

THE KEG ROYALTIES INCOME FUND

FIRST QUARTER REPORT

For the three months ended March 31, 2012

TO OUR UNITHOLDERS

On behalf of the Board of Trustees, I am pleased to present the results of The Keg Royalties Income Fund (the "Fund") for the three months ended March 31, 2012.

RESULTS

The gross sales reported by the 102 Keg restaurants in the Royalty Pool were \$124,366,000 for the quarter, an increase of \$3,762,000 or 3.1% from the comparable quarter of the prior year. These gross sales reflect the sales of the new Keg restaurants which opened during the period from October 3, 2010 through October 2, 2011, which were added to the Royalty Pool on January 1, 2012, and same store sales increases of 1.8% for the quarter.

Royalty income increased by \$125,000 or 2.6% from \$4,867,000 in the three months ended March 31, 2011 to \$4,992,000 in the three months ended March 31, 2012.

Distributable cash before SIFT tax increased by \$240,000 from \$3,839,000 (34.8 cents/Fund unit) to \$4,079,000 (35.9 cents/Fund unit) for the quarter. Distributable cash available to pay distributions to public unitholders increased from \$2,913,000 (26.4 cents/Fund unit) to \$3,183,000 (28.0 cents/Fund unit) for the quarter. The increase in distributable cash during the quarter, both before and after SIFT tax, was primarily due to positive changes in non-cash working capital, which are expected to reverse in subsequent periods. The Fund remains financially well positioned with surplus cash on hand of \$706,000 and a positive working capital balance of \$1,985,000 as of March 31, 2012.

OUTLOOK

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
May 14, 2012

FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Jan. 1 to Mar. 31, 2012	Jan. 1 to Mar. 31, 2011
Restaurants in the Royalty Pool	102	102
Gross sales reported by restaurants in the Royalty Pool	\$ <u>124,366</u>	\$ <u>120,604</u>
Royalty income ⁽¹⁾	\$ 4,992	\$ 4,867
Interest income ⁽²⁾	<u>1,066</u>	<u>1,055</u>
Total income	\$ 6,058	\$ 5,922
Administrative expenses ⁽³⁾	(104)	(100)
Interest and financing expenses ⁽⁴⁾	<u>(173)</u>	<u>(174)</u>
Operating income	\$ 5,781	\$ 5,648
Distributions to KRL ⁽⁵⁾	(2,041)	(1,996)
Distributions declared to Fund unitholders ⁽⁶⁾	<u>-</u>	<u>-</u>
Profit (loss) before market value adjustment and income taxes	\$ 3,740	\$ 3,652
Market value adjustment ⁽⁷⁾	(5,571)	(684)
Income taxes ⁽⁸⁾	<u>(947)</u>	<u>(1,138)</u>
Profit (loss)	\$ <u>(2,778)</u>	\$ <u>1,830</u>
Distributable cash before SIFT tax ⁽⁹⁾	\$ <u>4,079</u>	\$ <u>3,839</u>
Distributable cash ⁽¹⁰⁾	\$ <u>3,183</u>	\$ <u>2,913</u>
Distributions paid to Fund unitholders	\$ <u>2,725</u>	\$ <u>2,945</u>
Payout Ratio ⁽¹¹⁾	<u>85.6%</u>	<u>101.1%</u>
Per Fund unit information ⁽¹²⁾		
Profit (loss) before market value adjustment and income taxes	\$ <u>.329</u>	\$ <u>.331</u>
Profit (loss)	\$ <u>(.245)</u>	\$ <u>.166</u>
Distributable cash before SIFT tax ⁽⁹⁾	\$ <u>.359</u>	\$ <u>.348</u>
Distributable cash ⁽¹⁰⁾	\$ <u>.280</u>	\$ <u>.264</u>
Distributions paid to Fund unitholders	\$ <u>.240</u>	\$ <u>.267</u>
SSSG ⁽¹³⁾		
Canada	1.7%	3.8%
United States	1.2%	3.2%
Consolidated	1.8%	3.1%
Restaurant Openings/Closings		
Opened	--	--
Closed	--	--
Relocated	--	1
Net Opened (Closed)	--	--

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 since January 1, 2011 have been recorded as distributions and charged to unitholder’s equity whereas the distributions declared prior to 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 March 31, 2012, include SIFT tax expense of \$896,000 (quarter ended March 31, 2011 - \$926,000) and non-cash deferred taxes of \$51,000 (quarter ended March 31, 2011 - \$212,000). 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, plus SIFT tax paid (including current year instalments), 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 current year SIFT tax expense. 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 March 31, 2012 was 11,353,500 (three months ended March 31, 2011 – 11,036,833). For comparative purposes, the profit (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).
- ⁽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

	Q1	Q4	Q3	Q2
(\$000's except per unit amounts)	2012	2011	2011	2011
Restaurants in the Royalty Pool	102	102	102	102
Gross sales reported by Keg restaurants in the Royalty Pool	\$ <u>124,366</u>	\$ <u>122,135</u>	\$ <u>117,125</u>	\$ <u>112,416</u>
Royalty income ⁽¹⁾	\$ 4,992	\$ 4,986	\$ 4,786	\$ 4,591
Interest income ⁽²⁾	<u>1,066</u>	<u>1,080</u>	<u>1,079</u>	<u>1,067</u>
Total income	\$ 6,058	\$ 6,066	\$ 5,865	\$ 5,658
Administrative expenses ⁽³⁾	(104)	(96)	(108)	(168)
Interest and financing expenses ⁽⁴⁾	<u>(173)</u>	<u>(183)</u>	<u>(174)</u>	<u>(174)</u>
Operating income	\$ 5,781	\$ 5,787	\$ 5,583	\$ 5,316
Distributions to KRL ⁽⁵⁾	(2,041)	(2,031)	(2,012)	(1,940)
Distributions declared to Fund unitholders ⁽⁶⁾	-	-	-	-
Profit (loss) before market value adjustment and income taxes	\$ 3,740	\$ 3,756	\$ 3,571	\$ 3,376
Market value adjustment ⁽⁷⁾	(5,571)	(2,057)	3,608	29
Income taxes ⁽⁸⁾	<u>(947)</u>	<u>(990)</u>	<u>(936)</u>	<u>(872)</u>
Profit (loss)	\$ <u>(2,778)</u>	\$ <u>709</u>	\$ <u>6,243</u>	\$ <u>2,533</u>
Distributable cash before SIFT taxes ⁽⁹⁾	\$ <u>4,079</u>	\$ <u>3,455</u>	\$ <u>3,483</u>	\$ <u>3,454</u>
Distributable cash ⁽¹⁰⁾	\$ <u>3,183</u>	\$ <u>2,500</u>	\$ <u>2,579</u>	\$ <u>2,592</u>
Distributions paid to Fund unitholders	\$ <u>2,725</u>	\$ <u>2,725</u>	\$ <u>2,725</u>	\$ <u>2,725</u>
Payout Ratio ⁽¹¹⁾	<u>85.6%</u>	<u>109.0%</u>	<u>105.7%</u>	<u>105.1%</u>
Per Fund unit information ⁽¹²⁾				
Profit (loss) before market value adjustment and income taxes	\$ <u>.329</u>	\$ <u>.331</u>	\$ <u>.315</u>	\$ <u>.297</u>
Profit (loss)	\$ <u>(.245)</u>	\$ <u>.062</u>	\$ <u>.550</u>	\$ <u>.223</u>
Distributable cash before SIFT tax ⁽⁹⁾	\$ <u>.359</u>	\$ <u>.304</u>	\$ <u>.307</u>	\$ <u>.304</u>
Distributable cash ⁽¹⁰⁾	\$ <u>.280</u>	\$ <u>.220</u>	\$ <u>.227</u>	\$ <u>.228</u>
Distributions paid to Fund unitholders	\$ <u>.240</u>	\$ <u>.240</u>	\$ <u>.240</u>	\$ <u>.240</u>
SSSG ⁽¹³⁾				
Canada	1.7%	4.8%	5.2%	1.8%
United States	1.2%	5.1%	3.6%	3.8%
Consolidated	1.8%	5.0%	4.5%	1.4%
Restaurants Openings/Closings				
Opened	--	--	--	--
Closed	--	--	--	1
Relocated	--	--	--	--
Net Opened (Closed)	--	--	--	(1)

SUMMARY OF QUARTERLY RESULTS

	Q1	Q4	Q3	Q2
(\$000's except per unit amounts)	2011	2010	2010	2010
Restaurants in the Royalty Pool	102	102	102	102
Gross sales reported by Keg restaurants in the Royalty Pool	\$ 120,604	\$ 114,298	\$ 110,382	\$ 111,153
Royalty income ⁽¹⁾	\$ 4,867	\$ 4,697	\$ 4,527	\$ 4,502
Interest income ⁽²⁾	1,055	1,079	1,078	1,066
Total income	\$ 5,922	\$ 5,776	\$ 5,605	\$ 5,568
Administrative expenses ⁽³⁾	(100)	(112)	(99)	(107)
Interest and financing expenses ⁽⁴⁾	(174)	(178)	(173)	(152)
Operating income	\$ 5,648	\$ 5,486	\$ 5,333	\$ 5,309
Distributions to KRL ⁽⁵⁾	(1,996)	(2,168)	(2,196)	(2,092)
Distributions declared to Fund unitholders ⁽⁶⁾	-	(4,516)	(3,388)	(3,388)
Profit (loss) before market value adjustment and income taxes	\$ 3,652	\$ (1,198)	\$ (251)	\$ (171)
Market value adjustment ⁽⁷⁾	(684)	(5,373)	(3,279)	4,404
Income taxes ⁽⁸⁾	(1,138)	(41)	(28)	(63)
Profit (loss)	\$ 1,830	\$ (6,612)	\$ (3,558)	\$ 4,170
Distributable cash before SIFT tax ⁽⁹⁾	\$ 3,839	\$ 3,056	\$ 3,206	\$ 3,188
Distributable cash ⁽¹⁰⁾	\$ 2,913	\$ 3,056	\$ 3,206	\$ 3,188
Distributions paid to Fund unitholders	\$ 2,945	\$ 3,388	\$ 3,388	\$ 3,388
Payout Ratio ⁽¹¹⁾	101.1%	110.9%	105.7%	106.3%
Per Fund unit information ⁽¹²⁾				
Profit (loss) before market value adjustment and income taxes	\$.331	\$.313	\$.296	\$.306
Profit (loss)	\$.166	\$ (.198)	\$ (.016)	\$.718
Distributable cash before SIFT tax ⁽⁹⁾	\$.348	\$.288	\$.302	\$.303
Distributable cash ⁽¹⁰⁾	\$.264	\$.288	\$.302	\$.303
Distributions paid to Fund unitholders	\$.267	\$.320	\$.320	\$.322
SSSG ⁽¹³⁾				
Canada	3.8%	1.5%	0.0%	1.9%
United States	3.2%	(0.5)%	(2.2)%	(6.2)%
Consolidated	3.1%	0.8%	(0.6)%	(0.1)%
Restaurant Openings/Closings				
Opened	--	1	--	--
Closed	--	--	1	1
Relocated	1	--	--	--
Net Opened (Closed)	--	1	(1)	(1)

MANAGEMENT'S DISCUSSION AND ANALYSIS

**For the Three Months Ended March 31, 2012
As of May 14, 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 fourteen years, the period for which current management has been in control of KRL, SSSG has averaged 3.0% 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 ROYALTY POOL (CONTINUED)

The total number of Keg restaurants included in the Royalty Pool has increased from the 80 Keg restaurants in existence on March 31, 2002, to 102 as of December 31, 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. 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 32,500 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.

KRL'S INTEREST IN THE FUND

KRL's interest in the earnings of the Partnership is from its ownership of Class A, entitled Class B, Class C and Class D Partnership units. The Class A, entitled Class B and Class D Partnership units are exchangeable into Fund units on a one-for-one basis in certain circumstances ("Exchangeable units"). KRL's effective ownership of the Fund and its interest in the earnings of the Partnership has grown from 10.00% at the time of the IPO to 20.48% as of December 31, 2011. The increase in KRL's effective ownership of the Fund is due to the cumulative Additional Entitlement received by KRL equivalent to 5,218,376 Fund units, less 3,200,000 Exchangeable units exchanged by KRL for Fund units and sold through the facilities of the Toronto Stock Exchange. The sale of the 3,200,000 Fund units increased 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. 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 increasing KRL's effective ownership of the Fund to 20.66%

FEDERAL GOVERNMENT TAX ON INCOME FUNDS

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".

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.

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 than 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.

DISTRIBUTIONS TO UNITHOLDERS (CONTINUED)

Year-to-date distributions paid were as follows:

Period	Payment Date	Per/Unit	Distributions	
			Total \$	Year-to-Date \$
December 1-31, 2011	January 31, 2012	8.00¢	\$ 908,280	\$ 908,280
January 1-31, 2012	February 29, 2012	8.00¢	\$ 908,280	\$1,816,560
February 1-29, 2012	March 30, 2012	8.00¢	\$ 908,280	\$2,724,840
March 1-31, 2012	April 30, 2012*	8.00¢*	\$ 908,280*	\$3,633,120*

*Paid subsequent to the period

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

Since inception, the Fund has generated \$104,679,000 of distributable cash and has paid cumulative distributions of \$104,409,000, which resulted in a cumulative surplus of \$270,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid since inception to the cumulative distributable cash generated since inception) is 99.7%.

DISTRIBUTABLE CASH

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, plus SIFT tax paid (including current year instalments), less the Partnership distributions attributable to KRL, less current year SIFT tax expense. 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)	Jan. 1 Mar. 31, 2012	Jan. 1 Mar. 31, 2011
Cash flow from operations ⁽¹⁾	\$ 1,563	\$ 5,835
SIFT tax paid on Fund units ⁽²⁾	\$ 4,557	\$ -
KRL's interest ⁽³⁾	<u>(2,041)</u>	<u>(1,996)</u>
Distributable cash before current year SIFT tax	\$ 4,079	\$ 3,839
SIFT tax expense on Fund units ⁽⁴⁾	<u>(896)</u>	<u>(926)</u>
Distributable cash ⁽⁵⁾	<u>\$ 3,183</u>	<u>\$ 2,913</u>

Notes:

⁽¹⁾ Represents the cash flow from operations as reported in the consolidated statements of cash flows.

⁽²⁾ Includes the SIFT taxes actually paid during the period consisting of payments of \$3,646,000 with respect to 2011, and \$911,000 on account for 2012.

⁽³⁾ 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.

⁽⁴⁾ Represents the SIFT tax expense for the respective period calculated at 25.0% of taxable income for the current year and at 26.5% of taxable income for the prior year.

⁽⁵⁾ Distributable cash is the amount of cash available for distribution to the Fund's public unitholders. It 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, plus SIFT tax paid (including current year instalments), less the earnings of the Partnership attributable to KRL, less current year SIFT tax expense.

OWNERSHIP OF THE FUND

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

	March 31, 2012 ⁽¹⁾		March 31, 2011	
	<u>#</u>	<u>%</u>	<u>#</u>	<u>%</u>
Fund units held by public unitholders ⁽²⁾	11,353,500	79.34	11,353,500	79.73
Exchangeable Partnership units held by KRL: ⁽³⁾				
Class A units ⁽⁴⁾	905,944	6.33	905,944	6.36
Class B units ⁽⁵⁾	176,700	1.23	176,700	1.24
Class D units ⁽⁵⁾	<u>1,874,176</u>	<u>13.10</u>	<u>1,803,902</u>	<u>12.67</u>
Total Exchangeable Partnership units ⁽⁶⁾	<u>2,956,820</u>	<u>20.66</u>	<u>2,886,546</u>	<u>20.27</u>
Total Fund and Exchangeable Partnership units	<u>14,310,320</u>	<u>100.00</u>	<u>14,240,046</u>	<u>100.00</u>

Notes:

⁽¹⁾ Information is current as of March 31, 2012.

⁽²⁾ Represents the public's total effective ownership of the Fund as of March 31, 2012 and 2011. 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 79.34% during the three months ended March 31, 2012 (three months ended March 31, 2011 – 77.51%). The weighted average number of Fund units outstanding for the three-month period ended March 31, 2012 were 11,353,500 (three-month period ended March 31, 2011 – 11,036,833).

⁽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 March 31, 2012, KRL is the registered holder of 176,700 Class B units and 1,874,176 Class D units (March 31, 2011 – 176,700 Class B units and 1,803,902 Class D units). Also included in these figures is 80% of the Additional Entitlement estimated at the beginning of each year, pursuant to which KRL receives a proportionate increase in monthly distributions from the Partnership. The remaining 20% of KRL's Additional Entitlement to Class B and Class D units is adjusted retroactively to January 1st of each year once the actual sales performance of the new restaurants has been confirmed. KRL is not entitled to proportionate monthly distributions from the Partnership on the remaining 20% of KRL's Additional Entitlement until such time as the Additional Entitlement is adjusted retroactively at the end of each year.

⁽⁶⁾ Represents KRL's total effective ownership of the Fund as of March 31, 2012 and 2011. 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 20.66% during the three months ended March 31, 2012 (three months ended March 31, 2011 – 22.49%). The weighted average number of Exchangeable units held by KRL during the three-month period ended March 31, 2012 were 2,956,820 (three-months ended March 31, 2011 – 3,203,213).

SYSTEM SALES

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

(\$000's)	13 weeks ended Apr. 1, <u>2012</u>	13 weeks ended Apr. 3, <u>2011</u>
Corporate Keg restaurants ⁽¹⁾	\$ 60,649	\$ 61,036
Franchised Keg restaurants ⁽²⁾	<u>63,731</u>	<u>61,045</u>
Total system sales	<u>\$ 124,380</u>	<u>\$ 122,081</u>

Notes:

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

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

FIRST QUARTER

System sales for the 13 weeks ended April 1, 2012 were \$124,380,000 compared to \$122,081,000 for the 13 weeks ended April 3, 2011, an increase of \$2,299,000 or 1.9%. During the 13 weeks ended April 1, 2012, no restaurants were opened or closed. During the 13 weeks ended April 3, 2011, one corporate restaurant was relocated. As of April 1, 2012, there were a total of 102 Keg restaurants as compared with 103 Keg restaurants at April 3, 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 1.7% in Canada and by 1.2% in the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 13-week period increased by 1.8%. The average exchange rate moved from 0.99 in KRL's second quarter of fiscal 2011 to 1.00 in KRL's second quarter of fiscal 2012, slightly increasing the Canadian dollar equivalent of the U.S. restaurant sales.

OPERATING RESULTS

GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool increased from \$120,604,000 to \$124,366,000 for the comparable quarter. The increase of \$3,762,000, or 3.1%, reflects the addition of net new sales to the Royalty Pool at the beginning of the year, and the same store sales increase of 1.8% for the quarter.

ROYALTY INCOME

Total royalty income earned by the Partnership increased by \$125,000 from \$4,867,000 in the first quarter of 2011, to \$4,992,000 in the first quarter of 2012. Royalty income increased by \$150,000 during the quarter as a result of the increase in gross sales for the reasons explained previously, and Make-whole Payments decreased by \$25,000 due to fewer restaurants closed during the quarter (8 fewer closed weeks).

INTEREST INCOME

Interest income earned by the Fund during the first quarter of the current year was \$1,066,000, comprised of interest income on the Keg Loan of \$1,063,000 and other interest income of \$3,000. Interest on the Keg Loan increased by \$9,000 during the quarter as 2012 is a leap year and therefore the first quarter of the current year included one extra day of interest income. Other interest income earned by the Trust increased by \$2,000 due to higher surplus cash balances on hand during the quarter.

ADMINISTRATIVE EXPENSES

Expenses incurred by the Partnership for the quarter ended March 31, 2012 were \$104,000, comprised of general and administrative expenses of \$106,000, and other interest income of \$2,000. The increase in Partnership expenses of \$4,000 over the comparable quarter of the prior year was due to an increase in general and administrative expenses of \$6,000, net of an increase in other interest income of \$2,000. General and administrative expenses increased as a result of fees paid to the TSX for listing the incremental exchangeable Class D units that were issued on January 1, 2012. Other interest income earned by the Partnership 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 \$173,000 for the three months ended March 31, 2012, and included interest on the long-term debt of \$165,000, and amortization of deferred financing charges of \$8,000. Although the interest rate on the term loan remained at 4.75% during the comparable quarter, interest costs increased by \$2,000 as 2012 is a leap year and therefore the first quarter of the current year included one extra day of interest expense. Amortization of deferred financing charges decreased by \$2,000 during the quarter.

OPERATING INCOME

The Fund's operating income increased from \$5,648,000 during the first quarter of 2011, to \$5,781,000 during the first quarter of 2012. The increase of \$133,000 is due to the net impact of the increase in royalty income of \$125,000, the increase in interest income of \$11,000, the increase in administrative expenses of \$4,000, and the decrease in interest and financing expenses of \$1,000.

DISTRIBUTIONS TO KRL

Distributions attributable to KRL during the quarter ended March 31, 2012 were \$2,041,000, which included distributions of \$972,000 on the Exchangeable units and \$1,069,000 on the Class C units. Distributions on the Exchangeable units increased by \$45,000 from the comparable quarter of the prior year primarily due to the increase in royalty income. 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.

PROFIT (LOSS) BEFORE MARKET VALUE ADJUSTMENT AND INCOME TAXES

Profit (loss) before market value adjustment and income taxes increased by \$88,000 from a profit of \$3,652,000 (33.1 cents/Fund unit) in the first quarter of 2011, to profit of \$3,740,000 (32.9 cents/Fund unit) in the first quarter of 2012.

MARKET VALUE ADJUSTMENT

The market value of the Exchangeable units increased \$5,571,000 during the three months ended March 31, 2012, as compared with an increase of \$684,000 during the three months ended March 31, 2011. The market price of a Fund unit, (the basis upon which Exchangeable units are valued) increased from \$12.70 to \$14.58 during the first quarter of the current year, and there were a total of 2,956,820 Exchangeable units outstanding at the end of the first quarter of 2012. The market price of a Fund unit increased from \$13.20 to \$13.26 during the comparable quarter of the prior year and there were a total of 2,886,546 Exchangeable units outstanding at the end of the first quarter of 2011.

INCOME TAXES

Income taxes for the quarter ended March 31, 2012, were \$947,000 and included SIFT tax expense of \$896,000 and non-cash deferred taxes of \$51,000. SIFT tax expense decreased by \$30,000 as the SIFT tax rate decreased from 26.5% to 25.0% effective January 1, 2012. Deferred taxes decreased by \$161,000 due to changes 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 decreased by \$4,608,000 from a profit of \$1,830,000 (16.6 cents/Fund unit) in the first quarter of 2011, to loss of \$2,778,000 (-24.5 cents/Fund unit) in the first quarter of 2012, mostly due to the non-cash market value adjustment of the Exchangeable unit liability.

DISTRIBUTABLE CASH

Distributable cash before SIFT tax increased by \$240,000 from \$3,839,000 (34.8 cents/Fund unit) to \$4,079,000 (35.9 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.

DISTRIBUTIONS TO FUND UNITHOLDERS

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 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 first quarter of 2012, as compared with \$2,945,000 (32.0 cents/Fund unit) in the first quarter of 2011. The decrease of \$220,000 was due to the distributions that were paid to Fund unitholders in January 2011 at the pre-SIFT tax rate of 10.65 cents per Fund unit per month rather than at the post-SIFT tax rate of 8.0 cents per Fund unit per month.

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 \$3,183,000 in distributable cash during the quarter and paid distributions of \$2,725,000 resulting in a surplus of \$458,000. The Fund has cash on hand of \$706,000 and a positive working capital balance of \$1,985,000 as at March 31, 2012.

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 March 31, 2012, 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. As at March 31, 2012, the entire \$1 million facility is available for use.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and Chief Financial Officer of The Keg GP Ltd., managing general partner of the Partnership and administrator to the Fund, have designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with GAAP. The control framework used to design the internal controls over financial reporting is “Internal Control – Integrated Framework” issued by the Committee of Sponsoring Organizations of the Treadway Commission. There have been no significant changes to the internal control over financial reporting for the quarter ended March 31, 2012, that have had or are reasonably likely to have a material effect on the Fund’s internal controls over financial reporting.

CRITICAL ACCOUNTING ESTIMATES

The preparation of the Fund’s consolidated financial statements in conformity with IFRS requires estimates and judgements to be made that affect the reported amounts of assets and liabilities, 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.

There have been no significant changes in the accounting estimates from those described in the MD&A for the year ended December 31, 2011.

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.

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 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

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STOCK EXCHANGE LISTING

Toronto Stock Exchange: KEG.UN

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THE KEG ROYALTIES INCOME FUND

CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS

For the three months ended March 31, 2012 and 2011

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars)

	<u>Note</u>	March 31, 2012 (unaudited)	December 31, 2011
ASSETS			
Current assets:			
Cash		\$ 706	\$ 4,011
Prepaid expenses and deposits		56	17
Due from Keg Restaurants Ltd.	9	2,435	2,796
Current income tax receivable	8	<u>14</u>	<u>-</u>
		3,211	6,824
Note receivable from Keg Restaurants Ltd.		57,000	57,000
Intangible assets, Keg Rights	5	<u>156,470</u>	<u>156,069</u>
		<u>\$ 216,681</u>	<u>\$ 219,893</u>
LIABILITIES AND UNITHOLDERS' EQUITY			
Current liabilities:			
Accounts payable and accrued liabilities		\$ 451	\$ 441
Interest payable on term loan		56	56
Distributions payable to Fund unitholders		-	908
Distributions payable to Keg Restaurants Ltd.	9	719	821
Current income tax payable	8	<u>-</u>	<u>3,647</u>
		1,226	5,873
Term loan, net of deferred financing charges		13,931	13,923
Deferred income taxes	8	1,674	1,623
Class C Partnership units	7(a)	57,000	57,000
Exchangeable Partnership units	7(b)	43,110	37,139
Unitholders' equity:			
Fund units		123,275	123,275
Accumulated deficit		<u>(23,535)</u>	<u>(18,940)</u>
		<u>99,740</u>	<u>104,335</u>
		<u>\$ 216,681</u>	<u>\$ 219,893</u>

See accompanying notes to consolidated financial statements.

Approved on behalf of the Board of Trustees

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

"George Tidball"
George Tidball, Trustee

CONDENSED CONSOLIDATED STATEMENTS COMPREHENSIVE INCOME (LOSS)

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

	<u>Note</u>	January 1 to March 31, <u>2012</u>	January 1 to March 31, <u>2011</u>
Revenue:			
Royalty income	4	\$ 4,992	\$ 4,867
Interest income		<u>1,066</u>	<u>1,055</u>
		6,058	5,922
Expenses:			
General and administrative		(104)	(100)
Interest and financing fees		(165)	(164)
Amortization of deferred financing charges		<u>(8)</u>	<u>(10)</u>
		<u>(277)</u>	<u>(274)</u>
Profit before distributions, change in market value and taxes		5,781	5,648
Distributions recorded as interest:			
Class C Partnership units	7(a)	(1,069)	(1,069)
Exchangeable Partnership units	7(b)	<u>(972)</u>	<u>(927)</u>
		<u>(2,041)</u>	<u>(1,996)</u>
Profit before change in market value and taxes		3,740	3,652
Increase in market value of Exchangeable Partnership units	7(b)	<u>(5,571)</u>	<u>(684)</u>
Profit (loss) before taxes		(1,831)	2,968
Taxes:			
Current	8	(896)	(926)
Deferred	8	<u>(51)</u>	<u>(212)</u>
		(947)	(1,138)
Profit (loss) and comprehensive income (loss) for the year		<u>\$ (2,778)</u>	<u>\$ 1,830</u>
Weighted average Fund units outstanding	3	<u>11,353,500</u>	<u>11,036,833</u>
Basic and diluted earnings (loss) per Fund unit	3	<u>\$ (0.24)</u>	<u>\$ 0.17</u>

See accompanying notes to consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Expressed in thousands of dollars - unaudited)

	Fund units	Accumulated deficit	Unitholders' equity
Balance, January 1, 2011	\$ 113,045	\$ (19,356)	\$ 93,689
Profit and comprehensive income for the year	-	1,830	1,830
Class B unit exchange, February 8, 2011	10,230	-	10,230
Distributions declared to Fund unitholders	-	(1,817)	(1,817)
Balance, March 31, 2011	\$ 123,275	\$ (19,343)	\$ 103,932
Balance, January 1, 2012	\$ 123,275	\$ (18,940)	\$ 104,335
Loss and comprehensive loss for the year	-	(2,778)	(2,778)
Distributions declared to Fund unitholders	-	(1,817)	(1,817)
Balance, March 31, 2012	\$ 123,275	\$ (23,535)	\$ 99,740

See accompanying notes to consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars - unaudited)

	<u>Note</u>	January 1 to March 31, 2012	January 1 to March 31, 2011
Cash provided by (used for):			
OPERATIONS:			
Profit (loss) for the year		\$ (2,778)	\$ 1,830
Items not involving cash:			
Amortization of deferred financing charges		8	10
Deferred income tax expense	8	51	212
Increase in market value of Exchangeable Partnership units	7(b)	5,571	684
Distributions recorded as interest:			
Class C Partnership units	7(a)	1,069	1,069
Exchangeable Partnership units	7(b)	972	927
Changes in non-cash operating working capital:			
Due from Keg Restaurants Ltd.		361	226
Prepaid expenses and deposits		(39)	(76)
Accounts payable and accrued liabilities		10	27
Interest income		(1,066)	(1,055)
Interest and financing fees		165	164
Current income taxes		896	926
Interest received		1,065	1,055
Interest and financing fees paid		(165)	(164)
Income taxes paid		<u>(4,557)</u>	<u>-</u>
		1,563	5,835
FINANCING:			
Distributions paid to Class C unitholder	7(a)	(1,069)	(1,069)
Distributions paid to Exchangeable unitholder	7(b)	(1,074)	(1,181)
Distributions paid to Fund unitholders	6	<u>(2,725)</u>	<u>(2,945)</u>
		<u>(4,868)</u>	<u>(5,195)</u>
Increase (decrease) in cash		(3,305)	640
Cash, beginning of period		<u>4,011</u>	<u>1,112</u>
Cash, end of period		<u>\$ 706</u>	<u>\$ 1,752</u>
Non-cash transactions:			
Increase in intangible assets on Royalty Pool net sales roll-in		<u>\$ 400</u>	<u>\$ 1,444</u>

See accompanying notes to consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2012 and 2011

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 and bar restaurants in Canada and the United States.

2. BASIS OF PREPARATION:

(a) Statement of compliance:

These condensed consolidated interim financial statements have been prepared in accordance with Intentional Accounting Standard (“IAS”) 34 *Interim Financial Reporting* as issued by the International Accounting Standards Board (“IASB”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”). These statements represent a condensed set of financial statements and accordingly do not include all of the information required for annual financial statements as at and for the year ended December 31, 2011. These statements follow the same accounting policies and methods of their application as the most recent annual financial statements.

These condensed consolidated interim financial statements were authorized for issue by the Fund’s Board of Trustees on May 3, 2012.

(b) Functional and reporting currency:

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2012 and 2011

3. 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.

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 March 31, <u>2012</u>	January 1 to March 31, <u>2011</u>
Basic profit (loss) for the period	\$ (2,778)	\$ 1,830
Distributions on Exchangeable Partnership units	972	927
Increase in market value of Exchangeable Partnership units	5,571	684
Increase in current tax expense.....	<u>(243)</u>	<u>(232)</u>
Diluted net profit for the period	<u>\$ 3,522</u>	<u>\$ 3,209</u>
Weighted average number of Fund units	11,353,500	11,036,833
Weighted average number of Exchangeable Partnership units	<u>2,956,820</u>	<u>3,203,213</u>
Weighted average number of units	<u>14,310,320</u>	<u>14,240,046</u>
Basic and fully diluted earnings per Fund unit	<u>\$ (0.24)</u>	<u>\$ 0.17</u>

For the periods ended March 31, 2012 and March 31, 2011, the Exchangeable Partnership units are anti-dilutive. Accordingly, the fully diluted earnings per Fund unit equals the basic earnings per Fund unit.

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.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2012 and 2011

4. ROYALTY POOL (CONTINUED):

The royalty payment from KRL to the Partnership is four percent of system sales for such period reported by Keg restaurants in the Royalty Pool plus a make-whole payment, if required by a restaurant closure, based on four percent of lost system sales. System sales for any period and for any Keg restaurant located in Canada and the United States, as defined in the Licence and Royalty Agreement, means the gross sales by such Keg restaurants for such period. The make-whole payment is based on one temporary closure due to an extended restaurant renovation for the period from January 1 to March 31, 2012 (January 1 to March 31, 2011 – one permanent closure and one temporary closure due to an extended restaurant renovation).

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 32,500 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.

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

	January 1 to March 31, <u>2012</u>	January 1 to March 31, <u>2011</u>
Restaurants in Royalty Pool	102	102
Royalty Pool system sales	<u>\$ 124,366</u>	<u>\$ 120,604</u>
Royalty income at 4% of system sales reported above	4,975	4,824
Make-whole payment, based on 4% of lost system sales	<u>17</u>	<u>43</u>
Total royalty income	<u>\$ 4,992</u>	<u>\$ 4,867</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2012 and 2011

5. 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 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).

The Fund has adopted a policy of accounting for the Additional Entitlement of Class B and Class D units based on the fair value of these units at the date of determination which results in an increase in intangible assets and in the Exchangeable Partnership unit liability. The value of the Keg Rights increased by \$400,000 as a result of the January 1, 2012 Additional Entitlement (January 1, 2011 – \$1,444,000).

6. DISTRIBUTIONS ON FUND UNITS:

	January 1 to March 31, <u>2012</u>	January 1 to March 31, <u>2011</u>
Distributions declared to Fund unitholders	\$ <u>1,817</u>	\$ <u>1,817</u>
Weighted average Fund units outstanding	<u>11,353,500</u>	<u>11,036,833</u>
Distributions declared per unit	\$ <u>0.16</u>	\$ <u>0.16</u>

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2012 and 2011

7. 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. 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.

(b) Exchangeable Partnership unit liability:

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

		March 31, <u>2012</u>	<u>Fair Value</u>
Class A Partnership units	(i)	905,944	\$ 13,209
Class B Partnership units	(ii)	176,700	2,576
Class D Partnership units	(iii)	<u>1,874,176</u>	<u>27,325</u>
		<u>2,956,820</u>	<u>\$ 43,110</u>

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 period in which the gain or loss occurs. The fair value of the Exchangeable Partnership units is determined by using Level 2 inputs being the closing market price of the Fund units on the Toronto Stock Exchange ("TSX") at the respective reporting date as Exchangeable Partnership units have similar distribution and voting rights as the Fund units. The closing unit price as at March 31, 2012 was \$14.58 (December 31, 2011 – \$12.70).

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

	Total number of Exchangeable <u>Partnership units</u>	January 1 to December 31, <u>2011</u>
Exchangeable Partnership units, January 1, 2011	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	<u>-</u>	<u>(896)</u>
Fair value of Exchangeable Partnership units, December 31, 2011	<u>2,924,320</u>	<u>\$ 37,139</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

For the three months ended March 31, 2012 and 2011

7. PARTNERSHIP UNIT LIABILITIES (CONTINUED):

- (b) Exchangeable Partnership unit liability (continued):

	Total number of Exchangeable <u>Partnership units</u>	<u>January 1 to March 31, 2012</u>
Exchangeable Partnership units, January 1, 2012	2,924,320	\$ 37,139
January 1 initial estimate of Class D unit entitlement (80%)	32,500	400
Fair value adjustment	<u>-</u>	<u>5,571</u>
Fair value of Exchangeable Partnership units, March 31, 2012	<u>2,956,820</u>	<u>\$ 43,110</u>

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

- (i) The Class A units are entitled to a preferential proportionate distribution equal to the distribution on the 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 March 31, 2012. 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. 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.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2012 and 2011

8. INCOME TAXES:

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 was 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 are as follows:

	January 1 to March 31, <u>2012</u>	January 1 to March 31, <u>2011</u>
Current income tax expense	\$ (896)	\$ (926)
Deferred tax expense	<u>(51)</u>	<u>(212)</u>
	<u>\$ (947)</u>	<u>\$ (1,138)</u>

During the three months ended March 31, 2012, the Fund made tax instalment payments of \$912,000 (three months ended March 31, 2011 – \$nil). Management estimates the Fund’s current income tax expense for each reporting period based on actual results and adjusts current income tax expense accordingly. Instalment payments required by the Canada Revenue Agency (“CRA”) are an estimate based on prior year’s results. As a result, the Fund has an estimated \$14,000 income tax receivable as at March 31, 2012

The balance of the Fund’s deferred tax liability increased to \$1,674,000 as at March 31, 2012 (December 31, 2011 – \$1,623,000). 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.

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

	March 31, <u>2012</u>	December 31, <u>2011</u>
Deferred tax liabilities:		
Temporary difference related to the Keg Rights.....	<u>\$ 1,674</u>	<u>\$ 1,623</u>
Deferred tax liability	<u>\$ 1,674</u>	<u>\$ 1,623</u>

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars - unaudited)

For the three months ended March 31, 2012 and 2011

9. 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 a summary of the balances due to and due from KRL:

	March 31, <u>2012</u>	December 31, <u>2011</u>
Royalty fee, including GST/HST	\$ 2,073	\$ 2,433
Interest on note receivable from Keg Restaurants Ltd.	<u>362</u>	<u>363</u>
Due from Keg Restaurants Ltd.	<u>\$ 2,435</u>	<u>\$ 2,796</u>

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

	March 31, <u>2012</u>	December 31, <u>2011</u>
Distribution payable to KRL	<u>\$ 719</u>	<u>\$ 821</u>

The above amounts were paid to KRL when due, subsequent to the end of the periods above.