
SIR ROYALTY INCOME FUND

MANAGEMENT'S DISCUSSION AND ANALYSIS

FIRST QUARTER

UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2007

SIR ROYALTY INCOME FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS
(For the 3-month periods ended March 31, 2007)

Executive Summary

Highlights for the 3-month periods ended March 31, 2007 ("Q1") for SIR Royalty Income Fund (the "Fund") include:

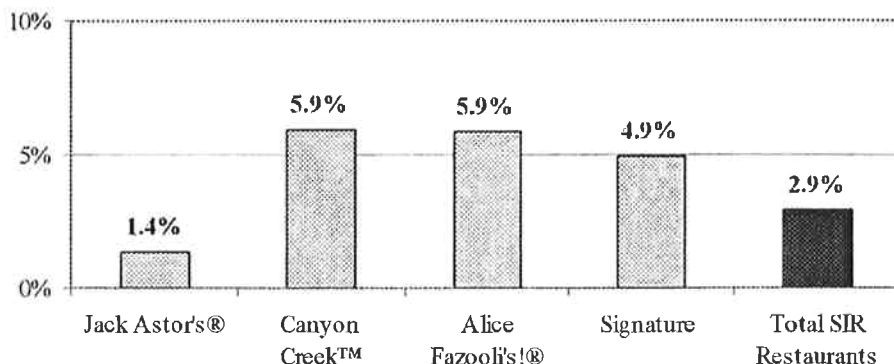
- Net earnings of \$1.7 million and net earnings per Fund Unit of \$0.32 in each of Q1 of 2007 and Q1 of 2006.
- The payout ratio was 97.5% in Q1 of 2007, compared to 93.4% in Q1 of 2006. Please refer to footnotes 2 and 8 on page 5 and page 9, respectively for the definition and calculation of payout ratio.
- Pooled Revenue increased by 7.0% in Q1 of 2007 to \$39.5 million, from \$36.9 million in Q1 of 2006.
- Same store sales growth⁽¹⁾ ("SSSG⁽¹⁾") for restaurants in the Royalty pool for Q1 of 2007 was 2.9%.
- SSSG⁽¹⁾ was positive in Q1 of 2007 for all of SIR Corp.'s ("SIR") Concept Restaurants (Jack Astor's®⁽¹⁾, Canyon Creek™⁽¹⁾, and Alice Fazooli's!®⁽¹⁾) as well as for the downtown Toronto Signature Restaurants: Jack Astor's SSSG⁽¹⁾ was 1.4% for Q1; Canyon Creek SSSG⁽¹⁾ was 5.9% for Q1; Alice Fazooli's! SSSG⁽¹⁾ was 5.9% for Q1; and the Signature Restaurants' SSSG⁽¹⁾ was 4.9% for Q1.
- On January 1, 2007, the Jack Astor's restaurant in Don Mills, Ontario was removed from the Royalty Pooled Restaurants and the three new Canyon Creek restaurants that opened in 2006 were added to the Royalty Pooled Restaurants.
- SIR opened Jack Astor's restaurants in Hamilton, Ontario on March 26, 2007 and in Dartmouth, Nova Scotia on May 7, 2007. It is expected that these two new restaurants will be added to the Royalty Pooled Restaurants on January 1, 2008.
- SIR has secured four new sites: three sites are for new Jack Astor's restaurants and the fourth new site is for a new Canyon Creek restaurant. One of the new Jack Astor's restaurants will replace an existing restaurant and as such, SIR anticipates closing one existing Jack Astor's location during the year upon opening of the new location.
- SIR has advised the Trustees that it is currently negotiating financing to accelerate its restaurant construction plans with a Canadian Chartered Bank.
- On October 31, 2006, the Federal Department of Finance announced a plan that proposes changes to the manner in which distributions from certain publicly listed flow-through entities ("FTE's") including income funds are taxed. However, existing Income Trusts would not be subject to this proposed taxation of distributions until the 2011 taxation year as long as the Fund meets the requirements for "normal growth". On March 27, 2007, the Minister of Finance issued a Notice of Ways and Means Motion to implement the draft legislation. The Trustees of the Fund and senior management of SIR will continue to monitor this development.
- While SIR is not owned by the Fund, the Fund is economically dependent upon SIR. SIR files its interim and annual consolidated financial statements and MD&A which, can be found on SEDAR under the Fund's listing named "Other". SIR's Q2 consolidated financial statements and MD&A are listed having a filing date of March 28, 2007.

(1) Same store sales ("SSS") and same store sales growth ("SSSG") are non-GAAP financial measures that do not have standardized meanings prescribed by GAAP. However, the Fund believes that SSS and SSSG are useful measures and provide investors with an indication of the change in year-over-year sales. The Fund's method of calculating SSS and SSSG may differ from those of other issuers and, accordingly, SSS and SSSG may not be comparable to measures used by other issuers.

SSS includes revenue from all SIR Restaurants included in Pooled Revenue except for the Jack Astor's® location in Don Mills, Ontario and the Canyon Creek™ locations in Scarborough, Vaughan, and at the Fallsview Casino Resort in Niagara Falls, Ontario because they were not open for the entire period of both 2007 and 2006. SSSG is the percentage increase in SSS over the prior comparable period.

Same Store Sales Growth⁽¹⁾
(unaudited)

**Same Store Sales Growth⁽¹⁾ for the 3-month period ended
March 31, 2007**



SIR reported to the Fund that SSSG⁽¹⁾ was 2.9% for Q1 of 2007, which is over and above the exceptional SSSG⁽¹⁾ of 13.8% experienced in the prior year (please see the below table).

SSSG⁽¹⁾ for Jack Astor's was 1.4% during Q1 of 2007. This growth was achieved on top of the SSSG⁽¹⁾ of 14.1% experienced in the prior year. The Jack Astor's evolution program started in 2004 and now only one of the Jack Astor's currently operating remains to be evolved. The evolved Jack Astor's restaurants experienced strong average SSSG⁽¹⁾, averaging over 10% in the first year following the year of evolution. Now that the program is near completion and most of the evolved restaurants have been evolved for more than one year, the velocity of Jack Astor's SSSG⁽¹⁾ driven by evolutions is reduced. SIR's management believes that changes in smoking legislation in Ontario and Quebec are negatively affecting bar sales, particularly in those restaurants that previously benefited from Designated Smoking Rooms in their bars. SIR's management believes that the effect of the Smoke-Free Ontario Act will be mitigated over time and anticipates that the effect will be lessened during the summer months when patios are open.

Canyon Creek continues to perform well, with SSSG⁽¹⁾ of 5.9% during Q1 2007 again on top of strong SSSG⁽¹⁾ of 14.1% in Q1 2006.

The performance of Alice Fazooli's! continues to improve. SSSG⁽¹⁾ in Q1 of 2007 was 5.9%. This growth is on top of the SSSG⁽¹⁾ of 14.4% experienced in the prior year.

During Q1, the Signature Restaurants, which are located in downtown Toronto, had SSSG⁽¹⁾ of 4.9%. Brasserie Frisco™ and Armadillo Texas Grill®/the Loose Moose® revenues were below the prior year during Q1. These declines in Q1 were offset by positive SSSG⁽¹⁾ at Far Nicnte®/Soul of the Vine® and reds®. SSSG⁽¹⁾ was 12.0% in the prior year.

SSSG ⁽¹⁾ for Restaurants in the Royalty pool	3-month period ended March 31, 2007 (unaudited)	3-month period ended March 31, 2006 (unaudited)
Jack Astor's®	1.4%	14.1%
Canyon Creek Chop House®	5.9%	14.1%
Alice Fazooli's! ®	5.9%	14.4%
Signature Restaurants	4.9%	12.0%
Overall SSSG⁽¹⁾	2.9%	13.8%

(1) See footnote (1) on page 2.

Restaurant Renovations and Advertising

SIR used a significant portion of the proceeds of the Fund's IPO to invest in its existing restaurants to drive SSSG⁽¹⁾. As at March 31, 2007 evolutions of 19 Jack Astor's restaurants had been completed (four of these had been completed prior to the IPO). These evolutions continue to drive sales in Jack Astor's. The renovations at the five Alice Fazooli's! restaurants which were completed during 2005 and 2006 have also delivered strong SSSG⁽¹⁾ on average, in excess of 10% in the first full year after the renovation. A renovation was completed at reds during Q3 of 2006. During Q4 of 2005, extensive renovations were completed at Far Niente in downtown Toronto. These renovations are driving increased guest counts and SSSG⁽¹⁾ going forward.

Since the IPO, SIR has increased its investment in marketing initiatives. In particular, Jack Astor's with 24 restaurants (which in Q1 of 2007 represented approximately 58.8% of Pooled Revenue) has benefited from radio-based campaigns created by a leading North American advertising agency. In 2006, Jack Astor's earned Gold recognitions at the London International Advertising Awards (for its Italian Festival) and also at the Canadian Marketing Association Awards.

New and Closed Restaurants

During 2006, SIR opened three Canyon Creek restaurants (Scarborough, Ontario in Q1, Vaughan, Ontario in Q2, and at the Fallsview Casino Resort in Niagara Falls, Ontario in Q3). Each of these three restaurants was added to the Royalty Pooled Restaurants on January 1, 2007. In return, SIR Royalty Limited Partnership ("the Partnership") paid SIR, in Partnership securities exchangeable for Units of the Fund, an amount intended to reflect the value to the Partnership of the increased future Royalty stream related to these restaurants, in accordance with the formula described in the Limited Partnership Agreement of SIR Royalty Limited Partnership (the "Partnership Agreement"). These adjustments for new revenues that will be part of the Royalty pool are designed to be accretive for Fund Unitholders.

One Royalty Pooled Restaurant has been closed since the IPO was completed. On May 27, 2006 the Jack Astor's in Don Mills, Ontario was closed. This location has been demolished by the landlord and is to be redeveloped into a major "lifestyle mall". It is expected that this project will be completed in the second half of 2008 and that a new Jack Astor's would open in this location at that time. Under the terms of the License and Royalty Agreement, SIR paid a Make-Whole Payment for this location from the date of the closure until December 31, 2006. In accordance with the Partnership Agreement, the revenue of the closed restaurant was netted against the revenue of the new SIR Restaurants opened from November 2, 2005 to November 1, 2006, to reduce the number of Class B GP Units of the Partnership, held by SIR, which were converted into Class A GP Units of the Partnership on January 1, 2007.

During Q1 of 2007, SIR opened a new Jack Astor's restaurant in Hamilton, Ontario on March 26, 2007. Subsequent to Q1 2007, SIR opened a new Jack Astor's restaurant, in Dartmouth, Nova Scotia on May 7, 2007. It is expected that these new restaurants would be added to the Royalty Pooled Restaurants on January 1, 2008.

SIR has also secured four new sites for Jack Astor's and Canyon Creek restaurants. One of these new sites is for a Jack Astor's at the corner of Dundas and Yonge Streets in Toronto, Ontario which is expected to open in fiscal 2008. Two new sites have been secured near the Toronto Pearson International Airport for a Jack Astor's and a Canyon Creek which are also expected to open in fiscal 2008. The fourth new site is located in Burlington, Ontario. It is expected that the existing Jack Astor's restaurant in Burlington would be closed and a new Jack Astor's would open at the new site in Burlington. In respect of the closed Burlington restaurant, SIR would be required to pay a Make-Whole Payment from the date of closure to December 31, 2007. Effective January 1, 2008, the closed restaurant would be removed from the Royalty Pooled Restaurants' as a New Closed Restaurant. The new site is expected to provide higher revenues and therefore a greater Royalty stream to the Partnership. The new Jack Astor's restaurant in Burlington is expected to open in Q4 of 2007 and provided that it opens before November 1, 2007, it would be added to the Royalty Pooled Restaurants effective January 1, 2008.

(1) See footnote (1) on page 2.

Distributions

Distributions to Unitholders are intended to be made monthly in arrears based on distributable cash⁽²⁾ and cash redemptions of Fund Units and subject to the Fund retaining such reasonable working capital and other reserves as may be considered appropriate by the Trustees of the Fund. The Fund's intention, with the assistance of SIR, is to pay even distributions, and if possible, allow the Fund to maintain consistent monthly distributions to Unitholders. The Fund intends to make monthly distributions of its available distributable cash⁽²⁾ to the extent possible and has paid its expected monthly cash distribution of \$0.10 per Unit per month since inception. On May 24, 2006 the Trustees authorized a 5.0% distribution increase to Unitholders. The monthly distributions increased from \$0.10 per Unit to \$0.105 per Unit beginning with the distribution paid in June 2006. This increased the estimated annualized distribution from \$1.20 to \$1.26.

The payout ratio⁽²⁾ of cash distributed to distributable cash⁽²⁾ is intended to average 100% per annum over the longer term. Since the Fund pays even monthly distributions when its underlying cash flow from the Partnership is subject to seasonal fluctuations (as experienced by SIR), there are times during the year when the payout ratio⁽²⁾ may exceed 100%. The payout ratio⁽²⁾ for the fourth quarter of 2006 was affected by the \$0.23 million Priority Special Conversion Distribution ("Conversion Distribution") paid by the Partnership. The payout ratio⁽²⁾ in Q1 of 2006 was 97.5% compared to 93.4% for the same period in 2006.

Overview and Business of the Fund

On October 1, 2004, the Fund filed a final prospectus for a public offering of Units of the Fund. The net proceeds of the Offering of \$51,166,670 were used by the Fund to acquire, directly, certain bank debt of SIR and indirectly, through SIR Holdings Trust (the "Trust"), all of the Ordinary LP Units of the Partnership. The Partnership owns the Canadian trademarks (the "SIR Rights") formerly owned or licensed by SIR or its subsidiaries and used in connection with the operation of the majority of SIR's restaurants in Canada. The Partnership has granted SIR a 99-year license to use the SIR Rights in most of Canada in consideration for a Royalty, payable by SIR to the Partnership, equal to 6% of the revenue of the restaurants included in the Royalty pool (the "License and Royalty Agreement"). The Partnership also issued its own securities to SIR in return for the SIR Rights acquired. The Fund indirectly participates in the revenue generated under the License and Royalty Agreement through its investment in the Partnership. The Partnership's financial statements are provided separately at www.sedar.com under the SIR Royalty Income Fund profile "other" category and on SIR's website at www.sircorp.com.

The Fund intends to make monthly distributions of its available cash to the extent possible. During the quarter, monthly distributions of \$562,450 or \$0.105 per Unit were declared and paid for each of the months of December 2006, January 2007 and February 2007. Subsequent to March 31, 2007, distributions of \$0.105 per Unit were declared and paid for the month of March 2007 and a distribution of \$0.105 per Unit was declared for the month of April 2007.

The Units of the Fund are publicly traded on the Toronto Stock Exchange under the symbol SRV.UN.

(2) *Distributable cash and payout ratio are non-GAAP financial measures and do not have a standardized meaning prescribed by GAAP. However, the Fund believes that distributable cash and the payout ratio are useful measures as they provide investors with an indication of cash available for distribution. The Fund's method of calculating distributable cash and the payout ratio may differ from that of other issuers and, accordingly, distributable cash and the payout ratio may not be comparable to measures used by other issuers. Investors are cautioned that distributable cash and the payout ratio should not be construed as an alternative to the statement of cash flows as a measure of liquidity and cash flows of the Fund. The payout ratio is calculated as cash distributed for the period as a percentage of the distributable cash for the period. Distributable cash represents the amount of money which the Fund expects to have available for distribution to Unitholders of the Fund, and is calculated as cash provided by operating activities of the Fund, adjusted for the net change in non-cash working capital items.*