

# **THE KEG ROYALTIES INCOME FUND**

## **YEAR END REPORT**

For the three and twelve months ended December 31, 2013

## 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, 2013.

### RESULTS

The gross sales reported by the 102 Keg restaurants in the Royalty Pool were \$120,093,000 for the quarter, a decrease of \$2,299,000 or 1.9% from the comparable quarter of the prior year. For the year, gross sales were \$474,864,000, a decrease of \$9,704,000 or 2.0% from the prior year. These gross sales reflect the closure of four corporate restaurants in the current year, and a same store sales increase of 0.04% for the quarter and a same store sales decrease of 0.3% for the year.

Royalty income increased by \$65,000 or 1.3% from \$4,896,000 in the three months ended December 31, 2012 to \$4,961,000 in the three months ended December 31, 2013, and increased by \$95,000 or 0.5% from \$19,401,000 for the year ended December 31, 2012, to \$19,496,000 for the year ended December 31, 2013.

Distributable cash before SIFT tax increased by \$17,000 from \$3,441,000 (30.3 cents/Fund unit) to \$3,458,000 (30.5 cents/Fund unit) for the quarter and decreased by \$9,000 from \$14,650,000 (\$1.290/Fund unit) to \$14,641,000 (\$1.290/Fund unit) for the year. Distributable cash available to pay distributions to public unitholders decreased by \$24,000 from \$2,558,000 (22.5 cents/Fund unit) to \$2,534,000 (22.3 cents/Fund unit) for the quarter, and by \$144,000 from \$11,168,000 (98.4 cents/Fund unit) to \$11,024,000 (97.1 cents/Fund unit) for the year. The Fund remains financially well positioned with surplus cash on hand of \$798,000 and a positive working capital balance of \$1,198,000 as of December 31, 2013.

### 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 4.6% in 2014, after an estimated 5.6% growth in 2013. In the United States, the National Restaurant Association expects sales in the full service segment to increase 2.6% in 2014, and has estimated that sales in this category grew by 2.3% in 2013. As such, we are optimistic that with strengthening consumer confidence, the industry has begun to see a change in momentum. Management of Keg Restaurants Ltd. (“KRL”) believes that as economic conditions and consumer sentiment continue to improve in North America, 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 Vision Critical in December 2011 that identified The Keg as the first choice of over 67% of Canadian diners when choosing a steak dinner. 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  
February 25, 2014

## FINANCIAL HIGHLIGHTS

(\$000's except per unit amounts)	Oct. 1 to Dec. 31, 2013	Oct. 1 to Dec. 31, 2012	Jan. 1 to Dec. 31, 2013	Jan. 1 to Dec. 31, 2012
<b>Restaurants in the Royalty Pool</b>	<b>102</b>	<b>102</b>	<b>102</b>	<b>102</b>
<b>Gross sales reported by Keg restaurants in the Royalty Pool</b> .....	<b>\$ 120,093</b>	<b>\$ 122,392</b>	<b>\$ 474,864</b>	<b>\$ 484,568</b>
Royalty income <sup>(1)</sup> .....	\$ 4,961	\$ 4,896	\$ 19,496	\$ 19,401
Interest income <sup>(2)</sup> .....	1,078	1,075	4,279	4,282
<b>Total income</b> .....	<b>\$ 6,039</b>	<b>\$ 5,971</b>	<b>\$ 23,775</b>	<b>\$ 23,683</b>
Administrative expenses <sup>(3)</sup> .....	(114)	(86)	(422)	(398)
Interest and financing expenses <sup>(4)</sup> .....	(161)	(176)	(681)	(705)
<b>Operating income</b> .....	<b>\$ 5,764</b>	<b>\$ 5,709</b>	<b>\$ 22,672</b>	<b>\$ 22,580</b>
Distributions to KRL <sup>(5)</sup> .....	(2,039)	(2,030)	(8,072)	(8,057)
<b>Profit before fair value adjustment and taxes</b> .....	<b>\$ 3,725</b>	<b>\$ 3,679</b>	<b>\$ 14,600</b>	<b>\$ 14,523</b>
Fair value adjustment <sup>(6)</sup> .....	(4,231)	(152)	(5,740)	(5,338)
Taxes <sup>(7)</sup> .....	(973)	(914)	(3,800)	(3,599)
<b>Profit (loss)</b> .....	<b>\$ (1,479)</b>	<b>\$ 2,613</b>	<b>\$ 5,060</b>	<b>\$ 5,586</b>
<b>Distributable cash before SIFT tax</b> <sup>(8)</sup> .....	<b>\$ 3,458</b>	<b>\$ 3,441</b>	<b>\$ 14,641</b>	<b>\$ 14,650</b>
<b>Distributable cash</b> <sup>(9)</sup> .....	<b>\$ 2,534</b>	<b>\$ 2,558</b>	<b>\$ 11,024</b>	<b>\$ 11,168</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ 2,725</b>	<b>\$ 2,725</b>	<b>\$ 10,899</b>	<b>\$ 10,899</b>
<b>Payout Ratio</b> <sup>(10)</sup> .....	<b>107.5%</b>	<b>106.5%</b>	<b>98.9%</b>	<b>97.6%</b>
Per Fund unit information <sup>(11)</sup>				
Profit before fair value adjustment and taxes .....	\$ .328	\$ .324	\$ 1.286	\$ 1.279
Profit (loss) .....	\$ (.130)	\$ .230	\$ .446	\$ .492
<b>Distributable cash before SIFT tax</b> <sup>(8)</sup> .....	<b>\$ .305</b>	<b>\$ .303</b>	<b>\$ 1.290</b>	<b>\$ 1.290</b>
<b>Distributable cash</b> <sup>(9)</sup> .....	<b>\$ .223</b>	<b>\$ .225</b>	<b>\$ .971</b>	<b>\$ .984</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ .240</b>	<b>\$ .240</b>	<b>\$ .960</b>	<b>\$ .960</b>
SSSG <sup>(12)</sup>				
Canada .....	(0.6)%	(1.9)%	(0.8)%	0.1%
United States .....	0.3%	0.7%	1.5%	0.7%
Consolidated .....	0.0%	(2.0)%	(0.3)%	0.2%
Restaurant Openings/Closings <sup>(13)</sup>				
Opened .....	2	4	3	4
Closed .....	--	--	4	--
Relocated .....	--	--	--	--
Net Opened (Closed) .....	2	4	(1)	4

Notes:

- <sup>(1)</sup> The Fund, indirectly through the Partnership, earns royalty income equal to 4% of gross sales of Keg restaurants in the Royalty Pool.
- <sup>(2)</sup> The Fund directly earns interest income on the \$57.0 million Keg Loan, with interest income accruing at 7.5% per annum, payable monthly.
- <sup>(3)</sup> The Fund, indirectly through the Partnership, incurs administrative expenses and interest on the operating line of credit, to the extent utilized.
- <sup>(4)</sup> The Fund, indirectly through the Trust, incurs interest expense on the \$14.0 million term loan and amortization of deferred financing charges.
- <sup>(5)</sup> 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.
- <sup>(6)</sup> Fair value adjustment is the non-cash increase or decrease in the market value of the Exchangeable units held by KRL during the respective period. Exchangeable units are classified as a financial liability under IFRS. The Fund is required to determine the fair value of that liability at the end of each reporting period and adjust for any increase or decrease, taking into consideration the sale of any Exchangeable units and additional entitlements during the same period.
- <sup>(7)</sup> Taxes for the quarter ended December 31, 2013, include SIFT tax expense of \$924,000 (quarter ended December 31, 2012 - \$883,000) and non-cash deferred taxes of \$49,000 (quarter ended December 31, 2012 - \$31,000). Taxes for the year ended December 31, 2013 include SIFT tax expense of \$3,617,000 (year ended December 31, 2012 - \$3,482,000) and non-cash deferred tax of \$183,000 (year ended December 31, 2012 - \$117,000). The obligation to pay SIFT tax came into effect on January 1, 2011.
- <sup>(8)</sup> Distributable cash before SIFT tax is defined as the periodic cash flows from operating activities as reported in the IFRS consolidated financial statements, including the effects of changes in non-cash working capital, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions 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.
- <sup>(9)</sup> 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.
- <sup>(10)</sup> 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).
- <sup>(11)</sup> 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, 2013 was 11,353,500 (three months ended December 31, 2012 - 11,353,500) and for the year ended December 31, 2013 was 11,353,500 (year ended December 31, 2012 - 11,353,500).
- <sup>(12)</sup> 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.
- <sup>(13)</sup> 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.
- <sup>(14)</sup> The interim financial results for all periods presented herein have not been audited.

## SUMMARY OF QUARTERLY RESULTS

	Q4	Q3	Q2	Q1
(\$000's except per unit amounts)	2013	2013	2013	2013
<b>Restaurants in the Royalty Pool</b>	<b>102</b>	<b>102</b>	<b>102</b>	<b>102</b>
<b>Gross sales reported by Keg restaurants in the Royalty Pool</b> .....	<b>\$ 120,093</b>	<b>116,016</b>	<b>\$ 114,426</b>	<b>\$ 124,329</b>
Royalty income <sup>(1)</sup> .....	\$ 4,961	\$ 4,776	\$ 4,693	\$ 5,066
Interest income <sup>(2)</sup> .....	1,078	1,079	1,067	1,055
<b>Total income</b> .....	<b>\$ 6,039</b>	<b>\$ 5,855</b>	<b>\$ 5,760</b>	<b>\$ 6,121</b>
Administrative expenses <sup>(3)</sup> .....	(114)	(117)	(91)	(100)
Interest and financing expenses <sup>(4)</sup> .....	(161)	(175)	(174)	(171)
<b>Operating income</b> .....	<b>\$ 5,764</b>	<b>\$ 5,563</b>	<b>\$ 5,495</b>	<b>\$ 5,850</b>
Distributions to KRL <sup>(5)</sup> .....	(2,039)	(1,996)	(1,980)	(2,058)
<b>Profit before fair value adjustment and taxes</b> .....	<b>\$ 3,725</b>	<b>\$ 3,567</b>	<b>\$ 3,515</b>	<b>\$ 3,792</b>
Fair value adjustment <sup>(6)</sup> .....	(4,231)	(2,278)	3,107	(2,338)
Taxes <sup>(7)</sup> .....	(973)	(904)	(950)	(973)
<b>Profit (loss)</b> .....	<b>\$ (1,479)</b>	<b>\$ 385</b>	<b>\$ 5,672</b>	<b>\$ 481</b>
<b>Distributable cash before SIFT taxes</b> <sup>(8)</sup> .....	<b>\$ 3,458</b>	<b>\$ 3,649</b>	<b>\$ 3,439</b>	<b>\$ 4,094</b>
<b>Distributable cash</b> <sup>(9)</sup> .....	<b>\$ 2,534</b>	<b>\$ 2,766</b>	<b>\$ 2,543</b>	<b>\$ 3,180</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ 2,725</b>	<b>\$ 2,725</b>	<b>\$ 2,725</b>	<b>\$ 2,725</b>
<b>Payout Ratio</b> <sup>(10)</sup> .....	<b>107.5%</b>	<b>98.5%</b>	<b>107.2%</b>	<b>85.7%</b>
Per Fund unit information <sup>(11)</sup>				
Profit before fair value adjustment and taxes .....	\$ .328	\$ .314	\$ .310	\$ .334
Profit (loss) .....	\$ (.130)	\$ .034	\$ .500	\$ .042
<b>Distributable cash before SIFT tax</b> <sup>(8)</sup> .....	<b>\$ .305</b>	<b>\$ .321</b>	<b>\$ .303</b>	<b>\$ .361</b>
<b>Distributable cash</b> <sup>(9)</sup> .....	<b>\$ .223</b>	<b>\$ .244</b>	<b>\$ .224</b>	<b>\$ .280</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ .240</b>	<b>\$ .240</b>	<b>\$ .240</b>	<b>\$ .240</b>
SSSG <sup>(12)</sup>				
Canada .....	(0.6)%	(1.5)%	(2.0)%	0.3%
United States .....	0.3%	0.8%	1.4%	3.3%
Consolidated .....	0.0%	(0.9)%	(1.6)%	0.7%
Restaurants Openings/Closings <sup>(13)</sup>				
Opened .....	2	--	1	--
Closed .....	--	1	--	3
Relocated .....	--	--	--	--
Net Opened (Closed) .....	2	(1)	1	(3)

## SUMMARY OF QUARTERLY RESULTS

	Q4	Q3	Q2	Q1
(\$000's except per unit amounts)	2012	2012	2012	2012
<b>Restaurants in the Royalty Pool</b>	<b>102</b>	<b>102</b>	<b>102</b>	<b>102</b>
<b>Gross sales reported by Keg restaurants in the Royalty Pool</b>	<b>\$ 122,392</b>	<b>\$ 119,285</b>	<b>\$ 118,525</b>	<b>\$ 124,366</b>
Royalty income <sup>(1)</sup>	\$ 4,896	\$ 4,772	\$ 4,741	\$ 4,992
Interest income <sup>(2)</sup>	1,075	1,075	1,066	1,066
<b>Total income</b>	<b>\$ 5,971</b>	<b>\$ 5,847</b>	<b>\$ 5,807</b>	<b>\$ 6,058</b>
Administrative expenses <sup>(3)</sup>	(86)	(104)	(104)	(104)
Interest and financing expenses <sup>(4)</sup>	(176)	(181)	(174)	(173)
<b>Operating income</b>	<b>\$ 5,709</b>	<b>\$ 5,562</b>	<b>\$ 5,529</b>	<b>\$ 5,781</b>
Distributions to KRL <sup>(5)</sup>	(2,030)	(1,998)	(1,989)	(2,041)
<b>Profit before fair value adjustment and taxes</b>	<b>\$ 3,679</b>	<b>\$ 3,564</b>	<b>\$ 3,540</b>	<b>\$ 3,740</b>
Fair value adjustment <sup>(6)</sup>	(152)	(1,478)	1,863	(5,571)
Taxes <sup>(7)</sup>	(914)	(876)	(862)	(947)
<b>Profit (loss)</b>	<b>\$ 2,613</b>	<b>\$ 1,210</b>	<b>\$ 4,541</b>	<b>\$ (2,778)</b>
<b>Distributable cash before SIFT tax <sup>(8)</sup></b>	<b>\$ 3,441</b>	<b>\$ 3,638</b>	<b>\$ 3,492</b>	<b>\$ 4,080</b>
<b>Distributable cash <sup>(9)</sup></b>	<b>\$ 2,558</b>	<b>\$ 2,784</b>	<b>\$ 2,643</b>	<b>\$ 3,184</b>
<b>Distributions paid to Fund unitholders</b>	<b>\$ 2,725</b>	<b>\$ 2,725</b>	<b>\$ 2,725</b>	<b>\$ 2,725</b>
<b>Payout Ratio <sup>(10)</sup></b>	<b>106.5%</b>	<b>97.9%</b>	<b>103.1%</b>	<b>85.6%</b>
Per Fund unit information <sup>(11)</sup>				
Profit before fair value adjustment and taxes	\$ .324	\$ .314	\$ .312	\$ .329
Profit (loss)	\$ .230	\$ .107	\$ .400	\$ (.245)
<b>Distributable cash before SIFT tax <sup>(8)</sup></b>	<b>\$ .303</b>	<b>\$ .320</b>	<b>\$ .308</b>	<b>\$ .359</b>
<b>Distributable cash <sup>(9)</sup></b>	<b>\$ .225</b>	<b>\$ .245</b>	<b>\$ .233</b>	<b>\$ .280</b>
<b>Distributions paid to Fund unitholders</b>	<b>\$ .240</b>	<b>\$ .240</b>	<b>\$ .240</b>	<b>\$ .240</b>
SSSG <sup>(12)</sup>				
Canada	(1.9)%	(0.6)%	1.3%	1.7%
United States	(0.7)%	(0.8)%	1.6%	1.5%
Consolidated	(2.0)%	(0.5)%	1.8%	1.8%
Restaurant Openings/Closings <sup>(13)</sup>				
Opened	4	--	--	--
Closed	--	--	--	--
Relocated	--	--	--	--
Net Opened (Closed)	4	--	--	--

## SELECTED ANNUAL INFORMATION

(\$000's except per unit amounts)	Jan. 1 to Dec. 31, 2013	Jan. 1 to Dec. 31, 2012	Jan. 1 to Dec. 31, 2011
<b>Restaurants in the Royalty Pool</b>	<b>102</b>	<b>102</b>	<b>102</b>
<b>Gross sales reported by Keg restaurants in the Royalty Pool</b> .....	<b>\$ 474,864</b>	<b>\$ 484,568</b>	<b>\$ 472,280</b>
Royalty income <sup>(1)</sup> .....	\$ 19,496	\$ 19,401	\$ 19,230
Interest income <sup>(2)</sup> .....	4,279	4,282	4,281
<b>Total income</b> .....	<b>\$ 23,775</b>	<b>\$ 23,683</b>	<b>\$ 23,511</b>
Administrative expenses <sup>(3)</sup> .....	(422)	(398)	(472)
Interest and financing expenses <sup>(4)</sup> .....	(681)	(705)	(705)
<b>Operating income</b> .....	<b>\$ 22,672</b>	<b>\$ 22,580</b>	<b>\$ 22,334</b>
Distributions to KRL <sup>(5)</sup> .....	(8,072)	(8,057)	(7,979)
<b>Profit before fair value adjustment and taxes</b> .....	<b>\$ 14,600</b>	<b>\$ 14,523</b>	<b>\$ 14,355</b>
Fair value adjustment <sup>(6)</sup> .....	(5,740)	(5,338)	896
Taxes <sup>(7)</sup> .....	(3,800)	(3,599)	(3,936)
<b>Profit (loss)</b> .....	<b>\$ 5,060</b>	<b>\$ 5,586</b>	<b>\$ 11,315</b>
<b>Distributable cash before SIFT tax</b> <sup>(8)</sup> .....	<b>\$ 14,641</b>	<b>\$ 14,650</b>	<b>\$ 14,231</b>
<b>Distributable cash</b> <sup>(9)</sup> .....	<b>\$ 11,024</b>	<b>\$ 11,168</b>	<b>\$ 10,584</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ 10,899</b>	<b>\$ 10,899</b>	<b>\$ 11,120</b>
<b>Payout Ratio</b> <sup>(10)</sup> .....	<b>98.9%</b>	<b>97.6%</b>	<b>105.1%</b>
Per Fund unit information <sup>(11)</sup>			
Profit before fair value adjustment and taxes .....	\$ 1.286	\$ 1.279	\$ 1.273
Profit (loss) .....	.446	.492	1.004
<b>Distributable cash before SIFT tax</b> <sup>(8)</sup> .....	<b>\$ 1.290</b>	<b>\$ 1.290</b>	<b>\$ 1.262</b>
<b>Distributable cash</b> <sup>(9)</sup> .....	<b>\$ .971</b>	<b>\$ .984</b>	<b>\$ .939</b>
<b>Distributions paid to Fund unitholders</b> .....	<b>\$ .960</b>	<b>\$ .960</b>	<b>\$ .986</b>
SSSG <sup>(12)</sup>			
Canada .....	(0.8)%	0.1%	3.9%
United States .....	1.5%	0.7%	3.9%
Consolidated .....	(0.3)%	0.2%	3.5%
Restaurant Openings/Closings <sup>(13)</sup>			
Opened .....	3	4	--
Closed .....	4	--	1
Relocated .....	--	--	1
Net Opened (Closed) .....	(1)	4	(1)
	Dec. 31, 2013	Dec. 31, 2012	Dec. 31, 2011
Total assets .....	\$ 216,851	\$ 216,800	\$ 219,893
Total liabilities .....	123,668	117,778	115,558

# MANAGEMENT'S DISCUSSION AND ANALYSIS

**For the Three and Twelve Months Ended December 31, 2013  
As of February 25, 2014**

## 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 ("TSX") 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 restaurant's gross sales when it was originally included in the Royalty Pool.

### THE ROYALTY POOL

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

## **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, 2012. Fifty new Keg restaurants that opened during the period from April 1, 2002, through October 2, 2012, with annual gross sales of \$241.3 million have been added to the Royalty Pool. Twenty-eight permanently closed Keg restaurants with annual sales of \$78.5 million have been removed from the Royalty Pool. This has resulted in a net increase in Royalty Pool sales of \$162.8 million annually, and KRL receiving a cumulative Additional Entitlement equivalent to 5,252,757 Fund units as of December 31, 2012.

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.

No new restaurants were opened during the period from October 3, 2011 through October 2, 2012, and hence there were no additions to the Royalty Pool on January 1, 2013.

During the first quarter of 2013, three corporate restaurants were closed, one located in New Westminster, British Columbia, and two in Washington State. During the third quarter of 2013, one additional corporate restaurant was closed in West Vancouver, British Columbia. The four closed corporate restaurants will remain in the Royalty Pool until December 31, 2013, at which time the lost sales from these closed restaurants will be replaced with gross sales from five new Keg restaurants opened between October 3, 2012 and October 2, 2013.

On January 1, 2014, five new restaurants, consisting of three corporate and two franchised restaurants, that opened during the period from October 3, 2012 to October 2, 2013 will be added to the Royalty Pool and the four closed restaurants will be removed from 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 (“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 20.67% as of December 31, 2013. The increase in KRL’s effective ownership of the Fund is due to the cumulative Additional Entitlement received by KRL equivalent to 5,252,757 Fund units, less 3,200,000 Exchangeable units exchanged by KRL for Fund units and sold through the facilities of the TSX. 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, 2014, KRL became entitled to the initial 80% of the Additional Entitlement for 2014. See “Subsequent Events”.

## **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. Due to 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. 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”. The Fund is subject to tax at a rate of 26.5% for 2011, 25.0% for 2012, 25.75% for 2013 and 26.0% for 2014. The blended rate of 25.75% for 2013 was due to the increase in the general corporate taxation rate from 10.0% to 11.0% enacted by the British Columbia government effective April 1, 2013, which increased the SIFT tax rate from 25.0% to 26.0%, effective that date.

## 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 Canadian 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 IFRS 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 (“KHT”), The Keg Rights Limited Partnership (the “Partnership”), the Fund’s 90% owned subsidiary The Keg GP Ltd. (“KGP”) and KRL or any third parties. KGP 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

IFRS 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. The consolidated financial statements include the accounts of the Fund, its wholly-owned subsidiary KHT, its 90%-owned subsidiary KGP and its interest in the Partnership. The Partnership’s significant assets include cash, royalties receivable from KRL, interest recoverable on the note receivable from KRL, and the Keg Rights, while its significant liabilities include, distributions payable to Fund unitholders, distributions payable to KRL, long-term debt, as well as the Exchangeable unit and Class C unit financial liabilities. The Partnership’s earnings are largely comprised of royalty income earned from the Keg Rights less administrative and interest expenses.

## 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 that came into effect on January 1, 2011, the Fund's Trustees had to adopt a new distribution policy which reflects the Fund's obligation to make these tax payments. Beginning with the distribution for the month of January 2011 (payable to unitholders on February 28, 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	\$ / Unit	Distributions	
			Total \$	Year-to-Date \$
December 1-31, 2012	January 31, 2013	8.00¢	\$ 908,280	\$ 908,280
January 1-31, 2013	February 28, 2013	8.00¢	\$ 908,280	\$ 1,816,560
February 1-28, 2013	March 28, 2013	8.00¢	\$ 908,280	\$ 2,724,840
March 1-31, 2013	April 30, 2013	8.00¢	\$ 908,280	\$ 3,633,120
April 1-30, 2013	May 31, 2013	8.00¢	\$ 908,280	\$ 4,541,400
May 1-31, 2013	June 28, 2013	8.00¢	\$ 908,280	\$ 5,449,680
June 1-30, 2013	July 31, 2013	8.00¢	\$ 908,280	\$ 6,357,960
July 1-31, 2013	August 30, 2013	8.00¢	\$ 908,280	\$ 7,266,240
August 1-31, 2013	September 30, 2013	8.00¢	\$ 908,280	\$ 8,174,520
September 1-30, 2013	October 31, 2013	8.00¢	\$ 908,280	\$ 9,082,800
October 1-31, 2013	November 29, 2013	8.00¢	\$ 908,280	\$ 9,991,080
November 1-30, 2013	December 31, 2013	8.00¢	\$ 908,280	\$ 10,899,360

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 \$123,688,000 of distributable cash and has paid cumulative distributions of \$123,482,000, which resulted in a cumulative surplus of \$206,000. The cumulative payout ratio (the ratio of cumulative cash distributions paid since inception to the cumulative distributable cash generated since inception) is 99.8%.

## DISTRIBUTABLE CASH

Distributable cash is defined as the periodic cash flows from operating activities as reported in the consolidated financial statements, including the change in non-cash working capital balances, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, 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)	Oct. 1, to Dec. 31, <u>2013</u>	Oct. 1, to Dec. 31, <u>2012</u>	Jan. 1, to Dec. 31, <u>2013</u>	Jan. 1, to Dec. 31, <u>2012</u>
Cash flow from operations <sup>(1)</sup> .....	\$ 4,787	\$ 4,727	\$ 20,051	\$ 16,086
SIFT tax paid on Fund units <sup>(2)</sup> .....	870	912	3,320	7,292
Interest and financing fees paid on term loan <sup>(3)</sup> .....	(160)	(168)	(658)	(671)
KRL's interest <sup>(4)</sup> .....	<u>(2,039)</u>	<u>(2,030)</u>	<u>(8,072)</u>	<u>(8,057)</u>
Distributable cash before current year SIFT tax .....	\$ 3,458	\$ 3,441	\$ 14,641	\$ 14,650
SIFT tax expense on Fund units <sup>(5)</sup> .....	<u>(924)</u>	<u>(883)</u>	<u>(3,617)</u>	<u>(3,482)</u>
Distributable cash <sup>(6)</sup> .....	<u>\$ 2,534</u>	<u>\$ 2,558</u>	<u>\$ 11,024</u>	<u>\$ 11,168</u>

Notes:

- <sup>(1)</sup> Represents the cash flow from operations as reported in the consolidated statements of cash flows.
- <sup>(2)</sup> Includes SIFT taxes actually paid during the respective period, consisting of \$870,000 during the fourth quarter of 2013 (fourth quarter of 2012 - \$912,000) and \$3,320,000 during 2013 (\$7,292,000 during 2012 consisting of \$3,646,000 with respect to 2011 and \$3,646,000 on account for 2012).
- <sup>(3)</sup> Represents the interest and financing fees paid on the term loan.
- <sup>(4)</sup> 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.
- <sup>(5)</sup> Represents the SIFT tax expense for the respective period calculated at a blended rate of 25.75% for 2013 and 25.0% for 2012.
- <sup>(6)</sup> 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 consolidated financial statements, including the change in non-cash working capital, plus SIFT tax paid (including current year instalments), less interest and financing fees paid on the term loan, less the Partnership distributions attributable to KRL, and less current year SIFT tax expense.

## OWNERSHIP OF THE FUND

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

	December 31, 2013 <sup>(1)</sup>		December 31, 2012	
	#	%	#	%
Fund units held by public unitholders <sup>(2)</sup> .....	11,353,500	79.33	11,353,500	79.33
Exchangeable Partnership units held by KRL: <sup>(3)</sup>				
Class A units <sup>(4)</sup> .....	905,944	6.33	905,944	6.33
Class B units <sup>(5)</sup> .....	176,700	1.23	176,700	1.23
Class D units <sup>(5)</sup> .....	<u>1,876,057</u>	<u>13.11</u>	<u>1,876,057</u>	<u>13.11</u>
Total Exchangeable Partnership units <sup>(6)</sup> .....	<u>2,958,701</u>	<u>20.67</u>	<u>2,958,701</u>	<u>20.67</u>
Total Fund and Exchangeable Partnership units .....	<u>14,312,201</u>	<u>100.00</u>	<u>14,312,201</u>	<u>100.00</u>

Notes:

<sup>(1)</sup> Information is current as of December 31, 2013. On January 1, 2014, KRL became entitled to the initial 80% of the Additional Entitlement for 2014. See “Subsequent Events”.

<sup>(2)</sup> Represents the public’s total effective ownership of the Fund as of December 31, 2013 and 2012. 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 79.33% during the three months ended December 31, 2013 (three months ended December 31, 2012 – 79.33%) and was 79.33% during the year ended December 31, 2013 (year ended December 31, 2012 – 79.33%). The weighted average number of Fund units outstanding for the three-month period ended December 31, 2013 were 11,353,500 (three-month period ended December 31, 2012 – 11,353,500) and for the year ended December 31, 2013 were 11,353,500 (year ended December 31, 2012 – 11,353,500).

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

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

<sup>(5)</sup> These exchangeable Partnership units are issued to KRL in return for adding net sales to the Royalty Pool on an annual basis. Class D units are equivalent to Class B units in all material respects but began to be issued once all Class B units became fully entitled to distributions on January 1, 2008. As of December 31, 2013, KRL is the registered holder of 176,700 Class B units and 1,876,057 Class D units (December 31, 2012 – 176,700 Class B units and 1,876,057 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.

<sup>(6)</sup> Represents KRL’s total effective ownership of the Fund as of December 31, 2013 and 2012. 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 20.67% during the three months ended December 31, 2013 (three months ended December 31, 2012 – 20.67%) and was 20.67% during the year ended December 31, 2013 (year ended December 31, 2012 – 20.67%). The weighted average number of Exchangeable units held by KRL during the three-month period ended December 31, 2013 were 2,958,701 (three-month period ended December 31, 2012 – 2,958,701) and for the year ended December 31, 2013 were 2,958,701 (year ended December 31, 2012 – 2,958,701).

## 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		52 weeks ended	
	Dec. 29, <u>2013</u>	Dec. 30, <u>2012</u>	Dec. 29, <u>2013</u>	Dec. 30, <u>2012</u>
Corporate Keg restaurants <sup>(1)</sup> .....	\$ 62,494	\$ 60,596	\$ 242,479	\$ 235,116
Franchised Keg restaurants <sup>(2)</sup> .....	<u>64,977</u>	<u>64,649</u>	<u>258,883</u>	<u>252,298</u>
Total system sales .....	<u>\$ 127,471</u>	<u>\$ 125,245</u>	<u>\$ 501,362</u>	<u>\$ 487,414</u>

Notes:

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

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

## FOURTH QUARTER

System sales for the 13 weeks ended December 29, 2013 were \$127,471,000 compared to \$125,245,000 for the 13 weeks ended December 30, 2012, an increase of \$2,226,000 or 1.8%. During the 13 weeks ended December 29, 2013, one new corporate and one new franchised restaurant were opened, and no restaurants were closed. During the 13 weeks ended December 30, 2012, two new corporate and two new franchised restaurants were opened, and no restaurants were closed. As at December 29, 2013, there were a total of 105 Keg restaurants as compared with 106 Keg restaurants at December 30, 2012.

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) decreased by 0.6% in Canada and increased by 0.3% in the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 13-week period increased by 0.04%. The average exchange rate moved from 0.99 in KRL's quarter ended December 30, 2012 to 1.05 in KRL's quarter ended December 29, 2013, significantly increasing the Canadian dollar equivalent of the U.S. restaurant sales.

## YEAR

System sales for the 52 weeks ended December 29, 2013 were \$501,362,000 compared to \$487,414,000 for the 52 weeks ended December 30, 2012, an increase of \$13,948,000 or 2.9%. During the 52 weeks ended December 29, 2013, two new corporate and one new franchised restaurant were opened, and four corporate restaurants were permanently closed. During the 52 weeks ended December 30, 2012, two new corporate and two new franchised restaurants were opened, and no restaurants were closed.

Same store sales (sales of restaurants that operated during the entire 52-week period of the current year and the 52-week period of the prior year) decreased by 0.8% in Canada and increased by 1.5% in the United States. After translating the sales of the U.S. restaurants into their Canadian dollar equivalent, consolidated same store sales for the comparable 52-week period decreased by 0.3%. The average exchange rate moved from 1.00 in KRL's 52-week period ended December 30, 2012, to 1.03 in KRL's 52-week period ended December 29, 2013, thereby increasing the Canadian dollar equivalent of the U.S. restaurant sales.

## **OPERATING RESULTS**

### **FOURTH QUARTER**

#### **GROSS SALES**

Gross sales reported by the Keg restaurants in the Royalty Pool decreased by \$2,299,000 from \$122,392,000 to \$120,093,000 for the comparable quarter. The decrease in gross sales was due to the net impact of the same store sales decreases at comparable restaurants during the quarter (\$584,000 decrease in sales), the positive effect of the exchange rate increase on the translation of the US restaurant sales into their Canadian dollar equivalent (\$726,000 increase in sales), sales of restaurants closed for renovation during the comparable quarter of the prior year (\$448,000 increase in sales), and the loss of sales from closed restaurants that did not operate during the quarter (\$2,889,000 decrease in sales).

#### **ROYALTY INCOME**

Total royalty income earned by the Partnership increased by \$65,000 from \$4,896,000 in the fourth quarter of 2012, to \$4,961,000 in the fourth quarter of 2013. Royalty income decreased by \$92,000 during the quarter as a result of the decrease in gross sales for the reasons explained previously, and Make-whole Payments increased by \$157,000 due to more restaurants closed during the quarter (52 more closed weeks).

#### **INTEREST INCOME**

Interest income earned by the Fund during the fourth quarter of the current year was \$1,078,000, comprised of interest income on the Keg Loan of \$1,077,000 and other interest income of \$1,000. Interest income on the Keg Loan increased by \$3,000 during the quarter as it is calculated based on 92 days of a 365 day year, rather than on 92 days of a 366 day year, as in the comparable quarter of the prior year, as 2012 was a leap year. Other interest income earned by the Trust on surplus cash balances remained the same during the quarter.

#### **ADMINISTRATIVE EXPENSES**

Expenses incurred by the Partnership for the quarter ended December 31, 2013 were \$114,000, comprised entirely of general and administrative expenses. The increase in Partnership expenses of \$28,000 over the comparable quarter of the prior year was due to an increase in general and administrative expenses of \$28,000, primarily as a result of increased legal costs incurred during the quarter.

#### **INTEREST AND FINANCING EXPENSES**

Interest and financing expenses incurred by the Trust were \$161,000 for the three months ended December 31, 2013, and included interest on the long-term debt of \$151,000, other financing charges of \$5,000, and amortization of deferred financing charges of \$5,000. Interest costs during the comparable quarter decreased by \$17,000 as the average interest rate on the term loan decreased from 4.75% to 4.25% as a result of an amendment to the banking agreement effective September 28, 2013. Other financing charges increased by \$5,000 during the comparable quarter as these costs were incurred in the fourth quarter of the current year, but in the third quarter of the prior year. Amortization of deferred financing charges decreased by \$3,000 during the comparable quarter.

## OPERATING INCOME

The Fund's operating income increased from \$5,709,000 during the fourth quarter of 2012, to \$5,764,000 during the fourth quarter of 2013. The increase of \$55,000 is due to the net impact of the increase in royalty income of \$65,000, the increase in interest income of \$3,000, the increase in administrative expenses of \$28,000, and the decrease in interest and financing expenses of \$15,000.

## DISTRIBUTIONS TO KRL

Distributions attributable to KRL during the three months ended December 31, 2013 were \$2,039,000 which included distributions of \$970,000 on the Exchangeable units and \$1,069,000 on the Class C units. Distributions on the Exchangeable units increased by \$9,000 from the comparable quarter of the prior year, primarily due to the increase in the operating income during the quarter. 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 BEFORE FAIR VALUE ADJUSTMENT AND TAXES

Profit before fair value adjustment and taxes increased by \$46,000 from a profit of \$3,679,000 (32.4 cents/Fund unit) in the fourth quarter of 2012, to a profit of \$3,725,000 (32.8 cents/Fund unit) in the fourth quarter of 2013.

## FAIR VALUE ADJUSTMENT

The fair value of the Exchangeable units increased \$4,231,000 during the three months ended December 31, 2013, as compared with an increase of \$152,000 during the three months ended December 31, 2012. The market price of a Fund unit (the basis upon which Exchangeable units are valued), increased from \$15.01 to \$16.44 during the fourth quarter of the current year; there were 2,958,701 Exchangeable units outstanding at the end of the fourth quarter of 2013. The market price of a Fund unit increased from \$14.45 to \$14.50 during the comparable quarter of the prior year; there were 2,958,701 Exchangeable units outstanding at the end of the fourth quarter of 2012.

## TAXES

Taxes for the three-month period ended December 31, 2013, were \$973,000 and included SIFT tax expense of \$924,000 and non-cash deferred taxes of \$49,000. SIFT tax expense increased by \$41,000 primarily due to the increase in the SIFT tax rate from 25.0% to 25.75%. The increase in the SIFT tax rate was due the increase in the general corporate taxation rate from 10.0% to 11.0% enacted by the British Columbia government effective April 1, 2013, resulting in a blended SIFT tax rate of 25.75% for 2013, versus the 25.0% rate for 2012. Deferred taxes increased by \$18,000 due to changes in the temporary differences between the accounting and tax bases of the Keg Rights owned by the Partnership, in addition to the change in the future tax rate from 25.0% to 26.0%.

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

Profit (loss) decreased by \$4,092,000 from a profit of \$2,613,000 (23.0 cents/Fund unit) in the fourth quarter of 2012, to a loss of \$1,479,000 (-13.0 cents/Fund unit) in the fourth quarter of 2013, primarily due to the increase in the non-cash fair value adjustment of the Exchangeable unit liability.

## DISTRIBUTABLE CASH

Distributable cash before SIFT tax increased by \$17,000 from \$3,441,000 (30.3 cents/Fund unit) to \$3,458,000 (30.5 cents/Fund unit) during the comparable quarter. Cash available for distribution to Fund unitholders decreased by \$24,000 from \$2,558,000 (22.5 cents/Fund unit) to \$2,534,000 (22.3 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, fair value adjustments, and deferred 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 both the fourth quarter of 2013 and 2012.

## YEAR

### GROSS SALES

Gross sales reported by the restaurants in the Royalty Pool decreased by \$9,704,000 from \$484,568,000 to \$474,864,000 for the year. The decrease in gross sales was due to the net impact of the same store sales decreases at comparable restaurants during the year (\$2,963,000 decrease in sales), the positive effect of the exchange rate increase on the translation of the US restaurant sales into their Canadian dollar equivalent (\$1,409,000 increase in sales), sales of restaurants closed for renovation during the prior year (\$674,000 increase in sales), and the loss of sales from closed restaurants that did not operate during the entire year (\$8,824,000 decrease in sales).

### ROYALTY INCOME

Total royalty income earned by the Partnership increased by \$95,000 from \$19,401,000 in 2012, to \$19,496,000 in 2013. Royalty income decreased by \$388,000 during the year as a result of the decrease in gross sales for the reasons explained previously, and Make-whole Payments increased by \$483,000 due to more restaurants closed during the year (105 more closed weeks).

### INTEREST INCOME

Interest income earned by the Fund during the current year was \$4,279,000, and was comprised of interest income on the Keg Loan of \$4,275,000 and other interest income of \$4,000. Interest income on the Keg Loan remained the same during the year. Other interest income decreased by \$3,000 due to lower surplus cash balances on hand during the year.

### ADMINISTRATIVE EXPENSES

Expenses incurred by the Partnership for the year ended December 31, 2013 were \$422,000, comprised of general and administrative expenses of \$423,000 and other interest income of \$1,000. The increase in Partnership expenses of \$24,000 over 2012 was due to the combination of an increase in general and administrative expenses of \$22,000 and a decrease in other interest income of \$2,000. General and administrative expenses increased as a result of significantly increased legal costs, which were only partially offset by reduced printing costs associated with the annual report. Other interest income decreased due to lower surplus cash balances on hand during the year.

## INTEREST AND FINANCING EXPENSES

Interest and financing expenses incurred by the Trust were \$681,000 for the year ended December 30, 2013, and included interest on the long-term debt of \$648,000, other financing charges of \$5,000 and amortization of deferred financing charges of \$28,000. Interest costs decreased by \$19,000 for the year as the average interest rate on the term loan decreased from 4.75% to 4.62% as a result of an amendment to the banking agreement effective September 28, 2013. Other financing charges remained the same during the year, while amortization of deferred financing charges decreased by \$5,000 during the year.

## OPERATING INCOME

The Fund's operating income increased from \$22,580,000 during 2012, to \$22,672,000 during 2013. The increase of \$92,000 is due to the net impact of the increase in royalty income of \$95,000, the decrease in interest income of \$3,000, the increase in administrative expenses of \$24,000, and the decrease in interest and financing expenses of \$24,000.

## DISTRIBUTIONS TO KRL

Distributions attributable to KRL during 2013 were \$8,072,000, which included distributions of \$3,797,000 on the Exchangeable units and \$4,275,000 on the Class C units. Distributions on the Exchangeable units increased by \$15,000 from the prior year primarily due to the increase in operating income during the year. The distributions declared on the Class C units remained the same during the year, which were \$0.0625 per Class C unit per month.

## PROFIT BEFORE FAIR VALUE ADJUSTMENT AND TAXES

Profit before fair value adjustment and taxes increased by \$77,000 from \$14,523,000 (\$1.279/Fund unit) in 2012, to \$14,600,000 (\$1.286/Fund unit) in 2013.

## FAIR VALUE ADJUSTMENT

The fair value of the Exchangeable units increased \$5,740,000 during, 2013, as compared with an increase of \$5,338,000 during 2012. The market price of a Fund unit (the basis upon which Exchangeable units are valued), increased from \$14.50 to \$16.44 during 2013; there were a total of 2,958,701 Exchangeable units outstanding as at December 31, 2013. The market price of a Fund unit increased from \$12.70 to \$14.50 during the prior year; there were a total of 2,958,701 Exchangeable units outstanding as at December 31, 2012.

## TAXES

Taxes for the year ended December 31, 2013, were \$3,800,000 and included SIFT tax expense of \$3,617,000 and non-cash deferred taxes of \$183,000. SIFT tax expense increased by \$135,000 primarily due to the increase in the SIFT tax rate from 25.0% to 25.75%. The increase in the SIFT tax rate was due the increase in the general corporate taxation rate from 10.0% to 11.0% enacted by the British Columbia government effective April 1, 2013, resulting in blended SIFT Tax rate of 25.75% for 2013, versus the 25.0% rate for 2012. Deferred taxes increased by \$66,000 due to changes in the temporary differences between the accounting and tax bases of the Keg Rights owned by the Partnership, in addition to the change in the future tax rate from 25.0% to 26.0%.

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

Profit decreased by \$526,000 from a profit of \$5,586,000 (49.2 cents/Fund unit) during the year ended December 31, 2012 to a profit of \$5,060,000 (44.6 cents/Fund unit) during the year ended December 31, 2013, mostly due to the increase in the non-cash fair value adjustment of the Exchangeable unit liability.

## **DISTRIBUTABLE CASH**

Distributable cash before SIFT tax decreased by \$9,000 from \$14,650,000 (\$1.290 /Fund unit) to \$14,641,000 (\$1.290 /Fund unit) during the year. Cash available for distribution to Fund unitholders decreased by \$144,000 from \$11,168,000 (98.4 cents/Fund unit) to \$11,024,000 (97.1 cents/Fund unit) during the year. The difference between the Fund's earnings and distributable cash is due to non-cash items such as amortization, fair value adjustments, and deferred income taxes included in the Fund's net earnings, as well as changes in non-cash working capital balances.

## **DISTRIBUTIONS TO FUND UNITHOLDERS**

Distributions of \$10,899,000 (96.0 cents/Fund unit) were paid to Fund unitholders in both 2013 and 2012.

## **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. During the quarter, the Fund generated \$2,534,000 in distributable cash and paid distributions of \$2,725,000 to public unitholders, resulting in a deficiency of \$191,000. For the year, the Fund generated \$11,024,000 in distributable cash and paid distributions of \$10,899,000 resulting in a surplus of \$125,000. The cumulative surplus since the inception of the Fund is \$206,000 as at December 31, 2013. The Fund has cash on hand of \$798,000 and a positive working capital balance of \$1,198,000 as at December 31, 2013.

## **TERM LOAN**

The Trust has a \$14 million non-revolving term loan facility, which bears interest at bank prime plus 1.25% 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 September 28, 2013, the Fund amended the terms of this loan with its existing banking syndicate and the maturity date was extended to July 1, 2016. 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, fair value adjustments, taxes, depreciation and amortization ("EBITDA"). As at December 31, 2013, 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 1.25% 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 December 31, 2013, the entire \$1 million facility is available for use.

## **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, 2013, 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 consolidated financial statements for external purposes in accordance with IFRS.

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.

The administrator of the Fund assessed the effectiveness of the Fund’s internal control over financial reporting as of December 31, 2013, 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, 2013. During the year ended December 31, 2013, 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 condensed consolidated interim 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 TAX EXPENSE**

The Fund uses the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the deferred tax consequences attributable to the differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of changes in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of such changes.

## DEFERRED TAX EXPENSE (CONTINUED)

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

## CURRENT INCOME TAX EXPENSE

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

## KEG RIGHTS

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

## EXCHANGEABLE UNIT FAIR VALUE ADJUSTMENT

The Fund is required under IFRS to classify the Exchangeable units as a financial liability at fair value. This requires that the Fund uses a valuation technique to determine the fair value of the Exchangeable units at the applicable reporting dates. The Fund estimates the fair value of this financial liability using the Fund's market capitalization at the end of the applicable period and allocating KRL's entitlement based upon its percentage ownership of the Fund on a fully-diluted basis as at December 31, 2013.

As at December 31, 2013, the closing price of a Fund unit was \$16.44 resulting in a market capitalization of \$235.3 million. KRL's 20.67% ownership of the Fund (on a fully-diluted basis) was calculated to be \$48.6 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

Effective January 1, 2013, the following standards and amendments have been adopted by the Fund:

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.

The Fund has reviewed the impact of this new standard and determined that upon adoption of the new standard on January 1, 2013, the consolidated financial statements will continue to include the accounts of the Fund, its wholly-owned subsidiaries KHT, its 90%-owned subsidiary KGP, and its interest in the Partnership.

## **NEW ACCOUNTING POLICIES (CONTINUED)**

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. The requirements of IFRS 12 relate to disclosures only and are applicable for the first annual period after adoption.

IFRS 13, *Fair Value Measurement*, sets out a single IFRS framework for fair value measurement and establishes disclosure requirements for fair value measurements. The new standard clarifies the information required to help users of the financial statements assess both of the following: for assets and liabilities that are measured at fair value on a recurring and non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop these measurements, and for recurring fair value measurements using significant unobservable inputs, the effect of the measurements on profit or loss or other comprehensive income ("OCI") for the period. The Fund has reviewed the impact of this new standard and has provided additional disclosures as required on fair value measurements noted in the consolidated financial statements.

IFRS 7, *Financial Instruments: Disclosures*, sets out the objective to enhance disclosures about offsetting of financial assets and financial liabilities. The Fund has reviewed the impact of this new standard and determined that it does not have an impact on the condensed consolidated interim financial statements.

IAS 1, *Presentation of Financial Statements*, was amended to change the disclosure of items presented in OCI, including a requirement to present separately the items of OCI that may be classified to profit or loss in the future from those that would never be reclassified to profit or loss. This amendment is effective for years beginning on or after July 1, 2012. The Fund has reviewed the impact of this new standard and determined that it does not have an impact on the condensed consolidated interim financial statements.

There have been amendments to existing standards, including IAS 27, *Separate Financial Statements*, and IAS 28, *Investments in Associated and Joint Ventures*. IAS 27 addressed 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.

## **FINANCIAL INSTRUMENTS**

The Fund's financial instruments consist of cash, royalty fee receivable from KRL, interest on note receivable 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, Class C Partnership unit liability 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 note receivable from KRL and the Class C unit liability approximate their carrying values due to the requirement of the Fund to settle the note receivable from KRL in exchange for Class C Partnership units equal to \$10.00 per Class C unit transferred. 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**

### **JANUARY 1, 2014 ROLL-IN**

On January 1, 2014, five new Keg restaurants that opened during the period from October 3, 2012 through October 2, 2013 were added to the Royalty Pool. The gross sales of these five new restaurants have been estimated at \$29.5 million annually. Four permanently closed Keg restaurants with annual sales of \$15.7 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$13.8 million annually. The total number of restaurants in the Royalty Pool increased to 103. The yield of the Fund units was determined to be 8.77% calculated using a weighted average unit price of \$14.70.

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 396,108 Fund units, being 2.69% of the Fund units on a fully diluted basis.

On January 1, 2014, KRL received 80% of this entitlement representing the equivalent of 316,886 Fund units, being 2.17% 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 3,275,588 Fund units representing 22.39% of the Fund units on a fully diluted basis.

The balance of the additional entitlement will be adjusted on December 31, 2014 to be effective January 1, 2014 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2014, it would have the right to exchange its Partnership units for 3,354,810 Fund units representing 22.81% of the Fund units on a fully diluted basis.

### **SALE OF CONTROLLING INTEREST IN KRL**

On February 4, 2014, Fairfax Financial Holdings Limited completed the transaction to acquire a 51% interest in KRL from David Aisenstat, the sole shareholder of KRL prior to the transaction. Mr. Aisenstat will continue to hold the remaining 49% interest in KRL and he, along with the rest of the current KRL management team, will remain in operational control of KRL.

## 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 5.6% in 2013 and has projected sales to increase by 4.6% in 2014. In the US, the National Restaurant Association has estimated that sales in the full-service category increased 2.3% in 2013, and has projected sales to increase by 2.6% in 2014. 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 US.

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 KRL currently expects to open seven restaurants prior to October 2, 2014, consisting of four corporate and three franchised restaurants 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 openings and adjust these as necessary. Since October 3, 2013, KRL has opened one corporate restaurant and one franchised restaurant in Canada, which will be added to the Royalty Pool on January 1, 2015.

## **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 US, 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 continues to monitor any cases of mad cow disease found in North America. The continued widespread testing of herds confirms that these were isolated cases; the risk to human health appears to be negligible. Most importantly to The Keg, there has not been any significant negative consumer reaction to beef in North America and there has not been a material impact on its restaurant traffic. KRL has maintained an uninterrupted supply of quality beef that meets its demanding specifications despite previous border closures. Management of KRL expects the demand for beef to remain strong among consumers and its supply to continue uninterrupted.

### **FLUCTUATIONS IN FOREIGN EXCHANGE RATES**

KRL presently has 14 restaurants located in the US, all of which are corporately owned through its wholly owned subsidiaries. Keg restaurants located in the US generate sales in US 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 US, which will affect the amount of the royalty.

## FORWARD LOOKING INFORMATION

Certain information included in this report contains forward-looking statements within the meaning of applicable securities laws. These statements include, but are not limited to, statements made in the Overview, Outlook, Competitive Strength and Growth, The Royalty Pool, Distributions to Unitholders, and Critical Accounting Estimates sections and other statements concerning the Fund's business plans and objectives, activities and management's beliefs, plans, estimates and intentions, and similar statements concerning the Fund's anticipated future events, results, performance or expectations that are not historical facts. Forward-looking statements generally can be identified by the use of forward-looking terminology such as "outlook", "objective", "may", "will", "would", "expect", "intend", "estimate", "anticipate", "believe", "should", "plan", "continue", or similar expressions suggesting future outcomes or events. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management. All forward-looking statements in this Management's Discussion and Analysis are qualified by these cautionary statements.

These forward looking statements are not guarantees of future events or performance and, by their nature, are based on the Fund's current estimates and assumptions, which are subject to risks and uncertainties, including those described in this Management's Discussion and Analysis, which could cause actual events or results to differ materially from the forward looking statements made in this Management's Discussion and Analysis. Those risks and uncertainties include, but are not limited to:

- changes in national and local business and economic conditions that may affect competition in the restaurant industry, changes in demographic trends, or changes in consumer preferences and discretionary spending patterns;
- availability and quality of raw materials;
- growth of the royalty fee and the impact on the royalty amount from the closure of Keg restaurants;
- the ability of franchisees' to generate sales and pay franchise fees and other amounts;
- dependence on key personnel;
- maintenance of strong intellectual property and brand equity;
- unexpected costs or liabilities related to changes in regulations governing alcoholic beverages, income or sales tax legislation, environmental matters or food-borne illnesses; and
- fluctuations in the foreign exchange rate between the Canadian and US dollar.

The foregoing list of factors is not exhaustive and should be considered in conjunction with the risks and uncertainties set out in KRL's Management's Discussion and Analysis for the 52 weeks ended September 29, 2013, which are available on SEDAR at [www.sedar.com](http://www.sedar.com).

Material assumptions or factors that were applied in drawing a conclusion or making an estimate set out in the forward looking information may include, but are not limited to:

- a stable pace of real estate development opportunities;
- absence of material changes in law;
- protection of the Keg Rights;
- continued access to financing by each of KRL and its franchisees;
- no unexpected closings of Keg restaurants that will have a material adverse affect on the royalty amount; and
- expectations related to future general economic conditions.

Although the forward looking information contained in this Management's Discussion and Analysis is based upon what management believes are reasonable assumptions, there can be no assurance that actual results will be consistent with these forward looking statements. The forward-looking information contained in this document is current only as of the date of this document and reflects current expectations regarding future events and operating performance. Except as required by law, the Fund undertakes no obligation to publicly update, supplement or revise any forward looking statement, whether as a result of new information, changing circumstances, future events or otherwise. Certain statements included in this Management's Discussion and Analysis may be considered "financial outlook" for purposes of applicable securities laws, and such financial outlook may not be appropriate for purposes other than this Management's Discussion and Analysis.

## **ADDITIONAL INFORMATION**

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

## UNITHOLDER INFORMATION

### CORPORATE HEAD OFFICE

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

### BOARD OF TRUSTEES

C. C. Woodward  
George Killy  
Tim Kerr

### 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  
Tim Kerr\*  
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

Neil Maclean

Telephone: (604) 276-0242  
Facsimile: (604) 276-2681  
E-mail: [neilm@kegrestaurants.com](mailto:neilm@kegrestaurants.com)  
Website: [www.kegincomefund.com](http://www.kegincomefund.com)

# **THE KEG ROYALTIES INCOME FUND**

## **CONSOLIDATED FINANCIAL STATEMENTS**

For the years ended December 31, 2013 and 2012

## 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 of The Keg GP Ltd. and the Trustees of The Keg Royalties Income Fund (the "Fund"). 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 Fund's external auditors have full and direct access to the Audit Committee.

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

(signed) C.C. Woodward

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

February 24, 2014



**KPMG LLP**  
**Chartered Accountants**  
PO Box 10426 777 Dunsmuir Street  
Vancouver BC V7Y 1K3  
Canada

Telephone (604) 691-3000  
Fax (604) 691-3031  
Internet www.kpmg.ca

## INDEPENDENT AUDITORS' REPORT

To the Unitholders of The Keg Royalties Income Fund

We have audited the accompanying consolidated financial statements of The Keg Royalties Income Fund ("the Fund"), which comprise the consolidated statements of financial position as at December 31, 2013 and December 31, 2012, the consolidated statements of comprehensive income, changes in equity and cash flows for the years then ended, 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 Fund'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 Fund'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, 2013 and December 31, 2012, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

Chartered Accountants

February 24, 2014  
Vancouver, Canada

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(Expressed in thousands of dollars)

	<u>Note</u>	December 31, <u>2013</u>	December 31, <u>2012</u>
<b>ASSETS</b>			
Current assets:			
Cash .....		\$ 798	\$ 429
Prepaid expenses and deposits .....		14	15
Royalty fee receivable from Keg Restaurants Ltd. ....	13	2,183	2,338
Interest on note receivable from Keg Restaurants Ltd. ....	13	363	362
Current income tax receivable .....		<u>-</u>	<u>163</u>
		3,358	3,307
Note receivable from Keg Restaurants Ltd. ....	6	57,000	57,000
Intangible assets, Keg Rights .....	7	<u>156,493</u>	<u>156,493</u>
		<u>\$ 216,851</u>	<u>\$ 216,800</u>
<b>LIABILITIES AND UNITHOLDERS' EQUITY</b>			
Current liabilities:			
Accounts payable and accrued liabilities .....		\$ 300	\$ 437
Interest payable on term loan .....		51	56
Distributions payable to Fund unitholders .....	9	908	908
Distributions payable to Keg Restaurants Ltd. ....	13	767	780
Current income tax payable .....	12	<u>134</u>	<u>-</u>
		2,160	2,181
Term loan, net of deferred financing charges .....	11(a)	13,944	13,956
Deferred taxes .....	12	1,923	1,740
Class C Partnership units .....	10(a)	57,000	57,000
Exchangeable Partnership units .....	10(b)	48,641	42,901
Unitholders' equity:			
Fund units .....	8	123,275	123,275
Accumulated deficit .....		<u>(30,092)</u>	<u>(24,253)</u>
		<u>93,183</u>	<u>99,022</u>
		<u>\$ 216,851</u>	<u>\$ 216,800</u>

Subsequent events (note 17)

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

Approved on behalf of the Board of Trustees

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

“George Killy”  
**George Killy, Trustee**

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

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

	<u>Note</u>	January 1 to December 31, 2013	January 1 to December 31, 2012
Revenue:			
Royalty income .....	5	\$ 19,496	\$ 19,401
Interest income .....		<u>4,279</u>	<u>4,282</u>
		23,775	23,683
Expenses:			
General and administrative .....		(422)	(398)
Interest and financing fees .....		(653)	(672)
Amortization of deferred financing charges .....		<u>(28)</u>	<u>(33)</u>
		<u>(1,103)</u>	<u>(1,103)</u>
Profit before distributions, change in fair value adjustment and taxes .....		22,672	22,580
Distributions recorded as interest:			
Class C Partnership units .....	10(a)	(4,275)	(4,275)
Exchangeable Partnership units .....	10(b)	<u>(3,797)</u>	<u>(3,782)</u>
		<u>(8,072)</u>	<u>(8,057)</u>
Profit before fair value adjustment and taxes .....		14,600	14,523
Change in fair value of Exchangeable Partnership units .....	10(b)	<u>(5,740)</u>	<u>(5,338)</u>
Profit before taxes .....		8,860	9,185
Taxes:			
Current .....	12	(3,617)	(3,482)
Deferred .....	12	<u>(183)</u>	<u>(117)</u>
		<u>(3,800)</u>	<u>(3,599)</u>
Profit and comprehensive income for the year .....		<u>\$ 5,060</u>	<u>\$ 5,586</u>
Weighted average Fund units outstanding .....	4(k)	<u>11,353,500</u>	<u>11,353,500</u>
Weighted average diluted units outstanding .....	4(k)	<u>14,312,201</u>	<u>14,312,201</u>
Basic and diluted earnings per Fund unit .....	4(k)	<u>\$ 0.45</u>	<u>\$ 0.49</u>

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

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Expressed in thousands of dollars)

	<u>Fund units</u>	<u>Accumulated deficit</u>	<u>Unitholders' equity</u>
Balance, January 1, 2012 .....	\$ 123,275	\$ (18,940)	\$ 104,335
Profit and comprehensive income for the year .....	-	5,586	5,586
Distributions declared to Fund unitholders .....	-	(10,899)	(10,899)
Balance, December 31, 2012 .....	<u>\$ 123,275</u>	<u>\$ (24,253)</u>	<u>\$ 99,022</u>
Balance, January 1, 2013 .....	\$ 123,275	\$ (24,253)	\$ 99,022
Profit and comprehensive income for the year .....	-	5,060	5,060
Distributions declared to Fund unitholders .....	-	(10,899)	(10,899)
Balance, December 31, 2013 .....	<u>\$ 123,275</u>	<u>\$ (30,092)</u>	<u>\$ 93,183</u>

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

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Expressed in thousands of dollars)

	<u>Note</u>	January 1 to December 31, 2013	January 1 to December 31, 2012
<b>Cash provided by (used for):</b>			
<b>OPERATIONS:</b>			
Profit for the year .....		\$ 5,060	\$ 5,586
Items not involving cash:			
Amortization of deferred financing charges .....		28	33
Deferred tax expense .....	12	183	117
Change in fair value of Exchangeable Partnership units .....	10(b)	5,740	5,338
Distributions recorded as interest:			
Class C Partnership units .....	10(a)	4,275	4,275
Exchangeable Partnership units .....	10(b)	3,797	3,782
Changes in non-cash operating working capital:			
Royalty fee receivable from Keg Restaurants Ltd. ....		155	95
Prepaid expenses and deposits .....		1	2
Accounts payable and accrued liabilities .....		(137)	(4)
Interest income .....		(4,279)	(4,282)
Interest and financing fees .....		653	672
Current income taxes .....	12	3,617	3,482
Interest received .....		4,278	4,282
Income taxes paid .....		<u>(3,320)</u>	<u>(7,292)</u>
		20,051	16,086
<b>FINANCING:</b>			
Distributions paid to Class C unitholder .....		(4,275)	(4,275)
Distributions paid to Exchangeable unitholder .....		(3,810)	(3,823)
Distributions paid to Fund unitholders .....		(10,899)	(10,899)
Deferred financing charges .....		(40)	-
Interest and financing fees paid .....		<u>(658)</u>	<u>(671)</u>
		<u>(19,682)</u>	<u>(19,668)</u>
Increase (decrease) in cash .....		369	(3,582)
Cash, beginning of year .....		<u>429</u>	<u>4,011</u>
Cash, end of year .....		<u>\$ 798</u>	<u>\$ 429</u>
Non-cash transactions:			
Increase in intangible assets on Royalty Pool net sales roll-in .....		\$ -	\$ 424

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 1. ORGANIZATION AND NATURE OF BUSINESS:

The Keg Royalties Income Fund (the “Fund”) is an unincorporated open-ended limited purpose trust established under the laws of Ontario, with the authority to issue an unlimited number of trust units and is governed by the Declaration of Trust signed May 31, 2002 and as amended on December 20, 2010. The Fund is registered and domiciled in Canada and its principal business office is located at 10100 Shellbridge Way, Richmond, British Columbia.

The Fund was established to invest in The Keg Rights Limited Partnership (the “Partnership”), which owns the trademarks, trade names, operating procedures and systems and other intellectual property (collectively, the “Keg Rights”) used in connection with the operation of Keg steakhouse restaurants and bars.

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

### 2. BASIS OF PREPARATION:

#### (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”).

The consolidated financial statements were authorized for issue by the Fund’s Board of Trustees on February 24, 2014.

#### (b) Functional and presentation 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 the Fund’s consolidated financial statements, in conformity with IFRS, requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets and 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 judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

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 and in any future periods affected.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 2. BASIS OF PREPARATION (CONTINUED):

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

Significant estimates and judgements made by management in the application of IFRS that have a significant effect on the amounts recognized in these consolidated financial statements are as follows:

(i) Intangible assets (note 7):

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 and bars 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 and bars being added to the existing Keg restaurants and bars 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 judgement, and as a result, the estimated net cash flows the Keg Rights are expected to generate could differ materially from actual results.

(ii) Fair value adjustment of Class A, B and D Partnership units (“Exchangeable Partnership units” or “Exchangeable units”) (note 10(b)):

The Fund measures the Exchangeable Partnership units as a financial liability at fair value through profit and loss. The Fund estimates the fair value of the Exchangeable Partnership units using the closing market price of the publicly traded units of the Fund (the “Fund units”) on the Toronto Stock Exchange (“TSX”). The Exchangeable Partnership units have similar distribution and voting rights as the Fund units and are exchangeable into Fund units on a one-for-one basis. Therefore, it is estimated that the fair value of an Exchangeable Partnership unit approximates the market value of a Fund unit. This valuation technique may not represent the actual liability should the distributions paid to the holders of the Exchangeable units differ significantly from that paid to Fund unitholders.

(iii) Current income taxes (note 12):

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 2. BASIS OF PREPARATION (CONTINUED):

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

(iv) Deferred taxes (note 12):

The determination of deferred income taxes requires the use of judgement and estimates in determining the timing when taxable differences will reverse and the appropriate tax rates to be applied. 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 could be materially impacted.

### 3. NEW ACCOUNTING POLICIES:

Effective January 1, 2013, the following standards and amendments have been adopted by the Fund:

- (a) 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. The Fund has reviewed the impact of this new standard and determined that upon adoption of the new standard on January 1, 2013, the consolidated financial statements will continue to include the accounts of the Fund, its wholly-owned subsidiary The Keg Holdings Trust ("KHT"), its 90%-owned subsidiary The Keg GP Ltd. ("KGP"), and its interest in the Partnership.
- (b) 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. The requirements of IFRS 12 relate to disclosures only and are applicable for the first annual period after adoption. IFRS 12 does not require the disclosures to be included for any period presented that precedes the first annual period for which IFRS 12 is applied.
- (c) IFRS 13, *Fair Value Measurement*, sets out a single IFRS framework for fair value measurement and establishes disclosure requirements for fair value measurements. The new standard clarifies the information required to help users of the financial statements assess both of the following: for assets and liabilities that are measured at fair value on a recurring and non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop these measurements, and for recurring fair value measurements using significant unobservable inputs, the effect of the measurements on profit or loss or other comprehensive income ("OCI") for the period. The Fund has reviewed the impact of this new standard and has provided additional disclosures as required on fair value measurements noted in the consolidated financial statements (note 4 (i)).
- (d) IFRS 7, *Financial Instruments: Disclosures*, sets out the objective to enhance disclosures about offsetting of financial assets and financial liabilities. The Fund has reviewed the impact of this new standard and determined that it does not have an impact on the consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

- (e) IAS 1, *Presentation of Financial Statements*, was amended to change the disclosure of items presented in OCI, including a requirement to present separately the items of OCI that may be classified to profit or loss in the future from those that would never be reclassified to profit or loss. This amendment is effective for years beginning on or after July 1, 2012. The Fund has reviewed the impact of this new standard and determined that it does not have an impact on the consolidated financial statements.
- (f) 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.

### 4. 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 7). 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 Exchangeable Partnership unit liability measured at fair value through profit or loss.

- (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 5).

Interest income is recognized and accrued for when earned.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

(e) Intangible assets (note 7):

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 9):

The amount of cash available to be distributed to Fund unitholders is determined with reference to the Fund's comprehensive income adjusted for non-cash items such as deferred income taxes, fair value adjustments on the Exchangeable Partnership units liability (note 10(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 5).

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 12):

Income tax comprises current and deferred tax expense and is recognized in comprehensive income.

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 recognized in respect of temporary 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 in the period that includes the enactment date. The carrying amount of deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

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

Deferred tax primarily arises because of temporary differences on the Keg Rights.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

#### (h) Borrowings (note 11):

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

#### (i) Financial Instruments:

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

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

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

- 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 Exchangeable Partnership unit liability is classified as a financial liability due to the Partnership's contractual obligation to distribute cash on the Exchangeable Partnership units and is measured at fair value through profit or loss due to certain conversion features discussed in note 10(b).

Financial instruments in this category are recognized initially and subsequently at fair value and transaction costs are charged to comprehensive income in the period incurred. Gains and losses arising from changes in fair value are charged in comprehensive income in the period in which they arise. These instruments 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.

- Derivative financial instruments: The requirement of the Fund to settle its note receivable from KRL in exchange for Class C Partnership units is classified as a derivative instrument (note 6). The Fund has reviewed the net impact of this potential exchange requirement on its cash flows and has determined there is no significant value applicable to this feature.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

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

- **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 from KRL, and the note receivable from KRL are included in 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 discount the loans and receivables to fair value.
- **Financial liabilities at amortized cost:** Financial liabilities at amortized cost include accounts payable and accrued liabilities, interest payable on term loan, distributions payable to Fund unitholders, distributions payable to KRL, Class C Partnership unit liability and the term loan. These items are initially recognized at the amount required to be paid, less a discount to reduce the payables to fair value or transactions 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 of the statement of financial position date. Otherwise, they are presented as non-current liabilities.

The carrying value of current financial assets and liabilities approximate their fair value due to their short-term nature. The note receivable from KRL and the Class C Partnership unit liability approximate their fair values due to the requirement of the Fund to settle the note receivable from KRL in exchange for Class C Partnership units (note 6). The term loan approximates fair value based on prevailing market interest rates in effect at the statement of financial position dates.

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

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

The following table presents the carrying amounts of each category of financial assets and liabilities:

	December 31, <u>2013</u>	December 31, <u>2012</u>
Financial assets:		
Loans and receivables:		
Cash .....	\$ 798	\$ 429
Royalty fee receivable from Keg Restaurants Ltd. ....	2,183	2,338
Interest on note receivable from Keg Restaurants Ltd. ....	363	362
Note receivable from Keg Restaurants Ltd. ....	<u>57,000</u>	<u>57,000</u>
	<u>\$ 60,344</u>	<u>\$ 60,129</u>
Financial liabilities:		
Amortized cost:		
Accounts payable and accrued liabilities .....	\$ 300	\$ 437
Interest payable on term loan .....	51	56
Distributions payable to Fund unitholders .....	908	908
Distributions payable to Keg Restaurants Ltd. ....	767	780
Term loan, net of deferred financing charges .....	13,944	13,956
Class C Partnership units .....	57,000	57,000
Fair value through profit and loss:		
Exchangeable Partnership units.....	<u>48,641</u>	<u>42,901</u>
	<u>\$ 121,611</u>	<u>\$ 116,038</u>

#### (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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

(j) Impairment (continued):

- Financial assets (continued):

When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss. The reversal is limited to an amount that does not result in the asset being valued at more than what its amortized cost would have been in the absence of impairment. The Fund has evaluated all its financial assets 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 impairment test.

Intangible assets are tested for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units or “CGU”s). The Fund defines a CGU as the Keg Rights. The recoverable amount is the higher of an asset’s fair value less costs to sell and value in use (being the present value of the expected future cash flows of the CGU). 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. An impairment loss is recognized for the amount by which the asset’s carrying amount exceeds its recoverable amount.

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.

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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the years ended December 31, 2013 and 2012

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

(k) Earnings per unit (continued):

The following reconciles the basic profit to the diluted profit:

	January 1 to December 31, <u>2013</u>	January 1 to December 31, <u>2012</u>
Basic profit and comprehensive income for the year .....	\$ 5,060	\$ 5,586
Distributions on Exchangeable Partnership units .....	3,797	3,782
Increase in current tax expense .....	(978)	(946)
Change in fair value of Exchangeable Partnership units .....	<u>5,740</u>	<u>5,338</u>
Diluted net profit for the period .....	<u>\$ 13,619</u>	<u>\$ 13,760</u>
Weighted average number of Fund units .....	11,353,500	11,353,500
Weighted average number of Exchangeable Partnership units .....	<u>2,958,701</u>	<u>2,958,701</u>
Weighted average number of units.....	<u>14,312,201</u>	<u>14,312,201</u>
Basic and diluted earnings per Fund unit .....	<u>\$ 0.45</u>	<u>\$ 0.49</u>

For the years ended December 31, 2013 and December 31, 2012, the Exchangeable Partnership units are anti-dilutive. Accordingly, the diluted earnings per Fund unit equals the basic earnings per Fund unit.

(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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

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

Unless otherwise noted, the following standards and amendments are effective for annual periods beginning on or after January 1, 2014 with earlier adoption permitted. The Fund intends to adopt the standards and amendments when they are effective. The extent of the impact of adopting these standards and amendments has not yet been determined.

(i) In November 2009 the IASB issued IFRS 9, *Financial Instruments*, and in October 2010 the IASB published amendments to IFRS 9. IFRS 9 replaces the guidance in IAS 39, *Financial Instruments – Recognition and Measurement*, on the classification and measurement of financial assets and financial liabilities. The standard eliminates the existing IAS 39 categories of held to maturity, available for sale and loans and receivables.

Financial assets will be classified into one of two categories on initial recognition:

- financial assets measured at amortized cost; or
- financial assets measured at fair value

Gains and losses on remeasurement of financial assets measured at fair value will be recognized in profit or loss.

The IASB has deferred the mandatory effective date of the existing chapters of IFRS 9 to annual periods beginning on or after January 1, 2015 and early adoption of the standard is permitted.

(ii) IAS 32, *Financial Instruments: Presentation*, has been amended to include additional presentation requirements for financial assets and financial liabilities that can be offset in the statement of financial position. The effective date for the amendments to IAS 32 is annual periods beginning on or after January 1, 2014.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars, except number of restaurants)

For the years ended December 31, 2013 and 2012

### 5. 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 is known with certainty.

The royalty payment from KRL to the Partnership is four percent of system sales for such period reported by Keg restaurants and bars 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 four permanent closures, from January 1 to December 31, 2013 (January 1 to December 31, 2012 – two permanent closures and one temporary closure due to an extended restaurant renovation).

No new restaurants were opened during the period from October 3, 2011 through October 2, 2012 resulting in no additions to the Royalty Pool on January 1, 2013.

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

	January 1 to December 31, <u>2013</u>	January 1 to December 31, <u>2012</u>
Restaurants in Royalty Pool .....	102	102
Royalty Pool system sales .....	<u>\$ 474,864</u>	<u>\$ 484,568</u>
Royalty income at 4% of system sales reported above .....	18,995	19,383
Make-whole payment, based on 4% of lost system sales .....	<u>501</u>	<u>18</u>
Total royalty income .....	<u>\$ 19,496</u>	<u>\$ 19,401</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

	December 31, <u>2013</u>	December 31, <u>2012</u>
Note receivable with interest payable monthly at 7.5% per annum and principal amount due May 31, 2042 .....	<u>\$ 57,000</u>	<u>\$ 57,000</u>

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

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

### 7. 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 5).

As described in note 4(e), the Fund has adopted a policy of accounting for the Additional Entitlement of Class B and Class D Partnership units ("Class D units") (note 5) 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, December 31, 2013 and December 31, 2012 ..... \$ 156,493

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 Licence and Royalty agreement between the Fund and KRL expires on December 31, 2101.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 7. INTANGIBLE ASSETS (CONTINUED):

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 fifty years.

These projected cash flows are discounted at the Fund's estimated before-tax yield of approximately 9% to arrive at the recoverable amount. The Fund's estimated pre-tax yield is determined using the Fund's closing price at December 31, 2013, the annualized distribution rate of \$0.96 and the SIFT tax rate of 26.0% enacted for the 2014 and later taxation years.

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, 2013, 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.

### 8. 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the years ended December 31, 2013 and 2012

### 9. DISTRIBUTIONS ON FUND UNITS:

	January 1 to December 31, <u>2013</u>	January 1 to December 31, <u>2012</u>
Distributions declared to Fund unitholders .....	\$ <u>10,899</u>	\$ <u>10,899</u>
Weighted average Fund units outstanding .....	<u>11,353,500</u>	<u>11,353,500</u>
Distributions declared per unit .....	\$ <u>0.96</u>	\$ <u>0.96</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.

### 10. PARTNERSHIP UNIT LIABILITIES:

#### (a) Class C Partnership unit liability:

Class C Partnership 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 6). 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:

		December 31, <u>2013</u>	<u>Fair Value</u>
Class A Partnership units .....	(i)	905,944	\$ 14,894
Class B Partnership units .....	(ii)	176,700	2,905
Class D Partnership units .....	(iii)	<u>1,876,057</u>	<u>30,842</u>
		<u>2,958,701</u>	<u>\$ 48,641</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

For the years ended December 31, 2013 and 2012

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

(b) Exchangeable Partnership unit liability (continued):

		December 31, <u>2012</u>	<u>Fair Value</u>
Class A Partnership units .....	(i)	905,944	\$ 13,136
Class B Partnership units .....	(ii)	176,700	2,562
Class D Partnership units .....	(iii)	<u>1,876,057</u>	<u>27,203</u>
		<u>2,958,701</u>	<u>\$ 42,901</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 they occur. 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 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, 2013 was \$16.44 (December 31, 2012 – \$14.50).

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

	Total number of Exchangeable <u>Partnership units</u>	January 1 to December 31, <u>2013</u>
Exchangeable Partnership units, beginning of period .....	2,958,701	\$ 42,901
Fair value adjustment .....	<u>-</u>	<u>5,740</u>
Fair value of Exchangeable Partnership units, end of period .....	<u>2,958,701</u>	<u>\$ 48,641</u>

	Total number of Exchangeable <u>Partnership units</u>	January 1 to December 31, <u>2012</u>
Exchangeable Partnership units, beginning of period .....	2,924,320	\$ 37,139
January 1 initial estimate of Class D unit entitlement (80%) .....	32,500	401
December 31 final Class D unit entitlement (20%) .....	1,881	23
Fair value adjustment .....	<u>-</u>	<u>5,338</u>
Fair value of Exchangeable Partnership units, end of period .....	<u>2,958,701</u>	<u>\$ 42,901</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

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

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

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 December 31, 2013. 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 Class A unit for one Fund 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 Class B unit for one Fund unit. 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 Class D unit for one Fund unit and receive the same distribution entitlement as the Class B units.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 11. BORROWINGS:

(a) Term loan:

On September 28, 2013, the Fund amended the terms of its \$14,000,000 term loan with its existing banking syndicate. The facility now bears interest at prime plus 1.25%, requires monthly interest only payments and is secured by a general security agreement over the assets of the Fund. The maturity date of the facility was also extended from April 1, 2014 to July 1, 2016.

In accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, the amendment was considered a modification of debt. As a result, the \$40,000 in deferred financing fees incurred on the extension was added to the \$29,000 unamortized balance of deferred financing fees associated with this facility.

The term loan is presented net of \$56,000 in deferred financing charges at December 31, 2013 (December 31, 2012 – \$44,000).

(b) Operating line of credit:

On September 28, 2013, the Partnership renegotiated the terms of its existing \$1,000,000 demand operating facility with KRIF's banking syndicate. This facility now bears interest at prime plus 1.25% 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, 2013, the entire \$1,000,000 remains available for use.

### 12. 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 is subject to tax at a rate of 25.0% for the 2012 taxation year, a blended rate of 25.75% for the 2013 taxation year and 26.0% for the 2014 and later taxation years, as a result of the increase in the British Columbia general corporate taxation rate from 10.0% to 11.0%, effective April 1, 2013.

The components of tax expense are as follows:

	January 1 to December 31, <u>2013</u>	January 1 to December 31, <u>2012</u>
Current income tax expense .....	\$ (3,617)	\$ (3,482)
Deferred tax expense .....	<u>(183)</u>	<u>(117)</u>
	<u>\$ (3,800)</u>	<u>\$ (3,599)</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 12. INCOME TAXES (CONTINUED):

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 profit before taxes. The reason for the difference is as follows:

	January 1 to December 31, <u>2013</u>	January 1 to December 31, <u>2012</u>
Profit before taxes .....	\$ 8,860	\$ 9,185
Combined Canadian federal and provincial rates .....	<u>25.75%</u>	<u>25.00%</u>
Computed "expected" tax expense .....	2,281	2,296
Increased (reduced) by:		
Permanent and other differences .....	1,444	1,300
Change in tax base of the Keg Rights .....	4	4
Differences between current and future tax rates and other items .....	<u>71</u>	<u>(1)</u>
Total tax expense per the statement of comprehensive income .....	<u>\$ 3,800</u>	<u>\$ 3,599</u>

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

	December 31, <u>2013</u>	December 31, <u>2012</u>
Temporary difference related to the Keg Rights .....	<u>\$ 1,923</u>	<u>\$ 1,740</u>
Deferred tax liability .....	<u>\$ 1,923</u>	<u>\$ 1,740</u>

The balance of the Fund's deferred tax liability increased to \$1,923,000 as at December 31, 2013 (December 31, 2012 – \$1,740,000). The deferred tax liability arises 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.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 13. 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:

	December 31, <u>2013</u>	December 31, <u>2012</u>
Royalty fee receivable from Keg Restaurants Ltd., including GST/HST .....	\$ 2,183	\$ 2,338
Interest on note receivable from Keg Restaurants Ltd. ....	<u>363</u>	<u>362</u>
Due from Keg Restaurants Ltd. ....	<u>\$ 2,546</u>	<u>\$ 2,700</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.

	December 31, <u>2013</u>	December 31, <u>2012</u>
Distributions payable to Keg Restaurants Ltd. ....	<u>\$ 767</u>	<u>\$ 780</u>

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 14. 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, <u>2013</u>	January 1 to December 31, <u>2012</u>
Remuneration of the Fund's Trustees, included in general and administrative expenses .....	\$ <u>65</u>	\$ <u>65</u>

### 15. FINANCIAL RISK MANAGEMENT:

The Fund is primarily exposed to the following financial risks as they relate to the Fund's identified financial instruments:

(a) Credit risk:

Credit risk is defined as the risk of financial loss to the Fund if a counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from the Fund's amounts due from KRL and the note receivable from KRL. The Fund monitors this risk through its regular review of the operating and financing activities of KRL. The Fund's maximum exposure to credit risk is the combined value of its royalty fee receivable from KRL, interest on note receivable from KRL and note receivable from KRL of \$59,546,000 (December 31, 2012 – \$59,700,000). Since its inception, the Fund has never failed to collect its receivables on a timely basis and as at December 31, 2013 there are no past-due accounts.

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 note receivable may be impacted.

Credit risk also arises from cash balances on deposit with financial institutions of \$798,000 at December 31, 2013 (December 31, 2012 – \$429,000). The Fund has placed its cash balances on deposit with a Canadian chartered bank of high creditworthiness.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 15. 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:

	<u>Value</u>	<u>Maturity</u>
Account payable and accrued liabilities .....	\$ 300	< 1 year
Interest payable on term loan .....	51	< 1 year
Distributions payable to Fund unitholders .....	908	< 1 year
Distributions payable to Keg Restaurants Ltd. ....	767	< 1 year
Current income tax payable .....	134	< 1 year
Term loan .....	14,000	2016

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. As at December 31, 2013, the Fund is in compliance with all covenants.

(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 1.25% 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, 2013, a 100 basis point change in the US dollar exchange rate would result in an approximate \$436,000 and \$17,000 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, 2013 and 2012

### 16. 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, 2013	December 31, 2012
Term loan .....	11(a)	<u>\$ 14,000</u>	<u>\$ 14,000</u>
Fund units .....	8	\$ 123,275	\$ 123,275
Accumulated deficit .....		<u>(30,092)</u>	<u>(24,253)</u>
Unitholders' equity .....		<u>\$ 93,183</u>	<u>\$ 99,022</u>

The term loan held by KHT is subject to certain financial covenants, including minimum equity amounts in both KHT and the Partnership and a minimum Partnership cash flow level, defined as profit (loss) before interest, change in fair value adjustment, taxes, depreciation and amortization ("EBITDA"). As at December 31, 2013, 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 10).

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts expressed in thousands of dollars)

For the years ended December 31, 2013 and 2012

### 17. SUBSEQUENT EVENTS:

- (a) On January 1, 2014, five new Keg restaurants that opened during the period from October 3, 2012 through October 2, 2013 were added to the Royalty Pool. The gross sales of these five new restaurants have been estimated at \$29.5 million annually. Four permanently closed Keg restaurants with annual sales of \$15.7 million were removed from the Royalty Pool, resulting in an estimated net increase in Royalty Pool sales of \$13.8 million annually. The total number of restaurants in the Royalty Pool increased to 103. The yield of the Fund units was determined to be 8.77% calculated using a weighted average unit price of \$14.70.

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 396,108 Fund units, being 2.69 % of the Fund units on a fully diluted basis.

On January 1, 2014, KRL received 80% of this entitlement representing the equivalent of 316,886 Fund units, being 2.17% 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 3,275,588 Fund units representing 22.39% of the Fund units on a fully diluted basis.

The balance of the Additional Entitlement will be adjusted on December 31, 2014 to be effective January 1, 2014 once the actual performance of the new restaurants has been confirmed. If KRL were to receive 100% of the estimated Additional Entitlement for 2014, it would have the right to exchange its Partnership units for 3,354,810 Fund units representing 22.81% of the Fund units on a fully diluted basis.

- (b) On February 4, 2014, Fairfax Financial Holdings Limited completed the transaction to acquire a 51% interest in KRL from David Aisenstat, the sole shareholder of KRL prior to the transaction. Mr. Aisenstat will continue to hold the remaining 49% interest in KRL and he, along with the rest of the current KRL management team, will remain in operational control of KRL.