

# **SIR Royalty Income Fund**

Consolidated Financial Statements  
(Unaudited)

**For the three-month periods ended  
March 31, 2010 and 2009**

# SIR Royalty Income Fund

## Consolidated Balance Sheets

(Unaudited)

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	<b>March 31, 2010</b>	<b>December 31, 2009</b>
	\$	\$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	23	96
Prepaid expenses and other assets	32,892	24,307
Amounts due from related parties (note 8)	1,054,456	1,192,403
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	1,087,371	1,216,806
<b>Loan receivable from SIR Corp.</b> (note 4)	40,000,000	40,000,000
<b>Investment in SIR Royalty Limited Partnership</b> (note 5)	11,166,671	11,166,671
	<hr/>	<hr/>
	52,254,042	52,383,477
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities	67,618	117,749
<b>Future income taxes</b>	676,000	676,000
	<hr/>	<hr/>
	743,618	793,749
<b>Unitholders' Equity</b> (note 6)	51,510,424	51,589,728
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	52,254,042	52,383,477
<b>Subsequent event</b> (note 6)		

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

# SIR Royalty Income Fund

## Consolidated Statements of Earnings and Comprehensive Income (Unaudited)

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	<b>Three-month period ended March 31, 2010 \$</b>	<b>Three-month period ended March 31, 2009 \$</b>
<b>Investment income</b>		
Distribution income from SIR Royalty Limited Partnership (notes 5 and 8)	1,097,212	1,077,656
Interest income (note 4)	750,000	750,000
	<hr/> 1,847,212	<hr/> 1,827,656
<b>Expenses</b>		
General and administrative (note 8)	78,466	127,669
	<hr/> 1,768,746	<hr/> 1,699,987
<b>Net earnings and comprehensive income for the period</b>		
	<hr/> <hr/> 1,768,746	<hr/> <hr/> 1,699,987
<b>Basic and diluted earnings per Fund unit</b> (note 7)	<hr/> \$ 0.33	<hr/> \$ 0.32

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

# SIR Royalty Income Fund

Consolidated Statements of Unitholders' Equity  
(Unaudited)

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	<b>Three-month period ended March 31, 2010 \$</b>	<b>Three-month period ended March 31, 2009 \$</b>
<b>Balance - Beginning of period</b>	51,589,728	51,725,853
Net earnings for the period	1,768,746	1,699,987
Distributions declared and paid (note 6)	(1,848,050)	(1,848,050)
<b>Balance - End of period</b>	<u>51,510,424</u>	<u>51,577,790</u>

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

# SIR Royalty Income Fund

## Consolidated Statements of Cash Flows

(Unaudited)

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	<b>Three-month period ended March 31, 2010 \$</b>	<b>Three-month period ended March 31, 2009 \$</b>
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net earnings for the period	1,768,746	1,699,987
Net change in non-cash working capital items (note 9)	79,231	148,194
	<u>1,847,977</u>	<u>1,848,181</u>
<b>Financing activities</b>		
Distributions paid	<u>(1,848,050)</u>	<u>(1,848,050)</u>
<b>Change in cash and cash equivalents</b>	(73)	131
<b>Cash and cash equivalents - Beginning of period</b>	<u>96</u>	<u>230</u>
<b>Cash and cash equivalents - End of period</b>	<u>23</u>	<u>361</u>

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

# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements

(Unaudited)

**March 31, 2010**

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## **1 Nature of operations and seasonality**

### **Nature of operations**

SIR Royalty Income Fund (the Fund) is a trust established on August 23, 2004 under the laws of the Province of Ontario.

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 to the Fund of \$51,166,670 were used by the Fund to acquire, directly, certain bank debt of SIR Corp. (the SIR loan) and, indirectly, through SIR Holdings Trust (the Trust), all of the Ordinary LP units of SIR Royalty Limited Partnership (the Partnership). The Partnership owns the Canadian trademarks (the SIR Rights) formerly owned or licensed by SIR Corp. (SIR) or its subsidiaries and used in connection with the operation of the majority of SIR's restaurants in Canada (the SIR Restaurants). The Partnership has granted SIR a 99-year licence 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 revenues of the restaurants included in the Royalty Pooled Restaurants (the Licence and Royalty Agreement). The Fund, indirectly, participates in the revenues generated under the Licence and Royalty Agreement through its investment in the Partnership (note 5).

### **Basis of presentation**

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 2009 audited annual consolidated financial statements and notes thereto. The financial performance of the Fund for the interim periods is not necessarily indicative of the results that may be expected for the full year due to the seasonality of the Fund's business.

### **Seasonality**

The full-service restaurant sector of the Canadian food-service industry, in which SIR operates, experiences seasonal fluctuations in revenues. Favourable summer weather generally results in increased revenues during SIR's fourth quarter (ending the last Sunday in August) when patios can be open. Additionally, certain holidays and observances also affect dining patterns both favourably and unfavourably. Accordingly, distribution income recognized by the Fund will vary in conjunction with the seasonality in revenues experienced by SIR.

## **2 Summary of significant accounting policies**

The Fund prepares its consolidated financial statements in accordance with Canadian generally accepting accounting principles and includes the accounts of the Fund and its subsidiaries, namely the Trust and SIR GP Inc. All intercompany accounts and transactions have been eliminated. The accounting policies as disclosed in these unaudited interim consolidated financial statements are consistent with those followed in the 2009 audited annual consolidated financial statements.

# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements

(Unaudited)

**March 31, 2010**

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## **3 Recently issued accounting pronouncements**

The Canadian Institute of Chartered Accountants (CICA) Handbook Sections 1582, Business Combinations, 1601, Consolidated Financial Statements, and 1602, Non-controlling Interests, replace the former CICA Handbook Sections 1581, Business Combinations, and 1600, Consolidated Financial Statements, and establish a new section for accounting for a non-controlling interest in a subsidiary. These sections provide the Canadian equivalent to International Financial Reporting Standard 3, Business Combinations, and International Accounting Standard 27, Consolidated and Separate Financial Statements. CICA Handbook Section 1582 is effective for the Fund for business combinations for which the acquisition date is on or after the reporting period beginning on or after January 1, 2011. CICA Handbook Sections 1601 and 1602 are effective for the Fund for interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011. Management has not yet determined the impact of the adoption of these changes on its consolidated financial statements.

## **4 Loan receivable from SIR Corp.**

The SIR loan bears interest at 7.5% per annum, is due October 12, 2044 and is collateralized by a general security agreement covering substantially all of the assets of SIR and its subsidiaries in Canada. Interest income of \$750,000 was earned during the three-month period ended March 31, 2010 (three-month period ended March 31, 2009 - \$750,000).

On November 13, 2009, SIR announced that it entered into a \$26,000,000 new senior term debt facility (New Credit Agreement). Part of the proceeds from the New Credit Agreement were used to repay \$12,740,000 outstanding on SIR's construction line. The remaining proceeds, as well as a portion of existing cash on hand, were used to repurchase 5,407,000 common shares of SIR from one shareholder of SIR, to acquire the rights to certain debts owed by U.S. S.I.R. L.L.C. from one shareholder of SIR and to pay professional fees and transaction costs related to these transactions.

The New Credit Agreement has a three-year term with a 10-year amortization. Interest will be calculated as the greater of 7.80% per annum and the three-month Canadian dollar banker's acceptance rate plus 7.55% per annum. Certain financial covenants apply to SIR. The loan is secured by substantially all of the assets of SIR and most of its subsidiaries, which are also guarantors. The Partnership and the Fund did not guarantee the New Credit Agreement. The New Credit Agreement qualifies as "permitted indebtedness" within the meaning of the agreements between the Fund, the Partnership and SIR and, as a result, the Fund and the Partnership have agreed to subordinate and postpone their claims against SIR to the claims of the new lender. The terms of this subordination are as contemplated in the existing agreements between the Fund, the Partnership and SIR. This subordination, which includes a subordination of the Partnership's rights under the Licence and Royalty Agreement between the Partnership and SIR whereby the Partnership licenses to SIR the right to use trademarks and related intellectual property in return for royalty payments based on revenues, is effected pursuant to the terms of a Subordination and Postponement Agreement.

# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements

(Unaudited)

**March 31, 2010**

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Under the Subordination and Postponement Agreement, absent a default or event of default under the New Credit Agreement, ordinary payments to the Partnership and the Fund could continue. However, if a default or an event of default were to occur, then payments to the Fund and the Partnership could cease and the related rights of the Fund and the Partnership could be subject to a “standstill” obligation for a period of up to 120 days (which may be extended if the lender is pursuing remedies). The Subordination and Postponement Agreement also contains various other typical covenants of the Fund and the Partnership. In addition, SIR provided an undertaking to the Fund and the Partnership to restrict the amount of the additional debt that SIR can incur without the consent of the Fund and the Partnership (which consent shall not be unreasonably withheld).

SIR has the right to require the Fund to, indirectly, purchase the Class C GP units and assume a portion of the SIR loan as consideration for the acquisition of the Class C GP units.

## **5 Investment in SIR Royalty Limited Partnership**

On October 12, 2004, the Fund, indirectly through the Trust, acquired all of the Ordinary LP units. The holders of the Ordinary LP and Class A GP units are entitled to receive a pro rata share of the distributions of the Partnership.

The distributions from the Partnership primarily comprise revenues earned by the Partnership under the Licence and Royalty Agreement (note 1) less certain general and administrative expenses. Distributions for the three-month period ended March 31, 2010 amounted to \$1,097,212 (three-month period ended March 31, 2009 - \$1,077,656).

## **6 Fund units**

An unlimited number of Fund units may be issued pursuant to the declaration of trust. Fund units are redeemable by the holder at a price equal to the lesser of 90% of the market price of a Fund unit during the 10 consecutive trading day period ending on the trading day immediately prior to the date on which the Fund units were surrendered for redemption and an amount based on the closing price on the redemption date, subject to certain restrictions. Each holder of Fund units participates pro rata in any distributions from the Fund. Income tax obligations related to distributions by the Fund are obligations of the unitholders.

As at March 31, 2010 and December 31, 2009, there are 5,356,667 Fund units issued and outstanding. Each Fund unit is entitled to one vote at any meeting of unitholders.

During the three-month period ended March 31, 2010, the Fund declared distributions of \$0.345 per unit (three-month period ended March 31, 2009 - \$0.345 per unit). Subsequent to March 31, 2010, the Fund declared a distribution of \$0.115 per unit for the month of March 2010.

The distribution policy of the Fund is, at the discretion of the Trustees, to make distributions of its available cash to the fullest extent possible, taking into account trends in revenues, earnings and cash flows.

# SIR Royalty Income Fund

Notes to Consolidated Financial Statements

(Unaudited)

March 31, 2010

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## 7 Earnings per Fund unit

Basic earnings per Fund unit is computed by dividing net earnings by the weighted average number of Fund units outstanding during the period.

SIR has the right to convert the Class A GP units into Fund units. Diluted earnings per Fund unit is calculated using the weighted average number of Fund units outstanding adjusted to include the effect of the conversion of the Class A GP units into Fund units.

The following table reconciles the basic and diluted weighted average number of Fund units outstanding and basic and diluted earnings per Fund unit:

	Basic earnings per Fund unit	Adjustment for conversion of Class A GP units	Diluted earnings per Fund unit
Net earnings for the three-month period ended March 31, 2010	\$ 1,768,746	\$ 980,448	\$ 2,749,194
Net earnings per Fund unit for the three-month period ended March 31, 2010	\$ 0.33	\$ -	\$ 0.33
Weighted average number of Fund units outstanding for the three-month period ended March 31, 2010	5,356,667	2,969,324	8,325,991
Net earnings for the three-month period ended March 31, 2009	\$ 1,699,987	\$ 864,928	\$ 2,564,915
Net earnings per Fund unit for the three-month period ended March 31, 2009	\$ 0.32	\$ -	\$ 0.32
Weighted average number of Fund units outstanding for the three-month period ended March 31, 2009	5,356,667	2,725,415	8,082,082

## 8 Related party transactions and balances

During the three-month period ended March 31, 2010, the Fund received distribution income of \$1,097,212 from the Partnership (three-month period ended March 31, 2009 - \$1,077,656). The Fund, indirectly through the Trust, is entitled to receive a pro rata share of all residual distributions. The Fund's distribution income is dependent upon the revenues generated by SIR for the restaurants subject to the Licence and Royalty Agreement. Under the terms of the Licence and Royalty Agreement, SIR may be required to pay a Make-Whole Payment in respect of the reduction in revenues for restaurants closed during a reporting period. SIR is not required to pay any Make-Whole Payment in respect of a closed restaurant following the date on which the number of restaurants in the Royalty Pooled Restaurants is equal to or greater than 68 or following October 12, 2019, whichever occurs first. On January 1 of each year (the Adjustment Date), the restaurants subject to the Licence and Royalty Agreement are adjusted for new restaurants opened for at least 60 days preceding such

# **SIR Royalty Income Fund**

Notes to Consolidated Financial Statements

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**March 31, 2010**

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Adjustment Date in the previous fiscal year. At each Adjustment Date, SIR will be entitled to convert its Class B GP units into Class A GP units based on a conversion formula defined in the Partnership Agreement.

On January 1 of each year, Class B GP units are converted into Class A GP units for new SIR Restaurants added to the Royalty Pooled Restaurants based on 80% of the initial estimated revenues and the formula defined in the Partnership Agreement. Additional Class B GP units may be converted into Class A GP units in respect of these new SIR Restaurants if actual revenues of the new SIR Restaurants exceeded 80% of the initial estimated revenues and the formula defined in the Partnership Agreement. Conversely, converted Class A GP units may be returned by SIR if the actual revenues of the new SIR Restaurants are less than 80% of the initial estimated revenues. In December of each year, an additional distribution will be payable to the Class B GP unitholders provided that actual revenues of the new SIR Restaurants exceed 80% of the initial estimated revenues, or there will be a reduction in the distributions to the Class A GP unitholders if revenues are less than 80% of the initial estimated revenues. In December 2009, an additional distribution of \$336,594 (2008 - \$177,888) was declared and paid in cash in January 2010.

On January 1, 2010, nil (2009 - six) new SIR Restaurants were added to and nil (2009 - nil) closed SIR Restaurants were removed from the Royalty Pooled Restaurants in accordance with the Partnership Agreement. As consideration for the additional Royalty associated with the addition of nil (2009 - six) new restaurants on January 1, 2010, as well as the second incremental adjustment for the six (2009 - three) new SIR Restaurants added to the Royalty Pooled Restaurants on January 1, 2009, SIR converted its Class B GP units into Class A GP units based on the formula defined in the Partnership Agreement. The number of Class B GP units that SIR converted into Class A GP units was reduced by an adjustment for the closure of nil (2009 - nil) SIR Restaurants during the prior year. The net effect of these adjustments to the Royalty Pooled Restaurants was that SIR converted 243,909 (2009 - 1,076,871) Class B GP units into 243,909 (2009 - 1,076,871) Class A GP units on January 1, 2010 at an estimated fair value of \$1,236,621 (2009 - \$5,972,477).

As a result of not adding any new SIR Restaurants to the Royalty Pooled Restaurants on January 1, 2010, there will not be an additional distribution declared in December 2010 or a second incremental adjustment on January 1, 2011.

Class A GP units and Class B GP units are held by SIR.

The Partnership has entered into an arrangement with the Fund and the Trust whereby the Partnership will provide or arrange for the provision of services required in the administration of the Fund and the Trust. The Partnership has arranged for these services to be provided by SIR GP Inc. in its capacity as the Managing General Partner, or SIR as the General Partner of the Partnership. SIR, on behalf of SIR GP Inc., also provides services to the Partnership for its administration. For the three-month period ended March 31, 2010, the Partnership provided these services to the Fund and the Trust for consideration of \$6,000 (three-month period ended March 31, 2009 - \$6,000), which was the amount of consideration agreed to by the related parties.

# SIR Royalty Income Fund

Notes to Consolidated Financial Statements

(Unaudited)

March 31, 2010

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Amounts due from (to) related parties consist of:

	<b>March 31, 2010</b>	<b>December 31, 2009</b>
	\$	\$
<b>SIR Royalty Limited Partnership</b>		
Distribution receivable	2,632,025	2,632,864
Advances payable	(1,751,645)	(1,614,537)
	<hr/>	<hr/>
Amounts receivable from SIR Royalty Limited Partnership	880,380	1,018,327
	<hr/>	<hr/>
<b>SIR Corp.</b>		
Interest receivable	250,000	250,000
Advances payable	(75,924)	(75,924)
	<hr/>	<hr/>
Amounts receivable from SIR Corp.	174,076	174,076
	<hr/>	<hr/>
Amounts due from related parties - net	<u>1,054,456</u>	<u>1,192,403</u>

Amounts due from (to) related parties are non-interest bearing and due on demand. All advances were conducted as part of the normal course of business operations.

## 9 Net change in non-cash working capital items

Net change in non-cash working capital items comprises:

	<b>Three-month period ended March 31, 2010</b>	<b>Three-month period ended March 31, 2009</b>
	\$	\$
Prepaid expenses and other assets	(8,585)	10,839
Amounts due from related parties	137,947	143,486
Accounts payable and accrued liabilities	(50,131)	(6,131)
	<hr/>	<hr/>
	79,231	148,194
	<hr/>	<hr/>

## 10 Economic dependence

The Fund's income is derived from interest income on the SIR loan and distributions from the Partnership and, accordingly, the Fund is economically dependent upon SIR.