# THE KEG ROYALTIES INCOME FUND

## YEAR END REPORT

For the three and twelve months ended December 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 and twelve months ended December 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, 2010 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 profit (loss) 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 $122,135,000 for the quarter, an increase of $7,837,000 or 6.9% from the comparable quarter of the prior year. For the year, gross sales were $472,280,000, an increase of $19,494,000 or 4.3% over 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 same store sales increases of 5.0% for the quarter and 3.5% for the year.

Royalty income increased by $289,000 or 6.2% from $4,697,000 in the three months ended December 31, 2010 to $4,986,000 in the three months ended December 31, 2011. For the year, royalty income increased by $808,000 or 4.4% from $18,422,000 for the twelve months ended December 31, 2010 to $19,230,000 for the twelve months ended December 31, 2011.

Distributable cash before SIFT tax increased by $398,000 from $3,056,000 (28.8 cents/Fund unit) to $3,454,000 (30.4 cents/Fund unit) for the quarter and by $1,367,000 from $12,864,000 ($1.24/Fund unit) to $14,231,000 ($1.26/Fund unit) for the year. Distributable cash available to pay distributions to public unitholders decreased from $3,056,000 (28.8 cents/Fund unit) to $2,499,000 (22.0 cents/Fund unit) for the quarter and decreased by $2,280,000 from $12,864,000 ($1.24/Fund unit) to $10,584,000 (93.9 cents/Fund unit) for the year. The decreases in distributable cash available to pay distributions to public unitholders were solely as a result of the SIFT tax. The Fund remains financially well positioned with surplus cash on hand of $4,011,000 and a positive working capital balance of $951,000 as of December 31, 2011.

## OUTLOOK

While 2009 and 2010 were challenging years for the restaurant industry in North America, indications are that the worst is now behind us in that sales growth for the industry appears to be returning to normalized levels. 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 by 3.0% in 2012, after an estimated 4.1% growth in 2011. In the United States, the National Restaurant Association expects sales in the full service segment to increase 2.9% in 2012, and has estimated that sales in this category grew by 3.3% in 2011. 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 December 2011 that identified The Keg as the first choice of over 67% of Canadian 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
March 23, 2012

# FINANCIAL HIGHLIGHTS

| ($000's except per unit amounts) | Oct. 1 to Dec. 31, 2011 | Oct.1 to Dec. 31, 2010 | Jan. 1 to Dec. 31, 2011 | Jan.1 to Dec. 31, 2010 |
|---|---|---|---|---|
| **Restaurants in the Royalty Pool** | **102** | **102** | **102** | **102** |
| **Gross sales reported by Keg restaurants in the Royalty Pool** | **$ 122,135** | **$ 114,298** | **$ 472,280** | **$ 452,786** |
| Royalty income [1] | $ 4,986 | $ 4,697 | $ 19,230 | $ 18,422 |
| Interest income [2] | 1,080 | 1,079 | 4,281 | 4,278 |
| **Total income** | **$ 6,066** | **$ 5,776** | **$ 23,511** | **$ 22,700** |
| Administrative expenses [3] | (96) | (112) | (472) | (417) |
| Interest and financing expenses [4] | (183) | (178) | (705) | (651) |
| **Operating income** | **$ 5,787** | **$ 5,486** | **$ 22,334** | **$ 21,632** |
| Distributions to KRL [5] | (2,031) | (2,168) | (7,979) | (8,775) |
| Distributions declared to Fund unitholders [6] | - | (4,516) | - | (13,360) |
| **Profit (loss) before market value adjustment and income taxes** | **$ 3,756** | **$ (1,198)** | **$ 14,355** | **$ (503)** |
| Market value adjustment [7] | (2,057) | (5,373) | 896 | (10,542) |
| Income taxes [8] | (990) | (41) | (3,936) | (201) |
| **Profit (loss)** | **$ 709** | **$ (6,612)** | **$ 11,315** | **$ (11,246)** |
| **Distributable cash before SIFT tax [9]** | **$ 3,454** | **$ 3,056** | **$ 14,231** | **$ 12,864** |
| **Distributable cash [10]** | **$ 2,499** | **$ 3,056** | **$ 10,584** | **$ 12,864** |
| **Distributions paid to Fund unitholders** | **$ 2,725** | **$ 3,388** | **$ 11,120** | **$ 13,264** |
| **Payout Ratio [11]** | **109.0%** | **110.9%** | **105.1%** | **103.1%** |
| Per Fund unit information [12] | | | | |
| Profit (loss) before market value adjustment and income taxes | $ .331 | $ .313 | $ 1.273 | $ 1.241 |
| Profit (loss) | $ .062 | $ (.198) | $ 1.004 | $ .204 |
| **Distributable cash before SIFT tax [9]** | **$ .304** | **$ .288** | **$ 1.262** | **$ 1.241** |
| **Distributable cash [10]** | **$ .220** | **$ .288** | **$ .939** | **$ 1.241** |
| **Distributions paid to Fund unitholders** | **$ .240** | **$ .320** | **$ .986** | **$ 1.280** |
| SSSG [13] | | | | |
| Canada | 4.8% | 1.5% | 3.9% | 0.0% |
| United States | 5.1% | (0.5)% | 3.9% | (5.8)% |
| Consolidated | 5.0% | 0.8% | 3.5% | (1.7)% |
| Restaurant Openings/Closings | | | | |
| Opened | -- | 1 | -- | 1 |
| Closed | -- | -- | 1 | 2 |
| Relocated | -- | -- | 1 | 1 |
| Net Opened (Closed) | -- | 1 | (1) | (1) |

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 of the Partnership attributable to KRL during the respective periods 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"). These distributions are presented as interest expense in the financial statements.

(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 and twelve months ended December 31, 2011 were recorded as distributions and charged to unitholder's equity whereas the distributions declared during the three and twelve months ended December 31, 2010 were expensed as interest.

(7) Market 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 market 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) Income taxes for the quarter ended December 31, 2011, include SIFT tax payable of $955,000 (quarter ended December 31, 2010 - $NIL) and non-cash deferred taxes of $35,000 (quarter ended December 31, 2010 - $41,000). Income taxes for the year ended December 31, 2011 include SIFT tax payable of $3,647,000 (year ended December 31, 2010 - $NIL) and non-cash deferred taxes of $289,000 (year ended December 31, 2010 - $201,000). The obligation to pay SIFT tax came into effect on January 1, 2011.

(9) 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. Distributable cash before SIFT tax 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.

(10) 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.

(11) 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).

(12) 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 December 31, 2011 was 11,353,500 (three months ended December 31, 2010 – 10,603,500) and for the year ended December 31, 2011 was 11,275,418 (year ended December 31, 2010 – 10,361,856). 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.

(13) 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

| ($000's except per unit amounts) | Q4 2011 | Q3 2011 | Q2 2011 | Q1 2011 |
|---|---|---|---|---|
| **Restaurants in the Royalty Pool** | **102** | **102** | **102** | **102** |
| **Gross sales reported by Keg restaurants in the Royalty Pool** | **$ 122,135** | **$ 117,125** | **$ 112,416** | **$ 120,604** |
| Royalty income [1] | $ 4,986 | $ 4,786 | $ 4,591 | $ 4,867 |
| Interest income [2] | 1,080 | 1,079 | 1,067 | 1,055 |
| **Total income** | **$ 6,066** | **$ 5,865** | **$ 5,658** | **$ 5,922** |
| Administrative expenses [3] | (96) | (108) | (168) | (100) |
| Interest and financing expenses [4] | (183) | (174) | (174) | (174) |
| **Operating income** | **$ 5,787** | **$ 5,583** | **$ 5,316** | **$ 5,648** |
| Distributions to KRL [5] | (2,031) | (2,012) | (1,940) | (1,996) |
| Distributions declared to Fund unitholders [6] | - | - | - | - |
| **Profit (loss) before market value adjustment and income taxes** | **$ 3,756** | **$ 3,571** | **$ 3,376** | **$ 3,652** |
| Market value adjustment [7] | (2,057) | 3,608 | 29 | (684) |
| Income taxes [8] | (990) | (936) | (872) | (1,138) |
| **Profit (loss)** | **$ 709** | **$ 6,243** | **$ 2,533** | **$ 1,830** |
| **Distributable cash before SIFT taxes** [9] | **$ 3,454** | **$ 3,483** | **$ 3,454** | **$ 3,840** |
| **Distributable cash** [10] | **$ 2,499** | **$ 2,579** | **$ 2,592** | **$ 2,914** |
| **Distributions paid to Fund unitholders** | **$ 2,725** | **$ 2,725** | **$ 2,725** | **$ 2,946** |
| **Payout Ratio** [11] | **109.0%** | **105.7%** | **105.1%** | **101.1%** |
| Per Fund unit information [12] | | | | |
| Profit (loss) before market value adjustment and income taxes | $ .331 | $ .315 | $ .297 | $ .331 |
| Profit (loss) | $ .062 | $ .550 | $ .223 | $ .166 |
| **Distributable cash before SIFT tax** [9] | **$ .304** | **$ .307** | **$ .304** | **$ .348** |
| **Distributable cash** [10] | **$ .220** | **$ .227** | **$ .228** | **$ .264** |
| **Distributions paid to Fund unitholders** | **$ .240** | **$ .240** | **$ .240** | **$ .267** |
| SSSG [13] | | | | |
| Canada | 4.8% | 5.2% | 1.8% | 3.8% |
| United States | 5.1% | 3.6% | 3.8% | 3.2% |
| Consolidated | 5.0% | 4.5% | 1.4% | 3.1% |
| Restaurants Openings/Closings | | | | |
| Opened | -- | -- | -- | -- |
| Closed | -- | -- | 1 | -- |
| Relocated | -- | -- | -- | 1 |
| Net Opened (Closed) | -- | -- | (1) | -- |

## SUMMARY OF QUARTERLY RESULTS

| ($000's except per unit amounts) | Q4 2010 | Q3 2010 | Q2 2010 | Q1 2010 |
|---|---|---|---|---|
| **Restaurants in the Royalty Pool** | **102** | **102** | **102** | **102** |
| **Gross sales reported by Keg restaurants in the Royalty Pool** | **$ 114,298** | **$ 110,382** | **$ 111,153** | **$ 116,953** |
| Royalty income [(1)] | $ 4,697 | $ 4,527 | $ 4,502 | $ 4,695 |
| Interest income [(2)] | 1,079 | 1,078 | 1,066 | 1,055 |
| **Total income** | **$ 5,776** | **$ 5,605** | **$ 5,568** | **$ 5,750** |
| Administrative expenses [(3)] | (112) | (99) | (107) | (98) |
| Interest and financing expenses [(4)] | (178) | (173) | (152) | (148) |
| **Operating income** | **$ 5,486** | **$ 5,333** | **$ 5,309** | **$ 5,504** |
| Distributions to KRL [(5)] | (2,168) | (2,196) | (2,092) | (2,320) |
| Distributions declared to Fund unitholders [(6)] | (4,516) | (3,388) | (3,388) | (2,068) |
| **Profit (loss) before market value adjustment and income taxes** | **$ (1,198)** | **$ (251)** | **$ (171)** | **$ 1,116** |
| Market value adjustment [(7)] | (5,373) | (3,279) | 4,404 | (6,294) |
| Income taxes [(8)] | (41) | (28) | (63) | (69) |
| **Profit (loss)** | **$ (6,612)** | **$ (3,558)** | **$ 4,170** | **$ (5,247)** |
| **Distributable cash before SIFT tax [(9)]** | **$ 3,056** | **$ 3,206** | **$ 3,188** | **$ 3,411** |
| **Distributable cash [(10)]** | **$ 3,056** | **$ 3,206** | **$ 3,188** | **$ 3,411** |
| **Distributions paid to Fund unitholders** | **$ 3,388** | **$ 3,388** | **$ 3,388** | **$ 3,100** |
| **Payout Ratio [(11)]** | **110.9%** | **105.7%** | **106.3%** | **90.9%** |
| Per Fund unit information [(12)] | | | | |
| Profit (loss) before market value adjustment and income taxes | $ .313 | $ .296 | $ .306 | $ .328 |
| Profit (loss) | $ (.198) | $ (.016) | $ .718 | $ (.328) |
| **Distributable cash before SIFT tax [(9)]** | **$ .288** | **$ .302** | **$ .303** | **$ .352** |
| **Distributable cash [(10)]** | **$ .288** | **$ .302** | **$ .303** | **$ .352** |
| **Distributions paid to Fund unitholders** | **$ .320** | **$ .320** | **$ .322** | **$ .319** |
| SSSG [(13)] | | | | |
| Canada | 1.5% | 0.0% | 1.9% | (3.2)% |
| United States | (0.5)% | (2.2)% | (6.2)% | (14.4)% |
| Consolidated | 0.8% | (0.6)% | (0.1)% | (6.6)% |
| Restaurant Openings/Closings | | | | |
| Opened | 1 | -- | -- | -- |
| Closed | -- | 1 | 1 | -- |
| Relocated | -- | -- | -- | 1 |
| Net Opened (Closed) | 1 | (1) | (1) | -- |

# MANAGEMENT'S DISCUSSION AND ANALYSIS

**For the Three and Twelve Months Ended December 31, 2011**
**As of March 23, 2012**

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

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

The total number of Keg restaurants included in the Royalty Pool has increased from the 80 Keg restaurants in existence on March 31, 2002, to 102 as of December 31, 2011. Forty-eight new Keg restaurants that opened during the period from April 1, 2002, through October 2, 2010, with annual gross sales of $232.1 million have been added to the Royalty Pool. Twenty-six permanently closed Keg restaurants with annual sales of $70.5 million have been removed from the Royalty Pool. This has resulted in a net increase in Royalty Pool sales of $161.6 million annually, and KRL receiving a cumulative Additional Entitlement equivalent to 5,218,376 Fund units as of December 31, 2011.

On January 1, 2012, two new Keg restaurants that opened during the period from October 3, 2010 through October 2, 2011 were added to the Royalty Pool. See "Subsequent Events".

### KRL'S INTEREST IN THE FUND

KRL's interest in the earnings of the Partnership is from its ownership of Class A, entitled Class B, Class C and Class D Partnership units. The Class A, entitled Class B and Class D Partnership units are exchangeable into Fund units on a one-for-one basis in certain circumstances. KRL's effective ownership of the Fund and its interest in the earnings of the Partnership has grown from 10.00% at the time of the IPO to 20.48% as of December 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 December 31, 2011. This has resulted in a net increase in Royalty Pool sales of $161.6 million and the issuance of 5,218,376 exchangeable units to KRL, as of December 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. On January 1, 2012, two new Keg restaurants that opened during the period from October 3, 2010 through October 2, 2011 were added to the Royalty Pool. See "Subsequent Events".

## 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, 2010 have all been prepared in accordance with 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 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 an 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 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 attributable 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 attributable to KRL in respect of the Class C units are classified as interest expense under IFRS rather than as distributions.

During the quarter ended June 30, 2011, the Fund changed its accounting policy with respect to the distributions on the Exchangeable and Class C Partnership units. Previously, the Fund recorded distributions on these units after such distributions were declared. Alternatively, the Fund will now accrue undistributed income in the Partnership that is attributable to Exchangeable and Class C units at each period end. The Fund has adopted this policy retrospectively. As a result of this change in accounting policy, distributions recorded as interest on Exchangeable and Class C Partnership units decreased by $705,000 from $2,736,000 to $2,031,000 during the quarter ended December 31, 2011 and by $755,000 from $2,923,000 to $2,168,000 during the quarter ended December 31, 2010. Distributions recorded as interest on Exchangeable and Class C Partnership units for any twelve month period ended December 31 are not affected by this change in accounting policy.

The amount of cash available for distribution to the Fund's public unitholders was also not affected by this change in accounting policy.

## FUND UNITS AND DISTRIBUTIONS

Fund units are classified as a financial liability under IFRS (in respect of the period from January 1, 2010 through December 19, 2010) because the Declaration of Trust contained a mandatory requirement to distribute no less then all of the taxable income of the Fund to the Fund's unitholders each year and because these units are redeemable.

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.

## MARKET VALUE ADJUSTMENT

The Exchangeable units of the Partnership held by KRL are classified as a financial liability under IFRS at fair value through profit or 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 market value of that liability at the end of the immediately preceding reporting period. The Fund estimates the market 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%.

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 28th, 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 quarters, 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 31, 2010 | January 31, 2011 | 10.65¢ | $ 1,129,273 |
| January 1-31, 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 |
| May 1-31, 2011 | June 30, 2011 | 8.00¢ | $ 908,280 |
| June 1-30, 2011 | July 29, 2011 | 8.00¢ | $ 908,280 |
| July 1-31, 2011 | August 31, 2011 | 8.00¢ | $ 908,280 |
| August 1-31, 2011 | September 30, 2011 | 8.00¢ | $ 908,280 |
| September 1-30, 2011 | October 31, 2011 | 8.00¢ | $ 908,280 |
| October 1-31, 2011 | November 30, 2011 | 8.00¢ | $ 908,280 |
| November 1-30, 2011 | December 30, 2011 | 8.00¢ | $ 908,280 |
| | | | $11,120,353 |

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 $101,497,000 of distributable cash and has paid cumulative distributions of $101,682,000, which resulted in a cumulative deficit of $189,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid since inception to the cumulative distributable cash generated since inception) is 100.2%.

## 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 Partnership distributions attributable to KRL, less SIFT tax payable.

## DISTRIBUTABLE CASH (CONTINUED)

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 is calculated as follows:

| ($000's) | Oct. 1, Dec. 31, 2011 | Oct. 1, Dec. 31, 2010 | Jan. 1, Dec. 31, 2011 | Jan. 1, Dec. 31, 2010 |
|---|---|---|---|---|
| Cash flow from operations [1] | $ 5,485 | $ 5,224 | $ 22,210 | $ 21,639 |
| KRL's interest [2] | (2,031) | (2,168) | (7,979) | (8,775) |
| Distributable cash before SIFT tax | $ 3,454 | $ 3,056 | $ 14,231 | $ 12,864 |
| SIFT tax on Fund units [3] | (955) | - | (3,647) | - |
| Distributable cash [4] | $ 2,499 | $ 3,056 | $ 10,584 | $ 12,864 |

Notes:

[1] Represents the cash flow from operations as reported in the consolidated statements of cash flows.

[2] Represents the distributions of the Partnership attributable to KRL during the respective periods on the Exchangeable and Class C units held by KRL. The distributions attributable to KRL will differ from the actual distributions paid to KRL during the same periods, due to the timing of the declaration of distributions.

[3] 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.

[4] 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:

| | December 31, 2011[1] | | December 31, 2010 | |
|---|---|---|---|---|
| | # | % | # | % |
| Fund units held by public unitholders [2] | 11,353,500 | 79.52 | 10,603,500 | 75.11 |
| Exchangeable Partnership units held by KRL: [3] | | | | |
| Class A units [4] | 905,944 | 6.35 | 905,944 | 6.42 |
| Class B units [5] | 176,700 | 1.24 | 926,700 | 6.56 |
| Class D units [5] | 1,841,676 | 12.90 | 1,680,911 | 11.91 |
| Total Exchangeable Partnership units [6] | 2,924,320 | 20.48 | 3,513,555 | 24.89 |
| Total Fund and Exchangeable Partnership units | 14,277,820 | 100.00 | 14,117,055 | 100.00 |

Notes:

(1) Information is current as of December 31, 2011.

(2) Represents the public's total effective ownership of the Fund as of December 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 79.52% during the three months ended December 31, 2011 (three months ended December 31, 2010 – 75.11%) and was 78.97% during the year ended December 31, 2011 (year ended December 31, 2010 – 73.40%). The weighted average number of Fund units outstanding for the three-month period ended December 31, 2011 were 11,353,500 (three-month period ended December 31, 2010 – 10,603,500) and for the year ended December 31, 2011 were 11,275,417 (year ended December 31, 2010 – 10,361,856).

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

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

(5) These exchangeable Partnership units are issued to KRL in return for adding net sales to the Royalty Pool on an annual basis. Class D units are equivalent to Class B units in all material respects but began to be issued once all Class B units became fully entitled to distributions on January 1, 2008. As of December 31, 2011, KRL is the registered holder of 176,700 Class B units and 1,841,676 Class D units (December 31, 2010 – 926,700 Class B units and 1,680,911 Class D units).

(6) Represents KRL's total effective ownership of the Fund as of December 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 20.48% during the three months ended December 31, 2011 (three months ended December 31, 2010 – 24.89%) and was 21.03% during the year ended December 31, 2011 (year ended December 31, 2010 – 26.60%).

## 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 Jan. 1, 2012 | 13 weeks ended Jan. 2, 2011 | 52 weeks ended Jan. 1, 2011 | 52 weeks ended Jan. 2, 2010 |
|---|---|---|---|---|
| Corporate Keg restaurants [1] | $ 60,746 | $ 60,111 | $ 236,291 | $ 231,604 |
| Franchised Keg restaurants [2] | 63,812 | 59,052 | 244,367 | 236,932 |
| Total system sales | $ 124,558 | $ 119,163 | $ 480,658 | $ 468,536 |

Notes:

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

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

## FOURTH QUARTER

System sales for the 13 weeks ended January 1, 2012 were $124,558,000 compared to $119,163,000 for the 13 weeks ended January 2, 2011, an increase of $5,395,000 or 4.5%. During the 13 weeks ended January 1, 2012, no restaurants were opened or closed. During the 13 weeks ended January 2, 2011, one new corporate restaurant was opened. As of January 1, 2012, there were a total of 102 Keg restaurants as compared with 103 Keg restaurants at January 2, 2011.

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 4.8% in Canada and by 5.1% 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 period increased by 5.0%. The average exchange rate moved from 1.01 in KRL's first quarter of fiscal 2011 to 1.02 in KRL's first quarter of fiscal 2012, slightly increasing the Canadian dollar equivalent of the U.S. restaurant sales.

## YEAR

System sales for the 52 weeks ended January 1, 2012 were $480,658,000 compared to $468,536,000 for the 52 weeks ended January 2, 2011 an increase of 12,122,000 or 2.6%. During the 52 weeks ended January 1, 2012, one corporate restaurant was relocated and one corporate restaurant was closed. The closed corporate restaurant, located in North York, Ontario, closed due to a lease expiry. During the 52 weeks ended January 2, 2011, one new corporate restaurant was opened, one corporate restaurant was relocated, and two franchised restaurants were closed.

The Keg's same store sales (sales of restaurants that operated during the entire 52-week period of both the current year and the prior year) increased by 3.9% in both Canada and the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 52-week periods increased by 3.5%. The average exchange rate moved from 1.03 in KRL's 52-week period ended January 2, 2011 to 0.99 in KRL's 52-week period ended January 1, 2012, significantly reducing the Canadian dollar equivalent of the U.S. restaurant sales.

## OPERATING RESULTS

## FOURTH QUARTER

### GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool increased from $114,298,000 to $122,135,000 for the comparable quarter. The increase of $7,837,000, or 6.9%, reflects the addition of net new sales to the Royalty Pool at the beginning of the year, and the same store sales increase of 5.0% for the quarter.

### ROYALTY INCOME

Total royalty income earned by the Partnership increased by $289,000 from $4,697,000 in the fourth quarter of 2010, to $4,986,000 in the fourth quarter of 2011. Royalty income increased by $313,000 during the quarter as a result of the increase in gross sales for the reasons explained previously, and Make-whole Payments decreased by $24,000 due to fewer restaurants closed during the quarter (13 fewer closed weeks).

### INTEREST INCOME

Interest income earned by the Fund during the fourth quarter of the current year was $1,080,000, comprised of interest income on the Keg Loan of $1,078,000 and other interest income of $2,000. Interest on the Keg Loan remained the same and other interest income increased by $1,000 due to higher surplus cash balances on hand during the quarter.

### ADMINSTRATIVE EXPENSES

Expenses incurred by the Partnership for the quarter ended December 31, 2011 were $96,000, comprised of general and administrative expenses of $97,000 and other interest income of $1,000. The decrease in Partnership expenses of $16,000 over the comparable quarter of the prior year was due to a decrease in general and administrative expenses of $15,000, net of an increase in other interest income of $1,000. General and administrative expenses decreased due to higher audit costs in the comparable quarter of the prior year as a result of the implementation of International Financial Reporting Standards for the Fund. Other interest income increased due to higher surplus cash balances on hand during the quarter.

### INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Trust were $183,000 for the three months ended December 31, 2011, and included interest on the long-term debt of $168,000, and amortization of deferred financing charges of $8,000 and other bank charges of $7,000. Interest costs were the same as the comparable quarter of the prior year as the interest rate remained constant at 4.75%. Other financing expenses increased by $7,000, and amortization of deferred financing charges decreased by $2,000 during the quarter.

### OPERATING INCOME

The Fund's operating income increased from $5,486,000 during the fourth quarter of 2010, to $5,787,000 during the fourth quarter of 2011. The increase of $301,000 is due to the net impact of the increase in royalty income of $289,000, the increase in interest income of $1,000, the decrease in administrative expenses of $16,000, and the increase in interest and financing expenses of $5,000.

## DISTRIBUTIONS TO KRL

Distributions attributable to KRL during the quarter ended December 31, 2011 were $2,031,000, which included distributions of $962,000 on the Exchangeable units and $1,069,000 on the Class C units. Distributions on the Exchangeable units decreased by $137,000 from the comparable quarter of the prior year, due to a decrease in KRL's average effective ownership in the Partnership from 24.89% during the fourth quarter of 2010 to 20.48% during the fourth quarter of 2011. The change in the average effective ownership of the Partnership during the comparable quarter 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 quarter, 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 December 31, 2011 of $3,633,000 (8.0 cents/Fund unit per month) were recorded directly to equity, whereas distributions declared to Fund unitholders during the three-month period ending December 31, 2010 of $4,516,000 (10.65 cents/Fund unit per month) were recorded as interest expense in comprehensive income. 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 Royalty Pool sales for the month of December (which is paid the following month in January) is recorded in the period which it was earned for income tax purposes.

Distributions of $2,725,000 (24.0 cents/Fund unit) were paid to Fund unitholders in the fourth quarter of 2011, as compared with $3,388,000 (32.0 cents/Fund unit) in the fourth quarter of 2010, the reduced distributions being a result of the SIFT tax.

## PROFIT (LOSS) BEFORE MARKET VALUE ADJUSTMENT AND INCOME TAXES

Profit (loss) before market value adjustment and income taxes increased by $4,954,000 from a loss of $1,198,000 (-11.3 cents/Fund unit) in the fourth quarter of 2010, to profit of $3,756,000 (33.1 cents/Fund unit) in the fourth quarter of 2011. On a comparative basis, after adjusting for the distributions declared to Fund unitholders during the period, the profit before market value adjustment and income taxes, was $3,318,000 (31.3 cents/Fund unit).

## MARKET VALUE ADJUSTMENT

The market value of the Exchangeable units increased $2,057,000 during the three months ended December 31, 2011, as compared with an increase of $5,373,000 during the three months ended December 31, 2010. The market price of a Fund unit, (the basis upon which Exchangeable units are valued) increased from $12.00 to $12.70 during the fourth quarter of the current year, and there were a total of 2,924,320 Exchangeable units outstanding at the end of the fourth quarter of 2011. The market price of a Fund unit increased from $11.77 to $13.20 during the comparable quarter of the prior year and there were a total of 3,513,555 Exchangeable units outstanding at the end of the fourth quarter of 2010.

## INCOME TAXES

Income taxes for the quarter ended December 31, 2011, were $990,000 and included SIFT tax payable of $955,000 and non-cash deferred taxes of $35,000. SIFT tax payable increased by $955,000 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 decreased by $6,000 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.

### PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

Profit increased by $9,801,000 from a loss of $6,612,000 (-62.4 cents/Fund unit) in the fourth quarter of 2010, to profit of $709,000 (6.2 cents/Fund unit) in the fourth quarter of 2011, mostly due to the non-cash market value adjustment of the Exchangeable unit liability. On a comparative basis, after adjusting for the distributions declared to Fund unitholders during the period, the loss for the comparable quarter of the prior year was $2,096,000 (-19.8 cents/Fund unit)

### DISTRIBUTABLE CASH

Distributable cash before SIFT tax increased by $398,000 from $3,056,000 (28.8 cents/Fund unit) to $3,454,000 (30.4 cents/Fund unit) during the comparable quarter. As a result of the imposition of the SIFT tax, cash available for distribution to Fund unitholders decreased by $557,000 from $3,056,000 (28.8 cents/Fund unit) to $2,499,000 (22.0 cents/Fund unit) during the comparable quarter. The difference between the Fund's profit (loss) and distributable cash is due to non-cash items such as amortization, market value adjustments, and deferred income taxes included in the Fund's profit (loss), as well as changes in non-cash working capital balances.

## YEAR

### GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool increased from $452,786,000 to $472,280,000 for the year. The increase of $19,494,000, or 4.3%, reflects the addition of net new sales to the Royalty Pool at the beginning of the year, and the same store sales increase of 3.5% for the year.

### ROYALTY INCOME

Total royalty income earned by the Partnership increased by $808,000 from $18,422,000 in 2010, to $19,230,000 in 2011. Royalty income increased by $780,000 during the period as a result of the increase in gross sales for the reasons explained previously, and Make-whole Payments increased by $28,000 due to more restaurants closed during the year (1 more closed week).

### INTEREST INCOME

Interest income earned by the Fund during the current year was $4,281,000, comprised of interest income on the Keg Loan of $4,275,000 and other interest income of $6,000. Interest on the Keg Loan remained the same during the year and other interest income increased by $3,000 due to higher surplus cash balances on hand during the year.

### ADMINSTRATIVE EXPENSES

Expenses incurred by the Partnership for the year ended December 31, 2011 were $472,000, comprised of general and administrative expenses of $477,000 and other interest income of $5,000. The increase in Partnership expenses of $55,000 over 2010 was due to an increase in general and administrative expenses of $60,000, net of an increase in other interest income of $5,000. General and administrative expenses increased mainly due to non-recurring fees paid to the TSX for listing the cumulatively entitled Class D exchangeable units. Other interest income increased due to higher surplus cash balances on hand during the year.

## INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Trust were $705,000 for the year ended December 31, 2011, and included interest on the long-term debt of $665,000, amortization of deferred financing charges of $33,000 and other bank charges of $7,000. Interest costs increased by $58,000 in the year, as a result of an increase in the average interest rate on the long-term debt from 4.34% in of 2010, to 4.75% in 2011. Other financing expenses increased by $2,000, and amortization of deferred financing charges decreased by $6,000 during the year.

## OPERATING INCOME

The Fund’s operating income increased from $21,632,000 during the year ended December 31, 2010, to $22,334,000 during the year ended December 31, 2011. The increase of $702,000 is due to the net impact of the increase in royalty income of $808,000, the increase in interest income of $3,000, the increase in administrative expenses of $55,000, and the increase in interest and financing expenses of $54,000.

## DISTRIBUTIONS TO KRL

Distributions attributable to KRL during the current year ended December 31, 2011 were $7,979,000, which included distributions of $3,704,000 on the Exchangeable units and $4,275,000 on the Class C units. Distributions on the Exchangeable units decreased by $796,000 from the prior year, due to a decrease in KRL’s average effective ownership in the Partnership from 26.60% during 2010 to 21.03% during 2011. The change in the average effective ownership of the Partnership during the year was a result of the 2011 initial Additional Entitlement (received by KRL on January 1, 2011), the sale of 750,000 Fund units owned by KRL on February 8, 2011, and the 2011 final Additional Entitlement (received by KRL on December 31, 2011). The distributions declared on the Class C units remained the same during the comparable periods, which were $0.0625 per Class C unit per month.

## DISTRIBUTIONS TO FUND UNITHOLDERS

Distributions declared to Fund unitholders during the year ended December 31, 2011 of $10,899,000 (8.0 cents/Fund unit per month) were recorded directly equity, whereas distributions declared to Fund unitholders during the twelve-month period ended December 31, 2010 of $13,360,000 (10.65 cents/Fund unit per month) were recorded as interest expense in comprehensive income.

Distributions of $11,120,000 (98.6 cents/Fund unit) were paid to Fund unitholders during the current year ended December 31, 2011, as compared with $13,264,000 ($1.28/Fund unit) during the prior year ended December 31, 2010, the change being a result of the SIFT tax.

## PROFIT BEFORE MARKET VALUE ADJUSTMENT AND INCOME TAXES

Profit before market value adjustment and income taxes increased by $14,858,000 from a loss of $503,000 (4.9 cents/Fund unit) in the year ended December 31, 2010, to profit of $14,355,000 ($1.27/Fund unit) in the year ended December 31, 2011. On a comparative basis, after adjusting for the distributions declared to Fund unitholders during the year, the profit before market value adjustment and income taxes, was $12,857,000 ($1.24/Fund unit).

### MARKET VALUE ADJUSTMENT

The market value of the Exchangeable units decreased $896,000 during the year ended December 30, 2011, as compared with an increase of $10,542,000 during the year ended December 31, 2010. The market price of a Fund unit, (the basis upon which Exchangeable units are valued) decreased from $13.20 to $12.70 during the current year and there were a total of 2,924,320 Exchangeable units outstanding as at December 31, 2011. KRL exchanged and subsequently sold 750,000 Exchangeable units during the period. The market price of a Fund unit increased from $10.70 to $13.20 during the comparable period of the prior year and there were a total of 3,513,555 Exchangeable units outstanding as at December 31, 2010. KRL exchanged and subsequently sold 900,000 Exchangeable units during this period.

### INCOME TAXES

Income taxes for the year ended December 31, 2011, were $3,936,000 and included SIFT tax payable of $3,647,000 and non-cash deferred taxes of $289,000. SIFT tax payable increased by $3,647,000 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 $88,000 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.

### PROFIT (LOSS) AND COMPREHENSIVE INCOME (LOSS)

Profit increased by $22,561,000 from a loss of $11,246,000 (-$1.09/Fund unit) during the twelve months ended December 31, 2010 to profit of $11,315,000 ($1.00/Fund unit) during the year ended December 31, 2011, mostly due to the non-cash market value adjustment of the Exchangeable unit liability. On a comparative basis, after adjusting for the distributions declared to Fund unitholders during the year, profit for the prior year was $2,114,000 (20.4 cents/Fund unit).

### DISTRIBUTABLE CASH

Distributable cash before SIFT tax increased by $1,367,000 from $12,864,000 ($1.24/Fund unit) to $14,231,000 ($1.26/Fund unit) during the comparable twelve-month period. As a result of the imposition of the SIFT tax, cash available for distribution to Fund unitholders decreased by $2,280,000 from $12,864,000 ($1.24/Fund unit) to $10,584,000 (93.9 cents/Fund unit) during the comparable period. The difference between the Fund’s profit (loss) and distributable cash is due to non-cash items such as amortization, market value adjustments, and deferred income taxes included in the Fund’s profit (loss), 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 $2,499,000 in distributable cash during the quarter and paid distributions of $2,725,000. Year to date, the Fund generated $10,584,000 in distributable cash and paid distributions of $11,120,000. The shortfall of $226,000 during the quarter and $536,000 during the twelve-month period were funded with surplus cash on hand from previous periods. The Fund has cash on hand of $4,011,000 and a positive working capital balance of $951,000 as at December 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 1, 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 profit (loss) before interest, market value adjustments, taxes, depreciation and amortization ("EBITDA"). As at December 31, 2011, the Trust and Partnership are in compliance with all financial covenants associated with this facility.

### OPERATING LINE OF CREDIT

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

## CONTROLS AND PROCEDURES

### DISCLOSURE CONTROLS

Disclosure controls and procedures are designed to provide reasonable assurance that relevant information is gathered and reported to Senior Management, including the Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") of The Keg GP Ltd., managing general partner of the Partnership and administrator of the Fund, on a timely basis so that the appropriate decisions can be made regarding public disclosure. As of December 31, 2011, an evaluation of the effectiveness of the Fund's disclosure controls and procedures, as defined under Multilateral Instrument 52-109 ("MI 52-109") issued by the Canadian Securities Administrators ("CSA"), was carried out under the supervision of and with the participation of management including the CEO and CFO. Based on the evaluation, the CEO and the CFO concluded that the design and operation of these disclosure controls and procedures were effective.

### INTERNAL CONTROL OVER FINANCIAL REPORTING

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

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

## INTERNAL CONTROL OVER FINANCIAL REPORTING (CONTINUED)

The administrator of the Fund assessed the effectiveness of the Fund's internal control over financial reporting as of December 31, 2011, based on the framework established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this assessment, the administrator concluded that the Fund maintained effective internal control over financial reporting as of December 31, 2011. During the year ended December 31, 2011, there has been no change in the Fund's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Fund's internal control over financial reporting.

## CRITICAL ACCOUNTING ESTIMATES

The 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, income 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. 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 MARKET VALUE ADJUSTMENT

The Fund is required under IFRS to classify the Exchangeable units as a financial liability at market value. This requires that the Fund uses a valuation technique to determine the market value of the Exchangeable units at the applicable reporting dates. The Fund estimates the market 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 December 31, 2011, the Fund's closing price was $12.70 per Fund unit resulting in a market capitalization of $181.3 million.

KRL's 20.48% ownership of the Fund (on a fully-diluted basis) was calculated to be $37.1 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 it's significant liabilities include the term loan and the financial liabilities of the Exchangeable and Class C Partnership units. The Fund's consolidated statements of 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.

## FINANCIAL PRESENTATION (IAS 32) (CONTINUED)

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 the 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 equity (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 market value of the Exchangeable unit liability using a valuation technique. The change in market 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 profit (loss). 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 or 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 re-characterizes 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 $3,647,000 during the year ended December 31, 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 period of the prior year.

The Fund's transition to reporting its financial results in accordance with IFRS from Canadian GAAP had no impact on 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 $289,000 during the year ended December 31, 2011 (year ended December 31, 2011 - $201,000) and a corresponding increase in the deferred income tax liability as at December 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 equity. 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, accounts payable and accrued liabilities, interest payable on the term loan, distributions payable to Fund unitholders, distributions payable to KRL, current income tax payable 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.

## SUBSEQUENT EVENTS

### *ADJUSTMENTS TO THE ROYALTY POOL*

On January 1, 2012, two new Keg restaurants that opened during the period from October 3, 2010 through October 2, 2011 were added to the Royalty Pool. The gross sales of these two new restaurants have been estimated at $9.4 million annually. Two permanently closed Keg restaurants with annual sales of $8.0 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of $1.4 million annually. The total number of restaurants in the Royalty Pool remains at 102. The yield of the Fund units was determined to be 10.52% calculated using a weighted average unit price of $12.33.

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 40,624 Fund units, being 0.28% of the Fund units on a fully diluted basis.

On January 1, 2012, KRL received 80% of this entitlement representing the equivalent of 32,499 Fund units, being 0.23% 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 2,956,820 Fund units representing 20.66% of the Fund units on a fully diluted basis.

The balance of the Additional Entitlement will be adjusted to be effective January 1, 2012 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2012, it would have the right to exchange its Partnership units for 2,964,945 Fund units representing 20.71% of the Fund units on a fully diluted basis.

## 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 4.1% in 2011 and has projected sales to increase by 3.0% in 2012. In the United States, the National Restaurant Association has estimated that sales in the full-service category increased 3.3% in 2011, and has projected sales to increase by 2.9% in 2012. 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.

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 forty years. Management of KRL has advised the Trustees that it has finalized the number of restaurants that opened prior to October 2, 2011 and that will be added to the Royalty Pool as of January 1, 2012. KRL opened one corporate restaurant in the United States, relocated one corporate restaurant in Canada, and closed one corporate restaurant in Canada. As a result, on January 1, 2012, the two additional restaurants will be added to the Royalty Pool, and the two permanently closed restaurants will be removed from the Royalty Pool. The total number of restaurants in the Royalty Pool will remain at 102. Management of KRL has further advised the Trustees that it expects to open three restaurants prior to October 2, 2012, consisting of two corporate and one franchised restaurant in Canada. 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 opening 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.

## 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 |
| Facsimile: | (416) 695-2401 |
| E-mail: | karynb@kegrestaurants.com |
| Website: | www.kegincomefund.com |

# THE KEG ROYALTIES INCOME FUND

## CONSOLIDATED FINANCIAL STATEMENTS

For the years ended December 31, 2011 and 2010

# MANAGEMENT'S STATEMENT OF RESPONSIBILITIES

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

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

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

The consolidated financial statements have been independently audited by KPMG LLP, in accordance with International Financial Reporting Standards. Their report following this statement expresses their opinion on the consolidated financial statements of the Fund.

(signed) C.C. Woodward

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

March 19, 2012

# INDEPENDENT AUDITORS' REPORT

To the Unitholders of Keg Royalties Income Fund:

We have audited the accompanying consolidated financial statements of Keg Royalties Income Fund ("the Fund") which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, the consolidated statements of comprehensive income (loss), changes in equity (deficiency) and cash flows for the years ended December 31, 2011 and December 31, 2010, and notes, comprising a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Consolidated Financial Statements*

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

*Auditors' Responsibility*

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

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

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

*Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Fund as at December 31, 2011, December 31, 2010 and January 1, 2010, and its consolidated financial performance and its consolidated cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Accountants
Vancouver, Canada

March 19, 2012

# CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars)

| | Note | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|---|
| **ASSETS** | | | | |
| Current assets: | | | | |
| Cash | | $ 4,011 | $ 1,112 | $ 1,658 |
| Prepaid expenses and deposits | | 17 | 23 | 23 |
| Due from Keg Restaurants Ltd. | 12 | 2,796 | 2,639 | 2,422 |
| | | 6,824 | 3,774 | 4,103 |
| Note receivable from Keg Restaurants Ltd. | 5 | 57,000 | 57,000 | 57,000 |
| Intangible assets, Keg Rights | 6 | 156,069 | 154,183 | 151,198 |
| | | $ 219,893 | $ 214,957 | $ 212,301 |
| **LIABILITIES AND UNITHOLDERS' EQUITY (DEFICIENCY)** | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | | $ 441 | $ 447 | $ 270 |
| Interest payable on term loan | | 56 | 56 | 48 |
| Distributions payable to Fund unitholders | | 908 | 1,129 | 1,033 |
| Distributions payable to Keg Restaurants Ltd. | 12 | 821 | 961 | 1,105 |
| Current income tax payable | 11 | 3,647 | - | - |
| Term loan, net of deferred financing charges | 10 | - | 13,963 | - |
| | | 5,873 | 16,556 | 2,456 |
| Term loan, net of deferred financing charges | 10 | 13,923 | - | 13,924 |
| Deferred income taxes | 11 | 1,623 | 1,334 | 1,133 |
| Class C Partnership units | 9(a) | 57,000 | 57,000 | 57,000 |
| Exchangeable Partnership units | 9(b) | 37,139 | 46,378 | 43,734 |
| Fund units liability | 7 | - | - | 102,164 |
| Unitholders' equity (deficiency): | | | | |
| Fund units | 7 | 123,275 | 113,045 | - |
| Accumulated deficit | | (18,940) | (19,356) | (8,110) |
| | | 104,335 | 93,689 | (8,110) |
| | | $ 219,893 | $ 214,957 | $ 212,301 |

See accompanying notes to consolidated financial statements.

Subsequent events (note 18)

Approved on behalf of the Board of Trustees

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

*"George Tidball"*
**George Tidball, Trustee**

# CONSOLIDATED STATEMENTS COMPREHENSIVE INCOME (LOSS)

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

| | Note | January 1 to December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|---|
| Revenue: | | | |
| Royalty income | 4 | $ 19,230 | $ 18,422 |
| Interest income | | 4,281 | 4,278 |
| | | 23,511 | 22,700 |
| Expenses: | | | |
| General and administrative | | (472) | (417) |
| Interest and financing fees | | (672) | (612) |
| Amortization of deferred financing charges | | (33) | (39) |
| | | (1,177) | (1,068) |
| Profit before distributions, change in market value and taxes | | 22,334 | 21,632 |
| Distributions recorded as interest: | | | |
| Class C Partnership units | 9(a) | (4,275) | (4,275) |
| Exchangeable Partnership units | 9(b) | (3,704) | (4,500) |
| Distributions to Fund unitholders | 7 | - | (13,360) |
| | | (7,979) | (22,135) |
| Profit (loss) before change in market value and taxes | | 14,355 | (503) |
| Decrease (increase) in market value of Exchangeable Partnership units | 9(b) | 896 | (10,542) |
| Profit (loss) before taxes | | 15,251 | (11,045) |
| Taxes: | | | |
| Current | 11 | (3,647) | - |
| Deferred | 11 | (289) | (201) |
| | | (3,936) | (201) |
| Profit (loss) and comprehensive income (loss) for the year | | $ 11,315 | $ (11,246) |
| Weighted average Fund units outstanding | 3(k) | 11,275,418 | 10,361,856 |
| Basic earnings per Fund unit | 3(k) | $ 1.00 | $ 0.20 |
| Fully diluted earnings per Fund unit | 3(k) | $ 0.92 | $ 0.20 |

See accompanying notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (DEFICIENCY)

(Expressed in thousands of dollars)

| | Fund units | Accumulated Deficit | Unitholders' equity (deficiency) |
|---|---|---|---|
| Balance, January 1, 2010 | $ - | $ (8,110) | $ (8,110) |
| Extinguishment of Fund unit liability | 113,045 | - | 113,045 |
| Loss and comprehensive loss for the year | - | (11,246) | (11,246) |
| Balance, December 31, 2010 | $ 113,045 | $ (19,356) | $ 93,689 |
| | | | |
| Balance, January 1, 2011 | $ 113,045 | $ (19,356) | $ 93,689 |
| Profit and comprehensive income for the year | - | 11,315 | 11,315 |
| Class B unit exchange, February 8, 2011 | 10,230 | - | 10,230 |
| Distributions declared to Fund unitholders | - | (10,899) | (10,899) |
| Balance, December 31, 2011 | $ 123,275 | $ (18,940) | $ 104,335 |

See accompanying notes to consolidated financial statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars)

| | Note | January 1 to December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|---|
| **Cash provided by (used for):** | | | |
| OPERATIONS: | | | |
| Profit (loss) for the year | | $ 11,315 | $ (11,246) |
| Items not involving cash: | | | |
| Amortization of deferred financing charges | | 33 | 39 |
| Deferred income tax expense | 11 | 289 | 201 |
| Increase (decrease) in market value of Exchangeable Partnership units | 9(b) | (896) | 10,542 |
| Distributions recorded as interest: | | | |
| Class C Partnership units | 9(a) | 4,275 | 4,275 |
| Exchangeable Partnership units | 9(b) | 3,704 | 4,500 |
| Distributions to Fund unitholders | 8 | - | 13,360 |
| Changes in non-cash operating working capital: | | | |
| Due from Keg Restaurants Ltd. | | (157) | (217) |
| Prepaid expenses and deposits | | 6 | - |
| Interest payable on Term loan | | - | 8 |
| Accounts payable and accrued liabilities | | (6) | 177 |
| Current income tax payable | | 3,647 | - |
| Interest income | | (4,281) | (4,278) |
| Interest and financing fees | | 672 | 612 |
| Interest received | | 4,281 | 4,278 |
| Interest paid | | (672) | (612) |
| | | 22,210 | 21,639 |
| FINANCING: | | | |
| Distributions paid to Class C unitholder | | (4,275) | (4,275) |
| Distributions paid to Exchangeable unitholder | | (3,843) | (4,646) |
| Distributions paid to Fund unitholders | | (11,120) | (13,264) |
| Deferred financing costs | | (73) | - |
| | | (19,311) | (22,185) |
| Increase (decrease) in cash | | 2,899 | (546) |
| Cash, beginning of period | | 1,112 | 1,658 |
| Cash, end of period | | $ 4,011 | $ 1,112 |

See note 16 for supplementary cash flow information.

See accompanying notes to consolidated financial statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 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, 1010. 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") as issued by the International Accounting Standards Board ("IASB"). These are the Fund's first annual 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 were authorized for issue by the Fund's Board of Trustees on March 19, 2012.

(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, liabilities, 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.

## 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.

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 Fund carries the Keg Rights at historical cost comprising the amount of consideration paid for the Keg Rights as well as the value of additional Keg restaurants rolled into the Royalty Pool ("Additional Entitlement"). The fair value of the Additional 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, and as a result, the value assigned to the Keg Rights could differ materially from actual results.

The Fund tests the Keg Rights for impairment annually, which requires that the Fund use a valuation technique to determine if impairment exists. This valuation technique is dependent on a number of different variables which requires management to exercise judgment, and as a result, the estimated net cash flows the Keg Rights are expected to generate could differ materially from actual results.

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

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 approach may not represent the actual value of the financial liability should the distributions paid to the holder of the Exchangeable units differ significantly from that paid to Fund unitholders.

(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, and are measured using enacted or substantially enacted tax rates expected to apply to taxable income in the periods in which the temporary differences are expected to reverse. If certain judgements or estimates prove to be inaccurate, including when temporary differences reverse, or if certain tax rates or laws change, the Fund's financial position and comprehensive income (loss) could be materially impacted.

## 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 (note 4).

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 comprehensive income; and
- Note receivable from KRL and Class C Partnership unit liability are measured at historical 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 profit (loss) adjusted for non-cash items such as deferred income taxes, fair value adjustments on the Exchangeable Partnership units liability (note 9(b)), 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).

## 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 comprehensive income (loss) 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.

## 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 the Exchangeable Partnership unit liability (note 9(b)) as a financial liability due to the contractual obligation to distribute cash and is measured at fair value through profit or loss due to certain conversion features and are discussed further in note 9(b).

  Financial instruments in this category are recognized initially and subsequently at fair value and transaction costs are expensed to comprehensive income in the period incurred. Gains and losses arising from changes in fair value are recognized in 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. Cash, 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, Class C Partnership unit liability, Fund unit liability, Term loan 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.

- 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. The Term loan approximates its fair value based on prevailing interest in effect at the statement of financial position dates.

## 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 the Exchangeable Partnership unit liability is determined using Level 2 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.

  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.

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

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(j) Impairment (continued):

- Non-financial assets (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 December 31, 2010, the $13,360,000 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 potentially 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 and adjusted to be effective January 1 of each year on December 31 when the actual full-year performance of the new restaurants is known with certainty.

The following reconciles the basic profit (loss) to the diluted profit:

| | January 1 to December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|
| Basic profit (loss) for the period | $ 11,315 | $ (11,246) |
| Distributions on Fund units | - | 13,360 |
| Adjusted basic net profit (loss) for the period | 11,315 | 2,114 |
| Distributions on Exchangeable Partnership units | 3,704 | 4,500 |
| Increase in current tax expense | (982) | - |
| Increase in market value of Exchangeable Partnership units | (896) | 10,542 |
| Diluted net profit for the period | $ 13,141 | $ 17,156 |
| Weighted average number of Fund units | 11,275,418 | 10,361,856 |
| Weighted average number of Exchangeable Partnership units | 3,002,402 | 3,755,200 |
| Weighted average number of units | 14,277,820 | 14,117,056 |
| Basic earnings per Fund unit | $ 1.00 | $ 0.20 |
| Fully diluted earnings per Fund unit | $ 0.92 | $ 0.20 |

For the year ended December 31, 2010, the Exchangeable Partnership units are anti-dilutive. Accordingly, the diluted earnings per Fund unit equals the basic earnings per Fund unit.

## 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.

(m) Accounting standards and amendments issued but not yet adopted:

Unless otherwise noted, the following revised standards and amendments are effective for annual periods beginning on or after January 1, 2013 with earlier adoption permitted. The Fund has not yet assessed the impact of these standards and amendments or determined whether they will be adopted early.

(i) IFRS 9, *Financial Instruments*, was issued in November 2009 and addresses classification and measurement of financial assets. It replaces the multiple category and measurement models in IAS 39, *Financial Instruments – Recognition and Measurement*, for debt instruments with a new mixed measurement model having only two categories: amortized costs and fair value through profit or loss. IFRS 9 also replaces the models for measuring equity instruments. Such instruments are either recognized at fair value through profit or loss or at fair value through other comprehensive income. Where equity instruments are measured at fair value through other comprehensive income, dividends are recognized in profit or loss to the extent that they do not clearly represent a return of investment; however, other gains and losses (including impairments) associated with such instruments remain in accumulated comprehensive income indefinitely.

Requirements for financial liabilities were added to IFRS 9 in October 2010 and they largely carried forward existing requirements in IAS 39 except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss are generally recorded in other comprehensive income.

(ii) IFRS 10, *Consolidated Financial Statements*, requires an entity to consolidate an investee when it has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12, *Consolidation – Special Purpose Entities* and parts of IAS 27, Consolidated and Separate Financial Statements. IFRS 12, *Disclosure of Interests in Other Entities*, establishes disclosure requirements for interests in other entities, such as subsidiaries, joint arrangements, associates, and unconsolidated structured entities. The standard carries forward existing disclosures and also introduces significant additional disclosure that address the nature of, and risks associated with, an entity's interest in other entities.

(iii) IFRS 13, *Fair Value Measurement*, is a comprehensive standard for fair value measurement and disclosure for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and does not always reflect a clear measurement basis or consistent disclosures.

## 3. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED):

(m) Accounting standards and amendments issued but not yet adopted (continued):

(iv) There have been amendments to existing standards, including IAS 27, *Separate Financial Statements*, and IAS 28, *Investments in Associated and Joint Ventures*. IAS 27 addresses accounting for subsidiaries, jointly controlled entities and associates in non-consolidated financial statements. IAS 28 has been amended to include joint ventures in its scope and to address the changes in IFRS 10 – 13.

(v) IFRS 7, *Financial Instruments: Disclosures*¸ has been amended to include additional disclosure requirements in the reporting of transfer transactions and risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position, particularly those involving securitization of financial assets. The amendment is applicable for annual periods beginning on or after July 1, 2011, with earlier application permitted.

## 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 two permanent closures and one temporary closure due to an extended restaurant renovation for the period from January 1 to December 31, 2011 (January 1 to December 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 were $15.9 million annually. Three permanently closed Keg restaurants with annual sales of $10.4 million have been removed from the Royalty Pool, resulting in a net increase in Royalty Pool sales of $5.5 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.

(Tabular amounts expressed in thousands of dollars)

## 4. ROYALTY POOL (CONTINUED):

As a result of the contribution of the additional net sales to the Royalty Pool, KRL's Additional Entitlement is equivalent to 160,764 Fund units, being 1.13% 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. On December 31, 2011, the performance of the new restaurants was confirmed and the Additional Entitlement adjusted to be effective as of January 1, 2011. KRL will also receive a proportionate increase in monthly distribution from the Partnership. Including the Additional Entitlement described above, KRL has the right to exchange its units in the capital of the Partnership for 2,924,320 Fund units, representing 20.48% of the Fund units on a fully diluted basis

On January 1, 2012, two new restaurants that opened during the period from October 3, 2010 through October 2, 2011 were added to the Royalty Pool (note 18).

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

| | January 1 to December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|
| Restaurants in Royalty Pool | 102 | 102 |
| Royalty Pool system sales | $ 472,280 | $ 452,786 |
| Royalty income at 4% of system sales reported above | 18,891 | 18,111 |
| Make-whole payment, based on 4% of lost system sales | 339 | 311 |
| Total royalty income | $ 19,230 | $ 18,422 |

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

| | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|
| Note receivable with interest payable monthly at 7.5% per annum and principal amount due May 31, 2042 | $ 57,000 | $ 57,000 | $ 57,000 |

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.

(Tabular amounts expressed in thousands of dollars)

## 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 (note 4) 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%) | 1,214 |
| Balance, December 31, 2010 | 154,183 |
| January 1, 2011 initial estimate of Additional Entitlement (80%) | 1,443 |
| December 31, 2011 final remaining Additional Entitlement (100%) | 443 |
| Balance, December 31, 2011 | $ 156,069 |

Each year on December 31, the Fund tests the carrying value of the Keg Rights for impairment. Impairment exists if the present value of the net cash flows the Fund expects the Keg Rights to generate over the next fifty years (the "value in use", or "recoverable amount") exceeds their carrying value. A fifty year period is appropriate as the Keg Rights are registered trademarks that have an indefinite life. The license and royalty agreement between the Fund and KRL expires on December 31, 2101.

The Fund determines the net cash flows it expects to receive from the licensing of the Keg Rights by taking the Fund's budgeted royalty revenue for the next year less budgeted general and administrative operating expenses. Since the Fund's operating expenses are relatively static, the key assumptions in determining the recoverable amount are budgeted royalty revenue and the discount rate used to determine the net present value of the net cash flows. The Fund bases its budgeted royalty revenue on past experience and future expectations formed using third party economic forecasts and industry publications. Using budgeted royalty revenue and operating expenses as a base, these amounts are projected to grow at an annual inflation rate of 2% (the midpoint of the Bank of Canada's inflation target range of 1% to 3%) over the following forty-nine years.

These projected cash flows are discounted at the Fund's estimated before-tax yield of 10% to arrive at the recoverable amount. The Fund's estimated pre-tax yield is determined using the Fund's closing price at December 30, 2011, the annualized distribution rate of $0.96 and the SIFT tax rate of 25.0% in effect January 1, 2012.

## 6. INTANGIBLE ASSETS (CONTINUED):

The Fund also considers other reasonably possible scenarios where forecasted revenue is less than budget along with other reasonably possible higher discount rates to determine whether the Keg Rights would be impaired under those scenarios. As at December 31, 2011, the Fund has tested the Keg Rights for impairment in the manner described above and has determined that the recoverable amount exceeds the carrying value using budgeted royalty revenue as well as forecasted royalty revenue for other reasonably possible scenarios and discount rates. The Fund has determined that no impairment exists.

## 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 comprehensive income (note 17(h)).

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 comprehensive income. Subsequent to March 31, 2011, the Fund has adjusted this treatment to account for the transaction on the carry over basis based on guidance received on the application of IFRS in this circumstance. This amendment results in the elimination of the IFRS to Canadian GAAP difference in earnings and equity related to the reclassification of Fund Units from a liability to equity for the year ended December 31, 2010 as previously disclosed in the March 31, 2011 financial statements. This adjustment is quantified in the table below:

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

## 7. FUND UNITS (CONTINUED):

December 31, 2010 net loss and comprehensive loss under IFRS:

| | | |
|---|---|---|
| As previously reported in the March 31, 2011 financial statements | $ | (31,487) |
| Effect of adjustment described above | | 20,241 |
| Adjusted | $ | (11,246) |

December 31, 2010 Fund units under IFRS:

| | | |
|---|---|---|
| As previously reported in the March 31, 2011 financial statements | $ | 133,286 |
| Effect of adjustment described above | | (20,241) |
| Adjusted | $ | 113,045 |

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 |
| Balance December 31, 2010 | 10,603,500 | - | 113,045 |
| Class B unit exchange for Fund units, February 8, 2011 | 750,000 | - | 10,230 |
| Balance, December 31, 2011 | 11,353,500 | $ - | $ 123,275 |

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

## 8. DISTRIBUTIONS ON FUND UNITS:

| | January 1 to December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|
| Distributions declared to Fund unitholders | $ 10,899 | $ 13,360 |
| Weighted average Fund units outstanding | 11,275,418 | 10,361,856 |
| Distributions declared per unit | $ 0.97 | $ 1.29 |

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 year ended December 31, 2011 were recorded directly to the consolidated statements of changes in equity whereas distributions declared to Fund unitholders during the year ended December 31, 2010 were recorded as interest expense in the consolidated statement of comprehensive income (note 7).

## 9. PARTNERSHIP UNIT LIABILITIES:

(a) 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.

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

## 9. PARTNERSHIP UNIT LIABILITIES (CONTINUED):

(b) Exchangeable Partnership unit liability:

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

| | Note | January 1, 2010 | Fair Value |
|---|---|---|---|
| Class A Partnership units | (i) | 905,944 | $ 9,694 |
| Class B Partnership units | (ii) | 1,826,700 | 19,546 |
| Class D Partnership units | (iii) | 1,354,591 | 14,494 |
| | | 4,087,235 | $ 43,734 |

| | | December 31, 2010 | Fair Value |
|---|---|---|---|
| Class A Partnership units | (i) | 905,944 | $ 11,958 |
| Class B Partnership units | (ii) | 926,700 | 12,232 |
| Class D Partnership units | (iii) | 1,680,912 | 22,188 |
| | | 3,513,556 | $ 46,378 |

| | | December 31, 2011 | Fair Value |
|---|---|---|---|
| Class A Partnership units | (i) | 905,944 | $ 11,506 |
| Class B Partnership units | (ii) | 176,700 | 2,244 |
| Class D Partnership units | (iii) | 1,841,676 | 23,389 |
| | | 2,924,320 | $ 37,139 |

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 2 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 December 31, 2011 was $12.70 (December 31, 2010 – $13.20; January 1, 2010 – $10.70).

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

For the years ended December 31, 2011 and 2010

## 9. PARTNERSHIP UNIT LIABILITIES (CONTINUED):

(b) Exchangeable Partnership unit liability (continued):

The components of the change in balances in the Exchangeable Partnership unit liability for the year are as follows:

| | Total number of Exchangeable Partnership units | January 1 to December 31, 2011 |
|---|---|---|
| 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) |
| December 31 final Class D unit entitlement (20%) | 37,774 | 443 |
| Fair value adjustment | - | (896) |
| Fair value of Exchangeable Partnership units, end of period | 2,924,320 | $ 37,139 |

| | Total number of Exchangeable Partnership units | January 1 to December 31, 2010 |
|---|---|---|
| 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 |
| Exchange of Class B units for Fund units | (900,000) | (10,881) |
| December 31 final Class D unit entitlement (20%) | 132,665 | 1,212 |
| Fair value adjustment | - | 10,542 |
| Fair value of Exchangeable Partnership units, end of period | 3,513,556 | $ 46,378 |

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.

## 9. PARTNERSHIP UNIT LIABILITIES (CONTINUED):

(b) Exchangeable Partnership unit liability (continued):

(i) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the Class C Partnership units (“Class C units”), multiplied by the number of Class A units divided by the number of LP Partnership units (“LP units”) issued and outstanding. KHT holds all of the 8,153,500 LP units issued and outstanding at December 31, 2011. In addition, the Class A units receive a residual distribution proportionately with the Class B units, Class D units, LP units and GP units relative to the aggregate number of each class issued and outstanding (or in the case of the Class B units and Class D units, the number issued and outstanding multiplied by the Class B and Class D current distribution entitlement, respectively). Class A units are exchangeable for Fund units on the basis of one Fund unit for one Class A unit and represent KRL’s initial 10% effective ownership of the Fund prior to the entitlement of Class B and Class D units.

(ii) 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.

(iii) 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 an identical distribution entitlement as the Class B units.

During the quarter ended June 30, 2011, the Fund changed its accounting policy with respect to recording distributions on Class C and Exchangeable Partnership units. Previously, the Fund recorded distributions on these units after such distributions have been declared. Alternatively, the Fund will now accrue undistributed income in the Partnership that is attributable to Class C and Exchangeable units at each period end. The Fund has adopted this policy retrospectively. As a result of this change in accounting policy, distributions recorded as interest on Class C and Exchangeable Partnership units have been restated for all quarterly reporting periods; however, the adoption of this policy has no effect on annual distributions recorded as interest.

## 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 amendment was considered a modification of debt. As a result, the deferred financing fees incurred on the modification have been added to the existing unamortized balance of deferred financing fees associated with the previous facility.

The term loan is presented net of $77,000 in deferred financing charges at December 31, 2011 (December 31, 2010 – $37,000; January 1, 2010 – $76,000).

(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 December 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 December 31, 2011. Deferred income tax expense is a non-cash item that does not affect cash flow.

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2011 and 2010

## 11. INCOME TAXES (CONTINUED):

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 December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|
| Current income tax expense | $ (3,647) | $ - |
| Deferred tax expense | (289) | (201) |
| | $ (3,936) | $ (201) |

The balance of the Fund's deferred tax liability increased to $1,623,000 as at December 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 December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|
| Profit (loss) before income taxes | $ 15,251 | $ (11,045) |
| Combined Canadian federal and provincial rates | 26.5% | 28.5% |
| Computed "expected" tax expense (recovery) | 4,042 | (3,148) |
| Increased (reduced) by: | | |
| Current year's profit not taxable | - | (3,493) |
| Permanent and other differences | (278) | 6,776 |
| Change in tax base of the Keg Rights | 181 | 80 |
| Differences between current and future tax rates and other items | (9) | (14) |
| Total income tax expense per the statement of comprehensive income (loss) | $ 3,936 | $ 201 |

(Tabular amounts expressed in thousands of dollars)

## 11. INCOME TAXES (CONTINUED):

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

| | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|
| Deferred tax liabilities: | | | |
| Temporary difference related to the Keg Rights ............ | $ 1,623 | $ 1,334 | $ 1,133 |
| Deferred tax liability ............................................................ | $ 1,623 | $ 1,334 | $ 1,133 |

## 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.

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

| | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|
| Royalty fee, including GST/HST ........................................ | $ 2,433 | $ 2,276 | $ 2,059 |
| Interest on note receivable from Keg Restaurants Ltd. ........ | 363 | 363 | 363 |
| Due from Keg Restaurants Ltd. ........................................... | $ 2,796 | $ 2,639 | $ 2,422 |

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.

| | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|
| Distribution payable to KRL ............................................... | $ 821 | $ 961 | $ 1,105 |

The above amount was paid to KRL when due, subsequent to the end of the periods above.

## 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 December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|
| Remuneration of the Fund's Trustees, included in general and administrative expenses | $ 54 | $ 54 |

## 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 profit or loss 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.

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.

(Tabular amounts expressed in thousands of dollars)

## 14. FINANCIAL RISK MANAGEMENT (CONTINUED):

(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:

| | Value | Maturity |
|---|---|---|
| Account payable and accrued liabilities | $ 441 | < 1 year |
| Distributions payable to Fund unitholders | 908 | < 1 year |
| Distributions payable to Keg Restaurants Ltd. | 821 | < 1 year |
| Interest payable on term loan | 56 | < 1 year |
| Current income tax payable | 3,647 | < 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 profit or loss 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 year ended December 31, 2011, a 100 basis point change in the US dollar exchange rate would result in an approximate $479,000 and $19,000 change in Royalty Pool sales and royalty revenue, respectively.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 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:

| | Note | December 31, 2011 | December 31, 2010 | January 1, 2010 |
|---|---|---|---|---|
| Term loan | 10(a) | $ 14,000 | $ 14,000 | $ 14,000 |
| Fund units liability | 7 | $ - | $ - | $ 102,164 |
| Fund units | 7 | $ 123,275 | $ 113,045 | $ - |
| Accumulated deficit | | (18,940) | (19,356) | (8,110) |
| Unitholders' equity (deficiency) | | $ 104,335 | $ 93,689 | $ (8,110) |

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 profit (loss) before interest, change in market value, taxes, depreciation and amortization ("EBITDA"). As at December 31, 2011, the Fund was in compliance with all financial covenants associated with this facility.

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 December 31, 2011 | January 1 to December 31, 2010 |
|---|---|---|
| Non-cash transactions: | | |
| Issuance of Fund units on Class B unit exchange | $ 10,230 | $ 10,881 |
| Increase in intangible assets on Royalty Pool net sales roll-in | 1,886 | 2,985 |

## 17. IFRS:

As stated in note 2(a), these are the Fund's first annual 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 year ended December 31, 2011, the comparative information presented for 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 comprehensive income, consolidated statement of financial position and statement of cash flows for 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.

The Fund has not taken any elective exemptions available under IFRS 1 on its transition to IFRS.

(Tabular amounts expressed in thousands of dollars)

## 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 |
| **ASSETS** | | | | |
| 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) | 1,036 | (1,036) | - |
| | | 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) | 56,586 | (56,586) | - |
| | | $ 116,364 | $ 95,937 | $ 212,301 |
| **LIABILITIES AND UNITHOLDERS' EQUITY (DEFICIENCY)** | | | | |
| 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) | - | 1,105 | 1,105 |
| | | 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 | | (530) | (7,580) | (8,110) |
| | | 99,484 | (107,594) | (8,110) |
| | | $ 116,364 | $ 95,937 | $ 212,301 |

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2011 and 2010

## 17. IFRS (CONTINUED):

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

| | | December 31, 2010 | | |
|---|---|---|---|---|
| | Note | GAAP | Effect of Transition to IFRS | IFRS |
| **ASSETS** | | | | |
| 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) | 1,089 | (1,089) | - |
| | | 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) | 67,488 | (67,488) | - |
| | | $ 126,873 | $ 88,084 | $ 214,957 |
| **LIABILITIES AND UNITHOLDERS' EQUITY (DEFICIENCY)** | | | | |
| 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) | - | 13,963 | 13,963 |
| | | 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 | 2,150 | 113,045 |
| Accumulated deficit | | (1,045) | (18,311) | (19,356) |
| | | 109,850 | (16,161) | 93,689 |
| | | $ 126,873 | $ 88,084 | $ 214,957 |

(Tabular amounts expressed in thousands of dollars)

### 17. IFRS (CONTINUED):

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

| | | January 1 to December 31, 2010 | | |
|---|---|---|---|---|
| | Note | 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 | | 4,278 | - | 4,278 |
| | | 13,496 | 9,204 | 22,700 |
| Expenses: | | | | |
| General and administrative | (a) | - | (417) | (417) |
| Interest and financing fees | | (612) | - | (612) |
| Amortization of deferred financing charges | | (39) | - | (39) |
| | | (651) | (417) | (1,068) |
| Profit before distributions, market value and taxes | | 12,845 | 8,787 | 21,632 |
| Distributions 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) | - | (13,360) | (13,360) |
| | | - | (22,135) | (22,135) |
| Profit (loss) before change in market value and taxes | | 12,845 | (13,348) | (503) |
| Decrease (increase) in market value of Exchangeable Partnership units | (a) (f) | - | (10,542) | (10,542) |
| | | 12,845 | (23,890) | (11,045) |
| Taxes: | | | | |
| Current | | - | - | - |
| Deferred | (e) | - | (201) | (201) |
| | | - | (201) | (201) |
| Profit (loss) and comprehensive income (loss) for the year | | $ 12,845 | $ (24,091) | $ (11,246) |

(Tabular amounts expressed in thousands of dollars)

## 17. IFRS (CONTINUED):

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

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

(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 | January 1, 2010 |
|---|---|---|---|
| ASSETS | | | |
| Cash | | $ 179 | $ 279 |
| Prepaid expenses and deposits | | 23 | 23 |
| Due from Keg Restaurants Ltd. | (b) | 2,276 | 2,059 |
| Intangible assets, Keg Rights | (c) | 154,813 | 151,198 |
| LIABILITIES | | | |
| Accounts payable and accrued liabilities | | 447 | 270 |
| Distributions payable Keg Restaurants Ltd | (b) | 961 | 1,105 |
| Exchangeable Partnership units | (f) | 46,378 | 43,734 |
| Class C Partnership units | (g) | 57,000 | 57,000 |

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 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 comprehensive income:

| | Note | Year Ended December 31, 2010 |
|---|---|---|
| REVENUE | | |
| Royalty Income | (i) | $ 18,422 |
| EXPENSES | | |
| General and administrative | | (417) |
| Distributions recorded as interest under IFRS: | | |
| Class C Partnership units | (g) | (4,275) |
| Exchangeable Partnership units | (f) | (4,500) |
| Decrease (increase) in market value of Exchangeable Partnership units | (f) | (10,542) |

(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 and December 31, 2010. In accordance with IFRS, the Fund presented the term loan as a current liability at December 31, 2010 as the original maturity date was less than one year as at the balance sheet date..

(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.

## 17. IFRS (CONTINUED):

(f) Exchangeable Partnership unit liability:

As described in note 9(b), 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.

(g) Class C unit liability:

As described in note 9(a), 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 were 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 initially 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.

As described in note 7, 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 December 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.

(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.

### 17. IFRS (CONTINUED):

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

The transition from GAAP to IFRS resulted in the consolidation of the accounts of the 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 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 $24,091,000 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 recorded as interest under IFRS. 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.

### 18. SUBSEQUENT EVENTS:

On January 1, 2012, two new Keg restaurants that opened during the period from October 3, 2010 through October 2, 2011 were added to the Royalty Pool. The gross sales of these two new restaurants have been estimated at $9.43 million annually. Two permanently closed Keg restaurants with annual sales of $8.01 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of $1.42 million annually. The total number of restaurants in the Royalty Pool remains at 102. The yield of the Fund units was determined to be 10.52% calculated using a weighted average unit price of $12.33.

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 40,624 Fund units, being 0.28% of the Fund units on a fully diluted basis.

On January 1, 2012, KRL received 80% of this entitlement representing the equivalent of 32,499 Fund units, being 0.23% 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 2,956,820 Fund units representing 20.66% of the Fund units on a fully diluted basis.

The balance of the Additional Entitlement will be adjusted to be effective January 1, 2012 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 2,964,945 Fund units representing 20.71% of the Fund units on a fully diluted basis.