowance for doubtful accounts due in 1 year	(13)	-	-
Less: allowance for doubtful accounts due after 1 year	(124)	-	-
	$ 618	$ 313	$ -
Less: Current portion	149	85	-
Notes and leases receivable - net	$ 469	$ 228	$ -

During 2011 the Company agreed to finance three franchise partners $50 to enable them to purchase certain equipment, furniture and fixtures all of which are owned by the Company as the underlying security. Title will be transferred to the franchise partner after collecting full payments on the receivable. During 2011 the Company entered into lease agreements with some franchise partners relating to point of sale systems ("POS"). These leases bear interest at 8%. These were accounted for as finance leases totalling $74. The Company owns title to all POS. During 2011 the Company capitalized $437 of trade receivables to notes receivable. Subsequently, the Company recorded an allowance for doubtful accounts totalling $137.

During 2010, the Fund settled the early termination of a café lease with a landlord. The café was leased jointly with a third party and after the Fund paid its 50% obligation to the landlord, the Fund issued a promissory note to the landlord for the third party's 50% share (note 19). The Fund took back a promissory note from the third party secured by a general security agreement totalling $200. The Company also agreed to finance certain franchise partners $178 to enable them to purchase certain equipment, furniture and fixtures all of which are owned by the Company as the underlying security. Title will be transferred to the franchise partner after collecting full payment on the receivable.

11. PROPERTY AND EQUIPMENT

	Leasehold improvements	Equipment, furniture, fixtures and other	Computer hardware	Total
Net book value				
At January 1, 2010				
Cost	$ 444	$ 541	$ 119	$ 1,104
Accumulated amortization	(200)	(231)	(73)	(504)
At January 1, 2010	244	310	46	600
Additions	287	1,084	49	1,420
Disposals - original cost	(142)	(368)	-	(510)
Disposals - accumulated amortization	4	121	(2)	123
Amortization	(51)	(61)	(30)	(142)
At December 31, 2010	$ 342	$ 1,086	$ 63	$ 1,491
Cost	589	1,257	168	2,014
Accumulated amortization	(247)	(171)	(105)	(523)
At December 31, 2010	$ 342	$ 1,086	$ 63	$ 1,491
Net book value				
At December 31, 2010				
Cost	$ 589	$ 1,257	$ 168	$ 2,014
Accumulated amortization	(247)	(171)	(105)	(523)
At December 31, 2010	342	1,086	63	1,491
Additions	664	1,959	108	2,731
Disposals - original cost	(25)	(107)	-	(132)
Disposals - accumulated amortization	1	24	-	25
Capitalized to lease	-	(67)	-	(67)
Impairment	(81)	-	-	(81)
Amortization	(104)	(331)	(54)	(489)
At December 31, 2011	$ 797	$ 2,564	$ 117	$ 3,478
Cost	1,228	3,042	276	4,546
Accumulated amortization	(431)	(478)	(159)	(1,068)
At December 31, 2011	$ 797	$ 2,564	$ 117	$ 3,478

12. GOODWILL

	December 31, 2011	December 31, 2010	January 1, 2010
Goodwill	$ 2,444	$ 2,444	$ 2,444

There were no additions, disposals or impairment charges during the above-noted reporting periods.

13. INTANGIBLE ASSETS

	Trademarks	Franchise rights	Software	Total
Net book value				
At January 1, 2010				
Cost	$ 86,905	$ 1,331	$ 126	$ 88,362
Accumulated amortization	-	(141)	(36)	(177)
At January 1, 2010	86,905	1,190	90	88,185
Additions (acquired)	-	-	186	186
Amortization	-	(283)	(63)	(346)
At December 31, 2010	$ 86,905	$ 907	$ 213	$ 88,025
Cost	86,905	1,331	312	88,548
Accumulated amortization	-	(424)	(99)	(523)
At December 31, 2010	$ 86,905	$ 907	$ 213	$ 88,025
Net book value				
At December 31, 2010				
Cost	$ 86,905	$ 1,331	$ 312	$ 88,548
Accumulated amortization	-	(424)	(99)	(523)
At December 31, 2010	86,905	907	213	88,025
Additions (acquired)	-	-	312	312
Disposals - original cost	-	-	(43)	(43)
Disposals - accumulated amortization	-	-	43	43
Capitalized to lease	-	-	(7)	(7)
Amortization	-	(283)	(109)	(392)
At December 31, 2011	$ 86,905	$ 624	$ 409	$ 87,938
Cost	86,905	1,331	574	88,810
Accumulated amortization	-	(707)	(165)	(872)
At December 31, 2011	$ 86,905	$ 624	$ 409	$ 87,938

Management concluded the estimated recoverable amount of its intangible assets exceeded their carrying value as at the Transition date and December 31, 2011 and 2010 and that the intangible assets were not impaired.

14. IMPAIRMENT OF ASSETS

During the accounting periods presented the Company had two main CGUs – corporate cafes and franchise business.

Goodwill of $2,444 as well as the Trademark was allocated fully to the franchise business CGU. The CGUs recoverable amount has been determined using fair value less costs to sell.

Key assumptions

The discounted cash flow estimates uses estimates and assumptions that are sensitive to change and require 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 recoverable amounts. General market uncertainty and the recessionary operating environment for the Company 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 Company's shares and market conditions. The changes in the market growth rates reflect the current general economic pressures now impacting the national economy.

These calculations use cash flow projections based on financial forecasts covering a five-year period. Cash flows beyond the five-year period are extrapolated using the estimated growth rates stated below. The following are key assumptions used in the fair value less costs to sell calculation:

Forecast same café sales growth	2% - 3%
Forecast revenue growth	1% - 6%
Average growth rate used to extrapolate cash flows beyond the budget period	2%
Weighted average cost of capital ("WACC")	11.5%

A discount rate of 11.5% was used, which was derived from the Company's weighted average cost of capital.

The valuation of the franchise business CGU based on the forecasted cash flows and using an 11.5% discount rate does not indicate any impairment.

The effect of a change in the management's key assumptions is reflected below and does not result in an impairment charge in either scenario:

Sensitivity	**Scenario**		
Key assumption	Low growth	Most Likely	High Growth
Revenue growth	1% - 3%	1% - 6%	2% - 6%
WACC	11.0%	11.5%	12.0%
Effect on fair value less cost to sell of CGU	($2,648)	-	$3,056
Impairment result	Fair value less cost to sell higher than carrying value.	Fair value less cost to sell higher than carrying value.	Fair value less cost to sell higher than carrying value.

15. PROVISIONS

	Headlease Liabilities	Legal	Total
At January 1, 2010	$ 1,236	$ 57	$ 1,293
Provisions charged (recovered) during the year	44	(7)	37
Provisions utilized during the year	(325)	-	(325)
At December 31, 2010	955	50	1,005
Provisions charged during the year	132	9	141
Provisions utilized during the year	(299)	(59)	(358)
At December 31, 2011	$ 788	$ -	$ 788
Less: Current portion	447	-	447
Provisions	$ 341	$ -	$ 341

16. INCOME TAXES

Income tax expense is recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year. As discussed above in note 5(c), under Canadian GAAP income trusts were not subject to income tax to the extent that its taxable income was distributed to unitholders. Under IAS 12 the rate to apply in 2010 was the highest marginal tax rate which was estimated to be 46.41%. After the Conversion the tax rate is estimated to be 28.16%. The benefit of the rate reduction due to the Conversion is $7,462. As a result of the Conversion, Second Cup recognized certain deferred tax assets and liabilities that were not previously recognized resulting in a net charge of $519 during the year. For the year ended December 31, 2010, the Fund recognized a future income tax recovery amounting to $67 arising primarily from a change in the temporary income tax differences expected to exist on January 1, 2011 at the tax rate applicable to Second Cup.

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:

	2011	2010
Income before income taxes	$ 8,887	$ 9,160
Combined Canadian federal and provincial tax rates	28.16%	46.41%
Tax provision at statutory rate	2,503	4,251
Reduced by following differences:		
Income distributed or accrued to unitholders not subject to tax in the Fund	-	(3,844)
Change in tax rates	(7,462)	(67)
Deferred tax assets and liabilities not previously recognized	519	-
Benefits derived from timing differences	-	(700)
Non-deductible permanent differences	9	219
Other	17	(9)
Income tax recovery	$ (4,414)	$ (150)

17. DEFERRED INCOME TAX

The analysis of deferred tax assets and deferred tax liabilities is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Deferred tax assets			
Deferred tax asset to be recovered after more than 12 months	$ (234)	$ (3,031)	$ (2,972)
Deferred tax asset to be recovered within 12 months	(237)	(264)	(256)
	(471)	(3,295)	(3,228)
Deferred tax liabilities			
Deferred tax liability to be recovered after more than 12 months	10,654	19,419	19,419
Deferred tax liability to be recovered within 12 months	-	-	-
	10,654	19,419	19,419
Deferred tax liabilities - net	$ 10,183	$ 16,124	$ 16,191

The gross movement on the deferred income tax account is as follows:

At January 1	$ 16,124	$ 16,191
Income tax recovery	(5,941)	(67)
End of period	$ 10,183	$ 16,124

The movement in deferred income tax assets and liabilities during the period is as follows:

	Property and equipment	Trademarks	Intangible assets	Other	Total
At January 1, 2010	$ (3,143)	$ 19,419	$ -	$ (85)	$ 16,191
(Credited) to the income statement	(22)	-	-	(45)	(67)
At December 31, 2010	(3,165)	19,419	-	(130)	16,124
Charged (credited) to the income statement	4,312	(10,070)	158	(341)	(5,941)
At December 31, 2011	$ 1,147	$ 9,349	$ 158	$ (471)	$ 10,183

18. TERM LOAN AND OPERATING FACILITY

On March 31, 2010, the Fund renegotiated its term loan and operating credit facilities including an extension of the maturity of the credit facilities to April 1, 2013. The revised $13,000 credit facilities are comprised of an $11,000 non-revolving term credit facility, fully drawn, and an undrawn $2,000 revolving credit facility. As a result of the refinancing, the Fund capitalized loan extension fees of $102 plus an additional $87 of fees related to the lender's consent to the Conversion discussed above in 2010. The term credit facilities are collateralized by substantially all the assets of the Company.

The $11,000 non-revolving term credit facility bears interest at the bankers' acceptance rate plus 3.50%. At December 31, 2011, the full amount of the $11,000 non-revolving term credit facility was drawn.

The $2,000 operating credit facility bears interest at the bankers' acceptance rate plus 3.50%. At December 31, 2011, no advances had been drawn on this facility.

An interest rate swap agreement has been entered into by the Company maturing April 1, 2013, which fixes the interest rate on the Company's non-revolving credit facility at 3.04% per annum plus the margin noted above, which results in a fixed effective interest rate of 6.54%. At December 31, 2011, the estimated fair value of this contract is a $302 liability to the Company (December 31, 2010 - $331) and is recorded as a liability on the Company's Statements of Financial Position and the fair value movement of the interest rate swap has been recorded as a non-cash charge to earnings on the Company's Statements of Income and Comprehensive Income.

Pursuant to the terms of the Company's operating loan and term loan, the Company is subject to certain financial and other customary covenants, including requirements to maintain a ratio of senior debt to EBITDA and to maintain a trailing four quarter fixed charge coverage ratio. During the years ended December 31, 2011 and 2010, the Company was in compliance with all financial and other covenants of the Company's operating loan and term loan.

In accordance with IFRS 7, Financial Instruments – Disclosures, the term loan is presented net of transaction costs. Transaction costs are amortized to the Statements of Income and Comprehensive Income using the effective interest method.

	December 31, 2011	December 31, 2010	January 1, 2010
Face value of long-term debt	$ 11,000	$ 11,000	$ 11,000
Unamortized transaction costs	(91)	(163)	(159)
	$ 10,909	$ 10,837	$ 10,841

At maturity, April 1, 2013, the Statements of Financial Position value of the term loan will be equal to the face value.

Interest expense consists of the following:

	2011	2010
Interest on term loan	$ 525	$ 471
Interest on derivative interest rate swap	192	247
Movement in fair value of derivative interest rate swap	(29)	33
Amortization of deferred financing charges	72	185
Other interest expense	22	31
	$ 782	$ 967

19. OTHER LONG-TERM LIABILITIES

	December 31, 2011	December 31, 2010	January 1, 2010
Deferred revenue (i)	$ 135	$ 210	$ 85
Promissory note payable (ii)	18	119	-
Leasehold inducement (note 3(m))	403	-	-
Other	2	14	26
	$ 558	$ 343	$ 111
Less: Current portion	166	288	72
	$ 392	$ 55	$ 39

(i) Deferred revenue on purchasing co-ordination fees and new term fees will be earned as follows: 2012 - $114, 2013 - $14, 2014 - $7.

(ii) The promissory note payable bearing interest at 5% is payable in blended monthly payments of $9, maturing February 1, 2012 with principal payments due as follows: 2012 - $18 (note 10).

20. CONTINGENCIES, COMMITMENTS AND GUARANTEES

Second Cup has lease commitments for Company operated cafés and also acts as the head tenant on leases, which it, in turn, subleases to franchise partners. To the extent that the Company may be required to make rent payments due to headlease commitments, a provision has been recognized (note 15). The Company's lease commitments at December 31, 2011 are as follows:

	Headlease commitments	Sublease to franchisees	Net
December 31, 2012	$ 18,491	$ 17,755	$ 736
December 31, 2013	17,445	16,948	497
December 31, 2014	16,282	15,776	506
December 31, 2015	14,784	14,275	509
December 31, 2016	12,515	12,004	511
Thereafter	32,999	31,144	1,855
	$ 112,516	$ 107,902	$ 4,614

Total occupancy and lease costs expensed in the year are as follows:

	2011	2010
Company head office and franchise café locations	$ 882	$ 440
Company operated cafés	504	325
	$ 1,386	$ 765

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. Second Cup believes 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 when determinable or in the period of settlement.

Second Cup has a contract with a third party company to purchase and roast the coffee that is sold in all Second Cup cafés by franchise partners. In terms of this supply agreement, Second Cup has guaranteed a minimum volume of coffee purchases amounting to $9,462 (2010 - $3,648). The coffee purchase commitment represents purchase commitments made up to the end of December 2012.

21. BASIC AND DILUTED EARNINGS PER SHARE/UNIT

Earnings per share/unit are based on the weighted average number of shares/units outstanding during the period. Basic and diluted earnings per share/unit are determined as follows:

	2011	2010
Net income	$ 13,301	$ 9,310
Weighted average number of shares/units issued and outstanding	9,903,045	9,862,054
Basic and diluted earnings per share/unit	$ 1.34	$ 0.94

22. OPERATING EXPENSES

Expenses by nature

	2011	2010
Head office		
Salaries, wages and benefits	$ 7,311	$ 6,971
Travel and franchise partner meetings	888	799
Head office overheads	833	725
Professional fees	476	681
Legal costs	394	515
Occupancy and lease costs	882	440
Amortization of intangible assets	392	346
Advertising and franchise development	263	323
Bad debt expense	280	149
Conversion costs	-	563
Amortization of property and equipment	289	73
	12,008	11,585
Company cafés		
Lease costs	504	325
Other operating expenses	253	267
Amortization of property and equipment	200	69
Advertising and local marketing	94	108
Impairment of property and equipment	81	-
Loss on disposal of property and equipment	36	92
	1,168	861
Operating expenses	$ 13,176	$ 12,446

Salaries, wages and employee benefits

	2011	2010
Salaries and wages	$ 6,271	$ 6,179
Employee benefits	625	661
Directors' fees	202	297
Severance costs	687	261
LTIP	93	192
DSUP	89	-
Recovery from Coop Fund	(656)	(619)
Total head office	$ 7,311	$ 6,971

23. COMPENSATION OF KEY MANAGEMENT

Key management is defined as the senior management team and the Board of Directors.

	2011	2010
Salaries and short-term employee benefits	$ 2,083	$ 2,400
Severance costs	687	-
Stock-based compensation – LTIP (note 27)	93	192
Stock-based compensation – DSUP (note 27)	89	-
Pension costs – defined contribution plans	29	36
Total compensation	$ 2,981	$ 2,628

24. SUPPLEMENTARY CASH FLOW INFORMATION

Changes in non-cash working capital items:

	2011	2010
Trade and other receivables	$ 505	$ (1,285)
Notes and leases receivable	(278)	(16)
Inventories	(30)	34
Prepaid expenses and other assets	167	(269)
Accounts payable and accrued liabilities	(2,350)	2,569
Provisions	(105)	(119)
Other long-term liabilities	(75)	125
Gift card liability	186	175
Deposits from franchise partners	9	73
	$ (1,971)	$ 1,287
Supplementary information		
Interest paid	$ 739	$ 739
Income tax recovered	$ (57)	$ (69)

25. MANAGEMENT OF CAPITAL

The capital structure of the Company consists of $10,909 (2010 - $10,837) in long-term debt and $71,402 (2010 - $62,557) in shareholders' equity, which is comprised of issued shares and accumulated earnings, less accumulated cash dividends.

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

1. safeguard its ability to continue as a going concern;
2. ensure it has sufficient cash and cash equivalents to pay declared dividends to its shareholders;
3. maintain a capital structure that provides financing options to the Company when the need arises to access capital;
4. maintain financial flexibility in order to preserve its ability to meet financial obligations; and
5. deploy capital to provide an adequate return to its shareholders.

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

The Company determines the appropriate level of long-term debt in the context of its cash flows and overall business risks. The Company has historically generated sufficient cash flows to pay quarterly dividends to its shareholders. In order to maintain or modify the capital structure, Second Cup may adjust the amount of dividends paid to its shareholders. The current level of capital is considered adequate in the context of current operations.

Under the term loan and operating facility, the Company 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 a fixed charge coverage ratio. To date, the Company has complied with these ratios.

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

26. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

Financial Instruments
The Company's financial instruments consist of cash and cash equivalents, accounts receivable, notes receivable, accounts payable and accrued liabilities, gift card liability, other long-term liabilities, dividends payable to shareholders, term loan, and the derivative interest rate swap.

Categories of financial instruments
The Company has designated each of its significant categories of financial instruments outstanding as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Financial assets			
Cash and cash equivalents	$ 5,465	$ 5,413	$ 4,562
Loans and receivables			
Trade and other receivables	5,338	5,843	4,558
Leases receivable	71	-	
Notes receivable	547	313	-
Financial liabilities			
Fair value through profit or loss (FVTPL)			
Derivative interest rate swap	302	331	298
Other financial liabilities			
Accounts payable and accrued liabilities	4,093	6,443	3,874
Gift card liability	4,353	4,167	3,992
Promissory note payable and other long-term liabilities	20	133	26
Distributions payable to unitholders	-	759	759
Term loan	10,909	10,837	10,841

Financial liabilities designated as at FVTPL

	2011	2010
Opening fair value	$ 331	$ 298
Additions during the period	-	-
Realized during the period	-	-
Change in value	(29)	33
Closing fair value	$ 302	$ 331

Fair value of financial instruments
The fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and gift card liability approximate their carrying amounts due to their short-term maturity. The fair value of notes receivable approximates their carrying value.

The fair value of the Company's term loan approximates its carrying value less transaction costs due to the floating interest rate of the term loan.

IFRS 7, Financial Instruments – Disclosures, requires for financial instruments that are measured subsequent to initial recognition at fair value, grouped in Levels 1 to 3, in the fair value hierarchy, based on the degree to which the fair value is observable. The three levels of the fair value hierarchy are:

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

The fair value for the derivative interest rate swap, classified as a Level 2, was derived using a discounted cash flow model that considers various observable inputs including time to maturity, forward interest rates and credit spreads.

As at December 31, 2010	Level 1	Level 2	Level 3
Cash	$ -	$ 5,413	$ -
Trade and other receivables	-	5,843	-
Accounts payable and accrued liabilities	-	(6,443)	-
Gift card liability	-	(4,167)	-
Derivative interest rate swap	-	(331)	-
	$ -	$ 315	$ -

As at December 31, 2011	Level 1	Level 2	Level 3
Cash	$ -	$ 5,465	$ -
Trade and other receivables	-	5,338	-
Accounts payable and accrued liabilities	-	(4,093)	-
Gift card liability	-	(4,353)	-
Derivative interest rate swap	-	(302)	-
	$ -	$ 2,055	$ -

There were no transfers between Level 1 and Level 2 in the year.

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

Credit Risk
The Company's financial instruments exposed to credit risk include cash and cash equivalents, trade and other receivables, leases receivable and notes receivable. The Company places its cash with institutions of high creditworthiness. The Company's trade and other receivables, leases receivable and notes receivable primarily comprise amounts due from franchise partners. Based on experience, management believes its trade and other receivables, leases receivable and notes receivable credit risk exposure is limited. Credit risk from trade and other receivables, leases receivable and notes receivable is minimized as a result of the review and evaluation of franchise partner account balances beyond a particular age, and management accounts for a specific bad debt provision when the expected recovery is less than the actual accounts receivable. The provision relating to past due trade and other receivables at December 31, 2011 was $111 (December 31, 2010 - $74). The provision relating to past leases receivable and notes receivable at December 31, 2011 was $151 (December 31, 2010 - $nil).

The maturities of the Company's trade and other receivables as at December 31, 2011 are as follows:

	Maturing in the next 90 days	Maturing between 90 days and less than a year	Maturing between 1 year and less than 2 years	Maturing after 2 years	Total
Total	$5,184	$154	-	-	$5,338

The creditworthiness of new franchise partners is reviewed during the application process. A new franchise partner requires a minimum 30% of their investment in unencumbered cash, written confirmation of financing for the remaining 70% from their bank and a deposit of $100 to accompany the signed franchise agreement.

The maturities of the Company's notes and leases receivable as at December 31, 2011 are as follows:

	Maturing in the next 90 days	Maturing between 90 days and less than a year	Maturing between 1 year and less than 2 years	Maturing after 2 years	Total
Total	$37	$112	$139	$330	$618

Liquidity Risk
Liquidity risk is the risk the Company will encounter difficulty in meeting obligations as they come due associated with its financial liabilities. The Company manages liquidity risk through regular monitoring of dividends, forecast and actual cash flows, and also the management of its capital structure and senior leverage ratios as outlined in note 18. The Company's main source of income is royalty receipts from its franchise partners.

The contractual maturities of the Company's financial liabilities as at December 31, 2011 are as follows:

	Maturing in the next 90 days	Maturing between 90 days and less than a year	Maturing between 1 year and less than 2 years	Maturing after 2 years	Total
Accounts payable and accrued liabilities	$ 3,111	$ 893	$ 88	$ 1	$ 4,093
Gift card liability	4,353	-	-	-	4,353
Promissory note payable and other long-term liabilities	20	-	-	-	20
Derivative interest rate swap	49	147	49		245
Term loan	130	390	11,130		11,650
Total	$ 7,663	$ 1,430	$11,267	$ 1	$ 20,361

Interest Rate Risk
Interest rate risk is the risk the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

The Company is exposed to interest rate risk on its cash and cash equivalents and term loan, which earn and bear interest at floating rates. The Company entered into an interest rate swap agreement to minimize risk.

Interest expense on the long-term debt is adjusted to include the payments made or received under the interest rate swap agreement. The interest rate swap agreement is recognized in the Statements of Financial Position at its estimated fair value. During the year ended December 31, 2011, the Company recorded a net interest recovery of $29 on the Statements of Income and Comprehensive Income relating to the interest rate swap (2010 – expense of $33).

Sensitivity Analysis
IFRS7, Financial Instruments – Disclosures, requires disclosure of a sensitivity analysis to illustrate the sensitivity of the Company's financial position and performance to changes in market variables such as interest rates as a result of changes in the fair value of cash flows associated with the Company's financial instruments. The sensitivity analysis provided discloses the effect on net earnings at December 31, 2011, assuming that a reasonably possible change in the relevant risk variable has occurred at December 31, 2011.

The following table shows the Company's exposure to interest rate risk and the pre-tax effects on net income for the period ended December 31, 2011 of a 1% change in interest rates management believes is reasonably possible:

	Pre-tax effects on net income – increase (decrease)		
	Carrying amount of liability	1% decrease in interest rates	1% increase in interest rates
Term loan	$ 11,000	$ (110)	$ 110
Interest rate swap agreement	302	110	(110)
		$ -	$ -

27. LONG-TERM INCENTIVE PLAN AND DIRECTORS DEFERRED SHARE UNIT PLAN

Shares granted under the LTIP vest over a three-year period and are paid out in cash on December 15 of each year. Shares are granted based on the weighted average price of the Company's shares for the 20 trading days prior to the grant date. The fair value of the shares outstanding is determined based on the market value of the underlying shares of the Company.

A summary of the status of the Company's LTIP is presented below:

	Notional Units	Fair value
Notional units outstanding as at January 1, 2010	41,391	$ 173
Units granted in lieu of distributions	6,268	38
Units granted on December 23, 2010	29,424	156
Change in fair value		78
Notional units outstanding as at December 31, 2010	77,083	$ 445
Amount expensed in current year		$ 192

	Notional Units	Fair value
Notional shares outstanding as at December 31, 2010	77,083	$ 445
Shares forfeited	(14,680)	(90)
Shares paid out	(6,263)	(50)
Shares granted in lieu of distributions	3,872	25
Shares granted on December 23, 2011	28,751	180
Change in fair value		(92)
Notional shares outstanding as at December 31, 2011	88,763	$ 418
Amount expensed in current year		$ 93

Shares granted under the DSUP vest on the last day of the year in which they are granted and are paid out in cash upon the termination of the director. Shares are granted based on the weighted average price of the Company's shares for the 5 trading days prior to the grant date. The fair value of the shares outstanding is determined based on the market value of the underlying shares of the Company.

A summary of the status of the Company's DSUP is presented below:

	Notional Units	Fair value
Notional shares outstanding as at December 31, 2010	-	$ -
Deferred share units granted	19,727	155
Shares granted in lieu of dividends	1,221	8
Shares forfeited	(4,367)	(34)
Shares paid out	(2,183)	(17)
Change in fair value		(23)
Notional shares outstanding as at December 31, 2011	14,398	$ 89
Amount expensed in current year		$ 89

28. SEGMENTED REPORTING

The Company's business is classified as one operating segment that is reported in a manner consistent with the internal reporting provided to the chief operating decision maker. The Company is structured as a franchisor with all of its operating revenues derived in Canada. Operating revenues comprise sale of goods from Company operated cafés and the sale of goods through ancillary channels, royalties and other service fees. Management is organized based on the Company's operations as a whole rather than the specific revenue streams.

29. SUBSEQUENT EVENT

On March 1, 2012 the Board of Directors of Second Cup approved a quarterly dividend of $0.15 per common share, payable on March 30, 2012 to shareholders of record at the close of business on March 16, 2012.

The Second Cup Ltd. (formerly Second Cup Income Fund)

Shareholder Information

CORPORATE HEAD OFFICE
The Second Cup Ltd.
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Mississauga, Ontario
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Registrar and Transfer Agent
Computershare Trust Company
of Canada

Auditors
PricewaterhouseCoopers LLP

Market Information
Shares Listed:
Toronto Stock Exchange
Symbol: **SCU**

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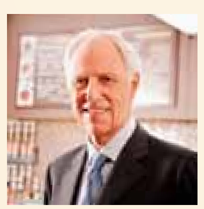
THE SECOND CUP LTD.
Board of Directors

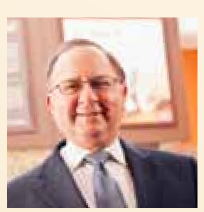
Michael Rosicki (1) (2)
Chairman

Peter Saunders (1) (2)

Bryna Goldberg (2)



Raymond Guyatt (1)



James Anas

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

THE SECOND CUP LTD.
Senior Management Team

Stacey Mowbray
President and
Chief Executive Officer

Robert Masson
Chief Financial Officer

Wayne Vanderhorst
Vice President,
Franchise Development

Cathy Whelan Molloy
Chief Marketing Officer

Rita Toporowski
Vice President,
Corporate Planning and Development

Tom Zacharias
Vice President, Operations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