

THE KEG ROYALTIES INCOME FUND

YEAR END REPORT

For the year ended December 31, 2009

TO OUR UNITHOLDERS

On behalf of the Board of Trustees, I am pleased to present the results of The Keg Royalties Income Fund (the “Fund”) for the three and twelve months ended December 31, 2009.

RESULTS

The Trustees are pleased to report that The Keg has reached another sales record for the year. The gross sales reported by the 102 Keg restaurants in the Royalty Pool were \$454,898,000 an increase of \$21,801,000 or 5.0% over the prior year. These higher gross sales reflect the very successful new Keg restaurants which opened during the period from October 3, 2007 through October 2, 2008, which were added to the Royalty Pool on January 1, 2009, and an extra week of sales, net of a same store sales decrease of 3.4% for the year.

Keg Restaurants Ltd (“KRL”), the company which makes the royalty payments to the Fund, has a year end which falls on the Sunday closest to September 30th in any year. As a result of the floating year-end date, approximately every fifth year contains 53 trading weeks of operation. KRL’s fiscal year ending October 3, 2010, will contain 53 weeks of sales and related costs, and the period ending January 3, 2010, contained 14 weeks of sales and related costs. Royalty Pool sales generated during the extra week of operation were \$8,099,000 and have been included in the financial results of the Fund for the year ended December 31, 2009.

The Fund generated earnings before income taxes of \$12,473,000 or \$1.285/Fund unit during 2009 compared with \$12,418,000 or \$1.280/Fund unit during the prior year, an increase of \$55,000 or 0.5 cents/Fund Unit. Distributable cash available to pay distributions to public Unitholders increased by \$119,000 to \$12,501,000 or \$1.288/Fund unit, from \$12,382,000 or \$1.276/Fund unit for the prior year.

OUTLOOK

The loss in consumer confidence as a result of the global recession has had a negative impact on the restaurant industry in North America, and The Keg has not been immune to its effects. The Canadian Restaurant and Foodservice Association (CRFA) has projected an increase in sales in the full-service restaurant category, the category in which The Keg operates, of 3.0% in 2010. The National Restaurant Association in the United States has projected a real sales increase of 1.2% in the full-service category in 2010. While the projections of total growth within the full-service category are encouraging, the key driver of growth in royalty income is same store sales growth. Management of Keg Restaurants Ltd. (“KRL”) expects a slight improvement in near-term economic conditions in North America and believes that The Keg will continue to outperform the full-service restaurant category with respect to same store sales growth. The Keg remains an industry leader in the full-service restaurant category in Canada; a fact confirmed by an independent research report from Angus Reid Strategies in July 2008 that identified The Keg as the first choice of over 60% of diners when choosing a steak dinner. In the United States management of KRL will continue to emphasize The Keg’s unique market niche between lower-priced, themed steakhouse chains and higher-priced, fine steakhouses to continue to grow brand awareness in that market.

KRL’s management remains committed to maintaining and improving the legendary high standards that have come to define the brand throughout North America including The Keg’s high quality menu, knowledgeable service and marketing innovation. KRL has consistently demonstrated its ability to deliver growth in both system sales and same store sales growth over the long term, which has provided not only stability but also growth in distributable cash and distributions to the Fund’s unitholders.

Sincerely,



C.C. Woodward
Chairman, The Keg Royalties Income Fund
on behalf of the Board of Trustees
March 4, 2010

FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Oct. 1 to Dec. 31, 2009	Oct. 1 to Dec. 31, 2008	Jan. 1 to Dec. 31, 2009	Jan. 1 to Dec. 31, 2008
Restaurants in the Royalty Pool	102	96	102	96
Gross sales reported by Keg restaurants in the Royalty Pool.....	<u>\$ 117,885</u>	<u>\$ 105,822</u>	<u>\$ 454,898</u>	<u>\$ 433,097</u>
Royalty income ⁽¹⁾	\$ 4,879	\$ 4,289	\$ 18,645	\$ 17,494
Partnership expenses ⁽²⁾	(101)	(103)	(397)	(376)
Partnership earnings	4,778	4,186	18,248	17,118
KRL's interest ⁽³⁾	(2,445)	(2,045)	(9,546)	(8,253)
Equity income ⁽⁴⁾	2,333	2,141	8,702	8,865
Interest income ⁽⁵⁾	1,078	1,083	4,280	4,319
Total income	3,411	3,224	12,982	13,184
Interest and financing expenses ⁽⁶⁾	(151)	(164)	(509)	(766)
Earnings before income taxes	<u>\$ 3,260</u>	<u>\$ 3,060</u>	<u>\$ 12,473</u>	<u>\$ 12,418</u>
Net earnings ⁽⁷⁾	<u>\$ 3,110</u>	<u>\$ 2,860</u>	<u>\$ 12,398</u>	<u>\$ 12,368</u>
Distributable cash ⁽⁸⁾	<u>\$ 3,182</u>	<u>\$ 2,999</u>	<u>\$ 12,501</u>	<u>\$ 12,382</u>
Distributions paid	<u>\$ 3,100</u>	<u>\$ 3,100</u>	<u>\$ 12,401</u>	<u>\$ 12,343</u>
Earnings before income taxes per Fund unit ⁽⁹⁾	<u>\$.336</u>	<u>\$.315</u>	<u>\$ 1.285</u>	<u>\$ 1.280</u>
Earnings per Fund unit ⁽⁹⁾	\$.321	\$.295	\$ 1.278	\$ 1.275
Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾	\$.328	\$.309	\$ 1.288	\$ 1.276
Distributions paid per Fund unit ⁽⁹⁾	\$.320	\$.320	\$ 1.278	\$ 1.272
Payout Ratio ⁽¹⁰⁾	<u>97.4%</u>	<u>103.4%</u>	<u>99.2%</u>	<u>99.7%</u>

Notes:

- ⁽¹⁾ The Fund, indirectly through the Partnership, earns royalty income equal to 4% of gross sales of Keg restaurants in the Royalty Pool.
- ⁽²⁾ The Fund, indirectly through the Partnership, incurs administrative expenses and interest on an operating line of credit, to the extent utilized.
- ⁽³⁾ Represents the interest of KRL in the earnings of the Partnership from the Class A, entitled Class B, Class C and Class D Partnership units. The Class A, entitled Class B and Class D Partnership units are exchangeable into Fund units on a one-for-one basis.
- ⁽⁴⁾ The Fund directly earns equity income from its investment in the Partnership. The amount is calculated as the royalty income, less the Partnership's operating expenses, less earnings attributable to KRL.
- ⁽⁵⁾ The Fund directly earns interest income on the \$57.0 million Keg Loan, with interest income accruing at 7.5% per annum, payable monthly.
- ⁽⁶⁾ The Fund directly incurs interest expense on the long-term debt and amortization of deferred financing charges.
- ⁽⁷⁾ Net earnings for the three months ended December 31, 2009 reflect the non-cash future income tax expense of \$150,000 (three months ended December 31, 2008 - \$200,000) and net earnings for the year ended December 31, 2009 reflect the non-cash future income tax expense of \$75,000 (year ended December 31, 2008 - \$50,000).
- ⁽⁸⁾ Distributable cash is defined as Standardized Distributable Cash which is the periodic cash flows from operating activities as reported in the GAAP financial statements, including the effects of changes in non-cash working capital.
- ⁽⁹⁾ All per unit amounts are calculated based on the weighted average number of Fund units outstanding, which are those units held by public unitholders during the respective period. The weighted average numbers of Fund units outstanding for the three and twelve months ended December 31, 2009 were 9,703,500 (three and twelve months ended December 31, 2008 - 9,703,500).
- ⁽¹⁰⁾ Payout ratio is computed as the ratio of aggregate cash distributions paid during the period (numerator) to the aggregate Standardized Distributable Cash of the period (denominator).
- ⁽¹¹⁾ Same Store Sales Growth ("SSSG") is the overall increase in gross sales from Keg restaurants (that operated during the entire period of both the current and the prior year) as compared to gross sales for the same period of the prior year.

SUMMARY OF QUARTERLY RESULTS

	Q4	Q3	Q2	Q1
(\$000's except per unit amounts)	2009	2009	2009	2009
Restaurants in the Royalty Pool	102	102	102	102
Gross sales reported by Keg restaurants in the Royalty Pool.....	\$ <u>117,885</u>	\$ <u>108,332</u>	\$ <u>107,824</u>	\$ <u>120,858</u>
Royalty income ⁽¹⁾	\$ 4,879	\$ 4,454	\$ 4,418	\$ 4,894
Partnership expenses ⁽²⁾	(101)	(100)	(108)	(88)
Partnership earnings	4,778	4,354	4,310	4,806
KRL's interest ⁽³⁾	(2,445)	(2,389)	(2,288)	(2,425)
Equity income ⁽⁴⁾	2,333	1,965	2,022	2,381
Interest income ⁽⁵⁾	1,078	1,078	1,067	1,058
Total income.....	3,411	3,043	3,089	3,439
Interest and financing expenses ⁽⁶⁾	(151)	(132)	(102)	(124)
Earnings before income taxes	\$ <u>3,260</u>	\$ <u>2,911</u>	\$ <u>2,987</u>	\$ <u>3,315</u>
Net earnings ⁽⁷⁾	\$ <u>3,110</u>	\$ <u>2,886</u>	\$ <u>2,937</u>	\$ <u>3,465</u>
Distributable cash ⁽⁸⁾	\$ <u>3,182</u>	\$ <u>2,991</u>	\$ <u>3,069</u>	\$ <u>3,258</u>
Distributions paid	\$ <u>3,100</u>	\$ <u>3,100</u>	\$ <u>3,100</u>	\$ <u>3,100</u>
Earnings before income taxes per Fund unit ⁽⁹⁾	\$ <u>.336</u>	\$ <u>.300</u>	\$ <u>.308</u>	\$ <u>.342</u>
Earnings per Fund unit ⁽⁹⁾	\$ <u>.321</u>	\$ <u>.297</u>	\$ <u>.303</u>	\$ <u>.357</u>
Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾	\$ <u>.328</u>	\$ <u>.308</u>	\$ <u>.316</u>	\$ <u>.336</u>
Distributions paid per Fund unit ⁽⁹⁾	\$ <u>.320</u>	\$ <u>.320</u>	\$ <u>.320</u>	\$ <u>.320</u>
Payout Ratio ⁽¹⁰⁾	<u>97.4%</u>	<u>103.7%</u>	<u>101.0%</u>	<u>95.2%</u>
SSSG Canada ⁽¹¹⁾	0.1%	(4.7)%	(6.9)%	(1.5)%
SSSG United States ⁽¹¹⁾	(9.6)%	(19.8)%	(15.7)%	(4.9)%
SSSG Consolidated ⁽¹¹⁾	(2.5)%	(5.9)%	(6.5)%	0.7%
Restaurants Opened	1	2	--	2
Restaurants Closed	--	--	1	3
Restaurants Relocated	1	1	--	--
Net Restaurants Opened (Closed)	1	2	(1)	(1)
			Dec. 31, 2009	Dec. 31, 2008
Total assets			\$ 116,364	\$ 116,327
Total liabilities.....			16,880	16,840

SUMMARY OF QUARTERLY RESULTS

	Q4	Q3	Q2	Q1
(\$000's except per unit amounts)	2008	2008	2008	2008
Restaurants in the Royalty Pool	96	96	96	96
Gross sales reported by Keg restaurants in the Royalty Pool.....	\$ <u>105,822</u>	\$ <u>108,035</u>	\$ <u>107,690</u>	\$ <u>111,550</u>
Royalty income ⁽¹⁾	\$ 4,289	\$ 4,383	\$ 4,334	\$ 4,488
Partnership expenses ⁽²⁾	<u>(103)</u>	<u>(93)</u>	<u>(81)</u>	<u>(99)</u>
Partnership earnings	4,186	4,290	4,253	4,389
KRL's interest ⁽³⁾	<u>(2,045)</u>	<u>(2,118)</u>	<u>(2,033)</u>	<u>(2,057)</u>
Equity income ⁽⁴⁾	2,141	2,172	2,220	2,332
Interest income ⁽⁵⁾	<u>1,083</u>	<u>1,084</u>	<u>1,075</u>	<u>1,077</u>
Total income	3,224	3,256	3,295	3,409
Interest and financing expenses ⁽⁶⁾	<u>(164)</u>	<u>(190)</u>	<u>(192)</u>	<u>(220)</u>
Earnings before income taxes	\$ <u>3,060</u>	\$ <u>3,066</u>	\$ <u>3,103</u>	\$ <u>3,189</u>
Net earnings ⁽⁷⁾	\$ <u>3,059</u>	\$ <u>3,066</u>	\$ <u>2,903</u>	\$ <u>3,539</u>
Distributable cash ⁽⁸⁾	\$ <u>2,999</u>	\$ <u>3,120</u>	\$ <u>3,065</u>	\$ <u>3,199</u>
Distributions paid	\$ <u>3,100</u>	\$ <u>3,100</u>	\$ <u>3,100</u>	\$ <u>3,042</u>
Earnings before income taxes per Fund unit ⁽⁹⁾	\$ <u>.315</u>	\$ <u>.316</u>	\$ <u>.320</u>	\$ <u>.329</u>
Earnings per Fund unit ⁽⁹⁾	\$ <u>.295</u>	\$ <u>.316</u>	\$ <u>.299</u>	\$ <u>.365</u>
Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾	\$ <u>.309</u>	\$ <u>.322</u>	\$ <u>.316</u>	\$ <u>.330</u>
Distributions paid per Fund unit ⁽⁹⁾	\$ <u>.320</u>	\$ <u>.320</u>	\$ <u>.320</u>	\$ <u>.314</u>
Payout Ratio ⁽¹⁰⁾	<u>103.4%</u>	<u>99.4%</u>	<u>101.2%</u>	<u>95.1%</u>
SSSG Canada ⁽¹¹⁾	(3.0)%	1.1%	4.7%	6.2%
SSSG United States ⁽¹¹⁾	(16.3)%	(8.3)%	(7.5)%	(3.6)%
SSSG Consolidated ⁽¹¹⁾	(2.2)%	0.0%	1.7%	2.2%
Restaurants Opened	1	3	4	1
Restaurants Closed	--	1	--	1
Restaurants Relocated	--	--	--	--
Net Restaurants Opened (Closed)	1	2	4	--

SELECTED ANNUAL INFORMATION

	Year Ended Dec. 31, 2009	Year Ended Dec. 31, 2008	Year Ended Dec. 31, 2007
(\$000's except per unit amounts)			
Restaurants in the Royalty Pool	102	96	95
Gross sales reported by Keg restaurants in the Royalty Pool.....	\$ 454,898	\$ 433,097	\$ 412,759
Royalty income ⁽¹⁾	\$ 18,645	\$ 17,494	\$ 16,827
Partnership expenses ⁽²⁾	(397)	(376)	(369)
Partnership earnings	18,248	17,118	16,458
KRL's interest ⁽³⁾	(9,546)	(8,253)	(7,696)
Equity income ⁽⁴⁾	8,702	8,865	8,762
Interest income ⁽⁵⁾	4,280	4,319	4,318
Total income.....	12,982	13,184	13,080
Interest and financing expenses ⁽⁶⁾	(509)	(766)	(943)
Earnings before income taxes	\$ 12,473	\$ 12,418	\$ 12,137
Net earnings ⁽⁷⁾	\$ 12,398	\$ 12,368	\$ 10,387
Distributable cash ⁽⁸⁾	\$ 12,501	\$ 12,382	\$ 12,199
Distributions paid	\$ 12,401	\$ 12,343	\$ 11,463
Earnings before income taxes per Fund unit ⁽⁹⁾	\$ 1.285	\$ 1.280	\$ 1.263
Earnings per Fund unit ⁽⁹⁾	\$ 1.278	\$ 1.275	\$ 1.081
Distributable cash per Fund unit ⁽⁸⁾⁽⁹⁾	\$ 1.288	\$ 1.276	\$ 1.269
Distributions paid per Fund unit ⁽⁹⁾	\$ 1.278	\$ 1.272	\$ 1.193
Payout Ratio ⁽¹⁰⁾	99.2%	99.7%	94.0%
SSSG Canada ⁽¹¹⁾	(3.1)%	2.0%	7.3%
SSSG United States ⁽¹¹⁾	(12.3)%	(9.0)%	2.1%
SSSG Consolidated ⁽¹¹⁾	(3.4)%	0.4%	5.5%
Restaurants Opened	5	9	1
Restaurants Closed	4	2	--
Restaurants Relocated	2	--	3
Net Restaurants Opened (Closed)	1	7	1
	Dec. 31, 2009	Dec. 31, 2008	Dec. 31, 2007
Total assets	\$ 116,364	\$ 116,327	\$ 116,261
Total liabilities	16,880	16,840	16,770

MANAGEMENT DISCUSSION AND ANALYSIS

**For the Three and Twelve Months Ended December 31, 2009
As of March 4, 2010**

OVERVIEW

KEY ATTRIBUTES OF THE FUND

The Keg Royalties Income Fund (the “Fund”) is a limited purpose, open-ended trust which trades on the Toronto Stock Exchange under the symbol KEG.UN. On May 31, 2002, as part of the Initial Public Offering (the “IPO”), the Fund, through its subsidiary The Keg Rights Limited Partnership (the “Partnership”), purchased The Keg trademarks and other related intellectual property (collectively, the “Keg Rights”) from Keg Restaurants Ltd. (“KRL”). The Partnership, in turn, granted KRL an exclusive licence to use the Keg Rights for a term of 99 years pursuant to a licence and royalty agreement, which obligates KRL to make monthly royalty payments to the Partnership equal to 4% of gross sales of Keg restaurants included in a specific royalty pool (the “Royalty Pool”).

The key feature of the Fund is that royalty income is based on the top-line, gross sales of Keg restaurants in the Royalty Pool and not on the profitability of either KRL or the Keg restaurants in the Royalty Pool. Moreover, the Fund is not subject to the variability of earnings or expenses associated with an operating business. The Fund’s only expenses are nominal administrative expenses and interest on non-amortizing term debt. Thus, the success of the Fund depends primarily on the ability of KRL to maintain and increase the gross sales of the Keg restaurants in the Royalty Pool.

Increases in gross sales are derived from both same store sales growth from existing restaurants (“SSSG”) and from the addition of new Keg restaurants. SSSG is the key driver of growth in royalty income and, since the Fund’s expenses are relatively fixed in nature, SSSG results in growth in distributable cash which allows for higher distributions to the Fund’s unitholders. KRL has generated SSSG through a combination of increased guest counts and increased guest average cheque. SSSG has been achieved by maintaining operational excellence within each Keg restaurant, innovative marketing and promotional programs, and pricing. Over the past twelve years, the period for which current management has been in control of KRL, SSSG has averaged 4.2% annually, a figure that compares very favourably against the restaurant industry as a whole. This consistent sales growth is one of the primary reasons that monthly cash distributions to the Fund’s unitholders have been increased 7 times since the Fund’s inception, most recently in March 2008.

In the event that a Keg restaurant is permanently closed during the year (including the termination of a franchise agreement), KRL will continue to pay the royalty amount for that closed Keg restaurant (“Make-whole Payment”) from the date of closure until those sales are replaced with gross sales from new Keg restaurants that are added to the Royalty Pool. The amount of the Make-whole Payment is based on the closed restaurant’s gross sales when it was originally included in the Royalty Pool.

KRL’S INTEREST IN THE FUND

KRL’s interest in the earnings of the Partnership is from its ownership of Class A, entitled Class B, Class C and Class D Partnership units. The Class A, entitled Class B and Class D Partnership units are exchangeable into Fund units on a one-for-one basis in certain circumstances. KRL’s effective ownership of the Fund and its interest in the earnings of the Partnership has grown from 10.00% at the time of the IPO to 29.64% as of December 31, 2009. The change in KRL’s effective ownership of the Fund is the result of adding net sales to the Royalty Pool on an annual basis, in return for which KRL receives the right to indirectly acquire additional Fund units (see “The Royalty Pool”). The total number of restaurants included in the Royalty Pool has increased from 80 Keg restaurants in existence at the time of the IPO to 102 as of December 31, 2009. This has resulted in a net increase in Royalty Pool sales of \$144.8 million and the issuance of 4,731,291 exchangeable units to KRL, as of December 31, 2009. KRL has exchanged a total of 1,550,000 Class B units for an equal number of Fund units (increasing the number of issued and outstanding Fund units from 8,153,500 at the time of the IPO to 9,703,500 as of February 23, 2007) and sold these units through the facilities of the Toronto Stock Exchange. On January 1, 2010, six new Keg restaurants that opened during the period from October 3, 2008 through October 2, 2009 were added to the Royalty Pool. See “Subsequent Events”.

VARIABLE INTEREST ENTITY

During 2005, the Partnership was determined to be a variable interest entity in accordance with the criteria established in the Canadian Institute of Chartered Accountants' ("CICA") Guideline, Consolidation of Variable Interest Entities ("AcG-15"). As a result of this guideline, the Fund accounts for its investment in the Partnership on an equity basis and KRL consolidates the Partnership. Readers are advised that this is an accounting basis of presentation only and that earnings and distributable cash attributable to Fund unitholders are not impacted nor does this impact the contractual obligations between the Fund, and the Partnership, and KRL. The consolidated financial statements of the Fund therefore include the accounts of the Fund, its wholly-owned subsidiary The Keg Holdings Trust ("KHT") and its 90% owned subsidiary The Keg GP Ltd. ("KGP") (collectively, the "Companies"). KGP is the managing general partner of the Partnership. All residual ownership of the Companies is either directly or indirectly controlled by KRL.

FEDERAL GOVERNMENT TAX ON INCOME FUNDS

On June 12, 2007, the Canadian federal government's legislation to tax publicly traded income trusts passed third reading in the House of Commons and thus the associated income tax became substantively enacted for accounting purposes. The legislation imposes a tax of 29.5% on distributions from Canadian public income trusts. The new tax is not expected to apply to the Fund until January 1, 2011 as a transition period applies to publicly traded trusts that existed prior to November 1, 2006. This rate was subsequently reduced to 26.5% for 2011 and 25% for 2012 and later taxation years. Historically, the Fund had been exempt from recognizing future income tax assets and liabilities associated with temporary differences arising in the Fund and its equity accounted investment, The Keg Rights Limited Partnership. As a result of the substantive enactment of the new tax legislation, the Fund has recognized future income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. Future income tax expense is a non-cash item that does not affect cash flow.

DISTRIBUTABLE CASH

During 2007, The Canadian Institute of Chartered Accountants and the Canadian Securities Administrators released a guideline on the measurement and reporting of distributable cash for income trusts and other flow through entities in Management's Discussion and Analysis. This guidance attempts to provide comparable measures of distributable cash among income trusts. The Fund adopted this guidance in 2007, and as a result, distributable cash is now defined as the periodic cash flows from operating activities as reported in the GAAP financial statements including the change in non-cash working capital balances, less adjustments for capital expenditures and restrictions on distributions arising from compliance with financial covenants. Distributable cash may not be comparable to other issuers who have adopted this guidance. Previously, distributable cash was computed as earnings for the period plus non-cash items such as amortization and future income taxes; a non-GAAP measure which was also not necessarily comparable to similar measures presented by other issuers. Given the Fund has no capital expenditures and no expected restriction on distributions arising from compliance with financial covenants, the only significant difference that may arise in any particular reporting period between the two definitions is due to the inclusion of changes in non-cash working capital balances.

The Trustees are of the opinion that the inclusion of changes in non-cash working capital balances in the determination of distributable cash will provide less meaningful information for Unitholders as the Fund's working capital requirements are not permanent in nature and are primarily due to the timing of payments between related parties. Readers are advised that this is a reporting change only, and that earnings and actual cash available for distribution to the Fund's unitholders are not impacted, nor are the contractual obligations between the Fund, the Partnership, and KRL.

THE ROYALTY POOL

Annually, on January 1st, the Royalty Pool is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2nd of the prior year, less gross sales from any Keg restaurants that have permanently closed during the preceding calendar year. In return for adding these net sales to the Royalty Pool, KRL receives the right to indirectly acquire additional Fund units (the “Additional Entitlement”). The Additional Entitlement is determined based on 92.5% of the estimated net royalty revenue added to the Royalty Pool, divided by the yield of the Fund units, divided by the weighted average unit price of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31st of each year when the actual full-year performance of the new restaurants is known with certainty.

Readers should note that the number of restaurants added to the Royalty Pool each year may differ from the number of restaurant openings and closings reported by KRL on an annual basis, as the periods for which they are reported differ slightly.

The total number of Keg restaurants included in the Royalty Pool has increased from the 80 Keg restaurants in existence on March 31, 2002, to 102 as of December 31, 2009. Thirty-nine new Keg restaurants that opened during the period from April 1, 2002, through October 2, 2008, with annual gross sales of \$187.7 million have been added to the Royalty Pool. Seventeen permanently closed Keg restaurants with annual sales of \$42.9 million have been removed from the Royalty Pool. This has resulted in a net increase in Royalty Pool sales of \$144.8 million annually, and KRL receiving a cumulative Additional Entitlement equivalent to 4,731,291 Fund units as of December 31, 2009.

On January 1, 2010, six new Keg Restaurants that opened during the period October 3, 2008 through October 2, 2009 were added to the Royalty Pool. See “Subsequent Events”.

DISTRIBUTIONS TO UNITHOLDERS

The Fund’s objective is to provide consistent monthly distributions to unitholders at the highest sustainable level, and the Trustees of the Fund continue to review distribution levels on an ongoing basis to fulfill that objective. Since the inception of the Fund, monthly distributions to unitholders have been increased seven times from the original level of \$0.09 per unit at the time of the IPO, to the current level of \$0.1065 per unit, an increase of 18.3%.

Year-to-date distributions were as follows:

Period	Payment Date	Per/Unit
January 1-31, 2009	February 27, 2009	10.65¢
February 1-28, 2009	March 31, 2009	10.65¢
March 1-31, 2009	April 30, 2009	10.65¢
April 1-30, 2009	May 29, 2009	10.65¢
May 1-31, 2009	June 30, 2009	10.65¢
June 1-30, 2009	July 31, 2009	10.65¢
July 1-31, 2009	August 31, 2009	10.65¢
August 1-31, 2009	September 30, 2009	10.65¢
September 1-30, 2009	October 30, 2009	10.65¢
October 1-31, 2009	November 30, 2009	10.65¢
November 1-30, 2009	December 31, 2009	10.65¢
December 1-31, 2009	January 29, 2010*	10.65¢

*Paid subsequent to the period

Distributions paid during the year were funded entirely by cash flow from operations and no debt was incurred at any point during the year to fund distributions.

Since inception, the Fund has generated \$78,875,000 of distributable cash and has paid cumulative distributions of \$78,034,000, which resulted in a cumulative surplus of \$841,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid since inception to the cumulative standardized distributable cash generated since inception) is 98.9%.

OWNERSHIP OF THE FUND

The ownership of the Fund on a fully diluted basis is as follows:

	December 31, 2009 ⁽¹⁾		December 31, 2008	
	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>
Fund units held by public unitholders ⁽²⁾	9,703,500	70.36	9,703,500	75.74
Exchangeable Partnership units held by KRL: ⁽³⁾				
Class A units ⁽⁴⁾	905,944	6.57	905,944	7.07
Class B units ⁽⁵⁾	1,826,700	13.25	1,826,700	14.26
Class D units ⁽⁵⁾	<u>1,354,591</u>	<u>9.82</u>	<u>375,497</u>	<u>2.93</u>
Total Exchangeable Partnership units ⁽⁶⁾	<u>4,087,235</u>	<u>29.64</u>	<u>3,108,141</u>	<u>24.26</u>
Total Fund and Exchangeable Partnership units.....	<u>13,790,735</u>	<u>100.00</u>	<u>12,811,641</u>	<u>100.00</u>

Notes:

⁽¹⁾ Information is current as of December 31, 2009.

⁽²⁾ Represents the public's total effective ownership of the Fund as of December 31, 2009 and 2008. The public's average effective ownership of the Fund (based on the weighted average number of Fund units held by public unitholders during the respective period) was 70.36% during the three and twelve months ended December 31, 2009 (three and twelve months ended December 31, 2008 – 75.74%). The weighted average number of Fund units outstanding for the three and twelve months ended December 31, 2009 was 9,703,500 (three and twelve months ended December 31, 2008 – 9,703,500).

⁽³⁾ Exchangeable into Fund units on a one-for-one basis.

⁽⁴⁾ Represents KRL's initial 10% effective ownership of the Fund, prior to the entitlement of Class B or Class D units.

⁽⁵⁾ These exchangeable Partnership units are issued to KRL in return for adding net sales to the Royalty Pool on an annual basis. Class D units are equivalent to Class B units in all material respects but may only be issued to KRL after all Class B units have become fully entitled to proportionate distributions from the Partnership (which occurred on January 1, 2008). As of December 31, 2009, KRL is the registered holder of 1,826,700 Class B units and 1,354,591 Class D units (December 31, 2008 – 1,826,700 Class B units and 375,497 Class D units).

⁽⁶⁾ Represents KRL's total effective ownership of the Fund as of December 31, 2009 and 2008. KRL's average effective ownership of the Fund (based on the weighted average number of Fund and exchangeable units held by KRL during the respective period) was 29.64% during the three and twelve months ended December 31, 2009 (three and twelve months ended December 31, 2008 – 24.26%).

SYSTEM SALES

While the Fund's income is indirectly based on a royalty of 4% of sales of Keg restaurants in the Royalty Pool, the total system sales of The Keg chain are of interest to the Fund and its unitholders as the total system sales best reflect the chain's overall performance. The following table sets out The Keg's total system sales for the periods indicated below:

(\$000's)	14 weeks ended Jan.3, <u>2010</u>	13 weeks ended Dec. 28, <u>2008</u>	53 weeks ended Jan.3, <u>2010</u>	52 weeks ended Dec. 28, <u>2008</u>
Corporate Keg restaurants ⁽¹⁾	\$ 62,967	\$ 59,649	\$ 233,139	\$ 227,131
Franchised Keg restaurants ⁽²⁾	<u>63,916</u>	<u>57,186</u>	<u>239,923</u>	<u>230,252</u>
Total system sales	<u>\$ 126,883</u>	<u>\$ 116,835</u>	<u>\$ 473,062</u>	<u>\$ 457,383</u>

Notes:

⁽¹⁾ The amount of system sales for the corporate Keg restaurants is the amount of gross sales from corporate Keg restaurants only.

⁽²⁾ The amount of system sales for the franchised Keg restaurants is the amount of gross sales reported to KRL by franchised Keg restaurants without independent audit.

KRL's year end falls on the Sunday closest to September 30th, in any year. As a result of the floating year-end date, approximately every fifth fiscal year contains 53 trading weeks of operation. KRL's fiscal year ending October 3, 2010 will contain 53 weeks of sales and related costs, and the period ending January 3, 2010 will contain 14 weeks of sales and related costs.

FOURTH QUARTER

System sales for the 14 weeks ended January 3, 2010 were \$126.8 million compared to \$116.8 million for the 13 weeks ended December 28, 2008, an increase of \$10.0 million or 8.6%. System sales due to the extra week of operation were \$8.6 million, so on a comparable basis, system sales increased by \$1.4 million or 1.2%. During the 14 weeks ended January 3, 2010, one new corporate restaurant was opened, one franchised restaurant was relocated, and no restaurants were closed. During the 13 weeks ended December 28, 2008, one new corporate restaurant was opened and no restaurants were closed. As of January 3, 2010, there were a total of 104 Keg restaurants as compared with 103 Keg restaurants at December 28, 2008.

The Keg's same store sales (sales of restaurants that operated during the entire 14-week period of the current year and the 13-week period of the prior year) increased by 7.3% in Canada and decreased by 2.9% in the United States. After deducting the extra week of sales for comparative purposes, same store sales for the comparable 13-week periods increased by 0.1% in Canada and decreased by 9.6% in the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 13-week periods decreased by 2.5%. The average exchange rate moved from 1.21 in KRL's first quarter of fiscal 2009 to 1.06 in KRL's first quarter of fiscal 2010, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales. Management of KRL attributes the same store sales performance experienced during the quarter solely to weak economic conditions in both Canada and the United States.

YEAR

System sales for the 53 weeks ended January 3, 2010 were \$473.1 million compared to \$457.4 million for the 52 weeks ended December 28, 2008, an increase of \$15.7 million or 3.4%. System sales due to the extra week of operation were \$8.6 million, so on a comparable basis, system sales increased by \$7.0 million or 1.5%. During the 53 weeks ended January 3, 2010, three new corporate and two new franchised restaurants were opened, two franchised restaurants were relocated and three corporate and one franchised restaurant were closed. The closed corporate restaurants, located in the Pacific Northwest region of the United States, were closed as part of an ongoing property rationalization. Although the restaurant closures were originally scheduled to correspond with the expiration of their location leases, two in 2009 and one in 2010, management of KRL elected to accelerate the closures to eliminate operating losses of these restaurants incurred primarily as a result of deteriorating economic conditions in the United States. The closed franchised restaurant, located in Bellingham, Washington closed primarily due to deteriorating economic conditions in the United States and an inability to refinance. During the 52 weeks ended December 28, 2008, six new corporate and three new franchised restaurants were opened and one corporate and one joint venture restaurant were closed.

The Keg's same store sales (sales of restaurants that operated during the entire 53-week period of the current year and the 52-week period of the prior year) decreased by 1.2% in Canada and by 10.6% in the United States. After deducting the extra week of sales for comparative purposes, same store sales for the comparable 52-week periods decreased by 3.1% Canada and by 12.3% in the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 52-week periods decreased by 3.4%. The average exchange rate moved from 1.06 in KRL's 52-week period ended December 28, 2008 to 1.14 in KRL's 53-week period ended January 3, 2010, significantly increasing the Canadian dollar equivalent of the U.S. restaurant sales. Management of KRL attributes the same store sales declines experienced during the year, solely to weak economic conditions in both Canada and the United States.

OPERATING RESULTS

FOURTH QUARTER

GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool increased from \$105,822,000 to \$117,885,000 for the comparable quarter. The increase of \$12,063,000, or 11.4%, reflects the addition of net new sales to the Royalty Pool at the beginning of the year, and the extra week of sales, net of the same store sales decreases discussed previously.

ROYALTY INCOME

Total royalty income earned by the Partnership increased by \$590,000 from \$4,289,000 in the fourth quarter of 2008, to \$4,879,000 in the fourth quarter of 2009. Royalty income increased by \$482,000 during the quarter as a result of the increase in gross sales for the reasons explained previously, and Make-whole Payments increased by \$108,000 due to the number of restaurants closed during the quarter (49 more closed weeks).

PARTNERSHIP EXPENSES

Expenses incurred by the Partnership for the three months ended December 31, 2009 were \$101,000 comprised entirely of general and administrative expenses of \$101,000. The decrease of \$2,000 over the comparable quarter in 2008 was due to a decrease in general and administrative expenses of \$3,000 and a decrease in other interest income of \$1,000. General and administrative expenses decreased primarily due to the timing of certain expenditures and other interest income decreased due to lower effective interest rates applied to the surplus cash balances on hand during the quarter.

KRL'S INTEREST

KRL's interest in the earnings of the Partnership from the Class A, entitled Class B, Class C and Class D Partnership units increased from \$2,045,000 for the three-month period ended December 31, 2008 to \$2,445,000 for the three-month period ended December 31, 2009. The increase of \$400,000 was partly due to the increase in Partnership earnings as a result of the increased royalty income. In addition, KRL's average effective ownership interest in the Partnership increased from 24.26% during the three-month period ended December 31, 2008, to 29.64% during the three-month period ended December 31, 2009. The change in the average effective ownership of the Partnership during the period was a result of the Additional Entitlement received by KRL on January 1, 2009.

EQUITY INCOME

The Fund's equity income from its investment in the Partnership increased from \$2,141,000 during the fourth quarter of 2008, to \$2,333,000 during the fourth quarter of 2009. The increase of \$192,000 is due to the net impact of the increase in royalty income of \$590,000, the decrease in Partnership expenses of \$2,000, and the increase in KRL's interest in the earnings of the Partnership of \$400,000.

INTEREST INCOME

Interest income earned by the Fund for the quarter was \$1,078,000 comprised entirely of interest income on the Keg Loan of \$1,078,000. Interest income earned by the Fund on the Keg Loan increased by \$3,000 during the quarter, as it is calculated based on 92 days of a 365 day year, whereas in the comparable quarter of the prior year, interest income was calculated based on 92 days of a 366 day year, as 2008 was a leap year. Other interest income decreased by \$8,000 due to lower effective interest rates applied to the surplus cash balances on hand during the quarter.

INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Fund were \$151,000 for the three months ended December 31, 2009, and included interest on the long-term debt of \$141,000, amortization of deferred financing charges of \$10,000. Interest costs decreased by \$18,000 in the quarter as a result of a decrease in the average interest rate on the long-term debt from 4.50% in the fourth quarter of 2008, to 4.00% in the fourth quarter of 2009. Amortization of deferred financing charges increased by \$5,000 during the quarter.

EARNINGS BEFORE INCOME TAXES

Earnings before income taxes increased by \$200,000 from \$3,060,000 (31.5 cents/Fund unit) in the fourth quarter of 2008, to \$3,260,000 (33.6 cents/Fund unit) in the fourth quarter of 2009.

FUTURE INCOME TAXES

Future income taxes decreased by \$50,000 from a future income tax expense of \$200,000 for the three months ended December 31, 2008, to a future income tax expense of \$150,000 for the three months ended December 31, 2009. Future income tax is a non-cash expense or recovery which does not affect distributable cash.

NET EARNINGS AND COMPREHENSIVE INCOME

Net earnings increased by \$250,000 from \$2,860,000 (29.5 cents/Fund unit) in the fourth quarter of 2008, to \$3,110,000 (32.1 cents/Fund unit) in the fourth quarter of 2009, partly due to the increase in equity income discussed previously.

DISTRIBUTABLE CASH

Cash available for distribution to Fund unitholders increased by \$183,000 from \$2,999,000 (30.9 cents/Fund unit) to \$3,182,000 (32.8 cents/Fund unit) during the comparable quarter. The difference between the Fund's earnings and distributable cash is due to non-cash items such as amortization and future income taxes included in the Fund's net earnings, as well as changes in non-cash working capital balances.

DISTRIBUTIONS

Distributions of \$3,100,000 (32.0 cents/Fund unit) were paid in both the fourth quarter of 2008, and the fourth quarter of 2009.

YEAR

GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool increased from \$433,097,000 to \$454,898,000 for the year. The increase of \$21,801,000 or 5.0% reflects the addition of net new sales to the Royalty Pool at the beginning of the year, and the extra week of sales, net of the same store sales decreases discussed previously.

ROYALTY INCOME

Total royalty income earned by the Partnership increased by \$1,151,000 from \$17,494,000 in 2008, to \$18,645,000 in 2009. Royalty income increased by \$872,000 during the year as a result of the increase in gross sales for the reasons explained previously, and Make-whole Payments increased by \$279,000 due to the number of restaurants closed during the year (127 more closed weeks).

PARTNERSHIP EXPENSES

Expenses incurred by the Partnership for the year ended December 31, 2009 were \$397,000 and included general and administrative expenses of \$398,000, net of interest income on the surplus cash balances of \$1,000. The increase of \$21,000 over 2008 was due to an increase in general and administrative expenses of \$18,000 and a decrease in other interest income of \$3,000. The increase in general and administrative expenses was partly due to an increase in audit costs incurred as a result of the pending implementation of the International Financing Reporting Standards. Other interest income decreased due to lower effective interest rates applied to the surplus cash balances on hand during the year.

KRL'S INTEREST

KRL's interest in the earnings of the Partnership from the Class A, entitled Class B, Class C and Class D Partnership units increased from \$8,253,000 for the year ended December 31, 2008, to \$9,546,000 for the year ended December 31, 2009. The increase of \$1,293,000 was partly due to the increase in Partnership earnings as a result of the increased royalty income. In addition, KRL's average effective ownership interest in the Partnership increased from 24.26% during the year ended December 31, 2008, to 29.64% during the year ended December 31, 2009. The change in the average effective ownership of the Partnership during the period was a result of the Additional Entitlement received by KRL on January 1, 2009.

EQUITY INCOME

The Fund's equity income from its investment in the Partnership decreased from \$8,865,000 during 2008 to \$8,702,000 during 2009. The decrease of \$163,000 is due to the net impact of the increase in royalty income of \$1,151,000, the increase in Partnership expenses of \$21,000, and the increase in KRL's interest in the earnings of the Partnership of \$1,293,000.

INTEREST INCOME

Interest income earned by the Fund for the year was \$4,280,000 and included interest income on the Keg Loan of \$4,275,000, and other interest income of \$5,000. Interest income on the Keg Loan remained the same during the year. Other interest income decreased by \$39,000 due to lower effective interest rates applied to the surplus cash balances on hand during the year.

INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Fund were \$509,000 for the year ended December 31, 2009, and included interest on the long-term debt of \$479,000, amortization of deferred financing charges of \$25,000, and financing expenses of \$5,000. Interest costs decreased by \$268,000 during the year as a result of a reduction in the average interest rate on the long-term debt from 5.32% in 2008, to 3.42% in 2009. Amortization of deferred financing charges increased by \$6,000 during the year. Financing expenses of \$5,000 were incurred during the third quarter of the current year as a result of the refinancing of the term loan on August 12, 2009. See “Liquidity & Capital Resources – Term Loan”.

EARNINGS BEFORE INCOME TAXES

Earnings before income taxes increased by \$55,000 from \$12,418,000 (\$1.280/Fund unit) in 2008, to \$12,473,000 (\$1.285/Fund unit) in 2009.

FUTURE INCOME TAXES

Future income taxes increased by \$25,000 from a future income tax expense of \$50,000 for the year ended December 31, 2008 to a future income tax expense of \$75,000 for the year ended December 31, 2009. Future income tax is a non-cash expense or recovery which does not affect distributable cash.

NET EARNINGS AND COMPREHENSIVE INCOME

Net earnings increased by \$30,000 from \$12,368,000 (\$1.275/Fund unit) in 2008, to \$12,398,000 (\$1.278/Fund unit) in 2009, partly due to the decrease in interest and financing expenses discussed previously.

DISTRIBUTABLE CASH

Cash available for distribution to Fund unitholders increased by \$119,000 from \$12,382,000 (\$1.276/Fund unit) to \$12,501,000 (\$1.288/Fund unit) during the year. The difference between the Fund’s earnings and distributable cash is due to the non-cash items such as amortization and future income taxes included in the Fund’s net earnings, as well as changes in non-cash working capital balances.

DISTRIBUTIONS

Distributions of \$12,343,000 (\$1.272/Fund unit) were paid in 2008 and \$12,401,000 (\$1.278 Fund/unit) in 2009.

LIQUIDITY & CAPITAL RESOURCES

It is the Fund’s policy to distribute all available cash on a monthly basis in order to provide consistent returns to unitholders and to maximize those returns. Any increase in distributions in the future will be implemented in such a manner so as to maintain uniform monthly distributions. The Fund has cash on hand of \$1,379,000 and a positive working capital balance of \$1,697,000 as at December 31, 2009.

TERM LOAN

The Keg Holdings Trust (“KHT”), a subsidiary of the Fund, has a \$14 million non-revolving term loan facility, which bears interest at bank prime plus 1.75% per annum. The facility was originally arranged during the IPO to partially finance the purchase of the Keg Rights from KRL, and to provide term debt as part of the capital structure. On August 12, 2009, this facility was refinanced, and the maturity date extended to October 31, 2011. The term loan held by KHT is subject to certain financial covenants, including minimum equity amounts in both KHT and the Partnership, and a minimum Partnership cash flow level defined as earnings before interest, taxes, depreciation and amortization (“EBITDA”). As at December 31, 2009, the KHT and Partnership equity amounts are approximately \$6.3 million and \$18.0 million in excess of the required minimum equity covenants, respectively. The Partnership EBITDA for the year ended December 31, 2009 (last four financial quarters) is approximately \$3.0 million greater than the required minimum amount.

OPERATING LINE OF CREDIT

The Partnership, a subsidiary of the Fund, has a \$1 million operating line of credit, which bears interest at bank prime plus 1.50% per annum. This facility is used primarily to bridge timing differences between the receipt of the royalty payments and distributions on the Partnership securities. This operating line is also available for general working capital purposes or, if required, to help finance periodic differences between receipt of the royalty payment, (which may vary due to small seasonal variations in the gross sales of those restaurants in the Royalty Pool), and distributions to unitholders.

CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS

Disclosure controls and procedures are designed to provide reasonable assurance that relevant information is gathered and reported to Senior Management, including the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”) of The Keg GP Ltd., managing general partner of the Partnership and administrator of the Fund, on a timely basis so that the appropriate decisions can be made regarding public disclosure. As of December 31, 2009, an evaluation of the effectiveness of the Fund’s disclosure controls and procedures, as defined under Multilateral Instrument 52-109 (“MI 52-109”) issued by the Canadian Securities Administrators (“CSA”), was carried out under the supervision of and with the participation of management including the CEO and CFO. Based on the evaluation, the CEO and the CFO concluded that the design and operation of these disclosure controls and procedures were effective.

INTERNAL CONTROL OVER FINANCIAL REPORTING

The Keg GP Ltd., as administrator of the Fund, is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined by the CSA. The CEO and CFO of The Keg GP Ltd. have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Fund’s financial reporting and the preparation of its financial statements for external purposes in accordance with GAAP.

The Fund’s internal control over financial reporting may not prevent or detect all misstatements because of inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

INTERNAL CONTROL OVER FINANCIAL REPORTING (CONTINUED)

The administrator of the Fund assessed the effectiveness of the Fund's internal control over financial reporting as of December 31, 2009, based on the framework established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this assessment, the administrator concluded that the Fund maintained effective internal control over financial reporting as of December 31, 2009.

During the year ended December 31, 2009, there has been no change in the Fund's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Fund's internal control over financial reporting.

CRITICAL ACCOUNTING ESTIMATES

The Fund's only critical accounting estimate is the valuation of its investment in the Partnership. As the Partnership's only significant assets are intangible assets consisting of the Keg Rights, the valuation of the Fund's investment is based primarily upon the valuation of intangible assets in the Partnership. The Keg Rights are not amortized as they have an indefinite life. The Keg GP Ltd., as the general partner of the Partnership and administrator of the Fund, reviews the carrying values of the intangible assets in the Partnership and the Fund's investment at least annually, taking into consideration any events or circumstances which may have impaired the carrying values of these items. If permanent declines in the carrying amounts are determined, these items are written down to their estimated net recoverable amount. The Keg GP Ltd. believes that there have been no declines in either the carrying value of the intangible assets in the Partnership or in the carrying value of the Fund's investment in the Partnership as of December 31, 2009.

NEW ACCOUNTING STANDARDS AND ACCOUNTING POLICY CHANGES

Effective January 1, 2009, the Fund has adopted the following new accounting standards that were issued by the Canadian Institute of Chartered Accountants (“CICA”):

GOODWILL AND INTANGIBLE ASSETS

In February 2008, the CICA issued Handbook Section 3064, *Goodwill and Intangible Assets*, which supersedes Section 3062, *Goodwill and Other Intangible Assets* and Section 3450, *Research and Development Costs*. Section 3064 provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the asset definition. The adoption of this new standard has had no impact on the Fund's financial statements.

FUTURE CHANGES IN ACCOUNTING POLICY

INTERNATIONAL FINANCIAL REPORTING STANDARDS

The CICA plans to converge Canadian GAAP for public companies with International Financial Reporting Standards (“IFRS”) commencing with fiscal years beginning on or after January 1, 2011. This will result in the Fund having to report under IFRS commencing with its fiscal year ended December 31, 2011. The Trustees of the Fund are currently evaluating the impact of IFRS on the Fund's financial statements and disclosures. While the effects of IFRS have not fully been determined, the Trustees have identified the key areas expected to be impacted to be the accounting treatment for the Fund's interest in the Partnership, the classification of unitholders' equity, whether a derivative exists in the note receivable from KRL and the method of calculation of future income taxes.

FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash, amounts due from KRL and the Partnership, note receivable from KRL, interest payable on the term loan, distributions payable to Fund unitholders, and the term loan. The requirement for the Fund to settle its note receivable from KRL in exchange for Class C Partnership units is classified as a derivative instrument. The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature. The fair values of the amounts due from KRL and the Partnership, interest payable on the term loan and the distributions payable to Fund unitholders approximate their carrying amounts, largely due to the short-term maturities of these instruments. The fair value of the term loan is not materially different from its carrying value as the variable rate of interest on the facility would not be significantly different from the current market rate of interest due to the considerable security held by the banking syndicate.

SUBSEQUENT EVENTS

On January 1, 2010, six new Keg restaurants that opened during the period from October 3, 2008 through October 2, 2009 were added to the Royalty Pool. The gross sales of these six new restaurants have been estimated at \$25.5 million annually. Six permanently closed Keg restaurants with annual sales of \$17.1 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$8.4 million annually. The total number of restaurants in the Royalty Pool will remain the same at 102. The yield of the Fund units was determined to be 13.97% calculated using a weighted average unit price of \$9.15.

As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 242,070 Fund units, being 1.73% of the Fund units on a fully diluted basis. On January 1, 2010, KRL received 80% of this entitlement representing the equivalent of 193,656 Fund units, being 1.38% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of the Additional Entitlement described above, KRL will have the right to exchange its units in the capital of the Partnership for 4,280,891 Fund units representing 30.61% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2010 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2010, it would have the right to exchange its Partnership units for 4,329,305 Fund units representing 30.85% of the Fund units on a fully diluted basis.

OUTLOOK

The Canadian Restaurant Foodservice Association (CRFA) has projected an increase in sales in the full-service restaurant category, the category in which The Keg operates, of 3.0% in 2010. The National Restaurant Association in the United States has projected a real sales increase of 1.2% in the full service category in 2010. While management of KRL expects limited improvement in economic conditions in North America in the near term, management believes that The Keg will continue to outperform the full-service restaurant category with respect to same store sales growth. Management of KRL continues to monitor the global economy and evaluate its potential impact on the North American business environment, particularly the effect on consumer confidence and discretionary spending.

Management of KRL has advised the Trustees that it intends to continue to focus on growing same store sales and to continue to expand the number of corporate and franchised restaurants in Canada and the United States. KRL management has also advised the Trustees that it believes that the strong same store sales growth KRL has delivered in the past will continue to be realized over the long term through a combination of increased guest counts and increased guest average cheque.

OUTLOOK (CONTINUED)

Advertising and promotions programs will continue to focus on food taste, quality and excellent service in a friendly atmosphere. Management of KRL has further advised the Trustees that it believes that continued Canadian market expansion will be leveraged by KRL's leading market position and national presence. Corporate market expansion in the United States will continue to focus on three target markets, specifically: Phoenix, Arizona; Denver, Colorado; and Dallas, Texas. KRL management has advised the Trustees that it intends to aggressively pursue franchising opportunities in the United States.

KRL continues to refurbish, and in some cases, relocate existing Keg restaurants in order to better serve its guests and to protect and enhance the strong leadership position The Keg brand has enjoyed for over thirty-eight years. Management of KRL has advised the Trustees that it has revised the number of restaurants it expects to open prior to October 2, 2010, primarily due to general economic conditions. Management of KRL has advised that it currently expects to open two restaurants, consisting of one new corporate restaurant in Canada, as well as one franchised restaurant in the United States. In addition management of KRL expect to relocate two corporate and one franchised restaurant in Canada during the same period. Management of KRL continues to monitor economic conditions and intends to regularly review the timing of its scheduled restaurant openings and adjust these as necessary.

RISKS AND UNCERTAINTIES

The Fund continues to recognize certain risks and uncertainties associated with the ordinary course of business, including those associated with the business and operations of KRL, upon which the Fund relies solely for its income.

THE RESTAURANT INDUSTRY

The performance of the Fund is directly dependent upon the royalty and interest payments received from KRL. The amount of the royalty is dependent upon restaurant sales, which is subject to a number of factors that affect the restaurant industry generally and the casual dining segment of the industry in particular. The casual dining segment of the restaurant industry is intensely competitive with respect to price, service, location and food quality. There are many well-established competitors, particularly in the United States, with substantially greater financial and other resources than KRL. Competitors include national and regional chains, as well as individually owned restaurants. Recently, competition has increased in the mid-price, full-service, casual dining segment in which Keg restaurants operate. If KRL and the Keg franchisees are unable to successfully compete in the casual dining segment of the restaurant industry, sales may be adversely affected, the amount of the royalty reduced and the ability of KRL to pay the royalty or interest on the Keg Loan may be impaired. The restaurant business is also affected by changes in demographic trends, traffic patterns, and the type, number, and location of competing restaurants.

In addition, factors such as inflation; increased food; labour and benefits costs; government regulations; smoking by-laws; and the availability of experienced management and hourly employees may adversely affect the restaurant industry in general, and therefore potentially KRL and its franchisees. Changing consumer preferences, discretionary spending patterns and factors affecting the availability of beef could force KRL to modify its restaurant content and menu, and could result in a reduction of restaurant sales. Accordingly, this could impact the amount of the royalty and financial condition of KRL. Consumer preferences could be affected by health concerns about the consumption of beef, the primary item served at Keg restaurants, and specific events such as the outbreak of "mad cow disease" could reduce the available supply of beef or significantly raise the price of beef. KRL's success also depends on numerous factors affecting discretionary consumer spending including economic conditions, disposable consumer income and consumer confidence. Adverse changes in these factors could reduce guest traffic or impose practical limits on pricing, either of which could reduce restaurant sales and operating income, which could adversely affect the royalty and the ability of KRL to pay the royalty, the make-whole payment or interest on the Keg Loan.

AVAILABILITY AND QUALITY OF RAW MATERIALS

Management of KRL has advised the Trustees that it continues to monitor the situation regarding the cases of BSE found in North America during the past several years. The widespread testing of herds confirms these are isolated cases; the risk to human health appears to be negligible. Most importantly to The Keg, there has been no significant negative consumer reaction to beef in North America and there has not been a material impact on its restaurant traffic. KRL management has further advised the Trustees that KRL has maintained an uninterrupted supply of quality beef that meets its demanding specifications despite the border closures and the unfortunate impact on cattle producers. Management of KRL has advised the Trustees that it expects the demand for beef to remain strong among consumers and its supply to continue uninterrupted.

FLUCTUATIONS IN FOREIGN EXCHANGE RATES

KRL presently has 16 restaurants located in the United States, 15 of which are corporately owned through its wholly owned subsidiaries, and one of which is franchised. Keg restaurants located in the United States generate sales in United States dollars, which must be translated into their Canadian dollar equivalent for Fund reporting purposes. Fluctuations in foreign exchange rates will affect the Canadian dollar equivalent of the sales of the restaurants located in the United States, which will affect the amount of the royalty.

FORWARD LOOKING INFORMATION

The information provided in this report includes forward-looking statements with respect to business plans, activities and events anticipated by the Fund and the Fund's future results. Although the Fund believes the assumptions underlying such statements to be reasonable, any of the assumptions may prove to be inaccurate and, as a result, the forward-looking information may prove to be incorrect. The forward-looking information contained in this document is current only as of 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

Additional information about the Fund including the Fund's most recent annual information form is available on SEDAR at www.sedar.com.

UNITHOLDER INFORMATION

CORPORATE HEAD OFFICE

The Keg Royalties Income Fund
10100 Shellbridge Way
Richmond, BC V6X 2W7

BOARD OF TRUSTEES

C. C. Woodward
George Killy
George Tidball

BOARD OF DIRECTORS AND OFFICERS OF THE KEG GP LTD., THE GENERAL PARTNER OF THE KEG RIGHTS LIMITED PARTNERSHIP

C. C. Woodward*
Chairman and Director
David Aisenstat
President and Director
Neil Maclean
Secretary, Treasurer and Director
George Killy*
Director
George Tidball*
Director

* Audit Committee and Governance Committee Member

REGISTRAR AND TRANSFER AGENT

Computershare Trust Company of Canada

STOCK EXCHANGE LISTING

Toronto Stock Exchange: KEG.UN

INVESTOR ENQUIRIES

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THE KEG ROYALTIES INCOME FUND

CONSOLIDATED
FINANCIAL STATEMENTS
For the years ended December 31, 2009 and 2008

MANAGEMENT'S STATEMENT OF RESPONSIBILITIES

The accompanying consolidated financial statements are the responsibility of management and have been reviewed and approved by the Board of Directors and the Trustees. The consolidated financial statements have been prepared by management, in accordance with Canadian generally accepted accounting principles and, where appropriate, reflect management's best estimates and judgements. Management has also prepared financial and all other information in the annual report and has ensured that this information is consistent with the consolidated financial statements.

The Fund maintains appropriate systems of internal control, policies and procedures, which provide management with reasonable assurance that assets are safeguarded and the financial records are reliable and form a proper basis for preparation of financial statements.

The Board of Directors and the Trustees ensure that management fulfills its responsibilities for financial reporting and internal control through an Audit Committee. The committee reviews the consolidated financial statements and reports to the Trustees. The auditors have full and direct access to the Audit Committee.

The consolidated financial statements have been independently audited by KPMG LLP, in accordance with Canadian generally accepted accounting standards. Their report following this statement expresses their opinion on the consolidated financial statements of the Fund.

(signed) C.C. Woodward

Chairman, The Keg Royalties Income Fund
on behalf of the Board of Trustees

February 19, 2010

AUDITORS' REPORT TO THE UNITHOLDERS OF THE KEG ROYALTIES INCOME FUND

We have audited the consolidated balance sheets of The Keg Royalties Income Fund as at December 31, 2009 and 2008 and the consolidated statements of earnings and comprehensive income, retained earnings (deficit) and cash flows for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

A handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, slightly slanted style. Below the signature is a single horizontal line that starts under the 'K' and extends past the 'P'.

Chartered Accountants

Vancouver, Canada

February 19, 2010

CONSOLIDATED BALANCE SHEETS

(Expressed in thousands of dollars)

	December 31, <u>2009</u>	December 31, <u>2008</u>
ASSETS		
Current assets:		
Cash	\$ 1,379	\$ 1,337
Due from Keg Restaurants Ltd. (note 7)	363	362
Due from The Keg Rights Limited Partnership (note 8)	<u>1,036</u>	<u>1,075</u>
	2,778	2,774
Note receivable from Keg Restaurants Ltd. (note 9)	57,000	57,000
Investment in The Keg Rights Limited Partnership (note 4)	<u>56,586</u>	<u>56,553</u>
	<u>\$ 116,364</u>	<u>\$ 116,327</u>
LIABILITIES AND UNITHOLDERS' EQUITY		
Current liabilities:		
Interest payable on term loan	\$ 48	\$ 49
Distributions payable to Fund unitholders	<u>1,033</u>	<u>1,033</u>
	1,081	1,082
Term loan, net of deferred financing charges (note 10)	13,924	13,958
Future income taxes (note 11)	1,875	1,800
Unitholders' equity:		
Capital contributions (note 12)	100,014	100,014
Deficit	<u>(530)</u>	<u>(527)</u>
	<u>99,484</u>	<u>99,487</u>
	<u>\$ 116,364</u>	<u>\$ 116,327</u>

See accompanying notes to consolidated financial statements.

Subsequent event (note 19)

Approved on behalf of the Board of Trustees

"C.C. Woodward"
C.C. Woodward, Trustee

"George Tidball"
George Tidball, Trustee

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

(Expressed in thousands of dollars, except unit and per unit amounts)

	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
Revenue:		
Equity income (note 4)	\$ 8,702	\$ 8,865
Interest income	<u>4,280</u>	<u>4,319</u>
	12,982	13,184
Expenses:		
Interest and financing fees	(484)	(747)
Amortization of deferred financing charges	<u>(25)</u>	<u>(19)</u>
	<u>(509)</u>	<u>(766)</u>
Earnings before income taxes	12,473	12,418
Future income tax expense (note 11)	<u>(75)</u>	<u>(50)</u>
Net earnings and comprehensive income for the year	<u>\$ 12,398</u>	<u>\$ 12,368</u>
Weighted average units outstanding (note 12)	<u>9,703,500</u>	<u>9,703,500</u>
Basic and diluted earnings per unit	<u>\$ 1.28</u>	<u>\$ 1.27</u>

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS (DEFICIT)

(Expressed in thousands of dollars)

	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
Deficit, beginning of year	\$ (527)	\$ (523)
Net earnings	12,398	12,368
Distributions declared to Fund unitholders	<u>(12,401)</u>	<u>(12,372)</u>
Deficit, end of year	<u>\$ (530)</u>	<u>\$ (527)</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars)

	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
Cash provided by (used for):		
OPERATIONS:		
Net earnings for the year	\$ 12,398	\$ 12,368
Items not involving cash:		
Amortization of deferred financing charges	25	19
Equity income (note 4)	(8,702)	(8,865)
Future income tax expense (note 11)	75	50
Distributions from The Keg Rights Limited Partnership (note 4).....	8,668	8,815
Change in non-cash operating working capital (note 18(a))	<u>37</u>	<u>(5)</u>
	12,501	12,382
FINANCING:		
Distributions paid to Fund unitholders	(12,401)	(12,343)
Deferred financing charges	<u>(58)</u>	<u>-</u>
	<u>(12,459)</u>	<u>(12,343)</u>
Increase in cash.....	42	39
Cash, beginning of year	<u>1,337</u>	<u>1,298</u>
Cash, end of year	<u>\$ 1,379</u>	<u>\$ 1,337</u>

See note 18(b) for supplementary cash flow information.

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

1. ORGANIZATION AND NATURE OF BUSINESS:

The Keg Royalties Income Fund (the “Fund”) is an unincorporated open-ended limited purpose trust established under the laws of Ontario with the authority to issue an unlimited number of trust units. The Fund was established to invest in The Keg Rights Limited Partnership (the “Partnership”), which owns the trademarks, trade names, operating procedures and systems and other intellectual property (collectively, the “Keg Rights”) used in connection with the operation of Keg steakhouse restaurants and bars. Pursuant to the declaration of trust of the Fund, an amount equal to all income of the Fund, together with the non-taxable portion of any net capital gain realized by the Fund, will be distributed by the Fund to its unitholders each year. As a result, the Fund is not currently liable for income taxes (note 11). Income tax obligations related to the distributions by the Fund are currently obligations of the unitholders.

The business of the Partnership is the ownership of the Keg Rights and through a Licence and Royalty Agreement (the “Licence and Royalty Agreement”) with Keg Restaurants Ltd. (“KRL”) to exploit the use of the Keg Rights and the collection of the royalty payable under the Licence and Royalty Agreement. KRL’s principal activity is the operation and franchising of Keg steakhouse restaurants and bars in Canada and the United States.

2. NEW ACCOUNTING STANDARDS AND ACCOUNTING POLICIES:

- (a) Effective January 1, 2009, the Fund has adopted the following new accounting standards that were issued by the Canadian Institute of Chartered Accountants (“CICA”):

Goodwill and Intangible Assets:

In February 2008, the CICA issued Handbook Section 3064, *Goodwill and Intangible Assets*, which supersedes Section 3062, *Goodwill and Other Intangible Assets* and Section 3450, *Research and Development Costs*. Section 3064 provides additional guidance on when expenditures qualify for recognition as intangible assets and requires that costs be deferred only when relating to an item meeting the asset definition. The adoption of this new standard has had no impact on the Fund’s financial statements.

- (a) *International Financial Reporting Standards:*

The CICA plans to converge Canadian GAAP for public companies with International Financial Reporting Standards (“IFRS”) commencing with fiscal years beginning on or after January 1, 2011. This will result in the Fund having to report under IFRS commencing with its fiscal year ended December 31, 2011. The Trustees of the Fund are currently evaluating the impact of IFRS on the Fund’s financial statements and disclosures. While the effects of IFRS have not fully been determined, the Trustees have identified the key areas expected to be impacted to be the accounting treatment for the Fund’s interest in the Partnership, the classification of unitholders’ equity, whether a derivative exists in the note receivable from KRL and the method of calculation of future income taxes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

3. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of presentation:

These consolidated financial statements include the accounts of the Fund, its wholly-owned subsidiary The Keg Holdings Trust (“KHT”) and its 90% owned subsidiary The Keg GP Ltd. (“KGP”) (collectively, the “Companies”). KGP is the managing general partner of the Partnership. All residual ownership of the Companies is either directly or indirectly controlled by KRL.

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

All significant intercompany transactions have been eliminated.

(b) Revenue recognition:

Interest income is recognized and accrued for when earned.

(c) Investment in The Keg Rights Limited Partnership:

The investment in the Partnership is accounted for using the equity method. Under the equity method, the original cost of the investment is adjusted for KHT’s share of post-acquisition earnings or losses and is reduced for distributions or advances received. The statement of earnings includes the Fund’s share of the Partnership’s earnings or losses for the year. The investment in the Partnership is also adjusted to record the entitled Class B and Class D units exchanged by KRL for Fund units. These Fund units are recorded at their fair value at the date they are issued.

(d) Distributions to Fund unitholders:

The amount of cash to be distributed to Fund unitholders is determined with reference to net earnings adjusted for amortization, other non-cash items and repayment of principal on term loans, if required.

Distributions to Fund unitholders are made monthly, based upon available cash less cash redemptions of Fund units, and are subject to the Fund retaining such reasonable working capital reserves as may be considered appropriate by the Trustees of the Fund.

(e) Income taxes:

KRL uses the asset and liability method of accounting for future tax assets and liabilities and recognizes the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Where it is considered to be more likely than not that the future income tax assets will not be realized, a valuation allowance is provided for the difference.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(f) Earnings per unit:

The earnings per unit calculations are based on the weighted average number of Fund and exchangeable units outstanding during the period (note 12).

(g) Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the valuation of the Fund's investment in the Partnership. Actual results could differ from those estimates.

(h) Economic dependence:

The Fund is entirely dependent upon the operations and assets of KRL to pay the royalty and make-whole payments to the Partnership and the interest payments to the Fund. Accordingly, it is subject to the risks encountered by KRL in the operation of its business.

4. EQUITY INVESTMENT:

	December 31, <u>2009</u>	December 31, <u>2008</u>
Investment in the Partnership, at cost	\$ 56,669	\$ 56,669
Accumulated equity earnings less distributions received, beginning of period	(117)	(166)
Equity income in the Partnership	8,702	8,865
Distributions from the Partnership	<u>(8,668)</u>	<u>(8,815)</u>
Equity investment in the Partnership	<u>\$ 56,586</u>	<u>\$ 56,553</u>

The Fund, through its ownership of The Keg Holdings Trust ("KHT"), holds all of the issued and outstanding Limited Partnership units ("LP units"), 1,550,000 Class B units and 99% of the General Partnership units ("GP units") of the Partnership through its 90% interest in KGP.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

4. EQUITY INVESTMENT (CONTINUED):

Summarized financial information of the Partnership is as follows:

	December 31, <u>2009</u>	December 31, <u>2008</u>
Current assets	\$ 2,360	\$ 2,121
Long-term assets, being Keg Rights	<u>151,198</u>	<u>141,671</u>
Total assets	<u>\$ 153,558</u>	<u>\$ 143,792</u>
Current liabilities	\$ 2,410	\$ 2,224
Partners' equity	<u>151,148</u>	<u>141,568</u>
Total liabilities and equity	<u>\$ 153,558</u>	<u>\$ 143,792</u>
	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
System sales reported by Keg restaurants in the Royalty Pool	<u>\$ 454,898</u>	<u>\$ 433,097</u>
Royalty income at 4% of system sales reported above	\$ 18,196	\$ 17,324
Make-whole payment, based on 4% of lost system sales	<u>449</u>	<u>170</u>
Total royalty income	18,645	17,494
Expenses	<u>(397)</u>	<u>(376)</u>
Net earnings of the Partnership for the period	18,248	17,118
KRL's interest in the net earnings of the Partnership.....	<u>(9,546)</u>	<u>(8,253)</u>
Equity income for the period	<u>\$ 8,702</u>	<u>\$ 8,865</u>

5. ROYALTY POOL:

Annually, on January 1, the Keg restaurants on which KRL pays a royalty to the Partnership (the "Royalty Pool") is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2 of the prior year, less gross sales from any Keg restaurants that have permanently closed during the preceding calendar year. In return for adding these net sales to the Royalty Pool, KRL receives the right to indirectly acquire additional Fund units (the "Additional Entitlement"). The Additional Entitlement is determined based on 92.5% of the estimated royalty revenue added to the Royalty Pool, divided by the yield of the Fund units. KRL receives 80% of the estimated Additional Entitlement initially, with the balance received on December 31 of each year when the actual full year performance of the new restaurants is known with certainty.

The gross sales reported by the 102 Keg restaurants on which KRL pays a royalty to the Partnership (the "Royalty Pool") are from January 1 to December 31, 2009 (January 1 to December 31, 2008 – 96 Keg restaurants).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the years ended December 31, 2009 and 2008

5. ROYALTY POOL (CONTINUED):

The royalty payment from KRL to the Partnership is four percent of system sales for such period reported by Keg restaurants in the Royalty Pool plus a make-whole payment, if required by a restaurant closure, based on four percent of lost system sales. System sales for any period and for any Keg restaurant located in Canada and the United States, as defined in the Licence and Royalty Agreement, means the gross sales by such Keg restaurants for such period. The make-whole payment is based on five restaurant closures for the period from January 1 to December 31, 2009 (January 1 to December 31, 2008 – two restaurant closures).

On January 1, 2009, eight new Keg restaurants that opened during the period from October 3, 2007 to October 2, 2008 were added to the Royalty Pool. The gross sales of these eight new restaurants were \$39.3 million. Two permanently closed Keg restaurants with annual sales of \$4.7 million have been removed from the Royalty Pool, resulting in a net increase in Royalty Pool sales of \$34.6 million. The yield of the Fund Units was determined to be 12.93% calculated using a weighted average unit price of \$9.73.

As a result of the contribution of the additional net sales to the Royalty Pool, KRL's Additional Entitlement is equivalent to 979,094 Fund units, being 7.10% of the Fund units on a fully diluted basis. On January 1, 2009, KRL received the initial estimated 80% of this entitlement representing the equivalent of 815,258 Fund units, being 5.98% of the Fund units on a fully diluted basis. On December 31, 2009, the performance of the new restaurants was confirmed and the Additional Entitlement adjusted to be effective as of January 1, 2009. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 4,087,235 Fund units, representing 29.64% of the Fund units on a fully diluted basis.

6. UNITHOLDER DISTRIBUTIONS:

	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
Distributions declared to Fund unitholders	\$ <u>12,401</u>	\$ <u>12,372</u>
Weighted average Fund units outstanding (note 12)	<u>9,703,500</u>	<u>9,703,500</u>
Distributions declared per unit	\$ <u>1.28</u>	\$ <u>1.28</u>

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the second and third quarters and four distributions in the fourth quarter. This is done to ensure that the distribution based on December KRL Royalty Pool system sales, which is paid the following month in January, is recorded in the period it was earned for income tax purposes. The determination to declare and make payable distributions from the Fund are at the discretion of the board of Trustees of the Fund and until declared payable, the Fund has no requirement to pay cash distributions to Fund unitholders.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

7. DUE FROM KEG RESTAURANTS LTD.:

	December 31, <u>2009</u>	December 31, <u>2008</u>
Interest on note receivable from Keg Restaurants Ltd.	\$ <u>363</u>	\$ <u>362</u>

The above amounts were received when due from KRL subsequent to the end of the above periods to facilitate the following month's distribution to Fund unitholders.

8. DUE FROM THE KEG RIGHTS LIMITED PARTNERSHIP:

The amounts due from the Partnership are working capital items owing to the Fund or its subsidiaries and are in the normal course of operations. Included in the amount due from the Partnership at December 31, 2009 is \$1,022,000 in distributions declared to KHT which are payable in January 2010 (December 31, 2008 - \$912,358).

9. NOTE RECEIVABLE FROM KEG RESTAURANTS LTD.:

	December 31, <u>2009</u>	December 31, <u>2008</u>
Note receivable with interest payable monthly at 7.5% per annum and principal amount due May 31, 2042	\$ <u>57,000</u>	\$ <u>57,000</u>

The note is secured by a general security agreement and may not be assigned without the prior consent of KRL.

KRL, the holder of the Class C units, has the right to transfer Class C units to KHT, in consideration for the assumption by KHT of an amount of the note receivable from KRL equal to \$10.00 per Class C unit transferred. The Class C units are entitled to a preferential monthly distribution equal to \$0.0625 per Class C unit issued and outstanding.

10. TERM LOAN:

On August 12, 2009, the Fund amended the terms of its \$14,000,000 term loan with its existing banking syndicate. The amended facility has an extension of the facility maturity date to October 31, 2011, bears interest at prime plus 1.75% and is secured by a general security agreement over the assets of the Fund. In accordance with CICA Handbook Section 3855, *Financial Instruments – Recognition and Measurement*, the amendment was considered a modification of debt. As a result, the \$58,443 in deferred financing fees incurred on the amendment have been added to the \$29,678 unamortized balance of deferred financing fees associated with the previous facility.

The term loan is presented net of \$75,657 in deferred financing charges at December 31, 2009 (\$42,174 – December 31, 2008).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

11. INCOME TAXES:

On June 12, 2007, the Canadian federal government's legislation to tax publicly traded income trusts passed third reading in the House of Commons and thus the associated income tax became substantively enacted for accounting purposes. The legislation imposes a tax of 29.5% on distributions from Canadian public income trusts. The new tax is not expected to apply to the Fund until January 1, 2011 as a transition period applies to publicly traded trusts that existed prior to November 1, 2006. This rate was subsequently reduced to 28.0% for 2012 and later taxation years. Historically, the Fund had been exempt from recognizing future income tax assets and liabilities associated with temporary differences arising in the Fund and its equity accounted investment, The Keg Rights Limited Partnership. As a result of the substantive enactment of the new tax legislation, the Fund has recognized future income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. Future income tax expense is a non-cash item that does not affect cash flow.

Income tax expense as reported differs from the amount that would be computed by applying the combined Federal and Provincial statutory income tax rates to the earnings before income taxes. The reason for the difference is as follows:

	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
Earnings before income taxes	\$ 12,473	\$ 12,148
Combined Canadian federal and provincial rates	<u>32.0%</u>	<u>33.00%</u>
Computed "expected" tax expense	3,991	4,009
Increased (reduced) by:		
Current year's earnings not taxable.....	(3,991)	(4,009)
Recognition of future tax liability for enacted changes in tax laws and rates ..	<u>75</u>	<u>50</u>
Total income tax expense per the statement of operations	<u>\$ 75</u>	<u>\$ 50</u>

The tax effect of the temporary difference that gives rise to the future tax liability is as follows:

	December 31, <u>2009</u>	December 31, <u>2008</u>
Future tax liabilities:		
Investment in The Keg Rights Limited Partnership	<u>\$ (1,875)</u>	<u>\$ (1,800)</u>
Net future tax liability	<u>\$ (1,875)</u>	<u>\$ (1,800)</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit amounts)

For the years ended December 31, 2009 and 2008

12. UNITHOLDERS' EQUITY:

	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
Fund units issued and outstanding, opening balance	9,703,500	9,703,500
Issuance of Fund units in exchange for additional interest in the Partnership	<u>-</u>	<u>-</u>
Fund units issued and outstanding, ending balance	<u>9,703,500</u>	<u>9,703,500</u>
Weighted average Fund units issued and outstanding	<u>9,703,500</u>	<u>9,703,500</u>

On May 31, 2002, the Fund issued 8,153,500 Fund units at \$10.00 per unit pursuant to a public underwriting. Expenses of the offering amounted to \$2,150,000 and were charged to unitholders' equity.

On July 4, 2005, the Fund issued 250,000 Fund units to KRL in exchange for 250,000 Class B units. The fair value of these units was approximately \$13.25 which resulted in an additional \$3,312,500 recorded as unitholders' equity. Thereafter, on July 6, 2005, KRL sold these 250,000 Fund units through the facilities of the Toronto Stock Exchange.

On March 9, 2006, the Fund issued 650,000 Fund units to KRL in exchange for 650,000 Class B units. The fair value of these units was approximately \$12.69 which resulted in an additional \$8,248,500 recorded as unitholders' equity. Thereafter, on March 14, 2006, KRL sold these 650,000 Fund units through the facilities of the Toronto Stock Exchange.

On February 22, 2007, the Fund issued 650,000 Fund units to KRL in exchange for 650,000 Class B units. The fair value of these units was approximately \$13.95 which resulted in an additional \$9,067,500 recorded as unitholders' equity. Thereafter, on February 23, 2007, KRL sold these 650,000 Fund units through the facilities of the Toronto Stock Exchange.

The declaration of trust of the Fund provides that an unlimited number of Fund units may be issued. Each Fund unit is transferable and represents an equal undivided beneficial interest in any distributions of the Fund and in the net assets of the Fund. All units have equal rights and privileges. Each Fund unit entitles the holder thereof to participate equally in the allocations and distributions and to one vote at all meetings of Fund unitholders for each whole Fund unit held. The Fund units issued are not subject to future calls or assessments.

Fund units are redeemable at any time at the option of the holder at a price based on market value as defined in the trust agreement, subject to a maximum of \$50,000 in cash redemptions by the Fund in any one month. The limitation may be waived at the discretion of the Trustees of the Fund. Redemption in excess of these amounts, assuming no waiving of the limitation, shall be paid by way of a pro-rata distribution of Partnership securities held by the Fund.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except unit amounts)

For the years ended December 31, 2009 and 2008

13. EXCHANGEABLE UNITS:

In return for adding net sales to the Royalty Pool, KRL has received the following Partnership units that are exchangeable into Fund units:

	December 31, <u>2009</u>	December 31, <u>2008</u>
Class A Partnership units (a)	905,944	905,944
Class B Partnership units (b)	1,826,700	1,826,700
Class D Partnership units (c)	<u>1,354,591</u>	<u>375,497</u>
	<u>4,087,235</u>	<u>3,108,141</u>

Pursuant to the declaration of trust, the holders (other than the Fund or its subsidiaries) of the Class A units and Class B units of the Partnership are entitled to vote in all votes of Fund unitholders as if they were holders of the number of Fund units they would receive if Class A units and entitled Class B units were exchanged into Fund units as of the record date of such votes, and will be treated in all respects as Fund unitholders for the purpose of any such votes.

- (a) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C Partnership units (“Class C units”) , multiplied by the number of Class A units divided by the number of LP Partnership units (“LP units”) issued and outstanding. KHT holds all of the 8,153,500 LP units issued and outstanding at December 31, 2009. In addition, the Class A units receive a residual distribution proportionately with the Class B units, LP units and GP units relative to the aggregate number of each class issued and outstanding (or in the case of the Class B units and Class D units, the number issued and outstanding multiplied by the Class B and Class D current distribution entitlement, respectively). Class A units are exchangeable for Fund units on the basis of one Fund unit for one Class A unit.
- (b) The Class B units are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership from new Keg restaurants. The distribution entitlements of the Class B units are adjusted annually on January 1 until such date that all Class B units have received entitlement (the “Class B Termination Date”). Concurrent with the January 1, 2008 roll-in, the Class B Termination Date was reached and the last of the Class B units became entitled. Class B units held by KRL are exchangeable for Fund units based upon a defined calculation that itself is based on system sales from new restaurants. As at December 31, 2009, 1,826,700 (December 31, 2008 – 1,826,700) Class B units held by KRL receive a distribution entitlement.
- (c) The Class D units are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership from new Keg restaurants. The distribution entitlements of the Class D units are adjusted annually on January 1. Class D units held by KRL are exchangeable for Fund units based upon a defined calculation that itself is based on system sales from new restaurants. As at December 31, 2009, 1,354,591 (December 31, 2008 – 375,497) Class D units held by KRL receive a distribution entitlement. Class D units are issued subsequent to the Class B Termination Date and are identical to Class B units except that the Trustees of KHT can require KRL to surrender any or all of the issued Class D units for a price that is equal to the one originally used in the formula to calculate the number of units issued.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

14. CAPITAL DISCLOSURES:

The Fund's objectives in managing its capital, which it defines as unitholders' equity and the term loan, are:

- To safeguard the Fund's ability to continue as a going concern;
- To provide financial capacity and flexibility to meet its strategic objectives;
- To provide adequate return to unitholders commensurate with the level of risk; and
- To distribute excess cash through distributions.

The Fund maintains financial policies and manages its liquidity and capital structure and makes adjustments to it in light of changes to economic conditions, the underlying risks inherent in its operations and capital requirement to maintain and grow its operations.

The term loan held by KHT is subject to certain financial covenants, including minimum equity amounts in both KHT and the Partnership and a minimum Partnership cash flow level, defined as earnings before interest, taxes, depreciation and amortization ("EBITDA"). As at December 31, 2009, the KHT and Partnership equity amounts are approximately \$6.3 million and \$18.0 million in excess of the required minimum equity covenants, respectively. The Partnership's EBITDA for the year ended December 31, 2009 is approximately \$3.0 million greater than the required minimum amount.

The Fund is not subject to any statutory capital requirements and has no commitments to sell or otherwise issue units, other than the commitment to exchange Class A, Class B and Class D units held by KRL for Fund units (note 13).

15. FINANCIAL INSTRUMENTS:

The Fund classified its financial instruments as follows:

- Cash as *held-for-trading*, which is measured at fair value.
- Amounts due from KRL and the Partnership and the note receivable from KRL as *loans and receivables*, which are initially measured at fair value and subsequently at amortized cost.
- Interest payable on term loan, distributions payable to Fund unitholders and the term loan as *other financial liabilities*, which are measured at amortized cost.

The requirement for the Fund to settle its note receivable from KRL in exchange for Class C units is considered to be a separate embedded derivative (classified as a *derivative instrument*). The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature at this time.

The fair values of the amounts due from KRL and the Partnership, interest payable on term loan and the distributions payable to Fund unitholders approximate their carrying amounts largely due to the short-term maturities of these instruments. The fair value of the term loan is not materially different from its carrying value as the variable rate of interest on the facility would not be significantly different from the current market rate due to the considerable security held by the banking syndicate.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

16. FINANCIAL RISK MANAGEMENT:

The Fund is exposed to credit risk, liquidity risk, interest rate risk and foreign currency exchange rate risk as they relate to the Fund's identified financial instruments.

(a) Credit risk:

Credit risk is defined by the Fund as an unexpected loss in cash and earnings if the other party is unable to pay its obligations in due time. The Fund's exposure to credit risk arises from its amounts due from KRL and the Partnership and the note receivable from KRL, which are consolidated in KRL's financial statements. The Fund monitors this risk through its regular review of the operating and financing activities of KRL. Since its inception, the Fund has never failed to collect its receivables on a timely basis.

The performance of the Fund is directly dependent upon the royalty and interest payments received from KRL. The amount of the royalty received from KRL is dependent on various factors that may affect the casual dining sector of the restaurant industry. The restaurant industry generally, and in particular the casual dining sector, is intensely competitive with respect to price, service, location and food quality. If KRL and the Keg franchisees are unable to successfully compete in the casual dining sector, sales may be adversely affected, the amount of royalty reduced and the ability of KRL to pay the royalty or interest on the loan from KRL to the Fund may be impacted.

(b) Liquidity risk:

Liquidity risk results from the Fund's potential inability to meet its financial liabilities. Beyond effective net working capital and cash management, the Fund constantly monitors the operations and cash flows of the Partnership to ensure that current and future distributions to unitholders will be met.

The Fund's capital resources are compromised of cash and cash flow from operating activities. The maturities of the Fund's financial liabilities are as follows:

	<u>Value</u>	<u>Maturity</u>
Interest payable on term loan	\$ 48	< 1 year
Distributions payable to Fund unitholders	1,033	< 1 year
Term loan	14,000	2011

The Fund is subject to certain guarantor covenants and reporting requirements arising from the Partnership's undrawn \$1 million operating line of credit and KHT's \$14 million term loan.

(c) Interest rate risk:

The Fund's interest rate risk exposure is mainly related to an interest-bearing note receivable from KRL and the \$14 million term loan. As the note receivable from KRL has a fixed rate of 7.5%, is from a related party and is due on May 31, 2042, the Fund does not perform interest rate risk management to minimize the overall financial interest rate risk on this financial instrument. The term loan requires interest payments at bank prime plus 1.75% and net earnings would change by approximately \$140,000 annually if the prime rate changed by 1.0%.

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(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2009 and 2008

16. FINANCIAL RISK MANAGEMENT (CONTINUED):

(d) Foreign currency exchange rate risk:

The Fund is exposed to foreign currency exchange rate risk as a result of the translation of KRL's US dollar sales into Canadian dollars for the purposes of calculating the monthly royalty. Based on the US dollar sales of Keg restaurants included in the Royalty Pool for the year ended December 31, 2009, a 100 basis point change in the US dollar exchange rate would result in an approximate \$434,000 and \$18,000 change in Royalty Pool sales and royalty revenue, respectively. This would translate into an approximate \$8,600 change in equity income reported by the Fund.

17. ADMINISTRATION AGREEMENT:

The Fund has entered into an administrative agreement with its subsidiary, the Partnership, whereby the Partnership will provide, or arrange for the provision of, services required in the administration of the Fund. In turn, the Partnership has arranged for certain of these services to be provided by KRL in its capacity as a partner of the Partnership. For the period from January 1 to December 31, 2009, KRL provided these services at no cost to the Partnership or the Fund (January 1 to December 31, 2008 - \$nil).

18. SUPPLEMENTARY CASH FLOW INFORMATION:

	Year ended December 31, <u>2009</u>	Year ended December 31, <u>2008</u>
(a) Change in non-cash operating working capital:		
Due from Keg Restaurants Ltd. (note 7)	\$ (1)	\$ 1
Due from The Keg Rights Limited Partnership (note 8)	39	22
Interest payable on term loan	<u>(1)</u>	<u>(28)</u>
	<u>\$ 37</u>	<u>\$ (5)</u>
(b) Supplementary information:		
Interest received	\$ 4,279	\$ 4,320
Interest paid	485	775

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For the years ended December 31, 2009 and 2008

19. SUBSEQUENT EVENT:

On January 1, 2010, six new Keg restaurants that opened during the period from October 3, 2008 to October 2, 2009 were added to the Royalty Pool. The gross sales of these six new restaurants have been estimated at \$25.5 million annually. Six permanently closed Keg restaurants with annual sales of \$17.1 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$8.4 million annually. The total number of restaurants in the Royalty Pool remains at 102. The yield of the Fund Units was determined to be 13.97% calculated using a weighted average unit price of \$9.15.

As a result of the contribution of the additional net sales to the Royalty Pool, and assuming 100% of the estimated Additional Entitlement is received, KRL's Additional Entitlement will be equivalent to 242,070 Fund units, being 1.73% of the Fund units on a fully diluted basis. On January 1, 2010, KRL received 80% of this entitlement representing the equivalent of 193,656 Fund units, being 1.38% of the Fund units on a fully diluted basis. KRL will also receive a proportionate increase in monthly distributions from the Partnership. Including the initial portion of Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 4,280,891 Fund units, representing 30.61% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2010 once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2010, it would have the right to exchange its Partnership Units for 4,329,305 Fund units, representing 30.85% of the Fund units on a fully diluted basis.