

A&W Food Services of Canada Inc.

Q1/2018

**Consolidated Financial
Statements**

For the first quarter ended
March 25, 2018

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 1, 2018 to March 25, 2018**

This report and the interim condensed consolidated financial statements of A&W Food Services of Canada Inc. (A&W or Food Services) for the 12 weeks ended March 25, 2018 are provided as a supplement to the interim condensed consolidated financial statements and Management Discussion and Analysis of the A&W Revenue Royalties Income Fund (the Fund) for the quarter ended March 25, 2018. This report is dated May 1, 2018 and should be read in conjunction with the interim condensed consolidated financial statements of Food Services for the 12 weeks ended March 25, 2018 and the audited annual consolidated financial statements of Food Services for the 52 weeks ended December 31, 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 2017 year was 52 weeks and ended December 31, 2017 (2016 – 52 weeks ended January 1, 2017). Food Services’ first quarter ends 12 weeks after its fiscal year end.

The financial results reported in this MD&A are in accordance with International Financial Reporting Standards (IFRS) as applicable to interim financial reports including International Accounting Standards (IAS) 34, Interim Financial Reporting. The accounting policies applied in the interim condensed consolidated financial statements and this report are consistent with those followed in the preparation of Food Services’ annual consolidated financial statements for the year ended January 1, 2017, with the exception of the adoption of IFRS 9, Financial Instruments, and IFRS 15 Revenue from Contracts with Customers. See “New standards and interpretations”.

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 Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
System sales ⁽¹⁾	\$275,426	\$250,307
System sales growth ⁽¹⁾	+10.0%	+3.5%
Same store sales growth ⁽¹⁾	+5.3%	-0.3%
New restaurants opened	7	7
Restaurants closed	1	-
Number of restaurants	924	886
Franchising & corporate restaurant revenue	\$37,810	\$36,946
Operating costs and general and administrative expenses	(32,128)	(28,512)
Depreciation of plant and equipment	498	473
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$6,180	\$8,907
Royalty expense	(8,031)	(7,306)
Net income (loss)	(\$344)	\$8,213

(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 first quarter of 2018 increased by 5.3% as compared to the same quarter of 2017. Same store sales growth continued to build on the momentum gained last year, despite unfavourable weather in several parts of the country. The improvement in same store sales was seen across the country, except in Saskatchewan which continues to be affected by a weaker economy and the introduction of a new 6% provincial sales tax on restaurant meals on April 1, 2017.

System Sales

System sales grew 10.0% for the quarter as compared to the same quarter of 2017. Total system sales for all A&W restaurants in Canada for the 12 weeks ended March 25, 2018 were \$275,426,000, an increase of \$25,119,000 from the 12 weeks ended March 26, 2017. The increase in system sales was due to the same store sales growth plus the increase in the number of restaurants from 886 at the end of the first quarter of 2017 to 924 at the end of the first quarter of 2018.

New Restaurant Openings and Restaurant Closures

Food Services opened seven new A&W restaurants during the first quarter of 2018, the same number as were opened in the first quarter of 2017. One restaurant was closed in 2018, compared to none in the same quarter of 2017. As at March 25, 2018, there were 924 A&W restaurants in Canada, of which 916 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 2018 adjustment to the Royalty Pool took place on January 5, 2018. The number of A&W restaurants in the Royalty Pool was increased by 42 new restaurants less seven restaurants that permanently closed during 2017. The addition of these 35 net new restaurants brings the total number of A&W restaurants in the Royalty Pool to 896. The estimated annual sales of the 42 new A&W restaurants are \$55,642,000 and annual sales for the seven permanently closed restaurants were \$3,210,000. The initial consideration for the estimated additional royalty stream was \$25,989,000, 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

30, 2017. The yield was adjusted to reflect income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$20,791,000 by issuance of 596,251 LP units which were subsequently exchanged for 1,192,502 non-voting common shares of Trade Marks. The remaining 20% of the consideration or \$5,198,000 will be paid in December 2018 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 2018 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, 2018 adjustment to the Royalty Pool, Food Services' indirect interest in the Fund increased to 24.7%.

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, 2016	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⁾	-	-	(2.4)	994,102	17,273	2.4	994,102	17,273
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 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⁾	-	-	(2.8)	1,192,502	20,791	2.8	1,192,502	20,791
Balance as at March 25, 2018	25,009,271	122,494	75.3	8,213,233	96,349	24.7	33,222,504	218,843

⁽¹⁾ The number of common shares does not include the 149,063 LP units exchangeable for 298,126 common shares of Trade Marks representing the remaining 20% of the consideration for the January 5, 2018 adjustment to the Royalty Pool which is held back until December 2018 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".

Ownership of the Fund

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

	March 25, 2018		December 31, 2017	
	Number of units	%	Number of units	%
Fund units held by public unitholders	12,504,673	75.3	12,504,673	78.1
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services ⁽¹⁾	4,106,616	24.7	3,510,365	21.9
Total equivalent units	16,611,289	100.0	16,015,038	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, 2018 adjustment to the Royalty Pool is expected to be paid in December 2018, by issuance of 149,063 LP units exchangeable for 298,126 common shares of Trade Marks. The actual amount of the consideration paid in December 2018 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	74.6
Number of Fund units issuable upon exchange of securities of Trade Marks held by Food Services	4,255,679	25.4
Total equivalent units	16,760,352	100.0

2018 Operating Results

Revenue

Food Services' franchising and corporate revenue for the first quarter of 2018 was \$37,810,000 compared to \$36,946,000 for the first quarter of 2017. 2018 franchising revenue for the quarter was \$34,642,000 compared to \$33,968,000, an increase of \$674,000. Revenue related to the Advertising fund contributions, sales from the distribution of food and supplies and services fees increased by \$1,316,000, \$1,306,000 and \$796,000, respectively, due to higher system sales. Turnkey revenue decreased by \$1,535,000 as more of the new restaurants opened in 2017 were constructed by Food Services and then sold to franchisees, as compared to 2018. Equipment revenue decreased due primarily to sales of equipment in connection with the launch of all-day breakfast in Q1 2017. The remainder of the increase is due to an increase in other franchise revenue.

Corporate restaurant sales were \$3,168,000 in the first quarter of 2018 compared to \$2,978,000 in 2017, an increase of \$190,000 or 6.4%.

Operating costs and general and administrative expenses

Operating costs for the first quarter of 2018 were \$22,114,000 compared to \$20,545,000 in the first quarter of 2017, an increase of \$1,569,000. Advertising expenses of the National Advertising Fund and costs of food and packaging for the first quarter of 2018 were higher than

in the same quarter in the prior year. Turnkey construction costs and costs of sales of equipment decreased in line with the decrease in revenue noted above.

General and administrative expenses represent costs of providing services to franchised restaurants and establishing new restaurants, and were \$10,014,000 in the first quarter of 2018 compared to \$7,967,000 for the first quarter of 2017, an increase of \$2,047,000. 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 Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
Franchising & corporate restaurant revenue	\$37,810	\$36,946
Operating costs and general and administrative expenses	(32,128)	(28,512)
Depreciation of plant and equipment	498	473
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$6,180	\$8,907

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) was \$6,180,000 for the first quarter 2018 compared to \$8,907,000 for the first quarter of 2017. The operating margin was 16.3% for the first quarter of 2018 compared to 24.1% for the first quarter of 2017. The decrease in operating margin is primarily due to the impact of a timing difference in the advertising expenses of the National Advertising Fund versus contributions partially offset by a decrease in the number of turnkey projects completed.

Royalty expense

Royalty expense for the first quarter of 2018 increased by \$725,000 to \$8,031,000 compared to \$7,306,000 for the first quarter of 2017. The increase in royalty expense resulted from the additional net 35 restaurants in the Royalty Pool and the same store sales growth of restaurants in the Royalty Pool.

Earnings (loss) after royalty expense

(dollars in thousands)	12 week period ended Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
Earnings before royalty expense, gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization	\$6,180	\$8,907
Royalty expense	(8,031)	(7,306)
Earnings (loss) after royalty expense (before gain on sale of Fund units, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	(\$1,851)	\$1,601

Earnings (loss) 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) decreased to a loss of \$1,851,000 for the first quarter of 2018 compared to earnings of \$1,601,000 for the first quarter of 2017. The decrease was comprised of the \$2,727,000 decrease in operating earnings and the \$725,000 increase in royalty expense related to the same store sales growth of restaurants in the Royalty Pool and the additional net 35 restaurants in the Royalty Pool.

Finance expense - net

(dollars in thousands)	12 week period ended Mar 25, 2018	12 week period ended Mar 26, 2017
Interest income	(\$8)	(\$11)
Interest on term loan	50	16
Interest cost on supplementary retirement benefit plan	129	129
Finance leases	37	34
	\$208	\$168

Interest expense increased by \$40,000 to \$208,000 for the first quarter of 2018 compared to \$168,000 for the first quarter of 2017. The increase is primarily due to interest expense on Food Services' new term loan. See "Liquidity and Capital Resources".

Food Services' share of Trade Marks' income

Food Services' share of Trade Marks' income for the first quarter of 2018 increased by \$140,000 to \$1,381,000 compared to \$1,241,000 for the first quarter of 2017. Trade Marks' net income was higher than the prior year due primarily to higher royalty income, an increase in the non-cash gain on the interest rate swap in 2018 compared to 2017, partially offset by an increase in income tax expense.

Net income (loss)

(dollars in thousands)	12 week period ended Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
Earnings (loss) after royalty expense (before gain on sale of Units of the Fund, share of Trade Marks' earnings, interest, taxes, depreciation and amortization)	(\$1,851)	\$1,601
Finance expense	(208)	(168)
Depreciation of plant and equipment	(498)	(473)
Amortization of deferred gain	421	414
Amortization of deferred finance fees	(5)	-
Gain on sale of Units of A&W Revenue Royalties Income Fund	-	6,314
Share of income from A&W Trade Marks Inc.	1,381	1,241
Earnings (loss) before income taxes	(760)	8,929
Provision for (recovery of) income taxes	(416)	716
Net income (loss)	(\$344)	\$8,213

The decrease in earnings (loss) 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 in the first quarter of 2017, and the decrease 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 (loss)

Other comprehensive income (loss) 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 gain (loss), net of tax, for the first quarter of 2018 was an actuarial gain of \$141,000 compared to an actuarial loss, net of tax, of \$216,000 for the first quarter of 2017.

Liquidity and Capital Resources

Food Services is primarily a franchise business with 916 of its 924 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 March 25, 2018, letters of credit totalling \$329,000 (December 31, 2017 - \$329,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,671,000 of the facility available (December 31, 2017 - \$7,671,000).

On March 3, 2017, Food Services entered into a \$7,000,000 term loan with the Bank. 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 March 25, 2018.

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

In April 2018, Food Services repaid the \$7,000,000 term loan.

Off-Balance Sheet Arrangements

Food Services has no off-balance sheet arrangements.

Related Party Transactions and Balances

Royalty expense for the year was \$8,031,000 (2017 - \$7,306,000), of which \$2,742,000 (December 31, 2017 - \$2,742,000) is payable to the Partnership at March 25, 2018.

During the period, Trade Marks declared dividends on common shares held by Food Services of \$1,118,000 (2017 - \$943,000) of which \$559,000 (December 31, 2017 - \$nil) is receivable at March 25, 2018.

During the year, 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 totalled \$69,000 (2017 - \$80,000). At March 25, 2018, \$nil (December 31, 2017 - \$nil) is payable to the private company by Food Services.

During the period, Food Services paid a dividend of \$5,000,000 (2017 - \$14,532,000) 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. See "Common Shares of A&W Trade Marks Inc." 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 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

IFRS 9, *Financial Instruments*, has been adopted effective January 1, 2018, retrospectively without restatement of comparatives. The new standard replaces IAS 39 Financial Instruments: Recognition and Measurement. Food Services classifies all its financial assets and financial liabilities at amortized cost. Under IFRS 9, Food Services assesses on a forward looking basis the expected credit losses associated with financial assets carried at amortized cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, Food Services applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

The adoption of this standard had no impact on the consolidated financial statements and no adjustments to opening retained earnings as at January 1, 2018 were necessary.

IFRS 15, *Revenue from Contracts with Customers*, has been adopted effective January 1, 2018, using the full retrospective method without the use of practical expedients.

The adoption of this standard has changed the timing of recognition of initial franchise fees and renewal fees. These fees were previously recognized upfront upon either opening of the respective restaurant or when a renewal agreement becomes effective. Under the new guidance, the Company has identified one distinct performance obligation, being the provision of franchising services. The Company recognized revenues on this performance obligation over time because franchisees consume services as they are provided. As a result, the Company defers the entire initial and renewal franchise fee and recognizes revenues over the term of the related franchise agreement.

The adoption of this standard has also changed the reporting of advertising fund contributions received from franchisees and the related advertising expenditures. These advertising fund contributions and expenditures were previously reported on a net basis in the consolidated statements of income. Under the new standard, advertising fund contributions from franchisees and advertising fund expenditures are reported on a gross basis, as the Company controls the advertising services prior to delivery of those services to the franchisees and the related advertising fund revenues and expenses may be reported in different periods in the consolidated statement of comprehensive income. At the balance sheet date, advertising fund contributions received from franchisees may not equal advertising expenditures for the period due to timing of promotions. To the extent that contributions received exceeded advertising expenditures, the

excess contributions are treated as deferred revenue. To the extent that advertising expenditures temporarily exceeded advertising fund contributions, the difference is recorded as a receivable.

The timing of the recognition of revenue related to the other revenue streams has not changed as a result of adopting the new guidance.

The cumulative effect of the changes made to the Consolidated Balance Sheet as at January 1, 2017 related to the adoption of IFRS 15 was as follows:

	As Previously Reported \$	Adjustment \$	Restated \$
<u>Assets</u>			
Accounts receivable	15,403	1,716	17,119
Deferred income taxes	12,087	6,055	18,142
<u>Liabilities</u>			
Income taxes payable	232	573	805
Deferred revenue	-	23,146	23,146
<u>Shareholders' Deficiency</u>			
Accumulated deficit	(77,463)	(15,948)	(93,411)

The cumulative effect of the changes made to the Consolidated Balance Sheet as at December 31, 2017 related to the adoption of IFRS 15 was as follows:

	As Previously Reported \$	Adjustment \$	Restated \$
<u>Assets</u>			
Accounts receivable	16,589	2,465	19,054
Deferred income taxes	12,995	6,692	19,687
<u>Liabilities</u>			
Income taxes payable	1,830	646	2,476
Deferred revenue	-	25,581	25,581
<u>Shareholders' Deficiency</u>			
Accumulated deficit	(92,030)	(17,070)	(109,100)

The cumulative effect of the changes made to the Consolidated Statement of Income for the 12-week period ended March 26, 2017 related to the adoption of IFRS 15 was as follows:

	As Previously Reported \$	Adjustment \$	Restated \$
<u>Revenue</u>			
Franchising	26,417	7,551	33,968
<u>Expenses</u>			
Operating costs	12,891	7,654	20,545
Provision for (recovery of) income taxes	803	(87)	716
Net income for the period	8,229	(16)	(8,213)

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). As a result of adopting this standard, Food Services will recognize a “right-of-use” asset and a corresponding lease liability for leases of property and equipment where it is the lessee, including its corporate restaurant locations. 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, as such, it will not affect the Company’s cash flows.

There are no other IFRS or IFRIC interpretations that are not yet effective that would be expected to have a material impact on Food Services.

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’ remains committed to its mission “to delight time-crunched Canadian burger lovers with the joy of great tasting natural food, made by people they trust.” Continued focus on its strategic initiatives, including repositioning and differentiating the A&W brand through the use of “better ingredients”; accelerating new restaurant growth, and delivering an industry leading guest experience, has delivered strong results and improved market share in the quick service restaurants (QSR) burger market.

Since 2013 A&W has been a leader in the QSR industry, sourcing simple, all-natural ingredients that guests can feel good about. Food Services was 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 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. 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.

Menu innovations are important to A&W's success. In February 2017, all-day breakfast was launched. In 2018, breakfast promotions have featured the All Canadian Special and the Classic Breakfast Combo. Additional limited time offers in 2018 have included Cheddar Jalapeno Burgers and 56 Burgers. A&W continues to offer the "Pick Your Perfect Size" first introduced in 2017 in connection with the limited time burger promotions, allowing guests to enjoy feature burgers in a size of their choice. These menu items have been well received by Food Services' guests.

Food Services' second strategic initiative is accelerating the pace of growth of new A&W restaurants, particularly in the key Ontario and Quebec markets. Seven new A&W restaurants were opened across the country in Q1 2018. As of March 25, 2018, an additional seventy are under construction or in varying stages of permitting.

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 94% 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 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.

Looking ahead for the remainder of 2018, Food Services plans to continue to focus on key strategies that accelerate trial and drive guest counts, which, in combination with the work to improve guest experience, aim to fuel additional visits and build loyalty. These initiatives are expected to build the competitiveness of the A&W brand and to enhance performance over the long term.

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; Food Services' plans to reposition and differentiate A&W in the QSR industry through its use of "better ingredients", accelerating new

restaurant growth, the number of new A&W restaurants under construction and the expected timing for their opening, and delivering an industry leading guest experience; Food Services expects to have sufficient capital resources to fund the expansion of corporate restaurants.

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;
- 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	March 25 2018	(Restated) December 31 2017	(Restated) January 1 2017
Assets				
Current assets				
Cash and cash equivalents		\$ 8,027	\$ 17,551	\$ 17,920
Accounts receivable		18,125	19,054	17,119
Dividends receivable	11	559	-	-
Inventories		3,923	4,901	5,999
Prepaid expenses		2,366	757	357
Income taxes recoverable		274	-	-
		33,274	42,263	41,395
Non-current assets				
Investment in A&W Trade Marks Inc.	4	93,375	72,322	62,289
Deferred income taxes		20,216	19,687	18,142
Plant and equipment		9,433	9,548	8,762
Other non-current assets	4	5,198	-	-
Total assets		\$ 161,496	\$ 143,820	\$ 130,588
Liabilities				
Current liabilities				
Accounts payable and accrued liabilities		\$ 26,389	\$ 29,849	\$ 27,469
Royalties payable	11	2,762	2,742	2,516
Deposits on franchise and equipment sales		11,216	8,112	8,216
Income taxes payable		-	2,476	805
		40,367	43,179	39,006
Non-current liabilities				
Deferred gain	4	176,919	151,351	135,898
Deferred revenue	2	25,919	25,581	23,146
Supplementary retirement benefit plan		13,959	14,114	14,218
Term loan		6,946	6,941	-
Other long-term liabilities		37	43	78
Obligations under finance leases		978	1,037	970
		265,125	242,246	213,316
Shareholders' Deficiency				
Share capital		10,500	10,500	10,500
Accumulated deficit		(114,465)	(109,100)	(93,411)
		(103,965)	(98,600)	(82,911)
Non-controlling interest				
		336	174	183
Total deficiency		(103,629)	(98,426)	(82,728)
Total liabilities and deficiency		\$ 161,496	\$ 143,820	\$ 130,588

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 (Loss)

Unaudited

(in thousands of dollars)

		(Restated)	
		12 week period ended Mar 25, 2018	12 week period ended Mar 26, 2017
Revenue			
Franchising	7	\$ 34,642	\$ 33,968
Corporate restaurants		3,168	2,978
		37,810	36,946
Expenses (income)			
Operating costs	8	22,114	20,545
General and administrative expenses		10,014	7,967
Royalty expense	11	8,031	7,306
Finance expense - net	9	208	168
Amortization of deferred gain	4	(421)	(414)
Amortization of deferred finance fees		5	-
Gain on sale of Units of A&W Revenue			
Royalties Income Fund	11	-	(6,314)
Share of income from A&W Trade Marks Inc.	4	(1,381)	(1,241)
		38,570	28,017
Income (loss) before income taxes		(760)	8,929
Provision for (recovery of) income taxes			
Current		165	1,683
Deferred		(581)	(967)
		(416)	716
Net income (loss) for the period		\$ (344)	\$ 8,213
Net income (loss) attributable to:			
Shareholders of A&W Food Services of Canada Inc.		\$ (506)	\$ 8,119
Non-controlling interest		162	94
		\$ (344)	\$ 8,213

A&W Food Services of Canada Inc.

Interim Condensed Consolidated Statement of Comprehensive Income (Loss)

Unaudited

(in thousands of dollars)

		(Restated)	
		12 week period ended Mar 25, 2018	12 week period ended Mar 26, 2017
Net income (loss) for the period		\$ (344)	\$ 8,213
Other comprehensive income (loss)			
Items that will not be reclassified to net income			
Actuarial gain (loss) on supplementary retirement benefit plan - net of tax		141	(216)
Comprehensive income (loss)		\$ (203)	\$ 7,997
Comprehensive income (loss) attributable to:			
Shareholders of A&W Food Services of Canada Inc.		\$ (365)	\$ 7,903
Non-controlling interest		162	94
		\$ (203)	\$ 7,997

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 1, 2017	10,500	(93,411)	(82,911)	183	(82,728)
Net income for the period	-	8,119	8,119	94	8,213
Dividends on common shares	-	(27,451)	(27,451)	-	(27,451)
Actuarial loss on supplementary retirement benefit plan - net of tax	-	(216)	(216)	-	(216)
Balance - March 26, 2017	10,500	(112,959)	(102,459)	277	(102,182)
Net income for the period	-	12,671	12,671	697	13,368
Dividends on common shares	-	(9,000)	(9,000)	(800)	(9,800)
Actuarial gain on supplementary retirement benefit plan - net of tax	-	188	188	-	188
Balance - December 31, 2017	10,500	(109,100)	(98,600)	174	(98,426)
Net income (loss) for the period	-	(506)	(506)	162	(344)
Dividends on common shares	11	(5,000)	(5,000)	-	(5,000)
Actuarial gain on supplementary retirement benefit plan - net of tax	-	141	141	-	141
Balance - March 25, 2018	\$ 10,500	\$ (114,465)	\$ (103,965)	\$ 336	\$ (103,629)

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

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

Unaudited

(in thousands of dollars)

	Note	12 week period ended Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
Cash flows used in operating activities			
Net income (loss) for the period		\$ (344)	\$ 8,213
Adjustments for			
Depreciation of plant and equipment		498	473
Deferred income taxes		(581)	(967)
Gain on sale of Units of A&W Revenue			
Royalties Income Fund		-	(6,314)
Gain on disposal of plant and equipment		(17)	(29)
Supplementary retirement benefit plan		(92)	(92)
Increase in deferred revenue		338	324
Decrease in other long-term liabilities		(6)	(9)
Amortization of deferred finance fees		5	-
Amortization of deferred gain	4	(421)	(414)
Share of income of A&W Trade Marks Inc.	4	(1,381)	(1,241)
Current income tax expense		165	1,683
Income tax paid		(2,915)	(743)
Finance expense - net		208	168
Finance expense paid		(78)	(39)
Changes in items of non-cash working capital	10	(12)	(3,864)
Net cash used in operating activities		(4,633)	(2,851)
Cash flows from investing activities			
Purchase of plant and equipment		(249)	(282)
Dividends from A&W Trade Marks Inc.		559	496
Net proceeds from sale of Units of A&W			
Revenue Royalties Income Fund		-	14,128
Net cash generated from investing activities		310	14,342
Cash flows used in financing activities			
Decrease in obligations under finance leases		(201)	(173)
Financing fees paid		-	(74)
Proceeds from new term loan		-	7,000
Dividends paid to shareholder		(5,000)	(27,451)
Net cash used in financing activities		(5,201)	(20,698)
Decrease in cash and cash equivalents		(9,524)	(9,207)
Cash and cash equivalents - beginning of period		17,551	17,920
Cash and cash equivalents - end of period		\$ 8,027	\$ 8,713
Non-cash investing activities			
Non-cash acquisition of automobiles through finance leases		\$ 152	\$ 495

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

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(figures in tables are expressed in thousands of dollars)

1 General information

A&W Food Services of Canada Inc. (the Company or Food Services) is in the business of developing and franchising quick-service restaurants in Canada. During the period ended March 25, 2018, the Company opened 7 locations and closed one location, bringing the total number of A&W restaurants to 924, of which 916 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 December 31, 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 December 31, 2017, with the exception of the adoption of IFRS 9, Financial Instruments and IFRS 15, Revenue from Contracts with Customers.

IFRS 9 – Financial Instruments

Food Services has adopted IFRS 9 effective January 1, 2018, retrospectively without restatement of comparatives. The new standard replaces IAS 39 Financial Instruments: Recognition and Measurement. Food Services classifies all its financial assets and financial liabilities at amortized cost. Under IFRS 9, Food Services assesses on a forward looking basis the expected credit losses associated with financial assets carried at amortized cost. The impairment methodology applied depends on whether there has been a significant increase in credit risk. For trade receivables, Food Services applies the simplified approach permitted by IFRS 9, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

The adoption of this standard had no impact on the consolidated financial statements and no adjustments to opening retained earnings as at January 1, 2018 were necessary.

IFRS 15 – Revenue from Contracts with Customers

Food Services has adopted IFRS 15 effective January 1, 2018, using the full retrospective method without the use of practical expedients.

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(figures in tables are expressed in thousands of dollars)

The adoption of this standard has changed the timing of recognition of initial franchise fees and renewal fees. These fees were previously recognized upfront upon either opening of the respective restaurant or when a renewal agreement becomes effective. Under the new guidance, the Company has identified one distinct performance obligation, being the provision of franchising services. The Company recognized revenues on this performance obligation over time because franchisees consume services as they are provided. As a result, the Company defers the entire initial and renewal franchise fee and recognizes revenues over the term of the related franchise agreement.

The adoption of the new guidance has also changed the reporting of advertising fund contributions received from franchisees and the related advertising expenditures. These advertising fund contributions and expenditures were previously reported on a net basis in the consolidated statements of income. Under the new standard, advertising contributions from franchisees and advertising fund expenditures are reported on a gross basis, as the Company controls the advertising services prior to delivery of those services to the franchisees and the related advertising fund revenues and expenses may be reported in different periods in the consolidated statement of comprehensive income. At the balance sheet date, advertising fund contributions received from franchisees may not equal advertising expenditures for the period due to timing of promotions. To the extent that contributions received exceeded advertising expenditures, the excess contributions are treated as deferred revenue. To the extent that advertising expenditures temporarily exceeded advertising fund contributions, the difference is recorded as a receivable.

The timing of the recognition of revenue related to the other revenue streams has not changed as a result of adopting the new guidance.

The cumulative effect of the changes made to the Consolidated Balance Sheet as at January 1, 2017 related to the adoption of IFRS 15 was as follows:

	As Previously Reported \$	Adjustment \$	Restated \$
<u>Assets</u>			
Accounts receivable	15,403	1,716	17,119
Deferred income taxes	12,087	6,055	18,142
<u>Liabilities</u>			
Income taxes payable	232	573	805
Deferred revenue	-	23,146	23,146
<u>Shareholders' Deficiency</u>			
Accumulated deficit	(77,463)	(15,948)	(93,411)

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(figures in tables are expressed in thousands of dollars)

The cumulative effect of the changes made to the Consolidated Balance Sheet as at December 31, 2017 related to the adoption of IFRS 15 was as follows:

	As Previously Reported \$	Adjustment \$	Restated \$
<u>Assets</u>			
Accounts receivable	16,589	2,465	19,054
Deferred income taxes	12,995	6,692	19,687
<u>Liabilities</u>			
Income taxes payable	1,830	646	2,476
Deferred revenue	-	25,581	25,581
<u>Shareholders' Deficiency</u>			
Accumulated deficit	(92,030)	(17,070)	(109,100)

The cumulative effect of the changes made to the Consolidated Statement of Income for the 12-week period ended March 26, 2017 related to the adoption of IFRS 15 was as follows:

	As Previously Reported \$	Adjustment \$	Restated \$
<u>Revenue</u>			
Franchising	26,417	7,551	33,968
<u>Expenses</u>			
Operating costs	12,891	7,654	20,545
Provision for (recovery of) income taxes	803	(87)	716
Net income for the period	8,229	(16)	(8,213)

These interim condensed consolidated financial statements were authorized for issue by the Board of Directors of Food Services on May 1, 2018.

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.

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(figures in tables are expressed in thousands of dollars)

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 2017 year was 52 weeks and ended December 31, 2017 (2016 - 52 weeks ended January 1, 2017).

Beverages uses a fiscal year ending December 31. The first quarter ends 12 weeks after the fiscal year end.

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 2018 adjustment to the Royalty Pool took place on January 5, 2018. The number of A&W restaurants in the Royalty Pool was increased by 42 new restaurants less seven restaurants that permanently closed during 2017. The addition of these 35 net new restaurants brings the total number of A&W restaurants in the Royalty Pool to 896. The estimated annual sales of the 42 new A&W

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(figures in tables are expressed in thousands of dollars)

restaurants are \$55,642,000 and annual sales for the seven permanently closed restaurants were \$3,210,000. The initial consideration for the estimated additional royalty stream was \$25,989,000, 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 30, 2017. The yield was adjusted to reflect income tax payable by Trade Marks. The Partnership paid Food Services 80% of the initial consideration or \$20,791,000 by issuance of 596,251 LP units which were subsequently exchanged for 1,192,502 non-voting common shares of Trade Marks. The remaining 20% of the consideration or \$5,198,000 will be paid in December 2018 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 2018 may differ from this amount depending on the actual annual sales reported by the new A&W restaurants.

Food Services' 24.7% (December 31, 2017 – 21.9%) investment in Trade Marks is recorded using the equity method.

	Common shares \$	Cumulative equity in earnings \$	Cumulative dividend \$	Total \$
Balance – January 1, 2017	66,099	23,524	(27,334)	62,289
January 5, 2017 adjustment to Royalty Pool	17,273	-	-	17,273
Exchange of common shares for Units of A&W Revenue Royalties Income Fund (note 10)	(7,814)	-	-	(7,814)
Equity in earnings	-	6,257	-	6,257
Dividends	-	-	(5,684)	(5,684)
Balance – December 31, 2017	75,559	29,781	(33,018)	72,321
January 5, 2018 adjustment to Royalty Pool	20,791	-	-	20,791
Equity in earnings	-	1,381	-	1,381
Dividends	-	-	(1,118)	(1,118)
Balance – March 25, 2018	96,349	31,162	(34,136)	93,375

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(figures in tables are expressed in thousands of dollars)

The deferred gain as at March 25, 2018 is as follows:

	Number of restaurants in Royalty Pool	Deferred gain \$	Accumulated amortization \$	Net deferred gain \$
Balance – January 1, 2017	838	152,276	(16,378)	135,898
January 5, 2017 adjustment to Royalty Pool	23	17,274	-	17,274
Amortization of deferred gain	-	-	(1,821)	(1,821)
Balance – January 31, 2017	861	169,550	(18,199)	151,351
January 5, 2018 adjustment to Royalty Pool	35	25,989	-	25,989
Amortization of deferred gain	-	-	(421)	(421)
Balance – March 25, 2018	896	195,539	(18,620)	176,919

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 March 25, 2018, letters of credit totalling \$329,000 (December 31, 2017 - \$329,000) have been issued by the Bank to landlords and cities for development of new restaurants, leaving \$7,671,000 of the facility available (December 31, 2017 - \$7,671,000).

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 March 25, 2018.

The term loan comprises:

	March 25, 2018 \$	December 31, 2017 \$
Term loan	7,000	7,000
Financing fees	(54)	(59)
	<u>6,946</u>	<u>6,941</u>

(figures in tables are expressed in thousands of dollars)

6 New restaurant openings

Food Services opened seven new franchised restaurants during the quarter (2017 – seven). There was a decrease in turnkey revenues and construction costs in the quarter as compared to the prior year related to a change in the number of new restaurants opened that were turnkey projects.

7 Franchising revenue

Included in franchising revenues are the following revenues disaggregated by revenue source:

	12 week period ended Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
	\$	\$
Advertising fund contributions	9,198	7,882
Distribution revenue	10,013	8,707
Equipment revenue	5,249	6,992
Service fees	7,095	6,299
Turnkey revenue	1,160	2,695
Initial franchise fees and renewal fees	301	337
Other revenue	1,626	1,056
	<u>34,642</u>	<u>33,968</u>

The table below shows the basis on which franchising revenues are recognized:

	12 week period ended Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
	\$	\$
At a point in time		
Advertising fund contributions	9,198	7,882
Distribution revenue	10,013	8,707
Equipment revenue	5,249	6,992
Service fees	7,095	6,299
Turnkey revenue	1,160	2,695
Other revenue	1,626	1,056
Over time		
Initial franchise fees and renewal fees	301	337
	<u>34,642</u>	<u>33,968</u>

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(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 Mar 25, 2018	12 week period ended Mar 26, 2017
	\$	\$
Depreciation of plant and equipment	498	473
Employee benefit costs		
Wages and salaries and other termination benefits	5,722	5,095
Pension costs - defined contribution plan	213	190
Total employee benefit costs	5,935	5,285

9 Finance (income) expense

	12 week period ended Mar 25, 2018	12 week period ended Mar 26, 2017
	\$	\$
Interest income	(8)	(11)
Interest on term loan	50	16
Interest cost on supplementary retirement benefit plan	129	129
Finance leases	37	34
	208	168

(figures in tables are expressed in thousands of dollars)

10 Working capital

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

	12 week period ended Mar 25, 2018	(Restated) 12 week period ended Mar 26, 2017
	\$	\$
Accounts receivable	929	1,339
Inventories	978	854
Prepaid expenses	(1,609)	(34)
Accounts payable and accrued liabilities	(3,434)	(7,087)
Royalties payable	20	(1)
Deposits on franchise and equipment sales	3,104	1,065
	<u>(12)</u>	<u>(3,864)</u>

11 Related party transactions and balances

Royalty expense for the period was \$8,031,000 (2017 - \$7,306,000), of which \$2,762,000 (December 31, 2017 - \$2,742,000) is payable to the Partnership at March 25, 2018.

During the period, Trade Marks declared dividends on common shares held by Food Services of \$1,118,000 (2017 - \$943,000), of which \$559,000 (December 31, 2017 - \$nil) is receivable at March 25, 2018.

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 the services provided under the contract during the period was \$69,000 (2017 - \$80,000). At March 25, 2018, \$nil (December 31, 2017 - \$nil) is payable to the private company by Food Services.

A&W Food Services of Canada Inc.

Notes to Interim Condensed Consolidated Financial Statements

(Unaudited)

March 25, 2018

(figures in tables are expressed in thousands of dollars)

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 Mar 25, 2018	12 week period ended Mar 26, 2017
	\$	\$
Salaries, bonuses and other short-term employee benefits	848	741
Pension costs - defined contribution plan	69	55
Pension costs - supplementary retirement benefit plan	130	129
Total	<u>1,047</u>	<u>925</u>

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 owned 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

During the period, Food Services paid a dividend of \$5,000,000 (2017 - \$14,532,000) 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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