

TIM HORTONS INC. AND SUBSIDIARIES
Notes to the Consolidated Financial Statements
(in thousands of Canadian dollars, except share and per share data)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of business

Tim Hortons Inc. is a corporation governed by the Canada Business Corporations Act. For periods on or before September 27, 2009, Tim Hortons Inc. was a Delaware corporation (together with its subsidiaries, collectively referred to herein as “THI USA”).

References herein to “Tim Hortons”, or the “Company” refer to THI USA and its subsidiaries for periods on or before September 27, 2009 and to Tim Hortons Inc., a corporation governed by the Canada Business Corporations Act and its subsidiaries for periods on or after September 28, 2009, unless specifically noted otherwise.

At 12:00 a.m. on September 28, 2009, THI USA effected a merger that resulted in the conversion of existing common stock of THI USA, US\$0.001 par value per share, into an equal number of common shares, without par value, in the Company. The Company conducts the business previously conducted by THI USA in substantially the same manner (see Note 17). The Merger was accounted for as a reorganization of entities under common control; therefore, there was no revaluation of THI USA’s consolidated assets and liabilities, and the Company will continue to use the historical cost basis method of accounting.

The Company’s principal business is the development and franchising, and, to a minimal extent, the operation of quick service restaurants that serve coffee and other hot and cold beverages, baked goods, sandwiches, soups, and other food products including ice cream in some of its locations. In addition, the Company has vertically integrated manufacturing, warehouse and distribution operations which supply a significant portion of the system restaurants with paper and equipment, as well as food products, including shelf-stable products, and, from one distribution centre, refrigerated and frozen food products. The Company also controls the real estate underlying a substantial majority of the system restaurants, which generates another source of revenue. As of January 3, 2010, the Company and its franchisees operated 3,015 restaurants in Canada (99.6% franchised) and 563 restaurants in the United States (“U.S.”) (99.1% franchised) under the name “Tim Hortons®.” In addition, the Company had 291 primarily self-serve licensed locations in the Republic of Ireland and the United Kingdom as of January 3, 2010.

Fiscal year

The Company’s fiscal year ends on the Sunday nearest to December 31. The Company’s 2009 fiscal year consisted of 53 weeks, and the 2008 and 2007 fiscal years of the Company both consisted of 52 weeks.

FASB Accounting Standards Codification

In June 2009, the Financial Accounting Standards Board (“FASB”) issued Statement of Accounting Standards (“SFAS”) No. 168—*The FASB Accounting Standards Codification™ and Hierarchy of Generally Accepted Accounting Principles – a replacement of FASB Statement No. 162* (“SFAS No. 168”), now known as FASB Accounting Standards Codification (“ASC”) 105—*Generally Accepted Accounting Principles* (“ASC 105”). The FASB Accounting Standards Codification™ (“Codification”) has become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. This Statement was effective for financial statements issued for interim and annual periods ending after September 15, 2009. Rules and interpretive releases of the Securities and Exchange Commission (“SEC”) under authority of federal securities laws are also sources of authoritative accounting principles generally accepted in the United States of America (“U.S. GAAP”) for SEC registrants. The Codification now supersedes all previous existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Codification has become nonauthoritative. As a result, these changes will have an impact on how companies reference U.S. GAAP in their financial statements. The Company has adopted this new accounting standard and references to the Codification topics have been provided alongside references to the pre-Codification standards.

Evaluation of subsequent events

Effective June 15, 2009, the Company adopted ASC 855—*Subsequent Events* (formerly SFAS No. 165—*Subsequent Events* (“SFAS No. 165”)) which resulted in additional disclosure in these financial statements. The objective of ASC 855 (formerly SFAS No. 165) was to establish general standards of accounting for and disclosure of events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. In particular, this Statement provides that: (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date.

In accordance with ASC 855 (formerly SFAS No. 165), the Company has evaluated events subsequent to January 3, 2010 (see Note 25).

Basis of presentation and principles of consolidation

The Company prepares its financial statements in accordance with U.S. GAAP. In the opinion of management, the accompanying Consolidated Financial Statements contain all adjustments (all of which are normal and recurring in nature) necessary to state fairly the Company’s financial position as of January 3, 2010 and December 28, 2008, and the consolidated results of operations, comprehensive income and cash flows for the years ended January 3, 2010, December 28, 2008 and December 30, 2007.

The functional currency of Tim Hortons Inc. is the Canadian dollar as the majority of the Company’s cash flows are in Canadian dollars. The functional currency of each of the Company’s subsidiaries and legal entities is the local currency in which each subsidiary operates, which is the Canadian dollar, the U.S. dollar or the Euro. The majority of the Company’s operations, restaurants and cash flows are based in Canada, and the Company is primarily managed in Canadian dollars. As a result, the Company’s reporting currency is the Canadian dollar.

The Consolidated Financial Statements include the results and balances of Tim Hortons Inc., its wholly-owned subsidiaries and certain independent operators consolidated according to ASC 810—*Consolidation* (formerly Interpretation No. (“FIN”) 46R—*Consolidation of Variable Interest Entities—an interpretation of ARB 51 (revised December 2003)* (“FIN 46R”)). Investments in non-consolidated affiliates over which the Company exercises significant influence but for which the Company is not the primary beneficiary and does not have control are accounted for using the equity method.

The Company’s share of the earnings or loss of these non-consolidated affiliates is included in equity income, which is included as part of operating income since these investments are operating ventures closely integrated in the Company’s business operations (see Note 11). Intercompany accounts and transactions among consolidated entities have been eliminated upon consolidation.

Use of estimates

The preparation of Consolidated Financial Statements in conformity with U.S. GAAP requires management to make assumptions and estimates. These assumptions and estimates affect the reported amounts of assets and

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

liabilities and the disclosure of contingent assets and liabilities as of the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the reporting periods. Estimates and judgments are inherent in, but not limited to the following: the estimation of the collectibility of royalty and other franchise related revenue; legal obligations; income taxes; various other commitments and contingencies; valuations used when assessing potential impairment of assets and other intangibles; inventory valuations; gift certificate and cash card breakage; property and equipment, including the estimation of the useful lives of property and equipment and other long-lived assets; and, valuations associated with estimating stock-based compensation expenses. While management applies its judgment based on assumptions believed to be reasonable under the circumstances and at the time, actual results could vary from these assumptions or had different assumptions been used. The Company evaluates and updates its assumptions and estimates based on new events occurring, additional information being obtained or more experience being acquired.

In the normal course of business, the Company must make continuing estimates of potential future legal obligations and liabilities, which also requires the use of management's judgment on the outcome of various issues. Management may also use outside legal advice to assist in the estimating process. However, the ultimate outcome of various legal issues could be different than management estimates, and adjustments to income could be required (see Note 16).

Cash and cash equivalents

The Company considers short-term investments, which are highly liquid and have original maturities of three months or less, as cash equivalents. The carrying values of cash and cash equivalents approximate their fair value due to the short-term nature of these investments. The Company has approximately \$19.5 million (2008 – \$24.2 million) in cash and \$83.8 million (2008 – \$77.4 million) in cash equivalents as at January 3, 2010.

Restricted cash and cash equivalents and restricted investments

Amounts presented as restricted cash and cash equivalents and restricted investments on the Company's Consolidated Balance Sheet relate to the Company's Tim Card[®] cash card program. The combined balances as of January 3, 2010 and December 28, 2008 represent the net amount of cash loaded on the cards by customers, less redemptions. The balances are restricted, and cannot be used for any purpose other than application to settle obligations under the cash card program. Since the inception of the program, the interest on the restricted cash and cash equivalents and restricted investments has been contributed by the Company to the Company's advertising and promotion funds to help offset costs associated with this program. Obligations under the cash card program are included in Accrued liabilities, Other on the Consolidated Balance Sheet and are disclosed in Note 12. The Company had approximately \$44.4 million (2008 – \$40.2 million) in restricted cash, \$16.2 million (2008 – \$22.1 million) in restricted cash equivalents, and \$20.2 million in restricted investments at January 3, 2010.

From time to time, the Company invests some of these funds, for periods in excess of three months, but less than one year. Only restricted cash and cash equivalents balances in excess of expected net redemptions over the investment time horizon are used for such investments, and the Company does not intend to redeem these investments prior to maturity. As a result, these investments are deemed to be held-to-maturity and are recorded at amortized cost on the Consolidated Balance Sheet. The carrying amount of the restricted investments approximates fair value due to the short-term nature of the investments. All restricted investments mature between February and August 2010.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

Increases or decreases in restricted cash and cash equivalents are reflected in Net cash provided from operating activities on the Consolidated Statement of Cash Flows since the funds will be used to fulfill current obligations to customers recorded in Accrued liabilities, Other on the Consolidated Balance Sheet. Changes in the customer obligations are included in Net cash provided from operating activities as the offset to changes in restricted cash and cash equivalents balances. Purchases of and proceeds upon the maturity of restricted investments are included in Net cash used in investment activities on the Consolidated Statement of Cash Flows. Funding for these investments are drawn from restricted cash and cash equivalents balances.

Inventories

Inventories are stated at the lower of cost (moving average) and market and consist primarily of restaurant food items, new equipment and parts, and paper supplies.

During 2009, the Company implemented a new integrated computer system and, in connection with this implementation, the Company changed its inventory valuation method from first-in-first-out to moving average. The Company determined that the moving average inventory valuation method is a preferable method because it improves the overall accuracy and efficiency of the Company's accounting for inventory. The impact of this change was not significant to all periods presented on both the Consolidated Statement of Operations and Consolidated Balance Sheet and, therefore, prior periods were not retroactively restated.

Property and equipment

The Company carries its property and equipment at cost and depreciates and amortizes these assets using the straight-line method over the following estimated useful lives:

	Depreciation Periods⁽¹⁾
Building and leasehold improvements	10 to 40 years or lease term ⁽²⁾
Restaurant and other equipment	7 to 10 years
Capital leases	8 to 40 years or lease term ⁽²⁾
Computer hardware and software	3 to 10 years
Advertising fund property and equipment	3 to 10 years
Other	4 to 10 years
Construction in progress	Reclassified to above categories when put in use

⁽¹⁾ The Company estimates useful lives on buildings and equipment based on historical data and industry trends. The Company monitors its capitalization and amortization policies to ensure they remain appropriate. Lives may be related to legal or contractual lives or must be estimated by the Company based on specific circumstances.

⁽²⁾ Lease term as defined in ASC 840—*Leases* ("ASC 840") (formerly SFAS No. 13—*Accounting for Leases* ("SFAS No. 13"), as amended).

Interest and other costs associated with the construction of new restaurants are capitalized. Major improvements are capitalized, while maintenance and repairs are expensed when incurred. Gains and losses on the disposition of property and equipment are classified in Other (income), net.

Advertising fund property and equipment includes certain assets purchased or leased by the advertising fund. Due to their long-term nature, these assets have been included in property and equipment on the Consolidated Balance Sheet rather than advertising fund restricted assets, which are classified as current assets. See Note 13 for a description of secured debt amounts associated with the purchase of certain of these assets and Note 8 for a general description of the Company's advertising funds.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Impairment of Long-lived Assets

Long-lived assets are grouped at the lowest level of independent cash flows and tested for impairment whenever an event or circumstance occurs that indicate impairment may exist (“triggering event”), which may include a current expectation that, more likely than not, a long-lived asset or asset group will be sold or otherwise disposed of prior to its estimated useful life.

Restaurant-related long-lived assets are grouped into operating markets as this is the lowest identifiable level of independent cash flows. Events such as prolonged negative same-store sales growth in the market, which is a key operating metric, or prolonged negative cash flows in the operating market, are indicators the Company uses in evaluating whether an impairment may exist. The Company also tests for impairment if it has a higher-than-normal amount of restaurant closures in any one market. The Company also considers the length of time the Company has been in the market as it takes time to fully establish a market. Generally, if same-store sales decline over time on a consecutive basis, further evaluation may be required, including review of operating market cash flows. In developed markets, one of the key indicators for the overall health of an operating market is same-store sales growth. In developing markets, the Company assesses a number of factors, including systemwide sales growth, which encompasses new restaurants and same-store sales growth, the stage of growth of the operating market and the average unit sales volume trends, as well as a higher-than-normal amount of restaurant closures in a market. Given the market conditions present for the majority of the period under review, the Company also makes assessments as to whether declines are an indication of expected long-term performance for the developing market.

Non-restaurant-related assets are grouped based on their ability to generate independent cash flows. In the case of the Company’s manufacturing facilities, they are grouped on a facility-by-facility basis. Corporate assets, which relate primarily to land, buildings, and computer hardware and software systems, are grouped on a consolidated level with all long-lived assets as they support the entire business and independent cash flows are not generated from these specific assets.

If it is determined that a triggering event has occurred, an undiscounted cash flow analysis is completed on the affected market to determine if the future expected cash flows of a market are sufficient to recover the carrying value of the assets. If it is determined that the undiscounted cash flows are insufficient, then the market is deemed to be impaired. The fair value of the property and equipment is estimated using primarily third-party appraisals or the discounted cash flows, as appropriate. The estimated fair value is allocated to individual assets within the group.

Leases

For operating leases, minimum lease payments, including minimum scheduled rent increases, are recognized as rent expense on a straight-line basis over the lease term as that term is defined in ASC 840 (formerly SFAS No. 13, as amended). This term includes certain option periods considered in the lease term and any periods during which the Company has use of the property but is not charged rent by a landlord (“rent holiday”). Contingent rentals are generally based on either a percentage of restaurant sales or as a percentage of restaurant sales in excess of stipulated amounts, and thus are not included in minimum lease payments but are included in rent expense when incurred. Rent incurred during the construction period is expensed. Leasehold improvement incentives paid to the Company by a landlord are recorded as a liability and amortized as a reduction of rent expense over the lease term. No individual lease is material to the Company.

When determining the lease term for purposes of recording depreciation and rent or for evaluating whether a lease is capital or operating, the Company includes option periods for which failure to renew the lease imposes

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

an economic penalty on the Company of such an amount that a renewal appears, at the inception of the lease, to be reasonably assured. For example, such an economic penalty would exist if the Company were to choose not to exercise an option on leased land upon which the Company had constructed a restaurant and, as a result, the Company would lose the ability to use the restaurant.

In the case of property that is leased or subleased by the Company to franchisees, minimum lease receipts, including minimum scheduled rent increases, are recorded as rent revenue on a straight-line basis consistent with the treatment of rental payments. Contingent rent revenue is generally based on a percentage of franchised restaurant sales and is recorded when these sales levels are met or exceeded.

Intangibles assets

Intangibles are recorded at fair value at the time they are acquired. Intangibles are amortized on a straight-line basis over periods of up to 12 years. Lives are generally related to legal or contractual lives, but in some cases must be estimated by management based on specific circumstances. The Company tests intangible assets for impairment whenever events or circumstances indicate that an impairment may exist.

Gift certificates and cash cards

The Company has a Tim Card[®] quick pay cash card program. Generally, customers can prepay for future purchases at participating Tim Hortons restaurants or over the Internet by reloading a dollar value onto their Tim Card through cash or credit card, when and as needed. A Tim Card entitles the holder to use the value for purchasing product only and the amounts generally are nonrefundable and not redeemable for cash. Tim Card holders are not entitled to any interest, dividends or returns on prepaid amounts. There are no expiration dates on the cash cards, and the Company does not charge any service fees that cause a decrease to customer balances.

Cash collected from the loading of the Tim Card are recorded as Restricted cash and cash equivalents and Restricted investments on the Consolidated Balance Sheet since these funds have been designated for use only by the cash card program to honour outstanding obligations. Changes in the Restricted cash and cash equivalents balances have been classified as an operating activity on the Consolidated Statement of Cash Flows, while changes in Restricted investments are classified as an investing activity. The Restricted cash and cash equivalents and Restricted investments balances at January 3, 2010 and December 28, 2008 represent the prepaid amounts not yet redeemed by customers. The outstanding customer obligations for both Tim Cards and gift certificates are recorded in Accrued liabilities, Other (see Note 12) on the Consolidated Balance Sheet. Since the inception of the program, interest on the Restricted cash and cash equivalents and Restricted investments has been contributed by the Company to the Company's advertising and promotion funds to help offset costs associated with this program.

While the Company will honour all cash cards presented for payment, the Company may, based on historical review after the program has been in place for some time, determine the likelihood of redemption to be remote for certain card balances due to, among other factors, long periods of inactivity. In these circumstances, to the extent management determines there is no requirement for remitting card balances to government agencies under unclaimed property laws, the obligation for any such card balances may be transferred to the Company's advertising and promotion funds. No such amounts were recognized in 2009, 2008 or 2007.

In addition to the Tim Card program, the Company has gift certificates available in certain locations for a limited time. The Company will continue to honour outstanding gift certificates. When a customer uses a gift certificate or a Tim Card to purchase product at a Company-operated restaurant, the Company recognizes the

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

revenue from the sale of the product. When a customer uses a gift certificate or Tim Card at a franchised restaurant, the Company recognizes revenues, in the form of rents and royalties, arising from the sale of the product. The Company recognizes income on unredeemed gift certificates (“gift certificate breakage”) when it can determine that the likelihood of the gift certificate being redeemed is remote and that there is no legal obligation to remit the unredeemed gift certificate value to relevant jurisdictions. The Company determines gift certificate breakage based on historical redemption patterns. Once the breakage rate is determined, it is recognized over a seven-year time period which is the estimated life of a gift certificate. Insignificant amounts have been recognized as a reduction in cost of sales in fiscal 2009, 2008 and 2007.

Revenue recognition

The timing of revenue recognition for Sales (distribution and Company-operated restaurants), and franchise revenues (rents and royalties and franchise fees) does not involve significant estimates and assumptions.

Sales

The Company operates warehouses in Canada to distribute coffee and other dry goods and refrigerated and frozen products to its extensive franchise system. Revenues from distribution sales are recorded when the product is delivered to the franchisee or, in certain cases, when the product is delivered to a third-party distributor. Revenues from Company-operated restaurants are recognized upon tender of payment at the time of sale.

Franchise revenues

The Company’s Tim Hortons restaurants are predominantly franchised. The Company grants franchise license or operator agreements to independent operators who in turn pay franchise fees and other payments, which may include payments for equipment, royalties and, in most cases, rents for each restaurant opened. Franchise fees are collected at the time of sale, resale or renovation of the franchised restaurant. Franchise fees and equipment sales are generally recognized as income when each restaurant commences operations and payment is received from the franchisee, unless the franchisee is participating in the Company’s franchise incentive program (“FIP”) (see below). Rental revenue, excluding contingent rent, is recognized on a straight-line basis. Contingent rent is recognized in the month earned. Royalties, based on a percentage of monthly sales, are recognized as income in the month earned on the accrual basis, and are normally collected within the month or shortly thereafter.

The Company has developed a FIP for some of the Company’s U.S. franchisees, which provides financing for both the initial franchise fee and the purchase of certain restaurant equipment, furniture, trade fixtures, and interior signs. The payment for those assets is deferred for a period of 104 weeks from the date of opening. The initial franchise fee is recognized at the time of sale and the equipment revenue is recognized after a sustained period of sales levels are achieved, or at the end of the 104 week term, whichever is earlier. In 2008, the FIP was modified by shortening the payment period from 130 weeks to 104 weeks. The franchisee has the option to pay for the initial franchise fee, including interest thereon, on a weekly basis over a period of up to 104 weeks from the opening of the restaurant. The initial franchise fee revenues are recognized at the time of sale, with consideration for potential uncollectibility.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The Company has established reserves, based on net realizable value, related to the collection of franchise royalties and other franchise-related receivables and commitments when it is not probable that amounts will be collected (see Notes 4 and 5).

The Company generally controls, either through ownership or by leasing, a significant majority of the real estate on which the Company's restaurants are located and leases the real estate to its franchisees. Rental income is recorded on the accrual basis. Most leases provide for fixed payments with contingent (or percentage) rent after sales exceed certain levels, while others provide for monthly rentals based solely on a percentage of sales. Fixed, or base, rental revenue is recorded on a straight-line basis and contingent rental revenue is recognized when sales exceed certain levels. Rental income included in rents and royalties from franchisees is presented in Note 15.

The Company generally controls the real estate site selection for restaurants. Franchise owners receive assistance in such areas as purchasing and marketing from Company personnel. These franchise expenses are included in franchise fee costs. Franchise fee revenues are comprised of revenues primarily from the sale of equipment related to establishing a franchisee's business and the initial franchise fee. Franchisees may receive other financial assistance, or "relief," relating to lower rents and royalties and reductions or assistance with certain other operating costs for restaurants in new and developing markets, and the amount of this relief is recorded as an offset to the Company's rents and royalties revenues.

The following progression outlines the Company's franchised locations and system activity for each of the years 2007 through 2009:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Franchise Restaurant Progression			
Franchise restaurants in operation – beginning of year	3,403	3,149	2,952
Franchises opened	172	265	192
Franchises closed	(34)	(36)	(17)
Net transfers within the franchised system (primarily resales)	<u>19</u>	<u>25</u>	<u>22</u>
Franchise restaurants in operation – end of year	3,560	3,403	3,149
Company-operated restaurants	<u>18</u>	<u>34</u>	<u>72</u>
Total systemwide restaurants – end of year ⁽¹⁾	<u>3,578</u>	<u>3,437</u>	<u>3,221</u>

⁽¹⁾ Includes various types of standard and non-standard restaurant formats with differing restaurant sizes and menu offerings as well as self-serve kiosks, which serve primarily coffee products and a limited selection of donuts. Collectively, the Company refers to all of these units as "systemwide restaurants."

Excluded from the above franchise restaurant progression table are 291 licensed locations in the Republic of Ireland and the United Kingdom as at January 3, 2010 (2008: 293 and 2007: 143).

Cost of sales related to Company-operated restaurant sales, excluding cost of sales from restaurants consolidated under in ASC 810—*Consolidation* ("ASC 810") (formerly FASB Interpretation No. ("FIN") 46R—*Consolidation of Variable Interest Entities—an interpretation of ARB 51 (revised December 2003)* ("FIN 46R")), were \$27.5 million, \$44.9 million, and \$64.5 million for the years ended 2009, 2008 and 2007, respectively.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Variable interest entities

The Company enters into lease arrangements with certain operators who are not required to invest a significant amount of capital. In addition, U.S. franchisees participating in the FIP (“FIP Franchisee”) do not have a significant amount of initial capital outstanding that is not financed directly by the Company. Because the legal entity within which such an operator or FIP Franchisee operates is considered not to be adequately capitalized, that entity is considered a variable interest entity (“VIE”) as defined in the Master Glossary of the FASB Codification and according to the provisions in ASC 810 (formerly FIN 46R). Based on management’s review of the financial statements it receives from these operators and FIP Franchisees, the projections performed by the Company indicate that the Company, in some instances, is the primary beneficiary of expected returns or losses as that term is defined by ASC 810 (formerly FIN 46R), of these VIEs. Accordingly, the Company has consolidated 129, 120 and 111 restaurants during fiscal 2009, 2008 and 2007, respectively, or approximately 3.6%, 3.5% and 3.4% of the Company’s total systemwide restaurants, during these periods, respectively.

Effective December 29, 2008, the Company adopted provisions within ASC 810—*Consolidation* related to noncontrolling interests (formerly SFAS No. 160—*Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51* (“SFAS No. 160”). This Statement amended Accounting Research Bulletin No. 51—*Consolidated Financial Statements* (“ARB 51”) and established accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. It clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. In addition to the amendments to ARB 51, this Statement amends ASC 260—*Earnings Per Share* (“ASC 260”) (formerly FASB Statement No. 128—*Earnings per Share* (“SFAS No. 128”)), with the result that earnings-per-share data will continue to be calculated the same way as it was calculated before this Statement was issued.

The adoption of provisions within ASC 810 (formerly SFAS No. 160) has resulted in a number of changes to the presentation of the Company’s Consolidated Financial Statements and associated note disclosure, which have been retrospectively applied for previously reported periods in accordance with the standard. The Consolidated Statement of Operations has been modified to present Net income attributable to noncontrolling interests as a separate line item, whereas this was previously included in Other (income), net. The Consolidated Balance Sheet and Consolidated Statement of Equity have been modified to present the equity associated with noncontrolling interests as a separate line item within Total equity, whereas previously this was included in Other long-term liabilities. The Consolidated Statement of Comprehensive Income has also been modified to present amounts attributable to noncontrolling interests separately. In addition, the Company has also modified its segment reporting disclosure (see Note 20) in accordance with ASC 280—*Segment Reporting* (“ASC 280”) (formerly SFAS No. 131—*Disclosures about Segments of an Enterprise and Related Information*) to present noncontrolling interest information as a reconciling item to the applicable Consolidated Financial Statement line item. Noncontrolling interests for the Company relate specifically to certain non-owned restaurants that the Company is required to consolidate under ASC 810 (formerly FIN 46R).

VIEs for which the Company is determined to be the primary beneficiary have an inconsequential impact on consolidated net income and cash flows reported by the Company. The impact of consolidating these VIEs to the Company’s Consolidated Balance Sheet is also not significant. There are a small percentage of restaurants considered to be VIEs for which the Company holds a significant variable interest, but for which the Company is not the primary beneficiary. The Company’s maximum exposure to loss as a result of its involvement with this small percentage of franchise restaurants is also inconsequential.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The Company has no equity interest in any of its franchisees. None of the Company's assets serve as collateral for the consolidated restaurants, and creditors of these operators have no recourse to the Company. The only significant exposure to the Company in connection with these VIEs relates to the collection of amounts due to the Company, which are collected weekly. The agreements governing the license arrangements can be cancelled by either the franchisee or the Company with 30 days notice, further reducing potential exposure to the Company.

In connection with restricted stock unit awards granted to Company employees, the Company established a Trust that purchases and retains common shares of the Company to satisfy the Company's contractual obligation to deliver shares to settle the awards for most Canadian employees. For accounting purposes, the cost of the shares held by the Trust has been accounted for as a reduction in outstanding common shares, and the Trust has been consolidated in accordance with ASC 810 (formerly FIN 46R) as a VIE since the Company is the primary beneficiary.

Effective December 29, 2008, the Company also adopted provisions within ASC 860—*Transfers and Servicing* ("ASC 860") and ASC 810 (formerly FSP No. FAS 140-4 and FIN 46(R)-8—*Disclosures by Public Entities (Enterprises) about Transfer of Financial Assets and Interests in Variable Interest Entities*). This FSP amends FASB Statement No. 140—*Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities* to require additional disclosures about transfers of financial assets. It also amends ASC 810 (formerly FIN 46R) to require public enterprises, including sponsors that have a variable interest in a variable interest entity, to provide additional disclosures about their involvement with VIEs. The adoption of this standard has resulted in additional disclosure in these financial statements.

Advertising costs

Advertising costs are expensed as incurred with the exception of media development costs, which are expensed in the month that the advertisement is first communicated (see Note 8).

Foreign currency translation and accumulated other comprehensive (loss)

The functional currency of the Company's U.S. operating subsidiaries is the U.S. dollar and for its Irish subsidiary, it is the Euro. For such entities, the assets and liabilities are translated at the year-end Canadian dollar exchange rates, and the revenues and expenses are translated at average Canadian dollar exchange rates for the period. Resulting translation adjustments relating from rate differences between the average rate and year-end rate are recorded as a component of Equity and in Other comprehensive income (loss).

Assets and liabilities denominated in a currency other than the functional currency of the legal entity are translated at the period-end exchange rate, and any currency adjustment is recorded in Other (income) expense, net in the Consolidated Statement of Operations.

Components of accumulated other comprehensive loss as at January 3, 2010 and December 28, 2008 included:

	2009	2008
	(in thousands)	
Translation adjustments (losses), net of tax	\$(115,696)	\$(53,804)
Cash flow hedges, net of tax	(4,930)	(1,132)
	\$(120,626)	\$(54,936)

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Total translation adjustments, net of tax included in accumulated other comprehensive expense at January 3, 2010 and December 28, 2008 were translation losses of \$61.9 million and translation gains of \$82.9 million, respectively. Included in Other (income) expense, net, were foreign exchange gains of \$0.3 million and \$0.7 million in 2009 and 2008, respectively, and foreign exchange losses of \$0.4 million in 2007.

Derivative instruments

ASC 815—*Derivatives and Hedging* (“ASC 815”) (formerly SFAS No. 133—*Accounting for Derivative Instruments and Hedging Activities* (“SFAS No. 133”), as amended), requires companies to recognize all derivatives as either assets or liabilities at fair value on the Consolidated Balance Sheet. ASC 815 (formerly SFAS No. 133, as amended) also permits companies to designate all derivatives that qualify as hedging instruments as fair value hedges, cash flow hedges, or hedges of net investments in foreign operations.

This designation is based on the exposure being hedged. The Company has a policy forbidding speculative trading in derivatives. The Company may enter into derivatives that are not designated as hedging instruments for accounting purposes, but which largely offset the economic impact of certain foreign currency transactions.

The Company limits its counterparty risk associated with its derivative instruments by utilizing a number of different financial institutions. The Company continually monitors its positions, and the credit ratings of its counterparties, and adjusts positions if appropriate. The Company did not have any significant exposure to any individual counterparty at January 3, 2010 or December 28, 2008.

Cash flow hedges: The Company’s exposure to foreign exchange risk is mainly related to fluctuations between the Canadian dollar and the U.S. dollar. The Company is also exposed to changes in interest rates. The Company seeks to manage its cash flow and income exposures arising from these fluctuations and may use derivative products to reduce the risk of a significant impact on its cash flows or income. The Company does not hedge foreign currency and interest rate exposure in a manner that would entirely eliminate the effect of changes in foreign currency exchange rates, or interest rates on net income and cash flows. The fair value of derivatives used by the Company are based on quoted market prices for comparable products and have therefore been classified as observable Level 2 inputs as defined by ASC 820 (formerly SFAS No. 157) (see Note 14).

The Company enters into cash flow hedges to reduce the exposure to variability in certain expected future cash flows. The types of cash flow hedges the Company may enter into include, but are not limited to: (i) interest rate swaps that effectively convert a portion of floating rate debt to fixed rate debt and are designed to reduce the impact of interest rate changes on future interest expense; and (ii) forward foreign exchange contracts that are entered into to fix the price of U.S. dollar denominated future purchases.

For cash flow hedges, the effective portion of the gains or losses on derivatives is reported in the cash flow hedges component of accumulated other comprehensive (loss) income in Total equity of Tim Hortons Inc. and reclassified into earnings in the same period or periods in which the hedged transaction affects earnings. The ineffective portion of gains or losses on derivatives is reported in the Consolidated Statement of Operations. The Company discontinues hedge accounting: (i) when it determines that the cash flow derivative is no longer effective in offsetting changes in the cash flows of a hedged item; (ii) when the derivative expires or is sold, terminated or exercised; (iii) when it is probable that the forecasted transaction will not occur; or (iv) when management determines that designation of the derivative as a hedge instrument is no longer appropriate.

Fair value hedges: The Company may, from time to time, enter into fair value hedges to reduce the exposure to changes in the fair values of certain assets or liabilities. For fair value hedges, the gains or losses on

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

derivatives, as well as the offsetting gains or losses attributable to the risk being hedged, are recognized in current earnings in the Consolidated Statement of Operations in Other (income) expense, net. The fair value of derivatives used by the Company are based on quoted market prices for comparable products and have, therefore, been classified as observable Level 2 inputs as defined by ASC 820 (formerly SFAS No. 157) (see below).

Other derivatives: The Company entered into total return swaps (“TRS”) during both 2008 and 2009 that are intended to reduce the variability of cash flows and, to a lesser extent, earnings associated with stock-based compensation awards that will settle in cash, namely, the tandem stock appreciation rights (“SARs”) that are associated with stock options (see Note 18). Neither TRS qualified as an accounting hedge under ASC 815 (formerly SFAS No. 133, as amended), and, as such, they are being adjusted to fair value in accordance with ASC 815 (formerly SFAS No. 133, as amended) at the end of each reporting period, and the impact of the revaluation is reported in the Consolidated Statement of Operations. The fair value of this derivative was determined using Level 2 inputs, as defined by ASC 820 (formerly SFAS No. 157) (Note 14). Changes in the fair value of this derivative are included in general and administrative expenses as an offset to fair value adjustments of the liability related to tandem SARs.

Effective December 29, 2008, the Company adopted provisions within ASC 815 (formerly SFAS No. 161—*Disclosures about Derivative Instruments and Hedging Activities* (“SFAS No. 161”)). This standard enhances disclosure requirements for derivative instruments in order to provide users of financial statements with an enhanced understanding of (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under ASC 815 (formerly SFAS No. 133, as amended) and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. The adoption of this standard has resulted in additional disclosure in these financial statements (see Note 14).

Accounting for fair value measurements

Effective December 29, 2008, the Company adopted ASC 820-10-65—*Fair Value Measurements and Disclosures—Overall— Transition and Open Effective Date Information* (“ASC 820-10-65”) (formerly FASB Staff Position No. FAS 157-2—*Effective Date of FASB Statement No. 157* (“SFAS No. 157-2”)), which amended SFAS No. 157—*Fair Value Measurements* (“SFAS No. 157”) by delaying its effective date by one year for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of this standard has resulted in additional disclosure in these financial statements (see Note 14).

Income taxes

As prescribed in ASC 740—*Income Taxes* (“ASC 740”) (formerly SFAS No. 109—*Accounting for Income Taxes*), the Company uses the asset and liability method whereby income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities for accounting purposes as compared to tax purposes. A deferred income tax asset or liability is determined for each temporary difference based on the currently enacted tax rates that are expected to be in effect when the underlying items of income and expense are expected to be realized, except for a portion of earnings related to foreign operations where repatriation is not contemplated in the foreseeable future. Income taxes reported in the Consolidated Statements of Operations include the current and deferred portions of the expense. Income taxes applicable to items charged or credited to equity are netted with such items. Changes in deferred income taxes related to a change in tax rates are recognized in the period when the tax rate change is enacted. In addition, the Consolidated

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Statements of Operations contain items that are non-taxable or non-deductible for income tax purposes and, accordingly, cause the income tax provision to be different from what it would be if based on statutory rates.

When considered necessary, the Company records a valuation allowance to reduce deferred tax assets to the balance that is more likely than not to be realized. The Company must make estimates and judgments on future taxable income, considering feasible tax planning strategies and taking into account existing facts and circumstances, to determine the proper valuation allowance. When the Company determines that deferred tax assets could be realized in greater or lesser amounts than recorded, the asset balance and income statement reflect the change in the period such determination is made. Due to changes in facts and circumstances and the estimates and judgments that are involved in determining the proper valuation allowance, differences between actual future events and prior estimates and judgments could result in adjustments to this valuation allowance.

The Company adopted the provisions ASC 740 (formerly FASB Interpretation No. 48—*Accounting for Uncertainty in Income Taxes* (“FIN 48”)) on January 1, 2007. FIN 48 requires an assessment in accordance with specified parameters of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under ASC 740 (formerly FIN 48), the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the tax authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon settlement. ASC 740 (formerly FIN 48) also provides guidance on derecognition, classification, interest and penalties, and also requires increased disclosure.

Stock-based compensation

The Company’s 2006 Stock Incentive Plan (the “2006 Plan”) is an omnibus plan, designed to allow for a broad range of equity-based compensation awards in the form of restricted stock units, stock options, SARs, dividend equivalent rights (“DERs”), performance awards and share awards. The Company currently provides compensation to certain employees under the 2006 plan in the form of restricted stock units and stock options with tandem SARs. In addition, the Company has issued deferred stock units to its directors under the Company’s Non-Employee Director Deferred Stock Unit Plan. The Company previously issued restricted stock units to directors, but these were fully vested and settled in November 2008. The Company accounts for stock-based compensation in accordance with the fair value recognition provisions of ASC 718—*Compensation—Stock Compensation* (“ASC 718”) (formerly SFAS No. 123R—*Share-based Payments*).

Restricted stock units—Restricted stock units are measured at the fair market value based on the closing price of the Company’s common shares traded on the Toronto Stock Exchange on the first business day preceding the grant date. Restricted stock units are generally expensed on a straight-line basis over the vesting period. The expense is recorded in general and administrative expenses, consistent with the classification of the related employee compensation expense. Grants related to retirement-eligible employees are expensed immediately. Restricted stock units have DERs. In addition, the Company may grant performance-conditioned restricted stock units to certain of its employees. The performance component is based on prior year performance and is only used to determine the amount of units granted. All other characteristics of the performance-based restricted stock units are the same as restricted stock units.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Deferred stock units—Deferred stock units are granted to non-employee members of the Company's Board of Directors and are expensed on the date of grant since they vest immediately, although they are not payable until a director's separation from service. Deferred stock units are notional units which track the value of the Company's common shares. These units are settled in cash based on the value of the Company's common shares on the Toronto Stock Exchange on the date of the director's separation of service from the Company. Since the awards are settled in cash, the award is accounted for using the liability method, which results in a revaluation of the liability to fair value each period and expensed. Deferred stock units have dividend equivalent rights, which are expensed as earned.

Stock options—The Company uses the Black-Scholes-Merton option pricing model which requires the use of subjective assumptions. These assumptions include the estimated length of time employees will retain their stock options before exercising them ("the expected term"), the expected volatility of the Company's common share price over the expected term, and the number of options that will ultimately not complete their vesting requirements ("forfeitures"). The awards are accounted for using the liability method, which results in a revaluation of the liability to fair value each period, and are expensed over the vesting period. Stock options with tandem SARs (see below) granted to retirement-eligible employees are expensed immediately. Changes in subjective assumptions, as well as changes in the share price from period to period, can materially affect the estimate of fair value of stock-based compensation and, consequently, the related amount of compensation expense recognized on the Consolidated Statement of Operations. The Company issued stock option awards with tandem SARs for the first time to its named executive officers in fiscal 2008 and to all officers of the Company in fiscal 2009 (see Note 18).

Stock appreciation rights—SARs may be granted alone or in conjunction with a stock option. A SAR related to an option generally terminates upon the expiration, forfeiture, or exercise of the related option, and is exercisable only to the extent that the related option is exercisable. Stock options with tandem SARs enable the employee to exercise the stock option to receive common shares or to exercise the SAR and receive a cash payment equal to the difference between the market price of the share on the exercise date and the exercise price of the stock option.

NOTE 2 EARNINGS PER COMMON SHARE ATTRIBUTABLE TO TIM HORTONS INC.

Basic earnings per common share attributable to Tim Hortons Inc. are computed by dividing net income attributable to Tim Hortons Inc.'s common shareholders by the weighted average number of common shares outstanding. Diluted computations are based on the treasury stock method and include assumed issuances of outstanding restricted stock units and stock options with tandem SARs, as prescribed in ASC 260 (formerly SFAS No. 128), as the sum of: (i) the amount, if any, the employee must pay upon exercise; (ii) the amount of compensation cost attributed to future services and not yet recognized; and (iii) the amount of tax benefits (both current and deferred), if any, that would be credited to contributed surplus assuming exercise of the options, net of shares assumed to be repurchased from the assumed proceeds, when dilutive. Stock options were anti-dilutive for 2009 and 2008, respectively, and, therefore, were excluded from the calculation of diluted earnings per common share attributable to Tim Hortons Inc.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The computations of basic and diluted earnings per common share attributable to Tim Hortons Inc. are shown below:

	Year ended		
	January 3, 2010	December 28, 2008	December 30, 2007
	(in thousands, except per share data)		
Net income attributable to Tim Hortons Inc. for computation of basic and diluted earnings per common share attributable to Tim Hortons Inc. . .	\$296,367	\$284,678	\$269,551
Weighted average shares outstanding for computation of basic earnings per common share attributable to Tim Hortons Inc. (in thousands)	180,477	183,298	188,465
Dilutive impact of restricted stock units (in thousands)	132	194	294
Weighted average shares outstanding for computation of diluted earnings per common share attributable to Tim Hortons Inc. (in thousands)	180,609	183,492	188,759
Basic earnings per common share attributable to Tim Hortons Inc.	\$ 1.64	\$ 1.55	\$ 1.43
Diluted earnings per common share attributable to Tim Hortons Inc.	\$ 1.64	\$ 1.55	\$ 1.43

NOTE 3 ASSET IMPAIRMENT AND RELATED CLOSURE COSTS

During the fourth quarter of 2008, the Company initiated a strategic review of its approach to the U.S. market. Upon completion of this review, it was determined that 11 underperforming restaurants in two southern New England markets would be closed. An impairment review was also performed for the remaining assets operating in the two affected southern New England markets. At the conclusion of this review, the Company determined that the future expected cash flows in these markets were insufficient to recover the carrying value of these assets, resulting in an impairment charge being recorded. The following table outlines the charges associated with the impairment and restaurant closures:

2008	Impairment	Restaurant closure costs (in thousands)	Total
Impairment of assets	\$13,703	\$2,856	\$16,559
Lease commitments	—	4,501	4,501
Other	—	206	206
Total asset impairment and related closure costs	\$13,703	\$7,563	\$21,266

Impairment: The fair value of these asset groups was determined in order to calculate the amount of impairment for the asset group. The most significant asset in these asset groups is property and buildings for which the fair value of the underlying real estate was primarily based on third-party appraisals of the assets. The shortfall of fair value compared to carrying value for each asset group was then allocated to the assets within the respective asset group.

Restaurant closure costs: The fair value of the assets associated with the closed restaurants was based on estimated salvage value for leaseholds and equipment and, in the case of owned properties, the fair value of

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

underlying real estate was based on third-party appraisals performed by the above-mentioned valuers. The liability relating to ongoing lease commitments takes into account sublease assumptions and is undiscounted. Other costs associated with restaurant closures relate primarily to severance costs.

The impairment loss and related restaurant closure costs are included in Asset impairment and related closure costs on the Consolidated Statement of Operations and Consolidated Statement of Cash Flow. They have also been reflected in the U.S. operating segment (see Note 20).

NOTE 4 ACCOUNTS RECEIVABLE

Accounts receivable are net of an allowance for doubtful accounts of \$1.7 million at January 3, 2010 (December 28, 2008: \$2.8 million). The carrying amount of the accounts receivable outstanding approximates fair value due to the short-term nature of these balances.

NOTE 5 NOTES RECEIVABLE

The Company has developed a franchise incentive program (“FIP”) for some of the Company’s U.S. franchisees, which provides financing for both the initial franchise fee and the purchase of certain restaurant equipment, furniture, trades fixtures, and interior signs. The payment for those assets is deferred for a period of 104 weeks from the date of opening, and the franchisee has the option to pay for the initial franchise fee on a weekly basis over a period of up to 104 weeks from the opening of the restaurant as well.

Notes receivable arise primarily from the financing of such arrangements under the FIP and from past-due franchisee obligations. Most of these notes are generally non-interest bearing and are payable in full at the end of 104 weeks. In certain circumstances, notes have been extended beyond the 104 week period to accommodate the franchisee being able to obtain third-party financing or other arrangements are made with the franchisee. The need for a reserve for uncollectible amounts is reviewed on a specific franchisee basis using information available to the Company, including past-due balances and the financial strength of the franchisee. Uncollectible amounts for notes receivable, both principal and interest, are provided for when those amounts are identified as uncollectible and were \$0.5 million and \$0.8 million at January 3, 2010 and December 28, 2008, respectively. The estimated fair value of the Company’s notes receivable was approximately \$48 million and \$39 million as at January 3, 2010 and December 28, 2008, respectively.

	2009	2008
	(in thousands)	
Notes receivable, discounted, short-term	\$38,609	\$22,615
Notes receivable, discounted, long-term	9,782	17,645
	\$48,391	\$40,260

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

NOTE 6 INCOME TAXES

The Company reorganized to become a Canadian public company on September 28, 2009. For periods prior to September 28, 2009, the parent company was a U.S. public company (see Notes 1 and 17). The provision for income taxes for the fiscal year 2009 consisted of the following:

	January 3, 2010
Current	
Canadian	\$142,267
Foreign (primarily U.S.)	13,535
	155,802
Deferred	
Canadian	3,771
Foreign (primarily U.S.)	18,690
	22,461
	\$178,263

The provision for income taxes in the fiscal years 2008 and 2007 consisted of the following:

	December 28, 2008	December 30, 2007
Current		
U.S. federal	\$ 616	\$ 1,259
U.S. state and local	281	426
Foreign (primarily Canada)	149,920	141,164
	150,817	142,849
Deferred		
U.S. federal	(7,986)	(5,829)
U.S. state and local	(392)	(236)
Foreign (primarily Canada)	(2,627)	2,657
	(11,005)	(3,408)
	\$139,812	\$139,441

The foreign income tax expense for the year ended January 3, 2010 was primarily U.S., as compared to the years ended December 28, 2008 and December 30, 2007, when the foreign income tax expense was primarily Canadian. The provision for foreign taxes includes withholding taxes. Income before income taxes for fiscal year 2009 was primarily Canadian in the amount of \$435.2 million. Income before income taxes for the fiscal years ended 2008 and 2007, which was also primarily Canadian, was \$422.5 million and \$382.9 million, respectively.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The tax-effected temporary differences which gave rise to deferred tax assets and liabilities at each year end consisted of the following:

	<u>2009</u>	<u>2008</u>
	(in thousands)	
Deferred tax assets		
U.S. foreign tax credit carry-forwards	\$ 21,925	\$ 47,567
Lease transactions	40,133	51,433
Property and equipment basis differences	9,321	4,523
Intangible assets basis differences	8,715	8,555
Benefit plans	3,026	3,600
Reserves not currently deductible	1,829	3,470
Deferred income	19,320	24,972
Loss carry-forwards	6,997	6,028
All other	1,453	5,043
	<u>112,719</u>	<u>155,191</u>
Valuation allowance	<u>(58,639)</u>	<u>(62,191)</u>
	<u>\$ 54,080</u>	<u>\$ 93,000</u>
Deferred tax liabilities		
Lease transactions	\$ 24,378	\$ 33,885
Property and equipment basis differences	20,487	18,407
Intangible assets basis differences	1,300	701
Unremitted earnings – foreign operations	283	980
All other	304	3,586
	<u>\$ 46,752</u>	<u>\$ 57,559</u>
Net deferred tax assets	<u>\$ 7,328</u>	<u>\$ 35,441</u>
Reported in Consolidated Balance Sheet as:		
Deferred income taxes – current asset	\$ 3,388	\$ 19,760
Deferred income taxes – long-term asset	8,919	29,285
Deferred income taxes – current liability	(376)	—
Deferred income taxes – long-term liability	<u>(4,603)</u>	<u>(13,604)</u>
	<u>\$ 7,328</u>	<u>\$ 35,441</u>

Net deferred tax assets decreased in 2009 by \$28.1 million primarily as a result of a reduction in U.S. deferred tax assets relating to the reorganization and the impact of foreign exchange. Of the \$28.1 million change, \$18.7 million impacted the effective tax rate.

A valuation allowance in the amount of \$58.6 million (2008 – \$62.2 million) has been established primarily as a result of the Company's determination that it is more likely than not that the Company will not entirely benefit from deferred tax assets in the U.S.

The Company's Canadian non-capital loss carry-forward of \$6.3 million will expire in 2029 for federal and provincial purposes. The Company's U.S. foreign tax credits of \$ 21.9 million will expire in 2013 through 2018, and U.S. state loss carry-forwards of \$78.6 million will expire in 2010 through 2029.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

A reconciliation of the 2009 statutory Canadian and provincial income tax rate of 33% and the U.S. federal income tax rate of 35% to the Company's effective tax rate for the fiscal years 2007 and 2008 is shown below:

	Year ended		
	January 3, 2010	December 28, 2008	December 30, 2007
	(in thousands)		
Income taxes at statutory rate	\$157,127	\$149,347	\$143,973
Taxation difference on foreign earnings ⁽¹⁾	(10,468)	(19,180)	(9,730)
Provincial, state and local tax rate differentials ⁽²⁾	(4,483)	170	486
Change in reserves for uncertain tax positions	6,388	6,258	4,035
Deferred tax assets and other amounts not benefited for tax purposes	24,718	6,042	—
Other	4,981	(2,825)	677
Income taxes at effective rate	<u>\$178,263</u>	<u>\$139,812</u>	<u>\$139,441</u>
Effective tax rate	37.4%	32.8%	33.9%

⁽¹⁾ Canadian earnings were considered foreign prior to September 28, 2009, the date of the reorganization.

⁽²⁾ Provincial rate differentials are only applicable commencing for the year end January 3, 2010. State and local differentials are only applicable prior to September 28, 2009.

The effective income tax rate in fiscal 2009 was 37.4% compared to 32.8% in 2008 and 33.9% in fiscal 2007. In 2009, the effective tax rate was higher than 2008 primarily as a result of the tax impact of the completion of the public company merger on September 28, 2009, and the subsequent reorganization of the Company and its subsidiaries. The items resulting from the reorganization that contributed to the increase in the 2009 effective tax rate include: a non-cash charge relating to the reduction of \$18.7 million of deferred tax assets associated with U.S. operations, U.S. withholding tax expense of \$7.8 million, and other tax charges of \$4.8 million.

The cumulative amounts of unrecognized tax benefits for ASC 740-10 (formerly FIN 48) purposes (excluding related interest) as of January 3, 2010 and December 28, 2008 were \$21.0 million and \$20.5 million, respectively (long-term portion of \$17.5 million, and \$12.7 million, respectively).

A reconciliation of the beginning and ending amounts of unrecognized tax benefits (excluding related interest), is as follows:

	Year ended	
	January 3, 2010	December 28, 2008
	(in thousands)	
Balance at beginning of year	\$20,544	\$13,819
Additions based on tax positions related to the current year	4,973	4,058
Additions for tax positions of prior years	3,717	3,915
Reduction for tax positions of prior years	(5,845)	(1,248)
Settlements	(2,357)	—
Reduction as a result of a lapse of applicable statute of limitations	—	—
Balance at end of year	<u>\$21,032</u>	<u>\$20,544</u>

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Included in the balance of unrecognized tax benefits at January 3, 2010 are \$1.0 million of uncertain tax positions for which ultimate deductibility or recoverability is highly certain but for which there is uncertainty about the timing of such deductibility or recoverability (\$5.2 million as of December 28, 2008). The deferral of the deductibility or recoverability of amounts to a future period would not affect the annual effective rate but would accelerate the payment of tax and related interest and penalties to an earlier period. The taxes paid or withheld would subsequently be recovered when the amounts become ultimately deductible or recoverable.

Of the \$21.0 million unrecognized tax benefits at January 3, 2010, approximately \$20.0 million would impact the effective tax rate over time, if recognized (2008 – \$15.3 million).

The Company accrues interest and potential penalties related to unrecognized tax benefits in income tax expense. As of January 3, 2010 and December 28, 2008, the Company had accrued approximately \$6.3 million and \$4.9 million, respectively, for the potential payment of interest and penalties. During fiscal 2009, the Company accrued an additional \$1.4 million in tax expense related to interest and penalties (2008 – \$0.8 million).

The determination of income tax expense takes into consideration amounts that may be needed to cover exposure for open tax years. A number of years may elapse before an uncertain tax position, for which the Company has unrecognized tax benefits, is audited and resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company currently believes that its unrecognized tax benefits reflect the outcomes determined in accordance with ASC 740-10 (formerly FIN 48). Unrecognized tax benefits are adjusted, as well as the related interest and penalties, in light of subsequent changes in facts and circumstances. Settlement of any particular uncertain tax position may require the use of cash. In addition, the resolution of a matter may result in an adjustment to the provision for income taxes, that may impact the effective tax rate in the period of resolution. The number of tax years that remain open and subject to tax audits varies depending on the tax jurisdiction. The Canada Revenue Agency is currently conducting an examination of various Canadian subsidiaries of the Company for 2004 and subsequent taxation years. The 2003 audit was completed for Canada in 2009 and resulted in no material change in taxes. The Internal Revenue Service completed in a previous year its examination of the Wendy's consolidated tax group which included Tim Hortons Inc. up to September 29, 2006. In addition, income tax returns filed with various provincial and state jurisdictions are generally open to examination for periods of three to five years subsequent to the filing of the respective return. The Company does not currently expect any material impact on earnings to result from the resolution of matters related to open taxation years, consistent with its ASC 740-10 (formerly FIN 48) analysis; however, it is possible that actual settlements may differ from amounts accrued.

It is reasonably possible that the total amount of unrecognized tax benefits will increase over the next twelve months by up to \$4.7 million, plus interest and penalties, as a result of tax authority audit and appeal settlements primarily relating to the deductibility of interest and other business expenses, and transfer pricing adjustments. In addition, it is also reasonably possible that unrecognized tax benefits will decrease by up to \$7.1 million over the next twelve months primarily related to the audit of scientific research and experimental development investment tax credits and transfer pricing related matters. There could be fluctuations in the amount of unrecognized tax benefits over the next twelve months as a result of the timing of the settlement of these tax audits and appeals and, currently, the Company cannot definitively determine the timing or the amount of individual settlements. The Company has, as part of its ASC 740-10 (formerly FIN 48) analysis, made its estimates based on current facts and circumstances and cannot predict with sufficient certainty subsequent or changed facts and circumstances that may affect its estimates.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

In accordance with ASC 740-30 (formerly APB 23), withholding taxes are not provided on undistributed earnings of subsidiaries which are considered to be indefinitely reinvested in the operations of such subsidiaries. The amount of these earnings was approximately \$225 million at January 3, 2010. The additional taxes payable on earnings considered indefinitely reinvested would approximate \$25 million if repatriated in 2010 or thereafter, consisting primarily of additional withholding taxes. The Company has provided for deferred taxes at January 3, 2010, where applicable, on \$13.3 million of unremitted earnings, which are not considered to be indefinitely reinvested.

NOTE 7 INVENTORIES AND OTHER, NET

Inventories (which are comprised primarily of finished goods), and other, net include the following for the 2009 and 2008 fiscal years:

	2009	2008
	(in thousands)	
Inventories	\$56,948	\$43,252
Inventory obsolescence provision	(1,138)	(873)
Inventories, net	55,810	42,379
Prepays and other	12,479	29,126
Total inventories and other, net	\$68,289	\$71,505

NOTE 8 RESTRICTED ASSETS AND LIABILITIES—ADVERTISING FUNDS

The Company participates in two advertising funds established to collect and administer funds contributed for use in advertising and promotional programs designed to increase sales and enhance the reputation of the Company and its franchise owners. Separate advertising funds are administered for Canada and the U.S. In accordance with ASC 952—*Franchisors* (formerly SFAS No. 45—*Accounting for Franchisee Fee Revenue*), the revenue, expenses and cash flows of the advertising funds are generally not included in the Company's Consolidated Statement of Operations and Cash Flows because the contributions to these advertising funds are designated for specific purposes, and the Company acts, in substance, as an agent with regard to these contributions. The assets and liabilities of these advertising funds are reflected in the Company's Consolidated Balance Sheet as follows:

	2009	2008
	(in thousands)	
Restricted assets—current	\$26,681	\$27,684
Property and equipment, net	18,159	26,789
Other assets—long-term	1,256	—
Total assets	\$46,096	\$54,473
Restricted liabilities—current	43,944	47,544
Restricted debt—long-term	415	6,929
Deferred income taxes—long-term	1,737	—
Total liabilities	\$46,096	\$54,473

Contributions to the advertising funds are required to be made from Company-operated and franchise restaurants and restaurants under operator agreements. These contributions are based on a percentage of

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

restaurant retail sales and are used for local, regional and national advertising as well as brand protection and development programs. The Company may collect up to 4.0% of restaurant sales from franchisees and Company-operated restaurants for contribution to the advertising funds. The following table summarizes actual contribution rates to the advertising funds for franchise and Company-operated restaurants:

	Advertising Fund Contribution Rate as of Year-end		
	2009	2008	2007
Canada	3.5% ⁽¹⁾	3.5%	3.5%
U.S.	4.0%	4.0%	4.0%

⁽¹⁾ The Company introduced a temporary reduction of 0.25% to the contribution rate for Canadian franchisees during July 2009 through December 2009. During this period, the Company continued to collect the full 3.5% contribution. A rebate for this temporary reduction will be issued in early 2010 to eligible franchisees.

Company contributions made from its Company-operated restaurants to its various advertising funds totaled \$0.9 million, \$1.4 million and \$2.0 million in 2009, 2008 and 2007, respectively. Total advertising expense of the Company, including these amounts and contributions made at the discretion of the Company, and expenditures for local advertising costs and other marketing and advertising expenses amounted to \$4.2 million, \$5.4 million and \$4.9 million for 2009, 2008 and 2007, respectively.

The total amount spent by the advertising funds in 2009, 2008 and 2007 amounted to \$190.2 million, \$176.1 million and \$173.7 million, respectively.

NOTE 9 PROPERTY AND EQUIPMENT, NET

Property and equipment, at cost, net of impairment charges, at 2009 and 2008 fiscal year ends consisted of the following:

	2009	2008
	(in thousands)	
Land	\$ 240,148	\$ 244,919
Buildings and leasehold improvements	1,213,298	1,172,703
Restaurant and other equipment	126,020	126,879
Capital leases	136,477	117,657
Computer hardware and software	104,667	80,564
Advertising fund property and equipment	57,687	55,975
Other	100,844	77,804
Construction-in-progress	17,860	36,198
	1,997,001	1,912,699
Less: Accumulated depreciation and amortization	(656,244)	(579,847)
	\$1,340,757	\$1,332,852

The Company capitalized \$0.4 million of interest and other costs in property and equipment, primarily associated with the construction of new restaurants (2008 – \$0.6 million).

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The Company's capitalized software costs, including certain costs associated with internally developed software, are \$63.9 million and \$51.3 million as at January 3, 2010 and December 28, 2008, respectively, and are included in either Computer hardware and software or Construction-in-progress above. The net book value of these assets is \$35.4 million and \$29.2 million as at January 3, 2010 and December 28, 2008, respectively.

Capital leases are comprised primarily of buildings. The Company added \$13.8 million of additional capital leased assets in 2009 (2008: \$13.7 million).

In 2008, the Company recorded pre-tax property and equipment impairment charges of \$16.6 million related to two New England markets in the U.S. operating segment (see Note 3).

NOTE 10 INTANGIBLE ASSETS, NET

The table below presents the intangible assets as of January 3, 2010 and December 28, 2008:

	2009	2008
	(in thousands)	
Persona	\$ 6,455	\$ 6,455
Exclusivity rights	4,000	—
	10,455	6,455
Accumulated amortization	(4,421)	(3,849)
Net carrying amount	\$ 6,034	\$ 2,606

Persona represents the use of the name and likeness of Ronald V. Joyce, a former owner of the Company. The name and likeness are being amortized over a period of twelve years ending in 2013.

In the fourth quarter of 2009, the Company entered into two separate collaborative arrangements with Kahala Corp., parent company of Cold Stone Creamery, Inc. The nature and purpose of the arrangements is to expand both parties' co-branding and other development initiatives. The Company has the exclusive development rights in Canada, and certain rights to use licenses within the U.S., to operate ice cream and frozen confections retail outlets in combination with Tim Hortons retail outlets.

The Company has paid a Master License Fee to Kahala Franchise Corp. in the amount of \$4 million to acquire the Company's exclusive Cold Stone Creamery® development rights in Canada. This exclusivity right is being amortized over a period of 10 years ending in 2019, corresponding with the initial term of the agreement.

Payments and receipts regarding collaborative agreements are presented in the Company's Consolidated Statement of Operations based on the nature and contractual terms of the arrangement, the nature of the payments, and applicable accounting guidance. For the fiscal year ended January 3, 2010, these payments (which include advertising, royalty and various product fees) were not significant.

Amounts attributable to transactions arising between the Company and its franchisees in connection with these arrangements are included in Revenues and, on a consolidated basis, were not significant for the year ended January 3, 2010.

Total intangibles amortization expense was \$0.6 million in 2009 and \$0.5 million in 2008 and 2007, respectively. The estimated annual intangibles amortization expense for 2010 through 2013 is approximately \$0.9 million, and approximately \$0.4 million through 2019.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

NOTE 11 EQUITY INVESTMENTS

Effective December 29, 2008, the Company adopted provisions within ASC 323—*Investments—Equity Method and Joint Ventures* (“ASC 323”) (formerly Emerging Issues Task Force 08-6—*Equity Method Accounting Considerations* (“EITF 08-6”)), which was issued to clarify the accounting for certain transactions and impairment considerations involving equity-method investments. The adoption of ASC 323 (formerly EITF 08-6) did not impact the Company’s Consolidated Financial Statements or associated note disclosure in 2009.

Combined summarized financial information for the Company’s investments accounted for using the equity method is shown below. These investments are almost exclusively in operating ventures closely integrated into the Company’s operations, such as the joint venture investments described below and in Note 22. These amounts are in aggregate at 100% levels. The net income amounts shown below include income tax expense of \$8.5 million, \$10.8 million, and \$7.6 million for 2009, 2008, and 2007, respectively. The Company’s ownership percentage of these income tax amounts is included as part of equity income shown on the Consolidated Statements of Operations, unless the investment pertains to a partnership or joint venture, in which case ownership percentage of earnings is attributed to the partner or venturer and the associated income tax is included in income taxes on the Consolidated Statement of Operations.

	Year ended		
	January 3, 2010	December 28, 2008	December 30, 2007
	(in thousands)		
Income Statement Information			
Revenues	\$ 227,032	\$ 219,271	\$ 199,520
Expenses attributable to revenues	\$(132,707)	\$(122,593)	\$(105,576)
Net Income	\$ 71,606	\$ 74,031	\$ 76,246
		2009	2008
		(in thousands)	
Balance Sheet Information			
Current assets		\$ 44,693	\$ 53,716
Non-current assets		\$243,598	\$257,564
Current liabilities		\$ 10,063	\$ 11,241
Non-current liabilities		\$ 17,234	\$ 17,281

The Company’s two most significant equity investments are its 50% owned joint venture with Arytza AG (formerly IAWS Group plc) (“Arytza”), which supplies the Company’s restaurants with certain par-baked products, and its 50% owned joint venture with Wendy’s International, Inc., which jointly holds real estate underlying Canadian combination restaurants (see Note 22). In fiscal 2009, the Company received distributions of \$16.5 million, representing the Company’s share, from its partnership with Wendy’s (\$15.0 million in 2008 and \$13.5 million in 2007) and dividends of \$30.0 million, representing the Company’s share, from its joint-venture with Arytza (\$24.0 million in both 2008 and 2007).

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

NOTE 12 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES—OTHER

Included within Accounts payable are the following obligations as at January 3, 2010 and December 28, 2008:

	2009	2008
	(in thousands)	
Accounts payable	\$109,288	\$138,704
Construction holdbacks and accruals	20,275	18,506
	\$129,563	\$157,210

Included within Accrued liabilities, Other are the following obligations as at January 3, 2010 and December 28, 2008:

	2009	2008
	(in thousands)	
Gift certificate obligations to customers	\$ 8,348	\$ 12,960
Cash card obligations to customers	74,292	62,882
Other accrued liabilities	29,533	34,676
	\$112,173	\$110,518

Accrued liabilities, Other include accrued rent expense, deposits, and various equipment and other accruals. The carrying amount of Accounts payable and Accrued liabilities approximates fair value due to the short-term nature of these balances.

NOTE 13 TERM DEBT

The Company has an unsecured five-year senior bank facility with a syndicate of Canadian and U.S. financial institutions that consists of a \$300.0 million Canadian term loan; a \$200.0 million Canadian revolving credit facility (which includes \$15.0 million in overdraft availability and a \$25.0 million letter of credit facility); and a US\$100.0 million U.S. revolving credit facility (which includes a US\$10.0 million letter of credit facility) (collectively referred to as the “Senior Bank Facility”). The Senior Bank Facility matures on February 28, 2011. The term loan bears interest at a variable rate per annum equal to Canadian prime rate or, alternatively, the Company may elect to borrow by way of bankers’ acceptances (or loans equivalent thereto) plus a margin. The Senior Bank Facility contains various covenants which, among other things, require the maintenance of two financial ratios—a consolidated maximum total debt to earnings before interest expenses, taxes, depreciation and amortization (“EBITDA”) ratio and a minimum fixed charge coverage ratio. The Company was in compliance with these covenants as at January 3, 2010.

The Canadian and U.S. revolving credit facilities are both undrawn, except for approximately \$8.6 million (2008: \$7.6 million) to support standby letters of credit. The revolving facilities are available for general corporate purposes. The Company incurs commitment fees based on the revolving credit facilities, whether used or unused. The fees vary according to the Company’s leverage ratio and, as at January 3, 2010 and December 28, 2008, equaled 0.08% and 0.125% of the facility amount, respectively. Advances under the Canadian revolving credit facility bear interest at a variable rate per annum equal to the Canadian prime rate or, alternatively, the Company may elect to borrow by way of bankers’ acceptances or LIBOR, plus a margin. Advances under the U.S. revolving credit facility bear interest at a rate per annum equal to the U.S. prime rate or LIBOR plus a

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

margin. This facility was amended and restated upon the completion of the public company reorganization (Note 1) to, among other administrative changes, include the Company and our primary U.S. operating subsidiary as borrowers.

The Senior Bank Facility contains certain covenants that will limit the ability of the Company to, among other things: incur additional indebtedness; create liens; merge with other entities; sell assets; make restricted payments; make certain investments, loans, advances, guarantees or acquisitions; change the nature of its business; enter into transactions with affiliates; enter into certain restrictive agreements; or pay dividends or make share repurchases if the Company is not in compliance with the financial covenants or if such transactions would cause the Company to not be in compliance with the financial covenants.

In connection with the term loan, the Company entered into a \$30.0 million and a \$100.0 million interest rate swap in June 2007 and March 2006, respectively, with multiple financial institutions to help manage its exposure to interest rate volatility. The interest rate swaps are recorded at fair value and are further described in Note 14.

In connection with the Senior Bank Facility, the Company incurred a total of \$1.5 million in financing costs upon closing, which were deferred and are being amortized over the initial term of the facility.

The Company's total debt at January 3, 2010 and December 28, 2008 was \$336.7 million and \$333.2 million, respectively, which includes \$36.2 million and \$32.4 million at January 3, 2010 and December 28, 2008, respectively, of debt recorded in accordance with ASC 840—*Leases* ("ASC 840") (formerly EITF 97-10—*The Effect of Lessee Involvement in Asset Construction* ("EITF 97-10")). Under ASC 840 (formerly EITF 97-10), the Company is considered to be the owner of certain restaurants leased by the Company from an unrelated lessor because the Company helped to construct some of the structural elements of those restaurants. Accordingly, the Company has included the restaurant construction costs for these restaurants in property and equipment and recorded the lessor's contributions to the construction costs for these certain restaurants as debt. The average imputed interest rate for the debt recorded in accordance with ASC 840 (formerly EITF 97-10) is approximately 15.7% (2008: 15.9%). The Company's weighted average effective interest rate on debt at January 3, 2010 is 4.4% (December 28, 2008 – 5.0%). In addition to debt recorded in accordance with ASC 840 (formerly EITF 97-10) and the Senior Bank Facility, the Company had other debt of \$0.5 million and \$0.8 million as at January 3, 2010 and December 28, 2008, respectively. Based on cash flows and market interest rates, the estimated fair value of the Company's recorded debt was approximately \$380 million and \$367 million at January 3, 2010 and December 28, 2008, respectively.

Future maturities for the Company's recorded debt, at January 3, 2010 are shown below.

	<u>(in thousands)</u>
2010	\$ 705
2011	300,830
2012	1,004
2013	1,242
2014	1,591
Later years	<u>31,328</u>
Total	336,700
Current portion	<u>(705)</u>
	<u><u>\$335,995</u></u>

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Advertising fund restricted long-term debt of \$7.3 million and \$14.6 million at January 3, 2010 and December 28, 2008 respectively, was incurred by the Canadian advertising fund for the purchase of certain property and equipment. The collateralized debt bears interest at 5.2% and is due in installments through 2013 as follows: 2010: \$6.9 million; 2011: \$0.3 million; and 2012: \$0.1 million. The estimated fair value of the advertising fund's restricted long-term debt approximates book value. See also Note 1 for a general description of the related assets and Note 8 for a description of the Company's advertising funds.

NOTE 14 DERIVATIVES AND FAIR VALUE MEASUREMENTS

Derivatives

The Company may enter into derivative instruments with maturities generally not longer than three years to hedge foreign exchange risk, interest rate risk, and the variability in cash flows related to the tandem SARs associated with stock options (Note 18).

Forward currency contracts to sell Canadian dollars and buy US\$75.0 million and US\$41.0 million were outstanding as of January 3, 2010 and December 28, 2008, respectively, to hedge purchases from third parties. The contracts outstanding at January 3, 2010 mature on various dates through January 2010 and December 2010. The fair value unrealized loss on these forward contracts was \$2.0 million as of January 3, 2010 (fair value unrealized gain of \$4.9 million as of December 28, 2008).

In both 2009 and 2008, the Company entered into separate total return swaps ("TRS") to help manage the variability in cash flows and, to a lesser extent, earnings associated with stock-based compensation awards that will settle in cash, namely, the tandem SARs that are associated with stock options (see Note 18). A TRS is a contract that involves the exchange of payments between the Company and a financial institution. The payments under the TRS are: (i) those based on changes in the value of reference assets, which, in this case, are the Company's common shares; (ii) dividends on the Company's common shares subject to the TRS, and; (iii) a variable interest rate specified in the contract. The number of the Company's underlying common shares covered under these contracts is 294,900. Neither TRS qualified as an accounting hedge under ASC 815 (formerly SFAS No. 133, as amended); and, as such, they are adjusted to fair value each reporting period in accordance with ASC 815 (formerly SFAS No. 133, as amended). Gains and losses on the fair value adjustment of the TRS are included in General and administrative expenses. The revaluation resulted in minimal gains for 2009 and 2008. Each TRS has a seven-year term, but the contracts allows for partial settlements over the term, without penalty.

In connection with the term loan facility, the Company entered into interest rate swaps in the amount of \$30.0 million and \$100.0 million with multiple financial institutions in June 2007 and March 2006, respectively, to help manage its exposure to interest rate volatility. By entering into the interest rate swaps, the Company agreed to receive interest at a variable rate and pay interest at a fixed rate. The interest rate swaps essentially fix a portion of the interest rate variability on the term loan, as described below, but the rate remains subject to variation if the applicable margin under the credit facilities increases or decreases. The interest rate swaps essentially fixed the interest rate on the swapped portion of the debt to 5.04% and 5.16% at January 3, 2010 and December 28, 2008, respectively, and mature on February 28, 2011. The weighted average interest rate on this debt, including the swapped portion, was 3.02% for fiscal 2009 (2008: 4.61%). The interest rate swaps are considered to be highly effective cash flow hedges according to criteria specified in ASC 815 (formerly SFAS No. 133, as amended). Tim Hortons Inc. and certain of its subsidiaries provided payment guarantees in connection with this transaction. The fair value unrealized loss on these contracts as of January 3, 2010 and December 28, 2008 was \$3.6 million, net of taxes of \$1.7 million, and \$6.1 million, net of taxes of \$3.0 million, respectively.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

Fair Value Measurements

ASC 820 (formerly SFAS No. 157) defines fair value, establishes a framework for measuring fair value under U.S. GAAP and enhances disclosures about fair value measurements. Fair value is defined under ASC 820 (formerly SFAS No. 157) as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value under ASC 820 (formerly SFAS No. 157) must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs. The first two levels are considered observable and the last unobservable. These are used to measure fair value as follows:

- Level 1—Quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access at the measurement date.
- Level 2—Inputs, other than Level 1 inputs, that are observable for the assets or liabilities, either directly or indirectly. Level 2 inputs include: quoted market prices for similar assets or liabilities; quoted prices in markets that are not active; or, other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

In accordance with ASC 815 (formerly SFAS No. 161) and ASC 820 (formerly SFAS No. 157), the tables below outline the Company's outstanding derivatives and fair value measurements as at and for the year ended January 3, 2010.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

Financial Assets and Liabilities

The following table summarizes the location and fair value of derivative instruments on our Consolidated Balance Sheet:

	As at January 3, 2010				As at December 28, 2008			
	Notional value	Fair value hierarchy	Fair value asset (liability)	Location on Consolidated Balance Sheet	Notional value	Fair value hierarchy	Fair value asset (liability)	Location on Consolidated Balance Sheet
Derivatives designated as cash flow hedging instruments⁽¹⁾								
Forward currency contracts ⁽²⁾	\$ 80,787	Level 2	\$(2,010)	Accounts payable	\$ 41,009	Level 2	\$ 4,933	Accounts receivable
Interest rate swaps ⁽³⁾	130,000	Level 2	(5,290)	Other long-term liabilities	130,000	Level 2	(9,050)	Other long-term liabilities
Total	<u>\$210,787</u>		<u>\$(7,300)</u>		<u>\$171,009</u>		<u>\$(4,117)</u>	
Income tax effect			2,370	Deferred income taxes (current asset)			2,985	Deferred income taxes (current asset)
Net of income taxes			<u>\$(4,930)</u>				<u>\$ 1,132</u>	
Derivatives not designated as hedging instruments⁽¹⁾								
TRS ⁽⁴⁾	\$ 8,958	Level 2	\$ 516	Other long-term assets	\$ 3,526	Level 2	\$ 26	Other long-term assets

- (1) In accordance with ASC 815 (formerly SRAS No. 133, as amended).
- (2) Maturities as at January 3, 2010 extend between January 2010 and December 2010.
- (3) Each matures February 2011.
- (4) Maturities of May 2015 and May 2016, respectively.

The Company values derivatives using valuations that are calibrated to the initial trade prices. Subsequent valuations are based on observable inputs to the valuation model, including exchange rates, interest rates, credit spreads, volatilities, and the Company's share price.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The table below summarizes the effect of derivative instruments on our Consolidated Statement of Comprehensive Income for the fiscal year ended January 3, 2010. The table does not include amounts related to ineffectiveness and excluded amounts from effectiveness testing, as they were immaterial:

	Year ended January 3, 2010			Total effect on OCI ⁽¹⁾
	Amount of gain (loss) recognized in OCI ⁽¹⁾	Amount of net (gain) loss reclassified to earnings	Location on Consolidated Statement of Operations	
Derivatives designated as cash flow hedging instruments under ASC 815 (formerly SFAS No. 133, as amended)				
Forward currency contracts	\$(11,386)	\$ 4,443	Cost of sales	\$(6,943)
Interest rate swaps	(1,177)	4,937	Interest (expense)	3,760
Total	\$(12,563)	\$ 9,380		\$(3,183)
Income tax effect	987	(1,602)	Income taxes	(615)
Net of income taxes	<u>\$(11,576)</u>	<u>\$ 7,778</u>		<u>\$(3,798)</u>

⁽¹⁾ Other comprehensive income.

Derivatives not designated as hedging instruments under ASC 815 (formerly SFAS No. 133, as amended), did not result in a material net income impact in 2009.

Non-financial Assets and Liabilities

The Company values its assets held for sale at the lower of historical cost or fair value less cost to sell. When applicable, fair value is generally based on third-party appraisals. Assets held for sale valued using fair value less cost to sell were immaterial as at January 3, 2010.

NOTE 15 LEASES

The Company occupies land and buildings and uses equipment under terms of numerous lease agreements expiring on various dates through 2049 (except for one lease that expires in 2086). Land and building leases generally have an initial term of 10 to 20 years, while land-only lease terms can extend longer. Many of these leases provide for future rent escalations and renewal options. Certain leases require contingent rent, determined as a percentage of sales. Most leases also obligate the Company to pay the cost of maintenance, insurance and property taxes.

Assets leased under capital leases and included in property and equipment, but excluding leasehold improvements, consisted of the following:

	2009	2008
	(in thousands)	
Buildings	\$129,098	\$110,507
Other	7,411	7,150
Accumulated depreciation	(45,389)	(38,762)
Balance as of end of year	<u>\$ 91,120</u>	<u>\$ 78,895</u>

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

At January 3, 2010, future minimum lease payments for all leases, and the present value of the net minimum lease payments for all capital leases, were as follows:

	<u>Capital Leases</u>	<u>Operating Leases</u>
	<u>(in thousands)</u>	
2010	\$ 13,767	\$ 73,818
2011	12,709	68,126
2012	10,532	57,637
2013	10,727	58,667
2014	10,246	54,649
Later years	68,503	471,355
Total minimum lease payments	<u>\$126,484</u>	<u>\$784,252</u>
Amount representing interest	<u>(52,390)</u>	
Present value of net minimum lease payments	74,094	
Current portion	<u>(6,938)</u>	
	<u>\$ 67,156</u>	

Included in the total minimum lease obligations are minimum payments due to the Company under non-cancelable subleases with lessees in amounts of \$109 million for capital leases and \$540 million for operating leases.

Rent expense consists of rentals for premises and equipment leases. Rent expense for each year is included in operating expenses and amounted to:

	<u>Year ended</u>		
	<u>January 3,</u>	<u>December 28,</u>	<u>December 30,</u>
	<u>2010</u>	<u>2008</u>	<u>2007</u>
	<u>(in thousands)</u>		
Minimum rents	\$ 80,133	\$ 73,823	\$ 68,613
Contingent rents	<u>68,026</u>	<u>65,007</u>	<u>60,580</u>
	<u>\$148,159</u>	<u>\$138,830</u>	<u>\$129,193</u>

In connection with the franchising of certain restaurants, the Company has leased or subleased land, buildings and equipment to the related franchise owners. Most leases provide for fixed payments with contingent rent after sales exceed certain levels, while others provide for monthly rentals based on a percentage of sales. Lease terms are generally ten years with one or more five-year renewal options. The franchise owners bear the cost of maintenance, insurance, and property taxes.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

At each year end, Company assets included in property and equipment leased under operating leases, including leasehold improvements under operating and capital leases, consisted of the following:

	<u>2009</u>	<u>2008</u>
	<u>(in thousands)</u>	
Land	\$ 216,409	\$ 216,363
Buildings and leasehold improvements	1,184,635	1,141,548
Restaurant equipment	<u>89,720</u>	<u>92,999</u>
	1,490,764	1,450,910
Accumulated depreciation	<u>(461,647)</u>	<u>(451,341)</u>
	<u>\$1,029,117</u>	<u>\$ 999,569</u>

At January 3, 2010, future minimum lease receipts were as follows:

	<u>Operating Leases</u>
	<u>(in thousands)</u>
2010	242,158
2011	189,301
2012	164,181
2013	135,358
2014	109,997
Later years	<u>222,490</u>
Total	<u>\$1,063,485</u>

Rental income for each year is included in rents and royalties revenues and amounted to:

	<u>Year ended</u>		
	<u>January 3, 2010</u>	<u>December 28, 2008</u>	<u>December 30, 2007</u>
	<u>(in thousands)</u>		
Minimum rents	\$256,358	\$236,347	\$207,923
Contingent rents	<u>221,554</u>	<u>206,953</u>	<u>202,117</u>
	<u>\$477,912</u>	<u>\$443,300</u>	<u>\$410,040</u>

NOTE 16 COMMITMENTS AND CONTINGENCIES

The Company has guaranteed certain leases and debt payments, primarily related to franchisees, amounting to \$0.5 million and \$0.7 million at January 3, 2010 and December 28, 2008, respectively. In the event of default by a franchise owner, the Company generally retains the right to acquire possession of the related restaurants. At January 3, 2010 and December 28, 2008, the Company is also the guarantor on \$9.3 million and \$8.7 million, respectively, in letters of credit and surety bonds with various parties; however, management does not expect any material loss to result from these instruments because management does not believe performance will be required as the underlying event(s) that would require payment are not expected to occur and have not occurred as of January 3, 2010. The length of the lease, loan and other arrangements guaranteed by the Company or for which the Company is contingently liable varies, but generally does not exceed seven years.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

The Company has entered into purchase arrangements with some of its suppliers for terms which generally do not exceed one fiscal year. The range of prices and volume of purchases under the agreements may vary according to the Company's demand for the products and fluctuations in market rates. These agreements help the Company secure pricing and product availability. The Company does not believe these agreements expose the Company to significant risk.

Third parties may seek to hold the Company responsible for retained liabilities of Wendy's International, Inc. ("Wendy's"). Under the separation agreements entered into with Wendy's at the time of our initial public offering, Wendy's has agreed to indemnify the Company for claims and losses relating to these retained liabilities. However, if those liabilities are significant, and Wendy's is not able to fully pay or will not make payment, and the Company is ultimately held liable for these liabilities, there can be no assurance that the Company will be able to recover the full amount of its losses from Wendy's.

In addition to the guarantees described above, the Company is party to many agreements executed in the ordinary course of business that provide for indemnification of third parties under specified circumstances, such as lessors of real property leased by the Company, distributors, service providers for various types of services (including commercial banking, investment banking, tax, actuarial and other services), software licensors, marketing and advertising firms, securities underwriters and others. Generally, these agreements obligate the Company to indemnify the third parties only if certain events occur or claims are made, as these contingent events or claims are defined in each of the respective agreements. The Company believes that the resolution of any such claims that might arise in the future, either individually or in the aggregate, would not materially affect the earnings or financial condition of the Company.

On June 12, 2008, a claim was filed against the Company and certain of its affiliates in the Ontario Superior Court of Justice ("Court") by two of its franchisees, Fairview Donut Inc. and Brule Foods Ltd., alleging, generally, that the Company's Always Fresh baking system and expansion of lunch offerings have led to lower franchisee profitability. The claim, which seeks class action certification on behalf of Canadian franchisees, asserts damages of approximately \$1.95 billion. The plaintiffs filed a motion for certification of the putative class in May of 2009, and the Company filed its responding materials as well as a motion for summary judgment in November of 2009. Cross examinations on both sides' affidavits are being scheduled prior to the hearing of both motions, which is scheduled for June 2010. The Company believes the claim is frivolous and completely without merit, and intends to oppose the certification motion and defend the claim vigorously. However, there can be no assurance that the outcome of the claim will be favourable to the Company or that it will not have a material adverse impact on the Company's financial position or liquidity in the event that the ultimate determinations by the Court and/or appellate court are not in accordance with the Company's evaluation of this claim. Neither the probability of this claims' success nor the ultimate amount payable, if any, are determinable at this time, and, coupled with the Company's position that this claim is without merit, the Company has not recorded any provisions in the Consolidated Financial Statements related to this claim.

In addition, the Company and its subsidiaries are parties to various legal actions and complaints arising in the ordinary course of business. Reserves related to the resolution of legal proceedings are included in Accounts payable on the Consolidated Balance Sheet. It is the opinion of the Company that the ultimate resolution of such matters will not materially affect the Company's financial condition or earnings.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

NOTE 17 COMMON SHARES

Corporate Reorganization

At a special meeting of stockholders held on September 22, 2009, THI USA's stockholders voted to approve the reorganization of the corporate structure of THI USA and its subsidiaries such that the public company parent would be a Canadian company. Pursuant to that approval, THI Mergeco Inc., a Delaware corporation and the then wholly-owned subsidiary of the entity that would become the Canadian public company, merged with and into THI USA, effective at 12:00 a.m. Eastern Time on September 28, 2009 (the "Merger"). In connection with the Merger, the Company, a corporation incorporated under the Canada Business Corporations Act, became the publicly held parent company of the group of companies previously controlled by THI USA. In connection with the Merger, each outstanding share of THI USA's common stock automatically converted into one common share of the Company. The issuance of common shares (and the associated share purchase rights) was registered under the Securities Act of 1933, as amended, pursuant to the registration statement of the Company on Form S-4 (No. 333-160286), which was declared effective by the U.S. Securities and Exchange Commission on August 12, 2009. The common shares of the Company are traded on both the New York Stock Exchange and the Toronto Stock Exchange under the symbol "THI."

The Company is authorized to issue an unlimited number of common shares, of which 177,318,614 are outstanding as at January 3, 2010. In addition, the Company is authorized to issue one Class A preferred share and an unlimited number of preferred shares, issuable in series. The Company does not have any preferred shares outstanding as at January 3, 2010. The Merger was accounted for as a reorganization of entities under common control; therefore, there was no revaluation of THI USA's consolidated assets and liabilities, and the Company will continue to use the historical cost basis method of accounting. In addition, consistent with Canadian corporate law, treasury shares previously held by THI USA were cancelled and were classified within common shares in the equity section of the Company's Consolidated Balance Sheet. In addition, the Senior Bank Facility and stock-based compensation plans were amended to replace THI USA with the Company, and to make certain other modifications in connection with the reorganization and otherwise. These amendments did not result in any change in accounting.

Share repurchase programs

In November 2008, the Company's Board of Directors approved a 2009 share repurchase program for up to \$200 million, not to exceed the regulatory maximum of 9,077,438 shares, which was equivalent to 5% of the Company's outstanding shares of common stock at the time of regulatory approval on February 25, 2009. The 2009 program commenced on March 2, 2009 and was suspended between April 2009 and October 2009 until the Company completed a review of its capital allocation activities after the reorganization as a Canadian public company. The program resumed in November 2009. Shares were repurchased through a combination of an automatic trading program, and through management's discretion, subject to regulatory requirements, market, cost, and other considerations (see Note 25).

In October 2007, the Company's Board of Directors approved the 2008 stock repurchase program authorizing the Company to purchase up to \$200 million of shares of common stock. The Company completed this program in October 2008.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

Details of the stock/shares repurchased under the Company’s publicly-announced share repurchase programs are as follows:

	Stock	Amount	Average Cost
	(in thousands)		(in dollars)
2008 Program			
Fiscal 2007	954	\$ 35,565	\$37.29
Fiscal 2008	4,999	163,964	32.80
	5,953	199,529	33.52
2009 Program			
Fiscal 2009	4,238	130,102	30.70
Total stock/share repurchases	10,191	\$329,631	\$32.35

In addition, the Company reissued approximately 7,800 treasury shares to Company employees to settle restricted stock units (see Note 18) that vested in May 2009 prior to the reorganization (31,857 in 2008). The Company will also occasionally repurchase its common shares from The TDL Employee Benefit Plan Trust (“Trust”) (see Note 18 and below) to facilitate the settlement of withholding obligations associated with the settlement of restricted stock units. The Company did not repurchase any shares from the Trust in 2009 (37,714 in 2008). The Company also purchased approximately 15,800 common shares in 2009 on the open market to settle restricted stock unit obligations (see Note 18) that vested during the year (approximately 6,800 in 2008).

Shares held in Trust

In connection with the restricted stock unit awards to Company employees (see Note 18), the Company established the Trust to purchase and retain shares to satisfy the Company’s obligation to deliver shares to settle the awards for most Canadian employees. A broker engaged by the trustee of the Trust purchased shares on the open market, set forth below. These shares will be held by the Trust until the restricted stock units become vested, at which time they will be disbursed to certain Canadian employees. Occasionally, the Trust may sell shares to the Company to facilitate the remittance of the associated employee withholding obligations.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The following table outlines the activities of the Trust:

	<u>Stock</u> (in thousands)	<u>Amount</u> (in thousands)	<u>Average Cost</u> (in dollars)
Shares held in Trust			
Fiscal 2007			
Opening balance	266	\$ 9,171	\$34.40
Purchased	207	7,202	34.95
Disbursed or sold	(52)	(1,745)	34.52
Closing balance	<u>421</u>	<u>\$14,628</u>	<u>\$34.68</u>
Fiscal 2008			
Opening balance	421	\$14,628	\$34.68
Purchased	116	3,842	33.14
Disbursed or sold	(179)	(6,183)	34.52
Closing balance	<u>358</u>	<u>\$12,287</u>	<u>\$34.30</u>
Fiscal 2009			
Opening balance	358	\$12,287	\$34.30
Purchased	25	713	28.94
Disbursed or sold	(104)	(3,563)	34.15
Closing balance	<u>279</u>	<u>\$ 9,437</u>	<u>\$33.89</u>

For accounting purposes, the cost of the purchase of common shares held by the Trust has been accounted for as a reduction in outstanding common shares, and the Trust has been consolidated in accordance with ASC 810 (formerly FIN 46R) since the Company is the primary beneficiary.

Share purchase rights

Pursuant to our shareholder rights plan (the “Rights Plan”), one right to purchase a common share (a “Right”) has been issued in respect of each of the outstanding common shares and an additional Right will be issued in respect of each additional common share issued prior to the Separation Time (as defined below). The purpose of the Rights Plan is to provide holders of our common shares, and our Board of Directors, with the time necessary to ensure that, in the event of a take-over bid (the Canadian term for a tender offer) of the Company, alternatives to the bid which may be in the best interests of our Company are identified and fully explored.

The Rights will become exercisable and begin to trade separately from the associated common shares at the “Separation Time,” which is generally the close of business on the tenth trading day after the earliest to occur of (a) a public announcement that a person or a group of affiliated or associated persons (an “Acquiring Person”) has acquired beneficial ownership of 20% or more of the outstanding common shares other than as a result of (i) a reduction in the number of common shares outstanding, (ii) a Permitted Bid or Competing Permitted Bid (both as defined in the Rights Plan), (iii) acquisitions of common shares in respect of which the Company’s Board of Directors has waived the application of the Rights Plan, or (iv) other specified exempt acquisitions in which shareholders participate on a pro rata basis; (b) the date of commencement of, or the first public announcement of an intention of any person to commence, a take-over bid where the common shares subject to the bid, together with common shares owned by that person (including affiliates, associates and others acting jointly or in concert therewith) would constitute 20% or more of the outstanding common shares; and (c) the date upon which a Permitted Bid or Competing Permitted Bid ceases to be such.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

After the Separation Time, each Right entitles the holder thereof to purchase one common share at the “Exercise Price,” which is initially \$150 per share. Following a transaction which results in a person becoming an Acquiring Person (a “Flip-in Event”), the Rights will entitle the holder thereof (other than a holder who is an Acquiring Person) to receive, upon exercise, common shares with a market value equal to twice the then Exercise Price of the Rights. For example, if, at the time of the Flip-in Event, the Exercise Price is \$150 per share and the common shares have a market price of \$25 per share, the holder of each Right would be entitled to receive \$300 per share in market value of the common shares (12 Common Shares) after paying \$150 per share for such shares (*i.e.*, the shares may be purchased at a 50% discount). In such event, however, any Rights directly or beneficially owned by an Acquiring Person (including affiliates, associates and others acting jointly or in concert therewith), or a transferee or any such person, will be void. A Flip-in Event does not include acquisitions pursuant to a Permitted Bid or Competing Permitted Bid.

The Rights Plan will remain in effect until September 28, 2018, subject to being reconfirmed by the Company’s shareholders every three years.

NOTE 18 STOCK-BASED COMPENSATION

The Company’s 2006 Stock Incentive Plan (“2006 Plan”) has been in place since the Company’s initial public offering. The 2006 Plan was assumed by the Company upon the completion of the reorganization to a Canadian public company. The 2006 Plan is an omnibus plan, designed to allow for a broad range of equity-based compensation awards in the form of stock options, restricted stock, restricted stock units (“RSUs”), SARs, dividend equivalent rights, performance awards and share awards to eligible employees and directors of the Company or its subsidiaries. Total share-based awards of 1.4 million have been made under the 2006 Plan during fiscal years 2007, 2008 and 2009 to officers and certain employees, of which 0.7 million were granted as RSUs and 0.7 million as stock options with tandem SARs. Dividend equivalent rights have accrued on the RSUs. A total of 2,900,000 shares were authorized under the 2006 Plan, of which 1,038,670 share-based awards are outstanding as at January 3, 2010.

Total stock-based compensation expense included in General and administrative expense on the Consolidated Statement of Operations is detailed as follows:

	Year ended		
	January 3, 2010	December 28, 2008	December 30, 2007
Restricted stock units	\$5,715	\$8,278	\$7,744
Stock options and tandem SARs	1,830	631	—
Deferred stock units	1,324	721	816
Total stock-based compensation expense	\$8,869	\$9,630	\$8,560

Details of stock-based compensation grants and settlements in fiscal 2009, 2008 and 2007 are set forth below.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

Restricted stock units

The following is a summary of RSU activity for employees and outside directors granted under the Company's 2006 Plan for the years ended December 30, 2007, December 28, 2008, and January 3, 2010:

	Restricted Stock Units	Weighted Average Fair Value per Unit
	(in thousands)	(in dollars)
<u>2007</u>		
Balance at January 1, 2007	344	\$28.13
Granted	295	34.99
Dividend equivalent rights	4	34.73
Vested and settled	(118)	28.40
Forfeited	<u>(21)</u>	<u>31.43</u>
Balance at December 30, 2007	<u>504</u>	<u>\$31.98</u>
<u>2008</u>		
Granted	233	\$33.02
Dividend equivalent rights	5	32.68
Vested and settled	(326)	30.38
Forfeited	<u>(10)</u>	<u>32.63</u>
Balance at December 28, 2008	<u>406</u>	<u>\$33.82</u>
<u>2009</u>		
Granted	140	\$28.87
Dividend equivalent rights	5	30.54
Vested and settled	(234)	34.41
Forfeited	<u>(5)</u>	<u>32.16</u>
Balance at January 3, 2010	<u>312</u>	<u>\$31.15</u>

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The Company's Human Resource and Compensation Committee (the "HRCC") approved RSU awards, which are reflected in the table above and below. RSUs were not granted in May 2009 to the named executive officers because the performance pre-condition, relating to a required threshold level of operating income, to the grant of the RSUs (prior to grant, referred to as performance-conditioned RSUs) was not satisfied. Also, commencing in 2009, the HRCC and Company management changed the equity award program for the remaining officers of the Company to match that previously approved (in December 2007) for the named executive officers. Namely, the total compensation value of the awards would change to 50% performance-conditioned RSUs (granted "at target" for these officers in 2009) and 50% options with tandem SARs. Both of these factors resulted in a lower number of RSUs being granted in 2009. The following table outlines the RSU grants, excluding the accumulation of dividend equivalent rights on outstanding RSUs, for fiscal 2007, 2008, and 2009:

	Restricted Stock Unit Grants	Fair Market Value of Award
	(in thousands)	(in dollars/share)
<u>2007</u>		
February 2007	12	\$36.65
May 2007	276	34.89
October 2007	7	35.87
Total Granted in 2007	295	\$34.99
<u>2008</u>		
May 2008	233	\$33.02
Total Granted in 2008	233	\$33.02
<u>2009</u>		
May 2009	140	\$28.87
Total Granted in 2009	140	\$28.87

The fair market value of each award prior to November 2009 was based on the mean of the high and low prices of the Company's common shares traded on the Toronto Stock Exchange on the day of grant. Grants vest over a maximum 30-month period or shorter. In November 2009, the fair market value of each award was changed to the closing price of the Company's common shares traded on the Toronto Stock Exchange on the first business day preceding the grant date. With respect to retirement-eligible employees, the expense associated with their grants are accelerated, in accordance with ASC 718—*Compensation—Stock Compensation* ("ASC 718") (formerly SFAS No. 123R).

As a result of the reorganization of the Company to a Canadian public company on September, 28, 2009, the stock-based grants were converted to grants from the new Canadian public company, resulting in a plan modification. This modification did not result in any accounting changes.

In 2009, 2008 and 2007, RSUs were settled by one of the following means: (i) by way of disbursement of shares from The TDL RSU Employee Benefit Plan Trust; (ii) the reissuance of treasury shares (for periods prior to the completion of the reorganization); or (iii) by way of an open market purchase by an agent of the Company on behalf of the eligible employee. The method of settlement is primarily dependent on the jurisdiction where the employee resides, but securities requirements and other factors are also considered.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

RSUs that vested during 2009, 2008 and 2007 were settled with the participants in the following manner:

	<u>Restricted Stock Unit</u> <u>(gross settlement)</u>	<u>RSU</u> <u>Settlement, net of tax</u>	
		<u>Unit</u>	<u>Amount</u>
	(in thousands of units or \$)		
2007			
Settled with shares from The TDL RSU Employee Benefit Plan			
Trust	95	52	\$1,745
Settled by the reissuance of treasury shares	17	12	420
Settled by an open market purchase	6	4	110
Total restricted stock settlement	<u>118</u>	<u>68</u>	<u>\$2,275</u>
2008			
Settled with shares from The TDL RSU Employee Benefit Plan			
Trust	263	141	\$4,889
Settled by the reissuance of treasury shares	51	32	1,099
Settled by an open market purchase	12	7	226
Total restricted stock settlement	<u>326</u>	<u>180</u>	<u>\$6,214</u>
2009			
Settled with shares from The TDL RSU Employee Benefit Plan			
Trust	194	104	\$3,563
Settled by the reissuance of treasury shares	12	8	264
Settled by an open market purchase	28	16	477
Total restricted stock settlement	<u>234</u>	<u>128</u>	<u>\$4,304</u>

RSUs are settled by the Company with the participant, after provision (on the account of the participant) for the payment of each participant's minimum statutory withholding tax requirements.

As of January 3, 2010, total unrecognized compensation cost related to non-vested RSUs outstanding was \$4.6 million (2008: \$6.5 million) and is expected to be recognized over a weighted-average period of 1.3 years (2008: 1.4 years). The Company expects substantially all of the outstanding RSUs to vest. A total of 234,000 (2008: 326,000) RSUs vested in 2009 with a fair value of \$8.1 million (2008: \$9.9 million).

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

Deferred stock units

Beginning in 2007, non-employee members of the Company’s Board of Directors receive the equity portion of their Board retainers, and may elect to receive the remainder of their Board and Committee compensation, in the form of deferred stock units (“DSUs”). The Company previously issued RSUs to directors, but these were fully vested and settled in November 2008. The following is a summary of DSU activity granted under the Company’s 2006 Non-Employee Director Deferred Stock Unit Plan for the years ended December 30, 2007, December 28, 2008, and January 3, 2010:

	Deferred Stock Units	Weighted Average Fair Value per Unit
	(in thousands)	(in dollars)
<u>2007</u>		
Balance at January 1, 2007	—	\$ —
Granted	17	35.40
Dividend equivalent rights	—	35.82
Balance at December 30, 2007	<u>17</u>	<u>\$35.40</u>
<u>2008</u>		
Granted	22	\$33.74
Dividend equivalent rights	—	32.69
Balance at December 28, 2008	<u>39</u>	<u>\$34.45</u>
<u>2009</u>		
Granted	43	\$31.03
Dividend equivalent rights	1	30.57
Balance at January 3, 2010	<u>83</u>	<u>\$32.64</u>

DSUs are expensed on the date of grant since they vest immediately, although they are not payable until a director’s separation from service. DSUs are notional units which track the value of the Company’s common shares. These units are settled in cash based on the value of the Company’s common shares on the Toronto Stock Exchange on the date of the director’s separation of service from the Company. Since the awards are settled in cash, the award is accounted for using the liability method, which results in a revaluation of the liability to fair value each period and expensed. DSUs have dividend equivalent rights, which are expensed as earned. As at January 3, 2010, the total fair value liability for DSUs was \$2.7 million (\$1.4 million in 2008).

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

Stock options and tandem stock appreciation rights

Stock options with tandem SARs enable the employee to exercise the stock option to receive common shares or to exercise the SAR and receive a cash payment equal to the difference between the market price of the share at the date and time of the exercise and the exercise price of the stock option or SAR. Exercise of either the option or SAR will result in cancellation and surrender to the Company of the equivalent amount of the other. The awards are accounted for using the liability method, which results in a revaluation of the liability to fair value each period, and are expensed over the vesting period. Stock options with tandem SARs granted to retirement-eligible employees are expensed immediately.

The stock option/SAR activity table below reflects the stock option/SAR awards approved by the HRCC:

	<u>Stock Options with SARs</u> (in thousands)	<u>Weighted Average Exercise Price</u> (in dollars)	<u>Total Intrinsic Value</u> (in thousands)	<u>Weighted Average Remaining Contractual Life</u> (in years)
2008				
May 2008	167	\$33.02		
Total Granted in 2008	<u>167</u>	<u>\$33.02</u>	<u>\$ nil</u>	<u>5.4</u>
2009				
May 2009	534	\$28.87		
November 2009	26	\$29.84		
Total Granted in 2009	<u>560</u>	<u>\$28.92</u>	<u>\$1,798</u>	<u>6.4</u>
Stock options/SARs outstanding at January 3,				
2010	727	\$29.86	\$1,798	6.1
Stock options/SARs exercisable at January 3,				
2010	56	\$33.02	\$ nil	5.4

No stock options or SARs were exercised or forfeited in 2009 or 2008.

The option/SAR awards were granted to officers of the Company including both retirement-eligible employees and non-retirement-eligible employees. For purposes of the Black-Scholes-Merton option pricing model, the grant was segregated by grant date and based on retirement eligibility, and the assumptions were adjusted accordingly. All options with tandem SARs granted in 2009 and 2008 vest over 3 years and expire 7 years from the date of issuance, provided that if an employee retires, the term decreases to the earlier of four years after retirement or expiration of the original term. The fair value of these awards was determined, in accordance with ASC 718 (formerly SFAS 123R), at the grant date and each subsequent remeasurement date by applying the Black-Scholes-Merton option-pricing model. The following assumptions were used to calculate the fair value of outstanding stock options/SARs:

	<u>Year ended</u>	
	<u>January 3, 2010</u>	<u>December 28, 2008</u>
Expected share price volatility	23% – 28%	23% – 24%
Risk-free interest rate	1.4% – 2.5%	1.4% – 1.7%
Expected life	1.9 – 4.4 years	2.9 – 4.4 years
Expected dividend yield	1.2%	1.1%

Expected share price volatility was estimated by using a combination of the Company's historical share price volatility (post-IPO) and Wendy's historical share price volatility (pre-IPO) for a period similar to the

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

expected life of the option. The Company selected Wendy's historical share price volatility for the period prior to the Company's IPO as a proxy for volatility since the Company was a significant wholly-owned subsidiary of Wendy's during this time.

The risk-free interest rate was referenced from Government of Canada bonds with a maturity period similar to the expected life of the options. If an exact match in maturity was not found, the closest two maturities, one before and one after the expected life of the options, were used to extrapolate an estimated risk-free rate.

Expected life is based on the simplified method of estimating a stock option term, in accordance with ASC 718-10-S99—*Compensation—Stock Compensation, Overall, SEC Materials* (formerly Staff Accounting Bulletin No. 110—*Year-End Help For Expensing Employee Stock Options*). The simplified method was used as there is insufficient historical detail to be used as an alternative basis to estimating the term.

Expected dividend yields are based on current, approved dividends expressed as a percentage of either the strike price or the closing price, depending on the date of the assumption.

Forfeitures have been assumed at 0% based on the expected turnover rate of the employees who were granted stock options with tandem SARs.

Awards granted to retirement-eligible employees are expensed on an accelerated basis, in accordance with ASC 718 (formerly SFAS 123R). The stock option with tandem SARs awards were revalued to fair value at January 3, 2010 using the closing share price on the Toronto Stock Exchange at the end of fiscal 2009, which was \$32.13. The intrinsic value of stock options/SARs is based upon the difference between the closing share price and the exercise price, representing the value an option holder would receive had the options been exercised.

As of January 3, 2010, total unrecognized compensation cost related to non-vested stock options outstanding was \$2.5 million (2008: \$0.3 million) and is expected to be recognized over a weighted-average period of 2.2 years (2008: 2.4 years). The Company expects substantially all of the remainder of the outstanding stock options to vest. A total of 56,000 (2008: nil) stock options/SARs vested in 2009 with an intrinsic value of \$nil (2008: nil).

NOTE 19 RETIREMENT PLANS

Certain Company employees participate in various defined contribution plans. Costs for Company employees participating in these plans were approximately \$6.6 million for 2009 and 2008, respectively, and \$6.0 million for 2007. These costs are included in General and administrative expense on the Consolidated Statement of Operations.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

NOTE 20 SEGMENT REPORTING

The Company operates exclusively in the food-service industry and has determined that its reportable segments are those that are based on the Company's methods of internal reporting and management structure and represent the manner in which the Company's chief decision maker views and evaluates the various aspects of the Company's business. The Company's reportable segments are the geographic locations of Canada and the U.S. As set forth in the table below, there are no amounts of revenues shown between reportable segments.

The table below presents information about reportable segments:

	Year ended					
	January 3, 2010	% of total	December 28, 2008	% of total	December 30, 2007	% of total
Revenues						
Canada	\$1,944,673	86.7%	\$1,764,869	86.4%	\$1,627,835	85.9%
U.S.	168,216	7.5%	142,874	7.0%	142,708	7.5%
Total reportable segments	2,112,889	94.2%	1,907,743	93.3%	1,770,543	93.4%
Noncontrolling interests – Non-owned consolidated restaurants	129,249	5.8%	135,950	6.7%	125,307	6.6%
Total	<u>\$2,242,138</u>	<u>100.0%</u>	<u>\$2,043,693</u>	<u>100.0%</u>	<u>\$1,895,850</u>	<u>100.0%</u>
Segment Operating Income (Loss)						
Canada	\$ 534,131	99.1%	\$ 507,006	105.5%	\$ 467,884	101.0%
U.S. ⁽¹⁾	4,840	0.9%	(26,488)	(5.5)%	(4,804)	(1.0)%
Reportable segment operating income	538,971	<u>100.0%</u>	480,518	<u>100.0%</u>	463,080	<u>100.0%</u>
Noncontrolling interests – Non-owned consolidated restaurants	1,732		2,772		2,951	
Corporate charges ⁽²⁾	(45,292)		(36,952)		(37,971)	
Consolidated Operating Income	495,411		446,338		428,060	
Interest, Net	(19,270)		(19,632)		(16,707)	
Income Taxes	(178,263)		(139,812)		(139,441)	
Net Income	297,878		286,894		271,912	
Net Income Attributable to Noncontrolling Interests	1,511		2,216		2,361	
Net Income Attributable to Tim Hortons	<u>\$ 296,367</u>		<u>\$ 284,678</u>		<u>\$ 269,551</u>	
Capital Expenditures						
Canada	\$ 130,897		\$ 113,775		\$ 114,501	
U.S.	29,604		60,472		61,040	
	<u>\$ 160,501</u>		<u>\$ 174,247</u>		<u>\$ 175,541</u>	

⁽¹⁾ Includes \$21,266 of asset impairment and related closure costs in 2008.

⁽²⁾ Corporate charges include certain overhead costs which are not allocated to individual business segments, the impact of certain foreign currency exchange gains and losses, and the operating income from the Company's wholly-owned Irish subsidiary which continues to be managed corporately.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

The following table provides a reconciliation of total reportable segment long-lived assets and total assets to total consolidated long-lived assets and total consolidated assets, respectively:

	<u>2009</u>	<u>2008</u>
	(in thousands)	
Total long-lived assets		
Canada	\$ 967,879	\$ 913,823
U.S.	<u>356,560</u>	<u>402,839</u>
Total reportable segment long-lived assets	1,324,439	1,316,662
Noncontrolling interests – non-owned consolidated restaurants long-lived assets	3,437	2,542
Corporate long-lived assets	<u>12,881</u>	<u>13,648</u>
Consolidated long-lived assets	<u>\$1,340,757</u>	<u>\$1,332,852</u>
	<u>2009</u>	<u>2008</u>
	(in thousands)	
Total Assets		
Canada	\$1,468,796	\$1,391,470
U.S.	<u>507,311</u>	<u>570,378</u>
Total reportable segment assets	1,976,107	1,961,848
Noncontrolling interests – non-owned consolidated restaurants assets ...	4,445	4,268
Corporate assets	<u>16,101</u>	<u>26,511</u>
Consolidated total assets	<u>\$1,996,653</u>	<u>\$1,992,627</u>

Corporate assets include a nominal amount of assets related to the Company's wholly-owned Irish subsidiary, which continues to be managed corporately.

Significant non-cash items included in reportable segment operating income and reconciled to total consolidated amounts is as follows:

	<u>Year ended</u>		
	<u>January 3,</u>	<u>December 28,</u>	<u>December 30,</u>
	<u>2010</u>	<u>2008</u>	<u>2007</u>
	(in thousands)		
Depreciation and amortization			
Canada	\$ 78,262	\$71,426	\$66,296
U.S.	<u>21,999</u>	<u>18,843</u>	<u>16,312</u>
Total reportable segments	100,261	90,269	82,608
Noncontrolling interests – non-owned consolidated restaurants	430	352	330
Corporate	<u>756</u>	<u>657</u>	<u>657</u>
	<u>\$101,447</u>	<u>\$91,278</u>	<u>\$83,595</u>
Asset impairment – U.S.	<u>\$ —</u>	<u>\$16,559</u>	<u>\$ —</u>

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

Revenues consisted of the following:

	Year ended		
	January 3, 2010	December 28, 2008	December 30, 2007
	(in thousands)		
Sales			
Distribution sales	\$1,340,711	\$1,173,738	\$1,067,106
Company-operated restaurant sales	24,236	38,327	56,161
Sales from non-owned consolidated restaurants	129,249	135,950	125,307
	<u>1,494,196</u>	<u>1,348,015</u>	<u>1,248,574</u>
Franchise revenues			
Rents and royalties	657,909	601,870	553,441
Franchise fees	90,033	93,808	93,835
	<u>747,942</u>	<u>695,678</u>	<u>647,276</u>
Total revenues	<u>\$2,242,138</u>	<u>\$2,043,693</u>	<u>\$1,895,850</u>

NOTE 21 SUPPLEMENTAL CASH FLOW INFORMATION

	Year ended		
	January 3, 2010	December 31, 2008	December 30, 2007
	(in thousands)		
Supplemental disclosures of cash flow information:			
Interest paid	\$ 21,097	\$ 23,088	\$ 25,255
Income taxes paid	\$153,789	\$153,973	\$130,727
Non-cash investing and financing activities:			
Capital lease obligations incurred	\$ 13,847	\$ 13,680	\$ 15,090

NOTE 22 RELATED PARTY TRANSACTIONS

In 2009, the Company purchased products from its bakery joint venture totaling \$73.6 million (2008: \$69.0 million). These purchases related to products produced by this joint venture and distributed, primarily by the Company, to a portion of its system of restaurants. The Company had accounts payable outstanding of \$3.6 million to its bakery joint-venture as at January 3, 2010 (\$3.2 million in 2008).

Included in contingent rent expense (see Note 16) are expenses associated with the Company's 50/50 joint venture with Wendy's for the years ended 2009 and 2008 of \$23.6 million and \$23.0 million, respectively. The Company had accounts payable outstanding of \$2.4 million with this joint venture as at January 3, 2010 (\$1.9 million in 2008) and accounts receivable from this joint venture of \$0.2 million (\$0.9 million in 2008).

In addition, the Company has a \$6.2 million note receivable outstanding as at January 3, 2010 (2008: nil) and due before December 31, 2010 from the trust fund holding plan assets in connection with the termination of the Company's former supplemental executive retirement plan and settlement of account balances to the participants as a result thereof.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

NOTE 23 RECENT ACCOUNTING PRONOUNCEMENTS

In June 2009, the FASB issued SFAS No. 167—*Amendments to FASB Interpretation No. 46(R)* (“SFAS No. 167”), now codified within ASC 810—*Consolidations*. This Statement amends Interpretation 46(R) to require an enterprise to perform an analysis to determine whether the enterprise’s variable interest or interests give it a controlling financial interest in a variable interest entity. This analysis identifies the primary beneficiary of a variable interest entity as the enterprise that has both of the following characteristics: (i) the power to direct the activities of a variable interest entity that most significantly impact the entity’s economic performance; and (ii) the obligation to absorb losses of the entity that could potentially be significant to the variable interest entity or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. Additionally, an enterprise is required to assess whether it has an implicit financial responsibility to ensure that a variable interest entity operates as designed when determining whether it has the power to direct the activities of the variable interest entity that most significantly impact the entity’s economic performance. This statement also amends Interpretation 46(R) to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity, amends certain guidance for determining whether an entity is a variable interest entity, adds an additional reconsideration event for determining whether an entity is a variable interest entity, and requires enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise’s involvement in a variable interest entity. This Standard is effective for annual reporting periods that begin after November 15, 2009. The Company is currently assessing the potential impact the adoption of SFAS No. 167 may have on its Consolidated Financial Statements.

In October 2009, the FASB issued Accounting Standard Update (“ASU”) No. 2009-13—*Multiple Deliverable Revenue Arrangements*, as codified in ASC 605—*Revenue Recognition*. The objective of this ASU is to address the accounting for multiple-deliverable arrangements to enable vendors to account for products or services (deliverables) separately rather than as a combined unit. The ASU also establishes a selling price hierarchy for determining the selling price of a deliverable and has expanded disclosures related to vendor’s multiple-deliverable revenue arrangements. This ASU is effective for fiscal years beginning after June 15, 2010, and the Company is currently assessing the potential impact, if any, the adoption of this ASU may have on its Consolidated Financial Statements.

In January 2010, the FASB issued Accounting Standard Update (“ASU”) No. 2010-02—*Accounting and Reporting for Decreases in Ownership of a Subsidiary-A Scope Clarification*, as codified in ASC 810—*Consolidations*. This ASU clarifies the applicable scope and implementation issues of ASC 810, originally issued as FASB Statement No. 160—*Noncontrolling Interests in Consolidated Financial Statements*, for a decrease in ownership in a subsidiary that is a business or nonprofit activity and expands disclosures about the deconsolidation of a subsidiary or derecognition of a group of assets. This ASU is effective for interim or annual periods ending on or after December 15, 2009 and should be applied retrospectively to the first time the Company adopted FASB Statement No. 160. The adoption of this ASU did not have an impact the Company’s 2009 Consolidated Financial Statements.

In January 2010, the FASB issued Accounting Standard Update (“ASU”) No. 2010-06—*Fair Value Measurements: Improving Disclosures about Fair Value Measurements*, as codified in ASC 820—*Fair Value Measurements*. This ASU provides amendments to ASC 820 that will provide more robust disclosures about (i) the different classes of assets and liabilities measured at fair value, (ii) the valuation techniques and inputs used, (iii) the activity in Level 3 fair value measurements, and (iv) the transfers between Levels 1, 2 and 3. This ASU is effective for interim or annual reporting periods beginning after December 15, 2009, except for certain disclosures applicable to Level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those years. The Company is currently assessing the potential impact, if any, the adoption of this ASU may have on its Consolidated Financial Statements.

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued)
(in thousands of Canadian dollars, except share and per share data)

NOTE 24 QUARTERLY FINANCIAL DATA (UNAUDITED)

	2009			
	Q1	Q2	Q3	Q4 ⁽¹⁾
	(in thousands, except per share data)			
Revenues				
Sales	\$339,619	\$372,119	\$373,035	\$409,423
Franchise revenues				
Rents and royalties	147,139	164,679	166,914	179,177
Franchise fees	20,427	19,287	23,605	26,714
	<u>167,566</u>	<u>183,966</u>	<u>190,519</u>	<u>205,891</u>
Total revenues	507,185	556,085	563,554	615,314
Total costs and expenses, net ⁽²⁾	402,292	434,235	434,319	475,881
Operating income	<u>\$104,893</u>	<u>\$121,850</u>	<u>\$129,235</u>	<u>\$139,433</u>
Net income attributable to Tim Hortons Inc. ⁽³⁾	<u>\$ 66,439</u>	<u>\$ 77,760</u>	<u>\$ 61,179</u>	<u>\$ 90,989</u>
Earnings per share – fully diluted ⁽⁴⁾	<u>\$ 0.37</u>	<u>\$ 0.43</u>	<u>\$ 0.34</u>	<u>\$ 0.51</u>

	2008			
	Q1	Q2	Q3	Q4
	(in thousands, except per share data)			
Revenues				
Sales	\$306,506	\$335,873	\$333,581	\$372,055
Franchise revenues				
Rents and royalties	135,880	153,546	155,214	157,230
Franchise fees	17,931	21,273	20,200	34,404
	<u>153,811</u>	<u>174,819</u>	<u>175,414</u>	<u>191,634</u>
Total revenues	460,317	510,692	508,995	563,689
Total costs and expenses, net ⁽⁵⁾	362,985	393,139	386,385	454,846
Operating income	<u>\$ 97,332</u>	<u>\$117,553</u>	<u>\$122,610</u>	<u>\$108,843</u>
Net income attributable to Tim Hortons Inc. ⁽⁶⁾	<u>\$ 61,820</u>	<u>\$ 74,974</u>	<u>\$ 78,757</u>	<u>\$ 69,127</u>
Earnings per share—fully diluted ⁽⁶⁾	<u>\$ 0.33</u>	<u>\$ 0.41</u>	<u>\$ 0.43</u>	<u>\$ 0.38</u>

(1) The 2009 fiscal year consists of 53 weeks. As a result, the fourth quarter of 2009 represents 14 weeks compared to all other quarters presented that represent 13 weeks. The extra operating week impacted revenues, costs and expense by approximately 6% to 7%.

(2) Total costs and expenses, net includes \$1.4 million, \$2.7 million and \$3.2 million of professional advisory and shareholder-related transaction costs in connection with the reorganization of the Company to a Canadian public company in the first, second, and third quarters of 2009, respectively (see Note 1).

(3) Net income attributable to Tim Hortons Inc. includes \$1.0 million, \$2.6 million and \$3.1 million of professional advisory and shareholder-related transaction costs, net of tax, and \$20.0 million of deferred tax expenses related primarily to a deferred tax valuation allowance related to the reorganization of the Company to a Canadian public company in the first, second, and third quarters of 2009, respectively (see Note 1 and 6).

TIM HORTONS INC. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements—(Continued) (in thousands of Canadian dollars, except share and per share data)

- (4) Earnings per share was impacted by \$0.01, \$0.01 and \$0.13 for professional advisory and shareholder-related transaction costs, net of tax, and the deferred tax valuation allowance noted above in the first, second, and third quarters of 2009, respectively.
- (5) Total costs and expenses, net includes management restructuring costs of \$3.1 million incurred in the second quarter of 2008 and asset impairment and related closure costs of \$21.3 million incurred in the fourth quarter of 2008.
- (6) Net income includes management restructuring costs, net of savings of \$1.7 million incurred in the second quarter of 2008 (EPS impact \$0.01) and asset impairment and related closure costs of \$15.4 million incurred in the fourth quarter of 2008 (EPS impact \$0.08).

NOTE 25 SUBSEQUENT EVENTS

On March 1, 2010, the Company obtained regulatory approval from the Toronto Stock Exchange (“TSX”) to commence its 2010 share repurchase program (“2010 program”) for up to \$200 million in common shares, not to exceed the regulatory maximum of 8,817,291 shares, equivalent to 5% of the outstanding common shares as of February 19, 2010. Purchases of common shares will be made through a combination of automatic trading plan purchases, and at management’s discretion in compliance with regulatory requirements, and given prevailing market, cost, and other considerations. Repurchases will be made by the Company on either the TSX, the New York Stock Exchange and/or other Canadian marketplaces, subject to regulatory requirements. Shares repurchased pursuant to the 2010 program will be cancelled.

The 2010 program commenced March 3, 2010 and will end on March 2, 2011, or sooner if the \$200 million or 5% share maximum has been reached. There can be no assurance as to the precise number of shares that will be repurchased under the 2010 program, or the aggregate dollar amount of the shares purchased. The 2010 program may also be terminated at the Company’s discretion in compliance with applicable regulatory requirements.