



CINEPLEX GALAXY INCOME FUND

**GO BIG**

SECOND QUARTER **2007**

Cineplex Entertainment LP owns, operates or has an interest in 129 theatres with 1,297 screens. The company operates theatres with the following top tier brands: Cineplex Odeon, Galaxy and Famous Players (including Colossus, Coliseum, SilverCity) and Scotiabank Theatres.

#### TABLE OF CONTENTS

- 1) Management's Discussion and Analysis of Financial Position
- 35) Cineplex Galaxy Income Fund

Letter to Unitholders:

I am pleased to present our second quarter 2007 results. Canadian box office revenues were up approximately 0.4% this quarter versus the same period last year while Cineplex box office revenues were up 5.3% for the same period. We attribute this success to strong film performances by the top three blockbusters of the summer *Spiderman 3*, *Shrek the Third* and *Pirate's of the Caribbean -- at Worlds End*; our IMAX theatres, and the continued success of our alternative programming including WWE, NHL hockey and the Metropolitan Opera – LIVE in High Definition series.

I am also pleased to report that our *Other Revenue* for the quarter was \$20.1 million compared to \$15.8 million reported for the same period in 2006 representing a 27.3% increase. This category comprises our *Cineplex Media* group as well as *Games* and *Other Revenues*. Cineplex Media continues to perform with revenues increasing 21% versus the same period last year primarily as a result of the rollout of our digital pre-show program implemented throughout 2006.

Total revenues for this quarter set a new quarterly record and increased 8.9% to \$199.9 million compared to \$183.6 million reported for 2006.

Our distributable cash per unit for the quarter was \$0.4337 compared to \$0.3394, a 27.8% increase per unit versus the prior year. Our adjusted EBITDA for the quarter was \$35.0 million compared to \$27.2 million for 2006 and represented an increase of 28.7%. Our declared distribution per unit for this period was \$0.2958.

In May, we launched our SCENE loyalty program on a national basis. Currently this program has more than 300,000 members as of last week. We also renamed the three Paramount theatres in Vancouver, Edmonton and Montreal to Scotiabank theatres. Also in May, we opened the seven-screen Galaxy Cinemas Collingwood and we acquired three Cinema City branded theatres located in Winnipeg and Edmonton adding an additional 32 screens to our circuits. This transaction closed on July 13<sup>th</sup> and brings our combined circuit total to 132 theatres and 1329 screens.

We are also pleased to announce our success as an industry in getting the Federal Government to amend the Criminal Code of Canada to make it illegal to record a movie or soundtrack in a theatre. This is a significant win for us in our fight against piracy!

On August 3, we announced that we had signed an agreement with Empire Theatres Limited to assume in-theatre media sales representation for all of Empire's theatres in Atlantic Canada effective September 1. This will give Cineplex Media nationwide sales coverage.

On behalf of the Board of Directors,



Ellis Jacob  
President and Chief Executive Officer

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### MANAGEMENT'S DISCUSSION AND ANALYSIS

*As of June 30, 2007, Cineplex Galaxy Income Fund indirectly owned an approximate 75.7% interest in Cineplex Entertainment Limited Partnership. As discussed in Overview below, effective April 2, 2007, Cineplex Galaxy Income Fund began to consolidate the results and operations of Cineplex Entertainment Limited Partnership. The following management's discussion and analysis of the Cineplex Entertainment Limited Partnership financial condition and results of operations should be read together with the unaudited consolidated interim financial statements and related notes of Cineplex Galaxy Income Fund. This management's discussion and analysis (MD&A) contains "forward-looking statements" within the meaning of applicable securities laws, such as statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts. These statements are not guarantees of future performance and are subject to numerous risks and uncertainties, including those described in our annual information form and in this MD&A. Those risks and uncertainties include adverse factors generally encountered in the film exhibition industry such as poor film product and unauthorized copying; the risks associated with world events, including war, terrorism, international conflicts, natural disasters, extreme weather conditions and infectious diseases, changes in income tax legislation, and general economic conditions. Many of these risks and uncertainties can affect our actual results and could cause our actual results to differ materially from those expressed or implied in any forward-looking statement made by us or on our behalf. All forward-looking statements in this MD&A are qualified by these cautionary statements. These statements are made as of the date of this MD&A and, except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Additionally, we undertake no obligation to comment on analyses, expectations or statements made by third parties in respect of Cineplex Galaxy Income Fund or Cineplex Entertainment Limited Partnership, its financial or operating results or its securities. Additional information, including Cineplex Galaxy Income Fund's Annual Information Form (AIF) can be found on SEDAR at [www.sedar.com](http://www.sedar.com).*

### OVERVIEW

Cineplex Entertainment Limited Partnership (the "Partnership") was formed on November 26, 2003 to acquire substantially all of the business assets of Cineplex Odeon Corporation ("COC") and all of the shares of Galaxy Entertainment Inc. ("GEI"). The Partnership's investors include Cineplex Galaxy Trust (the "Trust"), Cineplex Entertainment Corporation (the "General Partner"), COC (indirectly through the newly formed partnership CELP 2007 LP), Cineplex Odeon (Quebec) Inc. and certain former investors in GEI. The Trust is wholly owned by Cineplex Galaxy Income Fund (the "Fund"). On July 22, 2005 the Partnership completed the acquisition (the "Acquisition") of the Famous Players Limited Partnership ("Famous Players") movie exhibition business from Viacom Inc. and Viacom Canada Inc., becoming Canada's largest film exhibition operator with theatres in six provinces. The Partnership's theatre circuit is concentrated in major metropolitan and mid-sized markets with principal geographic areas being Toronto, Montreal, Vancouver, Calgary, Edmonton, Ottawa and Quebec City. As of June 30, 2007, the Partnership owned, leased or had a joint-venture interest in 1,297 screens in 129 theatres. This total includes 58 screens in seven theatres held in joint ventures.

On April 2, 2007, under provisions of an exchange agreement entered into at the time of the Fund's initial public offering (as amended or restated from time to time, the "Exchange Agreement") designed to facilitate the exchange of LP Units into Fund Units, certain minority investing partners of Onex Corporation ("Onex") exchanged 9,122,751 Class B, Series 1 and Series 2-C Partnership Units ("LP Units") for 9,122,751 units of the Fund ("Fund Units"). The Fund recorded the LP Units it acquired at the fair market value of the Fund Units on the date of the transaction, \$143.1 million. As a result of the exchange, the interest under Onex's effective control in the Partnership was reduced to approximately 23.7% on a fully diluted basis (assuming the exchange of all outstanding exchangeable units and the conversion of all outstanding convertible debentures of the Fund).

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Prior to the April 2, 2007 exchange, the Fund accounted for the Partnership under the equity method. As a result of the exchange, the Fund indirectly acquired an additional 16.0% interest in the Partnership, increasing its ownership to 75.7% (excluding the Class C Limited Partnership units ("Class C LP Units")). The acquisition of the additional interest in the Partnership will be accounted for as a step acquisition as at April 2, 2007. As a result of this transaction, the Fund acquired control of the Partnership and will consolidate the Partnership on a prospective basis. Accordingly, the results of operations of the business acquired will be included in the consolidated financial statements effective with the acquisition of control. The Fund's financial statements for the period ended March 31, 2007 do not reflect the step acquisition.

As result of the issuance of Fund Units by the Fund during 2004, 2005, 2006 and 2007, in one-for-one exchanges for LP Units under the provisions of the Exchange Agreement, transactions surrounding the acquisition of Famous Players, and the additional investment by the Fund on June 20, 2006 (discussed below) in connection with an equity offering by the Fund, as at June 30, 2007 the Fund indirectly owned approximately 75.7% of the Partnership (excluding the Class C LP Units).

During the three months ended June 30, 2006, the Fund issued 2,000,000 Fund Units for gross proceeds of \$31.8 million. The Fund used the proceeds to indirectly purchase 2,000,000 Class A Limited Partnership Units ("Class A LP Units") for an additional 1.7% interest in the Partnership. The Partnership and the Fund entered into a reimbursement agreement under which the fees associated with the issuance of the Fund Units in the amount of approximately \$2.0 million were reimbursed by the Partnership. The proceeds received by the Partnership on the issuance of the Class A LP Units to the Fund were used to indirectly repay indebtedness under the Partnership's Development Facility (discussed below under "Liquidity and Capital Resources – Credit Facilities") and to pay certain expenses of the Fund.

The Fund's only source of income arises from its' investment in the Partnership. Prior to the second quarter of 2007, the Fund accounted for its' investment in the Partnership under the equity method of accounting. As a result of the April 2, 2007 exchange, the Fund commenced consolidating the results of the Partnership during the second quarter of 2007 and, as such, the Fund's financial statements do not contain historic comparative results for the Partnership on a line-by-line basis. In order to provide meaningful commentary on the results of operations, the following discussion focuses on the financial statements of the Partnership which include line-by-line comparative information.

### **REVENUE AND EXPENSES**

#### ***Revenues***

The Partnership generates revenues primarily from box office and concession sales. These revenues are affected primarily by attendance levels and by changes in the average per patron admission and average concession revenue per patron. The commercial appeal of the films released during the period and the success of marketing and promotion for those films by film studios and distributors drives attendance. Average admissions per patron are affected by the mix of film genres (*e.g.*, its appeal to certain audiences, such as children, teens or young adults) and established ticket prices. Average concession revenue per patron is affected by concession product mix, concession prices and type of film. In addition, the Partnership generates other revenues from screen advertising sales through its Cineplex Media business, promotional activities, game rooms, screenings, private parties, corporate events and theatre management fees.

#### ***Expenses***

Film cost represents the film rental fees paid on films exhibited in the Partnership's theatres. Film costs are calculated as a percentage of box office revenue and vary directly with changes in box office revenue. Film costs are accrued on the related box office receipts at either mutually agreed-upon terms established prior to the opening of the film, or on a mutually agreed settlement upon conclusion of the film's run, depending upon the film licensing arrangement.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Cost of concessions represents the costs of concession items sold and vary directly with changes in concession revenue.

Occupancy costs include lease related expenses, property and business related taxes and insurance. Lease expenses are primarily a fixed cost at the theatre level because the Partnership's theatre leases generally require a fixed monthly minimum rent payment. However, a number of the Partnership's theatre leases also include a percentage rent clause whereby the landlord is paid an additional amount of rent based primarily upon box office revenues over a specified threshold.

Other theatre operating expenses consist of fixed and variable expenses, including marketing and advertising, salaries and wages, utilities and maintenance. Certain operating costs, such as salaries and wages, will vary directly with changes in revenues and attendance levels. Although theatre salaries and wages include a fixed cost component, these expenses vary in relation to revenues as theatre staffing levels are adjusted to handle fluctuations in attendance.

General and administrative expenses are primarily costs associated with executive and corporate management and the overhead of the Partnership's business, which includes functions such as film buying, marketing and promotions, operations and concession management, accounting and financial reporting, legal, treasury, construction and design, real estate development and administration and information systems. The Partnership's general and administrative costs primarily consist of payroll, occupancy costs related to its corporate office in Toronto, Ontario, professional fees (such as public accountant and legal fees) and travel and related costs. The Partnership's general and administrative staffing and associated costs are maintained at a level that it deems appropriate to manage and support the size and nature of its theatre portfolio and its business activities.

### *Accounting for joint ventures*

The financial statements incorporate the operating results of joint ventures in which the Partnership has an interest using the proportionate consolidation method as required by generally accepted accounting principles in Canada ("GAAP").

### **DISCLOSURE CONTROLS AND PROCEDURES**

Management of the Fund is responsible for establishing and maintaining disclosure controls and procedures for the Fund as defined under Multilateral Instrument 52-109 issued by the Canadian Securities Administrators. Management has designed such disclosure controls and procedures, or caused them to be designed under its supervision, to provide reasonable assurance that material information relating to the Fund, including its consolidated subsidiaries, is made known to the Chief Executive Officer and the Chief Financial Officer by others within those entities, particularly during the period in which the annual filings are being prepared.

### **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Management of the Fund is responsible for designing internal controls over financial reporting for the Fund as defined under Multilateral Instrument 52-109 issued by the Canadian Securities Administrators. Management has designed such internal controls over financial reporting, or caused them to be designed under their supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with GAAP.

There has been no change in the Partnership's internal control over financial reporting that occurred during the Partnership's most recent interim period that has materially affected, or is reasonably likely to materially affect, the Partnership's internal control over financial reporting.

# **Cineplex Galaxy Income Fund**

## **Management's Discussion and Analysis**

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### **UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS OF THE PARTNERSHIP**

The following Consolidated Balance Sheets for the Partnership as at June 30, 2007 and December 31, 2006, Consolidated Statements of Operations and Consolidated Statements of Cash Flows for the Partnership for the three and six months ended June 30, 2007 and 2006, and Consolidated Statements of Partners' Equity and Comprehensive Income for the six months ended June 30, 2007 and 2006 are presented to provide comparable results to prior periods.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### CINEPLEX ENTERTAINMENT LIMITED PARTNERSHIP CONSOLIDATED BALANCE SHEETS (i)

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
<b>Assets</b>	(Unaudited)	
<b>Current assets</b>		
Cash and cash equivalents	\$ 21,036	\$ 56,383
Accounts receivable	23,946	35,500
Inventories	3,394	3,193
Prepaid expenses and other current assets	10,394	4,297
Income taxes receivable	23	34
Due from related parties	343	11
	<u>59,136</u>	<u>99,418</u>
<b>Property, equipment and leaseholds</b>	432,194	447,932
<b>Goodwill</b>	196,911	200,910
<b>Fair value of interest rate swap agreements</b>	4,376	-
<b>Intangible assets</b>	55,199	57,946
<b>Future income taxes</b>	6,652	6,156
<b>Deferred charges</b>	1,152	7,329
	<u>\$ 755,620</u>	<u>\$ 819,691</u>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued expenses	\$ 52,613	\$ 90,596
Distributions payable	4,548	4,308
Due to related parties	1,145	3,143
Deferred revenue	36,626	50,184
Capital lease obligations – current portion	1,536	1,470
Bank indebtedness	10,000	-
	<u>106,468</u>	<u>149,701</u>
<b>Long-term debt</b>	250,544	248,000
<b>Capital lease obligations – long term portion</b>	35,638	36,426
<b>Due to Cineplex Galaxy Trust (ii)</b>	100,000	100,000
<b>Accrued pension benefit liability</b>	2,737	3,840
<b>Other liabilities</b>	145,143	146,791
<b>Class C Limited Partnership Units – liability component</b>	100,917	100,037
	<u>741,447</u>	<u>784,795</u>
<b>Non-controlling interest</b>	-	561
<b>Partners' Equity</b>	14,173	34,335
	<u>\$ 755,620</u>	<u>\$ 819,691</u>

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### CINEPLEX ENTERTAINMENT LIMITED PARTNERSHIP CONSOLIDATED STATEMENTS OF INCOME (LOSS) (i) (Unaudited)

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
<b>Revenue</b>				
Box office	\$ 120,066	\$ 114,013	\$ 232,953	\$ 217,027
Concessions	59,792	53,849	112,116	102,881
Other	20,083	15,780	33,468	26,396
	<u>199,941</u>	<u>183,642</u>	<u>378,537</u>	<u>346,304</u>
<b>Expenses</b>				
Film cost	63,445	60,384	120,322	111,691
Cost of concessions	12,955	11,793	23,378	21,489
Occupancy	37,023	35,879	73,655	72,904
Other theatre operating expenses	43,042	39,938	84,696	78,207
General and administrative	8,432	8,436	16,787	16,519
	<u>164,897</u>	<u>156,430</u>	<u>318,838</u>	<u>300,810</u>
<b>Income before undernoted</b>	35,044	27,212	59,699	45,494
<b>Amortization</b>	16,478	15,834	32,752	31,072
<b>Loss (gain) on disposal of theatre assets</b>	1,002	(4,003)	2,869	(3,819)
<b>Interest on long-term debt and capital lease obligations</b>	6,604	8,026	14,110	15,440
<b>Interest on loan from Cineplex Galaxy Trust (ii)</b>	3,500	3,500	7,000	7,000
<b>Interest income</b>	<u>(223)</u>	<u>(156)</u>	<u>(475)</u>	<u>(260)</u>
<b>Income (loss) before income taxes, non-controlling interest and discontinued operations</b>	7,683	4,011	3,443	(3,939)
<b>Provision for (recovery of) income taxes</b>				
Current	5	(346)	11	(291)
Future	(25)	589	(496)	589
	<u>(20)</u>	<u>243</u>	<u>(485)</u>	<u>298</u>
<b>Income (loss) before non-controlling interest and discontinued operations</b>	7,703	3,768	3,928	(4,237)
Non controlling interest	<u>(561)</u>	<u>(352)</u>	<u>(561)</u>	<u>(389)</u>
<b>Income (loss) from continuing operations</b>	8,264	4,120	4,489	(3,848)
Loss from discontinued operations	<u>-</u>	<u>1,223</u>	<u>-</u>	<u>2,181</u>
<b>Net income (loss) for the period</b>	<u>\$ 8,264</u>	<u>\$ 2,897</u>	<u>\$ 4,489</u>	<u>\$ (6,029)</u>



# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### CINEPLEX ENTERTAINMENT LIMITED PARTNERSHIP CONSOLIDATED STATEMENTS OF PARTNERS' EQUITY AND COMPREHENSIVE INCOME

For the six months ended June 30, 2007 (i)  
(Unaudited)

	Accumulated income	Accumulated distributions	Accumulated distributions in excess of accumulated income	Accumulated other comprehensive income	Partners' capital	Formation of Partnership deficit	Total Partners' equity	Comprehensive income
<b>Balance – December 31, 2006</b>	\$59,761	(140,405)	<b>(80,644)</b>	-	262,774	(147,795)	<b>34,335</b>	-
Adoption of new accounting standards	(1,894)	-	<b>(1,894)</b>	2,427	-	-	<b>533</b>	-
<b>Balance – January 1, 2007</b>	57,867	(140,405)	<b>(82,538)</b>	2,427	262,774	(147,795)	<b>34,868</b>	-
Distributions declared	-	(26,330)	<b>(26,330)</b>	-	-	-	<b>(26,330)</b>	-
Investment in Cineplex Galaxy Income Fund units	-	-	-	-	(1,677)	-	<b>(1,677)</b>	-
LTIP compensation obligation	-	-	-	-	899	-	<b>899</b>	-
Net income for the period	4,489	-	<b>4,489</b>	-	-	-	<b>4,489</b>	<b>4,489</b>
Other comprehensive income – interest rate swaps	-	-	-	1,924	-	-	<b>1,924</b>	<b>1,924</b>
<b>Comprehensive income for the period</b>								<b>6,413</b>
<b>Balance – June 30, 2007</b>	\$62,356	(166,735)	<b>(104,379)</b>	4,351	261,996	(147,795)	<b>14,173</b>	

The sum of accumulated distributions in excess of accumulated income and accumulated other comprehensive income as at June 30, 2007 is (\$100,028).

For the six months ended June 30, 2006  
(Unaudited)

	Accumulated income	Accumulated distributions	Accumulated distributions in excess of accumulated income	Partners' capital	Formation of Partnership deficit	Total Partners' equity
<b>Balance – January 1, 2006</b>	\$51,925	(89,664)	<b>(37,739)</b>	232,975	(147,795)	<b>47,441</b>
Issuance of Partnership units	-	-	-	30,210	-	<b>30,210</b>
Other issuance costs	-	-	-	(466)	-	<b>(466)</b>
Distributions declared	-	(24,892)	<b>(24,892)</b>	-	-	<b>(24,892)</b>
Vesting of Fund units	-	-	-	142	-	<b>142</b>
LTIP compensation obligation	-	-	-	(105)	-	<b>(105)</b>
Net loss for the period	(6,029)	-	<b>(6,029)</b>	-	-	<b>(6,029)</b>
<b>Balance – June 30, 2006</b>	\$45,896	(114,556)	<b>(68,660)</b>	262,756	(147,795)	<b>46,301</b>

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### CINEPLEX ENTERTAINMENT LIMITED PARTNERSHIP CONSOLIDATED STATEMENTS OF CASH FLOWS (i) (Unaudited)

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the period	\$8,264	\$2,897	\$4,489	\$(6,029)
Adjustments to reconcile net income (loss) to net cash used in operating activities				
Amortization of property, equipment and leaseholds, deferred charges and intangible assets	16,478	15,834	32,752	31,072
Amortization of tenant inducements, rent averaging liabilities and fair value lease contract liabilities	(522)	(189)	(969)	(273)
Amortization of debt issuance costs	264	667	450	1,319
Loss (gain) on disposal of theatre assets	1,002	(2,757)	2,869	(2,235)
Future income taxes	(25)	589	(496)	589
Cash flow hedges - interest rate swaps, ineffective portion	(701)	-	(452)	-
Non-controlling interest	(561)	(352)	(561)	(389)
Tenant inducements	2,535	2,907	3,152	3,881
Changes in operating assets and liabilities	(15,195)	(4,487)	(43,786)	(36,945)
	<u>11,539</u>	<u>15,109</u>	<u>(2,552)</u>	<u>(9,010)</u>
<b>Investing activities</b>				
Proceeds from sale of theatre assets	2	-	2,477	70
Proceeds from sale of discontinued operations	-	150	-	652
Purchases of property, equipment and leaseholds	(9,480)	(20,956)	(14,408)	(36,062)
Theatre shutdown payout	-	(900)	(1,445)	(900)
Acquisition of Famous branded magazines	-	-	(406)	(1,100)
Lease guarantee payment and acquisition of theatre assets	-	-	(4,500)	-
	<u>(9,478)</u>	<u>(21,706)</u>	<u>(18,282)</u>	<u>(37,340)</u>
<b>Financing activities</b>				
Borrowings under credit facility	17,000	20,400	38,000	51,000
Repayment of credit facility	(12,000)	(30,108)	(23,000)	(33,117)
Issuance of Partnership units - net of issuance costs	-	30,166	-	30,166
Payments under capital leases	(364)	(339)	(721)	(666)
Distributions paid	(13,165)	(12,350)	(26,090)	(24,700)
Dividends paid to non-controlling interest	-	(196)	-	(196)
Investment in Cineplex Galaxy Income Fund units	-	-	(2,702)	-
Deferred financing fees	-	(115)	-	(115)
	<u>(8,529)</u>	<u>7,458</u>	<u>(14,513)</u>	<u>22,372</u>
<b>(Decrease) increase in cash and cash equivalents during the period</b>	<b>(6,468)</b>	<b>861</b>	<b>(35,347)</b>	<b>(23,978)</b>
<b>Cash and cash equivalents - Beginning of period</b>	<b>27,504</b>	<b>20,956</b>	<b>56,383</b>	<b>45,795</b>
<b>Cash and cash equivalents - End of period</b>	<b>\$21,036</b>	<b>\$21,817</b>	<b>\$21,036</b>	<b>\$21,817</b>
<b>Supplemental information</b>				
Cash paid for interest	\$8,111	\$8,875	\$16,488	\$17,551
Class C LP distributions paid and classified as interest	3,161	3,161	3,161	3,161
Cash paid for income taxes - net	5	263	11	315

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

- i) Certain line items presented in the Fund's interim consolidated financial statements differ from those presented for the Partnership. These differences are the result of the Fund's acquisition of control of the Partnership on April 2, 2007 and the accounting for the acquisition using the purchase method in the Fund's interim consolidated financial statements. This has resulted in a valuation basis for certain financial statement items in the Fund's financial statements (including the related amortizations) which are different than the historic costs contained in the Partnership financial statements. See note 2 of the Fund's interim consolidated financial statements for the period ended June 30, 2007.
- ii) The loan from Cineplex Galaxy Trust (\$100.0 million) and the resulting interest expense thereon (\$3.5 million and \$7.0 million for the three and six months ended June 30, 2007) is eliminated upon consolidation of the financial statements of the Partnership provided by the Fund.

### RESULTS OF OPERATIONS

The following table presents summarized financial data for the Partnership for the three and six months ended June 30, 2007 and June 30, 2006 (expressed in thousands of dollars except per LP Unit and per patron data).

	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
Total revenue	\$199,941	\$183,642	\$378,537	\$346,304
Cost of operations	164,897	156,430	318,838	300,810
Income from operations	35,044	27,212	59,699	45,494
Amortization	16,478	15,834	32,752	31,072
Loss (gain) on disposal of theatre assets	1,002	(4,003)	2,869	(3,819)
Interest on long-term debt	6,604	8,026	14,110	15,440
Interest on loan from the Trust	3,500	3,500	7,000	7,000
Interest income	(223)	(156)	(475)	(260)
Income tax (recovery) expense	(20)	243	(485)	298
Loss from discontinued operations	-	1,223	-	2,181
Non-controlling interest	(561)	(352)	(561)	(389)
Net income	\$8,264	\$2,897	\$4,489	(\$6,029)
Net income per LP Unit (i)	\$0.145	\$0.052	\$0.079	(\$0.109)
Total assets	755,620	788,098	755,620	788,098
Total long term financial liabilities (ii)	353,000	335,000	353,000	335,000
Cash distributions declared per LP Unit	\$0.2958	\$0.2874	\$0.5832	\$0.5748
Distributable cash per LP Unit	\$0.4337	\$0.3394	\$0.7131	\$0.5226
Box office revenue per patron	\$7.98	\$7.87	\$8.05	\$7.84
Concession revenue per patron	\$3.97	\$3.72	\$3.87	\$3.72
Film cost as a percentage of box office revenue	52.8%	53.0%	51.7%	51.5%
Attendance	15,050	14,481	28,943	27,676

- (i) Computed using weighted average number of LP Units outstanding for the period (excluding Class C LP Units).
- (ii) Excludes the Class C LP Units – liability component, capital lease obligations, accrued pension liability, other liabilities, liabilities related to property held for sale, and deferred financing fees net against the balance.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### DISTRIBUTABLE CASH

Management calculates distributable cash per LP Unit for the Partnership as follows (expressed in thousands of dollars except per unit data):

	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
Cash provided by (used in) operating activities	\$11,539	\$15,109	(\$2,552)	(\$9,010)
Less: Changes in operating assets and liabilities (i)	15,195	4,487	43,786	36,945
Tenant inducements (ii)	(2,535)	(2,907)	(3,152)	(3,881)
Capital lease payments	(364)	(339)	(721)	(666)
Dividends paid by subsidiary to non-controlling interest	-	(196)	-	(196)
Maintenance capital expenditures (iii)	(2,974)	(1,057)	(4,469)	(1,906)
Add: Interest on loan from Cineplex Galaxy Trust (iv)	3,500	3,500	7,000	7,000
Non cash components in operating assets and liabilities (v)	405	312	826	632
Expenses funded through integration and restructuring reserve (vi)	21	32	37	76
Distributable cash (vii)	<u>\$24,787</u>	<u>\$18,941</u>	<u>\$40,755</u>	<u>\$28,994</u>
Number of LP Units outstanding (viii)	57,150,421	55,809,762	57,150,421	55,481,913
Distributable cash per LP Unit	\$ 0.4337	\$ 0.3394	\$ 0.7131	\$ 0.5226

- (i) Changes in operating assets and liabilities are not considered a source or use of distributable cash.
- (ii) Tenant inducements received are for the purpose of funding new theatre capital expenditures and are not considered a source of distributable cash.
- (iii) Maintenance capital expenditures are funded out of distributable cash. Board approved projects are funded out of the Partnership's Development Facility (discussed below under "Liquidity and Capital Resources – Credit Facilities"). Certain integration related capital expenditures are funded out of reserve funds established on November 26, 2003 and July 22, 2005.
- (iv) Subject to "Catch-up Payment" provision and is considered part of distributable cash.
- (v) Reflects non-cash expenses including accretion on Class C LP Units and amortization of deferred gain on a RioCan Real Estate Investment Trust ("RioCan") sale-leaseback transaction. 2006 also includes non-cash amortization of swap on extinguished debt.
- (vi) Amounts financed by the \$25 million reserve set up upon completion of the Acquisition not considered a use of distributable cash. See discussion under "Liquidity and Capital Resources - Future Obligations" below.
- (vii) Distributable cash is a non-GAAP measure generally used in Canadian open-ended trusts, as an indicator of financial performance and it should not be seen as a measure of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. The Partnership's distributable cash may differ from similar calculations as reported by other entities and accordingly may not be comparable to distributable cash as reported by such entities.
- (viii) Excluding Class C LP Units. LP Units outstanding reflect the issuance on June 20, 2006 of 2,000,000 Class A LP Units.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

Alternatively, the calculation of distributable cash using the income statement as a reference point would be as follows (expressed in thousands of dollars):

	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
Income before undernoted	\$ 35,044	\$ 27,212	\$ 59,699	\$ 45,494
Adjust for:				
Interest on long-term debt	(6,604)	(8,026)	(14,110)	(15,440)
Interest income	223	156	475	260
Income taxes - current portion	(5)	346	(11)	291
Maintenance capital expenditures (i)	(2,974)	(1,057)	(4,469)	(1,906)
Dividends paid by subsidiary to non-controlling interest	-	(196)		(196)
Principal component of capital lease obligations	(364)	(339)	(721)	(666)
Expenses funded through integration and restructuring reserve (ii)	21	32	37	76
Income before undernoted from discontinued operations	-	23	-	(597)
Non-cash items:				
Amortization of tenant inducements, rent averaging liabilities and fair value lease contract assets	(522)	(189)	(969)	(273)
Amortization of debt issuance costs	264	667	450	1,319
Other non-cash items (iii)	(296)	312	374	632
Distributable cash (iv)	<u>\$ 24,787</u>	<u>\$ 18,941</u>	<u>\$ 40,755</u>	<u>\$ 28,994</u>

- (i) Maintenance capital expenditures are funded out of distributable cash. Board approved projects are funded out of the Partnership's Development Facility (discussed below under "Liquidity and Capital Resources – Credit Facilities"). Certain integration related capital expenditures are funded out of reserve funds established on November 26, 2003 and July 22, 2005.
- (ii) Amounts financed by the \$25 million reserve set up upon completion of the Acquisition not considered a use of distributable cash. See discussion under "Liquidity and Capital Resources – Future Obligations" below.
- (iii) Includes accretion on Class C LP Units, amortization of deferred gain on RioCan sale-leaseback transaction and non-cash movement in the fair value of the interest rate swap (2006 – includes amortization of swap on extinguished debt).
- (iv) Distributable cash is a non-GAAP measure generally used in Canadian open-ended trusts, as an indicator of financial performance and it should not be seen as a measure of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. The Partnership's distributable cash may differ from similar calculations as reported by other entities and accordingly may not be comparable to distributable cash as reported by such entities.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

The following table reconciles standardized distributable cash (as defined by the CICA in the release "Standardized Distributable Cash in Income Trusts and other Flow-Through Entities" issued in July 2007) to distributable cash as defined by the Partnership:

	For the three months ended June 30,		For the six months ended June 30,	
	2007	2006	2007	2006
Cash provided by (used in) operating activities	\$11,539	\$15,109	(\$2,552)	(\$9,010)
Total capital expenditures	(9,480)	(20,956)	(14,408)	(36,062)
Standardized distributable cash	\$2,059	(\$5,847)	(\$16,960)	(\$45,072)
Less: Changes in operating assets and liabilities (i)	15,195	4,487	43,786	36,945
Tenant inducements (ii)	(2,535)	(2,907)	(3,152)	(3,881)
Capital lease payments	(364)	(339)	(721)	(666)
Dividends paid by subsidiary to non-controlling interest	-	(196)	-	(196)
New build capital expenditures (iii)	6,506	19,899	9,939	34,156
Add: Interest on loan from Cineplex Galaxy Trust (iv)	3,500	3,500	7,000	7,000
Non cash components in operating assets and liabilities (v)	405	312	826	632
Expenses funded through integration and restructuring reserve (vi)	21	32	37	76
Distributable cash (vii)	\$24,787	\$18,941	\$40,755	\$28,994
Number of LP Units outstanding (viii)	57,150,421	55,809,762	57,150,421	55,481,913
Distributable cash per LP Unit	\$0.4337	\$0.3394	\$0.7131	\$0.5226

- (i) Changes in operating assets and liabilities are not considered a source or use of distributable cash.
- (ii) Tenant inducements received are for the purpose of funding new theatre capital expenditures and are not considered a source of distributable cash.
- (iii) Maintenance capital expenditures are funded out of distributable cash. Board approved projects are funded out of the Partnership's Development Facility (discussed below under "Liquidity and Capital Resources – Credit Facilities"). Certain integration related capital expenditures are funded out of reserve funds established on November 26, 2003 and July 22, 2005.
- (iv) Subject to "Catch-up Payment" provision and is considered part of distributable cash.
- (v) Reflects non-cash expenses including accretion on Class C LP Units and amortization of deferred gain on a RioCan Real Estate Investment Trust ("RioCan") sale-leaseback transaction. 2006 also includes non-cash amortization of swap on extinguished debt.
- (vi) Amounts financed by the \$25 million reserve set up upon completion of the Acquisition not considered a use of distributable cash. See discussion under "Liquidity and Capital Resources - Future Obligations" below.
- (vii) Distributable cash is a non-GAAP measure generally used in Canadian open-ended trusts, as an indicator of financial performance and it should not be seen as a measure of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. The Partnership's distributable cash may differ from similar calculations as reported by other entities and accordingly may not be comparable to distributable cash as reported by such entities.
- (viii) Excluding Class C LP Units. LP Units outstanding reflect the issuance on June 20, 2006 of 2,000,000 Class A LP Units.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### *Three and six months ended June 30, 2007 compared to the three and six months ended June 30, 2006 for the Partnership*

*Total revenues.* Total revenues for the three months ended June 30, 2007 increased \$16.3 million to \$199.9 million. Total revenues for the six months ended June 30, 2007 increased \$32.2 million to \$378.5 million. A discussion of the factors affecting the changes in box office, concession and other revenues for this period in comparison to the same period in 2006 is provided below.

*Box office revenues.* Box office revenues for the three months ended June 30, 2007 increased \$6.1 million to \$120.1 million compared to the same period in 2006. Canadian industry box office was up approximately 0.4% (source: Motion Picture Theatre Associations of Canada) for the second quarter of 2007 due to stronger overall film product in the second quarter of 2007 versus the same quarter in 2006. Box office revenues also include admissions for alternative programming including opera, hockey, wrestling and music concerts. The increase in box office revenues was due to increased average ticket prices (\$1.7 million), increased same store attendance levels (\$0.5 million) and an increase due to new theatres (\$4.7 million), partially offset by the impact of disposed theatres (\$0.8 million). The average box office revenue per patron of the Partnership increased from \$7.87 to \$7.98. The increase in average box office revenue per patron was a result of a slate of films that catered to teen and adult audiences in the second quarter of 2007 including *Spiderman 3* and *Pirates of the Caribbean: At Worlds End* as compared to several top films in the second quarter of 2006 which catered to children (*Ice Age: The Meltdown*, *Over the Hedge*, and *Cars*).

Box office revenues for the six months ended June 30, 2007 increased \$15.9 million to \$233.0 million compared to the same period in 2006. Canadian industry box office was up approximately 1.2% (source: Motion Picture Theatre Associations of Canada) for the first half of 2007 due to stronger overall film product in the first half of 2007 versus 2006. Box office revenues also include admissions for alternative programming including opera, hockey, wrestling and music concerts. The increase in box office revenues was due to increased average ticket prices (\$6.1 million), increased same store attendance levels (\$2.5 million) and an increase due to new theatres (\$8.9 million), partially offset by the impact of disposed theatres (\$1.6 million). The average box office revenue per patron of the Partnership increased from \$7.84 to \$8.05. The increase in average box office revenue per patron was a result of a slate of films that catered to adult audiences in the first half of 2007 including *Spiderman 3*, *Pirates of the Caribbean: At Worlds End* and *300*.

*Concession revenues.* Concession revenues for the three months ended June 30, 2007 increased \$5.9 million to \$59.8 million compared to the same period in 2006. The increase was due to increased average concession revenues per patron (\$3.5 million), increased same store attendance levels (\$0.2 million) and additional revenues from the operation of new theatres (\$2.6 million), partially offset by the impact of disposed theatres (\$0.4 million). The average concession revenue per patron of the Partnership increased from \$3.72 to \$3.97.

Concession revenues for the six months ended June 30, 2007 increased \$9.2 million to \$112.1 million compared to the same period in 2006. The increase was due to increased average concession revenues per patron (\$4.0 million), increased same store attendance levels (\$1.2 million) and additional revenues from the operation of new theatres (\$4.8 million), partially offset by the impact of disposed theatres (\$0.8 million). The average concession revenue per patron of the Partnership increased from \$3.72 to \$3.87.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

*Other revenues.* Other revenues for the three months ended June 30, 2007 increased \$4.3 million, or 27.3% to \$20.1 million. The components of other revenue are as follows (expressed in millions of dollars):

	<b>Three months ended June 30, 2007</b>	<b>Three months ended June 30, 2006</b>	<b>% Change</b>
Media	\$ 13.5	\$ 11.1	21%
Games	1.4	1.2	17%
Other	5.2	3.5	50%
	<u>\$ 20.1</u>	<u>\$ 15.8</u>	<u>27%</u>

Media revenue increased 21% versus the same period one year ago primarily as a result of the incremental contribution of the digital pre-show program which was implemented throughout 2006 and revenue enhancement initiatives. Games revenues increased 17% as a result of a combination of increased attendance and an increase in game machine utilization. The Other component increased principally due to breakage revenue for the second quarter of 2006 being adversely impacted by the standardization and net extension of expiry dates on the Partnership's gift certificate and discount ticket programs implemented in November 2005.

Other revenues for the six months ended June 30, 2007 increased \$7.1 million, or 26.8% to \$33.5 million. The components of other revenue are as follows (expressed in millions of dollars):

	<b>Six months ended June 30, 2007</b>	<b>Six months ended June 30, 2006</b>	<b>% Change</b>
Media	\$ 21.0	\$ 17.1	23%
Games	2.8	2.4	16%
Other	9.7	6.9	40%
	<u>\$ 33.5</u>	<u>\$ 26.4</u>	<u>27%</u>

Media revenue increased 23% over the prior year primarily as a result of the incremental contribution of the digital pre-show program which was implemented throughout 2006 and revenue enhancement initiatives. Games revenues increased 16% as a result of a combination of increased attendance and an increase in game machine utilization. The Other component increased principally due to breakage revenue for the first half of 2006 being adversely impacted by the standardization and net extension of expiry dates on the Partnership's gift certificate and discount ticket programs implemented in November 2005.

The SCENE loyalty program was created to drive incremental attendance and concession purchase incidence. Benefits of the program are reflected in box office and concession revenue respectively. Membership in the SCENE loyalty program as at June 30, 2007 was approximately 230,000 people.

*Film cost.* Film cost for the three months ended June 30, 2007 increased \$3.1 million to \$63.4 million. As a percentage of box office revenue, film cost decreased to 52.8% for the three months ended June 30, 2007 from 53.0% for the three months ended June 30, 2006.

Film cost for the six months ended June 30, 2007 increased \$8.6 million to \$120.3 million. As a percentage of box office revenue, film cost increased to 51.7% for the six months ended June 30, 2007 from 51.5% for the six months ended June 30, 2006.

*Cost of concessions.* Cost of concessions for the three months ended June 30, 2007 increased \$1.2 million to \$13.0 million. The increase in cost of concessions was due to additional costs from the operation of new theatres (\$0.7 million), increased purchase incidence (\$0.5 million) and increased same-store attendance (\$0.1 million), partially offset by the impact of disposed theatres (\$0.1 million). As a percentage of concession revenues, cost of concessions decreased from 21.9% for the three months ended June 30, 2006, to 21.7% for the three months ended June 30, 2007. During the second quarter, based on



# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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the anticipated product mix, the Partnership modified its concession sales strategy to increase per patron transaction values, including offering product-themed collectibles and an increased emphasis on discounted combo items. As a result of the strategy, the Partnership achieved its highest ever concession revenue per patron of \$3.97. The change in concession product offering mix resulted in a higher cost percentage than a typical quarter.

Cost of concessions for the six months ended June 30, 2007 increased \$1.9 million to \$23.4 million. The increase in cost of concessions was due to additional costs from the operation of new theatres (\$1.1 million), increased purchase incidence (\$0.7 million) and increased same-store attendance (\$0.2 million), partially offset by the impact of disposed theatres (\$0.1 million). As a percentage of concession revenues, cost of concessions was 20.9% for both the six months ended June 30, 2006 and the six months ended June 30, 2007.

*Occupancy expense.* Occupancy expense for the three months ended June 30, 2007 increased \$1.1 million to \$37.0 million. The increase was primarily due to incremental costs associated with new theatres that were opened (\$1.3 million) and higher rent expenses (\$0.7 million), partially offset by benefits related to the settlement of lease related amounts during the period (\$0.6 million) and the impact of disposed theatres (\$0.3 million).

Occupancy expense for the six months ended June 30, 2007 increased \$0.8 million to \$73.7 million. The increase was primarily due to incremental costs associated with new theatres (\$2.5 million), partially offset by benefits related to the settlement of lease-related amounts during the period (\$1.3 million) and the impact of disposed theatres (\$0.4 million).

*Other theatre operating expenses.* Other theatre operating expenses for the three months ended June 30, 2007 increased \$3.1 million to \$43.0 million. The overall increase in other theatre operating expenses was due to the incremental impact of costs associated with new theatres that were opened (\$1.3 million) and increased operating costs (\$2.1 million) due to variable costs and inflationary increases, launch costs associated with the SCENE loyalty program and development costs of the Partnership's interactive business, partially offset by the impact of disposed theatres (\$0.3 million).

Other theatre operating expenses for the six months ended June 30, 2007 increased \$6.5 million to \$84.7 million. The overall increase in other theatre operating expenses was due to the incremental impact of costs associated with new theatres that were opened (\$2.9 million) and increased operating costs (\$4.2 million) due to variable costs and inflationary increases, launch costs associated with the SCENE loyalty program and development costs of the Partnership's interactive business, partially offset by the impact of disposed theatres (\$0.6 million).

*General and administrative costs.* General and administrative costs were \$8.4 million for both the three months ended June 30, 2006 and for the three months ended June 30, 2007. General and administrative costs increased from \$16.5 million for the six months ended June 30, 2006 to \$16.8 million for the six months ended June 30, 2007 as a result of increased costs under the Partnership's Long Term Incentive Plan (\$1.0 million), partially offset by decreased supplies and services (\$0.5 million) and professional fees (\$0.3 million).

*Income before undernoted.* The Partnership reported income before undernoted for the three months ended June 30, 2007 of \$35.0 million as compared to income before undernoted of \$27.2 million for the three months ended June 30, 2006. This change was due to the aggregate effect of the factors described above.

The Partnership reported income before undernoted for the six months ended June 30, 2007 of \$59.7 million as compared to income before undernoted of \$45.5 million for the six months ended June 30, 2006. This change was due to the aggregate effect of the factors described above.

*Amortization.* For the three months ended June 30, 2007 amortization costs increased \$0.6 million to \$16.5 million. The increase was due primarily to the impact of new theatres.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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For the six months ended June 30, 2007 amortization costs increased \$1.7 million to \$32.8 million. The increase was due primarily to the impact of new theatres.

*Loss (gain) on disposal of theatre assets.* The loss on disposal of theatre assets represents the loss on theatre assets that were sold or otherwise disposed of. For the three months ended June 30, 2007 the Partnership recorded a loss of \$1.0 million as compared to a gain of \$4.0 million for the three months ended June 30, 2006. The loss primarily relates to the disposition of theatre equipment. During the first quarter of 2007, the Partnership determined that a \$2.8 million gain relating to a theatre disposed of during the second quarter of 2006 no longer met the requirements to be classified as part of discontinued operations, therefore the historical results have been reclassified to include the gain in continuing operations.

For the six months ended June 30, 2007 the Partnership recorded a loss of \$2.9 million as compared to a gain of \$3.8 million for the six months ended June 30, 2006. The loss primarily relates to a lease termination payment of \$2.0 million related to a theatre generating negative cash flow and the disposition of theatre equipment. During the first quarter of 2007, the Partnership determined that a \$2.8 million gain relating to a theatre disposed of during the second quarter of 2006 no longer met the requirements to be classified as part of discontinued operations, therefore the historical results have been reclassified to include the gain in continuing operations.

*Interest on long-term debt and capital lease obligations.* Interest on long-term debt for the three months ended June 30, 2007 decreased to \$6.6 million from \$8.0 million for the three months ended June 30, 2006. Interest expense is comprised of \$0.3 million for the amortization of deferred financing fees, interest on capital leases of \$0.7 million, interest of \$1.6 million and accretion expense of \$0.6 million on the Class C LP Units and \$4.1 million of interest on long-term debt, partially offset by a benefit of \$0.7 million relating to the ineffective portion of the Partnership's cash flow hedge that was recognized in the period. For the three months ended June 30, 2006 interest expense includes \$0.7 million for the amortization of deferred financing fees, interest on capital leases of \$0.7 million, interest of \$1.6 million and accretion expense of \$0.6 million on the Class C LP Units and \$4.4 million of interest on long-term debt.

Interest on long-term debt for the six months ended June 30, 2007 decreased to \$14.1 million from \$15.4 million for the six months ended June 30, 2006. Interest expense is comprised of \$0.5 million for the amortization of deferred financing fees, interest on capital leases of \$1.4 million, interest of \$3.2 million and accretion expense of \$1.2 million on the Class C LP Units and \$8.3 million of interest on long-term debt, partially offset by \$0.5 million relating to the ineffective portion of the Partnership's cash flow hedge that was recognized in the period. For the six months ended June 30, 2006 interest expense includes \$1.3 million for the amortization of deferred financing fees, interest on capital leases of \$1.4 million, interest of \$3.2 million and accretion expense of \$1.2 million on the Class C LP Units and \$8.3 million of interest on long-term debt.

*Interest on loan from Cineplex Galaxy Trust.* Interest on the loan from the Trust represents interest at a rate of 14% on the \$100 million loan from the Trust that was drawn on November 26, 2003.

*Interest income.* Interest income was \$0.2 million for both the three months ended June 30, 2007 and June 30, 2006. Interest income was \$0.5 million for the six months ended June 30, 2007 and \$0.3 million for the six months ended June 30, 2006.

*Income taxes.* For the three months ended June 30, 2007, a subsidiary of the Partnership recorded a future income tax recovery of \$25 thousand (2006 – expense of \$0.6 million) offset by a current tax expense of \$5 thousand (2006 – recovery of \$0.3 million). For the six months ended June 30, 2007, a subsidiary of the Partnership recorded a future income tax recovery of \$0.5 million (2006 – expense of \$0.6 million) offset by a current tax expense of \$11 thousand (2006 – recovery of \$0.3 million).

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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*Loss from discontinued operations.* Loss from discontinued operations for the three months ended June 30, 2006 amounted to a loss of \$1.2 million, of which \$1.2 million related to a loss associated with the disposal of theatre properties and income of \$23 thousand arising from the operations of the Alliance Atlantis branded theatres that were still held, in part, by the Partnership. During the first quarter of 2007, the Partnership determined that a \$2.8 million gain relating to a theatre disposed of during the second quarter of 2006 no longer met the requirements to be classified as part of discontinued operations, therefore the historical results have been reclassified to include the gain in continuing operations.

Loss from discontinued operations for the six months ended June 30, 2006 amounted to a loss of \$2.2 million, of which \$1.6 million related to a loss associated with the disposal of theatre properties and a loss of \$0.6 million arising from the operations of the Alliance Atlantis branded theatres that were still held, in part, by the Partnership and the seven Quebec theatres sold at the end of the first quarter of 2006. During the first quarter of 2007, the Partnership determined that a \$2.8 million gain relating to a theatre disposed of during the second quarter of 2006 no longer met the requirements to be classified as part of discontinued operations, therefore the historical results have been reclassified to include the gain in continuing operations.

*Non-controlling interests.* Non-controlling interests for the three and six months ended June 30, 2007 of \$0.6 million arises from the wind-up activities being undertaken at FP Media Inc., which has ceased operations.

*Net income (loss).* Net income for the three months ended June 30, 2007 increased from \$2.9 million for the three months ended June 30, 2006 to \$8.3 million, due to the net effect of all the other factors described above.

Net income for the six months ended June 30, 2007 was \$4.5 million, up \$10.5 million from a net loss of \$6.0 million for the six months ended June 30, 2006 due to the net effect of all the other factors described above.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### EBITDA

EBITDA is defined as income before interest expense, income taxes and amortization expense. Adjusted EBITDA excludes from EBITDA the non-controlling interest, loss (income) from discontinued operations, and the loss (gain) on disposal of theatre assets. Partnership management uses adjusted EBITDA to evaluate performance primarily because of the significant effect certain unusual or non-recurring charges and other items have on EBITDA from period to period. EBITDA adjusted for various unusual items is also used to define certain financial covenants in the Partnership's credit facilities. EBITDA and adjusted EBITDA are not presentations made in accordance with GAAP in Canada and are not measures of financial condition or profitability.

While the Partnership's management uses these measures to remove non-cash items and non-operating charges in order to evaluate the performance of the business, they are not necessarily comparable to other similarly titled captions of other issuers due, among other things, to differences in methods of calculation (expressed in thousands of dollars):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
<b>Net income (loss)</b>	\$8,264	\$2,897	\$4,489	(\$6,029)
Amortization	16,478	15,834	32,752	31,072
Interest on long-term debt	6,604	8,026	14,110	15,440
Interest on loan from Cineplex Galaxy Trust	3,500	3,500	7,000	7,000
Interest income	(223)	(156)	(475)	(260)
Income tax (recovery) expense	(20)	243	(485)	298
<b>EBITDA</b>	\$34,603	\$30,344	\$57,391	\$47,521
Non-controlling interest	(561)	(352)	(561)	(389)
Loss from discontinued operations	-	1,223	-	2,181
Loss (gain) on disposal of theatre assets	1,002	(4,003)	2,869	(3,819)
<b>Adjusted EBITDA</b>	\$35,044	\$27,212	\$59,699	\$45,494

### SEASONALITY AND QUARTERLY RESULTS

Historically, the Partnership's revenues have been seasonal, coinciding with the timing of major film releases by the major distributors. The most marketable motion pictures are generally released during the summer and the late-November through December holiday season. This may cause changes, from quarter to quarter, in attendance levels, theatre staffing levels and reported results. In order to stabilize working capital requirements during the slower quarters, the Partnership has available for its use a \$50.0 million Working Capital Facility (see "Liquidity and Capital Resources – Credit Facilities" discussed below). As of June 30, 2007, \$10.0 million was drawn on the Working Capital Facility.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### Summary of Quarterly Results (expressed in thousands of dollars except per unit and per patron data)

	2007		2006				2005	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Total revenue	\$199,941	\$178,596	\$194,964	\$198,976	\$183,642	\$162,662	\$193,186	\$151,879
Cost of operations	164,897	153,941	158,539	163,273	156,430	144,380	157,735	140,883
Income from operations	35,044	24,655	36,425	35,703	27,212	18,282	35,451	10,996
Amortization	16,478	16,274	17,081	16,340	15,834	15,238	16,235	14,136
Loss (gain) on disposal of theatre assets	1,002	1,867	3,623	344	(4,003)	184	(54)	195
Loss on extinguishment of debt	-	-	-	-	-	-	-	4,156
Loss on impairment of assets	-	-	-	-	-	-	-	4,296
Interest on long-term debt	6,604	7,506	7,912	8,002	8,026	7,414	7,691	6,160
Interest on loan from Cineplex Galaxy Trust	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500
Interest income	(223)	(252)	(248)	(237)	(156)	(104)	(91)	(109)
Income taxes	(20)	(465)	(112)	(1,450)	243	55	(925)	(712)
Income (loss) from discontinued operations	-	-	-	108	(1,223)	(958)	(620)	26,912
Non-controlling interest	(561)	-	106	10	(352)	(37)	1,214	614
Net income (loss)	\$8,264	(\$3,775)	\$4,563	\$9,302	\$2,897	(\$8,926)	\$7,261	\$5,672
Net income (loss) per LP Unit (i)	\$0.145	(\$0.066)	\$0.080	\$0.163	\$0.052	(\$0.162)	\$0.132	\$0.106
Cash flows from operations	11,539	(12,551)	79,639	30,415	15,109	(24,119)	57,141	327
Cash flows from investing activities	(9,478)	(10,344)	(13,771)	(21,757)	(21,706)	(15,634)	(10,083)	(286,671)
Cash flows from financing activities	(8,529)	(5,984)	(33,182)	(6,778)	7,458	14,914	(26,697)	302,255
Net change in cash	(6,468)	(\$28,879)	\$32,686	\$1,880	\$861	(\$24,839)	\$20,361	\$15,911
Box office revenue per patron	\$7.98	\$8.13	\$8.17	\$8.09	\$7.87	\$7.81	\$7.97	\$7.76
Concession revenue per patron	\$3.97	\$3.77	\$3.67	\$3.77	\$3.72	\$3.72	\$3.68	\$3.40
Attendance	15,050	13,893	14,369	15,380	14,481	13,195	14,815	12,471

(i) Computed using weighted average number of LP Units outstanding for the period (excluding Class C LP Units).

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### Distributable Cash

Management calculates distributable cash per LP Unit for the Partnership as follows (expressed in thousands of dollars except per unit data):

	2007		2006			2005		
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Cash provided by (used in) operating activities	\$11,539	\$(14,091)	\$79,639	\$30,415	\$15,109	\$(24,119)	\$57,141	\$ 327
Less: Changes in operating assets and liabilities (i)	15,195	28,591	(46,995)	5,027	4,487	32,458	(27,864)	8,922
Tenant inducements (ii)	(2,535)	(617)	(6,829)	(10,604)	(2,907)	(974)	(5,497)	(269)
Capital lease payments	(364)	(357)	(347)	(345)	(339)	(327)	(322)	(210)
Dividends paid by subsidiary to non-controlling interest	-	-	-	-	(196)	-	(490)	(1,372)
Maintenance capital expenditures (iii)	(2,974)	(1,495)	(4,039)	(1,905)	(1,057)	(849)	(1,482)	(590)
Add: interest on loan from Cineplex Galaxy Trust (iv)	3,500	3,500	3,500	3,500	3,500	3,500	3,500	3,500
Non cash components in operating assets and liabilities (v)	405	421	320	333	312	320	319	283
Expenses funded through integration and restructuring reserve (vi)	21	16	20	27	32	44	65	784
Distributable cash (vii)	\$24,787	\$ 15,968	\$25,269	\$26,448	\$18,941	\$ 10,053	\$25,370	\$11,375
Number of units outstanding (viii)	57,150,421	57,150,421	57,150,421	57,150,421	55,809,762	55,150,421	55,150,421	55,150,421
Distributable cash per LP Unit	\$0.4337	\$0.2794	\$0.4421	\$0.4628	\$0.3394	\$0.1823	\$0.4600	\$0.2063

- (i) Changes in operating assets and liabilities are not considered a source or use of distributable cash.
- (ii) Tenant inducements received are for the purpose of funding new theatre capital expenditures and are not considered a source of distributable cash flow.
- (iii) Maintenance capital expenditures are funded out of distributable cash. Board approved projects are funded out of the Partnership's Development Facility (discussed below under "Liquidity and Capital Resources – Credit Facilities"). Certain integration related capital expenditures are funded out of reserve funds established on November 26, 2003 and July 22, 2005. Maintenance capital expenditures for 2006 are not representative of the expected run-rate as the Partnership has focused on integrating the two circuits and evaluating capital requirements.
- (iv) Subject to "Catch-up Payment" provision and is considered part of distributable cash.
- (v) Reflects non-cash expenses including accretion on Class C LP Units, amortization of deferred gain on RioCan sale-leaseback transaction and amortization of swap on extinguished debt.
- (vi) Amounts financed by the \$25 million reserve set up upon completion of the Acquisition not considered a use of distributable cash. See discussion under "Liquidity and Capital Resources – Future Obligations" below.
- (vii) Distributable cash is a non-GAAP measure generally used by Canadian open-ended trusts, as an indicator of financial performance and it should not be seen as a measure of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. The Partnership's distributable cash may not be comparable to distributable cash as reported by such entities.
- (viii) LP Units outstanding reflect the issuance on July 22, 2005 of 6,835,000 Class A LP Units and 748,447 Class D LP Units to the fund the Acquisition and the June 20, 2006 issuance of 2,000,000 Class A LP Units, and excludes Class C LP Units.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### Balance Sheet

#### Assets

Assets decreased \$64.1 million to \$755.6 million as at June 30, 2007 due mainly to a decrease in cash of \$35.3 million, property, equipment and leaseholds of \$15.7 million, accounts receivable of \$11.6 million, and deferred charges of \$6.2 million; partially offset by an increase in prepaid expenses and other current assets of \$6.1 million.

*Property, equipment and leaseholds.* The decrease in fixed assets from \$447.9 million as at December 31, 2006 to \$432.2 million as at June 30, 2007 is due to amortization expenses (\$29.9 million) and asset dispositions (\$0.8 million) offset by new theatre build capital expenditures (\$10.0 million) and maintenance capital expenditures (\$5.0 million).

*Accounts receivable.* Accounts receivable decreased \$11.6 million to \$23.9 million as at June 30, 2007 from \$35.5 million as at December 31, 2006. This decrease was due mainly to the collection of media advertising receivables from the 2006 holiday season.

*Deferred charges.* Deferred charges decreased \$6.2 million to \$1.1 million as at June 30, 2007 from \$7.3 million as at December 31, 2006. Of this decrease, \$6.1 million related to the adoption of the CICA handbook section 3855, "Financial Instruments – Recognition and Measurement". The remaining difference is due to amortization expenses.

*Prepaid expenses and other current assets.* Prepaid expenses and other current assets increased by \$6.1 million from \$4.3 million as at December 31, 2006 to \$10.4 million as at June 30, 2007. This increase is due mainly to the prepayment of property taxes.

#### Liabilities

Liabilities decreased \$43.4 million from \$784.8 million as at December 31, 2006 to \$741.4 million as at June 30, 2007 primarily due to a decrease in accounts payable and accrued expenses of \$38.0 million and a decrease in deferred revenue of \$13.6 million, offset by an increase in borrowings, net of transitional adjustments upon the adoption of CICA handbook section 3855, of \$12.5 million.

*Accounts payable and accrued expenses.* Accounts payable and accrued expenses decreased from \$90.6 million as at December 31, 2006 to \$52.6 million as at June 30, 2007. The decrease is due to the settlement of year end liabilities that were high due to increased business volumes during the fourth quarter of 2006.

*Deferred revenue.* Deferred revenue decreased by \$13.6 million to \$36.6 million as at June 30, 2007 from \$50.2 million as at December 31, 2006. This was due primarily to the redemption of Cineplex gift cards and coupons that were sold during the holiday season in December 2006 and a traditional slow period in gift card and coupon sales in the first half of 2007.

*Current and long-term debt.* Current debt increased \$10.0 million at June 30, 2007. The Partnership borrowed \$33.0 million and repaid \$23.0 million on the Working Capital Facility to fund general corporate requirements. Long term debt increased from \$248.0 million as at December 31, 2006 to \$250.5 million as at June 30, 2007 as a result of amounts borrowed to fund construction and approved projects (\$5.0 million) partially offset by a \$2.9 million transitional adjustment upon the adoption of CICA handbook section 3855.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### Outstanding Fund Units

The Fund had the following Fund Units outstanding for the three months ended June 30 (expressed in thousands of dollars, except for Fund Unit amounts):

	Three months ended				Six months ended			
	June 30, 2007		June 30, 2006		June 30, 2007		June 30, 2006	
	Number of Fund Units	Amount	Number of Fund Units	Amount	Number of Fund Units	Amount	Number of Fund Units	Amount
Fund Units beginning of period	34,116,698	\$419,819	27,924,232	\$326,930	34,116,698	\$419,819	27,838,992	\$ 325,741
Issuance of Fund Units	-	-	2,000,000	31,800	-	-	2,000,000	31,800
Issuance of Fund Units under Exchange Agreement	9,122,751	143,136	3,621,000	53,114	9,122,751	143,136	3,706,240	54,303
Units - End of period	43,239,449	\$562,955	33,545,232	\$411,844	43,239,449	\$562,955	33,545,232	\$411,844
Convertible Debentures - equity component	-	8,546	-	8,546	-	8,546	-	8,546
Total Unitholder's equity	43,239,449	\$571,501	33,545,232	\$420,390	43,239,449	\$571,501	33,545,232	\$420,390

Under the terms of the Exchange Agreement, on April 2, 2007, COC exchanged 18,411,913 Class B, Series 1 and 2,086,957 Class B, Series 2-C LP Units for 11,376,119 units of CELP 2007 LP ("CELP 2007 LP Units") and 9,122,751 Fund Units.

Class B and Class D LP Units of the Partnership and CELP 2007 LP Units may be exchanged for Fund Units. As at June 30, the following Class B and Class D LP Units and CELP 2007 LP Units had not been exchanged for Fund Units:

	Number of Exchangeable Units	
	2007	2006
Class B Series 1 LP units	626,589	19,061,785
Class B Series 2-C LP units	-	2,086,957
Class B Series 2-G LP units	1,779,264	2,202,447
Class D LP units	129,000	254,000
CELP 2007 LP Units	11,376,119	-
	<u>13,910,972</u>	<u>23,605,189</u>



# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### **LIQUIDITY AND CAPITAL RESOURCES**

#### *Operating Activities*

Cash flow is generated primarily from the sale of admission tickets, concession sales and other revenues. Generally, this provides the Partnership with positive working capital, since cash revenues are normally collected in advance of the payment of certain expenses. Operating revenue levels are directly related to the success and appeal of the film product produced and distributed by the studios.

Cash provided by operating activities was \$11.5 million for the three months ended June 30, 2007 as compared to a source of \$15.1 million for the three months ended June 30, 2006. The primary reason for the difference was an increase in the changes in operating assets and liabilities versus the same period one year earlier (\$10.7 million), non-cash movement in interest expense related to interest rate swaps (\$0.7 million), decreased future income taxes (\$0.6 million), reduced amortization of debt issuance costs (\$0.4 million) and reduced tenant inducement receipts (\$0.4 million), offset by an increase in the net income for the period versus the same period one year earlier (\$5.4 million) and an increase in the non-cash loss on disposal of theatre assets (\$3.8 million).

Cash used by operating activities was \$2.6 million for the six months ended June 30, 2007 as compared to a use of \$9.0 million for the six months ended June 30, 2006. The primary reason for the difference was increased net income for the period versus the same period one year earlier (\$10.5 million) and an increase in the non-cash loss on disposal of theatre assets (\$5.1 million), partially offset by an increase in the changes in operating assets and liabilities versus the same period one year earlier (\$6.8 million), decreased future income taxes (\$1.1 million), non-cash movement in interest expense related to interest rate swaps (\$0.5 million) and reduced tenant inducement receipts (\$0.8 million).

#### *Investing Activities*

Cash used by investing activities for the three months ended June 30, 2007 of \$9.5 million related to capital expenditures. Cash used by investing activities for the three months ended June 30, 2006 of \$21.7 million primarily related to capital expenditures (\$21.0 million).

Cash used by investing activities for the six months ended June 30, 2007 of \$18.3 million primarily related to capital expenditures (\$14.4 million), a lease guarantee payment (see "Future Obligations" below) (\$4.5 million) and theatre shutdown payments (\$2.0 million), partially offset by proceeds from real estate transactions (\$3.0 million). Cash used by investing activities for the six months ended June 30, 2006 of \$37.3 million primarily related to capital expenditures of \$36.1 million.

The Partnership funds maintenance capital expenditures through internally generated cash flow and cash on hand. The Partnership funds new theatre capital expenditures through the Development Facility discussed below under "Liquidity and Capital Resources – Credit Facilities". In addition, at the Acquisition date, the Partnership identified certain capital expenditures required for the integration of the two businesses (principally point-of-sale systems and the standardization of the digital advertising network) which were pre-funded from the proceeds of the financing transactions on the Acquisition.

#### *Financing Activities*

Cash used by financing activities for the three months ended June 30, 2007 of \$8.5 million was due primarily to distribution payments (\$13.2 million) partially offset by net borrowings under the amended credit facilities described below (the "Amended Credit Facilities") (\$5.0 million). Cash provided by financing activities for the three months ended June 30, 2006 of \$7.5 million was due primarily to the issuance of 2,000,000 Class A LP Units (net proceeds \$30.2 million), offset by net repayments under the Amended Credit Facilities (\$9.7 million) and distribution payments (\$12.4 million).

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Cash used by financing activities for the six months ended June 30, 2007 of \$14.5 million was due primarily to distribution payments (\$26.1 million) partially offset by net borrowings under the Amended Credit Facilities (\$15.0 million). Cash provided by financing activities for the six months ended June 30, 2006 of \$22.4 million was due to the issuance of Partnership units (\$30.2 million) and net borrowings under the Amended Credit Facilities (\$17.9 million), offset by distribution payments (\$24.7 million).

The Partnership believes that it will be able to meet its future cash obligations with its cash and cash equivalents, cash flows from operations and funds available under the Amended Credit Facilities.

### *Distributions*

Partnership distributions are made on a monthly basis to unit holders of record of Class A LP Units, Class B LP Units and Class D LP Units on the last business day of each month. For the three months ended June 30, 2007, the Partnership's distributable cash flow per LP Unit was \$0.4337 compared to \$0.3394 for the three months ended June 30, 2006. The declared distribution per LP Unit and interest on the Galaxy Note (see "Credit Facilities" below) per LP Unit for the three months ended June 30, 2007 totaled \$0.2958, and for the three months ended June 30, 2006 totaled \$0.2874. For the period from January 1, 2007 to June 30, 2007, the Partnership's distributable cash flow per unit was \$0.7131 and \$0.5226 for the same period in 2006. The declared distribution per LP Unit and interest on the Galaxy Note per LP Unit for the six months ended June 30, 2007 totaled \$0.5832, and for the six months ended June 30, 2006 totaled \$0.5748. Distributable cash is a non-GAAP measure generally used by Canadian open-ended trusts, as an indicator of financial performance and it should not be seen as a measure of liquidity or a substitute for comparable metrics prepared in accordance with GAAP. The Partnership's distributable cash may differ from similar calculations as reported by other similar entities and accordingly may not be comparable to distributable cash as reported by such entities.

The Partnership made distributions on the Class C LP Units during the three months ended June 30, 2007 and 2006 of \$3.2 million. Distributions on the Class C LP Units are made twice a year, on the business day before June 30 and December 31. Distributions on Class C LP Units are deducted by the Partnership in computing its net income and distributable cash.

For the three months ended June 30, 2007 and June 30, 2006, the Fund declared distributions totaling \$0.2958 and \$0.2874 per Fund Unit, respectively. Effective for the May 2007 distribution, the Fund increased its monthly distribution from \$0.0958 to \$0.1000 per Fund Unit, or \$1.20 per Fund Unit on an annualized basis. For the six months ended June 30, 2007 and June 30, 2006, the Fund declared distributions totaling \$0.5832 and \$0.5748 per Fund Unit, respectively. The Fund is entirely dependent on distributions from the Partnership and interest payments from GEI to make its own distributions.

The after-tax return to unitholders of the Fund subject to Canadian federal income tax from an investment in Fund Units will depend, in part, on the composition for tax purposes of the distributions paid by the Fund, portions of which may be fully or partially taxable or may constitute non-taxable returns of capital, which are not included in a unitholder's income but which reduce the adjusted cost base of the Fund Units to the unitholder. The composition for tax purposes of these distributions may change over time, thus affecting the after-tax return to such unitholders. For the year ended December 31, 2006, 93.3% of the Fund's distributions (\$1.07256 per Fund Unit) represented taxable income and 6.7% (\$0.07704 per Fund Unit) represented a return of capital to the unitholder. For the year ended December 31, 2005, 67.3% of the Fund's distributions (\$0.77332 per Fund Unit) represented taxable income, 16.6% of the Fund's distributions (\$0.19097 per Fund Unit) represented a capital gain with the balance, 16.1% of the Fund's distributions (\$0.18531 per Fund Unit) represented a return of capital to the unitholder.

As at June 30, 2007, based on the tax returns filed to that date, the Partnership has tax pools of \$624.9 million available to offset future taxable income. Use of these tax pools is restricted to a percentage claim based on the nature of the original expenditure.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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On October 31, 2006 the Department of Finance (Canada) introduced modifications to the income tax rules that will result in the taxation of distributions made by the Fund beginning in the year 2011. On June 12, 2007, the legislation enacting the Minister of Finance's October 31, 2006 proposals was substantively enacted. See "Accounting Policies and Recent Developments – Income Taxes".

### *Credit Facilities*

In connection with the Acquisition, the Partnership entered into the Amended Credit Facilities that are comprised of the following:

- (i) a 364-day \$50 million extendible senior secured revolving credit facility ("Working Capital Facility");
- (ii) a four-year \$315 million senior secured non-revolving term credit facility ("Term Facility"); and
- (iii) a four-year \$60 million senior secured revolving credit facility ("Development Facility").

The Amended Credit Facilities bear interest at a floating rate based on the Canadian dollar prime rate, or banker's acceptance rate, plus an applicable margin, and amended and restated the Partnership's former credit facilities ("Former Credit Facilities") under which \$141 million was outstanding as at July 22, 2005.

The Working Capital Facility is a revolving facility available for general corporate purposes, including up to \$15 million to stabilize monthly cash distributions to be paid by the Partnership throughout the year. The Working Capital Facility may be extended for a period not to exceed the maturity date of the Term Facility.

The Development Facility is to be used for the development or acquisition of projects approved by the Trustees of the Fund. The Development Facility has a term of four years and is payable in full at maturity.

The Term Facility has a term of four years and is payable in full at maturity, with no scheduled repayment of principal required prior to maturity. The Term Facility was used to finance a portion of the purchase price of the Acquisition.

During the three months ended June 30, 2007, the Partnership borrowed \$17.0 million and repaid \$12.0 million under the Amended Credit Facilities. During the six months ended June 30, 2007, the Partnership borrowed \$38.0 million and repaid \$23.0 million under the Amended Credit Facilities. As at June 30, 2007 the Partnership had \$10.0 million outstanding under the Working Capital Facility, \$235.0 million outstanding under the Term Facility and \$18.0 million outstanding under the Development Facility.

The Partnership's Amended Credit Facilities contain numerous restrictive covenants that limit the discretion of the Partnership's management with respect to certain business matters. These covenants place restrictions on, among other things, the ability of the Partnership to create liens or other encumbrances, to pay distributions or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity.

The Amended Credit Facilities are secured by all of the Partnership's assets and are guaranteed by the Trust.

*Interest rate swap.* Effective July 22, 2005, the Partnership entered into three interest rate swap agreements. In accordance with the swap agreements, the Partnership pays interest at a fixed rate of 3.8% per annum, plus an applicable margin, and receives a floating rate. The 3.8% fixed interest rate reflects the mark-to-market buyout of the previous interest rate swap on the Former Credit Facilities. The swaps have a term of four years in the aggregate principal amount outstanding of \$200 million. The purpose of the interest rate swaps is to act as a cash flow hedge to manage the floating rate payable under the four-year senior secured non-revolving Term Facility. Under the provisions of CICA handbook Section 3865, "Hedges", the interest rate swap is recorded on the balance sheet at its fair market value effective January

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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1, 2007, with subsequent changes in fair value recorded in either net income or other comprehensive income. As at June 30, 2007, the fair market value of the swap is an unrealized gain of \$4.4 million (\$5.5 million as at June 30, 2006).

*Due to Cineplex Galaxy Trust.* On November 26, 2003, the Trust entered into an agreement with GEI, a wholly-owned subsidiary of the Partnership, whereby it loaned to GEI \$100 million (the "Galaxy Note"). The Galaxy Note bears interest at a rate of 14% per annum and has no scheduled repayments prior to maturity. The Galaxy Note matures on November 26, 2028 at which time it is payable in full. The Galaxy Note is subordinated to the Amended Credit Facilities discussed above.

### *Future Obligations*

As of June 30, 2007, the Partnership had aggregate capital commitments of \$16.2 million related to the completion of construction of four theatre properties to include an aggregate of 38 screens. The Partnership expects to complete construction and to open these theatres during 2007 and 2008.

As of June 30, 2007 the Partnership had outstanding letters of credit totaling \$0.6 million (2006 – \$1.3 million).

The Partnership conducts a significant part of its operations in leased premises. The Partnership's leases generally provide for minimum rent and a number of the leases also include percentage rent based primarily upon sales volume. The Partnership's leases may also include escalation clauses, guarantees and certain other restrictions, and generally require it to pay a portion of the real estate taxes and other property operating expenses. Initial lease terms generally range from 15 to 20 years and contain various renewal options, generally in intervals of five to ten years.

During 2005, the Partnership and Famous Players sold 29 theatres to third parties, of which 24 were leased properties. The Partnership and Famous Players are guarantors under the leases for the remainder of the lease term in the event that the purchaser of each theatre does not fulfill its obligations under the respective lease.

During the six months ended June 30, 2006, the Partnership entered into an agreement with a third party to divest seven theatres, six of which were leased properties and to provide advertising services to the purchaser until December 31, 2012. The Partnership is guarantor under the leases for the remainder of the lease term in the event that the purchaser of the theatres does not fulfill its obligations under the respective lease. The Partnership has also guaranteed certain advertising revenues based on attendance levels. During 2006, the Partnership entered into an agreement with a related party to divest its 49% share in its three remaining Alliance Atlantis branded theatres. The Partnership is guarantor for its 49% share of the leases for the remainder of the lease term in the event that the purchaser of the Partnership's share in the theatres does not fulfill its obligations under the respective lease. No amounts have been provided in the consolidated financial statements for these guarantees as at June 30, 2007 in accordance with the transitional provisions for CICA Section 3855, "Financial Instruments – Recognition and Measurement", the Partnership assessed the fair value of these guarantees to be a nominal amount. Should the purchasers of the theatres fail to fulfill their lease commitment obligations, the Partnership could face a substantial financial burden. During January 2007, the Partnership was notified that the guarantee provided to a landlord of one of the theatre properties disposed of had been triggered. As a result, in December 2006 the Partnership reversed the gain previously recognized as part of discontinued operations on disposition of the theatre. During the first quarter of 2007, the Partnership made a payment of \$4.5 million to the landlord of the guaranteed property as payment for the settlement of the guarantee relating to that property. The Partnership also took possession of assets from this former theatre location for use in its other theatre properties. The Partnership recognized a loss of \$0.1 million upon settlement of the liability.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### RELATED PARTY TRANSACTIONS

The Fund has entered into transactions with parties to which it is related. During the three months ended June 30, 2007 and 2006, distributions in the amount of \$8.2 million and \$4.6 million, respectively, were received from the Partnership. During the six months ended June 30, 2007 and 2006, distributions in the amount of \$14.5 million and \$9.1 million, respectively, were received from the Partnership. The Fund had distributions receivable from the Partnership at June 30, 2007 and 2006 in the amount of \$3.2 million and \$2.0 million, respectively.

The Fund recorded interest income from the Partnership with respect to the Class C LP Units during the three months and six months ended June 30, 2007 in the amount of \$1.6 million and \$3.1 million, respectively (2006 – \$1.6 million and \$3.1 million).

The Fund received interest income in the amount of \$3.5 million and \$7.0 million for the three and six months ended June 30, 2007 and 2006 with respect to the Galaxy Note.

The Partnership has entered into transactions with certain parties to which it is related as summarized below.

COC charged the Partnership \$0.1 million and \$0.3 million for the three and six months ended June 30, 2007 for rent for the Partnership's head office (2006 - \$0.1 million and \$0.3 million). The Partnership charged COC \$7 thousand for certain theatre management services during the three and six months ended June 30, 2007 (2006 - \$11 thousand).

For the three months ended June 30, 2007 and 2006, the Partnership incurred expenses for film rental totaling \$5.0 million and \$7.5 million, respectively, to Motion Picture Distribution LP ("Motion Picture"), a subsidiary of Alliance Atlantis Communications Inc. ("Alliance"). For the six months ended June 30, 2007 and 2006, the Partnership incurred expenses for film rental totaling \$11.4 million and \$16.0 million, respectively, to Motion Picture. Ellis Jacob, Chief Executive Officer of the Partnership, is a member of the Board of Directors and Audit Committee of Alliance.

The Partnership performs certain management and film booking services for the joint ventures in which it is a partner. During the three months ended June 30, 2007, the Partnership earned revenue in the amount of \$0.2 million with respect to these services (2006 - \$0.3 million). During the six months ended June 30, 2007, the Partnership earned revenue in the amount of \$0.4 million with respect to these services (2006 - \$0.4 million).

Distributions paid by the Partnership to related parties consist of (expressed in thousands of dollars):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Fund	\$8,234	\$4,561	\$14,540	\$9,078
Onex and its subsidiaries	4,813	7,439	11,318	14,878
Other related parties	74	180	147	396

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Distributions payable by the Partnership to related parties consist of (expressed in thousands of dollars):

	As at June 30,	
	2007	2006
Fund	\$3,157	\$2,047
Onex and its subsidiaries	1,351	2,168
Other related parties	25	36

Transactions noted above are in the normal course of business and unless otherwise noted are measured at the exchange amount, which is the amount of consideration established and agreed to by related parties.

### **ACCOUNTING POLICIES AND RECENT DEVELOPMENTS**

#### **Critical Accounting Policies and Estimates**

The Partnership prepares its financial statements in conformity with GAAP, which requires management to make estimates, judgments and assumptions that the Partnership believes are reasonable based upon the information available. These estimates, judgments and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The policies which the Partnership believes are the most critical to aid in fully understanding and evaluating its reported financial results include the following:

#### ***Revenues***

Box office and concession revenues are recognized, net of applicable taxes, when admission and concession sales are collected at the theatre. Amounts collected on advance ticket sales and long-term screen advertising agreements are deferred and recognized in the period earned. Amounts collected on the sale of gift certificates are deferred and recognized when redeemed by the patron.

#### ***Film Rental Costs***

Film rental costs are recorded based upon the terms of the respective film license agreements. In some cases the final film cost is dependent upon the ultimate duration of the film play and until this is known, management uses its best estimate of the ultimate settlement of these film costs. Film costs and the related film costs payable are adjusted to the final film settlement in the period the Partnership settles with the distributors. Actual settlement of these film costs could differ from those estimates.

#### ***Leases***

Leases are classified as either capital or operating. Leases that transfer substantially all of the risks and benefits of ownership to the Partnership and meet the criteria for capital leases set out in CICA handbook Section 3065, "Leases", are accounted for as an acquisition of an asset and an assumption of an obligation at the inception of the lease, measured at the present value of minimum lease payments. Related building and equipment are amortized on a straight-line basis over the term of the lease. All other leases are accounted for as operating leases wherein rental payments are charged to income as incurred.

Tenant inducements received are amortized into occupancy expenses over the term of the related lease agreement. Lease payments are recorded in occupancy expenses on a straight-line basis over the term of the related lease.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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The unamortized portion of tenant inducements and the difference between the straight-line rent expense and the payments, as stipulated under the lease agreement, are included in other liabilities. Certain of the leases to which the Partnership is party require a portion of rent to be determined with respect to the volume of activity at the specific theatre. An estimate of the expected expense is determined by management and recorded throughout the lease year.

### *Goodwill*

Goodwill represents the excess purchase price of acquired businesses over the estimated fair value of the net assets acquired. Goodwill is not amortized but is reviewed for impairment annually or more frequently if impairment indicators arise. A goodwill impairment loss will be recognized in net income if the estimated fair value of the goodwill is less than its carrying amount.

### *Intangible Assets*

Intangible assets represent the value of trademarks, trade names and advertising contracts of GEI and Famous Players as well as the fair value of Famous Players leases that are recorded as assets. As the useful life of the trademarks and trade names is indefinite, no amortization is recorded. The advertising contracts have limited lives and are amortized over their useful lives, estimated to be between five to nine years. The fair value of lease contract assets is amortized on a straight-line basis over the remaining term of the lease into amortization expense.

### *Income Taxes*

The Partnership is not subject to income or capital taxes, as the income, if any, is taxed in the hands of the individual partners.

Income taxes for the Partnership's subsidiaries, GEI and FP Media, are accounted for under the asset and liability method, whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base. Future tax assets and liabilities are measured using enacted or substantially enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Future income tax assets are recorded in the financial statements to the extent that realization of such benefits is more likely than not.

On October 31, 2006, the Department of Finance (Canada) announced the "Tax Fairness Plan" whereby the income tax rules applicable to publicly traded trusts and partnerships will be significantly modified. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation.

On December 15, 2006, the Department of Finance (Canada) released the normal growth guidelines for income trusts and other flow-through entities that qualify for the four-year transitional relief. The guidance establishes objective tests with respect to how much an income trust is permitted to grow without jeopardizing its transitional relief. In general, the Fund will be permitted to issue new equity over the next four years equal to its market capitalization as of the end of trading on October 31, 2006 (subject to certain annual limits). Market capitalization, for these purposes, is to be measured in terms of the value of the Fund's issued and outstanding publicly-traded units. If these limits are exceeded, the Fund may lose its transitional relief and thereby become immediately subject to the enacted rules.

On June 12, 2007, legislation enacting these proposals was substantively enacted. For trusts which were publicly traded or listed prior to November 1, 2006, the application of the rules is delayed to the

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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earlier of (i) the trust's 2011 taxation year, and (ii) a taxation year of the trust in which the trust exceeds normal growth as determined by reference to the normal growth guidelines, as amended from time to time, unless that excess arose as a result of a prescribed transaction. The rules are effective for the 2007 taxation year with respect to trusts which commence public trading after October 31, 2006.

As a result of the enacted rules, the Fund has reflected future income taxes of \$7.7 million in its unaudited consolidated interim financial statements for the period ended June 30, 2007. The future income taxes recorded reflect temporary differences expected to reverse in 2011 and thereafter at a rate of 31.5%.

The new rules may adversely affect the marketability of the Fund's units and the ability of the Fund to undertake financings and acquisitions, and the distributable cash of the Fund may be materially reduced.

### *Disposal of long-term assets and discontinued operations*

As per CICA handbook Section 3475, "Disposal of Long-Term Assets and Discontinued Operations," a long-term asset must be classified as an asset held for sale in the period during which all required criteria have been met. A long-term asset to be disposed of by sale must be measured at the lower of its carrying amount or fair market value less selling costs and should not be amortized as long as it is classified as an asset to be disposed of by sale. Assets and liabilities classified as held for sale are recorded on the consolidated balance sheets as assets held for sale and as liabilities related to property held for sale. When a disposal group is a portion of a reporting unit that constitutes a business, goodwill is allocated to the disposal group and included in its carrying amount prior to determining any write-down or gain on sale of the discontinued operations. A long-term asset to be disposed of other than by sale, namely abandonment, before the end of its useful service life estimated previously, is classified as an asset held for sale until its disposal and the amortization estimates must be revised according to the assets' abbreviated useful service life. In addition, this standard specifies that the operating results of a company's component disposed of by sale, or by withdrawal, or being classified as held for sale, be included in the discontinued operations if the operations or cash flows of the component have been or will be eliminated from the Partnership's current operations pursuant to the disposal, and if the Partnership does not have significant continuing involvement in the operations of the component after the disposal transaction. Each theatre is considered a component of the Partnership as the operations and cash flows can be distinguished from the rest of the enterprise. Interest on debt that is assumed by the Partnership and interest on debt that is required to be repaid as a result of the disposal transaction is allocated to discontinued operations.

### *Long-Lived Assets*

The Partnership continuously assesses the recoverability of its long-lived assets by determining whether the carrying value of these balances over the remaining life can be recovered through undiscounted projected cash flows associated with these assets. Generally this is determined on a theatre-by-theatre basis for the theatre related assets. In making its assessment, the Partnership also considers the useful lives of its assets, the competitive landscape in which those assets operate, the introduction of new technologies within the industry and other factors affecting the sustainability of asset cash flows.

### *Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The most significant assumptions made by management in the preparation of the financial statements relate to the allocation of the purchase price to the assets and liabilities acquired in the Famous Players business combination, the assessment of theatre cash flows to identify potential asset impairments, the assessment of the fair value of GEI and Famous Players to identify a potential goodwill impairment, estimating the fair value of the indefinite life assets to identify a potential impairment, the value of gift certificates that remain unutilized and in circulation for revenue recognition



# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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purposes, the film cost payable accrual, valuation of future income tax assets and the determination of the asset retirement obligation as certain leases may require the retirement of leaseholds, and this outcome is at the landlords' discretion at the end of the lease. Actual results could differ from those estimates. Where required, management has obtained external valuation assistance. For other estimates, management uses historical indicators adjusted for new developments and anticipated future events.

### Recent Accounting Developments

In April 2005, the CICA issued new handbook Sections: Section 1530, "Comprehensive Income"; Section 3251, "Equity"; and Section 3855, "Financial Instruments – Recognition and Measurement", for annual and interim periods beginning on or after October 1, 2006. Section 1530 establishes standards for reporting comprehensive income. These standards require that an enterprise present comprehensive income and its components in a separate financial statement that is displayed with the same prominence as other primary financial statements. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period in addition to the requirements of Section 1530. Section 3855 establishes standards for the recognition and measurement of all financial instruments, provides a characteristics-based definition of a derivative financial instrument, provides criteria to be used to determine when a financial instrument should be recognized, and provides criteria to be used when a financial instrument is to be extinguished. Sections 1530, 3251 and 3855 all apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2006. The Fund and the Partnership adopted these standards during the first quarter of 2007. Details of the impact of the application of these standards are discussed in Note 2 to the Fund's consolidated financial statements.

In October 2005, the CICA issued EIC-157, "Implicit Variable Interest Under AcG-15" which was effective for the first interim period or first annual fiscal period beginning subsequent to the date of the issuance of EIC-157, therefore, it was effective for the first quarter of 2006 for the Partnership. The standard addresses implicit variable interests which are an implied financial interest in an entity that changes with the changes in the fair value of that entity's net assets exclusive of variable interests. The Fund and the Partnership adopted the standard in the first quarter of 2006. Management has reviewed the requirements under EIC-157 and determined that it has no impact on the Fund's consolidated financial statements.

In December 2005, the CICA issued EIC-159, "Conditional Asset Retirement Obligations" which is effective for all interim and annual reporting periods ending after March 31, 2006 with early adoption encouraged. The standard addresses the issue of a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The Fund and the Partnership adopted this standard in the second quarter of 2006. Management has assessed the requirements under this standard and determined there is no significant impact on the Fund's consolidated financial statements.

In April 2006, the CICA issued EIC-161, "Discontinued Operations" which was to be applied prospectively and should be applied to all disposal transactions initiated after the date of issue (April 12, 2006). The standard addresses the allocation of interest expense and general corporate overhead expenses to Discontinued Operations, as well as the use of the Discontinued Operations classification to an entity where the remaining operations are insignificant. Subsequent to April 12, 2006, the Partnership has not identified any assets as held for sale. Management has assessed the requirements under this standard and determined that it has no impact on the Fund's consolidated financial statements.

In July 2006, the Accounting Standards Board ("AcSB") issued a replacement of CICA handbook Section 1506, "Accounting Changes". The new standard allows for voluntary changes in accounting policy only when they result in the financial statements providing reliable and more relevant information, requires changes in accounting policy to be applied retrospectively unless doing so is impracticable, requires prior period errors to be corrected retrospectively and calls for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. Section 1506 also requires

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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disclosure of information relevant to assessing the possible impact that the application of a new GAAP standard will have on the financial statements in the period of initial application. The impact that the adoption of Section 1506 will have on the Fund or Partnership's results of operations and financial condition will depend on the nature of future accounting changes. The adoption of Section 1506 effective January 1, 2007 has had no impact on the unaudited interim consolidated financial statements dated June 30, 2007 for the Fund.

In December 2006, the CICA issued new handbook sections: Section 1535, "Capital Disclosures"; Section 3862, "Financial Instruments – Disclosures"; and Section 3863, "Financial Instruments – Presentation", for annual and interim periods beginning on or after October 1, 2007. Section 1530 establishes disclosure requirements about capital. Sections 3862 and 3863 replace CICA 3861, revising and enhancing its disclosure requirements and carrying forward its presentation requirements. Management is considering the new handbook sections and the impact of the proposed rules to the Fund and the Partnership.

### **RISKS AND UNCERTAINTIES**

Investment in the Fund Units is subject to a number of risk factors. Cash distributions to unitholders are dependent upon the ability of the Partnership to generate income. The ability of the Partnership to generate income is susceptible to a number of risk factors which include: (i) the reliance on film production and film performance; (ii) alternative film delivery methods and other forms of entertainment; (iii) increased capital expenditures resulting from the development of digital technologies for film exhibition; (iv) reliance on key personnel; (v) the acquisition and development of new theatre sites; (vi) impact of new theatres; (vii) unauthorized copying of films; (viii) rising insurance and labor costs; (ix) financial liability arising from lawsuits; (x) the shrinking DVD window; and (xi) the ability to generate additional ancillary revenue. See "Risk Factors" detailed in the Fund's Annual Information Form dated March 27, 2007 for a more detailed description of risks facing the Partnership.

On October 31, 2006 the Department of Finance (Canada) announced the "Tax Fairness Plan" whereby income tax rules applicable to publicly traded trusts and partnerships will be significantly modified. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation. These proposals will be effective for the 2007 taxation year with respect to trusts which commence public trading after October 31, 2006, but the application of the rules will be delayed to the 2011 taxation year with respect to trusts which were publicly traded prior to November 1, 2006. On June 12, 2007, the legislation enacting the Minister of Finance's October 31, 2006 "Tax Fairness Plan" was substantively enacted. See discussion under "Accounting Policies and Recent Developments – Income Taxes."

As at June 30, 2007, COC, Cineplex Odeon (Quebec) Inc. ("COQ"), and former investors in GEI (collectively the "Investors") directly and indirectly controlled in aggregate approximately 24.3% of the outstanding LP Units of the Partnership (excluding the Class C LP Units) which, pursuant to the Exchange Agreement, could be exchanged for Fund Units at any time, subject to certain conditions. Restrictions on the ability of COC and COQ to exchange certain of their exchangeable securities expired on November 26, 2006. If COC and COQ sell substantial amounts of Fund Units in the public market, the market price of the Fund Units could fall. The perception among the public that these sales may occur could also produce such effect.

The Partnership is a guarantor under the leases disposed of during 2005 and 2006. There is a risk that the Partnership could have a substantial financial burden should the purchasers of the theatres fail to fulfill their lease commitment obligations (see "Future Obligations").

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### Market Risk

The Partnership is exposed to financial market risks, including changes in interest rates and other relevant market prices. As discussed in "Liquidity and Capital Resources – Credit Facilities" the Partnership has entered into various interest rate swaps agreements on \$200 million of outstanding indebtedness. The fair market value of the swap is an unrealized gain of \$4.4 million (gain of \$5.5 million as at June 30, 2006). As required by CICA handbook section 3865, this balance is recorded on the balance sheet. Fair value changes in the swap are recorded in net income and other comprehensive income as appropriate.

### Interest Rate Risk

As of June 30, 2007, the Partnership had long-term debt and amounts due to the Trust of \$353.0 million, excluding deferred financing fees. Approximately \$253.0 million of this debt is variable rate debt. An increase or decrease in interest rates would affect interest costs relating to this debt. For comparative purposes, for every change of 0.125% in interest rates, the Partnership's interest costs would change by approximately \$0.3 million per year. Offsetting this risk is the impact of the interest rate swap referred to above.

### Other

Since 2003, three complaints were filed with the Ontario Human Rights Commission against the Partnership, Famous Players Limited Partnership and the Alliance Atlantis Cinemas Partnership alleging discrimination against hearing-impaired individuals for not providing sufficient technology to accommodate their disability. Similar complaints were filed against other exhibitors and certain film distributors. In July, 2007, the Partnership, Famous Players Limited Partnership and the Alliance Atlantis Cinemas Partnership settled each of the complaints. The settlement provides for the installation of newly-developing closed captioning systems in multiple Ontario theatres when such systems become commercially available. These installations will occur on a phased-in basis following the Partnership's comprehensive selection and testing of the new technologies.

The Partnership and its subsidiaries are parties to various disputes arising in the ordinary course of business. From time to time, the Partnership is involved in disputes or litigation with landlords, contractors, past employees and other third parties. It is the opinion of management that any liability to the Partnership, which may arise as a result of these existing disputes, will not have a material adverse effect on the Partnership's operating results, financial position or cash flows.

In addition to the above, the Partnership would be adversely impacted by a national or global flu pandemic and could be impacted by any future changes to existing income trust income tax regulations.

### OUTLOOK

Management believes there are opportunities to grow revenue and distributable cash per unit. For example, cinema advertising in Canada has only recently been established and represents a growth opportunity for the Partnership. Management believes that its cinema advertising network, which reaches an audience of up to 80 million guests annually on a national basis, will continue to receive enhanced demand from advertisers. In addition, the Partnership continues to realize and seek out other revenue growth opportunities which include such opportunities as naming rights on certain theatres, extracting the benefits of the recently announced loyalty program, alternative programming and entertainment opportunities and web-based initiatives.

The Partnership believes that its' Amended Credit Facilities and ongoing cash flow from operations will be sufficient to allow it to meet ongoing requirements for capital expenditures, investments in working capital and distributions. However, the Partnership's needs may change and in such event the Partnership's

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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ability to satisfy its obligations will be dependent upon future financial performance, which in turn will be subject to financial, tax, business and other factors, including elements beyond the Partnership's control.

### **SUBSEQUENT EVENTS**

On July 13, 2007 the Partnership acquired the Cinema City brand theatres located in Winnipeg, Manitoba and Edmonton, Alberta for \$6.1 million. The three theatres will add 32 screens to Cineplex Entertainment's circuit of 129 theatres and 1,297 screens. Based on management's preliminary assessment, the assets acquired include property and equipment, tradenames and goodwill. The purchase price allocation has not been determined as fair value assessments are not yet practicable to estimate.

On July 25, 2007 the Partnership entered into the second amended and restated credit agreement. This amendment includes increased commitment amounts, an extended five-year term, financial covenant improvements, reductions in interest margins and additional flexibility in the permitted use of funds. The amended facilities total \$365.0 million and are comprised of a \$235.0 million five-year senior secured non-revolving term credit facility and a \$130.0 million five-year senior secured revolving credit facility. In addition, there are provisions to increase the \$130.0 million revolving credit facility commitment to an additional \$100.0 million with the consent of the lenders.

August 2, 2007

# Cineplex Galaxy Income Fund

## Interim Consolidated Balance Sheets (note 2(i))

(expressed in thousands of Canadian dollars)

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
	(Unaudited)	
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 22,659	\$ 1,270
Distributions receivable from Cineplex Entertainment Limited Partnership	-	2,102
Accounts receivable	23,946	-
Inventories	3,394	-
Prepaid expenses and other current assets	10,394	-
Income taxes receivable	23	-
Due from related parties	21	-
	<hr/>	
	60,437	3,372
<b>Property, equipment and leaseholds</b>	474,414	-
<b>Fair value of interest rate swap agreements</b> (note 3)	4,376	-
<b>Future income taxes</b> (note 10)	14,297	-
<b>Deferred charges</b>	1,152	-
<b>Due from Galaxy Entertainment Inc.</b> (note 2)	-	100,000
<b>Investment in Cineplex Entertainment Limited Partnership</b> (notes 1 and 2)	-	275,921
<b>Investment in Cineplex Entertainment Limited Partnership Class C Units</b> (note 2)	-	105,000
<b>Investment in Cineplex Entertainment Corporation</b>	-	2
<b>Intangible assets</b> (note 2)	142,055	-
<b>Goodwill</b> (note 2)	595,548	-
	<hr/>	
	\$ 1,292,279	\$ 484,295
	<hr/>	

These financial statements consolidate the results of the Partnership from April 2, 2007. Prior to that, the results of the Partnership were accounted for on an equity basis (see note 2(i)).

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

# Cineplex Galaxy Income Fund

Interim Consolidated Balance Sheets ...continued (note 2(i))

(expressed in thousands of Canadian dollars)

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
	(Unaudited)	
<b>Liabilities</b>		
<b>Current liabilities</b>		
Distributions payable (note 8)	\$ 5,715	\$ 3,268
Bank indebtedness	10,000	-
Due to Cineplex Entertainment Limited Partnership	-	4
Accounts payable and accrued expenses	52,860	-
Due to related parties	1,145	-
Deferred revenue	36,626	-
Capital lease obligations - current portion	1,536	-
	<hr/>	
	107,882	3,272
<b>Long-term debt</b> (note 4)	250,544	-
<b>Capital lease obligations</b> - long-term portion	35,931	-
<b>Accrued pension benefit liability</b>	1,867	-
<b>Other liabilities</b>	102,591	-
<b>Convertible debentures</b> - liability component	98,220	98,112
	<hr/>	
	597,035	101,384
<b>Non-controlling interests</b> (note 2)	180,290	-
<b>Unitholders' Equity</b>	514,954	382,911
	<hr/>	
	\$ 1,292,279	\$ 484,295
	<hr/>	

**Business acquisition** (note 2)

**Commitments, guarantees and contingencies** (note 6)

**Approved by the Board of Trustees**

"Howard Beck"  
Trustee

"Robert Steacy"  
Trustee

These financial statements consolidate the results of the Partnership from April 2, 2007. Prior to that, the results of the Partnership were accounted for on an equity basis (see note 2(i)).

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

# Cineplex Galaxy Income Fund

## Interim Consolidated Statements of Operations (note 2(i)) (Unaudited)

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

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
<b>Revenues</b>				
Box office	\$ 120,066	\$ -	\$ 120,066	\$ -
Concessions	59,792	-	59,792	-
Other	20,083	-	20,083	-
	<u>199,941</u>	<u>-</u>	<u>199,941</u>	<u>-</u>
<b>Expenses</b>				
Film cost	63,445	-	63,445	-
Cost of concessions	12,955	-	12,955	-
Occupancy	39,910	-	39,910	-
Other theatre operating expenses	43,042	-	43,042	-
General and administrative	8,450	-	8,450	-
	<u>167,802</u>	<u>-</u>	<u>167,802</u>	<u>-</u>
<b>Income before undernoted</b>	32,139	-	32,139	-
<b>Amortization</b>	20,069	-	20,069	-
<b>Loss on disposal of theatre assets</b>	219	-	219	-
<b>Share of loss of Cineplex Entertainment Limited Partnership (note 7)</b>	-	403	4,241	7,010
<b>Interest and accretion expense on Convertible Debentures</b>	1,809	1,861	3,607	3,718
<b>Interest on long-term debt and capital lease obligations</b>	4,419	-	4,419	-
<b>Interest income</b>	(236)	(5,094)	(5,323)	(10,178)
<b>Income (loss) before income taxes and non-controlling interests</b>	<u>5,859</u>	<u>2,830</u>	<u>4,907</u>	<u>(550)</u>
<b>Provision for (recovery of) income taxes</b>				
Current	5	-	5	-
Future	(7,669)	-	(7,669)	-
	<u>(7,664)</u>	<u>-</u>	<u>(7,664)</u>	<u>-</u>
<b>Income (loss) before non-controlling interests</b>	13,523	2,830	12,571	(550)
<b>Non-controlling interests</b>	2,100	-	2,100	-
<b>Net income (loss) for the period</b>	<u>\$ 11,423</u>	<u>\$ 2,830</u>	<u>\$ 10,471</u>	<u>\$ (550)</u>
<b>Basic earnings (loss) per unit</b>	\$ 0.27	\$ 0.10	\$ 0.27	\$ (0.02)
<b>Weighted average number of units outstanding used in computing basic earnings (loss) per unit</b>	43,021,708	28,754,628	38,593,802	28,334,189
<b>Diluted earnings (loss) per unit</b>	\$ 0.25	\$ 0.08	\$ 0.20	\$ (0.04)
<b>Weighted average number of units outstanding used in computing diluted earnings (loss) per unit (note 13)</b>	57,032,930	55,063,208	57,091,351	54,734,418

These financial statements consolidate the results of the Partnership from April 2, 2007. Prior to that, the results of the Partnership were accounted for on an equity basis (see note 2(i)).

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

CINEPLEX GALAXY INCOME FUND  
2007 SECOND QUARTER REPORT - CONSOLIDATED STATEMENTS OF OPERATIONS

# Cineplex Galaxy Income Fund

## Interim Consolidated Statements of Unitholders' Equity and Comprehensive Income (Unaudited)

(expressed in thousands of Canadian dollars)

### For the six months ended June 30, 2007

	Accumulated income	Accumulated distributions	Accumulated distributions in excess of accumulated income	Accumulated other comprehensive income	Unitholders' capital	Total unitholders' equity	Comprehensive income
<b>Balance - December 31, 2006</b>	\$ 43,089	\$ (88,543)	\$ (45,454)	\$ -	\$ 428,365	\$ 382,911	\$ -
Adoption of new accounting standards (note 3)	(782)	-	(782)	1,449	-	667	-
<b>Balance - January 1, 2007</b>	42,307	(88,543)	(46,236)	1,449	428,365	383,578	-
Distributions declared (note 8)	-	(22,595)	(22,595)	-	-	(22,595)	-
Net income for the period	10,471	-	10,471	-	-	10,471	10,471
Issuance of units under Exchange Agreement (note 2)	-	-	-	-	143,136	143,136	-
LTIP compensation obligation (note 9)	-	-	-	-	768	768	-
Treasury stock - LTIP units	-	-	-	-	(1,802)	(1,802)	-
Other comprehensive income - interest rate swaps	-	-	-	1,398	-	1,398	1,398
<b>Comprehensive income for the period</b>							<b>\$ 11,869</b>
<b>Balance - June 30, 2007</b>	\$ 52,778	\$ (111,138)	\$ (58,360)	\$ 2,847	\$ 570,467	\$ 514,954	

The sum of the accumulated distributions in excess of accumulated income and accumulated other comprehensive income as at June 30, 2007 is \$(55,513).

### For the six months ended June 30, 2006

	Accumulated income	Accumulated distributions	Accumulated distributions in excess of accumulated income	Unitholders' capital	Total unitholders' equity
<b>Balance - January 1, 2006</b>	\$ 32,988	\$ (52,436)	\$ (19,448)	\$ 334,287	\$ 314,839
Issuance of units (note 2)	-	-	-	31,800	31,800
Issuance of units under Exchange Agreement (note 9)	-	-	-	54,303	54,303
Distributions declared (note 8)	-	(16,625)	(16,625)	-	(16,625)
Net loss for the period	(550)	-	(550)	-	(550)
<b>Balance - June 30, 2006</b>	\$ 32,438	\$ (69,061)	\$ (36,623)	\$ 420,390	\$ 383,767

These financial statements consolidate the results of the Partnership from April 2, 2007. Prior to that, the results of the Partnership were accounted for on an equity basis (see note 2(i)).

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



# Cineplex Galaxy Income Fund

## Interim Consolidated Statements of Cash Flows (Unaudited)

(expressed in thousands of Canadian dollars)

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income (loss) for the period	\$ 11,423	\$ 2,830	\$ 10,471	\$ (550)
Adjustments to reconcile net income (loss) to net cash used in operating activities				
Share of loss from equity investee (note 7)	-	403	4,241	7,010
Amortization of property, equipment and leaseholds, deferred charges and intangible assets	20,069	-	20,069	-
Amortization of tenant inducements, rent averaging liabilities and fair value lease contract liabilities	2,365	-	2,365	-
Amortization of debt issuance costs	264	-	264	-
Loss on disposal of theatre assets	219	-	219	-
Future income taxes	(7,669)	-	(7,669)	-
Cash flow hedges - interest rate swaps, ineffective portion	(701)	-	(701)	-
Non-controlling interests	2,100	-	2,100	-
Accretion of Convertible Debentures	230	283	457	569
Distributions received from Cineplex Entertainment Limited Partnership	-	4,560	6,306	9,078
Tenant inducements	2,535	-	2,535	-
Changes in operating assets and liabilities (note 5)	(15,455)	5	(15,461)	-
	<u>15,380</u>	<u>8,081</u>	<u>25,196</u>	<u>16,107</u>
<b>Investing activities</b>				
Investment in Cineplex Entertainment Limited Partnership (note 2)	-	(31,800)	-	(31,800)
Proceeds from sale of theatre assets	2	-	2	-
Purchases of property, equipment and leaseholds	(9,480)	-	(9,480)	-
Cash acquired on the acquisition of Cineplex Entertainment Limited Partnership (note 2)	27,504	-	27,504	-
	<u>18,026</u>	<u>(31,800)</u>	<u>18,026</u>	<u>(31,800)</u>
<b>Financing activities</b>				
Issuance of units (note 2)	-	31,800	-	31,800
Distributions paid	(11,735)	(8,061)	(21,539)	(16,078)
Distributions paid to non-controlling interests	(4,930)	-	(4,930)	-
Borrowings under credit facility	17,000	-	17,000	-
Repayment of credit facility	(12,000)	-	(12,000)	-
Payments under capital leases	(364)	-	(364)	-
	<u>(12,029)</u>	<u>23,739</u>	<u>(21,833)</u>	<u>15,722</u>
<b>Increase in cash and cash equivalents during the period</b>	<b>21,377</b>	<b>20</b>	<b>21,389</b>	<b>29</b>
<b>Cash and cash equivalents - Beginning of period</b>	<b>1,282</b>	<b>1,218</b>	<b>1,270</b>	<b>1,209</b>
<b>Cash and cash equivalents - End of period</b>	<b>\$ 22,659</b>	<b>\$ 1,238</b>	<b>\$ 22,659</b>	<b>\$ 1,238</b>
<b>Supplemental information</b>				
Cash received for interest	\$ 236	\$ 3,509	\$ 3,747	\$ 7,017
Cash paid for interest	7,762	3,150	7,762	3,150
Cash paid for income taxes - net	5	-	5	-

Certain non-cash transactions occurred relating to exchanges of Class B LP and Class D LP units for Fund units (note 9).

These financial statements consolidate the results of the Partnership from April 2, 2007. Prior to that, the results of the Partnership were accounted for on an equity basis (see note 2(i)).

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

**CINEPLEX GALAXY INCOME FUND**  
**2007 SECOND QUARTER REPORT - CONSOLIDATED STATEMENTS OF CASH FLOWS**

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## 1 Description of the Fund

Cineplex Galaxy Income Fund (the "Fund") is an unincorporated, open-ended, limited purpose trust established under the laws of the Province of Ontario on October 2, 2003, pursuant to the Fund Declaration of Trust. The Fund was established to invest, through Cineplex Galaxy Trust (the "Trust"), a newly constituted wholly owned trust, in partnership units of Cineplex Galaxy Limited Partnership (renamed Cineplex Entertainment Limited Partnership) (the "Partnership") and shares of Cineplex Galaxy General Partner Corporation (renamed Cineplex Entertainment Corporation) (the "General Partner"), the general partner of the Partnership. The Partnership was formed on November 26, 2003 to acquire substantially all of the theatre business assets and liabilities of Cineplex Odeon Corporation ("COC") and all of the shares of Galaxy Entertainment Inc. ("GEI"). The Partnership's investors comprise the Trust, the General Partner, COC, Cineplex Odeon (Quebec) Inc., Onex Corporation and other former investors in GEI.

On July 22, 2005, the Partnership acquired 100% of Famous Players Limited Partnership and its general partner, Famous Players Co.

On June 20, 2006, the Fund issued 2,000,000 Fund units for proceeds of \$31,800. The Partnership and the Fund entered into a reimbursement agreement under which the fees associated with the issuance of the Fund units in the amount of \$1,984 were reimbursed by the Partnership.

On April 2, 2007, under the provisions of the Exchange Agreement, COC, a related party investor, exchanged 9,122,751 Class B Limited Partnership Units ("Class B LP Units") for 9,122,751 Fund Units (see note 2).

## 2 Business acquisition

### i) April 2, 2007

As a result of the various step acquisitions that took place prior to December 31, 2006, the Fund's indirect ownership of the Partnership, held through the Trust, was approximately 59.7% as at April 1, 2007. These step acquisitions were a result of subscriptions of Partnership units as well as exchanges of Fund units for Class B LP Units and Class D LP Units, indirectly through the Trust, on a one-for-one basis.

On April 2, 2007, under the provisions of the Exchange Agreement, COC, a related party investor, exchanged 9,122,751 Class B, Series 1 and Series 2-C LP Units for 9,122,751 Fund units. The Fund recorded the Partnership units it acquired at the fair market value of the Fund units, which was \$143,136 on the date of the transaction.

Prior to the April 2, 2007 step acquisition, the Fund accounted for its ownership interest in the Partnership under the equity method. As a result of the April 2, 2007 exchange, the Fund indirectly acquired an additional 16.0% interest in the Partnership, increasing its ownership to 75.7%. The acquisition of the additional interest in the Partnership is accounted for as a step acquisition as at April 2, 2007 for the purpose of purchase price allocation and the assigning of costs to identifiable assets and liabilities, intangible assets and goodwill.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

As a result of all of the Fund's step acquisitions in the Partnership (collectively referred to as the "Step Acquisitions"), the Fund acquired control of the Partnership and applied consolidation accounting effective April 2, 2007. The Step Acquisitions have been accounted for by the purchase method with the non-controlling interests accounted for in accordance with The Canadian Institute of Chartered Accountants' (the "CICA") recommendations in Emerging Issues Committee-151, *Exchangeable Securities Issued by Subsidiaries of Income Trusts* ("EIC-151"); accordingly, the results of operations of the Partnership have been included in these consolidated financial statements effective with the change in control. Based on management's best estimates, the cumulative purchase price has been allocated to the assets and liabilities of the Partnership as follows:

### Assets and liabilities acquired

Property, equipment and leaseholds	\$	481,914
Advertising contracts - amortized over three to five years		52,694
Trademarks and trade names - indefinite useful lives		70,611
Goodwill		595,548
Fair value of interest rate swap agreements		2,121
Fair value of leases - assets		22,402
Future income taxes		6,627
Other assets		1,185
Net working capital deficiency (including cash of \$27,504)		(39,576)
Bank indebtedness		(5,000)
Long-term debt		(250,280)
Net pension liability		(2,513)
Other liabilities		(98,995)
Capital leases		(37,838)
Non-controlling interests		<u>(181,172)</u>

**Net assets** \$ 617,728

### Consideration given

Initial investments in Partnership, net of Fund's share of accumulated Partnership income and distributions	\$	265,914
Investment in Partnership on April 2, 2007		143,136
Due from Galaxy Entertainment Inc.		100,000
Investment in Class C Partnership Units		105,000
Distributions and interest receivable from the Partnership		<u>3,678</u>
	\$	<u>617,728</u>

Prior to the Fund's Step Acquisitions of the Partnership, the Fund and the Partnership entered into a reimbursement agreement under which fees associated with the acquisitions were reimbursed by the Partnership. Therefore the transaction costs are included in the acquired net assets of the Partnership.

Famous Players Limited Partnership (Famous Players) and the Partnership are currently not subject to income or capital taxes as income, if any, is taxed in the hands of the individual partners. As at the date of the step acquisition, the amount of goodwill that is deductible for income tax purposes was estimated to be \$209,000.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

The above allocation of the purchase price is preliminary, as the fair value assessments have not been finalized. The actual calculation and allocation of the purchase price will be based on the estimated fair value of the assets acquired and liabilities assumed at each of the Step Acquisitions. Accordingly, the final purchase price allocation will be adjusted subsequent to completion of the final fair value assessment process; variations may be material.

ii) June 20, 2006

On June 20, 2006, the Fund issued 2,000,000 Fund units for gross proceeds of \$31,800. The Fund used the proceeds to indirectly purchase 2,000,000 Class A LP Units for an additional 1.7% interest in the Partnership. In addition, on June 20, 2006, certain investors exchanged 3,250,000 Class B and Class D LP Units for an equivalent number of units in the Fund. These Step Acquisitions have been accounted for as part of the purchase price allocation in the Fund's April 2, 2007 acquisition of control and consolidation of the Partnership.

### Non-controlling interests

Class B Partnership units and Class D Partnership units ("exchangeable units") are indirectly exchangeable one-for-one for Fund units in the manner set out in the Exchange Agreement. As a result of the Step Acquisitions and the Fund's acquiring control of the Partnership, exchangeable units are accounted for in accordance with EIC-151.

EIC-151 addresses whether or not the exchangeable units should be recorded as equity in the Fund's consolidated balance sheets. In accordance with this accounting abstract, the exchangeable units issued by the Partnership do not meet the definition of a liability and are considered transferable to third parties and must therefore be reflected as non-controlling interests.

EIC-151 also provides guidance on how the exchangeable units classified as non-controlling interests should be measured. When the Fund acquired the Partnership, it met the criteria for use of the exchange amount. The Fund's acquisition of the Partnership was accomplished by Step Acquisitions since the inception of the Partnership; therefore, the April 2, 2007 exchange amount used to initially record the non-controlling interests is the weighted average of the fair value of the Fund's Step Acquisitions of the Partnership. Since the exchangeable units are presented as non-controlling interests in these consolidated financial statements and were recorded at the exchange amount, any subsequent exchange after April 2, 2007 is accounted for as a rollover to unitholders' equity at that same value.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)  
June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

### 3 Summary of significant accounting policies

#### Basis of presentation

The Fund prepares its unaudited interim consolidated financial statements in accordance with Canadian generally accepted accounting principles (“GAAP”). The disclosures contained in these unaudited interim consolidated financial statements do not include all requirements of GAAP for annual financial statements and should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2006.

Prior to April 2, 2007, the Fund accounted for its investment in the Partnership under the equity method. Therefore, due to the limited amount of information that these unaudited interim consolidated financial statements provide on the underlying operations of the Partnership prior to April 2, 2007, these unaudited interim consolidated financial statements should be read in conjunction with the unaudited interim consolidated financial statements of the Fund for the six months ended June 30, 2006, which include the unaudited interim consolidated financial statements of the Partnership.

The unaudited interim consolidated financial statements follow the same accounting policies and methods of application as the audited consolidated financial statements for the year ended December 31, 2006, except as described in the remainder of this note. In addition, certain accounting policies were adopted by the Fund as a result of the Fund’s acquiring control and consolidating the Partnership effective April 2, 2007.

#### Accounting changes

In July 2006, the Accounting Standards Board issued a replacement of The Canadian Institute of Chartered Accountants’ Handbook (“CICA Handbook”) Section 1506, *Accounting Changes*. The new standard allows for voluntary changes in accounting policy only when they result in the financial statements providing reliable and more relevant information, requires changes in accounting policy to be applied retrospectively, unless doing so is impracticable, requires prior period errors to be corrected retrospectively and calls for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. Section 1506 also requires disclosure of information relevant to assessing the possible impact that the application of a new GAAP standard will have on the Fund’s financial statements in the period of initial application. The impact that the adoption of Section 1506 will have on the Fund’s results of operations and financial condition will depend on the nature of future accounting changes. The adoption of Section 1506 effective January 1, 2007 has had no impact on these unaudited interim consolidated financial statements.

#### Financial instruments

As required by the CICA, on January 1, 2007, the Fund adopted CICA Handbook Section 1530, *Comprehensive Income*; Section 3251, *Equity*; Section 3855, *Financial Instruments - Recognition and Measurement*; Section 3861, *Financial Instruments - Disclosure and Presentation*; and Section 3865, *Hedges*. The adoption of these new standards resulted in changes in the accounting and presentation for financial instruments and the recognition of certain transition adjustments that have been recorded in opening accumulated income or opening accumulated other comprehensive income as described below. As required by

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

---

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

the implementation of these new standards, the prior period consolidated financial statements have not been restated. The principal changes in the accounting for financial instruments due to the adoption of these accounting standards are described below.

**a) Section 1530, Comprehensive Income**

Section 1530 requires a statement of comprehensive income, which consists of net income and other comprehensive income ("OCI"). OCI is a new requirement to temporarily present certain gains and losses from changes in fair value outside net income. It includes adjustments to the accumulated income and OCI of the Partnership that impact the Fund's equity method investment in the Partnership prior to the Fund's April 2, 2007 Step Acquisition of the Partnership, and the Fund's unrealized gains and losses, such as the effective portion of gains and losses and derivatives designated as cash flow hedges. Comprehensive income and its components are presented in the consolidated statements of unitholders' equity and comprehensive income.

**b) Section 3251, Equity**

Section 3251 describes the changes in how to report and disclose equity and changes in equity as a result of the new requirements of Section 1530, including the changes in equity for the period arising from OCI. Accumulated changes in OCI are included in accumulated other comprehensive income ("AOCI") and are presented in the consolidated statements of unitholders' equity and comprehensive income as a separate component of unitholders' equity.

**c) Section 3855, Financial Instruments - Recognition and Measurement  
Section 3861, Financial Instruments - Disclosure and Presentation**

**Financial assets and financial liabilities**

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and their subsequent measurements are dependent on their classification, as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Fund's designation of such instruments. The standards require that all financial assets be classified either as held-for-trading, available-for-sale, held-to-maturity or loans and receivables. The standards require that all financial assets, including all derivatives, be measured at fair value, with the exception of loans and receivables, debt securities classified as held-to-maturity and available-for-sale financial assets that do not have quoted market prices in an active market. Settlement date accounting continues to be used for all financial assets, except that changes in fair value between the trade date and settlement date are reflected in the consolidated statements of operations for held-for-trading financial assets, while changes in fair value between trade date and settlement date are reflected in OCI for available-for-sale financial assets.

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## **Held-for-trading**

Held-for-trading financial assets are measured at fair value at the dates of the balance sheets. Interest earned, interest accrued, gains and losses realized on disposal and unrealized gains and losses from market fluctuations are included in interest income or expense. Speculative financial assets or liabilities, other than loans and receivables and derivative instruments, are accounted for as held-for-trading financial assets or liabilities, unless the derivative is linked to, and must be settled with, equity instruments of another entity whose fair value cannot be reliably measured. In addition, if the fair value of a non-derivative instrument is reliably measurable, the Fund may elect to designate it as held-for-trading at the time of its initial recognition. The designation for such an instrument is irrevocable.

Financial liabilities designated at fair value are those non-derivative financial liabilities that the Fund elects to designate on initial recognition as instruments that it will measure at fair value through the consolidated statements of operations. These are accounted for in the same manner as held-for-trading financial assets. The Fund has not designated any non-derivative financial liabilities as fair value financial liabilities.

## **Held-to-maturity**

Held-to-maturity financial assets are non-derivative financial assets such as investments in debt securities with fixed or determinable payments and a fixed maturity, other than loans and receivables, that an entity has the positive intention and ability to hold to maturity. After initial recognition at fair value, these financial assets are measured at amortized cost.

## **Available-for-sale**

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or that are not classified as loans and receivables, held-to-maturity investments or held-for-trading. Available-for-sale financial assets are carried at fair value with unrealized gains and losses and are included in OCI until realized when the cumulative gain or loss is recorded in the consolidated statements of operations. The Fund has not designated any financial assets as available-for-sale.

## **Loans and receivables**

Loans and receivables are non-derivative financial assets that are initially recognized at fair value and, thereafter, are accounted for at cost or amortized cost.

## **Other liabilities**

Other liabilities are non-derivative financial liabilities that are initially recognized at fair value and thereafter are recorded at cost or amortized cost and include all liabilities, other than derivatives or liabilities to which the fair value designation has been applied.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)  
June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

### **Derivatives**

Derivatives are carried at fair value and are reported as assets where they have a positive fair value and as liabilities where they have a negative fair value unless the derivative qualifies for hedge accounting. These changes in fair value during the period are recorded in income. As at June 30, 2007, the only derivatives outstanding are the Fund's interest rate swaps, which are accounted for as cash flow hedges.

### **Embedded derivatives**

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivative are the same as those of a free-standing derivative; and the combined instrument or contract is not measured at fair value, with changes in fair value recognized in the consolidated statements of operations. These embedded derivatives are measured at fair value with changes therein recognized in the consolidated statements of operations.

### **Transaction costs**

Transaction costs are expensed as incurred. Transaction costs do not include debt premiums or discounts or financing costs, which are netted against the carrying value of the liability and then amortized over the expected life of the instrument using the effective interest method. In addition, transaction costs do not include direct transaction costs in a business combination which are included as part of the purchase price of the acquisition.

### **Determination of fair value**

The fair value of a financial instrument is the amount of consideration that would be agreed on in an arm's-length transaction between knowledgeable, willing parties who are under no compulsion to act. The fair value of a financial instrument on initial recognition is the transaction price, which is the fair value of the consideration given or received. Subsequent to initial recognition, the fair values of financial instruments that are quoted in active markets are based on bid prices for financial assets held and offer prices for financial liabilities. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparisons with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. For certain derivatives, fair values may be determined in whole or in part from valuation techniques using non-observable market data or transaction prices. A number of factors such as bid-offer spread, credit profile and model uncertainty are taken into account, as appropriate, when values are calculated using valuation techniques.



# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## Classification of financial instruments

The following is a summary of the accounting model the Fund has elected to apply to each of its significant categories of financial instruments:

- Cash and cash equivalents are classified as held-for-trading. Changes in fair value for the period are recorded in income as interest income;
- Accounts receivable are classified as loans and receivables;
- Due from related parties is accounted for on recognition in accordance with Section 3840, *Related Party Transactions* and, subsequently, classified as loans and receivables;
- Interest rate swaps are accounted for as cash flow hedges;
- Interest and distributions receivable are classified as loans and receivables;
- Interest, distributions payable and accounts payable and accrued expenses are classified as other liabilities;
- Due to related parties is accounted for on recognition in accordance with Section 3840, *Related Party Transactions* and, subsequently, classified as other liabilities;
- Bank indebtedness and long-term debt are accounted for as other liabilities measured at amortized cost; and
- On July 22, 2005, the Fund issued Convertible Debentures for proceeds of \$105,000 (“Convertible Debentures”). Convertible Debentures are recorded at amortized cost using the effective interest method. The Convertible Debentures are traded on the Toronto Stock Exchange. The Convertible Debentures are accounted for in accordance with their substance rather than their legal form and are presented in the consolidated financial statements in component parts, measured at their respective fair value at the time of issuance, with \$8,546 recorded in equity and, originally, \$96,454 classified as a liability accreting interest using the effective interest method to the face value of \$105,000 on December 31, 2012. Based on the published fair values, management estimates that the Convertible Debentures have a fair value of \$110,250 as at June 30, 2007 (December 31, 2006 - \$105,525).

### d) Section 3865, Hedges

Section 3865 addresses the identification, designation, documentation and effectiveness of hedging transactions for the purpose of applying hedge accounting. It also establishes conditions for applying, and the discontinuance of, hedge accounting and hedge effectiveness testing requirements. Under the guideline, the Fund is required to document its hedging transactions and explicitly demonstrate that hedges are effective in order to continue hedge accounting for positions hedged with derivatives. Any derivative financial instruments that fail to meet the hedging criteria will be recorded on the consolidated balance

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

---

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

sheets at fair value and changes in fair value will be recognized in income in the period in which the change occurs.

The Fund enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its long-term debt. Effective July 22, 2005, the Partnership entered into three interest rate swap agreements. In accordance with the swap agreements, the Fund pays interest at a fixed rate of 3.8% per annum, plus an applicable margin, and receives a floating rate. The 3.8% fixed interest rate reflects the mark-to-market buyout of the previous interest rate swap on the previous credit facilities. The swaps have a term of four years in the aggregate principal amount outstanding of \$200,000. The purpose of the interest rate swaps is to act as a cash flow hedge to manage the floating rate payable under the term facility. The Fund considered the Partnership's hedging relationships and determined that its interest rate swap agreements on the term facility qualified for hedge accounting.

These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which payments are based. Interest expense on the long-term debt is adjusted to include the payments made or received under the interest rate swaps. The estimated fair value of the interest rate swaps is recognized in the consolidated balance sheets at their estimated fair value. The effective portion of the change in fair value of the interest rate swaps is recognized in OCI while the ineffective portion is recognized in the consolidated statements of operations as interest expense.

Realized and unrealized gains or losses previously recognized in AOCI that are associated with cash flow hedges, which have been terminated or cease to be effective prior to maturity, are recognized in income in the period in which the underlying hedged transaction is recognized. In the event that a designated hedged item is sold, extinguished or matures prior to the termination of the related derivative instrument, any realized or unrealized gain or loss on such derivative instrument is recognized immediately as an adjustment to the gain or loss on the extinguishment of debt.

The three interest rate swap cash flow hedges totalling \$200,000 have a July 22, 2009 maturity date, which is consistent with the term facility maturity date. During the three and six months ended June 30, 2007, the Fund recorded interest income of \$974 and \$974, respectively, relating to the ineffective portion of the cash flow hedge that was realized during the period.

**Cineplex Galaxy Income Fund**  
Interim Notes to Consolidated Financial Statements  
(Unaudited)  
**June 30, 2007**

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

**Transitional adjustments**

On January 1, 2007, the Fund made certain transitional adjustments to its consolidated balance sheets to adopt the new requirements. As required by the standards, prior periods have not been restated. The following transitional adjustments to the consolidated balance sheets were made to adopt the new requirements:

	<b>December 31, 2006</b>	<b>Transition adjustments</b>	<b>January 1, 2007</b>
<b>Assets</b>			
Investment in Cineplex Entertainment Limited Partnership (i)	\$ 275,921	\$ 318	\$ 276,239
All other assets	208,374	-	208,374
	<u>\$ 484,295</u>	<u>\$ 318</u>	<u>\$ 484,613</u>
<b>Liabilities</b>			
Convertible Debentures - liability component (ii)	\$ 98,112	\$ (349)	\$ 97,763
All other liabilities	3,272	-	3,272
	<u>101,384</u>	<u>(349)</u>	<u>101,035</u>
<b>Unitholders' Equity</b>			
Accumulated distributions in excess of accumulated income (i), (ii)	(45,454)	(782)	(46,236)
AOCI (i)	-	1,449	1,449
Unitholders' capital	428,365	-	428,365
	<u>382,911</u>	<u>667</u>	<u>383,578</u>
<b>Total Liabilities and Unitholders' Equity</b>	<u>\$ 484,295</u>	<u>\$ 318</u>	<u>\$ 484,613</u>

**i) Investment in Cineplex Entertainment Limited Partnership**

Transitional provisions for Sections 3855, 3865 and 1530 resulted in the Partnership making various transitional adjustments to its balance sheet on January 1, 2007. For these transitional adjustments that impact accumulated income and AOCI, the Fund accounts for its share of these adjustments under the equity method. As the Fund held a 59.7% interest in the Partnership as at January 1, 2007, the Fund's investment in the Partnership was increased by \$318, its accumulated income was decreased by \$1,131, and its AOCI was increased by \$1,449 to reflect the Fund's share of the Partnership's adjustments.

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## ii) Convertible Debentures - liability component

Section 3855 requires that the Fund use the effective interest method to accrete interest whereby the interest recognized varies over the expected lives of the Convertible Debentures, based on the liability balance outstanding. Prior to January 1, 2007, an equal amount of accretion expense was recognized each period over the expected lives of the Convertible Debentures. As at January 1, 2007, the Fund adjusted the carrying value of the liability component of the Convertible Debentures using the effective interest method. The impact was a decrease in the carrying value of the Convertible Debentures by \$349 and an increase in opening accumulated income.

## Revenues

Box office and concession revenues are recognized, net of applicable taxes, when sales are received at the theatres. Other revenues include revenues from advertising, games and theatre rentals and are recognized when services are provided. Amounts collected on advance ticket sales and screen advertising agreements are deferred and recognized in the period earned or redeemed.

## Gift certificates and gift cards

The Fund sells gift certificates and gift cards (collectively referred to as "gift cards") to its customers. The proceeds from the sales of gift cards are deferred and recognized as revenue either upon redemption of the gift card or in accordance with the Fund's accounting policy for breakage. Breakage income is included in other revenues and represents the estimated value of gift cards that are not expected to be redeemed by customers and is estimated based on the terms of the gift cards and historical redemption patterns, including available industry data.

## Multiple deliverable arrangements

The Fund enters into multiple deliverable arrangements related to certain sales of theatre assets, which may also include an advertising contract or an operational agreement. In addition, the Fund receives payment from certain vendors for advertising contracts, auditorium rentals and ticket purchases. When a sales arrangement requires the delivery of more than one service, the individual deliverables are accounted for separately, if applicable criteria are met. Specifically, the revenue is allocated to each deliverable if reliable and objective evidence of fair value for each deliverable is available. The amount allocated to each unit is then recognized when each unit or service is delivered, provided all other relevant revenue recognition criteria are met with respect to that unit. If, however, evidence of fair value is only available for undelivered elements, the revenue is allocated first to the undelivered items, with the remainder of the revenue being allocated to the delivered items, according to a calculation known as the residual method. If evidence of fair value is only available for the delivered items but not the undelivered items, the arrangement is considered a single element arrangement and revenue is recognized as the relevant recognition criteria are met.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)  
June 30, 2007

---

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

### **Film rental costs**

Film rental costs are recorded based on the terms of the respective film licence agreements. In some cases, the final film cost is dependent upon the ultimate duration of the film play and, until this is known, management uses its best estimate of the ultimate settlement of these film costs. Film costs and the related film costs payable are adjusted to the final film settlement in the period the Fund settles with the distributors. Actual settlement of these film costs could differ from those estimates.

### **Inventories**

Inventories are stated at the lower of cost or net realizable value. Cost is determined by the first-in, first-out method.

### **Disposal of long-term assets and discontinued operations**

As per CICA Handbook Section 3475, *Disposal of Long-Term Assets and Discontinued Operations*, a long-term asset must be classified as an asset held-for-sale in the period during which all required criteria have been met. A long-term asset to be disposed of by sale must be measured at the lower of its carrying amount or fair market value less selling costs and should not be amortized as long as it is classified as an asset to be disposed of by sale. Assets and liabilities classified as held-for-sale are recorded in the consolidated balance sheets as assets held-for-sale and as liabilities related to property held-for-sale. When a disposal group represents a portion of a reporting unit that constitutes a business, goodwill is allocated to the disposal group and included in its carrying amount prior to determining any writedown or gain on sale of the discontinued operations. A long-lived asset to be disposed of other than by sale continues to be classified as held and used until it is disposed. In addition, this standard specifies that the operating results of the Fund's component disposed of by sale, or by withdrawal, or being classified as held-for-sale, be included in discontinued operations if the operations or cash flows of the component have been, or will be, eliminated from the Fund's current operations pursuant to the disposal, and if the Fund does not have significant continuing involvement in the operations of the component after the disposal transaction. Each theatre is considered a component of the Fund as the operations and cash flows can be distinguished from the rest of the enterprise.

Interest on debt that is assumed by the buyer and interest on debt that is required to be repaid as a result of the disposal transaction is allocated to discontinued operations.

### **Theatre shutdown and lease buyouts**

Theatre lease costs and other closure expenses are recognized at the time a theatre closes and are recorded to (gain) loss on disposal of theatre assets in the consolidated statements of operations unless the theatre's operating results are included in discontinued operations. A provision is taken based on estimated expected future payments related to the contractual and ongoing maintenance of the property, adjusted for any negotiated termination of the lease obligation and reduced by estimated sublease rentals. Provisions are classified as current or long-term based on management's intention to settle the obligation within one year.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

### Property, equipment and leaseholds

Property, equipment and leaseholds are stated at cost, less accumulated amortization. Construction-in-progress is amortized from the date the asset is ready for productive use. Amortization is provided on the straight-line basis over the following useful lives:

Buildings (a)	30 to 40 years
Equipment	5 to 10 years
Leasehold improvements	term of lease but not in excess of the useful lives

- a) For owned buildings constructed on leased property, the useful lives do not exceed the terms of the land lease.

Property, equipment and leaseholds are evaluated for impairment in accordance with CICA Handbook Section 3063, *Impairment of Long-Lived Assets*. The Fund assesses the recoverability of its long-lived assets by determining whether the carrying value of these assets over the remaining life can be recovered through undiscounted projected cash flows associated with these assets. Generally, this is determined on a theatre-by-theatre basis for theatre related assets. In making its assessment, the Fund also considers the useful lives of its assets, the competitive landscape in which those assets are used, the introduction of new technologies within the industry and other factors affecting the sustainability of asset cash flows. While the Fund believes its estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect the evaluation. In the event that such cash flows are not expected to be sufficient to recover the carrying amount of the assets, the assets would be written down to their estimated fair values.

### Leases

Leases are classified as either capital or operating. Leases that transfer substantially all of the risks and benefits of ownership to the Fund and meet the criteria for capital leases set out in CICA Handbook Section 3065, *Leases*, are accounted for as an acquisition of an asset and an assumption of an obligation at the inception of the lease, measured at the present value of minimum lease payments. Related buildings and equipment are amortized on a straight-line basis over the term of the lease but not in excess of their useful lives. All other leases are accounted for as operating leases wherein rental payments are recorded in occupancy expenses on a straight-line basis over the term of the related lease. Tenant inducements received are amortized into occupancy expenses over the term of the related lease agreement. The unamortized portion of tenant inducements and the difference between the straight-line rent expense and the payments, as stipulated under the lease agreement, are included in other liabilities.

### Consideration received by a vendor

The Fund receives rebates from certain vendors with respect to the purchase of concession goods. In addition, the Fund receives payments from vendors for advertising undertaken by the theatres on behalf of the vendor. Under EIC-144, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, the Fund recognizes rebates earned for purchases of a vendor's product as a reduction of concession costs and recognizes payments received for services delivered to the vendor as other revenue.

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## Asset retirement obligation

CICA Handbook Section 3110, *Asset Retirement Obligations*, addresses the recognition and measurement of legal obligations associated with the retirement of property, equipment and leaseholds when those obligations result from the acquisition, construction, development or normal operation of the asset. The standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is identified if a reasonable estimate of fair value can be made. The fair value is added to the carrying amount of the associated asset and amortized over the estimated remaining life of the asset. The asset retirement obligation accretes due to the increase in the fair value resulting from the passage of time. This accretion amount is charged to other theatre operating expense for the period.

The Fund has recognized a discounted liability associated with obligations arising from specific provisions in certain lease agreements regarding the exiting of leased properties at the end of the respective lease terms and the removal of certain property, equipment and leaseholds from the leased building.

The total undiscounted amount of the cash flows required to settle the obligations, factoring in the effect of inflation and the dates that the leases are expected to end, which range from July 2007 to December 2028, has been estimated to be \$1,780. The credit-adjusted, risk-free rate at which the cash flows have been discounted is in the range of 5.44% to 6.27%.

## Capitalized interest

The Fund capitalizes interest on amounts drawn on the Development Facility that are used to finance the ongoing development of theatre projects. Interest is capitalized on projects under development up to the date the theatre enters productive use.

## Goodwill

Goodwill represents the excess purchase price of acquired businesses over the estimated fair value of the net assets acquired. Goodwill is not amortized but is reviewed for impairment annually, or more frequently if impairment indicators arise. For the purpose of impairment testing and determining the gain (loss) on disposal of theatre assets, goodwill is allocated to the individual theatres, which management has determined meet the definition of a reporting unit. A goodwill impairment loss will be recognized in net income if the estimated fair value of the goodwill of a theatre is less than the carrying amount of the goodwill of that theatre.

## Intangible assets and liabilities

Intangible assets represent the value of trademarks, trade names, leases and advertising contracts of the Partnership, GEI and Famous Players. As the useful lives of the trademarks and trade names are indefinite, no amortization is recorded. Intangible assets with indefinite service lives, representing trademarks and trade names, are accounted for at cost and are not amortized but are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. A trademark or trade name impairment loss will be recognized in net income if the estimated fair value of the trademark or trade name is less than the carrying value. The advertising contracts have limited lives and are amortized over their

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

---

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

useful lives, estimated to be between five to nine years. The estimated fair value of lease contract assets is recorded as an intangible asset and amortized on a straight-line basis over the remaining term of the lease into amortization expense. The fair value of lease contract liabilities is recorded as other liabilities and amortized against occupancy expense.

### **Pre-opening costs**

Expenses incurred for advertising, marketing and staff training relating to the opening of new theatres are expensed as incurred and included in operating expenses.

### **Deferred charges**

Deferred charges consist principally of payments made with respect to the early termination of leases and are amortized according to the terms of the termination agreement.

### **Employee future benefits**

The Fund is the sponsor of a number of employee benefit plans. These plans include defined benefit plans, a defined contribution plan, and additional unfunded defined benefit obligations for former Famous Players employees.

#### a) Defined benefit plans

The accumulated benefit method has been used to determine the accrued benefit obligation in respect of the defined benefit plans, as future salary levels do not affect the benefits. The expected return on assets is based on the fair value of assets. The excess of unamortized actuarial gains or losses over 10% of the greater of the fair value of plan assets and the benefit obligation is amortized over the average remaining service period of active employees. The average remaining service period is estimated at 13 years.

#### b) Defined contribution plan

Costs for the Fund's defined contribution plan are recognized in income during the period in which the service is provided.

### **Foreign currency translation**

The consolidated financial statements are presented in Canadian dollars because it is the currency of the primary economic environment in which the Fund conducts its operations.

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at the rate of exchange in effect as at the dates of the consolidated balance sheets. Non-monetary assets and liabilities and revenues and expenses are translated at the exchange rate in effect at the date of the transaction. Exchange gains and losses arising from translation are included in operations.



# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

---

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## Income taxes

The Fund is a mutual fund trust for income tax purposes. As such, the Fund is only taxable on any amount not allocated to unitholders. Income tax liabilities relating to distributions of the Fund are taxed in the hands of the unitholders.

On October 31, 2006, the Department of Finance (Canada) announced tax proposals pertaining to the taxation of income distributed by publicly listed income trusts and the tax treatment of trust distributions to their unitholders. Currently, the Fund does not pay tax on income it distributes to its unitholders. The income tax proposals were substantively enacted into law on June 12, 2007 and resulted in Fund income being subject to income taxes at the trust level effective January 1, 2011.

The enactment of the proposals also resulted in the Fund accounting for future income taxes under the asset and liability method, whereby future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Future income tax assets are recorded in the consolidated financial statements to the extent that realization of such benefits is more likely than not.

## Upcoming accounting pronouncements

The potential impact that the application of a new GAAP standard will have on the Fund's financial statements in the period of initial adoption is as follows:

In December 2006, the CICA issued Handbook Section 1535, *Capital Disclosures*. This section establishes standards for disclosing information about an entity's objectives, policies and processes for managing capital. This standard is effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis. The Fund will adopt this new standard effective January 1, 2008.

In December 2006, the CICA issued Handbook Section 3862, *Financial Instruments - Disclosures*, and Section 3863, *Financial Instruments - Presentation*. These standards enhance existing disclosures in previously issued Section 3861, *Financial Instruments - Disclosure and Presentation*. Section 3862 places greater emphasis on disclosures about risks related to recognized and unrecognized financial instruments and how those risks are managed. Section 3863 carries forward the same presentation standards as Section 3861. These new standards are effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2007 on a prospective basis. The Fund will adopt these new standards effective January 1, 2008.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)  
**June 30, 2007**

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

### 4 Long-term debt

Long-term debt consists of:

	June 30, 2007	December 31, 2006
Term facility	\$ 235,000	\$ -
Development facility	18,000	-
Deferred financing fees	(2,456)	-
	<u>\$ 250,544</u>	<u>\$ -</u>

Subsequent to June 30, 2007, the Fund amended the long-term credit facility (note 14).

### 5 Consolidated statements of cash flows

The following summarizes the changes in operating assets and liabilities:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Accounts receivable	\$ (5,077)	\$ -	\$ (5,077)	\$ -
Inventories	(633)	-	(633)	-
Prepaid expenses and other current assets	(2,893)	-	(2,893)	-
Due from related parties	(15)	1,576	(15)	-
Income taxes receivable	(8)	-	(8)	-
Accounts payable and accrued expenses	(684)	-	(684)	-
Due to related parties	(3,403)	-	(3,403)	-
Deferred revenue	(1,699)	-	(1,699)	-
Accrued pension benefit liability	(648)	-	(648)	-
Other liabilities	(395)	(1,571)	(401)	-
	<u>\$ (15,455)</u>	<u>\$ 5</u>	<u>\$ (15,461)</u>	<u>\$ -</u>
Non-cash investing activities				
Property, equipment and leasehold purchases financed through accrued liabilities	\$ 725	\$ -	\$ 725	\$ -

### 6 Commitments, guarantees and contingencies

#### Commitments

As at June 30, 2007, the Fund has aggregate capital commitments as follows:

Capital commitments for four theatres to be completed during 2007 and 2008	\$ 16,234
Digital pre-show equipment	\$ 327
Theatre rebranding	\$ 47
Letters of credit	\$ 632

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## Guarantees

During 2005 and 2006, the Partnership entered into agreements with third parties to divest a total of 36 theatres, 30 of which were leased properties, and to provide advertising services until December 31, 2012. The Partnership is guarantor under the leases for the remainder of the lease term in the event that the purchaser of the theatres does not fulfill its obligations under the respective lease. The Partnership has also guaranteed certain advertising revenues based on attendance levels. During January 2007, the Partnership was notified that the guarantee provided to a landlord of one of the theatre properties disposed of had been triggered; this was settled for \$4,500 during the first quarter of 2007. A provision for this guarantee, net of the estimated value of the assets acquired from this former theatre as a result of the transaction, was previously recorded in the December 31, 2006 consolidated financial statements.

Also during 2006, the Partnership entered into an agreement with a related party to divest its 49% share in its two remaining Alliance Atlantis branded theatres. The Partnership is guarantor for its 49% share of the leases for the remainder of the lease term in the event that the purchaser of the Partnership's share in the theatres does not fulfill its obligation under the respective lease.

The Fund has assessed the fair market value of the above-noted guarantees and determined that the fair market value of these guarantees as at June 30, 2007 is nominal. As such, no amounts have been provided in the consolidated financial statements for these guarantees. Should the purchaser of the theatres fail to fulfill its lease commitment obligations, the Fund could face a substantial financial burden.

## Contingencies

Since 2003, three complaints have been filed with the Ontario Human Rights Commission against the Partnership, Famous Players Limited Partnership and the Alliance Atlantis Cinemas partnership alleging discrimination against hearing-impaired individuals for not providing sufficient technology to accommodate for their disability. Similar complaints were filed against other exhibitors and certain film distributors. In July 2007, the Partnership, Famous Players Limited Partnership and the Alliance Atlantis Cinemas partnership settled each of the complaints. The settlement provides for the installation of newly developing closed captioning systems in multiple Ontario theatres when such systems become commercially available. These installations will occur on a phased-in basis following the Partnership's comprehensive selection and testing of the new technologies.

The Fund and its subsidiaries are parties to various disputes arising in the ordinary course of business. From time to time, the Fund is involved in disputes or litigation with landlords, contractors, past employees and other third parties. It is the opinion of management that any liability to the Fund, which may arise as a result of these existing disputes, will not have a material adverse effect on the Fund's operating results, financial position or cash flows.

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

## 7 Share of Cineplex Entertainment Limited Partnership loss

The Fund's share of the Partnership's loss has been calculated as follows:

	Three months ended June 30, 2007 (note 2)	Three months ended June 30, 2006	Six months ended June 30, 2007 (note 2)	Six months ended June 30, 2006
Consolidated Partnership net income (loss)	\$ -	\$ 2,897	\$ (3,775)	\$ (6,029)
Adjustment for Catch-up Payment from Partnership to Class B LP and Class D LP unitholders	-	(3,249)	(2,364)	(6,666)
Remaining loss to be distributed pro rata to Class A LP, Class B LP and Class D LP unitholders	\$ -	\$ (352)	\$ (6,139)	\$ (12,695)
Fund's proportionate % share (a)	\$ -	\$ (46)	\$ (3,665)	\$ (6,296)
Adjustments for excess of purchase price over net assets acquired	-	(357)	(576)	(714)
Share of Partnership loss	\$ -	\$ (403)	\$ (4,241)	\$ (7,010)

- a) During the period, the Fund's indirect ownership of the Partnership, held through the Trust, increased from approximately 59.7% as at December 31, 2006 to approximately 75.7% as at June 30, 2007 (58.7% as at June 30, 2006) (note 2). The Fund's proportionate share of the loss available to be distributed to the Class A LP, Class B LP and Class D LP unitholders has been adjusted to reflect its increased ownership.

The Fund's share of the Partnership's loss from discontinued operations for the three and six months ended June 30, 2007 is \$nil and \$nil (2006 - \$637 and \$1,119), respectively.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

(Unaudited)  
**June 30, 2007**

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(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

### 8 Distributions payable

The Fund has declared the following distributions during the six-month periods ended June 30, 2007 and 2006:

Record date	2007		2006	
	Amount	Amount per unit	Amount	Amount per unit
January	\$ 3,268.4	\$ 0.0958	\$ 2,675.1	\$ 0.0958
February	3,268.4	0.0958	2,675.1	0.0958
March	3,268.4	0.0958	2,675.1	0.0958
April	4,142.3	0.0958	2,675.1	0.0958
May	4,323.9	0.1000	2,710.7	0.0958
June	4,323.9	0.1000	3,213.6	0.0958

The distributions will be paid within 30 days following the end of each month. Distributions are determined by reducing the amounts received by the Fund by all interest, expenses and repayment of borrowings incurred or reasonably expected to be incurred by the Fund, including any tax liabilities of the Fund, and all amounts which are related to the redemption of the Convertible Debentures or Fund units. Distributions paid are at the discretion of the Board of Trustees of the Fund. In addition to the above, the Partnership has amounts payable at June 30, 2007 to the non-controlling interests of \$1,391.

### 9 Unitholders' capital

During the three and six months ended June 30, 2007, under the provisions of the Exchange Agreement, COC, a related party investor, exchanged 9,122,751 Class B, Series 1 and Series 2-C LP units for 9,122,751 Fund units. The Fund recorded the Partnership units it acquired at the \$143,136 fair market value of the Fund units on April 2, 2007, the date of the transaction.

During the three and six months ended June 30, 2006, the Fund issued 2,000,000 Fund units for proceeds of \$31,800. The Partnership and the Fund entered into a reimbursement agreement under which the fees associated with the issuance of the Fund units in the amount of \$1,984 were reimbursed by the Partnership.

During the three and six months ended June 30, 2006, under the provisions of the Exchange Agreement, certain investors including related parties exchanged 1,236,169 and 1,259,452 Class B, Series 1 Partnership units for 1,236,169 and 1,259,452 Fund units, respectively. During the three and six months ended June 30, 2006, under the provisions of the Exchange Agreement, certain investors including related parties exchanged 1,890,384 and 1,952,341 Class B, Series 2-G Partnership units for 1,890,384 and 1,952,341 Fund units, respectively. During the three and six months ended June 30, 2006, under the provisions of the Exchange Agreement, certain investors including related parties exchanged 494,447 and 494,447 Class D Partnership units for 494,447 and 494,447 Fund units, respectively. The Fund recorded the Partnership units it acquired at the fair market value of the Fund units on the date of the transaction. The differences between the fair market value and the value at which the Fund units were issued in the amounts of \$2,814 and \$2,865 have been charged to unitholders' equity, resulting in a net increase in unitholders' capital of \$53,114 and \$54,303, respectively.

# Cineplex Galaxy Income Fund

## Interim Notes to Consolidated Financial Statements

### (Unaudited)

### June 30, 2007

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

Fund units issued as at June 30 are as follows:

	Three months ended				Six months ended			
	June 30, 2007		June 30, 2006		June 30, 2007		June 30, 2006	
	Number of Fund units	Amount	Number of Fund units	Amount	Number of Fund units	Amount	Number of Fund units	Amount
Units - Beginning of period	34,116,698	\$ 419,819	27,924,232	\$ 326,930	34,116,698	\$ 419,819	27,838,992	\$ 325,741
Issuance of Fund units (note 2)	-	-	2,000,000	31,800	-	-	2,000,000	31,800
Issuance of Fund units under Exchange Agreement	9,122,751	143,136	3,621,000	53,114	9,122,751	143,136	3,706,240	54,303
Units - End of period	43,239,449	562,955	33,545,232	411,844	43,239,449	562,955	33,545,232	411,844
Convertible Debentures equity component	-	8,546	-	8,546	-	8,546	-	8,546
	43,239,449	571,501	33,545,232	420,390	43,239,449	571,501	33,545,232	420,390
LTIP compensation obligation	-	768	-	-	-	768	-	-
Treasury stock - LTIP units	(117,491)	(1,802)	-	-	(117,491)	(1,802)	-	-
Total unitholders' equity	43,121,958	\$ 570,467	33,545,232	\$ 420,390	43,121,958	\$ 570,467	33,545,232	\$ 420,390

The Fund treats its \$1,802 (December 31, 2006 - \$125) investment in Fund units relating to the Long-Term Incentive Plan (the "LTIP") as treasury stock and nets this investment against the Fund's unitholders' capital. The LTIP compensation obligation is recorded as a liability until the corresponding LTIP pool of funds is utilized to acquire Fund units, at which point, it is reclassified against the Fund's unitholders' capital, as the Partnership is now obligated to deliver a fixed number of Fund units, the value of which will vary with the market value of the Fund units. Subsequent changes in the fair value of the Fund units are not recognized.

## 10 Income taxes

On October 31, 2006, the Department of Finance (Canada) announced tax proposals pertaining to the taxation of income distributed by publicly listed income trusts and the tax treatment of trust distributions to their unitholders. Currently, the Fund does not pay tax on income it distributes to its unitholders. The income tax proposals were substantively enacted into law on June 12, 2007 and resulted in Fund income being subject to income taxes at the trust level effective January 1, 2011.

**Cineplex Galaxy Income Fund**  
 Interim Notes to Consolidated Financial Statements  
 (Unaudited)  
 June 30, 2007

---

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

The future income taxes recorded reflect temporary differences expected to reverse in 2011 and, thereafter, at a rate of 31.5% as follows:

Future income tax assets		
Property, equipment and leaseholds and deferred tenant inducements - difference in net book value and undepreciated capital cost	\$	23,900
Accounting provisions not currently deductible		3,584
Rent averaging liabilities		7,441
Financing costs		581
Deferred revenue		162
Losses available for carry-forward		<u>5,459</u>
Total gross future income tax assets		<u>41,127</u>
Future income tax liabilities		
Intangible assets		(22,721)
Goodwill		(3,892)
Other		<u>(217)</u>
Total gross future income tax liabilities		<u>(26,830)</u>
Net future income tax asset	\$	<u>14,297</u>

## 11 Segment information

The Fund has determined that the theatre exhibition industry qualifies as a single business segment with all of its revenue and assets generated and held within Canada.

## 12 Seasonal fluctuations

The Fund's business is seasonal. Consequently, the results of operations and cash flows for the three and six months ended June 30, 2007 and 2006 are not necessarily indicative of the results to be expected for the full year, although film studios have expanded the historical summer and holiday release windows and increased the number of heavily marketed films released during traditionally weaker periods.

## 13 Diluted earnings (loss) per unit

The weighted average number of units outstanding used in computing diluted earnings (loss) per unit includes the dilutive effect of the full exercise of the non-controlling interest unitholders' right to exchange their units, on a one-for-one basis, for Fund units. The weighted average number of units outstanding excludes treasury stock held by the Partnership for the LTIP plan totalling 117,491 and 59,070 for the three and six months ending June 30, 2007. Convertible Debentures in the amount of \$105,000 were excluded from the computation of diluted earnings (loss) per unit for the three and six months ended June 30, 2007 and 2006 as their effect

# Cineplex Galaxy Income Fund

Interim Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2007

---

(expressed in thousands of Canadian dollars, except per unit amounts or as otherwise noted)

would have been antidilutive. If converted at the beginning of the period, the weighted average number of units outstanding used in computing diluted earnings (loss) per unit would be 5,600,000 units higher.

## 14 Subsequent events

On July 13, 2007, the Partnership acquired the Cinema City brand theatres located in Winnipeg, Manitoba and Edmonton, Alberta for \$6,100. The three theatres will add 32 screens to the Partnership's circuit of 129 theatres and 1,297 screens. Based on management's preliminary assessment, the assets acquired include property and equipment, trade names and goodwill. The purchase price allocation has not been determined as fair value assessments are not yet practicable to estimate.

On July 25, 2007, the Partnership entered into the second amended and restated credit agreement. This amendment includes increased commitment amounts, an extended five-year term, financial covenant improvements, reductions in interest margins and additional flexibility in the permitted use of funds. The amended facilities total \$365,000 and comprise a \$235,000 five-year senior secured non-revolving term credit facility and a \$130,000 five-year senior secured revolving credit facility. In addition, there are provisions to increase the \$130,000 revolving credit facility commitment by an additional \$100,000, with the consent of the lenders.