

# THE KEG ROYALTIES INCOME FUND

## FIRST QUARTER REPORT

For the three months ended March 31, 2011

## 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 months ended March 31, 2011.

### ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Fund was required to adopt International Financial Reporting Standards (“IFRS”) as of January 1, 2011. All financial results disclosed in this Management’s Discussion and Analysis for all periods commencing on or after January 1, 2009 have therefore been prepared in accordance with IFRS. Readers are advised that the Fund’s transition to reporting its financial results in accordance with IFRS from Canadian Generally Accepted Accounting Principles (“GAAP”) has had no impact, nor is it expected to have any future impact, on the operations of the Fund’s business, the contractual obligations between the Fund, and Keg Restaurants Ltd., the operating company from which the Fund receives the royalty payments. Most importantly, the amount of cash that is available for distribution to the Fund’s unitholders is not affected. The adoption of IFRS requires numerous and sometimes significant non-cash adjustments which can distort earnings and earnings per Fund unit in any reporting period which has rendered traditional earnings measurements far less meaningful, at least for income trusts.

Also on January 1, 2011 the legislative changes to the tax treatment of certain income trusts, as a result of the Specified Investment Flow-through Trust tax (“SIFT tax”) came into effect. As a result of the imposition of this tax, income trusts are no longer entitled to deduct distributions for tax purposes, and will therefore be subject to taxation similar to corporations. The Fund adopted a new distribution policy which reflects the Fund’s obligation to make these tax payments. The eligible dividend portion of the Fund’s revised distribution, combined with the return of capital component of the distribution, should provide taxable Canadian individuals with an effective after-tax cash return very closely comparable to the return that existed before the imposition of the SIFT tax.

As a result of the adoption of IFRS and the imposition of the SIFT tax, we believe the key metric for unitholders to assess the actual cash generated by the business during any reporting period is distributable cash. We will therefore focus our future discussion on distributable cash, both before and after the SIFT tax, so that unitholders also have a basis for comparison of the distributable cash generated in prior periods.

### RESULTS

The gross sales reported by the 102 Keg restaurants in the Royalty Pool were \$120,604,000 for the quarter, an increase of \$3,651,000 or 3.1% from the comparable quarter of the prior year. These gross sales reflect the sales of the new Keg restaurants which opened during the period from October 3, 2009 through October 2, 2010, which were added to the Royalty Pool on January 1, 2011, and a same store sales increase of 3.1% for the quarter.

Royalty income increased by \$172,000 or 3.7% from \$4,695,000 in the three months ended March 31, 2010 to \$4,867,000 in the three months ended March 31, 2011.

Distributable cash before SIFT tax increased by \$431,000 from \$3,401,000 to \$3,832,000 for the quarter, but decreased slightly by 0.3 cents/Fund unit, from 35.0 cents/Fund unit in the first quarter of 2010 to 34.7 cents/Fund unit in the first quarter of 2011. Distributable cash available to pay distributions to public unitholders decreased from \$3,401,000 (35.0 cents/Fund unit) to \$2,906,000 (26.3 cents/Fund unit) during the comparable quarter, solely as a result of the SIFT tax.

The Fund remains financially well positioned with surplus cash on hand of \$1,752,000 and a positive working capital balance of \$2,807,000 as of March 31, 2011.

## **OUTLOOK**

While the past two years have been challenging for the restaurant industry in North America, indications are that the worst is now behind us. In Canada, the Canadian Restaurant and Foodservice Association has forecast sales in the full-service restaurant category, the category in which The Keg operates, to increase 2.6% in 2011, after meagre growth of 1.3% in 2010. In the United States, the National Restaurant Association expects sales in the full service segment to increase 3.1% in 2011, after three consecutive years of real sales declines. As such, we are optimistic that with strengthening consumer confidence, the industry has begun to see a change in momentum. For Unitholders, the key driver of growth in royalty income is same store sales growth. Management of KRL believes that as economic conditions and consumer sentiment continue to improve in North America, that sales for The Keg will also improve, leading it to once again outperform the full service category with respect to same store sales growth.

## **COMPETITIVE STRENGTH AND GROWTH**

The Keg remains an industry leader in the full-service restaurant category in Canada; a fact confirmed by an independent research report from VisionCritical (formerly Angus Reid Strategies) in October 2010 that identified The Keg as the first choice of over 67% of diners when choosing a steak dinner. In 2010, JD Power and Associates named The Keg as the highest ranked casual restaurant in both Toronto and Vancouver, in their 2010 Canadian Restaurant Satisfaction Survey. 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  
June 14, 2011

## FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Jan. 1 to Mar. 31, 2011	Jan. 1 to Mar. 31, 2010
<b>Restaurants in the Royalty Pool</b>	<b>102</b>	<b>102</b>
<b>Gross sales reported by restaurants in the Royalty Pool</b> .....	<b>\$ <u>120,604</u></b>	<b>\$ <u>116,953</u></b>
Royalty income <sup>(1)</sup> .....	\$ 4,867	\$ 4,695
Interest income <sup>(2)</sup> .....	<u>1,055</u>	<u>1,055</u>
<b>Total income</b> .....	<b>\$ 5,922</b>	<b>\$ 5,750</b>
Administrative expenses <sup>(3)</sup> .....	(100)	(98)
Interest and financing expenses <sup>(4)</sup> .....	<u>(174)</u>	<u>(148)</u>
<b>Operating income</b> .....	<b>\$ 5,648</b>	<b>\$ 5,504</b>
Distributions declared to KRL <sup>(5)</sup> .....	(1,290)	(1,567)
Distributions declared to Fund unitholders <sup>(6)</sup> .....	<u>-</u>	<u>(2,068)</u>
<b>Earnings before fair value adjustment and income taxes</b> .....	<b>\$ 4,358</b>	<b>\$ 1,869</b>
Fair value adjustment <sup>(7)</sup> .....	(684)	(6,294)
Income taxes <sup>(9)</sup> .....	<u>(1,138)</u>	<u>(69)</u>
<b>Net earnings (loss)</b> .....	<b>\$ <u>2,536</u></b>	<b>\$ <u>(4,494)</u></b>
<b>Distributable cash before SIFT tax</b> <sup>(10)</sup> .....	<b>\$ <u>3,832</u></b>	<b>\$ <u>3,401</u></b>
<b>Distributable cash</b> <sup>(11)</sup> .....	<b>\$ <u>2,906</u></b>	<b>\$ <u>3,401</u></b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ <u>2,945</u></b>	<b>\$ <u>3,100</u></b>
<b>Payout Ratio</b> <sup>(12)</sup> .....	<b><u>101.3%</u></b>	<b><u>91.1%</u></b>
<b>Per Fund unit information</b> <sup>(13)</sup>		
<b>Earnings before fair value adjustment and income taxes</b> .....	<b>\$ <u>.395</u></b>	<b>\$ <u>.406</u></b>
<b>Net earnings (loss)</b> .....	<b>\$ <u>.230</u></b>	<b>\$ <u>(.250)</u></b>
<b>Distributable cash before SIFT tax</b> <sup>(10)</sup> .....	<b>\$ <u>.347</u></b>	<b>\$ <u>.350</u></b>
<b>Distributable cash</b> <sup>(11)</sup> .....	<b>\$ <u>.263</u></b>	<b>\$ <u>.350</u></b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ <u>.267</u></b>	<b>\$ <u>.320</u></b>
<b>SSSG</b> <sup>(14)</sup>		
<b>Canada</b> .....	<b>3.8%</b>	<b>(3.2)%</b>
<b>United States</b> .....	<b>3.2%</b>	<b>(14.4)%</b>
<b>Consolidated</b> .....	<b>3.1%</b>	<b>(6.6)%</b>
<b>Restaurant Openings/Closings</b>		
<b>Opened</b> .....	<b>--</b>	<b>--</b>
<b>Closed</b> .....	<b>--</b>	<b>--</b>
<b>Relocated</b> .....	<b>1</b>	<b>1</b>
<b>Net Opened (Closed)</b> .....	<b>--</b>	<b>--</b>

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 directly earns interest income on the \$57.0 million Keg Loan, with interest income accruing at 7.5% per annum, payable monthly.
- (3) The Fund, indirectly through the Partnership, incurs administrative expenses and interest on the operating line of credit, to the extent utilized.
- (4) The Fund, indirectly through the Trust, incurs interest expense on the \$14.0 million term loan and amortization of deferred financing charges.
- (5) Represents the distributions declared during the period by the Partnership to KRL on the Exchangeable and Class C units held by KRL. The Class A, entitled Class B and Class D Partnership units are exchangeable into Fund units on a one-for-one basis (“Exchangeable units”).
- (6) Represents the distributions declared on the publicly traded Fund units during the period. The distributions declared to the Fund’s public unitholders during the three months ended March 31, 2011 were recorded as distributions and charged to unitholder’s equity whereas the distributions declared during the three months ended March 31, 2010 were expensed as interest.
- (7) Fair value adjustment is the non-cash increase or decrease in the market value of the Exchangeable units held by KRL during the respective period. Exchangeable units are classified as a financial liability under IFRS. The Fund is required to determine the fair value of that liability at the end of each reporting period and adjust for any increase or decrease, taking into consideration the sale of any Exchangeable units during the same period.
- (8) Represents the non-cash loss recognized on the extinguishment of the Fund unit liability, which was recorded in the fourth quarter of 2010. This loss was due to the re-classification of the Fund units from a financial liability to equity on December 20, 2010, as a result of the amendment to the Declaration of Trust, which removed the mandatory distribution requirement. It is the amount by which the fair value of the Fund units on December 20, 2010 (\$133,286,000) exceeded the carrying costs of those Fund units (\$113,045,000).
- (9) Income taxes for the quarter ended March 31, 2011, include SIFT tax payable of \$926,000 (quarter ended March 31, 2010 - \$NIL) and non-cash deferred taxes of \$212,000 (quarter ended March 31, 2010 - \$69,000). The obligation to pay SIFT tax did not come into effect until January 1, 2011.
- (10) Distributable cash before SIFT tax, is defined as the periodic cash flows from operating activities as reported in the IFRS financial statements, including the effects of changes in non-cash working capital, less the earnings of the Partnership attributable to KRL through its ownership of Exchangeable units.
- (11) Distributable cash is the amount of cash available for distribution to the Fund’s public unitholders and is calculated as distributable cash before SIFT tax, less SIFT tax payable. Distributable cash is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers. However, the Fund believes that distributable cash, both before and after SIFT tax, provides useful information regarding the amount of cash available for distribution to the Fund’s public unitholders.
- (12) Payout ratio is computed as the ratio of aggregate cash distributions paid during the period (numerator) to the aggregate distributable cash of the period (denominator).
- (13) 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 number of Fund units outstanding for the three months ended March 31, 2011 was 11,036,833 and for the three months ended March 31, 2010 was 9,703,500. For comparative purposes, the earnings (loss) per Fund unit calculations for reporting periods prior to and including December 31, 2010, have been adjusted to exclude distributions declared to Fund unitholders, which were previously recorded as interest (prior to December 20, 2010) as a result of the adoption of IFRS.
- (14) Same Store Sales Growth (“SSSG”) is the overall increase or decrease 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. SSSG is not an IFRS financial measure and does not have a standardized meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. However the Fund believes that SSSG provides useful information regarding the increase or decrease in gross sales for comparable restaurants.

## SUMMARY OF QUARTERLY RESULTS

	Q1	Q4	Q3	Q2
(\$000's except per unit amounts)	2011	2010	2010	2010
<b>Restaurants in the Royalty Pool</b>	<b>102</b>	<b>102</b>	<b>102</b>	<b>102</b>
<b>Gross sales reported by Keg restaurants in the Royalty Pool</b> .....	<b>\$ 120,604</b>	<b>\$ 114,298</b>	<b>\$ 110,382</b>	<b>\$ 111,153</b>
Royalty income <sup>(1)</sup> .....	\$ 4,867	\$ 4,697	\$ 4,527	\$ 4,502
Administrative expenses <sup>(2)</sup> .....	1,055	1,079	1,078	1,066
<b>Total income</b> .....	<b>\$ 5,922</b>	<b>\$ 5,776</b>	<b>\$ 5,605</b>	<b>\$ 5,568</b>
Administrative expenses <sup>(3)</sup> .....	(100)	(112)	(99)	(107)
Interest and financing expenses <sup>(4)</sup> .....	(174)	(178)	(173)	(152)
<b>Operating income</b> .....	<b>\$ 5,648</b>	<b>\$ 5,486</b>	<b>\$ 5,333</b>	<b>\$ 5,309</b>
Distributions declared to KRL <sup>(5)</sup> .....	(1,290)	(3,025)	(2,091)	(2,092)
Distributions declared to Fund unitholders <sup>(6)</sup> .....	-	(4,516)	(3,388)	(3,388)
<b>Earnings (loss) before fair value adjustment and income taxes</b> ....	<b>\$ 4,358</b>	<b>\$ (2,055)</b>	<b>\$ (146)</b>	<b>\$ (171)</b>
Fair value adjustment <sup>(7)</sup> .....	(684)	(5,373)	(3,279)	4,404
Extinguishment of Fund unit liability <sup>(8)</sup> .....	--	(20,241)	--	--
Income taxes <sup>(9)</sup> .....	(1,138)	(41)	(28)	(63)
<b>Net earnings (loss)</b> .....	<b>\$ 2,536</b>	<b>\$ (27,710)</b>	<b>\$ (3,453)</b>	<b>\$ 4,170</b>
<b>Distributable cash before SIFT taxes</b> <sup>(10)</sup> .....	<b>\$ 3,832</b>	<b>\$ 2,955</b>	<b>\$ 3,310</b>	<b>\$ 3,184</b>
<b>Distributable cash</b> <sup>(11)</sup> .....	<b>\$ 2,906</b>	<b>\$ 2,955</b>	<b>\$ 3,310</b>	<b>\$ 3,184</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ 2,945</b>	<b>\$ 3,388</b>	<b>\$ 3,388</b>	<b>\$ 3,388</b>
<b>Payout Ratio</b> <sup>(12)</sup> .....	<b>101.3%</b>	<b>114.7%</b>	<b>102.4%</b>	<b>106.4%</b>
<b>Per Fund unit information</b> <sup>(13)</sup>				
<b>Earnings (loss) before fair value adjustment and income taxes</b> ...	<b>\$ .395</b>	<b>\$ .232</b>	<b>\$ .306</b>	<b>\$ .306</b>
<b>Net earnings (loss)</b> .....	<b>\$ .230</b>	<b>\$ (.278)</b>	<b>\$ (.006)</b>	<b>\$ .718</b>
<b>Distributable cash before SIFT tax</b> <sup>(10)</sup> .....	<b>\$ .347</b>	<b>\$ .279</b>	<b>\$ .312</b>	<b>\$ .303</b>
<b>Distributable cash</b> <sup>(11)</sup> .....	<b>\$ .263</b>	<b>\$ .279</b>	<b>\$ .312</b>	<b>\$ .303</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ .267</b>	<b>\$ .320</b>	<b>\$ .320</b>	<b>\$ .322</b>
<b>SSSG</b> <sup>(14)</sup>				
<b>Canada</b> .....	<b>3.8%</b>	<b>1.5%</b>	<b>0.0%</b>	<b>1.9%</b>
<b>United States</b> .....	<b>3.2%</b>	<b>(0.5)%</b>	<b>(2.2)%</b>	<b>(6.2)%</b>
<b>Consolidated</b> .....	<b>3.1%</b>	<b>0.8%</b>	<b>(0.6)%</b>	<b>(0.1)%</b>
<b>Restaurants Openings/Closings</b>				
<b>Opened</b> .....	<b>--</b>	<b>1</b>	<b>--</b>	<b>--</b>
<b>Closed</b> .....	<b>--</b>	<b>--</b>	<b>1</b>	<b>1</b>
<b>Relocated</b> .....	<b>1</b>	<b>--</b>	<b>--</b>	<b>--</b>
<b>Net Opened (Closed)</b> .....	<b>--</b>	<b>1</b>	<b>(1)</b>	<b>(1)</b>

## SUMMARY OF QUARTERLY RESULTS

	Q1	Q4	Q3	Q2
(\$000's except per unit amounts)	2010	2009	2009	2009
<b>Restaurants in the Royalty Pool</b>	<b>102</b>	<b>102</b>	<b>102</b>	<b>102</b>
<b>Gross sales reported by Keg restaurants in the Royalty Pool.....</b>	<b>\$ 116,953</b>	<b>\$ 117,885</b>	<b>\$ 108,332</b>	<b>\$ 107,824</b>
Royalty income <sup>(1)</sup> .....	\$ 4,695	\$ 4,879	\$ 4,454	\$ 4,418
Interest income <sup>(2)</sup> .....	1,055	1,078	1,078	1,067
<b>Total income .....</b>	<b>\$ 5,750</b>	<b>\$ 5,957</b>	<b>\$ 5,532</b>	<b>\$ 5,485</b>
Administrative expenses <sup>(3)</sup> .....	(98)	(101)	(100)	(108)
Interest and financing expenses <sup>(4)</sup> .....	(148)	(151)	(132)	(102)
<b>Operating income .....</b>	<b>\$ 5,504</b>	<b>\$ 5,705</b>	<b>\$ 5,300</b>	<b>\$ 5,275</b>
Distributions declared to KRL <sup>(5)</sup> .....	(1,567)	(2,953)	(2,274)	(2,306)
Distributions declared to Fund unitholders <sup>(6)</sup> .....	(2,068)	(4,133)	(3,100)	(3,100)
<b>Earnings (loss) before fair value adjustment and income taxes.....</b>	<b>\$ 1,869</b>	<b>\$ (1,381)</b>	<b>\$ (74)</b>	<b>\$ (131)</b>
Fair value adjustment <sup>(7)</sup> .....	(6,294)	(5,495)	1,609	(5,767)
Extinguishment of Fund unit liability <sup>(8)</sup> .....	--	--	--	--
Income taxes <sup>(9)</sup> .....	(69)	(23)	(21)	(1)
<b>Net earnings (loss) .....</b>	<b>\$ (4,494)</b>	<b>\$ (6,899)</b>	<b>\$ 1,514</b>	<b>\$ (5,899)</b>
<b>Distributable cash before SIFT tax <sup>(10)</sup> .....</b>	<b>\$ 3,401</b>	<b>\$ 3,020</b>	<b>\$ 3,009</b>	<b>\$ 3,062</b>
<b>Distributable cash <sup>(11)</sup> .....</b>	<b>\$ 3,401</b>	<b>\$ 3,020</b>	<b>\$ 3,009</b>	<b>\$ 3,062</b>
<b>Distributions paid to Fund unitholders.....</b>	<b>\$ 3,100</b>	<b>\$ 3,100</b>	<b>\$ 3,100</b>	<b>\$ 3,100</b>
<b>Payout Ratio <sup>(12)</sup> .....</b>	<b>91.1%</b>	<b>102.6%</b>	<b>103.0%</b>	<b>101.2%</b>
<b>Per Fund unit information <sup>(13)</sup></b>				
<b>Earnings (loss) before fair value adjustment and income taxes.....</b>	<b>\$ .406</b>	<b>\$ .284</b>	<b>\$ .312</b>	<b>\$ .306</b>
<b>Net earnings (loss) .....</b>	<b>\$ (.250)</b>	<b>\$ (.285)</b>	<b>\$ .475</b>	<b>\$ (.288)</b>
<b>Distributable cash before SIFT tax <sup>(10)</sup> .....</b>	<b>\$ .350</b>	<b>\$ .311</b>	<b>\$ .310</b>	<b>\$ .316</b>
<b>Distributable cash <sup>(11)</sup> .....</b>	<b>\$ .350</b>	<b>\$ .311</b>	<b>\$ .310</b>	<b>\$ .316</b>
<b>Distributions paid to Fund unitholders.....</b>	<b>\$ .320</b>	<b>\$ .320</b>	<b>\$ .320</b>	<b>\$ .320</b>
<b>SSSG <sup>(14)</sup></b>				
<b>Canada.....</b>	<b>(3.2)%</b>	<b>0.1%</b>	<b>(4.7)%</b>	<b>(6.9)%</b>
<b>United States .....</b>	<b>(14.4)%</b>	<b>(9.6)%</b>	<b>(19.8)%</b>	<b>(15.7)%</b>
<b>Consolidated .....</b>	<b>(6.6)%</b>	<b>(2.5)%</b>	<b>(5.9)%</b>	<b>(6.5)%</b>
<b>Restaurant Openings/Closings</b>				
<b>Opened .....</b>	<b>--</b>	<b>1</b>	<b>2</b>	<b>--</b>
<b>Closed .....</b>	<b>--</b>	<b>--</b>	<b>--</b>	<b>1</b>
<b>Relocated .....</b>	<b>1</b>	<b>1</b>	<b>1</b>	<b>--</b>
<b>Net Opened (Closed) .....</b>	<b>--</b>	<b>1</b>	<b>2</b>	<b>(1)</b>

# MANAGEMENT'S DISCUSSION AND ANALYSIS

**For the Three Months Ended March 31, 2011  
As of June 14, 2011**

## 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 3.6% annually, a figure that compares very favourably against the restaurant industry as a whole.

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.

### THE ROYALTY POOL

Annually, on January 1<sup>st</sup>, the Royalty Pool is adjusted to include the gross sales from new Keg restaurants that have opened on or before October 2<sup>nd</sup> 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 31<sup>st</sup> 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 ROYALTY POOL (CONTINUED)**

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, 2010. Forty-five new Keg restaurants that opened during the period from April 1, 2002, through October 2, 2009, with annual gross sales of \$216.2 million have been added to the Royalty Pool. Twenty-three permanently closed Keg restaurants with annual sales of \$60.1 million have been removed from the Royalty Pool. This has resulted in a net increase in Royalty Pool sales of \$156.1 million annually, and KRL receiving a cumulative Additional Entitlement equivalent to 5,057,611 Fund units as of December 31, 2010.

On January 1, 2011 three new Keg restaurants that opened during the period from October 3, 2009 through October 2, 2010 were added to the Royalty Pool. The gross sales of these three new restaurants have been estimated at \$15.7 million annually. Three permanently closed Keg restaurants with annual sales of \$10.4 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$5.3 million annually. The total number of restaurants in the Royalty Pool remains at 102. The yield of the Fund units was determined to be 10.90% calculated using a weighted average unit price of \$11.73.

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 153,737 Fund units, being 1.08% of the Fund units on a fully diluted basis. On January 1, 2011, KRL received 80% of this entitlement representing the equivalent of 122,990 Fund units, being 0.86% 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 2,886,546 Fund units representing 20.27% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2011 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2011, it would have the right to exchange its Partnership units for 2,917,293 Fund units representing 20.44% of the Fund units on a fully diluted basis.

## **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 ("Exchangeable units"). 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 20.27% as of March 31, 2011. 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 March 31, 2011. This has resulted in a net increase in Royalty Pool sales of \$156.1 million and the issuance of 5,057,611 exchangeable units to KRL, as of March 31, 2011. KRL has exchanged a total of 3,200,000 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 11,353,500 as of February 8, 2011) and sold these units through the facilities of the Toronto Stock Exchange.

## **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. Historically, the Fund had been exempt from recognizing deferred income tax assets and liabilities associated with temporary differences arising in the Fund and its equity accounted investment, the Partnership. As a result of the substantive enactment of the new tax legislation, the Fund has recognized deferred income tax assets and liabilities that are expected to reverse subsequent to January 1, 2011. Deferred income tax expense is a non-cash item that does not affect cash flow.

## **FEDERAL GOVERNMENT TAX ON INCOME FUNDS (CONTINUED)**

On January 1, 2011, legislative changes to the tax treatment of certain income trusts, as a result of the Specified Investment Flow-through Trust tax (the “SIFT tax”), came into effect. As a result of these changes, income trusts will not be entitled to deduct distributions of certain types of income for tax purposes, and will therefore be subject to taxation similar to corporations. Accordingly, the Fund is subject to tax at a rate of 26.5% for 2011 and 25% for the 2012 and later taxation years. As a result of this taxation imposed by the Federal Government, the Fund’s Trustees had to adopt a new distribution policy which reflects the Fund’s obligation to make the SIFT tax payments. See “Distributions to Unitholders”.

## **ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS**

### **OVERVIEW**

The Canadian Accounting Standards Board announced in February 2008 that publicly accountable entities would be required to adopt International Financial Reporting Standards (“IFRS”) in place of Canadian Generally Accepted Accounting Principles (“GAAP”) for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011. As a result, the Handbook of the Institute of Chartered Accountants (the “CICA Handbook”) was amended to incorporate IFRS and to require publicly accountable entities to apply such standards for fiscal years beginning on or after January 1, 2011. Accordingly, the Fund adopted IFRS on January 1, 2011 and financial results disclosed in this Management’s Discussion and Analysis for all periods commencing on or after January 1, 2009 have all been prepared in accordance with International Accounting Standard 34 – *Interim Financial Reporting* and International Financial Reporting Standard 1 – *First-time Adoption of IFRS* (“IFRS 1”).

Readers are advised that the Fund’s transition to reporting its financial results in accordance with IFRS from GAAP, has had no impact, nor is it expected to have any future impact on the operations of the Fund’s business, the amount of cash that is available to distribute to the Fund’s unitholders or on the contractual obligations between the Fund, the Fund’s wholly-owned subsidiary The Keg Holdings Trust (the “Trust”), The Keg Rights Limited Partnership (the “Partnership”), the Fund’s 90% owned subsidiary The Keg GP Ltd. (“Keg GP”) (collectively, the “Companies”) and KRL or any third parties. Keg GP is the managing general partner of the Partnership. All residual ownership of the Companies is either directly or indirectly controlled by KRL.

The adoption of IFRS has impacted the presentation of certain key financial metrics of the Fund which will be discussed in detail below. The comparative financial results contained in this Management’s Discussion and Analysis for periods in 2010 and 2009 have been restated to conform to IFRS rather than GAAP.

### **CONSOLIDATION OF THE PARTNERSHIP**

In 2005, the Partnership was determined to be a Variable Interest Entity under GAAP in accordance with the criteria established in the Canadian Institute of Chartered Accountants’ Guideline 15, Consolidation of Variable Interest Entities (AcG-15). As a result of that guideline, the Fund previously accounted for its investment in the Partnership on an equity basis and KRL previously consolidated the Partnership in its financial statements. The Fund’s transition to reporting its financial results in accordance with IFRS from GAAP has resulted in the Fund now consolidating the accounts of the Partnership.

Under IFRS consolidation is based on control, which is the power to govern the financial and operating policies of the entity to obtain economic benefits from its activities. Since the Fund controls the Partnership, the Fund consolidates the accounts of the Partnership rather than accounting for the Fund’s investment in the Partnership using the equity method. The Partnership’s significant assets include cash, royalties receivable from KRL and the Keg Rights, while its significant liabilities include distributions payable to KRL, long-term debt, as well as the Exchangeable unit and Class C unit financial liabilities. The Fund’s consolidated statements of earnings and comprehensive income under IFRS do not include equity income of the Partnership, but rather the actual income and expenses of the Partnership. The Partnership’s earnings are largely comprised of royalty income earned from the Keg Rights less administrative and interest expenses. The consolidated financial statements of the Fund therefore now include the accounts of the Fund, the Trust, the Partnership, and Keg GP.

## **PARTNERSHIP UNITS AND DISTRIBUTIONS**

The Exchangeable units of the Partnership held by KRL are also classified as financial liabilities under IFRS because the Partnership has a contractual obligation to distribute cash on all of the units of the Partnership on a monthly basis and because these units are exchangeable into Fund units. As such, the amounts paid by the Partnership to KRL in respect of Exchangeable units are classified as interest expense under IFRS rather than as distributions.

The Class C units of the Partnership held by KRL are classified as a financial liability under IFRS because the Partnership has a contractual obligation to distribute \$0.0625 per Class C unit per month to KRL as long as the \$57.0 million loan receivable from KRL remains outstanding. As such, the amounts paid to KRL in respect of the Class C units are classified as interest expense under IFRS rather than as distributions.

## **FUND UNITS AND DISTRIBUTIONS**

Fund units are classified as a financial liability under IFRS (in respect of the period from January 1, 2009 through December 19, 2010) because the Declaration of Trust contained a mandatory requirement to distribute no less than all of the taxable income of the Fund to the Fund's unitholders each year and because these units are redeemable. Since the amounts paid by the Fund to its public unitholders (in respect of that period) relate to a financial liability, those payments must be classified as interest expense of the Fund rather than as distributions.

The Trustees of the Fund determined that it would be more appropriate for the Fund units to be classified as equity under IFRS as they represent a residual equity interest in the Fund. As a result, the Fund convened a Special Meeting on December 20, 2010 at which Fund unitholders approved, among other things, an amendment to the Fund's Declaration of Trust to remove the mandatory distribution requirement. Upon this amendment, the Fund units were reclassified under IFRS from a financial liability to equity. The distributions declared to the Fund's public unitholders during the three months ended March 31, 2011 were recorded as distributions, that is, as a reduction in unitholder's equity rather than as an interest expense as was required for the prior periods.

As a further result of the re-classification of the Fund units from a financial liability to equity on December 20, 2010, the Fund recorded a \$20.2 million loss on the extinguishment of that liability, being the amount by which the fair value of the Fund units outstanding on December 20, 2010 exceeded the carrying costs of those Fund units.

## **FAIR VALUE ADJUSTMENT**

The Exchangeable units of the Partnership held by KRL are classified as a financial liability under IFRS at fair value through profit and loss. As a result, the Fund is now required to fair value that liability at the end of each reporting period and adjust for any increase or decrease as compared to the fair value of that liability at the end of the immediately preceding reporting period. The Fund estimates the fair value of the Exchangeable units using the closing market price of a Fund unit on the reporting date. The amount is calculated as the change in the market value of a Fund unit during the period, multiplied by the number of Exchangeable units held by KRL at the end of the respective period, after taking into consideration any sale of Exchangeable units during the same period. This is a non-cash adjustment which has no impact on the cash available for distribution to the Fund's unitholders.

## **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 \$0.1065 per unit starting in the month of March 2008, an increase of 18.3%.

## DISTRIBUTIONS TO UNITHOLDERS (CONTINUED)

As a result of the SIFT tax imposed by the Federal Government, the Fund's Trustees had to adopt a new distribution policy which reflects the Fund's obligation to make these tax payments. Beginning with the distribution for the month of January 2011 (payable to Unitholders on February 28<sup>th</sup>, 2011), distributions were set at \$0.08 per unit per month. This amounts to a distribution of \$0.96 per unit annually. At this level, the eligible dividend portion of the Fund's distribution, combined with the return of capital component of the distribution, should provide taxable Canadian individuals with an effective after-tax cash return very closely comparable to the return that existed before the imposition of the SIFT tax.

Annually, two distributions are expected to be declared during the first quarter, three distributions in each of the second and third quarter, and four distributions in the fourth quarter. This is done to ensure that the distribution based on the Royalty Pool sales for the month of December (which is paid the following month in January), is recorded in the period in which 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.

Year-to-date distributions paid were as follows:

Period	Payment Date	Per/Unit	Total
December 1-31, 2010	January 31, 2011	10.65¢	\$1,129,273
January 1-30, 2011	February 28, 2011	8.00¢	\$ 908,280
February 1-28, 2011	March 31, 2011	8.00¢	\$ 908,280
March 1-31, 2011	April 29, 2011*	8.00¢*	\$ 908,280*
April 1-30, 2011	May 31, 2011*	8.00¢*	\$ 908,280*

*\*Paid subsequent to the period*

Distributions paid during the period 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 \$94,479,000 of distributable cash and has paid cumulative distributions of \$94,242,000, which resulted in a cumulative surplus of \$237,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid since inception to the cumulative distributable cash generated since inception) is 99.8%.

## DISTRIBUTABLE CASH

Prior to the adoption of IFRS, distributable cash was 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 under IFRS is now defined as the periodic cash flows from operating activities as reported in the IFRS financial statements, including the change in non-cash working capital balances, less the earnings of the Partnership attributable to KRL, less SIFT tax payable.

The only difference that may arise in any particular reporting period between distributable cash as reported under GAAP and distributable cash as determined under IFRS, is due to the inclusion of the change in non-cash working capital balances of the Partnership. Under IFRS the accounts of the Partnership, including its non-cash working capital, are included in the consolidation of the Fund; under GAAP, the Fund accounted for its investment in the Partnership on an equity basis, and hence the non-cash working capital of the Partnership was excluded in the consolidation of the Fund.

Readers are advised that the inclusion of the change in the non-cash working capital balances of the Partnership will not affect distributable cash on an annual basis, but may cause slight increases or decreases in any particular reporting period. Distributable cash is a non-IFRS financial measure that does not have a standardized meaning prescribed by IFRS, and therefore may not be comparable to similar measures presented by other issuers.

## DISTRIBUTABLE CASH (CONTINUED)

Distributable cash is calculated as follows:

(\$000's)	Jan. 1 Mar. 31, 2011	Jan. 1 Mar. 31, 2010
Cash flow from operations <sup>(1)</sup> .....	\$ 5,836	\$ 5,731
KRL's interest <sup>(2)</sup> .....	<u>(2,004)</u>	<u>(2,330)</u>
Distributable cash before SIFT tax .....	\$ 3,832	\$ 3,401
SIFT tax on Fund units <sup>(3)</sup> .....	<u>(926)</u>	<u>-</u>
Distributable Cash <sup>(4)</sup> .....	<u>\$ 2,906</u>	<u>\$ 3,401</u>

Notes:

- <sup>(1)</sup> Represents the cash flow from operations as reported in the consolidated statements of the cash flows.
- <sup>(2)</sup> Represents the earnings of the Partnership attributable to KRL during the period from its ownership of Exchangeable units. The earnings attributable to KRL will differ from the actual distributions paid to KRL during the same period, due to the timing of the declaration of distributions.
- <sup>(3)</sup> The SIFT tax came into effect on January 1, 2011 and is therefore not applicable to reporting periods prior to that date. Distributable cash is defined as the periodic cash flows from operating activities as reported in the IFRS financial statements, including the effects of changes in non-cash working capital, less the earnings of the Partnership attributable to KRL, less the SIFT taxes payable.
- <sup>(4)</sup> Distributable cash is the amount of cash available for distribution to the Fund's public unitholders.

## OWNERSHIP OF THE FUND

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

	March 31, 2011 <sup>(1)</sup>		March 31, 2010	
	#	%	#	%
Fund units held by public unitholders <sup>(2)</sup> .....	11,353,500	79.73	9,703,500	69.39
Exchangeable Partnership units held by KRL: <sup>(3)</sup>				
Class A units <sup>(4)</sup> .....	905,944	6.36	905,944	6.48
Class B units <sup>(5)</sup> .....	176,700	1.24	1,826,700	13.06
Class D units <sup>(5)</sup> .....	<u>1,803,902</u>	<u>12.67</u>	<u>1,548,247</u>	<u>11.07</u>
Total Exchangeable Partnership units <sup>(6)</sup> .....	<u>2,886,546</u>	<u>20.27</u>	<u>4,280,891</u>	<u>30.61</u>
Total Fund and Exchangeable Partnership units.....	<u>14,240,046</u>	<u>100.00</u>	<u>13,984,391</u>	<u>100.00</u>

Notes:

<sup>(1)</sup> Information is current as of March 31, 2011.

<sup>(2)</sup> Represents the public's total effective ownership of the Fund as of March 31, 2011 and 2010. On April 9, 2010, KRL exchanged 900,000 Class B Partnership units for an equal number of Fund units, and sold them, thereby increasing the total number of Fund units held by public unitholders to 10,603,500. On February 8, 2011, KRL exchanged 750,000 Class B Partnership units for an equal number of Fund units, and sold them, thereby increasing the total number of Fund units held by public unitholders to 11,353,500. 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 77.51% during the three months ended March 31, 2011 (three months ended March 31, 2010 – 69.39%). The weighted average number of Fund units outstanding for the three-month period ended March 31, 2011 was 11,036,833 (three-month period ended March 31, 2010 – 9,703,500).

<sup>(3)</sup> Exchangeable into Fund units on a one-for-one basis.

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

<sup>(5)</sup> 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 March 31, 2011, KRL is the registered holder of 176,700 Class B units and 1,803,902 Class D units (March 31, 2010 – 1,826,700 Class B units and 1,548,247 Class D units).

<sup>(6)</sup> Represents KRL's total effective ownership of the Fund as of March 31, 2011 and 2010. On April 9, 2010, KRL exchanged 900,000 Class B Partnership units for an equal number of Fund units, and sold them, thereby decreasing the total number of exchangeable units held by KRL to 3,380,891. On February 8, 2011, KRL exchanged 750,000 Class B Partnership units for an equal number of Fund units, and sold them, thereby decreasing the total number of exchangeable units held by KRL to 2,886,546. 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 22.49% during the three months ended March 31, 2011 (three months ended March 31, 2010 – 30.61%).

## 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)	13 weeks ended Apr. 3, <u>2011</u>	13 weeks ended Apr. 4, <u>2010</u>
Corporate Keg restaurants <sup>(1)</sup> .....	\$ 61,036	\$ 60,253
Franchised Keg restaurants <sup>(2)</sup> .....	<u>61,045</u>	<u>60,073</u>
Total system sales .....	<u>\$ 122,081</u>	<u>\$ 120,326</u>

Notes:

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

<sup>(2)</sup> 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.

System sales for the 13 weeks ended April 3, 2011 were \$122,081,000 compared to \$120,326,000 for the 13 weeks ended April 4, 2010, an increase of \$1,755,000 or 1.5%. During the 13 weeks ended April 3, 2011, one new corporate restaurant was relocated and no restaurants were closed. During the 13 weeks ended April 4, 2010, one corporate restaurant was relocated, and no restaurants were closed. As of April 3, 2011, there were a total of 103 Keg restaurants as compared with 104 Keg restaurants at April 4, 2010.

The Keg's same store sales (sales of restaurants that operated during the entire 13-week period of the current year and the 13-week period of the prior year) increased by 3.8% in Canada and by 3.2% 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 increased by 3.1%. The average exchange rate moved from 1.04 in KRL's second quarter of fiscal 2010 to 0.99 in KRL's second quarter of fiscal 2011, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales.

## OPERATING RESULTS

### GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool increased from \$116,953,000 to \$120,604,000 for the comparable quarter. The increase of \$3,651,000, or 3.1%, reflects the addition of net new sales to the Royalty Pool at the beginning of the year, and the same store sales increases discussed previously.

### ROYALTY INCOME

Total royalty income earned by the Partnership increased by \$172,000 from \$4,695,000 in the first quarter of 2010, to \$4,867,000 in the first quarter of 2011. Royalty income increased by \$146,000 during the quarter as a result of the increase in gross sales for the reasons explained previously, and Make-whole Payments increased by \$26,000 due to more restaurants closed during the quarter (13 more closed weeks).

## INTEREST INCOME

Interest income earned by the Fund during the first quarter of the current year was \$1,055,000, comprised of interest income on the Keg Loan of \$1,054,000 and other interest income of \$1,000. Interest on the Keg Loan and other interest income both remained the same during the quarter.

## PARTNERSHIP EXPENSES

Expenses incurred by the Partnership for the three months ended March 31, 2011 were \$100,000, comprised entirely of general and administrative expenses. The increase in Partnership expenses of \$2,000 over the comparable quarter of the prior year was due to an increase in general and administrative expenses of \$1,000 and a decrease in other interest income of \$1,000. General and administrative expenses increased due to the timing of certain expenditures. Other interest income decreased due to the lower surplus cash balances of the Partnership on hand during the quarter.

## INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Trust were \$174,000 for the three months ended March 31, 2011, and included interest on the long-term debt of \$164,000, and amortization of deferred financing charges of \$10,000. Interest costs increased by \$26,000 in the quarter as a result of an increase in the average interest rate on the long-term debt from 4.00% in the first quarter of 2010, to 4.75% in the first quarter of 2011. Amortization of deferred financing charges remained the same during the quarter.

## OPERATING INCOME

The Fund's operating income increased from \$5,504,000 during the first quarter of 2010, to \$5,648,000 during the first quarter of 2011. The increase of \$144,000 is due to the net impact of the increase in royalty income of \$172,000, the increase in administrative expenses of \$2,000, and the increase in interest and financing expenses of \$26,000.

## DISTRIBUTIONS TO KRL

Distributions declared to KRL during the quarter ended March 31, 2011 were \$1,290,000, which included distributions declared of \$577,000 on the Exchangeable units and \$713,000 on the Class C units. Distributions declared on the Exchangeable units decreased by \$277,000 from the comparable quarter of the prior year, due to a decrease in KRL's average effective ownership in the Partnership from 30.61% during the first quarter of 2010 to 22.49% during the first quarter of 2011. The change in the average effective ownership of the Partnership during the period was a result of the 2011 initial Additional Entitlement (received by KRL on January 1, 2011), the sale of 900,000 Fund units owned by KRL on April 9, 2010, and the sale of an additional 750,000 Fund units owned by KRL on February 8, 2011. The distributions declared on the Class C units remained the same during the comparable quarters, which were \$0.0625 per Class C unit per month.

## DISTRIBUTIONS TO FUND UNITHOLDERS

Distributions declared to Fund unitholders during the three month period ended March 31, 2011 of \$1,817,000 (8.0 cents/Fund unit per month) were recorded directly to the consolidated statement of retained earnings, whereas distributions declared to Fund unitholders during the three month period ending March 31, 2010 of \$2,068,000 (10.65/Fund unit per month) were recorded as interest expense in the consolidated statements of earnings and comprehensive income.

Distributions of \$2,945,000 (26.7 cents/Fund unit) were paid to Fund unitholders in the first quarter of 2011, as compared with \$3,100,000 (32.0 cents/Fund unit) in the first quarter of 2010, the reduced distributions being a result of the SIFT tax.



## **EARNINGS BEFORE FAIR VALUE ADJUSTMENT AND INCOME TAXES**

Earnings before fair value adjustment and income taxes increased by \$2,489,000 from \$1,869,000 (19.3 cents/Fund unit) in the first quarter of 2010, to \$4,358,000 (39.5 cents/Fund unit) in the first quarter of 2011. On a comparative basis, after adjusting for the distributions declared to Fund unitholders during the period, the earnings before fair value adjustment and income taxes, was \$3,937,000 (40.6 cents/Fund unit).

## **FAIR VALUE ADJUSTMENT**

The fair value of the Exchangeable units increased \$684,000 during the three months ended March 31, 2011, as compared with an increase of \$6,294,000 during the three months ended March 31, 2010. The market price of a Fund unit, (the basis upon which Exchangeable units are valued) increased from \$13.20 to \$13.26 during the first quarter of the current year, and there were a total of 2,886,546 Exchangeable units outstanding at the end of the first quarter of 2011. KRL also exchanged and subsequently sold 750,000 Exchangeable units during the quarter. The market price of a Fund unit increased from \$10.70 to \$12.10 during the comparable quarter of the prior year and there were a total of 4,280,891 Exchangeable units outstanding at the end of the first quarter of 2010.

## **INCOME TAXES**

Income taxes for the quarter ended March 31, 2011, were \$1,138,000 and included SIFT tax payable of \$926,000 and non-cash deferred taxes of \$212,000. SIFT tax payable increased by \$926,000 as the Fund was not liable to pay SIFT tax in the prior year, as it did not become effective until January 1, 2011. Deferred taxes increased by \$143,000 primarily as a result of the increase in the temporary differences between the accounting and tax bases of the Keg Rights owned by the Partnership.

## **NET EARNINGS (LOSS) AND COMPREHENSIVE INCOME**

Net earnings increased by \$7,030,000 from a loss of \$4,494,000 (-46.3 cents/Fund unit) in the first quarter of 2010, to \$2,536,000 (23.0 cents/Fund unit) in the first quarter of 2011, mostly due to the non-cash fair value adjustment of the Exchangeable unit liability. On a comparative basis, after adjusting for the distributions declared to Fund unitholders during the period, the net loss \$2,426,000 (-25.0 cents/Fund unit).

## **DISTRIBUTABLE CASH**

Distributable cash before SIFT tax increased by \$431,000 from \$3,401,000 (35.0 cents /Fund unit) to \$3,832,000 (34.7 cents/Fund unit). As a result of the imposition of the SIFT tax, cash available for distribution to Fund unitholders decreased by \$495,000 from \$3,401,000 (35.0 cents/Fund unit) to \$2,906,000 (29.3 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, fair value adjustments, and deferred income taxes included in the Fund's net earnings, as well as changes in non-cash working capital balances.

## **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 generated \$2,906,000 in distributable cash during the quarter and paid distributions of \$2,945,000. The shortfall of \$39,000 during the quarter was funded with surplus cash on hand from previous periods. The Fund has cash on hand of \$1,752,000 and a positive working capital balance of \$2,807,000 as at March 31, 2011.

## **TERM LOAN**

The Trust 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 March 9, 2011, the maturity date of the facility was extended from October 31, 2011 to April 2, 2012. On April 12, 2011 the maturity date of the facility was further extended from April 2, 2012 to April 2, 2014. The term loan held by the Trust is subject to certain financial covenants, including minimum equity amounts in both the Trust and the Partnership, and a minimum Partnership cash flow level defined as earnings before interest, taxes, depreciation and amortization (“EBITDA”). As at March 31, 2011, the Trust and Partnership equity amounts are approximately \$27.4 million and \$13.8 million in excess of the required minimum equity covenants, respectively. The Partnership EBITDA for year ended March 31, 2011 (last four financial quarters) is approximately \$3.4 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.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

The Chief Executive Officer and Chief Financial Officer of The Keg GP Ltd., managing general partner of the Partnership and administrator to the Fund, have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The control framework used to design the internal controls over financial reporting is “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission. There have been no significant changes to the internal control over financial reporting for the quarter ended March 31, 2011, that have had or are reasonably likely to have a material effect on the Fund’s internal controls over financial reporting.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of the Fund’s consolidated financial statements in conformity with IFRS requires estimates and judgements to be made that affect the reported amounts of assets and liabilities, net earnings and expenses, and related disclosures. These estimates are based on historical experience and knowledge of economics, market factors and the restaurant industry along with various other assumptions that are believed to be reasonable under the circumstances.

The Fund believes that the following selected accounting policies are critical to understanding the estimates, assumptions and uncertainties that affect the amounts reported and disclosed in the Fund’s consolidated financial statements and related notes.

## **DEFERRED INCOME TAX EXPENSE**

The Fund uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the deferred tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred 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 deferred tax assets and liabilities of changes in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of such changes.

## DEFERRED INCOME TAX EXPENSE (CONTINUED)

The determination of deferred income taxes requires the use of judgment and estimates. If certain judgements or estimates prove to be inaccurate, or if certain tax rates or laws change, the Fund's results of operations and financial position could be materially impacted.

## CURRENT INCOME TAX EXPENSE

The Fund estimates its liability for current income taxes (SIFT tax) by determining its share of the Partnership's taxable income and applying the current SIFT tax rate. The Fund's share of the Partnership taxable income involves certain assumptions which may differ from actual results at the end of the Fund's tax year. There is also the possibility that the Fund's tax rate could change.

## KEG RIGHTS

The Fund carries the Keg Rights at historical cost comprising the amount of consideration paid for the Keg Rights in 2002 as part of the Fund's IPO, as well as the value of additional sales of net new Keg restaurants added to the Royalty Pool since inception. The value of the gross sales of new Keg restaurants added to the Royalty Pool is determined on a formula basis that is designed to estimate the present value of the cash flows due to the Fund as a result of the sales of these new Keg restaurants being added to the Royalty Pool. As such, the calculation is dependent on a number of variables including the estimated long-term sales of the new Keg restaurants and a discount rate. The value assigned to the sales of net new Keg restaurants, and as a result, the value assigned to the Keg Rights, could differ from actual results.

## EXCHANGEABLE UNIT FAIR VALUE ADJUSTMENT

The Fund is required under IFRS to classify the Exchangeable units as a financial liability at fair value. This requires that the Fund use a valuation technique to determine the fair value of the Exchangeable units at the applicable reporting dates. The Fund estimates the fair value of this financial liability using the Fund's market capitalization at the end of the applicable period and allocating KRL's entitlement based upon its percentage ownership of the Fund on a fully-diluted basis. As at March 31, 2011, the Fund's closing price was \$13.26 per Fund unit resulting in a market capitalization of \$188.8 million. KRL's 20.27% ownership of the Fund (on a fully-diluted basis) was calculated to be \$38.3 million. This valuation technique may not represent the actual value of the financial liability should such Exchangeable units be extinguished, and changes in the distribution rate on the Exchangeable units and the yield of the Fund's units could materially impact the Fund's financial position and results of operations.

## NEW ACCOUNTING POLICIES

### INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Canadian Accounting Standards Board announced in February 2008 that publicly accountable entities would be required to adopt IFRS in place of Canadian GAAP for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011 (the "Adoption Date"). As noted previously, the Fund adopted IFRS effective the Adoption Date, however, has done so effective January 1, 2010 (the "Transition Date") in order to present comparative financial information under IFRS for the fiscal year 2010. Listed below are the various accounting policies that the Fund was required to adopt, and did adopt, on the Adoption Date (but effective the Transition Date) in connection with transitioning from Canadian GAAP to IFRS.

## CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS (IAS 27)

This standard applies to the preparation of consolidated financial statements for a group of entities under control of a parent entity and, in accordance with IFRS 1, the Fund has applied the standard prospectively effective the Transition Date. Under Canadian GAAP, the accounts of the Partnership were consolidated by KRL as a result of AcG-15. However, since the Fund controls the Partnership, the Fund now consolidates the accounts of the Partnership in its financial statements. The Partnership's significant assets include cash, royalties receivable from KRL, and the Keg Rights while its significant liabilities include the term loan and the financial liabilities of the Exchangeable and Class C Partnership units. The Fund's consolidated statements of earnings and comprehensive income will no longer include the equity income from the Partnership but rather the actual income and expenses of the Partnership. The Partnership's earnings are largely comprised of royalty income earned from Keg Rights less administrative and interest expenses. The adoption of this accounting policy is expected to have no impact on the Fund's business.

## FINANCIAL PRESENTATION (IAS 32)

The purpose of this standard is to establish principles for presenting financial instruments as liabilities or equity from the perspective of the issuer and applies to the classification of related interest, dividends, and losses or gains on such financial instruments. In accordance with IFRS 1, the Fund has applied this standard prospectively effective the Transition Date. This standard requires any financial instrument that has an obligation to deliver cash or other financial asset to another entity to be classified as a financial liability and that any payment made to the holder of such a financial liability be recorded as interest expense on the statement of profit or loss. Since the Fund consolidates the accounts of the Partnership under IFRS, the result of the adoption of the standard is to record the Exchangeable units and Class C units as financial liabilities and any payments in respect of these financial liabilities as interest expense. Additionally, the units are classified as a financial liability for all periods before December 20, 2010 and all distributions are recorded as interest expense as a result of the mandatory requirement existing in the Fund's Declaration of Trust for the Fund to distribute all taxable income to unitholders. On December 20, 2010 the Declaration of Trust was amended to, among other things, remove the mandatory requirement to distribute all taxable income, the result being that the Fund units qualify as an equity instrument under IFRS from and after December 20, 2010. Under Canadian GAAP, these financial instruments would have been classified as equity instruments and all associated distributions would have been charged to retained earnings (accumulated deficit). Despite the impacts on the Fund's financial statements described in the previous sections of this Management's Discussion and Analysis, there is no effect on the Fund's business as a result of this new accounting standard.

## FINANCIAL RECOGNITION AND MEASUREMENT (IAS 39)

The purpose of this standard is to establish principles for recognizing and measuring financial liabilities and, in accordance with IFRS 1, the Fund has applied this standard prospectively effective the Transition Date. Under IFRS, the Exchangeable units are classified as a financial liability and the Fund units are classified as a financial liability at all times prior to December 20, 2010. As a result of the embedded derivatives in the Exchangeable units, this standard requires that the Exchangeable unit liability be reported at fair value. The result of this standard is that on each reporting date, the Fund must estimate the fair value of the Exchangeable unit liability using a valuation technique. The change in fair value from one period to another will be reported on the statement of comprehensive income as a fair value adjustment. The requirement to record fair value adjustments through the Fund's statement of comprehensive income may give rise to material variations in the Fund's net earnings. Such adjustments have no impact on the Fund's cash flows or business.

### INTANGIBLE ASSETS (IAS 38)

The purpose of this standard is to prescribe the accounting treatment for intangible assets and, in accordance with IFRS 1, the Fund has applied this standard prospectively effective the Transition Date. This standard applies to the accounting for the Keg Rights and is substantially the same as Canadian GAAP. Under IFRS, the value of the intangible asset was tested for indications of impairment on the Transition Date and, similar to Canadian GAAP, at least annually thereafter. If an indicator of impairment exists, then an analysis must determine if the asset is indeed impaired, and if so, the value of the asset is written down to its reduced value with the loss expensed in the statement of profit and loss. IFRS differs from Canadian GAAP, however, in that the value of previously impaired assets may be increased should certain conditions be met. A significant amount of disclosure is required if any entity reverses previous impairments. The Fund does not anticipate any impact on its financial statements or business as a result of the adoption of this new standard.

### INCOME TAXES (IAS 12)

This standard governs the accounting treatment for current and deferred income taxes and, in accordance with IFRS 1, the Fund has applied this standard prospectively effective the Transition Date. The adoption of this standard is expected to have no significant impact on the Fund's financial statements. Financial statement readers will notice a current income tax expense and corresponding current income tax liability in 2011 whereas none existed in prior periods. These current income tax amounts are as a result of the Fund being liable to pay SIFT tax effective January 1, 2011 and are not the result of the adoption of IFRS. The Fund does not anticipate any impact on its financial statements or business as a result of the adoption of this new standard.

### REVENUE (IAS 18)

This standard governs the treatment of the Fund's revenue. The Fund's key source of revenue is the royalty income earned from KRL's use of the Keg Rights. IAS 18 states that revenue arising from the use by others of entity assets yielding royalties shall be recognized on an accrual basis in accordance with the relevant agreement. In accordance with IFRS 1, the Fund has applied this standard prospectively effective the Transition Date. The standard as applied to the Fund is substantially the same as Canadian GAAP and has no impact on the Fund's financial statements or its business.

### CURRENT INCOME TAXES

On January 1, 2011, the Fund became subject to the SIFT tax. The payment of the SIFT tax reduces the amount of cash available for distributions to the Fund's public unitholders. The SIFT tax also recharacterizes such distributions as eligible dividends received from a taxable Canadian corporation. Eligible dividend treatment for distributions to unitholders will generally be beneficial to Canadian resident investors holding their Units in taxable accounts compared to the previous characterization primarily as ordinary income. The Trustees of the Fund previously announced that they have examined alternatives available to the Fund to maximize unitholder value in the face of the legislative changes to the tax treatment of income trusts, which became effective on January 1, 2011, and believe that the Fund remaining a trust is in the best interest of unitholders. The Trustees will continue to examine alternatives for the structure of the Fund and can choose to convert to a new structure on a tax-deferred basis until December 31, 2012. If the Trustees decide, in the future, to change the Fund's existing structure, there is no way of determining the potential impact (positively or negatively) that any such change might have on the value or trading price of Fund units or any publicly traded replacement securities.

The Fund recorded a current income tax expense of \$926,000 during the first quarter of 2011 as a result of the Fund being liable to pay SIFT tax effective January 1, 2011. There were no taxes payable in the comparable quarter of the prior year.

The Fund's transition to reporting its financial results in accordance with IFRS from Canadian GAAP had no impact to how the Fund calculates or reports current income tax liabilities.

## DEFERRED INCOME TAXES

Deferred income taxes are recorded on the temporary differences arising between the accounting and tax bases of balance sheet assets and liabilities.

The Fund recorded a deferred income tax expense of \$0.2 million during the first quarter of 2011 (first quarter 2010 - \$0.1 million) and a corresponding increase in the deferred income tax liability as at March 31, 2011. The deferred income tax liability arises mainly as a result of the Fund recording its cumulative share of the temporary differences between the accounting and tax bases of the Keg Rights owned by the Partnership generated since the inception of the Fund. The deferred income tax amounts had no impact on the Fund's cash flows.

The Fund's transition to reporting its financial results in accordance with IFRS from Canadian GAAP had an impact on how the Fund calculates or reports deferred income tax liabilities. Under Canadian GAAP, costs related to the issuance of Fund units were netted against their carrying value. Under IFRS, these costs were charged to retained earnings. This change had no significant impact on the amount of deferred income tax expense for the period.

## FINANCIAL INSTRUMENTS

The Fund's financial instruments consist of cash, amount due from KRL, 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 that there is no significant value applicable to this feature. The fair values of the amount due from KRL, 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.

## OUTLOOK

In Canada, The Canadian Restaurant and Foodservice Association has estimated that sales in the full-service category, the category in which The Keg operates, increased by 1.3% in 2010 and has projected sales to increase by 2.6% in 2011. In the United States, the National Restaurant Association has projected sales in the full-service category to increase by 3.1% in 2011, after three consecutive years of real sales declines. Given the close historical relationship between disposable income and foodservice spending, management of KRL expects that as economic conditions continue to improve in North America, so will sales in the full-service category of the restaurant industry. While management of KRL does not expect a significant improvement in economic conditions 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. Advertising and promotions programs will continue to focus on food taste, quality and excellent service in a friendly atmosphere.

## **OUTLOOK (CONTINUED)**

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 continue to 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-nine years. Management of KRL has advised the Trustees that it currently expects to open three restaurants prior to October 2, 2011, consisting of one corporate and one franchised restaurant in Canada, as well as one corporate restaurant in the United States. The scheduled opening of these new restaurants is conditional upon the timely receipt of municipal approvals, construction permits, and ongoing evaluation of the current economic environment. 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, all of which are corporately owned through its wholly owned subsidiaries. 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, except as required by law.



## **ADDITIONAL INFORMATION**

Additional information about the Fund including the Fund's most recent annual information form is available on SEDAR at [www.sedar.com](http://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**

Karyn Byrne  
Investor Relations Manager  
Telephone: (416) 646-4960  
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E-mail: [karynb@kegrestaurants.com](mailto:karynb@kegrestaurants.com)  
Website: [www.kegincomefund.com](http://www.kegincomefund.com)

# THE KEG ROYALTIES INCOME FUND

## CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended March 31, 2011 and 2010

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars)

	Note	March 31, 2011	December 31, 2010	January 1, 2010
<b>ASSETS</b>				
Current assets:				
Cash .....		\$ 1,752	\$ 1,112	\$ 1,658
Prepaid expenses and deposits .....		99	23	23
Due from Keg Restaurants Ltd. ....	12	<u>2,413</u>	<u>2,639</u>	<u>2,422</u>
		4,264	3,774	4,103
Note receivable from Keg Restaurants Ltd. ....	5	57,000	57,000	57,000
Intangible assets, Keg Rights .....	6	<u>155,626</u>	<u>154,183</u>	<u>151,198</u>
		<u>\$ 216,890</u>	<u>\$ 214,957</u>	<u>\$ 212,301</u>
<b>LIABILITIES AND UNITHOLDERS' EQUITY (DEFICIENCY)</b>				
Current liabilities:				
Accounts payable and accrued liabilities .....		\$ 475	\$ 447	\$ 270
Interest payable on term loan .....		56	56	48
Distributions payable to Fund unitholders .....		-	1,129	1,033
Distributions payable to Keg Restaurants Ltd. ....	12	-	961	1,105
Current income tax payable .....	11	926	-	-
Term loan, net of deferred financing charges .....	10	<u>-</u>	<u>13,963</u>	<u>-</u>
		1,457	16,556	2,456
Term loan, net of deferred financing charges .....	10	13,973	-	13,924
Deferred income taxes .....	11	1,546	1,334	1,133
Class C Partnership units .....	9(b)	57,000	57,000	57,000
Exchangeable Partnership units .....	9(a)	38,276	46,378	43,734
Fund units liability .....	7	-	-	102,164
Unitholders' equity (deficiency):				
Fund units .....	7	143,516	133,286	-
Accumulated deficit .....		<u>(38,878)</u>	<u>(39,597)</u>	<u>(8,110)</u>
		<u>104,638</u>	<u>93,689</u>	<u>(8,110)</u>
		<u>\$ 216,890</u>	<u>\$ 214,957</u>	<u>\$ 212,301</u>

See accompanying notes to consolidated financial statements.

Subsequent events (note 10(a))

Approved on behalf of the Board of Trustees

“C.C. Woodward”  
**C.C. Woodward, Trustee**

“George Tidball”  
**George Tidball, Trustee**

## CONSOLIDATED STATEMENTS OF EARNINGS (LOSS) AND COMPREHENSIVE INCOME (LOSS)

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

	<u>Note</u>	January 1 to March 31, 2011	January 1 to March 31, 2010
Revenue:			
Royalty income .....	4	\$ 4,867	\$ 4,695
Interest income .....		<u>1,055</u>	<u>1,055</u>
		5,922	5,750
Expenses:			
General and administrative .....		(100)	(98)
Interest and financing fees .....		(164)	(138)
Amortization of deferred financing charges .....		<u>(10)</u>	<u>(10)</u>
		(274)	(246)
Earnings before undernoted .....		5,648	5,504
Distributions (declared) recorded as interest:			
Class C Partnership units .....	9(b)	(713)	(713)
Exchangeable Partnership units .....	9(a)	(577)	(854)
Distributions to Fund unitholders .....	7	<u>-</u>	<u>(2,068)</u>
		(1,290)	(3,635)
Earnings before change in market value and income taxes .....		4,358	1,869
Increase in market value of Exchangeable Partnership units .....	9(a)	<u>(684)</u>	<u>(6,294)</u>
		3,674	(4,425)
Taxes:			
Current .....	11	(926)	-
Deferred .....	11	<u>(212)</u>	<u>(69)</u>
		(1,138)	(69)
Net earnings (loss) and comprehensive income (loss) for the period .....		<u>\$ 2,536</u>	<u>\$ (4,494)</u>
Weighted average Fund units outstanding .....	3(k)	<u>11,036,833</u>	<u>9,703,500</u>
Basic and diluted earnings (loss) per Fund unit .....	3(k)	<u>\$ 0.23</u>	<u>\$ (0.25)</u>

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (DEFICIENCY)

(Expressed in thousands of dollars - unaudited)

	Fund units	Accumulated Deficit	Unitholders' equity (deficiency)
Balance, January 1, 2010 .....	\$ -	\$ (8,110)	\$ (8,110)
Net loss and comprehensive loss for the period .....	-	(4,494)	(4,494)
Balance, March 31, 2010 .....	\$ -	\$ (12,604)	\$ (12,604)
Balance, January 1, 2010 .....	\$ -	\$ (8,110)	\$ (8,110)
Net loss and comprehensive loss for the period .....	-	(31,487)	(31,487)
Extinguishment of Fund unit liability .....	133,286	-	133,286
Balance, December 31, 2010 .....	\$ 133,286	\$ (39,597)	\$ 93,689
Balance, January 1, 2011 .....	\$ 133,286	\$ (39,597)	\$ 93,689
Net earnings and comprehensive income for the period .....	-	2,536	2,536
Class B unit exchange, February 8, 2011 .....	10,230	-	10,230
Distributions declared to Fund unitholders .....	-	(1,817)	(1,817)
Balance, March 31, 2011 .....	\$ 143,516	\$ (38,878)	\$ 104,638

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

	<u>Note</u>	January 1 to March 31, 2011	January 1 to March 31, 2010
<b>Cash provided by (used for):</b>			
<b>OPERATIONS:</b>			
Net earnings (loss) for the period .....		\$ 2,536	\$ (4,494)
Items not involving cash:			
Amortization of deferred financing charges .....		10	10
Deferred income tax expense .....	11	212	69
Increase in market value of Exchangeable Partnership units .....	9(a)	684	6,294
Distributions (declared) recorded as interest:			
Class C Partnership units .....	9(b)	713	713
Exchangeable Partnership units .....	9(a)	577	854
Distributions to Fund unitholders .....	8	-	2,068
Change in non-cash operating working capital .....	16(a)	<u>1,104</u>	<u>217</u>
		5,836	5,731
<b>FINANCING:</b>			
Distributions paid to Class C unitholders .....		(713)	(713)
Distributions paid to Exchangeable unitholders .....		(1,538)	(1,959)
Distributions paid to Fund unitholders .....		<u>(2,945)</u>	<u>(3,100)</u>
		<u>(5,196)</u>	<u>(5,772)</u>
Increase (decrease) in cash .....		640	(41)
Cash, beginning of period .....		<u>1,112</u>	<u>1,658</u>
Cash, end of period .....		<u>\$ 1,752</u>	<u>\$ 1,617</u>

See note 16(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 - unaudited)

For the three months ended March 31, 2011 and 2010

### 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 and is governed by the Declaration of Trust signed May 31, 2002 and as amended on December 20, 2010. The Fund is registered and domiciled in Canada and its principal business office is located at 10100 Shellbridge Way, Richmond, British Columbia.

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.

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. BASIS OF PREPARATION AND ADOPTION OF IFRS:

#### (a) Statement of compliance:

These consolidated financial statements, including comparatives, have been prepared in accordance with International Financial Reporting Standards (“IFRS”) and in accordance with International Accounting Standard (“IAS”) 34 *Interim Financial Reporting*. These are the Fund’s first consolidated financial statements prepared in accordance with IFRS and IFRS 1 *First-time Adoption of International Financial Reporting Standards* has been applied. The consolidated financial statements do not include all of the information required for full annual financial statements.

An explanation of how the transition to IFRS has affected the financial position, financial performance and cash flows of the Fund is provided in note 17. This note includes reconciliations of equity and total comprehensive income for comparative periods and of equity on the date of transition reported under previous Canadian generally accepted accounting principles (“GAAP”) to those reports for those periods and at the date of transition to IFRS.

The consolidated financial statements were authorized for issue by the Fund’s Board of Trustees on June 13, 2011.

#### (b) Functional and reporting currency:

These consolidated financial statements have been prepared in Canadian dollars, which is also the Fund’s functional currency.

#### (c) Use of estimates and judgements:

The preparation of financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and liabilities, and revenue and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 2. BASIS OF PREPARATION AND ADOPTION OF IFRS (CONTINUED):

(c) Use of estimates and judgements (continued):

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and further periods if the review affects both current and future periods.

The key estimates and judgments made by management in the application of IFRS that have a significant effect on the amounts recognized in these consolidated financial statements relate to the determination of:

(i) Intangible assets (note 6):

The fair value of the annual entitlement is determined on a formula basis that is designed to estimate the present value of the cash flows due to the Fund as a result of net new Keg Restaurants being added to the existing Keg restaurants on which KRL pays a royalty to the Partnership (the "Royalty Pool"). As such, the calculation is dependent on a number of different variables including the estimated long-term sales of the new restaurants and a discount rate. The value assigned to the new Keg Restaurants, and as a result, the value assigned to the Keg Rights, could differ materially from actual results.

(ii) Fair value adjustment of Partnership Class A, B and D units ("Exchangeable Partnership units") (note 9(a)):

The Fund estimates the fair value of the Exchangeable Partnership unit liability using the Fund's closing market price on a given reporting date. This valuation technique may not represent the actual value of the financial liability should such units be extinguished and changes in the distribution rate on the Exchangeable Partnership units and the yield of the Fund's units could materially impact the Fund's financial position and net income.

(iii) Current income taxes (note 11):

The determination of the Fund's share of the Partnership's taxable income involves certain assumptions which may differ from actual results at the end of the Fund's taxation year. There is also the possibility that the Fund's tax rate could change, consequently, actual results could differ from these estimates.

(iv) Deferred income taxes (note 11):

The determination of deferred income taxes requires the use of judgement and estimates. If certain judgements or estimates prove to be inaccurate, or if certain tax rates or laws change, the Fund's financial position and net income could be materially impacted



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 3. SIGNIFICANT ACCOUNTING POLICIES:

(a) Basis of consolidation:

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”) and the Partnership (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.

All significant intercompany transactions and balances have been eliminated on consolidation.

(b) Basis of measurement:

These consolidated financial statements have been prepared on the historical cost basis, except for the following material items in the statement of financial position:

- Exchangeable Partnership unit liability measured at fair value through the consolidated statement of earnings and comprehensive income; and
- Note receivable from KRL and Class C Partnership unit liability are measured at amortized cost.

(c) Cash:

Cash consists of cash on hand and balances on deposit with a Canadian chartered bank.

(d) Revenue recognition:

Royalty revenue is recognized on the accrual basis and is accrued for when earned. Royalty payments 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 (note 4).

Interest income is recognized and accrued for when earned.

(e) Intangible assets (note 6):

Intangible assets consisting of the Keg Rights are recorded at their historical cost. The intangible assets are adjusted to record Class B and D units of the Partnership at their fair value at the date of determination of their respective annual entitlement. The Keg Rights are not amortized as they have an indefinite life.

(f) Distributions to Fund unitholders (note 8):

The amount of cash available to be distributed to Fund unitholders is determined with reference to the Fund’s net earnings adjusted for non-cash items such as deferred income taxes, fair value adjustments on the Exchangeable Partnership units liability (note 9(a)), and gains or losses arising from the retirement or extinguishment of Fund unit financial liabilities. Adjustments are also made for changes in non-cash working capital, distributions and/or interest paid to Fund and Partnership unitholders, current income tax liabilities, and KRL’s share of the Fund’s available cash by virtue of KRL’s investment in the Partnership (note 4).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(f) Distributions to Fund unitholders (continued):

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

(g) Income taxes (note 11):

Income tax expense comprises current and deferred tax expense and is recognized in profit or loss.

Current tax expense is the expected tax payable on the Fund's taxable income for the year, using enacted or substantively enacted tax rates at the reporting date, adjusted for amendments to tax payable in respect of previous years.

Deferred taxes are recorded using the statement of financial position liability method of accounting for deferred tax assets and liabilities and recognizes the deferred tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases. Deferred 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 deferred tax assets and liabilities of a change in tax rates is recognized in comprehensive income (loss) in the period that includes the enactment date. Where it is considered to be more likely than not that the deferred income tax assets will not be realized, a valuation allowance is provided for the difference.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Fund intends to settle its current tax assets and liabilities on a net basis or the tax assets and liabilities will be realized simultaneously.

(h) Borrowings (note 10):

Borrowings are initially recognized at fair value net of any financing fees. Borrowings are classified as current liabilities unless the Fund has an unconditional right to defer settlement of the liability for more than twelve months. After initial recognition borrowings are carried at amortized cost with any difference between the proceeds (net of financing fees) and the redemption value recognized in the consolidated statement of earnings and comprehensive income over the period of the borrowing using the effective interest rate method.

(i) Financial Instruments:

The Fund initially recognizes financial assets and liabilities when the Fund becomes a party to the contractual provisions of the instrument. The Fund derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred.

Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Fund has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

#### (i) Financial Instruments (continued):

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

- Financial assets and liabilities at fair value through profit or loss: A financial asset or liability is generally classified in this category if acquired principally for the purposes of selling or repurchasing in the short term. Derivatives are also included in this category unless they are designated as hedges. The Fund has classified cash as a financial asset as it is short term. Exchangeable Partnership unit liability (note 9(a)) is classified as a financial liability due to the contractual obligation to distribute cash and is measured at fair value due to certain conversion features.

Financial instruments in this category are recognized initially and subsequently at fair value and transaction costs are expensed in the consolidated statement of earnings and comprehensive income in the period incurred. Gains and losses arising from changes in fair value are presented in the statement of earnings and comprehensive income within other gains and losses in the period in which they arise. Financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which is classified as non-current.

- Loans and receivables: Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in the active market. Interest receivable on the note receivable from KRL, royalties receivable, and the note receivable from KRL comprise this category. Loans and receivables are initially recognized at the amount expected to be received less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized costs using the effective interest method and when material an adjustment to loans and receivables to fair value.
- Financial liabilities at amortized cost: Financial liabilities at amortized cost include accounts payable and accrued liabilities, interest payable to Fund unitholders, interest payable to KRL, current income tax payable, Class C Partnership unit liability, Fund unit liability, and distributions payable to unitholders. These items are initially recognized at the amount required to be paid less, when material, a discount to reduce the payables to fair value or transaction costs incurred. Subsequently, these items are measured at amortized cost using the effective interest rate method. Financial liabilities are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities. Exchangeable Partnership units have been classified as financial liabilities and are discussed further in note 9(a).
- Derivative financial instruments: The requirement of the Fund to settle its note receivable from KRL in exchange for Class C 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.

Unless otherwise noted, the fair values on instruments noted approximate their carrying amount largely due to the short-term maturities of these instruments.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

#### (i) Financial Instruments (continued):

The Fund must classify fair value measurements according to a hierarchy that reflects the significance of the inputs used in performing such measurements. The Fund's fair value hierarchy comprises the following levels:

- Level 1 – quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – pricing inputs are other than quoted in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reporting date.
- Level 3 – valuations in this level are those with inputs for the asset or liability that are not based on observable data.

The fair value of cash and the Exchangeable Partnership unit liability were determined using Level 1 inputs.

#### (j) Impairment:

##### • Financial assets:

A financial asset not carried at fair value through profit or loss is assessed at each reporting date to determine whether there is objective evidence that it is impaired. A financial asset is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and that the loss event had a negative effect on the estimated future cash flows of that asset that can be estimated reliably.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate.

When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss. The Fund has tested its note receivable from KRL and has determined that no indicators of impairment exist.

##### • Non-financial assets:

Intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets that are not amortized, such as the Keg Rights, are subject to an annual test. If a permanent decline in the carrying amount is determined, the intangible assets are written down to their estimated net recoverable amount.

An impairment loss is recognized when the carrying amount of the intangible assets is determined to exceed its recoverable amount and impairment losses are recognized in profit or loss for the period. The recoverable amount is the greater of the assets fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2011 and 2010

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(j) Impairment (continued):

An impairment loss is reversed if there is an indication that there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the intangible asset's carrying amount does not exceed the carrying amount that would have been determined if no impairment loss had been recognized.

(k) Earnings per unit:

Basic earnings per unit calculations are based on the weighted average number of Fund units outstanding during the period. Diluted earnings per unit calculations are based on the weighted average number of Fund units and Exchangeable Partnership units outstanding during the period.

For the period from January 1 to March 31, 2010, the \$2,068,000 in distributions declared to Fund unitholders has been added back to basic and diluted earnings (loss) per Fund unit for comparative purposes.

Diluted earnings per unit includes the Exchangeable Partnership units and is calculated by adjusting the weighted average number of Fund units outstanding to assume conversion of all potential, dilutive Fund units. For the purposes of the weighted average number of units outstanding, units are determined to be outstanding from the date they are issued.

The following reconciles the basic net earnings (loss) to the diluted net earnings:

	January 1 to March 31, 2011	January 1 to March 31, 2010
Basic net earnings (loss) for the period .....	\$ 2,536	\$ (4,494)
Distributions on Fund units .....	<u>-</u>	<u>2,068</u>
Adjusted basic net earnings (loss) for the period .....	2,536	(2,426)
Distributions on Exchangeable Partnership units .....	577	854
Increase in market value of Exchangeable Partnership units .....	<u>684</u>	<u>6,294</u>
Diluted net earnings for the period .....	<u>\$ 3,797</u>	<u>\$ 4,722</u>
Weighted average number of Fund units .....	11,036,833	9,703,500
Weighted average number of Exchangeable Partnership units .....	<u>3,203,212</u>	<u>4,280,491</u>
Weighted average number of units.....	<u>14,240,045</u>	<u>13,983,991</u>
Basic earnings (loss) per Fund unit .....	<u>\$ 0.23</u>	<u>\$ (0.25)</u>

For the three months ended March 31, 2011 and March 31, 2010, the Exchangeable Partnership units are anti-dilutive. Accordingly, the diluted earnings (loss) per Fund unit equals the basic earnings per Fund unit.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

#### (l) 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. ROYALTY POOL:

Annually, on January 1, 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 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 31 of each year when the actual full year performance of the new restaurants have been confirmed.

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 one permanent closure and one temporary closure due to an extended restaurant renovation for the period from January 1 to March 31, 2011 (January 1 to March 31, 2010 – one restaurant closure).

On January 1, 2011, three new Keg restaurants that opened during the period from October 3, 2009 to October 2, 2010 were added to the Royalty Pool. The gross sales of these three new restaurants have been estimated at \$15.7 million annually. Three permanently closed Keg restaurants with annual sales of \$10.4 million have been removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$5.3 million annually. The total number of restaurants in the Royalty Pool remains at 102. The yield of the Fund Units was determined to be 10.90% calculated using a weighted average unit price of \$11.73.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 4. ROYALTY POOL (CONTINUED):

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 153,737 Fund units, being 1.08% of the Fund units on a fully diluted basis. On January 1, 2011, KRL received 80% of this entitlement representing the equivalent of 122,990 Fund units, being 0.86% 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 2,886,546 Fund units, representing 20.27% of the Fund units on a fully diluted basis. The balance of the Additional Entitlement will be adjusted to be effective January 1, 2011 once the actual performance of the new restaurants have been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2011, it would have the right to exchange its Partnership units for 2,917,293 Fund units, representing 20.44% of the Fund units on a fully diluted basis.

Royalty income for the three-month periods was calculated as follows:

	January 1 to March 31, <u>2011</u>	January 1 to March 31, <u>2010</u>
Restaurants in Royalty Pool .....	102	102
Royalty Pool system sales .....	<u>\$ 120,604</u>	<u>\$ 116,953</u>
Royalty income at 4% of system sales reported above .....	4,824	4,678
Make-whole payment, based on 4% of lost system sales .....	<u>43</u>	<u>17</u>
Total royalty income .....	<u>\$ 4,867</u>	<u>\$ 4,695</u>

### 5. NOTE RECEIVABLE FROM KEG RESTAURANTS LTD.:

	<u>March 31, 2011</u>	<u>December 31, 2010</u>	<u>January 1, 2010</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>	<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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 6. INTANGIBLE ASSETS:

On May 31, 2002, the Partnership acquired the Keg Rights from KRL for \$113,546,820 of which \$30,487,380 was paid in cash, \$9,059,440 was paid by the issuance of 905,944 Class A Partnership units ("Class A Units"), \$17,000,000 was paid by the issuance of 3,376,700 Class B Partnership units ("Class B units") and \$57,000,000 was paid by the issuance of 5,700,000 Class C Partnership units ("Class C units"). Concurrent with the sale of the Keg Rights, the Partnership granted KRL a licence to use the Keg Rights for a period of 99 years. As consideration, KRL pays the Partnership a royalty of four percent of system sales reported by the Keg restaurants included the Royalty Pool (note 4).

As described in note 3(e), the Fund has adopted a policy of accounting for the Additional Entitlement of Class B and D units based on the fair value of these units at the date of determination which results in an increase in intangible assets and in the Exchangeable Partnership unit liability.

Balance, January 1, 2010 .....	\$	151,198
January 1, 2010 initial estimate of Additional Entitlement (80%) .....		1,771
December 31, 2010 final remaining Additional Entitlement (100%) .....		<u>1,214</u>
Balance, December 31, 2010 .....		154,183
January 1, 2011 initial estimate of Additional Entitlement (80%) .....		<u>1,443</u>
Balance, March 31, 2011 .....	\$	<u>155,626</u>

### 7. FUND UNITS:

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.

As at January 1, 2010, the Fund units were classified as a financial liability because of specific distribution requirements set out in the declaration of trust. The Fund unit liability was initially measured at fair value and subsequently at amortized cost. All related distributions from the Fund units were recognized as interest expense in the consolidated statement of earnings and comprehensive income (note 17(i)).



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2011 and 2010

### 7. FUND UNITS (CONTINUED):

On December 20, 2010, the Fund held a special meeting of its unitholders which amended the terms of Declaration of Trust and removed the specific distributions requirements. Upon this amendment, the difference between the carrying amount of Fund units (\$113,045,000) and the fair value of the Fund units as the close of business on December 20, 2010 (\$133,286,000) was recognized as a loss on the extinguishment of the Fund unit liability (\$20,241,000) through the Fund's consolidated statement of earnings and comprehensive income. Prior to this meeting date, \$2,068,000 was recognized as interest expense in the consolidated statement of earnings and comprehensive income for the three-month period ended March 31, 2010. Distributions to Fund unitholders are recorded as a reduction in unitholders' equity for the three-month period ended March 31, 2011.

On February 8, 2011, the Fund completed a secondary offering of units after filing a short form prospectus with the British Columbia Securities Commission to qualify the distribution by KRL of 750,000 units of the Fund at a price of \$13.65 per unit, for gross proceeds of \$10,237,500. The Fund did not receive any proceeds pursuant to this offering. As a result of this transaction, the number of Fund units outstanding increased from 10,603,500 as at December 31, 2010 to 11,353,500 on February 8, 2011 and the public's effective ownership of the Fund increased from 74.46% as at January 1, 2011 to 79.73% on February 8, 2011.

	Number of Fund units	Fund unit liability	Fund units as equity
Balance, January 1, 2010 .....	9,703,500	\$ 102,164	\$ -
Class B unit exchange for Fund units, April 9, 2010 .....	900,000	10,881	-
Reclassification of Fund units to equity .....	-	(113,045)	113,045
Loss on extinguishment of Fund unit liability .....	<u>-</u>	<u>-</u>	<u>20,241</u>
Balance December 31, 2010 .....	10,603,500	-	133,286
Class B unit exchange for Fund units, February 8, 2011 .	<u>750,000</u>	<u>-</u>	<u>10,230</u>
Balance, March 31, 2011 .....	<u>11,353,500</u>	<u>\$ -</u>	<u>\$ 143,516</u>

### 8. DISTRIBUTIONS ON FUND UNITS:

	January 1 to March 31, 2011	January 1 to March 31, 2010
Distributions declared to Fund unitholders .....	<u>\$ 1,817</u>	<u>\$ 2,068</u>
Weighted average Fund units outstanding .....	<u>11,036,833</u>	<u>9,703,500</u>
Distributions declared per unit .....	<u>\$ 0.16</u>	<u>\$ 0.21</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2011 and 2010

### 8. DISTRIBUTIONS ON FUND UNITS (CONTINUED):

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.

Distributions declared to Fund unitholders during the three-month period ending March 31, 2011 were recorded directly to the consolidated statements of retained earnings whereas distributions declared to Fund unitholders during the three-month period ending March 31, 2010 were recorded as interest expense in the consolidated statement of earnings and comprehensive income (note 7).

On January 1, 2011, legislative changes to the tax treatment of certain income trusts, as a result of the SIFT tax, came into effect (note 11). As a result of this taxation imposed by the Federal Government, the Fund's trustees have had to adopt a new distribution policy which reflects the Funds obligation to make the SIFT tax payments. Beginning with the distribution paid to unitholders on February 28, 2011, distributions were set at \$0.08 per unit per month. This amounts to a distribution of \$0.96 per unit annually. At this level, the eligible dividend portion of the Fund's distribution, combined with the return of capital component of the distribution, should provide taxable Canadian individuals with an effective after-tax cash return very closely comparable to the return that existed before the imposition of the SIFT tax.

### 9. PARTNERSHIP UNIT LIABILITIES:

(a) Exchangeable Partnership unit liability:

KRL has the following Exchangeable Partnership units that are exchangeable into Fund units:

	<u>Note</u>	<u>January 1, 2010</u>	<u>Fair Value</u>
Class A Partnership units .....	(i)	905,944	\$ 9,694
Class B Partnership units .....	(ii)	1,826,700	19,546
Class D Partnership units .....	(iii)	<u>1,354,591</u>	<u>14,494</u>
		<u>4,087,235</u>	<u>\$ 43,734</u>
		<u>December 31, 2010</u>	<u>Fair Value</u>
Class A Partnership units .....	(i)	905,944	\$ 11,958
Class B Partnership units .....	(ii)	926,700	12,232
Class D Partnership units .....	(iii)	<u>1,680,912</u>	<u>22,188</u>
		<u>3,513,556</u>	<u>\$ 46,378</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2011 and 2010

### 9. PARTNERSHIP UNIT LIABILITIES (CONTINUED):

(a) Exchangeable Partnership unit liability:

	<u>Note</u>	March 31, <u>2011</u>	<u>Fair Value</u>
Class A Partnership units .....	(i)	905,944	\$ 12,013
Class B Partnership units .....	(ii)	176,700	2,343
Class D Partnership units .....	(iii)	<u>1,803,902</u>	<u>23,920</u>
		<u>2,886,546</u>	<u>\$ 38,276</u>

As a result of the Fund consolidating the accounts of the Partnership on adoption of IFRS (note 17(a)), the Exchangeable Partnership units are presented in the Fund's financial statements as a financial liability and measured at fair value. Changes in fair value are recognized in profit or loss in the reporting period that the gain or loss occurs. The fair value of the Exchangeable Partnership units is determined by using Level 1 inputs being the closing price of the Fund units on the Toronto Stock Exchange ("TSX") at the respective reporting date as Exchangeable Partnership units have similar distribution and voting rights as the Fund units. The closing unit price as at March 31, 2011 was \$13.26 (December 31, 2010 – \$13.20; January 1, 2010 – \$10.70).

The components of the change in balances in the Exchangeable Partnership unit liability for the three-month periods are as follows:

	Total number of Exchangeable <u>Partnership units</u>	January 1 to March 31, <u>2011</u>
Exchangeable Partnership units, beginning of period .....	3,513,556	\$ 46,378
January 1 initial estimate of Class D unit entitlement (80%) .....	122,990	1,444
Exchange of Class B units for Fund units .....	(750,000)	(10,230)
Fair value adjustment .....	<u>-</u>	<u>684</u>
Fair value of Exchangeable Partnership units, end of period .....	<u>2,886,546</u>	<u>\$ 38,276</u>
	Total number of Exchangeable <u>Partnership units</u>	January 1 to March 31, <u>2010</u>
Exchangeable Partnership units, beginning of period .....	4,087,236	\$ 43,734
January 1 initial estimate of Class D unit entitlement (80%) .....	193,655	1,771
Fair value adjustment .....	<u>-</u>	<u>6,294</u>
Fair value of Exchangeable Partnership units, end of period .....	<u>4,280,891</u>	<u>\$ 51,799</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 9. PARTNERSHIP UNIT LIABILITIES (CONTINUED):

(a) Exchangeable Partnership unit liability (continued):

Pursuant to the declaration of trust, the holders (other than the Fund or its subsidiaries) of the Class A Partnership units ("Class A units"), Class B Partnership units ("Class B units") and Class D Partnership units ("Class D units") 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, entitled Class B and Class D 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.

- (i) The Class B units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. The distribution entitlements of the Class B units were adjusted annually on January 1 until the January 1, 2008 roll-in when 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 on the basis of one Fund unit for one Class B unit and a total of 750,000 Class B units were exchanged for 750,000 Fund units on February 8, 2011 and a total of 900,000 Class B units were exchanged for 900,000 Fund units on April 9, 2010. Class B units held by KRL receive a distribution entitlement.
- (ii) The Class D units were issued to KRL in return for adding net sales from new Keg restaurants to the Royalty Pool and are entitled to a preferential proportionate distribution and a residual distribution based on the incremental royalty paid to the Partnership. 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 on the basis of one Fund unit for one Class D unit. 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.

(b) Class C unit liability:

Class C units are those units which have been issued to and are held by KRL. These units have an obligation to pay the Class C distribution of \$0.0625 per unit on a monthly basis as long as the note receivable from KRL is outstanding (note 5). Accordingly, the Class C units are classified as a financial liability and are measured at amortized cost under IFRS.

The requirement of the Fund to settle its note receivable from KRL in exchange for Class C units represents an embedded derivative. 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 10. BORROWINGS:

(a) Term Loan:

On August 12, 2009, the Fund amended the terms of its \$14,000,000 term loan with its existing banking syndicate. The facility bears interest at prime plus 1.75% and is secured by a general security agreement over the assets of the Fund. On March 9, 2011, the maturity date of the facility was extended from October 3, 2011 to April 2, 2012 and further extended on April 12, 2011 to April 1, 2014.

The term loan is presented net of \$27,106 in deferred financing charges at March 31, 2011 (December 31, 2010 – \$37,050; January 1, 2010 – \$75,657).

(b) Operating Line of Credit:

On August 12, 2009, the Partnership renegotiated the terms of its existing \$1,000,000 demand operating facility with KRL's banking syndicate. This facility bears interest at prime plus 1.50% and is secured by a general security agreement over the assets of the Partnership, an assignment of the royalty earned under the Licence and Royalty Agreement and a guarantee from KRL. As at March 31 2011, the entire \$1,000,000 remains available for use.

### 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. Historically, the Fund had been exempt from recognizing deferred income tax assets and liabilities associated with temporary differences arising in the Fund and its equity accounted investment, the Partnership. As a result of the substantive enactment of the new tax legislation, the Fund has recognized deferred income tax assets and liabilities that are expected to reverse subsequent to March 31, 2011. Deferred income tax expense is a non-cash item that does not affect cash flow.

On January 1, 2011, legislative changes to the tax treatment of certain income trusts came into effect. As a result of these changes, income trusts will not be entitled to deduct distributions of certain types of income for tax purposes, and are therefore subject to taxation similar to corporations. Accordingly, the Fund will be subject to tax at a rate of 26.5% for 2011 and 25.0% for the 2012 and later taxation years.

The components of income tax expense periods are as follows:

	January 1 to March 31, 2011	January 1 to March 31, 2010
Current income tax expense .....	\$ (926)	\$ -
Deferred tax expense .....	(212)	(69)
	<u>\$ (1,138)</u>	<u>\$ (69)</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 11. INCOME TAXES (CONTINUED):

The balance of the Fund's deferred tax liability increased to \$1,546,000 as at March 31, 2011 (December 31, 2010 – \$1,334,000; January 1, 2010 – \$1,133,000). The deferred tax liability arises mainly as a result of the Fund recording, in the current period, its cumulative share of the temporary differences between the accounting and tax bases of the Keg Rights, owned by the Partnership, generated since inception of the Fund.

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:

	January 1 to March 31, 2011	January 1 to March 31, 2010
Net earnings (loss) before income taxes .....	\$ 3,674	\$ (4,425)
Combined Canadian federal and provincial rates .....	<u>26.5%</u>	<u>28.5%</u>
Computed "expected" tax expense (recovery) .....	974	(1,261)
Increased (reduced) by:		
Current year's earnings not taxable .....	-	(865)
Permanent and other differences .....	(17)	2,157
Change in tax base of the Keg Rights .....	184	42
Differences between current and future tax rates and other items .....	<u>(3)</u>	<u>(4)</u>
Total income tax expense per the statement of comprehensive income (loss) .....	<u>\$ 1,138</u>	<u>\$ 69</u>

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

	March 31, 2011	December 31, 2010	January 1, 2010
Deferred tax liabilities:			
Temporary difference related to the Keg Rights .....	<u>\$ 1,546</u>	<u>\$ 1,334</u>	<u>\$ 1,133</u>
Deferred tax liability .....	<u>\$ 1,546</u>	<u>\$ 1,334</u>	<u>\$ 1,133</u>

### 12. RELATED PARTY TRANSACTIONS AND BALANCES:

KRL is considered to be a related party of the Fund by virtue of common directors of KRL and KGP, the General Partner of the Partnership and Administrator of the Fund. 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. KRL provided these services at no cost to the Partnership or the Fund.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 12. RELATED PARTY TRANSACTIONS AND BALANCES (CONTINUED):

The following is as summary of the balances due to and due from KRL:

	March 31, <u>2011</u>	December 31, <u>2010</u>	January 1, <u>2010</u>
Royalty fee, including GST/HST .....	\$ 2,050	\$ 2,276	\$ 2,059
Interest on note receivable from Keg Restaurants Ltd. ....	<u>363</u>	<u>363</u>	<u>363</u>
Due from Keg Restaurants Ltd. ....	<u>\$ 2,413</u>	<u>\$ 2,639</u>	<u>\$ 2,422</u>

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

	March 31, <u>2011</u>	December 31, <u>2010</u>	January 1, <u>2010</u>
Distribution payable to KRL .....	<u>\$ -</u>	<u>\$ 961</u>	<u>\$ 1,105</u>

The above amount was paid to KRL when due, subsequent to the end of the December 31, 2010 period.

### 13. COMPENSATION OF KEY MANAGEMENT:

Key management personnel are the Trustees of the Fund. Aggregate details of their remuneration are set out in the table below with further information about individual trustee remuneration provided in the Fund's Annual Information Form.

	January 1 to March 31, <u>2011</u>	January 1 to March 31, <u>2010</u>
Remuneration paid to the Fund's Trustees .....	<u>\$ 13</u>	<u>\$ 14</u>

### 14. 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 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 14. FINANCIAL RISK MANAGEMENT (CONTINUED):

(a) Credit risk (continued):

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.

Credit risk also arises from cash balances on deposit with financial institutions. The Fund has placed its cash balances on deposit with a Canadian chartered bank of high creditworthiness.

(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 comprised 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>
Account payable and accrued liabilities .....	\$ 475	< 1 year
Interest payable on term loan .....	56	< 1 year
Current income tax payable .....	926	< 1 year
Term loan .....	14,000	2014

The Fund is subject to certain guarantor covenants and reporting requirements arising from the Partnership's undrawn \$1,000,000 operating line of credit and KHT's \$14,000,000 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 \$14,000,000 term loan. As the note receivable from KRL has a fixed interest 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%.

(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 restaurant 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 quarter ended March 31, 2011, a 100 basis point change in the US dollar exchange rate would result in an approximate \$122,000 and \$4,880 change in Royalty Pool sales and royalty revenue, respectively.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 15. 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 following summarizes the Fund's managed capital:

	<u>Note</u>	March 31, 2011	December 31, 2010	January 1, 2010
Term loan .....	10(a)	\$ <u>14,000</u>	\$ <u>14,000</u>	\$ <u>14,000</u>
Fund units .....	7	\$ 143,516	\$ 133,286	\$ -
Accumulated deficit .....		<u>(38,878)</u>	<u>(39,597)</u>	<u>(8,110)</u>
Unitholders' equity (deficiency) .....		<u>\$ 104,638</u>	<u>\$ 93,689</u>	<u>\$ (8,110)</u>

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 March 31, 2011 the KHT and Partnership equity amounts are approximately \$27,411,000 and \$13,840,000 in excess of the required minimum equity covenants, respectively. The Partnership's EBITDA for the twelve-months ended March 31, 2011 is approximately \$3,372,000 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 9).

### 16. SUPPLEMENTARY CASH FLOW INFORMATION:

	January 1 to March 31, 2011	January 1 to March 31, 2010
(a) Change in non-cash operating working capital:		
Due from Keg Restaurants Ltd. ....	\$ 226	\$ 243
Prepaid expenses and deposits .....	(76)	(22)
Accounts payable and accrued liabilities .....	28	(4)
Current tax payable .....	<u>926</u>	<u>-</u>
	<u>\$ 1,104</u>	<u>\$ 217</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 16. SUPPLEMENTARY CASH FLOW INFORMATION (CONTINUED):

	January 1 to March 31, <u>2011</u>	January 1 to March 31, <u>2010</u>
(b) Supplementary information:		
Interest received .....	\$ 1,055	\$ 1,055
Interest paid .....	164	138
Non-cash transactions:		
Issuance of Fund units on Class B unit exchange .....	\$ 10,230	\$ -
Increase in intangible assets on Royalty Pool net sales roll-in .....	1,443	1,771

### 17. IFRS:

As stated in note 2(a), these are the Fund's first consolidated financial statements prepared in accordance with IFRS and IFRS 1 which sets forth guidance for the initial adoption of IFRS. The Fund's IFRS adoption date is January 1, 2011.

The accounting policies set out in note 3 have been consistently applied in preparing the consolidated financial statements for the quarter ended March 31, 2011, the comparative information presented for both the quarter ended March 31, 2010 and the year ended December 31, 2010 and in preparation of the opening IFRS statement of financial position at January 1, 2010 (the "Transition Date").

IFRS employs a conceptual framework that is similar to GAAP. However, significant differences exist in certain matters of recognition, measurement and disclosure. In preparing its opening IFRS statement of financial position, the Fund has adjusted amounts previously reported in accordance GAAP. In order to allow the users of the financial statements to better understand these changes, the Fund's GAAP consolidated statement of earnings and comprehensive income, consolidated statement of financial position and statement of cash flows for the quarter ended March 31, 2010 and the year ended December 31, 2010 have been reconciled to IFRS, with the resulting differences explained in the following tables and the notes that accompany the tables.

IFRS 1 also outlines specific guidelines that a first-time adopter must adhere to under certain circumstances. In accordance with IFRS 1, an entity's estimates under IFRS at the date of transition to IFRS must be consistent with estimates made for the same date under its previous GAAP, unless there is objective evidence that those estimates were in error. The Fund's IFRS estimates as of January 1, 2010 are consistent with the previous GAAP estimates for the same date.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

The January 1, 2010 GAAP consolidated statement of financial position has been reconciled to IFRS as follows:

		January 1, 2010		
	Note	GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>				
Current assets:				
Cash .....	(a)	\$ 1,379	\$ 279	\$ 1,658
Prepaid expenses and deposits .....	(a)	-	23	23
Due from Keg Restaurants Ltd. ....	(a) (b)	363	2,059	2,422
Due from The Keg Rights Limited Partnership .....	(a) (b)	<u>1,036</u>	<u>(1,036)</u>	<u>-</u>
		2,778	1,325	4,103
Note receivable from Keg Restaurants Ltd. ....		57,000	-	57,000
Intangible assets, Keg Rights .....	(a) (c)	-	151,198	151,198
Investment in The Keg Rights Ltd. Partnership .....	(a) (c)	<u>56,586</u>	<u>(56,586)</u>	<u>-</u>
		<u>\$ 116,364</u>	<u>\$ 95,937</u>	<u>\$ 212,301</u>
<b>LIABILITIES AND UNITHOLDERS' EQUITY (DEFICIENCY)</b>				
Current liabilities:				
Accounts payable and accrued liabilities .....	(a)	\$ -	\$ 270	\$ 270
Interest payable on term loan .....		48	-	48
Distributions payable to Fund unitholders .....		1,033	-	1,033
Distributions payable to Keg Restaurants Ltd. ....	(a) (b)	<u>-</u>	<u>1,105</u>	<u>1,105</u>
		1,081	1,375	2,456
Term loan, net of deferred financing charges .....	(d)	13,924	-	13,924
Deferred income taxes .....	(e)	1,875	(742)	1,133
Class C Partnership units .....	(a) (g)	-	57,000	57,000
Exchangeable Partnership units .....	(a) (f)	-	43,734	43,734
Fund units classified as liability .....	(h)	-	102,164	102,164
Unitholders' equity (deficiency):				
Fund units .....	(h)	100,014	(100,014)	-
Accumulated deficit .....		<u>(530)</u>	<u>(7,580)</u>	<u>(8,110)</u>
		<u>99,484</u>	<u>(107,594)</u>	<u>(8,110)</u>
		<u>\$ 116,364</u>	<u>\$ 95,937</u>	<u>\$ 212,301</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

The March 31, 2010 GAAP consolidated statement of earnings and comprehensive income has been reconciled to IFRS as follows:

	Note	January 1 to March 31, 2010		
		GAAP	Effect of Transition to IFRS	IFRS
<b>Revenue:</b>				
Equity Income .....	(a) (i)	\$ 2,267	\$ (2,267)	\$ -
Royalty Income .....	(a) (i)	-	4,695	4,695
Interest Income .....		<u>1,055</u>	<u>-</u>	<u>1,055</u>
		3,322	2,428	5,750
<b>Expenses:</b>				
General and administrative .....	(a)	-	(98)	(98)
Interest and financing fees .....		(138)	-	(138)
Amortization of deferred financing charges .....		<u>(10)</u>	<u>-</u>	<u>(10)</u>
		(148)	(98)	(246)
Earnings before undernoted .....		3,174	2,330	5,504
<b>Distributions (declared) recorded as interest:</b>				
Class C Partnership units .....	(a) (g)	-	(713)	(713)
Exchangeable Partnership units .....	(a) (f)	-	(854)	(854)
Distributions to Fund unitholders .....	(h)	<u>-</u>	<u>(2,068)</u>	<u>(2,068)</u>
		-	(3,635)	(3,635)
Earnings (loss) before change in market value and taxes..		3,174	(1,305)	1,869
<b>Decrease (increase) in market value of</b>				
Exchangeable Partnership units .....	(a) (f)	<u>-</u>	<u>(6,294)</u>	<u>(6,294)</u>
		3,174	(7,599)	(4,425)
<b>Taxes:</b>				
Current .....		-	-	-
Deferred .....	(e)	<u>100</u>	<u>(169)</u>	<u>(69)</u>
		100	(169)	(69)
Net earnings (loss) and comprehensive income (loss) for the period .....		<u>\$ 3,274</u>	<u>\$ (7,768)</u>	<u>\$ (4,494)</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

The December 31, 2010 GAAP consolidated statement of financial position has been reconciled to IFRS as follows:

	Note	December 31, 2010		
		GAAP	Effect of Transition to IFRS	IFRS
<b>ASSETS</b>				
Current assets:				
Cash .....	(a)	\$ 933	\$ 179	\$ 1,112
Prepaid expenses and deposits .....	(a)	-	23	23
Due from Keg Restaurants Ltd. ....	(a) (b)	363	2,276	2,639
Due from The Keg Rights Limited Partnership .....	(a) (b)	<u>1,089</u>	<u>(1,089)</u>	<u>-</u>
		2,385	1,389	3,774
Note receivable from Keg Restaurants Ltd. ....		57,000	-	57,000
Intangible assets, Keg Rights .....	(a) (c)	-	154,183	154,183
Investment in The Keg Rights Limited Partnership .....	(a) (c)	<u>67,488</u>	<u>(67,488)</u>	<u>-</u>
		<u>\$ 126,873</u>	<u>\$ 88,084</u>	<u>\$ 214,957</u>
<b>LIABILITIES AND UNITHOLDERS' EQUITY (DEFICIENCY)</b>				
Current liabilities:				
Accounts payable and accrued liabilities .....	(a)	\$ -	\$ 447	\$ 447
Interest payable on term loan .....		56	-	56
Distributions payable to Fund unitholders .....		1,129	-	1,129
Distributions payable to Keg Restaurants Ltd. ....	(a) (b)	-	961	961
Term loan, net of deferred financing charges .....	(d)	<u>-</u>	<u>13,963</u>	<u>13,963</u>
		1,185	15,371	16,556
Term loan, net of deferred financing charges .....		13,963	(13,963)	-
Deferred income taxes .....	(e)	1,875	(541)	1,334
Class C Partnership units .....	(a) (g)	-	57,000	57,000
Exchangeable Partnership units .....	(a) (f)	-	46,378	46,378
Unitholders' equity (deficiency):				
Fund units .....	(h)	110,895	22,391	133,286
Accumulated deficit .....		<u>(1,045)</u>	<u>(38,552)</u>	<u>(39,597)</u>
		<u>109,850</u>	<u>(16,161)</u>	<u>(93,689)</u>
		<u>\$ 126,873</u>	<u>\$ 88,084</u>	<u>\$ 214,957</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

The December 31, 2010 GAAP consolidated statement of earnings and comprehensive income has been reconciled to IFRS as follows:

	Note	January 1 to December 31, 2010		
		GAAP	Effect of Transition to IFRS	IFRS
Revenue:				
Equity Income .....	(a) (i)	\$ 9,218	\$ (9,218)	\$ -
Royalty Income .....	(a) (i)	-	18,422	18,422
Interest Income .....		<u>4,278</u>	<u>-</u>	<u>4,278</u>
		13,496	9,204	22,700
Expenses:				
General and administrative .....	(a)	-	(417)	(417)
Interest and financing fees .....		(612)	-	(612)
Amortization of deferred financing charges .....		<u>(39)</u>	<u>-</u>	<u>(39)</u>
		(651)	(417)	(1,068)
Earnings before undernoted .....		12,845	8,787	21,632
Distributions (declared) recorded as interest:				
Class C Partnership units .....	(a) (g)	-	(4,275)	(4,275)
Exchangeable Partnership units .....	(a) (f)	-	(4,500)	(4,500)
Distributions to Fund unitholders .....	(h)	<u>-</u>	<u>(13,360)</u>	<u>(13,360)</u>
		-	(22,135)	(22,135)
Earnings (loss) before change in market value and taxes..		12,845	(13,348)	(503)
Extinguishment of Fund unit liability .....	(h)	-	(20,241)	(20,241)
Decrease (increase) in market value of				
Exchangeable Partnership units.....	(a) (f)	<u>-</u>	<u>(10,542)</u>	<u>(10,542)</u>
		12,845	(44,131)	(31,286)
Taxes:				
Current .....		-	-	-
Deferred .....	(e)	<u>-</u>	<u>(201)</u>	<u>(201)</u>
		-	(201)	(201)
Net earnings (loss) and comprehensive income (loss)				
for the period .....		<u>\$ 12,845</u>	<u>\$ (44,332)</u>	<u>\$ (31,487)</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

Unitholders' equity (deficiency) under GAAP has been reconciled to IFRS as follows:

	Note	December 31, 2010	March 31, 2010	January 1, 2010
Unitholders' equity as reported under GAAP .....		\$ 109,850	\$ 100,690	\$ 99,484
Increase (decrease) due to adoption of IFRS:				
Net impact on consolidation of the Partnership .....	(a)	86,676	97,096	94,562
Adjustment to deferred income taxes .....	(e)	541	573	742
Reclassification of units to financial liabilities:				
Exchangeable Partnership units .....	(f)	(46,378)	(51,799)	(43,734)
Class C Partnership units .....	(g)	(57,000)	(57,000)	(57,000)
Fund units .....	(h)	-	(100,014)	(100,014)
To expense IPO unit issue costs .....	(h)	-	(2,150)	(2,150)
Unitholders' equity (deficiency) as reported under IFRS .....		<u>\$ 93,689</u>	<u>\$ (12,604)</u>	<u>\$ (8,110)</u>

#### (a) Consolidation of the Partnership:

In accordance with IFRS, the Fund now consolidates the accounts of the Partnership rather than account for the Fund's investment in the Partnership using the equity method, as the Partnership was considered a variable interest entity ("VIE") under GAAP. These adjustments pertain to the Fund's consolidation of the Partnership's accounts under IFRS and elimination of intercompany transactions and balances. The following assets and liabilities of the Partnership have been included in the Fund's consolidated statements of financial position:

	Note	December 31, 2010	March 31, 2010	January 1, 2010
<b>ASSETS</b>				
Cash .....		\$ 179	\$ 85	\$ 279
Prepaid expenses and deposits .....		23	45	23
Due from Keg Restaurants Ltd. ....	(b)	2,276	1,816	2,059
Intangible assets, Keg Rights .....	(c)	154,183	152,969	151,198
<b>LIABILITIES</b>				
Accounts payable and accrued liabilities .....		447	267	270
Distributions payable Keg Restaurants Ltd .....	(b)	961	-	1,105
Exchangeable Partnership units .....	(f)	46,378	51,799	43,734
Class C Partnership units .....	(g)	57,000	57,000	57,000

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

(a) Consolidation of the Partnership (continued):

The following revenues and expenses of the Partnership have been included in the Fund's consolidated statements of earnings and comprehensive income:

	<u>Note</u>	Year Ended December 31, <u>2010</u>	January 1 to March 31, <u>2010</u>
REVENUE			
Royalty Income .....	(i)	\$ 18,422	\$ 4,695
EXPENSES			
General and administrative .....		(417)	(98)
Distributions recorded as interest under IFRS:			
Class C Partnership units .....	(g)	(4,275)	(713)
Exchangeable Partnership units .....	(f)	(4,500)	(854)
Decrease (increase) in market value of			
Exchangeable Partnership units .....	(f)	(10,542)	(6,294)

(b) Due from Keg Restaurants Ltd., due from The Keg Rights Ltd. Partnership and distributions payable to Keg Restaurants Ltd.:

On consolidation of the Partnership, the Fund must recognize the royalty fee receivable from KRL and the distribution payable to KRL on the Exchangeable Partnership units and Class C units in the accounts of the Partnership, and must eliminate intercompany distributions receivable from the Partnership.

(c) Intangible assets and Investment in The Keg Rights Ltd. Partnership:

On consolidation of the Partnership, the Fund now recognizes the full value of the Keg Rights (note 6) in the accounts of the Partnership and must eliminate its equity investment in the Partnership.

(d) Term Loan:

As described in note 10, the Fund extended the maturity date of the facility on March 9, 2011 from the scheduled maturity date of October 31, 2011 to April 2, 2012 and further extended it on April 12, 2011 to April 1, 2014. Accordingly, the term loan was presented as a long-term liability as at January 1, 2010. In accordance with IFRS, the Fund presented the term loan as a current liability as the original maturity date was less than one year as at December 31, 2010.

(e) Deferred income taxes:

The recognition and measurement of deferred income taxes changed under IFRS. The adjustment reflects the net impact of the IFRS adjustments.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

(f) Exchangeable Partnership unit liability:

As described in note 9(a), the Exchangeable Partnership units are classified as a financial liability under IFRS and must therefore be deducted from equity. Due to the fact that the Exchangeable Partnership units are convertible into Fund units, IFRS deems that these units contain a derivative and must be measured at fair value on initial recognition and at each subsequent reporting date.

	Fair Value <u>Continuity</u>
Fair value of Exchangeable Partnership units, January 1, 2010 .....	\$ 43,734
January 1, 2010 initial estimate of Class D unit entitlement (80%) .....	1,771
Fair value adjustment at March 31, 2010 .....	<u>6,294</u>
Fair value of Exchangeable Partnership units, March 31, 2010 .....	<u>\$ 51,799</u>
Fair value of Exchangeable Partnership units, January 1, 2010 .....	\$ 43,734
January 1, 2010 initial estimate of Class D unit entitlement (80%) .....	1,771
April 9, 2010 Exchange of Class B units for Fund units .....	(10,964)
December 31, 2010 final remaining Class D unit entitlement (100%) .....	1,213
Fair value adjustment at December 31, 2010 .....	<u>10,624</u>
Fair value of Exchangeable Partnership units, December 31, 2010 .....	<u>\$ 46,378</u>

(g) Class C unit liability:

As described in note 9(b), the Class C units are classified as a financial liability under IFRS and must therefore be deducted from equity. The \$57,000,000 adjustment at the Transition Date represents KRL's residual interest in the Fund on consolidation in respect of the Class C units held by KRL.

(h) Fund units:

The Fund units were presented as equity under GAAP. However, under IFRS, the Fund units are required to be classified as a financial liability with distributions classified as interest expense, due to a requirement in the Fund's declaration of trust to pay out all of its taxable income and net realized capital gains each year. The Fund has elected to measure its Fund unit liability at amortized cost and write-off to accumulated deficit along with previously capitalized unit issue costs related to the IPO of the Fund of \$2,150,000 which has been presented as an offset to the Fund units.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

#### (h) Fund units (continued):

The declaration of trust was amended (the "Amendment") on December 20, 2010 to remove the requirement to pay out all of its taxable income and net realized capital gains each year. As a result, the Fund units and distributions are classified as equity as at March 31, 2011 and December 31, 2010. The financial statements for the periods before the Amendment have presented the Fund units and distributions as a financial liability and interest expense, respectively.

The Amendment also resulted in the Fund recognizing an accounting loss of \$20,241,000 on the extinguishment of the Fund unit liability. The loss recognized is the difference between the carrying value of the financial liability and the market value of the Fund units on December 20, 2010 and is a non-cash transaction with no impact on the Fund's cash-flows.

#### (i) Equity and royalty income:

On consolidation of the Partnership, the Fund no longer accounts for its investment in the Partnership under the equity method, thus previously reported equity income is eliminated and the Partnership's Royalty income is recorded on consolidation.

#### (j) Adjustments to the consolidated statements of cash flows:

The transition from GAAP to IFRS resulted in the consolidation of the accounts of Partnership. The impact on the cash flows of the Fund is the inclusion of the Partnership's cash in its statement of financial position and the sources and uses of the Partnership's cash in the Fund's statement of cash flows.

For the three months ended March 31, 2010, the effect of including the Partnership's cash sources and uses was an increase of \$2,478,000 in cash flows from operating activities and a \$2,672,000 increase in cash used in financing activities. The \$2,478,000 increase in cash provided from operating activities is the net effect of the \$7,768,000 increase in net loss and comprehensive loss for the period, increase of \$169,000 in deferred tax expense, recognition of the \$6,294,000 increase in market value of the Exchangeable Partnership unit liability, elimination of the \$2,267,000 equity income and \$1,314,000 distributions from the Partnership reported under GAAP, and the recording of distributions of \$713,000 on Class C Partnership units, \$854,000 on Exchangeable Partnership units and \$2,068,000 on Fund units as interest under IFRS. The \$2,672,000 increase in cash used in financing activities is the result of including the Partnership's distributions paid of \$713,000 on Class C units and \$1,959,000 distributions paid on Exchangeable units to KRL. The net impact was an \$85,000 increase in cash for the period which represents the Partnership's cash balance on hand at the end of the period.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2011 and 2010

### 17. IFRS (CONTINUED):

(j) Adjustments to the consolidated statement of cash flows (continued):

For the year ended December 31, 2010, the effect of including the Partnership's cash sources and uses was an increase of \$8,821,000 in cash flows from operating activities and a \$8,921,000 decrease in cash used in financing activities. The \$8,821,000 increase in cash provided from operating activities is the net effect of the \$44,332,000 increase in net loss and comprehensive loss for the period, increase of \$201,000 in deferred tax expense, recognition of the \$10,542,000 increase in market value of the Exchangeable Partnership unit liability, elimination of the \$9,218,000 equity income and \$13,360,000 distributions from the Partnership reported under GAAP, the recording of distributions of \$4,275,000 on Class C Partnership units, \$4,500,000 on Exchangeable Partnership units and \$13,360,000 on Fund units as interest under IFRS and the \$20,241,000 loss on extinguishment of Fund unit liability. The \$8,921,000 decrease in cash used in financing activities is the net result of including the Partnership's distributions paid of \$4,275,000 on Class C units and \$4,646,000 distributions paid on Exchangeable units to KRL. The net impact was a \$179,000 increase in cash for the period which represents the Partnership's cash balance on hand at the end of the period.