

# **A&W Food Services of Canada Inc.**

## **Q2/2017**

### **Consolidated Financial Statements**

For the second quarter ended  
June 18, 2017

Provided as a supplement to the financial  
statements of A&W Revenue Royalties Income  
Fund





**A&W Food Services of Canada Inc.  
Report to Unitholders of A&W Revenue Royalties Income Fund  
January 2, 2017 to June 18, 2017**

This report and the interim condensed consolidated financial statements of A&W Food Services of Canada Inc. (A&W or Food Services) for the 12 weeks and 24 weeks ended June 18, 2017 are provided as a supplement to the interim condensed consolidated financial statements and Management Discussion and Analysis of the A&W Revenue Royalties Income Fund (the Fund) for the period ended June 18, 2017. This report is dated July 25, 2017 and should be read in conjunction with the interim condensed consolidated financial statements of Food Services for the 12 weeks and 24 weeks ended June 18, 2017 and the audited annual consolidated financial statements of Food Services for the 52 weeks ended January 1, 2017. Such financial statements and additional information about the Fund and Food Services are available at [www.sedar.com](http://www.sedar.com) or [www.awincomefund.ca](http://www.awincomefund.ca).

**Glossary**

Consolidated Financial Statements	Consolidated financial statements which include the accounts of A&W Food Services of Canada Inc. and its 60% ownership interest in A&W Root Beer Beverages of Canada Inc.
A&W or Food Services	Financial and operating results of A&W Food Services of Canada Inc. and A&W Root Beer Beverages of Canada Inc.
The Fund	A&W Revenue Royalties Income Fund
Trade Marks	A&W Trade Marks Inc. and A&W Trade Marks Limited Partnership
The Partnership	A&W Trade Marks Limited Partnership
Beverages	A&W Root Beer Beverages of Canada Inc.

To align its financial reporting with the business cycle of its operations, Food Services uses a fiscal year comprising a 52 or 53 week period ending on the Sunday nearest December 31. The fiscal 2016 year was 52 weeks and ended January 1, 2017 (2015 – 53 weeks ended January 3, 2016). Food Services' second quarter ends 24 weeks after its fiscal year end.

The financial results reported in this MD&A are in accordance with International Financial Reporting Standards (IFRS) as applicable to interim financial reports including International Accounting Standards (IAS) 34, Interim Financial Reporting. The accounting policies applied in the interim condensed consolidated financial statements and this report are consistent with those followed in the preparation of Food Services' annual consolidated financial statements for the year ended January 1, 2017.

## Financial Highlights

The following selected information, other than “System sales”, “System sales growth” and “Same store sales growth” has been derived from financial statements prepared in accordance with IFRS and all dollar amounts are reported in Canadian currency.

(dollars in thousands)	12 week period ended Jun 18, 2017	12 week period ended Jun 19, 2016	24 week period ended Jun 18, 2017	24 week period ended Jun 19, 2016
System sales <sup>(1)</sup>	<b>\$284,397</b>	\$269,673	<b>\$534,704</b>	\$511,454
System sales growth <sup>(1)</sup>	<b>+5.5%</b>	+5.5%	<b>+4.5%</b>	+8.3%
Same store sales growth <sup>(1)</sup>	<b>+0.7%</b>	+2.7%	<b>+0.2%</b>	+5.4%
New restaurants opened	<b>10</b>	5	<b>17</b>	7
Restaurants closed	<b>2</b>	2	<b>2</b>	3
Number of restaurants	<b>894</b>	858	<b>894</b>	858
Franchising & corporate restaurant revenue	<b>\$31,044</b>	\$26,820	<b>\$60,439</b>	\$51,857
Operating costs and general and administrative expenses	<b>(20,886)</b>	(16,845)	<b>(41,744)</b>	(33,943)
Depreciation of plant and equipment	<b>478</b>	432	<b>951</b>	862
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks’ earnings, interest, taxes, depreciation and amortization	<b>\$10,636</b>	\$10,407	<b>\$19,646</b>	\$18,776
Royalty expense	<b>(8,224)</b>	(7,922)	<b>(15,530)</b>	(15,046)
Net income	<b>\$2,950</b>	\$2,772	<b>\$11,179</b>	\$4,608

<sup>(1)</sup> Same store sales growth does not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other companies. This important information is provided as it is a key driver of growth.

## Same Store Sales

Same store sales growth is the change in sales of A&W restaurants that operated during the entire 13 4-week periods of both the current and the prior year.

Same store sales for the second quarter of 2017 increased by 0.7% as compared to the same quarter of 2016. Year to date same store sales growth was +0.2% compared to 2016 year to date. Same store sales growth improved during the second quarter, despite a generally weak Canadian food service industry, especially in Alberta and Saskatchewan as a result of the downturn in the oil industry and the introduction of a new 6% provincial sales tax on restaurant meals in Saskatchewan effective April 1, 2017. A&W is continuing to focus on its strategy of using better ingredients, including beef raised without the use of hormones or steroids, eggs from hens fed a diet without animal by-products, chicken raised without the use of antibiotics, organic and Fair Trade coffee and bacon from pork raised without the use of antibiotics. On July 17<sup>th</sup>, A&W introduced A&W Root Beer made with only natural flavours and 100% cane sugar, across the system.

## **System Sales**

System sales grew 5.5% for the second quarter as compared to the same quarter of 2016. Total system sales for all A&W restaurants in Canada for the 12 weeks ended June 18, 2017 were \$284,397,000, an increase of \$14,724,000 from the 12 weeks ended June 19, 2016. Year to date system sales were \$534,704,000, an increase of 4.5% from 2016 year to date. The increase in system sales was due to the same store sales growth plus the increase in the number of restaurants from 858 at the end of second quarter of 2016 to 894 at the end of the second quarter of 2017.

## **New Restaurant Openings and Restaurant Closures**

Food Services opened ten new A&W restaurants during the quarter and seventeen year to date in 2017 compared to five new restaurants in the same quarter of 2016 and seven in 2016 year to date. Two restaurants were closed in the second quarter and year to date 2017, compared to two closures in the same quarter of 2016 and three in the year to date period. As at June 18, 2017, there were 894 A&W restaurants in Canada, of which 886 were operated by franchisees and eight were corporately owned and operated.

## **Overview**

Food Services is the franchisor of the A&W restaurant chain in Canada. Food Services' revenue consists of fees from franchised restaurants, revenue from the sale of food and supplies to franchisees and distributors, revenue from the opening of new franchised restaurants, revenue from company-owned restaurants, and revenue from sales of A&W Root Beer concentrate to licensed bottlers who produce and distribute A&W Root Beer for sale in retail grocery stores.

Food Services' operating costs include the cost of materials, supplies and equipment sold either directly to franchisees or to distributors that service the restaurants or that are sold to the licensed bottlers, and costs of sales and other expenses of the restaurants operated corporately by Food Services. General and administrative expenses are expenses associated with providing services to the franchised A&W restaurants and establishing new A&W restaurants.

The A&W trade-marks used in the A&W quick service restaurant business in Canada are owned by the Partnership. The Partnership has granted Food Services a licence (the Amended and Restated Licence and Royalty Agreement) to use the A&W trade-marks in Canada for a term expiring December 30, 2100, for which Food Services pays a royalty of 3% of the sales reported by specific A&W restaurants in Canada (the Royalty Pool).

## **Annual Adjustment to the Royalty Pool**

The Royalty Pool is adjusted annually to reflect sales from new A&W restaurants added to the Royalty Pool, net of the sales of any A&W restaurants that have permanently closed. Food Services is paid for the additional royalty stream related to the sales of the net new A&W restaurants, based on a formula set out in the Amended and Restated Licence and Royalty Agreement. The formula provides for a payment to Food Services based on 92.5% of the amount of estimated sales from the net new A&W restaurants and the current yield on the units of the Fund, adjusted for income taxes payable by Trade Marks. The consideration is paid to Food Services in the form of additional limited partnership units (LP units). The additional LP units are, at the option of Food Services, exchangeable for additional common shares of Trade Marks which are in turn exchangeable for units of the Fund on the basis of two common shares for one unit of the Fund. The consideration paid for the annual adjustment to the Royalty Pool is recorded by Food Services as an increase in its investment in Trade Marks, and an increase in the deferred gain.

The 2017 adjustment to the Royalty Pool took place on January 5, 2017. The number of A&W restaurants in the Royalty Pool was increased by 30 new restaurants less seven restaurants that permanently closed during 2016. The addition of these 23 net new restaurants brings the total number of A&W restaurants in the Royalty Pool to 861. The estimated annual sales of the 30 new A&W restaurants are \$33,355,000 and annual sales for the seven permanently closed restaurants were \$4,251,000. The initial consideration for the estimated additional royalty stream was \$15,046,000, calculated by discounting the estimated additional royalties by 7.5% and dividing the result by the yield on units of the Fund for the 20 trading days ending October 31, 2016. The yield was adjusted to reflect income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$12,037,000 by issuance of 346,386 LP units which were subsequently exchanged for 692,772 non-voting common shares of Trade Marks. The remaining 20% of the consideration or \$3,009,000 will be paid in December 2017 by issuance of additional LP units, which may be exchanged for non-voting common shares of Trade Marks. The actual amount of the consideration paid in December 2017 may differ from this amount depending on the actual annual sales reported by the new A&W restaurants.

After the initial consideration was paid for the January 5, 2017 adjustment to the Royalty Pool, Food Services' indirect interest in the Fund increased to 23.5%.

### Common Shares of A&W Trade Marks Inc.

The common shares of Trade Marks are owned by the Fund and Food Services as follows:

(dollars in thousands)	Fund			Food Services			Total	
	Number of shares	Trade Marks' book value \$	%	Number of shares	Trade Marks' book value \$	%	Number of shares	Trade Marks' book value \$
Balance as at January 3, 2016	24,262,671	114,680	81.6	5,477,987	49,093	18.4	29,740,658	163,773
January 5, 2016 adjustment to the Royalty Pool	-	-	(3.4)	1,295,242	17,006	3.4	1,295,242	17,006
Balance as at January 1, 2017	24,262,671	114,680	78.2	6,773,229	66,099	21.8	31,035,900	180,779
January 5, 2017 adjustment to the Royalty Pool <sup>(1)</sup>	-	-	(1.7)	692,772	12,037	1.7	692,772	12,037
March 3, 2017 exchange of common shares for units of the Fund	746,600	7,814	2.3	(746,600)	(7,814)	(2.3)	-	-
Balance as at June 18, 2017	25,009,271	122,494	78.8	6,719,401	70,322	21.2	31,728,672	192,816

<sup>(1)</sup> The number of common shares does not include the 86,596 LP units exchangeable for 173,192 common shares of Trade Marks representing the remaining 20% of the consideration for the January 5, 2017 adjustment to the Royalty Pool which is held back until December 2017 when the actual annual sales are reported by the new restaurants.

On March 3, 2017, Food Services exchanged 746,600 common shares of Trade Marks for 373,300 Units of the Fund, which were then sold by Food Services at a price of \$39.25 per Unit. Food Services recognized a gain at fair value on the exchange of \$6,314,000, net of transaction costs. The Fund did not receive any proceeds of the sale of the units. Food Services used the net proceeds from the sale to pay a dividend to its shareholder, A&W of Canada Inc. See “Related Party Transactions and Balances”. Following the sale of the Units, Food Services owns approximately 21.2% of the units of the Fund on a fully diluted basis.

### Ownership of the Fund

The ownership of the Fund, on a fully-diluted basis, is as follows:

	June 18, 2017		January 1, 2017	
	Number of units	%	Number of units	%
Fund units held by public unitholders	12,504,673	78.8	12,131,373	78.2
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services <sup>(1)</sup>	3,359,701	21.2	3,386,615	21.8
Total equivalent units	15,864,374	100.0	15,517,988	100.0

<sup>(1)</sup> Common shares of Trade Marks held by Food Services may be exchanged for units of the Fund on the basis of two common shares for a unit of the Fund.

The chart below shows the ownership of the Fund, on a fully-diluted basis, when the remaining 20% of the consideration for the January 5, 2017 adjustment to the Royalty Pool is expected to be paid in December 2017, by issuance of 86,596 LP units exchangeable for 173,192 common shares of Trade Marks. The actual amount of the consideration paid in December 2017 may differ from this amount depending on the actual annual sales reported by the new A&W restaurants.

	Number of units	%
Fund units held by public unitholders	12,504,673	78.4
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services	3,446,297	21.6
Total equivalent units	15,950,970	100.0

### 2017 Operating Results

#### Revenue

Food Services’ franchising and corporate revenue for the second quarter of 2017 was \$31,044,000 compared to \$26,820,000 for the second quarter of 2016. Year to date total revenue was \$60,439,000 compared to \$51,857,000 for 2016 year to date.

Franchising revenue for the second quarter was \$27,895,000 compared to \$23,537,000 for the same quarter of the prior year, an increase of \$4,358,000. Year to date franchising revenue was \$54,312,000, compared to \$45,505,000 for 2016 year to date, an increase of \$8,807,000. The increase in revenue was primarily due to higher turnkey construction revenue from opening seventeen new restaurants in the first half of 2017 compared to seven in the same period last year. Revenue also increased as a result of higher equipment sales primarily related to new restaurants and the system sales growth.

Corporate restaurant sales in the second quarter of 2017 were \$3,149,000 compared to \$3,283,000 in the same quarter of 2016. Year to date corporate restaurant sales were \$6,127,000 compared to \$6,352,000 in 2016 year to date. One new corporate restaurant was opened in late 2016 in the Ottawa market however total corporate restaurant sales declined as two restaurants were operated corporately in 2016 until they were refranchised in the third quarter of 2016.

### ***Operating costs and general and administrative expenses***

Operating costs for the second quarter of 2017 were \$12,234,000 compared to \$8,689,000 in the same quarter of 2016, an increase of \$3,545,000. Year to date operating costs were \$25,125,000 compared to \$18,092,000 in 2016 year to date, an increase of \$7,033,000. Turnkey construction costs increased as well as costs of sales of equipment, and food and packaging in line with the increase in revenue noted above.

General and administrative expenses represent costs of providing services to franchised restaurants and establishing new restaurants, and were \$8,652,000 in the second quarter of 2017 compared to \$8,156,000 for the second quarter of 2016, an increase of \$496,000 or 6.1%. Year to date general and administrative expenses were \$16,619,000 compared to \$15,851,000 for the same period in the prior year. The increase was due to inflationary increases, investments in strategic initiatives and the growth in the number of restaurants and system sales.

### ***Operating earnings***

<b>(dollars in thousands)</b>	<b>12 week period ended Jun 18, 2017</b>	12 week period ended Jun 19, 2016	<b>24 week period ended Jun 18, 2017</b>	24 week period ended Jun 19, 2016
Franchising & corporate restaurant revenue	<b>\$31,044</b>	\$26,820	<b>\$60,439</b>	\$51,857
Operating costs and general and administrative expenses	<b>(20,886)</b>	(16,845)	<b>(41,744)</b>	(33,943)
Depreciation of plant and equipment	<b>478</b>	432	<b>951</b>	862
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	<b>\$10,636</b>	\$10,407	<b>\$19,646</b>	\$18,776

Operating earnings (earnings before royalty expense, gain on sale of Fund units, Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) increased by \$229,000 to \$10,636,000 for the second quarter of 2017 compared to \$10,407,000 for the second quarter of 2016. Year to date operating earnings increased by \$870,000 to \$19,646,000 for 2017 as compared to \$18,776,000 for 2016 year to date. The year to date operating margin was 32.5% compared to 36.2% for the 2016 year to date.

### ***Royalty expense***

Royalty expense for the second quarter of 2017 increased by \$302,000 to \$8,224,000 compared to \$7,922,000 for the second quarter of 2016. Year to date royalty expense increased by \$484,000 to \$15,530,000 compared to \$15,046,000 for 2016 year to date. The increase in royalty expense resulted from the additional net 23 restaurants in the Royalty Pool.



**Earnings after royalty expense**

(dollars in thousands)	12 week period ended Jun 18, 2017	12 week period ended Jun 19, 2016	24 week period ended Jun 18, 2017	24 week period ended Jun 19, 2016
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	<b>\$10,636</b>	\$10,407	<b>\$19,646</b>	\$18,776
Royalty expense	<b>(8,224)</b>	(7,922)	<b>(15,530)</b>	(15,046)
Earnings after royalty expense (before gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	<b>\$2,412</b>	\$2,485	<b>\$4,116</b>	\$3,730

Earnings after royalty expense (but before the gain on sale of Fund units, Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) decreased by \$73,000 to \$2,412,000 for the second quarter of 2017 compared to \$2,485,000 for the second quarter of 2016. Year to date earnings after royalty expense (but before the gain on sale of Fund units, Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) increased by \$386,000 to \$4,116,000 for 2017 as compared to \$3,730,000 for 2016. The \$386,000 increase was comprised of the \$870,000 increase in operating earnings, offset by the \$484,000 increase in royalty expense related to additional net 23 restaurants in the Royalty Pool.

**Finance expense - net**

(dollars in thousands)	12 week period ended Jun 18, 2017	12 week period ended Jun 19, 2016	24 week period ended Jun 18, 2017	24 week period ended Jun 19, 2016
Interest income	<b>(\$-)</b>	(\$11)	<b>(\$11)</b>	(\$23)
Interest on term loan	<b>48</b>	-	<b>64</b>	-
Interest cost on supplementary retirement benefit plan	<b>130</b>	126	<b>259</b>	252
Finance leases	<b>46</b>	38	<b>80</b>	72
	<b>\$224</b>	\$153	<b>\$392</b>	\$301

Interest expense increased by \$71,000 to \$224,000 for the second quarter of 2017 compared to \$153,000 for the second quarter of 2016. Year to date interest expense increased by \$91,000 to \$392,000 in 2017 as compared to \$301,000 for year to date 2016. The increase is primarily due to interest expense on Food Services' new term loan and a reduction in interest income. See "Liquidity and Capital Resources".

**Food Services' share of Trade Marks' income**

Food Services' share of Trade Marks' income for the second quarter of 2017 increased by \$171,000 to \$1,380,000 compared to \$1,209,000 for the second quarter of 2016. Food Services' year to date share of Trade Marks' income increased by \$713,000 to \$2,621,000 compared to \$1,908,000 for the 2016 year to date. Trade Marks' net income was higher than the prior year due primarily to a non-cash gain on the interest rate swap in 2017 versus a loss in 2016, plus lower income tax expense.

## **Net income**

(dollars in thousands)	12 week period ended Jun 18, 2017	12 week period ended Jun 19, 2016	24 week period ended Jun 18, 2017	24 week period ended Jun 19, 2016
Earnings after royalty expense (before gain on sale of Units of the Fund, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	\$2,412	\$2,485	\$4,116	\$3,730
Finance expense	(224)	(153)	(392)	(301)
Depreciation of plant and equipment	(478)	(432)	(951)	(862)
Amortization of deferred gain	415	370	829	740
Amortization of deferred finance fees	(6)	-	(6)	-
Gain on sale of Units of A&W Revenue Royalties Income Fund	-	-	6,314	-
Share of income from A&W Trade Marks Inc.	1,380	1,209	2,621	1,908
Earnings before income taxes	3,499	3,479	12,531	5,215
Provision for income taxes	(549)	(707)	(1,352)	(607)
Net income	\$2,950	\$2,772	\$11,179	\$4,608

The increase in year to date earnings before income taxes, income taxes and net income is due primarily to the gain on the exchange of common shares of Trade Marks for Units of the Fund and subsequent sale of the Units of the Fund. See "Common Shares of A&W Trade Marks Inc.".

### **Net income attributable to non-controlling interests**

The non-controlling interest in Beverages represents the 40% interest of Beverages owned by Unilever Canada Inc.

### **Other comprehensive loss**

Other comprehensive loss consists of actuarial losses, net of tax, on the supplementary retirement benefit plan. Actuarial losses result from a decrease in the discount rate used to determine the accrued benefit obligation. The actuarial loss, net of tax, for the second quarter of 2017 was \$498,000 compared to \$280,000 for the second quarter of 2016. Year to date, the actuarial loss was \$714,000 for 2017 compare to \$550,000 for 2016.

### **Liquidity and Capital Resources**

Food Services is primarily a franchise business with 886 of its 894 restaurants franchised. Food Services' capital requirements are related to its corporate restaurants and head office and investments in technology and information. Future restaurant growth will continue to be funded by franchisees although from time to time, Food Services expects to incur capital expenditures to open new corporate restaurants in the Ottawa market. Food Services also expects to incur capital expenditures for the Urban Franchise Associate program aimed at attracting millennials to become owner-operators of urban concept restaurants where Food Services will contribute to the cost of building the physical location. Food Services expects to have sufficient capital resources to fund these capital requirements and has sufficient cash on hand to meet its obligations. On

March 3, 2017, Food Services increased its \$5,000,000 demand operating loan facility with a Canadian chartered bank (the Bank) to \$8,000,000 to fund working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at the bank prime rate plus 0.5% and are repayable on demand. As at June 18, 2017, letters of credit totalling \$299,000 (January 1, 2017 - \$236,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,701,000 of the facility available (January 1, 2017 - \$4,764,000).

On March 3, 2017, Food Services entered into a \$7,000,000 term loan with the Bank to fund long term working capital and operating requirements. The term loan bears interest at the bank prime rate plus 0.5% and is repayable on December 31, 2020. Interest only is payable monthly. The term loan contains a number of covenants including the requirement to meet certain debt to earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA) ratios and debt to Food Services' investment in A&W Trade Marks Inc. ratios during each trailing four quarter period. Food Services was in compliance with all of its financial covenants as at June 18, 2017.

Food Services has provided 2,000,000 common shares of Trade Marks as security for the operating loan facility and the term loan.

#### **Off-Balance Sheet Arrangements**

Food Services has no off-balance sheet arrangements.

#### **Related Party Transactions and Balances**

Royalty expense for the year to date period was \$15,530,000 (2016 - \$15,046,000), of which \$2,779,000 (January 1, 2017 - \$2,516,000) is payable to the Partnership at June 18, 2017. Royalty expense for the quarter was \$8,224,000 (2016 - \$7,922,000).

During the year to date period, Trade Marks declared dividends on common shares held by Food Services of \$2,284,000 (2016 - \$2,034,000), of which \$447,000 (January 1, 2017 - \$nil) is receivable at June 18, 2017. Dividends declared payable to Food Services during the quarter were \$1,341,000 (2016 - \$1,226,000).

During the period, Food Services contracted with a private company controlled by a shareholder and director of Food Services, for rental of a private plane and crew for business travel. The cost of services provided under the contract during the period were \$80,000 (2016 - \$129,000). At June 18, 2017, \$nil (January 1, 2017 - \$nil) is payable to the private company by Food Services. The cost of services provided during the quarter were \$nil (2016 - \$64,000).

During the year to date period, Food Services paid \$125,000 (2016 - \$125,000) to a professional baseball club, of which a shareholder, director and officer of Food Services is a part owner, in exchange for advertising the A&W brand at the ballpark. At June 18, 2017, \$nil (January 1, 2017 - \$nil) is payable to the baseball club by Food Services. The amount paid during the quarter was \$125,000 (2016 - \$125,000).

Food Services maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$232,000 (2016 - \$218,000) to Food Services during the year to date period for marketing, promotional and administrative

services provided to the advertising fund. The amount paid by the advertising fund to Food Services during the quarter was \$116,000 (2016 - \$110,000). At June 18, 2017, the advertising fund had a deficit balance of \$3,175,000 which is included in accounts receivable (January 1, 2017 – deficit balance of \$475,000). The advertising fund balance is affected by seasonality of sales and timing of expenditures for advertising and promotional programs.

On February 23, 2017 and May 3, 2017, Food Services paid a dividend of \$14,532,000 and \$3,000,000, respectively, from working capital to its shareholder, A&W of Canada Inc. On March 3, 2017 Food Services paid a dividend of \$12,919,000 from the proceeds of the sale of Units of the Fund to its shareholder, A&W of Canada Inc. See “Common Shares of A&W Trade Marks Inc.”. A&W of Canada Inc. used the dividends received to repurchase, indirectly, 10% of its outstanding shares from certain shareholders. There was no change of control of A&W of Canada Inc.

Other related party transactions and balances are referred to elsewhere in this report.

### **Critical Accounting Estimates**

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. It is reasonably possible that circumstances may arise that would cause actual results to differ from management estimates; however, management does not believe it is likely that such differences will materially affect Food Services’ financial position. Significant areas requiring the use of management estimates are investment in Trade Marks, supplementary retirement benefit plan and deferred income taxes. However, such estimates are not “critical accounting estimates” as (i) they do not require Food Services to make assumptions about matters that are highly uncertain at the time the estimate is made, and (ii) different estimates that could have been used, or changes in the accounting estimates that are reasonably likely to occur from period to period, would not have had a material impact on Food Services’ financial condition, changes in financial condition or financial performance.

### **Risks and Uncertainties**

The success of Food Services is dependent on the ability of Food Services to (i) grow same store sales, (ii) maintain and grow the current system of franchises, (iii) locate new retail sites in prime locations and (iv) obtain qualified operators to become A&W franchisees. Sales are subject to a number of factors that affect the restaurant industry generally and the quick service segment of this industry in particular, including the highly competitive nature of the industry, traffic patterns, demographic considerations, and the type, number and proximity of competing quick service restaurants. Any significant event that adversely affects consumption of quick service food or beverages, such as increased food and labour costs, changing tastes or health concerns, inflation, publicity from any food borne illness, government regulations concerning menu labelling or disclosure and drive-thru restrictions could adversely impact the sales of A&W restaurants and consequently, the amount of the royalty payable to the Partnership. Economic conditions, unemployment, changes in disposable consumer income, and a disease outbreak, could adversely impact consumer visits to restaurants, and consequently sales in A&W restaurants and royalty income for the Partnership. Any significant event that adversely impacts traffic to shopping centres, including closures of “anchor” stores, could adversely impact the sales of A&W restaurants in those shopping centres and consequently, the amount of the royalty payable to the Partnership.

The Saskatchewan government announcement of a 6% provincial sales tax on food served at restaurants effective April 1, 2017 effectively added a new 6% tax on restaurant meals in this province and impacted sales at A&W restaurants. Any introduction of new sales taxes or an increase in sales taxes on sales by restaurants could adversely affect sales at A&W restaurants.

Food Services competes with other companies, including other well-capitalized franchisors with extensive financial, technological, marketing and personnel resources and high brand name recognition and awareness. There can be no assurance that Food Services or its franchisees will be able to respond to various competitive factors affecting the franchise operations of Food Services in the quick service restaurant industry.

Sales by A&W franchisees are dependent upon the availability and quality of raw materials used in the products sold by such A&W franchisees. The availability and price of these commodities are subject to fluctuation and may be affected by a variety of factors affecting the supply and demand of the products used in these products. A significant reduction in the availability or quality of raw materials purchased by A&W franchisees resulting from any of the above factors could have a material adverse effect on sales of A&W restaurants.

Certain of the products that Food Services provides to A&W franchisees are sourced from a single or a limited number of suppliers. An interruption in the supply of such products could materially adversely affect sales in A&W restaurants.

Food Services faces competition for retail locations and franchisees from its competitors and from franchisors of other businesses. Food Services' inability to successfully obtain qualified franchisees could adversely affect its business development. The opening and success of franchised restaurants is dependent on a number of factors, including the availability of suitable sites, negotiations of acceptable lease or purchase terms for new locations, permits and government regulatory compliance, continued access to suitable financing, the ability to meet construction schedules, and the availability of experienced management and hourly employees (including limitations on temporary foreign workers). Increases in minimum wage rates may also affect the opening and success of franchisee restaurants, as a significant portion of the employees of these restaurants are paid at rates related to minimum wage. A&W franchisees may not have all these business abilities or access to financial resources necessary to open an A&W restaurant or to successfully develop or operate an A&W restaurant in their franchise areas in a manner consistent with Food Services' standards.

Food Services depends on the uninterrupted operation of its information systems, networks and services including point-of-sale processing at restaurants, to operate its business. Food Services' operations depend on its ability to protect its computer equipment and systems against damage from physical theft, fire, power loss, computer and telecommunications failure or other catastrophic events, as well as from internal and external security breaches, viruses and other disruptive events. The failure of these systems to operate effectively, maintenance problems, upgrading or transitioning to new systems or platforms or a breach in security of these systems could result in transaction errors, processing inefficiencies, the loss of or failure to attract new customers, the loss of sales, the loss of or unauthorized access to confidential and personal information, the loss of or damage to intellectual property or trade secrets, damage to Food Services' reputation, litigation, regulatory enforcement actions, violation of privacy, security or other laws and regulations and remediation costs. Furthermore, adverse publicity resulting from allegations of security breaches resulting in the theft of credit and debit card information or personal information of guests may materially affect the sales of A&W restaurants.

Sales at A&W restaurants can be materially and adversely affected by publicity, including social media, alleging food-related illnesses, injuries suffered on the premises, poor food quality or safety, animal welfare practices of suppliers or any other health or operational concerns relating to one or more A&W restaurants. Adverse publicity resulting from such allegations, any related litigation or from public health inspection reports may materially affect guest traffic at one or more restaurants, reducing sales in A&W restaurants, regardless of whether such allegations are true or whether Food Services or an A&W franchisee is ultimately held liable. Food Services has a number of procedures in place for managing food safety and quality, however the risk of food borne illness or contamination cannot be completely eliminated. Any outbreak of such illness or contamination at an A&W restaurant or within the foodservice industry more generally (even if it does not affect any A&W restaurants), or the perception of such an outbreak, could have a material adverse effect on sales in A&W restaurants.

## **Outlook**

Food Services is committed to its mission “to delight time-crunched Canadian burger lovers with the joy of great tasting natural food, made by people they trust”. Strategic initiatives are focussed on growing market share in the quick service restaurants (QSR) burger market and include repositioning and differentiating the A&W brand through the use of “better ingredients”; accelerating new restaurant growth, and delivering an industry leading guest experience.

A&W has led the QSR industry in sourcing “better ingredients” since 2013, when Food Services became the first national QSR in Canada to use only beef raised without the use of hormones and steroids, free of additives, fillers or preservatives. A&W’s beef is primarily grass-fed and any feed provided is strictly vegetarian. And the whole Burger Family — from Baby to Uncle® to Grandpa® — contains 100% pure beef. The following year, Food Services began to serve only chicken raised without the use of antibiotics and fed a grain-based, vegetarian diet without animal by-products. All of the chicken menu items on Food Services’ menu are made with seasoned 100% chicken breast, without fillers. Also in 2014, Food Services enhanced its breakfast menu by moving to eggs from hens fed a fully vegetarian diet without animal by-products. Breakfast was further supported by the launch in January 2015 of organic and Fair Trade coffee, another first for a national QSR in Canada. In 2016, Food Services became the first national QSR in Canada to use bacon from pork that is raised without the use of antibiotics. Also in 2016, Food Services announced that A&W restaurants switched to French’s ketchup and mustard, made with 100% Canadian tomatoes and 100% Canadian mustard seeds.

A&W’s menu innovations have continued in 2017. Building on an already strong breakfast daypart, all-day breakfast was launched in February. This has been well received. Limited time offers so far in 2017 have included the Peppered Bacon Burger, Sriracha Teen Burgers and Eggers, and Smoky BBQ Teen and Double Cheese Double Bacon Burgers. These menu items have been well received by Food Services’ guests.

The next step in A&W’s journey to source simple, all-natural ingredients that guests can feel good about was taken with the recent announcement of the new Root Beer Guarantee. A&W Root Beer served in restaurants is now made from natural cane sugar and all-natural flavours - another first for the QSR industry.

Food Services’ second strategic initiative is accelerating the pace of growth of new A&W restaurants, particularly in the key Ontario and Quebec markets. Seventeen new A&W restaurants were opened across the country in 2017 year to date. One of these new restaurants is

the first restaurant under the Urban Franchise Associate program. The Urban Franchise Associate program was launched in 2016 and is aimed at attracting millennials to become owner-operators of urban concept restaurants. As this younger demographic may not have the capital and experience necessary to invest in a traditional franchise, under this new program Food Services contributes to the cost of building the physical location and provides extensive training. As of June 18, 2017, an additional twenty-nine new restaurants are under construction or in varying stages of permitting and are expected to open in the coming months.

A third strategic initiative of Food Services is to deliver an industry leading guest experience. To ensure each guest at an A&W restaurant has a positive experience, Food Services has introduced changes in its satisfaction measurement and feedback systems, system level processes, staffing, CLIMATE, and restaurant equipment. This initiative also includes the ongoing re-imaging and modernizing of our existing restaurants, and innovation in technology. Including the new restaurants opened in the new design since the beginning of the re-image program, approximately 85% of A&W's restaurants now have the new design. New "Good Food Makes Good Food" interior elements are also being introduced in restaurants to communicate Food Services' ingredients guarantee to its guests. Costs of re-imaging A&W restaurants are borne by the franchisees and there is no cost to the Fund.

Food Services is also taking steps to reduce its environmental impact. Foil bags have been replaced with compostable paper. Dine-in orders for fries and onion rings are served in reusable wire baskets and dine-in breakfasts are served on real china with metal cutlery.

### **FORWARD LOOKING INFORMATION**

Certain statements in this report contain forward-looking information within the meaning of applicable securities laws in Canada (forward-looking information). The words "anticipates", "believes", "budgets", "could", "estimates", "expects", "forecasts", "intends", "may", "might", "plans", "projects", "schedule", "should", "will", "would" and similar expressions are often intended to identify forward-looking information, although not all forward-looking information contains these identifying words.

The forward-looking information in this report includes, but is not limited to: expected future consideration receivable on adjustments to the Royalty Pool; Food Services' plans to reposition and differentiate A&W in the QSR industry through its use of "better ingredients", accelerating new restaurant growth, and delivering an industry leading guest experience; Food Services expects to have sufficient capital resources to fund the expansion of corporate restaurants.

The forecasts and projections that make up the forward-looking information are based on assumptions which include, but are not limited to: the general risks that affect the restaurant industry will not arise including that there are no changes in availability of experienced management and hourly employees and no material changes in government regulations concerning menu labelling and disclosure and drive-thru restrictions; no publicity from any food borne illness; no changes in competition; no changes in the quick service restaurant burger market including as a result of changes in consumer taste or health concerns or changes in economic conditions or unemployment or a disease outbreak; no impact on sales from closures of "anchor" stores in shopping centres; no increases in food and labour costs; the continued availability of quality raw materials; continued additional franchise sales and maintenance of franchise operations; Food Services is able to grow same store sales; Food Services is able to maintain and grow the current system of franchises; Food Services is able to locate new retail sites in prime locations; Food Services is able to obtain qualified operators to become A&W franchisees; no closures of A&W restaurants that materially affect the amount of the Royalty; no material changes in traffic patterns at shopping centres; no supply disruptions; franchisees duly pay franchise fees and other amounts; no impact from new or increased sales taxes on gross sales; continued availability of key personnel; continued ability to preserve intellectual

property; no material litigation from guests alleging food-related illness, injuries suffered on the premises or other food quality, health or operations concerns; Food Services continues to pay the Royalty; the Partnership continues to make distributions on its units; Trade Marks continues to pay dividends on the common shares; Trade Marks can continue to comply with its obligations under its credit arrangements; and, Trade Marks performance does not fluctuate such that cash distributions are affected.

The forward-looking information is subject to risks, uncertainties and other factors that could cause actual results to differ materially from the results anticipated by the forward-looking information. The factors which could cause results to differ from current expectations include, but are not limited to: general risks that affect the restaurant industry including changes in the availability of experienced management and hourly employees and changes in government regulations concerning menu labelling and disclosure and drive-thru restrictions; publicity from any food-borne illness; competition; changes in the quick service restaurant burger market including as a result of changes in consumer taste and health concerns and changes in economic conditions and unemployment and a disease outbreak; adverse impact on sales from closures of “anchor” stores in shopping centres; increases in food and labour costs; dependence on the availability and quality of raw materials; dependence on additional franchise sales and franchise operations; Food Services’ ability to grow same store sales; Food Services’ ability to maintain and grow the current system of franchises; Food Services’ ability to locate new retail sites in prime locations; Food Services’ ability to obtain qualified operators to become A&W franchisees; the closure of A&W restaurants may affect the amount of the Royalty; changes in traffic patterns at shopping centres; dependence on certain suppliers; dependence on A&W franchisees’ ability to pay franchise fees and other amounts; the impact of new or increased sales taxes upon gross sales; dependence on key personnel; dependence on intellectual property; potential litigation from guests alleging food-related illness, injuries suffered on the premises or other food quality, health or operations concerns; dependence on intellectual property; dependence of the Fund on Trade Marks, the Partnership and Food Services; dependence of the Partnership on Food Services; risks related to leverage and restrictive covenants; the risk that cash distributions are not guaranteed and will fluctuate with the Partnership’s performance; risks relating to the nature of units; risks relating to the distribution of securities on redemption or termination of the Fund; the Fund may issue additional units diluting existing unitholders’ interests; and changes to the Canadian federal income tax treatment of publicly listed trusts and of partnerships and other income tax matters, all as more particularly described in this report under the heading “Risks and Uncertainties” and in the Fund’s Annual Information Form under the heading “Risk Factors”.

All forward-looking information in this report is qualified in its entirety by this cautionary statement and, except as required by law, Food Services undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.



**A&W Food Services of Canada Inc.**  
**Interim Condensed Consolidated Balance Sheet**  
**Unaudited**

(in thousands of dollars)

	Note	June 18, 2017	January 1, 2017
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents		\$ 10,889	\$ 17,920
Accounts receivable		15,917	15,403
Dividends receivable	10	447	-
Inventories		4,144	5,999
Prepaid expenses		255	357
		<b>31,652</b>	<b>39,679</b>
<b>Non-current assets</b>			
Investment in A&W Trade Marks Inc.	4	66,849	62,289
Deferred income taxes		13,202	12,087
Plant and equipment		8,936	8,762
Other non-current assets	4	3,009	-
<b>Total assets</b>		<b>\$ 123,648</b>	<b>\$ 122,817</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		\$ 24,275	\$ 27,469
Royalties payable	10	2,779	2,516
Deposits on franchise and equipment sales		8,988	8,216
Income taxes payable		978	232
		<b>37,020</b>	<b>38,433</b>
<b>Non-current liabilities</b>			
Deferred gain	4	150,115	135,898
Supplementary retirement benefit plan		15,260	14,218
Term Loan		6,931	-
Other long-term liabilities		67	78
Obligations under finance leases		1,021	970
		<b>210,414</b>	<b>189,597</b>
<b>Shareholders' Deficiency</b>			
Share capital		10,500	10,500
Accumulated deficit		(97,670)	(77,463)
		<b>(87,170)</b>	<b>(66,963)</b>
<b>Non-controlling interest</b>			
		<b>404</b>	<b>183</b>
<b>Total deficiency</b>		<b>(86,766)</b>	<b>(66,780)</b>
<b>Total liabilities and deficiency</b>		<b>\$ 123,648</b>	<b>\$ 122,817</b>

These interim condensed financial statements have been prepared by and are the responsibility of management. As A&W Food Services of Canada Inc. is a private entity, the company's auditors have not performed a review of these financial statements.

The accompanying notes form an integral part of these financial statements.

**A&W Food Services of Canada Inc.**  
**Interim Condensed Consolidated Statement of Income**  
**Unaudited**

(in thousands of dollars)

		12 week period ended Jun 18, 2017	12 week period ended Jun 19, 2016	24 week period ended Jun 18, 2017	24 week period ended Jun 19, 2016
	Note				
<b>Revenue</b>					
Franchising		\$ 27,895	\$ 23,537	\$ 54,312	\$ 45,505
Corporate restaurants		3,149	3,283	6,127	6,352
		<b>31,044</b>	26,820	<b>60,439</b>	51,857
<b>Expenses (income)</b>					
Operating costs	7	12,234	8,689	25,125	18,092
General and administrative expenses		8,652	8,156	16,619	15,851
Royalty expense	10	8,224	7,922	15,530	15,046
Finance expense - net	8	224	153	392	301
Amortization of deferred gain	4	(415)	(370)	(829)	(740)
Amortization of deferred finance fees		6	-	6	-
Gain on sale of Units of A&W Revenue					
Royalties Income Fund	10	-	-	(6,314)	-
Share of income from A&W Trade Marks Inc.	4	(1,380)	(1,209)	(2,621)	(1,908)
		<b>27,545</b>	23,341	<b>47,908</b>	46,642
<b>Income before income taxes</b>					
		<b>3,499</b>	3,479	<b>12,531</b>	5,215
<b>Provision for (recovery of) income taxes</b>					
Current		529	540	2,214	736
Deferred		20	167	(862)	(129)
		<b>549</b>	707	<b>1,352</b>	607
<b>Net income for the period</b>					
		<b>\$ 2,950</b>	\$ 2,772	<b>\$ 11,179</b>	\$ 4,608
<b>Net income attributable to:</b>					
Shareholders of A&W Food Services of Canada Inc.		\$ 2,823	\$ 2,558	\$ 10,958	\$ 4,222
Non-controlling interest		127	214	221	386
		<b>\$ 2,950</b>	\$ 2,772	<b>\$ 11,179</b>	\$ 4,608

**A&W Food Services of Canada Inc.**  
**Interim Condensed Consolidated Statement of Comprehensive Income**  
**Unaudited**

(in thousands of dollars)

		12 week period ended Jun 18, 2017	12 week period ended Jun 19, 2016	24 week period ended Jun 18, 2017	24 week period ended Jun 19, 2016
<b>Net income for the period</b>					
		\$ 2,950	\$ 2,772	\$ 11,179	\$ 4,608
<b>Other comprehensive loss</b>					
<b>Items that will not be reclassified to net income</b>					
Actuarial loss on supplementary retirement benefit plan - net of tax		(498)	(280)	(714)	(550)
<b>Comprehensive income</b>					
		<b>\$ 2,452</b>	\$ 2,492	<b>\$ 10,465</b>	\$ 4,058
<b>Comprehensive income attributable to:</b>					
Shareholders of A&W Food Services of Canada Inc.		\$ 2,325	\$ 2,278	\$ 10,244	\$ 3,672
Non-controlling interest		127	214	221	386
		<b>\$ 2,452</b>	\$ 2,492	<b>\$ 10,465</b>	\$ 4,058

The accompanying notes form an integral part of these financial statements.

## A&W Food Services of Canada Inc.

### Interim Condensed Consolidated Statement of Changes in Shareholders' Deficiency

Unaudited

(in thousands of dollars)

	Note	Share capital	Accumulated deficit	Total	Non- controlling interest	Total deficiency
<b>Balance - January 3, 2016</b>		\$ 10,500	\$ (80,971)	\$ (70,471)	\$ 216	\$ (70,255)
Net income for the period		-	4,222	4,222	386	4,608
Dividends on common shares		-	(4,000)	(4,000)	-	(4,000)
Actuarial loss on supplementary retirement benefit plan - net of tax		-	(550)	(550)	-	(550)
<b>Balance - June 19, 2016</b>		10,500	(81,299)	(70,799)	602	(70,197)
Net income for the period		-	9,587	9,587	421	10,008
Dividends on common shares		-	(6,000)	(6,000)	(840)	(6,840)
Actuarial gain on supplementary retirement benefit plan - net of tax		-	249	249	-	249
<b>Balance - January 1, 2017</b>		10,500	(77,463)	(66,963)	183	(66,780)
Net income for the period		-	10,958	10,958	221	11,179
Dividends on common shares	<b>10</b>	-	(30,451)	(30,451)	-	(30,451)
Actuarial loss on supplementary retirement benefit plan - net of tax		-	(714)	(714)	-	(714)
<b>Balance - June 18, 2017</b>		\$ 10,500	\$ (97,670)	\$ (87,170)	\$ 404	\$ (86,766)

The accompanying notes form an integral part of these financial statements.

**A&W Food Services of Canada Inc.**  
**Interim Condensed Consolidated Statement of Cash Flows**

Unaudited

(in thousands of dollars)

	12 week period ended Note Jun 18, 2017	12 week period ended Jun 19, 2016	24 week period ended Jun 18, 2017	24 week period ended Jun 19, 2016
<b>Cash flows from operating activities</b>				
Net income for the period	\$ 2,950	\$ 2,772	\$ 11,179	\$ 4,608
Adjustments for				
Depreciation of plant and equipment	478	432	951	862
Deferred income taxes	20	167	(862)	(129)
Gain on sale of Units of A&W Revenue				
Royalties Income Fund	-	-	(6,314)	-
Gain on disposal of plant and equipment	(11)	(13)	(40)	(22)
Supplementary retirement benefit plan	(92)	(38)	(184)	(76)
Decrease in other long-term liabilities	(2)	(9)	(11)	(17)
Amortization of deferred finance fees	6	-	6	-
Amortization of deferred gain	4 (415)	(370)	(829)	(740)
Share of income of A&W Trade Marks Inc.	4 (1,380)	(1,209)	(2,621)	(1,908)
Current income tax expense	529	540	2,214	736
Income tax paid	(725)	(319)	(1,468)	(842)
Finance expense - net	224	153	392	301
Finance expense paid	(94)	(27)	(133)	(49)
Changes in items of non-cash working capital	9 2,904	898	(739)	(490)
<b>Net cash generated from operating activities</b>	<b>4,392</b>	<b>2,977</b>	<b>1,541</b>	<b>2,234</b>
<b>Cash flows from investing activities</b>				
Purchase of plant and equipment	(364)	(82)	(646)	(209)
Dividends from A&W Trade Marks Inc.	1,341	1,210	1,837	1,614
Net proceeds from sale of Units of A&W				
Revenue Royalties Income Fund	-	-	14,128	-
<b>Net cash generated from investing activities</b>	<b>977</b>	<b>1,128</b>	<b>15,319</b>	<b>1,405</b>
<b>Cash flows used in financing activities</b>				
Decrease in obligations under finance leases	(193)	(160)	(366)	(306)
Financing fees paid	-	-	(74)	-
Proceeds from new term loan	-	-	7,000	-
Dividends paid to shareholder	(3,000)	(4,000)	(30,451)	(4,000)
<b>Net cash used in financing activities</b>	<b>(3,193)</b>	<b>(4,160)</b>	<b>(23,891)</b>	<b>(4,306)</b>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>2,176</b>	<b>(55)</b>	<b>(7,031)</b>	<b>(667)</b>
<b>Cash and cash equivalents - beginning of period</b>	<b>8,713</b>	<b>10,791</b>	<b>17,920</b>	<b>11,403</b>
<b>Cash and cash equivalents - end of period</b>	<b>\$ 10,889</b>	<b>\$ 10,736</b>	<b>\$ 10,889</b>	<b>\$ 10,736</b>
<b>Non-cash investing activities</b>				
Non-cash acquisition of automobiles through finance leases	\$ 100	\$ 371	\$ 595	\$ 613

The accompanying notes form an integral part of these financial statements.

**A&W Food Services of Canada Inc.**

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 18, 2017

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(figures in tables are expressed in thousands of dollars)

**1 General information**

A&W Food Services of Canada Inc. (the Company or Food Services) is in the business of developing and franchising quick-service restaurants in Canada. During the year to date period ended June 18, 2017, the Company opened 17 locations and closed two locations, bringing the total number of A&W restaurants to 894, of which 886 are franchised and eight are owned and operated corporately. Food Services' registered offices are located at Suite 300 - 171 West Esplanade, North Vancouver, British Columbia, Canada.

**2 Basis of preparation**

These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as applicable to interim financial reports including International Accounting Standards (IAS) 34, *Interim Financial Reporting*. The interim condensed consolidated financial statements do not include all of the information and disclosures required in the annual financial statements, and should be read in conjunction with Food Services' audited annual consolidated financial statements as at January 1, 2017.

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of Food Services' annual consolidated financial statements for the year ended January 1, 2017.

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors of Food Services on July 25, 2017.

**3 Significant accounting policies****Consolidation**

The financial statements include the accounts of Food Services and its 60% interest in A&W Root Beer Beverages of Canada Inc. (Beverages). The non-controlling interest represents an equity interest in Beverages owned by outside parties, and is presented as a component of equity.

**Fiscal year**

To align its financial reporting with the business cycle of its operations, the Company uses a fiscal year comprising a 52- or 53-week period ending the Sunday nearest December 31. The fiscal 2016 year was 52 weeks and ended January 1, 2017 (2015 - 53 weeks ended January 3, 2016). Beverages uses a fiscal year ending December 31. The second quarter ends 24 weeks after the fiscal year end.

**A&W Food Services of Canada Inc.**

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 18, 2017

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(figures in tables are expressed in thousands of dollars)

**4 Investment in A&W Trade Marks Inc. and deferred gain**

In 2002, Food Services sold the A&W trade-marks used in the A&W quick service restaurant business in Canada to A&W Trade Marks Inc. (Trade Marks), which subsequently transferred them to the A&W Trade Marks Limited Partnership (the Partnership). The Partnership has granted Food Services a licence (the Amended and Restated Licence and Royalty Agreement) to use the A&W trade-marks in Canada for a term expiring December 30, 2100, for which Food Services pays a royalty of 3% of the sales reported to Food Services by specific A&W restaurants in Canada (the Royalty Pool). The gain realized on the sale of the A&W trade-marks was deferred and is being amortized over the term of the Amended and Restated Licence and Royalty Agreement. Prior to October 2003, the amortization was based upon the present value of the expected royalty payments made under the Amended and Restated Licence and Royalty Agreement. Amortization of the gain is recognized on the consolidated statement of income.

The Royalty Pool is adjusted annually to reflect sales from new A&W restaurants added to the Royalty Pool, net of the sales of any A&W restaurants that have permanently closed. Food Services is paid for the additional royalty stream related to the sales of the net new restaurants, based on a formula set out in the Amended and Restated Licence and Royalty Agreement. The formula provides for a payment to Food Services based on 92.5% of the amount of estimated sales from the net new restaurants and the current yield on the Units of the A&W Revenue Royalties Income Fund (the Fund), adjusted for income taxes payable by Trade Marks. The consideration is paid to Food Services in the form of additional limited partnership units (LP units). The additional LP units are, at the option of Food Services, exchangeable for additional common shares of Trade Marks which are in turn exchangeable for Units of the Fund on the basis of two common shares for one unit of the Fund. The consideration paid for the annual adjustment to the Royalty Pool is recorded by Food Services as an increase in its investment in Trade Marks, and an increase in the deferred gain. These additions to the deferred gain are amortized over the remaining term of the Amended and Restated Licence and Royalty Agreement from the date of addition.

The 2017 adjustment to the Royalty Pool took place on January 5, 2017. The number of A&W restaurants in the Royalty Pool was increased by 30 new restaurants less seven restaurants that permanently closed during 2016. The addition of these 23 net new restaurants brings the total number of A&W restaurants in the Royalty Pool to 861. The estimated annual sales of the 30 new A&W restaurants are \$33,355,000 and annual sales for the seven permanently closed restaurants were \$4,251,000. The initial consideration for the estimated additional royalty stream was \$15,046,000, calculated by discounting the estimated additional royalties by 7.5% and dividing the result by the yield on units of the Fund for the 20 trading days ending October 31, 2016. The yield was adjusted to reflect income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$12,037,000 by issuance of 346,386 LP units which were subsequently exchanged for 692,772 non-voting common shares of Trade Marks. The remaining 20% of the consideration or \$3,009,000 will be paid in December 2017 by issuance of additional LP units, which may be exchanged for non-voting common shares of Trade Marks, and is recorded in other assets. The actual amount of the consideration paid in December 2017 may differ from this amount depending on the actual annual sales reported by the new A&W restaurants.

**A&W Food Services of Canada Inc.**

## Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 18, 2017

(figures in tables are expressed in thousands of dollars)

Food Services' 21.2% (January 1, 2017 – 21.8%) investment in Trade Marks is recorded using the equity method.

	Common shares \$	Cumulative equity in earnings \$	Cumulative dividend \$	Total \$
Balance – January 3, 2016	49,093	18,310	(22,058)	45,345
January 5, 2016 adjustment to Royalty Pool	17,006	-	-	17,006
Equity in earnings	-	5,214	-	5,214
Dividends	-	-	(5,276)	(5,276)
Balance – January 1, 2017	66,099	23,524	(27,334)	62,289
January 5, 2017 adjustment to Royalty Pool	12,037	-	-	12,037
Exchange of common shares for Units of A&W Revenue Royalties Income Fund (note 10)	(7,814)	-	-	(7,814)
Equity in earnings	-	2,621	-	2,621
Dividends	-	-	(2,284)	(2,284)
Balance – June 18, 2017	<u>70,322</u>	<u>26,145</u>	<u>(29,618)</u>	<u>66,849</u>

The deferred gain as at June 18, 2017 is as follows:

	Number of restaurants in Royalty Pool	Deferred gain \$	Accumulated amortization \$	Net deferred gain \$
Balance – January 3, 2016	814	135,270	(14,762)	120,508
January 5, 2016 adjustment to Royalty Pool	24	17,006	-	17,006
Amortization of deferred gain	-	-	(1,616)	(1,616)
Balance – January 3, 2016	838	152,276	(16,378)	135,898
January 5, 2017 adjustment to Royalty Pool	23	15,046	-	15,046
Amortization of deferred gain	-	-	(829)	(829)
Balance – June 18, 2017	<u>861</u>	<u>167,322</u>	<u>(17,207)</u>	<u>150,115</u>

**A&W Food Services of Canada Inc.**

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 18, 2017

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(figures in tables are expressed in thousands of dollars)

**5 Operating loan facility and term loan**

On March 3, 2017, Food Services increased its \$5,000,000 demand operating loan facility with a Canadian chartered bank (the Bank) to \$8,000,000 to fund working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at the bank prime rate plus 0.5% and are repayable on demand. As at June 18, 2017, letters of credit totalling \$299,000 (January 1, 2017 - \$236,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,701,000 of the facility available (January 1, 2017 - \$4,764,000).

On March 3, 2017, Food Services entered into a \$7,000,000 term loan with the Bank to fund long term working capital and operating requirements. The term loan bears interest at the bank prime rate plus 0.5% and is repayable on December 31, 2020. Interest only is payable monthly. The term loan contains a number of covenants including the requirement to meet certain debt to earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA) ratios and debt to Food Services' investment in A&W Trade Marks Inc. ratios during each trailing four quarter period. Food Services was in compliance with all of its financial covenants as at June 18, 2017.

The term loan comprises:

	<b>June 18, 2017</b>	<b>January 1, 2017</b>
	\$	\$
Term loan	7,000	-
Financing fees	(69)	-
	<hr/> 6,931	<hr/> -

**6 New restaurant openings**

Food Services opened ten new franchised restaurants during the quarter (2016 – five). The increase in the number of new restaurant openings caused an increase in revenue and operating costs in the quarter as compared to the prior year.



**A&W Food Services of Canada Inc.**

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 18, 2017

(figures in tables are expressed in thousands of dollars)

**7 Expenses by nature**

Included in operating costs and general and administrative expenses are the following expenses by nature:

	<b>12 week period ended Jun 18, 2017</b>	12 week period ended Jun 19, 2016	<b>24 week period ended Jun 18, 2017</b>	24 week period ended Jun 19, 2016
	\$	\$	\$	\$
Depreciation of plant and equipment	478	432	951	862
Employee benefit costs				
Wages and salaries and other termination benefits	5,392	4,866	10,487	9,574
Pension costs - defined contribution plan	157	149	347	369
Pension costs - supplementary retirement benefit plan	-	54	-	108
Total employee benefit costs	5,549	5,069	10,834	10,051

**8 Finance (income) expense**

	<b>12 week period ended Jun 18, 2017</b>	12 week period ended Jun 19, 2016	<b>24 week period ended Jun 18, 2017</b>	24 week period ended Jun 19, 2016
	\$	\$	\$	\$
Interest income	-	(11)	(11)	(23)
Interest on term loan	48	-	64	-
Interest cost on supplementary retirement benefit plan	130	126	259	252
Finance leases	46	38	80	72
	224	153	392	301

**9 Working capital**

Net changes in items of non-cash working capital are as follows:

	<b>12 week period ended Jun 18, 2017</b>	12 week period ended Jun 19, 2016	<b>24 week period ended Jun 18, 2017</b>	24 week period ended Jun 19, 2016
	\$	\$	\$	\$
Accounts receivable	(2,073)	(240)	(514)	(752)
Inventories	1,001	(666)	1,855	557
Prepaid expenses	136	12	102	162
Accounts payable and accrued liabilities	3,869	(470)	(3,217)	(4,179)
Royalties payable	264	217	263	(404)
Deposits on franchise and equipment sales	(293)	2,045	772	4,126
	2,904	898	(739)	(490)

**A&W Food Services of Canada Inc.**

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**10 Related party transactions and balances**

Royalty expense for the year to date period was \$15,530,000 (2016 - \$15,046,000), of which \$2,779,000 (January 1, 2017 - \$2,516,000) is payable to the Partnership at June 18, 2017. Royalty expense for the quarter was \$8,224,000 (2016 - \$7,922,000).

During the year to date period, Trade Marks declared dividends on common shares held by Food Services of \$2,284,000 (2016 - \$2,034,000), of which \$447,000 (January 1, 2017 - \$nil) is receivable at June 18, 2017.

During the year to date period, Food Services contracted with a private company controlled by a shareholder and director of Food Services for rental of a private plane and crew for business travel. The cost of the services provided under the contract during the year to date period were \$80,000 (2016 - \$129,000). At June 18, 2017, \$nil (January 1, 2017 - \$nil) is payable to the private company by Food Services. The cost of services provided during the quarter were \$nil (2016 - \$64,000).

During the year to date period, Food Services paid \$125,000 (2016 - \$125,000) to a professional baseball club, of which a shareholder, director and officer of Food Services is a part owner, in exchange for advertising the A&W brand at the ballpark. At June 18, 2017, \$nil (January 1, 2017 - \$nil) is payable to the baseball club by Food Services. The amount paid during the quarter was \$125,000 (2016 - \$125,000).

Food Services maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$232,000 (2016 - \$218,000) to Food Services during the year to date period for marketing, promotional and administrative services provided to the advertising fund. The amount paid by the advertising fund to Food Services during the quarter was \$116,000 (2016 - \$110,000). At June 18, 2017, the advertising fund had a deficit balance of \$3,175,000 which is included in accounts receivable (January 1, 2017 – deficit balance of \$475,000).

**Key management compensation**

Key management includes the Company's directors and members of the Company's Strategy Team. The compensation awarded to key management includes:

	<b>12 week period ended Jun 18, 2017</b>	12 week period ended Jun 19, 2016	<b>24 week period ended Jun 18, 2017</b>	24 week period ended Jun 19, 2016
	\$	\$	\$	\$
Salaries, bonuses and other short-term employee benefits	821	675	1,562	1,366
Pension costs - defined contribution plan	41	38	96	119
Pension costs - supplementary retirement benefit plan	130	180	259	360
Total	<u>992</u>	<u>893</u>	<u>1,917</u>	<u>1,845</u>

**A&W Food Services of Canada Inc.**

Notes to Interim Condensed Consolidated Financial Statements

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(figures in tables are expressed in thousands of dollars)

**Sale of Units of A&W Revenue Royalties Income Fund**

On March 3, 2017, Food Services exchanged 746,600 common shares of Trade Marks for 373,300 Units of the Fund, which were then sold by Food Services at a price of \$39.25 per Unit. Food Services recognized a gain at fair value on the exchange of \$6,314,000, net of transaction costs. Following the sale of the Units, Food Services owns approximately 21.2% of the Units of the Fund on a fully diluted basis. The net proceeds from the sale were used to pay a dividend to Food Services' shareholder, A&W of Canada Inc. (A&W Canada).

**Dividends**

On February 23, 2017 and May 3, 2017, Food Services paid a dividend of \$14,532,000 and \$3,000,000, respectively, from working capital to its shareholder, A&W Canada. On March 3, 2017, Food Services paid a dividend of \$12,919,000 from the proceeds of the sale of Units of the Fund to its shareholder, A&W Canada. A&W Canada used the dividends received to repurchase, indirectly, 10% of its outstanding shares from certain shareholders. There was no change of control of A&W Canada.

Other related party transactions are disclosed elsewhere within these consolidated financial statements.



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