

A&W Food Services of Canada Inc.

Q3/2017

Consolidated Financial Statements

For the third quarter ended
September 10, 2017

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



**A&W Food Services of Canada Inc.
Report to Unitholders of A&W Revenue Royalties Income Fund
January 2, 2017 to September 10, 2017**

This report and the interim condensed consolidated financial statements of A&W Food Services of Canada Inc. (A&W or Food Services) for the 12 weeks and 36 weeks ended September 10, 2017 are provided as a supplement to the interim condensed consolidated financial statements and Management Discussion and Analysis of the A&W Revenue Royalties Income Fund (the Fund) for the period ended September 10, 2017. This report is dated October 16, 2017 and should be read in conjunction with the interim condensed consolidated financial statements of Food Services for the 12 weeks and 36 weeks ended September, 2017 and the audited annual consolidated financial statements of Food Services for the 52 weeks ended January 1, 2017. Such financial statements and additional information about the Fund and Food Services are available at www.sedar.com or www.awincomefund.ca.

Glossary

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

To align its financial reporting with the business cycle of its operations, Food Services uses a fiscal year comprising a 52 or 53 week period ending on the Sunday nearest December 31. The fiscal 2016 year was 52 weeks and ended January 1, 2017 (2015 – 53 weeks ended January 3, 2016). Food Services' third quarter ends 36 weeks after its fiscal year end.

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

Financial Highlights

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

(dollars in thousands)	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
System sales ⁽¹⁾	\$308,858	\$284,929	\$843,562	\$796,383
System sales growth ⁽¹⁾	+8.4%	+5.3%	+5.9%	+7.2%
Same store sales growth ⁽¹⁾	+3.6%	+2.3%	+1.5%	+4.3%
New restaurants opened	5	4	22	11
Restaurants closed	1	-	3	3
Number of restaurants	898	862	898	862
Franchising & corporate restaurant revenue	\$29,796	\$28,977	\$90,235	\$80,834
Operating costs and general and administrative expenses	(16,915)	(16,965)	(58,659)	(50,908)
Depreciation of plant and equipment	473	440	1,424	1,302
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks’ earnings, interest, taxes, depreciation and amortization	\$13,354	\$12,452	\$33,000	\$31,228
Royalty expense	(8,905)	(8,354)	(24,435)	(23,400)
Net income	\$4,874	\$4,143	\$16,053	\$8,751

⁽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. This important information is provided as it is a key driver of growth.

Same Store Sales

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

Same store sales for the third quarter of 2017 increased by 3.6% as compared to the same quarter of 2016. Year to date same store sales growth was +1.5% compared to 2016 year to date. Same store sales growth improved during the third quarter, gaining momentum from marketing initiatives in connection with the successful launch of natural root beer on July 17th and continued focus on the strategy of using better ingredients. In addition, same store sales was positively impacted by an improvement in Alberta sales and an increase in tourism related to favourable weather in many areas of the country, a lower Canadian dollar, affordable gasoline and special celebrations for Canada 150. This was partially offset by weaker sales in Saskatchewan affected by the April 1, 2017 introduction of a new 6% provincial sales tax on restaurant meals.

System Sales

System sales grew 8.4% for the third quarter as compared to the same quarter of 2016. Total system sales for all A&W restaurants in Canada for the 12 weeks ended September 10, 2017 were \$308,858,000, an increase of \$23,929,000 from the 12 weeks ended September 11, 2016. Year to date system sales were \$843,562,000, an increase of 5.9% from 2016 year to date. The increase in system sales was due to the same store sales growth plus the increase in the number of restaurants from 862 at the end of third quarter of 2016 to 898 at the end of the third quarter of 2017.

New Restaurant Openings and Restaurant Closures

Food Services opened five new A&W restaurants during the quarter and 22 year to date in 2017 compared to four new restaurants in the same quarter of 2016 and eleven in 2016 year to date. One restaurant was closed in the third quarter and three in the year to date period of 2017, compared to no closures in the same quarter of 2016 and three in the year to date period last year. As at September 10, 2017, there were 898 A&W restaurants in Canada, of which 890 were operated by franchisees and eight were corporately owned and operated.

Overview

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

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

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

Annual Adjustment to the Royalty Pool

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

deferred gain.

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

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

Common Shares of A&W Trade Marks Inc.

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

(dollars in thousands)	Fund			Food Services			Total	
	Number of shares	Trade Marks' book value		Number of shares	Trade Marks' book value		Number of shares	Trade Marks' book value
		\$	%		\$	%		
Balance as at January 3, 2016	24,262,671	114,680	81.6	5,477,987	49,093	18.4	29,740,658	163,773
January 5, 2016 adjustment to the Royalty Pool	-	-	(3.4)	1,295,242	17,006	3.4	1,295,242	17,006
Balance as at January 1, 2017	24,262,671	114,680	78.2	6,773,229	66,099	21.8	31,035,900	180,779
January 5, 2017 adjustment to the Royalty Pool ⁽¹⁾	-	-	(1.7)	692,772	12,037	1.7	692,772	12,037
March 3, 2017 exchange of common shares for units of the Fund	746,600	7,814	2.3	(746,600)	(7,814)	(2.3)	-	-
Balance as at September 10, 2017	25,009,271	122,494	78.8	6,719,401	70,322	21.2	31,728,672	192,816

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

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

Ownership of the Fund

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

	September 10, 2017		January 1, 2017	
	Number of units	%	Number of units	%
Fund units held by public unitholders	12,504,673	78.8	12,131,373	78.2
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services ⁽¹⁾	3,359,701	21.2	3,386,615	21.8
Total equivalent units	15,864,374	100.0	15,517,988	100.0

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

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

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

2017 Operating Results

Revenue

Food Services’ franchising and corporate revenue for the third quarter of 2017 was \$29,796,000 compared to \$28,977,000 for the third quarter of 2016. Year to date total revenue was \$90,235,000 compared to \$80,834,000 for 2016 year to date.

Franchising revenue for the third quarter was \$26,461,000 compared to \$25,849,000 for the same quarter of the prior year, an increase of \$612,000. Year to date franchising revenue was \$80,773,000, compared to \$71,354,000 for 2016 year to date, an increase of \$9,419,000. The increase in revenue was primarily due to higher turnkey construction revenue from opening 22 new restaurants in the first three quarters of 2017 compared to eleven in the same period last year. Revenue also increased as a result of higher equipment sales primarily related to new restaurants and the system sales growth.

Corporate restaurant sales in the third quarter of 2017 were \$3,335,000 compared to \$3,128,000 in the same quarter of 2016. Year to date corporate restaurant sales were \$9,462,000 compared to \$9,480,000 in 2016 year to date. One new corporate restaurant was opened in late 2016 in the Ottawa market however total corporate restaurant sales declined as two restaurants were operated corporately in 2016 until they were refranchised in the third quarter of 2016.

Operating costs and general and administrative expenses

Operating costs for the second quarter of 2017 were \$9,464,000 compared to \$10,302,000 in the same quarter of 2016, a decrease of \$838,000. Year to date operating costs were \$34,589,000 compared to \$28,394,000 in 2016 year to date, an increase of \$6,195,000. Turnkey construction costs increased as well as costs of sales of equipment, and food and packaging in line with the increase in revenue noted above.

General and administrative expenses represent costs of providing services to franchised restaurants and establishing new restaurants, and were \$7,451,000 in the third quarter of 2017 compared to \$6,663,000 for the third quarter of 2016, an increase of \$788,000 or 11.8%. Year to date general and administrative expenses were \$24,070,000 compared to \$22,514,000 for the same period in the prior year. The increase was due to inflationary increases, investments in strategic initiatives and the growth in the number of restaurants and system sales.

Operating earnings

(dollars in thousands)	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
Franchising & corporate restaurant revenue	\$29,796	\$28,977	\$90,235	\$80,834
Operating costs and general and administrative expenses	(16,915)	(16,965)	(58,659)	(50,908)
Depreciation of plant and equipment	473	440	1,424	1,302
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$13,354	\$12,452	\$33,000	\$31,228

Operating earnings (earnings before royalty expense, gain on sale of Fund units, Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) increased by \$902,000 to \$13,354,000 for the third quarter of 2017 compared to \$12,452,000 for the third quarter of 2016. Year to date operating earnings increased by \$1,772,000 to \$33,000,000 for 2017 as compared to \$31,228,000 for 2016 year to date. The year to date operating margin was 36.6% compared to 38.6% for the 2016 year to date.

Royalty expense

Royalty expense for the third quarter of 2017 increased by \$551,000 to \$8,905,000 compared to \$8,354,000 for the third quarter of 2016. Year to date royalty expense increased by \$1,035,000 to \$24,435,000 compared to \$23,400,000 for 2016 year to date. The increase in royalty expense resulted from the additional net 23 restaurants in the Royalty Pool and the same store sales growth of restaurants in the Royalty Pool.

Earnings after royalty expense

(dollars in thousands)	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$13,354	\$12,452	\$33,000	\$31,228
Royalty expense	(8,905)	(8,354)	(24,435)	(23,400)
Earnings after royalty expense (before gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	\$4,449	\$4,098	\$8,565	\$7,828

Earnings after royalty expense (but before the gain on sale of Fund units, Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) increased by \$351,000 to \$4,449,000 for the third quarter of 2017 compared to \$4,098,000 for the third quarter of 2016. Year to date earnings after royalty expense (but before the gain on sale of Fund units, Food Services' share of income from Trade Marks, interest, taxed, depreciation and amortization) increased by \$737,000 to \$8,565,000 for 2017 as compared to \$7,828,000 for 2016. The \$737,000 increase was comprised of the \$1,772,000 increase in operating earnings, offset by the \$1,035,000 increase in royalty expense related to the additional net 23 restaurants in the Royalty Pool.

Finance expense - net

(dollars in thousands)	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
Interest income	(\$7)	(\$14)	(\$18)	(\$37)
Interest on term loan	50	-	114	-
Interest cost on supplementary retirement benefit plan	130	128	389	380
Finance leases	36	38	116	110
	\$209	\$152	\$601	\$453

Interest expense increased by \$57,000 to \$209,000 for the third quarter of 2017 compared to \$152,000 for the third quarter of 2016. Year to date interest expense increased by \$148,000 to \$601,000 in 2017 as compared to \$453,000 for year to date 2016. The increase is primarily due to interest expense on Food Services' new term loan and a reduction in interest income. See "Liquidity and Capital Resources".

Food Services' share of Trade Marks' income

Food Services' share of Trade Marks' income for the third quarter of 2017 increased by \$515,000 to \$1,745,000 compared to \$1,230,000 for the third quarter of 2016. Food Services' year to date share of Trade Marks' income increased by \$1,228,000 to \$4,366,000 compared to \$3,138,000 for the 2016 year to date. Trade Marks' net income was higher than the prior year due primarily to a non-cash gain on the interest rate swap in 2017 versus a loss in 2016, plus lower income tax expense.

Net income

(dollars in thousands)	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
Earnings after royalty expense (before gain on sale of Units of the Fund, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	\$4,449	\$4,098	\$8,565	\$7,828
Finance expense	(209)	(152)	(601)	(453)
Depreciation of plant and equipment	(473)	(440)	(1,424)	(1,302)
Amortization of deferred gain	414	371	1,243	1,111
Amortization of deferred finance fees	(5)	-	(11)	-
Gain on sale of Units of A&W Revenue Royalties Income Fund	-	-	6,314	-
Share of income from A&W Trade Marks Inc.	1,745	1,230	4,366	3,138
Earnings before income taxes	5,921	5,107	18,452	10,322
Provision for income taxes	(1,047)	(964)	(2,399)	(1,571)
Net income	\$4,874	\$4,143	\$16,053	\$8,751

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

Net income attributable to non-controlling interests

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

Other comprehensive income (loss)

Other comprehensive income (loss) consists of actuarial gains (losses), net of tax, on the supplementary retirement benefit plan. Actuarial gains (losses) result from a decrease in the discount rate used to determine the accrued benefit obligation. The actuarial gain, net of tax, for the third quarter of 2017 was \$216,000 compared to an actuarial loss, net of tax, of \$478,000 for the third quarter of 2016. Year to date, the actuarial loss was \$498,000 for 2017 compared to \$1,028,000 for 2016.

Liquidity and Capital Resources

Food Services is primarily a franchise business with 890 of its 898 restaurants franchised. Food Services' capital requirements are related to its corporate restaurants and head office and investments in technology and information. Future restaurant growth will continue to be funded by franchisees although from time to time, Food Services expects to incur capital expenditures to open new corporate restaurants in the Ottawa market. Food Services also expects to incur capital expenditures for the Urban Franchise Associate program aimed at attracting millennials to become owner-operators of urban concept restaurants where Food Services will contribute to the

cost of building the physical location. Food Services expects to have sufficient capital resources to fund these capital requirements and has sufficient cash on hand to meet its obligations. On March 3, 2017, Food Services increased its \$5,000,000 demand operating loan facility with a Canadian chartered bank (the Bank) to \$8,000,000 to fund working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at the bank prime rate plus 0.5% and are repayable on demand. As at September 10, 2017, letters of credit totalling \$299,000 (January 1, 2017 - \$236,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,701,000 of the facility available (January 1, 2017 - \$4,764,000).

On March 3, 2017, Food Services entered into a \$7,000,000 term loan with the Bank to fund long term working capital and operating requirements. The term loan bears interest at the bank prime rate plus 0.5% and is repayable on December 31, 2020. Interest only is payable monthly. The term loan contains a number of covenants including the requirement to meet certain debt to earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA) ratios and debt to Food Services' investment in A&W Trade Marks Inc. ratios during each trailing four quarter period. Food Services was in compliance with all of its financial covenants as at September 10, 2017.

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

Off-Balance Sheet Arrangements

Food Services has no off-balance sheet arrangements.

Related Party Transactions and Balances

Royalty expense for the year to date period was \$24,435,000 (2016 - \$23,400,000), of which \$2,993,000 (January 1, 2017 - \$2,516,000) is payable to the Partnership at September 10, 2017. Royalty expense for the quarter was \$8,905,000 (2016 - \$8,354,000).

During the year to date period, Trade Marks declared dividends on common shares held by Food Services of \$3,625,000 (2016 - \$3,312,000), of which \$447,000 (January 1, 2017 - \$nil) is receivable at September 10, 2017. Dividends declared payable to Food Services during the quarter were \$1,341,000 (2016 - \$1,278,000).

During the period, Food Services contracted with a private company controlled by a shareholder and director of Food Services, for rental of a private plane and crew for business travel. The cost of services provided under the contract during the period were \$80,000 (2016 - \$235,000). At September 10, 2017, \$nil (January 1, 2017 - \$nil) is payable to the private company by Food Services. The cost of services provided during the quarter were \$nil (2016 - \$106,000).

During the year to date period, Food Services paid \$125,000 (2016 - \$125,000) to a professional baseball club, of which a shareholder, director and officer of Food Services is a part owner, in exchange for advertising the A&W brand at the ballpark. At September 10, 2017, \$nil (January 1, 2017 - \$nil) is payable to the baseball club by Food Services. The amount paid during the quarter was \$nil (2016 - \$nil).

Food Services maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$347,000 (2016 - \$332,000) to Food Services during the year to date period for marketing, promotional and administrative services provided to the advertising fund. The amount paid by the advertising fund to Food Services during the quarter was \$115,000 (2016 - \$114,000). At September 10, 2017, the advertising fund had a deficit balance of \$1,532,000 which is included in accounts receivable (January 1, 2017 – deficit balance of \$475,000). The advertising fund balance is affected by seasonality of sales and timing of expenditures for advertising and promotional programs.

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

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

Critical Accounting Estimates

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

Risks and Uncertainties

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

payable to the Partnership.

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

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

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

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

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

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

allegations of security breaches resulting in the theft of credit and debit card information or personal information of guests may materially affect the sales of A&W restaurants.

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

Outlook

Food Services' commitment to its mission "to delight time-crunched Canadian burger lovers with the joy of great tasting natural food, made by people they trust" has built a strong foundation on which improved results have been delivered despite a soft economy and a very competitive market place. Strategic initiatives are focussed on growing market share in the quick service restaurants (QSR) burger market and include repositioning and differentiating the A&W brand through the use of "better ingredients"; accelerating new restaurant growth, and delivering an industry leading guest experience.

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

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

The next step in A&W's journey to source simple, all-natural ingredients that guests can feel good about was taken with the launch of the new Root Beer Guarantee on July 17th. A&W Root Beer served in the restaurants is now made from natural cane sugar and all-natural flavours - another first for the QSR industry.

Food Services' second strategic initiative is accelerating the pace of growth of new A&W restaurants, particularly in the key Ontario and Quebec markets. Twenty-two new A&W restaurants were opened across the country in 2017 year to date. One of these new restaurants is the first restaurant under the Urban Franchise Associate program. The Urban Franchise Associate program was launched in 2016 and is aimed at attracting millennials to become owner-operators of urban concept restaurants. As this younger demographic may not have the capital and experience necessary to invest in a traditional franchise, under this new program Food Services contributes to the cost of building the physical location and provides extensive training. As of September 10, 2017, an additional thirty new restaurants are under construction or in varying stages of permitting and are expected to open in the coming months. The opening of the 900th restaurant was recently celebrated, even more significant as it also represents the 50th Urban Concept restaurant – a design with open ceilings, modern music and communal seating that allows Food Services to leverage the opportunity of the “urbanization” of Canada, with the very rapid growth in the number of people living, working, and “playing” in big cities. The first Urban restaurant opened in 2010 in Vancouver, and was quickly followed by several other openings, in Vancouver, Toronto, and Montreal.

A third strategic initiative of Food Services is to deliver an industry leading guest experience. To ensure each guest at an A&W restaurant has a positive experience, Food Services has introduced changes in its satisfaction measurement and feedback systems, system level processes, staffing, CLIMATE, and restaurant equipment. This initiative also includes the ongoing re-imaging and modernizing of our existing restaurants, and innovation in technology. Including the new restaurants opened in the new design since the beginning of the re-image program, approximately 89% of A&W's restaurants now have the new design. New “Good Food Makes Good Food” interior elements are also being introduced in restaurants to communicate Food Services' ingredients guarantee to its guests. Costs of re-imaging A&W restaurants are borne by the franchisees and there is no cost to the Fund.

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

On August 24, 2017, Food Services partnered with the Multiple Sclerosis Society of Canada and Christine Sinclair to build excitement and awareness of its 9th annual “Burgers to Beat MS Day” and of MS. A&W is proud to report that a record-setting \$1.8M was raised to go towards research and support for the 100,000 Canadians living with Multiple Sclerosis.

FORWARD LOOKING INFORMATION

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

The forward-looking information in this report includes, but is not limited to: expected future consideration receivable on adjustments to the Royalty Pool; Food Services' plans to reposition and differentiate A&W in the QSR industry through its use of “better ingredients”, accelerating new

restaurant growth, and delivering an industry leading guest experience; Food Services expects to have sufficient capital resources to fund the expansion of corporate restaurants.

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

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

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

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

(in thousands of dollars)

	Note	September 10 2017	January 1 2017
Assets			
Current assets			
Cash and cash equivalents		\$ 16,307	\$ 17,920
Accounts receivable		15,670	15,403
Dividends receivable	10	447	-
Inventories		7,041	5,999
Prepaid expenses		512	357
		39,977	39,679
Non-current assets			
Investment in A&W Trade Marks Inc.	4	67,253	62,289
Deferred income taxes		13,108	12,087
Plant and equipment		8,831	8,762
Other non-current assets	4	3,009	-
Total assets		\$ 132,178	\$ 122,817
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		\$ 22,664	\$ 27,469
Royalties payable	10	2,993	2,516
Deposits on franchise and equipment sales		14,301	8,216
Income taxes payable		1,289	232
		41,247	38,433
Non-current liabilities			
Deferred gain	4	149,701	135,898
Supplementary retirement benefit plan		15,005	14,218
Term Loan		6,935	-
Other long-term liabilities		61	78
Obligations under finance leases		905	970
		213,854	189,597
Shareholders' Deficiency			
Share capital		10,500	10,500
Accumulated deficit		(92,804)	(77,463)
		(82,304)	(66,963)
Non-controlling interest			
		628	183
Total deficiency		(81,676)	(66,780)
Total liabilities and deficiency		\$ 132,178	\$ 122,817

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

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

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

(in thousands of dollars)

		12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
Revenue					
Franchising		\$ 26,461	\$ 25,849	\$ 80,773	\$ 71,354
Corporate restaurants		3,335	3,128	9,462	9,480
		29,796	28,977	90,235	80,834
Expenses (income)					
Operating costs	7	9,464	10,302	34,589	28,394
General and administrative expenses		7,451	6,663	24,070	22,514
Royalty expense	10	8,905	8,354	24,435	23,400
Finance expense - net	8	209	152	601	453
Amortization of deferred gain	4	(414)	(371)	(1,243)	(1,111)
Amortization of deferred finance fees		5	-	11	-
Gain on sale of Units of A&W Revenue					
Royalties Income Fund	10	-	-	(6,314)	-
Share of income from A&W Trade Marks Inc.	4	(1,745)	(1,230)	(4,366)	(3,138)
		23,875	23,870	71,783	70,512
Income before income taxes					
		5,921	5,107	18,452	10,322
Provision for (recovery of) income taxes					
Current		1,030	895	3,244	1,631
Deferred		17	69	(845)	(60)
		1,047	964	2,399	1,571
Net income for the period					
		\$ 4,874	\$ 4,143	\$ 16,053	\$ 8,751
Net income attributable to:					
Shareholders of A&W Food Services of Canada Inc.		\$ 4,650	\$ 3,983	\$ 15,608	\$ 8,205
Non-controlling interest		224	160	445	546
		\$ 4,874	\$ 4,143	\$ 16,053	\$ 8,751

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

(in thousands of dollars)

		12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
Net income for the period					
		\$ 4,874	\$ 4,143	\$ 16,053	\$ 8,751
Other comprehensive income (loss)					
Items that will not be reclassified to net income					
Actuarial gain (loss) on supplementary retirement benefit plan - net of tax		216	(478)	(498)	(1,028)
Comprehensive income					
		\$ 5,090	\$ 3,665	\$ 15,555	\$ 7,723
Comprehensive income attributable to:					
Shareholders of A&W Food Services of Canada Inc.		\$ 4,866	\$ 3,505	\$ 15,110	\$ 7,177
Non-controlling interest		224	160	445	546
		\$ 5,090	\$ 3,665	\$ 15,555	\$ 7,723

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)

	Share capital	Accumulated deficit	Total	Non- controlling interest	Total deficiency
Balance - January 3, 2016	\$ 10,500	\$ (80,971)	\$ (70,471)	\$ 216	\$ (70,255)
Net income for the period	-	8,205	8,205	546	8,751
Dividends on common shares	-	(4,000)	(4,000)	-	(4,000)
Actuarial loss on supplementary retirement benefit plan - net of tax	-	(1,028)	(1,028)	-	(1,028)
Balance - September 11, 2016	10,500	(77,794)	(67,294)	762	(66,532)
Net income for the period	-	5,604	5,604	261	5,865
Dividends on common shares	-	(6,000)	(6,000)	(840)	(6,840)
Actuarial gain on supplementary retirement benefit plan - net of tax	-	727	727	-	727
Balance - January 1, 2017	10,500	(77,463)	(66,963)	183	(66,780)
Net income for the period	-	15,608	15,608	445	16,053
Dividends on common shares	10	(30,451)	(30,451)	-	(30,451)
Actuarial loss on supplementary retirement benefit plan - net of tax	-	(498)	(498)	-	(498)
Balance - September 10, 2017	\$ 10,500	\$ (92,804)	\$ (82,304)	\$ 628	\$ (81,676)

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

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

Unaudited

(in thousands of dollars)

	12 week period ended Note Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
Cash flows from operating activities				
Net income for the period	\$ 4,874	\$ 4,143	\$ 16,053	\$ 8,751
Adjustments for				
Depreciation of plant and equipment	473	440	1,424	1,302
Deferred income taxes	17	69	(845)	(60)
Gain on sale of Units of A&W Revenue				
Royalties Income Fund	-	-	(6,314)	-
Gain on disposal of plant and equipment	(2)	(33)	(42)	(55)
Supplementary retirement benefit plan	(92)	(200)	(276)	(276)
Decrease in other long-term liabilities	(6)	(9)	(17)	(26)
Amortization of deferred finance fees	5	-	11	-
Amortization of deferred gain	4 (414)	(371)	(1,243)	(1,111)
Share of income of A&W Trade Marks Inc.	4 (1,745)	(1,230)	(4,366)	(3,138)
Current income tax expense	1,030	895	3,244	1,631
Income tax paid	(719)	(626)	(2,187)	(1,468)
Finance expense - net	209	152	601	453
Finance expense paid	(79)	(24)	(212)	(73)
Changes in items of non-cash working capital	9 1,019	3,902	280	3,412
Net cash generated from operating activities	4,570	7,108	6,111	9,342
Cash flows from investing activities				
Purchase of plant and equipment	(303)	(91)	(949)	(300)
Dividends from A&W Trade Marks Inc.	1,341	1,269	3,178	2,883
Net proceeds from sale of Units of A&W Revenue				
Royalties Income Fund	-	-	14,128	-
Net cash generated from investing activities	1,038	1,178	16,357	2,583
Cash flows used in financing activities				
Decrease in obligations under finance leases	(190)	(169)	(556)	(475)
Financing fees paid	-	-	(74)	-
Proceeds from new term loan	-	-	7,000	-
Dividends paid to shareholder	-	-	(30,451)	(4,000)
Net cash used in financing activities	(190)	(169)	(24,081)	(4,475)
Increase (decrease) in cash and cash equivalents	5,418	8,117	(1,613)	7,450
Cash and cash equivalents - beginning of period	10,889	10,736	17,920	11,403
Cash and cash equivalents - end of period	\$ 16,307	\$ 18,853	\$ 16,307	\$ 18,853
Non-cash investing activities				
Non-cash acquisition of automobiles through finance leases	\$ 76	\$ 303	\$ 671	\$ 916

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)

September 10, 2017

(figures in tables are expressed in thousands of dollars)

1 General information

A&W Food Services of Canada Inc. (the Company or Food Services) is in the business of developing and franchising quick-service restaurants in Canada. During the year to date period ended September 10, 2017, the Company opened 22 locations and closed three locations, bringing the total number of A&W restaurants to 898, of which 890 are franchised and eight are owned and operated corporately. Food Services' registered offices are located at Suite 300 - 171 West Esplanade, North Vancouver, British Columbia, Canada.

2 Basis of preparation

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

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

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors of Food Services on October 16, 2017.

3 Significant accounting policies

Consolidation

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

Fiscal year

To align its financial reporting with the business cycle of its operations, the Company uses a fiscal year comprising a 52- or 53-week period ending the Sunday nearest December 31. The fiscal 2016 year was 52 weeks and ended January 1, 2017 (2015 - 53 weeks ended January 3, 2016). Beverages uses a fiscal year ending December 31. The third quarter ends 36 weeks after the fiscal year end.

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

September 10, 2017

(figures in tables are expressed in thousands of dollars)

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

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

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

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

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

September 10, 2017

(figures in tables are expressed in thousands of dollars)

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

	Common shares \$	Cumulative equity in earnings \$	Cumulative dividend \$	Total \$
Balance – January 3, 2016	49,093	18,310	(22,058)	45,345
January 5, 2016 adjustment to Royalty Pool	17,006	-	-	17,006
Equity in earnings	-	5,214	-	5,214
Dividends	-	-	(5,276)	(5,276)
Balance – January 1, 2017	66,099	23,524	(27,334)	62,289
January 5, 2017 adjustment to Royalty Pool	12,037	-	-	12,037
Exchange of common shares for Units of A&W Revenue Royalties Income Fund (note 10)	(7,814)	-	-	(7,814)
Equity in earnings	-	4,366	-	4,366
Dividends	-	-	(3,625)	(3,625)
Balance – September 10, 2017	<u>70,322</u>	<u>27,890</u>	<u>(30,959)</u>	<u>67,253</u>

The deferred gain as at September 10, 2017 is as follows:

	Number of restaurants in Royalty Pool	Deferred gain \$	Accumulated amortization \$	Net deferred gain \$
Balance – January 3, 2016	814	135,270	(14,762)	120,508
January 5, 2016 adjustment to Royalty Pool	24	17,006	-	17,006
Amortization of deferred gain	-	-	(1,616)	(1,616)
Balance – January 3, 2016	838	152,276	(16,378)	135,898
January 5, 2017 adjustment to Royalty Pool	23	15,046	-	15,046
Amortization of deferred gain	-	-	(1,243)	(1,243)
Balance – September 10, 2017	<u>861</u>	<u>167,322</u>	<u>(17,621)</u>	<u>149,701</u>

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

September 10, 2017

(figures in tables are expressed in thousands of dollars)

5 Operating loan facility and term loan

On March 3, 2017, Food Services increased its \$5,000,000 demand operating loan facility with a Canadian chartered bank (the Bank) to \$8,000,000 to fund working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at the bank prime rate plus 0.5% and are repayable on demand. As at September 10, 2017, letters of credit totalling \$299,000 (January 1, 2017 - \$236,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,701,000 of the facility available (January 1, 2017 - \$4,764,000).

On March 3, 2017, Food Services entered into a \$7,000,000 term loan with the Bank to fund long term working capital and operating requirements. The term loan bears interest at the bank prime rate plus 0.5% and is repayable on December 31, 2020. Interest only is payable monthly. The term loan contains a number of covenants including the requirement to meet certain debt to earnings before interest, taxes, depreciation, amortization and non-cash charges/income (EBITDA) ratios and debt to Food Services' investment in A&W Trade Marks Inc. ratios during each trailing four quarter period. Food Services was in compliance with all of its financial covenants as at September 10, 2017.

The term loan comprises:

	September 10, 2017	January 1, 2017
	\$	\$
Term loan	7,000	-
Financing fees	(65)	-
	<hr/> 6,935	<hr/> -

6 New restaurant openings

Food Services opened five new franchised restaurants during the quarter (2016 – four). The increase in the number of new restaurant openings caused an increase in revenue and operating costs in the quarter as compared to the prior year offset by a decrease in turnkey revenues and construction costs.

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

September 10, 2017

(figures in tables are expressed in thousands of dollars)

7 Expenses by nature

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

	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
	\$	\$	\$	\$
Depreciation of plant and equipment	473	440	1,424	1,302
Employee benefit costs				
Wages and salaries and other termination benefits	5,207	4,808	15,694	14,382
Pension costs - defined contribution plan	158	140	505	509
Pension costs - supplementary retirement benefit plan	-	(108)	-	-
Total employee benefit costs	5,365	4,840	16,199	14,891

8 Finance (income) expense

	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
	\$	\$	\$	\$
Interest income	(7)	(14)	(18)	(37)
Interest on term loan	50	-	114	-
Interest cost on supplementary retirement benefit plan	130	128	389	380
Finance leases	36	38	116	110
	209	152	601	453

9 Working capital

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

	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
	\$	\$	\$	\$
Accounts receivable	247	557	(267)	(195)
Inventories	(2,897)	(1,012)	(1,042)	(455)
Prepaid expenses	(257)	(25)	(155)	137
Accounts payable and accrued liabilities	(1,601)	837	(4,818)	(3,342)
Royalties payable	214	97	477	(307)
Deposits on franchise and equipment sales	5,313	3,448	6,085	7,574
	1,019	3,902	280	3,412

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

September 10, 2017

(figures in tables are expressed in thousands of dollars)

10 Related party transactions and balances

Royalty expense for the year to date period was \$24,435,000 (2016 - \$23,400,000), of which \$2,993,000 (January 1, 2017 - \$2,516,000) is payable to the Partnership at September 10, 2017. Royalty expense for the quarter was \$8,905,000 (2016 - \$8,354,000).

During the year to date period, Trade Marks declared dividends on common shares held by Food Services of \$3,625,000 (2016 - \$3,312,000), of which \$447,000 (January 1, 2017 - \$nil) is receivable at September 10, 2017.

During the year to date period, Food Services contracted with a private company controlled by a shareholder and director of Food Services for rental of a private plane and crew for business travel. The cost of the services provided under the contract during the year to date period were \$80,000 (2016 - \$235,000). At September 10, 2017, \$nil (January 1, 2017 - \$nil) is payable to the private company by Food Services. The cost of services provided during the quarter were \$nil (2016 - \$106,000).

During the year to date period, Food Services paid \$125,000 (2016 - \$125,000) to a professional baseball club, of which a shareholder, director and officer of Food Services is a part owner, in exchange for advertising the A&W brand at the ballpark. At September 10, 2017, \$nil (January 1, 2017 - \$nil) is payable to the baseball club by Food Services. The amount paid during the quarter was \$nil (2016 - \$nil).

Food Services maintains an advertising fund that is supported by prescribed contributions from corporate and franchise restaurants. The advertising fund paid \$347,000 (2016 - \$332,000) to Food Services during the year to date period for marketing, promotional and administrative services provided to the advertising fund. The amount paid by the advertising fund to Food Services during the quarter was \$115,000 (2016 - \$114,000). At September 10, 2017, the advertising fund had a deficit balance of \$1,532,000 which is included in accounts receivable (January 1, 2017 – deficit balance of \$475,000).

Key management compensation

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

	12 week period ended Sep 10, 2017	12 week period ended Sep 11, 2016	36 week period ended Sep 10, 2017	36 week period ended Sep 11, 2016
	\$	\$	\$	\$
Salaries, bonuses and other short-term employee benefits	761	677	2,323	2,043
Pension costs - defined contribution plan	41	31	137	150
Pension costs - supplementary retirement benefit plan	130	20	389	380
Total	932	728	2,849	2,573

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

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(figures in tables are expressed in thousands of dollars)

Sale of Units of A&W Revenue Royalties Income Fund

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

Dividends

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

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



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