

SIR Royalty Income Fund

Consolidated Financial Statements
December 31, 2014 and 2013

March 13, 2015

Independent Auditor's Report

To the Unitholders of SIR Royalty Income Fund

We have audited the accompanying consolidated financial statements of SIR Royalty Income Fund and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2014 and December 31, 2013 and the consolidated statements of earnings and comprehensive income, changes in unitholders' equity and cash flows for the years then ended, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of SIR Royalty Income Fund and its subsidiaries as at December 31, 2014 and December 31, 2013 and their financial performance and their cash flows for the years then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers LLP

Chartered Professional Accountants, Licensed Public Accountants
Toronto, Ontario

SIR Royalty Income Fund
 Consolidated Statements of Financial Position
 As at December 31, 2014 and 2013

	2014 \$	2013 \$
Assets		
Current assets		
Cash	478,655	577,089
Prepaid expenses and other assets	27,652	27,333
Amounts due from related parties (note 10)	977,562	1,034,319
	<u>1,483,869</u>	<u>1,638,741</u>
Loan receivable from SIR Corp. (note 5)	40,000,000	40,000,000
Investment in SIR Royalty Limited Partnership (note 6)	40,371,821	28,985,871
	<u>81,855,690</u>	<u>70,624,612</u>
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	104,647	69,071
Income taxes payable	387,172	536,062
	<u>491,819</u>	<u>605,133</u>
Deferred income taxes (note 14)	1,548,000	1,493,000
	<u>2,039,819</u>	<u>2,098,133</u>
Fund units (note 8)	85,557,287	74,171,337
Deficit	<u>(5,741,416)</u>	<u>(5,644,858)</u>
Total unitholders' equity	<u>79,815,871</u>	<u>68,526,479</u>
	<u>81,855,690</u>	<u>70,624,612</u>
Subsequent events (notes 8 and 10)		

Approved by the Board of Trustees

(Signed) "Peter Luit" _____ Director

(Signed) "Peter Fowler" _____ Director

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

SIR Royalty Income Fund

Consolidated Statements of Earnings and Comprehensive Income

For the years ended December 31, 2014 and 2013

	2014 \$	2013 \$
Investment income		
Equity income from SIR Royalty Limited Partnership (notes 6 and 10)	8,591,235	7,315,183
Interest income (note 5)	3,000,000	3,000,000
	<hr/> 11,591,235	<hr/> 10,315,183
General and administrative expenses (note 10)	<hr/> 409,297	<hr/> 417,290
Net earnings before income taxes	11,181,938	9,897,893
Income tax expense (note 14)	<hr/> 2,998,600	<hr/> 2,776,500
Net earnings and comprehensive income for the year	<hr/> 8,183,338	<hr/> 7,121,393
Basic and diluted earnings per Fund unit (note 9)	<hr/> \$1.13	<hr/> \$1.08

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

SIR Royalty Income Fund

Consolidated Statements of Changes in Unitholders' Equity

For the years ended December 31, 2014 and 2013

	Year ended December 31, 2014			
	Number of Fund units	Amount \$	Deficit \$	Total \$
Balance - Beginning of year	6,775,567	74,171,337	(5,644,858)	68,526,479
Net earnings for the year	-	-	8,183,338	8,183,338
Distributions declared (note 8)	-	-	(8,279,896)	(8,279,896)
Issuance of Fund units (note 8)	850,000	11,385,950	-	11,385,950
Balance - End of year	7,625,567	85,557,287	(5,741,416)	79,815,871

	Year ended December 31, 2013			
	Number of Fund units	Amount \$	Deficit \$	Total \$
Balance - Beginning of year	5,880,567	63,162,837	(5,436,769)	57,726,068
Net earnings for the year	-	-	7,121,393	7,121,393
Distributions declared (note 8)	-	-	(7,329,482)	(7,329,482)
Issuance of Fund units (note 8)	895,000	11,008,500	-	11,008,500
Balance - End of year	6,775,567	74,171,337	(5,644,858)	68,526,479

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

SIR Royalty Income Fund

Consolidated Statements of Cash Flows

For the years ended December 31, 2014 and 2013

	2014 \$	2013 \$
Cash provided by (used in)		
Operating activities		
Net earnings for the year	8,183,338	7,121,393
Items not affecting cash		
Deferred income taxes (note 14)	55,000	148,000
Current income taxes (note 14)	2,943,600	2,628,500
Equity income from SIR Royalty Limited Partnership	(8,591,235)	(7,315,183)
Distributions received from SIR Royalty Limited Partnership	8,469,134	7,216,079
Income taxes paid	(3,092,490)	(2,085,899)
Net change in non-cash working capital items (note 12)	214,115	171,121
	<hr/>	<hr/>
	8,181,462	7,884,011
Financing activities		
Distributions paid to unitholders	(8,279,896)	(7,623,510)
	<hr/>	<hr/>
Change in cash during the year	(98,434)	260,501
Cash - Beginning of year	577,089	316,588
	<hr/>	<hr/>
Cash - End of year	478,655	577,089
	<hr/>	<hr/>

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

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

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, Canada.

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 6).

The address of the registered office of the Fund is 5360 South Service Road, Suite 200, Burlington, Ontario. The consolidated financial statements were approved by the Board of Trustees on March 13, 2015.

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, equity income from the Partnership recognized by the Fund will vary in conjunction with the seasonality in revenues experienced by SIR.

2 Basis of presentation

The Fund prepares its consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board.

3 Summary of significant accounting policies

The significant accounting policies used in the preparation of the consolidated financial statements are as follows:

Basis of measurement

The consolidated financial statements have been prepared under the historical cost convention.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Consolidation

The Fund prepares its consolidated financial statements in accordance with IFRS and include the accounts of the Fund and its subsidiaries, namely the Trust and SIR GP Inc. All intercompany accounts and transactions have been eliminated.

The Fund consolidates an investee when it is exposed to or has rights to variable returns from its involvement with the investee and has the ability to affect these returns through its power over the investee. Subsidiaries are fully consolidated from the date on which control is obtained by the Fund and are deconsolidated from the date control ceases.

Use of estimates

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect income and expenses during the reporting periods, in addition to the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the consolidated financial statements. Actual results could differ materially from those estimates in the near term.

Financial instruments

Financial assets and liabilities are recognized when the Fund becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Fund has transferred substantially all risks and rewards of ownership.

Financial assets and liabilities are offset and the net amount is reported in the consolidated statements of financial position when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or realize the asset and settle the liability simultaneously.

At initial recognition, the Fund classifies its financial instruments in the following categories, depending on the purpose for which the instruments were acquired:

- i) **Loans and receivables:** Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Fund's loans and receivables comprise cash and amounts due from related parties, which are included in current assets due to their short-term nature, and the SIR Loan, which is classified as non-current. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less a provision for impairment.
- ii) **Financial liabilities at amortized cost:** Financial liabilities at amortized cost comprise accounts payable and accrued liabilities and advances payable to related parties. Accounts payable and accrued liabilities, and advances payable to related parties are initially recognized at the amount required to be paid less, when material, a discount to reduce the financial liabilities to fair value. Subsequently, accounts payable and accrued liabilities, and advances payable to related parties are measured at amortized cost using the effective interest method.

Financial liabilities are classified as current liabilities if payment is due within 12 months, otherwise, they are presented as non-current liabilities.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Impairment of financial assets

At each reporting date, the Fund assesses whether there is objective evidence that a financial asset at amortized cost is impaired. If such evidence exists, the Fund recognizes an impairment loss as the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount either directly or indirectly through the use of an allowance account.

Impairment losses on financial assets carried at amortized cost are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized.

Investments in associates and unconsolidated structured entities

Associates are entities over which the Fund has significant influence, but not control, and include the investment in the Partnership.

A structured entity is an entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only, and the relevant activities are directed by means of contractual arrangements. The Fund has determined that its investment in the Partnership is an investment in a structured entity.

The Partnership is a structured entity established to own the Canadian trademarks used in connection with the operations of the SIR Restaurants. SIR consolidates the Partnership, as the sale of Canadian trademarks to the Partnership had no impact on SIR's use of the Canadian trademarks. The Fund has voting control of SIR GP Inc., the managing general partner for the Partnership, with an 80% ownership of SIR GP Inc.'s common shares; however, the Fund does not have the ability to affect the returns on the investment in the Partnership through its power over the Partnership. Accordingly, since the Fund is able to significantly influence the Partnership, it is accounted for as an investment in an associate.

The financial results of the Fund's investments in associates are included in the Fund's consolidated results according to the equity method. Subsequent to the acquisition date, the Fund's share of profits or losses of associates is recognized in the consolidated statements of earnings and its share of other comprehensive income of associates is included in other comprehensive income.

Unrealized gains on transactions between the Fund and an associate are eliminated to the extent of the Fund's interest in the associate. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Dilution gains and losses arising from changes in interests in investments in associates are recognized in the consolidated statements of earnings.

The Fund assesses whether there is any objective evidence that its interests in associates are impaired. If impaired, the carrying value of the Fund's share of the underlying assets of the associates is written down to its estimated recoverable amount (being the higher of fair value less cost to sell and value in use) and charged to the consolidated statements of earnings.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Earnings per Fund unit

Earnings per Fund unit are based on the weighted average number of Fund units outstanding during the period. Diluted earnings per Fund unit are calculated to reflect the dilutive effect, if any, of SIR exercising its right to exchange its Class A GP units into Fund units at the beginning of the period.

Distributions

Distributions to unitholders are intended to be made monthly in arrears and are recorded when declared by the Trustees of the Fund. Distributions to unitholders are recorded as a financing activity in the consolidated statements of cash flows.

Income taxes

Income taxes comprise current and deferred taxes and are recognized in the consolidated statements of earnings and comprehensive income.

Current income taxes are the expected taxes payable on taxable income for the year, using tax rates enacted, or substantively enacted, at the end of the reporting period.

In general, deferred income taxes are recognized in respect of temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income taxes are determined on a non-discounted basis using tax rates and laws that have been enacted, or substantively enacted, at the consolidated statements of financial position date and are expected to apply when the deferred income tax asset or liability is settled. Deferred income tax assets are recognized to the extent it is probable that the assets can be recovered.

Adoption of new accounting standards and amendments

Effective January 1, 2014, the following standards and amendments have been adopted by the Fund:

IAS 36, Impairment of assets

IAS 36, Impairment of assets has been amended to include limited scope amendments to the impairment disclosures. Management has determined that this amendment had no impact on its consolidated financial statements.

IFRS issued but not yet effective

IFRS 7, Financial Instruments – Disclosure

IFRS 7, Financial Instruments: Disclosure has been amended to require disclosures on transition from IAS 39 to IFRS 9. This amendment is effective on adoption of IFRS 9, which is effective for years beginning on or after January 1, 2015. Management has evaluated the amendment and concluded that this amendment will not have a material impact on the consolidated financial statements.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

IFRS 9, Financial Instruments - Classification and Measurement

In July 2014, the International Accounting Standards Board (IASB), issued the final version of IFRS 9, Financial Instruments, bringing together the classification and measurement, impairment and hedge accounting phases of the IASB's project to replace IAS 39 Financial Instruments: Recognition and Measurement. The mandatory effective date of IFRS 9 would be annual periods beginning on or after January 1, 2018 with early adoption permitted. Management is evaluating the standard and has not yet determined the impact on its consolidated financial statements.

IAS 24, Related Party Transactions

IAS 24, Related party transactions has been amended to (i) revise the definition of "related party" to include an entity that provides key management personnel services to the reporting entity or its parent, and (ii) clarify related disclosure requirements. This amendment is effective for annual periods beginning on or after July 1, 2014. Management has evaluated this amendment and concluded that the adoption of this amendment will not have a material impact on the consolidated financial statements.

4 Critical accounting estimates and judgments

The Fund makes estimates and assumptions concerning the future that will by definition seldom equal actual results. The following are estimates and judgments that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

Investment in the Partnership/consolidation of structured entities

The Partnership receives royalties on the SIR Rights, which are licensed to SIR for use in Royalty Pooled Restaurants. The Fund and SIR each hold an investment in the Partnership. Generally, the Partnership units have no voting rights, except in certain specified conditions.

The determination of the entity having the ability to affect the returns on their investment in the Partnership required significant judgment. Based on an evaluation of the activities of the Partnership and the Partnership Agreement, management concluded the substance of the relationships between the Partnership, SIR and the Fund indicates the Partnership is controlled by SIR. In addition, the evaluation of whether or not the Fund has significant influence over the Partnership is a matter of significant judgment. Based on a review of the operating and financing activities of the Partnership, management has concluded that the Fund is able to significantly influence these activities. Management has re-evaluated its policy upon the acquisition of additional investments in the Class A LP units in 2014 and 2013 and has concluded that these acquisitions do not require a change in its accounting policy for the investment in the Partnership. Accordingly, the Fund's investment in the Partnership continues to be accounted for as an investment in an associate.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Valuation of the SIR Loan and investment in the Partnership

Management reviews for objective evidence whether there may be an impairment of the SIR Loan or the investment in the Partnership. The review includes a review of the earnings, cash flows and available cash of SIR on a prospective basis to assess SIR's ability to meet its obligations to the Fund for interest payments on the SIR Loan and to the Partnership for the Royalty. Based on the analysis completed during the years ended December 31, 2014 and 2013, no impairments have been recorded in the consolidated financial statements.

5 Loan receivable from SIR Corp.

The SIR Loan of \$40,000,000 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 \$3,000,000 was earned during the year ended December 31, 2014 (2013 – \$3,000,000).

SIR has a credit facility that consists of a term loan (the Term Loan) and three development loans. On June 23, 2014, SIR entered into a Third Amended and Restated Loan Agreement (the Credit Agreement) that includes the Term Loan and the Tranche A and Tranche B Development Loans which were outstanding as at December 31, 2014 and also provided for additional contemplated financing (Tranche C Development Loan). All loans under the Credit Agreement, except the Tranche C Development Loan, are due on November 13, 2016. The Term Loan and the Tranche A Development Loan have a variable interest rate equal to the greater of 6.0% per annum and the three-month Canadian dollar bankers' acceptance rate plus 5.75% per annum. The Tranche B Development Loan has a variable rate equal to the greater of 5.9% per annum and the three-month Canadian dollar bankers' acceptance rate plus 5.65% per annum. Interest on the Tranche C Development Loan will be calculated as the greater of 5.55% per annum and the three-month Canadian dollar bankers' acceptance rate plus 5.30% per annum. SIR can also elect to fix the interest rate. The amortization periods for the Term Loan, the Tranche A Development Loan, the Tranche B Development Loan and the Tranche C Development Loan are seven years.

The lender has made available the Tranche A Development Loan and Tranche B Development Loan to SIR only for the purpose of financing: (a) costs incurred in connection with the acquisition of furniture, fixtures, equipment and leasehold improvements relating to new locations; and (b) renovations and capital expenditure costs relating to existing locations. The Tranche A Development Loan and Tranche B Development Loan have been fully drawn and no further advances are permitted.

The Tranche C Development Loan is not to exceed \$6,000,000 and was available to SIR by ways of multiple advances until September 19, 2014, but could be extended to March 19, 2015 at the sole discretion of the lender upon request by SIR. No draws were made on Tranche C and the draw down date has not been extended.

The Credit Agreement is collateralized by a general security agreement and entitles the lender to a first charge on all of SIR's assets, including a pledge of all shares and the investment in the Partnership and a specific assignment of the rights under the Licence and Royalty Agreement. However, the lender does not have a pledge over the assets of the Partnership. The Partnership and the Fund did not guarantee the credit agreement.

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Under an Amended and Restated Subordination and Postponement Agreement, absent a default or event of default under the Credit Agreement, ordinary payments to the Fund and the Partnership 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 Amended and Restated 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.

6 Investment in SIR Royalty Limited Partnership

On October 12, 2004, the Fund, indirectly through the Trust and SIR GP Inc., respectively, acquired all of the Ordinary LP Units and 99 Ordinary GP Units. The holders of the Ordinary LP Units are entitled to receive a pro rata share of distributions and the holders of the Ordinary GP Units receive a fixed monthly distribution of \$5 in aggregate.

During the year ended December 31, 2014, SIR converted 850,000 (December 31, 2013 – 895,000) of its Class A GP Units in the Partnership into 850,000 (December 31, 2013 – 895,000) Fund units and sold these Fund units. In accordance with the exchange agreement, the Fund converted the 850,000 (December 31, 2013 – 895,000) Class A GP Units received into 850,000 (December 31, 2013 – 895,000) Class A LP Units. The 850,000 (December 31, 2013 – 895,000) Class A LP Units were issued by the Partnership to the Trust at a fair value of \$11,385,950 (December 31, 2013 – \$11,008,500) (note 8).

The holders of the Class A LP Units are entitled to receive a pro rata share of all residual distributions of the Partnership. As at December 31, 2014, the Fund's interest in the residual earnings of the Partnership was 78.1% (2013 – 75.6%). Generally, the Partnership units have no voting rights, except in certain specified conditions.

The Partnership makes cash distributions to its partners in the following order of priority: i) First, to the holders of the Class C GP Units and the Class C LP Units, ii) second, to the holders of the Class B GP Units, iii) third, to the holders of the Ordinary GP Units, and iv) thereafter, to the holders of the Class A GP Units, the Class A LP Units, and the Ordinary LP Units.

SIR Royalty Income Fund
Notes to Consolidated Financial Statements
December 31, 2014 and 2013

The continuity of the Investment in the Partnership is as follows:

	Year ended December 31, 2014 \$	Year ended December 31, 2013 \$
Balance - Beginning of year	28,985,871	17,977,371
Issuance of Class A LP units	11,385,950	11,008,500
Equity income	8,591,235	7,315,183
Distributions declared	(8,591,235)	(7,315,183)
	<hr/>	<hr/>
Balance - End of year	40,371,821	28,985,871

The summarized financial information of the Partnership is as follows:

	As at December 31, 2014 \$	As at December 31, 2013 \$
Cash	143,363	534,590
Other current assets	750,841	507,857
Non-current assets	88,933,733	77,497,638
	<hr/>	<hr/>
Total assets	89,827,937	78,540,085
	<hr/>	<hr/>
Current liabilities and total liabilities	894,194	1,042,437
	<hr/>	<hr/>
Partners' Interest		
SIR Royalty Income Fund	27,628,759	19,171,810
SIR Corp.	61,304,984	58,325,838
	<hr/>	<hr/>
Total partners' interest	88,933,743	77,497,648
	<hr/>	<hr/>
	Year ended December 31, 2014 \$	Year ended December 31, 2013 \$
Revenues	15,509,900	14,123,410
	<hr/>	<hr/>
Net earnings and comprehensive income of the Partnership	15,428,728	14,023,948

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

The reconciliation of the Fund's investment in the Partnership to the Partnership's partners' interest is as follows:

	As at December 31, 2014 \$	As at December 31, 2013 \$
Investment in the Partnership	40,371,821	28,985,871
Transaction costs incurred by the Partnership to issue Ordinary LP units	(3,533,090)	(3,533,090)
Difference between carrying value and fair value on the conversion of the Class A GP units to Class A LP units	(9,209,972)	(6,280,971)
	<u>27,628,759</u>	<u>19,171,810</u>
Partners' interest to SIR Royalty Income Fund		

The reconciliation of the Partnership's net earnings to the Fund's equity income is as follows:

	Year ended December 31, 2014 \$	Year ended December 31, 2013 \$
Net earnings and comprehensive income of the Partnership	15,428,720	14,023,948
Priority income allocated to SIR Corp. (Class C GP and Class B GP units)	(2,994,634)	(3,168,831)
	<u>12,434,086</u>	<u>10,855,117</u>
Residual earnings SIR Corp.'s share	(3,842,851)	(3,539,934)
	<u>8,591,235</u>	<u>7,315,183</u>
Equity income		

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

The following table presents the carrying amounts of assets and liabilities recognized by the Fund relating to its interest in the Partnership as well as the Fund's maximum exposure to loss from those interests:

	As at December 31, 2014		As at December 31, 2013	
	Carrying Amount	Maximum Exposure to Loss	Carrying Amount	Maximum Exposure to Loss
Distributions receivable	3,189,074	3,189,074	3,066,973	3,066,973
Advances payable	(2,477,002)	(2,477,002)	(2,269,697)	(2,269,697)
Amounts due from related parties	712,072	712,072	797,276	797,276
Investment in SIR Royalty Limited Partnership	40,371,821	40,371,821	28,985,871	28,985,871
Total	41,083,893	41,083,893	29,783,147	29,783,147

The maximum exposure to loss is equal to the current carrying amounts of the assets and liabilities recognized by the Fund. The Fund does not provide financial support to the Partnership, nor has the Fund provided any guarantees or other contingent support to the Partnership.

7 Financial instruments

Classification

As at December 31, 2014 and 2013, the classifications of the financial instruments, as well as their carrying and fair values, are as follows:

		Carrying and fair value	
Classification		As at December 31, 2014	As at December 31, 2013
		\$	\$
Cash	Loans and receivables	477,655	577,089
Distributions, interest and advances receivable from related parties	Loans and receivables	3,454,564	3,316,973
Loan receivable from SIR Corp.	Loans and receivables	See below	See below
Accounts payable and accrued liabilities	Financial liabilities at amortized cost	104,647	69,071
Advances payable to related parties	Financial liabilities at amortized cost	2,477,002	2,282,654

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

Carrying and fair values

Cash, distributions, interest and advances receivable from related parties, accounts payable and accrued liabilities, and advances payable to related parties are short-term financial instruments whose fair value approximates the carrying amount given that they will mature in the short term. The SIR Loan is accounted for at amortized cost and the investment in the Partnership is accounted for by the equity method. The carrying values of the SIR Loan and the investment in the Partnership as at December 31, 2014 are \$40,000,000 and \$40,371,821, respectively (2013 – \$40,000,000 and \$28,985,871, respectively). The fair values of the SIR Loan and the investment in the Partnership could only be determined through the valuation of the individual assets. The aggregate fair value of the SIR Loan and the investment in the Partnership as at December 31, 2014 is estimated to be approximately \$97,226,000 (2013 – \$94,790,000) based on the fair value of the Fund units as of the close of business on December 31, 2014.

Objectives and policy relating to financial risk management

Financial risk management is carried out by management and the Trustees of the Fund. The Fund's main financial risk exposure, as well as its risk management policy, is detailed as follows:

Interest rate risk

The SIR Loan has a fixed interest rate of 7.5% per annum and has been designated as loans and receivable financial asset. Accordingly, changes in interest rates would not impact the consolidated statements of earnings and comprehensive income or the carrying value of the SIR Loan. However, the fair value of the SIR Loan will vary with changes in interest rates. The Fund is restricted to investing excess cash in short-term investments and it is not the Fund's practice to hedge against changes in interest rates.

Credit risk

The Fund is exposed to credit risk in its cash, distributions, interest and advances receivable from related parties and the SIR Loan. The maximum exposure to credit risk is the full carrying value of the financial instruments. The Fund minimizes the credit risk of cash by depositing funds with reputable financial institutions and minimizes the credit risk of its distributions, interest and advances receivable from related parties by managing and analyzing the cash flow of these related parties through the preparation of budgets and forecasts of these related parties. As at December 31, 2014, distributions, interest and advances receivable from related parties are not past due. Credit risk also arises from the potential default of SIR on the SIR Loan. Management monitors the SIR Loan for impairment. To date, a provision for uncollectible amounts has not been necessary.

SIR has certain restrictions relating to its bank financing, which could affect payments to the Fund if a default or an event of default were to occur (note 5).

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

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Liquidity risk

Liquidity risk is the risk the Fund will not be able to meet its financial obligations as they fall due and meet expected distributions to its unitholders. The Fund currently settles these obligations out of cash. The ability to do this relies on the Fund collecting its distributions from the Partnership and interest on the SIR Loan. The Fund intends to maintain equal monthly distributions to its unitholders. However, the Trustees of the Fund may authorize increased or decreased distributions from time to time or halt distributions entirely, as they see fit, at their sole discretion. Both the Fund and the Partnership prepare budgets and forecasts to evaluate their ability to meet future cash obligations.

8 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 ten 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.

During the year ended December 31, 2014, SIR converted 850,000 (2013 – 895,000) of its Class A GP Units into 850,000 (2013 – 895,000) Fund units and sold these Fund units. In exchange for the Fund issuing an additional 850,000 (2013 – 895,000) Fund units, the Fund received an increased interest in the Partnership recorded at fair value of \$11,385,950 (2013 – \$11,008,500). The issuance of the Fund units has been recorded at \$11,385,950 (2013 – \$11,008,500), being the gross proceeds received by SIR for the sale of the Fund units received. In accordance with the exchange agreement between the Fund, the Partnership, the Trust and SIR, the Fund exchanged the Class A GP Units received from SIR for the 850,000 (2013 – 895,000) Class A LP Units. Accordingly, the Partnership issued 850,000 (2013 – 895,000) Class A LP Units to the Fund.

These transactions did not have a dilutive effect on the Fund. As at December 31, 2014, there are 7,625,567 (2013 – 6,775,567) Fund units issued and outstanding. Each Fund unit is entitled to one vote at any meeting of unitholders.

During the year ended December 31, 2014, the Fund declared distributions of \$1.14 per unit (2013 – \$1.105 per unit). Subsequent to December 31, 2014, the Fund declared distributions of \$0.095 per unit for each of the months of January and February 2015.

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

December 31, 2014 and 2013

9 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 year.

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	Adjustment for conversion of Class A GP units		Diluted	
Net earnings for the year ended						
December 31, 2014	\$	8,183,338	\$	2,820,543	\$	11,003,881
Earnings per Fund unit for the year ended						
December 31, 2014	\$	1.13	\$	-	\$	1.13
Weighted average number of Fund units outstanding for the year ended						
December 31, 2014		7,261,046		2,505,865		9,766,911
Net earnings for the year ended						
December 31, 2013	\$	7,121,393	\$	2,539,413	\$	9,660,805
Earnings per Fund unit for the year ended						
December 31, 2013	\$	1.08	\$	-	\$	1.08
Weighted average number of Fund units outstanding for the year ended						
December 31, 2013		6,589,109		2,374,409		8,963,518

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

10 Related party transactions and balances

During the year ended December 31, 2014, the Fund recorded equity income of \$8,591,235 (2013 – \$7,315,183) and received distributions of \$8,469,134 (2013 – \$7,216,079) from the Partnership. The Fund, indirectly through the Trust, is entitled to receive a pro rata share of all residual distributions. The Fund's equity 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 permanently closed during a reporting period. SIR is not required to pay any Make-Whole Payment in respect of a permanently 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 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 will 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.

On January 1, 2015, two (January 1, 2014 – four) new SIR Restaurants were added to Royalty Pooled Restaurants in accordance with the Partnership Agreement. As consideration for the additional Royalty associated with the addition of two new SIR Restaurants on January 1, 2015 (January 1, 2014 – four), as well as the Second Incremental Adjustment for four new SIR Restaurants added to Royalty Pooled Restaurants on January 1, 2014 (January 1, 2013 – four), 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 permanent closure of nil (January 1, 2014 – nil) SIR Restaurants during the prior year. The net effect of these adjustments to Royalty Pooled Restaurants was that SIR converted 347,077 (January 1, 2014 – 803,393) Class B GP Units into 347,077 (January 1, 2014 – 803,393) Class A GP Units on January 1, 2015 at an estimated fair value of \$4,454,091 (January 1, 2014 – \$11,436,095).

In addition, the revenues of the four new SIR Restaurants added to Royalty Pooled Restaurants on January 1, 2014 were less than 80% of the Initial Adjustment's estimated revenue (January 1, 2013 – four new SIR Restaurants exceeded 80% of the Initial Adjustment's estimated revenue) and, as a result, the distributions on the Class A GP Units were reduced by a special conversion refund of \$5,378 in December 2014 and paid in January 2015 (a special conversion distribution of \$168,819 was declared in December 2013 and paid in January 2014).

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

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

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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. SIR, on behalf of SIR GP Inc., also provides services to the Partnership for its administration. For the year ended December 31, 2014, the Partnership provided these services to the Fund and the Trust for consideration of \$24,000 (2013 – \$24,000), which was the amount of consideration agreed to by the related parties and has been recorded in general and administrative expenses.

Amounts due from (to) related parties consist of:

	As at December 31, 2014 \$	As at December 31, 2013 \$
SIR Royalty Limited Partnership		
Distribution receivable	3,189,074	3,066,973
Advances payable	(2,477,002)	(2,269,697)
	<hr/>	<hr/>
Amounts receivable from SIR Royalty Limited Partnership - net	712,072	797,276
SIR Corp.		
Interest receivable	250,000	250,000
Advances receivable (payable)	15,490	(12,957)
	<hr/>	<hr/>
Amounts receivable from SIR Corp. - net	265,490	237,043
	<hr/>	<hr/>
Amounts due from related parties - net	977,562	1,034,319
	<hr/>	<hr/>

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.

Compensation of key management

The Fund does not have any employees. Compensation awarded to the Board of Trustees consists of fees of \$93,700 for the year ended December 31, 2014 (2013 – \$99,600).

11 Capital management

The Fund's capital consists of units of the Fund, as described in note 8. The objectives in managing the capital are to safeguard the Fund's ability to continue as a going concern, to provide an adequate return to its unitholders appropriate to their level of risk and to distribute excess cash to the unitholders. The Fund has no third party debt or bank lines of credit. The Fund had no capital expenditures during the year ended December 31, 2014 and is not expected to have significant capital expenditures in the future.

SIR has a credit agreement, which requires the Fund and the Partnership to subordinate and postpone their claims against SIR to the claims of the lender in the event of a default (note 5).

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

December 31, 2014 and 2013

12 Net change in non-cash working capital items

Net change in non-cash working capital items comprises:

	Year ended December 31, 2014 \$	Year ended December 31, 2013 \$
Prepaid expenses and other assets	(319)	941
Amounts due from related parties	178,858	171,039
Accounts payable and accrued liabilities	35,576	(859)
	<hr/>	<hr/>
	214,115	171,121
	<hr/>	<hr/>

13 Economic dependence

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

14 Income taxes

Income tax expense is recognized based on management's best estimate of the weighted average annual income tax rate expected for the full financial year. The estimated average annual rate used for the year ended December 31, 2014 was 26.5% (2013 – 26.5%).

Income tax expense is as follows:

	Year ended December 31, 2014 \$	Year ended December 31, 2013 \$
Current	2,943,600	2,628,500
Deferred	55,000	148,000
	<hr/>	<hr/>
	2,998,600	2,776,500
	<hr/>	<hr/>

The Fund's income not distributed to its unitholders is taxable at a rate of 49.53% (2013 – 49.53%). Distributions to unitholders are taxable at the combined federal and provincial tax rate, which is 26.5% for the year ended December 31, 2014 (2013 – 26.5%).

SIR Royalty Income Fund

Notes to Consolidated Financial Statements

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The reconciliation of the Fund's effective tax rate to the combined Canadian federal and provincial tax rate is as follows:

	Year ended December 31, 2014 \$	Year ended December 31, 2013 \$
Earnings before income taxes	11,181,938	9,897,893
Income tax provision at 49.53% (2013 – 49.53%)	5,538,414	4,902,426
Add (deduct):		
Distribution income not taxable	(549,789)	(382,482)
Partnership expenses deductible for tax purposes	55,000	58,000
Change in tax rates	-	90,000
Taxable interest income of Fund eliminated on consolidation	489,313	364,606
Non-deductible expenses	49,358	50,969
Differences in tax rates	(2,583,696)	(2,307,019)
	<u>2,998,600</u>	<u>2,776,500</u>

Deferred tax liabilities consist of the following:

	Investment in the Partnership \$
Balance as at December 31, 2012	1,345,000
Charged to consolidated statements of earnings	<u>148,000</u>
Balance as at December 31, 2013	1,493,000
Charged to consolidated statements of earnings	<u>55,000</u>
Balance as at December 31, 2014	<u>1,548,000</u>