

**Menu Foods Income Fund****Consolidated Balance Sheets***(All figures expressed in thousands of Canadian dollars, unaudited)*

	As at	
	March 31, 2007	December 31, 2006
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash	487	2,813
Accounts receivable		
Trade (note 2)	69	20,062
Other (note 2)	1,143	2,175
Inventories (notes 2 and 5)	50,340	49,576
Prepaid expenses and sundry assets	1,768	1,956
Future income taxes (note 17)	947	1,657
<b>Total Current Assets</b>	<b>54,754</b>	<b>78,239</b>
<b>Property, plant and equipment (note 6)</b>	<b>94,347</b>	<b>97,734</b>
<b>Goodwill (note 7)</b>	<b>71,972</b>	<b>71,972</b>
<b>Other assets (note 8)</b>	<b>3,468</b>	<b>3,634</b>
<b>Total Assets</b>	<b>224,541</b>	<b>251,579</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Bank indebtedness (note 9)	13,846	15,627
Accounts payable and accrued liabilities (note 2)	36,531	19,806
Income taxes payable	400	603
Current portion of long-term debt (note 10)	27	27
<b>Total Current Liabilities</b>	<b>50,804</b>	<b>36,063</b>
<b>Long-term debt (note 10)</b>	<b>86,800</b>	<b>86,442</b>
<b>Future income taxes (note 17)</b>	<b>947</b>	<b>16,085</b>
<b>Total Liabilities</b>	<b>138,551</b>	<b>138,590</b>
<b>Class B Exchangeable Units (note 11)</b>	<b>18,559</b>	<b>27,823</b>
<b>Unitholders' Equity</b>		
Trust Units (note 12)	174,702	174,648
Contributed surplus (note 14)	343	272
Deficit	(99,909)	(82,400)
Accumulated other comprehensive loss (note 15)	(7,705)	(7,354)
<b>Total Unitholders' Equity</b>	<b>67,431</b>	<b>85,166</b>
<b>Total Liabilities, Class B Exchangeable Units and Unitholders' Equity</b>	<b>224,541</b>	<b>251,579</b>

**Menu Foods Income Fund**  
**Consolidated Statements of Operations and Deficit**

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

	Quarter ended March 31,	
	2007 \$	2006 \$
Sales	64,506	93,854
Cost of sales (note 18)	56,747	82,011
Gross profit	7,759	11,843
Selling, general and administrative expenses	6,366	6,967
Income before the undernoted	1,393	4,876
Product recall (note 2)	39,115	-
Financial expenses (note 16)	3,282	2,839
Income (loss) before income taxes and non-controlling interest	(41,004)	2,037
Current income taxes	(214)	216
Future income taxes	(14,201)	(298)
Total income taxes (note 17)	(14,415)	(82)
Income (loss) before non-controlling interest	(26,589)	2,119
Non-controlling interest of Class B Exchangeable Units (note 11)	(9,080)	816
Net (loss) income for the period	(17,509)	1,303
Deficit - beginning of period	(82,400)	(88,830)
Deficit - end of period	(99,909)	(87,527)
<b>Deficit comprises:</b>		
Accumulated net loss	(39,720)	(27,338)
Accumulated distributions	(60,189)	(60,189)
	(99,909)	(87,527)
Basic net (loss) income per Trust Unit	\$ (0.918)	\$ 0.073
Diluted net (loss) income per Trust Unit	\$ (0.918)	\$ 0.073
Basic weighted average number of Trust Units outstanding (note 12)	19,081,280	17,766,989
Diluted weighted average number of Trust Units outstanding (note 12)	29,244,963	28,944,413

**Consolidated Statements of Other Comprehensive Income (loss)**

(All figures expressed in thousands of Canadian dollars, unaudited)

	Quarter ended March 31,	
	2007 \$	2006 \$
Net (loss) income for the period	(17,509)	1,303
Other comprehensive income (loss), net of tax of \$nil (2006 - \$nil):		
Unrealized (losses) gains on translating financial statements of self-sustaining foreign operations	(958)	388
Gains (losses) on hedges of unrealized foreign currency translation	607	(261)
Comprehensive (loss) income for the period	(17,860)	1,430

**Menu Foods Income Fund**  
**Consolidated Statements of Cash Flows**

(All figures expressed in thousands of Canadian dollars, unaudited)

	Quarter ended March 31,	
	2007	2006
	\$	\$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net (loss) income for the period	(17,509)	1,303
Adjustments for non-cash items		
Non-controlling interest of Class B Exchangeable Units	(9,080)	816
Amortization of property, plant and equipment	3,957	3,823
Amortization of customer relationship	133	132
Amortization of deferred financing costs	1,176	65
Unit-based compensation	81	325
Gain on sale of property, plant and equipment	(6)	(29)
Marked-to-market adjustment	216	(116)
Future income taxes	(14,201)	(298)
	<b>(35,233)</b>	<b>6,021</b>
Change in non-cash working capital items		
Accounts receivable	20,973	(7,215)
Inventories	(783)	(5,955)
Prepaid expenses and sundry assets	186	(396)
Income taxes	(318)	310
Accounts payable and accrued liabilities	16,363	8,641
	<b>1,188</b>	<b>1,406</b>
<b>Financing activities</b>		
Change in bank indebtedness	(1,781)	(5,875)
Issuance of Trust Units, net	44	8
Long-term debt repayments	(6)	(6)
Deferred financing charges	-	(625)
	<b>(1,743)</b>	<b>(6,498)</b>
<b>Investing activities</b>		
Purchase of property, plant and equipment	(1,801)	(741)
Other assets	-	43
Proceeds from sale of property, plant and equipment	30	-
	<b>(1,771)</b>	<b>(698)</b>
<b>Decrease in cash</b>	<b>(2,326)</b>	<b>(5,790)</b>
<b>Cash - beginning of period</b>	<b>2,813</b>	<b>5,790</b>
<b>Cash - end of period</b>	<b>487</b>	<b>-</b>
<b>Supplementary information</b>		
Income taxes paid	76	40
Interest paid	1,865	1,818

**Menu Foods Income Fund**  
**Notes to Consolidated Financial Statements**  
**March 31, 2007**

*(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)*

**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").

Menu was incorporated on May 17, 1971 under the laws of the Province of Ontario. Menu 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. Product recall and litigation**

On March 16, 2007, the Fund announced the recall of a portion of the dog and cat food it manufactured between December 3, 2006 and March 6, 2007. Other products and dates of manufacture were added to the recall on April 5, April 10, April 17, May 2, 2007 and May 22, 2007 and the Fund announced a voluntary withdrawal of certain products on March 24, 2007. The recalls and withdrawal relate primarily to "cuts and gravy" style products manufactured by Menu, but include certain other products as well. These products were manufactured and sold under private label and contract manufactured for some national brands.

Management estimates that the costs associated with the recalls and withdrawal noted above will amount to approximately \$45,000. This estimate includes \$3,000 in costs which, under generally accepted accounting principles in Canada, won't be recognized until paid. The costs associated with the recall result in the Fund not being in compliance with certain existing financial covenants with its Lenders for all of 2007. Accordingly, on May 15, 2007 the Fund entered into amended Agreements with its Lenders, which among other things, define the terms and conditions governing the Fund's US\$30,000 bank and US\$85,000 senior secured notes facilities, going forward. The amendments to the senior secured notes facility were such that under Canadian generally accepted accounting principles they resulted in a settlement of the original facility, necessitating a write-off of \$1,001 in related transaction costs. This write-off, together with the expected direct costs of the recall, aggregates to \$46,101. In addition, the agreement with the bank was expanded to include a new US\$20,000 credit facility.

The estimated product recall costs are based on the best information currently available to the management of the Fund. The ultimate determination of these costs is dependant on the amount of product actually returned and certain other factors. Accordingly, actual amounts could differ from these estimates and the differences could be significant.

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***2. Product recall and litigation (continued)**

The recall costs noted above, and reflected in the quarter ended March 31, 2007, include product collection, write-off and disposal costs of \$36,475, lost margin on returned product of \$2,885, \$2,400 to establish and operate a call centre to respond to customer concerns and \$240 in professional and associated fees necessary to manage through this difficult process. During the first quarter, the Fund incurred \$1,980 of actual recall costs and accrued a further \$40,020 for costs not yet incurred in connection with the recall. These accruals have been reflected in various balance sheet accounts, as set out below:

	<b>As at March 31, 2007</b>
	\$
Accounts receivable	12,193
Other accounts receivable	1,001
Inventory	13,748
Accrued liabilities	13,078
<hr/>	
Total expenses accrued	40,020
Actual costs incurred	1,980
<hr/>	
Total recall expenses	42,000

In addition, the Fund expects to incur a further \$3,000 of period expenses over the balance of 2007, bringing the total estimated cost of the recall to \$45,000.

Lawsuits have been filed against the Fund and certain of its subsidiaries in the United States and in Canada, which seek to recover damages on behalf of the named plaintiffs and a purported class of affected pet owners. The U.S. Food and Drug Administration is also conducting an investigation of the situation. The offices of two United States' Attorneys have informed Menu that it is the target of criminal investigations for possible violations of the U.S. Federal Food, Drug and Cosmetic Act. It is possible that additional actions or investigations may arise in the future. The Fund expects to expend significant amounts on, and to devote considerable management time to these matters. The Fund cannot predict the amount of such expenses, the resolution of any claims or investigations, or the extent to which these items will be paid by the Fund's insurers. Furthermore, the Fund cannot predict the effect the recall will have on its relationships with its customers. Accordingly, no amounts related to these actions have been accrued in these financial statements.

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***3. Changes in accounting policies**

On January 1, 2007, the Fund adopted Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1530, Comprehensive Income; Section 3855, Financial Instruments – Recognition and Measurement; Section 3861, Financial Instruments – Disclosure and Presentation; and Section 3865 – Hedges.

Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with generally accepted accounting principles.

Section 3855 prescribes when a financial asset or liability or non-financial derivative is to be recognized on the balance sheet and at what amount, requiring fair value or cost-based measures under different circumstances. Under Section 3855, financial instruments must be classified into one of these five categories; held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured at fair value except for loans and receivables, held to maturity investments and other financial liabilities, which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net earnings; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired, at which time the amounts would be recorded in net earnings.

Section 3861 establishes standards for presentation of financial instruments and non-financial derivatives, and identifies the information that should be disclosed about them.

Section 3865 describes when and how hedge accounting can be applied as well as the disclosure requirements. Hedge accounting enables the recording of gains, losses, revenues and expenses from derivative financial instruments in the same period as for those related to the hedged item.

Under the new standards, policies followed for periods prior to the effective date generally are not changed and, therefore, the comparative figures have not been restated, except for the requirement in Section 1530 to include the currency translation adjustment as part of other comprehensive income, which is included in a separate statement in these consolidated financial statements.

Upon adoption of Section 3855, the Fund designated its cash as held-for-trading, which is measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Bank indebtedness, accounts payable and accrued liabilities and long-term debt are classified as other financial liabilities, which are recorded at amortized cost. Derivative instruments are recorded in the statement of operations at fair value except for contracts entered into for the purposes of the Fund’s own usage requirements. The Fund uses interest rate swaps (the “Swaps”) to fix interest rates on a portion of its indebtedness. Previously the Swaps were marked-to-market, and consequently are unaffected by this new standard. The Fund established January 1, 2003 as its transition date for the purpose of identifying embedded derivatives. Consequently, only contracts or financial instruments entered into or modified after the transition date were examined for embedded derivatives. As at March 31, 2007 and December 31, 2006 the Fund does not have any embedded derivatives.

There was no impact on the Fund as a result of adopting Section 3865.

**Menu Foods Income Fund**  
**Notes to Consolidated Financial Statements**  
**March 31, 2007**

*(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)*

**4. 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.

These consolidated financial statements are based on accounting principles consistent with those used and described in the annual consolidated financial statements as at December 31, 2006 except as discussed in note 3, and should be read in conjunction with those consolidated financial statements. The disclosures contained in these unaudited interim consolidated financial statements may not include all requirements of Canadian generally accepted accounting principles for annual statements.

Accounting measurements at interim dates involve greater reliance on estimates than at year-end. In the opinion of management, the accompanying unaudited interim consolidated financial statements include all adjustments of a normal recurring nature to present fairly the financial position of the Fund as at March 31, 2007.

**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 fair value.

**d) Inventories**

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

**Menu Foods Income Fund**  
**Notes to Consolidated Financial Statements**  
**March 31, 2007**

*(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)*

**4. Summary of significant accounting policies (continued)**

**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 value 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 balance is transferred to the appropriate asset class and amortization commences.

**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) Other financial liabilities**

The Fund classified long-term debt as other financial liabilities, which are measured at amortized cost. Transaction costs, which are netted against the carrying value of the long-term debt are amortized using the effective interest rate method, and are included in financial expenses.



**Menu Foods Income Fund**  
**Notes to Consolidated Financial Statements**  
**March 31, 2007**

*(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)*

**4 Summary of significant accounting policies (continued)**

**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) Customer relationship**

The customer relationship includes an exclusive agreement to supply a portion of a customer's canned wet pet food requirements in the United States and Canada. The customer relationship is carried at cost less accumulated amortization. Amortization is charged to cost of sales on a straight-line basis, over a ten-year period. The customer relationship 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 customer relationship are less than the carrying value of the customer relationship. Should an impairment loss be recognized, the carrying value of the customer relationship 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 period. Gains or losses arising from these translations are included in net income.

The assets and liabilities of all foreign 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 period. The Fund has designated a portion of its United States' dollar indebtedness as a hedge of its net investment in the United States. The indebtedness is translated at the exchange rate in effect at the consolidated balance sheet date. The resulting gains or losses, together with the related income taxes, are included in the foreign currency translation adjustment in the consolidated statement of comprehensive income.

**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, when the goods are shipped, the Fund includes in sales the invoice price to the customer and includes in cost of sales the Fund's portion of costs incurred.

The Fund enters into "take-or-pay" arrangements with certain customers, which require the customer to make payments to Menu if their purchases do not meet or exceed contracted volumes. These arrangements are reflected in sales - as a consequence of the product recall (note 2), no revenue has been reflected from these arrangements during the quarter ended March 31, 2007 (2006 - \$397). At present the Fund has two such contracts that expire in September 2007 and December 2008.

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***4 Summary of significant accounting policies (continued)****m) Supplier rebates**

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

**n) Unit-based compensation**

The Fund expenses awards made under its unit-based compensation plans in accordance with the fair value based method.

**o) Asset retirement obligations**

The fair value of any liability for an asset retirement obligation is recognized in the period 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 March 31, 2007, the Fund has concluded that there were no asset retirement obligations associated with its assets.

**5. Inventories**

	As at March 31, 2007	As at December 31, 2006
	\$	\$
Raw materials and packaging	17,366	13,498
Finished goods	32,974	36,078
	<b>50,340</b>	<b>49,576</b>

**6. Property, plant and equipment**

	As at March 31, 2007		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Land	5,226	-	5,226
Buildings	43,832	7,114	36,718
Machinery and equipment	92,856	45,729	47,127
Other property and equipment	15,548	12,533	3,015
Equipment under capital lease	97	83	14
Construction-in-progress	2,247	-	2,247
	<b>159,806</b>	<b>65,459</b>	<b>94,347</b>

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***6. Property, plant and equipment (continued)**

	As at December 31, 2006		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Land	5,255	-	5,255
Buildings	44,174	6,752	37,422
Machinery and equipment	93,681	43,749	49,932
Other property and equipment	15,203	11,890	3,313
Equipment under capital lease	97	83	14
Construction-in-progress	1,798	-	1,798
	<b>160,208</b>	<b>62,474</b>	<b>97,734</b>

**7. 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 30th of each year, unless events indicate that an impairment has arisen at some other time. Since the Fund's units were trading at lower than their book value, an assessment of the carrying value of goodwill was carried out in 2005, resulting in a writedown of \$93,415. The carrying value of goodwill is \$71,972 as at March 31, 2007 and December 31, 2006.

**8. Other assets**

	As at March 31, 2007		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Customer relationship	5,792	2,324	3,468
Deferred long-term incentive plan (note 14)	518	518	-
	<b>6,310</b>	<b>2,842</b>	<b>3,468</b>

	As at December 31, 2006		
	Cost	Accumulated amortization	Net
	\$	\$	\$
Customer relationship	5,846	2,212	3,634
Deferred long-term incentive plan (note 14)	518	518	-
	<b>6,364</b>	<b>2,730</b>	<b>3,634</b>

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***9. Bank indebtedness**

The banking agreement provides the Fund with a US\$30,000 operating facility of which \$13,359 (US\$11,574) was drawn upon as at March 31, 2007 (December 31, 2006 - \$12,814 (US\$10,995)). At March 31, 2007, the Fund has an outstanding letter of credit in the amount of \$981 (US\$850) (December 31, 2006 - \$991 (US\$850)) which further reduces the facility.

The costs associated with the product recall first announced on March 16, 2007 (note 2) will be significant and resulted in the Fund not being in compliance with certain financial covenants with its bank and senior secured noteholders (note 10) (the "Lenders") as at March 31, 2007 and for all of 2007. Accordingly, on May 15, 2007, the Fund entered into amended agreements (the "Agreements") with its Lenders, that among other things, define the terms and conditions governing the Fund's US\$30,000 bank and US\$85,000 senior secured notes facilities going forward. In addition, the agreement with the bank was extended to June 30, 2009 and expanded to include a new US\$20,000 credit facility.

Pursuant to its amended banking agreement, this operating facility bears interest at Canadian prime rate plus 3.5% (6.00% as at March 31, 2007), U.S. base rate plus 3.5% (8.25% as at March 31, 2007) or Euro rate plus 4.75% (5.35% as at March 31, 2007) (the "Base Rates") depending on the currency advanced. These interest rates will continue to apply until the additional US\$20,000 facility is extinguished and the balance owing under the US\$30,000 facility is less than US\$15,000 for five consecutive business days and the Fund achieves a total debt to EBITDA (a non GAAP measure that is defined in the amended banking agreement), ratio (the "Leverage Ratio"), on a trailing twelve months basis, of 3 to 1 or less, at which time the interest rates will revert to those set out in Menu's credit facilities prior to amendment, provided that there are no other defaults. The Fund is precluded from paying distributions to its Unitholders at any time the Leverage Ratio exceeds 3 to 1.

The existing covenants have been suspended until such time as the recall costs no longer impact the Funds's Leverage Ratio and until the additional US\$20,000 facility is extinguished and the balance owing under the US\$30,000 facility is less than US\$15,000 for five consecutive business days and the Fund achieves a Leverage Ratio, on a trailing twelve months basis, of 3 to 1 or less. In addition, the cumulative consolidated EBITDA before recall costs and operating leases must be at least \$7,500 as at March 31, 2007; \$8,000 as at June 30, 2007; \$14,000 as at September 30, 2007; \$18,500 as at December 31, 2007; and \$20,000 per quarter, on a trailing twelve-months basis, thereafter. Under the terms of the amended agreements, not more than \$45,000 may be utilized by the Fund for recall-related costs. The amended agreements also require the Fund to pay fees to the bank of US\$380, plus all associated professional costs.

Certain bank indebtedness has been identified as priority indebtedness under an agreement between the bank and senior secured noteholders. Otherwise, the Fund has pledged, on a pari pasu basis with its senior secured noteholders, as security for bank

**10. Long-term debt**

	As at March 31, 2007 \$	As at December 31, 2006 \$
Senior secured notes (a)	86,777	86,411
Obligation under capital lease (b)	50	58
	<hr/> 86,827	<hr/> 86,469
Less: Current portion	27	27
	<hr/> <b>86,800</b>	<hr/> <b>86,442</b>

**Menu Foods Income Fund**  
**Notes to Consolidated Financial Statements**  
**March 31, 2007**

*(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)*

**10. Long-term debt (continued)**

**a) Senior secured notes**

	As at March 31, 2007	As at December 31, 2006
	\$	\$
Senior secured notes obligation	86,777	87,587
Transaction costs	-	1,176
	<u>86,777</u>	<u>86,411</u>

On October 31, 2003, the Fund closed a private placement offering for US\$85,000 in floating rate senior secured notes (the "Notes Facility"). The notes are repayable on October 31, 2010, with interest payable quarterly. Certain bank indebtedness has been identified as priority indebtedness under an agreement between the bank and senior secured noteholders. Otherwise, the Fund has pledged, on a pari pasu basis with its banker, as security for its senior secured notes, all moveable property and book debts and, in addition, has signed a general security agreement.

The costs associated with the product recall first announced on March 16, 2007 (note 2) will be significant and result in the Fund not being in compliance with certain financial covenants with its Lenders as at March 31, 2007 and for all of 2007. Accordingly, on May 15, 2007, the Fund entered into amended agreements (the "Agreements") with its Lenders, which among other things, define the terms and conditions governing the Fund's US\$30,000 bank (note 9) and US\$85,000 senior secured notes facilities going forward. In addition, the agreement with the bank was extended to June 30, 2009 and expanded to include a new US\$20,000 credit facility.

Pursuant to the terms of the Agreements, the Notes Facility bears interest at floating rate, three-month LIBOR plus 530 basis points. This rate will continue to apply until the additional US\$20,000 bank facility is extinguished and the balance owing under the US\$30,000 bank facility is less than US\$15,000 for five consecutive business days and the Fund achieves a Leverage Ratio, on a trailing twelve months basis, of 3 to 1 or less, at which time the interest rates will revert to those set out in Menu's existing Notes Facility, provided that there are no other defaults. The Fund is precluded from paying distributions to its Unitholders at any time the Leverage Ratio exceeds 3 to 1.

The existing covenants have been suspended until such time as the recall costs no longer impact the Funds's Leverage Ratio and until the additional US\$20,000 facility is extinguished and the balance owing under the US\$30,000 bank facility is less than US\$15,000 for five consecutive business days and the Fund achieves a Leverage Ratio, on a trailing twelve months basis, of 3 to 1 or less,. In addition, the cumulative consolidated EBITDA before recall costs and operating leases must be at least \$7,500 as at March 31, 2007; \$8,000 as at June 30, 2007; \$14,000 as at September 30, 2007; \$18,500 as at December 31, 2007; and \$20,000 per quarter, on a trailing twelve-month basis, thereafter. Under the terms of the amended agreements, not more than \$45,000 may be utilized by the Fund for recall-related costs.

The amendments to the Agreements with the Fund's Lenders were such that under Canadian generally accepted accounting principles, they resulted in a settlement of the original senior secured notes facility. As a consequence, it was necessary to write-off \$1,100 in costs associated with the establishment of the original facility that remained outstanding on March 31, 2007.

During the quarter ended March 31, 2006, the Fund fixed interest rates at 5.35% plus the applicable spread on US\$50,000 through to October 2010 (note 22).

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**10. Long-term debt (continued)**

**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 (2006 - \$14).

Minimum lease payments:	As at March 31, 2007 \$	As at December 31, 2006 \$
2007	24	32
2008	31	31
Total minimum lease payments	55	63
Less: Amounts representing interest at 10.40 % (6.60% - 2006)	5	5
Balance of obligation	50	58
Less: Current portion	27	27
	<b>23</b>	<b>31</b>

**11. Class B Exchangeable Units**

	Number of units	Carrying value \$
<b>Class B Exchangeable Units of MFLP</b>		
December 31, 2005	11,133,655	27,268
Conversion of Class B Exchangeable Units to Trust Units (note 12)	(1,236,431)	(3,700)
Foreign currency translation adjustment attributed to conversion		491
Share of net income for the year		3,699
Share of foreign currency translation adjustment for the year		65
December 31, 2006	9,897,224	27,823
Share of net loss for the period		(9,080)
Share of foreign currency translation adjustment for the period		(184)
March 31, 2007	<b>9,897,224</b>	<b>18,559</b>

The Class B Exchangeable Units together with their related Special Trust Units (note 12) can be exchanged on a one-for-one basis with the Fund for Trust Units at the option of the holder.

Gains or losses arising from the translation of foreign subsidiaries are included in other comprehensive income in unitholders' equity. The foreign currency translation adjustment is allocated between the Class B Exchangeable units and unitholders' equity on a pro-rata basis.

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. Distributions subordinated amounted to \$4,151. Such Unitholders are 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 declares distributions in excess of 9 cents per unit, per month, accordingly, no amount has been accrued in distributions payable at March 31, 2007 and December 31, 2006.

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***11. Class B Exchangeable Units (continued)**

The Class B Units have economic and voting rights equivalent, in all material respects, to the Trust Units.

**12. Trust Units****Authorized**

Unlimited number of Trust Units

Unlimited number of Special Trust Units

**Issued**

	<b>Number of units</b>	<b>Gross proceeds \$</b>	<b>Issuance costs \$</b>	<b>Net proceeds \$</b>
<b>Trust Units</b>				
December 31, 2005	17,766,159	181,754	11,300	170,454
Conversion of Class B Exchangeable Units during the quarter ended (note 11)				
June 30, 2006	876,598	2,602	-	2,602
September 30, 2006	359,833	1,098	-	1,098
Exercise of options during quarter ended (note 14)				
March 31, 2006	2,575	17	-	17
September 30, 2006	11,037	73	-	73
December 31, 2006	61,071	404	-	404
December 31, 2006	<b>19,077,273</b>	<b>185,948</b>	<b>11,300</b>	<b>174,648</b>
Exercise of options during the quarter ended (note 14)				
March 31, 2007	9,746	54		54
March 31, 2007	<b>19,087,019</b>	<b>186,002</b>	<b>11,300</b>	<b>174,702</b>

**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 11) 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 9,897,224 Special Trust Units outstanding as at March 31, 2007 (note 11).

**Weighted average number of Units outstanding**

Basic net income (loss) per Trust Unit is computed by dividing net income for the period by the weighted average number of Trust Units outstanding during the period. Diluted net income (loss) per Trust Unit includes the effect of exercising unit options (note 14), only if dilutive and includes the Class B Exchangeable Units using the "if converted" method.

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*(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)*

**12. Trust Units (continued)**

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

	<b>Quarter ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Weighted average number of Trust Units outstanding - basic	19,081,280	17,766,989
Weighted average number of Class B Units outstanding - basic (note 11)	9,897,224	11,133,655
Dilutive effect of options (note 14)	266,459	43,769
<b>Weighted average number of units outstanding - diluted</b>	<b>29,244,963</b>	<b>28,944,413</b>

**13. Distributions**

No distributions were declared on the Trust Units during the quarter ended March 31, 2007 (2006 - \$nil).

No distributions were declared on the Class B Units during the quarter ended March 31, 2007 (2006 - \$nil).

**14. Unit-based compensation**

**Unit option plan**

During the quarter ended March 31, 2006, 959,296 unit options with an exercise price of \$4.56 were granted to 41 employees and 6,000 unit options with an exercise price of \$5.25 were granted to one employee. During the quarter ended June 30, 2006, 21,000 unit options with an exercise price of \$5.00 were granted to one employee and 15,000 unit options with an exercise price of \$4.56 were forfeited. During the quarter ended December 31, 2006, 21,000 unit options with an exercise price of \$6.20 were granted to one employee, 6,000 unit options with an exercise price of \$6.55 were granted to one employee and 42,000 unit options with an exercise price of \$4.56 were forfeited. These options vest one-third annually over three years except for 238,148 which will vest after 36 months. During the quarter ended March 31, 2007, 390,156 units with an exercise price of \$7.34 were granted to 47 employees. These options will vest one-third annually over three years. All options will expire 39 months after the date of grant, if not exercised.

The option plan under which these options were granted, which authorizes 2,815,000 units, was approved by the Unitholders at the Annual and Special Meeting of the Fund held on May 11, 2006. Compensation expense of \$81 was recognized for the quarter ended March 31, 2007, (2006 - \$31) which was added to contributed surplus. Total compensation expense to be recognized under these awards is estimated to be \$1,510.

The fair value of the Trust Unit options issued in 2006 was determined using the Black-Scholes model, incorporating a 3.90% risk free interest rate, a 34% volatility factor, 3.33% expected distributions and expected life of 39 months. On this basis, each Trust Unit option was valued at \$1.02.

The fair value of the Trust Unit options issued in 2007 was determined using the Black-Scholes model, incorporating a 4.05% risk free interest rate, a 31% volatility factor, 4.2% expected distributions and expected life of 39 months. On this basis, each Trust Unit option was valued at \$1.40.



**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***14. Unit-based compensation (continued)**

A summary of option activities since January 1, 2005 is as follows:

	Number of options	Range of exercise prices \$	Weighted average exercise prices \$
December 31, 2005	74,683	2.977	2.977
Options granted during quarter ended			
March 31, 2006	965,296	4.560-5.250	4.564
June 30, 2006	21,000	5.000	5.000
December 31, 2006	27,000	6.200-6.550	6.278
Options forfeited during quarter ended			
June 30, 2006	(15,000)	4.560	4.560
December 31, 2006	(42,000)	4.560	4.560
Exercise of options during quarter ended			
March 31, 2006	(2,575)	2.977	2.977
September 30, 2006	(11,037)	2.977	2.977
December 31, 2006	(61,071)	2.977	2.977
December 31, 2006	956,296	4.560-6.550	4.622
Options granted during quarter ended			
March 31, 2007	390,156	7.340	7.340
Exercise of options during quarter ended			
March 31, 2007	(9,746)	4.560	4.560
<b>March 31, 2007</b>	<b>1,336,706</b>	<b>4.560-7.340</b>	<b>5.416</b>

The outstanding options are summarized as follows:

Exercise price	Options outstanding		Vested options outstanding	
	Number	Weighted average remaining life	Number	Weighted average remaining life
4.560	892,550	26 months	221,383	26 months
5.250	6,000	26 months	2,000	26 months
5.000	21,000	29 months	-	-
6.200	21,000	35 months	-	-
6.550	6,000	35 months	-	-
7.340	390,156	38 months	-	-
	<b>1,336,706</b>	<b>29.73 months</b>	<b>223,383</b>	<b>26 months</b>

**Menu Foods Income Fund**  
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**14. Unit-based compensation (continued)**

**Contributed surplus attributed to Trust Unit options**

	<b>As at March 31,</b>	<b>As at December 31,</b>
	<b>2007</b>	<b>2006</b>
	\$	\$
Opening balance	272	272
Compensation expense recognized for unit options	81	272
Options exercised	(10)	(272)
<b>Ending balance</b>	<b>343</b>	<b>272</b>

As the Trust Unit options are exercised, the associated contributed surplus is reclassified to Trust Units (note 12).

**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 exceeded \$33,500 and \$34,000 for the 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 vested over a three-year period, subject to the provisions of the Incentive Plan. If the employment of a Participant was terminated prior to the final vesting of the Units attributed to such Participant, such Participant's unvested Units were sold and the net proceeds returned to the Fund. In February 2005, 36,390 Trust Units were purchased for \$518 for the benefit of 22 individuals of which 6,330 units had vested by December 31, 2005. The Compensation and Corporate Governance Committee determined that during the quarter ended March 31, 2006, all outstanding units vested to the participants and the Incentive Plan was replaced by the unit option plan discussed above. Consequently compensation expense of \$300 was recognized.

**15. Accumulated other comprehensive income (loss)**

	<b>As at March 31,</b>	<b>As at December 31,</b>
	<b>2007</b>	<b>2006</b>
	\$	\$
Unrealized gains and losses on translating financial statements of self-sustaining foreign operations	(16,888)	(15,930)
Gains on hedges of unrealized foreign currency translation	9,183	8,576
	<b>(7,705)</b>	<b>(7,354)</b>

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***16. Financial expenses**

	Quarter ended March 31,	
	2007	2006
	\$	\$
Interest and accretion on senior secured notes	2,735	1,986
Interest on bank indebtedness	328	401
Interest on capital leases	1	2
Net loss (gain) on interest rate swap	216	(116)
Amortization of deferred financing costs and associated costs	-	570
Other, net	2	(4)
	<b>3,282</b>	<b>2,839</b>

**17. Income taxes**

On October 31, 2006, the Department of Finance (Canada) announced tax proposals pertaining to the taxation of income distributed by publicly listed trusts and the tax treatment of trust distributions to their unitholders. If enacted, the proposals would apply to the Fund effective January 1, 2011 and would result in a portion of the Fund's income being subject to tax at the trust level.

Currently, income tax obligations relating to distributions from the Fund are obligations of the Unitholders and, accordingly, no provision for income taxes is 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.

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:

	Quarter ended March 31,	
	2007	2006
	\$	\$
Income (loss) before income taxes and non-controlling interest	(41,004)	2,037
Income taxes at statutory rate	(15,173)	702
Increase (decrease) resulting from:		
Effect of foreign tax rate	(1,907)	(392)
Deductions not previously recognized	-	(759)
Valuation allowance	2,204	769
Other and permanent differences	461	(402)
	<b>(14,415)</b>	<b>(82)</b>

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***17. Income taxes (continued)**

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

	As at March 31, 2007 \$	As at December 31, 2006 \$
Current future income tax assets:		
Accounts receivable, accounts payable and accrued liabilities	346	335
Inventory provisions	601	1,322
	<b>947</b>	<b>1,657</b>
Long-term future income tax liabilities:		
Property, plant and equipment	15,012	15,272
Withholding tax on foreign retained earnings	-	652
Tax benefits of loss carry-forwards	(20,152)	(4,229)
Valuation allowance	4,952	4,229
Other	1,135	161
	<b>947</b>	<b>16,085</b>

The benefits of these future tax loss carry-forwards expire between 2008 and 2027.

**18. Other expenses and income**

Research and development expenses amounted to \$64 for the quarter ended March 31, 2007 (2006 - \$65). These expenses are included in cost of sales.

**19. Obligations under operating leases**

Future minimum payments under operating leases at March 31, 2007 are as follows:

	\$
2007	657
2008	791
2009	569
2010	245
2011	4
Thereafter	-
	<b>2,266</b>

**20. 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 \$416 for the quarter ended March 31, 2007 (2006 - \$414).

**Menu Foods Income Fund****Notes to Consolidated Financial Statements****March 31, 2007***(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)***21. Segmented information**

The Fund's operations fall into one reportable business segment. The Fund is principally engaged in the manufacture of 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.

	Quarter ended March 31,	
	2007	2006
	\$	\$
Sales		
Canada		
Domestic	10,603	12,336
Foreign	18,546	27,386
Intersegment transfers	3,541	3,393
	<hr/> 32,690	<hr/> 43,115
United States		
Domestic	37,565	56,907
Foreign	341	261
Intersegment transfers	23,236	32,578
	<hr/> 61,142	<hr/> 89,746
	93,832	132,861
Elimination of intersegment transfers	(26,777)	(35,971)
Discounts	(2,549)	(3,036)
	<hr/> <b>64,506</b>	<hr/> <b>93,854</b>

	As at March 31,	
	2007	2006
	\$	\$
Property, plant and equipment		
Canada	35,874	35,203
United States	123,932	125,005
	<hr/> 159,806	<hr/> 160,208
Less: Accumulated amortization	65,459	62,474
	<hr/> <b>94,347</b>	<hr/> <b>97,734</b>

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.

## **Menu Foods Income Fund**

### **Notes to Consolidated Financial Statements**

**March 31, 2007**

*(All figures, except per Unit amounts, expressed in thousands of Canadian dollars, unaudited)*

## **22. 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 March 31, 2007 and December 31, 2006 the Fund did not have any outstanding foreign currency forward contracts.

The Fund has fixed interest rates on a portion of its indebtedness (note 10). The marked-to-market value of the contract at March 31, 2007 resulted in an unrealized loss of \$216 (2006 - gain of \$116), which is included in accounts payable and in interest expense for the quarter ended March 31, 2007.

### **Fair value of financial instruments**

The carrying values of cash, trade and other receivables, bank indebtedness, accounts payable and accrued liabilities and income taxes payable approximate their fair values because of the short-term nature of these instruments. The carrying value of long-term debt bearing interest at variable rates (note 10) approximates its fair value because effective rates represent the rates that would be used to calculate fair value.

## **23. Economic dependence**

The Fund has approximately 16.2% and 10.4% of its sales to its two largest customers. Other than these customers, the Fund does not have a significant exposure to any individual customer. The Fund relies on single suppliers for the majority of its can and pouch requirements. Should these suppliers fail to deliver in a timely manner, delays and/or shutdowns of the Fund's operations could result.