

A&W Food Services of Canada Inc.

Q2/2019

**Consolidated Financial
Statements**

For the second quarter ended
June 16, 2019

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
December 31, 2018 to June 16, 2019**

This report and the interim condensed consolidated financial statements of A&W Food Services of Canada Inc. (A&W or Food Services) for the 12 weeks and 24 weeks ended June 16, 2019 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 June 16, 2019. This report is dated July 23, 2019 and should be read in conjunction with the interim condensed consolidated financial statements of Food Services for the 12 weeks and 24 weeks ended June 16, 2019 and the audited annual consolidated financial statements of Food Services for the 52 weeks ended December 30, 2018. 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 2018 year was 52 weeks and ended December 30, 2018 (2017 – 52 weeks ended December 31, 2017). Food Services' second quarter ends 24 weeks after its fiscal year end.

The financial results reported in this report 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 December 30, 2018.

Financial Highlights

The following selected information, other than "System Sales", "System Sales Growth", "Same Store Sales Growth", "Gross sales reported by A&W restaurants in the Royalty Pool", "Royalty Pool Same Store Sales Growth" and information with respect to numbers of restaurants has been derived from financial statements prepared in accordance with IFRS and all dollar amounts are reported in Canadian currency. See "Non-IFRS Measures".

(dollars in thousands)	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
System Sales ⁽¹⁾	\$363,878	\$315,596	\$680,856	\$591,022
System Sales Growth ⁽²⁾	+15.3%	+11.0%	+15.2%	+10.5%
Same Store Sales Growth ⁽³⁾	+10.3%	+6.6%	+10.2%	+6.0%
New restaurants opened	6	7	15	14
Restaurants closed	2	3	2	4
Number of restaurants in the Royalty Pool	934	896	934	896
Gross sales reported by A&W restaurants in the Royalty Pool ⁽⁴⁾	\$351,845	\$305,132	\$660,668	\$572,820
Royalty Pool Same Store Sales Growth ⁽⁵⁾	10.3%	6.6%	10.2%	6.0%
Number of restaurants	965	928	965	928
Franchising & corporate restaurant revenue	\$50,921	\$42,097	\$99,375	\$79,907
Operating costs and general and administrative expenses	(37,406)	(32,150)	(75,600)	(64,278)
Depreciation of plant and equipment	579	510	1,163	1,008
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$14,094	\$10,457	\$24,938	\$16,637
Royalty expense	(10,555)	(9,154)	(19,820)	(17,185)
Net income	\$26,786	\$2,206	\$30,052	\$1,862

- (1) "System Sales" is calculated in respect of all A&W restaurants in Canada, as the amount of gross sales reported to Food Services by franchisees of such A&W restaurants without audit, verification or other form of independent assurance and the gross sales of A&W restaurants owned and operated by Food Services, in each case, after deducting amounts for discounts for coupons and other promotional offerings and applicable sales taxes, System Sales is a non-IFRS measure – see "Non-IFRS Measures". Food Services believes System Sales is a key performance indicator for Food Services as it provides investors with an indication of the sales figures on which Food Services' franchise revenues are based. See "System Sales".
- (2) "System Sales Growth" is calculated in respect of all A&W Restaurants in Canada as the percentage change in System Sales in one period compared to the same period in the prior year. System Sales Growth is a non-IFRS measure – see "Non-IFRS Measures". This important information is provided as it is a key driver of growth. See "System Sales".
- (3) "Same Store Sales Growth" is calculated as the change in System Sales of A&W restaurants that operated during the entire 26 4-week periods ending June 16, 2019, and is based on an equal number of days in each quarter and year. Same Store Sales Growth is a non-IFRS measure – see "Non-IFRS Measures". This important information is provided as it is a key driver of

growth and provides investors with an indication of the change in year-over-year sales of A&W restaurants. See “Same Store Sales”.

- (4) “Gross sales reported by A&W restaurants in the Royalty Pool” is calculated in respect of A&W restaurants in Canada in the Royalty Pool (as defined below), as the amount of gross sales reported to Food Services by franchisees of such A&W restaurants in the Royalty Pool without audit, verification or other form of independent assurance and the gross sales of A&W restaurants owned and operated by Food Services in the Royalty Pool, in each case, after deducting amounts for discounts for coupons and other promotional offerings and applicable sales taxes. “Gross sales reported by A&W restaurants in the Royalty Pool” is a non-IFRS measure – see “Non-IFRS Measures”.
- (5) “Royalty Pool Same Store Sales Growth” is calculated as the change in Gross sales reported by A&W restaurants in the Royalty Pool that operated during the entire 26 4-week periods ending June 16, 2019, and is based on an equal number of days in each quarter and year. Royalty Pool Same Store Sales Growth is a non-IFRS measure – see “Non-IFRS Measures”.

Same Store Sales

As noted above, Same Store Sales Growth is the change in gross sales of A&W restaurants that operated during the entire 26 4-week periods ending June 16, 2019.

Same Store Sales for the second quarter of 2019 increased by 10.3% as compared to the same quarter of 2018. Year to date Same Store Sales Growth was +10.2% compared to 2018 year to date. Same Store Sales Growth was achieved in all concepts and was led by strong growth in BC, Quebec and Ontario. Same Store Sales and Same Stores Sales Growth are non-IFRS measures. See “Financial Highlights” and “Non-IFRS Measures” for further information.

System Sales

System Sales grew 15.3% for the second quarter as compared to the same quarter of 2018. Total System Sales for all A&W restaurants in Canada for the 12 weeks ended June 16, 2019 were \$363,878,000, an increase of \$48,282,000 from the 12 weeks ended June 17, 2018. Year to date System Sales were \$680,856,000, an increase of 15.2% from year to date 2018. The increase in System Sales was due to the Same Store Sales Growth plus the increase in the number of restaurants from 928 at the end of the second quarter of 2018 to 965 at the end of the second quarter of 2019. System Sales and Same Store Sales Growth are non-IFRS measures. See “Financial Highlights” and “Non-IFRS Measures” for further information

New Restaurant Openings and Restaurant Closures

Food Services opened six new A&W restaurants during the second quarter and fifteen year to date in 2019, compared to seven opened in the same quarter of 2018 and fourteen year to date in 2018. Two restaurants were closed during the second quarter and year to date of 2019, compared to three in the same quarter and four year to date of 2018. As at June 16, 2019, there were 965 A&W restaurants in Canada, of which 956 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 gross sales reported by those A&W restaurants in Canada identified in the Amended and Restated Licence and Royalty Agreement, as amended from time to time (the Royalty Pool).

Annual Adjustment to the Royalty Pool

The Royalty Pool is adjusted annually to reflect gross sales from new A&W restaurants added to the Royalty Pool, net of the gross sales of any A&W restaurants that have permanently closed. Food Services is paid for the additional royalty stream related to the gross 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 gross 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 2019 adjustment to the Royalty Pool took place on January 5, 2019. The number of A&W restaurants in the Royalty Pool was increased by 46 new restaurants less eight restaurants that permanently closed during 2018. The addition of these 38 net new restaurants brings the total number of A&W restaurants in the Royalty Pool to 934. The estimated annual gross sales of the 46 new A&W restaurants are \$62,283,000 and annual gross sales for the eight permanently closed restaurants were \$4,795,000. The initial consideration for the estimated additional royalty stream was \$27,305,000, 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 day ending October 29, 2018. The yield was adjusted to reflect income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$21,844,000 by issuance of 627,514 LP units which were subsequently exchanged for 1,255,028 non-voting common shares of Trade Marks. The remaining 20% of the initial consideration or \$5,461,000 will be paid in December 2019 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 2019 may differ from this amount depending on the actual annual gross sales reported by the new A&W restaurants.

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 December 31, 2017	25,009,271	122,494	78.1	7,020,731	75,558	21.9	32,030,002	198,052
January 5, 2018 adjustment to the Royalty Pool ⁽¹⁾	-	-	(4.0)	1,719,446	29,978	4.0	1,719,446	29,978
Balance as at December 31, 2018	25,009,271	122,494	74.1	8,740,177	105,536	25.9	33,749,448	228,030
January 5, 2019 adjustment to the Royalty Pool ⁽²⁾	-	-	(2.7)	1,255,028	21,844	2.7	1,255,028	21,844
June 5, 2019 exchange of common shares for units of the Fund	3,120,000	42,111	9.0	(3,120,000)	(42,111)	(9.0)	-	-
Balance as at June 16, 2019	28,129,271	164,605	80.4	6,875,205	85,269	19.6	35,004,476	249,874

(1) The number of common shares includes the 263,472 LP units exchanged for 526,944 common shares of Trade Marks representing the final consideration paid in December 2018 for the for the January 5, 2018 adjustment to the Royalty Pool.

(2) The number of common shares does not include the 156,878 LP units exchangeable for 313,756 common shares of Trade Marks representing the remaining 20% of the initial consideration for the for the January 5, 2019 adjustment to the Royalty Pool which is held back until December 2019 when the actual annual gross sales are reported by the new A&W restaurants. The actual amount of the consideration paid in December 2019 may differ from this amount depending on the actual annual gross sales reported by the new A&W restaurants.

On June 5, 2019, Food Services exchanged 3,120,000 common shares of Trade Marks for 1,560,000 Units of the Fund, which Units were then sold by Food Services at a price of \$44.55 per Unit pursuant to a short form prospectus of the Fund dated May 29, 2019 (the Offering). Food Services recognized a gain at fair value on the exchange of \$24,307,000, net of transaction costs. Following the sale of the Units pursuant to the Offering, Food Services owned approximately 19.6% of the Units of the Fund on a fully diluted basis. The net proceeds from the Offering were used to pay dividends to Food Services' shareholder. The Fund did not receive any proceeds from the Offering and Food Services paid for the expenses of the Offering. See "Related Party Transactions and Balances".

Ownership of the Fund

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

	June 16, 2019		December 31, 2018	
	Number of units	%	Number of units	%
Fund units held by public unitholders	14,064,673	80.4	12,504,673	74.1
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services ⁽¹⁾	3,437,603	19.6	4,370,089	25.9
Total equivalent units	17,502,276	100.0	16,874,762	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 initial consideration for the January 5, 2019 adjustment to the Royalty Pool is expected to be paid in December 2019, by issuance of 156,878 LP units exchangeable for 313,756 common shares of Trade Marks. The actual amount of the consideration paid in December 2019 may differ from this amount depending on the actual annual gross sales reported by the new A&W restaurants.

	Number of units	%
Fund units held by public unitholders	14,064,673	79.6
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services	3,594,481	20.4
Total equivalent units	17,659,154	100.0

2019 Operating Results

Revenue

Food Services' franchising and corporate revenue for the second quarter of 2019 was \$50,921,000 compared to \$42,097,000 for the second quarter of 2018. Year to date total revenue was \$99,375,000 compared to \$79,907,000 for 2018 year to date.

Franchising revenue for the second quarter was \$46,421,000 compared to \$38,705,000, an increase of \$7,716,000. Revenue related to sales from the distribution of food and supplies and services fees and Advertising fund contributions have increased for the second quarter due to higher System Sales. Equipment and turnkey revenue increased for the second quarter due to an increase in revenues from turnkey projects, reimage, renovation and the sale of other miscellaneous equipment. The increase in other franchise revenue for the quarter was driven by increased sales of A&W Root Beer concentrate.

Corporate restaurant System Sales were \$4,500,000 in the second quarter of 2019 compared to \$3,392,000 in the second quarter of 2018. The \$1,108,000 increase is due to the Same Store Sales Growth and a new restaurant opened late in 2018. System Sales and Same Store Sales Growth are non-IFRS measures. See "Financial Highlights" and "Non-IFRS Measures" for further information.

Operating costs and general and administrative expenses

Operating costs for the second quarter of 2019 were \$28,952,000 compared to \$22,384,000 in the second quarter of 2018, an increase of \$6,568,000. Year to date operating costs were \$56,077,000 compared to \$44,498,000 in 2018 year to date, an increase of \$11,579,000. Advertising expenses of the National Advertising Fund and costs of food and packaging were higher than in the prior year. Turnkey construction costs and costs of sales of equipment also 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 \$8,454,000 for the second quarter of 2019 compared to \$9,766,000 for the second quarter of 2018, a decrease of \$1,312,000. The decrease in the quarter is primarily due to the timing of expenses incurred. Year to date general and administrative expenses were \$19,523,000 compared to \$19,780,000 for the same period in the prior year.

Operating earnings

(dollars in thousands)	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
Franchising & corporate restaurant revenue	\$50,921	\$42,097	\$99,375	\$79,907
Operating costs and general and administrative expenses	(37,406)	(32,150)	(75,600)	(64,278)
Depreciation of plant and equipment	579	510	1,163	1,008
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$14,094	\$10,457	\$24,938	\$16,637

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 \$3,637,000 to \$14,094,000 for the second quarter of 2019 as compared to \$10,457,000 for the second quarter of 2018. Year to date operating earnings increased by \$8,301,000 to \$24,938,000 for 2019 as compared to \$16,637,000 for 2018 year to date. The year to date operating margin for 2019 was 25.1% compared to 20.8% for 2018. The increase in margin is primarily attributable to the impact of the timing difference in the National Advertising Fund contributions and expenses, which was smaller in 2019.

Royalty expense

Royalty expense for the second quarter of 2019 increased by \$1,401,000 to \$10,555,000 compared to \$9,154,000 for the second quarter of 2018. Year to date royalty expense increased by \$2,635,000 to \$19,820,000 compared to \$17,185,000 for 2018 year to date. The increase in royalty expense resulted from the additional net 38 restaurants in the Royalty Pool and the positive Royalty Pool Same Store Sales Growth. Royalty Pool Same Stores Sales Growth is a non-IFRS measure. See "Financial Highlights" and "Non-IFRS Measures" for further information.

Earnings (loss) after royalty expense

(dollars in thousands)	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$14,094	\$10,457	\$24,938	\$16,637
Royalty expense	(10,555)	(9,154)	(19,820)	(17,185)
Earnings (loss) after royalty expense (before gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	\$3,539	\$1,303	\$5,118	(\$548)

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 \$2,236,000 to \$3,539,000 for the second quarter of 2019 compared to \$1,303,000 for the second quarter of 2018. Year to date earnings after royalty expense (but before the gain on sale of Fund units, Food Services' share of income from Trade Marks, interest, taxes, depreciation and amortization) increased by \$5,666,000 to \$5,118,000 as compared to a loss of \$548,000 for 2018. The year to date increase was comprised of the \$8,301,000 increase in operating earnings, partially offset by the \$2,635,000 increase in royalty expense related to the Royalty Pool Same Store Sales Growth and the additional net 38 restaurants in the Royalty Pool. Royalty Pool Same Store Sales Growth is a non-IFRS measure. See "Financial Highlights" and "Non-IFRS Measures" for further information.

Finance expense - net

(dollars in thousands)	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
Interest income	(\$24)	(\$14)	(\$57)	(\$22)
Interest on term loan	-	(14)	-	36
Interest cost on supplementary retirement benefit plan	113	130	226	259
Finance leases	37	34	70	71
	\$126	\$136	\$239	\$344

Interest expense decreased by \$10,000 to \$126,000 for the second quarter of 2019 compared to \$136,000 for the second quarter of 2018. Year to date interest expense decreased by \$105,000 to \$239,000 in 2019 compared to \$344,000 for year to date 2018. The year to date decrease is primarily due to interest expense on Food Services' term loan which was repaid in April 2018, lower interest cost on the retirement benefit plan and an increase in interest income. See "Liquidity and Capital Resources".

Food Services' share of Trade Marks' income

Food Services' share of Trade Marks' income for the second quarter of 2019 decreased by \$89,000 to \$1,837,000 compared to \$1,926,000 for the second quarter of 2018. Food Services' year to date share of Trade Marks' income increased by \$208,000 to \$3,515,000 compared to

\$3,307,000 for the 2018 year to date period. The year to date increase is attributable to Food Services' share of Trade Mark's income being 28.0% for the 2019 year to date period as compared to 24.7% for the 2018 year to date period, partially offset by a decrease in Trade Mark's net income due to a non-cash loss on the interest rate swap, versus a gain in 2018, and higher income tax expense.

Net income

(dollars in thousands)	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
Earnings (loss) after royalty expense (before gain on sale of Units of the Fund, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	\$3,539	\$1,303	\$5,118	(\$548)
Finance expense	(126)	(136)	(239)	(344)
Depreciation of plant and equipment	(579)	(510)	(1,163)	(1,008)
Amortization of deferred gain	656	421	1,160	842
Amortization of deferred finance fees	-	(54)	-	(59)
Gain on sale of Units of A&W Revenue Royalties Income Fund	24,307	-	24,307	-
Share of income from A&W Trade Marks Inc.	1,837	1,926	3,515	3,307
Earnings before income taxes	29,634	2,950	32,698	2,190
Provision for income taxes	2,848	744	2,646	328
Net income	\$26,786	\$2,206	\$30,052	\$1,862

The year to date increase in 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 the subsequent sale of the Units of the Fund in the second quarter of 2019, and the increase in earnings previously noted, net of the impact of the change in the provision for income taxes. 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

Other comprehensive income consists of actuarial gains and 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 and actuarial losses result from a decrease in the discount rate. The actuarial loss, net of tax, for the second quarter of 2019 was \$227,000 compared to \$516,000 for the second quarter of 2018. Year to date, the actuarial loss, net of tax, was \$947,000 for 2019 compared to \$375,000 for 2018.

Liquidity and Capital Resources

Food Services is primarily a franchise business with 956 of its 965 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. Food Services has a demand operating loan facility with a Canadian chartered bank (the Bank) of \$8,000,000 to fund working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at the bank prime rate plus 0.5% and are repayable on demand. As at June 16, 2019, letters of credit totalling \$298,000 (December 30, 2018 - \$329,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,702,000 of the facility available (December 30, 2018 - \$7,671,000).

In April 2018, Food Services repaid the \$7,000,000 term loan that had been entered into with the Bank on March 3, 2017. While the term loan was outstanding, interest only was payable monthly at the bank prime rate plus 0.5%.

Food Services 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.

Cash Flows

Cash flows from operating activities increased by \$3,816,000 in the second quarter of 2019 as compared to the second quarter of 2018 and increased by \$7,480,000 on a year to date basis. The increase was primarily driven by the increase in operating earnings discussed previously.

Related Party Transactions and Balances

Royalty expense for the year to date period was \$19,820,000 (2018 - \$17,185,000), of which \$3,600,000 (December 30, 2018 - \$3,262,000) is payable to the Partnership at June 16, 2019. Royalty expense for the quarter was \$10,555,000 (2018 - \$9,154,000).

During the year to date period, Trade Marks declared dividends on common shares held by Food Services of \$3,482,000 (2018 - \$2,809,000), of which \$529,000 (December 30, 2018 - \$nil) is receivable at June 16, 2019.

During the year to date period, Food Service paid \$125,000 (2018- \$125,000) to a professional baseball club, of which a shareholder and director of Food Services is a part owner, in exchange for advertising the A&W brand at the ballpark. At June 16, 2019, \$nil (December 30, 2018 - \$nil) is payable to the baseball club by Food Services. The amount paid during the quarter was \$nil (2018 - \$125,000).

The Offering was completed by Food Services and the Fund following the exercise by Food Services of its registration rights pursuant to the terms of the registration rights agreement between Food Services and the Fund dated February 15, 2002, a copy of which is available on

SEDAR at www.sedar.com. Food Services agreed to indemnify the Fund and its subsidiaries and their respective trustees, directors, officers, agents and employees against certain liabilities and expenses of the Offering. For full details of the Offering, see the short form prospectus of the Fund dated May 29, 2019, a copy of which is available on SEDAR at www.sedar.com.

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.

New standards and interpretations not yet adopted

IFRS 16, *Leases*, replaces the current guidance in International Accounting Standards (IAS) 17 and is effective for periods beginning on or after January 1, 2019, with earlier application permitted if IFRS 15, *Revenue from Contracts with Customers*, is also applied. The standard requires lessees to recognize a lease liability reflecting future lease payments and a "right-of-use asset" for virtually all lease contracts. For lessors, the IASB has updated the guidance on the definition of a lease (as well as the guidance on the combination and separation of contracts). Food Services will adopt IFRS 16 for its annual reporting period commencing December 30, 2019. Management is evaluating the impact of the adoption of this standard for leases where it is a party in lease arrangements with franchisees. The impact of IFRS 16 is non-cash in nature, and as such, will not affect the Company's cash flows.

Risks and Uncertainties

Information with regards to the risks and uncertainties applicable to the business operations of Food Services is contained in the Fund's most recent Annual Information Form under the heading "Risk Factors". Additional risks and uncertainties not currently known or that are currently not considered to be material also may impair Food Services' business operations. If any of the risks actually occur, Food Services' business, results of operations and financial condition could be adversely affected.

Outlook

Food Services is committed to its mission "to be loved for our natural ingredients, great taste, convenience, and for doing what's right." Strategic initiatives, including repositioning and differentiating the A&W brand through the use of "better ingredients"; continued rapid new restaurant growth, and delivering an industry leading guest experience, are key to delivering strong results and improved market share in the quick service restaurants (QSR) burger market.

A&W has been a leader in the QSR industry, sourcing simple, all-natural ingredients that guests can feel good about. This focus began in 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. And the whole Burger Family[®] - from Baby[®] to Uncle[®] to Grandpa[®] - contains 100% pure beef. Over the following years, Food Services began to serve only chicken raised without the use of antibiotics and enhanced its breakfast menu by moving to eggs from hens fed a fully vegetarian diet without animal by-products. In January 2015, organic and Fair Trade coffee was introduced, 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, and announced that A&W restaurants switched to French's ketchup and mustard, made with 100% Canadian tomatoes and 100% Canadian mustard seeds. In 2017, A&W launched the new Root Beer Guarantee. 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.

In 2018, A&W further strengthened its positioning as a leader in food and innovation with the introduction of the Beyond Meat Burger. Food Services is very excited to be the first national burger chain in Canada to offer burger lovers across Canada this burger patty made using 100% plant-based protein including peas, rice, mung beans, coconut oil, pomegranates, potatoes, apples and beets. In 2019, the Beyond Meat Sausage & Egger was introduced.

A&W also moved to using real cheese on all burgers and breakfast sandwiches. A&W's real cheeses include cheddar, mozzarella, jalapeno jack, and cheddar cheese curds, all made in Canada. All processed cheese was removed from A&W's menu.

Food Services' continues to rapidly grow new A&W restaurants, particularly in the key Ontario and Quebec markets. Fifteen new A&W restaurants were opened across the country in 2019 by the end of the second quarter. As of June 16, 2019, an additional seventy-five were under construction or in varying stages of permitting.

A further important 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, almost all of A&W's restaurants now have the new design. A new "Good Food Makes Good Food" design is now 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 striving to lead the industry in minimizing its environmental footprint. Changes have been made to food packaging and dine-in customers are served with ceramic and glass mugs for hot and cold beverages, metal baskets for fries and onion rings, ceramic bowls for poutine and ceramic plates and stainless steel cutlery for breakfast in an effort to reduce waste going to landfills. In 2018, Food Services eliminated all plastic straws from all restaurants. A&W is the first QSR chain in North America to make this commitment. The switch to paper straws, which are 100% biodegradable, compostable and are sustainably sourced, will keep 82 million plastic straws out of landfills every year.

In summary, with rapid growth of new locations and industry leading innovation, A&W's brand positioning is strong. In addition, continued efforts to consistently deliver great food and a better

guest experience, in combination with the reimage progress, is contributing to winning guest visits and building loyalty, and to enhancing performance over the long term.

NON-IFRS MEASURES

Food Services believes that disclosing certain non-IFRS financial measures provides readers of this report with important information regarding Food Services' financial performance and its ability to pay the royalty to the Partnership. By considering these measures in combination with the most closely comparable IFRS measure, if any, Food Services believes that readers are provided with additional and more useful information about Food Services than readers would have if they simply considered IFRS measures alone.

Food Services uses "System Sales", "System Sales Growth", "Same Store Sales Growth", "Gross sales reported by A&W restaurants in the Royalty Pool" and "Royalty Pool Same Store Sales Growth" as non-IFRS measures in this report. These measures do not have a standardized meaning prescribed by IFRS and Food Services' method of calculating these measures may differ from those of other issuers or companies and may not be comparable to similar measures used by other issuers or companies. For further details, including how such measures are calculated by Food Services, see "Financial Highlights" above.

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 payable on adjustments to the Royalty Pool; the expected impact on Food Services' financial position, results of operations and cash flows from the adoption of IFRS 16; Food Services' plans to reposition and differentiate A&W in the QSR industry through its use of "better ingredients", new restaurant growth, and delivering an industry leading guest experience; the number of new A&W restaurants under construction and the expected timing for their opening; Food Services' strategic initiatives, including ongoing reimagining and modernizing of existing A&W restaurants, innovation in technology and minimizing its environmental footprint; Food Services' expectation that it will incur capital expenditures to open new corporate restaurants in the Ottawa market, that it will incur capital expenditures for the Urban Franchise Associate program where Food Services will contribute to the cost of building the physical location, and that it will have sufficient capital resources to fund these capital requirements; Food Services' continued efforts to consistently deliver great food and a better guest experience, in combination with reimage progress, contributing to winning guest visits and building loyalty and enhancing performance over the long term.

The forward looking information is based on various assumptions, that include, but are not limited to:

- the general risks that affect the restaurant industry will not arise;
- there are no changes in availability of experienced management and hourly employees;
- there are no material changes in government regulations concerning menu labelling and disclosure and drive-thru restrictions;
- no publicity from any food borne illness;
- no material changes in competition;
- no material 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 material impact on sales from closures of “anchor” stores in shopping centres;
- no material 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 continue 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 material impact from new or increased sales taxes upon gross sales;
- continued availability of key personnel;
- continued ability to preserve intellectual property;
- no material litigation from guests at A&W restaurants;
- Food Services continues to pay the royalty;
- Trade Marks continues to pay dividends on the common shares and the Partnership continues to make distributions on its units;
- Trade Marks can continue to comply with its obligations under its credit arrangements; 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 related to the quick service restaurant industry that include, but are not limited to:

- the general risks that affect the restaurant industry in general and the quick service segment in particular;
- changes in consumer preferences that adversely affect the consumption of quick service restaurant hamburgers, chicken, fries, breakfast items or soft drinks;
- negative publicity, litigation or complaints from perceived or actual food safety events or other events involving the foodservice industry in general or A&W restaurants in particular;
- changes in the availability and quality of raw materials, including A&W’s “better ingredients”;
- changes in climate or increases in environmental regulation;
- changes in Food Services’ ability to continue to grow same store sales, locate new retail sites in prime locations and obtain qualified operators to become A&W franchisees;
- increases in closures of A&W restaurants adversely affecting the Royalty;
- decreases in traffic at shopping centers;
- changes in Food Services’ ability to pay the Royalty due to changes in A&W franchisees’ ability to generate sales and pay franchise fees and other amounts to Food Services;
- changes in government regulation that affects the restaurant industry in general or the quick service restaurant industry in particular;
- changes in the availability of key personnel, including qualified franchise operators;
- changes in the ability to enforce or maintain intellectual property;
- risks related to technological breakdowns and cybersecurity breaches;
- risks related to the amplificatory effects of media and social media; and,
- increases in catastrophic events.

The forward-looking information is subject to risks, uncertainties and other factors related to the structure of the Fund that include, but are not limited to:

- dependence of the Fund on Trade Marks, 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 and could be suspended at any time;
- risks related to the nature of units;
- risks related to the distribution of securities on redemption or termination of the Fund;
- risks related to the Fund issuing additional units diluting existing unitholders' interests; and,
- risks related to income tax matters.

These risks, uncertainties and other factors are more particularly described in the Fund's most recent 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, the Food Services undertakes no obligation to revise or update any forward-looking information as a result of new information, future events or otherwise after the date hereof.

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

(in thousands of dollars)

	Note	June 16 2019	December 30 2018
Assets			
Current assets			
Cash and cash equivalents		\$ 14,849	\$ 11,137
Accounts receivable		29,750	28,969
Dividends receivable	11	529	-
Inventories		7,204	11,275
Prepaid expenses		221	1,332
		52,553	52,713
Non-current assets			
Investment in A&W Trade Marks Inc.	4	82,927	103,161
Deferred income taxes		23,505	19,671
Plant and equipment		12,459	11,950
Other non-current assets	4	5,461	-
Total assets		\$ 176,905	\$ 187,495
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		\$ 35,250	\$ 44,350
Royalties payable	11	3,600	3,262
Deposits on franchise and equipment sales		17,739	12,626
Deferred revenue		2,357	2,247
Income taxes payable		4,149	1,446
		63,095	63,931
Non-current liabilities			
Deferred gain	4	205,293	179,148
Deferred revenue		25,712	25,184
Supplementary retirement benefit plan		14,078	12,942
Other long-term liabilities		34	44
Obligations under finance leases		1,053	865
		309,265	282,114
Shareholders' Deficiency			
Share capital		10,500	10,500
Accumulated deficit		(143,435)	(105,290)
		(132,935)	(94,790)
Non-controlling interest			
		575	171
Total deficiency		(132,360)	(94,619)
Total liabilities and deficiency		\$ 176,905	\$ 187,495

These interim condensed consolidated 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 auditor has not performed a review 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 June 16, 2019	12 week period ended Jun 17, 2018	24 week period ended June 16, 2019	24 week period ended Jun 17, 2018
Revenue					
Franchising	7	\$ 46,421	\$ 38,705	\$ 90,758	\$ 73,347
Corporate restaurants		4,500	3,392	8,617	6,560
		50,921	42,097	99,375	79,907
Expenses (income)					
Operating costs	8	28,952	22,384	56,077	44,498
General and administrative expenses		8,454	9,766	19,523	19,780
Royalty expense	11	10,555	9,154	19,820	17,185
Finance expense - net	9	126	136	239	344
Amortization of deferred gain	4	(656)	(421)	(1,160)	(842)
Amortization of deferred finance fees		-	54	-	59
Gain on sale of Units of A&W Revenue					
Royalties Income Fund	11	(24,307)	-	(24,307)	-
Share of income from A&W Trade Marks Inc.	4	(1,837)	(1,926)	(3,515)	(3,307)
		21,287	39,147	66,677	77,717
Income before income taxes		29,634	2,950	32,698	2,190
Provision for (recovery of) income taxes					
Current		5,765	776	6,133	941
Deferred		(2,917)	(32)	(3,487)	(613)
		2,848	744	2,646	328
Net income for the period		\$ 26,786	\$ 2,206	\$ 30,052	\$ 1,862
Net income attributable to:					
Shareholders of A&W Food Services of Canada Inc.		\$ 26,550	\$ 1,993	\$ 29,648	\$ 1,487
Non-controlling interest		236	213	404	375
		\$ 26,786	\$ 2,206	\$ 30,052	\$ 1,862

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

(in thousands of dollars)

		12 week period ended June 16, 2019	12 week period ended Jun 17, 2018	24 week period ended June 16, 2019	24 week period ended Jun 17, 2018
Net income for the period		\$ 26,786	\$ 2,206	\$ 30,052	\$ 1,862
Other comprehensive loss					
Items that will not be reclassified to net income					
Actuarial loss on supplementary retirement benefit plan - net of tax		(227)	(516)	(947)	(375)
Comprehensive income		\$ 26,559	\$ 1,690	\$ 29,105	\$ 1,487
Comprehensive income attributable to:					
Shareholders of A&W Food Services of Canada Inc.		\$ 26,323	\$ 1,477	\$ 28,701	\$ 1,112
Non-controlling interest		236	213	404	375
		\$ 26,559	\$ 1,690	\$ 29,105	\$ 1,487

The accompanying notes form an integral part of these interim condensed consolidated 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 - December 31, 2017	10,500	(109,100)	(98,600)	174	(98,426)
Net income for the period	-	1,487	1,487	375	1,862
Dividends on common shares	-	(5,000)	(5,000)	-	(5,000)
Actuarial gain on supplementary retirement benefit plan - net of tax	-	217	217	-	217
Balance - June 17, 2018	10,500	(112,396)	(101,896)	549	(101,347)
Net income for the period	-	14,030	14,030	502	14,532
Dividends on common shares	-	(7,316)	(7,316)	(880)	(8,196)
Actuarial gain on supplementary retirement benefit plan - net of tax	-	392	392	-	392
Balance - December 31, 2018	10,500	(105,290)	(94,790)	171	(94,619)
Net income for the period	-	29,648	29,648	404	30,052
Dividends on common shares	11	(66,846)	(66,846)	-	(66,846)
Actuarial loss on supplementary retirement benefit plan - net of tax	-	(947)	(947)	-	(947)
Balance - June 16, 2019	\$ 10,500	\$ (143,435)	\$ (132,935)	\$ 575	\$ (132,360)

The accompanying notes form an integral part of these interim condensed consolidated 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 June 16, 2019	12 week period ended Jun 17, 2018	24 week period ended June 16, 2019	24 week period ended Jun 17, 2018
Cash flows used in operating activities				
Net income for the period	\$ 26,786	\$ 2,206	\$ 30,052	\$ 1,862
Adjustments for				
Depreciation of plant and equipment	579	510	1,163	1,008
Deferred income taxes	(2,917)	(32)	(3,487)	(613)
Gain on sale of Units of A&W Revenue				
Royalties Income Fund	(24,307)	-	(24,307)	-
Net loss (gain) on disposal of plant and equipment	57	(23)	27	(40)
Supplementary retirement benefit plan	(192)	(222)	(384)	(314)
Increase in deferred revenue	346	248	638	586
Decrease in other long-term liabilities	(5)	(5)	(10)	(11)
Amortization of deferred finance fees	-	54	-	59
Amortization of deferred gain	4 (656)	(421)	(1,160)	(842)
Share of income of A&W Trade Marks Inc.	4 (1,837)	(1,926)	(3,515)	(3,307)
Current income tax expense	5,765	776	6,133	941
Income tax paid	(1,752)	(718)	(3,430)	(3,633)
Finance expense - net	126	136	239	344
Finance expense paid	(13)	(7)	(13)	(85)
Changes in items of non-cash working capital	10 1,735	(677)	800	(689)
Net cash generated from (used in) operating activities	3,715	(101)	2,746	(4,734)
Cash flows generated from (used in) investing activities				
Purchase of plant and equipment	(164)	(752)	(1,078)	(1,001)
Dividends from A&W Trade Marks Inc.	2,240	1,683	2,953	2,242
Net proceeds from sale of Units of A&W Revenue				
Royalties Income Fund	66,418	-	66,418	-
Net cash generated from investing activities	68,494	931	68,293	1,241
Cash flows used in financing activities				
Increase in obligations under finance leases	(278)	(205)	(481)	(406)
Repayment of term loan	-	(7,000)	-	(7,000)
Dividends paid to shareholder	(66,132)	-	(66,846)	(5,000)
Net cash used in financing activities	(66,410)	(7,205)	(67,327)	(12,406)
Increase (decrease) in cash and cash equivalents	5,799	(6,375)	3,712	(15,899)
Cash and cash equivalents - beginning of period	9,050	8,027	11,137	17,551
Cash and cash equivalents - end of period	\$ 14,849	\$ 1,652	\$ 14,849	\$ 1,652
Non-cash investing activities				
Non-cash acquisition of automobiles through finance leases	\$ 422	\$ 146	\$ 723	\$ 298

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

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 16, 2019

(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 June 16, 2019, the Company opened 15 locations and closed two locations, bringing the total number of A&W restaurants to 965, of which 956 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 December 30, 2018.

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 December 30, 2018.

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors of Food Services on July 23, 2019.

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 2018 year was 52 weeks and ended December 30, 2018 (2017 - 52 weeks ended December 31, 2017). Beverages uses a fiscal year ending December 31. The second quarter ends 24 weeks after the fiscal year end.

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 16, 2019

(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 2019 annual adjustment to the Royalty Pool took place on January 5, 2019. The number of A&W restaurants in the Royalty Pool was increased by 46 new restaurants less eight restaurants that permanently closed during 2018. The addition of these 38 net new restaurants brings the total number of A&W restaurants in the Royalty Pool to 934. The estimated annual sales of the 46 new A&W restaurants are \$62,283,000 and annual sales for the eight permanently closed restaurants were \$4,795,000. The initial consideration for the estimated additional royalty stream was \$27,305,000, 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 29, 2018. The yield was adjusted to reflect the income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$21,844,000, by issuance of 627,514 LP units which were subsequently exchanged for 1,255,028 non-voting common shares of Trade Marks. The remaining 20% of the consideration or \$5,461,000 will be paid in December 2019 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 2019 may differ from this amount depending on the actual annual sales reported by the new A&W restaurants.

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 16, 2019

(figures in tables are expressed in thousands of dollars)

Food Services' 19.6% (December 30, 2018 – 25.9%) investment in Trade Marks is recorded using the equity method.

	Common shares \$	Cumulative equity in earnings \$	Cumulative dividend \$	Total \$
Balance – December 31, 2017	75,558	29,781	(33,018)	72,321
January 5, 2018 adjustment to Royalty Pool	29,978	-	-	29,978
Equity in earnings	-	8,178	-	8,178
Dividends	-	-	(7,316)	(7,316)
Balance – December 30, 2018	105,536	37,959	(40,334)	103,161
January 5, 2019 adjustment to Royalty Pool	21,844	-	-	21,844
Equity in earnings	-	3,515	-	3,515
Dividends	-	-	(3,482)	(3,482)
Exchange of common shares for Units of A&W Revenue Royalties Income Fund (note 11)	(42,111)	-	-	(42,111)
Balance – June 16, 2019	85,269	41,474	(43,816)	82,927

The deferred gain as at June 16, 2019 is as follows:

	Number of restaurants in Royalty Pool	Deferred gain \$	Accumulated amortization \$	Net deferred gain \$
Balance – December 31, 2017	861	169,550	(18,199)	151,351
January 5, 2018 adjustment to Royalty Pool	35	29,978	-	29,978
Amortization of deferred gain	-	-	(2,181)	(2,181)
Balance – December 30, 2018	896	199,528	(20,380)	179,148
January 5, 2019 adjustment to Royalty Pool	38	27,305	-	27,305
Amortization of deferred gain	-	-	(1,160)	(1,160)
Balance – June 16, 2019	934	226,833	(21,540)	205,293

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 16, 2019

(figures in tables are expressed in thousands of dollars)

5 Operating loan facility and term loan

Food Services has a demand operating loan facility with a Canadian chartered bank (the Bank) of \$8,000,000 to fund working capital requirements and for general corporate purposes. Amounts advanced under the facility bear interest at the bank prime rate plus 0.5% and are repayable on demand. As at June 16, 2019, letters of credit totalling \$298,000 (December 30, 2018 - \$329,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,702,000 of the facility available (December 30, 2018 - \$7,671,000).

In April 2018, Food Services repaid the \$7,000,000 term loan that had been entered into with the Bank on March 3, 2017. While the term loan was outstanding, interest only was payable monthly at the bank prime rate plus 0.5%.

6 New restaurant openings

Food Services opened six new franchised restaurants during the quarter (2018 – seven). There was an increase in turnkey revenues and construction costs in the quarter as compared to the prior year related to an increase in the number of new restaurants opened that were turnkey projects.

7 Franchising revenue

Franchising revenues disaggregated by revenue source are outlined below. The table also shows the basis on which franchising revenues are recognized.

	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
	\$	\$	\$	\$
At a point in time				
Advertising fund contributions	11,406	9,242	21,935	18,440
Distribution revenue and service fees	21,959	18,781	40,719	35,889
Equipment and turnkey revenue	9,608	8,106	22,088	14,515
Other revenue	2,843	2,304	4,942	3,930
Over time				
Initial franchise fees and renewal fees	605	272	1,074	573
	46,421	38,705	90,758	73,347

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 16, 2019

(figures in tables are expressed in thousands of dollars)

8 Expenses by nature

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

	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
	\$	\$	\$	\$
Depreciation of plant and equipment	579	510	1,163	1,008
Employee benefit costs				
Wages and salaries and other termination benefits	6,292	5,970	12,565	11,692
Pension costs - defined contribution plan	117	169	433	382
	<u>6,409</u>	<u>6,139</u>	<u>12,998</u>	<u>12,074</u>

9 Finance (income) expense

	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
	\$	\$	\$	\$
Interest income	(24)	(14)	(57)	(22)
Interest on term loan	-	(14)	-	36
Interest cost on supplementary retirement benefit plan	113	130	226	259
Finance leases	37	34	70	71
	<u>126</u>	<u>136</u>	<u>239</u>	<u>344</u>

10 Working capital

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

	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
	\$	\$	\$	\$
Accounts receivable	(4,276)	(6,523)	(781)	(5,594)
Inventories	(1,718)	326	4,071	1,304
Prepaid expenses	236	1,492	1,111	(117)
Accounts payable and accrued liabilities	3,115	3,992	(9,052)	558
Royalties payable	403	400	338	420
Deposits on franchise and equipment sales	3,975	(364)	5,113	2,740
	<u>1,735</u>	<u>(677)</u>	<u>800</u>	<u>(689)</u>

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

June 16, 2019

(figures in tables are expressed in thousands of dollars)

11 Related party transactions and balances

Royalty expense for the year to date period was \$19,820,000 (2018 - \$17,185,000), of which \$3,600,000 (December 30, 2018 - \$3,262,000) is payable to the Partnership at June 16, 2019. Royalty expense for the quarter was \$10,555,000 (2018 - \$9,154,000).

During the year to date period, Trade Marks declared dividends on common shares held by Food Services of \$3,482,000 (2018 - \$2,809,000), of which \$529,000 (December 30, 2018 - \$nil) is receivable at June 16, 2019.

During the year to date period, Food Service paid \$125,000 (2018- \$125,000) to a professional baseball club, of which a shareholder and director of Food Services is a part owner, in exchange for advertising the A&W brand at the ballpark. At June 16, 2019, \$nil (December 30, 2018 - \$nil) is payable to the baseball club by Food Services. The amount paid during the quarter was \$nil (2018 - \$125,000).

Key management compensation

Key management includes the Company's executive team. The compensation awarded to key management includes:

	12 week period ended June 16, 2019	12 week period ended June 17, 2018	24 week period ended June 16, 2019	24 week period ended June 17, 2018
	\$	\$	\$	\$
Salaries, bonuses and other short-term employee benefits	700	737	1,371	1,585
Pension costs - defined contribution plan	35	39	112	108
Pension costs - supplementary retirement benefit plan	113	129	226	259
Total	<u>848</u>	<u>905</u>	<u>1,709</u>	<u>1,952</u>

Sale of Units of A&W Revenue Royalties Income Fund

On June 5, 2019, Food Services exchanged 3,120,000 common shares of Trade Marks, with a book value of \$42,111,000, for 1,560,000 Units of the Fund, which were then sold by Food Services at a price of \$44.55 per Unit. Food Services recognized a gain for this transaction of \$24,307,000, net of transaction costs. Prior to the sale of the Units, Food Services owned approximately 28.6% of the Units of the Fund on a fully diluted basis. Following the sale of the Units, Food Services owned approximately 19.6% of the Units of the Fund on a fully diluted basis. The net proceeds from the sale were used to pay dividends to Food Services' shareholder.

Dividends

During the year to date period of 2019, Food Services paid dividends of \$5,953,000 (2018 - \$5,000,000) from working capital to its parent. On June 5, 2019, Food Services paid a dividend of \$60,893,000 from the proceeds of the sale of Units of the Fund to its shareholder.

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



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