



MENU FOODS INCOME FUND

Annual Report 2005

<u>Message to Unitholders</u>	<u>2</u>
<u>Management's Discussion and Analysis</u>	<u>4</u>
<u>Administrator's Report</u>	<u>19</u>
<u>Auditors' Report</u>	<u>20</u>
<u>Consolidated Balance Sheet</u>	<u>21</u>
<u>Consolidated Statement of Operations & Deficit</u>	<u>22</u>
<u>Consolidated Statement of Cash Flows</u>	<u>23</u>
<u>Notes to Consolidated Financial Statements</u>	<u>24</u>
<u>Unitholder Information</u>	<u>38</u>

Message to Unitholders

We present, to unitholders of Menu Foods Income Fund, our report for the year ended December 31, 2005. The table below reports selected highlights of the year's results

	Year ended December 31,	
	2005 (\$ millions)	2004 (\$ millions)
Sales	346.9	380.7
Income before non-controlling interest and goodwill impairment loss	4.7	23.1
Goodwill impairment loss	93.4	-
EBITDA	25.0	46.2
Distributable cash	16.3	38.7
Distributions declared	21.5	35.4
Distributions declared per Trust unit (\$)	0.8900	1.2600
Distributions declared (net of subordinated amounts) per Class B unit (\$)	0.5262	1.2600

Generally speaking, 2005 was a challenging year for the Fund. Performance reflected the difficult business environment, which was due in large part to our continued inability to recover cost increases from our customers, together with the ongoing strength of the Canadian dollar relative to its United States counterpart. In this context:

- Sales declined by 8.9% or \$33.8 million when compared with last year, due in large part to a 5.1% decline in volume (expressed in cases of 24 cans or pouches) and the significant appreciation of the Canadian dollar.
- EBITDA of \$25.0 million was \$21.2 million or 45.9% less than last year. EBITDA was adversely impacted by various factors including, the decline in sales, together with a \$1.1 million inventory write-off and the absorption of \$16.1 million in higher raw material and manufacturing costs that could not be passed on to customers.
- The net loss for the year reflected a \$93.4 million impairment in goodwill that arose upon application of the assessment required under Canadian generally accepted accounting principles. This impairment charge had no impact on EBITDA or the Fund's ability to generate distributable cash or the ability to pay future distributions or on its credit agreements.
- Distributions declared for the year represented a pay-out ratio of 131.9% of distributable cash.

In January 2006, following a price increase announced by a leading national brand manufacturer, Menu announced a price increase on its canned products sold to its private-label customers in the United States. While costs continue to rise, this price increase should enable Menu to recover much of the margin erosion experienced over the past two years on the sale of cans to United States private-label customers.

On February 28, 2006, the Fund finalized agreements with its bank and the holders of its senior secured notes, which among other things define the terms and conditions governing the Fund's US\$30 million bank and US\$85 million senior secured note facilities, going forward. In addition to modifying existing covenants and introducing a sliding scale of interest charges, the amended agreements require that the Fund not pay distributions until it is in compliance

with the covenants set out in its former credit facilities, including a total debt to EBITDA ratio of 3 to 1 or less. The Fund is required to use its excess cash to reduce its indebtedness until this level of leverage is achieved. The conclusion of these arrangements stabilizes the Fund's current financial position.

As we look ahead to 2006, we are encouraged by recent events that should positively impact upon the Fund. The Fund's performance is expected to benefit from the long-awaited price increase on canned product sold to United States private-label customers. Furthermore, previously reported new or expanded business has commenced on schedule and will contribute favourably to the 2006 results. These factors, combined with management's continued focus on improving operating performance, should increase the Fund's available distributable cash in 2006, as compared to 2005. As a consequence, management expects to be able to strengthen the Fund's capital structure by using the distributable cash generated to finance its working capital and to reduce its outstanding debt. We look forward to reporting our progress to you throughout 2006.

We continue to appreciate the support of our investors, customers and suppliers and the ongoing dedication of our employees, in these difficult times.

Paul K. Henderson (signed)
President and Chief Executive Officer
Menu Foods GenPar Limited
Administrator of Menu Foods Income Fund

Presentation of Financial Information

The following discussion and analysis of the financial results of Menu Foods Income Fund (the "Fund") is dated as of March 29, 2006 and is supplementary to and should be read in conjunction with the audited consolidated financial statements for the years ended December 31, 2005 and 2004.

The Fund is the indirect owner of Menu Foods Limited ("Menu"), the leading North American private-label/contract manufacturer of wet pet food products. The Fund's results include those of Menu, its subsidiaries, affiliates and the partnerships which conduct its day-to-day business.

Where applicable, financial information contained herein is prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and is reported in Canadian dollars.

The nature of the Fund's operations does not give rise to many critical accounting estimates. The most significant accounts where such estimates might apply are accounts receivable, inventory, the supply contract and goodwill. In the case of accounts receivable and inventory, required provisions and/or reserves are specific in nature. In the case of goodwill, impairment is assessed based on estimated fair value of the business, determined by reference to the trading value of the Fund's units, which is allocated to goodwill and other identifiable tangible and intangible assets, based on their respective fair values.

Certain statements in this Management's Discussion and Analysis of Financial Results are "forward-looking statements," which reflect management's expectations regarding the Fund and Menu's future growth, results of operations, performance, business prospects and opportunities. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. Many factors could cause results to differ materially from the results discussed in the forward-looking statements, including risks related to dependence on key suppliers, economic conditions, competition, regulatory change, foreign exchange rates and interest rates, among others. Although the forward-looking statements are based on what management believes to be reasonable assumptions, the Fund and Menu cannot assure investors that actual results will be consistent with these forward-looking statements. These forward-looking statements are made as of the date of this report, and neither the Fund nor Menu assumes any obligation to update or revise them to reflect new events or circumstances.

Overall Performance and Selected Annual Information

The following tables highlight selected comparative results:

	For the year ended December 31,		
	2005	2004	2003
	\$	\$	\$
Sales	346,932	380,712	320,873
Income before the undernoted	1,803	26,546	14,907
Goodwill impairment loss	(93,415)	-	-
Income taxes	(2,911)	3,428	763
Income (loss) income before non-controlling interest	(88,701)	23,118	14,144
Net (loss) income	(54,665)	12,717	7,198
Basic net (loss) income per Trust Unit	(3.201)	0.828	0.550
Diluted net (loss) income per Unit	(3.201)	0.821	0.540
Total assets	263,233	371,753	362,733
Total long-term financial liabilities	98,936	102,591	114,270
Distributions per Trust Unit	0.8900	1.2600	1.2529
Distributions per Class B Unit	0.5262	1.2600	1.2529

Using 2003 as a base year, the opportunities and challenges that the Fund has faced are evident. In 2005, a goodwill impairment loss of \$93.4 million was recognized in accordance with GAAP in Canada. This charge was a non-cash item and does not impact EBITDA (see Note A) or Distributable Cash (see Note A). This impairment charge needs to be considered when assessing the performance trend of the Fund. Allowing for this leads to the following comparative results:

	For the year ended December 31,		
	2005	2004	2003
	\$	\$	\$
Income before non-controlling interest (excluding goodwill impairment and income taxes)	1,803	26,546	14,907
EBITDA	24,974	46,189	33,116

Since 2003, sales have increased from \$320.8 million to \$346.9 million. This growth has been largely volume driven with comparative volume in 2005 and 2004, relative to 2003, up by 16.3% and 22.6%, respectively. Unfortunately, some of the volume gains in 2004 were given back in 2005 as a number of significant customers chose to reduce their inventory levels. In dollar terms, the growth in sales would have been even more dramatic but for the strengthening of the Canadian dollar relative to the United States dollar in both 2004 and 2005, which served to reduce sales relative to 2003 by \$22.6 million and \$45.5 million, respectively. Selling price increases during both 2004 and 2005 were modest. The pouch format continues to perform well, growing by 14.5% in 2005 versus 52.8% in 2004 and 51.9% in 2003, and now comprises 23.1% of the Fund's total sales volume.

Performance in 2005 reflects the fact that costs of certain inputs to the production process rose significantly and could not be passed onto the Fund's customers. This had the effect of reducing EBITDA in 2005 by over \$16.0 million relative to both 2004 and 2003. Relative to 2003, the stronger Canadian dollar served to reduce EBITDA by about \$7.0 million in 2005 and about \$4.0 million in 2004. The impacts of changes in sales volumes and the benefits of the stronger Canadian dollar on selling, general and administrative expenses account for most of the remaining change in EBITDA over the period.

In January 2006, following a price increase announced by a leading national brand manufacturer, the Fund announced a price increase on its canned products sold to its private-label customers in the United States. While costs continue to rise, this price increase should enable Menu to recover much of the margin erosion experienced over the past two years on the sale of cans to United States private-label customers.

Summary of Operations

The following table highlights selected comparative results:

	For the year ended December 31,	
	2005 \$	2004 \$
Sales	346,932	380,712
Cost of sales	313,681	324,667
Gross profit	33,251	56,045
Selling, general and administrative expenses	24,532	25,231
Income before the undernoted	8,719	30,814
Goodwill impairment loss	93,415	-
Financial expenses	6,916	4,268
Income (loss) before income taxes and non-controlling interest	(91,612)	26,546
Current income taxes	69	1,194
Future income taxes	(2,980)	2,234
Total income taxes	(2,911)	3,428
Income (loss) income before non-controlling interest	(88,701)	23,118
Non-controlling interest of Class B Exchangeable Units	(34,036)	10,401
Net (loss) income for the year	(54,655)	12,717
Average US/Cdn exchange rate per Bank of Canada	0.8255	0.7683

Sales for the year ended December 31, 2005, were \$346.9 million, down 8.9% or \$33.8 million compared to the same period last year. This decrease is attributable to:

1. the strengthening of the Canadian dollar relative to the United States dollar as compared to that relationship for the same period in the prior year had the effect of reducing sales by \$22.9 million relative to 2004;
2. a 5.1% decrease in volume resulting in a net sales decrease of \$19.4 million relative to the year ended December 31, 2004;
3. the impact of a price increase to Menu's private-label customers initiated in the second quarter of 2004 in the United States and the first quarter of 2005 in Canada, as well as the effect of passing through cost increases to Menu's co-pack customers, together with changes to sales mix and other variables, had the effect of increasing sales by \$7.4 million; and
4. the net impact of payments under take-or-pay agreements increased sales by \$1.1 million relative to the same period in 2004.

Overall, volume (expressed in cases of 24 cans or pouches) was down 5.1% compared to the year ended December 31, 2004. Can volume, which represented 76.9% of Menu's volume in 2005, contracted by 9.7% (equating to a decline in total volume of 7.9%). This decline was primarily attributable to the 20.7% decline, in 2005, in case volume of canned wet pet food to Menu's largest customer, which reduced the overall can volume for the year by 4.0%. Volume was also negatively impacted during 2005 because: during the first quarter, two other key customers initiated an inventory reduction program within their organizations and, during the second quarter, a Canadian co-pack customer, who had relied on Menu for its supply of certain products for sale in the Canadian market, decided to reduce its dependence on Menu and self-manufacture that product in its United States facilities. This loss of business together with reduced sales to existing customers, particularly within the pet specialty and supermarket channels, whose private-label sales were impacted by the national brand promotional activity during the period, account for the balance of the decline.

The lower case sales of canned wet pet food as described above, was partially offset by the continued growth in sales of Menu's pouch product. During 2005, case sales of the pouch product, which represented 23.1% of total volume, grew by 14.5% compared to the year ended December 31, 2004. This increase in pouch case sales had the effect of increasing Menu's volume for 2005 by 2.8%.

Gross profit decreased by \$22.8 million (or 40.7%) for the year ended December 31, 2005, compared to the prior year. This decrease is attributable to:

1. Foreign Exchange Effect on Sales. The strengthening of the Canadian dollar relative to the United States dollar during 2005 had the effect of reducing sales by approximately \$22.9 million and that translated into a reduction in gross profit of \$3.0 million for the year ended December 31, 2005;
2. Effect of Change in Sales Volume. As previously noted, total volume for the year declined by 5.1%, which reduced gross profit by \$3.3 million;
3. Impact of Take-or-Pay Agreements. The net impact of take-or-pay agreements during 2005 relative to 2004 has been to increase comparative gross profit by \$1.1 million;
4. Inventory Write-down. At December 31, 2005 Menu still had inventory on hand that related to pre-May 20, 2003 (the date when a single case of Bovine Spongiform Encephalopathy was discovered in Alberta). Since this inventory was not saleable in the United States, it proved to be a challenge to sell in the normal channels available to Menu. Throughout 2005, as efforts to sell this inventory were underway, Menu made provisions amounting to \$0.9 million;
5. Price and Cost Increases. During the past year, the cost of certain inputs to production, including raw and packaging materials, labour and benefits, utilities and freight increased and adversely impacted cost of sales, compared to 2004. In accordance with the arrangements with its co-pack customers, Menu has been able to recover some of these cost increases through periodic pricing adjustments. Furthermore, during the first quarter of 2004, Menu followed the national brands and initiated a price increase to its United States customers to recover cost increases incurred to that point in time. Similarly, during the first quarter of 2005, Menu initiated a price increase to its Canadian customers. Unfortunately, the effects of these price increases fell far short of the cost increases experienced during 2005, with the net effect of reducing gross profit by \$16.1 million; and
6. Increase in Amortization. The amortization of capital projects completed in the past year offset by the rise in the value of the Canadian dollar relative to its US counterpart resulted in an increase in the amortization associated with the cost of goods sold of \$0.6 million versus 2004.

SG&A expenses for the year ended December 31, 2005 decreased by \$0.7 million compared to the prior year. This decrease reflects savings of approximately \$1.2 million due to lower SG&A spending in 2005 compared to the prior year, primarily as a result of the stronger Canadian dollar as well as lower bonus expense reflecting the lower earnings in 2005. These savings were offset by the \$0.5 million increase in the foreign exchange losses on Menu's United States dollar exposure in working capital, net of the mark-to-market gains on forward foreign exchange contracts entered into to hedge distributions.

The foregoing resulted in EBITDA of \$25.0 million for the year ended December 31, 2005, a decrease of \$21.2 million (or 45.9%) compared to the same period in 2004. The strengthening of the Canadian dollar, relative to the United States dollar, has reduced sales, gross margin, selling, general and administrative expenses, amortization, interest and EBITDA. The

Fund estimates that each change of \$0.01 in the cost of the Canadian dollar changes EBITDA by approximately \$0.48 million and Distributable Cash (see Note A) by approximately \$0.36 million, on an annual basis. These estimates differ from those previously reported to reflect the change in contribution by the Fund's United States dollar denominated business during 2005. The Fund estimates that the strengthening of the Canadian dollar during 2005 versus the same period in 2004 reduced EBITDA by approximately \$2.7 million and Distributable Cash by approximately \$2.1 million.

In order to mitigate the impacts of short-term foreign exchange fluctuations on Distributable Cash, the Fund had implemented a hedging program under which United States dollar denominated cash flow was hedged, for periods of up to one year, by way of foreign currency forward contracts. This approach removed some of the uncertainty associated with generating cash flow in United States dollars while paying distributions in Canadian dollars. Since the program hedged distributions, which are primarily capital in nature, it did not qualify for hedge accounting. With the decision to suspend distributions in December 2005, this hedging program has been discontinued.

Amortization (which is included in cost of sales and SG&A expense) in 2005 was \$0.9 million higher than in 2004. Amortization increased reflecting the amortization on the \$10.4 million of capital expenditures made during the year ended December 31, 2005 and the full period amortization for the \$31.7 million of capital expenditures made during the year ended December 31, 2004. However, this increase was largely offset by the effects of the strengthening of the Canadian dollar, relative to the United States dollar.

When the Fund purchased its interest in Menu Foods Limited Partnership, \$165.4 million of the purchase price was assigned as goodwill in the consolidated financial statements. Under GAAP in Canada, goodwill is subject to an annual impairment test that, for the Fund, takes place as at September 30 of each year. Since the Fund's units were trading at September 30 and through to October 31 at lower than their book value, the application of current accounting principles identified an impairment in the carrying value of goodwill. Following a fair value assessment of other assets, at September 30, 2005, goodwill was written down by \$70.3 million. During the remainder of 2005, the Fund's units continued to trade below the value used in the September 30, 2005 impairment test. Accordingly, the fair value assessment was repeated at December 31, 2005 and a further write-down of \$23.1 million was taken during the fourth quarter. These two write-downs amounted to \$93.4 million or 56.5% of the Fund's book value as presented in the consolidated financial statements immediately prior to the first write-down. This charge is a non-cash item and does not impact EBITDA, Distributable Cash or the Fund's credit facilities. No impairment in the value of the Fund's intangible assets or property, plant and equipment has been identified.

Financial expenses were \$2.6 million greater during the year ended December 31, 2005, than in 2004. Interest expense during the third and fourth quarters of 2005 reflects the sliding scale of increased interest rates agreed to by the Fund as part of the waiver arrangement with its bankers, together with fees of \$0.2 million associated with waiver and forbearance agreements. Higher interest rates incurred on the Fund's variable rated bank indebtedness and senior secured notes, together with higher average amounts borrowed under the bank facility, when compared to the prior year, accounted for virtually all of the increase. In addition, the Fund's policy of recording unrealized gains and losses on its outstanding interest rate swaps directly to the income statement had the Fund recording a gain of \$0.3 million in 2004, while in 2005 the Fund recorded a loss of \$0.3 million resulting in a year over year net change of \$0.6 million.

The Fund operates using a number of different legal structures (e.g., partnerships, trusts, corporations, etc.) in a number of jurisdictions, each of which is subject to income tax at different

rates. This means that the effective tax rate can vary from quarter-to-quarter, and year-to-year, depending on the taxing jurisdiction and the legal structure in which the income is earned. During 2005, the Fund's effective tax rate fluctuated materially as a result, and reflects a significant recovery as compared to the 12.9% effective tax rate for all of fiscal 2004.

The loss before non-controlling interest of Class B Exchangeable Units ("Class B Units") for the year ended December 31, 2005, was \$88.7 million, compared to net income of \$23.1 million for the year ended December 31, 2004.

Summary of Quarterly Results

The following table highlights quarterly comparative results:

	For the Quarter Ended							
	Dec. 31, 2005 \$	Sep. 30, 2005 \$	Jun. 30, 2005 \$	Mar. 31, 2005 \$	Dec. 31, 2004 \$	Sep. 30, 2004 \$	Jun 30, 2004 \$	Mar. 31, 2004 \$
Sales	84,842	93,643	83,660	84,787	91,334	102,030	96,788	90,560
Income (loss) before non-controlling interest	(22,444)	(69,949)	698	2,994	5,832	5,367	6,155	5,764
Net income (loss)	(13,797)	(42,952)	403	1,681	3,260	2,987	3,425	3,045
Net income (loss) per Trust Unit								
Basic (\$)	(\$0.777)	(\$2.425)	\$0.024	\$0.104	\$0.205	\$0.189	\$0.217	\$0.220
Diluted (\$)	(\$0.777)	(\$2.425)	\$0.024	\$0.104	\$0.203	\$0.186	\$0.213	\$0.214
Weighted average number of Trust Units outstanding (^{'000} 's)								
Basic	17,776	17,713	16,645	16,160	15,925	15,829	15,818	13,832
Diluted	28,920	28,943	28,926	28,918	28,716	28,870	28,861	26,901
Exchange rate - US\$ ⁽¹⁾	\$1.1732	\$1.2016	\$1.2439	\$1.2270	\$1.2207	\$1.3072	\$1.3595	\$1.3178

⁽¹⁾ Average three-month rate per Bank of Canada

During the eight quarters ended December 31, 2005 it is important to note the following:

- Under GAAP in Canada, goodwill is subject to an annual impairment test that, for the Fund, takes place on September 30 of each year or at any other time when events or changes have occurred that would suggest an impairment of the carrying value. In the third and fourth quarters of 2005 goodwill was written down by \$70.3 million and \$23.1 million, respectively.
- Since between 80% and 90% of sales and a similar proportion of costs are transacted in United States dollars, the continued strengthening of the Canadian dollar relative to the United States dollar has a major impact on reported sales and results for each period.
- Sales volumes were down 5.1% in 2005 compared to 2004. Compared to the same quarters in 2004 these declines amounted to: 2.3% in the first quarter; 6.5% in the second quarter; 3.9% in the third quarter; and 7.6% in the fourth quarter.
- Sales of pouch product continue to grow, comprising 23.1% of total sales in 2005, compared to 19.1% in 2004.

5. The cost of certain inputs to the production process, including raw and packaging materials, labour and benefits, utilities and freight increased steadily throughout 2005. These costs could not be passed onto private-label customers and adversely impacted gross margin and net income. Compared to the same quarters in 2004 these increased costs amounted to: \$2.4 million in the first quarter; \$3.7 million in the second quarter; \$5.3 million in the third quarter; and \$4.7 million in the fourth quarter.

Liquidity

During the year ended December 31, 2005, the Fund generated cash flow from operations of \$18.9 million, coupled with an increase in cash flow of \$6.1 million as a result of changes in non-cash working capital items. The decrease in non-cash working capital items primarily resulted from an \$8.0 million reduction in inventory and a \$1.2 million decrease in accounts receivable offset by a \$3.5 million reduction in accounts payable. The reduction in inventory reflects the higher level of finished goods inventory carried in the fourth quarter of 2004 in anticipation of specific capital projects to be undertaken in the first quarter of 2005 in two of the Fund's United States facilities. While these projects were underway, the facilities were shut down. This higher level of inventory was intended to enable the Fund to maintain customer service levels during the scheduled shutdowns. As no such projects were planned for the first quarter of 2006, there was no corresponding requirement for the higher inventory levels at the end of 2005. The higher levels of inventory in the final quarter of 2004 also resulted in a higher level of accounts payable that did not recur in 2005. The decrease in accounts receivable is consistent with the timing of sales activity and subsequent collections.

With the Trustees' approval of the Fund's audited consolidated financial statements for 2004, the Board of Directors of Menu Foods GenPar Limited (the Administrator of the Fund) declared that the Class B Units were no longer subordinate to the Trust Units. However, in the second quarter of 2005, certain holders of Class B Units agreed to forego their entitlement to the majority of their distributions beginning with the distribution payable for the month of May 2005 and ending with the distribution payable for the month of February 2006. Such Unitholders are entitled to a reimbursement of such foregone distributions only to the extent that the Fund generates sufficient Distributable Cash. For the year ended December 31, 2005, the Fund announced distributions on the Trust Units of \$15.0 million (\$0.890 per unit) and paid \$16.7 million. During this same period, the Fund announced distributions on the Class B Units of \$10.7 million (\$0.890 per unit). Certain Class B Unitholders agreed to subordinate their right to \$4.2 million of distributions and the Fund paid \$10.5 million in distributions.

During the fourth quarter, the pay-out ratio was 53.5%. However, during the first and second quarters of 2005, the Fund paid out distributions in excess of its Distributable Cash. Consequently, for the year ended December 31, 2005, the pay-out ratio (including the distributions on the Class B Units) was 131.9% (and 100.1% since inception).

During 2005, the Fund breached certain covenants in its Agreements with its bankers and noteholders (collectively the "Lenders"). The Fund obtained waivers of these breaches from its bankers and forbearance from its senior secured noteholders and on February 28, 2006 entered into amended agreements with its Lenders. These amended agreements, among other things, define the terms and conditions governing the Fund's US\$30 million operating facility and US\$85 million senior secured notes facilities, going forward. The Fund will be unable to pay distributions until it is in compliance with the covenants set out in its original Agreements, including a debt to EBITDA ratio of 3 to 1 or less. In the meantime, the Fund is

required to use a portion of its excess cash to reduce its indebtedness until this level of leverage is achieved.

Cash flow from operations together with cash balances on hand and existing unutilized operating credit facilities are expected to be sufficient to fund Menu's ongoing operating requirements and capital expenditures.

The following table highlights the Fund's contractual obligations as at December 31, 2005:

Contractual Obligations	Total	Payments Due by Period			
		Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
	\$	\$	\$	\$	\$
Senior secured notes	98,855	-	-	98,855	-
Capital lease obligations	95	32	63	-	-
Operating leases	4,737	1,847	1,863	1,027	-
Total contractual obligations	103,687	1,879	1,926	99,882	-

Capital Resources

During the year ended December 31, 2005, Menu invested \$10.4 million in property, plant and equipment. The largest expenditures during this period (\$6.8 million) reflected equipment purchased to expand pouch capacity as part of a multi-phase expansion initiated in 2004. The final phase of this capital project was completed during the second quarter of 2005 and all related costs have now been reflected as capital additions.

Capital expenditures of a maintenance nature, which totaled \$2.4 million for 2005, were financed from the cash flow of the business. These maintenance capital expenditures were over and above the \$15.2 million (2004 - \$15.5 million) for labour and parts incurred by Menu for the ongoing repairs and maintenance of its plants that have been expensed during 2005 as part of cost of sales.

Off-balance Sheet Arrangements

The Fund is not party to any contractual arrangements under which a non-consolidated entity may have any obligation under certain guaranteed contracts, a retained or contingent interest in assets transferred to a non-consolidated entity or similar arrangement that serves as credit, liquidity or market risk support to that entity for such assets. Except as discussed under Financial Instruments, the Fund has no obligations under derivative instruments, or a material variable interest in a non-consolidated entity that provides financing, liquidity, market risk or credit risk support or engages in leasing, hedging or research and development services with the Fund.

Disclosure Controls and Procedures

Multilateral Instrument 52-109 ("MI 52-109") requires the Fund's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") to make certain certifications related to the information contained in the Fund's annual filings. Specifically, the CEO and CFO must acknowledge that they are responsible for establishing and maintaining disclosure controls and procedures for the Fund and certify that they have designed such disclosure controls and procedures, or caused them to be designed under their supervision, to provide reasonable assurance that material information relating to the Fund, including its consolidated subsidiaries, is made known to them in a timely manner. Furthermore, they must also certify that they have evaluated the effectiveness of the Fund's disclosure controls and procedures.

As at December 31, 2005, the Fund's management, under the supervision of, and with the participation of the CEO and CFO evaluated the effectiveness of the design and operation of the disclosure controls and procedures. Based on this evaluation, the CEO and CFO have concluded that as at December 31, 2005, the Fund's disclosure controls and procedures were effective.

Consistent with the concept of reasonable assurance, the Fund recognizes that the relative cost of maintaining these controls and procedures should not exceed their expected benefits. As such, the Fund's disclosure controls and procedures can only provide reasonable, and not absolute, assurance that the objectives of such controls and procedures are met.

Critical Accounting Estimates

In preparing the Fund's consolidated financial statements, management is required to make estimates and assumptions based on information available as of the date of the consolidated financial statements that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities as of the date of the consolidated financial statements, and revenues and expenses for the periods reported. Notwithstanding that management applies judgement based on assumptions believed to be reasonable in the circumstances, actual results can vary from these assumptions. It is possible that materially different results could be reported if different assumptions were used.

The most significant of these estimates relate to the collectibility of accounts receivable, and the valuation of inventory, goodwill and the supply contract.

Accounts Receivable

Creditworthiness is assessed both at the commencement of the business relationship and on a regular basis thereafter. Should management consider, based on historical trends or current developments, the recoverability of any account to be in doubt, appropriate reserves are immediately established and the ongoing business relationship monitored closely.

Inventory

Inventory is valued at the lower of cost and net realizable value. Inventory reserves are established whenever management believes the recoverability of the carrying value of the inventory to be in doubt.

Goodwill

Goodwill is recorded at cost and is not amortized. The Fund reviews goodwill on an annual basis or at any other time when events or changes have occurred that suggest an impairment of the carrying value. Impairment is recognized when the estimated fair value of the goodwill is lower than its carrying value. Since the Fund operates as one reporting unit, the trading value of the Fund's units is used to establish the fair value of the Fund, which is then compared to the fair value of the other net assets to derive a residual value for goodwill.

Supply Contract

The supply contract is an exclusive agreement to supply all of the canned wet pet food requirements for Proctor & Gamble/Iams in Canada and the United States. The contract is carried at cost and is being amortized over a ten-year period. The contract is evaluated for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognized when estimated undiscounted cash flows expected to result from the contract are less than its carrying value.

Financial Instruments and Other Instruments

Credit Risk

The Fund has approximately 18% of its sales to one customer and has approximately 37% of its sales to its top three customers. Other than these customers, the Fund does not have a significant exposure to any individual customer. The Fund, in the normal course of business, reviews each new customer's credit history and financial statements before extending credit and performs regular reviews of its existing credit performance.

Foreign Exchange Risks

The Fund generates significant cash flows in foreign currency and is therefore exposed to risks relating to foreign exchange fluctuations. In order to reduce this risk, the Fund uses derivative financial instruments, which are not held or issued for speculative purposes.

As at December 31, 2005 and 2004, the Fund did not have any outstanding foreign currency forward contracts.

Interest Rate Risks

During the fourth quarter of 2002, the Fund fixed interest rates at 2.93% or 2.97% plus a stamping fee of 1.55% on US\$22.5 million through December 2005. The mark-to-market value of the contracts as at December 31, 2005 was \$nil (2004 – unrealized gain of \$17) and resulted in a loss, including the impact of the amortization on the transitional amount, of \$266 for the year ended December 31, 2005 (2004 – gain of \$266), which was charged to interest expense during the year.

Fair Value of Financial Instruments

The carrying values of cash, trade and other receivables, accounts payable and accrued liabilities, distributions payable and income taxes payable and recoverable approximate their fair values because of the near term maturity of these instruments. The carrying value of long-term debt bearing interest at variable rates approximates its fair value because effective rates represent the rates that should be used to calculate fair value.

The carrying value of long-term debt, bearing interest at a fixed rate approximates its fair value.

Outstanding Units

The following table highlights the number of Units outstanding:

	Trust Units	Class B Exchangeable Units
December 31, 2002	13,044,584	12,631,915
Options exercised during the year	215,239	-
December 31, 2003	13,259,823	12,631,915
Options exercised during the year	380,413	-
Issuance during the year	2,500,000	-
December 31, 2004	16,140,236	12,631,915
Conversion of Class B Units during the year	1,498,260	(1,498,260)
Options exercised during the year	127,663	-
December 31, 2005	17,766,159	11,133,655

Menu Foods Corporation (the former parent company of Menu) had a stock option plan pursuant to which there were outstanding options issued to 61 of its directors, executive officers and key employees. In connection with the initial public offering and acquisition, these options were exchanged for Trust Unit options in the Fund having equivalent terms and conditions. As at December 31, 2005, 74,683 vested Trust Unit options, having a weighted-average exercise price of \$2.977 per unit, were outstanding. These Trust Unit options expire in November and December 2006. In February 2005, 36,390 units were purchased on the open market under the Fund's Long-Term Incentive Plan for the benefit of 22 individuals.

Outlook

Cost and Price Increases

In the United States, in early 2004, and in Canada, in early 2005, Menu initiated price increases to its private-label customers, following the price increases taken by the leading national brands. Since the time of those increases, Menu has continued to experience increases in certain operating and administrative costs. Rising costs of steel and aluminum mean higher can costs, while the strengthening of the Euro has increased the cost of empty pouches purchased

by Menu. Higher utility costs, together with increases in property insurance and medical benefits (both escalating at rates well above inflation) have pushed the cost of operating higher. Higher fuel costs, together with new legislation in the United States on work hours for truck drivers and trucking delays crossing the Canadian/United States border have increased the cost of delivery. In January 2006, following a price increase announced by a leading national brand manufacturer, Menu announced a price increase on its canned products sold to its private-label customers in the United States. This price increase will be effective by late March 2006 and, while costs continue to rise, should enable Menu to recover much of the margin erosion experienced over the past two years on the sale of cans to United States private-label customers.

Largely as a consequence of the last hurricane season in the United States, commencing in the third quarter of 2005 and continuing for the rest of 2005, the Fund experienced significant increases in delivery costs, as well as in the cost of natural gas used in its production process. While some abatement in fuel surcharges has occurred, the demand for truckers in the hurricane affected regions of the United States means that it will remain challenging to hire truckers at reasonable rates. The Fund anticipates this situation will continue, at least, for the early part of 2006.

For the contract-manufacturing portion of Menu's business, most of these increases are automatically passed on to customers (albeit with some timing delays). However, for its private-label business, Menu's practice, with respect to price increases, has been to follow the brand leaders. While this practice at times squeezes Menu's margins (as it did in 2005), it nonetheless helps to ensure that Menu's products are competitively priced at retail.

Menu expects that input costs for its products in both Canada and the United States will continue to rise. Aluminum cans in particular are expected to increase in cost throughout 2006, as the cost of aluminum continues to rise. The price increase announced in January 2006 will help to mitigate the impact that rising costs over the past two years have had on margins. However, absent regular price increases in the future, Menu expects that its margins will continue to be squeezed.

Bovine Spongiform Encephalopathy ("BSE")

On May 20, 2003, a single case of BSE was discovered in Alberta, Canada. This incident resulted in the closure of the United States border to Canadian-made pet food. As discussed previously, Menu's response to this closure adversely impacted the Fund's financial performance for its second, third and fourth quarters of 2003. Two additional cases of BSE were discovered in Canada on January 2 and 11, 2005. The latter case involved an animal born after the feed ban in Canada should have prevented feed exposure to the animal. One more case was confirmed January 22, 2006 in a six-year old crossbred cow, which was also born well after the feed ban was initiated and this case is still under investigation.

On December 23, 2003, the USDA announced the discovery of a single case of BSE in Washington State, USA. This animal was subsequently found to be of Canadian origin. The first case of BSE in a cow born in the United States was a 12-year old Brahma-cross beef cow harvested on November 15, 2004. Because of some testing method results discrepancies the case was not made public until June 2005. This was the first cow identified to be infected with BSE in nearly 400,000 cattle that had been tested in the United States over the past year.

The most recent case is significant as it clearly identifies BSE as a North American rather than Canadian issue and supports the conclusion that the incidence is likely quite low. Both the United States and Canadian governments are working toward a strengthened feed ban to further reduce risk of BSE transfer. Depending on the final outcome, this could impact the

pricing situation with respect to beef products because of additional competition for a more limited raw material supply.

With respect to finished product, the border remains open to pet food transfer. However, there remain significant differences with respect to raw material supply in Canada compared to the United States. The former can only use beef materials originating in the United States or BSE-free countries such as New Zealand, and with respect to the United States, only certain materials approved by the Canadian Food Inspection Agency ("CFIA"). The United States, on the other hand, can use any beef materials other than certain tissues identified as Specified Risk Materials, which are thought to be highly infective with respect to BSE. The source of these raw materials can even include Canadian cattle.

Both governments have been made aware of this serious discrepancy and hopefully logic will prevail to once again allow the use of Canadian beef in Canadian pet food manufacturing facilities.

In addition to this Canadian border closure, Mexico had closed its border to United States made pet food. During the last quarter of 2005, the Mexican government approved Menu's registration of certain products that allowed it to resume shipment to its Mexican customers. While only about 1% of Menu's sales are transacted with customers in that country the reopening of the border represents a positive development.

Subordination and Distribution

The Fund has two classes of units: (a) publicly traded Trust Units and (b) privately held Class B Exchangeable Units (the "Class B Units"). The Declaration of Trust established that the Class B Units' rights to distributions were subordinated to those of the public Trust Units until such time as certain conditions were satisfied. These conditions were met by February 2005, since which time, except as discussed below, the Class B Units have no longer been subordinated to the publicly traded Trust Units.

On May 11, 2005, certain holders of Class B Units (including senior management), representing more than 11 million units, agreed to forego a portion of their distributions until February 2006. Specifically, holders of approximately 3.4 million units have agreed to forego all distributions, while holders of approximately 7.7 million units have agreed to forego receipt of distributions in excess of \$0.02 per unit. In addition, those same holders of more than 11 million Class B Units have agreed to forego their entitlement to convert into Trust Units until February 2006. Such unitholders shall be entitled to a reimbursement of such foregone distributions, which at December 31, 2005 amounted to \$4.2 million, only to the extent that the Fund generates sufficient Distributable Cash in the future.

Financial Covenants

Most of the Fund's outstanding debt is represented by its operating facility and senior secured notes. As at December 31, 2005, the Fund had \$29,309 drawn on its operating facility and \$98,855 of senior secured notes outstanding. Each of these facilities has financial covenants and cross default provisions that must be met. Since June 30, 2005, the Fund was not in compliance with the financial covenants contained in its Agreements with its Lenders. On February 28, 2006, the Fund entered into amended Agreements with its Lenders which, among other things, define the terms and conditions governing the Fund's US\$30 million operating facility and US\$85 million senior secured notes facilities going forward. Management of the Fund believes that it will be able to comply with these amended terms and conditions throughout 2006.

Risks and Uncertainties

Menu and the Fund are subject to numerous risk factors in its ongoing business. These include reliance on a key customer, absence of long-term sales contracts, customer performance and relationships, foreign exchange fluctuations, governmental regulations and restrictions, reliance on key suppliers, reliance on key personnel, among others. For a review of some of the risks affecting the business, please refer to notes 19 and 20 to the accompanying consolidated financial statements. Additional information about the Fund is available at www.sedar.com.

In the present economic climate, the most significant risks and uncertainties facing the Fund and its ability to re-establish distributions at historical levels, result from the continued strength of the Canadian dollar relative to the United States dollar, and from the ongoing inability to pass input cost increases on to customers in a timely manner. Since a majority of the Fund's operations and assets are in the United States, a "natural" business hedge exists. However, while it is possible to hedge Distributable Cash flow against future fluctuations in the currency (as has been done), it is not possible to hedge business operations, so a continuation of a strong Canadian dollar will have a negative impact on the relative contribution of the Fund's United States denominated business. Similarly, if the Fund must continue to absorb increased raw material costs without the benefit of a price increase to its customers, gross margin will remain depressed and profitability and the Fund's ability to pay distributions will be curtailed. Given the nature of our industry, price increases are largely beyond Menu's control.

The Fund's Lenders will no longer permit the Fund to make any monthly distributions until it is in compliance with the covenants contained in the original Agreements with the Lenders, including a total debt to EBITDA ratio of 3 to 1 or less. There can be no assurance as to either when the Fund can resume monthly distributions, or the amount of the monthly distributions that can be paid at that time.

Additional Information

Additional information regarding the Fund, including its Annual Information Form and all public filings, can be found on SEDAR at www.sedar.com.

Note A: EBITDA is not a recognized measure under Canadian GAAP. Management believes that in addition to net income, EBITDA is a useful supplemental measure of operating performance as it provides investors with an indication of cash available for distribution prior to debt service, capital expenditures and income taxes. EBITDA, as defined in the Menu Foods Limited Partnership Agreement, is Earnings Before Interest, Taxes, Depreciation, Amortization and Non-controlling Interest.

Distributable Cash is not a recognized measure under GAAP. Management believes that together with net income and EBITDA, Distributable Cash is a useful supplemental measure of operating performance, which provides investors with an indication of cash available for distribution after adjusting for maintenance capital expenditures and certain principal repayments. Distributable Cash is defined as cash flow from operating activities adjusted for changes in non-cash working capital items, maintenance capital expenditures and principal repayments.

Investors should be cautioned, however, that neither EBITDA nor Distributable Cash should be construed as an alternative to net income determined in accordance with GAAP as an indicator of Menu's performance or to cash flows from operating, investing and financing activities as a measure of liquidity and cash flow. Menu's method of calculating EBITDA and Distributable Cash may differ from other companies and, accordingly, EBITDA and Distributable Cash may not be comparable to measures used by other companies.

For the year ended December 31, 2005

(All tabular amounts, except per unit amounts, expressed in thousands of Canadian dollars, unless otherwise noted.)

The following are reconciliations of: net income to EBITDA and Cash Flow from Operating Activities to Distributable Cash for the year-to-date and since the inception of the Fund:

	For the year ended December 31,		Since Inception (May 22, 2002) to December 31,
	2005 \$'000s	2004 \$'000s	2005 \$'000s
Net (loss) income	(54,665)	12,717	(28,468)
Adjust for:			
Goodwill impairment loss	93,415	-	93,415
Non-controlling interest of Class B Exchangeable Units	(34,036)	10,401	(10,771)
Amortization of property, plant and equipment	15,702	14,153	52,290
Amortization of supply contract	553	1,222	1,974
Future income taxes	(2,980)	2,234	4,898
Current income taxes	69	1,194	1,106
Interest	6,916	4,268	17,569
EBITDA	24,974	46,189	132,013

	For the year ended December 31,		Since Inception (May 22, 2002) to December 31,
	2005 \$'000s	2004 \$'000s	2005 \$'000s
Cash flow from operating activities	24,986	19,167	88,117
Adjust for:			
Change in non-cash working capital items	(6,091)	22,152	27,316
Maintenance capital expenditures	(2,432)	(2,520)	(8,936)
Principal repayments	(157)	(148)	(543)
Distributable Cash	16,306	38,651	105,954

Administrator's Report

The preparation of the consolidated financial statements of Menu Foods Income Fund is the responsibility of Menu Foods GenPar Limited (the "Administrator"). The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using the Administrator's best estimates and judgements, where appropriate.

The Administrator is responsible for the reliability and integrity of the consolidated financial statements, the notes to the consolidated financial statements and other financial information contained in this report. In preparing these consolidated financial statements, estimates are sometimes necessary, as a precise determination of certain assets and liabilities is dependent on future events. The Administrator believes such estimates have been based on careful judgements and have been properly reflected in the accompanying consolidated financial statements.

The Administrator maintains a system of internal controls designed to provide reasonable assurance that assets are safeguarded and that accounting systems provide timely, accurate and reliable financial information.

The Board of Directors of the Administrator is responsible for ensuring that the Administrator fulfills its responsibilities for financial reporting and internal control. The Board is assisted in exercising its responsibilities through the Audit Committee, which is composed of three non-management Directors. The Committee meets periodically with the Administrator and the auditors to satisfy themselves that the Administrator's responsibilities are properly discharged, to review the consolidated financial statements and to recommend approval of the consolidated financial statements to the Board.

PricewaterhouseCoopers LLP, Chartered Accountants, the independent auditors, have audited the Fund's consolidated financial statements, in accordance with Canadian generally accepted auditing standards and their report follows. The independent auditors have full and unrestricted access to the Audit Committee to discuss their audit and their related findings as to the integrity of the financial reporting process.

Paul Henderson (signed)
President and
Chief Executive Officer

Mark Wiens (signed)
Executive Vice-President and
Chief Financial Officer

February 13, 2006

Auditors' Report

To the Unitholders of Menu Foods Income Fund:

We have audited the consolidated balance sheets of Menu Foods Income Fund (the "Fund") as at December 31, 2005 and 2004 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



PricewaterhouseCoopers LLP
Chartered Accountants
Toronto, Ontario
February 13, 2006, except for notes 7 and 8 which are as of February 28, 2006

(All figures expressed in thousands of Canadian dollars)

Consolidated Balance Sheets

	As at	
	December 31, 2005	December 31, 2004
	\$	\$
Assets		
Current Assets		
Cash	5,790	-
Accounts receivable		
Trade	17,298	18,716
Other	2,133	2,316
Inventories (note 3)	49,475	59,120
Prepaid expenses and sundry assets	1,318	1,898
Income taxes recoverable	550	259
Future income taxes (note 14)	1,701	1,874
Total Current Assets	78,265	84,183
Property, plant and equipment (note 4)	107,622	116,130
Goodwill (note 5)	71,972	165,387
Other assets (note 6)	5,374	6,053
Total Assets	263,233	371,753
Liabilities		
Current Liabilities		
Bank indebtedness (note 7)	29,309	10,398
Accounts payable and accrued liabilities	18,803	21,735
Distributions payable	-	5,674
Current portion of long-term debt (note 8)	24	157
Total Current Liabilities	48,136	37,964
Long-term debt (note 8)	98,912	102,434
Future income taxes (note 14)	13,996	17,381
Total Liabilities	161,044	157,779
Class B Exchangeable Units (note 9)	31,639	81,363
Unitholders' Equity		
Trust Units (note 10)	170,454	160,372
Contributed surplus (note 12)	272	808
Deficit	(88,830)	(19,182)
Foreign currency translation adjustment	(11,346)	(9,387)
Total Unitholders' Equity	70,550	132,611
Total Liabilities and Unitholders' Equity	263,233	371,753

Approved by the Board of Trustees

Thomas A. Di Giacomo (signed)
Trustee

Robert W. Luba (signed)
Trustee

The accompanying notes are an integral part of these consolidated financial statements.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

Consolidated Statements of Operations and Deficit

For the years ended December 31,	2005 \$	2004 \$
Sales	346,932	380,712
Cost of sales (note 15)	313,681	324,667
Gross profit	33,251	56,045
Selling, general and administrative expenses	24,532	25,231
Income before the undernoted	8,719	30,814
Goodwill impairment loss (note 5)	93,415	-
Financial expenses (note 13)	6,916	4,268
Income (loss) before income taxes and non-controlling interest	(91,612)	26,546
Current income taxes	69	1,194
Future income taxes	(2,980)	2,234
Total income taxes (note 14)	(2,911)	3,428
Income (loss) before non-controlling interest	(88,701)	23,118
Non-controlling interest of Class B Exchangeable Units (note 9)	(34,036)	10,401
Net (loss) income for the year	(54,665)	12,717
Deficit - beginning of year	(19,182)	(12,438)
Distributions (note 11)	(14,983)	(19,461)
Deficit - end of year	(88,830)	(19,182)
Deficit comprises:		
Accumulated net (loss) income	(28,641)	26,024
Accumulated distributions	(60,189)	(45,206)
	(88,830)	(19,182)
Basic net (loss) income per Trust Unit	(3.201)	0.828
Diluted net (loss) income per Trust Unit	(3.201)	0.821
Basic weighted average number of Trust Units outstanding (note 10)	17,077,197	15,354,036
Diluted weighted average number of Trust Units outstanding (note 10)	28,889,067	28,145,498

The accompanying notes are an integral part of these consolidated financial statements.

(All figures expressed in thousands of Canadian dollars)

Consolidated Statements of Cash Flows

For the years ended December 31,	2005 \$	2004 \$
Cash Provided by (used in)		
Operating activities		
Net (loss) income for the year	(54,665)	12,717
Adjustments for non-cash items		
Goodwill impairment loss	93,415	-
Non-controlling interest of Class B Exchangeable Units	(34,036)	10,401
Amortization of property, plant and equipment	15,702	14,153
Amortization of supply contract	553	1,222
Amortization of deferred financing costs	422	447
Vesting of long-term incentive plan	218	-
Gain on sale of property, plant and equipment	-	(65)
Mark-to-market adjustment	266	210
Future income taxes	(2,980)	2,234
	<u>18,895</u>	<u>41,319</u>
Change in non-cash working capital items		
Accounts receivable	1,241	(1,540)
Inventories	8,012	(18,748)
Prepaid expenses and sundry assets	570	(65)
Income taxes recoverable	(238)	2,745
Accounts payable and accrued liabilities	(3,494)	(4,544)
	<u>24,986</u>	<u>19,167</u>
Financing activities		
Advance in bank indebtedness	18,777	10,398
Issuance of Trust Units, net	380	37,153
Long-term debt repayments	(157)	(2,702)
Distributions paid to Trust Units	(16,678)	(19,158)
Distributions paid to Class B Exchangeable Units	(10,501)	(16,737)
	<u>(8,179)</u>	<u>8,954</u>
Investing activities		
Purchase of property, plant and equipment	(10,367)	(31,700)
Other assets	(650)	(80)
Proceeds from sale of property, plant and equipment	-	164
	<u>(11,017)</u>	<u>(31,616)</u>
Increase (decrease) in cash	5,790	(3,495)
Cash - beginning of year	-	3,495
Cash - end of year	<u>5,790</u>	<u>-</u>
Supplementary information		
Income taxes paid (refunded)	222	(1,593)
Interest paid	5,845	3,792

The accompanying notes are an integral part of these consolidated financial statements.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

1. Description of the business

Menu Foods Income Fund (the "Fund") is an unincorporated open-ended trust, established under the laws of the Province of Ontario by Declaration of Trust dated March 25, 2002 (the "Declaration of Trust"). The Fund was created to hold directly or indirectly, investments in entities engaged in the manufacture and sale of pet food products, including the securities or assets of Menu Foods Limited ("Menu" or the "Company").

Menu was incorporated on May 17, 1971 under the laws of the Province of Ontario. The Company is mainly engaged in the manufacture of wet pet food products, which are sold primarily to retail and wholesale operations in Canada and the United States.

2. Summary of significant accounting policies

a) Basis of presentation

The Fund prepares its consolidated financial statements in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements include the accounts of the Fund and all of its subsidiaries. All inter-company transactions and accounts have been eliminated on consolidation.

b) Use of estimates

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

c) Cash and cash equivalents

Deposits in banks and short-term investments with original maturities of three months or less are considered cash and cash equivalents. Cash equivalents are carried at cost, which approximates fair market value, due to the short-term nature of these instruments.

d) Inventories

Inventories are valued at the lower of cost, determined on a first-in, first-out basis, and net realizable value.

e) Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated amortization. Cost represents the cost of acquisition or construction, including preparation and testing charges and direct financing costs incurred until the beginning of commercial production. An impairment loss is recognized when the asset's carrying value is no longer recoverable from estimated future undiscounted cash flows. When an impairment loss is recognized, the carrying amount of the asset would be reduced to its estimated fair value. Amortization is calculated using the straight-line method applied to the cost of the assets, at annual rates based on their estimated useful lives, as follows:

Buildings	20 - 40 years
Machinery and equipment	3 - 10 years
Equipment under capital lease	3 - 10 years
Other property and equipment	3 - 20 years

Construction-in-progress represents expenditures incurred for uncompleted projects. Upon completion, the related construction-in-progress is transferred to the appropriate asset class and amortization commences.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

2. Summary of significant accounting policies (continued)

f) Future income taxes

The Fund follows the liability method of accounting for future income taxes. Under the liability method, future income tax assets and liabilities are determined based on temporary differences (differences between the accounting basis and the tax basis of the assets and liabilities) and are measured using the currently enacted, or substantively enacted, tax rates and laws expected to apply when these differences reverse. A valuation allowance is recorded against any future income tax asset, if it is more likely than not that the asset will not be realized. Applicable withholding taxes are accrued as foreign sourced income is earned to the extent that the repatriation of earnings from foreign subsidiaries is expected to occur.

g) Research and development

Research expenditures are expensed as incurred. Development expenditures are written off as incurred unless, in the view of management, the expenditures are incurred in the development of products or processes, which are expected to be commercially viable for a period that exceeds one year and have a long-term commercial future. In these cases, development costs are deferred and amortized over the estimated commercial life of the product or process on a straight-line basis, not to exceed five years.

h) Deferred financing charges

Costs associated with the arrangement of long-term financing are deferred and amortized on a straight-line basis over the term of the debt. The amortization is included in financial expenses.

i) Goodwill

Goodwill reflects the price paid for the Menu business in excess of the fair market value of net tangible assets and identifiable intangible assets acquired. Menu operates as one reporting unit for purposes of allocating and evaluating goodwill. The Fund reviews goodwill on an annual basis or at any other time when events or changes have occurred that suggest an impairment of the carrying value. Impairment is recognized when the estimated fair value of the goodwill is lower than the carrying value.

j) Supply contract

The supply contract (the "Contract") consists of an exclusive agreement to supply all the canned wet pet food requirements for Proctor & Gamble/Iams ("P&G/Iams") in the United States and Canada. The Contract is carried at cost less accumulated amortization. Amortization is charged to cost of sales on a straight-line basis, over the estimated term of the Contract, which is ten years. The Contract is evaluated for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. An impairment loss is recognized when estimated undiscounted cash flows expected to result from the Contract are less than its carrying value. Should an impairment loss be recognized, the carrying amount of the Contract would be reduced to its estimated fair value.

k) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies, except those of self-sustaining subsidiaries, are translated at the exchange rate in effect at the consolidated balance sheet date and non-monetary items are translated at historical exchange rates. Operating revenue and expenses are translated at average exchange rates prevailing during the year. Gains or losses arising from these translations are included in net income.

The assets and liabilities of all subsidiaries, which are considered to be self-sustaining operations, are translated at the exchange rate in effect at the consolidated balance sheet date. Revenues and expenses are translated at average exchange rates prevailing during the year. The Fund has designated its United States' dollar loans as a hedge of its net investment in the United States. The loans are translated at the exchange rate in effect at the consolidated balance sheet date. The resulting gains or losses are included in the foreign currency translation adjustment in unitholders' equity.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

2. Summary of significant accounting policies (continued)

l) Revenue recognition

The Fund recognizes revenue from the sale of manufactured goods at the time of product shipment. From time to time the Fund enters into contracts with customers to manufacture products on their behalf. In some instances the customers provide a portion of the inventory to be used in the manufacturing process. Accordingly, the Fund includes in sales the invoice price to the customer and includes in cost of sales the Fund's portion of costs incurred when the goods are shipped.

The Fund enters into "Take-or-pay" arrangements with certain customers, which require the customer to pay Menu if their purchases do not exceed contracted volumes. These arrangements are reflected in sales (2005 - \$1,122; 2004 - \$Nil).

m) Supplier rebates

Volume rebates on supplier purchases are recorded throughout the year as a reduction of cost of sales based on management's best estimate of the amounts that will ultimately be collected.

n) Unit based compensation

The Fund expenses awards made under its long-term incentive plan in accordance with the fair value based method.

o) Derivative instruments

Any trading, speculative or non-qualifying hedging derivative financial instruments are recognized in the consolidated balance sheet and measured at fair value, with changes in fair value recognized in net income as charge or credit to selling, general and administrative expenses.

p) Asset retirement obligations

The fair value of a liability for an asset retirement obligation is recognized in the year in which it is incurred, if a reasonable estimate of fair value can be made. The associated retirement costs are capitalized as part of the carrying amount of the long-lived assets and amortized over the life of the asset. As at December 31, 2005, the Fund has concluded that there were no asset retirement obligations associated with its assets.

q) Non-controlling interest

Effective January 1, 2004, the Fund adopted the requirements of the Emerging Issues Committee of The Canadian Institute of Chartered Accountants Abstract 151. This abstract described circumstances whereby exchangeable units, previously included in unitholders' equity, should be shown as non-controlling interest. This change in accounting policy was given retroactive application.

3. Inventories

	2005 \$	2004 \$
Raw materials and packaging	16,462	15,794
Finished goods	33,013	43,326
	<u>49,475</u>	<u>59,120</u>

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

4. Property, plant and equipment

	2005		Net \$
	Cost \$	Accumulated amortization \$	
Land	5,248	-	5,248
Buildings	43,671	5,094	38,577
Machinery and equipment	90,563	32,275	58,288
Other property and equipment	14,069	9,619	4,450
Equipment under capital lease	97	81	16
Construction-in-progress	1,043	-	1,043
	<u>154,691</u>	<u>47,069</u>	<u>107,622</u>

	2004		Net \$
	Cost \$	Accumulated amortization \$	
Land	5,319	-	5,319
Buildings	44,996	3,547	41,449
Machinery and equipment	77,711	21,761	55,950
Other property and equipment	14,107	7,520	6,587
Equipment under capital lease	809	578	231
Construction-in-progress	6,594	-	6,594
	<u>149,536</u>	<u>33,406</u>	<u>116,130</u>

5. Goodwill

When the Fund purchased its interest in Menu Foods Limited Partnership, \$165,387 of the purchase price was assigned as goodwill in the consolidated financial statements. Under Canadian generally accepted accounting principles, goodwill is subject to an annual impairment test which, for the Fund, takes place as at September 30 of each year. Since the Fund's units were trading at lower than their book value at September 30, 2005 and through December 31, 2005, the application of current accounting principles identified an impairment in the carrying value of goodwill. Following a fair value assessment of other assets, goodwill was written down, for the year ended December 31, 2005 by \$93,415. This charge is a non-cash item and does not impact the Fund's credit facilities. No impairment in the value of the Fund's identifiable intangible assets or property, plant and equipment has been identified.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

6. Other assets

	2005		Net \$
	Cost \$	Accumulated amortization \$	
Supply contract	5,834	1,677	4,157
Deferred financing charges	1,842	925	917
Deferred long-term incentive plan (note 12)	518	218	300
	<u>8,194</u>	<u>2,820</u>	<u>5,374</u>

	2004		Net \$
	Cost \$	Accumulated amortization \$	
Supply contract	6,030	1,184	4,846
Deferred financing charges	1,711	504	1,207
	<u>7,741</u>	<u>1,688</u>	<u>6,053</u>

7. Bank indebtedness

The banking agreement provides the Fund with a US\$30,000 operating facility of which \$29,309 (US\$25,201) was drawn as at December 31, 2005 (December 31, 2004 \$8,704 (US\$7,241)).

The Fund must adhere to certain restrictive covenants and requires financial ratios in order to satisfy its obligations under the terms of its financing agreements with both its bankers and senior secured noteholders (note 8) (the "Lenders"). During 2005, the Fund was not in compliance with certain covenants contained in these agreements. The Fund obtained waivers of these breaches from its bankers and forbearance from its senior secured noteholders and on February 28, 2006 entered into amended agreements (the "Agreements") with its Lenders. The Agreements, among other things, define the terms and conditions governing the Fund's US\$30,000 operating facility and US\$85,000 senior secured notes facilities, going forward. As part of these renegotiations, the Fund agreed to pay US\$75 in fees to the bank, plus all associated legal expenses. The bank operating facility is a 364-day revolving term facility, which expires on February 27, 2007.

Pursuant to the amended banking agreement, when the Fund's total debt to EBITDA ratio (the "Leverage Ratio") is less than or equal to 3 to 1, this operating facility bears interest at Canadian prime rate (5.00% as at December 31, 2005), U.S. base rate (7.25% as at December 31, 2005) or Euro rate plus 1.50% (6.32% as at December 31, 2005) depending on the currency advanced. When the Leverage Ratio increases above 3 to 1, but is less than or equal to 4 to 1 these rates increase to Canadian prime rate plus 1%, U.S. base rate plus 1% or Euro rate plus 2.5%, respectively. Similarly, should the Leverage Ratio be greater than 4 to 1 these rates increase to Canadian prime rate plus 1.25%, U.S. base rate plus 1.25% or Euro rate plus 2.75%, respectively. In addition, the Fund is precluded from paying distributions to its Unitholders at any time the Leverage Ratio exceeds 3 to 1.

The Fund has pledged, as security for bank indebtedness, all moveable property and book debts and, in addition, has signed a general security agreement.

At December 31, 2005, the Fund has an outstanding letter of credit in the amount of \$645 (US\$555) (2004 - \$667 (US\$555)).

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

8. Long-term debt

	2005 \$	2004 \$
Senior secured notes (a)	98,855	102,170
Obligation under capital lease (b)	81	238
Forgivable loan (c)	-	183
	98,936	102,591
Less: Current portion	24	157
	98,912	102,434

a) Senior secured notes

On October 31, 2003, the Fund closed a private placement offering for US\$85,000 in floating rate, three-month LIBOR plus 155 basis points, (5.80% as at December 31, 2005 and 3.71% as at December 31, 2004) senior secured notes (the "Notes Facility"). The notes are repayable on October 31, 2010 with interest payable quarterly. The Fund has pledged, as security for its senior secured notes, all moveable property and book debts and, in addition, has signed a general security agreement. The Fund must adhere to certain restrictive covenants and required financial ratios in order to satisfy its obligations under the terms of its financing arrangements with both its bankers (note 7) and senior secured noteholders. During 2005, the Fund was not in compliance with certain covenants contained in these agreements. The Fund obtained waivers of these breaches from its bankers and forbearance from its senior secured noteholders and on February 28, 2006 entered into amended Agreements with its Lenders. The Agreements, among other things, define the terms and conditions governing the Fund's US\$85,000 senior secured notes facilities and US\$30,000 operating facility, going forward. As part of the renegotiations, the Fund agreed to pay US\$468 in fees to the noteholders, plus all associated legal expenses.

Pursuant to the terms of the amended Agreement, when the Fund's Leverage Ratio is less than or equal to 3 to 1, this Notes Facility bears interest at floating rate, three-month LIBOR plus 155 basis points. When the Leverage Ratio increases above 3 to 1, but is less than or equal to 4 to 1 this rate increases to three-month LIBOR plus 255 basis points. Similarly, should the Leverage Ratio be greater than 4 to 1 this rate increases to three-month LIBOR plus 305 basis points. From January 1, 2006 until April 29, 2006 the interest rate is fixed at three-month LIBOR plus 355 basis points. In addition, the Fund is precluded from paying distributions to its Unitholders at any time the Leverage Ratio exceeds 3 to 1. In the meantime, the Fund is required to use a portion of its excess cash to reduce its indebtedness until this level of leverage is achieved.

The Fund had fixed interest rates at 2.93% or 2.97% plus a stamping fee of 155 basis points on US\$22,500, which expired in December 2005.

b) Obligation under capital lease

The Fund entered into a capital lease in December 2002, collateralized by certain computer equipment. The lease, which was modified in December 2005, provides for blended monthly payments of \$3 (2004 - \$14).

Minimum lease payments:

	2005 \$	2004 \$
2005	-	168
2006	32	84
2007	32	-
2008	31	-
Total minimum lease payments	95	252
Less: Amounts representing interest at 10.40% (6.60% - 2004)	14	14
Balance of obligation	81	238
Less: Current portion	24	157
	57	81

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

8. Long-term debt (continued)

c) Forgivable loan

During 2002, the Fund finalized an agreement whereby the City of Emporia provided incentive money in the form of a non-interest bearing forgivable loan. As at December 31, 2005, the loan was completely forgiven. The outstanding amount on December 31, 2004 was \$183 (US\$151). Since the incentive arrangement was provided to assist in the construction of the building, the Fund reduced its property, plant and equipment by the amount forgiven, as it was forgiven.

9. Class B Exchangeable Units

	Number of units	Carrying value \$
Class B Exchangeable Units of MFLP		
December 31, 2003	12,631,915	86,878
Share of net income for the year		10,401
Distributions for the year (note 11)		(15,916)
December 31, 2004	12,631,915	81,363
Conversion of Class B units into Trust units (note 10)	(1,498,260)	(9,166)
Share of net loss for the year		(34,036)
Distributions for the year (note 11)		(6,522)
December 31, 2005	11,133,655	31,639

Except as described below, the Class B Units together with their related Special Trust Units (note 10) can be exchanged on a one-for-one basis with the Fund for Trust Units at the option of the holder.

During the second quarter of 2005, certain holders of Class B Exchangeable Units agreed to subordinate their entitlement to distributions for a ten-month period beginning with the distributions in respect of the month of May 2005 and ending with the distributions in respect of the month of February 2006. Such unitholders shall be entitled to a reimbursement of such subordinated distributions before distributions can be increased above 9 cents per unit, per month. No obligation arises to the Fund in respect of these subordinated amounts until it has generated sufficient distributable cash and, accordingly, no amount has been accrued in distributions payable at December 31, 2005. These same unitholders have agreed to forego their entitlement to convert their Class B Exchangeable Units into Trust units until February 2006.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

10. Trust Units

Authorized

Unlimited number of Trust Units
 Unlimited number of Special Trust Units

Issued

	Number of units	Gross proceeds \$	Issuance costs \$	Net proceeds \$
Trust Units				
December 31, 2003	13,259,823	132,000	10,820	121,180
Issued during the year	2,500,000	36,500	480	36,020
Exercise of options during the year (note 12)	380,413	3,172	-	3,172
December 31, 2004	16,140,236	171,672	11,300	160,372
Conversion of Class B Units during the year (note 9)	1,498,260	9,166	-	9,166
Exercise of options during the year (note 12)	127,663	916	-	916
December 31, 2005	17,766,159	181,754	11,300	170,454

Special Trust Units

Special Trust Units are used solely for providing voting rights to the holders of Class B Exchangeable Units ("Class B Units") (note 9) and by their terms have voting rights of the Fund. Special Trust Units are not transferable separately from the Class B Units to which they relate. Conversely, the Special Trust Units will automatically be transferred upon a transfer of the associated Class B Units. Each Special Trust Unit entitles the holder thereof to a number of votes at any meeting of Unitholders and holders of Special Trust Units equal to the number of Units that may be obtained upon the exchange of the Class B Units to which the Special Trust Unit relates, but do not otherwise entitle the holder to any rights with respect to the Fund's property or income. The Fund issued 12,631,915 Special Trust Units relating to the Class B Units at the date of acquisition of Menu. There were 11,133,655 Special Trust Units outstanding as at December 31, 2005 (note 9).

Weighted average number of Units outstanding

Basic net income (loss) per Trust Unit is computed by dividing net income (loss) for the year by the weighted average number of Trust Units outstanding during the year. Diluted net income (loss) per Trust Unit includes the effect of exercising unit options (note 12), only if dilutive, and includes the Class B Exchangeable Units using the "if converted" method.

The following table reconciles the basic weighted average number of units outstanding to the diluted weighted average number of units outstanding:

	2005	2004
Weighted average number of Trust Units outstanding - basic	17,077,197	15,354,036
Weighted average number of Class B Units outstanding - basic (note 9)	11,761,693	12,631,915
Dilutive effect of options (note 12)	50,177	159,547
Weighted average number of units outstanding - diluted	28,889,067	28,145,498

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

11. Distributions

Distributions declared during the year ended December 31, 2005 were as follows:

Unitholder Record Date

	Total \$	Per unit \$	Paid or payable
Trust Units			
January 31, 2005	1,696	0.1050	February 15, 2005
February 28, 2005	1,697	0.1050	March 15, 2005
March 31, 2005	1,700	0.1050	April 15, 2005
April 29, 2005	1,699	0.1050	May 16, 2005
May 31, 2005	1,456	0.0900	June 15, 2005
June 30, 2005	1,592	0.0900	July 15, 2005
July 29, 2005	1,592	0.0900	August 15, 2005
August 31, 2005	886	0.0500	September 15, 2005
September 30, 2005	889	0.0500	October 17, 2005
October 31, 2005	888	0.0500	November 15, 2005
November 30, 2005	888	0.0500	December 15, 2005
	<u>14,983</u>	<u>0.8900</u>	

During the year ended December 31, 2004, distributions declared to Trust Units amounted to \$19,461 (\$1.260 per unit).

Unitholder Record Date

	Total \$	Per unit \$	Paid or payable
Class B Units			
January 31, 2005	1,326	0.1050	February 15, 2005
February 28, 2005	1,327	0.1050	March 15, 2005
March 31, 2005	1,326	0.1050	April 15, 2005
April 29, 2005	1,326	0.1050	August 15, 2005
May 31, 2005	1,137	0.0900	August 15, 2005
June 30, 2005	1,002	0.0900	August 15, 2005
July 29, 2005	1,002	0.0900	November 15, 2005
August 31, 2005	557	0.0500	November 15, 2005
September 30, 2005	557	0.0500	November 15, 2005
October 31, 2005	556	0.0500	November 15, 2005
November 30, 2005	557	0.0500	December 15, 2005
	<u>10,673</u>	<u>0.8900</u>	
Distributions subordinated (note 9)	(4,151)		
	<u>6,522</u>		

During the year ended December 31, 2004, distributions to Class B Units amounted to \$15,916 (\$1.260 per unit).

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

12. Unit based compensation

Unit option plan

Menu Foods Corporation (the former parent company of Menu) had an executive stock option plan pursuant to which there were outstanding options issued to 61 of its directors, executive officers and key employees. In connection with the Fund's Initial Public Offering and the acquisition of Menu, these options were exchanged for Trust Unit options in the Fund having equivalent terms and conditions. As at December 31, 2005, 74,683 Trust Unit options, all of which were vested and have a weighted average exercise price of \$2.977 per unit, were outstanding. The Trust Unit options will expire in November and December 2006.

	2005	2004
Opening balance	202,346	582,759
Exercised	(127,663)	(380,413)
Ending balance	74,683	202,346

The fair value of the Trust Unit options was determined as part of the cost of the acquisition of Menu Foods Limited Partnership ("MFLP") using the Black-Scholes model, incorporating a 4.25% risk free interest rate, at a 35% volatility factor and 11.75% expected distributions. On this basis, each Trust Unit option was valued at \$5.36. The valuation of total Trust Unit options, after allowing for expected forfeitures, aggregated to \$4,776, which was included as contributed surplus at the acquisition date.

Contributed surplus attributed to Trust Unit options

	2005 \$	2004 \$
Opening balance	808	2,847
Options exercised	(536)	(2,039)
Ending balance	272	808

As the Trust Unit options are exercised, the associated contributed surplus is reclassified to Trust Units (note 10). During the year ended December 31, 2005, \$536 was reclassified to Trust Units (2004 - \$2,039).

Long-term incentive plan

In 2003, the Fund adopted a discretionary long-term incentive plan (the "Incentive Plan") for the 2003, 2004 and 2005 financial years in which trustees, directors, officers and employees (collectively the "Participants") were all eligible to participate. Pursuant to the Incentive Plan, the Fund could contribute an amount, equal to 14.286% of the amount by which distributable cash, as defined by the Declaration of Trust for a calendar year, exceeds \$33,500 and \$34,000 for calendar years 2004 and 2005, respectively, to a trust on behalf of the Participants in the Incentive Plan. The trust would then purchase Units, on the open market, equal in value to the amount contributed. Units would be awarded to Participants based on determinations made by the Compensation and Corporate Governance Committee of Menu Foods GenPar Limited's Board of Directors (the "Committee"). Once purchased, the Committee would determine the number of Units acquired on behalf of each Participant based on the amount contributed to the Trust on their behalf. Units awarded will vest over a three-year period, subject to the provisions of the Incentive Plan.

If the employment of a Participant is terminated prior to the final vesting of the Units attributed to such Participant, such Participant's unvested Units shall be sold and the net proceeds returned to the Fund. The Fund intends to review the Incentive Plan for calendar year 2006 and beyond. In February 2005, 36,390 Trust Units were purchased for \$518 for the benefit of 22 individuals.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

13. Financial expenses

	2005 \$	2004 \$
Interest on senior secured notes	5,057	3,299
Interest on term loans and bank indebtedness	1,106	596
Interest on capital leases	11	197
Net loss (gain) on interest rate swap	266	(266)
Amortization of deferred financing charges	422	447
Other, net	54	(5)
	6,916	4,268

14. Income taxes

Income tax obligations relating to distributions from the Fund are obligations of the unitholders and, accordingly, no provision for income taxes has been made in respect of distributed income of the Fund. A provision for income taxes is recognized for the Fund's subsidiaries that are subject to tax, including large corporations tax.

The provision for income taxes in the consolidated statement of operations and deficit reflects an effective rate that differs from the combined Canadian federal and provincial rates for the following reasons:

	2005 \$	2004 \$
Income (loss) before income taxes	(91,612)	26,546
Goodwill impairment loss	93,415	-
Income of the Fund subject to tax in the hands of recipients	(10,375)	(11,258)
Income (loss) of subsidiary entities subject to tax	(8,572)	15,288
Income taxes at statutory rate	(2,956)	5,271
Increase (decrease) resulting from:		
Effect of foreign tax rate	(2,209)	(1,969)
Large corporations tax	(205)	205
Valuation allowance	1,082	(53)
Other and permanent differences	1,377	(132)
	(2,911)	3,428

The tax effects of temporary differences that give rise to the future tax assets and future tax liabilities are:

	2005 \$	2004 \$
Current future income tax assets:		
Accounts receivable, accounts payable and accrued liabilities	290	373
Inventory provisions	1,411	1,903
Share of net partnership income not yet subject to tax	-	(402)
	1,701	1,874
Long-term future income tax liabilities:		
Property, plant and equipment	16,849	18,030
Withholding tax on foreign retained earnings	331	245
Tax benefits of loss carry-forwards	(5,984)	(1,624)
Valuation allowance	1,768	686
Other	1,032	44
	13,996	17,381

The benefits of these future tax loss carry-forwards expire between 2008 and 2010.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

15. Other expenses and income

Research and development expenses amounted to \$256 for the year ended December 31, 2005 (2004 - \$295). Employment incentive grants amounting to \$232 (US\$200) (2004 - \$235 (US\$200)) were earned in each year. These expenses and grants are included in cost of sales.

16. Obligations under operating leases

Future minimum payments under operating leases at December 31, 2005 are as follows:

	\$
2006	1,847
2007	979
2008	884
2009	711
2010	316
Thereafter	-
	<hr/> 4,737

17. Employee benefit plans

The Fund sponsors a 401(K) retirement savings plan in the United States for all eligible employees and a registered defined contribution pension plan for all eligible Canadian employees. The Fund has no past service pension liabilities.

Under the above plans, contributions are made by plan members, with varying matching contributions from the Fund.

The total expense related to these plans was \$1,633 for the year ended December 31, 2005 (2004 - \$1,654).

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

18. Segmented information

The Fund's operations fall into one reportable business segment. The Fund is principally engaged in the manufacture of private-label wet pet food products, where it serves major customers on a North American basis. Geographic segment information is presented below.

Accounting policies relating to each geographic operating segment are identical to those used for the purposes of these consolidated financial statements. Intersegment sales are made at values that approximate those prevailing in the markets, less a distribution margin. The point of invoicing and the location of the assets determine the geographic areas.

	2005 \$	2004 \$
Sales		
Canada		
Domestic	49,647	54,079
Foreign	79,561	96,220
Intersegment transfers	12,052	15,149
	<u>141,260</u>	<u>165,448</u>
United States		
Domestic	228,836	242,726
Foreign	898	1,347
Intersegment transfers	89,920	95,558
	<u>319,654</u>	<u>339,631</u>
	460,914	505,079
Elimination of intersegment transfers	(101,972)	(110,707)
Discounts	(12,010)	(13,660)
	<u>346,932</u>	<u>380,712</u>
	2005 \$	2004 \$
Property, plant and equipment		
Canada	33,423	33,117
United States	121,268	116,419
	<u>154,691</u>	<u>149,536</u>
Less: Accumulated amortization	47,069	33,406
	<u>107,622</u>	<u>116,130</u>

Given the nature of the Fund's operations, goodwill relates to the Fund as a whole and cannot practicably be allocated on a geographic basis.

(All figures, except per unit amounts, expressed in thousands of Canadian dollars)

19. Financial instruments

Credit risk

The Fund, in the normal course of business, reviews significant new customers' credit history and financial statements before extending credit and performs regular reviews of its existing credit performance.

Foreign exchange and interest rate risks

The Fund generates significant cash flows in foreign currency and is therefore exposed to risks relating to foreign exchange fluctuations. It is also subject to risks relating to interest rate fluctuations. In order to reduce these risks, the Fund uses derivative financial instruments, which are not held or issued for speculative purposes.

As at December 31, 2005 and 2004, the Fund did not have any outstanding foreign currency forward contracts.

The Fund had fixed interest rate contracts on a portion of its indebtedness, which expired on December 31, 2005. The mark-to-market value of the contracts as at December 31, 2005 was \$Nil (December 31, 2004 - \$17) and resulted in a loss, including the impact of the amortization on the transitional amount, of \$266 for the year ended December 31, 2005 (2004 - gains of \$266), which were charged to interest expense during the years.

Fair value of financial instruments

The carrying values of cash, trade and other receivables, accounts payable and accrued liabilities, distributions payable and income taxes payable and recoverable approximate their fair values because of the near maturity of these instruments. The carrying value of long-term debt bearing interest at variable rates (note 8) approximates its fair value because effective rates represent the rates that would be used to calculate fair value.

20. Economic dependence

The Fund has approximately 18% of its sales to one customer and has approximately 37% of its sales to the top three customers. Other than these customers, the Fund does not have a significant exposure to any individual customer. The Fund relies on a single supplier for the majority of its can requirements. Should this supplier fail to deliver in a timely manner, delays and/or shutdowns of the Fund's operations could result.

Unitholder Information

Senior Management

Paul K. Henderson
President
and Chief Executive Officer

Mark A. Wiens
Executive Vice-President
and Chief Financial Officer

Dr. Richard G. Shields, Jr.
Executive Vice-President,
Technical Services

Randall C. Copeland
Executive Vice-President,
Sales and Marketing

William F. Grant
Executive Vice-President,
Corporate Purchasing
and Logistics

Christopher J. Mifflin
Executive Vice-President,
Operations

Trustees

Robert W. Luba
Thomas A. Di Giacomo
Serge K. Darkazanli
Alexander R. Aird
Eric A. Demirian

Legal Counsel

Goodmans LLP

Auditors

PricewaterhouseCoopers LLP

Registrar and Transfer Agent

Computershare Investor Services Inc.

Market Information

Stock Symbol: MEW.UN
Stock Exchange: Toronto

Investor Enquiries

Mark A. Wiens
Executive Vice-President and Chief Financial
Officer
Menu Foods GenPar Limited
Tel: 905-826-3870
Fax: 905-826-4995
E-mail: investorrelations@menufoods.com
Web site: www.menufoods.com

MENU FOODS INCOME FUND

Corporate Head Office
8 Falconer Drive, Streetsville, Ontario, L5N 1B1

Fax 905.826.4995

Tel 905.826.3870

www.menufoods.com

E-Mail investorrelations@menufoods.com