

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

## **Q1/2016**

### **Consolidated Financial Statements**

For the first quarter ended  
March 27, 2016

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 4, 2016 to March 27, 2016**

This report and the interim condensed consolidated financial statements of A&W Food Services of Canada Inc. (A&W or Food Services) for the 12 weeks ended March 27, 2016 are provided as a supplement to the interim condensed consolidated financial statements and Management Discussion and Analysis of the A&W Revenue Royalties Income Fund (the Fund) for the quarter ended March 27, 2016. This report is dated May 3, 2016 and should be read in conjunction with the interim condensed consolidated financial statements of Food Services for the 12 weeks ended March 27, 2016 and the audited annual consolidated financial statements of Food Services for the 53 weeks ended January 3, 2016. Such financial statements and additional information about the Fund and Food Services are available at [www.sedar.com](http://www.sedar.com) or [www.awincomefund.ca](http://www.awincomefund.ca).

**Glossary**

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

To align its financial reporting with the business cycle of its operations, Food Services uses a fiscal year comprising a 52 or 53 week period ending on the Sunday nearest December 31. The fiscal 2015 year was 53 weeks and ended January 3, 2016 (2014 – 52 weeks ended December 28, 2014). Food Services' first quarter ends 12 weeks after its fiscal year end.

The financial results reported in this MD&A are in accordance with International Financial Reporting Standards (IFRS) as applicable to interim financial reports including International Accounting Standards (IAS) 34, Interim Financial Reporting. The accounting policies applied in the interim condensed consolidated financial statements and this report are consistent with those followed in the preparation of Food Services' annual consolidated financial statements for the year ended January 3, 2016.

## Financial Highlights

(dollars in thousands)	12 week period ended Mar 27, 2016	12 week period ended Mar 22, 2015
System sales	\$241,781	\$216,624
System sales growth	11.6%	12.5%
Same store sales growth <sup>(1)</sup>	+8.6%	+9.1%
New restaurants opened	2	3
Restaurants closed	1	1
Number of restaurants	855	833
Franchising & corporate restaurant revenue	\$25,037	\$19,975
Operating costs and general and administrative expenses	(17,098)	(12,894)
Depreciation of plant and equipment	430	409
Earnings before royalty expense, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$8,369	\$7,490
Royalty expense	(7,124)	(6,306)
Net income	\$1,836	\$1,323

(1) Same store sales growth does not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other companies.

### Same Store Sales

Same store sales growth is the change in sales of A&W restaurants that operated during the entire 26 4-week periods ending March 27, 2016.

Same store sales for the first quarter of 2016 grew by 8.6% as compared to the same quarter of 2015. The 2016 and 2015 two year stacked same store sales growth for the quarter was +17.7%. These strong sales results reflect the continued positive guest response to A&W's ingredients guarantee of beef raised without the use of hormones or steroids, eggs from hens fed a diet without animal by-products, chicken raised without the use of antibiotics, organic and Fair Trade coffee and bacon from pork raised without the use of antibiotics. Same store sales growth has been positive for 12 consecutive quarters.

### System Sales

Total system sales for all A&W restaurants in Canada for the 12 weeks ended March 27, 2016 were \$241,781,000, an increase of 11.6% from the 12 weeks ended March 22, 2015. The increase in system sales was due to the same store sales growth plus the increase in the number of restaurants from 833 at the end of the first quarter of 2015 to 855 at the end of the first quarter of 2016.

### New Restaurant Openings and Restaurant Closures

Food Services opened two new A&W restaurants during the first quarter of 2016 compared to three in the first quarter of 2015. Four additional new restaurants are currently under construction and are expected to open in the coming months. One restaurant closed in the quarter, the same as in the first quarter of 2015. As at March 27, 2016, there were 855 A&W

restaurants in Canada, of which 846 were operated by franchisees and nine were corporately owned and operated.

## **Overview**

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

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

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

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

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

The 2016 annual adjustment to the Royalty Pool took place on January 5, 2016. The number of A&W restaurants in the Royalty Pool was increased by 32 new restaurants less eight restaurants that permanently closed during 2015. The addition of these 24 net new restaurants brings the total number of A&W restaurants in the Royalty Pool to 838. The estimated annual sales of the 32 new A&W restaurants are \$41,502,000 and annual sales for the eight permanently closed restaurants were \$3,905,000. The initial consideration for the estimated additional royalty stream was \$16,079,000, calculated by discounting the estimated additional royalties by 7.5% and dividing the result by the yield on units of the Fund for the 20 trading days ending October 26, 2015. The yield was adjusted to reflect income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$12,863,000 by issuance of 489,847 LP units which were subsequently exchanged for 979,694 non-voting common shares of Trade Marks. The remaining 20% of the consideration or \$3,216,000 will be paid in December

2016 by issuance of additional LP units, which may be exchanged for non-voting common shares of Trade Marks. The actual amount of the consideration paid in December 2016 may differ from this amount depending on the actual annual sales reported by the new A&W restaurants.

After the initial consideration was paid for the January 5, 2016 adjustment to the Royalty Pool, Food Services' indirect interest in the Fund increased to 21.0%.

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

The ownership of common shares of Trade Marks is as follows:

(dollars in thousands)	Fund				Food Services			Total
	Number of shares	Trade Marks' book value	%	Number of shares	Trade Marks' book value	%	Number of shares	Trade Marks' book value
		\$			\$			\$
Balance as at December 28, 2014	24,262,671	114,680	84.7	4,376,669	35,498	15.3	28,639,340	150,178
January 5, 2015 adjustment to the Royalty Pool	-	-	(3.1)	1,101,318	13,595	3.1	1,101,318	13,595
Balance as at January 3, 2016	24,262,671	114,680	81.6	5,477,987	49,093	18.4	29,740,658	163,773
January 5, 2016 adjustment to the Royalty Pool <sup>(1)</sup>	-	-	(2.6)	979,694	12,863	2.6	979,694	12,863
Balance as at March 27, 2016	24,262,671	114,680	79.0	6,457,681	61,956	21.0	30,720,352	176,636

<sup>(1)</sup> The number of common shares and consideration for the January 5, 2016 adjustment to the Royalty Pool does not include the 122,462 LP units exchangeable for 244,924 common shares of Trade Marks representing the remaining 20% of the consideration for the January 5, 2016 adjustment to the Royalty Pool which is held back until December 2016 when the actual annual sales are reported by the new restaurants.

### Ownership of the Fund

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

	March 27, 2016		January 3, 2016	
	Number of units	%	Number of units	%
Fund units held by public unitholders	12,131,373	79.0	12,131,373	81.6
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services <sup>(1)</sup>	3,228,841	21.0	2,738,994	18.4
Total equivalent units	15,360,214	100.0	14,870,367	100.0

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

The chart below shows the ownership of the Fund, on a fully-diluted basis, when the remaining 20% of the consideration for the January 5, 2016 adjustment to the Royalty Pool is expected to be paid in December 2016, by issuance of 122,462 LP units exchangeable for 244,924 common shares of Trade Marks. The actual amount of the consideration paid in December 2016 may differ from this amount depending on the actual annual sales reported by the new A&W restaurants.

	Number of units	%
Fund units held by public unitholders	12,131,373	78.4
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services	3,351,303	21.6
<b>Total equivalent units</b>	<b>15,482,676</b>	<b>100.0</b>

## 2016 Operating Results

### **Revenue**

Food Services' franchising and corporate revenue for the first quarter of 2016 was \$25,037,000 compared to \$19,975,000 for the first quarter of 2015. Franchising revenue for the quarter was \$21,968,000 compared to \$17,145,000 for the same quarter of the prior year, an increase of \$4,823,000. Revenue generated by the system sales growth increased by \$2,096,000 and revenue from equipment sales increased by \$2,727,000. Corporate restaurant sales in the first quarter of 2016 were \$3,069,000 compared to \$2,830,000 in the same quarter of 2015. Same store sales growth in the corporately owned and operated restaurants was in line with national same store sales growth.

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

Operating costs for the first quarter of 2016 were \$9,403,000 compared to \$6,280,000 in the same quarter of 2015, an increase of \$3,123,000. Costs of sales of food, packaging and equipment increased in line with the increase in revenue noted above.

General and administrative expenses represent costs of providing services to franchised restaurants and establishing new restaurants, and were \$7,695,000 in the first quarter of 2016 compared to \$6,614,000 for the first quarter of 2015. The increase in the quarter was due to inflationary increases and the growth in the number of restaurants.

### **Operating earnings**

(dollars in thousands)	12 week period ended Mar 27, 2016	12 week period ended Mar 22, 2015
Franchising & corporate restaurant revenue	<b>\$25,037</b>	\$19,975
Operating costs and general and administrative expenses	<b>(17,098)</b>	(12,894)
Depreciation of plant and equipment	<b>430</b>	409
Operating earnings (earnings before royalty expense, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	<b>\$8,369</b>	\$7,490

Operating earnings (earnings before royalty expense, Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) increased by \$879,000 to \$8,369,000 for

the first quarter of 2016 compared to \$7,490,000 for the first quarter of 2015. The operating margin for the first quarter of 2016 was 33.4% compared to 37.5% for the first quarter of 2015.

### ***Royalty expense***

Royalty expense for the first quarter of 2016 increased by \$818,000 to \$7,124,000 compared to \$6,306,000 for the first quarter of 2015. The increase in royalty expense resulted from the additional net 24 restaurants in the Royalty Pool and the same store sales growth of restaurants in the Royalty Pool.

### ***Earnings after royalty expense***

(dollars in thousands)	<b>12 week period ended Mar 27, 2016</b>	12 week period ended Mar 22, 2015
Operating earnings	<b>\$8,369</b>	\$7,490
Royalty expense	<b>(7,124)</b>	(6,306)
Earnings after royalty expense (before share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	<b>\$1,245</b>	\$1,184

Earnings after royalty expense (but before Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) increased by \$61,000 to \$1,245,000 for the first quarter of 2016 compared to \$1,184,000 for the first quarter of 2015. The \$61,000 increase was comprised of the \$879,000 increase in operating earnings, offset by the \$818,000 increase in royalty expense related to same store sales growth of restaurants in the Royalty Pool.

### ***Finance expense - net***

(dollars in thousands)	<b>12 week period ended Mar 27, 2016</b>	12 week period ended Mar 22, 2015
Interest income	<b>(\$12)</b>	(\$23)
Interest cost on supplementary retirement benefit plan	<b>126</b>	125
Finance leases	<b>34</b>	37
	<b>\$148</b>	\$139

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

Food Services' share of Trade Marks' income for the first quarter of 2016 increased by \$346,000 to \$699,000 compared to \$353,000 for the first quarter of 2015. Trade Marks' net income for the quarter was higher than the prior year due to the growth in royalty income and a lower non-cash loss on the interest rate swap in the first quarter of 2016 as compared to the same quarter of 2015. In addition, Food Services' ownership in Trade Marks increased from 17.4% as at the end of the first quarter of 2015 to 21.0% as at the end of the first quarter of 2016.

## ***Net income***

(dollars in thousands)	<b>12 week period ended Mar 27, 2016</b>	12 week period ended Mar 22, 2015
Earnings after royalty expense (before share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	<b>\$1,245</b>	\$1,184
Finance expense	<b>(148)</b>	(139)
Depreciation of plant and equipment	<b>(430)</b>	(409)
Amortization of deferred gain	<b>370</b>	320
Share of income from A&W Trade Marks Inc.	<b>699</b>	353
Earnings before income taxes	<b>1,736</b>	1,309
Recovery of income taxes	<b>100</b>	14
Net income	<b>\$1,836</b>	\$1,323

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

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

### ***Other comprehensive income***

Other comprehensive income (loss) consists of actuarial gains or losses, net of tax, on the supplementary retirement benefit plan. Actuarial gains result from an increase in the discount rate used to determine the accrued benefit obligation; actuarial losses results from a decrease in the discount rate. The actuarial loss, net of tax, for the first quarter of 2016 was \$270,000 compared to \$639,000 for the first quarter of 2015.

### ***Liquidity and Capital Resources***

Food Services is primarily a franchise business with 846 of its 855 restaurants franchised. Food Services has minimal capital requirements related to its corporate restaurants and head office. Future restaurant growth will continue to be funded by franchisees although from time to time, Food Services expects to incur capital expenditures to open new corporate restaurants in the Ottawa market. Food Services expects to have sufficient capital resources to fund the expansion of corporate restaurants and has no long term debt obligations. Food Services has sufficient cash on hand to meet its obligations and has a \$5,000,000 demand operating loan facility with HSBC Bank Canada (the Bank) to fund its working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at the bank prime rate plus 0.5% and are repayable on demand. Food Services has provided 2,000,000 common shares of Trade Marks as collateral. As at March 27, 2016, letters of credit totalling \$25,000 (January 3, 2016 - \$25,000) have been issued by the Bank on behalf of Food Services to landlords and cities for development of new restaurants, leaving \$4,975,000 (January 3, 2016 - \$4,975,000) of the facility available.

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

Food Services has no off-balance sheet arrangements.

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

Royalty expense for the quarter was \$7,124,000 (2015 - \$6,306,000), of which \$2,441,000 (January 3, 2016 - \$3,062,000) is payable to the Partnership by Food Services at March 27, 2016.

During the quarter, Trade Marks declared dividends on common shares held by Food Services of \$808,000 (2015 - \$598,000), of which \$404,000 (January 3, 2016 - \$nil) is receivable at March 27, 2016.

During the quarter, Food Services contracted with a private company controlled by a shareholder, director and officer of Food Services, for rental of a private plane and crew for business travel. The cost of the services provided under the contract during the quarter totalled \$65,000 (2015 - \$87,000). At March 27, 2016, \$65,000 (January 3, 2016 - \$nil) is payable to the private company by Food Services.

During the quarter, Food Services paid \$nil (2015 - \$100,000) to a professional baseball club, of which a shareholder, director and officer of Food Services is a part owner, in exchange for advertising the A&W brand at the ballpark. At March 27, 2016, \$nil (January 3, 2016 - \$nil) is payable to the baseball club by Food Services.

Food Services maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$108,000 (2015 - \$146,000) to Food Services during the quarter for marketing, promotional and administrative services provided to the advertising fund. At March 27, 2016, the advertising fund has a deficit balance of \$1,975,000 which is included in accounts receivable (January 3, 2016 – surplus balance of \$85,000 included in accounts payable). The advertising fund’s contributions from restaurants are based on sales which fluctuate seasonally. In freestanding A&W restaurants, weather impacts sales. In A&W restaurants in shopping centres, sales fluctuate due to higher traffic during the back-to-school and Christmas shopping seasons. The advertising fund balance is also affected by timing of expenditures for advertising and promotional programs.

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

### **Critical Accounting Estimates**

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

### **Risks and Uncertainties**

The success of Food Services is dependent on the ability of Food Services to (i) grow same store sales, (ii) maintain and grow the current system of franchises, (iii) locate new retail sites in prime locations and (iv) obtain qualified operators to become A&W franchisees. Sales are subject to a number of factors that affect the restaurant industry generally and the quick service segment of this industry in particular, including the highly competitive nature of the industry, traffic patterns, demographic considerations, and the type, number and proximity of competing quick service restaurants. Any significant event that adversely affects consumption of quick service

food or beverages, such as increased food and labour costs, changing tastes or health concerns, inflation, publicity from any food borne illness, government regulations concerning menu labelling or disclosure and drive-thru restrictions could adversely impact the sales of A&W restaurants and consequently, the amount of the royalty payable to the Partnership. Economic conditions, unemployment, changes in disposable consumer income, and a disease outbreak, could adversely impact consumer visits to restaurants, and consequently sales in A&W restaurants and royalty income for the Partnership. Any significant event that adversely impacts traffic to shopping centres, including closures of “anchor” stores, could adversely impact the sales of A&W restaurants in those shopping centres and consequently, the amount of the royalty payable to the Partnership.

The introduction of sales taxes upon sales by restaurants could negatively impact sales at A&W restaurants. In addition, an increase in sales taxes on sales by restaurants could adversely affect sales at A&W restaurants.

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

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

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

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

Food Services 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 or from public health

inspection reports 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 continued positive sales performance is a result of A&W's strategy to differentiate itself with better ingredients, coupled with television and on-line advertising campaigns and a new chicken menu.

Food Services is a strategy driven company with initiatives in place aimed at growing market share in the quick service restaurants (QSR) burger market. These initiatives include repositioning and differentiating A&W in the QSR industry through its use of natural ingredients, accelerating new restaurant growth, and delivering an industry leading guest experience.

A&W's mission is "to delight time-crunched Canadian burger lovers with the joy of great tasting natural food, made by people they trust."

Work on differentiating A&W through the use of "better ingredients" began in 2013, when Food Services became the first major QSR chain to use only beef raised without the use of hormones and steroids. The following year, Food Services began to serve only chicken raised without the use of antibiotics. As chicken is one of the fastest growing segments of the QSR industry, this move was a key element in Food Services' strategy to accelerate growth. Also in 2014, Food Services enhanced its breakfast menu by moving to eggs from hens fed a diet without animal by-products. Breakfast was further supported by the launch in January 2015 of organic and Fair Trade coffee, another first for a major chain. In 2016, Food Services introduced bacon from pork raised without the use of antibiotics, naturally smoked and farmed locally in Canada. Also in 2016, Food Services announced that A&W restaurants are switching to French's ketchup and mustard, made with 100 per cent Canadian tomatoes and 100 per cent Canadian mustard seeds.

Menu innovation continued in 2016 with the launch of a new Chicken Menu featuring the Chicken Buddy Burger and the Spicy Habanero Chicken Burger. The new chicken menu also features a new all-natural 7-grain bun made without preservatives and additives. The first quarter of 2016 also included the limited time offers Peppered Bacon Burger and Peppered Bacon & Egger. All of these menu items were very well received by Food Services' guests.

Food Services' second strategic initiative is accelerating the pace of growth of new A&W restaurants, particularly in the key Ontario and Quebec markets. Two new A&W restaurants were opened across the country in the first quarter of 2016, and additional new restaurants are under construction and expected to open in the coming months.

A third strategic initiative of Food Services is to deliver a great guest experience. This initiative includes the ongoing re-imaging and modernizing of our existing restaurants, and innovation in equipment, operating systems and technology. 66% of A&W's existing restaurants have completed the re-image to the new design. Including the new restaurants opened in the new design since the beginning of the re-image program, over 600 A&W restaurants now have the new design. Costs of re-imaging A&W restaurants are borne by the franchisees and there is no cost to the Fund.

## FORWARD LOOKING INFORMATION

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

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

The forecasts and projections that make up the forward-looking information are based on assumptions which include, but are not limited to: the general risks that affect the restaurant industry will not arise including that there are no changes in availability of experienced management and hourly employees and no material changes in government regulations concerning menu labelling and disclosure and drive-thru restrictions; no publicity from any food borne illness; no changes in competition; no changes in the quick service restaurant burger market including as a result of changes in consumer taste or health concerns or changes in economic conditions or unemployment or a disease outbreak; no increases in food and labour costs; the continued availability of quality raw materials; continued additional franchise sales and maintenance of franchise operations; Food Services is able to grow same store sales; Food Services is able to maintain and grow the current system of franchises; Food Services is able to locate new retail sites in prime locations; Food Services is able to obtain qualified operators to become A&W franchisees; no closures of A&W restaurants that materially affect the amount of the Royalty; no material changes in traffic patterns at shopping centres; no supply disruptions; franchisees duly pay franchise fees and other amounts; no impact from new or increased sales taxes on gross sales; continued availability of key personnel; continued ability to preserve intellectual property; no material litigation from guests alleging food-related illness, injuries suffered on the premises or other food quality, health or operations concerns; Food Services continues to pay the Royalty; the Partnership continues to make distributions on its units; Trade Marks continues to pay dividends on the common shares; Trade Marks can continue to comply with its obligations under its credit arrangements; Trade Marks performance does not fluctuate such that cash distributions are affected.

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

of the Fund; the Fund may issue additional units diluting existing unitholders' interests; and changes to the Canadian federal income tax treatment of publicly listed trusts and of partnerships and other income tax matters, all as more particularly described in this report under the heading "Risks and Uncertainties" and in the Fund's Annual Information Form under the heading "Risk Factors".

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

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

(in thousands of dollars)

	Note	March 27 2016	January 3 2016
<b>Assets</b>			
<b>Current assets</b>			
Cash and cash equivalents		\$ 10,791	\$ 11,403
Accounts receivable		14,592	14,080
Dividends receivable		404	-
Inventories		3,555	4,778
Prepaid expenses		178	328
Income taxes recoverable		392	65
		<b>29,912</b>	<b>30,654</b>
<b>Non-current assets</b>			
Investment in A&W Trade Marks Inc.	4	58,099	45,345
Deferred income taxes		12,622	12,229
Plant and equipment		7,753	7,883
Other non-current assets	4	3,216	-
<b>Total assets</b>		<b>\$ 111,602</b>	<b>\$ 96,111</b>
<b>Liabilities</b>			
<b>Current liabilities</b>			
Accounts payable and accrued liabilities		\$ 21,685	\$ 25,394
Royalties payable	8	2,441	3,062
Deposits on franchise and equipment sales		4,718	2,637
		<b>28,844</b>	<b>31,093</b>
<b>Non-current liabilities</b>			
Deferred gain	4	136,217	120,508
Supplementary retirement benefit plan		14,157	13,702
Other long-term liabilities		97	105
Obligations under finance leases		976	958
		<b>180,291</b>	<b>166,366</b>
<b>Shareholders' Deficiency</b>			
Share capital		10,500	10,500
Accumulated deficit		(79,577)	(80,971)
		<b>(69,077)</b>	<b>(70,471)</b>
<b>Non-controlling interest</b>			
		<b>388</b>	<b>216</b>
<b>Total deficiency</b>		<b>(68,689)</b>	<b>(70,255)</b>
<b>Total liabilities and deficiency</b>		<b>\$ 111,602</b>	<b>\$ 96,111</b>
<b>Subsequent event</b>	<b>9</b>		

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

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

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

(in thousands of dollars)

	Note	12 week period ended Mar 27, 2016	12 week period ended Mar 22, 2015
<b>Revenue</b>			
Franchising		\$ 21,968	\$ 17,145
Corporate restaurants		3,069	2,830
		<b>25,037</b>	<b>19,975</b>
<b>Expenses (income)</b>			
Operating costs		9,403	6,280
General and administrative expenses		7,695	6,614
Royalty expense	8	7,124	6,306
Finance expense - net	6	148	139
Amortization of deferred gain	4	(370)	(320)
Share of income from A&W Trade Marks Inc.	4	(699)	(353)
		<b>23,301</b>	<b>18,666</b>
<b>Income before income taxes</b>		<b>1,736</b>	<b>1,309</b>
<b>Provision for (recovery of) income taxes</b>			
Current		196	168
Deferred		(296)	(182)
		<b>(100)</b>	<b>(14)</b>
<b>Net income for the period</b>		<b>\$ 1,836</b>	<b>\$ 1,323</b>
<b>Net income attributable to:</b>			
Shareholders of A&W Food Services of Canada Inc.		\$ 1,664	\$ 1,181
Non-controlling interest		172	142
		<b>\$ 1,836</b>	<b>\$ 1,323</b>

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

(in thousands of dollars)

	12 week period ended Mar 27, 2016	12 week period ended Mar 22, 2015
<b>Net income for the period</b>	<b>\$ 1,836</b>	<b>\$ 1,323</b>
<b>Other comprehensive loss</b>		
<b>Items that will not be reclassified to net income</b>		
Actuarial loss on supplementary retirement benefit plan - net of tax	(270)	(639)
<b>Comprehensive income</b>	<b>\$ 1,566</b>	<b>\$ 684</b>
<b>Comprehensive income attributable to:</b>		
Shareholders of A&W Food Services of Canada Inc.	\$ 1,394	\$ 542
Non-controlling interest	172	142
	<b>\$ 1,566</b>	<b>\$ 684</b>

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

**A&W Food Services of Canada Inc.****Interim Condensed Consolidated Statement of Changes in Shareholders' Deficiency****Unaudited**

(in thousands of dollars)

	<b>Share capital</b>	<b>Accumulated deficit</b>	<b>Total</b>	<b>Non- controlling interest</b>	<b>Total deficiency</b>
<b>Balance - December 28, 2014</b>	\$ 10,500	\$ (82,295)	\$ (71,795)	\$ 204	\$ (71,591)
Net income for the period	-	1,181	1,181	142	1,323
Actuarial loss on supplementary retirement benefit plan - net of tax	-	(639)	(639)	-	(639)
<b>Balance - March 22, 2015</b>	10,500	(81,753)	(71,253)	346	(70,907)
Net income for the period	-	9,300	9,300	630	9,930
Dividends on common shares	-	(9,000)	(9,000)	(760)	(9,760)
Actuarial loss on supplementary retirement benefit plan - net of tax	-	482	482	-	482
<b>Balance - January 3, 2016</b>	10,500	(80,971)	(70,471)	216	(70,255)
Net income for the period	-	1,664	1,664	172	1,836
Actuarial loss on supplementary retirement benefit plan - net of tax	-	(270)	(270)	-	(270)
<b>Balance - March 27, 2016</b>	\$ 10,500	\$ (79,577)	\$ (69,077)	\$ 388	\$ (68,689)

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

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

**Unaudited**

(in thousands of dollars)

	Note	12 week period ended Mar 27, 2016	12 week period ended Mar 22, 2015
<b>Cash flows from operating activities</b>			
Net income for the period		\$ 1,836	\$ 1,323
Adjustments for			
Depreciation of plant and equipment		430	409
Deferred income taxes		(296)	(182)
Gain on disposal of plant and equipment		(9)	(12)
Supplementary retirement benefit plan		(38)	(50)
Decrease in other long-term liabilities		(8)	(9)
Amortization of deferred gain	4	(370)	(320)
Share of income of A&W Trade Marks Inc.	4	(699)	(353)
Current income tax expense		196	168
Income tax paid		(523)	(529)
Finance expense - net		148	139
Finance expense paid		(22)	(14)
Changes in items of non-cash working capital	7	(1,388)	(1,429)
<b>Net cash used for operating activities</b>		<b>(743)</b>	<b>(859)</b>
<b>Cash flows from investing activities</b>			
Purchase of plant and equipment		(127)	(63)
Dividends from A&W Trade Marks Inc.		404	299
<b>Net cash generated from investing activities</b>		<b>277</b>	<b>236</b>
<b>Cash flows from financing activities</b>			
Decrease in obligations under finance leases		(146)	(151)
<b>Net cash used for financing activities</b>		<b>(146)</b>	<b>(151)</b>
<b>Decrease in cash and cash equivalents</b>		<b>(612)</b>	<b>(774)</b>
<b>Cash and cash equivalents - beginning of period</b>		<b>11,403</b>	<b>10,488</b>
<b>Cash and cash equivalents - end of period</b>		<b>\$ 10,791</b>	<b>\$ 9,714</b>
<b>Non-cash investing activities</b>			
Non-cash acquisition of automobiles through finance leases		\$ 242	\$ 104

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

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

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 27, 2016

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(figures in tables are expressed in thousands of dollars)

## **1 General information**

A&W Food Services of Canada Inc. (the Company or Food Services) is in the business of developing and franchising quick-service restaurants in Canada. During the period ended March 27, 2016, the Company opened two locations and closed one location, bringing the total number of A&W restaurants to 855, of which 846 are franchised and nine are owned and operated corporately. Food Services' registered offices are located at Suite 300 - 171 West Esplanade, North Vancouver, British Columbia, Canada.

## **2 Basis of preparation**

These interim condensed consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS), as applicable to interim financial reports including International Accounting Standards (IAS) 34, *Interim Financial Reporting*. The interim condensed consolidated financial statements do not include all of the information and disclosures required in the annual financial statements, and should be read in conjunction with Food Services' audited annual consolidated financial statements as at January 3, 2016.

The accounting policies adopted in the preparation of the interim condensed consolidated financial statements are consistent with those followed in the preparation of Food Services' annual consolidated financial statements for the year ended January 3, 2016.

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors of Food Services on May 3, 2016.

## **3 Significant accounting policies**

### **Consolidation**

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

### **Fiscal year**

To align its financial reporting with the business cycle of its operations, the Company uses a fiscal year comprising a 52- or 53-week period ending the Sunday nearest December 31. The fiscal 2015 year was 53 weeks and ended January 3, 2016 (2014 - 52 weeks ended December 28, 2014). Beverages uses a fiscal year ending December 31. The first quarter ends 12 weeks after the fiscal year end.

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

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 27, 2016

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(figures in tables are expressed in thousands of dollars)

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

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

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

The 14<sup>th</sup> annual adjustment to the Royalty Pool took place on January 5, 2016. The number of A&W restaurants in the Royalty Pool was increased by 32 new restaurants less eight restaurants that permanently closed during 2015. The estimated annual sales of the 32 new A&W restaurants are \$41,502,000 and annual sales for the eight permanently closed restaurants were \$3,905,000. The initial consideration for the estimated additional royalty stream was \$16,079,000, calculated by discounting the estimated additional royalties by 7.5% and dividing the result by the yield on the units of the Fund for the 20 trading days ending October 26, 2015. The yield was adjusted to reflect the income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$12,863,000 by issuance of 489,847 LP units which were subsequently exchanged for 979,694 non-voting common shares of Trade Marks. The remaining 20% of the consideration or

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

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 27, 2016

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(figures in tables are expressed in thousands of dollars)

\$3,216,000 will be paid in December 2016 by issuance of additional LP units, which may be exchanged for non-voting common shares of Trade Marks. The actual amount of the consideration paid in December 2016 may differ from this amount depending on the actual annual sales reported by the new restaurants.

Food Services' 21.0% (January 3, 2016 – 18.4%) investment in Trade Marks is recorded using the equity method.

	<b>Common shares \$</b>	<b>Cumulative equity in earnings \$</b>	<b>Cumulative dividend \$</b>	<b>Total \$</b>
Balance – December 28, 2014	35,498	14,387	(18,114)	31,771
January 5, 2015 adjustment to Royalty Pool	13,595	-	-	13,595
Equity in earnings	-	3,923	-	3,923
Dividends	-	-	(3,944)	(3,944)
Balance – January 3, 2016	49,093	18,310	(22,058)	45,345
January 5, 2016 adjustment to Royalty Pool	12,863	-	-	12,863
Equity in earnings	-	699	-	699
Dividends	-	-	(808)	(808)
Balance – March 27, 2016	61,956	19,009	(22,866)	58,099

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

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The deferred gain as at March 27, 2016 is as follows:

	<b>Number of restaurants in Royalty Pool</b>	<b>Deferred gain \$</b>	<b>Accumulated amortization \$</b>	<b>Net deferred gain \$</b>
Balance – December 28, 2014	790	121,675	(13,346)	108,329
January 5, 2015 adjustment to Royalty Pool	24	13,595	-	13,595
Amortization of deferred gain	-	-	(1,416)	(1,416)
Balance – January 3, 2016	814	135,270	(14,762)	120,508
January 5, 2016 adjustment to Royalty Pool	24	16,079	-	16,079
Amortization of deferred gain	-	-	(370)	(370)
Balance – March 27, 2016	838	151,349	(15,132)	136,217

**5 Expenses by nature**

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

	<b>12 week period ended Mar 27, 2016 \$</b>	12 week period ended Mar 22, 2015 \$
Depreciation of plant and equipment	430	409
Employee benefit costs		
Wages and salaries and other termination benefits	4,708	4,566
Pension costs - defined contribution plan	220	203
Pension costs - supplementary retirement benefit plan	54	42
Total employee benefit costs	4,982	4,811

(figures in tables are expressed in thousands of dollars)

## 6 Finance (income) expense

	<b>12 week period ended Mar 27, 2016</b>	12 week period ended Mar 22, 2015
	\$	\$
Interest income	(12)	(23)
Interest cost on supplementary retirement benefit plan	126	125
Finance leases	34	37
	<u>148</u>	<u>139</u>

## 7 Working capital

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

	<b>12 week period ended Mar 27, 2016</b>	12 week period ended Mar 22, 2015
	\$	\$
Accounts receivable	(512)	2,734
Inventories	1,223	(581)
Prepaid expenses	150	1
Accounts payable and accrued liabilities	(3,709)	(4,490)
Royalties payable	(621)	(143)
Deposits on franchise and equipment sales	2,081	1,050
	<u>(1,388)</u>	<u>(1,429)</u>

## 8 Related party transactions and balances

Royalty expense for the period was \$7,124,000 (2015 - \$6,306,000), of which \$2,441,000 (January 3, 2016 - \$3,062,000) is payable to the Partnership at March 27, 2016.

During the period, Trade Marks declared dividends on common shares held by Food Services of \$808,000 (2015 - \$598,000), of which \$404,000 (January 3, 2016 - \$nil) is receivable at March 27, 2016.

During the period, Food Services contracted with a private company controlled by certain shareholders and directors of Food Services, for rental of a private plane and crew for business travel. The cost of the services provided under the contract during the period were \$65,000 (2015 - \$87,000). At March 27, 2016, \$65,000 (January 3, 2016 - \$nil) is payable to the private company by Food Services.

During the period, Food Services paid \$nil (2015 - \$100,000) to a professional baseball club, of which a shareholder, director and officer of Food Services is a part owner, in exchange for

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

Notes to Interim Condensed Consolidated Financial Statements

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(figures in tables are expressed in thousands of dollars)

advertising the A&W brand at the ballpark. At March 27, 2016, \$nil (January 3, 2016 - \$nil) is payable to the baseball club by Food Services.

Food Services maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$108,000 (2015 - \$146,000) to Food Services during the year to date period for marketing, promotional and administrative services provided to the advertising fund. At March 27, 2016, the advertising fund had a deficit balance of \$1,975,000 which is included in accounts receivable (January 3, 2016 – surplus balance of \$85,000 included in accounts payable).

**Key management compensation**

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

	<b>12 week period ended Mar 27, 2016</b>	12 week period ended Mar 22, 2015
	\$	\$
Salaries, bonuses and other short-term employee benefits	691	663
Pension costs - defined contribution plan	81	53
Pension costs - supplementary retirement benefit plan	180	167
Total	<u>952</u>	<u>883</u>

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

**9 Subsequent event**

On May 3, 2016, Food Services declared a dividend from working capital of \$4,000,000 to its parent, which subsequently declared a dividend of \$4,000,000 to its shareholders who are directors and/or certain officers of Food Services.



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