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[WWW.GALAXYCINEMAS.COM](http://WWW.GALAXYCINEMAS.COM)

Pat Marshall  
Vice President Investor Relations  
[pmarshall@cineplexgalaxy.com](mailto:pmarshall@cineplexgalaxy.com)  
416-323-6648

Gord Nelson  
Chief Financial Officer  
[gnelson@cineplexgalaxy.com](mailto:gnelson@cineplexgalaxy.com)  
416-323-6602

CINEPLEX GALAXY  
1303 YONGE ST.  
TORONTO, ON M4T 2Y9

416 323 6600  
[WWW.CINEPLEXGALAXY.COM](http://WWW.CINEPLEXGALAXY.COM)



Cineplex Galaxy LP is a leading exhibitor of motion pictures, operating 86 theatres with 775 screens in six provinces as at July 31<sup>st</sup>, 2005. Cineplex Odeon Cinemas, Galaxy Cinemas and the associated brands are owned and operated by Cineplex Galaxy LP.

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#### Letter to Unitholders:

We are pleased to present our second quarter 2005 report. We have several great accomplishments to report this quarter including our announcement on June 13, 2005 to acquire the Famous Players movie exhibition business. Subsequent to that, we announced a \$215 million public offering on a bought deal basis along with the sale of real estate interests in four theatre locations as a means of partially funding the Famous Players acquisition. The public offering was a success realizing "net" proceeds of approximately \$205 million. On July 22, 2005, we successfully concluded the Famous Players acquisition.

Canadian Box Office results continued to be poor this quarter with the industry results down 16.9% compared to Cineplex Galaxy's *Box Office Revenues* decrease of 13.2%. *Total Revenue* for the three months ended June 30, 2005 was \$84,100,000 as compared to \$93,400,000 for the three months ended June 30, 2004, which represents a decrease of 10.0%. This is mainly due to the decline in attendance as a result of weak film product. We expect to see an improvement in the second half of 2005 with strong film releases anticipated in the fourth quarter.

On the positive side, *Concession Per Patron (CPP)* hit a record high this quarter of \$3.22, up 5.6% from the previous year's second quarter. *Other Income* also increased 23.7% to \$6.8 million primarily due to higher advertising sales generated from the new digital pre-show cinema network that launched April 1<sup>st</sup> of this year. This is the fourth consecutive quarter where *Other Income* has increased by greater than 20% versus the prior year.

On April 1st, the Digital Pre-show Cinema Network was launched on 215 screens in 21 theatres in the Toronto Extended Market Area (EMA). The network enables theatres to show *Reel Entertainment*, a dynamic, interactive and engaging new digital pre-show. This network also allows us to expand our alternative programming plans beyond the select theatres it was previously available in. We have just concluded our first full quarter with the new network and early results are extremely positive. Advertisers and theatre guests are both very supportive of the new pre-show's content and technology. Our next phase of the implementation will be to complete installations in the Famous Players brand theatre locations in the Toronto EMA by the end of this year and the balance of the combined circuit in the first half of 2006.

The acquisition of Famous Players includes a new theatre project previously announced by Famous Players for Saskatoon, Saskatchewan. The 12 screen complex is expected to open for summer 2006. Planned theatre openings in Aurora and Barrhaven, Ontario are on schedule and will open in the fourth quarter as planned. Previously announced projects in Milton, Brockville and Burloak in Ontario, and in Brossard, Quebec are all moving forward and will open in 2006 as scheduled.

For the second quarter of 2005 *Distributable Cash Flow* per unit was \$0.1664 and the *Declared Distribution* per unit for this period was \$0.2874. For the twelve months ended December 31, 2004 *Distributable Cash Flow* per unit was \$1.2283 and the *Declared Distribution* was \$1.1496.

While we continue to be disappointed with box office results this year, we are very pleased with this quarter's growth in the controllable areas of our business. Moving forward, our focus will be on continuing to integrate both the people and the assets of Famous Players into Cineplex Galaxy. Once again we have proven our ability to acquire and integrate a new company into our core business in a cost effective, focused and accretive manner.

On behalf of the Board of Directors,



Ellis Jacob  
President & Chief Executive Officer

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2005

*As of June 30, 2005, Cineplex Galaxy Income Fund indirectly owns an approximate 43.8% interest in Cineplex Galaxy Limited Partnership. Cineplex Galaxy Income Fund does not consolidate the results and operations of Cineplex Galaxy Limited Partnership. For this reason we present unaudited interim financial statements with accompanying notes therein for both Cineplex Galaxy Income Fund and Cineplex Galaxy Limited Partnership. The following management's discussion and analysis of the Cineplex Galaxy Limited Partnership financial condition and results of operations should be read together with the financial statements and related notes. This discussion contains forward-looking statements. Forward looking statements are subject by their nature to risks and uncertainties, and actual results, actions or events could differ materially from those set forth in this discussion. The forward-looking information contained herein is current only as at the date of this document. There should not be an expectation that such information will in all circumstances be updated, supplemented or revised whether as a result of new information, changing circumstances, future events or otherwise. 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**

As at June 30, 2005 Cineplex Galaxy Limited Partnership (the "Partnership") was Canada's second 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, 2005, the Partnership owned, operated or had an interest in 775 screens in 86 theatres including 57 screens in 7 theatres held in joint ventures.

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 Galaxy General Partner Corporation (the "General Partner"), Cineplex Odeon Corporation, Cineplex Odeon (Quebec) Inc., and former investors in GEI. The Trust is wholly owned by Cineplex Galaxy Income Fund (the "Fund").

Under the provisions of an Exchange Agreement designed to facilitate the exchange of units of the Partnership ("Units") into Fund Units, the Fund issued 679,498 and 834,154 Fund Units during the three and six months ended June 30, 2005 respectively in exchange for Notes and units from the Trust and, as a result, an indirect increase in its ownership in the Partnership. As a result of the issuance of Fund Units by the Fund during 2004 and 2005, in a one-for-one exchange of Units, as at June 30, 2005 the Fund indirectly owned approximately 43.8% of the Partnership.

During the second quarter the Partnership announced that it had agreed to purchase the Famous Players Limited Partnership ("Famous Players") movie exhibition business from Viacom Inc ("Viacom") (the "Acquisition"). The Acquisition is valued at \$500 million, inclusive of approximately \$36 million in capital lease obligations. The transaction closed on July 22, 2005.

The Acquisition combines Canada's two leading theatre exhibition companies. Famous Players operates a total of 80 theatres with 785 screens across the country, including theatres in its joint ventures with IMAX and its partnership with Alliance Atlantis. Famous Players theatres include the Coliseum, Colossus, Paramount and SilverCity brands. A discussion of the accounting implications of the acquisition can be found in Note 10 of the Partnership's interim financial statements.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### **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, 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.

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 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***

These 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").

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### RESULTS OF OPERATIONS

The following table presents summarized financial data for the Partnership for three and six months ended June 30, 2005 and June 30, 2004 (expressed in thousands of dollars except per Unit and per patron data).

	Three months ended June 30		Six months ended June 30	
	2005	2004	2005	2004
Total Revenue	\$84,120	\$93,443	\$162,379	\$172,482
Cost of Operations	71,304	73,691	137,595	137,657
Income from Operations	\$12,816	\$19,752	\$24,784	\$34,825
Amortization	6,690	5,607	13,214	11,042
Gain on disposal of theatre assets	(19)	(36)	(19)	(42)
Interest on long-term debt	2,344	1,904	4,550	3,905
Interest on loan from Cineplex Galaxy Trust	3,500	3,500	7,000	7,000
Interest Income	(60)	(61)	(178)	(155)
Income Taxes	119	61	174	97
Net Income for the period	\$242	\$8,777	\$43	\$12,978
Net income per unit, basic and fully diluted	\$0.005	\$0.185	\$0.001	\$0.273
Distributable cash per Unit (fully diluted)	\$0.1664	\$0.3282	\$0.3373	\$0.5760
Cash distributions declared per Unit	\$0.2874	\$0.2874	\$0.5748	\$0.5748
Attendance	7,242	8,429	14,287	15,602
Average box office revenue per patron	\$7.46	\$7.39	\$7.38	\$7.44
Average concession revenue per patron	\$3.22	\$3.05	\$3.15	\$3.00
Film cost as a percentage of box office	54.5%	53.6%	52.5%	51.7%

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Cash provided by operating activities	\$3,189	\$9,471	\$2,119	\$3,176
Less: Changes in operating assets and liabilities (i)	2,532	3,802	8,861	18,735
Total Capital expenditures	(3,225)	(3,386)	(8,366)	(5,458)
Add: Interest on loan from Cineplex Galaxy Trust (ii)	3,500	3,500	7,000	7,000
New theatre and Project capital expenditures (iii)	1,279	2,226	5,474	3,946
POS/Rebranding capital expenditures (iv)	642	-	958	-
Distributable	\$7,917	\$15,613	\$16,046	\$27,399
Number of Units outstanding (fully diluted)	47,566,974	47,566,974	47,566,974	47,566,974
Distributable cash per Unit (fully diluted)	\$0.1664	\$0.3282	\$0.3373	\$0.5760

- (i) Changes in operating assets and liabilities are not considered a source of distributable cash
- (ii) Subject to "Catch-up Payment" provision and is considered part of distributable cash
- (iii) The total capital expenditures noted above includes new theatre and maintenance capital expenditures of which the new theatre capital expenditures and Board approved projects are funded out of the Partnership's Development Facility (discussed below under "Liquidity and Capital Resources – Credit Facilities – Revolving Facilities) and therefore are added back to calculate distributable cash.
- (iv) Point-of-Sale ("POS") and rebranding capital expenditures are funded out of a \$5.5 million reserve fund established on November 26, 2003.

### ***Three and Six months ended June 30, 2005 Compared to the Three and Six months ended June 30, 2004 for the Partnership***

**Total revenues.** Total revenues for the three months ended June 30, 2005 decreased \$9.3 million, or 10.0%, to \$84.1 million. Total revenues for the six months ended June 30, 2005 decreased \$10.1 million, or 5.9%, to \$162.4 million. A discussion of the factors affecting the changes in box office, concession and other revenues for these periods in comparison to the same periods in 2004 is provided below.

**Box office revenues.** Box office revenues for the three months ended June 30, 2005 decreased \$8.2 million, or 13.2%, to \$54.0 million. Canadian industry box office declined 16.9% for the second quarter of 2005 primarily due to the lack of successful film product during the quarter. The Partnership's decrease in box office revenues was due to decreased same store attendance levels (\$9.9 million) offset by an average increase in box office revenues per patron (\$0.5 million) and by the operation of new theatres (\$1.2 million). The average box office revenue per patron increased \$0.07 or 1.0% from \$7.39 for the three months ended June 30, 2004 to \$7.46 for the three months ended June 30, 2005. The increase in average box office revenue per patron was a result of shift in attendance mix to higher priced admission categories as a result of the more adult friendly film product in 2005 (Star Wars Episode III) versus 2004 (Shrek II and Harry Potter).



# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Box office revenues for the six months ended June 30, 2005 decreased \$10.7 million, or 9.2%, to \$105.4 million. Canadian industry box office declined 11.7% for the first half of 2005 primarily due to the lack of successful film product during the period. The Partnership's decrease in box office revenues was due to decreased same store attendance levels (\$11.9 million) and average box office revenues per patron (\$1.1 million) offset by the operation of new theatres (\$2.3 million). The average box office revenue per patron decreased \$0.06 or 0.8% from \$7.44 for the six months ended June 30, 2004 to \$7.38 for the six months ended June 30, 2005. The decrease in average box office revenue per patron was a result of shift in attendance mix to lower priced admission categories as a result an increase in discounted corporate ticket sales and selected price reductions implemented since the second quarter in 2004.

*Concession revenues.* Concession revenues for the three months ended June 30, 2005 decreased \$2.4 million, or 9.2%, to \$23.3 million. The decrease in concession revenues was due to lower same store attendance levels (\$4.0 million) which was offset by additional revenues from the operation of new theatres (\$0.6 million) and an improvement in concession revenues per patron (\$1.0 million). The average concession revenue per patron increased \$0.17 or 5.6% from \$3.05 for the three months ended June 30, 2004 to \$3.22 for the three months ended June 30, 2005, the highest quarterly average concession revenue per patron achieved to date. The increase is due to a combination of factors including expanded product offerings, the introduction of new combination products with expanded options at a higher price point and film product that drew audiences more likely to have an increased likelihood of purchase incidence.

Concession revenues for the six months ended June 30, 2005 decreased \$1.9 million, or 4.0%, to \$45.0 million. The decrease in concession revenues was due to lower same store attendance levels (\$4.8 million) which was offset by additional revenues from operation of new theatres (\$1.2 million) and an improvement in average concession revenues per patron (\$1.7 million). The average concession revenue per patron increased \$0.14 or 4.8% from \$3.00 for the six months ended June 30, 2004 to \$3.15 for the six months ended June 30, 2005.

*Other revenues.* Other revenues for the three months ended June 30, 2005 increased \$1.3 million, or 23.7%, to \$6.8 million mainly as a result of higher advertising revenues including the contribution of the digital advertising network which was launched in 21 Toronto extended market theatres on April 1, 2005. Other revenue is a key area of focus for the Partnership and additional sales staff were added in 2004 to service this portion of the business. Other revenues for 2005 and 2004 reflect the Partnership's retroactive adoption at December 31, 2004 of the provisions of EIC-144 (discussed in "Accounting Policies and Recent Developments – Recent Accounting Developments").

Other revenues for the six months ended June 30, 2005 increased \$2.5 million, or 25.8%, to \$12.0 million mainly as a result of higher advertising revenues. It should be noted that the Partnership launched its digital advertising network in its 21 Toronto extended market area theatres on April 1, 2005 and accordingly, there is no revenue from this activity included in the first quarter results. Other revenues for 2005 and 2004 reflect the Partnership's retroactive adoption at December 31, 2004 of the provisions of EIC-144 (discussed in "Accounting Policies and Recent Developments – Recent Accounting Developments").

*Film cost.* Film cost for the three months ended June 30, 2005 decreased \$4.0 million, or 11.9%, to \$29.4 million due to a decrease in box office revenue. As a percentage of box office revenue, film cost increased to 54.5% for the three months ended June 30, 2005 from 53.6% for the three months ended June 30, 2004. This increase is due primarily to higher film rental terms paid in the three months ended June 30, 2005 on specific strong releases.

Film cost for the six months ended June 30, 2005 decreased \$4.7 million, or 7.8%, to \$55.3 million due to a decrease in box office revenue. As a percentage of box office revenue, film cost increased to 52.5% for the six months ended June 30, 2005 from 51.7% for the six months ended June 30, 2004. This increase is due to a combination of lower film rental terms paid in the six months ended June 30, 2004 on specific

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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strong releases and higher film rental terms paid on specific strong releases during the six months ended June 30, 2005.

*Cost of concessions.* Cost of concessions for the three months ended June 30, 2005 decreased \$0.3 million, or 5.6%, to \$4.8 million. This decrease in cost of concessions was due primarily to decreased same store attendance (\$0.7 million) which was partially offset by the costs associated with new theatres that were opened (\$0.2 million) and increase purchase incidence (\$0.2 million). As a percentage of concession revenues, cost of concessions increased from 19.7% in the three months ended June 30, 2004, to 20.5% in the three months ended June 30, 2005. Concession costs for 2005 and 2004 reflect the Partnership's retroactive adoption at December 31, 2004 of the provisions of EIC-144 (discussed in "Accounting Policies and Recent Developments – Recent Accounting Developments").

Cost of concessions for the six months ended June 30, 2005 decreased \$0.1 million, or 1.3%, to \$9.2 million. This decrease in cost of concessions was due primarily to decreased same store attendance (\$0.7 million) which was partially offset by the costs associated with new theatres that were opened (\$0.3 million) and increased incidence (\$0.3 million). As a percentage of concession revenues, cost of concessions increased from 19.9% in the six months ended June 30, 2004, to 20.5% in the six months ended June 30, 2005. Concession costs for 2005 and 2004 reflect the Partnership's retroactive adoption at December 31, 2004 of the provisions of EIC-144 (discussed in "Accounting Policies and Recent Developments – Recent Accounting Developments").

*Occupancy.* Occupancy expense for the three months ended June 30, 2005 decreased \$0.1 million, or 1.0%, to \$13.7 million. The overall decrease in occupancy expense was primarily due to the incremental costs associated with new theatres that were opened (\$0.3 million) and offset by a decrease in percentage rents that are based on revenue (\$0.3 million) and other items (\$0.1 million).

Occupancy expense for the six months ended June 30, 2005 increased \$0.6 million, or 2.1%, to \$27.6 million. The overall increase in occupancy expense was due to the incremental costs associated with new theatres that were opened (\$0.9 million) and an increase in insurance costs (\$0.3 million) offset by decrease in percentage rents that are based on revenue (\$0.4 million) and other items (\$0.2 million).

*Other theatre operating expenses.* Other theatre operating expenses for the three months ended June 30, 2005 increased \$1.2 million, or 7.0%, to \$18.8 million. The overall increase in other theatre operating expenses was due to the incremental impact of costs associated with new theatres that were opened (\$0.3 million) and the impact of additional business activities and inflationary increases (\$0.9 million). As a percentage of total revenues, other theatre operating expenses increased to 22.4% for the three months ended June 30, 2005 from 18.8% for the three months ended June 30, 2004 due to the overall decline in revenue.

Other theatre operating expenses for the six months ended June 30, 2005 increased \$1.8 million, or 5.3%, to \$35.8 million. The overall increase in other theatre operating expenses was due to the incremental impact of costs associated with new theatres that were opened (\$0.8 million) and the impact of additional business activities and inflationary increases (\$1.0 million). As a percentage of total revenues, other theatre operating expenses increased to 22.0% for the six months ended June 30, 2005 from 19.7% for the six months ended June 30, 2004 due to the overall decline in revenue.

*General and administrative costs.* General and administrative costs for the three months ended June 30, 2005 increased \$0.9 million to \$4.5 million. General and administrative costs for the second quarter of 2005 included \$0.8 million in professional fees related to the acquisition of Famous Players, (see discussion under "Subsequent Event"), \$0.4 million in consulting fees related to preparation for Bill 198 compliance offset by a decrease of \$0.7 million under the Partnership's Long Term Incentive Plan versus the second quarter of 2004. As a percentage of total revenues, general and administrative expenses increased to 5.4% for the three months ended June 30, 2005 from 3.9% for the three months ended June 30, 2004 principally due to the factors above and the lower revenue base.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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General and administrative costs for the six months ended June 30, 2005 increased \$2.5 million to \$9.4 million. General and administrative costs for the first half of 2005 included \$1.6 million in professional fees related to the acquisition of Famous Players (see discussion under "Subsequent Event"), \$0.2 million in recruitment and resource costs related to the establishment of an information technology department in the Canadian head office which will allow the Partnership to terminate the services agreement for management information systems support and eliminate the Loews Cineplex Theatres Inc. ("LCT") management fee, \$0.5 million in consulting fees related to preparation for Bill 198 compliance and a decrease of \$0.4 million under the Partnership's Long Term Incentive Plan versus the second half of 2004. As a percentage of total revenues, general and administrative expenses increased to 5.8% for the six months ended June 30, 2005 from 4.0% for the six months ended June 30, 2004 principally due to the factors above and the lower revenue base.

*Management fee.* Effective November 26, 2003, the Partnership entered into a services agreement with Cineplex Odeon Corporation ("COC") (subsequently assumed by LCT) under which management information systems (MIS support) support is provided to the Partnership at a cost of US\$500,000 per annum. The management fee payable to LCT for management information systems (MIS) support decreased \$0.1 million from the three and six months ended June 30, 2004 to the three and six months ended June 30, 2005 due to fluctuations in exchange rates and the termination of the agreement in the second quarter of 2005. Accordingly, the Partnership has recruited additional staff and acquired additional hardware and software licenses to repatriate this MIS function. Included in the second quarter of 2005 are both the cost of these additional resources and the management fee paid up to the date of the contract termination.

*Income before undernoted.* The Partnership reported income before undernoted for the three months ended June 30, 2005 of \$12.8 million as compared to income before undernoted of \$19.8 million for the three months ended June 30, 2004. 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, 2005 of \$24.8 million as compared to income before undernoted of \$34.8 million for the six months ended June 30, 2004. This change was due to the aggregate effect of the factors described above.

*Amortization costs.* For the three months ended June 30, 2005 amortization costs increased \$1.1 million or 19.3% to \$6.7 million. This increase was due primarily to the incremental impact of new theatres. For the six months ended June 30, 2005 amortization costs increased \$2.2 million or 19.7% to \$13.2 million. This increase was due primarily to the incremental impact of new theatres.

*Gain on disposal of theatre assets.* The gain on disposal of theatre assets represents the gains on theatre assets that were sold or otherwise disposed of. For the three months ended June 30, 2005 and 2004 the Partnership recorded a gain of \$19 thousand and \$36 thousand respectively. For the six months ended June 30, 2005 and 2004 the Partnership recorded a gain of \$19 thousand and \$42 thousand respectively.

*Interest on long-term debt.* Interest on long-term debt for the three months ended June 30, 2005 increased to \$2.3 million from \$1.9 million for the three months ended June 30, 2004. Interest expense is comprised of the amortization of \$0.3 million of deferred financing fees and \$2.0 million of interest on long-term debt for the three months ended June 30, 2005. For the three months ended June 30, 2004 interest expense includes \$0.2 million for the amortization of deferred financing fees and \$1.7 million of interest on long-term debt. The increase in interest expense was due primarily to a higher average outstanding debt balance during three months ended June 30, 2005 versus 2004 as a result of additional borrowings under the Partnership's Development Facility, discussed below (under "Liquidity and Capital Resources – Credit Facilities – Revolving Facilities), in order to fund new theatre build activity.

Interest on long-term debt for the six months ended June 30, 2005 increased to \$4.6 million from \$3.9 million for the six months ended June 30, 2004. Interest expense is comprised of the amortization of \$0.5 million of deferred financing fees and \$4.1 million of interest on long-term debt for the six months ended

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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June 30, 2005. For the six months ended June 30, 2004 interest expense includes \$0.4 million for the amortization of deferred financing fees and \$3.5 million of interest on long-term debt. The increase in interest expense was due primarily to a higher average outstanding debt balance during six months ended June 30, 2005 versus 2004 as a result of additional borrowings under the Partnership's Development Facility, discussed below (under "Liquidity and Capital Resources – Credit Facilities – Revolving Facilities), in order to fund new theatre build activity.

*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 \$0.1 million for each of the three months ended June 30, 2005 and 2004. Interest income was \$0.2 million for each of the six months ended June 30, 2005 and 2004.

*Net income.* Net income for the three months ended June 30, 2005 decreased to \$0.2 million from \$8.8 million for the three months ended June 30, 2004, primarily due to the net effect of all of the other factors described above.

Net income for the six months ended June 30, 2005 decreased to \$43 thousand from \$13.0 million for the six months ended June 30, 2004, primarily due to the net effect of all of the other factors described above.

### ***EBITDA***

EBITDA is defined as income before interest expense, income taxes and amortization expense. Adjusted EBITDA excludes from EBITDA 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.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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,	
	2005	2004	2005	2004
<b>Net income</b>	\$242	\$8,777	\$43	\$12,978
Amortization	6,690	5,607	13,214	11,042
Interest on long-term debt	2,344	1,904	4,550	3,905
Interest on loan from Cineplex Galaxy Trust	3,500	3,500	7,000	7,000
Interest income	(60)	(61)	(178)	(155)
Income tax expense	119	61	174	97
<b>EBITDA</b>	\$12,835	\$19,788	\$24,803	\$34,867
Gain on disposal of theatre assets	(19)	(36)	(19)	(42)
<b>Adjusted EBITDA</b>	\$12,816	\$19,752	\$24,784	\$34,825

### 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 cash flow during the slower first and second quarters, the Partnership has available for its use up to \$10 million of its Working Capital facility (see "Credit Facilities" discussed below) to fund distributions. Despite the weak results from the first and second quarter of 2005 the Partnership has never drawn on this facility in order to meet its distribution obligations. Management expects a stronger third and fourth quarter with anticipated stronger summer and fourth quarter film product.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### Summary of Quarterly Results (expressed in thousands of dollars except per Unit data)

	2005		2004			2003		
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Total Revenue	\$84,120	\$78,259	\$85,643	\$95,613	\$93,443	\$79,039	\$91,897	\$90,195
Cost of Operations	71,304	66,291	67,908	73,642	73,691	63,966	72,964	72,433
Income from Operations	12,816	11,968	17,735	21,971	19,752	15,073	18,933	17,762
Amortization	6,690	6,524	6,535	6,159	5,607	5,435	6,496	4,755
Gain on disposal of theatre assets	(19)	-	3	(72)	(36)	(6)	(176)	69
Interest on long-term debt	2,344	2,206	2,307	2,068	1,904	2,001	1,177	1,054
Interest on loan from Cineplex Galaxy Trust	3,500	3,500	3,500	3,500	3,500	3,500	1,381	-
Interest Income	(60)	(118)	(118)	(200)	(61)	(94)	(17)	(408)
Foreign exchange Gain/Loss	-	-	-	-	-	-	83	10
Income Taxes	119	55	(1,320)	74	61	36	(1,109)	630
Non-Controlling Interest	-	-	-	-	-	-	(418)	506
Net Income	\$242	(\$199)	\$6,828	\$10,442	\$8,777	\$4,201	\$11,516	\$11,146
Net income per unit, basic and fully diluted	\$0.005	(\$0.004)	\$0.144	\$0.220	\$0.185	\$0.088	n/a	n/a
Cash Flows from Operations	3,189	(1,070)	24,361	12,573	9,471	(6,295)	47,793	15,450
Cash flows from investing activities	(20,706)	2,471	(10,661)	(10,760)	(5,417)	(3,449)	(27,985)	(9,452)
Cash flows used in financing activities	2,897	(15,921)	(877)	(2,301)	(6,509)	(5,000)	(10,174)	4,101
Net change in cash	(\$14,620)	(\$14,520)	\$12,823	(\$488)	(\$2,455)	(\$14,744)	\$9,634	\$10,099

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

### Distributable Cash

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

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Cash provided by operating activities	\$3,189	\$9,471	\$2,119	\$3,176
Less: Changes in operating assets and liabilities (i)	2,532	3,802	8,861	18,735
Total Capital expenditures	(3,225)	(3,386)	(8,366)	(5,458)
Add: Interest on loan from Cineplex Galaxy Trust (ii)	3,500	3,500	7,000	7,000
New theatre and Project capital expenditures (iii)	1,279	2,226	5,474	3,946
POS/Rebranding capital expenditures (iv)	642	-	958	-
Distributable	\$7,917	\$15,613	\$16,046	\$27,399
Number of Units outstanding (fully diluted)	47,566,974	47,566,974	47,566,974	47,566,974
Distributable cash per Unit (fully diluted)	\$0.1664	\$0.3282	\$0.3373	\$0.5760

- (i) Changes in operating assets and liabilities are not considered a source of distributable cash.
- (ii) Subject to "Catch-up Payment" provision and is considered part of distributable cash.
- (iii) The total capital expenditures noted above includes new theatre and maintenance capital expenditures of which the new theatre capital expenditures and Board approved projects are funded out of the Partnership's Development Facility (discussed below under "Liquidity and Capital Resources – Credit Facilities – Revolving Facilities) and therefore are added back to calculate distributable cash.
- (iv) Point-of-Sale ("POS") and rebranding capital expenditures are funded out of a \$5.5 million reserve fund established on November 26, 2003.

### Balance Sheet

#### Assets

Assets decreased \$24.6 million to \$300.8 million as at June 30, 2005. This decrease is due primarily to a decrease in cash (\$29.1 million), accounts receivable (\$3.5 million), fixed assets (\$4.7 million) and restricted distributions on Support Theatre Units (\$7.6 million) (discussed in "Liquidity and Capital Resources -Distributions" below) offset by an increase in prepaid expenses and other current assets of \$18.9 million.

*Accounts Receivable.* Accounts receivable decreased \$3.5 million to \$7.4 million as at June 30, 2005 from \$10.9 million as at December 31, 2004. This decrease is due to collection of accounts receivable arising during the first quarter of 2005 from the increased ancillary revenue activities.

*Fixed Assets.* The decrease in fixed assets from \$234.9 million at December 31, 2004 to \$230.1 million at June 30, 2005 is due to amortization net of expenditures on the digital advertising network and new theatre construction.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

*Prepaid Expenses and other assets:* During June 2005 the Partnership entered in a purchase agreement with Viacom and Viacom Canada Inc. ("Viacom Canada") to purchase the Famous Players theatre assets (discussed in "Subsequent Event" below). Pursuant to the purchase agreement the Partnership was required to make a deposit in the amount of \$17.5 million, to be applied toward the purchase price upon completion of the transaction

### Liabilities

Liabilities decreased \$4.2 million from \$368.7 million as at December 31, 2004 to \$364.5 million as at June 30, 2005. This decrease is mainly due to an decrease in distributions payable relating to the restricted distributions on the Support Theatre Units (discussed in "Liquidity and Capital Resources -Distributions" below) (\$7.6 million), deferred revenue (\$6.7 million), and accounts payable and accrued expenses (\$3.1 million) offset by an increase in the long-term debt (\$15.5 million) (discussed in "Liquidity and Capital Resources – Financing Activities").

*Accounts Payable and Accrued Expense.* Accounts payable and accrued expenses decreased from \$27.7 million as at December 31, 2004 to \$24.6 million as at June 30, 2005. The decrease is due to the settlement of amounts accrued at December 31, 2004 with respect to theatres that had recently opened and of year-end liabilities that were higher due to increased activity during the fourth quarter of 2004.

*Deferred Revenue.* Deferred revenues decreased \$6.7 million to \$6.9 million as at June 30, 2005 from \$13.6 million as at December 31, 2004. This was due primarily to the redemption of gift certificates that were sold during the holiday season in December 2004 and a traditional slow period in new gift certificate sales in the first half of 2005.

### Outstanding Fund Units

The Fund had the following units issued for the years ended June 30 (expressed in thousands of dollars):

	Three months ended				Six months ended			
	June 2005		June 2004		June 2005		June 2004	
	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	20,178,345	\$203,832	19,400,000	\$194,000	20,023,689	\$201,477	19,400,000	\$194,000
Issuance of Fund Units under Exchange agreement	679,498	9,513	148,870	1,489	834,154	11,868	148,870	1,489
	<u>20,857,843</u>	<u>\$213,345</u>	<u>19,548,870</u>	<u>\$195,489</u>	<u>20,857,843</u>	<u>\$213,345</u>	<u>19,548,870</u>	<u>\$195,489</u>



# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Subject to certain restrictions, Class B LP Units of the Partnership may be exchanged for Fund Units. As at June 30, the following Class B LP Units had not been exchanged for Fund units:

	<b>Number of Units</b>	
	<b>2005</b>	<b>2004</b>
Class B Series 1	20,321,237	20,800,712
Class B Series 2-C	2,086,957	2,086,957
Class B Series 2-G	4,300,937	5,130,435
	<u>26,709,131</u>	<u>28,018,104</u>

### **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 \$3.2 million for the three months ended June 30, 2005 as compared to \$9.5 million for the three months ended June 30, 2004. The primary reason for the difference was due to a decrease in net income from \$8.8 million for the three months ended June 30, 2004 to \$0.2 million for the three months ended June 30, 2005.

Cash provided by operating activities was \$2.1 million for the six months ended June 30, 2005 as compared to \$3.2 million for the six months ended June 30, 2004. The primary reason for the difference was due to a decrease in net income from \$13.0 million for the six months ended June 30, 2004 to \$43 thousand for the six months ended June 30, 2005 offset by changes in operating assets and liabilities, which was a use of \$8.9 million in 2005 versus a use of \$18.7 million in 2004. A number of factors contributed to this difference including the settlement of inter-company payables arising on the formation of the Partnership in November 2003 and due to its formation in November 2003 under normal supplier credit terms, the Partnership made minimal payments in the month of December 2003.

#### *Investing Activities*

Cash used by investing activities for the three months ended June 30, 2005 of \$20.7 million primarily related to capital expenditures on new theatre builds and the introduction of the Partnership's digital advertising network (\$3.2 million) and the deposit made with respect to the planned acquisition of Famous Players (\$17.5 million) (discussed in "Subsequent Event" below).

Cash used by investing activities for the six months ended June 30, 2005 of \$18.2 million primarily related to capital expenditures on new theatre builds and the introduction of the Partnership's digital advertising network (\$8.4 million) and the deposit made with respect to the planned acquisition of Famous Players (\$17.5 million) (discussed in "Subsequent Event" below) offset by the removal of the restrictions on distributions on the Support Theatre Units (discussed in "Liquidity and Capital Resources - Distributions" below).

Cash used in investing activities for the three months ended June 30, 2004 was primarily related to capital expenditures on new theatre builds. In addition the Partnership transferred \$2.1 million to a segregated account representing distributions on certain Class B Series 2 LP Units (discussed in "Liquidity and Capital Resources -Distributions" below) during this period.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Cash used in investing activities for the six months ended June 30, 2004 was primarily related to capital expenditures on new theatre builds. In addition the Partnership transferred \$3.5 million to a segregated account representing distributions on certain Class B Series 2 LP Units ("Support Units") (discussed in "Liquidity and Capital Resources -Distributions" below) during this period.

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 – Revolving Facilities.

### *Financing Activities*

Cash provided by financing activities for the three months ended June 30, 2005 of \$2.9 million was due primarily to distribution payments of \$10.2 million and the payment of financing fees of \$2.0 million offset by net borrowings of \$14.5 million under existing credit facilities and tenant inducements received of \$0.6 million. For the three months ended June 30, 2004 cash used by financing activities (\$6.5 million) was due primarily to distribution payments of \$8.1 million offset by borrowings under existing credit facilities of \$1.5 million.

Cash used by financing activities for the six months ended June 30, 2005 of \$13.0 million was due primarily to distribution payments of \$27.9 million and the payment of financing fees of \$2.0 million offset by net borrowings of \$15.5 million under existing credit facilities and tenant inducements received of \$1.9 million. Distribution payments included payment of distributions of \$8.3 million on the Support Units (discussed in "Liquidity and Capital Resources -Distributions" below). For the six months ended June 30, 2004 cash used by financing activities (\$11.5 million) was due primarily to distribution payments of \$17.4 million offset by borrowings under existing credit facilities of \$5.5 million and tenant inducements received of \$0.6 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 existing credit facilities.

### *Distributions*

Partnership distributions are made on a monthly basis to holders of record of Class A LP Units and Class B LP Units on the last business day of each month. For the three months ended June 30, 2005, Partnership distributable cash flow per Unit was \$0.1664. For the three months ended June 30, 2004, the Partnership distributable cash flow per Unit was \$0.3282. The declared distributions per Unit and interest on the Galaxy Note (discussed in "Liquidity and Capital Resources – Credit Facilities" below) per Unit for the three months ended June 30 for each of 2005 and 2004 totaled \$0.2874 per Unit. For the period from January 1, 2005 to June 30, 2005, the Partnership's distributable cash flow per unit was \$0.3373 and \$0.5760 for the same period in 2004. The declared distribution per unit and interest on the GEI note per unit for this period 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. While the Partnership's year to date payout ratio is greater than 100%, a number of factors that are either one time events or that management does not expect to continue have contributed to this result. Adjusting distributable income for the Partnership for the management fees paid to Loews in prior periods under the now cancelled MIS support agreement and the expenses incurred for the now completed acquisition of Famous Players, the Partnership's payout ratio from inception to June 30, 2005 is less than 100%. In addition management expects distributable income to increase as a result of anticipated strong summer and fourth quarter film product to be released. In order to stabilize cash flow during the slower first and second quarters, the Partnership has available for its use up to \$10 million of its Working Capital facility (see "Credit Facilities"

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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discussed below) to fund distributions. Despite the weak results from the first and second quarter of 2005 the Partnership has never drawn on this facility to meet its distribution obligations.

As part of the Partnership's support arrangements with certain limited partners, the amount of the distributions paid in respect of the Support Units was dependent on the annual cash flows from 7 prescribed new theatres. Amounts totaling \$2.1 million and \$4.2 million are included in the distribution amounts above for the three and six months ended June 30, 2004. During the year ended December 31, 2004 the performance targets were met for the 7 Support Theatres and, as a result, the Partnership paid the full amount of the withheld distributions of \$8.3 million to the holders of the Support Units during the three months ended March 31, 2005. The support arrangements were terminated effective December 31, 2004, and the holders of the Support Units were thereafter fully entitled to receive cash distributions in a manner consistent with the Class B Series 1 LP Units.

For the three months ended June 30, 2005 and June 30, 2004, the Fund declared distributions totaling \$0.2874 per Fund Unit. For the six months ended June 30, 2005 and June 30, 2004, the Fund declared distributions totaling \$0.5748 per Fund Unit. 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 subject to Canadian federal income tax from an investment in 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 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, 2004, 21.8% of the Fund's distributions (\$0.25108 per unit) represented a nontaxable return of capital with the balance representing taxable income to the Unitholder.

### ***Credit Facilities***

*Revolving Facilities.* On November 26, 2003, the Partnership entered into two senior secured revolving credit facilities, one in the principal amount of \$20 million (the "Working Capital Facility") and the other in the principal amount of \$40 million (the "Development Facility"). The Working Capital Facility is for general corporate purposes, including up to \$10 million to stabilize monthly cash distributions to be paid by the Partnership throughout the year. The Development Facility is to be used for the development or acquisition of theatre projects approved by the Trustees of the Fund. Both facilities have a term of three years and are repayable in full at maturity. These revolving credit facilities bear interest at a floating rate based on the Canadian dollar prime rate or on the bankers acceptance rates plus, in each case, an applicable margin to those rates. As at June 30, 2005 the Partnership has borrowed \$17.5 million under the Development Facility. As at June 30, 2005 the Partnership has drawn \$13.5 million under the Working Capital Facility. This amount was drawn to partially fund the deposit of \$17.5 million required for the potential acquisition of Famous Players (discussed below in "Subsequent Event").

*Term Facility.* On November 26, 2003, the Partnership entered into a senior secured term facility in the amount of \$110 million (the "Term Facility"). The Term Facility matures on November 25, 2006 with no scheduled repayments of principal required prior to maturity. The Term Facility bears interest at a floating rate based on the Canadian dollar prime rate or on the bankers acceptance rates plus, in each case, an applicable margin to those rates. The Term Facility was fully drawn as at June 30, 2005.

The Partnership's credit facilities contain numerous restrictive covenants that limit the discretion of the Partnership's management with respect to certain business matters. These covenants place significant 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.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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The above credit facilities are secured by all of the Partnership's assets and are guaranteed by the Trust.

*Interest Rate Swap.* As of June 30, 2005, the Partnership had an interest rate swap agreement in place whereby the Partnership pays an interest rate of 4.29% and receives a floating rate. The swap is for a term of three years, expiring November 26, 2006 and the initial principal outstanding was \$44 million. The principal outstanding under the swap increased to \$77 million on August 26, 2004 and increases to \$110 million on May 26, 2005. The estimated fair market value of the swap is an unrealized loss of \$2.6 million (loss of \$1.2 million as at June 30, 2004) that is not recognized on the balance sheet or statement of income in accordance with GAAP.

*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 Notes"). The Galaxy Notes bear interest at a rate of 14% per annum and have no scheduled repayments prior to maturity. The Galaxy Notes mature on November 26, 2028 at which time they are payable in full. The Galaxy Notes are subordinated to the bank credit facilities discussed above.

### ***Future Obligations***

As of June 30, 2005, the Partnership has aggregate capital commitments of \$26.3 related to the completion of construction of 6 theatre properties to comprise of 58 screens. The Partnership expects to complete construction and to open these theatres throughout 2005 and 2006.

As of June 30, 2005, approximately \$2.9 million in cash remains of the \$5.5 million reserve fund that is to be used for point-of-sale upgrades and rebranding. As at June 30, 2005 the Partnership had commitments of approximately \$3.8 million related to point-of-sale upgrades and rebranding of which it had spent \$2.6 million.

During 2004, the Partnership announced its plans to move forward with the launch of a digital advertising network in its 21 Toronto extended market area theatres. Digital projectors were installed in 215 theatre auditoriums and the digital advertising network was launched on April 1, 2005. If the program is expanded outside of the Toronto extended market area, the total expected cost is in the range of \$7 million to \$9 million over the next two years. During the three months ended June 30, 2005, the Partnership fully funded its obligations of \$3.2 million on this project. This project was funded through the Development Facility discussed above.

The Partnership conducts a significant part of its operations in leased premises. The Partnership's leases generally provide for minimum rentals and a number of the leases also include percentage rentals 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.

### **RELATED PARTY TRANSACTIONS**

The Fund has entered into transactions with parties to which it is related. During the three months ended June 30, 2005 and 2004, distributions in the amount of \$2.3 million and \$2.1 million respectively were received from the Partnership. During the six months ended June 30, 2005 and 2004, distributions in the amount of \$4.6 million and \$4.2 million respectively were received from the Partnership. The Fund had distributions receivable from the Partnership at June 30, 2005 in the amount of \$0.8 million.

The Fund earned interest income in the amount of \$3.5 million and \$7.0 million for the three and six months ended June 30, 2005 respectively with respect to the Galaxy Notes (2004 - \$3.5 million and \$7.0 million).

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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

COC and LCT provided the Partnership with management information systems support pursuant to a service agreement. For the three months ended June 30, 2004, the Partnership was charged \$165 thousand for these services. As a result of the sale of LCT by Onex on July 30, 2004, LCT, which is no longer a related party, provides these services to the Partnership. This service agreement was terminated during the second quarter of 2005.

COC charged the Partnership \$130 thousand and \$0.3 million for the three and six months ended June 30, 2005 for rent for the Partnership's head office (2004 - \$130 thousand and \$0.3 million). The Partnership charged COC \$21 thousand for certain theatre management services during the three and six months ended June 30, 2005 (2004 - \$47 thousand and \$67 thousand respectively).

For the three months ended June 30, 2005 and 2004 the Partnership incurred expenses for film rental totaling \$4.0 million and \$2.6 million, respectively, to Alliance Atlantis Communications Inc. ("Alliance") and Motion Picture Distribution Limited Partnership ("Motion Picture"). For the six months ended June 30, 2005 and 2004 the Partnership incurred expenses for film rental totaling \$7.2 million and \$10.9 million, respectively, to Alliance. Alliance is a former shareholder of GEI and Ellis Jacob, Chief Executive Officer of the Partnership, is a member of the Board of Directors and Audit Committee of Alliance. On March 24, 2005, Mr. Jacob resigned from the Board of Directors of Motion Picture.

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, 2005, the Partnership earned revenue in the amount of \$0.2 million with respect to these services (2004 - \$0.2 million). During the six months ended June 30, 2005, the Partnership earned revenue in the amount of \$0.4 million with respect to these services (2004 - \$0.3 million).

A member of the Trustees of the Fund and a Director of Cineplex Galaxy General Partner Corporation received fees for consulting services provided with respect to the acquisition of Famous Players (see "Subsequent Event" discussed below) in the amount of \$0.1 million and \$0.1 million for the three months and six months ended June 30, 2005.

A trustee of the Fund is the President and Chief Executive Officer of Riocan Real Estate Investment Trust ("Riocan"). The Partnership incurred rental costs for theatres under lease commitments with Riocan in the amount of \$2.8 million and \$1.8 million for the quarters ended June 30, 2005 and 2004 respectively. For the six months ended June 30 2005 and 2004 the Partnership incurred rental costs for theatres under lease commitments with Riocan of \$5.6 million and \$3.7 million respectively. Effective August 1, 2005 this trustee resigned from the Board of the Fund.

Future minimum rental commitments at June 30, 2005 under the Riocan operating leases are set forth as follows (expressed in millions of dollars):

2005	\$	3.7
2006		7.5
2007		7.6
2008		7.4
2009		7.2
Thereafter		<u>58.3</u>
	\$	<u>91.7</u>

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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,	
	2005	2004	2005	2004
Fund	\$2,364	\$2,076	\$4,634	\$4,248
Onex and its subsidiaries	7,367	5,822	20,400	12,569
Alliance	130	73	1,041	226
Other related parties	114	67	645	207

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

	As at June 30,	
	2005	2004
Fund	\$831	\$706
Onex and its subsidiaries	2,456	5,031
Alliance	-	415
Other related parties	38	364

During the quarter ended June 30, 2004 Ellis Jacob, Chief Executive Officer of the Partnership, exchanged 148,870 Class B LP units for 148,870 Fund units under the provisions of the Exchange Agreement. The exchange has been restated to reflect fair market as required by EIC Abstract 151, Exchangeable Securities Issued by Subsidiaries of Income Trusts, which is effective for financial statements issued subsequent to January 19, 2005 (see Recent Accounting Developments below).

During the quarter ended June 30, 2005 Alliance exchanged 679,498 Fund units under the provision of the Exchange Agreement. The exchange has been recorded at fair market value as required by Abstract 151, Exchangeable Securities Issued by Subsidiaries of Income Trusts, which is effective for financial statements issued subsequent to January 19, 2005 (see Recent Accounting Developments below).

In April 2004, the Partnership acquired from COC two theatres for nominal consideration. The transaction has been recorded by the Partnership at \$24 thousand, the amount for which the asset had been carried in the books of COC. The difference between COC's carrying value and the consideration paid by the Partnership has been credited to the Partners' Equity in accordance with Section 3840 of the Handbook.

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**

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:

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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### *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*

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. 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.

### *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 subsidiary, GEI, 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.

### *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 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.

### **Recent Accounting Developments**

In September 2003, the CICA issued Accounting Guideline 15, "Consolidation of Variable Interest Entities" (the "Guideline"). In September 2003 the CICA amended the Guideline to make it effective for annual and interim periods beginning on or after November 1, 2004. The Guideline addresses the application of consolidation principles to entities that are subject to control on a basis other than ownership

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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of voting interests. The Fund and the Partnership adopted the Guideline during the first quarter of 2005. As a result of the adoption of the Guideline, the Partnership was required to consolidate the trust that was formed to act as Trustee of the Partnership's Long-Term Incentive Plan. Details of the impact of the application of the Guideline are discussed in Note 2 to the Fund's and Partnership's Consolidated Financial Statements.

In 2003, the Canadian Institute of Chartered Accountants ("CICA") issued Handbook Section 3110, "Asset Retirement Obligations", effective for annual and interim periods beginning on or after January 1, 2004. This standard requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The implementation of Section 3110, requiring retroactive restatement of the financial statements, has had no material impact on the Partnership's financial position or results of operations.

Effective January 1, 2004, the Partnership adopted CICA Accounting Guideline 13 ("AcG 13") "Hedging Relationships". AcG 13 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 new guideline, the Partnership 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 accounted for in accordance with EIC-128, "Accounting for Trading, Speculative or Non-Hedging Derivative Financial Instruments". These instruments will be recorded on the balance sheet at fair value, and changes in fair value will be recognized in income in the period in which the change occurs.

In connection with the implementation of AcG 13, the Partnership considered its hedging relationships as at January 1, 2004 and during the six months ended June 30, 2005, and determined that its interest rate swap agreement on its Term Facility qualified for hedge accounting for Canadian GAAP purposes and, therefore, the estimated fair value of the swap is not recognized in the balance sheet.

The Partnership receives rebates from certain vendors with respect to the purchase of concession goods. Payments received from vendors are composed of amounts for purchases made by the Partnership from the vendor in addition to amounts paid in return for advertising undertaken by the theatres on behalf of the vendor. The Partnership previously recorded all rebates received as a reduction of concession costs. Under Emerging Issues ("EIC") Abstract 144, Accounting By A Customer (Including a Reseller) For Certain Consideration Received From a Vendor, the Partnership continues to recognize rebates earned for purchases of a vendor's product as a reduction of concession costs; however, it is required to recognize rebates received for services delivered to the vendor as revenue. As a result, the Partnership has recorded rebates received with respect to advertising services performed for the vendor as other revenue. As required by EIC-144, the Partnership has applied this change retroactively resulting in an increase in other revenue and concession costs for the three and six months ended June 30, 2005 of \$0.5 million and \$1.0 million respectively (2004 - \$0.5 million and \$1.0 million).

The Fund implemented, on a retroactive basis with prior periods restated, the new EIC Abstract 151, Exchangeable Securities Issued by Subsidiaries of Income Trusts, which is effective for financial statements issued subsequent to January 19, 2005. The standard addresses whether or not the exchangeable Units should be recorded as equity in the Fund's balance sheet. In addition, it provides guidance on the accounting treatment for the conversion of exchangeable securities that are not presented as part of the Fund's unitholders' equity and it addresses how earnings per Fund Unit should be calculated in the Fund's financial statements.

Class B LP Units are exchangeable for Fund Units. The Class B LP Units are not shown as part of the Fund's unitholders' equity in the balance sheet until they have been exchanged for Fund Units as there are no requirements for the Class B LP Units to be exchanged into Fund Units. As such, the Class B LP Units are considered as part of the calculation of diluted earnings per Fund Unit using the if-converted method.



# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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When Class B LP Units are converted into Fund Units, the Fund accounts for the exchange of Units at fair market value at the date of the exchange. The impact to the Fund's share of the Partnership's income as a result of the retroactive implementation of this new standard is immaterial.

### **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 labour costs; and (ix) the ability to generate additional ancillary revenue. See "Risk Factors" detailed in the Fund's Annual Information Form dated June 30, 2005 for a more detailed description of risks facing the Partnership.

#### **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. The estimated fair market value of the swap is an unrealized loss of \$2.6 million (loss of \$1.2 million as at June 30, 2004) that is not recognized on the balance sheet or statement of income in accordance with GAAP.

#### **Interest Rate Risk**

As of June 30, 2005, the Partnership had long-term debt and amounts due to the Trust (including current maturities) of \$241 million. Approximately \$141 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 \$176 thousand per year. Offsetting this risk is the impact of the interest rate swap referred to above.

#### **Other**

Since 2003, three complaints have been filed with the Ontario Human Rights Commission against the Partnership alleging discrimination against hearing impaired individuals for not providing sufficient technology to accommodate for their disability. Similar complaints have been filed against other exhibitors and certain film distributors. All complaints have been referred to the Human Rights Tribunal (the "Tribunal") and have been joined together for hearing. The Partnership does not anticipate a judicial resolution of this matter for a significant period of time. At the present time the Partnership is unable to assess the magnitude of any potential judgment from the Tribunal. There is the potential for a mediated resolution that could occur on a shorter time frame. However were the Tribunal to rule against the Partnership and force the maximum provision of technology to the complainants, the Partnership could face a substantial financial burden.

The Partnership has been and will continue to research changing technologies to make a determination about how it can best accommodate the hearing impaired community. The Partnership has allocated funds in its 2005 budget to provide for increased technology to accommodate hearing impaired patrons. The Partnership is also in contact with groups that represent both the hearing and vision impaired communities in an effort to reach consensus on what technology each respective community prefers.

The Partnership is a defendant in various lawsuits arising in the ordinary course of business and is involved in certain environmental matters. From time to time, the Partnership is involved in disputes with landlords, contractors and other third parties. It is the opinion of management that any liability to the

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Partnership, which may arise as a result of these matters, will not have a material adverse effect on the Partnership's operating results, financial position or cash flows.

### SUBSEQUENT EVENT

The Partnership, Viacom and Viacom Canada Inc ("Viacom Canada") entered into a purchase agreement dated June 10, 2005 ("Purchase Agreement") pursuant to which the Partnership agreed to acquire the Famous Players Limited Partnership ("Famous Players") and its general partner, Famous Players Co. ("the Acquisition"), which together hold substantially all the assets and liabilities of Viacom Canada's film exhibition business formerly operated by its Famous Players division, including its subsidiaries' shares and joint venture interests, and excluding liabilities to related parties other than to related parties relating solely to film distributions rights on arm's length terms. The Partnership deposited \$17.5 million in an escrow account on June 13, 2005 which was applied toward the cash consideration payable to Viacom Canada. On closing of the transaction, total consideration incurred by the Partnership to acquire the net assets noted above amounts to \$464 million in cash plus transaction costs and the assumption of capital leases. The Purchase Agreement provides that the net cash flow of the Famous Players business from and including April 29, 2005 to closing of the Acquisition is to be for the account of the Partnership in the form of a purchase price adjustment. This purchase price adjustment has not yet been finalized. The Acquisition was completed on July 22, 2005.

In order to fund the Acquisition, the Partnership entered into a number of transactions. The Partnership issued indirectly to the Fund 6,835,000 Class A LP Units for gross proceeds of approximately \$110 million and 5,600,000 Class C LP Units for gross proceeds of \$105 million. Class C LP Units will be entitled to a distribution on the business day before June 30 and December 31 each year in priority to distributions paid on the Class A LP Units and Class B LP Units equal to 6.02%.

The Fund financed the acquisition of the Class A LP Units and Class C LP Units through the issuance of 6,835,000 Units at \$16.10 per Unit to raise gross proceeds of approximately \$110 million and the issuance of \$105 million convertible extendible unsecured subordinated debentures (the "Convertible Debentures"), bearing interest at a rate of 6% per annum, payable semi-annually and convertible, at the option of the holder into units of the Fund at \$18.75 per unit. Upon conversion of the Convertible Debentures to Fund units, distributions on Class C LP Units will automatically adjust such that the holder of Class C LP Units will receive distributions in the same manner as distributions are made on the corresponding number of Class A LP Units. The Partnership and the Fund have entered into a reimbursement agreement under which fees associated with the issuance of the Fund Units and Convertible Debentures in the amounts of \$5.5 million and \$4.2 million will be reimbursed by the Partnership. The Partnership will record the fees in partners' equity and deferred charges, respectively, and amortize the deferred charges over 3.5 years. As a result of the Fund's investment in Class A LP Units and Class C LP Units, the Fund's investment in the Partnership increased by 6.4% from 43.8% as at June 30, 2005 to 50.2% as at July 22, 2005. The Fund will continue to account for the Partnership under the equity method as Onex Corporation ("Onex") continues to hold both a substantial equity interest in the Partnership and indirectly the majority controlling interest in the General Partner that controls the Partnership.

The Class C LP Units are redeemable by the Trust under certain conditions and as such they have characteristics of both debt and equity. As a result, under the provisions of CICA Handbook Section 3860, "Financial Instruments Disclosure and Presentation", an amount of \$96,454 will be classified as a liability and the remainder of \$8,546 will be recorded in equity. Distributions and accretion on the Class C LP Units will be included interest expense.

In connection with the Acquisition, the Partnership entered into an amended and restated credit agreement (the "Amended Credit Agreement") with a syndicate of lenders pursuant to which it will have available a (i) 364 day \$50 million extendible senior secured revolving credit facility, (ii) a four year \$315 million senior secured non-revolving term credit facility, and (iii) a four year \$60 million senior secured revolving credit facility. The Amended Credit Facilities to be drawn as prime rate loans or bankers acceptances and which will bear interest at a floating rate based on the Canadian dollar prime rate or on the

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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banker's acceptance rates plus an applicable margin will amend and restate the Partnership's existing credit facilities under which \$141 million was outstanding as at July 22, 2005. The repayment of the existing credit facilities is considered an extinguishment of debt under Emerging Issues Committee ("EIC") Abstract 88, "Debtors Accounting for a Modification or Exchange of Debt Instruments", and as a result deferred financing charges of approximately \$1.2 million will be charged to the net earnings of the Partnership upon repayment of the existing credit facilities. In addition, upon extinguishment of the existing credit facilities, the Partnership will recognize the estimated mark-to-market adjustment on the existing interest rate swap agreement. As at July 22, 2005 the unrecognized loss on the hedge was \$2.2 million. Effective July 22, 2005 the Partnership entered into a new interest rate swap. In accordance with the swap agreement, the Partnership pays an interest rate of 3.8% and receives a floating rate. The 3.8% interest rate includes the mark to market buy out of the interest rate swap on the existing credit facilities. The swap is for a term of four years and the principal outstanding is \$200,000.

On June 29, 2005, the Partnership entered into a letter of intent to sell real estate interests in four theatre locations (two of which are Famous Players theatres) for an estimated \$67 million to RioCan. The transaction was subject to RioCan's due diligence and the Partnership's right to obtain property appraisals. As part of the agreement, the Partnership will lease back the four theatres. The transaction closed on August 3, 2005 and proceeds of the sale were used to repay amounts borrowed to finance a portion of the purchase price for the Acquisition.

The Partnership issued 500,000 Class D LP Units, a new class of Partnership units, at an estimated value of \$8,050 to certain of its executives upon closing the Acquisition. This amount will be recorded as compensation expense as at July 22, 2005. These units are not exchangeable for units of the Fund and will be entitled to receive distributions on substantially the same basis as the Class B LP Units. At the next meeting of unitholders of the Fund, unitholders will be asked to approve a resolution which would make the Class D LP Units exchangeable for units of the Fund.

In addition the Partnership agreed to pay Onex, a related party, a transaction fee of \$4,000 in connection with advisory services rendered by Onex in connection with the Acquisition, issuance of Fund units and Convertible Debentures, and entering into the Amended Credit Facilities. The fee was satisfied by the issuance of 248,447 Fee Units upon completion of the Acquisition.

Using the proceeds from the above transactions, the Partnership acquired limited partnership units of Famous Players Limited Partnership and the shares of Famous Players Co. for total cash consideration of \$464,000 and the assumption of capital leases. The acquisition will be accounted for by the purchase method. The purchase price will be allocated to the estimated fair value of the net assets acquired. Based on management's best estimates, the purchase price has been allocated to the assets and liabilities of Famous Players as follows:

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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<b>Assets and liabilities acquired:</b>	
Property, plant and equipment	\$403
Advertising contracts	32
Trademarks and trade names	44
Goodwill	135
Net pension liability	(6)
Net working capital deficiency	(47)
Other liabilities	(57)
Capital leases	(36)
	<hr/>
Total Purchase Price	<u>\$468</u>
 <b>Consideration given</b>	
Cash paid for acquisition of Famous Players	\$464
Transactions costs associated with the acquisition	4
	<hr/>
	<u>\$468</u>

The above allocation of purchase price is preliminary and 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 the effective date of the acquisition. Accordingly, the purchase price will be adjusted subsequent to completion of the Acquisition and the final purchase price allocation process; variations may be material.

In contemplation of completing the Acquisition, on May 27, 2005 the Partnership entered into a consent agreement (the "Consent Agreement") with the Commissioner of Competition in respect of its proposal to acquire Famous Players. Under the terms of the Consent Agreement, upon completion of the Acquisition, the Partnership agreed to divest 34 specified theatres, held by both the Partnership and Famous Players within a specified period of time on the terms and conditions set out in the Consent Agreement. Until May 27, 2010, the Partnership must provide the Commissioner with prior written notice of any acquisition by it of any non-Partnership theatre or assumption of lease where the remaining term exceeds two years. The Partnership also may not, during this time, re-acquire any of the divested theatres without prior approval of the Commissioner.

In addition, the Partnership and its joint venture partner intend to sell the Alliance Atlantis brand theatres.

### OUTLOOK

Management believes that the Acquisition will be immediately 5% accretive (4% fully diluted) to the Fund's distributable cash per Unit. In addition, management believes that the Partnership will benefit from cost-saving opportunities and other synergies through the integration of the operations of the Partnership and Famous Players. Specifically, management expects to realize cost savings through a reduction in consolidated general and administrative expenses, improved supply chain cost management and greater operational efficiency. Management expects that these synergies will result in annual savings of approximately \$20 million once the operations of Famous Players and those of the Partnership have been fully integrated, which is expected to occur within 12 months of the closing of the Acquisition.

# Cineplex Galaxy Income Fund

## Management's Discussion and Analysis

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Management believes there are significant opportunities to grow revenue and distributable cash per Unit following the Acquisition. For example, cinema advertising in Canada has only recently been established and represents a significant growth opportunity for the Partnership. Management believes that the larger cinema network resulting from the Acquisition will enhance demand from advertisers, enabling them to reach a broader audience of up to 70 million guest visits annually on a national basis. Management believes that the enhanced demand from advertisers and the sharing of best practices between the Partnership and Famous Players will result in greater advertising revenue and distributable cash per Unit. Other significant revenue growth opportunities include the sale of naming rights on certain theatres and auditoriums, increased revenue from games and the exploitation of benefits related to the Partnership's loyalty programs. In addition, the Acquisition will provide the opportunity to apply each company's core expertise to the other's operations. These improvements are expected to lead to higher revenues and improved operating margins on a combined basis than would be achievable if the entities continued to operate separately.

The Partnership believes that its 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 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.

August 9, 2005

# Cineplex Galaxy Income Fund

## Consolidated Balance Sheets

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(expressed in thousands of Canadian dollars)

	<b>June 30, 2005</b> (Unaudited)	<b>December 31, 2004</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 1,187	\$ 1,179
Distributions receivable	832	752
	<u>2,019</u>	<u>1,931</u>
<b>Due from Galaxy Entertainment Inc.</b>	<b>100,000</b>	<b>100,000</b>
<b>Investment in Cineplex Galaxy Limited Partnership</b>	<b>100,766</b>	<b>98,046</b>
<b>Investment in Cineplex Galaxy General Partner Corporation</b>	<b>2</b>	<b>2</b>
	<u>\$ 202,787</u>	<u>\$ 199,979</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Distributions payable (note 4)	\$ 1,998	\$ 1,918
Due to Cineplex Galaxy Limited Partnership	4	4
	<u>2,002</u>	<u>1,922</u>
<b>Unitholders' Equity</b>	<u>200,785</u>	<u>198,057</u>
	<u>\$ 202,787</u>	<u>\$ 199,979</u>

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

### Approved by the Board of Trustees

“BRUCE BIRMINGHAM”

\_\_\_\_\_  
Bruce Birmingham  
Trustee

“ROBERT STEACY”

\_\_\_\_\_  
Robert Steacy  
Trustee

# Cineplex Galaxy Income Fund

## Consolidated Statements of Earnings (Unaudited)

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

	Three months € June 30, 2005	Three months € June 30, 2004	Six months ended June 30, 2005	Six months ended June 30, 2004
<b>Share of income (loss) of Cineplex Galaxy Limited Partnership (note 3)</b>	\$ (2,080)	\$ 1,274	\$ (4,434)	\$ 668
<b>Interest income</b>	<u>3,504</u>	<u>3,500</u>	<u>7,008</u>	<u>7,000</u>
<b>Net earnings</b>	<u>\$ 1,424</u>	<u>\$ 4,774</u>	<u>\$ 2,574</u>	<u>\$ 7,668</u>
<b>Basic earnings per unit</b>	\$ 0.07	\$ 0.25	\$ 0.13	\$ 0.39
<b>Weighted average number of units outstanding used in computing earnings per unit</b>	20,603,965	19,435,991	20,346,056	19,417,995
<b>Diluted earnings per unit</b>	\$ 0.07	\$ 0.25	\$ 0.12	\$ 0.39
<b>Weighted average number of units outstanding used in computing diluted earnings per unit</b>	47,566,974	47,566,974	47,566,974	47,566,974

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

# Cineplex Galaxy Income Fund

## Consolidated Statements of Unitholders' Equity (Unaudited)

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(expressed in thousands of Canadian dollars)

### For the six months ended June 30, 2005

	Unitholders' capital (note 5)	Accumulated earnings	Accumulated distributions	Total
<b>Balance - January 1, 2005</b>	\$ 201,477	\$ 21,313	\$ (24,733)	\$ 198,057
<b>Issuance of units under Exchange Agreement</b> (note 5)	11,868	-	-	11,868
<b>Distributions declared</b> (note 4)	-	-	(11,714)	(11,714)
<b>Net earnings for the period</b>	-	2,574	-	2,574
<b>Balance - June 30, 2005</b>	<u>\$ 213,345</u>	<u>\$ 23,887</u>	<u>\$ (36,447)</u>	<u>\$ 200,785</u>

### For the six months ended June 30, 2004

	Unitholders' capital (note 5)	Accumulated earnings	Accumulated distributions	Total
<b>Balance - January 1, 2004</b>	\$ 194,000	\$ 4,046	\$ (2,169)	\$ 195,877
<b>Issuance of units under Exchange Agreement</b> (note 5)	1,489	-	-	1,489
<b>Distributions declared</b> (note 4)	-	-	(11,165)	(11,165)
<b>Net earnings for the period</b>	-	7,668	-	7,668
<b>Balance - June 30, 2004</b>	<u>\$ 195,489</u>	<u>\$ 11,714</u>	<u>\$ (13,334)</u>	<u>\$ 193,869</u>

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



# Cineplex Galaxy Income Fund

## Consolidated Statements of Cash Flows (Unaudited)

(expressed in thousands of Canadian dollars)

	Three months June 30, 2005	Three months June 30, 2004	Six months ended June 30, 2005	Six months ended June 30, 2004
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net earnings for the period	\$ 1,424	\$ 4,774	\$ 2,574	\$ 7,668
Item not affecting cash and cash equivalents				
Share of loss (income) from equity investee (note 3)	2,080	(1,274)	4,434	(668)
Interest receivable from Galaxy Entertainment Inc.	-	(45)	-	214
Distributions received from Cineplex Galaxy Limited Partnership (note 7)	2,364	2,121	4,634	4,248
	<u>5,868</u>	<u>5,576</u>	<u>11,642</u>	<u>11,462</u>
<b>Financing activities</b>				
Distributions paid	(5,864)	(5,576)	(11,634)	(11,462)
Due to Cineplex Galaxy Limited Partnership	-	4	-	(11)
	<u>(5,864)</u>	<u>(5,572)</u>	<u>(11,634)</u>	<u>(11,473)</u>
<b>Increase (decrease) in cash and cash equivalents during the period</b>	<b>4</b>	<b>4</b>	<b>8</b>	<b>(11)</b>
<b>Cash and cash equivalents - Beginning of period</b>	<u><b>1,183</b></u>	<u>445</u>	<u><b>1,179</b></u>	<u>460</u>
<b>Cash and cash equivalents - End of period</b>	<u><b>\$ 1,187</b></u>	<u>\$ 449</u>	<u><b>\$ 1,187</b></u>	<u>\$ 449</u>
<b>Supplemental information</b>				
Cash received for interest	\$ 3,504	\$ 3,456	\$ 7,008	\$ 7,215

Certain non-cash transactions occurred relating to exchanges of Class B LP units for Fund units (note 5).

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

# Cineplex Galaxy Income Fund

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

## 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 (the “Partnership”) and shares of Cineplex Galaxy General Partner Corporation (the “General Partner”), the general partner of the Partnership. The Partnership is Canada’s second largest film exhibition organization with theatres in six provinces and commenced operations on November 26, 2003.

The Fund prepares its unaudited interim consolidated financial statements in accordance with Canadian generally accepted accounting principles. The disclosures contained in these unaudited interim consolidated financial statements do not include all requirements of generally accepted accounting principles for annual financial statements and should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2004.

Due to the limited amount of information that these unaudited interim consolidated financial statements provide on the underlying operations of the Partnership, these unaudited interim consolidated financial statements should be read in conjunction with the unaudited interim consolidated financial statements of the Partnership for the six months ended June 30, 2005.

Results for the six months ended June 30, 2005 are not necessarily indicative of results expected for the full fiscal year or any other future period due to business seasonality of the Partnership. As the Fund has significant influence over the Partnership, its investment is accounted for using the equity method.

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, 2004, except as disclosed herein.

## 2 Summary of significant accounting policies

### Variable interest entities

In June 2003, The Canadian Institute of Chartered Accountants (“CICA”) issued Accounting Guideline 15, “Consolidation of variable interest entities” (“AcG 15”). In November 2004, the CICA amended AcG 15 to make it effective for annual and interim periods beginning on or after November 1, 2004. AcG 15 addresses the consolidation of business enterprises to which the usual condition (ownership of a majority voting interest) of consolidation does not apply. This interpretation focuses on controlling financial interests that may be achieved through arrangements that do not involve voting interests. It concludes that in the absence of clear control through voting interests, a company’s exposure (variable interest) to the economic risks and potential rewards from the variable interest entity’s (“VIE’s”) assets and activities is the best evidence of control. If an enterprise holds a majority of the variable interests of an entity by either absorbing the majority of the VIE’s expected losses or receiving the majority of the VIE’s expected residual returns, or both, it would be considered the primary beneficiary. Upon consolidation, the primary beneficiary is generally required to include assets,

# Cineplex Galaxy Income Fund

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

liabilities and non-controlling interests at fair value and subsequently account for the variable interest as if it were consolidated based on the majority voting interest.

The Fund holds a significant variable interest in the Partnership through its investment in units of the Partnership. This variable interest originated on November 26, 2003 upon the formation of the Partnership and the Fund's investment therein. The Fund's maximum exposure to loss as a result of its involvement with the Partnership is its \$100,766 equity investment in the Partnership as at June 30, 2005. In addition, the Trust has guaranteed the New Credit Facilities undertaken by the Partnership and has granted a security interest over its assets, including a pledge of its Class A LP Units, shares of the General Partner and the Galaxy Notes. Total debt outstanding under the New Credit Facilities as at June 30, 2005 is \$141,000.

The Fund also holds a significant variable interest in Galaxy Entertainment Inc. ("GEI") through the Galaxy Note. This variable interest originated on November 26, 2003 upon the formation of the Partnership. The Galaxy Note is subordinated to the Partnership's New Credit Facilities and has been pledged by the Trust against the New Credit Facilities. The Fund's maximum exposure to loss as a result of its involvement with GEI is its \$100,000 investment in the Galaxy Note and any unpaid accrued interest thereon. The Galaxy Note bears interest at the rate of 14% per annum, and the balance of accrued unpaid interest as at March 31, 2005 is \$nil.

However, based on an evaluation of the risks held by the Fund through its variable interests in the Partnership and GEI, respectively, it has been determined that it is not the primary beneficiary of the Partnership or GEI. The Fund, therefore, continues to account for its interest in the Partnership under the equity method of accounting, and the Partnership continues to consolidate GEI.

**Cineplex Galaxy Income Fund**  
Notes to Consolidated Financial Statements  
(Unaudited)  
**June 30, 2005**

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

**3 Share of Partnership income (loss)**

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

	<b>Three months June 30, 2005</b>	<b>Three months June 30, 2004</b>	<b>Six months ended June 30, 2005</b>	<b>Six months ended June 30, 2004</b>
Consolidated Partnership net income	\$ 242	\$ 8,777	\$ 43	\$ 12,978
Adjustment for Catch-up Payment from Partnership to Class B LP unitholders	<u>(4,583)</u>	<u>(5,075)</u>	<u>(9,374)</u>	<u>(10,157)</u>
Remaining income (loss) to be distributed pro rata to Class A LP and Class B LP unitholders	<u>\$ (4,341)</u>	<u>\$ 3,702</u>	<u>\$ (9,331)</u>	<u>\$ 2,821</u>
Fund's proportionate % share (a)	\$ (1,834)	\$ 1,520	\$ (3,941)	\$ 1,161
Adjustments for excess of purchase price over net assets acquired	<u>(246)</u>	<u>(246)</u>	<u>(493)</u>	<u>(493)</u>
Share of Partnership income (loss)	<u>\$ (2,080)</u>	<u>\$ 1,274</u>	<u>\$ (4,434)</u>	<u>\$ 668</u>

- (a) During the period, the Fund's indirect ownership of the Partnership, held through the Trust, increased from approximately 42.1% as at December 31, 2004 to approximately 43.8% as at June 30, 2005 (41.1% as at June 30, 2004) (note 5). The Fund's proportionate share of the income (loss) available to be distributed to the Class A LP and Class B LP unitholders has been adjusted to reflect its increased ownership.

**4 Distributions payable**

The Fund has declared the following distributions during the six-month periods ended June 30, 2005 and 2004:

<b>Record date</b>	<b>2005</b>		<b>2004</b>	
	<b>Amount</b>	<b>Amount per unit</b>	<b>Amount</b>	<b>Amount per unit</b>
January	\$ 1,918.7	\$ 0.0958	\$ 1,858.5	\$ 0.0958
February	1,933.1	0.0958	1,858.5	0.0958
March	1,933.1	0.0958	1,858.5	0.0958
April	1,933.1	0.0958	1,858.5	0.0958
May	1,998.2	0.0958	1,858.5	0.0958
June	1,998.2	0.0958	1,872.8	0.0958

The distributions will be paid within 30 days following the end of each month.

# Cineplex Galaxy Income Fund

## Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

### 5 Unitholders' capital

During the three-month and six-month periods ended June 30, 2005, under the provisions of the Exchange Agreement, certain investors including a related party exchanged 679,498 and 834,154 Class B, Series 1 Partnership units for 679,498 and 834,154 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 \$161 and \$113 have been charged to unitholders' equity resulting in a net increase in unitholders' capital of \$9,513 and \$11,868, respectively.

On June 9, 2004, under the provisions of the Exchange Agreement, an investor related to the Fund exchanged 148,870 Class B, Series 1 Partnership units for 148,870 Fund units. As this was a related party transaction, the Fund initially recorded the Partnership units it acquired at the exchanging investor's carrying value. The difference between the investor's carrying value and the value at which the Fund units were issued was previously charged to unitholders' equity in the amount of \$205 resulting in a net increase in unitholders' capital of \$1,303. Effective December 31, 2004, the Fund implemented, on a retroactive basis with prior periods restated, Emerging Issues Committee ("EIC") Abstract 151, Exchangeable Securities Issued by Subsidiaries of Income Trusts. As a result, the Fund has restated the Partnership units it acquired to be recorded at fair market value of the Fund units on the date of the transaction. The revised difference between the fair market value and the value at which the Fund units were issued has been credited to unitholders' equity in the amount of \$19 resulting in a net increase to unitholders' capital and investment in Cineplex Galaxy Limited Partnership of \$1,489.

There are 20,857,843 (June 30, 2004 - 19,548,870) Fund units issued at June 30, 2005 for \$213,345 (June 30, 2004 - \$195,489).

	Three months ended				Six months ended			
	June 2005		June 2004		June 2005		June 2004	
	Number of Fund units	Amount	Number of Fund units	Amount	Number of Fund units	Amount	Number of Fund units	Amount
Units - Beginning of period	20,178,345	\$ 203,832	19,400,000	\$ 194,000	20,023,689	\$ 201,477	19,400,000	\$ 194,000
Issuance of units under Exchange Agreement	679,498	9,513	148,870	1,489	834,154	11,868	148,870	1,489
Units - End of period	20,857,843	\$ 213,345	19,548,870	\$ 195,489	20,857,843	\$ 213,345	19,548,870	\$ 195,489

# Cineplex Galaxy Income Fund

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

## 6 Subsequent events

The Partnership, Viacom Inc. and Viacom Canada Inc. (“Viacom Canada”) entered into a purchase agreement dated June 10, 2005 (“Purchase Agreement”) pursuant to which the Partnership agreed to acquire the Famous Players Limited Partnership (“Famous Players”) and its general partner, Famous Players Co. (the “Acquisition”), which together hold substantially all the assets and liabilities of Viacom Canada’s film exhibition business formerly operated by its Famous Players division, including its subsidiaries’ shares and joint venture interests and excluding liabilities to related parties other than to related parties relating solely to film distribution rights on arm’s-length terms. The Partnership deposited \$17,500 in an escrow account on June 13, 2005, which was applied toward the cash consideration payable to Viacom Canada. On closing of the transaction, total consideration incurred by the Partnership to acquire the net assets noted above amounts to \$464,000 in cash plus transaction costs. The Purchase Agreement provides that the net cash flow of the Famous Players’ business from and including April 29, 2005 to closing of the Acquisition is to be for the account of the Partnership in the form of a purchase price adjustment. This purchase price adjustment has not yet been finalized. The Acquisition was completed on July 22, 2005.

On July 22, 2005, the Fund issued 6,835,000 Units for proceeds of approximately \$110,044 and convertible extendible unsecured subordinated debentures (“Convertible Debentures”) for proceeds of \$105,000, on the closing of the offering (the “Offering”). The Convertible Debentures have a final maturity date of December 31, 2012, are convertible into Fund units at the option of the holder and bear interest at a rate of 6% per annum. The Convertible Debentures cannot be redeemed by the Fund prior to December 31, 2008, but are redeemable thereafter under certain circumstances. The Convertible Debentures have characteristics of both debt and equity and as such, an amount of \$96,454 will be classified as a liability and the remainder of \$8,546 recorded in equity. As a result, interest expense will include a charge for interest as well as accretion of the liability to the final maturity date. The Partnership and the Fund entered into a reimbursement agreement under which fees associated with the issuance of the Fund units and Convertible Debentures in the amounts of \$5,502 and \$4,200, respectively, were reimbursed by the Partnership.

The Fund will indirectly purchase 6,835,000 Class A LP Units for an additional 6.4% interest in the Partnership and 6.4% of common shares of Cineplex Galaxy General Partner Corporation for a nominal amount. As a result, the Fund’s indirect ownership of the Partnership, held through the Trust, increased to approximately 50.2% as at July 22, 2005. The allocation of the purchase price will be based on the estimated fair value of the assets acquired and liabilities assumed at the date of the Acquisition and has not yet been finalized. In addition, the Fund will indirectly acquire 5,600,000 Class C LP Units. The total cash paid for the Class A LP Units and Class C LP Units is \$215,044. The Fund will continue to account for the Partnership under the equity method as Onex Corporation continues to hold both a substantial equity interest in the Partnership and indirectly the majority controlling interest in the General Partner that controls the Partnership.

# Cineplex Galaxy Income Fund

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

The Partnership will use these proceeds to help finance the Acquisition. The additional investment in the Partnership will be comprised of an investment of \$110,044 in Class A LP Units and an investment of \$105,000 in Class C LP Units. The Class C LP Units will be entitled to a distribution on the business day before June 30 and December 31 each year, in priority to distributions paid on the Class A LP Units and the Class B LP Units, equal to 6.02%. Upon conversion of the Convertible Debentures, the Class C LP Units will automatically adjust such that each Class C LP Unit will receive distributions in the same manner as the distributions are made for a corresponding Class A LP Unit. The Class C LP Units are redeemable by the holder under certain conditions.

## 7 Comparative figures

Comparative amounts for distributions received from Cineplex Galaxy Limited Partnership have been reclassified from an investing activity to an operating activity in the consolidated statements of cash flows to conform to the current year's financial statement presentation.

# Cineplex Galaxy Limited Partnership

## Consolidated Balance Sheets

(expressed in thousands of Canadian dollars)

	June 30, 2005 (Unaudited)	December 31, 2004
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 9,523	\$ 38,663
Restricted cash (note 2)	-	7,637
Accounts receivable	7,411	10,937
Inventories	2,083	2,123
Prepaid expenses and other current assets (note 10)	21,586	2,680
Due from related parties	7	4
	<u>40,610</u>	62,044
<b>Property, equipment and leaseholds</b>	<b>230,146</b>	234,854
<b>Goodwill</b>	<b>22,942</b>	22,942
<b>Future income taxes</b>	<b>1,698</b>	1,615
<b>Deferred charges and other intangibles</b>	<b>5,398</b>	3,975
	<u>\$ 300,794</u>	<u>\$ 325,430</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued expenses	\$ 24,551	\$ 27,654
Distributions payable	3,390	10,996
Due to related parties	-	373
Income taxes payable	21	153
Deferred revenue	6,888	13,580
Current portion of long-term debt (note 3)	51	52
	<u>34,901</u>	52,808
<b>Long-term debt (note 3)</b>	<b>141,000</b>	125,512
<b>Due to Cineplex Galaxy Trust</b>	<b>100,000</b>	100,000
<b>Accrued pension liability</b>	<b>529</b>	589
<b>Other liabilities</b>	<b>88,048</b>	89,784
	<u>364,478</u>	368,693
<b>Partners' Deficiency</b>		
<b>Partners' deficit</b>	<u>(63,684)</u>	(43,263)
	<u>\$ 300,794</u>	<u>\$ 325,430</u>

### Commitments and contingencies (note 5)

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

### Approved by the Board of Directors

“ELLIS JACOB”

Ellis Jacob  
Director

“ANTHONY MUNK”

Anthony Munk  
Director



# Cineplex Galaxy Limited Partnership

## Consolidated Statements of Income (Unaudited)

(expressed in thousands of Canadian dollars)

	Three months € June 30, 2005	Three months € June 30, 2004	Six months end June 30, 2005	Six months end June 30, 2004
<b>Revenue</b>				
Box office	\$ 54,029	\$ 62,275	\$ 105,427	\$ 116,110
Concessions	23,324	25,699	44,950	46,830
Other	6,767	5,469	12,002	9,542
	<u>84,120</u>	<u>93,443</u>	<u>162,379</u>	<u>172,482</u>
<b>Expenses</b>				
Film cost	29,449	33,407	55,346	60,047
Cost of concessions	4,776	5,060	9,221	9,340
Occupancy	13,665	13,798	27,598	27,035
Other theatre operating expenses	18,829	17,605	35,798	33,982
General and administrative	4,514	3,651	9,408	6,918
Management fee	71	170	224	335
	<u>71,304</u>	<u>73,691</u>	<u>137,595</u>	<u>137,657</u>
<b>Income before undernoted</b>	12,816	19,752	24,784	34,825
<b>Amortization</b>	6,690	5,607	13,214	11,042
<b>Gain on disposal of theatre assets</b>	(19)	(36)	(19)	(42)
<b>Interest on long-term debt</b>	2,344	1,904	4,550	3,905
<b>Interest on loan from Cineplex Galaxy Trust</b>	3,500	3,500	7,000	7,000
<b>Interest income</b>	(60)	(61)	(178)	(155)
<b>Income before income taxes</b>	361	8,838	217	13,075
<b>Current income taxes</b>	119	61	174	97
<b>Net income for the period</b>	<u>\$ 242</u>	<u>\$ 8,777</u>	<u>\$ 43</u>	<u>\$ 12,978</u>

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

# Cineplex Galaxy Limited Partnership

## Consolidated Statements of Partners' Deficiency (Unaudited)

(expressed in thousands of Canadian dollars)

### For the six months ended June 30, 2005

	Partners' capital (note 6)	Deficit	Accumulated e:	Accumulated d	Total
<b>Balance - January 1, 2005</b>	\$ 110,203	\$ (147,795)	\$ 38,949	\$ (44,620)	\$ (43,263)
Distributions declared	-	-	-	(20,342)	(20,342)
Investment in Cineplex Galaxy Income Fund units (notes 2 and 6)	(282)	-	-	-	(282)
LTIP compensation obligation (notes 2 and 6)	160	-	-	-	160
Net income for the period	-	-	43	-	43
<b>Balance - June 30, 2005</b>	<b>\$ 110,081</b>	<b>\$ (147,795)</b>	<b>\$ 38,992</b>	<b>\$ (64,962)</b>	<b>\$ (63,684)</b>

### For the six months ended June 30, 2004

	Partners' capital (note 6)	Deficit	Accumulated e:	Accumulated d	Total
<b>Balance - January 1, 2004, as previously reported</b>	\$ 110,425	\$ (147,698)	\$ 8,707	\$ (3,937)	\$ (32,503)
Adoption of asset retirement obligation standard	-	(121)	(6)	-	(127)
<b>Balance - January 1, 2004, as restated</b>	110,425	(147,819)	8,701	(3,937)	(32,630)
Distributions declared	-	-	-	(20,342)	(20,342)
Formation of Partnership issuance costs	(102)	-	-	-	(102)
Contribution of capital on acquisition of theatres	-	24	-	-	24
Net income for the period	-	-	12,978	-	12,978
<b>Balance - June 30, 2004</b>	<b>\$ 110,323</b>	<b>\$ (147,795)</b>	<b>\$ 21,679</b>	<b>\$ (24,279)</b>	<b>\$ (40,072)</b>

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

# Cineplex Galaxy Limited Partnership

## Consolidated Statements of Cash Flows (Unaudited)

(expressed in thousands of Canadian dollars)

	Three months June 30, 2005	Three months June 30, 2004	Six months ended June 30, 2005	Six months ended June 30, 2004
<b>Cash provided by (used in)</b>				
<b>Operating activities</b>				
Net income for the period	\$ 242	\$ 8,777	\$ 43	\$ 12,978
Adjustments to reconcile net income to net cash used in operating activities				
Amortization of property, equipment and leaseholds	6,690	5,607	13,214	11,042
Amortization of tenant inducements and rent averaging liabilities	(1,426)	(1,285)	(2,727)	(2,481)
Amortization of debt issuance costs	234	210	469	414
Gain on disposal of theatre assets	(19)	(36)	(19)	(42)
Changes in operating assets and liabilities (note 4)	(2,532)	(3,802)	(8,861)	(18,735)
	<u>3,189</u>	<u>9,471</u>	<u>2,119</u>	<u>3,176</u>
<b>Investing activities</b>				
Proceeds from sale of theatre assets	19	44	25	50
Capital expenditures	(3,225)	(3,386)	(8,366)	(5,458)
Deposit paid for subsequent acquisition (note 10)	(17,500)	-	(17,500)	-
Cash received from segregated account for distribution (note 2)	-	-	8,297	-
Cash transferred to segregated account for future distributions (note 2)	-	(2,075)	(691)	(3,458)
	<u>(20,706)</u>	<u>(5,417)</u>	<u>(18,235)</u>	<u>(8,866)</u>
<b>Financing activities</b>				
Borrowings under credit facility (note 3)	18,500	1,500	19,500	5,500
Formation of Partnership issuance costs paid	-	(102)	-	(102)
Distributions paid	(10,170)	(8,142)	(27,946)	(17,432)
Tenant inducements	605	250	1,896	550
Repayment of long-term debt	(4,000)	(15)	(4,013)	(25)
Investment in Cineplex Galaxy Income Fund units (note 2)	-	-	(423)	-
Deferred financing fees	(2,038)	-	(2,038)	-
	<u>2,897</u>	<u>(6,509)</u>	<u>(13,024)</u>	<u>(11,509)</u>
<b>Decrease in cash and cash equivalents during the period</b>	<b>(14,620)</b>	<b>(2,455)</b>	<b>(29,140)</b>	<b>(17,199)</b>
<b>Cash and cash equivalents - Beginning of period</b>	<b>24,143</b>	<b>28,783</b>	<b>38,663</b>	<b>43,527</b>
<b>Cash and cash equivalents - End of period</b>	<b>\$ 9,523</b>	<b>\$ 26,328</b>	<b>\$ 9,523</b>	<b>\$ 26,328</b>
<b>Supplemental information</b>				
Cash paid for interest	\$ 5,693	\$ 5,005	\$ 11,087	\$ 9,907
Cash paid for income taxes - net	\$ 313	\$ 44	\$ 377	\$ 104

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

# Cineplex Galaxy Limited Partnership

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

## 1 Description of business

Cineplex Galaxy Limited Partnership (the "Partnership") commenced operations on November 26, 2003 and was formed 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").

## 2 Summary of significant accounting policies

### Basis of presentation

The Partnership 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, 2004.

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, 2004, except as disclosed herein.

### Restricted cash

Restricted cash represents year to date distributions accrued and maintained in a segregated Partnership bank account for Class B, Series 2 Limited Partnership units (the "Support Units"). Distributions on the Support Units were dependent on the performance of seven new theatres that, as at November 26, 2003, had either not yet been opened or had been open for less than one year. For periods commencing January 2004, distributions on the Support Units were held in a segregated account until the end of the fiscal year when a determination was made regarding the actual cash flows of the new theatres. A shortfall in the performance of the new theatres would result in a reduction in the distributions to the holders of the Support Units. The term of the Support Arrangements was dependent on the performance of the new theatres.

For the year ended December 31, 2004, the performance targets established in connection with Cineplex Galaxy Income Fund's (the "Fund") initial public offering were met for the seven new theatres and, as a result, the Partnership released the full amount of the escrowed distributions of \$8,297 to the holders of the Class B, Series 2 LP Units of the Partnership on February 25, 2005. Additionally, the Support Arrangements were terminated effective December 31, 2004, and the holders of the Class B, Series 2 LP Units are hereafter fully entitled to receive cash distributions in a manner consistent with the Class B, Series 1 LP Units.

# Cineplex Galaxy Limited Partnership

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

## Variable interest entities

In June 2003, The Canadian Institute of Chartered Accountants (“CICA”) issued Accounting Guideline 15, “Consolidation of variable interest entities” (“AcG 15”). In November 2004, the CICA amended AcG 15 to make it effective for annual and interim periods beginning on or after November 1, 2004. AcG 15 addresses the consolidation of business enterprises to which the usual condition (ownership of a majority voting interest) of consolidation does not apply. This interpretation focuses on controlling financial interests that may be achieved through arrangements that do not involve voting interests. It concludes that in the absence of clear control through voting interests, a company’s exposure (variable interest) to the economic risks and potential rewards from the variable interest entity’s (“VIE’s”) assets and activities is the best evidence of control. If an enterprise holds a majority of the variable interests of an entity by either absorbing the majority of the VIE’s expected losses or receiving the majority of the VIE’s expected residual returns, or both, it would be considered the primary beneficiary. Upon consolidation, the primary beneficiary is generally required to include assets, liabilities and non-controlling interests at fair value and subsequently account for the variable interest as if it were consolidated based on the majority voting interest.

The Partnership holds a variable interest in GEI through its investment in 100% of the outstanding equity of GEI, which it acquired on November 26, 2003. GEI is considered a VIE as the total investment at risk is not sufficient to permit GEI to finance its activities without additional support. The Partnership is the primary beneficiary of GEI and, therefore, under AcG 15, is required to consolidate GEI. Prior to the application of AcG 15, the Partnership consolidated its interest in GEI; therefore, implementation of AcG 15 has not resulted in a change in the accounting for its investment. Holders of GEI’s liabilities have no recourse to the Partnership in the event of default by GEI on its debt or interest payments. Interest payments on the GEI debt are included in the calculation of the Class B LP Catch-up Payments.

On March 15, 2005, the Partnership created a trust, administered by a third party, to act as trustee for the Partnership’s Long-Term Incentive Plan (“LTIP”). On March 16, 2005, the Partnership funded \$423 to the trust for exceeding certain 2004 defined distributable cash threshold amounts, subsequent to which the trustee acquired 27,527 units of the Fund on the open market. One-third of these units vested prior to March 31, 2005 and were distributed to the plan members. The remaining units recorded at their carrying value of \$282 are held in the trust to be distributed under the terms of the LTIP. The trust is considered a VIE as the total investment at risk is not sufficient to permit the trust to finance its activities without additional support. The Partnership holds a variable interest in the trust and has determined that it is the primary beneficiary of the trust and, therefore, consolidated the trust. The Partnership has not guaranteed the value of the units held by the trust should the market value of the Fund’s units decrease from the value at which the trust acquired the units. Consolidating the trust resulted in a \$282 decrease in assets, a \$282 decrease in partners’ capital and had no impact on the net income of the Partnership.

The Partnership has an interest in five joint ventures through which it holds investments in seven theatres. The joint ventures were determined not to be VIEs and, accordingly, they continue to be accounted for using proportionate consolidation.

# Cineplex Galaxy Limited Partnership

## Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

### 3 Long-term debt

During the three and six months ended June 30, 2005, the Partnership drew \$1,000 and \$2,000, respectively, under its \$40,000 Development Facility for a total draw under this facility of \$17,500 as at June 30, 2005. These funds are being used to finance the ongoing development of theatre projects and other projects including the digital advertising network (note 5). During the three and six months ended June 30, 2005, the Partnership drew \$17,500 under its \$20,000 Working Capital Facility of which it repaid \$4,000 for a net draw under this facility of \$13,500 as at June 30, 2005. These funds are being used to finance the deposit made with respect to the acquisition of the theatre assets and liabilities of Famous Players (a division of Viacom Canada Inc.) ("Famous Players") (note 10).

### 4 Cash flow statement

The following summarizes the change in operating assets and liabilities:

	Three months ended June 30,		Six months ended June 30,	
	2005	2004	2005	2004
Accounts receivable	\$ 19	\$ (1,860)	\$ 2,504	\$ (3,415)
Inventories	(213)	(304)	40	50
Prepaid expenses and other current assets	(649)	(284)	(1,406)	(259)
Due from related parties	3	1,152	(3)	1,411
Deferred charges and intangibles	-	(169)	-	(185)
Accounts payable and accrued expenses	303	399	(2,798)	(8,298)
Due to related parties	-	(2,653)	(373)	(3,798)
Income taxes payable	(182)	(151)	(216)	(180)
Deferred revenue	(1,833)	16	(6,692)	(4,245)
Accrued pension liability	(30)	-	(60)	75
Other liabilities	50	52	112	109
Restricted cash	-	-	31	-
	\$ (2,532)	\$ (3,802)	\$ (8,861)	\$ (18,735)
Non-cash investing activities				
Capital asset purchases financed through accrued liabilities	\$ 1,203	\$ 566	\$ 1,203	\$ 566

# Cineplex Galaxy Limited Partnership

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

## 5 Commitments and contingencies

### Commitments

As of June 30, 2005, the Partnership has aggregate capital commitments of \$26,282 primarily related to the completion of construction of six theatre properties comprising 58 screens. The Partnership expects to complete construction and to open these theatres during the remainder of 2005 and 2006.

As of June 30, 2005, the Partnership has commitments of approximately \$1,420 related to point-of-sale equipment and re-branding upgrades.

### Other

Since 2003, three complaints have been filed with the Ontario Human Rights Commission against the Partnership alleging discrimination against hearing impaired individuals for not providing sufficient technology to accommodate for their disability. Similar complaints have been filed against other exhibitors and certain film distributors. All complaints have been referred to the Human Rights Tribunal (the "Tribunal") and have been joined together for hearing. The Partnership does not anticipate a judicial resolution of this matter for a significant period of time. There is the potential for a mediated resolution that could occur on a shorter time frame. At the present time, the Partnership is unable to assess the magnitude of any potential judgment from the Tribunal. As such, no amounts have been provided in the accounts related to this claim. However, were the Tribunal to rule against the Partnership and force the maximum provision of technology to the complainants, the Partnership could face a substantial financial burden.

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

# Cineplex Galaxy Limited Partnership

## Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

### 6 Partners' capital

There have been no Partnership units issued or repurchased and cancelled during the three and six months ended June 30, 2005. Partnership units issued at June 30, 2005 are as follows:

	Units		Amount
Class A Partnership units	19,400,000	\$	79,480
Class B, Series 1 Partnership units	20,949,582		16,860
Class B, Series 2-C Partnership units	2,086,957		-
Class B, Series 2-G Partnership units	5,130,435		14,085
	47,566,974		110,425
Formation of Partnership issuance costs	-		(222)
Investment in Fund units (note 2)	-		(282)
LTIP compensation obligation (note 2)	-		160
	47,566,974	\$	110,081

As the Fund's only investment is in the Partnership, the Partnership treats its \$282 investment in Fund units relating to the LTIP plan as treasury stock and nets this investment against partners' 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 in time it is reclassified as partners' 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.

### 7 Segment information

The Partnership 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.

### 8 Seasonal fluctuations

The Partnership's business is seasonal. Consequently, the results of operations and cash flows for the three- and six-month periods ended June 30, 2005 and 2004 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.

### 9 Comparative figures

Certain of the prior year's balances have been reclassified to conform with the current year's financial statement presentation.



# Cineplex Galaxy Limited Partnership

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

## 10 Subsequent events

The Partnership, Viacom Inc. and Viacom Canada Inc. (“Viacom Canada”) entered into a purchase agreement dated June 10, 2005 (“Purchase Agreement”) pursuant to which the Partnership agreed to acquire the Famous Players Limited Partnership (“Famous Players”) and its general partner, Famous Players Co. (the “Acquisition”), which together hold substantially all the assets and liabilities of Viacom Canada’s film exhibition business formerly operated by its Famous Players division, including its subsidiaries’ shares and joint venture interests and excluding liabilities to related parties other than to related parties relating solely to film distribution rights on arm’s-length terms. The Partnership deposited \$17,500 in an escrow account on June 13, 2005, which was applied toward the cash consideration payable to Viacom Canada. On closing of the transaction, total consideration incurred by the Partnership to acquire the net assets noted above amounts to \$464,000 in cash plus transaction costs. The Purchase Agreement provides that the net cash flow of the Famous Players’ business from and including April 29, 2005 to closing of the Acquisition is to be for the account of the Partnership in the form of a purchase price adjustment. This purchase price adjustment has not yet been finalized. The Acquisition was completed on July 22, 2005.

In order to fund the Acquisition, the Partnership entered into a number of transactions. The Partnership issued indirectly to the Fund 6,835,000 Class A LP Units for gross proceeds of approximately \$110,044 and 5,600,000 Class C LP Units for gross proceeds of \$105,000. Class C LP Units will be entitled to a distribution on the business day before June 30 and December 31 each year in priority to distributions paid on the Class A LP Units and Class B LP Units equal to 6.02% per annum. The Fund will finance the acquisition of the Class A LP Units and Class C LP Units through the issuance of 6,835,000 units at \$16.10 per unit to raise gross proceeds of approximately \$110,044, and the issuance of \$105,000 convertible extendible unsecured subordinated debentures (the “Convertible Debentures”), bearing interest at a rate of 6.0% per annum, payable semi-annually and convertible at the option of the holder into units of the Fund at \$18.75 per unit. Upon conversion of the Convertible Debentures to Fund units, distributions on Class C LP Units will automatically adjust such that the holder of Class C LP Units will receive distributions in the same manner as distributions are made on the corresponding number of Class A LP Units. The Partnership and the Fund will enter into a reimbursement agreement under which fees associated with the issuance of the Fund units and Convertible Debentures in the amounts of \$5,502 and \$4,200 will be reimbursed by the Partnership. The Partnership will record the fees in partners’ equity and deferred charges, respectively, and amortize the deferred charges over 3.5 years.

The Class C LP Units are redeemable by the Trust under certain conditions and as such they have characteristics of both debt and equity. As a result, under the provisions of CICA handbook Section 3860, “Financial Instruments - Disclosure and Presentation”, an amount of \$96,454 will be classified as a liability and the remainder of \$8,546 will be recorded in equity. Distributions and accretion on the Class C LP Units will be included in interest expense.

In connection with the Acquisition, the Partnership entered into an amended and restated credit agreement with a syndicate of lenders pursuant to which it will have available: (i) a 364-day \$50,000 extendible senior secured revolving credit facility, (ii) a four-year \$315,000 senior secured non-revolving term credit facility, and (iii) a four-year \$60,000 senior secured revolving credit facility (“Amended Credit Facilities”). The Amended Credit Facilities will bear interest at a floating rate based on the Canadian dollar prime rate, or bankers’ acceptance rate, plus an applicable margin and will amend and restate the Partnership’s existing credit facilities under

# Cineplex Galaxy Limited Partnership

Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

which \$141,000 is outstanding as at July 22, 2005. The repayment of the existing credit facilities is considered an extinguishment of debt under Emerging Issues Committee (“EIC”) Abstract 88, “Debtor’s Accounting for a Modification or Exchange of Debt Instruments” and, as a result, deferred financing charges of approximately \$1,200 will be charged to the net earnings of the Partnership upon repayment of the existing credit facilities. In addition, upon extinguishment of the existing credit facilities, the Partnership will recognize the estimated mark-to-market loss of \$2,200 at July 22, 2005 on the existing interest rate swap agreement. 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 existing 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 four-year senior secured non-revolving term credit facility.

On June 29, 2005, the Partnership entered into a letter of intent to sell real estate interests in four theatre locations (two of which are Famous Players theatres) for an estimated \$67,000 to RioCan Real Estate Investment Trust (“RioCan”), a related party. The transaction is subject to RioCan’s due diligence and the Partnership’s right to obtain property appraisals. As part of the agreement, the Partnership will agree to lease back the four theatres. Proceeds of the sale were used to repay amounts borrowed to finance a portion of the purchase price for the Acquisition.

The Partnership issued 500,000 Class D LP Units, a new class of Partnership units, at an estimated value of \$8,050 to certain of its executives upon closing the Acquisition. This amount will be recorded as compensation expense as at July 22, 2005. These units are not exchangeable for units of the Fund and will be entitled to receive distributions on substantially the same basis as the Class B LP Units. In addition, the Partnership agreed to pay Onex Corporation (“Onex”), a related party, a transaction fee of \$4,000 in connection with advisory services rendered by Onex in connection with the Acquisition, issuance of Fund units and Convertible Debentures, and entering into the Amended Credit Facilities. The fee was satisfied by the issuance of 248,447 Class D LP Units on completion of the Acquisition. At the next meeting of unitholders of the Fund, unitholders will be asked to approve a resolution which would make the Class D LP Units exchangeable for units of the Fund.

# Cineplex Galaxy Limited Partnership

## Notes to Consolidated Financial Statements

(Unaudited)

June 30, 2005

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

Using the proceeds from the above transactions, the Partnership acquired all of the limited partnership units of Famous Players and all of the shares of Famous Players Co. for total cash consideration of \$464,000. The Acquisition will be accounted for by the purchase method. The purchase price will be allocated to the estimated fair value of the net assets acquired. Based on management's best estimates, the purchase price has been allocated to the assets and liabilities of Famous Players as follows (table in millions of Canadian dollars):

	\$
<b>Assets and liabilities acquired</b>	
Property, equipment and leaseholds	403
Advertising contracts	32
Trademarks and trade names	44
Goodwill	135
Net pension liability	(6)
Net working capital deficiency	(47)
Other liabilities	(57)
Capital leases	(36)
	<hr/>
	468
	<hr/>
<b>Consideration given</b>	
Cash paid for Acquisition of Famous Players	464
Transaction costs associated with the Acquisition	4
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	468
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The above allocation of the purchase price is preliminary. 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 the effective date of the Acquisition. Accordingly, the purchase price will be adjusted subsequent to completion of the Acquisition and the final purchase price allocation process; variations may be material.

In contemplation of completing the Acquisition, on May 27, 2005, the Partnership entered into a consent agreement (the "Consent Agreement") with the Commissioner of Competition (the "Commissioner") in respect of its proposal to acquire Famous Players. Under the terms of the Consent Agreement, the Partnership agreed to divest a total of 34 specified theatres, held by both the Partnership and Famous Players, within a specified period of time on the terms and conditions set out in the Consent Agreement. Should the required theatres not be divested in the time required, a divestiture trustee appointed under the agreement would be entitled to divest certain theatres on the terms and conditions set out in the Consent Agreement. Until May 27, 2010, the Partnership must provide the Commissioner with prior written notice of any acquisition by it of any non-Partnership theatre or assumption of lease where the remaining term exceeds two years. The Partnership also may not, during this time, re-acquire any of the divested theatres without prior approval of the Commissioner.

In addition, the Partnership and its joint venture partner intend to sell the Alliance Atlantis brand theatres.





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[WWW.GALAXYCINEMAS.COM](http://WWW.GALAXYCINEMAS.COM)

Pat Marshall  
Vice President Investor Relations  
[pmarshall@cineplexgalaxy.com](mailto:pmarshall@cineplexgalaxy.com)  
416-323-6648

Gord Nelson  
Chief Financial Officer  
[gnelson@cineplexgalaxy.com](mailto:gnelson@cineplexgalaxy.com)  
416-323-6602

CINEPLEX GALAXY  
1303 YONGE ST.  
TORONTO, ON M4T 2Y9

416 323 6600  
[WWW.CINEPLEXGALAXY.COM](http://WWW.CINEPLEXGALAXY.COM)