

# A&W Revenue Royalties Income Fund

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# Q2

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Second Quarter Report to Unitholders  
for the period ended  
June 18, 2006

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## To our Unitholders

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On behalf of the Trustees of the A&W Revenue Royalties Income Fund (the Fund), I am very pleased to report the results for the second quarter ended June 18, 2006. Strong business momentum continued in the second quarter, driven by a same store sales increase of 6.3%. On a year to date basis, same store sales have now increased by 7.6%. This is the thirteenth straight quarter of same store sales increases for the A&W restaurants included in the Royalty Pool for the Fund.

As a result of the continued strong performance, the Trustees have increased monthly distributions for a third time this year. Effective with the July distribution, payable on August 31, 2006, monthly distributions will increase by 2.1% to 9.7 cents per unit. On an annualized basis this represents a distribution rate of \$1.164 per unit.

The source of revenue for the Fund is through its 64% ownership in A&W Trade Marks Inc., which in turn receives royalty income from A&W Food Services of Canada Inc. based on 3% of the sales of the 654 A&W restaurants in the Royalty Pool. As such, increases in same store sales are one of the most important drivers of success for the Fund. The Royalty Pool was expanded on January 5, 2006 from 638 restaurants to 654 restaurants to reflect the addition of new restaurants opened between September 2004 and September 2005, adjusted for restaurants which closed during 2005.

The Fund and the underlying A&W restaurant business enjoyed another excellent quarter. Total sales of restaurants in the Royalty Pool increased by 9.7% during the quarter, driven primarily by the 6.3% same store sales increase plus the increase in the number of restaurants in the Royalty Pool. For the quarter, total distributable cash increased by 15% and distributable cash per equivalent unit increased from 27.2 cents to 30.1 cents compared to the same quarter last year. Year to date distributable cash per unit increased from 50.7 cents to 55.0 cents versus the prior year.

The continued strong same store sales growth is a result of A&W's strategy to be "the number one choice of the baby boomer generation". In particular the advertising program continued to generate a strong response with consumers, especially through the positive impact of the "Burger Family" spot, which aired again in the second quarter. Breakfast also continued to be an important contributor to the growth. Finally, the continued roll out of the retro-modern restaurant design favourably impacted sales.

The Trustees continue to be pleased with the overall performance of the Fund and the underlying A&W restaurant business. In particular, we are pleased to be able to increase distributions for the third time this year, and consistent with the trust that our investors have placed in the Fund, continue to maintain a conservative rate of distribution versus our income. Our thanks to our unitholders for their continued support.

A handwritten signature in black ink, appearing to read "John R. McLernon", followed by a period.

John R. McLernon  
Chairman, A&W Revenue Royalties Income Fund  
On behalf of the Board of Trustees

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## **A&W Revenue Royalties Income Fund Management Discussion and Analysis**

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The following is a discussion on the unaudited financial statements and results of operations of the A&W Revenue Royalties Income Fund (the Fund) for the quarter ended June 18, 2006. This report is dated July 25, 2006 and should be read in conjunction with the interim unaudited financial statements for the quarter ended June 18, 2006 and the annual audited financial statements for the year ended December 31, 2005. A copy of this report and additional information about the Fund is available at [www.sedar.com](http://www.sedar.com) or [www.awincomefund.ca](http://www.awincomefund.ca).

In addition, readers are directed to the annual audited financial statements of A&W Trade Marks Inc. (Trade Marks) for the year ended December 31, 2005 and the interim unaudited financial statements for the quarter ended June 18, 2006.

Readers should be aware that 2006 results are not directly comparable to the prior year due to the increase in the number of restaurants in the Royalty Pool from 638 in 2005 to 654 in 2006. In addition, the first quarter of 2006 is not directly comparable to the first quarter of 2005 as there were 85 days in Q1 2006 compared to 86 days in Q1 2005. There were 84 days in the second quarter of both years. Same store sales growth is based on an equal number of days for 2006 and 2005.

### **OVERALL PERFORMANCE**

Same store sales growth for the restaurants in the Royalty Pool was 6.3% for the quarter and 7.6% year to date. Royalty income for the quarter increased 9.7% over the same quarter in 2005 and 10.5% year to date, due to the same store sales growth and the increase in the number of restaurants in the Royalty Pool from 638 during 2005 to 654 during 2006.

Distributable cash available to pay distributions to unitholders and dividends on Class A and B preferred shares and common shares increased by 15.0% to \$3,930,000 for the quarter and by 12.5% to \$7,171,000 year to date. This increase in distributable cash was generated primarily through growth in royalty income. Overall cash taxes and expenses for Trade Marks and the Fund decreased by \$151,000 for the quarter and \$67,000 year to date. While the year to date general and administrative expenses increased \$36,000 over the prior year, this increase was more than offset by the elimination of the federal Large Corporations Tax and reduction in interest expense.

The Fund is pleased to announce that, as a result of this continued strong performance, it is increasing monthly distributions to unitholders by 2.1% to 9.7 cents per month beginning with the July 2006 distribution which is payable on August 31, 2006. On an annualized basis this represents a distribution rate of \$1.164 per unit. This is the third increase in distributions this year.

## FINANCIAL HIGHLIGHTS

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

<b>(dollars in thousands except per unit amounts)</b>	<b>12 week period ended Jun 18, 2006</b>	12 week period ended Jun 19, 2005	<b>Period from Jan 1, 2006 to Jun 18, 2006</b>	Period from Jan 1, 2005 to Jun 19, 2005
Same store sales growth	<b>6.3%</b>	3.0%	<b>7.6%</b>	4.2%
Number of restaurants in the Royalty Pool	<b>654</b>	638	<b>654</b>	638
Sales reported by the restaurants in the Royalty Pool	<b>\$135,605</b>	\$123,598	<b>\$257,322</b>	\$232,950
Royalty income	<b>\$4,069</b>	\$3,708	<b>\$7,720</b>	\$6,989
Cash taxes and expenses	<b>\$139</b>	\$290	<b>\$549</b>	\$616
Total distributable cash generated for distributions and dividends	<b>\$3,930</b>	\$3,418	<b>\$7,171</b>	\$6,373
Distributable cash per equivalent unit (2006 – 13,039,828 units; 2005 - 12,579,462 units)	<b>\$0.301</b>	\$0.272	<b>\$0.550</b>	\$0.507
Distributions declared per unit (8,340,000 units)	<b>\$0.283</b>	\$0.270	<b>\$0.469</b>	\$0.450

Distributable cash 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 identifies the amount of actual cash available to pay distributions to unitholders and dividends to Food Services.

## OVERVIEW

### The Fund

The Fund is a limited purpose trust established to invest in Trade Marks, which 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.

The Fund earns interest income on A&W notes issued by Trade Marks. The A&W notes are in the amount of \$83,399,000, bear interest at 10.75% per annum and mature on February 15, 2034. Payments of interest only are receivable from Trade Marks monthly in arrears.

The Fund also earns dividends from its 64% investment in the common shares of Trade Marks.

The Fund's distributions to unitholders are based on its net cash receipts, less minimal expenses of the Fund which are limited to bank charges.

The Fund is not taxed on any income that is distributed to unitholders. Income tax obligations related to the distributions by the Fund are obligations of the unitholders.

### **Trade Marks**

On February 15, 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, \$27,800,000 was paid by the issuance of 2,779,975 Class A preferred shares and 2,780,000 common shares of Trade Marks and the balance (the Balance) of \$40,000,000 is due without interest on January 31, 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 three per cent 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 adjustment to the Royalty Pool.

The Balance of the purchase price will be reduced by all amounts Trade Marks is required to pay Food Services in respect of annual adjustments to the Royalty Pool up to January 31, 2010. If the total annual adjustments are less than the Balance, the obligation of Trade Marks to pay the remaining Balance of the purchase price is extinguished.

The Royalty Pool is adjusted in January of each year to reflect sales from new restaurants, net of the sales of any A&W restaurants that have permanently closed. Trade Marks pays Food Services 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 the amount of estimated sales from the net new restaurants and the current yield on the units of the Fund, discounted by 7.5%. The payment is in the form of common shares and Class B preferred shares of Trade Marks which are the economic equivalent of units of the Fund. Twenty percent of the shares are held in escrow for a year until the actual sales of the new restaurants are known and the corresponding adjustment is made to the consideration.

Trade Marks' expenses include general and administrative expenses, amortization of deferred financing fees, interest expenses on its \$10 million term loan and the A&W notes, and taxes. Also, GAAP stipulates that the dividends on the Class A and B preferred shares be classified as interest expense by Trade Marks.

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.

The Class A and Class B preferred shares of Trade Marks are owned by Food Services and comprise:

(dollars in thousands)	June 18, 2006		December 31, 2005	
	#	\$	#	\$
Class A shares – at cost	2,779,975	27,800	2,779,975	27,800
Class B shares – at cost:				
2003 annual adjustment	452,469	5,108	452,469	5,108
2004 annual adjustment	495,681	5,210	495,681	5,210
2005 annual adjustment	511,337	6,197	511,337	6,197
2006 annual adjustment	460,366	5,695	-	-
	1,919,853	22,210	1,459,487	16,515
Accrued dividends		234		360
	4,699,828	50,244	4,239,462	44,675

The Class A and B preferred shares entitle Food Services to a fixed cumulative preferential cash dividend at a rate of \$1.075 per share per annum. The Class A and B preferred shares may 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 preferred share and, in turn, one common share of Trade Marks and a \$10 A&W note are exchangeable for a unit in the Fund.

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

	The Fund		Food Services		Total
	#	%	#	%	#
February 15, 2002	8,340,000	75.0%	2,780,000	25.0%	11,120,000
2003 annual adjustment		-2.9%	452,469	2.9%	452,469
2004 annual adjustment		-3.0%	495,681	3.0%	495,681
2005 annual adjustment		-2.8%	511,337	2.8%	511,337
2006 annual adjustment		-2.3%	460,366	2.3%	460,366
	8,340,000	64.0%	4,699,853	36.0%	13,039,853

## Summary

Trade Marks earns royalty income from Food Services and distributes its available cash by way of dividends on its shares, after satisfaction of its debt service obligations, provisions for administrative expenses of Trade Marks and the Fund, and retention of reasonable working capital reserves. The Fund receives interest income and dividends from Trade Marks and pays its net cash receipts to unitholders. An important aspect of the structure of the Fund is that, provided Food Services holds an indirect interest in the Fund, distributions to unitholders are made in priority to distributions to Food Services. Food Services' consolidated financial statements are included as a supplement to this report.

## EXPANSION OF THE ROYALTY POOL

On January 5, 2006, the number of A&W restaurants for which royalties are paid to Trade Marks was increased by 27 new restaurants less 11 restaurants which permanently closed during 2005. Trade Marks paid Food Services \$5,695,000, by issuance of 460,366 Class B preferred shares and 460,366 common shares of Trade

Marks, as initial consideration for the estimated royalty stream from the 16 net restaurants added to the Royalty Pool. Together these shares are the economic equivalent of units of the Fund and are valued at \$12.37 per share, being the weighted average trading price of the units of the Fund for the 20 trading days ending October 31, 2005.

A final adjustment to the share consideration will be made in December 2006 based upon the actual annual sales reported by the new restaurants. Until then, 20% of the shares will be held in escrow.

After the January 5, 2006 adjustment to the Royalty Pool, Food Services owns the equivalent of 36% of the units of the Fund on a fully-diluted basis.

## OWNERSHIP OF THE FUND

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

	June 18, 2006 <sup>(1)</sup>		December 31, 2005	
	#	%	#	%
Fund units held by public unitholders	8,340,000	63.96	8,340,000	66.30
Trade Marks' Class A and B preferred shares held by Food Services: <sup>(2)</sup>				
Class A <sup>(3)</sup>	2,779,975	21.32	2,779,975	22.10
Class B <sup>(4)</sup>	1,919,853	14.72	1,459,487	11.60
	4,699,828	36.04	4,239,462	33.70
<b>Total equivalent units</b>	<b>13,039,828</b>	<b>100.00</b>	<b>12,579,462</b>	<b>100.00</b>

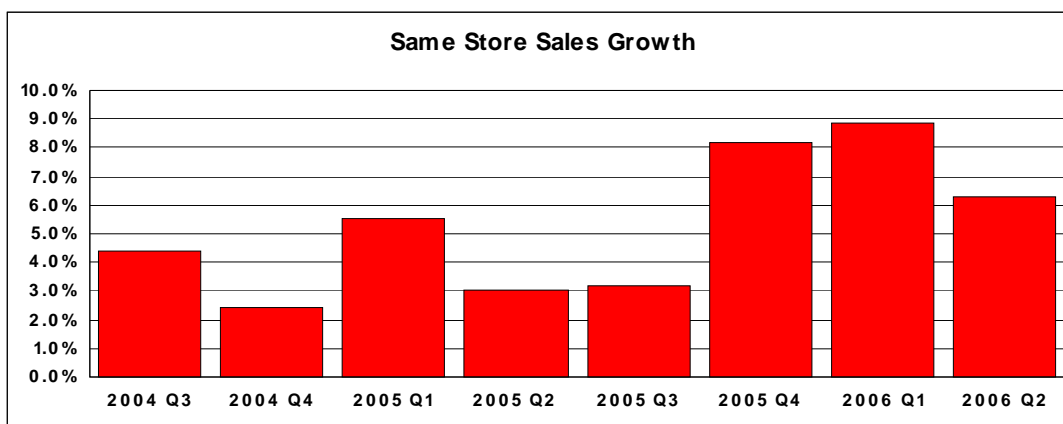
Notes:

- (1) Information is current as at July 25, 2006.
- (2) May be redeemed 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 preferred share and, in turn, one common share of Trade Marks and a \$10 A&W note are exchangeable for a unit in the Fund.
- (3) Represents Food Services' initial 25% equivalent ownership of the Fund, prior to the issuance of the Class B preferred shares.
- (4) Represents Class B preferred shares issued to Food Services as consideration for annual adjustments to the Royalty Pool.

## SAME STORE SALES GROWTH

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

Same store sales growth was 6.3% for the quarter and 7.6% year to date. Same store sales growth has now been positive for 13 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

During the quarter ended June 18, 2006, the Fund earned interest income from Trade Marks on the A&W notes of \$2,063,000, the same as in the second quarter last year. Year to date interest income was \$4,151,000, compared to \$4,176,000 for 2005. The \$25,000 decrease is due to the shorter first quarter in 2006. The Fund's share of Trade Marks' earnings was \$199,000 for the quarter and \$35,000 year to date, compared to losses of \$9,000 for the quarter and \$298,000 year to date last year. The increase in earnings was due to the increase in Trade Marks' royalty income discussed below.

Royalty income earned by Trade Marks from Food Services in the second quarter was \$4,069,000 based on sales of \$135,605,000 reported by the A&W restaurants in the Royalty Pool. This is an increase of 9.7% over royalty income of \$3,708,000 and sales of \$123,598,000 during the same quarter of 2005. Year to date royalty income was \$7,720,000 based on sales of \$257,322,000, an increase of 10.5% over royalty income of \$6,989,000 and sales of \$232,950,000 for 2005. These increases are due to the combined impact of the additional 16 restaurants in the Royalty Pool and the same store sales increase of 7.6%.

## EXPENSES AND TAXES

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

(dollars in thousands)	12 week period ended Jun 18, 2006	12 week period ended Jun 19, 2005	Period from Jan 1, 2006 to Jun 18, 2006	Period from Jan 1, 2005 to Jun 19, 2005
General and administrative	\$50	\$119	\$304	\$268
Amortization of deferred financing fees	5	4	9	8
Interest on term loan	117	134	245	275
Interest on A&W notes	2,063	2063	4,151	4,176
Accrued dividends on Class A&B preferred shares <sup>(1)</sup>	1,163	1,051	2,339	2,127
Large corporations tax	(28)	37	-	73
Future income taxes	388	313	617	511

(1) As required by GAAP, the dividends are classified as interest expense and accrued accordingly

General and administrative expenses in the second quarter, including expenses for the Fund under the administration agreement between Trade Marks and the Fund, decreased by \$69,000 to \$50,000, compared to \$119,000 in 2005. The decrease in expenses in the quarter was due to timing of expenses with respect to the Fund's annual report which were recorded in the first quarter in 2006 versus the second quarter in 2005. Year to date general and administrative expenses increased by \$36,000 due to increased public reporting costs, including higher printing and postage costs for the annual report and higher filing fees.

Trade Marks' net interest expense on its term loan decreased by \$17,000 to \$117,000 in the quarter and decreased by \$30,000 to \$245,000 year to date. The decrease was due to the interest rate swap agreement which came into effect on February 16, 2005 and higher interest income which is netted against interest expense. Interest on the A&W notes was \$2,063,000 in the second quarter of both years, and decreased by \$25,000 to \$4,151,000 year to date which was one day shorter than 2005.

The Class A and B preferred shares entitle 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 are treated for accounting purposes by Trade Marks as interest expense and, as such, are accrued and deducted to arrive at net earnings. Class A and Class B preferred share dividends accrued in the quarter increased by \$112,000, from \$1,051,000 in the second quarter of 2005 to \$1,163,000 in 2006. The year to date increase was \$212,000, from \$2,127,000 in 2005 to \$2,339,000 in 2006. The increase is due to the additional Class B shares which were issued in January 2006.

The federal Large Corporations Tax was eliminated retroactive to January 1, 2006, resulting in a decrease of \$65,000 for the quarter and \$73,000 year to date. Future income taxes, a non-cash expense, increased by \$75,000 for the quarter and \$106,000 year to date. The increase is attributable to the increase in earnings before taxes for the year.

## **DISTRIBUTABLE CASH**

Distributable cash is calculated as the combined operating cash flows of the Fund and Trade Marks, adjusted for the dividends on Trade Marks' Class A and B preferred shares. Distributable cash is not an earnings measure recognized by GAAP and therefore may not be comparable to similar measures presented by other issuers.

(dollars in thousands except per unit amounts)	12 week period ended Jun 18, 2006	12 week period ended Jun 19, 2005	Period from Jan 1, 2006 to Jun 18, 2006	Period from Jan 1, 2005 to Jun 19, 2005
Trade Marks' cash flow from (used for) operating activities <sup>(1)</sup>	\$604	\$208	\$555	\$(50)
Add: Change in accrued dividends	100	96	126	120
Dividends on Class A & B preferred shares	1,163	1,051	2,339	2,127
Distributable cash – Trade Marks	1,867	1,355	3,020	2,197
The Fund's cash flow from operating activities <sup>(1)</sup>	2,063	2,063	4,151	4,176
Total distributable cash	\$3,930	\$3,418	\$7,171	\$6,373
Cumulative surplus – beginning of period	1,545	21	1,692	269
Distributable cash for unitholders	(2,212)	(2,073)	(4,379)	(4,195)
Distributable cash for Food Services	(1,247)	(1,055)	(2,468)	(2,136)
Cumulative surplus – end of period	\$2,016	\$311	\$2,016	\$311
Distributable cash per equivalent unit	\$0.301	\$0.272	\$0.550	\$0.507
Number of equivalent units	13,039,828	12,579,462	13,039,828	12,579,462
Distributions declared per unit (8,340,000 units)	\$0.283	\$0.270	\$0.469	\$0.450

(1) before changes in non-cash working capital

Total distributable cash increased by \$512,000 to \$3,930,000 for the quarter and by \$798,000 to \$7,171,000 year to date, due to the increase in royalty income and decrease in cash taxes and expenses discussed previously.

Distributable cash for unitholders increased to \$2,212,000 from \$2,073,000 for the quarter and to \$4,379,000 from \$4,195,000 year to date due to the increase in the annual distribution rate.

Distributable cash for dividends to Food Services increased to \$1,247,000 from \$1,055,000 for the quarter and to \$2,468,000 from \$2,136,000 year to date. The increase is due to the additional common and Class B preferred shares issued to Food Services in January 2006 as a result of the annual adjustment to the Royalty Pool and the increase in the annual distribution rate.

At the end of the second quarter there was a cumulative surplus of distributable cash of \$2,016,000 compared to a cumulative surplus of \$1,692,000 at the end of 2005.

## DISTRIBUTIONS TO UNITHOLDERS

During the quarter ended June 18, 2006, the Fund declared distributions to unitholders of \$2,360,000 or \$0.283 per unit, compared to \$2,252,000 or \$0.270 per unit in the same quarter of 2005. Year to date distributions were as follows:

(dollars in thousands except per unit amounts)	Declaration date	Payment date	Amount	Per unit
January 2006	February 6, 2006	February 28, 2006	\$ 776	\$0.093
February 2006	March 6, 2006	March 31, 2006	776	0.093
March 2006	April 4, 2006	April 28, 2006	776	0.093
April 2006	May 4, 2006	May 31, 2006	792	0.095
May 2006	June 6, 2006	June 30, 2006	792	0.095
			\$3,911	\$0.469

The distribution for December 2005 of \$750,600, which was paid on January 31, 2006, was declared and recorded for income tax purposes in 2005, the period in which it was earned. Therefore, only two distributions were declared during the first quarter.

The May 2006 distribution of \$792,300 which was declared on June 6, 2006 and paid on June 30, 2006 is reported as a current liability at June 18, 2006. On July 5, 2006, the Fund declared the June 2006 distribution of \$792,300 or \$0.095 per unit, payable to unitholders on July 31, 2006.

Due to the continued strong performance of the Fund, the Trustees have announced an increase in monthly distributions to unitholders from 9.5 cents per unit to 9.7 cents per unit starting with the July 2006 distribution which will be paid on August 31, 2006 to unitholders of record on August 15, 2006. The new monthly distribution rate translates into an annualized distribution of \$1.164 per unit, an increase of 2.1% from the prior level of \$1.140. This is the third increase in distributions this year.

## **DIVIDENDS ON TRADE MARKS' COMMON SHARES**

During the quarter, Trade Marks declared dividends on its common shares of \$186,000 or \$0.014 per share. The May 2006 dividend on common shares of \$71,000 was declared on June 6, 2006 and paid on June 30, 2006 and is reported as a current liability at June 18, 2006. Year to date common share dividends are as follows:

<b>(dollars in thousands except per share amounts)</b>	<b>Declaration date</b>	<b>Payment date</b>	<b>Food Services</b>	<b>The Fund</b>	<b>Total</b>	<b>Per Share</b>
January 2006	February 6, 2006	February 28, 2006	16	28	44	.0034
February 2006	March 6, 2006	March 31, 2006	15	29	44	.0034
March 2006	April 4, 2006	April 28, 2006	16	29	45	.0034
April 2006	May 4, 2006	May 31, 2006	26	45	71	.0054
May 2006	June 6, 2006	June 30, 2006	26	45	71	.0054
Total common share dividends			\$99	\$176	\$275	.0210

On July 5, 2006, Trade Marks declared a dividend on common shares of \$71,000 or \$0.00542 per share, payable on July 31, 2006.

## **DIVIDENDS ON TRADE MARKS' CLASS A AND B PREFERRED SHARES**

During the quarter, Trade Marks declared dividends on Class A and B preferred shares of \$1,263,000 or \$0.269 per share. The May 2006 dividend of \$421,000 was declared on June 6, 2006 and paid on June 30, 2006 and is reported as a current liability at June 18, 2006. Year to date dividends are as follows:

<b>(dollars in thousands except per share amounts)</b>	<b>Declaration date</b>	<b>Payment date</b>	<b>Amount</b>	<b>Per Share</b>
Total dividends in respect of 2005			\$ 360	
January 2006	February 6, 2006	February 28, 2006	421	.0896
February 2006	March 6, 2006	March 31, 2006	421	.0896
March 2006	April 4, 2006	April 28, 2006	421	.0896
April 2006	May 4, 2006	May 31, 2006	421	.0896
May 2006	June 6, 2006	June 30, 2006	421	.0896
Total dividends in respect of 2006			2,105	\$0.448
Total Class A and B preferred share dividends			\$2,465	

On July 5, 2006, Trade Marks declared a dividend on Class A and B preferred shares of \$421,000 or \$0.08958 per share, payable to Food Services on July 31, 2006.

## SUMMARY OF QUARTERLY RESULTS

<b>(dollars in thousands except per unit amounts)</b>	<b>Q2 2006</b>	<b>Q1 2006</b>	<b>Q4 2005</b>	<b>Q3 2005</b>
Number of restaurants in the Royalty Pool	654	654	638	638
Royalty income	\$4,069	\$3,651	\$5,202	\$3,970
The Fund's interest income	\$2,063	\$2,088	\$2,726	\$2,063
The Fund's net earnings	\$2,262	\$1,924	\$3,343	\$2,223
Basic and diluted earnings per unit	\$0.271	\$0.231	\$0.401	\$0.267
Distributable cash	\$3,930	\$3,241	\$4,887	\$3,748
Number of equivalent units	13,039,828	13,039,828	12,579,462	12,579,462
Distributable cash per equivalent unit	\$0.301	\$0.249	\$0.388	\$0.298
Distributions declared	\$2,360	\$1,552	\$3,002	\$2,252
Distributions declared per unit (8,340,000 units)	\$0.283	\$0.186	\$0.360	\$0.270
Number of days in the quarter	84	85	111	84

<b>(dollars in thousands except per unit amounts)</b>	<b>Q2 2005</b>	<b>Q1 2005</b>	<b>Q4 2004</b>	<b>Q3 2004</b>
Number of restaurants in the Royalty Pool	638	638	620	620
Royalty income	\$3,708	\$3,281	\$4,849	\$3,706
The Fund's interest income	\$2,063	\$2,113	\$2,866	\$2,057
The Fund's net earnings	\$2,054	\$1,824	\$2,850	\$2,181
Basic and diluted earnings per unit	\$0.246	\$0.219	\$0.342	\$0.262
Distributable cash	\$3,418	\$2,955	\$4,493	\$3,486
Number of equivalent units	12,579,462	12,579,462	12,068,125	12,068,125
Distributable cash per equivalent unit	\$0.272	\$0.235	\$0.372	\$0.289
Distributions declared	\$2,252	\$1,501	\$3,002	\$2,252
Distributions declared per unit (8,340,000 units)	\$0.270	\$0.180	\$0.360	\$0.270
Number of days in the quarter	84	86	117	84

## 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 has sufficient financial resources to pay ongoing future distributions as it receives income by way of interest on the A&W notes and dividends on its common shares of Trade Marks.

Trade Marks has a demand operating loan facility with HSBC Bank Canada of up to \$2,000,000 to fund its working capital requirements and to meet its cash flow needs. The operating loan bears interest at bank prime rate plus 0.5% and is repayable on demand. As at June 18, 2006, the full amount of the facility was available.

Trade Marks has a term loan with HSBC Bank Canada in the amount of \$10,000,000. The term loan is repayable on March 15, 2008 and bears interest at bank prime rate plus between 0.0% and 0.5% depending on specified financial ratios. Interest only is payable monthly, provided that 12 month trailing earnings before interest, taxes, depreciation and amortization (EBITDA) at any time are not less than \$10,000,000. In the event that EBITDA is less than \$10,000,000, the term loan will be fully amortized over the remaining term and repayment will be by way of blended monthly instalments of principal and interest.

An interest rate swap effective February 16, 2005 and maturing February 18, 2008 fixes the interest rate on the term loan at 5.81% per annum.

A general security agreement over the assets of Trade Marks was provided as security for the demand operating loan facility and term loan.

<b>Payments due by period (dollars in thousands)</b>	<b>Total</b>	<b>Less than 1 year</b>	<b>1 – 3 years</b>	<b>4 – 5 years</b>	<b>After 5 years</b>
Term loan	\$10,000	\$0	\$10,000	\$0	\$0

The Fund and Trade Marks have no other contractual or purchase obligations. 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, with the exception of the interest rate swap discussed previously.

## **RELATED PARTY TRANSACTIONS AND BALANCES**

Trade Marks' interest expense and the Fund's interest income on the A&W notes for the year to date was \$4,151,000 (2005 - \$4,176,000), of which \$1,203,000 (December 31, 2005 - \$761,000) is receivable by the Fund from Trade Marks at June 18, 2006. Interest on the A&W notes for the quarter was \$2,063,000 (2005 - \$2,063,000).

Royalty income of \$7,720,000 (2005 - \$6,989,000) was earned by Trade Marks from Food Services for the year to date, of which \$1,349,000 (December 31, 2005 - \$1,316,000) is receivable by Trade Marks at June 18, 2006. Royalty income for the quarter was \$4,069,000 (2005 - \$3,708,000).

As at June 18, 2006, \$66,000 (December 31, 2005 - \$31,000) is due to Trade Marks by 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 for the administration of the Fund. In turn, Trade Marks has arranged for certain of these services to be provided by Food Services until 2011.

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 June 18, 2006.

## **FINANCIAL INSTRUMENTS**

The Fund's financial instruments consist of cash, accounts receivable, investment in Trade Marks, distribution payable to unitholders, and due to Trade Marks. Unless otherwise noted, it is management's opinion that the Fund is not exposed to significant interest or credit risks arising from these financial instruments. Management estimates that the fair values of these financial instruments, except for the investment in Trade Marks, approximate their carrying values. It is not practicable to determine the fair value of the investment in Trade Marks given the many terms and conditions that would influence such a determination.

Trade Marks' 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 Trade Marks' term loan approximates its carrying value due to the floating interest rate. The fair value of the interest rate swap is \$20,000 favourable. It is not practicable to determine the fair value of the A&W notes payable and Class A and B preferred shares given the many terms and conditions that would influence such a determination.

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 from Food Services. All of Trade Marks' financial instruments are non-interest bearing except for the term loan and operating line of credit and the A&W notes payable, which bear interest as disclosed previously.

## **RISKS AND UNCERTAINTIES**

The performance of the Fund is dependent upon the interest income and dividends it receives from Trade Marks. The performance of Trade Marks is dependent on the royalty it receives from Food Services. The amount of the royalty is dependent upon the sales of the A&W restaurants in the Royalty Pool. 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. In addition, factors such as the availability of experienced management and hourly employees may also adversely affect the sales of the quick service restaurant industry in general and the sales by A&W restaurants in particular.

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.

Any significant event that adversely affects consumption of hamburgers, chicken, fries and soft drinks, such as cost, changing tastes or health concerns, could adversely impact the sales of A&W restaurants and consequently, the amount of the royalty payable to Trade Marks.

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. 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, 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**

The overall growth and performance of Trade Marks and the Fund is driven primarily by growth in same store sales and by increasing the number of restaurants in the Royalty Pool.

A&W is well positioned for continued success in the remainder of 2006 due to the ongoing implementation of its strategic initiatives designed to enhance A&W's appeal to its target baby boomer customers.

### **Menu Innovation**

A&W's menu strategy is focussed on appealing to baby boomers and building three strong dayparts. In 2005, A&W introduced the new Homestyle Breakfast sandwiches and the Fresh Choices menu (featuring the premium Swiss Veggie Deluxe burger, a new tossed salad program and a reformulated all white meat Chicken Grill Deluxe sandwich). In 2006, A&W will continue to focus on building the important breakfast daypart and to build on its dominant market position in Canada for best tasting burgers.

### **Advertising and Marketing Campaigns**

A&W's advertising and promotions programs continue to provide good results in 2006. The "Drive" television commercial which was launched in 2004 and followed up in 2005 with the equally successful "Burger Family" spot appealed to the strong emotional connection that boomers have with A&W. The newest television commercial which was launched in July 2006 focuses on A&W serving great burgers. Advertising will continue to be developed in 2006 to support specific promotional offers.

Cruisin' the Dub events at freestanding restaurants across the country continue to be a big success, celebrating the music and classic cars of the boomers' youth. The upcoming quarter is the peak season for Cruisin' the Dub events and a large number are scheduled throughout the summer months.

### **Restaurant Re-imaging**

The roll out of the retro-modern restaurant image is continuing during 2006. The cost of these upgrades is paid entirely by the franchise operator and therefore there is no cost impact on Trade Marks or the Fund.

Looking forward, A&W will continue to focus on the key strategic initiatives which will build A&W's appeal to the baby boomers and grow customer traffic and sales.

Certain statements in this Management Discussion and Analysis and the annual report of the Fund may be forward-looking in nature. These include references to liquidity, subordinated dividends, earnings and anticipated earnings from growth in same store sales and new restaurant openings. Actual results may differ materially from those expressed or implied in these forward-looking statements. The forward-looking statements are based on assumptions that management considered reasonable at the time they were prepared. These forward-looking statements are subject to a number of risk factors, including the ability of A&W Food Services of Canada Inc. to implement its marketing strategies, the opening of new A&W restaurants, general economic and business conditions, financial and political instability, and other factors disclosed previously and from time to time in the Fund's public filings. The forward looking information contained in this document is current only as of the date of this document. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise.

# A&W Revenue Royalties Income Fund

## Financial Statements

For the second quarter ended June 18, 2006

### Balance Sheet

Unaudited  
(in thousands of dollars)

	June 18 2006	December 31 2005
<b>Assets</b>		
<b>Current assets</b>		
Cash	\$ 5	\$ -
Accounts receivable (note 4)	1,248	761
	<b>1,253</b>	<b>761</b>
Investment in A&W Trade Marks Inc. (note 2)	75,594	75,735
	<b>\$ 76,847</b>	<b>\$ 76,496</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Distribution payable to unitholders (note 3)	\$ 792	\$ 751
Due to A&W Trade Marks Inc. (note 4)	66	31
	<b>858</b>	<b>782</b>
<b>Unitholders' Equity:</b>		
Capital contributions	77,115	77,115
Accumulated earnings	37,632	33,446
Accumulated distributions (note 3)	(38,758)	(34,847)
	<b>75,989</b>	<b>75,714</b>
	<b>\$ 76,847</b>	<b>\$ 76,496</b>

Subsequent event (note 5)

See accompanying notes to these financial statements.

## Statement of Earnings and Accumulated Earnings

Unaudited

(in thousands of dollars, except per Unit amounts)

	<b>12 week period ended Jun 18, 2006</b>	12 week period ended Jun 19, 2005	<b>Period from Jan 1, 2006 to Jun 18, 2006</b>	Period from Jan 1, 2005 to Jun 19, 2005
<b>Interest income</b>	<b>\$ 2,063</b>	\$ 2,063	<b>\$ 4,151</b>	\$ 4,176
<b>Equity in earnings (loss) of A&amp;W Trade Marks Inc.</b>	<b>199</b>	(9)	<b>35</b>	(298)
<b>Net earnings for the period</b>	<b>2,262</b>	2,054	<b>4,186</b>	3,878
<b>Accumulated earnings - beginning of period</b>	<b>35,370</b>	25,826	<b>33,446</b>	24,002
<b>Accumulated earnings - end of period</b>	<b>\$ 37,632</b>	\$ 27,880	<b>\$ 37,632</b>	\$ 27,880
<b>Basic and diluted earnings per unit (8,340,000 units)</b>	<b>\$ 0.271</b>	\$ 0.246	<b>\$ 0.502</b>	\$ 0.465

See accompanying notes to these financial statements.

## Statement of Cash Flows

Unaudited

(in thousands of dollars)

	12 week period ended <b>Jun 18, 2006</b>	12 week period ended Jun 19, 2005	Period from <b>Jan 1, 2006 to Jun 18, 2006</b>	Period from Jan 1, 2005 to Jun 19, 2005
<b>Cash flows from operating activities</b>				
Net earnings for the period	\$ 2,262	\$ 2,054	\$ 4,186	\$ 3,878
Items not affecting cash				
Equity in (earnings) loss of A&W Trade Marks Inc.	(199)	9	(35)	298
	<b>2,063</b>	2,063	<b>4,151</b>	4,176
Net changes in non-cash working capital	<b>158</b>	123	<b>(407)</b>	(419)
	<b>2,221</b>	2,186	<b>3,744</b>	3,757
<b>Cash flows from investing activities</b>				
Dividends received from A&W Trade Marks Inc.	102	-	131	-
<b>Cash flows from financing activities</b>				
Distributions paid to unitholders	(2,344)	(2,252)	(3,870)	(3,753)
<b>Increase (decrease) in cash for the period</b>	<b>(21)</b>	(66)	<b>5</b>	4
<b>Cash - beginning of period</b>	<b>26</b>	72	-	2
<b>Cash - end of period</b>	<b>\$ 5</b>	\$ 6	<b>\$ 5</b>	\$ 6
<b>Supplementary cash flow information</b>				
<b>Interest received</b>	<b>\$ 2,186</b>	\$ 2,186	<b>\$ 3,709</b>	\$ 3,707

See accompanying notes to these financial statements.

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# A&W Revenue Royalties Income Fund

## Notes to the Interim Financial Statements

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**For the second quarter ended June 18, 2006**

**Unaudited**

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

### 1. Nature of operations and basis of presentation

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

The Fund prepares its financial statements in accordance with Canadian generally accepted accounting principles (GAAP) and has applied the accounting policies described in the annual audited financial statements for the year ended December 31, 2005. These interim unaudited financial statements do not include all of the disclosure requirements of GAAP for annual financial statements.

These interim unaudited financial statements should be read in conjunction with the annual audited financial statements of the Fund for the year ended December 31, 2005 and the annual audited financial statements of Trade Marks for the year ended December 31, 2005, and the interim unaudited financial statements of Trade Marks for the quarter ended June 18, 2006.

The Fund uses a fiscal year ending December 31. A&W Food Services of Canada Inc. (Food Services) uses a fiscal year comprising a 52 or 53 week period ending the Sunday nearest December 31, therefore Food Services' 2005 fiscal year ended January 1, 2006 (2004 – January 2, 2005). To align its financial reporting with that of Food Services, the Fund's second quarter of 2006 ended June 18, 2006 (2005 – June 19, 2005), 24 weeks after Food Services' fiscal year end.

### 2. Investment in A&W Trade Marks Inc.

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

	June 18, 2006	December 31, 2005
Common shares	\$1	\$1
A&W notes receivable	83,399	83,399
Cumulative equity in loss	(7,504)	(7,539)
Cumulative dividends	(302)	(126)
	<u>\$75,594</u>	<u>\$75,735</u>

The Fund's 64% (2005 – 66%) investment in the common shares of Trade Marks is recorded using the equity method. Trade Marks owns the A&W trade-marks used in the A&W quick service restaurant business in Canada. Concurrently 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 three per cent of the sales reported to Food Services by A&W restaurants in the Royalty Pool. The Royalty Pool is adjusted in January of each year to include new restaurants, less any restaurants that permanently closed. Trade Marks pays Food Services for the additional royalty stream from the net new restaurants by issuing additional common shares and Class B preferred shares. As a result, the Fund's equity interest in Trade Marks is diluted as annual adjustments to the Royalty Pool take place.

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

	The Fund		Food Services		Total
	#	%	#	%	#
February 15, 2002	8,340,000	75.0%	2,780,000	25.0%	11,120,000
2003 annual adjustment		-2.9%	452,469	2.9%	452,469
2004 annual adjustment		-3.0%	495,681	3.0%	495,681
2005 annual adjustment		-2.8%	511,337	2.8%	511,337
2006 annual adjustment		-2.3%	460,366	2.3%	460,366
	8,340,000	64.0%	4,699,853	36.0%	13,039,853

The A&W notes, issued by Trade Marks, amount to \$83,399,000, bear interest at 10.75% per annum and mature on February 15, 2034. Interest only payments are receivable monthly in arrears.

### 3. Distributions

During the year to date ended June 18, 2006, the Fund declared distributions to Unitholders of \$3,911,000 or \$0.469 per Unit. The amounts of these distributions were as follows:

Month	Declaration date	Payment date	Amount	Per Unit
January 2006	February 6, 2006	February 28, 2006	\$ 776	\$ 0.093
February 2006	March 6, 2006	March 31, 2006	776	0.093
March 2006	April 4, 2006	April 28, 2006	776	0.093
April 2006	May 4, 2006	May 31, 2006	792	0.095
May 2006	June 6, 2006	June 30, 2006	792	0.095
			3,911	\$ 0.469
Accumulated distributions - beginning of period			34,847	
Accumulated distributions - end of period			\$ 38,758	

The May 2006 distribution of \$792,000 which was declared on June 6, 2006 and paid on June 30, 2006 is reported as a current liability at June 18, 2006.

#### **4. Related party transactions and balances**

During the year to date ended June 18, 2006, interest income of \$4,151,000 (2005 - \$4,176,000) was earned from Trade Marks on the A&W notes, of which \$1,203,000 (December 31, 2005 - \$761,000) is receivable at June 18, 2006. Interest income on the A&W notes for the quarter was \$2,063,000 (2005 - \$2,063,000).

Dividends declared by Trade Marks for the year to date period ended June 18, 2006 were \$176,000 (2005 - \$nil), of which \$45,000 (December 31, 2005 - \$nil) is receivable at June 18, 2006. Dividends declared in the quarter were \$119,000 (2005 - \$nil).

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.

Amounts due to Trade Marks are without interest and due on demand.

#### **5. Subsequent event**

On July 5, 2006, the Fund declared a distribution to Unitholders of \$0.095 per Unit or \$792,000, payable on July 31, 2006 to Unitholders of record as at July 15, 2006.

# A&W Trade Marks Inc.

## Financial Statements

For the second quarter ended June 18, 2006

### Balance Sheet

Unaudited  
(in thousands of dollars)

	June 18 2006	December 31 2005
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 2,663	\$ 1,624
Accounts receivable (note 8)	1,415	1,351
Corporate taxes recoverable	65	18
Prepaid interest	90	48
	4,233	3,041
<b>Intangible assets (note 3)</b>	<b>142,966</b>	137,271
<b>Deferred financing fees</b>	<b>32</b>	41
	<b>\$ 147,231</b>	<b>\$ 140,353</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 8)	\$ 1,354	\$ 934
Dividends payable (notes 6 and 7)	492	-
	1,846	934
<b>Term loan (note 4)</b>	<b>10,000</b>	10,000
<b>Future income taxes</b>	<b>10,100</b>	9,483
<b>A&amp;W notes payable (note 5)</b>	<b>83,399</b>	83,399
<b>Class A and Class B preferred shares (note 6)</b>	<b>50,244</b>	44,675
	155,589	148,491
<b>Shareholders' deficiency:</b>		
Common shares (note 7)	1	1
Deficit	(8,359)	(8,139)
	(8,358)	(8,138)
	<b>\$ 147,231</b>	<b>\$ 140,353</b>

### Subsequent events (note 9)

These unaudited interim financial statements of the company have been prepared by and are the responsibility of the company's management. As the company is a private entity, the company's auditor has not performed a review of these financial statements.

See accompanying notes to these financial statements.

## Statement of Loss and Deficit

Unaudited

(in thousands of dollars)

	12 week period ended Jun 18, 2006	12 week period ended Jun 19, 2005	Period from Jan 1, 2006 to Jun 18, 2006	Period from Jan 1, 2005 to Jun 19, 2005
<b>Gross sales reported by A&amp;W restaurants in the Royalty Pool</b>	<b>\$ 135,605</b>	\$ 123,598	<b>\$ 257,322</b>	\$ 232,950
<b>Royalty income</b>	<b>\$ 4,069</b>	\$ 3,708	<b>\$ 7,720</b>	\$ 6,989
<b>Expenses</b>				
General and administrative	50	119	304	268
Amortization of deferred financing fees	5	4	9	8
Interest expense				
- term loan	117	134	245	275
- A&W notes	2,063	2,063	4,151	4,176
- Class A and B preferred share dividends	1,163	1,051	2,339	2,127
	<b>3,398</b>	3,371	<b>7,048</b>	6,854
<b>Earnings before income taxes</b>	<b>671</b>	337	<b>672</b>	135
<b>Provision for income taxes</b>				
Large corporations tax	(28)	37	-	73
Future income taxes	388	313	617	511
	<b>360</b>	350	<b>617</b>	584
<b>Net earnings (loss) for the period</b>	<b>311</b>	(13)	<b>55</b>	(449)
<b>Deficit - beginning of period</b>	<b>(8,484)</b>	(9,235)	<b>(8,139)</b>	(8,799)
<b>Dividends declared on common shares</b>	<b>(186)</b>	-	<b>(275)</b>	-
<b>Deficit - end of period</b>	<b>\$ (8,359)</b>	\$ (9,248)	<b>\$ (8,359)</b>	\$ (9,248)

See accompanying notes to these financial statements.

## Statement of Cash Flows

Unaudited

(in thousands of dollars)

	12 week period ended Jun 18, 2006	12 week period ended Jun 19, 2005	Period from Jan 1, 2006 to Jun 18, 2006	Period from Jan 1, 2005 to Jun 19, 2005
<b>Cash flows from operating activities</b>				
Net earnings (loss) for the period	\$ 311	\$ (13)	\$ 55	\$ (449)
Items not affecting cash				
Amortization of deferred financing fees	5	4	9	8
Provision for future income taxes	388	313	617	511
Change in accrued dividends	(100)	(96)	(126)	(120)
	<b>604</b>	208	<b>555</b>	(50)
Changes in non-cash working capital	<b>(348)</b>	(249)	<b>688</b>	536
	<b>256</b>	(41)	<b>1,243</b>	486
<b>Cash flows from financing activities</b>				
Dividends paid on common shares	<b>(160)</b>	-	<b>(204)</b>	-
<b>Increase (decrease) in cash for the period</b>	<b>96</b>	(41)	<b>1,039</b>	486
<b>Cash - beginning of period</b>	<b>2,567</b>	930	<b>1,624</b>	403
<b>Cash - end of period</b>	<b>\$ 2,663</b>	\$ 889	<b>\$ 2,663</b>	\$ 889
<b>Supplementary cash flow information</b>				
Interest paid on term loan and A&W notes payable	\$ (2,327)	\$ (2,332)	\$ (3,996)	\$ (4,005)
Dividends paid on Class A and B preferred shares	\$ (1,247)	\$ (1,147)	\$ (2,044)	\$ (2,255)
Taxes paid	\$ (8)	\$ (41)	\$ (47)	\$ (93)
<b>Non-cash financing activities</b>				
Issuance of Class B preferred and common shares	\$ -	\$ -	\$ 5,695	\$ 6,197

See accompanying notes to these financial statements.

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# **A&W Trade Marks Inc.**

## **Notes to the Interim Financial Statements**

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**For the second quarter ended June 18, 2006**

**Unaudited**

(figures in tables are expressed in thousands of dollars)

### **1. Nature of operations and basis of presentation**

The business of A&W Trade Marks Inc. (Trade Marks) is the ownership of the A&W trade-marks and through a Licence and Royalty Agreement with A&W Food Services of Canada Inc. (Food Services), the exploitation of the A&W trade-marks including the development of new A&W restaurants by Food Services, and the collection of the royalty payable under the Licence and Royalty Agreement. Food Services is a leading franchisor of hamburger quick service restaurants in Canada.

The common shares of Trade Marks are owned by A&W Revenue Royalties Income Fund (the Fund) (64%) and Food Services (36%).

Trade Marks prepares its financial statements in accordance with Canadian generally accepted accounting principles (GAAP) and has applied the accounting policies described in the annual audited financial statements for the year ended December 31, 2005. These interim unaudited financial statements do not include all of the disclosure requirements of GAAP for annual financial statements.

These interim unaudited financial statements should be read in conjunction with the annual audited financial statements of Trade Marks for the year ended December 31, 2005 and the annual audited financial statements of the Fund for the year ended December 31, 2005, and the interim unaudited financial statements of the Fund for the quarter ended June 18, 2006.

Trade Marks uses a fiscal year ending December 31. Food Services uses a fiscal year comprising a 52 or 53 week period ending the Sunday nearest December 31, therefore Food Services' 2005 fiscal year ended January 1, 2006 (2004 – January 2, 2005). To align its financial reporting with that of Food Services, Trade Marks' second quarter of 2006 ended June 18, 2006 (2005 – June 19, 2005), 24 weeks after Food Services' fiscal year end.

### **2. Seasonality**

Trade Marks' revenue is subject to variances due to the seasonality of sales in the quick service restaurant industry. In freestanding restaurants, weather impacts sales. In shopping centres, sales fluctuate due to higher traffic during back to school and Christmas shopping seasons.

### 3. Intangible Assets

On February 15, 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, \$27,800,000 was paid by the issuance of 2,779,975 Class A preferred shares and 2,780,000 common shares of Trade Marks, and the balance of the purchase price (the Balance) of \$40,000,000 is due, without interest, on January 31, 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 three per cent of the sales reported to Food Services by A&W restaurants in the Royalty Pool (the Licence and Royalty Agreement).

The Balance of the purchase price will be reduced by all amounts Trade Marks is required to pay Food Services in respect of annual adjustments to the Royalty Pool up to January 31, 2010. If the total annual adjustments are less than the Balance, the obligation of Trade Marks to pay the remaining Balance of the purchase price is extinguished. Accordingly, for accounting purposes, the Balance is being recognized in the periods such adjustments become payable. The annual adjustments to the Royalty Pool are as follows:

	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
2003 annual adjustment	27	(8)	19	452,469	-	452,469	5,108
2004 annual adjustment	28	(12)	16	495,681	-	495,681	5,210
2005 annual adjustment	27	(9)	18	511,337	-	511,337	6,197
2006 annual adjustment	27	(11)	16	460,366	-	460,366	5,695
	694	(40)	654	4,699,853	2,779,975	1,919,853	142,966

The issuance of the shares subsequent to the acquisition comprises the payments of the Balance of the purchase price of the A&W trade-marks and is recorded as an additional cost of the A&W trade-marks.

On January 5, 2006, the number of A&W restaurants for which royalties are paid to Trade Marks was increased by 27 new restaurants, less 11 restaurants that permanently closed during 2005. The consideration Trade Marks provided to Food Services for the additional net 16 restaurants added to the Royalty Pool consisted of shares of Trade Marks, based upon a formula set out in the Licence and Royalty Agreement. The formula is based on the estimated sales from the net new restaurants and the current yield on the Units of the Fund, discounted by 7.5%. The consideration provided by Trade Marks to Food Services for this

additional royalty stream was \$5,695,000, by the issuance of 460,366 Class B preferred shares and 460,366 common shares of Trade Marks. These shares are the economic equivalent of Units of the Fund and have been valued at \$12.37 per share, being the weighted average trading price of the Units of the Fund for the 20 trading days ending October 31, 2005. A final adjustment to the share consideration will be made in December 2006 based upon the actual annual gross sales reported by the new restaurants. Until then, 20% of the shares will be held in escrow.

#### 4. Term loan and operating bank line of credit

Trade Marks has a demand operating loan facility with HSBC Bank Canada of \$2,000,000 to fund working capital requirements and for general corporate purposes. The operating loan bears interest at the bank prime rate plus 0.5% and is repayable on demand. As at June 18, 2006, the full amount of the facility was available.

Trade Marks has a term loan with HSBC Bank Canada in the amount of \$10,000,000. The term loan is repayable on March 15, 2008 and bears interest at bank prime rate plus between 0% and 0.5% depending on specified financial ratios. Interest only is payable monthly, providing 12 month trailing earnings before interest, taxes, depreciation and amortization (EBITDA) at any time is not less than \$10,000,000. In the event that EBITDA is less than \$10,000,000, the term loan will be fully amortized over the remaining term and repayment will be by way of blended monthly instalments of principal and interest.

An interest rate swap effective February 16, 2005 and maturing February 18, 2008 fixes the interest rate on the term loan at 5.81% per annum.

#### 5. A&W notes payable

The A&W notes, held by the Fund, amount to \$83,399,000, bear interest at 10.75% per annum and mature on February 15, 2034. Interest only payments are payable monthly in arrears.

#### 6. Class A and Class B preferred shares

The preferred shares are owned by Food Services and comprise:

	June 18, 2006		December 31, 2005	
	#	\$	#	\$
Class A shares - at cost	2,779,975	27,800	2,779,975	27,800
Class B shares - at cost:				
2003 annual adjustment	452,469	5,108	452,469	5,108
2004 annual adjustment	495,681	5,210	495,681	5,210
2005 annual adjustment	511,337	6,197	511,337	6,197
2006 annual adjustment	460,366	5,695	-	-
	1,919,853	22,210	1,459,487	16,515
Accrued dividends		234		360
		50,244		44,675

On January 5, 2006, Trade Marks issued 460,366 (2005 – 511,337) Class B preferred and common shares as consideration of \$5,695,000 (2005 -

\$6,197,000) for the royalty stream from the 16 (2005 - 18) net restaurants added to the Royalty Pool (note 3).

The Class A and Class B shares entitle Food Services to a fixed cumulative preferential cash dividend at a rate of \$1.075 per share per annum. The Class A and Class B shares may 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 common share of Trade Marks and a \$10 A&W note are exchangeable for a Unit in the Fund. Accordingly, the Class A and Class B shares are classified as liabilities of Trade Marks and the cumulative dividends are classified as interest expense in the statement of earnings.

During the year to date ended June 18, 2006, Trade Marks declared dividends on the Class A and B preferred shares of \$2,465,000 of which \$360,000 was in respect of 2005 and \$2,105,000 or \$0.448 per share was in respect of 2006. \$2,044,000 has been paid and \$421,000, payable on June 30, 2006, is reported as a current liability at June 18, 2006. During the quarter, Trade Marks declared dividends on the Class A and B preferred shares of \$1,263,000 and paid dividends of \$1,247,000.

## 7. Common shares

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

	The Fund		Food Services		Total	
	#	%	#	%	#	\$
February 15, 2002	8,340,000	75.0%	2,780,000	25.0%	11,120,000	1
2003 annual adjustment		-2.9%	452,469	2.9%	452,469	-
2004 annual adjustment		-3.0%	495,681	3.0%	495,681	-
2005 annual adjustment		-2.8%	511,337	2.8%	511,337	-
2006 annual adjustment		-2.3%	460,366	2.3%	460,366	-
	8,340,000	64.0%	4,699,853	36.0%	13,039,853	1

During the year to date ended June 18, 2006, Trade Marks declared dividends on common shares of \$275,000 or \$0.021 per share. \$204,000 has been paid and \$71,000, payable on June 30, 2006, is reported as a current liability as at June 18, 2006. During the quarter, Trade Marks declared common share dividends of \$186,000 and paid dividends of \$160,000.

## 8. Related party transactions and balances

During the year to date ended June 18, 2006, royalty income of \$7,720,000 (2005 - \$6,989,000) was earned from Food Services, of which \$1,349,000 (December 31, 2005 - \$1,316,000) is receivable at June 18, 2006. During the quarter, royalty income of \$4,069,000 (2005 - \$3,708,000) was earned from Food Services.

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 until 2011.

Interest expense on the A&W notes for the year to date ended June 18, 2006 was \$4,151,000 (2005 - \$4,176,000), of which \$1,203,000 (December 31, 2005 - \$761,000) is payable to the Fund at June 18, 2006. Interest expense on the A&W notes for the quarter was \$2,063,000 (2005 - \$2,063,000).

Included in accounts receivable is \$66,000 (December 31, 2005 – \$31,000) due from the Fund without interest and due on demand.

## **9. Subsequent events**

On July 5, 2006, Trade Marks declared a dividend on Class A and Class B preferred shares of \$421,000 or \$0.08958 per share and a dividend on common shares of \$71,000 or \$0.00542 per share, payable on July 31, 2006.

## Unitholder Information

### Corporate Head Office

A&W Trade Marks Inc.  
c/o 26<sup>th</sup> Floor  
Toronto-Dominion Bank Tower  
700 West Georgia Street  
Vancouver, BC, V7Y 1B3

### Mailing Address

A&W Revenue Royalties Income Fund  
300 – 171 West Esplanade  
North Vancouver, BC, V7M 3K9

### 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 and Officers

John R. McLernon <sup>(2)</sup>  
Chairman  
Carl P. Vanderspek <sup>(2)</sup>  
President  
Conrad A. Pinette <sup>(2)</sup>  
Secretary-Treasurer  
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.

### Market Information

Units Listed:  
Toronto Stock Exchange  
Symbol: AW.UN

### Investor Enquiries

Don Leslie  
Chief Financial Officer

Tel: 604-988-2141  
Fax: 604-988-5531

E-mail: [investorrelations@aw.ca](mailto:investorrelations@aw.ca)  
Website: [www.awincomefund.ca](http://www.awincomefund.ca)



**A&W Revenue Royalties Income Fund**  
**300 – 171 West Esplanade**  
**North Vancouver, BC**  
**V7M 3K9**

**[www.awincomefund.ca](http://www.awincomefund.ca)**



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

**Q2/2006**

**Consolidated Financial  
Statements**

For the second quarter ended  
June 18, 2006

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



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

### **Report to Unitholders of A&W Revenue Royalties Income Fund January 2, 2006 to June 18, 2006**

This report and the unaudited consolidated financial statements of A&W Food Services of Canada Inc. are provided as a supplement to the quarterly report of the A&W Revenue Royalties Income Fund. This report is dated July 25, 2006 and should be read in conjunction with the interim unaudited consolidated financial statements for A&W Food Services of Canada Inc. for the quarter ended June 18, 2006 and the annual audited consolidated financial statements for the year ended January 1, 2006. 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% owned subsidiary, A&W Root Beer Beverages of Canada Inc., and its 36% ownership interest in A&W Trade Marks Inc.
Food Services	Financial results of A&W Food Services of Canada Inc. and A&W Root Beer Beverages of Canada Inc.
The Fund	A&W Revenue Royalties Income Fund
Trade Marks	A&W Trade Marks Inc.
Beverages	A&W Root Beer Beverages of Canada Inc.

#### **Same Store Sales**

Same store sales at A&W restaurants grew by 6.3% in the second quarter of 2006. This marks the 13th consecutive quarter of positive same store sales growth. Year to date same store sales growth is 7.6%. These same store sales increases resulted from the continued implementation of a number of strategic initiatives that A&W has in place to enhance its appeal to its target baby boomer customers.

#### **System Sales**

System sales grew 8.8% for the quarter and 10.1% year to date. For the 12 weeks ended June 18, 2006, total system sales for all A&W restaurants in Canada were \$138,843,000, an increase of \$11,270,000 from the same period in 2005. Year to date system sales were \$261,757,000, an increase of \$24,084,000 from the prior

year. This increase is due to the increase in the number of restaurants from 651 to 660 and the 7.6% same store sales growth.

### **New Restaurant Development and Restaurant Closures**

Food Services opened one new franchised restaurant in the second quarter of 2006, compared to three new restaurants in the second quarter of 2005. Three new A&W restaurants have been opened in 2006 year to date, compared to eight in 2005 year to date.

Four restaurants were closed in the second quarter, the same as in the second quarter of the prior year. Year to date, seven restaurants have closed in 2006 compared to five in 2005. All of the closed restaurants were older shopping centre restaurants with low sales volumes and were at the end of their lease and Food Services and the respective franchisees chose to close the restaurants.

### **Consolidated Financial Highlights**

<b>(dollars in thousands)</b>	<b>12 week period ended Jun 18, 2006</b>	<b>12 week period ended Jun 19, 2005</b>	<b>24 week period ended Jun 18, 2006</b>	<b>24 week period ended Jun 19, 2005</b>
System sales	<b>\$138,843</b>	\$127,573	<b>\$261,757</b>	\$237,673
System sales growth	<b>8.8%</b>	6.7%	<b>10.1%</b>	8.1%
Same store sales growth	<b>6.3%</b>	3.0%	<b>7.6%</b>	4.2%
New restaurants opened	<b>1</b>	3	<b>3</b>	8
Restaurants closed	<b>4</b>	4	<b>7</b>	5
Number of restaurants	<b>660</b>	651	<b>660</b>	651
Franchising & corporate restaurant revenue	<b>\$12,330</b>	\$11,626	<b>\$22,638</b>	\$22,709
Direct costs and administrative expenses	<b>\$8,135</b>	\$7,886	<b>\$15,482</b>	\$16,415
Earnings before interest, amortization, taxes and non-controlling interests	<b>\$4,195</b>	\$3,740	<b>\$7,156</b>	\$6,294
Net earnings	<b>\$1,251</b>	\$936	<b>\$738</b>	\$620

### **Overview**

Food Services is the franchisor of the A&W restaurant chain in Canada and derives revenues from franchise fees, sales in corporate-owned restaurants, sales of goods and services to franchisees, initial and regrant franchise fees, lease guarantee fees and other fees. Food Services also receives 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 and supplies and equipment sold either directly to franchisees or to distributors that service the restaurants or that are sold to the licenced bottlers. In addition, direct costs include the expenses and costs of the corporate restaurants operated 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**

On February 15, 2002, Food Services sold the A&W trade-marks used in the A&W quick service restaurant business in Canada to Trade Marks. Trade Marks in turn 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 three per cent of the sales reported to Food Services by A&W restaurants in the Royalty Pool.

The Royalty Pool is adjusted in January of each year to reflect sales from new restaurants, net of the sales of any A&W restaurants that have permanently closed. Trade Marks pays Food Services 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 the amount of estimated sales from the net new restaurants and the current yield on the Units of the Fund, discounted by 7.5%. The payment is in the form of common shares and Class B preferred shares of Trade Marks which are the economic equivalent of Units of the Fund. Twenty percent of the shares are held in escrow for a year until the actual sales of the new restaurants are known and the corresponding adjustment is made to the consideration.

The fourth adjustment to the Royalty Pool took place on January 5, 2006. The number of A&W restaurants for which royalties are paid increased by 27 new restaurants less 11 restaurants which permanently closed during 2005. Food Services was paid \$5,695,000, by issuance of 460,366 Class B preferred shares and 460,366 common shares, as initial consideration for the estimated royalty stream from the 16 new restaurants added to the Royalty Pool. Twenty percent of the shares will be held in escrow until December 2006 when the final consideration will be determined based on the actual sales of the net new restaurants.

After the January 5, 2006 amendment to the Royalty Pool, Food Services owns 36% (2005 – 34%) of the common shares of Trade Marks with the majority interest held by the Fund as follows:

	The Fund		Food Services		Total
	#	%	#	%	#
February 15, 2002	8,340,000	75.0%	2,780,000	25.0%	11,120,000
2003 annual adjustment		-2.9%	452,469	2.9%	452,469
2004 annual adjustment		-3.0%	495,681	3.0%	495,681
2005 annual adjustment		-2.8%	511,337	2.8%	511,337
2006 annual adjustment		-2.3%	460,366	2.3%	460,366
	8,340,000	64.0%	4,699,853	36.0%	13,039,853

Trade Marks' Class A and Class B preferred shares are owned by Food Services as follows:

(dollars in thousands)	June 18, 2006		December 31, 2005	
	#	\$	#	\$
Class A shares – at cost	2,779,975	27,800	2,779,975	27,800
Class B shares – at cost:				
2003 annual adjustment	452,469	5,108	452,469	5,108
2004 annual adjustment	495,681	5,210	495,681	5,210
2005 annual adjustment	511,337	6,197	511,337	6,197
2006 annual adjustment	460,366	5,695	-	-
	1,919,853	22,210	1,459,487	16,515
Accrued dividends		234		360
	4,699,828	50,244	4,239,462	44,675

The Class A and Class B preferred shares entitle Food Services to a fixed cumulative preferential cash dividend at a rate of \$1.075 per share per annum. The Class A and Class B preferred shares may 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 preferred share and, in turn, a \$10 A&W note plus one common share of Trade Marks are exchangeable for a unit in the Fund. Therefore Food Services, through its 36% (2005 – 34%) investment in Trade Marks, owns the equivalent of 36% (2005 – 34%) of the units of the Fund.

### **Basis of Consolidation**

Food Services and its related entities were required to adopt the Canadian Institute of Chartered Accountants' Accounting Guideline (AcG-15), "Consolidation of Variable Interest Entities" (VIE), effective January 1, 2005. As a result of the adoption of AcG-15, these Consolidated Financial Statements include the accounts of Trade Marks, and the trade-marks sold to Trade Marks by Food Services are recorded on the consolidated balance sheet at their book value at the time of the transaction. Food Services' investment in Trade Marks, its deferred gain on the sale of the trade-marks, and Trade Marks' intangible assets and Class A and B preferred 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 and Trade Marks. It is important to note that Trade Marks continues to legally own the A&W trade-marks and receive royalty income from Food Services and pay dividends to Food Services and 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 second quarter report for the quarter ended June 18, 2006 (which includes the financial statements of Trade Marks) which is available at [www.sedar.com](http://www.sedar.com) or on the Fund's website at [www.awincomefund.ca](http://www.awincomefund.ca).

## **2006 Second Quarter Operating Results**

### **Revenue**

Food Services' second quarter franchising and corporate revenues increased by \$704,000 to \$12,330,000, from \$11,626,000 in the second quarter of 2005. Year to date franchising and corporate revenues decreased by \$71,000 to \$22,638,000 from \$22,709,000 in 2005.

Key factors in the changes in revenue are:

- increase in franchising revenue from existing restaurants of \$1,067,000 for the quarter and \$1,491,000 year to date due to the system sales growth;
- decrease in new restaurant fees and sales of equipment of \$243,000 for the quarter and \$1,431,000 year to date due to fewer new restaurant openings this year compared to last year;
- increase in sales in the eight corporate restaurants in Ottawa of \$63,000 for the quarter and \$211,000 year to date;
- decrease in sales in restaurants being operated corporately while being held for refranchising of \$183,000 for the quarter and \$342,000 year to date as two of the three restaurants being operated last year have since been refranchised.

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

Direct costs and administrative expenses increased by \$249,000 to \$8,135,000 for the second quarter of 2006 compared to \$7,886,000 in 2005 and operating contribution margin increased from 32.2% in 2005 to 34.0% in 2006. Year to date expenses decreased by \$933,000 from \$16,415,000 in 2005 to \$15,482,000 in 2006. Year to date direct costs and administrative expenses decreased at a higher rate than the decrease in franchising and corporate revenue, resulting in an improved operating contribution margin of 31.6% for 2006, compared to 27.7% in 2005.

### **Earnings before Interest, Amortization, Taxes and Non-controlling Interests**

Earnings before interest, amortization, taxes and non-controlling interests increased by \$455,000 to \$4,195,000 for the second quarter and by \$862,000 to \$7,156,000 year to date due to the improved operating contribution margin discussed above.

### **Interest Expense**

Interest expense is comprised primarily of Trade Marks' net interest expense on its term loan and the A&W notes payable to the Fund. Interest expense decreased by \$47,000 to \$2,113,000 for the quarter and by \$81,000 to \$4,290,000 year to date. The decrease is due to a new interest rate swap agreement which came into effect on February 16, 2005 and higher interest income which is netted against interest expense. These debt service obligations are obligations of Trade Marks, not of Food Services.

### **Income Taxes**

Year to date income taxes increased due to a provision for taxes payable on a portion of the capital gain on the 2002 sale of the trade-marks which was deferred until 2006.

### **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 Trade Marks represents the common equity of Trade Marks held by the Fund. The Fund's share of Trade Marks' earnings was \$199,000 for the quarter compared to a \$9,000 loss for 2005 and \$35,000 earnings year to date compared to a \$298,000 loss for 2005. The increase in Trade Marks' earnings was due to higher royalty income.

### **Net Earnings**

Net earnings for the quarter increased by \$315,000, from \$936,000 in 2005 to \$1,251,000 in 2006. Year to date net earnings increased by \$118,000 from \$620,000 in 2005 to \$738,000 in 2006.

### **Liquidity and Capital Resources**

Food Services is primarily a franchise business with 651 of its 660 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. Food Services has no long term debt obligations. Food Services has sufficient cash on hand to meet its obligations and has a demand operating loan available of up to \$5,000,000 to fund its working capital requirements and for general corporate purposes. Food Services' operating facility is secured by the Class A preferred shares and 2,780,000 common shares of Trade Marks owned by Food Services. As at June 18, 2006, the full amount of the facility was available.

Trade Marks has a demand operating loan facility of up to \$2,000,000 to fund its working capital requirements and to meet its cash flow needs. The operating loan bears interest at bank prime rate plus 0.5% and is repayable on demand. As at June 18, 2006, the full amount of the facility was available.

Trade Marks has a term loan in the amount of \$10,000,000. The term loan is repayable on March 15, 2008 and bears interest at bank prime rate plus between 0.0% and 0.5% depending on specified financial ratios of Trade Marks. Interest only is payable monthly, provided that 12 month trailing earnings before interest, taxes, depreciation and amortization (EBITDA) at any time is not less than \$10,000,000. In the event that EBITDA is less than \$10,000,000, the term loan will be fully amortized over the remaining term and repayment will be by way of blended monthly instalments of principal and interest. An interest rate swap effective February 16, 2005 and maturing February 18, 2008 fixes the interest rate on the term loan at 5.81% per annum. A general security agreement over the assets of Trade Marks has been provided as security for Trade Marks' demand operating loan facility and term loan.

The A&W notes, issued by Trade Marks and held by the Fund, amount to \$83,399,000, bear interest at 10.75% per annum and mature on February 15, 2034. Interest only payments are payable monthly in arrears.

The liabilities of Trade Marks, including the A&W notes payable to the Fund, the operating facility and the term loan, are obligations of Trade Marks, not Food Services.

Trade Marks has no other contractual or purchase obligations. 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.

### **Off-Balance Sheet Instruments**

Food Services and Trade Marks have no off-balance sheet arrangements, other than the interest rate swap discussed previously.

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

Trade Marks' interest expense on the A&W notes for the year to date was \$4,151,000 (2005 - \$4,176,000), of which \$1,203,000 (January 1, 2006 - \$761,000) is payable to the Fund by Trade Marks at June 18, 2006. Interest expense on the A&W notes for the quarter was \$2,063,000 (2005 - \$2,063,000).

During the year to date, Trade Marks declared dividends on its common shares held by the Fund of \$176,000 (2005 - \$nil), of which \$45,000 (January 1, 2006 - \$nil) is payable to the Fund by Trade Marks as at June 18, 2006. Dividends declared payable to the Fund in the quarter were \$119,000 (2005 - \$nil).

Included in accounts receivable is \$66,000 (January 1, 2006 - \$31,000) due to Trade Marks by the Fund without interest and due 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. In turn, Trade Marks has arranged for certain of these services to be provided by Food Services until 2011.

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 earned by Trade Marks from Food Services was \$4,069,000 for the quarter and \$7,720,000 year to date, of which \$1,349,000 is payable by Food Services to Trade Marks at June 18, 2006;
- dividends on Trade Marks' Class A and B preferred shares of \$1,263,000 were declared by Trade Marks during the quarter and \$2,465,000 year to date, of which \$421,000 is payable by Trade Marks to Food Services at June 18, 2006;
- dividends on Trade Marks' common shares held by Food Services of \$67,000 were declared by Trade Marks during the quarter and \$99,000 year to date, of which \$26,000 is payable by Trade Marks to Food Services at June 18, 2006.

## **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 June 18, 2006.

## **Financial Instruments**

The fair values of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities approximate their carrying values given the short term to maturity of these instruments. The long term notes receivable bear interest at market rates and therefore it is management's opinion that the carrying value approximates the fair value.

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 \$20,000 favourable.

It is not practicable to determine the fair value of the net liabilities due the Fund given the many terms and conditions that would influence such a determination.

Exposure to credit risk is as indicated by the carrying amount of its accounts receivable. Food Services does not have a significant exposure to any individual franchisee.

All of the financial instruments are non-interest bearing except for the operating line of credit and Trade Marks' term loan and A&W notes, which bear interest as disclosed previously.

## **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. In addition, factors such as the availability of experienced management and hourly employees may also adversely affect the gross sales of the quick service restaurant industry in general and the gross sales by A&W restaurants in particular.

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.

Any significant event that adversely affects consumption of hamburgers, chicken, fries and soft drinks, such as cost, changing tastes or health concerns, could adversely impact the gross sales of A&W restaurants.

Food Services faces competition for retail locations and franchisees from its competitors and from franchisors of other businesses. Food Services' inability to successfully obtain qualified franchisees could adversely affect its business development. The opening and success of franchised restaurants is dependent on a number of factors, including availability of suitable sites, negotiations of acceptable lease or purchase terms for new locations, permits and government regulatory compliance, 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**

A&W's strategy is to focus on attracting baby boomers who are the core customer for the restaurants. Over the past several years, key initiatives in marketing and advertising, menu and product development, and restaurant design were undertaken. Innovation in these areas will continue in 2006. Further information on these initiatives is contained in the Fund's Management Discussion and Analysis for the quarter ended June 18, 2006.

In 2006, Food Services will continue to expand on its base of over 660 restaurants across Canada, focusing on new restaurant development in Ontario, Quebec and Atlantic Canada. Of note, the new restaurant expansion in Ontario continues to gain momentum, with an increasing level of interest among new franchisees and strong consumer response to the new restaurant openings. At the same time, opportunities will be aggressively sought in the more mature Western Canada markets. The timing of new restaurant openings is later in 2006 as compared to previous years. The bulk of new restaurants will open in the fourth quarter.

In 2005 a new profit management system was selected for A&W franchise operators. The purpose of this new "back of the house" administration system is to provide the A&W franchise operators with better tools to operate their day to day business and to control costs more effectively. This system also provides Food Services as the franchisor with more useful information on the performance of the overall business. The new system was implemented in over 140 restaurants in 2005

and roll-out is continuing in 2006. Response from franchisees has been very favourable, with a total of over 225 A&W restaurants now utilizing the system.

Finally, in 2006 A&W celebrates a very important milestone, the 50<sup>th</sup> Anniversary of its first restaurant, an A&W drive-in which opened in Winnipeg, Manitoba in 1956. Events and promotions were held in A&W restaurants across the country in June which generated a large amount of very favourable on-air media exposure. We would like to take this opportunity to thank all of our customers and franchisees who have supported A&W over the last half century.

This report contains certain forward-looking statements based on assumptions that management considered reasonable at the time they were prepared. These forward-looking statements, by their nature, necessarily involve risks and uncertainties that could cause actual results to differ materially from those contemplated by the forward-looking statements. These forward-looking statements are subject to a number of risk factors, including the ability of A&W Food Services of Canada Inc. to implement its marketing strategies, the opening of new A&W restaurants, general economic and business conditions, financial and political instability, and other factors disclosed previously and from time to time in the Fund's public filings.

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

For the second quarter ended June 18, 2006

## Consolidated Balance Sheet

Unaudited  
(in thousands of dollars)

	June 18 2006	January 1 2006
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 4,824	\$ 4,238
Accounts receivable	5,873	8,819
Inventories	655	674
Prepaid expenses	156	161
Future income taxes	258	239
	<b>11,766</b>	14,131
<b>Intangible assets</b>	<b>80,384</b>	80,384
<b>Deferred financing fees</b>	<b>32</b>	41
<b>Future income taxes</b>	<b>7,017</b>	7,648
<b>Property, plant and equipment</b>	<b>1,491</b>	1,556
<b>Notes receivable</b>	<b>420</b>	417
	<b>\$ 101,110</b>	\$ 104,177
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	\$ 9,676	\$ 12,029
Deposits on franchise and equipment sales	2,345	789
Income taxes payable	424	391
	<b>12,445</b>	13,209
<b>Net liabilities due to A&amp;W Revenue Royalties Income Fund (note 3)</b>	<b>75,594</b>	75,735
<b>Term loan (note 4)</b>	<b>10,000</b>	10,000
<b>Long-term liabilities</b>	<b>5,966</b>	5,895
<b>Non-controlling interest</b>	<b>412</b>	223
	<b>104,417</b>	105,062
<b>Shareholders' Equity</b>		
<b>Capital stock</b>	<b>10,500</b>	10,500
<b>Deficit</b>	<b>(13,807)</b>	(11,385)
	<b>(3,307)</b>	(885)
	<b>\$ 101,110</b>	\$ 104,177

Subsequent event (note 7)

These unaudited interim financial statements of the company have been prepared by and are the responsibility of the company's management. As the company is a private entity, the company's auditor has not performed a review of these financial statements.

See accompanying notes to these financial statements.

## Consolidated Statement of Earnings and Deficit

Unaudited

(in thousands of dollars)

	12 Week Period Ended Jun 18, 2006	12 Week Period Ended Jun 19, 2005	24 Week Period Ended Jun 18, 2006	24 Week Period Ended Jun 19, 2005
<b>Revenue</b>				
Franchising	\$ 10,775	\$ 9,951	\$ 19,509	\$ 19,449
Corporate restaurants	1,555	1,675	3,129	3,260
	<b>12,330</b>	11,626	<b>22,638</b>	22,709
<b>Direct costs and administrative expenses</b>	<b>8,135</b>	7,886	<b>15,482</b>	16,415
<b>Earnings before the following:</b>	<b>4,195</b>	3,740	<b>7,156</b>	6,294
<b>Interest expense (note 6)</b>	<b>2,113</b>	2,160	<b>4,290</b>	4,371
<b>Amortization of deferred financing fees</b>	<b>5</b>	4	<b>9</b>	8
<b>Amortization of property, plant and equipment</b>	<b>115</b>	108	<b>222</b>	205
<b>Earnings before income taxes and non-controlling interests</b>	<b>1,962</b>	1,468	<b>2,635</b>	1,710
<b>Provision for income taxes</b>				
Current	14	88	1,061	630
Future income taxes	381	381	612	603
	<b>395</b>	469	<b>1,673</b>	1,233
<b>Earnings for the period before non-controlling interests</b>	<b>1,567</b>	999	<b>962</b>	477
<b>Non-controlling interest in A&amp;W Root Beer Beverages of Canada Inc.</b>	<b>(117)</b>	(72)	<b>(189)</b>	(155)
<b>A&amp;W Revenue Royalties Income Fund's interest in (earnings) loss of A&amp;W Trade Marks Inc.</b>	<b>(199)</b>	9	<b>(35)</b>	298
<b>Net earnings for the period</b>	<b>1,251</b>	936	<b>738</b>	620
<b>Deficit - beginning of period</b>	<b>(13,090)</b>	(8,953)	<b>(11,385)</b>	(8,157)
Dividends paid	(3,000)	(4,000)	(3,000)	(4,000)
Refundable dividend tax (paid) recovered	1,032	356	(160)	(124)
<b>Deficit - end of period</b>	<b>\$ (13,807)</b>	\$ (11,661)	<b>\$ (13,807)</b>	\$ (11,661)

See accompanying notes to these financial statements.

# Consolidated Statement of Cash Flows

Unaudited

(in thousands of dollars)

	12 Week Period Ended Jun 18, 2006	12 Week Period Ended Jun 19, 2005	24 Week Period Ended Jun 18, 2006	24 Week Period Ended Jun 19, 2005
<b>Cash flows from operating activities</b>				
Net earnings for the period	\$ 1,251	\$ 936	\$ 738	\$ 620
Items not affecting cash				
Amortization of deferred financing fees	5	4	9	8
Amortization of property, plant and equipment	115	108	222	205
Future income taxes	381	381	612	603
(Gain) loss on disposal of property, plant and equipment	(1)	(5)	1	(5)
Increase (decrease) in long-term liabilities	35	(51)	71	26
Non-controlling interest in A&W Root Beer Beverages of Canada Inc.	117	72	189	155
A&W Revenue Royalties Income Fund's interest in earnings (loss) of A&W Trade Marks Inc.	199	(9)	35	(298)
	<b>2,102</b>	1,436	<b>1,877</b>	1,314
Net changes in non-cash working capital	<b>(3,529)</b>	(2,291)	<b>2,161</b>	1,568
	<b>(1,427)</b>	(855)	<b>4,038</b>	2,882
<b>Cash flows from investing activities</b>				
(Increase) decrease in notes receivable	(16)	6	(3)	(15)
Purchase of property, plant and equipment	(63)	(118)	(159)	(118)
Proceeds from disposal of property, plant and equipmen	1	6	1	6
	<b>(78)</b>	(106)	<b>(161)</b>	(127)
<b>Cash flows from financing activities</b>				
Refundable dividend tax recovered (paid)	1,032	356	(160)	(124)
Payment of dividends	(3,000)	(4,000)	(3,000)	(4,000)
Dividend to A&W Revenue Royalties Income Fund	(102)	-	(131)	-
	<b>(2,070)</b>	(3,644)	<b>(3,291)</b>	(4,124)
<b>(Decrease) increase in cash and cash equivalents</b>	<b>(3,575)</b>	(4,605)	<b>586</b>	(1,369)
<b>Cash and cash equivalents - beginning of period</b>	<b>8,399</b>	6,878	<b>4,238</b>	3,642
<b>Cash and cash equivalents - end of period</b>	<b>\$ 4,824</b>	\$ 2,273	<b>\$ 4,824</b>	\$ 2,273
<b>Supplementary cash flow information</b>				
Net interest paid	\$ (2,260)	\$ (2,295)	\$ (3,890)	\$ (3,925)
Net income taxes paid	\$ (374)	\$ (220)	\$ (1,188)	\$ (548)

See accompanying notes to these financial statements.

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

## **Notes to the Interim Consolidated Financial Statements**

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**For the second quarter ended June 18, 2006**

**Unaudited**

(figures in tables are expressed in thousands of dollars)

### **1. Nature of operations and basis of presentation**

A&W Food Services of Canada Inc. (Food Services) is in the business of developing and franchising quick service restaurants in Canada.

Food Services prepares its interim financial statements in accordance with Canadian generally accepted accounting principles (GAAP) and has applied the accounting policies described in the annual audited consolidated financial statements. These interim unaudited consolidated financial statements do not include all of the disclosure requirements of GAAP for annual financial statements.

These interim unaudited consolidated financial statements include the accounts of Food Services and its 60% owned subsidiary, A&W Root Beer Beverages of Canada Inc. (Beverages), and its 36% ownership interest in A&W Trade Marks Inc. (Trade Marks). The non controlling interest comprises the common equity of Beverages held by Unilever Canada Inc. and the common equity of Trade Marks held by the A&W Revenue Royalties Income Fund (the Fund).

These interim unaudited consolidated financial statements should be read in conjunction with the annual audited consolidated financial statements for the year ended January 1, 2006.

Food Services uses a fiscal year comprising a 52 or 53 week period ending Sunday nearest December 31, therefore Food Services' 2005 fiscal year ended January 1, 2006 (2004 – January 2, 2005). Food Services' second quarter of 2006 ends 24 weeks after its fiscal year end.

### **2. Seasonality**

Food Services' revenue is subject to variances due to the seasonality of sales in the quick service restaurant industry. In freestanding restaurants, weather impacts sales. In shopping centres, sales fluctuate due to higher traffic during back to school and Christmas shopping seasons.

### **3. Net liabilities due to A&W Revenue Royalties Income Fund**

The Class A and B preferred shares of Trade Marks are owned by Food Services and 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
	#	%	#	%	#
February 15, 2002	8,340,000	75.0%	2,780,000	25.0%	11,120,000
2003 annual adjustment		-2.9%	452,469	2.9%	452,469
2004 annual adjustment		-3.0%	495,681	3.0%	495,681
2005 annual adjustment		-2.8%	511,337	2.8%	511,337
2006 annual adjustment		-2.3%	460,366	2.3%	460,366
	8,340,000	64.0%	4,699,853	36.0%	13,039,853

The net liabilities due to the Fund by Trade Marks are comprised of:

	June 18, 2006	January 1, 2006
A&W notes payable	83,399	83,399
The Fund's equity interest in A&W Trade Marks Inc.	(7,805)	(7,664)
	\$75,594	\$75,735

The A&W notes, issued by Trade Marks and held by the Fund, amount to \$83,399,000, bear interest at 10.75% per annum and mature on February 15, 2034. Interest only payments are payable monthly in arrears.

The A&W notes are contractual obligations of Trade Marks, not Food Services.

#### 4. Term loan and operating bank line of credit

Food Services has a demand operating facility of \$5,000,000 to fund working capital requirements and for general corporate purposes. The operating loan bears interest at the bank prime rate plus 0.5% and is repayable on demand. As at June 18, 2006, the full amount of the facility was available.

Trade Marks has a demand operating loan facility of \$2,000,000 to fund working capital requirements and for general corporate purposes. The operating loan bears interest at the bank prime rate plus 0.5% and is repayable on demand. As at June 18, 2006, the full amount of the facility was available.

Trade Marks has a term loan in the amount of \$10,000,000. The term loan is repayable on March 15, 2008 and bears interest at bank prime rate plus between 0% and 0.5% depending on specified financial ratios of Trade Marks. Interest only is payable monthly, provided that 12 month trailing earnings before interest, taxes, depreciation and amortization (EBITDA) at any time is not less than \$10,000,000. In the event that EBITDA is less than \$10,000,000, the term loan will be fully amortized over the remaining term and repayment will be by way of blended monthly instalments of principal and interest.

An interest rate swap effective February 16, 2005 and maturing February 18, 2008 fixes the interest rate on the term loan at 5.81% per annum.

Trade Marks' operating facility and term loan are contractual obligations of Trade Marks, not Food Services.

## 5. Related party transactions and balances

Trade Marks' interest expense on the A&W notes for the year to date ended June 18, 2006 was \$4,151,000 (2005 - \$4,176,000), of which \$1,203,000 (January 1, 2006 - \$761,000) is payable to the Fund by Trade Marks at June 18, 2006. Interest expense on the A&W notes for the quarter was \$2,063,000 (2005 - \$2,063,000).

Included in accounts receivable is \$66,000 (January 1, 2006 - \$31,000) due from the Fund without interest and due on demand.

During the year to date ended June 18, 2006, Trade Marks declared dividends on its common shares of \$275,000 (2005 - \$nil) of which \$176,000 was earned by the Fund. \$131,000 has been paid to the Fund and \$45,000, payable on June 30, 2006, is reported as a current liability at June 18, 2006. Dividends of \$186,000 were declared in the quarter and \$102,000 was paid to the Fund in the quarter.

## 6. Interest expense

	12 Week Period Ended Jun 18, 2006	12 Week Period Ended Jun 19, 2005	24 Week Period Ended Jun 18, 2006	24 Week Period Ended Jun 19, 2005
<b>Interest</b>				
Interest income	\$ (67)	\$ (37)	\$ (106)	\$ (80)
Term loan	117	134	245	275
A&W notes payable	2,063	2,063	4,151	4,176
	<u>\$ 2,113</u>	<u>\$ 2,160</u>	<u>\$ 4,290</u>	<u>\$ 4,371</u>

## 7. Subsequent event

On July 5, 2006, Trade Marks declared a dividend on common shares of \$71,000 or \$0.00542 per share, of which \$26,000 is payable to Food Services and \$45,000 is payable to the Fund on July 31, 2006.



**A&W Food Services of Canada Inc.  
300 -171 West Esplanade  
North Vancouver, BC  
V7M 3K9**

**Tel: 604-988-2141  
[www. aw.ca](http://www.aw.ca)**