

# BUILDING ON FUNDAMENTALS

# 2010

ANNUAL REPORT

A&W Revenue Royalties

Income Fund



## About the A&W Revenue Royalties Income Fund

The source of income for the A&W Revenue Royalties Income Fund is through its ownership in A&W Trade Marks Inc. which indirectly owns the A&W trade-marks and licenses A&W Food Services of Canada Inc. to franchise and operate A&W restaurants under those trade-marks. These trade-marks include some of the strongest brand names in the Canadian foodservice industry. In exchange, A&W Trade Marks Inc. receives a royalty of 3% of the sales of 700 A&W restaurants across Canada.

This structure makes the A&W Revenue Royalties Income Fund a “top-line” fund because income is based solely on the sales of A&W restaurants, minus the Fund’s minimal operating expenses. As a result, the Fund is not subject to the variability of earnings or expenses associated with an operating business.

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## Performance at a Glance: Fiscal 2010

### Financial Highlights

(in thousands of dollars)

	Year ended December 31 2010	Year ended December 31 2009
Same store sales growth	2.2%	1.5%
Number of restaurants in the Royalty Pool*	700	685
Gross sales reported by the restaurants in the Royalty Pool	\$ 776,701	\$ 736,209
Royalty income	\$ 23,301	\$ 22,086

\* Effective January 5, 2011 the number of restaurants in the Royalty Pool increased to 715

### Financial Achievements

- Same store sales increased by 2.2%, the eighth straight year of positive same store sales growth.
- \$20,783,000 of distributable cash generated, resulting in surplus distributable cash of \$2,971,000 at year end.
- Two Special Distributions of 10¢ per unit each paid in May 2010 and November 2010.
- Recapitalization and reorganization completed in December 2010, resulting in an increase in monthly distributions to 11.7¢ per unit in 2011.

### Strategic Achievements

- 26 new restaurants opened by A&W Food Services of Canada Inc. during 2010.
- Multi-Site Development Agreements signed representing 115 new restaurants to be opened in the next 5 to 7 years.
- First Urban concept restaurants opened.

## Chairman's Report to Unitholders

**O**n behalf of the Trustees of the A&W Revenue Royalties Income Fund, I am pleased to report that the Fund enjoyed another strong year. 2010 was an important year for the Fund. In addition to enjoying strong underlying business performance, the Fund undertook two major initiatives to maximize distributions to unitholders.

The first initiative was the completion of a successful Substantial Issuer Bid and the second was the completion of the restructuring of the capital structure of the Fund's subsidiary, A&W Trade Marks Inc. As a result of these initiatives, regular monthly distributions per unit were increased from 10.6 cents to 11.7 cents, effective January 1, 2011 and payable as and from February 28, 2011. This is an important development for unitholders, as many other Income Trusts were forced to cut distributions as a result of the imposition of the SIFT tax by the federal government.

As noted above, the Fund enjoyed strong performance. Total royalty income generated by the 700 restaurants in the royalty pool increased by 5.5% during 2010. This increase was the result of the eighth consecutive year of same store sales growth coupled with the addition of 15 net new restaurants to the Royalty Pool on January 5, 2010.

Total distributable cash before the costs associated with the restructuring initiatives increased by 5.2%, and distributions paid to unitholders, including two Special Distributions, were maintained at \$1.472 for the year.

Despite continuing challenges in the economy and the impact of the Harmonized Sales Tax on the restaurant industry in British Columbia, the A&W restaurants

posted system wide same store sales growth of 2.2%. This was driven by the key strategic initiatives undertaken by A&W Food Services of Canada Inc.

We are also pleased that A&W Food Services' initiatives to expand new restaurants have continued to be successful. As a result, a total of 15 net new restaurants were added to the Royalty Pool effective January 5, 2011.

At the upcoming Annual General Meeting, Conrad Pinette will not be standing for re-election as a Trustee. Conrad has served the Fund and its unitholders from the very inception of the Fund in February 2002. As Chair of the Audit Committee he has provided a tremendous level of care and leadership to the financial affairs of the Fund. On behalf of all unitholders we express our thanks to Conrad.

In summary, 2010 was a very important year for the Fund. We have made good progress not just in the performance of the Fund, but in positioning it for continued success in the future.



A handwritten signature in black ink that reads "John R. McLernon". The signature is fluid and cursive, with a period at the end.

**John R. McLernon**  
Chairman  
A&W Revenue Royalties  
Income Fund

## Report to Fund Unitholders

I am pleased to report that the A&W restaurant chain once again made strong progress in 2010. The 8th straight year of same store sales increases is one of the longest periods of sustained same store sales growth in the company's history.

The overall A&W restaurant chain achieved total system sales of \$794M, an increase of 5.0%. This was driven not only by same store sales growth, but also by the opening of 26 new restaurants across the country.

As a strategy driven business, one of the most important strategic thrusts is to accelerate our pace of growth. In particular we are focused on building a much larger presence in Ontario and Quebec, Canada's two most populous provinces. During 2010 a total of 26 new restaurants opened, of which over half were in Ontario. There are now over 160 A&W restaurants in the Ontario market. In addition, there has been strong franchise demand for new opportunities. Multi-Site Development Agreements have been signed over the past 18 months representing commitments to build 115 restaurants over the next five to seven years.

A major innovation during 2010 was the opening of the new generation of A&W restaurants targeted for urban markets. Five of these opened during 2010 in Vancouver, Calgary and Toronto.

There was continued menu innovation during 2010 as we continued to strengthen our position as the premium burger provider in the industry. The limited time offers of

both the Mini Sirloin Twins and the Spicy Mama Burger were very well received by customers.

Finally, an important piece of innovation is the launch of our new restaurant design, which was rolled out in 2010 to both malls and freestanding restaurants.

Re-imagining our restaurants is a critical strategy to maintain the competitiveness of the A&W brand. The pace of re-imagining is set to accelerate in 2011 as there has been strong interest in the program by franchised operators.

Overall, despite continued uncertain economic conditions and the impact of the Harmonized Sales Tax on the restaurant industry in British Columbia, we are pleased with our continued progress and the continued excellent performance of the A&W chain.



A handwritten signature in black ink that reads "Paul F.B. Hollands". The signature is fluid and cursive.

**Paul F.B. Hollands**  
President &  
Chief Executive Officer  
A&W Food Services of  
Canada Inc.

A&W is famous for strategic renewal: thinking deeply about the future and constantly moving forward. But progress that sticks is always founded on an equally deep understanding of who we are and what we do best.

Over the years, A&W has become sharper and sharper about what its greatest skills are, about who its customers are, and about how to equip itself to respond to the needs and desires of those customers.

Not fast food, but  
**BURGERS**

Not everybody, but  
**BOOMERS**

Not only consumers, but also  
**FRANCHISEES**

Many skills, but first among them,  
**CLIMATE**



**The Evolution of**

50's Our beginnings: a drive-in >>

60's Drive-in:

We are proud of our recent rapid growth and believe it is due to our strategic clarity combined with a commitment to invest in connecting with our customers, both restaurant owners and individual consumers. The payoffs are the ability to attract top calibre franchisees, grow market presence, increase same store sales, and improve profitability.

**Connecting With Customers**

The physical manifestation of how we understand our connection to consumers is the design of our restaurants. The first of our re-imaged restaurants opened in 2010. They include both newly-built and remodelled buildings.



Many elements of the aesthetics of these restaurants are keys to memories built by Baby Boomers in the days of the drive-in. The “boomerang” roofline itself is a clear tip of the hat to the 1960’s. Yet the functional design of the restaurant recognizes the needs of today’s consumer: convenience

and speed. We also introduced an upgraded operating system over the past two years that has dramatically improved speed of service at drive-thru, which in many cases represents well over half of a restaurant’s sales. Both innovations have brought rewards. Sales in the new-design restaurants are up and drive-thru volume has increased. Furthermore, new systems for tracking and training in cost management are leading to rising profitability across the chain.

Extending the customer connection further is a new entrant in our stable of design concepts: the urban restaurant. The product of two years’ development and research, this style of restaurant recognizes the significant population of urban dwellers who are not in proximity to our typical suburban restaurant. This underserved market has some different characteristics and desires which we have addressed with an edgier design and some changes to the menu and service style. However, the concept is still solidly burger based and recognizably A&W. The Burger Family now lives downtown!





## a n A & W R e s t a u r a n t

Home of the Burger Family >>

70's Enclosed Drive-in: adding seats to serve customers more comfortably >>

80's Brand new freestanding concept featuring drive-thru >>

### The Best Burgers

A&W has a reputation for the best burgers in the business. The core of that burger menu has been consistent, and consistently successful, for forty years: Mama, Papa, Grandpa, Teen and Baby Burger. However, we know that consumers today are more sophisticated, looking for premium products and innovation. The successful Sirloin Uncle Burger, launched in 2008, was one response to both of these desires; we have seen the Uncle Burger produce exciting sales results this year. Early 2011 will see the launch of another industry-leading premium product.

Other innovations take the form of short-term promotional products: the Mini Sirloin Twins reappeared in 2010, and the Spicy Mama Burger made her debut. She received a very warm welcome from our customers!



### Speeding Our Growth

At the end of 2010, there were 730 A&W restaurants in Canada, including 26 new restaurants. We expect growth to continue to be more rapid than in past years because of the enthusiastic response we have seen to the introduction of the multi-site development agreement. The multi-site idea recognizes the needs of a particular kind of franchisee customer: the one who envisions a larger business and can bring to bear greater organizational and financial resources than a one-store franchisee can muster.

Under these multi-site development agreements, a developer enters into a contract to open a specified number of restaurants on a set schedule in a defined territory. This gives us predictable growth and efficiencies in franchising. Franchisees engage with us in this way because they then know they can build the businesses they want and can predict their cash flows. It is gratifying to see so many existing franchisees avail themselves of this opportunity. At the end of 2010 26 multi-site development agreements representing 115 restaurants have been granted, with more planned for 2011.



Groundbreaking restaurant design for urban markets



90's Freestanding retrofit with brand livery >>



00's New retro-modern design for great street impact >>



10's New "boomerang" high-visibility freestanding restaurant

## The Evolution of an A & W Restaurant

The multi-site development agreement is an important tool in our program of hastening development in Ontario and Quebec. These markets, encompassing well over half of Canada's population, are still underserved by A&W. For example, Saskatchewan, our most highly saturated province, has four times as many restaurants per capita as Ontario. This disparity indicates how great an opportunity Ontario and Quebec present us, and development there is our number one priority. Sixteen of the 26 restaurants opened in 2010 were in Ontario or Quebec, and we continue to deepen our resources in those markets.

### Applying Climate Principles

Of all A&W's strengths, Climate is the most distinctive and the most powerful. We invest very intentionally in training about the means of maintaining strong, productive relationships within the organization as articulated in our Climate goals. We use the Climate goals in support of strategy. And we apply those goals in our relationships with everyone inside and outside A&W; very few companies can say that. The result is win-win relationships with suppliers and employees and tremendous alignment of effort from everyone associated with A&W.

A&W is respected for growth and innovation. But that success is founded on things that do not change: consistent focus on Climate, understanding the customer, and strategic discipline. All of our business results show what a winning combination that is.



Paul Hollands, CEO, with Bernice and Bruce Buffin and their staff – winners of the 2010 President's Award for the best A&W restaurant in the country.

## Management Discussion and Analysis

For the Year Ended December 31, 2010

This Management Discussion and Analysis covers the fourth quarter period from September 13, 2010 to December 31, 2010 and the year ended December 31, 2010, and is dated February 8, 2011. This report should be read in conjunction with the annual audited financial statements of A&W Revenue Royalties Income Fund (the Fund) for the year ended December 31, 2010 and the annual audited consolidated financial statements of A&W Trade Marks Inc. (Trade Marks) for the year ended December 31, 2010. A copy of this report and additional information about the Fund, including the Fund's Annual Information Form, is available at [www.sedar.com](http://www.sedar.com) or [www.awincomefund.ca](http://www.awincomefund.ca).

Readers should be aware that 2010 results are not directly comparable to 2009 due to three factors:

- The Fund and Trade Marks undertook a recapitalization and reorganization during the fourth quarter resulting in increases in professional fees and financing fees which impacted net earnings and distributable cash. See "Recapitalization and Reorganization";
- the number of restaurants in the Royalty Pool increased from 685 during 2009 to 700 effective January 5, 2010;
- the first and fourth quarters of 2010 and 2009 were not directly comparable as there were 87 days in Q1, 2010 compared to 81 days in Q1, 2009, and 110 days in Q4, 2010 compared to 116 days in Q4, 2009. There were 84 days in the second and third quarters of both years. Same store sales growth is based on an equal number of days in each quarter.

### Overall Performance

Same store sales growth for the A&W restaurants in the Royalty Pool was 2.2% for the year and 1.1% for the quarter compared to 2009. Same store sales growth has now been positive for 31 consecutive quarters. Total sales reported by restaurants in the Royalty Pool and corresponding royalty income increased by 5.5% in 2010 compared to 2009 due to the same store sales growth and the increase in the number of restaurants in the Royalty Pool. Total sales and royalty income decreased by 0.2% in Q4, 2010 as compared to Q4, 2009 due to the decrease in the number of days in Q4, 2010 compared to Q4, 2009.

The Fund's net earnings for 2010 were \$11,982,000 or \$1.437 per unit compared to \$11,624,000 or \$1.394 per unit in 2009. The Fund's net earnings for the fourth quarter were \$3,633,000 or 43.6¢ per unit compared to \$4,010,000 or 48.1¢ per unit for the same quarter in 2009.

Due to one-time costs of \$775,000 for the Fund's recapitalization and reorganization which took place in the fourth quarter of 2010, Trade Marks' net earnings decreased by \$359,000 from \$4,007,000 for 2009 to \$3,648,000 for 2010 and decreased by \$931,000 from \$1,962,000 for the fourth quarter of 2009 to \$1,031,000 for the fourth quarter of 2010. Before payment of these costs, Trade Marks' net earnings for 2010 increased by \$416,000 over 2009.

The one-time costs of \$775,000 and financing fees of \$449,000 also impacted distributable cash. Distributable cash decreased by \$129,000 from \$20,912,000 for 2009 to \$20,783,000 for 2010 and decreased by \$1,287,000 from \$6,831,000 for the fourth quarter of 2009 to \$5,544,000 for the fourth quarter of 2010. Before payment of these one-time costs totalling \$1,224,000, distributable cash increased by \$1,095,000 or 5.2% over 2009. Distributable cash and earnings in the fourth quarter were also negatively impacted by the decrease in the number of days in the quarter compared to 2009.

## Financial Highlights

The following table sets out selected highlights of the Fund and Trade Marks, and should be read in conjunction with the annual audited financial statements of the Fund and Trade Marks.

(dollars in thousands except per unit amounts)

	Q4 2010	Q4 2009	Year end 2010	Year end 2009
Same store sales growth <sup>(1)</sup>	1.1%	0.03%	2.2%	1.5%
Number of restaurants in the Royalty Pool	700	685	700	685
Sales reported by the restaurants in the Royalty Pool	\$ 238,900	\$ 239,385	\$ 776,701	\$ 736,209
Royalty income	\$ 7,167	\$ 7,181	\$ 23,301	\$ 22,086
General and administrative expenses	237	167	601	647
Recapitalization and reorganization costs	661	–	775	–
Financing fees	449	–	449	–
Net third party interest expense	269	183	670	570
Recovery of current income taxes	–	–	–	(43)
Partnership distributions to Food Services	7	–	23	–
Total distributable cash generated for distributions and dividends <sup>(2)</sup>	\$ 5,544	\$ 6,831	\$ 20,783	\$ 20,912
Distributable cash <sup>(2)</sup> per weighted average equivalent unit (2010 – 14,644,999 units; 2009 – 14,289,993 units)	\$ 0.382	\$ 0.478	\$ 1.419	\$ 1.463
Distributions and dividends declared per equivalent unit	\$ 0.424	\$ 0.424	\$ 1.272	\$ 1.272
Special distribution per equivalent unit	\$ 0.100	\$ 0.100	\$ 0.200	\$ 0.200
Trade Marks' net earnings	\$ 1,031	\$ 1,962	\$ 3,648	\$ 4,007
The Fund's net earnings	\$ 3,633	\$ 4,010	\$ 11,982	\$ 11,624
The Fund's basic and diluted earnings per unit	\$ 0.436	\$ 0.481	\$ 1.437	\$ 1.394
Weighted average units outstanding	8,332,994	8,340,000	8,337,889	8,340,000

(1) Same store sales growth is not an earnings measure recognized by generally accepted accounting principles (GAAP) and therefore may not be comparable to similar measures presented by other issuers. This information is provided as it is a key driver of growth in the Fund. See "Same Store Sales Growth".

(2) Distributable cash is not an earnings measure recognized by GAAP and therefore may not be comparable to similar measures presented by other issuers. This information is provided as it identifies the amount of actual cash available to pay distributions to unitholders and dividends to Food Services. See "Distributable Cash".

## Overview

### The Fund

The Fund is a limited purpose trust established to invest in Trade Marks, which through its ownership interest in A&W Trade Marks Limited Partnership (the Partnership) owns the A&W trade-marks used in the A&W quick service restaurant business in Canada. The trade-marks comprise some of the best-known brand names in the Canadian foodservice industry.

Prior to the reorganization described below, the Fund earned interest income on A&W notes issued by Trade Marks. The A&W notes were in the amount of \$83,399,000 and bore interest at 10.75% per annum. Payments of interest only were receivable from Trade Marks monthly in arrears. The Fund also earned dividends from its investment in common shares of Trade Marks.

The Fund's distributions to unitholders were based on its net cash receipts, being interest on the A&W notes and dividends on common shares received by the Fund from Trade Marks, less minimal expenses of the Fund limited to bank charges.

The Fund is not currently taxed on any income that is distributed to unitholders. Until 2011, income tax obligations related to the distributions by the Fund are obligations of the unitholders. See "Recapitalization and Reorganization".

### Trade Marks

In 2002, Trade Marks acquired the A&W trade-marks used in the A&W quick service restaurant business in Canada from A&W Food Services of Canada Inc. (A&W or Food Services) for \$152,676,000, of which \$84,876,000 was paid in cash, and \$27,800,000 was paid by the issuance of 2,779,975 Class A preferred shares and 2,780,000 common shares. The balance of the purchase price of \$40,000,000 was paid in full by all amounts Trade Marks paid Food Services in respect of annual adjustments to the Royalty Pool up to January 5, 2010.

Concurrent with the purchase of the A&W trade-marks, Trade Marks granted Food Services a licence to use the A&W trade-marks in Canada for a term of 99 years, for which Food Services pays Trade Marks a royalty of 3% of the sales reported to Food Services by A&W restaurants in the Royalty Pool (the Licence and Royalty Agreement).

In the event that a restaurant in the Royalty Pool closes, Food Services pays the royalties that would have been paid to Trade Marks if the restaurant had not closed, until the next annual adjustment to the Royalty Pool.

On January 21, 2009, Trade Marks and Food Services formed a limited partnership, the Partnership, in which Trade Marks is the general partner with a 99.9% interest and Food Services is the limited partner with a 0.1% interest. Trade Marks transferred the A&W trade-marks to the Partnership in exchange for the general partnership interest held by Trade Marks. The existing Licence and Royalty Agreement between Trade Marks and Food Services was assumed by the Partnership with the result that the royalty paid by Food Services for the use of the A&W trade-marks is paid to the Partnership rather than Trade Marks. The Partnership in turn pays partnership distributions to Trade Marks (99.9%) and Food Services (0.1%).

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 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 Fund. Prior to the formation of the Partnership, Trade Marks paid Food Services by issuing common shares and preferred shares of Trade Marks which are the economic equivalent of units of the Fund. Effective January 5, 2010, additional partnership units (LP units) are issued to Food Services to reflect the annual adjustment. Food Services' additional LP units are exchangeable for additional shares of Trade Marks which are exchangeable for units of the Fund.

Trade Marks' expenses include general and administrative expenses, amortization of deferred financing fees, interest expenses and taxes. Trade Marks' general and administrative expenses include the expenses of the Fund as the Fund has entered into an administration agreement with Trade Marks whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund.

## Recapitalization and Reorganization

In the fourth quarter, the Fund and Trade Marks implemented two important changes to the structure of the Fund in order to maximize ongoing distributable cash available for unitholders. These changes were a successful substantial issuer bid which reduced the number of units outstanding by 17%, and a reorganization of the capital structure of Trade Marks to minimize the impact of the new Specified Investment Flow Through (SIFT) tax on income funds.

### (a) A&W Revenue Royalties Income Fund's offer to purchase units

On November 10, 2010, the Fund announced its intention to make a substantial issuer bid (the Offer) to purchase for cancellation 2,500,000 of its units at a price of \$20 per unit. The Offer was financed by a new loan to Trade Marks in the amount of \$50,000,000. As a result of the purchase of units under the Offer and the new loan, distributable cash available for distributions to unitholders is expected to increase by approximately 10.1 cents (8%) per unit per annum over the amount of distributable cash had the Offer and new loan not occurred. Therefore, on November 10, 2010, the Trustees of the Fund approved a 10% increase in monthly distributions to unitholders to 11.7 cents per unit per month, from the current rate of 10.6 cents per unit per month. The new monthly distribution rate is effective January 1, 2011 and payable as and from February 28, 2011.

A total of 2,588,663 units were deposited under the Offer, including 2,500,000 securities of Trade Marks held by Food Services exchangeable for a total of 2,500,000 units. As the aggregate number of units deposited under the Offer exceeded the 2,500,000 units for which the Offer was made, units were taken up under the Offer on a pro-rata basis, resulting in 85,627 units being purchased from unitholders other than Food Services and 2,414,373 units being purchased from Food Services.

### (b) Exchange of securities

On December 22, 2010, prior to the completion of the Offer, Food Services exchanged 2,414,373 Class A shares of Trade Marks with a book value of \$24,549,000, for \$24,144,000 principal amount of A&W notes. Food Services and Trade Marks recorded the additional A&W notes at a book value of \$24,549,000. Subsequently, Food Services

exchanged the \$24,144,000 principal amount of A&W notes and 2,414,373 common shares of Trade Marks (comprising 303,790 non-voting common shares and 2,110,583 voting common shares) for 2,414,373 units of the Fund. The Fund recorded an increase in its investment in Trade Marks through the acquisition of the new A&W notes at the principal amount of \$24,144,000, and the acquisition of the 2,414,373 common shares at \$10 per share or \$24,144,000. Food Services recorded its investment in units of the Fund at \$20 per unit or \$48,288,000, and recognized a gain on the exchange of \$21,552,000, represented by the excess of Food Services' \$48,288,000 investment in the Fund over Food Services' carrying value of the 2,414,373 common shares of Trade Marks of \$2,187,000 and the A&W notes of Trade Marks of \$24,549,000.

### (c) Completion of the Offer

The completion of the Offer also took place on December 22, 2010. The Fund's carrying value of the 2,500,000 units was \$49,080,000, and the excess of the \$50,000,000 cost of acquisition over the carrying value, or \$920,000, was charged to the Fund's accumulated earnings. Food Services recorded its \$48,288,000 proceeds from its sale of 2,414,373 units of the Fund reducing its investment in the Fund to \$nil.

The units purchased under the Offer represented approximately 17% of the units outstanding on a fully diluted basis. After the completion of the purchase of the units, 8,254,373 units, and securities exchangeable for a further 3,968,540 units remain outstanding. After the 2,414,373 units were purchased from Food Services, Food Services' indirect interest in the Fund decreased from 43.4% to 32.5% on a fully diluted basis.

Units outstanding after completion of the Offer are:

(dollars in thousands)

	#	\$
Balance as at December 31, 2009	8,340,000	77,115
Units issued in exchange for common shares and A&W notes of Trade Marks	2,414,373	48,288
Purchase and cancellation of units	(2,500,000)	(49,080)
Balance as at December 31, 2010	8,254,373	76,323

(d) Recapitalization and new loan

The Fund financed the amount paid for the units by repayment by Trade Marks of \$50,000,000 of A&W notes of Trade Marks held by the Fund, prior to which the Fund and Trade Marks agreed to amend the A&W notes to allow early repayment. Trade Marks financed the \$50,000,000 repayment of A&W notes by increasing its \$10,000,000 term loan with HSBC Bank Canada to \$60,000,000.

(e) Reorganization

Also on December 22, 2010, subsequent to Food Services' exchange of securities of Trade Marks, and the completion of the Offer, the reorganization (the Reorganization) of the capital structure of Trade Marks took place. The Reorganization was approved by unitholders of the Fund at the Annual General Meeting held May 4, 2010 and was initiated to minimize the impact of the new SIFT tax on income trusts announced by the federal government in October 2006. The SIFT tax is effective January 1, 2011 and treats an income trust like a corporation, requiring it to pay tax on its taxable income. The Trustees of the Fund examined the alternatives available to maximize unitholder value in the face of this new tax, and proposed this Reorganization to minimize the impact of the new SIFT tax and maximize amounts available for distribution to unitholders in light of the SIFT tax.

As a result of the Reorganization, the Fund will receive dividends paid by Trade Marks rather than interest paid on the A&W notes. These dividends are not subject to the SIFT Tax. Trade Marks' earnings (representing the royalty paid by Food Services less general and administrative expenses and interest on its term loan) will therefore be taxed at an effective rate of 18% versus an approximate tax rate of 25% if the reorganization were not implemented. In effect this leaves 82% of Trade Mark's net income before income taxes available to be paid as dividends, instead of 75% if the reorganization were not implemented.

Commencing in 2011 distributions to unitholders will be taxed as non-eligible dividends, rather than "other" income. Investors who are entitled to dividend tax credits will be able to enhance their after-tax yield and reduce the after-tax impact of the reduction in distributions. The total amount of tax paid in 2011 by the Fund and an individual unitholder taxed in Canada at the highest marginal rate on distributions by the Fund, and the tax that would be paid by the unitholder on distributions by the Fund had the SIFT tax not been

implemented, is approximately the same.

The following is a summary of the Reorganization:

- i. Trade Marks continued as a company under the British Columbia Business Corporations Act.
- ii. The \$57,543,000 remaining A&W notes held by the Fund were exchanged for 5,754,298 new non-voting common shares with \$10 par value having an aggregate value of \$57,543,000. The excess of Trade Marks' carrying value of the A&W notes of \$57,948,000 over the value of the new non-voting common shares of \$57,543,000, or \$405,000, was credited to Trade Marks' contributed surplus.
- iii. The 3,868,368 voting common shares and 100,185 non-voting common shares of Trade Marks held by Food Services were exchanged for 3,968,553 voting common shares without par value with a value of \$2,652,000.
- iv. The 10,754,373 voting common shares of Trade Marks held by the Fund were exchanged for 10,754,373 voting common shares without par value with a value of \$2,187,000.
- v. The 769,577 Class A preferred shares of Trade Marks held by Food Services were exchanged for 769,577 non-voting common shares without par value with a value of \$7,826,000.
- vi. The 3,198,951 Class B preferred shares of Trade Marks held by Food Services were exchanged for 3,198,951 new non-voting common shares with \$10 par value with a value of \$36,363,000.

(f) Exchange rights

The common shares of Trade Marks held by Food Services may be exchanged at the option of Food Services into units of the Fund on the basis of two common shares for one unit of the Fund, except that Food Services may not exchange non-voting common shares for units of the Fund if it would result in Food Services having a voting interest in Trade Marks greater than its economic interest. Therefore, after the Offer and Reorganization, Food Services holds, indirectly, the equivalent of 32.5% of the units of the Fund on a fully-diluted basis, on the basis of two common shares being the economic equivalent of one unit of the Fund. Food Services will continue to be entitled to additional LP units of the Partnership on the annual adjustment of the restaurants in the Royalty Pool. The additional LP units are exchangeable for non-voting common shares of Trade Marks on the basis of one LP unit for two non-voting common shares of Trade Marks.

All of the voting and non-voting common shares held by the Fund and Food Services are entitled to the same dividends per share.

(g) Costs

The costs of the Offer and the Reorganization were \$775,000 and were expensed during the year by Trade Marks under an administration agreement with the Fund whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund. In addition,

financing fees of \$449,000 were incurred by Trade Marks for the additional \$50,000,000 term loan. The financing fees will be amortized over the term of the loan.

After the completion of the Offer and the Reorganization, there are no Class A or Class B preferred shares of Trade Marks and no A&W notes, and the common shares of Trade Marks are owned by the Fund and Food Services as follows:

(dollars in thousands)

	The Fund			Food Services			Total
	#	\$	%	#	\$	%	#
Balance as at December 31, 2009	8,340,000	1	58.4	5,950,018	3,552	41.6	14,290,018
January 5, 2010 adjustment to Royalty Pool	–	–	(1.8)	432,908	1,287	1.8	432,908
December 22, 2010 exchange of Class A shares for A&W notes and A&W notes and common shares for units of the Fund	2,414,373	2,187	16.4	(2,414,373)	(2,187)	(16.4)	–
December 22, 2010 exchange of A&W notes for non-voting common shares with \$10 par value	5,754,298	57,543	7.6	–	–	(7.6)	5,754,298
December 22, 2010 exchange of Class A shares for non-voting common shares without par value	–	–	(2.9)	769,577	7,826	2.9	769,577
December 22, 2010 exchange of Class B shares for non-voting common shares with \$10 par value	–	–	(10.2)	3,198,951	36,363	10.2	3,198,951
Balance as at December 31, 2010	16,508,671	59,731	67.5	7,937,081	46,841	32.5	24,445,752

**Summary**

The Partnership earns royalty income from Food Services and distributes its available cash by way of distributions on its partnership units to Trade Marks and Food Services. Trade Marks in turn distributes its available cash by way of dividends on its shares held by the Fund and Food Services, after satisfaction of its debt service and income tax obligations, provisions for administrative expenses of Trade Marks and the Fund, and retention of reasonable working capital reserves. The Fund receives dividends from Trade Marks and pays its net cash receipts to unitholders. Trade Marks' consolidated financial statements which include its 99.9% interest in

the Partnership are included in this report and Food Services' consolidated financial statements are provided as a supplement to this report.

**Basis of Consolidation**

The Fund, Trade Marks, the Partnership and Food Services have adopted the CICA Accounting Guideline 15 "Consolidation of Variable Interest Entities" (AcG-15).

AcG-15 expands upon existing accounting guidance in CICA Handbook Section 1590 that addresses when an enterprise should consolidate another entity in its financial statements. Under CICA 1590, an enterprise generally consolidates another entity when it controls

the entity through a majority voting interest. AcG-15 clarifies this guidance when the entity being consolidated is a “Variable Interest Entity” (VIE) which is defined to be an entity that, by design, does not have sufficient equity at risk to finance its activities without additional subordinated financial support. If the entity being consolidated is a VIE, under AcG-15 the “primary beneficiary” of that entity should consolidate the VIE and not necessarily the shareholder with the majority voting interest.

The Fund and Food Services have determined that Trade Marks is a VIE and that Food Services is the “primary beneficiary” of Trade Marks. As a result, Food Services consolidates Trade Marks, and the Fund does not consolidate Trade Marks, but instead accounts for its investment in Trade Marks using the equity method. Food Services’ consolidated financial statements include the accounts of Trade Marks and the Partnership. Trade Marks also prepares consolidated financial statements (which include the Partnership) for information purposes to the unitholders of the Fund.

#### **Future Accounting Changes**

In January 1, 2011, The Fund and Trade Marks will adopt the new accounting standard CICA Handbook Section 1582, “Business Combinations”, which replaced Handbook Section 1581, “Business Combinations”, and Handbook Section 1601, “Consolidated Financial Statements”, and Handbook Section 1602, “Non-Controlling Interests”, which replaced Handbook Section 1600, “Consolidated Financial Statements”. These new sections are based on the International Accounting Standards Board’s (IASB) International Financial Reporting Standards (IFRS) 3R, “Business Combinations”. The new standards replaced the existing guidance on business combinations and consolidated financial statements. The adoption of these new standards is not expected to have an impact on the Fund’s and Trade Marks’ financial results.

#### **International Financial Reporting Standards (IFRS)**

Publicly reported companies are required to adopt IFRS for interim and annual reporting purposes beginning January 1, 2011. The Fund’s and Trade Marks’ transition from Canadian GAAP to IFRS will take place in the first quarter of 2011 at which time both current and comparative financial information will be reported using IFRS.

The Fund and Trade Marks commenced the process to transition from current Canadian GAAP to IFRS in 2009. Progress reports are provided to the audit committee on the status of the IFRS implementation project on a quarterly basis. The implementation project consists of three primary phases:

- Scoping and diagnostic phase
- Impact analysis, evaluation and design phase
- Implementation and review phase

#### **Scoping and Diagnostic Phase**

A preliminary diagnostic review was completed by an external consultant which included the determination, at a high level, of the financial reporting differences under IFRS and the key areas that may be impacted. The areas with the highest potential impact were identified to include the basis of consolidation, classification of unitholders’ equity, related party transactions, impairment of assets, financial instruments and initial adoption of IFRS under the provisions of IFRS 1.

#### **Impact Analysis, Evaluation and Design Phase**

A detailed evaluation has been undertaken and involved assessing the impact on financial reporting, information technology and systems, financial reporting expertise, accounting policies, internal controls over financial reporting and disclosure controls, and developing systems and accounting policies to address identified issues. This phase also involved a detailed analysis of the differences between IFRS and Canadian GAAP. Significant increases in disclosure are anticipated and the Fund and Trade Marks have identified these additional disclosure requirements.

The Fund and Trade Marks are in the final stages of their assessment of the impacts of adopting IFRS based on the standards as they currently exist, and identified the following as having the greatest potential to impact its accounting policies, financial reporting and information systems requirements upon conversion to IFRS.

#### **(a) Basis of Consolidation**

Under Canadian GAAP, Food Services consolidates Trade Marks as the Fund and Food Services have determined that Trade Marks is a VIE and that Food Services is the “primary beneficiary” of Trade Marks. Under current IFRS, there is no “variable interests” model to determine which entities are consolidated.

Consolidation is based on “control” which is the ability to direct or dominate an entity’s decision making, regardless of whether this power is actually exercised. A detailed assessment is underway pending the finalization of the consolidation standard under IFRS.

*(b) Classification of Unitholders’ Equity*

Under Canadian GAAP, the units are classified as equity. Under IFRS, an instrument is classified as a financial liability if it contains a contractual obligation to transfer cash or other financial assets. The Fund has concluded that under IFRS, the units will be classified as a current financial liability as the Fund’s Declaration of Trust contains an administrative clause which creates a contractual obligation to deliver cash or other financial assets in certain circumstances. As a financial liability, the units will be transferred from equity to current liabilities on the balance sheet and distributions will be classified as interest expense on the income statement instead of a reduction in unitholders’ equity.

*(c) Related Party Transactions*

IFRS will require more extensive disclosure of related party transactions and balances between related parties, which include the Fund, Trade Marks, the Partnership and Food Services. Relationships with parent companies and subsidiaries must be disclosed irrespective of whether there have been transactions between those related parties. Compensation of key management personnel which is defined as persons with authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including, but not limited to, directors and trustees, must be disclosed in aggregate. For each related party transaction, the nature of the relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship must be disclosed. Significant additional note disclosures are likely to be needed to comply with IFRS requirements.

*(d) Impairment of Assets*

Currently, the A&W trade-marks are classified as intangible assets with an indefinite life, and are carried at cost. The carrying value is tested at least annually for impairment, by comparing the carrying value to the “fair value” determined using forecast future cash flows, which is consistent with IFRS.

Trade Marks’ intangible asset impairment model has been revised to comply with IFRS requirements. Unlike Canadian GAAP, impairment losses may be reversed under IFRS. IFRS requires significant additional disclosures in the event an impairment loss is recorded or reversed.

*(e) Financial Instruments*

The Fund and Trade Marks have applied the new Canadian GAAP standards in relation to the recognition, measurement, presentation and disclosure of financial instruments. Trade Marks uses the “short-cut” or “all critical terms match” hedge effectiveness assessment for the interest rate swap. The new Canadian GAAP standards for financial instruments are aligned with IFRS, therefore GAAP differences in this area are limited, with the exception of the “short-cut” hedge effectiveness assessment which does not exist under IFRS. The documentation of the hedge effectiveness has been revised accordingly.

Differences between IFRS and Canadian GAAP, in addition to those referred to above, may still be identified based on final analysis by the Fund and Trade Marks and consideration of the final IFRS standards for 2011. The IASB currently has projects underway that are expected to result in new pronouncements and as a result, IFRS as at the transition date is expected to differ from its current form. The final impact of IFRS on the financial statements will only be determined once all applicable standards at the conversion date are known.

*Implementation and Review Phase*

This phase involves the execution of changes to accounting policies and information systems and will culminate in the collection of the necessary financial information to compile IFRS financial statements and audit committee approval of IFRS interim and annual financial statements for 2011.

The Fund and Trade Marks anticipate that there will be changes in accounting policies and that these changes may materially impact the financial statements. The full impact on future financial reporting is not reasonably determinable or estimable at this time. The transition to IFRS is not expected to have an impact on the Fund’s or Trade Marks’ cash flows.

## Expansion of the Royalty Pool

The eighth adjustment to the Royalty Pool took place on January 5, 2010. The number of A&W restaurants in the Royalty Pool was increased by 23 new restaurants less eight restaurants which permanently closed during 2009. The Partnership paid Food Services \$4,758,000 by issuance of 332,723 LP units to Food Services, representing 80% of the initial consideration based on the estimated annual sales of the net new restaurants. The LP units were exchanged for 28,933 Class B preferred shares valued at \$328,000, 28,933 voting common shares valued at \$86,000, 303,790 Class A preferred shares valued at \$3,441,000 and 303,790 non-voting common shares valued at \$903,000.

The final adjustment to the number of LP units issued was made on December 15, 2010 based upon the actual annual sales reported by the new restaurants. The actual annual sales of the 23 new restaurants were \$25,781,000 compared to the original estimate of \$24,879,000. As a result, the remaining 20% of the initial consideration or \$1,189,000 and additional consideration of \$243,000 was paid to Food Services by issuance of 100,185 additional LP units which were exchanged for 100,185 Class A preferred shares valued at \$1,134,000 and 100,185 non-voting common shares valued at \$298,000.

Subsequent to year end, the ninth adjustment to the Royalty Pool took place on January 5, 2011. The number of A&W restaurants in the Royalty Pool was increased by 20 new restaurants less five restaurants which

permanently closed during 2010. The estimated annual sales of the 20 new A&W restaurants are \$20,160,000 and annual sales for the five permanently closed restaurants were \$1,673,000. The net sales of \$18,487,000 translate into estimated additional annual royalty payments to the Partnership of \$555,000 on the basis of the royalty of 3% of sales. The initial consideration for this estimated additional royalty stream is \$6,859,000, calculated by discounting the estimated additional royalties by 7.5% and dividing the result by the yield on the units of the Fund for the 20 trading days ending November 1, 2010. The Partnership paid Food Services \$5,487,000 by issuance of 278,818 LP units to Food Services, representing 80% of the initial consideration. The additional LP units were exchanged for 557,636 non-voting common shares of Trade Marks. The remaining 20% of the consideration and a final adjustment to the consideration based on the actual annual sales reported by the new restaurants will be made in December 2011 by issuance of additional LP units which may be exchanged for non-voting common shares of Trade Marks.

After the January 5, 2011 adjustment to the Royalty Pool, the number of restaurants in the Royalty Pool increased to 715 and Food Services owns the equivalent of 34% of the units of the Fund on a fully-diluted basis.

## Ownership of the Fund

After the completion of the Offer and the Reorganization, the ownership of the Fund, on a fully-diluted basis, is as follows:

	February 8 2011 <sup>(1)</sup>		December 31 2010		December 31 2009	
	#	%	#	%	#	%
Fund units held by public unitholders	8,254,373	66.0	8,254,373	67.5	8,340,000	58.4
Securities of Trade Marks' held by Food Services exchangeable for Fund units <sup>(2)</sup>	4,247,358	34.0	3,968,540	32.5	5,949,993	41.6
Total equivalent units	12,501,731	100.0	12,222,913	100.0	14,289,993	100.0

(1) Represents the ownership of the Fund as at February 8, 2011 after the initial consideration for the January 5, 2011 expansion of the Royalty Pool.

(2) Common shares of Trade Marks held by Food Services may be exchanged for units in the Fund on the basis of two common shares for a unit in the Fund.

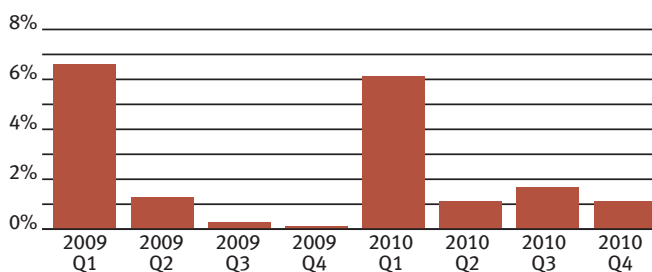
## Same Store Sales Growth

The source of revenue for Trade Marks is through the royalty income that the Partnership receives from Food Services. Royalty income is equal to 3% of sales of the A&W restaurants in the Royalty Pool. Therefore, same store sales growth by A&W restaurants is a key performance indicator for Trade Marks and the Fund.

Same store sales growth is the change in sales of A&W restaurants in the Royalty Pool that operated during the entire 26 4-week periods ending December 31, 2010.

Same store sales growth was 1.1% for the fourth quarter of 2010 compared to the same quarter of 2009, and 2.2% for the full year 2010 compared to 2009. Same store sales growth has been positive for 31 consecutive quarters.

The following chart shows the percentage change in same store sales by A&W restaurants for the eight most recently completed quarters:



## Results of Operations

### Income

#### The Fund

During 2010, the Fund earned interest income from Trade Marks on the A&W notes of \$8,745,000, compared to \$8,965,000 for 2009. Interest income for the fourth quarter was \$2,482,000, compared to \$2,849,000 in the fourth quarter of 2009. The decrease in interest income was due to the A&W notes being exchanged for non-voting common shares on December 22, 2010. The shorter fourth quarter in 2010 also impacted interest income for the quarter.

The Fund's share of Trade Marks' earnings was \$2,463,000 for the full year 2010, an increase of \$123,000 from 2009, and \$979,000 for the quarter, a decrease of \$165,000 from the same quarter last year. The Fund's ownership interest in Trade Marks was 67.5% as at December 31, 2010 and 58.4% as at December 31, 2009. Trade Marks' income and expenses are discussed in detail below.

In accordance with GAAP, a non-cash dilution gain of \$774,000 was recognized in 2010 due to the value ascribed to the common shares issued by Trade Marks to Food Services as consideration for the eighth Royalty Pool adjustment on January 5, 2010. The dilution gain recognized in 2009 was \$319,000.

#### Trade Marks

Royalty income for 2010 was \$23,301,000 based on sales of \$776,701,000, an increase of 5.5% over royalty income of \$22,086,000 and sales of \$736,209,000 for 2009. These increases were due to the combined impact of the additional net 15 restaurants in the Royalty Pool and the same store sales increase of 2.2%. Royalty income earned by Trade Marks in the fourth quarter was \$7,167,000 based on sales of \$238,900,000 reported by the A&W restaurants in the Royalty Pool. This was a decrease of 0.2% over royalty income of \$7,181,000 and sales of \$239,385,000 during the same quarter of 2009. The decrease in the fourth quarter was due to the quarter having six fewer days in 2010 compared to the same quarter in 2009.

## Expenses and Taxes

The Fund had no direct expenses while Trade Marks' expenses were as follows:

(dollars in thousands)

	Q4 2010 \$	Q4 2009 \$	Year end 2010 \$	Year end 2009 \$
General and administrative	237	167	601	647
Recapitalization and reorganization costs	661	-	775	-
Amortization of deferred financing fees	6	3	12	9
Interest on term loan	288	184	695	581
Interest income	(19)	(1)	(25)	(11)
Interest on A&W notes	2,482	2,849	8,745	8,965
Dividends on Class A and Class B preferred shares <sup>(1)</sup>	1,911	2,050	6,692	6,396
Recovery of current income taxes	-	-	-	(43)
Provision for future income taxes	563	(40)	2,135	1,514

(1) As required by GAAP, the dividends were classified as interest expense.

The impact of the Offer and Reorganization on Trade Marks' expenses were:

- one-time costs of \$775,000, comprised mainly of professional fees;
- additional interest on the term loan which was increased to \$60,000,000 from \$10,000,000 on December 22, 2010;
- a \$49,000 payment to terminate the interest rate swap on the \$10,000,000 term loan;
- lower interest on the A&W notes which were extinguished December 22, 2010;
- lower dividends on the Class A and Class B preferred shares which were converted to common shares on December 22, 2010.

Normal general and administrative expenses for 2010 decreased by \$46,000 to \$601,000, compared to \$647,000 for 2009. General and administrative expenses in the fourth quarter, including expenses for the Fund under the administration agreement between Trade Marks and the Fund, increased by \$70,000 to \$237,000, compared to \$167,000 in the fourth quarter of 2009.

Trade Marks' interest expense on its term loan for 2010 was \$695,000 compared to \$581,000 for 2009. Interest on the term loan for the fourth quarter of 2010 was \$288,000, compared to \$184,000 for the same

quarter of 2010. The increase in term loan interest was due to the increase in the amount of the term loan by \$50,000,000 to \$60,000,000 effective December 22, 2010. Also included in interest expense was a \$49,000 payment to terminate the interest rate swap on the \$10,000,000 term loan.

Interest on the A&W notes for the fourth quarter was \$2,482,000, compared to \$2,849,000 in the fourth quarter of 2009, and \$8,745,000 for 2010 compared to \$8,965,000 for 2009. The decrease in interest expense was due to the A&W notes being extinguished on December 22, 2010 under the Reorganization of Trade Marks. In addition, there were six fewer days in the fourth quarter of 2010 compared to the fourth quarter of 2009.

The Class A and Class B preferred shares entitled Food Services to a fixed cumulative preferential cash dividend at a rate of \$1.075 per share per annum. In accordance with GAAP, the cumulative dividends were treated for accounting purposes by Trade Marks as interest expense and, as such, were deducted to arrive at net earnings. Class A and Class B preferred share dividends were \$1,911,000 for the quarter and \$6,692,000 for the year compared to \$2,050,000 for the quarter and \$6,396,000 last year. The increase in Class A and Class B share dividends resulting from the

issue of 432,908 additional shares for the Royalty Pool Amendment was offset by fewer days accrued in 2010 as the Class A and Class B shares were exchanged for common shares on December 22, 2010 under the Reorganization. In addition, there were six fewer days in the fourth quarter of 2010 compared to the fourth quarter of 2009.

There are no current income taxes for 2010 compared to a recovery of taxes of \$43,000 for 2009. Future income taxes, a non-cash expense, were \$2,135,000 for 2010 compared to \$1,514,000 for 2009.

## Net Earnings and Comprehensive Earnings

### The Fund

The Fund's net earnings for 2010 were \$11,982,000 or \$1.437 per weighted average unit outstanding compared to \$11,624,000 or \$1.394 per unit for 2009. The Fund's net earnings for the quarter were \$3,633,000 or 43.6¢ per weighted average unit outstanding compared to \$4,010,000 or 48.1¢ per unit for the same quarter in 2009.

### Trade Marks

Trade Marks' 2010 net earnings were \$3,648,000 compared to \$4,007,000 for 2009. Trade Marks' net earnings for the quarter were \$1,031,000 compared to \$1,962,000 for the same quarter of 2009. As discussed previously, the decrease in Trade Marks' earnings was due to the \$775,000 one-time transaction costs for the Offer and Reorganization.

In accordance with CICA Handbook Section 3865 "Hedges", Trade Marks recorded other comprehensive income of \$545,000 for 2010 and \$356,000 for the quarter compared to \$266,000 in 2009 and \$116,000 in the fourth quarter of 2009 to reflect the change in the fair value of the interest rate swap agreement, net of tax. Trade Marks' comprehensive earnings were \$4,193,000 for 2010 and \$1,387,000 for the quarter, compared to \$4,273,000 for 2009 and \$2,078,000 for the same quarter in 2009. Accumulated other comprehensive earnings as at December 31, 2010 were \$245,000 compared to other comprehensive losses of \$300,000 at the end of 2009.

The Fund's share of Trade Marks' other comprehensive income was \$340,000 for 2010 and \$228,000 for the quarter and compared to \$163,000 for 2009 and \$68,000 in the same quarter last year. The Fund's comprehensive earnings were \$12,322,000 for 2010

and \$3,861,000 for the quarter and compared to \$11,787,000 for 2009 and \$4,078,000 for the same quarter of 2009. Accumulated other comprehensive earnings as at December 31, 2010 were \$165,000 compared to other comprehensive losses of \$175,000 at the end of 2009.

## Distributable Cash

The distributable cash measure is provided as it identifies the amount of actual cash available to pay distributions to unitholders and dividends to Food Services. Distributable cash is not an earnings measure recognized by GAAP and therefore may not be comparable to similar measures presented by other issuers.

Distributable cash is calculated as the combined operating cash flows of the Fund and Trade Marks (which includes the Partnership), adjusted for the dividends on Trade Marks' Class A and Class B preferred shares, the Partnership's 0.1% distributions to Food Services, financing fees and changes in non-cash working capital. Dividends on Trade Marks' Class A and Class B preferred shares are added back in order to show the total distributable cash available to pay distributions to unitholders and dividends to Food Services on a fully-diluted basis. Changes in non-cash working capital are excluded as Trade Marks' and the Fund's working capital requirements are not permanent and are primarily due to the timing of payments between related parties. No deduction is made for capital expenditures as neither the Fund nor Trade Marks have capital expenditures. There are no restrictions on distributions arising from compliance with financial covenants.

With respect to the guidance issued by CICA on the measurement and disclosure of distributable cash in income trusts and other flow-through entities, the Fund and Trade Marks believe that this Management Discussion and Analysis provides appropriate disclosure to unitholders.

Before payment of one-time costs and financing fees totaling \$1,224,000 for the Offer and Reorganization, distributable cash generated in 2010 to pay distributions to unitholders and dividends to Food Services increased by \$1,095,000 or 5.2% over 2009. After payment of these one-time costs and financing fees, distributable cash generated to pay distributions to unitholders and dividends to Food Services decreased by \$129,000 from \$20,912,000 for 2009 to \$20,783,000 for 2010,

and decreased by \$1,287,000 from \$6,831,000 for the fourth quarter of 2009 to \$5,544,000 for the fourth quarter of 2010. Distributable cash and earnings in the fourth quarter were also negatively impacted by the decrease in the number of days in the quarter compared to 2009.

The amount of cash distributed in 2010 to unitholders and Food Services in monthly distributions and dividends was \$1.272 per equivalent unit compared to distributable cash generated of \$1.419. In addition, two Special Distributions of \$0.100 per equivalent unit each were paid to unitholders and Food Services, bringing the total amount of cash distributed in 2010 to \$1.472 per equivalent unit.

Before payment of the one-time financing fees and transaction costs of \$1,224,000, the cumulative surplus of distributable cash at the end of the year was \$4,195,000, compared to a cumulative surplus of \$3,706,000 at the end of 2009. After payment of the one-time costs, the cumulative surplus of distributable cash was \$2,971,000.

The chart below reconciles distributable cash to the most directly comparable measure calculated in accordance with GAAP, cash flows from operating activities including changes in non-cash working capital balances.

(dollars in thousands except per unit amounts)

	Q4 2010	Q4 2009	Year end 2010	Year end 2009
Trade Marks' cash flow from (used for) operating activities	\$ (296)	\$ 1,668	\$ 4,609	\$ 5,369
Add:				
Changes in accrued dividends	218	98	–	–
Dividends on Class A & Class B preferred shares	1,911	2,050	6,692	6,396
Changes in non-cash working capital	1,685	166	1,209	182
Partnership distributions paid to Food Services	(7)	–	(23)	–
Financing fees	(449)	–	(449)	–
Distributable cash – Trade Marks	3,062	3,982	12,038	11,947
The Fund's cash flow from operating activities	3,508	2,967	9,506	8,963
Add:				
Changes in non-cash working capital	(1,026)	(118)	(761)	2
Distributable cash – the Fund	2,482	2,849	8,745	8,965
Total distributable cash	\$ 5,544	\$ 6,831	\$ 20,783	\$ 20,912
Cumulative surplus – beginning of period	4,406	4,102	3,706	3,828
Distributable cash paid to unitholders at current annual distribution rate (2010 - \$1.272 per unit, 2009 - \$1.272 per unit)	(3,188)	(3,371)	(10,599)	(10,608)
Distributable cash paid to Food Services at current annual distribution rate (2010 - \$1.272 per share, 2009 - \$1.272 per share)	(2,338)	(2,425)	(7,995)	(7,568)
Special distributions paid to unitholders (\$0.20 per unit)	(834)	(834)	(1,668)	(1,668)
Equivalent special dividends paid to Food Services (\$0.20 per share)	(619)	(597)	(1,256)	(1,190)
Cumulative surplus – end of period	\$ 2,971	\$ 3,706	\$ 2,971	\$ 3,706
Distributable cash per weighted average equivalent unit	\$ 0.382	\$ 0.478	\$ 1.419	\$ 1.463
Number of equivalent units	12,222,913	14,289,993	12,222,913	14,289,993
Weighted average equivalent units	14,503,826	14,289,993	14,644,999	14,289,993
Monthly distributions declared per unit	\$ 0.424	\$ 0.424	\$ 1.272	\$ 1.272
Special distributions declared per unit	\$ 0.100	\$ 0.100	\$ 0.200	\$ 0.200
Payout ratio (excluding special distributions)	111.0%	88.7%	89.6%	86.9%
Payout ratio (including special distributions)	137.1%	109.6%	103.7%	100.6%

## Distributions to Unitholders

Distributions in 2010 were as follows:

*(dollars in thousands except per unit amounts)*

	Record date	Amount	Per unit
January 2010	February 15, 2010	\$ 884	\$ 0.106
February 2010	March 15, 2010	884	0.106
March 2010	April 15, 2010	884	0.106
Special Distribution	May 15, 2010	834	0.100
April 2010	May 15, 2010	884	0.106
May 2010	June 15, 2010	884	0.106
June 2010	July 15, 2010	884	0.106
July 2010	August 15, 2010	884	0.106
August 2010	September 15, 2010	884	0.106
September 2010	October 15, 2010	884	0.106
October 2010	November 15, 2010	884	0.106
Special Distribution	November 15, 2010	834	0.100
November 2010	December 15, 2010	884	0.106
December 2010	December 31, 2010	875	0.106
		\$ 12,267	\$ 1.472

The December 2010 distribution of \$875,000 which was declared on December 20, 2010 and paid on January 31, 2011 is reported as a current liability as at December 31, 2010. This distribution was declared and recorded for income tax purposes in 2010, the period in which it was earned, and as it had a record date of December 31, 2010, 8,254,373 units were outstanding and the monthly distribution at \$0.106 was \$875,000.

On February 2, 2011, the Fund declared the January 2011 monthly distribution to unitholders of \$0.117 per unit or \$966,000, payable on February 28, 2011.

### TAX TREATMENT OF DISTRIBUTIONS

Of the \$1.472 per unit in distributions declared year to date, \$1.049 per unit or 71.3% will be taxable to unitholders as other investment income and \$0.423 per unit or 28.7% will be designated as non-eligible dividends.

## Dividends on Trade Marks' Common Shares

During 2010, Trade Marks declared dividends on its common shares totaling \$6,082,000, of which \$3,523,000 was earned by the Fund and \$2,559,000 was earned by Food Services. Additional compensation of \$38,000 was paid to Food Services representing the dividends that Food Services would have received on the 100,185 non-voting common shares issued to Food Services on December 15, 2010 in relation to the adjustment to the January 5, 2010 Royalty Pool amendment, had they been issued on January 5, 2010.

On February 2, 2011, Trade Marks declared a dividend on its common shares of \$1,463,000, payable to Food Services and the Fund on February 28, 2011.

## Dividends on Trade Marks' Class A and Class B Preferred Shares

During 2010, Trade Marks declared and paid dividends on its Class A and Class B preferred shares totaling \$6,692,000.

## Selected Annual Information

The following selected annual information, other than “Same store sales growth” and “Total distributable cash available for distributions and dividends”, has been prepared in accordance with GAAP and all dollar

amounts are reported in Canadian currency. With the exception of same store sales growth, 2010, 2009 and 2008 results are not directly comparable to each other due to the different number of restaurants in the Royalty Pool in each year.

*(dollars in thousands except per unit amounts)*

	2010	2009	2008
Same store sales growth <sup>(1)</sup>	2.2%	1.5%	7.3%
Number of restaurants in the Royalty Pool	700	685	676
Sales reported by the restaurants in the Royalty Pool	\$ 776,701	\$ 736,209	\$ 710,479
Royalty income	\$ 23,301	\$ 22,086	\$ 21,314
Total distributable cash available for distributions and dividends <sup>(2)</sup>	\$ 20,783	\$ 20,912	\$ 20,257
Distributions declared per unit	\$ 1.472	\$ 1.472	\$ 1.472
Net earnings of the Fund	\$ 11,982	\$ 11,624	\$ 11,869
Basic and diluted earnings per unit	\$ 1.437	\$ 1.394	\$ 1.423
Total assets of the Fund	\$ 74,819	\$ 76,485	\$ 76,974
Trade Marks' term loan	\$ 59,553	\$ 9,990	\$ 9,981

(1) Same store sales growth is not an earnings measure recognized by GAAP and therefore may not be comparable to similar measures presented by other issuers. This information is provided as it is a key driver of growth in the Fund. See “Same Store Sales Growth”.

(2) Distributable cash is not an earnings measure recognized by GAAP and therefore may not be comparable to similar measures presented by other issuers. This information is provided as it identifies the amount of actual cash available to pay distributions to unitholders and dividends to Food Services. See “Distributable Cash”.

## Summary of Quarterly Results

The following selected quarterly results, other than “Distributable cash” and “Distributable cash per

equivalent unit”, have been prepared in accordance with GAAP and all dollar amounts are reported in Canadian currency.

(dollars in thousands except per unit amounts)

	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Number of restaurants in the Royalty Pool	700	700	700	700
Royalty income	\$ 7,167	\$ 5,654	\$ 5,330	\$ 5,150
The Fund's interest income	\$ 2,482	\$ 2,063	\$ 2,063	\$ 2,137
The Fund's net earnings	\$ 3,633	\$ 2,741	\$ 2,585	\$ 3,023
Basic and diluted earnings per unit	\$ 0.436	\$ 0.329	\$ 0.310	\$ 0.362
Distributable cash <sup>(1)</sup>	\$ 5,544	\$ 5,466	\$ 5,128	\$ 4,645
Number of equivalent units <sup>(2)</sup>	12,222,913	14,705,897	14,705,897	14,705,897
Distributable cash per weighted average equivalent unit <sup>(1)(2)</sup>	\$ 0.382	\$ 0.372	\$ 0.349	\$ 0.316
Monthly distributions declared per unit (8,340,000 units) <sup>(3)</sup>	\$ 0.424	\$ 0.318	\$ 0.318	\$ 0.212
Special distribution declared per unit	\$ 0.100	–	\$ 0.100	–
Number of days in the quarter	110	84	84	87
	Q4 2009	Q3 2009	Q2 2009	Q1 2009
Number of restaurants in the Royalty Pool	685	685	685	685
Royalty income	\$ 7,181	\$ 5,408	\$ 5,115	\$ 4,382
The Fund's interest income	\$ 2,849	\$ 2,063	\$ 2,063	\$ 1,990
The Fund's net earnings	\$ 4,010	\$ 2,698	\$ 2,546	\$ 2,370
Basic and diluted earnings per unit	\$ 0.481	\$ 0.324	\$ 0.305	\$ 0.284
Distributable cash <sup>(1)</sup>	\$ 6,831	\$ 5,218	\$ 4,899	\$ 3,964
Number of equivalent units <sup>(2)</sup>	14,289,993	14,289,993	14,289,993	14,289,993
Distributable cash per weighted average equivalent unit <sup>(1)(2)</sup>	\$ 0.478	\$ 0.365	\$ 0.343	\$ 0.277
Monthly distributions declared per unit (8,340,000 units) <sup>(3)</sup>	\$ 0.424	\$ 0.318	\$ 0.318	\$ 0.212
Special distribution declared per unit	\$ 0.100	–	\$ 0.100	–
Number of days in the quarter	116	84	84	81

(1) Distributable cash is not an earnings measure recognized by GAAP and therefore may not be comparable to similar measures presented by other issuers. This information is provided as it identifies the amount of actual cash available to pay distributions to unitholders and dividends to Food Services. See “Distributable Cash”.

(2) The number of equivalent units and distributable cash per weighted average equivalent unit in Q1, Q2 and Q3 2010 includes the 83,181 common shares of Trade Marks representing the remaining 20% of the consideration for the January 5, 2010 adjustment to the Royalty Pool which was held back until December 2010 when the actual annual sales were reported by the new restaurants. The actual additional consideration was 100,185 common shares based on the actual annual sales.

(3) The distribution for December of each year, which is paid on January 31 of the following year, is declared and recorded in the year in which it is earned. Therefore, four monthly distributions are declared in the fourth quarter of each year, and two monthly distributions are declared in the first quarter of each year.

## Seasonality

Sales in the quick service restaurant industry fluctuate seasonally. In freestanding restaurants, weather impacts sales. In shopping centres, sales fluctuate due to higher traffic during the back-to-school and Christmas shopping seasons.

## Liquidity and Capital Resources

The Fund expects to have sufficient financial resources to pay ongoing future distributions as it receives income by way of dividends on its common shares of Trade Marks.

Trade Marks expects to have sufficient financial resources to fund its working capital requirements and to meet its cash flow needs including ongoing common share dividends. Trade Marks has a \$2,000,000 demand operating loan facility with HSBC Bank Canada (the Bank) to fund working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at bank prime rate plus 0.5% and are repayable on demand. As at December 31, 2010 and February 8, 2011, the full amount of the facility was available.

On December 22, 2010, Trade Marks increased its existing \$10,000,000 term loan with the Bank to \$60,000,000 to finance repayment of \$50,000,000 of A&W notes (see "Recapitalization and Reorganization"). The new term loan is repayable on December 22, 2015 and bears interest at bank prime rate plus 1% depending on specified financial ratios. Interest only is payable monthly, provided that Trade Marks' earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA), tested quarterly on a trailing four quarters basis, in arrears, is not less than specified amounts. In the event that EBITDA is less than these specified amounts, the term loan will be fully amortized over the greater of three years or the remaining term and repayment will be by way of blended monthly instalments of principal and interest.

The new loan contains a number of covenants including the requirement for Trade Marks to meet certain EBITDA levels and debt to EBITDA ratios during each trailing four quarters period. Trade Marks was in compliance with all of its financial covenants as at December 31, 2010.

Trade Marks uses an interest rate swap agreement to manage risks from fluctuations in interest rates. The interest rate swap on the \$10,000,000 term loan

was terminated effective December 22, 2010 and Trade Marks entered into a new interest rate swap on the new \$60,000,000 term loan on the same day. As a result, the term loan bears interest at 5.03% per annum, of which 2.53% per annum is fixed under an interest rate swap agreement that matures December 22, 2015 and 2.50% per annum is subject to annual review by the Bank. The interest rate swap agreement is considered to be a cash flow hedge and in accordance with CICA Handbook Section 3865 "Hedges", qualifies for hedge accounting. Changes in the fair value of the interest rate swap agreement, to the extent it is an effective hedge, are recorded in other comprehensive income (loss) and are only recognized in earnings when the hedged item is realized. Any ineffectiveness in the hedging relationship is recognized in earnings immediately.

Prepaid interest on the term loan was \$500,000 as at December 31, 2010 as a portion of the interest on the \$60,000,000 term loan was paid in advance in accordance with the terms of the interest rate swap.

The fair value of the interest rate swap as at December 31, 2010 is \$299,000 favourable (December 31, 2009 - \$370,000 unfavourable) and the change in fair value is recorded in other comprehensive income, net of income taxes.

A general security agreement over the assets of Trade Marks was provided as collateral for the demand operating loan facility and term loan. The Partnership has provided its guarantee in favour of the Bank of all of the indebtedness, covenants and obligations of Trade Marks to the Bank.

Payments due by Period:

*(dollars in thousands)*

Term Loan	Total	\$ 60,000
	Less than 1 year	\$ 0
	1 - 3 years	\$ 0
	4 - 5 years	\$ 60,000
	After 5 years	\$ 0

The Fund and Trade Marks have no other contractual or purchase obligations except as described under the section Related Party Transactions and Balances. The Fund and Trade Marks do not have any capital expenditures; their operating and administrative expenses are expected to be stable and reasonably predictable and are considered to be in the ordinary course of business.

## Off-Balance Sheet Arrangements

The Fund and Trade Marks have no off-balance sheet arrangements.

## Related Party Transactions and Balances

Trade Marks' interest expense and the Fund's interest income on the A&W notes for the year was \$8,745,000 (2009 - \$8,965,000), of which \$nil (December 31, 2009 - \$761,000) is receivable by the Fund from Trade Marks at December 31, 2010. Interest on the A&W notes for the quarter was \$2,482,000 (2009 - \$2,849,000).

Royalty income of \$23,301,000 (2009 - \$22,086,000) was earned by Trade Marks from Food Services, of which \$1,720,000 (December 31, 2009 - \$1,992,000) is receivable by Trade Marks at December 31, 2010. Royalty income earned during the quarter was \$7,167,000 (2009 - \$7,181,000).

As at December 31, 2010, \$36,000 (December 31, 2009 - \$36,000) is due to Trade Marks by the Fund, without interest and on demand.

Under an administration agreement between Trade Marks and the Fund, Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund. In turn, Trade Marks has arranged for certain of these services to be provided by Food Services.

Related party transactions described in this section are recorded at the exchange amounts which are the amounts agreed to by both parties.

Other related party transactions and balances are referred to elsewhere in this Management Discussion and Analysis.

## Critical Accounting Estimates

Trade Marks' intangible assets consist of the A&W trade-marks and are recorded at cost. Management tests the intangible assets annually for impairment or more frequently if events or changes in circumstances indicate that the assets might be impaired. The impairment test compares the carrying amount of the intangible asset with its fair value, and an impairment loss is recognized in income for the excess, if any. Management believes that there has been no impairment of the intangible assets during the period ended December 31, 2010.

## Financial Instruments

The Fund's financial instruments consist of cash and cash equivalents, distribution payable to unitholders, and amounts due to Trade Marks. The Fund classifies its financial instruments as follows:

- Cash and cash equivalents as loans and receivables, which are initially measured at fair value and subsequently at amortized cost.
- Distribution payable to unitholders and amounts due to Trade Marks as other financial liabilities, which are measured at amortized cost.

The Fund's Trustees have oversight responsibilities for risk management policies. The Board of Directors of Trade Marks and the Fund's Trustees closely monitor the cash position and internal controls related to Trade Marks, along with the level of distributions of the Fund. The Fund, through dividends from Trade Marks, is expected to have sufficient financial resources to pay future distributions.

Management estimates that the fair values of the Fund's financial instruments approximate their carrying values due to the short-term maturities of these instruments.

The Fund is exposed to credit risk arising from the concentration of the amounts due from Trade Marks. Trade Marks is the Fund's primary source of cash to fund distributions to unitholders. Trade Marks is dependent, through the Partnership, on the royalty of 3% of sales reported to Food Services by A&W restaurants in the Royalty Pool as its main source of revenue.

Monthly cash distributions to unitholders are the primary source of liquidity risk pertaining to the Fund. This risk is assessed as low due to the stable nature of income the Fund receives from the investment in Trade Marks and the Trustees' ability to reduce future distributions if necessary. Additionally, the Fund manages liquidity risk by actively monitoring forecast and actual cash flows.

The Fund is not exposed to interest rate risk as all of the Fund's financial instruments are non-interest bearing, except for cash and cash equivalents which earn interest at market rates.

Trade Mark's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, dividends payable, the term loan, and the interest rate swap.

Trade Marks classifies its financial instruments as follows:

- Cash and cash equivalents and accounts receivable as loans and receivables, which are initially measured at fair value and subsequently at amortized cost.
- Accounts payable and accrued liabilities, dividends payable, and the term loan as other financial liabilities, which are measured at amortized cost.
- Interest rate swap as available-for-sale.

Management estimates that the fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and dividends payable approximate their carrying values given the short term to maturity of these instruments. The fair value of the term loan approximates its carrying value due to the floating interest rate. The fair value of the interest rate swap is \$299,000 favourable (2009 - \$370,000 unfavourable).

Trade Marks' exposure to credit risk is as indicated by the carrying amount of its accounts receivable. The majority of accounts receivable relates to royalties due to the Partnership from Food Services.

The primary sources of liquidity risk are the monthly payment of dividends to the Fund and Food Services. Trade Marks' primary source of funds to pay dividends is the partnership distribution it receives from the Partnership. The Partnership's primary source of funds to pay the partnership distribution is the 3% royalty income the Partnership receives from Food Services. Additionally, Trade Marks manages liquidity risk by actively monitoring forecast and actual cash flows.

The term loan bears a floating rate of interest as disclosed previously. Trade Marks has used an interest rate swap to fix the rate of interest on the term loan. Cash and cash equivalents earn interest at market rates. All of Trade Marks' other financial instruments are non-interest bearing.

## Capital Disclosure

The Fund's capital consists of unitholders' equity. The Fund's capital management objective is to have sufficient cash to pay distributions to its unitholders. The Fund manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying

assets. In order to maintain or adjust the capital structure, the Fund may adjust the amount of distributions paid to its unitholders.

Trade Marks' capital consists of shareholders' equity and the term loan. Trade Marks' capital management objectives are to have sufficient cash and cash equivalents to pay dividends on its common shares to its shareholders, after satisfaction of its debt service and income tax obligations, provisions for administration expenses of Trade Marks and the Fund, and retention of reasonable working capital reserves. Trade Marks manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, Trade Marks may adjust the amount of dividends paid to shareholders.

## Disclosure Controls

Disclosure controls and procedures have been established to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) of the Fund and Trade Marks and the CEO and CFO of Food Services, on a timely basis so that appropriate decisions can be made regarding public disclosure.

An evaluation of the effectiveness of the Fund's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 issued by the Canadian Securities Administrators, was carried out under the supervision of and with the participation of management, including the CEO and CFO. Based upon that evaluation, the CEO and the CFO have concluded that the design and operation of these disclosure controls and procedures were effective in providing reasonable assurance that (i) information required to be disclosed by the Fund in its annual filings, interim filings or other reports filed or submitted by it under applicable securities legislation is recorded, processed, summarized and reported within the prescribed time periods, and (ii) material information regarding the Fund is accumulated and communicated to the Fund's management, including its CEO and CFO in a timely manner.

## Internal Control Over Financial Reporting

The CEO and the CFO have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Fund's and Trade Marks' financial reporting and the preparation of its financial statements for external purposes in accordance with GAAP.

Management conducted an evaluation of the effectiveness of its controls over financial reporting on a risk based approach using the elements of the framework in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and COSO's guidance on how to apply the framework to smaller companies. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Based on management's assessment, the Fund concluded that its internal control over financial reporting was effective as at December 31, 2010. There have been no material changes to the internal controls during the period covered by this Management Discussion and Analysis that have had a material effect on the Fund's internal control over financial reporting.

## Risks and Uncertainties

### The Restaurant Industry

The net earnings and distributable cash generated by the Fund are directly dependent upon the dividends it receives from Trade Marks, and the amount of its income tax obligations. The net earnings and distributable cash generated by Trade Marks are entirely dependent on the royalty the Partnership receives from Food Services, its operating costs, and Trade Marks' income tax obligations. The growth of the royalty is dependent upon 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 hamburgers, chicken, fries and soft drinks, such as, increased food and labour costs, changing tastes or health concerns, publicity from any food borne illness, the availability of experienced management and hourly employees, and government regulations concerning smoking bans, 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.

The harmonization of GST with provincial sales taxes in British Columbia effective July 1, 2010 effectively added a new 7% tax on restaurant meals in this province. While not announced, the potential future harmonization in Saskatchewan would also effectively add a new tax on restaurant meals in Saskatchewan. The harmonization of GST with provincial sales taxes in Ontario and British Columbia and the increase in the harmonized sales tax in Nova Scotia from 13% to 15% could adversely affect disposable consumer income and consequently consumer visits to restaurants in general and the sales of A&W restaurants in particular, and the amount of royalty payable to the Partnership.

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 will be able to respond to various competitive factors affecting the franchise operations of Food Services in the quick service restaurant industry.

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 availability of suitable sites, negotiations of acceptable lease or purchase terms for new locations, permits and government regulatory compliance, availability of financing and the ability to meet construction schedules. 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 and A&W franchisees may be the subject of complaints or litigation from guests alleging food-related illnesses, injuries suffered on the premises or other food quality, health or operational concerns. Adverse publicity resulting from such allegations may materially affect the sales of A&W restaurants, regardless of whether such allegations are true or whether Food Services or an A&W franchisee is ultimately held liable.

## Outlook

During the year, A&W continued to focus on strengthening its appeal to its core baby boomer customer. The Cruisin' the Dub program was a great success again in the summer of 2010, with over 4,000 events held at freestanding restaurants compared to 3,700 in 2009. A&W's Cruisin' the Dub program creates an opportunity for Canadian baby boomers that grew up enjoying warm summer evenings in their cars at A&W drive-ins – often with the radio blaring and trays of Teen Burgers, onion rings and icy cold A&W Root Beer delivered by car hops – to revisit those fond memories.

A&W continues to focus on burgers, its most powerful differentiator from the competition. Building on innovations like the Mini Sirloin Twins, A&W featured the Spicy Mama Burger for a limited time during the fourth quarter. It was very well received.

A strategic initiative underway in 2010 was A&W's "next generation" re-image program, to modernize and enhance the appeal of A&W restaurants. Rollout of this new design began in the fourth quarter of 2010 with six restaurants completed. The pace of re-imaging

will increase sharply in 2011. Costs of re-imaging restaurants are borne by the franchisees and there is no cost to the Fund.

Another major initiative in A&W's strategy is accelerating the pace of growth of new restaurants, particularly in the key Ontario market. A&W has now entered into Multi-Site Development Agreements for a total of 115 new restaurants to be built over the next five to seven years. A&W opened 26 new restaurants in 2010 and four additional new restaurants were opened subsequent to the end of the year. Of the 26 restaurants opened in 2010, 15 were located in Ontario.

A key factor continues to be the impact of the Harmonized Sales Tax (HST) on the restaurant industry in British Columbia. The addition of a 7% sales tax on restaurant meals is reported to be reducing consumption by consumers. A&W is continuing to respond tactically to both the HST and to market conditions and plans to continue to focus on building the A&W brand through successful advertising and marketing campaigns, menu innovation, facilities design and expanding to serve customers in new markets. A&W is a strategy driven company whose mission is "to make A&W the number one national burger choice for baby boomers and the fastest growing and most successful burger businesses in Canada."

## Forward Looking Information

Certain statements in this Management Discussion and Analysis 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 Management Discussion and Analysis includes, but is not limited to: the addition of 15 net new restaurants to the Royalty Pool on January 5, 2011; the Fund and Trade Marks expect distributable cash available for distributions to unitholders to increase as a result of the Offer and new loan; Food Services' strategy and Mission "to make A&W the number one burger choice for baby boomers and the fastest growing and most successful burger businesses in Canada"; Food Services' plans to respond tactically to market conditions; Food Services' plans to build the A&W brand through

advertising and marketing campaigns, menu innovation, facilities design and expanding to serve customers in new markets; Food Services' plans to modernize and enhance the appeal of A&W restaurants; Food Services' plans to expand the brand by building new restaurants in 2011 with emphasis on Ontario; the Fund expects to have sufficient financial resources to pay ongoing future distributions; Trade Marks expects to have sufficient financial resources to fund its working capital requirements and to meet its cash flow needs including ongoing common share dividends; and, the operating and administrative expenses of the Fund and Trade Marks are expected to be stable and reasonably predictable.

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 smoking bans, menu labelling and disclosure and drive-thru restrictions; no publicity from any food borne illness; no changes in competition; no changes in the retail hamburger 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 increases in food and labour costs; the continued availability of quality raw materials; continued additional franchise sales and maintenance of franchise operations; no closures of A&W restaurants that materially affect the amount of the Royalty; franchisees duly pay franchise fees and other amounts; no impact on sales from harmonization of sales taxes in British Columbia and Ontario; no harmonization of sales taxes in Saskatchewan; no new or increased sales taxes; continued availability of key personnel; no material litigation from guests alleging food-related illness, injuries suffered on the premises or other food quality, health or operations concerns; continued ability to preserve intellectual property; 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; Food Services continues to pay the Royalty; Trade Marks continues to pay dividends on the common shares and the Partnership continues to make distributions on its units; Trade Marks can continue to comply with its obligations under its credit arrangements; 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 smoking bans, menu labelling and disclosure and drive-thru restrictions; publicity from any food-borne illness; competition; changes in the retail hamburger market including as a result of changes in consumer taste and health concerns and changes in economic conditions and unemployment and a disease outbreak; increases in food and labour costs; dependence on the availability and quality of raw materials; dependence on additional franchise sales and franchise operations; the closure of A&W restaurants may affect the amount of the Royalty; dependence on A&W franchisees' ability to pay franchise fees and other amounts; the impact of new or increased or harmonization of sales taxes upon gross sales; dependence on key personnel; material litigation from guests alleging food-related illness, injuries suffered on the premises or other food quality, health or operations concerns; dependence on intellectual property; 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; 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; changes in investment eligibility and penalties for foreign property; and changes to the Canadian federal income tax treatment of publicly listed trusts and other income tax matters, all as more particularly described in this Management Discussion and Analysis 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 Management Discussion and Analysis is qualified in its entirety by this cautionary statement and, except as required by law, the Fund 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.

## Financial Statements

### Management's Responsibilities

The accompanying financial statements of A&W Revenue Royalties Income Fund (the Fund) are the responsibility of management and have been reviewed and approved by the Trustees. The financial statements have been prepared by management, in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect management's best estimates and judgements. Management has also prepared financial and all other information in the Annual Report and has ensured that this information is consistent with the financial statements.

The Fund maintains appropriate systems of internal control, policies and procedures, which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles.

The Trustees ensure that management fulfills its responsibilities for financial reporting and internal

control through an Audit Committee. This committee reviews the financial statements and reports to the Trustees. The auditors have full and direct access to the Audit Committee.

The financial statements have been independently audited by PricewaterhouseCoopers LLP, in accordance with Canadian generally accepted auditing standards. Their report, which follows, expresses their opinion on the financial statements of the Fund.



Chief Executive Officer



Chief Financial Officer

## Financial Statements

### Independent Auditor's Report

#### To the Unitholders of A&W Revenue Royalties Income Fund

We have audited the accompanying financial statements of A&W Revenue Royalties Income Fund, which comprise the balance sheets as at December 31, 2010 and 2009 and the statements of earnings and accumulated earnings, comprehensive earnings and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

#### Management's responsibility for the financial statements

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

#### Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of

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

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

#### Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of A&W Revenue Royalties Income Fund as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants

February 8, 2011

## Balance Sheets

(in thousands of dollars)

	As at December 31, 2010 \$	As at December 31, 2009 \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	893	140
Due from A&W Trade Marks Inc. (note 7)	—	761
	893	901
<b>Investment in A&amp;W Trade Marks Inc.</b> (note 4)	73,926	75,584
	74,819	76,485
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Distribution payable to Unitholders (note 5)	875	884
Due to A&W Trade Marks Inc. (note 7)	36	36
	911	920
<b>UNITHOLDERS' EQUITY</b>		
Capital contributions (note 6)	76,323	77,115
Accumulated earnings	89,619	78,557
Accumulated distributions (note 5)	(92,199)	(79,932)
Accumulated other comprehensive earnings (loss)	165	(175)
	73,908	75,565
	74,819	76,485

Subsequent events (note 10)

Approved by the Trustees



John R. McLernon  
Trustee



Conrad A. Pinette  
Trustee

See accompanying notes to the financial statements

## Statements of Earnings and Accumulated Earnings

(in thousands of dollars, except per Unit amounts)

	Year ended December 31, 2010 \$	Year ended December 31, 2009 \$
<b>Interest income</b>	8,745	8,965
<b>Equity in earnings of A&amp;W Trade Marks Inc.</b>	2,463	2,340
<b>Dilution gain</b> <sup>(note 4)</sup>	774	319
<b>Net earnings for the year</b>	11,982	11,624
<b>Accumulated earnings - Beginning of year</b>	78,557	66,933
<b>Loss on purchase and cancellation of Units</b> <sup>(note 3)</sup>	(920)	—
<b>Accumulated earnings - End of year</b>	89,619	78,557
<b>Basic and diluted earnings per Trust Unit</b>	1.437	1.394
<b>Weighted average Trust Units outstanding</b>	8,337,889	8,340,000

## Statements of Comprehensive Earnings

(in thousands of dollars)

	Year ended December 31, 2010 \$	Year ended December 31, 2009 \$
<b>Net earnings for the year</b>	11,982	11,624
Other comprehensive income		
Equity in change in fair value of A&W Trade Marks Inc.'s interest rate swap	340	163
<b>Comprehensive earnings for the year</b>	12,322	11,787
<b>Accumulated other comprehensive loss - Beginning of year</b>	(175)	(338)
Other comprehensive income		
Equity in change in fair value of A&W Trade Marks Inc.'s interest rate swap	340	163
<b>Accumulated other comprehensive earnings (loss) - End of year</b>	165	(175)

See accompanying notes to the financial statements

## Statements of Cash Flows

(in thousands of dollars)

	Year ended December 31, 2010 \$	Year ended December 31, 2009 \$
<b>Cash flows from operating activities</b>		
Net earnings for the year	11,982	11,624
Items not affecting cash		
Equity in earnings of A&W Trade Marks Inc.	(2,463)	(2,340)
Dilution gain	(774)	(319)
	8,745	8,965
Net change in non-cash working capital	761	(2)
	9,506	8,963
<b>Cash flows from investing activities</b>		
Dividends received from A&W Trade Marks Inc.	3,523	3,311
<b>Cash flows from financing activities</b>		
Distributions paid to Unitholders	(12,276)	(12,276)
Proceeds from repayment of A&W notes <sup>(note 3)</sup>	50,000	-
Purchase and cancellation of Units <sup>(note 3)</sup>	(50,000)	-
	(12,276)	(12,276)
<b>Increase (decrease) in cash</b>	753	(2)
<b>Cash - Beginning of year</b>	140	142
<b>Cash - End of year</b>	893	140
<b>Supplementary cash flow information</b>		
Interest received	9,506	8,963

See accompanying notes to the financial statements

# Notes to Financial Statements

December 31, 2010 and 2009

(figures in tables are expressed in thousands of dollars, except per Unit amounts)

## 1 Organization and nature of business

A&W Revenue Royalties Income Fund (the Fund) is a limited purpose trust established on December 18, 2001 with an unlimited number of Trust Units (Units) under the laws of the Province of British Columbia pursuant to the Declaration of Trust. The Fund was established to invest in A&W Trade Marks Inc. (Trade Marks), which through its ownership interest in A&W Trade Marks Limited Partnership (the Partnership) owns the A&W trade-marks used in the A&W quick service restaurant business in Canada.

The business of the Partnership is the ownership of the A&W trade-marks and, through the Licence and Royalty Agreement with A&W Food Services of Canada Inc. (Food Services), exploitation of the A&W trade-marks including the development of new A&W restaurants by Food Services, and the collection of the royalty of 3% of sales reported to Food Services by A&W restaurants in the Royalty Pool (the Licence and Royalty Agreement). Food Services is a leading franchisor of hamburger quick service restaurants in Canada.

## 2 Significant accounting policies

### *Basis of presentation*

The Fund prepares its financial statements in accordance with Canadian generally accepted accounting principles (GAAP).

### *Basis of consolidation*

The Fund, Trade Marks, Food Services and the Partnership have adopted the Canadian Institute of Chartered Accountants (CICA) Accounting Guideline 15, "Consolidation of Variable Interest Entities" (AcG-15).

AcG-15 expands upon accounting guidance in CICA Handbook Section 1590 that addresses when an enterprise should consolidate another entity in its financial statements. Under CICA 1590, an enterprise generally consolidates another entity when it controls the entity through a majority voting interest. AcG-15 clarifies this guidance when the entity being consolidated is a "Variable Interest Entity" (VIE), which is defined to be an entity that, by design, does not have sufficient equity at risk to finance its activities without additional subordinated financial support. If the entity being consolidated is a VIE, under AcG-15 the "primary beneficiary" of that entity should consolidate the VIE and not necessarily the shareholder with the majority voting interest.

The Fund and Food Services have determined that Trade Marks is a VIE and that Food Services is the primary beneficiary of Trade Marks. As a result, the Fund does not consolidate Trade Marks, but instead accounts for its investment in Trade Marks using the equity method, and Food Services consolidates Trade Marks and the Partnership.

### *Future accounting changes*

In January 2009, the CICA issued Handbook Section 1582, "Business Combinations", which replaces Handbook Section 1581, "Business Combinations". The CICA also issued Handbook Section 1601, "Consolidated Financial Statements", and Handbook Section 1602, "Non-controlling Interests", which replace Handbook Section 1600, "Consolidated Financial Statements". These new sections are based on the International Accounting Standards Board's (IASB) International Financial Reporting Standards (IFRS) 3R, "Business Combinations". The new standards replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and US accounting standards. The new standards are to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards will not be adjusted upon application of these new standards. The non-controlling interests standard should be applied retrospectively except for certain items. The adoption of these new standards is not expected to have an impact on the Fund's financial results.

### *Income taxes*

The Fund is a unit trust for income tax purposes. As such, prior to January 1, 2011, the Fund is only taxable on any taxable income not allocated to the Unitholders. During 2010 and 2009, all taxable income of the Fund has been allocated to the Unitholders. Income tax obligations relating to distributions from the Fund are the obligations of the Unitholders.

On October 31, 2006, the Federal Government announced a new Specified Investment Flow Through (SIFT) tax on income trusts. The SIFT tax is effective January 1, 2011 and treats an income trust like a corporation, requiring it to pay tax on its taxable income.

## 2 Significant accounting policies (continued)

### Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments with a maturity of three months or less.

### Earnings per Unit

The Fund's earnings per Unit are based on the weighted average number of Units outstanding during the year.

### Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect certain amounts reported in the financial statements and accompanying notes. Accordingly, actual amounts could differ from those estimates.

## 3 Recapitalization and Reorganization

### a) A&W Revenue Royalties Income Fund's offer to purchase Units

On November 10, 2010, the Fund announced its intention to make a substantial issuer bid (the Offer) to purchase for cancellation 2,500,000 of its Units at a price of \$20 per Unit. A total of 2,588,663 Units were deposited under the Offer, including 2,500,000 securities of Trade Marks held by Food Services exchangeable for a total of 2,500,000 Units. As the aggregate number of Units deposited under the Offer exceeded the 2,500,000 Units for which the Offer was made, Units were taken up under the Offer on a pro-rata basis, resulting in 85,627 Units being purchased from Unitholders other than Food Services and 2,414,373 Units being purchased from Food Services.

### b) Exchange of securities

On December 22, 2010, prior to the completion of the Offer, Food Services exchanged 2,414,373 Class A shares of Trade Marks with a book value of \$24,549,000 for \$24,144,000 principal amount of A&W notes. Food Services and Trade Marks recorded the additional A&W notes at a book value of \$24,549,000. Subsequently, Food Services exchanged the \$24,144,000 principal amount of A&W notes and 2,414,373 common shares of Trade Marks (comprising 303,790 non-voting common shares and 2,110,583 voting common shares) for 2,414,373 Units of the Fund. The Fund recorded an increase in its investment in Trade Marks through the acquisition of the new A&W notes at the principal amount of \$24,144,000, and the acquisition of the 2,414,373 common shares at \$10 per share or \$24,144,000. Food Services recorded its investment in Units of the Fund at \$20 per Unit or \$48,288,000, and recognized a gain on the exchange of \$21,552,000, represented by the excess of Food Services' \$48,288,000 investment in the Fund over Food Services' carrying value of the 2,414,373 common shares of Trade Marks of \$2,187,000 and the A&W notes of Trade Marks of \$24,549,000.

### c) Completion of the Offer

The completion of the Offer also took place on December 22, 2010. The Fund's carrying value of the 2,500,000 Units was \$49,080,000, and the excess of the \$50,000,000 cost of acquisition over the carrying value, or \$920,000, was charged to the Fund's accumulated earnings. Food Services recorded its \$48,288,000 proceeds from its sale of 2,414,373 Units of the Fund reducing its investment in the Fund to \$nil.

### d) Recapitalization and new loan

The Fund financed the amount paid for the Units by repayment by Trade Marks of \$50,000,000 of A&W notes of Trade Marks held by the Fund, prior to which the Fund and Trade Marks agreed to amend the A&W notes to allow early repayment. Trade Marks financed the \$50,000,000 repayment of A&W notes by increasing its \$10,000,000 term loan with HSBC Bank Canada to \$60,000,000.

### e) Reorganization

Also on December 22, 2010, subsequent to Food Services' exchange of securities of Trade Marks, and the completion of the Offer, the reorganization (the Reorganization) of the capital structure of Trade Marks took place. The Reorganization was approved by Unitholders of the Fund at the Annual General Meeting held May 4, 2010 and was initiated to minimize the impact of the new SIFT tax on income trusts announced by the federal government in October 2006. The SIFT tax is effective January 1, 2011 and treats an income trust like a corporation, requiring it to pay tax on its taxable income. The Trustees of the Fund examined the alternatives available to maximize Unitholder value in the face of this new tax, and proposed this Reorganization to minimize the impact of the new SIFT tax and maximize amounts available for distribution to Unitholders in light of the SIFT tax.

The following is a summary of the Reorganization:

- i) Trade Marks continued as a company under the British Columbia Business Corporations Act.
- ii) The \$57,543,000 remaining A&W notes held by the Fund were exchanged for 5,754,298 new non-voting common shares with \$10 par value having an aggregate value of \$57,543,000. The excess of Trade Marks' carrying value of the A&W notes of \$57,948,000 over the value of the new non-voting common shares of \$57,543,000, or \$405,000, was credited to Trade Marks' contributed surplus.
- iii) The 3,868,368 voting common shares and 100,185 non-voting common shares of Trade Marks held by Food Services were exchanged for 3,968,553 voting common shares without par value with a value of \$2,652,000.
- iv) The 10,754,373 voting common shares of Trade Marks held by the Fund were exchanged for 10,754,373 voting common shares without par value with a value of \$2,187,000.

**3 Recapitalization and Reorganization (continued)**

- v) The 769,577 Class A preferred shares of Trade Marks held by Food Services were exchanged for 769,577 non-voting common shares without par value with a value of \$7,826,000.
- vi) The 3,198,951 Class B preferred shares of Trade Marks held by Food Services were exchanged for 3,198,951 new non-voting common shares with \$10 par value with a value of \$36,363,000.

**f) Exchange rights**

The common shares of Trade Marks held by Food Services may be exchanged at the option of Food Services into Units of the Fund on the basis of two common shares for one Unit of the Fund, except that Food Services may not exchange non-voting common shares for Units of the Fund if it would result in Food Services having a voting interest in Trade Marks greater than its economic interest. Therefore, after the Offer and Reorganization, Food Services holds, indirectly, the equivalent of 32.5% of the Units of the Fund on a fully diluted basis, on the basis of two common shares being the economic equivalent of one Unit of the Fund. Food Services

will continue to be entitled to additional limited partnership units (LP units) of the Partnership on the annual adjustment of the restaurants in the Royalty Pool. The additional LP units are exchangeable for non-voting common shares of Trade Marks on the basis of one LP unit for two non-voting common shares of Trade Marks.

All of the voting and non-voting common shares held by the Fund and Food Services are entitled to the same dividends per share.

**g) Costs**

The costs of the Offer and the Reorganization were \$775,000 and were expensed in the year by Trade Marks under an administration agreement with the Fund whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund. In addition, financing fees of \$449,000 were incurred by Trade Marks for the additional \$50,000,000 term loan. The financing fees will be amortized over the term of the loan.

**4 Investment in A&W Trade Marks Inc.**

The Fund's investment in Trade Marks is as follows:

	Common shares \$	A&W notes receivable \$	Cumulative equity in earnings (loss) \$	Cumulative dividends \$	Cumulative dilution gain \$	Cumulative equity in OCI \$	Total \$
Balance as at December 31, 2009	1	83,399	(674)	(9,350)	2,383	(175)	75,584
Repayment of A&W notes receivable (note 3(d))	–	(50,000)	–	–	–	–	(50,000)
Acquisition of additional A&W notes receivable and Trade Marks' voting common shares by issuing Fund Units to Food Services (note 3(b))	24,144	24,144	–	–	–	–	48,288
Exchange of A&W notes receivable for non-voting common shares with \$10 par value of Trade Marks ((note 3(e)(ii))	57,543	(57,543)	–	–	–	–	–
Equity in Trade Marks' earnings	–	–	2,463	–	–	–	2,463
Dividends received	–	–	–	(3,523)	–	–	(3,523)
Dilution gain	–	–	–	–	774	–	774
Equity in Trade Marks' other comprehensive income	–	–	–	–	–	340	340
Balance as at December 31, 2010	81,688	–	1,789	(12,873)	3,157	165	73,926

**4 Investment in A&W Trade Marks Inc. (continued)**

The Fund's investment in Trade Marks is recorded using the equity method. Trade Marks, through its 99.9% interest in the Partnership, owns the A&W trade-marks used in the A&W quick service restaurant business in Canada. In return for licensing Food Services to use its trade-marks, Trade Marks (through the Partnership) receives a royalty of 3% of the sales reported to Food Services by A&W restaurants in the Royalty Pool. The Royalty Pool is adjusted annually to include new restaurants, less any restaurants that permanently closed. The consideration for adjustments to the Royalty Pool is paid by the Partnership by increasing the limited partnership interest of Food Services. Food Services' limited partnership interest may be exchanged for non-voting common shares of

Trade Marks which are exchangeable for Units of the Fund on the basis of two common shares for one Unit of the Fund. The Fund's equity interest in Trade Marks is diluted as annual adjustments to the Royalty Pool take place. In accordance with Canadian GAAP, a dilution gain is recognized due to the value ascribed to the common shares issued by Trade Marks to Food Services.

After the completion of the Offer and the Reorganization, the Fund owns 67.5% (2009 - 58.4%) of the common shares of Trade Marks.

The issued and outstanding common shares of Trade Marks are as follows:

	The Fund		Food Services		Total
	Number of shares	%	Number of shares	%	Number of shares
Balance as at					
December 31, 2009	8,340,000	58.4	5,950,018	41.6	14,290,018
January 5, 2010 adjustment to Royalty Pool	–	(1.8)	432,908	1.8	432,908
December 22, 2010 acquisition of additional voting common shares by issuing Fund Units to Food Services (note 3(b))	2,414,373	16.4	(2,414,373)	(16.4)	–
December 22, 2010 exchange of A&W notes for non-voting common shares with \$10 par value (note 3(e)(ii))	5,754,298	7.6	–	(7.6)	5,754,298
December 22, 2010 exchange of Class A shares for non-voting common shares without par value (note 3(e)(v))	–	(2.9)	769,577	2.9	769,577
December 22, 2010 exchange of Class B shares for non-voting common shares with \$10 par value (note 3(e)(vi))	–	(10.2)	3,198,951	10.2	3,198,951
Balance as at					
December 31, 2010	16,508,671	67.5	7,937,081	32.5	24,445,752

## 5 Distributions

During the year ended December 31, 2010, the Fund declared distributions to its Unitholders of \$12,267,000 or \$1.472 per Unit. The record dates and amounts of these distributions are as follows:

	Amount \$	Per Unit \$
Year ended December 31, 2010		
February 15	884	0.106
March 15	884	0.106
April 15	884	0.106
May 15	884	0.106
May 15	834	0.100
June 15	884	0.106
July 15	884	0.106
August 15	884	0.106
September 15	884	0.106
October 15	884	0.106
November 15	884	0.106
November 15	834	0.100
December 15	884	0.106
December 31	875	0.106
	12,267	1.472
Accumulated distributions		
- Beginning of year	79,932	
Accumulated distributions		
- End of year	92,199	

During December 2010, the Fund declared a distribution of \$875,000 (2009 - \$884,000) to Unitholders of record on December 31, 2010, which was paid subsequent to year-end and is reported as a current liability at December 31, 2010.

## 6 Trust Units

The Declaration of Trust provides that an unlimited number of Units may be issued. Each Unit is transferable and represents an equal undivided beneficial interest in any distributions of the Fund and in the net assets of the Fund. All Units have equal rights and privileges. Each Unit entitles the holder thereof to participate equally in allocations and distributions

and to one vote at all meetings of Unitholders for each whole Unit held. The Units issued are not subject to future calls or assessments.

Units are redeemable at any time at the option of the holder at amounts related to market prices at the time, subject to a maximum of \$50,000 in total cash redemptions by the Fund in any one month. The limitation may be waived at the discretion of the Trustees of the Fund. Redemption in excess of these amounts, assuming no waiving of the limitation, shall be paid by way of distribution in specie of a pro rata number of securities of Trade Marks held by the Fund. On February 15, 2002, the Fund issued 8,340,000 Units at \$10 per Unit pursuant to a public underwriting.

### Units outstanding

	Number of Units	Amount \$
Balance as at December 31, 1009	8,340,000	77,115
Units issued in exchange for common shares and A&W notes of Trade Marks (note 3(b))	2,414,373	48,288
Purchase and cancellation of Units (note 3(c))	(2,500,000)	(49,080)
Balance as at December 31, 2010	8,254,373	76,323

## 7 Related party transactions and balances

During the year ended December 31, 2010, interest income of \$8,745,000 (2009 - \$8,965,000) was earned from Trade Marks on the A&W notes receivable, of which \$nil (2009 - \$761,000) is receivable at December 31, 2010. During the year ended December 31, 2010, the Fund became entitled to \$3,523,000 (2009 - \$3,311,000) of dividends from Trade Marks, of which \$nil (2009 - \$nil) is receivable at December 31, 2010.

The Fund has entered into an administration agreement with Trade Marks whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund.

Included in current liabilities is \$36,000 (2009 - \$36,000) due to Trade Marks without interest and on demand.

Other related party transactions and balances are referred to elsewhere in these notes.

## 8 Financial instruments and financial risk management

The Fund's financial instruments consist of cash and cash equivalents, distribution payable to Unitholders, and amounts due to Trade Marks.

The Fund classifies its financial instruments as follows:

- cash and cash equivalents as loans and receivables, which are initially measured at fair value and subsequently at amortized cost.
- distribution payable to Unitholders and amounts due to Trade Marks as other financial liabilities, which are measured at amortized cost.

The Fund's Trustees have oversight responsibilities for risk management policies. The Board of Directors of Trade Marks and the Fund's Trustees closely monitor the cash position and internal controls related to Trade Marks, along with the level of distributions of the Fund. The Fund, through dividends from Trade Marks, is expected to have sufficient financial resources to pay future distributions.

### Fair values

Management estimates that the fair values of the Fund's financial instruments approximate their carrying values due to the short-term maturities of these instruments.

### Credit risk

The Fund is exposed to credit risk arising from the concentration of the amounts due from Trade Marks. Trade Marks is the Fund's primary source of cash to fund distributions to Unitholders. Trade Marks is dependent on the royalty of 3% of sales reported to Food Services by A&W restaurants in the Royalty Pool as its main source of revenue.

### Liquidity risk

Monthly cash distributions to Unitholders are the primary source of liquidity risk pertaining to the Fund. This risk is assessed as low due to the stable nature of income the Fund receives from the investment in Trade Marks and the Trustees' ability to reduce future distributions if necessary. Additionally,

the Fund manages liquidity risk by actively monitoring forecast and actual cash flows.

### Interest rate risk

The Fund is not exposed to interest rate risk as all of the Fund's financial instruments are non-interest bearing, except for cash and cash equivalents which earn interest at market rates.

## 9 Capital disclosures

The Fund's capital consists of Unitholders' equity. The Fund's capital management objective is to have sufficient cash to pay distributions to its Unitholders. The Fund manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Fund may adjust the amount of distributions paid to its Unitholders.

## 10 Subsequent events

On January 5, 2011, the number of A&W restaurants in the Royalty Pool was increased by 20 new restaurants less five restaurants that permanently closed during 2010. The initial consideration for the estimated royalty revenue from the net 15 restaurants added to the Royalty Pool is \$6,859,000. The Partnership paid Food Services \$5,487,000, by issuance of 278,818 LP units, representing 80% of the initial consideration. The LP units were exchanged for 557,636 non-voting common shares without par value of Trade Marks. The remaining 20% and a final adjustment to the consideration based on the actual annual sales reported by the new restaurants will be paid in December 2011 by issuance of additional LP units, which may be exchanged for shares of Trade Marks. This transaction will result in the Fund recognizing a dilution gain on its investment in Trade Marks in the first quarter of 2011.

On February 2, 2011, the Fund declared a distribution to Unitholders of \$0.117 per Unit or \$966,000, payable on February 28, 2011 to Unitholders of record as at February 15, 2011.

## Financial Statements

### Management's Responsibilities

The accompanying consolidated financial statements are the responsibility of management and have been reviewed and approved by the Board of Directors. The financial statements have been prepared by management, in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect management's best estimates and judgements. Management has also prepared financial and all other information in the Annual Report and has ensured that this information is consistent with the financial statements. The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting.

The company maintains appropriate systems of internal control, policies and procedures which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of financial statements for external purposes in accordance with Canadian generally accepted accounting principles.

The financial statements have been independently audited by PricewaterhouseCoopers LLP, in accordance with Canadian generally accepted auditing standards. Their report, which follows, expresses their opinion on the financial statements of the company.



**Paul F.B. Hollands**  
Chief Executive Officer  
A&W Trade Marks Inc.



**Donald T. Leslie**  
Chief Financial Officer  
A&W Trade Marks Inc.

# Financial Statements

## Independent Auditor's Report

### To the Shareholders of A&W Trade Marks Inc.

We have audited the accompanying consolidated financial statements of A&W Trade Marks Inc. and its subsidiary, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of earnings and deficit, comprehensive earnings and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

### Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including

the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of A&W Trade Marks Inc. and its subsidiary as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*  
Chartered Accountants  
February 8, 2011


# Consolidated Balance Sheets

(in thousands of dollars)

	As at December 31, 2010 \$	As at December 31, 2009 \$
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	1,094	3,039
Accounts receivable (note 9)	1,756	2,028
Prepaid interest	500	–
Income taxes receivable	–	56
	3,350	5,123
<b>Intangible assets</b> (note 3)	167,484	160,343
<b>Interest rate swap</b> (note 4)	299	–
	171,133	165,466
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	390	894
Dividends payable	–	533
Future income taxes (note 5)	3,001	1,523
	3,391	2,950
<b>Term loan</b> (note 4)	59,553	9,990
<b>Interest rate swap</b> (note 4)	–	370
<b>Future income taxes</b> (note 5)	15,557	13,825
<b>A&amp;W notes payable</b> (note 6)	–	83,399
<b>Class A and B preferred shares</b> (note 7)	–	63,835
	78,501	174,369
<b>SHAREHOLDERS' EQUITY</b>		
Common shares (note 8)	106,572	3,553
Contributed surplus (note 2)	405	–
Deficit	(14,590)	(12,156)
Accumulated other comprehensive earnings (loss)	245	(300)
	92,632	(8,903)
	171,133	165,466

**Subsequent events** (note 13)

Approved by the Board of Directors

  
John R. McLernon, Director

  
Conrad A. Pinette, Director

See accompanying notes to the financial statements

# Consolidated Statements of Earnings and Deficit

(in thousands of dollars)

	Year ended December 31, 2010 \$	Year ended December 31, 2009 \$
<b>Gross sales reported by A&amp;W restaurants in the Royalty Pool</b>	776,701	736,209
<b>Royalty income</b>	23,301	22,086
<b>Expenses</b>		
General and administrative	601	647
Recapitalization and reorganization costs (note 2)	775	–
Interest expense		
Term loan and other (note 12)	670	570
Amortization of deferred financing fees	12	9
A&W notes payable	8,745	8,965
Class A and Class B preferred share dividends	6,692	6,396
	17,495	16,587
<b>Earnings before income taxes and non-controlling interest</b>	5,806	5,499
<b>Provision for (recovery of) income taxes (note 5)</b>		
Current	–	(43)
Future	2,135	1,514
	2,135	1,471
<b>Earnings before non-controlling interest</b>	3,671	4,028
<b>A&amp;W Food Services of Canada Inc.'s non-controlling interest in earnings of A&amp;W Trade Marks Limited Partnership</b>	(23)	(21)
<b>Net earnings for the year</b>	3,648	4,007
<b>Deficit - Beginning of year</b>	(12,156)	(10,447)
<b>Adjustment on entering A&amp;W Trade Marks Limited Partnership</b>	–	(43)
<b>Dividends declared</b>	(6,082)	(5,673)
<b>Deficit - End of year</b>	(14,590)	(12,156)

See accompanying notes to the financial statements

## Consolidated Statements of Comprehensive Earnings

(in thousands of dollars)

	Year ended December 31, 2010 \$	Year ended December 31, 2009 \$
<b>Net earnings for the year</b>	3,648	4,007
Other comprehensive income		
Change in fair value of the interest rate swap - net of income taxes	545	266
<b>Comprehensive earnings for the year</b>	4,193	4,273
<b>Accumulated other comprehensive loss - Beginning of year</b>	(300)	(566)
Other comprehensive income		
Change in fair value of the interest rate swap - net of income taxes	545	266
<b>Accumulated other comprehensive earnings (loss) - End of year</b>	245	(300)

See accompanying notes to the financial statements

# Consolidated Statements of Cash Flows

(in thousands of dollars)

	Year ended December 31, 2010 \$	Year ended December 31, 2009 \$
<b>Cash flows from operating activities</b>		
Net earnings for the year	3,648	4,007
Items not affecting cash		
Amortization of deferred financing fees	12	9
Provision for future income taxes	2,135	1,514
A&W Food Services of Canada Inc.'s non-controlling interest in earnings of A&W Trade Marks Limited Partnership	23	21
	5,818	5,551
Changes in non-cash working capital	(1,209)	(182)
	4,609	5,369
<b>Cash flows from financing activities</b>		
Financing fees paid	(449)	–
Repayment of A&W notes <sup>(note 2)</sup>	(50,000)	–
New loan <sup>(note 2)</sup>	50,000	–
Dividends paid on common shares	(6,082)	(5,673)
Intercompany advance	–	(43)
Partnership distribution paid to A&W Food Services of Canada Inc.	(23)	(19)
	(6,554)	(5,735)
<b>Decrease in cash and cash equivalents</b>	(1,945)	(366)
<b>Cash and cash equivalents - Beginning of year</b>	3,039	3,405
<b>Cash and cash equivalents - End of year</b>	1,094	3,039
<b>Supplementary cash flow information</b>		
Interest paid on term loan and A&W notes payable	(10,698)	(9,479)
Dividends paid on Class A and Class B preferred shares	(7,225)	(6,366)
Taxes recovered (paid)	56	(56)
<b>Non-cash financing activities</b>		
Issuance of preferred and common shares <sup>(note 3)</sup>	6,190	3,782

See accompanying notes to the financial statements

# Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(figures in tables are expressed in thousands of dollars)

## 1 Nature of operations and significant accounting policies

### *Nature of operations*

In 2002, A&W Trade Marks Inc. (Trade Marks or the company) acquired the A&W trade-marks used in the A&W quick service restaurant business in Canada from A&W Food Services of Canada Inc. (Food Services). Concurrently, Trade Marks granted Food Services a licence to use the A&W trade-marks in Canada for a term of 99 years, in exchange for a royalty of 3% of sales reported to Food Services by A&W restaurants in the Royalty Pool (the Licence and Royalty Agreement). Food Services is a leading franchisor of hamburger quick service restaurants in Canada.

On January 21, 2009, Trade Marks and Food Services formed a limited partnership, the A&W Trade Marks Limited Partnership (the Partnership), in which Trade Marks is the general partner with a 99.9% interest and Food Services is the limited partner with a 0.1% interest. Trade Marks transferred the A&W trade-marks to the Partnership in exchange for the general partnership interest held by Trade Marks. The existing Licence and Royalty Agreement between Trade Marks and Food Services was assumed by the Partnership with the result that the royalty paid by Food Services for the use of the A&W trade-marks is paid to the Partnership. The consideration paid by the Partnership for the annual adjustment to the Royalty Pool is in the form of an increase in the limited partnership interest of Food Services. Food Services' limited partnership interest may be exchanged for additional common shares of Trade Marks. These shares are exchangeable for Units of the A&W Revenue Royalties Income Fund (the Fund).

The common shares of Trade Marks are owned by the Fund (67.5%) and Food Services (32.5%) (note 8).

### *Basis of presentation*

Trade Marks prepares its financial statements in accordance with Canadian generally accepted accounting principles (GAAP).

### *Basis of consolidation*

The Fund, Trade Marks, Food Services and the Partnership have adopted the Canadian Institute of Chartered Accountants (CICA) Accounting Guideline 15, "Consolidation of Variable Interest Entities" (AcG-15).

AcG-15 expands upon accounting guidance in CICA Handbook Section 1590 that addresses when an enterprise should consolidate another entity in its financial statements. Under CICA 1590, an enterprise generally consolidates another

entity when it controls the entity through a majority voting interest. AcG-15 clarifies this guidance when the entity being consolidated is a "Variable Interest Entity" (VIE), which is defined to be an entity that, by design, does not have sufficient equity at risk to finance its activities without additional subordinated financial support. If the entity being consolidated is a VIE, under AcG-15 the "primary beneficiary" of that entity should consolidate the VIE and not necessarily the shareholder with the majority voting interest.

The Fund and Food Services have determined that Trade Marks is a VIE and that Food Services is the primary beneficiary of Trade Marks. As a result, the Fund does not consolidate Trade Marks, but instead accounts for its investment in Trade Marks using the equity method. Food Services' consolidated financial statements include the accounts of Trade Marks and the Partnership. These consolidated financial statements of Trade Marks include Trade Marks' 99.9% interest in the Partnership and are presented for information purposes to the Unitholders of the Fund.

### *Revenue recognition*

Revenue comprises royalty income equal to 3% of reported sales from specific A&W restaurants in Canada (the Royalty Pool) and is recognized on an accrual basis.

### *Future accounting changes*

In January 2009, the CICA issued Handbook Section 1582, "Business Combinations", which replaces Handbook Section 1581, "Business Combinations". The CICA also issued Handbook Section 1601, "Consolidated Financial Statements", and Handbook Section 1602, "Non-controlling Interests", which replace Handbook Section 1600, "Consolidated Financial Statements". These new sections are based on the International Accounting Standards Board's (IASB) International Financial Reporting Standards (IFRS) 3R, "Business Combinations". The new standards replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and US accounting standards. The new standards are to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards will not be adjusted upon application of these new standards. The non-controlling interests standard should be applied retrospectively except for certain items. The adoption of these new standards is not expected to have an impact on Trade Marks' financial results.

## 1 Nature of operations and significant accounting policies (continued)

### *Intangible assets*

Intangible assets, which have an indefinite life, comprise the A&W trade-marks. The company assesses the carrying value of long-lived assets for recoverability whenever events or changes in circumstances indicate that the carrying value may not be recoverable from future undiscounted cash flows. If the carrying amount exceeds the fair value of the intangible asset, an impairment loss is recognized equal to that excess through the consolidated statements of earnings.

### *Term loan*

The term loan is initially recognized at fair value, net of transaction costs incurred. The term loan is subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the statements of earnings over the term of the loan using the effective interest method.

### *Income taxes*

Income taxes are calculated using the asset and liability method of tax accounting. Under this method, future income tax assets and liabilities are recognized for temporary differences between the tax basis of an asset or liability and its carrying amount on the balance sheet. Future income tax assets and liabilities are calculated using the substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Future income tax assets and liabilities are adjusted for the effect of changes in tax laws and rates on the date of enactment or substantive enactment.

### *Cash and cash equivalents*

Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments with a maturity of three months or less.

### *Hedging instruments*

The company uses interest rate swap agreements to manage risks from fluctuations in interest rates. All such instruments are used only for risk management purposes. These agreements are considered to be cash flow hedges; as a result, changes in the fair value, to the extent they are effective, are recorded in other comprehensive income (loss) and are only recognized in earnings when the hedged item is realized. Any ineffectiveness in the hedging relationship is recognized in earnings immediately.

### *Use of estimates*

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates include the intangible assets, the interest rate swap, future income taxes, and accrued royalty income.

## 2 Recapitalization and Reorganization

### a) A&W Revenue Royalties Income Fund's offer to purchase Units

On November 10, 2010, the Fund announced its intention to make a substantial issuer bid (the Offer) to purchase for cancellation 2,500,000 of its Units at a price of \$20 per Unit. A total of 2,588,663 Units were deposited under the Offer, including 2,500,000 securities of Trade Marks held by Food Services exchangeable for a total of 2,500,000 Units. As the aggregate number of Units deposited under the Offer exceeded the 2,500,000 Units for which the Offer was made, Units were taken up under the Offer on a pro-rata basis, resulting in 85,627 Units being purchased from Unitholders other than Food Services and 2,414,373 Units being purchased from Food Services.

### b) Exchange of securities

On December 22, 2010, prior to the completion of the Offer, Food Services exchanged 2,414,373 Class A shares of Trade Marks with a book value of \$24,549,000, for \$24,144,000 principal amount of A&W notes. Food Services and Trade Marks recorded the additional A&W notes at a book value of \$24,549,000. Subsequently, Food Services exchanged the \$24,144,000 principal amount of A&W notes and 2,414,373 common shares of Trade Marks (comprising 303,790 non-voting common shares and 2,110,583 voting common shares) for 2,414,373 Units of the Fund. The Fund recorded the acquisition of the new A&W notes at the principal amount of \$24,144,000, and recorded the acquisition of the 2,414,373 common shares at \$10 per share or \$24,144,000. Food Services recorded its investment in Units of the Fund at \$20 per Unit or \$48,288,000, and recognized a gain on the exchange of \$21,552,000, represented by the excess of the \$48,288,000 investment in the Fund over Food Services' carrying value of the 2,414,373 common shares of \$2,187,000 and the A&W notes of \$24,549,000.

### c) Completion of the Offer

The completion of the Offer also took place on December 22, 2010. The Fund's carrying value of the 2,500,000 Units was \$49,080,000, and the excess of the \$50,000,000 cost of acquisition over the carrying value, or \$920,000, was charged to the Fund's accumulated earnings. Food Services recorded its \$48,288,000 proceeds from its sale of 2,414,373 Units of the Fund reducing its investment in the Fund to \$nil.

### d) Recapitalization and new loan

The Fund financed the amount paid for the Units by repayment by Trade Marks of \$50,000,000 of A&W notes of Trade Marks held by the Fund, prior to which the Fund and Trade Marks agreed to amend the A&W notes to allow early repayment. Trade Marks financed the \$50,000,000 repayment of A&W notes by increasing its \$10,000,000 term loan with HSBC Bank Canada to \$60,000,000 (note 4).

## 2 Recapitalization and Reorganization (continued)

### e) Reorganization

Also on December 22, 2010, subsequent to Food Services' exchange of securities of Trade Marks, and the completion of the Offer, the reorganization (the Reorganization) of the capital structure of Trade Marks took place. The Reorganization was approved by Unitholders of the Fund at the Annual General Meeting held May 4, 2010 and was initiated to minimize the impact of the new Specified Investment Flow Through (SIFT) tax on income trusts announced by the federal government in October 2006. The SIFT tax is effective January 1, 2011 and treats an income trust like a corporation, requiring it to pay tax on its taxable income. The Trustees of the Fund examined the alternatives available to maximize Unitholder value in the face of this new tax, and proposed this Reorganization to minimize the impact of the new SIFT tax and maximize amounts available for distribution to Unitholders in light of the SIFT tax.

The following is a summary of the Reorganization:

- i) Trade Marks continued as a company under the British Columbia Business Corporations Act.
- ii) The \$57,543,000 remaining A&W notes held by the Fund were exchanged for 5,754,298 new non voting common shares with \$10 par value having an aggregate value of \$57,543,000. The excess of Trade Marks' carrying value of the A&W notes of \$57,948,000 over the value of the new non-voting common shares of \$57,543,000, or \$405,000, was credited to Trade Marks' contributed surplus.
- iii) The 3,868,368 voting common shares and 100,185 non-voting common shares of Trade Marks held by Food Services were exchanged for 3,968,553 voting common shares without par value with a value of \$2,652,000.
- iv) The 10,754,373 voting common shares of Trade Marks held by the Fund were exchanged for 10,754,373 voting common shares without par value with a value of \$2,187,000.
- v) The 769,577 Class A preferred shares of Trade Marks held by Food Services were exchanged for 769,577 non-voting common shares without par value with a value of \$7,826,000.
- vi) The 3,198,951 Class B preferred shares of Trade Marks held by Food Services were exchanged for 3,198,951 new non-voting common shares with \$10 par value with a value of \$36,363,000.

### f) Exchange rights

The common shares of Trade Marks held by Food Services may be exchanged at the option of Food Services into Units of the Fund on the basis of two common shares for one Unit of the Fund, except that Food Services may not exchange non-voting common shares for Units of the Fund if it would result in Food Services having a voting interest in Trade Marks greater than its economic interest. Therefore, after the Offer and Reorganization, Food Services holds, indirectly, the equivalent of 32.5% of the Units of the Fund on a fully diluted basis, on the basis of two common shares being the economic equivalent of one Unit of the Fund. Food Services will continue to be entitled to additional limited partnership units (LP units) of the Partnership on the annual adjustment of the restaurants in the Royalty Pool. The additional LP units are exchangeable for non-voting common shares of Trade Marks on the basis of one LP unit for two non voting common shares of Trade Marks.

All of the voting and non-voting common shares held by the Fund and Food Services are entitled to the same dividends per share.

### g) Costs

The costs of the Offer and the Reorganization were \$775,000 and were expensed during the year by Trade Marks under an administration agreement with the Fund whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund. In addition, financing fees of \$449,000 were incurred by Trade Marks for the additional \$50,000,000 term loan. The financing fees will be amortized over the term of the loan.

## 3 Intangible assets

In 2002, Trade Marks acquired the A&W trade-marks used in the A&W quick service restaurant business in Canada for \$152,676,000, of which \$84,876,000 was paid in cash, and \$27,800,000 was paid by the issuance of 2,779,975 Class A preferred shares and 2,780,000 voting common shares of Trade Marks. The balance of the purchase price of \$40,000,000 was paid in full by all amounts Trade Marks paid Food Services in respect of annual adjustments to the Royalty Pool up to January 5, 2010.

On January 21, 2009, the A&W trade-marks owned by Trade Marks were transferred to the Partnership in exchange for the general partnership interest held by Trade Marks.

The Royalty Pool is adjusted annually to reflect sales from new A&W restaurants, net of the sales of any A&W restaurants that have permanently closed. Food Services is paid for the

**3 Intangible assets** (continued)

additional royalty stream related to the sales of the net new restaurants, based on a formula set out in the 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 Fund.

	New restaurants	Closed restaurants	Royalty Pool	Share consideration			Amount \$
				Common shares	Class A shares	Class B shares	
Initial consideration							
Cash	585	–	585	–	–	–	84,876
Shares	–	–	–	2,780,000	2,779,975	–	27,800
Future income taxes	–	–	–	–	–	–	8,080
	585	–	585	2,780,000	2,779,975	–	120,756
Adjustments							
January 5, 2003	27	(8)	19	452,469	–	452,469	5,108
January 5, 2004	28	(12)	16	495,681	–	495,681	5,210
January 5, 2005	27	(9)	18	511,337	–	511,337	6,197
January 5, 2006	27	(11)	16	558,993	–	558,993	6,915
December 31, 2006	19	(13)	6	335,456	–	335,456	5,908
January 5, 2008	23	(7)	16	484,051	–	484,051	6,467
January 5, 2009	17	(8)	9	332,031	–	332,031	3,782
January 5, 2010	23	(8)	15	432,908	403,975	28,933	6,190
Future income taxes	–	–	–	–	–	–	951
	776	(76)	700	6,382,926	3,183,950	3,198,951	167,484

The issuance of the shares subsequent to the acquisition is recorded as an additional cost of the A&W trade marks.

The eighth adjustment to the Royalty Pool took place on January 5, 2010. The number of A&W restaurants in the Royalty Pool was increased by 23 new restaurants less eight restaurants which permanently closed during 2009. The Partnership paid Food Services \$4,758,000 by issuance of 332,723 LP units to Food Services, representing 80% of the initial consideration based on the estimated annual sales of the net new restaurants. The LP units were exchanged for 28,933 Class B preferred shares valued at \$328,000, 28,933 voting common shares valued at \$86,000, 303,790 Class A preferred shares valued at \$3,441,000 and 303,790 non-voting common shares valued at \$903,000.

The final adjustment to the number of LP units issued was made on December 15, 2010 based upon the actual annual sales reported by the new restaurants. The actual annual sales of the 23 new restaurants were \$25,781,000 compared to the original estimate of \$24,879,000. As a result, the remaining 20% of the initial consideration or \$1,189,000 and additional consideration of \$243,000 was paid to Food Services by issuance of 100,185 additional LP units which were exchanged for 100,185 Class A preferred shares valued at \$1,134,000 and 100,185 non-voting common shares valued at \$298,000.

**4 Term loan and operating loan facility**

Trade Marks has a \$2,000,000 demand operating loan facility with HSBC Bank Canada (the Bank) 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 December 31, 2010, the full amount of the facility was available.

On December 22, 2010, Trade Marks increased its existing \$10,000,000 term loan with the Bank to \$60,000,000 to finance repayment of \$50,000,000 of A&W notes. The new term loan is repayable on December 22, 2015 and bears interest at bank prime rate plus 1%. Interest only is payable monthly, providing that the company's earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA), tested quarterly on a trailing four quarters basis, in arrears, is not less than specified amounts. In the event that EBITDA is less than these specified amounts, the term loan will be fully amortized over the greater of three years and the remaining term and repayment will be by way of blended monthly instalments of principal and interest. The new loan contains a number of covenants including the requirement to meet certain EBITDA levels and debt to EBITDA ratios during each trailing four quarter period. Trade Marks was in compliance with all of its financial covenants as at December 31, 2010.

**4 Term loan and operating loan facility** (continued)

Trade Marks uses an interest rate swap agreement to manage risks from fluctuations in interest rates. The interest rate swap on the \$10,000,000 term loan was terminated effective December 22, 2010 and Trade Marks entered into a new swap on the new \$60,000,000 term loan on the same day. As a result, the term loan bears interest at 5.03% per annum, of which 2.53% per annum is fixed under an interest rate swap maturing December 22, 2015 and 2.50% per annum is subject to annual review by the Bank. The fair value of the interest rate swap as at December 31, 2010 is \$299,000 favourable (2009 - \$370,000 unfavourable) and the change in fair value is recorded in other comprehensive income, net of income taxes.

A general security agreement over the assets of Trade Marks has been provided as collateral for the demand operating loan facility and term loan. The Partnership has provided its guarantee in favour of the Bank of all the indebtedness, covenants and obligations of Trade Marks to the Bank.

The term loan comprises:

	2010 \$	2009 \$
Term loan	60,000	10,000
Deferred financing fees	(447)	(10)
	<u>59,553</u>	<u>9,990</u>

See note 12.

**5 Income taxes**

a) The provision for income taxes shown in the statements of earnings differs from the amount obtained by applying statutory tax rates to the earnings before income taxes for the following reasons:

	2010	2009
Statutory combined federal and provincial income tax rates on investment income	16.6%	19.0%
	\$	\$
Provision for income taxes based on statutory income tax rates	964	1,045
Class A and Class B preferred share dividends not deductible	1,238	1,215
Rate changes on future income taxes	(67)	(789)
Provision for income taxes	<u>2,135</u>	<u>1,471</u>

b) Future income taxes comprise the following:

	2010 \$	2009 \$
Current assets		
Non-capital losses	280	1,741
Current liabilities		
Investment in A&W Trade Marks Limited Partnership	(3,281)	(3,264)
	<u>(3,001)</u>	<u>(1,523)</u>
Long-term assets		
Fair value of interest rate swap	(53)	70
Long-term liabilities		
Intangible assets	(15,504)	(13,895)
	<u>(15,557)</u>	<u>(13,825)</u>

c) At December 31, 2010, the company has \$1,557,000 (2009 - \$9,162,000) of non-capital losses available to carry forward. These losses expire in 2030.

**6 A&W notes payable**

A&W notes in the amount of \$83,399,000 were held by the Fund and bore interest at a fixed rate of 10.75% per annum. Interest only was payable monthly in arrears. The A&W notes were extinguished December 22, 2010 as a result of the recapitalization and Reorganization (note 2).

	\$
Balance as at December 31, 2009	83,399,000
Repayment	(50,000,000)
Exchange of Class A shares for A&W notes (note 2(b))	24,549,000
Exchange of A&W notes for non-voting common shares with \$10 par value (note 2(e)(ii))	(57,948,000)
Balance as at December 31, 2010	<u>–</u>

**7 Class A and Class B preferred shares**

As a result of the recapitalization and Reorganization (note 2), there are no Class A or Class B shares outstanding as at December 31, 2010.

## 7 Class A and Class B preferred shares (continued)

	Class A shares		Class B shares		Total	
	Number of shares	Amount \$	Number of shares	Amount \$	Number of shares	Amount \$
Balance as at December 31, 2009	2,779,975	27,800	3,170,018	36,035	5,949,993	63,835
January 5, 2010 adjustment to Royalty Pool (note 3)	403,975	4,575	28,933	328	432,908	4,903
December 22, 2010 exchange of Class A shares for A&W notes (note 2(b))	(2,414,373)	(24,549)	–	–	(2,414,373)	(24,549)
December 22, 2010 exchange of Class A shares for non-voting common shares without par value (note 2(e)(v))	(769,577)	(7,826)	–	–	(769,577)	(7,826)
December 22, 2010 exchange of Class B shares for non-voting common shares with \$10 par value (note 2(e)(vi))	–	–	(3,198,951)	(36,363)	(3,198,951)	(36,363)
Balance as at December 31, 2010	–	–	–	–	–	–

The Class A and Class B shares entitled Food Services to a fixed cumulative preferential cash dividend at a rate of \$1.075 per share per annum and could be redeemed at the option of Food Services into A&W notes of Trade Marks on the basis of \$10 principal amount of A&W notes for one Class A or Class B share, and, in turn, one voting common share of Trade Marks and a \$10 A&W note was exchangeable for a Unit in the Fund. Accordingly, the Class A and Class B shares were classified as

liabilities of Trade Marks and the cumulative dividends prior to conversion of the shares under the Reorganization were classified as interest expense in the statements of earnings.

During the year, Trade Marks declared and paid dividends on Class A and Class B preferred shares of \$6,692,000 or \$1.048 per share (2009 - \$6,396,000 or \$1.075 per share).

## 8 Common shares

### Authorized

- Unlimited number of voting common shares
- Unlimited number of non-voting common shares without par value
- Unlimited number of non-voting common shares with \$10 par value

### Issued

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

	The Fund			Food Services			Total	
	Number of shares	Amount \$	%	Number of shares	Amount \$	%	Number of Shares	Amount \$
Balance as at December 31, 2009	8,340,000	1	58.4	5,950,018	3,552	41.6	14,290,018	3,553
January 5, 2010 adjustment to Royalty Pool (note 3)	–	–	(1.8)	432,908	1,287	1.8	432,908	1,287
December 22, 2010 exchange of Class A shares for A&W notes, and A&W notes and common shares for units of Fund (note 2(b))	2,414,373	2,187	16.4	(2,414,373)	(2,187)	(16.4)	–	–
December 22, 2010 exchange of A&W notes for non-voting common shares with \$10 par value (note 2(e) (ii))	5,754,298	57,543	7.6	–	–	(7.6)	5,754,298	57,543
December 22, 2010 exchange of Class A shares for non-voting common shares without par value (note 2(e)(v))	–	–	(2.9)	769,577	7,826	2.9	769,577	7,826
December 22, 2010 exchange of Class B shares for new non-voting common shares with \$10 par value (note 2(e)(vi))	–	–	(10.2)	3,198,951	36,363	10.2	3,198,951	36,363
Balance as at December 31, 2010	16,508,671	59,731	67.5	7,937,081	46,841	32.5	24,445,752	106,572

During the year, Trade Marks declared dividends on its common shares of \$6,082,000 (2009 - \$5,673,000), of which \$3,523,000 was paid to the Fund and \$2,559,000 was paid to Food Services. Additional compensation of \$38,000 was paid to Food Services representing the dividends that Food

Services would have received on the 100,185 non-voting common shares issued to Food Services on December 15, 2010 in relation to the adjustment to the January 5, 2010 Royalty Pool amendment (note 3), had they been issued on January 5, 2010.

## 9 Related party transactions and balances

During the year ended December 31, 2010, royalty income of \$23,301,000 (2009 - \$22,086,000) was earned from Food Services, of which \$1,720,000 (2009 - \$1,992,000) is receivable at December 31, 2010.

Trade Marks has entered into an administration agreement with the Fund whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund. In turn, Trade Marks has arranged for certain of these services to be provided by Food Services at no cost.

Interest expense on the A&W notes for the year ended December 31, 2010 was \$8,745,000 (2009 - \$8,965,000), of which \$nil (2009 - \$761,000) is payable to the Fund at December 31, 2010.

Included in accounts receivable is \$36,000 (2009 - \$36,000) due from the Fund without interest and on demand.

Other related party transactions and balances are referred to elsewhere in these notes.

## 10 Financial instruments and financial risk management

Trade Marks' financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, dividends payable, the term loan, and interest rate swap.

Trade Marks classifies its financial instruments as follows:

- cash and cash equivalents and accounts receivable as loans and receivables, which are initially measured at fair value and subsequently at amortized cost.
- accounts payable and accrued liabilities, dividends payable and term loan as other financial liabilities, which are measured at amortized costs.
- interest rate swap as available-for-sale.

### Fair values

Management estimates that the fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and dividends payable approximate their carrying values given the short term to maturity of these instruments. The fair value of the term loan approximates its carrying value due to the floating interest rate. The fair value of the interest rate swap is \$299,000 favourable (2009 - \$370,000 unfavourable).

### Credit risk

The company's exposure to credit risk is as indicated by the carrying amount of its accounts receivable. The majority of accounts receivable relates to royalties due from Food Services.

### Liquidity risk

The primary sources of liquidity risk are the monthly payments of dividends to the Fund and Food Services. The company's primary source of funds to pay dividends is the 3% royalty income it receives from Food Services. Additionally, Trade

Marks manages liquidity risk by actively monitoring forecast and actual cash flows.

### Interest rate risk

The term loan bears a floating rate of interest as disclosed in note 4. The company has used an interest rate swap to fix the rate of interest on the term loan. Cash and cash equivalents earn interest at market rates. All of the company's other financial instruments are non-interest bearing.

## 11 Capital disclosures

Trade Marks' capital consists of shareholders' equity and the term loan. Trade Marks' capital management objectives are to have sufficient cash and cash equivalents to pay dividends on its common shares to its shareholders, after satisfaction of its debt service and income tax obligations; provisions for administration expenses of Trade Marks and the Fund; and retention of reasonable working capital reserves. Trade Marks manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, Trade Marks may adjust the amount of dividends paid to shareholders.

## 12 Term loan and other interest

	2010 \$	2009 \$
Interest expense	695	581
Interest income	(25)	(11)
	670	570

## 13 Subsequent events

On January 5, 2011, the number of A&W restaurants in the Royalty Pool was increased by 20 new restaurants less five restaurants that permanently closed during 2010. The initial consideration for the estimated royalty revenue from the net 15 restaurants added to the Royalty Pool is \$6,859,000. The Partnership paid Food Services \$5,487,000, by issuance of 278,818 LP units, representing 80% of the initial consideration. The LP units were exchanged for 557,636 non-voting common shares without par value of Trade Marks. The remaining 20% and a final adjustment to the consideration based on the actual annual sales reported by the new restaurants will be paid in December 2011 by issuance of additional LP units, which may be exchanged for shares of Trade Marks.

On February 2, 2011, Trade Marks declared dividends on its voting and non-voting common shares of \$1,463,000 payable on February 28, 2011.

## Unitholder Information

### Corporate Head Office

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### Mailing Address

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### A&W Revenue Royalties Income Fund Board of Trustees

John R. McLernon<sup>(1)</sup>  
Conrad A. Pinette<sup>(1)</sup>  
Carl P. Vanderspek<sup>(1)</sup>

### A&W Trade Marks Inc. Board of Directors

John R. McLernon<sup>(2)</sup> Chairman  
Conrad A. Pinette<sup>(2)</sup> Secretary -Treasurer  
Carl P. Vanderspek<sup>(2)</sup>  
Jefferson J. Mooney  
David A. Mindell

### Committees of the Board

<sup>(1)</sup> Audit Committee and  
<sup>(2)</sup> Governance Committee

### Registrar and Transfer Agent

Computershare Investor Services Inc.

### Auditors

PricewaterhouseCoopers LLP

### Market Information

Units Listed:  
Toronto Stock Exchange  
Symbol: AW.UN

### Investor Enquiries

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## A&W Revenue Royalties Income Fund

### Board of Trustees

**John R. McLernon** is President of McLernon Consultants Ltd., a private consulting company. He is Honorary Chairman and Co-Founder of the Colliers Macaulay Nicolls Group of Companies, of which he was Chief Executive Officer and Chairman for 25 years. He is also Chairman of Village Farms International Inc., a public entity, as well as a director of British Columbia Lottery Corporation, Canadian Urban Limited and Mission Hill Family Estate.

**Conrad A. Pinette** is President of Condor Holdings Ltd., a private investment company. Mr. Pinette attended the University of British Columbia where he specialized in forestry. He was owner, manager and President of a family lumber business until its sale in 1980, President and Chief Operating Officer of Lignum Limited, a private forest product company until its sale in 2004, the Executive Vice President of Riverside Forest Products Limited, one of British Columbia's largest forest products companies, until its sale in 2005 and Executive Vice President of Tolko Industries, a large private forest products company, until his retirement at the end of 2006. As Chairman of Pinetree Developments Ltd., he continues to be responsible for another established family business. He is a director of Northgate Minerals Corporation and Canfor Corporation, both public companies. He is a member of the Vancouver General Hospital and UBC Prostate Advisory Board and Cariboo Foundation Board, both community support organizations. He was an active member of the Young Presidents' Organization and is now a member of the World Presidents' Organization.

**Carl P. Vanderspek** is founder, sole shareholder, Chairman and Chief Executive Officer of Lions Gate Industries Inc., the company that owns Lions Gate Trailers Ltd. which is involved with the rental, leasing, repairs and sales of semi trailers across Canada. Mr. Vanderspek received a Bachelor of Commerce degree from the University of British Columbia. He is a Chartered Accountant and has been a member of the Institute of Chartered Accountants of British Columbia for 45 years. Mr. Vanderspek is past Chairman of the B.C. Chapter of the Young Presidents' Organization and the current Treasurer of the B.C. Chapter of the World Presidents' Organization.



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# A&W Food Services of Canada Inc.

Consolidated Financial Statements

January 2, 2011  
and January 3, 2010

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

# Report to Unitholders of A&W Revenue Royalties Income Fund

January 4, 2010 to January 2, 2011

This report and the audited consolidated financial statements of A&W Food Services of Canada Inc. for the 16 weeks and year ended January 2, 2011 are provided as a supplement to the annual financial statements and Management Discussion and Analysis of the A&W Revenue Royalties Income Fund for the year ended December 31, 2010. This report is dated February 8, 2011 and should be read in conjunction with the annual audited consolidated financial statements for A&W Food Services of Canada Inc. for the year ended January 2, 2011. A copy of this report and additional information about the Fund and Food Services is 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., its 60% ownership interest in A&W Root Beer Beverages of Canada Inc. and its 32.5% ownership interest in A&W Trade Marks Inc., a “variable interest entity” in which Food Services is the “primary beneficiary” as these terms are defined in the Canadian Institute of Chartered Accountants (CICA) Accounting Guideline 15 “Consolidation of Variable Interest Entities”.

### 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

Consolidated financial results of 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 2010 year was 52 weeks and ended January 2, 2011 (2009 – 53 weeks ended January 3, 2010). System sales and same store sales for the 16 weeks and 52 weeks ended January 2, 2011 are compared to the 16 weeks and 52 weeks ended December 27, 2009 in order to be comparable to the prior year.

## Same Store Sales

Same store sales at A&W restaurants grew by 2.2% in 2010 compared to 2009, the eighth straight year of positive same store sales growth. Same store sales grew by 1.1% in the fourth quarter of 2010, marking the 31st straight quarter of same store sales growth. 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 year and the prior year.

## System Sales

System sales grew 5.0% for the full year and 4.1% for the quarter. System sales for all A&W restaurants in Canada for the 52 weeks ended January 2, 2011 were \$794,383,000, an increase of \$37,782,000 from the 52 weeks ended December 27, 2009. For the 16 weeks ended January 2, 2011, system sales were \$250,154,000, an increase of \$9,757,000 from the same period in 2009. These increases were due to the increase in the number of restaurants from 710 to 730 and the same store sales growth.

## New Restaurant Development and Restaurant Closures

Food Services opened 26 new A&W restaurants during 2010 compared to 22 in 2009. Six franchised restaurants closed in 2010 compared to seven closures in 2009. As at January 2, 2011, there were 730 A&W restaurants in Canada, of which 720 were operated by franchisees and ten were corporately owned and operated in the Ottawa region. Subsequent to January 2, 2011, four additional new restaurants were opened and as at February 8, 2011, there are 734 A&W restaurants in Canada.

## Consolidated Financial Highlights

(dollars in thousands)

	52 week period ended Jan 2, 2011	53 week period ended Jan 3, 2010 <sup>(1)</sup>
System sales <sup>(1)</sup>	\$ 794,383	\$ 756,601
System sales growth <sup>(1)</sup>	5.0%	4.5%
Same store sales growth <sup>(1)</sup>	2.2%	1.5%
New restaurants opened	26	22
Restaurants closed	6	7
Number of restaurants	730	710
Franchising & corporate restaurant revenue	\$ 83,244	\$ 78,523
Direct costs and administrative expenses	\$ 54,599	\$ 52,516
Earnings before gain on sale of Fund units, interest, amortization, taxes and non-controlling interests	\$ 28,645	\$ 26,007
Net earnings	\$ 28,190	\$ 9,471

(1) System sales, system sales growth and same store sales growth are reported for the 52 weeks ended December 27, 2009 in order to be comparable to the prior year and for 2010 to be comparable to 2009. Same store sales growth is not an earnings measure recognized by generally accepted accounting principles (GAAP) and therefore may not be comparable to similar measures presented by other companies.

### 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 granting multi-site development areas, revenue from company-owned restaurants and revenue from its subsidiary's sales of flavour concentrate to licensed bottlers who produce and distribute A&W Root Beer for sale in retail grocery stores.

Food Services' direct costs and administrative expenses 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. In addition, direct costs include the expenses and costs of the restaurants operated corporately by Food Services and salaries and general and administrative costs associated with providing services to the franchised A&W restaurants and establishing new A&W restaurants.

Also included in direct costs and administrative expenses in the Consolidated Financial Statements are Trade Marks' general and administrative expenses. Trade Marks' general and administrative expenses include the expenses of the Fund under an administration agreement between Trade Marks and the Fund. Under this agreement, Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund.

### Sale of A&W Trade-marks and Licence and Royalty Agreement

In 2002, Food Services sold the A&W trade-marks used in the A&W quick service restaurant business in Canada to Trade Marks for \$152,676,000, of which \$84,876,000 was paid in cash, and \$27,800,000 was paid by the issuance of 2,779,975 Class A preferred shares and 2,780,000 voting common shares of Trade Marks. The balance of the purchase price of \$40,000,000 was paid in full by all amounts Trade Marks paid Food Services in respect of annual adjustments to the Royalty Pool up to January 5, 2010.

Concurrent with the purchase of the trade-marks, Trade Marks granted Food Services a licence to use the A&W trade-marks in Canada for a term of 99 years, for which Food Services pays Trade Marks a royalty of 3% of the sales reported to Food Services by A&W restaurants in the Royalty Pool (the Licence and Royalty Agreement). In the event a restaurant in the Royalty Pool closes, Food Services pays the royalties that would have been paid to Trade Marks if the restaurant had not closed, until the next adjustment to the Royalty Pool.

On January 21, 2009, Trade Marks and Food Services formed a limited partnership, the Partnership, in which Trade Marks is the general partner with a 99.9% interest and Food Services is the limited partner with a 0.1% interest. Trade Marks transferred the A&W trade-marks to the Partnership in exchange for the general partnership interest held by Trade Marks. The existing Licence and

Royalty Agreement between Trade Marks and Food Services was assumed by the Partnership with the result that the royalty paid by Food Services for the use of the A&W trade-marks is paid to the Partnership rather than Trade Marks. The Partnership in turn pays partnership distributions to Trade Marks (99.9%) and Food Services (0.1%).

The Royalty Pool is adjusted annually to reflect sales from new A&W restaurants, 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 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 Fund. Prior to the formation of the Partnership, Trade Marks paid Food Services for the additional royalty stream by issuing common shares and preferred shares of Trade Marks which are the economic equivalent of units of the Fund. Effective January 5, 2010, additional limited partnership units (LP units) are issued to Food Services to reflect the annual adjustments. Food Services' additional LP units are exchangeable for additional shares of Trade Marks which are exchangeable for units of the Fund.

### **Recapitalization and Reorganization**

In the fourth quarter, the Fund and Trade Marks implemented two important changes to the structure of the Fund in order to maximize ongoing distributable cash available for unitholders. These changes were a successful substantial issuer bid which reduced the number of units outstanding by 17%, and a reorganization of the capital structure of Trade Marks to minimize the impact of the new Specified Investment Flow Through (SIFT) tax on income funds.

#### *(a) A&W Revenue Royalties Income Fund's offer to purchase units*

On November 10, 2010, the Fund announced its intention to make a substantial issuer bid (the Offer) to purchase for cancellation 2,500,000 of its units at a price of \$20 per unit. The Offer was financed by a new loan to Trade Marks in the amount of \$50,000,000. As a result of the purchase of the units under the Offer and the new loan, distributable cash available for distributions to unitholders is expected to increase by approximately 10.1 cents (8%) per unit per annum over the amount of distributable cash had the Offer and new loan not occurred. Therefore, the Trustees of the Fund approved a 10% increase in monthly distributions to unitholders to 11.7 cents per unit per month, from the current rate of 10.6 cents per unit per month. The new monthly distribution rate is effective January 1, 2011 and payable as and from February 28, 2011.

A total of 2,588,663 units were deposited under the Offer, including 2,500,000 securities of Trade Marks held by Food Services exchangeable for a total of 2,500,000 units. As the aggregate number of units deposited under the Offer exceeded the 2,500,000 units for which the Offer was made, units were taken up under the Offer on a pro-rata basis, resulting in 85,627 units being purchased from unitholders other than Food Services and 2,414,373 units being purchased from Food Services.

#### *(b) Exchange of securities*

On December 22, 2010, prior to the completion of the Offer, Food Services exchanged 2,414,373 Class A shares of Trade Marks with a book value of \$24,549,000, for \$24,144,000 principal amount of A&W notes. Food Services and Trade Marks recorded the additional A&W notes at a book value of \$24,549,000. Subsequently, Food Services exchanged the \$24,144,000 principal amount of A&W notes and 2,414,373 common shares of Trade Marks (comprising 303,790 non-voting common shares and 2,110,583 voting common shares) for 2,414,373 units of the Fund. The Fund recorded an increase in its investment in Trade Marks through the acquisition of the new A&W notes at the principal amount of \$24,144,000, and the acquisition of the 2,414,373 common shares at \$10 per share or \$24,144,000. Food Services recorded its investment in units of the Fund at \$20 per unit or \$48,288,000, and recognized a gain on the exchange of \$21,552,000, represented by the excess of Food Services' \$48,288,000 investment in the Fund over Food Services' carrying value of the 2,414,373 common shares of Trade Marks of \$2,187,000 and the A&W notes of Trade Marks of \$24,549,000.

#### *(c) Completion of the Offer*

The completion of the Offer also took place on December 22, 2010. The Fund's carrying value of the 2,500,000 units was \$49,080,000, and the excess of the \$50,000,000 cost of acquisition over the carrying value, or \$920,000, was charged to the Fund's accumulated earnings. Food Services recorded its \$48,288,000 proceeds from its sale of 2,414,373 units of the Fund reducing its investment in the Fund to \$nil.

The units purchased under the Offer represented approximately 17% of the units outstanding on a fully diluted basis. After the completion of the purchase of the units, 8,254,373 units, and securities exchangeable for a further 3,968,540 units remain outstanding. After the 2,414,373 units were purchased from Food Services, Food Services' indirect interest in the Fund decreased from 43.4% to 32.5% on a fully diluted basis.

*(d) Recapitalization and new loan*

The Fund financed the amount paid for the units by repayment by Trade Marks of \$50,000,000 of A&W notes of Trade Marks held by the Fund, prior to which the Fund and Trade Marks agreed to amend the A&W notes to allow early repayment. Trade Marks financed the \$50,000,000 repayment of A&W notes by increasing its \$10,000,000 term loan with HSBC Bank Canada to \$60,000,000.

*(e) Reorganization*

Also on December 22, 2010, subsequent to Food Services' exchange of securities of Trade Marks, and the completion of the Offer, the reorganization (the Reorganization) of the capital structure of Trade Marks took place. The Reorganization was approved by unitholders of the Fund at the Annual General Meeting held May 4, 2010 and was initiated to minimize the impact of the new SIFT tax on income trusts announced by the federal government in October 2006. The SIFT tax is effective January 1, 2011 and treats an income trust like a corporation, requiring it to pay tax on its taxable income. The Trustees of the Fund examined the alternatives available to maximize unitholder value in the face of this new tax, and proposed this Reorganization to minimize the impact of the new SIFT tax and maximize amounts available for distribution to unitholders in light of the SIFT tax.

As a result of the Reorganization, the Fund will receive dividends paid by Trade Marks rather than interest paid on the A&W notes. These dividends are not subject to the SIFT Tax. Trade Marks' earnings (representing the royalty paid by Food Services less general and administrative expenses and interest on its term loan) will therefore be taxed at an effective rate of 18% versus an approximate tax rate of 25% if the reorganization were not implemented. In effect this leaves 82% of Trade Mark's net income before income taxes available to be paid as dividends, instead of 75% if the reorganization were not implemented.

Commencing in 2011 distributions to unitholders will be taxed as non-eligible dividends, rather than "other" income. Investors who are entitled to dividend tax credits will be able to enhance their after-tax yield and reduce the after-tax impact of the reduction in distributions. The total amount of tax paid in 2011 by the Fund and an individual unitholder taxed in Canada at the highest marginal rate on distributions by the Fund, and the tax that would be paid by the unitholder on distributions by the Fund had the SIFT tax not been implemented, is approximately the same.

The following is a summary of the Reorganization:

- i. Trade Marks continued as a company under the British Columbia Business Corporations Act.
- ii. The \$57,543,000 remaining A&W notes held by the Fund were exchanged for 5,754,298 new non-voting common shares with \$10 par value having an aggregate value of \$57,543,000. The excess of Trade Marks' carrying value of the A&W notes of \$57,948,000 over the value of the new non-voting common shares of \$57,543,000, or \$405,000, was credited to Trade Marks' contributed surplus.
- iii. The 3,868,368 voting common shares and 100,185 non-voting common shares of Trade Marks held by Food Services were exchanged for 3,968,553 voting common shares without par value with a value of \$2,652,000.
- iv. The 10,754,373 voting common shares of Trade Marks held by the Fund were exchanged for 10,754,373 voting common shares without par value with a value of \$2,187,000.
- v. The 769,577 Class A preferred shares of Trade Marks held by Food Services were exchanged for 769,577 non-voting common shares without par value with a value of \$7,826,000.
- vi. The 3,198,951 Class B preferred shares of Trade Marks held by Food Services were exchanged for 3,198,951 new non-voting common shares with \$10 par value with a value of \$36,363,000.

*(f) Exchange rights*

The common shares of Trade Marks held by Food Services may be exchanged at the option of Food Services into units of the Fund on the basis of two common shares for one unit of the Fund, except that Food Services may not exchange non-voting common shares for units of the Fund if it would result in Food Services having a voting interest in Trade Marks greater than its economic interest. Therefore, after the Offer and Reorganization, Food Services holds, indirectly, the equivalent of 32.5% of the units of the Fund on a fully-diluted basis, on the basis of two common shares being the economic equivalent of one unit of the Fund. Food Services will continue to be entitled to additional LP units of the Partnership on the annual adjustment of the restaurants in the Royalty Pool. The additional LP units are exchangeable for non-voting common shares of Trade Marks on the basis of one LP unit for two non-voting common shares of Trade Marks.

All of the voting and non-voting common shares held by the Fund and Food Services are entitled to the same dividends per share.

(g) Costs

The costs of the Offer and the Reorganization were \$775,000 and were expensed during the year by Trade Marks under an administration agreement with the Fund whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund. In addition, financing fees of \$449,000 were incurred by Trade Marks for the additional \$50,000,000 term loan. The financing fees will be amortized over the term of the loan.

**Expansion of the Royalty Pool**

The eighth adjustment to the Royalty Pool took place on January 5, 2010. The number of A&W restaurants in the Royalty Pool was increased by 23 new restaurants less eight restaurants which permanently closed during 2009. The Partnership paid Food Services \$4,758,000 by issuance of 332,723 LP units to Food

Services, representing 80% of the initial consideration based on the estimated annual sales of the net new restaurants. The LP units were exchanged for 28,933 Class B preferred shares valued at \$328,000, 28,933 voting common shares valued at \$86,000, 303,790 Class A preferred shares valued at \$3,441,000 and 303,790 non-voting common shares valued at \$903,000.

The final adjustment to the number of LP units issued was made on December 15, 2010 based upon the actual annual sales reported by the new restaurants. The actual annual sales of the 23 new restaurants were \$25,781,000 compared to the original estimate of \$24,879,000. As a result, the remaining 20% of the initial consideration or \$1,189,000 and additional consideration of \$243,000 was paid to Food Services by issuance of 100,185 additional LP units which were exchanged for 100,185 Class A preferred shares valued at \$1,134,000 and 100,185 non-voting common shares valued at \$298,000.

After completion of the eighth adjustment to the Royalty Pool, the Offer and the Reorganization, the common shares of Trade Marks are owned by the Fund and Food Services as follows:

	The Fund		Food Services		Total
	#	%	#	%	#
Balance as at January 3, 2010	8,340,000	58.4%	5,950,018	41.6%	14,290,018
January 5, 2010 adjustment to Royalty Pool		-1.8%	432,908	1.8%	432,908
December 22, 2010 exchange of Class A shares for A&W notes, and A&W notes and common shares for units of the Fund	2,414,373	16.4%	(2,414,373)	-16.4%	—
December 22, 2010 exchange of A&W notes for non-voting common shares with \$10 par value	5,754,298	7.6%		-7.6%	5,754,298
December 22, 2010 exchange of Class A shares for non-voting common shares without par value		-2.9%	769,577	2.9%	769,577
December 22, 2010 exchange of Class B shares for non-voting common shares with \$10 par value		-10.2%	3,198,951	10.2%	3,198,951
Balance as at January 2, 2011	16,508,671	67.5%	7,937,081	32.5%	24,445,752

Subsequent to year end, the ninth adjustment to the Royalty Pool took place on January 5, 2011. The number of A&W restaurants in the Royalty Pool was increased by 20 new restaurants less five restaurants which permanently closed during 2010. The estimated annual sales of the 20 new A&W restaurants are \$20,160,000 and annual sales for the five permanently closed restaurants were \$1,673,000. The net sales of \$18,487,000 translate into estimated additional annual royalty payments to the Partnership of \$555,000 on the basis of the royalty of 3% of sales. The initial consideration for this estimated additional royalty stream is \$6,859,000, calculated by discounting the estimated additional royalties by 7.5% and dividing the result by the yield on the units of the Fund for the 20 trading days ending November 1, 2010.

The Partnership paid Food Services \$5,487,000 by issuance of 278,818 limited partnership units (LP units) to Food Services, representing 80% of the initial consideration. The additional LP units were exchanged for 557,636 non-voting common shares of Trade Marks. The remaining 20% of the consideration and a final adjustment to the consideration based on the actual annual sales reported by the new restaurants will be made in December 2011 by issuance of additional LP units which may be exchanged for non-voting common shares of Trade Marks.

After the January 5, 2011 adjustment to the Royalty Pool, the number of restaurants in the Royalty Pool increased to 715 and Food Services owns the equivalent of 34% of the units of the Fund on a fully-diluted basis.

## Basis of Consolidation

Food Services, the Fund, Trade Marks and the Partnership have adopted CICA Accounting Guideline 15, "Consolidation of Variable Interest Entities" (AcG-15).

AcG-15 expands upon existing accounting guidance in CICA Handbook Section 1590 that addresses when an enterprise should consolidate another entity in its financial statements. Under CICA 1590, an enterprise generally consolidates another entity when it controls the entity through a majority voting interest. AcG-15 clarifies this guidance when the entity being consolidated is a "Variable Interest Entity" (VIE) which is defined to be an entity that, by design, does not have sufficient equity at risk to finance its activities without additional subordinated financial support. If the entity being consolidated is a VIE, under AcG-15 the "primary beneficiary" of that entity should consolidate the VIE and not necessarily the shareholder with the majority voting interest.

The Fund and Food Services have determined that Trade Marks is a VIE and that Food Services is the "primary beneficiary" of Trade Marks. As a result, Food Services consolidates Trade Marks, and the Fund accounts for its investment in Trade Marks using the equity method. Food Services' consolidated financial statements include the accounts of Trade Marks and the Partnership.

As a result of AcG-15, all intercompany accounts and transactions between Food Services, Trade Marks and the Partnership are eliminated in the consolidated financial statements. The trade-marks are recorded on the consolidated balance sheet at their historical book value. Food Services' investments in Trade Marks and the Partnership, its deferred gain on the sale of the trade-marks, and Trade Marks' intangible assets and Class A and Class B preferred shares and common shares held by Food Services are eliminated upon consolidation.

The adoption of AcG-15 does not change the contractual obligations nor the cash flows between Food Services, Trade Marks and the Partnership. It is important to note that the Partnership legally owns the A&W trade-marks, receives royalty income from Food Services and pays distributions to Trade Marks and Food Services. Trade Marks in turn pays dividends to Food Services and the Fund and interest on the A&W notes to the Fund. The liabilities of Trade Marks, comprising the A&W notes payable to the Fund and the term loan, are obligations of Trade Marks, not Food Services. For further information on the financial results of the Fund and Trade Marks, readers are referred to the Fund's and Trade Marks' financial statements for the year ended December 31, 2010 which are available at [www.sedar.com](http://www.sedar.com) or on the Fund's website at [www.awincomefund.ca](http://www.awincomefund.ca).

## Future Accounting Changes

On January 3, 2011, Food Services will adopt the new accounting standard CICA Handbook Section 1582, "Business Combinations", which replaced Handbook Section 1581, "Business Combinations", and Handbook Section 1601, "Consolidated Financial Statements", and Handbook Section 1602, "Non-Controlling Interests", which replaced Handbook Section 1600, "Consolidated Financial Statements". These new sections are based on the International Accounting Standards Board's (IASB) International Financial Reporting Standards (IFRS) 3R, "Business Combinations". The new standards replaced the existing guidance on business combinations and consolidated financial statements. The adoption of these new standards is not expected to have an impact on Food Services' financial results.

## International Financial Reporting Standards (IFRS)

Food Services will adopt IFRS for interim and annual reporting purposes beginning January 3, 2011. Food Services' transition from Canadian GAAP to IFRS will take place in the first quarter of 2011 at which time both current and comparative financial information will be reported using IFRS.

Food Services commenced the process to transition from current Canadian GAAP to IFRS in 2009. Progress reports are provided to the directors of Food Services on the status of the IFRS implementation project on a regular basis. The implementation project consists of three primary phases:

- Scoping and diagnostic phase
- Impact analysis, evaluation and design phase
- Implementation and review phase

### *Scoping and Diagnostic Phase*

A preliminary diagnostic review was completed by an external consultant which included the determination, at a high level, of the financial reporting differences under IFRS and the key areas that may be impacted. The areas with the highest potential impact were identified to include leases; basis of consolidation; related party transactions; employee benefits; provisions, contingent liabilities and contingent assets; impairment of assets; financial instruments and initial adoption of IFRS under the provisions of IFRS 1.

### *Impact Analysis, Evaluation and Design Phase*

A detailed evaluation has been undertaken and involved assessing the impact on financial reporting, information technology and systems, financial accounting expertise,

accounting policies, internal controls over financial reporting and disclosure controls, and developing systems and accounting policies to address identified issues. This phase also involved a detailed analysis of the differences between IFRS and Canadian GAAP. Significant increases in disclosure are anticipated and Food Services has identified these additional disclosure requirements.

Food Services is in the final stages of its assessment of the impacts of adopting IFRS based on the standards as they currently exist, and identified the following as having the greatest potential to impact its accounting policies, financial reporting and information systems requirements upon conversion to IFRS.

*(a) Leases*

Food Services has a number of leasing arrangements which are currently classified as capital or operating depending upon the terms and conditions of the contract. Under IFRS, the threshold tests for determining if leases are finance leases or operating leases are not interpreted as literally. Therefore, all leases, including discount rates and excluded costs, have been reviewed and no significant differences have been noted. Generally, disclosure requirements for leases are more extensive than those under Canadian GAAP.

*(b) Basis of Consolidation*

Under Canadian GAAP, Food Services consolidates Trade Marks as the Fund and Food Services have determined that Trade Marks is a VIE and that Food Services is the “primary beneficiary” of Trade Marks. Under current IFRS, there is no “variable interests” model to determine which entities are consolidated. Consolidation is based on “control” which is the ability to direct or dominate an entity’s decision making, regardless of whether this power is actually exercised. A detailed assessment is underway pending the finalization of the consolidation standard under IFRS.

*(c) Related Party Transactions*

IFRS will require more extensive disclosure of related party transactions and balances between related parties, which include the Fund, Trade Marks and the Partnership. Relationships with parent companies and subsidiaries must be disclosed irrespective of whether there have been transactions between those related parties. Compensation of key management personnel which is defined as persons with authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including, but not limited to, directors and trustees, must be

disclosed in aggregate. For each related party transaction, the nature of the relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship must be disclosed. Significant additional note disclosures are likely to be needed to comply with IFRS requirements.

*(d) Employee Benefits*

IFRS standards for accounting for employee future benefits plans are similar, although not identical to Canadian GAAP. Under transition rules, existing actuarial gains and losses would be recognized as an adjustment to retained earnings. There is a one-time election (i) to amortize future actuarial gains and losses in expense or (ii) to recognize future actuarial gains and losses immediately in shareholders’ equity. Management has elected to utilize option (ii) and therefore an adjustment to retained earnings will be recorded on transition. Significant additional disclosure will be required.

*(e) Provisions, Contingent Liabilities and Contingent Assets*

Food Services has no material provisions under Canadian GAAP. Under IFRS, a provision should be recognized for onerous contracts, measured at management’s best estimate. Provisions may need to be recognized for certain sub-leasing contracts.

*(f) Impairment of Assets*

Currently, the A&W trade-marks are classified as intangible assets with an indefinite life and are carried at cost. The carrying value is tested at least annually for impairment, by comparing the carrying value to the “fair value” determined using forecast future cash flows, which is consistent with IFRS. Trade Marks’ intangible asset impairment model has been revised to comply with IFRS requirements. Unlike Canadian GAAP, impairment losses may be reversed under IFRS. IFRS requires significant additional disclosures in the event an impairment loss is recorded or reversed.

*(g) Financial Instruments*

Food Services has applied the new Canadian GAAP standards in relation to the recognition, measurement, presentation and disclosure of financial instruments. Trade Marks uses the “short-cut” or “all critical terms match” hedge effectiveness assessment for its interest rate swap. The new Canadian GAAP standards for financial instruments are aligned with IFRS, therefore GAAP differences in this area are limited, with the exception of the “short-cut” hedge effectiveness assessment which does not exist under IFRS. The documentation of the hedge effectiveness has been revised accordingly.

Differences between IFRS and Canadian GAAP, in addition to those referred to above, may still be identified based on final analysis by Food Services and consideration of the final IFRS standards for 2011. The IASB currently has projects underway that are expected to result in new pronouncements and as a result, IFRS as at the transition date is expected to differ from its current form. The final impact of IFRS on the financial statements will only be determined once all applicable standards at the conversion date are known. The transition to IFRS is not expected to have an impact on Food Services' cash flows.

#### *Implementation and Review Phase*

This phase involves the execution of changes to accounting policies and information systems and will culminate in the collection of the necessary financial information to compile IFRS financial statements and directors' approval of IFRS interim and annual financial statements for 2011.

Food Services anticipates that there will be changes in accounting policies and that these changes may materially impact the financial statements. The full impact on future financial reporting cannot be reasonably determined or estimated at this time.

## **2010 Operating Results**

### **Revenue**

Food Services' franchising and corporate revenue for 2010 was \$83,244,000 compared to \$78,523,000 for 2009. Franchising revenue for 2010 was \$72,782,000 compared to \$67,255,000 for 2009. The increase of \$5,527,000 was due to the system sales growth which resulted in higher franchise fees, and higher revenue from new restaurant openings.

Corporate restaurant sales in 2010 were \$10,462,000 compared to \$11,268,000 in 2009. Sales growth in the Ottawa region was offset by a decrease in the number of corporate restaurants held for franchising. During 2009 there were two restaurants being held for franchising, one of which was franchised in December 2009 and the other in April 2010. There are currently no restaurants being operated while held for franchising.

### **Expenses and Operating Contribution Margin**

Direct costs and administrative expenses for 2010 were \$54,599,000 compared to \$52,516,000 for 2009. The increase of \$2,083,000 was due to higher costs of sales for new restaurant openings. In addition, direct costs and administrative costs include the \$775,000 costs of the Offer and the Reorganization which were expensed during the year by Trade Marks in accordance with the administration agreement between

Trade Marks and the Fund. The operating contribution margin was 34.4% for 2010 compared to 33.1% for 2009.

Earnings before interest, amortization, taxes, non-controlling interests and Food Services' gain on its sale of units of the Fund increased by \$2,638,000 to \$28,645,000 for 2010 compared to \$26,007,000 for 2009.

### **Gain on sale of units of A&W Revenue Royalties Income Fund**

Food Services recorded a gain of \$21,552,000 on its exchange of securities of Trade Marks for units of the Fund which were subsequently purchased and cancelled by the Fund. See "Recapitalization and Reorganization".

### **Interest Expense**

Interest expense was comprised primarily of Trade Marks' interest expense on its term loan and A&W notes payable.

*(dollars in thousands)*

	52 week period ended Jan 2, 2011 \$	53 week period ended Jan 3, 2010 \$
<b>Interest</b>		
Interest income	(84)	(34)
Term loan	695	581
A&W notes payable	8,745	8,965
Amortization of deferred financing fees	12	9
Capital leases	97	47
	<u>9,465</u>	<u>9,568</u>

The increase in Trade Marks' term loan interest expense was due to the increase in the amount of the term loan from \$10,000,000 to \$60,000,000 effective December 22, 2010. Also included in term loan interest expense was a \$49,000 payment to terminate the interest rate swap on the \$10,000,000 term loan. The decrease in interest on the A&W notes payable was due to the A&W notes being extinguished on December 22, 2010. See "Recapitalization and Reorganization".

### **Income Taxes**

Income tax expense increased by \$4,915,000 to \$8,266,000 for 2010 compared to \$3,351,000 for 2009 due to the taxable capital gain on the sale of units of the Fund, and higher operating earnings before taxes.

## Non-controlling Interests

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

The Fund's interest in the earnings of Trade Marks represents the common equity of Trade Marks held by the Fund. The Fund's share of Trade Marks' earnings was \$2,463,000 for 2010 compared to \$2,340,000 for 2009. The Fund's ownership interest in Trade Marks was 67.5% as at January 2, 2011 compared to 58.4% as at January 3, 2010.

## Net Earnings and Comprehensive Earnings

Net earnings increased by \$18,719,000 to \$28,190,000 in 2010 compared to \$9,471,000 for 2009. The increase in net earnings was due to higher operating earnings and the gain on the sale of units of the Fund, net of tax.

In accordance with CICA Handbook Section 3865, "Hedges", other comprehensive income of \$205,000 was recorded in 2010, compared to \$103,000 in 2009, to reflect the change in the fair value of Trade Marks' interest rate swap agreement, net of income taxes and the Fund's equity interest. Comprehensive earnings for 2010 were \$28,395,000 compared to \$9,574,000 for 2009. Accumulated other comprehensive earnings as at January 2, 2011 were \$80,000 compared to accumulated other comprehensive losses of \$125,000 at the end of 2009.

## Liquidity and Capital Resources

Food Services is primarily a franchise business with 720 of its 730 restaurants franchised. Food Services has minimal capital requirements related to its corporate restaurants and head office. Future restaurant growth will continue to be funded by franchisees although Food Services may from time to time choose to open new corporate restaurants in the Ottawa market. Food Services expects to have sufficient capital resources to fund the expansion of corporate restaurants and has no long term debt obligations. Food Services has sufficient cash on hand to meet its obligations and has a \$5,000,000 demand operating loan facility with HSBC Bank Canada (the Bank) to fund its 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. Food Services has provided 1,000,000 voting common shares and 1,000,000 non-voting common shares of Trade Marks as collateral. As at January 2, 2011 and February 8, 2011, the full amount of the facility was available.

Trade Marks expects to have sufficient financial resources to fund its working capital requirements and to meet its cash flow needs including ongoing common share dividends. Trade Marks has a \$2,000,000 demand operating loan facility with the Bank 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 January 2, 2011 and February 8, 2011, the full amount of the facility was available.

On December 22, 2010, Trade Marks increased its existing \$10,000,000 term loan with the Bank to \$60,000,000 to finance repayment of \$50,000,000 of A&W notes payable to the Fund (see "Recapitalization and Reorganization"). The new term loan is repayable on December 22, 2015 and bears interest at the bank prime rate plus 1%. Interest only is payable monthly, provided that Trade Marks' earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA), tested quarterly on a trailing four quarter basis, in arrears, are not less than specified amounts. In the event that EBITDA is less than these specified amounts, the term loan will be fully amortized over the greater of three years and the remaining term and repayment will be by way of blended monthly instalments of principal and interest. The new loan contains a number of covenants including the requirement to meet certain EBITDA levels and debt to EBITDA ratios during each trailing four quarters period. Trade Marks was in compliance with all of its financial covenants as at January 2, 2011.

Trade Marks uses an interest rate swap agreement to manage risks from fluctuations in interest rates. The interest rate swap on the \$10,000,000 term loan was terminated effective December 22, 2010 and Trade Marks entered into a new interest rate swap on the new \$60,000,000 term loan on the same day. As a result, the term loan bears interest at 5.03% per annum, of which 2.53% per annum is fixed under an interest rate swap agreement that matures December 22, 2015 and 2.50% per annum is subject to annual review by the Bank. The interest rate swap agreement is considered to be a cash flow hedge and in accordance with CICA Handbook Section 3865, "Hedges", qualifies for hedge accounting. Changes in the fair value of the interest rate swap agreement, to the extent it is an effective hedge, are recorded in other comprehensive income (loss) and are only recognized in earnings when the hedged item is realized. Any ineffectiveness in the hedging relationship is recognized in earnings immediately.

The fair value of the interest rate swap as at January 2, 2011 is \$299,000 favourable (January 3, 2010 - \$370,000 unfavourable) and the change in fair value is recorded in other comprehensive income (loss), net of income taxes and the Fund's equity interest.

A general security agreement over the assets of Trade Marks was provided as collateral for the demand operating loan facility and term loan. The Partnership has provided its guarantee in favour of

the Bank of all the indebtedness, covenants and obligations of Trade Marks to the Bank.

The liabilities of Trade Marks, including the operating facility and the term loan, are obligations of Trade Marks, not Food Services.

Trade Marks has no other contractual or purchase obligations except as described under the section Related Party Transactions and Balances. Trade Marks does not have any capital expenditures; its operating and administrative expenses are expected to be stable and reasonably predictable and are considered to be in the ordinary course of business.

Payments due by period:

*(dollars in thousands)*

	Term loan \$
Total	60,000
Less than 1 year	0
1 - 3 years	0
4 - 5 years	60,000
After 5 years	0

### Off-Balance Sheet Arrangements

Food Services and Trade Marks have no off-balance sheet arrangements.

### Related Party Transactions and Balances

Trade Marks' interest expense on the A&W notes for the year was \$8,745,000 (2009 - \$8,965,000), of which \$nil (January 3, 2010 - \$761,000) is receivable by the Fund from Trade Marks at January 2, 2011.

Included in accounts receivable is \$36,000 (January 3, 2010 - \$36,000) due to Trade Marks by the Fund without interest and on demand.

Under an administration agreement between Trade Marks and the Fund, Trade Marks, at its expense, will provide or arrange for the provision of services required in the administration of the Fund. Trade Marks has arranged for management, administrative and accounting services to be provided by Food Services.

During the year, Food Services contracted with Biting Buffalo Holdings Inc. for rental of a private plane and crew for business travel. A shareholder, director and officer of Food Services who is also a director of Trade Marks, is the shareholder of Biting Buffalo Holdings Inc. The cost of the services provided under the contract during the year was \$386,000 (2009 - \$446,000). At January 2, 2011, \$nil (January 3, 2010 - \$nil) is payable to Biting Buffalo Holdings Inc. by Food Services.

During the year, Food Services paid \$92,000 (2009 - \$95,000) to the Vancouver Canadians Professional Baseball Club, of which a shareholder, director and officer of Food Services and director of Trade Marks, is a part owner, in exchange for advertising the A&W brand at the ballpark. At January 2, 2011, \$nil (January 3, 2010 - \$nil) is payable to the Vancouver Canadians by Food Services.

During the year to date, Trade Marks declared dividends on its common shares totaling \$6,082,000 (2009 - \$5,673,000) of which \$3,523,000 (2009 - \$3,311,000) was paid to the Fund and \$2,559,000 (2009 - \$2,362,000) was paid to Food Services. Additional compensation of \$38,000 was paid to Food Services representing the dividends that Food Services would have received on the 100,185 non-voting common shares issued to Food Services on December 15, 2010 in relation to the adjustment to the January 5, 2010 Royalty Pool Amendment, had they been issued on January 5, 2010.

Food Services maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$532,000 (2009 - \$506,000) to Food Services during the year for marketing, promotional and administrative services provided to the advertising fund.

Related party transactions described in this section are recorded at the exchange amounts which are the amounts agreed to by both parties.

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

Related party transactions and balances that were eliminated upon the consolidation of Food Services and Trade Marks are as follows:

- Royalty income of \$23,301,000 (2009 - \$22,086,000) was earned by Trade Marks from Food Services, of which \$1,720,000 (January 3, 2010 - \$1,992,000) is receivable by Trade Marks at January 2, 2011.
- Dividends of \$6,692,000 (2009 - \$6,396,000) were declared and paid by Trade Marks on its Class A and Class B preferred shares held by Food Services, of which \$nil (January 3, 2010 - \$533,000) is payable as at January 2, 2011.
- Partnership distributions of \$23,574,000 (2009 - \$18,823,000) were declared of which \$23,551,000 was paid to Trade Marks and \$23,000 was paid to Food Services.
- Trade Marks' issuance to Food Services of 28,933 Class B preferred shares valued at \$328,000, 28,933 voting common shares valued at \$86,000, 403,975 Class A

preferred shares valued at \$4,575,000 and 403,975 non-voting common shares of Trade Marks valued at \$1,201,000 as consideration for the January 5, 2010 adjustment to the Royalty Pool. The tax entries relating to this transaction were also eliminated upon consolidation.

### Critical Accounting Estimates

The intangible assets consist of the A&W trade-marks and are recorded at their book value at the time of the sale of the trade-marks to Trade Marks. Management tests the intangible assets annually for impairment or more frequently if events or changes in circumstances indicate that the assets might be impaired. The impairment test compares the carrying amount of the intangible asset with its fair value, and an impairment loss is recognized in income for the excess, if any. Management believes that there has been no impairment of the intangible assets during the period ended January 2, 2011.

### Financial Instruments

Food Services' financial instruments consist of cash and cash equivalents, accounts receivable, notes receivable, accounts payable and accrued liabilities, the term loan and the interest rate swap.

Food Services classifies its financial instruments as follows:

- Cash and cash equivalents, accounts receivable and notes receivable as loans and receivables, which are initially measured at fair value and subsequently at amortized cost.
- Accounts payable and accrued liabilities and term loan as other financial liabilities, which are measured at amortized cost.
- Interest rate swap as available-for-sale.

Management estimates that the fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and notes receivable approximate their carrying values given the short term to maturity of these instruments.

The fair value of Trade Marks' term loan approximates its carrying value due to the floating interest rate. The fair value of the interest rate swap is \$299,000 favourable (January 3, 2010 - \$370,000 unfavourable).

Food Services' exposure to credit risk is as indicated by the carrying amount of its accounts receivable and notes receivable. Receivables are due from franchisees and distributors. Food Services does not have a significant exposure to any individual

franchisee. However as at January 2, 2011 \$3,930,000 (January 3, 2010 - \$6,369,000) is receivable from one distributor.

The primary sources of liquidity risk are dividends on the common shares. Trade Marks' primary source of funds to pay dividends is the 3% royalty income the Partnership receives from Food Services. Food Services' primary sources of funds to pay the royalty to the Partnership are the fees from franchised restaurants and revenues from the development of franchised restaurants, the sale of food and supplies to franchisees and distributors, company-owned restaurants and the sale of A&W Root Beer concentrate. The liquidity risk is assessed as low due to the nature of the income Food Services receives from the franchisees and the ability to reduce future dividends if necessary.

Trade Marks' term loan and the operating loan facilities bear floating rates of interest as disclosed previously. Trade Marks has used an interest rate swap to fix the rate of interest on the term loan. Cash and cash equivalents earn interest at market rates. All of Food Services and Trade Marks other financial instruments are non-interest bearing.

### Capital Disclosure

Food Services' capital consists of shareholders' deficiency. Food Services' capital management objectives are to have sufficient cash and cash equivalents to ensure the growth of the business, fund its investing activities, and pay dividends on its common shares to its shareholders, after satisfaction of its debt service and income tax obligations; provisions for direct costs and administration expenses; and retention of reasonable working capital reserves. Food Services manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, Food Services may adjust the amount of dividends paid to its shareholders.

### 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 hamburgers, chicken, fries and soft drinks, such as increased food and labour costs, changing tastes or health concerns, publicity from any food borne illness, the availability of experienced management and hourly employees, and government regulations concerning smoking bans, 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.

The harmonization of GST with provincial sales taxes in British Columbia effective July 1, 2010 effectively added a new 7% tax on restaurant meals in this province. While not announced, the potential future harmonization in Saskatchewan would also effectively add a new tax on restaurant meals in Saskatchewan. The harmonization of GST with provincial sales taxes in Ontario and British Columbia and the increase in the harmonized sales tax in Nova Scotia from 13% to 15% could adversely affect disposable consumer income and consequently consumer visits to restaurants in general and the sales of A&W restaurants in particular, and the amount of royalty payable to the Partnership.

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 will be able to respond to various competitive factors affecting the franchise operations of Food Services in the quick service restaurant industry.

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 availability of suitable sites, negotiations of acceptable lease or purchase terms for new locations, permits and government regulatory compliance, availability of financing and the ability to meet construction schedules. 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 and A&W franchisees may be the subject of complaints or litigation from guests alleging food-related illnesses, injuries suffered on the premises or other food quality, health or operational concerns. Adverse publicity resulting from such allegations may materially affect the sales of A&W restaurants, regardless of whether such allegations are true or whether Food Services or an A&W franchisee is ultimately held liable.

## Outlook

During the year, A&W continued to focus on strengthening its appeal to its core baby boomer customer. The Cruisin' the Dub program was a great success again in the summer of 2010, with over 4,000 events held at freestanding restaurants compared to 3,700 in 2009. A&W's Cruisin' the Dub program creates an opportunity for Canadian baby boomers that grew up enjoying warm summer evenings in their cars at A&W drive-ins - often with the radio blaring and trays of Teen Burgers, onion rings and icy cold A&W Root Beer delivered by car hops - to revisit those fond memories.

The successful Uncle Burger and Cheddar Bacon Uncle Burger promotions and the return of the Mini Sirloin Twins for a limited time extended A&W's reputation for menu innovation and having the best tasting hamburgers in Canada. The Uncle Burger and the Mini Sirloin Twins are unique products featuring real sirloin beef. A&W will continue to innovate and expand its offering in the Premium Burger segment of the quick service restaurant market.

A strategic initiative underway in 2010 was A&W's "next generation" re-image program, to modernize and enhance the appeal of A&W restaurants. Rollout of this new design began in the fourth quarter of 2010 with six re-image projects completed. There is strong demand from franchisees and the pace of re-imagining will accelerate in 2011. Costs of re-imagining restaurants are borne by the franchisees and there is no cost to the Fund.

Another major initiative in A&W's strategy is accelerating the pace of growth of new restaurants, particularly in the key Ontario market. A&W has now entered into Multi-Site Development Agreements for a total of 115 new restaurants to be built in British Columbia, Ontario and Quebec over the next five to seven years.

Another important strategic initiative is the launch of A&W's new "urban" concept design. Developed to appeal to younger consumers who live and work in dense urban markets, this new expansion vehicle incorporates innovations in restaurant design, menu, service systems and signage. A total of five of these restaurants opened in 2010, and more are planned for 2011.

A key factor continues to be the impact of the Harmonized Sales Tax (HST) on the restaurant industry in British Columbia. The addition of a 7% sales tax on restaurant meals is reported to be reducing consumption by consumers. A&W is continuing to respond tactically to both the HST and to market conditions and plans to continue to focus on building the A&W brand through successful advertising and marketing campaigns, menu innovation, facilities design and expanding to serve customers in new markets. A&W is a strategy driven company whose mission is “to make A&W the number one national burger choice for baby boomers and the fastest growing and most successful burger businesses in Canada.”

### **Subsequent Events**

On February 2, 2011, Trade Marks declared dividends on its common shares of \$1,463,000, payable to Food Services and the Fund on February 28, 2011.

### **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: the addition of 15 net new restaurants to the Royalty Pool on January 5, 2011; Food Services’ Mission and strategy to “make A&W the number one national burger choice for baby boomers and the fastest growing and most successful burger businesses in Canada”; Food Services’ plans to respond tactically to the HST in BC and market conditions; Food Services’ plans to build the A&W brand through advertising and marketing campaigns, menu innovation, facilities design and expanding to serve customers in new markets; Food Services’ plans to focus on strengthening its appeal to its core baby boomer customer; Food Services’ plans to continue to innovate and expand its offering in the Premium Burger segment of the quick service restaurant market; Food Services’ plans to modernize and enhance the appeal of A&W restaurants; Food Services’ plans to accelerate the pace of growth of new restaurants, particularly in the key Ontario market; Food Services’ plans to build new restaurants in British

Columbia, Ontario and Quebec under Multi-Site Development Agreements over the next five to seven years; Food Services’ plans to open more “urban” concept restaurants in 2011; the Fund and Trade Marks expect distributable cash available for distributions to unitholders to increase as a result of the Offer and new loan; Food Services expects to have sufficient capital resources to fund the expansion of corporate restaurants; Trade Marks expects to have sufficient financial resources to fund its working capital requirements and to meet its cash flow needs including ongoing common share dividends; and, Trade Marks’ operating and administrative expenses are expected to be stable and reasonably predictable.

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 smoking bans, menu labelling and disclosure and drive-thru restrictions; no publicity from any food borne illness; no changes in competition; no changes in the retail hamburger 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 increases in food and labour costs; the continued availability of quality raw materials; continued additional franchise sales and maintenance of franchise operations; no closures of A&W restaurants that materially affect the amount of the Royalty; franchisees duly pay franchise fees and other amounts; no impact on sales from harmonization of sales taxes in British Columbia and Ontario; no harmonization of sales taxes in Saskatchewan; no new or increased sales taxes; continued availability of key personnel; no material litigation from guests alleging food-related illness, injuries suffered on the premises or other food quality, health or operations concerns; continued ability to preserve intellectual property; 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; Food Services continues to pay the Royalty; the Partnership continues to make distributions on its units; Trade Marks continues to pay its obligations under the A&W Notes and pay dividends on the common shares; Trade Marks can continue to comply with its obligations under its credit arrangements; 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 smoking bans, menu labelling and disclosure and drive-thru restrictions; publicity from any food-borne illness; competition; changes in the retail hamburger market including as a result of changes in consumer taste and health concerns and changes in economic conditions and unemployment and a disease outbreak; increases in food and labour costs; dependence on the availability and quality of raw materials; dependence on additional franchise sales and franchise operations; the closure of A&W restaurants may affect the amount of the Royalty; dependence on A&W franchisees' ability to pay franchise fees and other amounts; the impact of new or increased or harmonization of sales taxes upon sales; dependence on key personnel; material litigation from guests alleging food-related illness, injuries suffered on the premises or other food quality, health or operations concerns; dependence on intellectual property; 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; 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; changes in investment eligibility and penalties for foreign property; and changes to the Canadian federal income tax treatment of publicly listed trusts 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.

# Independent Auditor's Report

## To the Shareholders of A&W Food Services of Canada Inc.

We have audited the accompanying consolidated financial statements of A&W Food Services of Canada Inc. and its subsidiaries, which comprise the consolidated balance sheets as at January 2, 2011 and January 3, 2010 and the consolidated statements of earnings and deficit, comprehensive earnings and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

### Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated 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 consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated 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 consolidated financial statements present fairly, in all material respects, the financial position of A&W Food Services of Canada Inc. and its subsidiaries as at January 2, 2011 and January 3, 2010 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*  
Chartered Accountants

Vancouver, British Columbia  
February 8, 2011

# A&W Food Services of Canada Inc. Consolidated Balance Sheets

(in thousands of dollars)

	As at January 2 2011 \$	As at January 3 2010 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	14,602	6,130
Accounts receivable	11,216	14,682
Inventories	2,521	1,521
Prepaid expenses	793	212
Income taxes recoverable	-	53
	29,132	22,598
<b>Intangible assets</b>		
Future income taxes (note 9)	-	199
Property, plant and equipment (note 3)	6,641	5,383
Interest rate swap (note 6)	299	-
Notes receivable (note 7)	42	70
	120,210	111,448
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	16,189	16,815
Deposits on franchise and equipment sales	2,912	1,177
Income taxes payable	5,204	-
Future income taxes (note 9)	2,710	1,271
	27,015	19,263
A&W notes payable (note 5)	-	83,399
Term loan (note 6)	59,553	9,990
Interest rate swap (note 6)	-	370
Long-term liabilities (note 8)	7,694	7,269
Obligations under capital leases (note 8)	807	478
Future income taxes (note 9)	689	-
A&W Revenue Royalties Income Fund's equity interest in A&W Trade Marks Inc. (note 4)	51,969	(7,815)
Non-controlling interest	215	106
	147,942	113,060
<b>Shareholders' Deficiency</b>		
Capital stock (note 10)	10,500	10,500
Contributed surplus (note 2)	405	-
Deficit	(38,717)	(11,987)
Accumulated other comprehensive earnings (loss)	80	(125)
	(27,732)	(1,612)
	120,210	111,448
<b>Commitments and contingencies (note 11)</b>		
<b>Subsequent event (note 17)</b>		
Approved by the Board of Directors		
 Director	 Director	

See accompanying notes to the consolidated financial statements.

## A&W Food Services of Canada Inc. Consolidated Statements of Earnings and Deficit

(in thousands of dollars)

Fiscal Year ended	January 2 2011 \$	January 3 2010 \$
<b>Revenue</b>		
Franchising	72,782	67,255
Corporate restaurants	10,462	11,268
	83,244	78,523
<b>Direct costs and administrative expenses</b>	54,599	52,516
<b>Earnings before the following</b>	28,645	26,007
Gain on sale of Units of A&W Revenue Royalties Income Fund (note 2)	(21,552)	-
Interest expense (note 16)	9,465	9,568
Amortization of property, plant and equipment	1,104	778
<b>Earnings before income taxes and non-controlling interests</b>	39,628	15,661
<b>Provision for income taxes</b> (note 9)		
Current	6,187	879
Future	2,079	2,472
	8,266	3,351
<b>Earnings before non-controlling interests</b>	31,362	12,310
Non-controlling interest in earnings of A&W Root Beer Beverages of Canada Inc.	(709)	(499)
A&W Revenue Royalties Income Fund's interest in earnings of A&W Trade Marks Inc.	(2,463)	(2,340)
<b>Net earnings for the year</b>	28,190	9,471
Deficit - Beginning of year	(11,987)	(12,946)
Dividends declared	(54,920)	(8,500)
Refundable dividend tax paid	-	(12)
<b>Deficit - End of year</b>	(38,717)	(11,987)

See accompanying notes to the consolidated financial statements.

## A&W Food Services of Canada Inc. Consolidated Statements of Comprehensive Earnings

(in thousands of dollars)

Fiscal Year ended	January 2 2011 \$	January 3 2010 \$
<b>Other comprehensive income</b>		
Change in fair value of the interest swap - net of income taxes	545	266
A&W Revenue Royalties Income Fund's interest in other comprehensive income of A&W Trade Marks Inc.	(340)	(163)
	205	103
<b>Net earnings for the year</b>	28,190	9,471
<b>Comprehensive earnings for the year</b>	28,395	9,574
 <b>Other comprehensive income (loss)</b>		
Change in fair value of the interest swap - net of income taxes	545	266
A&W Revenue Royalties Income Fund's interest in other comprehensive income of A&W Trade Marks Inc.	(340)	(163)
	205	103
<b>Accumulated other comprehensive loss - Beginning of year</b>	(125)	(228)
<b>Accumulated other comprehensive earnings (loss) - End of year</b>	80	(125)

See accompanying notes to the consolidated financial statements.

## A&W Food Services of Canada Inc. Consolidated Statements of Cash Flows

(in thousands of dollars)

Fiscal Year ended	January 2 2011 \$	January 3 2010 \$
<b>Cash flows from operating activities</b>		
Net earnings for the year	28,190	9,471
Items not affecting cash		
Amortization of deferred financing fees	12	9
Amortization of property, plant and equipment	1,104	778
Future income taxes	2,079	2,472
Loss (gain) on disposal of property, plant and equipment	5	(1)
Gain on sale of Units of A&W Revenue Royalties Income Fund (note 2)	(21,552)	-
Increase in long-term liabilities	425	41
Non-controlling interest in earnings of A&W Root Beer Beverages of Canada Inc.	709	499
A&W Revenue Royalties Income Fund's interest in earnings of A&W Trade Marks Inc.	2,463	2,340
	13,435	15,609
Net changes in non-cash working capital	8,184	(3,312)
	21,619	12,297
<b>Cash flows from investing activities</b>		
Decrease in notes receivable	28	60
Purchase of property, plant and equipment	(1,655)	(2,855)
Proceeds from disposal of property, plant and equipment	23	3
Proceeds from disposal of Units of A&W Revenue Royalties Income Fund (note 2)	48,288	-
	46,684	(2,792)
<b>Cash flows from financing activities</b>		
Dividends paid to shareholder	(54,920)	(8,500)
Refundable dividend tax paid	-	(12)
Dividends paid to non-controlling interest in A&W Root Beer Beverages of Canada Inc.	(600)	(484)
Dividends paid to A&W Revenue Royalties Income Fund	(3,523)	(3,311)
Decrease in obligations under capital leases	(339)	(251)
New loan (note 2)	50,000	-
Repayment of A&W notes (note 2)	(50,000)	-
Financing fees paid	(449)	-
	(59,831)	(12,558)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>8,472</b>	<b>(3,053)</b>
<b>Cash and cash equivalents - Beginning of year</b>	<b>6,130</b>	<b>9,183</b>
<b>Cash and cash equivalents - End of year</b>	<b>14,602</b>	<b>6,130</b>
<b>Supplementary cash flow information</b>		
Net interest paid	(10,736)	(9,492)
Net income taxes paid	(981)	(1,177)
<b>Non-cash investing activities</b>		
Non-cash acquisition of automobiles through capital leases	(1,041)	(211)
Non-cash disposal of assets through capital leases	306	-

See accompanying notes to the consolidated financial statements.

# Notes to Consolidated Financial Statements

January 2, 2011

*(figures in tables are expressed in thousands of dollars)*

## 1 Nature of operations and significant accounting policies

### Nature of operations

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 ended January 2, 2011, the company opened 26 locations, bringing the total number of A&W restaurants to 730, of which 720 are franchised and 10 are owned and operated corporately.

### Basis of presentation

Food Services prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles (GAAP). These consolidated financial statements include the accounts of the company, its 60% ownership interest in A&W Root Beer Beverages of Canada Inc. (Beverages), its 32.5% ownership interest in A&W Trade Marks Inc. (Trade Marks), and Trade Marks' subsidiary, A&W Trade Marks Limited Partnership (the Partnership). The non controlling interests comprise the common equity of Beverages held by Unilever Canada and the common equity of Trade Marks held by the A&W Revenue Royalties Income Fund (the Fund).

### Basis of consolidation

Food Services, the Fund, Trade Marks and the Partnership have adopted the Canadian Institute of Chartered Accountants (CICA) Accounting Guideline 15, "Consolidation of Variable Interest Entities" (AcG 15).

AcG-15 expands upon accounting guidance in CICA Handbook Section 1590 that addresses when an enterprise should consolidate another entity in its financial statements. Under CICA 1590, an enterprise generally consolidates another entity when it controls the entity through a majority voting interest. AcG-15 clarifies this guidance when the entity being consolidated is a "Variable Interest Entity" (VIE), which is defined to be an entity that, by design, does not have sufficient equity at risk to finance its activities without additional subordinated financial support. If the entity being consolidated is a VIE, under AcG-15 the "primary beneficiary" of that entity should consolidate the VIE and not necessarily the shareholder with the majority voting interest.

Food Services and the Fund have determined that Trade Marks is a VIE and that Food Services is the primary beneficiary of Trade Marks. As a result, Food Services consolidates Trade Marks (which includes the accounts of the Partnership) and the Fund accounts for its investment in Trade Marks using the equity method.

### 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 2010 year was 52 weeks and ended January 2, 2011 (fiscal 2009 - 53 weeks ended January 3, 2010). Trade Marks and Beverages use a fiscal year ending December 31.

### Future accounting changes

In January 2009, the CICA issued Handbook Section 1582, "Business Combinations", which replaces Handbook Section 1581, "Business Combinations". The CICA also issued Handbook Section 1601, "Consolidated Financial Statements", and Handbook Section 1602, "Non-controlling Interests", which replace Handbook Section 1600, "Consolidated Financial Statements". These new sections are based on the International Accounting Standards Board's (IASB) International Financial Reporting Standards (IFRS) 3R, "Business Combinations". The new standards replace the existing guidance on business combinations and consolidated financial statements. The objective of the new standards is to harmonize Canadian accounting for business combinations with the international and US accounting standards. The new standards are to be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the new standards will not be adjusted upon application of these new standards. The non-controlling interests standard should be applied retrospectively except for certain items. The adoption of these new standards is not expected to have an impact on Food Services' financial results.

### Revenue recognition

The company's revenues consist 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 granting multi-site development areas, revenue from company-owned restaurants, and revenue from the sale of A&W Root Beer concentrate. Fees from franchised restaurants include initial fees, service fees and other fees. Initial fees are recognized upon opening a restaurant, which is when the company has performed substantially all initial services required by the franchise agreement. Service fees, in the amount of 2.5% to 3.6% of net sales of franchise operations, are recognized as reported by the franchisee. Other fees are recognized in the period earned. Revenue from the sale of food and supplies to franchisees and distributors is recognized at the time of shipment. Revenue from the opening of new franchised restaurants is recognized when the restaurant commences operation. Revenue from the granting of multi-site development areas is recognized when the agreement is signed. Revenue from company-owned restaurants is recognized when services are rendered. Revenue from the sale of A&W Root Beer concentrate is recognized when it is shipped to bottlers.

### Inventories

Inventories consist of finished goods, equipment for resale to franchisees, and work-in-progress relating to new franchisee store openings. They are valued at the lower of cost and estimated net realizable value. The cost of finished goods includes all direct costs relating to the purchase of these items.

### Intangible assets

Intangible assets, which have an indefinite life, comprise the A&W trade-marks. The company assesses the carrying value of long-lived assets for recoverability whenever events or changes in circumstances indicate that the carrying value may not be recoverable from future undiscounted cash flows. If the carrying amount exceeds the fair value of the intangible asset, an impairment loss is recognized equal to that excess through the consolidated statements of earnings.

### Term loan

Trade Marks' term loan is initially recognized at fair value, net of transaction costs incurred. The term loan is subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated statements of earnings over the term of the loan using the effective interest method.

### Property, plant and equipment

Property, plant and equipment are recorded at cost, less accumulated amortization.

Amortization is provided using the straight-line method. Machinery and equipment are amortized at rates from 7% to 50%. Amortization of leasehold improvements is charged over the term of the lease plus the first renewal term. Automobiles are amortized at rates from 24% to 33%.

The company reviews its property, plant and equipment and tests for recoverability when events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying value of an asset exceeds the undiscounted estimated future cash flows related to the asset, an impairment loss is recognized to the extent that the carrying value exceeds the fair value of the asset.

### Leases

Leases are classified as capital or operating depending upon the terms and conditions of the contracts. Asset values recorded under capital leases are amortized using the straight-line method over the period of expected use. Obligations recorded under capital leases are reduced by lease payments net of imputed interest. Rental payments under operating leases are expensed as incurred.

### Income taxes

Income taxes are calculated using the asset and liability method of tax accounting. Under this method, future income tax assets and liabilities are recognized for temporary differences between the tax basis of an asset or liability and its carrying amount on the balance sheet. Future income tax assets and liabilities are calculated using the substantively enacted tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. Future income tax assets and liabilities are adjusted for the effect of changes in tax laws and rates on the date of enactment or substantive enactment.

### Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks, and short-term investments with a maturity of three months or less.

### Hedging instruments

Trade Marks uses interest rate swap agreements to manage risks from fluctuations in interest rates. All such instruments are used only for risk management purposes. These agreements are considered to be cash flow hedges; as a result, changes in the fair

1 *Nature of operations and significant accounting policies (continued)*

value, to the extent they are effective, are recorded in other comprehensive income (loss) and are only recognized in earnings when the hedged item is realized. Any ineffectiveness in the hedging relationship is recognized in earnings immediately.

**Use of estimates**

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates include the intangible assets, future income taxes, and the supplementary retirement benefit plan.

**Pension plans**

The company has a defined contribution pension plan for its employees and has entered into agreements with certain officers to provide supplementary retirement benefits.

The company has adopted the following accounting policies for the supplementary retirement benefit plan:

- The actuarial determination of the accrued benefit obligation for the plan uses the projected benefit method pro-rated on service and management's best estimate of salary escalation and retirement ages of officers.
- Actuarial gains (losses) arise from changes in actuarial assumptions used to determine the accrued benefit obligation. The excess of the net actuarial gain (loss) over 10% of the benefit obligation is amortized over the average remaining service period of the active officers. The average remaining service period of the active officers covered by the supplementary plan is 4-1/2 years.

For the defined contribution plan, the pension expense recorded in earnings is the amount of the contributions the company is required to pay for services rendered by employees.

**2 A&W Revenue Royalties Income Fund's recapitalization and reorganization**

a) A&W Revenue Royalties Income Fund's offer to purchase Units

On November 10, 2010, the Fund announced its intention to make a substantial issuer bid (the Offer) to purchase for cancellation 2,500,000 of its Units at a price of \$20 per Unit. A total of 2,588,663 Units were deposited under the Offer, including 2,500,000 securities of Trade Marks held by Food Services exchangeable for a total of 2,500,000 Units. As the aggregate number of Units deposited under the Offer exceeded

the 2,500,000 Units for which the Offer was made, Units were taken up under the Offer on a pro-rata basis, resulting in 85,627 Units being purchased from Unitholders other than Food Services and 2,414,373 Units being purchased from Food Services.

b) Exchange of securities

On December 22, 2010, prior to the completion of the Offer, Food Services exchanged 2,414,373 Class A shares of Trade Marks with a book value of \$24,549,000 for \$24,144,000 principal amount of A&W notes. Food Services and Trade Marks recorded the additional A&W notes at a book value of \$24,549,000. Subsequently, Food Services exchanged the \$24,144,000 principal amount of A&W notes and 2,414,373 common shares of Trade Marks (comprising 303,790 non-voting common shares and 2,110,583 voting common shares) for 2,414,373 Units of the Fund. The Fund recorded an increase in its investment in Trade Marks through the acquisition of the new A&W notes at the principal amount of \$24,144,000, and the acquisition of the 2,414,373 common shares at \$10 per share or \$24,144,000. Food Services recorded its investment in Units of the Fund at \$20 per Unit or \$48,288,000, and recognized a gain at fair value on the exchange of \$21,552,000, represented by the excess of Food Services' \$48,288,000 investment in the Fund over Food Services' carrying value of the 2,414,373 common shares of Trade Marks of \$2,187,000 and the A&W notes of Trade Marks of \$24,549,000.

c) Completion of the Offer

The completion of the Offer also took place on December 22, 2010. The Fund's carrying value of the 2,500,000 Units was \$49,080,000, and the excess of the \$50,000,000 cost of acquisition over the carrying value, or \$920,000, was charged to the Fund's accumulated earnings. Food Services recorded its \$48,288,000 proceeds from its sale of 2,414,373 Units of the Fund reducing its investment in the Fund to \$nil.

d) Recapitalization and new loan

The Fund financed the amount paid for the Units by repayment by Trade Marks of \$50,000,000 of A&W notes of Trade Marks held by the Fund, prior to which the Fund and Trade Marks agreed to amend the A&W notes to allow early repayment. Trade Marks financed the \$50,000,000 repayment of A&W notes by increasing its \$10,000,000 term loan with HSBC Bank Canada to \$60,000,000 (note 6).

e) Reorganization

Also on December 22, 2010, subsequent to Food Services' exchange of securities of Trade Marks, and the completion of the Offer, the reorganization (the Reorganization) of the capital structure of Trade Marks took place. The Reorganization was approved by Unitholders of the Fund at the Annual General Meeting held May 4, 2010 and was initiated to minimize the impact of the new Specified Investment Flow Through (SIFT) tax on income trusts announced by the federal government in October 2006. The SIFT tax is effective January 1, 2011 and treats an income trust like a corporation, requiring it to pay tax on its taxable income. The Trustees of the Fund examined the alternatives available to maximize Unitholder value in the face of this new tax, and proposed this Reorganization to minimize the impact of the new SIFT tax and maximize amounts available for distribution to Unitholders in light of the SIFT tax.

The following is a summary of the Reorganization:

- i) Trade Marks continued as a company under the British Columbia Business Corporations Act.
- ii) The \$57,543,000 remaining A&W notes held by the Fund were exchanged for 5,754,298 new non voting common shares with \$10 par value having an aggregate value of \$57,543,000. The excess of Trade Marks' carrying value of the A&W notes of \$57,948,000 over the value of the new non voting common shares of \$57,543,000, or \$405,000, was credited to Trade Marks' contributed surplus.
- iii) The 3,868,368 voting common shares and 100,185 non-voting common shares of Trade Marks held by Food Services were exchanged for 3,968,553 voting common shares without par value with a value of \$2,652,000.
- iv) The 10,754,373 voting common shares of Trade Marks held by the Fund were exchanged for 10,754,373 voting common shares without par value with a value of \$2,187,000.

v) The 769,577 Class A preferred shares of Trade Marks held by Food Services were exchanged for 769,577 non-voting common shares without par value with a value of \$7,826,000.

vi) The 3,198,951 Class B preferred shares of Trade Marks held by Food Services were exchanged for 3,198,951 new non-voting common shares with \$10 par value with a value of \$36,363,000.

f) Exchange rights

The common shares of Trade Marks held by Food Services may be exchanged at the option of Food Services into Units of the Fund on the basis of two common shares for one Unit of the Fund, except that Food Services may not exchange non-voting common shares for Units of the Fund if it would result in Food Services having a voting interest in Trade Marks greater than its economic interest. Therefore, after the Offer and Reorganization, Food Services holds indirectly, the equivalent of 32.5% of the Units of the Fund on a fully diluted basis, on the basis of two common shares being the economic equivalent of one Unit of the Fund. Food Services will continue to be entitled to additional limited partnership units (LP units) of the Partnership on the annual adjustment of the restaurants in the Royalty Pool. The additional LP units are exchangeable for non-voting common shares of Trade Marks on the basis of one LP unit for two non voting common shares of Trade Marks.

All of the voting and non-voting common shares held by the Fund and Food Services are entitled to the same dividends per share.

g) Costs

The costs of the Offer and the Reorganization were \$775,000 and were expensed during the year by Trade Marks under an administration agreement with the Fund whereby Trade Marks, at its expense, provides or arranges for the provision of services required in the administration of the Fund. In addition, financing fees of \$449,000 were incurred by Trade Marks for the additional \$50,000,000 term loan. The financing fees will be amortized over the term of the loan.

**3 Property, plant and equipment**

	January 2, 2011			January 3, 2010		
	Cost	Accumulated amortization	Net	Cost	Accumulated amortization	Net
	\$	\$	\$	\$	\$	\$
Leasehold improvements	4,890	1,620	3,270	4,380	1,344	3,036
Machinery and equipment	5,799	3,503	2,296	4,755	3,158	1,597
Automobiles under capital lease	1,596	521	1,075	1,167	417	750
	12,285	5,644	6,641	10,302	4,919	5,383

**4 A&W Revenue Royalties Income Fund's equity interest in A&W Trade Marks Inc.**

The common shares of Trade Marks are owned by Food Services and the Fund. As a result, the Fund has an equity interest in Trade Marks. The issued and outstanding common shares of Trade Marks are as follows:

	The Fund		Food Services		Total
	Number of Shares	%	Number of Shares	%	Number of Shares
Balance as at January 3, 2010	8,340,000	58.4	5,950,018	41.6	14,290,018
January 5, 2010 adjustment to Royalty Pool	-	(1.8)	432,908	1.8	432,908
December 22, 2010 acquisition of additional voting common shares by issuing Fund Units to Food Services (note 2(b))	2,414,373	16.4	(2,414,373)	(16.4)	-
December 22, 2010 exchange of A&W notes for non-voting common shares with \$10 par value (note 2(e)(ii))	5,754,298	7.6	-	(7.6)	5,754,298
December 22, 2010 exchange of Class A shares for non-voting common shares without par value (note 2(e)(v))	-	(2.9)	769,577	2.9	769,577
December 22, 2010 exchange of Class B shares for non-voting common shares with \$10 par value (note 2(e)(vi))	-	(10.2)	3,198,951	10.2	3,198,951
Balance as at January 2, 2011	16,508,671	67.5	7,937,081	32.5	24,445,752

## A&W Food Services of Canada Inc. — Notes to Consolidated Financial Statements — January 2, 2011 and January 3, 2010

4 A&W Revenue Royalties Income Fund's equity interest in A&W Trade Marks Inc. (continued)

The Fund's equity interest in Trade Marks comprises:

	Common Shares \$	Cumulative equity in earnings (loss) \$	Cumulative dividends \$	Cumulative dilution gain \$	Cumulative equity in other comprehensive income (loss) \$	Total \$
Balance as at January 3, 2010	1	(674)	(9,350)	2,383	(175)	(7,815)
Acquisition of additional A&W notes receivable and Trade Marks' voting common shares by issuing Fund Units to Food Services (note 2(b))	2,187	-	-	-	-	2,187
Exchange of A&W notes for non-voting common shares with \$10 par value of Trade Marks (note 2(e)(ii))	57,543	-	-	-	-	57,543
Equity in Trade Marks' earnings	-	2,463	-	-	-	2,463
Dividends received	-	-	(3,523)	-	-	(3,523)
Dilution gain	-	-	-	774	-	774
Equity in Trade Marks' other comprehensive income	-	-	-	-	340	340
Balance as at January 2, 2011	59,731	1,789	(12,873)	3,157	165	51,969

### 5 A&W notes payable

A&W notes in the amount of \$83,399,000 were issued by Trade Marks and held by the Fund, and bore interest at 10.75% per annum. Interest only was payable monthly in arrears. The A&W notes were extinguished on December 22, 2010 as a result of the Fund's recapitalization and reorganization (note 2).

Trade Marks' interest expense on the A&W notes for the year ended January 2, 2011 was \$8,745,000 (January 3, 2010 - \$8,965,000), of which \$nil (January 3, 2010 - \$761,000) is payable to the Fund by Trade Marks at January 2, 2011.

### 6 Term loan and operating loan facilities

Food Services has a \$5,000,000 demand operating loan facility with HSBC Bank Canada (the Bank) 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 January 2, 2011, the full amount of the facility was available.

Food Services' operating facility is secured by 1,000,000 voting common shares and 1,000,000 non-voting common shares of Trade Marks owned by Food Services.

Trade Marks has a \$2,000,000 demand operating loan facility with the Bank 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 January 2, 2011, the full amount of the facility was available.

On December 22, 2010, Trade Marks increased its existing \$10,000,000 term loan with the Bank to \$60,000,000 to finance repayment of \$50,000,000 of A&W notes. The new term loan is repayable on December 22, 2015 and bears interest at bank prime rate plus 1%. Interest only is payable monthly, providing that the company's earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA), tested quarterly on a trailing four quarter basis, in arrears, is not less than specified amounts. In the event that EBITDA is less than these specified amounts, the term loan will be fully amortized over the greater of three years and the remaining term and repayment will be by way of blended monthly instalments of principal and interest. The new loan contains a number of covenants including the requirement to meet certain EBITDA levels and debt to EBITDA ratios during each trailing four quarter period. Trade Marks was in compliance with all of its financial covenants as at January 2, 2011.

Trade Marks uses an interest rate swap agreement to manage risks from fluctuations in interest rates. The interest rate swap on the \$10,000,000 term loan was terminated effective December 22, 2010 and Trade Marks entered into a new interest rate swap on the new \$60,000,000 term loan on the same day. As a result,

6 Term loan and operating loan facilities (continued)

the term loan bears interest at 5.03% per annum, of which 2.53% per annum is fixed under an interest rate swap maturing December 22, 2015 and 2.50% per annum is subject to annual review by the Bank. The fair value of the interest rate swap as at January 2, 2011 is \$299,000 favourable (January 3, 2010 - \$370,000 unfavourable) and the change in fair value is recorded in other comprehensive income (loss), net of income taxes.

A general security agreement over the assets of Trade Marks has been provided as collateral for the demand operating loan facility and term loan. The Partnership has provided its guarantee in favour of the Bank of all the indebtedness, covenants and obligations of Trade Marks to the Bank.

The term loan comprises:

	January 2 2011 \$	January 3 2010 \$
Term loan	60,000	10,000
Deferred financing fees	(447)	(10)
	<u>59,553</u>	<u>9,990</u>

## 7 Notes receivable

The notes are receivable from certain franchisees with varying rates of interest up to 8%. The notes are repayable in monthly instalments over periods not exceeding seven years. At January 2, 2011, the notes outstanding amounted to \$86,000 (January 3, 2010 - \$207,000), of which \$44,000 (January 3, 2010 - \$137,000) is current and included in accounts receivable.

## 8 Long-term liabilities and obligations under capital leases

	January 2 2011 \$	January 3 2010 \$
Long-term pension liability (note 12)	7,730	7,339
Long-term rent subsidies	105	117
Long-term employee benefits (note 12)	179	116
	<u>8,014</u>	<u>7,572</u>
Less: Current portion included in accrued liabilities	320	303
	<u>7,694</u>	<u>7,269</u>
Obligations under capital leases, bearing interest at 4.25% - 11.65%	1,149	753
Less: Current portion included in accrued liabilities	342	275
	<u>807</u>	<u>478</u>

## 9 Income taxes

a) The provision for income taxes shown in the consolidated statements of earnings differs from the amounts obtained by applying statutory tax rates to the earnings before income taxes for the following reasons:

Fiscal year ended	January 2 2011 \$	January 3 2010 \$
Statutory combined federal and provincial income tax rates	25.6%	21.5%
	<u>\$</u>	<u>\$</u>
Provision for income taxes based on statutory income tax rates	10,145	3,367
Non-deductible items	209	94
Rate reduction for Canadian controlled private corporations	(68)	(68)
Rate changes on future income taxes	75	(42)
Adjustment to prior year provisions	(146)	-
Rate difference on capital gain	(1,949)	-
Provision for income taxes	<u>8,266</u>	<u>3,351</u>

b) Future income tax assets and liabilities comprise the following:

	January 2 2011 \$	January 3 2010 \$
Current		
Non-capital losses	280	1,741
Current tax reserves	291	252
Investment in A&W Trade Marks Limited Partnership	(3,281)	(3,264)
	<u>(2,710)</u>	<u>(1,271)</u>
Long term		
Long-term liabilities	1,813	1,820
Intangible assets	(2,466)	(1,644)
Property, plant and equipment	(36)	23
	<u>(689)</u>	<u>199</u>

At January 2, 2011, Trade Marks has \$1,557,000 (January 3, 2010 - \$9,162,000) of non-capital losses available to carry forward. These losses expire in 2030.

## 10 Capital stock

### Authorized

Unlimited number of common shares

Unlimited number of preferred shares

Issued	January 2 2011 \$	January 3 2010 \$
4,781,250 common shares	10,500	10,500

## 11 Commitments and contingencies

### Leases

The company has base rental obligations under operating leases for premises, equipment and automobiles and under capital leases for automobiles. Certain of the premises leases require additional payments contingent on sales volume. The company generally arranges premises leases and enters into agreements whereby the company licenses the premises to the franchisee,

for which the company receives a premises licence fee. Under the terms of the agreements, the franchisee assumes all rights and obligations under the lease. Accordingly, the company records net operating lease expenses in its consolidated statements of earnings.

The annual rental payments under capital leases and operating leases, excluding contingent rentals, are as follows

	Capital lease obligations \$	Operating lease obligations \$	Operating lease subleases \$	Net operating lease liability \$
For fiscal year				
2011	464	22,470	21,368	1,102
2012	437	21,659	20,679	980
2013	362	20,475	19,697	778
2014	86	19,051	18,296	755
2015	-	17,021	16,274	747
Balance of commitments	-	89,728	85,694	4,034
	1,349	190,404	182,008	8,396
Less: Imputed interest	200	-	-	-
	1,149	190,404	182,008	8,396

### Purchase obligations

The company has purchase obligations for supply to franchisees for food supplies, packaging and equipment of \$32,751,000 (January 3, 2010 - \$25,787,000).

### National Advertising Fund

The company maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$532,000 (January 3, 2010 - \$506,000) to Food Services during the year for marketing, promotional and administrative services provided to the advertising fund. At January 2, 2011, the advertising fund had a surplus balance of \$113,000 (January 3, 2010 - \$12,000) which is included in accounts payable and accrued liabilities.

### Contingencies

In the normal course of operations, the company is party to various legal proceedings. Management has assessed the company's likely liability for all claims outstanding and has made provision for these claims in the consolidated financial statements. The actual liability could differ from these estimates.

### 12 Employee benefits

The accrued benefit obligation and related expense for the supplementary retirement benefit plan are actuarially determined using the projected benefit method and management's best estimate of expected salary escalation and inflation rates.

The discount rate used to determine the accrued benefit obligation and related expense is determined using a current settlement discount rate. The most recent actuarial valuation of the unfunded liability was as of December 31, 2010 with a measurement date of December 31, 2010 and the next required valuation will be as of December 31, 2011. The unfunded liability of the company under these agreements as at January 2, 2011, assuming retirement of each officer at normal retirement age, was \$7,730,000 (January 3, 2010 - \$7,339,000) and is included in long-term liabilities (note 8).

Pension expense for the year for the defined contribution pension plan and the supplementary retirement benefit plan was \$524,000 (January 3, 2010 - \$443,000) and \$650,000 (January 3, 2010 - \$400,000), respectively. Total cash payments in the year for the defined contribution pension plan and the supplementary retirement benefit were \$524,000 (January 3, 2010 - \$443,000) and \$259,000 (January 3, 2010 - \$263,000), respectively.

The significant actuarial assumptions adopted in determining the accrued benefit obligation are as follows:

	January 2 2011 %	January 3 2010 %
Discount rate	5.70	6.75
Increase in earnings	4.00	4.00
Inflation rate	2.50	2.50

The long-term employee benefits comprise medical and dental premiums paid on behalf of former employees on long-term disability.

### 13 Related party transactions and balances

Trade Marks' interest expense on the A&W notes for the year was \$8,745,000 (January 3, 2010 - \$8,965,000), of which \$nil (January 3, 2010 - \$761,000) is payable to the Fund by Trade Marks at January 2, 2011.

During the year, Trade Marks declared dividends on its common shares held by the Fund of \$3,523,000 (January 3, 2010 - \$3,311,000), of which \$nil (January 3, 2010 - \$nil) is payable to the Fund by Trade Marks as at January 2, 2011.

Included in accounts receivable is \$36,000 (January 3, 2010 - \$36,000) due to Trade Marks from the Fund without interest and on demand.

The Fund has entered into an administration agreement with Trade Marks whereby Trade Marks, at its expense, will provide or arrange for the provision of services required in the administration of the Fund. Trade Marks has arranged for management, administrative and accounting services to be provided by Food Services at no cost until 2011.

During the year, Food Services contracted with Biting Buffalo Holdings Inc. for rental of a private plane and crew for business travel. A shareholder, director and officer of Food Services, who is also a director of Trade Marks, is the shareholder of Biting Buffalo Holdings Inc. The cost of the services provided under the contract during the year totalled \$386,000 (January 3, 2010 - \$446,000) and was negotiated on normal commercial terms. At January 2, 2011, \$nil (January 3, 2010 - \$nil) is payable to Biting Buffalo Holdings Inc. by Food Services.

During the year, the company entered into an agreement with the Vancouver Canadians Professional Baseball Club, of which a shareholder, director and officer of Food Services and director of

Trade Marks is a part owner. The funds provided to the Vancouver Canadians under the agreement during the year were \$92,000 (January 3, 2010 - \$95,000), in exchange for advertising the A&W brand at the ballpark.

Other related party transactions and balances are referred to elsewhere in these notes.

## 14 Financial instruments and financial risk management

Food Services' financial instruments consist of cash and cash equivalents, accounts receivable, notes receivable, accounts payable and accrued liabilities, term loan, and interest rate swap.

Food Services classifies its financial instruments as follows:

- cash and cash equivalents, accounts receivable and notes receivable as loans and receivables, which are initially measured at fair value and subsequently at amortized cost.
- accounts payable and accrued liabilities and term loan as other financial liabilities, which are measured at amortized cost.
- interest rate swap as available-for-sale.

### Fair values

Management estimates that the fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities, and notes receivable approximate their carrying values given the short term to maturity of these instruments.

The fair value of the term loan approximates its carrying value due to the floating interest rate. The fair value of the interest rate swap is \$299,000 favourable (January 3, 2010 - \$370,000 unfavourable).

### Credit risk

The company's exposure to credit risk is as indicated by the carrying amount of its accounts receivable and notes receivable. Receivables are due from franchisees and distributors. The company does not have a significant exposure to any individual franchisee. However, as at January 2, 2011, \$3,930,000 (January 3, 2010 - \$6,369,000) is receivable from one distributor.

### Liquidity risk

The primary sources of liquidity risk are dividends on the common shares. The primary sources of funds to pay dividends are the fees from franchised restaurants and revenues from the development of franchised restaurants, the sale of food and supplies to franchisees and distributors, company-owned restaurants and the sale of A&W Root Beer concentrate. The liquidity risk is assessed

as low due to the nature of the income Food Services receives from the franchisees and the company's ability to reduce future dividends if necessary.

### Interest rate risk

The term loan and operating loan facilities bear floating rates of interest as disclosed in note 6. The company has used an interest rate swap to fix the rate of interest on the term loan. Cash and cash equivalents earn interest at market rates. All of the company's other financial instruments are non-interest bearing.

## 15 Capital disclosures

Food Services' capital consists of shareholders' deficiency. Food Services' capital management objectives are to have sufficient cash and cash equivalents to ensure the growth of the business, fund its investing activities, and pay dividends on its common shares to its shareholders, after satisfaction of its debt service and income tax obligations; provisions for direct costs and administration expenses; and retention of reasonable working capital reserves. Food Services manages its capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, Food Services may adjust the amount of dividends paid to its shareholders.

## 16 Interest expense

Fiscal year ended	January 2 2011 \$	January 3 2010 \$
Interest income	(84)	(34)
Term loan	695	581
A&W notes payable	8,745	8,965
Amortization of deferred financing fees	12	9
Capital leases	97	47
	9,465	9,568

## 17 Subsequent event

On February 2, 2011, Trade Marks declared a dividend on its common shares of \$1,463,000, of which \$966,000 is payable to the Fund on February 28, 2011.

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



**Jefferson J. Mooney**  
Chairman

Jeff Mooney joined A&W Food Services in 1973, became President and Chief Executive Officer in 1991 and Chairman in 1995. In 2005 Mr. Mooney retired as Chief Executive Officer but remains Chairman. He holds a Bachelor of Arts degree from the University of Saskatchewan and is an alumnus of the

Harvard University School of Business. In addition, Jeff is a director of the Vancouver Organizing Committee for the 2010 Olympic and Paralympic Winter Games and a co-owner of the Vancouver Canadians Professional Baseball Club.



**Paul F.B. Hollands**  
President and Chief Executive Officer

Paul Hollands joined A&W Food Services in 1980, became Executive Vice President and Chief Operating Officer in 1995, President in 2002, and Chief Executive Officer in 2005. He holds a Bachelor of Commerce degree from the University of British Columbia, and is a recipient of the first class of Canada's

national Top 40 Under 40 leadership award. Paul is Chairman of the Faculty Advisory Board of the Sauder School of Business at the University of British Columbia. He is past Chairman of the Canadian Association of Income Funds and past Chairman of the Canadian Restaurant and Foodservices Association.



**Donald T. Leslie**  
Chief Financial Officer

Don Leslie joined A&W Food Services in 2003 as Vice President, Finance and was appointed Chief Financial Officer in 2005. He holds a Bachelor of Commerce degree from the University of British Columbia and he also holds a Chartered Accountant designation. Prior to joining A&W Don had extensive

senior management experience with several public and privately owned companies. In addition to his finance responsibility, Don has overall responsibility for Investor Relations for the A&W Revenue Royalties Income Fund. He is a member of the Vancouver Chapter of Financial Executives International (FEI) Canada.



**J. Graham Cooke**  
Vice President, New Restaurant Expansion

Graham Cooke joined A&W Food Services in 1981, became Director of Purchasing and Distribution in 1986, Vice President of Franchising in 1991, Vice President, Operations in 1997 and Vice President, New Restaurant Expansion in 2002. He holds a Masters of Business Administration degree from Queen's

University. Graham is also a director of the Canadian Franchise Association and currently serves as Chair.



**Janice Beer**  
Vice President, People Potential

Janice Beer joined A&W in 2001 as Director of People Potential and was appointed Vice President, People Potential in April 2004. In this capacity she is responsible for all human resource functions. Prior to joining A&W Janice held various positions with a major downstream oil company in the areas of human resources,

public affairs and finance. Janice holds a Bachelor of Commerce degree and a Master of Education in Adult Education.



**Susan Senecal**  
Vice President, Operations

Susan Senecal joined A&W in 1992 as an Area Manager. She became Regional Director of Operations in 1996, General Manager, Quebec in 1997 and was appointed Vice President, Operations in December 2002. Susan holds a Bachelor of Science degree from McGill University

and is a director of the Canadian Restaurant and Food Services association.



**P.M. (Trish) Sahlstrom**  
Vice President, Purchasing & Distribution

Trish Sahlstrom joined A&W in 1981 in the Purchasing and Distribution area. She assumed increasing responsibilities in the organization and in 2001 became Vice President, Purchasing & Distribution. Trish is also General Manager for the canned and bottled A&W Root Beer business. She sits on the International Advisory

Board for the William F Harrah College, University of Nevada Las Vegas; and on the Customer Advisory Task Force for the National Association of Food Equipment Manufacturers.



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of Canada Inc.**

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