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# **SIR ROYALTY INCOME FUND**

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

### **SECOND QUARTER**

#### **UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**FOR THE THREE- AND SIX-MONTH PERIODS ENDED JUNE 30, 2010**

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**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**(For the 3- and 6-month periods ended June 30, 2010)**

***Executive Summary***

Highlights for the 3-month period ended June 30, 2010 ("Q2") and the 6-month period ended June 30, 2010 ("YTD") for SIR Royalty Income Fund (the "Fund") includes:

- Net earnings of the Fund were \$1.9 million and \$3.6 million for Q2 and YTD, respectively for both 2010 and 2009. Net earnings per Fund Unit were \$0.35 and \$0.68 for Q2 and YTD 2010, respectively and were \$0.35 and \$0.67 for Q2 and YTD 2009, respectively.
- Distributable cash<sup>(1)</sup> per Fund Unit, both on a basic and diluted basis was \$0.35 for Q2 2010 and Q2 2009 and was \$0.68 and \$0.67 for YTD 2010 and YTD 2009, respectively.
- The payout ratio<sup>(1)</sup> increased from 97.5% in Q2 2009 to 98.4% in Q2 2010. The payout ratio since the Fund's inception, up to and including Q2 2010, is 98.7%.
- Pooled Revenue increased by 2.9% in Q2 2010 to \$51.1 million, from \$49.6 million in Q2 2009.
- The same store sales growth<sup>(2)</sup> ("SSSG<sup>(2)</sup>") for the Royalty Pooled Restaurants was 2.9% for Q2 2010.
- Jack Astor's®<sup>(1)</sup>, which accounts for approximately 68.9% of Pooled Revenue experienced SSSG<sup>(2)</sup> of 3.6% in Q2 2010. Canyon Creek® had a decline in SSS<sup>(2)</sup> of 0.8%, Alice Fazooli's® had SSSG<sup>(2)</sup> of 3.5% and the Signature Restaurants had SSSG<sup>(2)</sup> of 1.9% for Q2 2010.
- On January 1, 2009, the five new Jack Astor's restaurants and one Canyon Creek restaurant that opened in 2008 were added to Royalty Pooled Restaurants. The revenues of these six restaurants exceeded 80% of their initial estimated revenue and as a result, an additional distribution of \$0.3 million was declared in December 2009 and paid in January 2010 and on January 1, 2010, SIR converted 243,909 Class B GP Units into 243,909 Class A GP Units. No new restaurants were added to Royalty Pooled Restaurants effective January 1, 2010.
- SIR has secured sites for three additional new restaurants: one with an expected opening in Q4 of this fiscal year and two with expected openings in 2011.
- On March 12, 2009, Bill C-10 – Budget Implementation Act 2009, which further modifies the rules applicable to certain publicly traded or listed trusts and partnerships, received Royal Assent. In particular, Bill C-10 provides rules to facilitate the conversion of an income trust into a corporation on a tax-deferred basis (the "Conversion Rules"). The Conversion Rules provide income trusts with tax efficient structuring options to convert to corporate form in advance of their 2011 taxation year – at which time most income trusts would become subject to a new entity-level tax based on corporate income tax rates. However, the new income tax rules under Bill C-52 do not require certain publicly traded or listed trusts and partnerships to convert into a corporation prior to December 31, 2010. The Fund does not have any current plans to convert to a corporation. As a result, assuming no material changes in the Fund's financial performance from its current levels, the Fund would be expected to reduce its distributions from their then current levels by approximately 30% commencing January 2011. The Fund is anticipating incurring increased professional fees during 2010, as a result of considering the possible impact of the new rules and reviewing its options.
- While SIR is not owned by the Fund, the Fund is economically dependent upon SIR. SIR files its unaudited interim and audited annual consolidated financial statements and Management's Discussion and Analysis ("MD&A") on SEDAR under the Fund's listing named "Other". SIR's Q3 unaudited consolidated financial statements and MD&A are listed having a filing date of June 23, 2010.

(1) *Distributable cash and payout ratio are non-GAAP financial measures and do not have a standardized meaning prescribed by GAAP. However, the Fund believes that distributable cash and the payout ratio are useful measures as they provide investors with an indication of cash available for distribution. The Fund's method of calculating distributable cash and the payout ratio may differ from that of other issuers and, accordingly, distributable cash and the payout ratio may not be comparable to measures used by other issuers. Investors are cautioned that distributable cash and the payout ratio should not be construed as an alternative to the statement of cash flows as a measure of liquidity and cash flows of the Fund. The payout ratio is calculated as cash distributed for the period as a percentage of the distributable cash for the period. Distributable cash represents the amount of money which the Fund expects to have available for distribution to Unitholders of the Fund, and is calculated as cash provided by operating activities of the Fund, adjusted for the net change in non-cash working capital items.*

(2) *Same store sales ("SSS") and same store sales growth ("SSSG") are non-GAAP financial measures that do not have standardized meanings prescribed by GAAP. However, the Fund believes that SSS and SSSG are useful measures and provide investors with an indication of the change in year-over-year sales. The Fund's method of calculating SSS and SSSG may differ from those of other issuers and, accordingly, SSS and SSSG may not be comparable to measures used by other issuers. SSS includes revenue from all SIR Restaurants included in Pooled Revenue. The US restaurant is not part of SSS.*

### ***Same Store Sales***<sup>(2)</sup>

(unaudited)

SIR reported to the Fund that SSSG<sup>(2)</sup> was 2.9% for Q2 and 3.7% for YTD 2010 (please see the table below). The Canadian Restaurant and Foodservices Association ("CRFA"), in its 2010 – 2014 Long Term Foodservice Forecast estimated that sales in 2009 in the full service restaurant industry declined and Management believes that the weaker economic conditions experienced in 2009 were the primary driver of the Royalty Pooled Restaurants' decline in SSS<sup>(2)</sup> in 2009. However, there were some positive signs in the fourth quarter of 2009 as Jack Astor's posted a 0.4% SSSG<sup>(2)</sup> and the other concepts experienced their lowest declines of the year. In the first two quarters of 2010, all but one concept experienced SSSG<sup>(2)</sup>. The remaining concept, Canyon Creek, has remained relatively flat, still experiencing a decline in SSS<sup>(2)</sup> of 0.3%. For 2010, the CRFA is projecting a modest increase in sales.

SSSG<sup>(2)</sup> by operating segment are summarized in the following table.

<b>SSSG<sup>(2)</sup> for the Royalty Pooled Restaurants</b>	<b>3-month period ended June 30, 2010</b>	<b>6-month period ended June 30, 2010</b>
Jack Astor's	3.6%	4.5%
Canyon Creek	(0.8%)	(0.3%)
Alice Fazooli's	3.5%	4.2%
Signature Restaurants	1.9%	2.9%
<b>Overall SSSG<sup>(2)</sup></b>	<b>2.9%</b>	<b>3.7%</b>

SIR continues to focus on sustaining and growing restaurant sales and profits while managing costs in light of the economic conditions in Canada.

### ***Restaurant Renovations and Advertising***

In 2009, SIR initiated certain cash preservation strategies including the previously announced slowing of growth plans. However, SIR's Management are committed to maximizing the performance of all of its restaurants.

During the first half of 2009, SIR limited its mass media advertising. However, by Q3 2009, SIR had advised the Fund that it would be returning to its regular advertising initiatives including mobile phone applications, print, television, on-line, and radio advertising. SIR has continued with its regular advertising initiatives in 2010.

### ***New and Closed Restaurants***

The six new restaurants that were opened during fiscal 2008 were added to Royalty Pooled Restaurants effective January 1, 2009 as New Additional Restaurants. No new restaurants were opened or existing restaurants were closed in 2009 and as such, no new restaurants were added or removed from Royalty Pooled Restaurants on January 1, 2010.

SIR has secured three new sites for SIR restaurants. Construction began late in Q2 at a Jack Astor's in Boisbriand, Quebec and is scheduled to open in Q4 of this fiscal year. Two new restaurants at the corner of Yonge and Gerrard Streets in Toronto, Ontario are estimated to open in fiscal 2012. SIR Management continues to monitor economic conditions and consumer confidence. Based on its assessment of these conditions, the timing of restaurant construction and opening schedules will be reviewed regularly by SIR Management and adjusted as necessary.

### ***Distributions***

Distributions to Unitholders are intended to be made monthly in arrears based on distributable cash<sup>(1)</sup> and cash redemptions of Fund Units and subject to the Fund retaining such reasonable working capital and other reserves as may be considered appropriate by the Trustees of the Fund. It is the Fund's intention to pay even distributions, and if possible, allow the Fund to maintain consistent monthly distributions to Unitholders.

The Fund intends to make monthly distributions of its available distributable cash<sup>(1)</sup> to the extent possible. During the quarter, monthly distributions of \$0.6 million or \$0.115 per Unit were declared and paid for each of the months of March, April, and May 2010. Subsequent to June 30, 2010, a distribution of \$0.115 per Unit was declared and paid for the month of June 2010 and a distribution of \$0.115 per Unit was declared for the month of July 2010.

(1) See footnote (1) on page 2

(2) See footnote (2) on page 2

The Fund has paid its expected monthly cash distribution of at least \$0.10 per Unit per month, or more, since inception. The estimated annualized distribution for 2010 is \$1.38 per Unit. Please refer to the chart on page 9 for a summary of monthly distributions since inception.

The payout ratio<sup>(1)</sup> of cash distributed to distributable cash<sup>(1)</sup> is intended to average 100% per annum over the longer term. Since the Fund pays even monthly distributions when its underlying cash flow from the Partnership is subject to seasonal fluctuations (as experienced by SIR), there are times during the year when the payout ratio<sup>(1)</sup> may exceed or could be lower than 100%. The payout ratio<sup>(1)</sup> in Q2 2010 was 98.4% compared to 97.5% in Q2 2009 and was 101.4% in YTD 2010 as compared to 102.8% in YTD 2009. The payout ratio since the Fund's inception up to and including Q2 2010 is 98.7%.

### ***Overview and Business of the Fund***

On October 1, 2004, the Fund filed a final prospectus for a public offering of Units of the Fund. The net proceeds of the Offering of \$51.2 million were used by the Fund to acquire, directly, certain bank debt of SIR and indirectly, through SIR Holdings Trust (the "Trust"), all of the Ordinary LP Units of the Partnership. The Partnership owns the Canadian trade-marks (the "SIR Rights") formerly owned or licensed by SIR or its subsidiaries and used in connection with the operation of the majority of SIR's restaurants in Canada. The Partnership has granted SIR a 99-year license to use the SIR Rights in most of Canada in consideration for a Royalty, payable by SIR to the Partnership, equal to 6% of the revenue of the Royalty Pooled Restaurants (the "License and Royalty Agreement"). The Partnership also issued its own securities to SIR in return for the SIR Rights acquired. The Fund indirectly participates in the revenue generated under the License and Royalty Agreement through its investment in the Partnership. The Partnership's financial statements are provided separately at [www.sedar.com](http://www.sedar.com) under the SIR Royalty Income Fund profile "Other" category and on SIR's website at [www.sircorp.com](http://www.sircorp.com).

The Units of the Fund are publicly traded on the Toronto Stock Exchange under the symbol SRV.UN.

### ***Overview and Business of SIR and the Partnership***

SIR is a private company amalgamated under the Business Corporations Act of Ontario. As at June 30, 2010, SIR operated 45 Concept Restaurants and Signature Restaurants in Canada (in Ontario, Quebec, Alberta and Nova Scotia). The Concept Restaurants are Jack Astor's Bar and Grill®, Canyon Creek Chop House® and Alice Fazooli's. The Signature Restaurants are *reds*®, Far Niente®/Petit Four™ and FOUR™, and the Loose Moose Tap & Grill®. On January 1, 2009, the five new Jack Astor's restaurants and one new Canyon Creek restaurant that opened in 2008 were added to Royalty Pooled Restaurants. No restaurants were opened during 2009 and as a result, no restaurants were added to Royalty Pooled Restaurants on January 1, 2010. As at June 30, 2010, 45 SIR Restaurants were included in Royalty Pooled Restaurants. During Q2 2009, SIR acquired the non-controlling interest in Jack Astor's Don Mills Limited and therefore now owns 100% of its Canadian restaurants.

SIR also owns one Jack Astor's restaurant in the U.S., which is not included in Royalty Pooled Restaurants.

The Partnership has granted SIR a 99-year license to use the SIR Rights in most of Canada in consideration for a Royalty, payable by SIR to the Partnership, equal to 6.0% of the revenue of the Royalty Pooled Restaurants. The Partnership also issued its own securities to SIR in return for the SIR Rights acquired.

On January 1 of each year (the "Adjustment Date"), the restaurants subject to the Partnership Agreement are adjusted for new restaurants that have been open for at least 60 days prior to the Adjustment Date and which were not previously included in Royalty Pooled Restaurants. Under the formula as defined in the Partnership Agreement, the number of Class A GP Units issued to SIR on the Initial Adjustment date is equal to 80% of the estimated value of the additional Royalty revenue. Additional Class B GP Units may be converted to Class A GP Units in respect of these new SIR Restaurants if the actual revenues of the new SIR Restaurants exceed 80% of the January 1 Initial Adjustment's estimated revenue applied to the formula defined in the Partnership Agreement. Conversely, Class A GP Units would be converted to Class B GP Units by SIR if the actual revenues of the new SIR Restaurants are less than 80% of the January 1 Initial Adjustment's estimated revenue. In December of each year, an additional distribution will be payable to the Class B GP Unitholders based on actual revenues of the new SIR Restaurants exceeding 80% of the initial adjustment's estimated revenue or there will be a reduction in the cash distributions to the Class A GP Unitholders if revenues are less than 80% of the initial adjustment's estimated revenue. The additional distribution results in an adjustment to SIR's share of the Partnership income to reflect the actual contribution of the revenues of the new SIR Restaurants for the fiscal year. As this amount is not declared until December 31st, when the actual revenues for the New Additional Restaurants are known, the effect of this adjustment is not included in the results of quarters one through three.

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(1) See footnote (1) on page 2

The revenues of the new SIR Restaurants added to Royalty Pooled Restaurants on January 1, 2009 exceeded 80% of the initial adjustment's estimated revenue and, as a result, an additional distribution of \$0.3 million (2008 - \$0.2 million) was declared in December 2009 and paid in cash to SIR in January 2010.

On January 1, 2010, nil (2009 - six) new SIR Restaurants were added to Royalty Pooled Restaurants in accordance with the Partnership Agreement. As consideration for the additional Royalty associated with the addition of nil (2009 - six) new restaurants on January 1, 2010, as well as the Second Incremental Adjustment for the six (2008 - three) new SIR Restaurants added to Royalty Pooled Restaurants on January 1, 2009, SIR converted a portion of its Class B GP Units into Class A GP Units based on the formula defined in the Partnership Agreement. The number of Class B GP Units that SIR converted to Class A GP Units was reduced by an adjustment for the closure of nil (2009 - nil) SIR Restaurants during the prior year. The net effect of these adjustments to Royalty Pooled Restaurants was that SIR converted 243,909 (2009 - 1,076,871) Class B GP Units into 243,909 (2009 - 1,076,871) Class A GP Units on January 1, 2010 at an estimated fair value of \$1.2 million (2009 - \$6.0 million).

As a result of not adding any new SIR Restaurants to Royalty Pooled Restaurants on January 1, 2010, there will not be an additional distribution declared in December 2010 or a Second Incremental Adjustment on January 1, 2011.

As at January 1, 2010, SIR retained a 35.7% (2009 - 33.7%) interest in the Partnership as the holder of the 2,969,324 (2009 - 2,725,415) Class A GP Units. The Class A GP Units are entitled to receive a pro rata share of all residual distributions of the Partnership and are exchangeable into Units of the Fund on a one for one basis. SIR is obligated to pay the Partnership a "Make-Whole Payment", subject to certain terms, initially equal to the amount of the Royalty that otherwise would have been paid to the Partnership in the event of a permanent closure of a Royalty Pooled Restaurant. SIR is not required to pay a "Make-Whole Payment" in respect of a closed Royalty Pooled Restaurant following the date on which the number of restaurants in Royalty Pooled Restaurants is equal to or greater than 68, or following October 12, 2019, whichever occurs first. However, other adjustments or payments may still be required in respect of closed restaurants after such date by SIR, depending upon the circumstances.

SIR's fiscal year is comprised of 13 periods of four weeks each, ending on the last Sunday in August. To preserve this year-end, an additional week must be added approximately every five years. Fiscal quarters of SIR consist of accounting periods of 12, 12, 12 and 16 (or 17) weeks. SIR's fiscal 2009 year consisted of 52 weeks and SIR's fiscal 2010 year will consist of 52 weeks.

Consolidated financial statements of SIR can be found at [www.sedar.com](http://www.sedar.com) under the SIR Royalty Income Fund profile, "Other" category and on SIR's website at [www.sircorp.com](http://www.sircorp.com).

### ***Seasonality***

The full service restaurant sector of the Canadian foodservice industry, in which SIR operates, experiences seasonal fluctuations in revenues. Favourable summer weather generally results in increased revenues during SIR's fourth quarter (ending the last Sunday in August) when patios have been open for an extended period. Additionally, certain holidays and observances also affect guest dining patterns both favourably and unfavourably. Accordingly, distribution income recognized by the Fund will vary in conjunction with the seasonality in revenue experienced by SIR. The Fund's intention is to pay even distributions in order to reduce the effect of seasonality, and if possible, allow the Fund to maintain consistent monthly distributions to Unitholders.

***Selected Consolidated Financial Information***

The unaudited consolidated financial statements of the Fund are presented in Canadian dollars, are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and include the accounts of the Fund and its subsidiaries, namely the Trust and SIR GP Inc. The information in this Management's Discussion and Analysis should be read in conjunction with the annual audited consolidated financial statements of the Fund, including the notes thereto. The Fund has been in existence since August 23, 2004, and began operating on October 12, 2004 upon closing of the Offering.

The following tables set out selected financial information of the Fund and the Partnership:

***Financial Highlights***

*(in thousands of dollars except restaurants and per Unit amounts) (unaudited)*

	<b>3-month period ended June 30, 2010</b>	<b>3-month period ended June 30, 2009</b>	<b>6-month period ended June 30, 2010</b>	<b>6-month period ended June 30, 2009</b>
Royalty Pooled Restaurants	45	45	45	45
Pooled Revenue generated by SIR	51,064	49,627	98,604	95,119
6% of Pooled Revenue	3,064	2,977	5,916	5,707
Partnership other income	6	6	12	15
Partnership expenses	(19)	(27)	(50)	(73)
Partnership earnings	3,051	2,956	5,878	5,649
SIR's interest (Class A, B and C GP Units)	(1,791)	(1,715)	(3,521)	(3,330)
<b>Partnership income allocated to Fund<sup>(3)</sup></b>	<b>1,260</b>	<b>1,241</b>	<b>2,357</b>	<b>2,319</b>
Interest income <sup>(4)</sup>	750	750	1,500	1,500
<b>Total income of the Fund</b>	<b>2,010</b>	<b>1,991</b>	<b>3,857</b>	<b>3,819</b>
General & administrative expenses	(133)	(96)	(211)	(224)
<b>Net earnings for the period</b>	<b>1,877</b>	<b>1,895</b>	<b>3,646</b>	<b>3,595</b>
Basic earnings per Fund Unit (5,356,667 Units)	\$0.35	\$0.35	\$0.68	\$0.67
Diluted earnings per Fund Unit (2010 – 8,325,991, 2009 – 8,082,082 Units) <sup>(5)</sup>	\$0.35	\$0.35	\$0.68	\$0.67

For the 6-month period from January 1, 2010 to June 30, 2010, the Fund declared and paid a distribution of \$0.115 per Unit for each of the months from December 2009 through May 2010. Subsequent to June 30, 2010, the Fund declared and paid a distribution of \$0.115 per Unit for the month of June 2010. The Fund also declared a distribution of \$0.115 per Unit for the month of July 2010, payable in August 2010.

- (3) On October 12, 2004, the Fund, indirectly through the Trust, acquired all of the Ordinary LP Units of the Partnership. The holders of the Ordinary LP Units and Class A GP Units are entitled to receive a pro rata share of all residual distributions of the Partnership.
- (4) Interest income is the interest earned during the periods from the \$40.0 million SIR Loan, which bears interest at 7.5% per annum.
- (5) Diluted earnings per Fund Unit is calculated as follows: Net earnings for the period plus the distributions related to the Class A GP Units plus (less) future income tax recovery (expense), which together total \$2.9 million and \$5.7 million for the 3- and 6-month periods ended June 30, 2010, respectively, divided by the weighted average number of Fund Units outstanding of 8,325,991 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 2,969,324. Diluted earnings per Fund Unit for 2009 is calculated as follows: net earnings for the period plus the distributions related to the Class A GP Units plus (less) future income tax recovery (expense), which together totaled \$2.8 million and \$5.4 million for the 3- and 6-month periods ended June 30, 2009, respectively, divided by the weighted average number of Fund Units outstanding of 8,082,082 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 2,725,415.

**Summary of Quarterly Financial Information**

*(in thousands of dollars except restaurants and per Unit amounts) (unaudited)*

	3-month period ended							
	June 30, 2010	March 31, 2010	December 31, 2009	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008	September 30, 2008
Royalty Pooled Restaurants	45	45	45	45	45	45	39	39
Pooled Revenue generated by SIR	51,064	47,540	50,485	48,539	49,627	45,492	43,902	43,680
6% of Pooled Revenue	3,064	2,852	3,030	2,912	2,977	2,730	2,635	2,621
Partnership other income	6	6	6	6	6	9	13	15
Partnership expenses	(19)	(30)	(12)	(31)	(27)	(46)	(24)	(21)
Partnership earnings	3,051	2,828	3,024	2,887	2,956	2,693	2,624	2,615
SIR's interest (Class A, B and C GP Units)	(1,791)	(1,731)	(1,955)	(1,682)	(1,715)	(1,615)	(1,477)	(1,339)
<b>Partnership income allocated to Fund<sup>(3)</sup></b>	1,260	1,097	1,069	1,205	1,241	1,078	1,147	1,276
Interest income <sup>(4)</sup>	750	750	750	750	750	750	750	750
<b>Total income of the Fund</b>	2,010	1,847	1,819	1,955	1,991	1,828	1,897	2,026
General & administrative expenses	(133)	(78)	(111)	(123)	(96)	(128)	(113)	(110)
<b>Net earnings before income taxes of the Fund</b>	1,877	1,769	1,708	1,832	1,895	1,700	1,784	1,916
Future income taxes	-	-	121	-	-	-	-	-
<b>Net earnings for the period</b>	1,877	1,769	1,829	1,832	1,895	1,700	1,784	1,916
Basic earnings per Fund Unit (5,356,667 Units)	\$0.35	\$0.33	\$0.34	\$0.34	\$0.35	\$0.32	\$0.33	\$0.36
Diluted earnings per Fund Unit (2010 – 8,325,991 Units, 2009 – 8,082,082 Units; 2008 – 7,005,211 Units) <sup>(6)</sup>	\$0.35	\$0.33	\$0.34	\$0.34	\$0.35	\$0.32	\$0.33	\$0.36

(3) See footnote (3) on page 6

(4) See footnote (4) on page 6

(6) Diluted earnings per Fund Unit is calculated as follows: Net earnings for the period plus the distributions related to the Class A GP Units plus (less) future income tax recovery (expense), which together total \$2.9 million and \$2.7 million for the 3-month periods ended June 30, 2010 and March 31, 2010, divided by the weighted average number of Fund Units outstanding of 8,325,991 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 2,969,324. Diluted earnings per Fund Unit for 2009 is calculated as follows: net earnings for the period plus the distributions related to the Class A GP Units plus (less) future income tax recovery (expense), which together totaled \$2.7 million, \$2.8 million, \$2.8 million and \$2.6 million for the 3-month periods ended December 31, 2009, September 30, 2009, June 30, 2009, and March 31, 2009, respectively, divided by the weighted average number of Fund Units outstanding of 8,082,082 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 2,725,415. Diluted earnings per Fund Unit for 2008 is calculated as follows: Net earnings for the period plus the distributions related to the Class A GP Units plus (less) future income tax recovery (expense), which together totaled \$2.3 million and \$2.5 million for the 3-month periods ended December 31, 2008 and September 30, 2008 respectively, divided by the weighted average number of Fund Units outstanding of 7,005,211 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 1,648,544.

**SIR ROYALTY INCOME FUND**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
**SECOND QUARTER 2010**

***Distributable Cash***<sup>(1)</sup>

(in thousands of dollars except per Unit amounts and payout ratio<sup>(1)</sup>)  
(unaudited)

	3-month period ended June 30, 2010	3-month period ended June 30, 2009	6-month period ended June 30, 2010	6-month period ended June 30, 2009
Cash provided by operating activities	1,848	1,848	3,696	3,696
Add/(deduct): Net change in non-cash working capital items <sup>(7)</sup>	29	48	(50)	(100)
<b>Distributable cash<sup>(1)</sup></b>	<b>1,877</b>	<b>1,896</b>	<b>3,646</b>	<b>3,596</b>
<b>Cash distributed for the period</b>	<b>1,848</b>	<b>1,848</b>	<b>3,696</b>	<b>3,696</b>
<b>Surplus/ (shortfall) of distributable cash<sup>(1)</sup></b>	<b>29</b>	<b>48</b>	<b>(50)</b>	<b>(100)</b>
Payout ratio <sup>(1)(8)</sup>	98.4%	97.5%	101.4%	102.8%
Distributable cash <sup>(1)</sup> per Fund Unit basic (5,356,667 Units)	\$0.35	\$0.35	\$0.68	\$0.67
Distributable cash <sup>(1)</sup> per Fund Unit diluted (2010 – 8,325,991 Units, 2009 – 8,082,082 Units) <sup>(9)</sup>	\$0.35	\$0.35	\$0.68	\$0.67

***Distributable Cash***<sup>(1)</sup>

(in thousands of dollars except per Unit amounts and payout ratio<sup>(1)</sup>)  
(unaudited)

	3-month periods ended							
	June 30, 2010	March 31, 2010	December 31, 2009	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008	September 30, 2008
Cash provided by operating activities	1,848	1,848	1,848	1,848	1,848	1,848	1,848	1,848
Add/(deduct): Net change in non-cash working capital items <sup>(7)</sup>	29	(79)	(141)	(16)	48	(148)	(64)	68
<b>Distributable cash<sup>(1)</sup></b>	<b>1,877</b>	<b>1,769</b>	<b>1,707</b>	<b>1,832</b>	<b>1,896</b>	<b>1,700</b>	<b>1,784</b>	<b>1,916</b>
<b>Cash distributed for the period</b>	<b>1,848</b>	<b>1,848</b>	<b>1,848</b>	<b>1,848</b>	<b>1,848</b>	<b>1,848</b>	<b>1,848</b>	<b>1,848</b>
<b>Surplus/ (shortfall) of distributable cash<sup>(1)</sup></b>	<b>29</b>	<b>(79)</b>	<b>(141)</b>	<b>(16)</b>	<b>48</b>	<b>(148)</b>	<b>(64)</b>	<b>68</b>
Payout ratio <sup>(1)(8)</sup>	98.4%	104.5%	108.3% <sup>(11)</sup>	100.9%	97.5%	108.7%	103.6% <sup>(11)</sup>	96.4%
Distributable cash <sup>(1)</sup> per Fund Unit basic (5,356,667 Units)	\$0.35	\$0.33	\$0.32	\$0.34	\$0.35	\$0.32	\$0.33	\$0.36
Distributable cash <sup>(1)</sup> per Fund Unit diluted (2010 – 8,325,991 Units; 2009 – 8,082,082 Units; 2008 -7,005,211 Units) <sup>(10)</sup>	\$0.35	\$0.33	\$0.32	\$0.34	\$0.35	\$0.32	\$0.33	\$0.36

(1) See footnote (1) on page 2

(7) Distributable cash is adjusted to exclude changes in non-cash working capital items as the Fund's working capital requirements are not permanent and are primarily due to the timing of payments between related parties.

(8) It is the Fund's intention to pay even distributions to reduce the effect of seasonality. Higher payout ratios during the colder months of the year are expected with the pattern of seasonality in the business, and it is anticipated that the payout ratio will decrease on average during the warm weather months.

(9) Diluted distributable cash per Fund Unit for the 3- and 6-month periods ended June 30, 2010 are calculated as follows: Distributable cash for the period plus the distributions related to the Class A GP Units, which together total \$2.9 million and \$5.7 million, respectively (2009 - \$2.8 million and \$5.4 million), divided by the weighted average number of Fund Units outstanding of 8,325,991 (2009 - 8,082,082) Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 (2009 – 5,356,667) plus the convertible Class A GP Units of 2,969,324 (2009 – 2,725,415).

(10) Diluted distributable cash per Fund Unit is calculated as follows: Distributable cash for the period plus the distributions related to the Class A GP Units, which together total \$2.9 million and \$2.7 million for the 3-month periods ended June 30, 2010 and March 31, 2010, respectively, divided by the weighted average number of fund Units outstanding of 8,325,991 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 2,969,324. Distributable cash per Fund Unit for 2009 is as follows: distributable cash for the period plus the distributions related to the Class A GP Units, which together total \$2.6 million, \$2.8 million, \$2.8 million and \$2.6 million for the 3-month periods ended December 31, 2009, September 30, 2009, June 30, 2009, and March 31, 2009 respectively, divided by the weighted average number of Fund Units outstanding of 8,082,082 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 2,725,415. Diluted distributable cash per Fund Unit for 2008 is as follows: Distributable cash for the period plus the distributions related to the Class A GP Units, which together total \$2.3 million and \$2.5 million for the 3-month periods ended December 31, 2008 and September 30, 2008, respectively, divided by the weighted average number of Fund Units outstanding of 7,005,211 Units. The weighted average number of Fund Units outstanding represents Fund Units of 5,356,667 plus the convertible Class A GP Units of 1,648,544.

(11) The payout ratio for the fourth quarter of 2009 was affected by the \$0.3 million (2008 - \$0.2 million) Priority Special Conversion Distribution paid by the Partnership. This distribution was paid on the Class B GP Units that were converted to Class A GP Units, effective January 1, 2009 (January 1, 2008) related to the Second Incremental Adjustment for the restaurants added to Royalty Pooled Restaurants effective January 1, 2009 (January 1, 2008).



Distributions to Unitholders are intended to be made monthly in arrears based on distributable cash<sup>(1)</sup> and cash redemptions of Fund Units and subject to the Fund retaining such reasonable working capital and other reserves as may be considered appropriate by the Trustees of the Fund. The Fund's intention is to pay even distributions, and if possible, allow the Fund to maintain consistent monthly distributions to Unitholders. The Fund intends to make monthly distributions of its available distributable cash<sup>(1)</sup> to the extent possible and has paid, at least, its expected minimum monthly cash distribution of \$0.10 per Unit per month since inception.

A history of monthly distributions is as follows:

<b>Months Paid</b>	<b>Monthly Distribution per Unit</b>	<b>Annualized Distribution per Unit</b>	<b>Increase in Monthly Distribution</b>
Inception to May, 2006	\$0.100	\$1.20	-
June, 2006 to May, 2007	\$0.105	\$1.26	5.0%
June, 2007 to May, 2008	\$0.110	\$1.32	4.8%
June, 2008 to May 2009	\$0.115	\$1.38	4.5%
June, 2009 to date	\$0.115	\$1.38	-

The payout ratio<sup>(1)</sup> of cash distributed to distributable cash<sup>(1)</sup> is intended to average 100% per annum. Since the Fund pays even monthly distributions when it's underlying cash flow from the Partnership is subject to seasonal fluctuations (as experienced by SIR), there are times during the year when the payout ratio may exceed or be lower than 100%. For the 3- and 6-month periods ended June 30, 2010, the payout ratio<sup>(1)</sup> was 98.4% and 101.4%, respectively. For the 3- and 6-month periods ended June 30, 2009 the payout ratio<sup>(1)</sup> was 97.5% and 102.8%, respectively. The payout ratio since the Fund's inception up to and including Q2 2010 is 98.7%. The Trustees continue to review the appropriateness of distributions on an on-going basis.

The following table provides disclosure regarding the relationship between cash flows from operating activities and net income, and historical distributed cash amounts:

	<b>3-month period ended June 30, 2010</b>	<b>3-month period ended June 30, 2009</b>	<b>6-month period ended June 30, 2010</b>	<b>6-month period ended June 30, 2009</b>
	(in thousands of dollars)			
Cash provided by operating activities	1,848	1,848	3,696	3,696
Net earnings for the period	1,877	1,896	3,646	3,596
Cash distributed for the period	1,848	1,848	3,696	3,696
<b>Excess (shortfall) of cash provided by operating activities over cash distributed for the period<sup>(12)</sup></b>	-	-	-	-
<b>Excess (shortfall) of net earnings for the period over cash distributions paid<sup>(13)</sup></b>	<b>29</b>	<b>48</b>	<b>(50)</b>	<b>(100)</b>

### ***Balance Sheet***

The following table shows total assets and Unitholders' equity of the Fund:

<i>(in thousands of dollars)</i> <i>(unaudited)</i>	<b>June 30, 2010</b>	<b>March 31, 2010</b>	<b>December 31, 2009</b>	<b>September 30, 2009</b>	<b>June 30, 2009</b>	<b>March 31, 2009</b>	<b>December 31, 2008</b>	<b>September 30, 2008</b>
Total assets	52,280	52,254	52,383	52,550	52,730	52,505	52,660	52,691
Unitholders' equity	51,540	51,510	51,590	51,610	51,626	51,578	51,726	51,790

(1) See footnote (1) on page 2

(12) Excess (shortfall) of cash provided by operating activities over cash distributed for the period is calculated by subtracting the cash distributed for the period from cash provided by operating activities.

(13) Excess (shortfall) of net earnings for the period over cash distributions paid is calculated by subtracting cash distributed for the period from net earnings for the period.

**Results of Operations - Fund**

The Fund's revenue of \$2.0 million for the 3-month period ended June 30, 2010 (\$2.0 million for the 3-month period ended June 30, 2009) is comprised of distribution income from the Partnership of \$1.3 million (\$1.2 million for the 3-month period ended June 30, 2009) and interest income of \$0.8 million (\$0.8 million for the 3-month period ended June 30, 2009). Revenue of \$3.9 million for the 6-month period ended June 30, 2010 (\$3.8 million for the 6-month period ended June 30, 2009) is comprised of distribution income from the Partnership of \$2.4 million (\$2.3 million for the 6-month periods ended June 30, 2009) and interest income of \$1.5 million (\$1.5 million for the 6-month period ended June 30, 2009). Distribution income from the Partnership is the pro rata share of the residual distributions of the Partnership for the 3- and 6-month periods ended June 30, 2010 and June 30, 2009. Interest income is interest earned for the 3- and 6-month periods ended June 30, 2010 and June 30, 2009 from the \$40.0 million SIR Loan which bears interest at 7.5% per annum.

The Fund's operating expenses are limited to general and administration expenses and total \$0.1 million and \$0.2 million for the 3- and 6-month periods ended June 30, 2010, respectively (\$0.1 million and \$0.2 million for the 3- and 6-month periods ended June 30, 2009, respectively). These expenses include professional fees, directors' and officers' liability insurance premiums, Trustees' fees, certain public company costs and other administrative fees.

Net earnings were \$1.9 million and \$3.6 million for the 3- and 6-month periods ended June 30, 2010, respectively (\$1.9 million and \$3.6 million for the 3- and 6-month periods ended June 30, 2009, respectively). Earnings per Fund Unit on both a basic and diluted basis were \$0.35 and \$0.68 for the 3- and 6-month periods ended June 30, 2010, respectively (\$0.35 and \$0.67 for the 3- and 6-month periods ended June 30, 2009, respectively).

**Pooled Revenue**

The Fund is indirectly dependent on the amount of the Royalty paid by SIR to the Partnership. The amount of this Royalty is dependent on Pooled Revenue. Pooled Revenue is the revenue of the SIR Restaurants included in Royalty Pooled Restaurants. As at June 30, 2010, there were 45 restaurants included in Pooled Revenue. Increases or decreases in Pooled Revenue are derived from same store revenue growth or decline, and new or closed SIR Restaurants subject to the SIR Rights. Pooled Revenue is affected by the risks associated with the operations and financial condition of SIR, the commercial foodservice industry generally and the casual and fine dining segment of the commercial foodservice industry in particular. The following table sets out Pooled Revenue for the 3- and 6-month periods ended June 30, 2010 and June 30, 2009:

**Summary of Pooled Revenue**

*(in thousands of dollars except number of restaurants included in Pooled Revenue)*  
*(Unaudited)*

	3-month period ended June 30, 2010		3-month period ended June 30, 2009		6-month period ended June 30, 2010		6-month period ended June 30, 2009	
	Restaurants included in		Restaurants included in		Restaurants included in		Restaurants included in	
	Pooled Revenue	Pooled Revenue	Pooled Revenue	Pooled Revenue	Pooled Revenue	Pooled Revenue	Pooled Revenue	Pooled Revenue
Jack Astor's	36,043	29	34,788	29	67,976	29	65,062	29
Canyon Creek	6,550	8	6,601	8	13,470	8	13,504	8
Alice Fazooli's	5,089	5	4,920	5	9,642	5	9,251	5
Signature	3,382	3	3,318	3	7,516	3	7,302	3
<b>Total included in Pooled Revenue</b>	<b>51,064</b>	<b>45</b>	<b>49,627</b>	<b>45</b>	<b>98,604</b>	<b>45</b>	<b>95,119</b>	<b>45</b>

### *Liquidity and Capital Resources*

The Fund has no third party debt. SIR currently has the \$40 million SIR Loan owed to the Fund (which SIR can surrender its Class C GP Units as consideration for principal payments under the loan), certain debt related to U.S. operations which is recorded on the consolidated financial statements of SIR and a credit agreement with a Commercial Financing Company, a copy of which has been filed on SEDAR. The Credit Agreement is "permitted indebtedness" within the meaning of the agreements between the Fund, the Partnership and SIR, and as a result the Fund and the Partnership have, as contemplated in the existing agreements, subordinated and postponed their claims against SIR to the claims of the Commercial Financing Company. This subordination, which includes a subordination of the Partnership's rights under the License and Royalty Agreement between the Partnership and SIR whereby the Partnership licenses to SIR the right to use trade-marks and related intellectual property in return for royalty payments based on revenues, has been effected pursuant to the terms of the Subordination and Postponement Agreement, a copy of which has also been filed on SEDAR.

On November 13, 2009, SIR announced that it entered into a \$26.0 million new senior term debt facility ("Credit Agreement"). Part of the proceeds from this Credit Agreement was used to repay \$12.7 million outstanding on SIR's construction line. The remaining proceeds, as well as a portion of existing cash on hand, were used to repurchase 5,407,000 common shares of SIR from one shareholder of SIR, to acquire the rights to certain debts owed by U.S. S.I.R. L.L.C. from one shareholder of SIR and to pay professional fees and transaction costs related to these transactions. This facility has a 3 year term and a 10 year amortization. Interest is calculated as the greater of 7.80% per annum and the three-month Canadian dollar bankers' acceptance rate ("BA Rate") plus 7.55% per annum, which on May 9, 2010 was 8.18%. Certain financial covenants apply to SIR. The loan is secured by substantially all of the assets of SIR and most of its subsidiaries, which are also guarantors. The Partnership and the Fund did not guarantee the Credit Agreement. The Credit Agreement qualifies as "permitted indebtedness" within the meaning of the agreements between the Fund, the Partnership and SIR, and as a result the Fund and the Partnership have agreed to subordinate and postpone their claims against SIR to the claims of the new lender. The terms of this subordination are as contemplated in the existing agreements between the Fund, the Partnership and SIR. This subordination, which includes a subordination of the Partnership's rights under the License and Royalty Agreement between the Partnership and SIR whereby the Partnership licenses to SIR the right to use trade-marks and related intellectual property in return for royalty payments based on revenues, is anticipated to be effected pursuant to the terms of a Subordination and Postponement Agreement.

Under the Subordination and Postponement Agreement, absent a default or event of default under the Credit Agreement, ordinary payments to the Partnership and the Fund could continue. However, if a default or an event of default were to occur, then payments to the Fund and the Partnership could cease and the related rights of the Fund and the Partnership could be subject to a "standstill" obligation for a period of up to 120 days (which may be extended if the lender is pursuing remedies). The Subordination and Postponement Agreement also contains various other typical covenants of the Fund and the Partnership. In addition, SIR provided an undertaking to the Fund and the Partnership to restrict the amount of additional debt that SIR can incur without the consent of the Fund and the Partnership (which consent shall not be unreasonably withheld).

While SIR's new debt is significantly greater in amount and at a higher interest rate, SIR believes and has advised the Fund that it expects to be able to comply with the covenants under the new debt and service the new debt, as well as meet its other obligations. However, there can of course be no assurance of this. If SIR were to be unable to do so, this could have material adverse consequences on SIR and the Fund.

The Fund does not have bank lines of credit. The Fund therefore relies on the payments of the distributions from the Partnership and interest income from SIR to meet its obligations to pay the distributions. The Fund believes that the distributions from the Partnership and interest payments will be sufficient to meet its current distribution intentions, subject to seasonal fluctuations. However, the actual amounts distributed will depend upon numerous factors, including the payment of the distributions from the Partnership and interest by SIR, and could fluctuate based on performance. The Fund intends to maintain even distributions in order to reduce the effect of fluctuations in revenue and, if possible, allow the Fund to maintain consistent monthly distributions to Unitholders. Under the terms of the License and Royalty Agreement, SIR is required to pay the 6.0% Royalty to the Partnership 21 days after the end of the four-week period for which the Royalty is determined.

During the 3- and 6-month periods ended June 30, 2010, the Fund distributed \$1.8 million and \$3.7 million, respectively to Unitholders. Subsequent to June 30, 2010, distributions of \$0.6 million (\$0.115 per Unit) were declared and paid for the month of June 2010 and a distribution of \$0.6 million (\$0.115 per Unit) was declared for the month of July 2010.

The Fund did not have any capital expenditures in Q2 2010 and by its nature is not expected to have significant capital expenditures in the future. Capital expenditures related to Royalty Pooled Restaurants are borne at the operating company (SIR) level. The Fund's operating and administrative expenses are expected to be fairly stable and predictable and are considered to be in the ordinary course of business. However, during 2010, the Fund is anticipating incurring professional fees related to the implementation of International Financial Reporting Standards (IFRS) and a review of options related to the January 1, 2011 change in the tax treatment of the Fund's distributions to Unitholders.

Management currently believes that there are sufficient cash resources retained in the Partnership in order to meet its obligations and pay distributions to its Unitholders. The Fund intends to continue to pay monthly distributions at the current level for the near future. However, should the distributions from the Partnership decline, the Fund may have to reduce distributions.

While SIR is not owned by the Fund, the Fund's income is derived from interest income on the SIR Loan and distributions from the Partnership and accordingly, the Fund is economically dependent upon SIR. Credit risk arises from the potential default of SIR on the SIR Loan. Management monitors the SIR Loan for credit risk and to date a provision for uncollectible amounts has not been necessary. Information regarding SIR and its liquidity can be found in SIR's interim unaudited and annual audited consolidated financial statements and MD&A, which can be found on SEDAR under the Fund's listing named "Other". The most recent unaudited consolidated financial statements and MD&A for SIR's second quarter are listed having a filing date of June 23, 2010. The following table is an excerpt of the previous eight quarters of SIR's consolidated statement of cash flows information:

<i><b>SIR's Selected Consolidated Statement of Cash Flows Information</b></i> <sup>(14)</sup>	3 <sup>rd</sup> Quarter Ended May 9, 2010 (12 weeks)	2 <sup>nd</sup> Quarter Ended February 14, 2010 (12 weeks)	1 <sup>st</sup> Quarter Ended November 22, 2009 (12 weeks)	4 <sup>th</sup> Quarter Ended August 30, 2009* (16 weeks)	3 <sup>rd</sup> Quarter Ended May 10, 2009* (12 weeks)	2 <sup>nd</sup> Quarter Ended February 15, 2009* (12 weeks)	1 <sup>st</sup> Quarter Ended November 23, 2008* (12 weeks)	4 <sup>th</sup> Quarter Ended August 31, 2008* (17 weeks)
	(in thousands of dollars) (unaudited)							
<b>Net cash provided by operations</b>	1,617	732	2,903	3,838	3,385	2,280	2,454	3,368
<b>Net cash used in investing activities</b>	(290)	(215)	(418)	(339)	(999)	(1,788)	(4,303)	(9,910)
<b>Net cash provided by (used in) financing activities</b>	(540)	(830)	(4,240)	(241)	(177)	(13)	2,601	5,005
Increase (decrease) in cash and cash equivalents during the period	787	(314)	(1,756)	3,256	2,201	479	764	(1,536)
Cash and cash equivalents – Beginning of period	6,113	6,427	8,183	4,927	2,726	2,247	1,483	3,019
<b>Cash and cash equivalents – End of period</b>	<b>6,900</b>	<b>6,113</b>	<b>6,427</b>	<b>8,183</b>	<b>4,927</b>	<b>2,726</b>	<b>2,247</b>	<b>1,483</b>

\* Prior period balances reflect the retroactive application of the change in accounting policy for goodwill and intangible assets as described in SIR Corp.'s notes to the consolidated financial statements for the 12- and 36-week periods ended May 9, 2010. The capitalization of pre-opening costs is no longer permitted and therefore these costs are now reflected as an expense in the statements of operations and the related amortization has been removed. In addition, certain computer software costs have been reclassified from property and equipment to intangible and other assets.

## **Controls and Procedures**

As at December 31, 2009, an evaluation was carried out under the supervision of and with the participation of the SIR GP Inc. management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the Fund's disclosure controls and procedures. Based on that evaluation, the CEO and the CFO concluded that, to their knowledge, the design and operation of these disclosure controls and procedures were effective as at December 31, 2009 to provide reasonable assurance that material information relating to the Fund and its consolidated subsidiaries would be made known to them by others within those entities.

(14) Information presented is derived solely from documents filed with the Canadian securities regulatory authorities by SIR in its interim Q3 MD&A filed on June 23, 2010 and has not been approved by the Fund or its trustees, officers, SIR GP Inc., or SIR Holdings Trust, or their respective trustees, managing general partners, directors, or officers.

An evaluation was carried out under the supervision of and with management, including the CEO and CFO, of internal controls over financial reporting as at December 31, 2009. Based on this evaluation, the CEO and the CFO have concluded that, internal controls over financial reporting have been designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with GAAP.

There have not been any material changes to disclosure controls or internal controls over financial reporting during the 3- and 6-month periods ended June 30, 2010.

The Fund does not own, control or consolidate SIR and therefore, the Fund's disclosure controls and procedures and the internal controls over financial reporting do not encompass SIR or SIR's disclosure controls and procedures or SIR's internal controls over financial reporting.

### ***Off-Balance Sheet Arrangements***

The Fund does not have any off-balance sheet arrangements.

### ***Transactions with Related Parties***

During the 3- and 6-month periods ended June 30, 2010, the Fund earned distribution income of \$1.3 million and \$2.4 million, respectively from the Partnership (for the 3- and 6-month periods ended June 30, 2009 – \$1.2 million and \$2.3 million, respectively). The Fund, indirectly through the Trust, is entitled to receive a pro rata share of all residual distributions. The Fund's distribution income is dependent upon the revenue generated by the SIR Restaurants subject to the License and Royalty Agreement.

During the 3- and 6-month periods ended June 30, 2010, the Fund earned interest income of \$0.8 million and \$1.5 million, respectively from the SIR Loan (for the 3- and 6-month periods ended June 30, 2009 – \$0.8 million and \$1.5 million, respectively). A description of the terms of the SIR Loan is included in the notes to the unaudited consolidated financial statements of the Fund for the 3- and 6-month periods ended June 30, 2010 and June 30, 2009.

As at June 30, 2010, the Fund had amounts receivable from SIR of \$0.2 million (December 31, 2009 - \$0.2 million) and amounts receivable from the Partnership of \$0.9 million (December 31, 2009 - \$1.0 million). The amounts receivable from SIR consist mainly of interest owing to the Fund on the SIR Loan for the month of June. The amounts due from the Partnership represent distributions receivable of \$2.8 million (December 31, 2009 - \$2.6 million) partially offset by advances payable of \$1.9 million (December 31, 2009 - \$1.6 million). All advances were conducted as part of the normal course of business operations.

### ***Critical Accounting Estimates***

Management believes that there have been no substantial changes in the nature of the critical accounting estimates as described in the annual MD&A for the year ended December 31, 2009.

### ***Changes in Accounting Policies, Including Initial Adoption***

There were no changes in accounting policies having an impact on the disclosures in the Fund's consolidated financial statements for the 3- and 6-month periods ended June 30, 2010.

### ***Recently Issued Accounting Standards***

The Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1582, Business Combinations, CICA Handbook Section 1601, Consolidated Financial Statements, and CICA Handbook Section 1602, Non-Controlling Interest replace the former CICA Handbook Section 1581, Business Combinations and CICA Handbook Section 1600, Consolidated Financial Statements and establish a new section for accounting for a non-controlling interest in a subsidiary. These sections provide the Canadian equivalent to IFRS 3, Business Combinations and IAS 27, Consolidated and Separate Financial Statements. CICA Handbook 1582 is effective for the Fund for business combinations for which the acquisition date is on or after the reporting period beginning on or after January 1, 2011. CICA Handbook Section 1601 and CICA Handbook Section 1602 is effective for the Fund for interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011. Management has not yet determined the impact of the adoption of this change in its financial statements.

The CICA, in collaboration with the International Accounting Standards Board ("IASB"), plans to converge Canadian Generally Accepted Accounting Principles ("GAAP") with International Financial Reporting Standards ("IFRS") for all publicly accountable enterprises over a transition period expected to end in 2011. At this date, publicly accountable enterprises will be required to prepare financial statements in accordance with IFRS.

The Fund has commenced the process to transition from Canadian GAAP to IFRS. This changeover process involves three separate and distinct phases:

- 1 Diagnostic Phase – assessing the differences between Canadian GAAP and IFRS and focusing on the areas that will have the most significant impacts on the Fund;
- 2 Design Phase – resulting in the design and development of detailed solutions to address the differences identified during the Diagnostic Phase; and
- 3 Implementation Phase – implementing all of the required changes necessary for IFRS compliance.

#### *Diagnostic Phase*

A high level diagnostic review identifying major differences between Canadian GAAP and IFRS was completed during the fourth quarter of 2008. This diagnostic review indicated that the areas most likely to have a significant impact on the Fund include: the requirements of IFRS 1 dealing with first time adoption choices; the classification of Fund Units; and the accounting treatment of the Fund's investment in the Partnership. These areas will impact policies, procedures and financial statement disclosures as discussed in more detail below.

#### *Design Phase*

The design phase is currently underway and it involves analyzing all differences between IFRS and Canadian GAAP as well as assessing the impact on accounting policies, financial reporting, internal controls over financial reporting and disclosure controls, and developing systems and accounting policies to address all issues identified. Several IFRS standards are in the process of being amended by the IASB and amendments to existing standards are expected to continue until the transition date of January 1, 2011. The Fund monitors the IASB's activities on an ongoing basis, giving consideration to any proposed changes, where applicable, in its assessment of differences between IFRS and Canadian GAAP. Management is anticipating increased disclosures in the consolidated financial statements and these additional disclosure requirements are currently being assessed. However, since all potential changes to IFRS that will be effective as at December 31, 2011 are not yet known, any conclusions drawn at this point in time must be considered preliminary.

#### *Implementation Phase*

The implementation phase involves the execution of the changes in accounting policies and the compilation of IFRS interim and annual financial statements for 2011. On implementation of IFRS, the Fund is anticipating that there will be changes in accounting policies and that these changes could significantly impact the Fund's consolidated statement of earnings and statement of cash flows. As mentioned above, the IASB continues to work through accounting issues that are expected to result in new accounting pronouncements. As a result, the IFRS at the transition date is expected to be different from its current form. The final impact of IFRS on the Fund's consolidated financial statements can only be determined once all applicable standards are known on the conversion date.

Upon assessing the areas that had the most significant differences between Canadian GAAP and IFRS, the following were determined to have the most significant impact on the Fund's accounting policies and financial reporting upon converting to IFRS.

#### *Classification of Fund Units*

Under Canadian GAAP, the Fund's Units are classified as equity and the monthly distributions on these Units flow through Unitholders' Equity. IFRS describes a financial liability as a contractual obligation to deliver cash or another financial asset. The Fund Units are redeemable and therefore an obligation to deliver cash or another financial asset exists and the Fund Units may be required to be classified as a liability unless the Fund Units meet the criteria of a puttable instrument in which case, the Fund Units would be classified as equity in the financial statements. If the Fund Units are determined to be a liability under IFRS, the units would be marked to market and the difference between the historical value and the current market value (at the reporting date) would flow through the statement of earnings. The distributions to the Fund's Unitholders would be classified as an expense also on the statement of earnings. The Fund continues to review its legal documents with its professional advisors to determine the appropriate accounting for the Fund Units under IFRS.

*The accounting treatment of the Fund's investment in the Partnership*

Under Canadian GAAP, a variable interest entity ("VIE") is consolidated with the "primary beneficiary". The Partnership, identified as a VIE, falls under these rules and its primary beneficiary is determined to be SIR and accordingly, the Partnership is consolidated with SIR. Under IFRS, there are no variable interests rules, but rather, the rules for consolidation are based on "control". Control is the ability to direct or dominate an entity's ability to make decisions, regardless of whether this power is exercised. As a result of the difference in the basis for consolidation, the consolidation process may change and the Partnership may be consolidated with the Fund (rather than SIR) under IFRS. The Fund continues to review its legal documents with its professional advisors to determine the appropriate accounting for the investment in the Partnership under IFRS.

The Fund continues to analyze the impact on its consolidated financial statements, systems and internal control over financial reporting and intends to complete this analysis during fiscal 2010. The Fund will continue to invest in training and resources where necessary throughout the transition period to facilitate a timely conversion.

***Financial Instruments***

There have been no changes in the Fund's financial instruments for the 3- and 6-month periods ended June 30, 2010. Financial instruments are described in the Fund's MD&A for the year ended December 31, 2009.

***Disclosure of Outstanding Unit Data***

The following summarizes the ownership structure of the Fund as at August 9, 2010 and June 30, 2010:

	<b>August 9, 2010</b>		<b>June 30, 2010</b>	
	<b>Number of</b>	<b>Amount</b>	<b>Number of</b>	<b>Amount</b>
	<b>Fund Units</b>	<b>\$</b>	<b>Fund Units</b>	<b>\$</b>
Units issued	5,356,667	51,166,670	5,356,667	51,166,670

***Risks and Uncertainties***

The performance of the Fund is directly dependent upon the interest payments the Fund receives from SIR under the SIR Loan and upon the Royalty received by the Partnership from SIR. The amount of the Royalty is dependent upon Pooled Revenue, which is subject to a number of factors that affect the restaurant industry generally and the casual and/or fine dining sectors of this industry in particular. The restaurant industry generally and, in particular, the casual and fine dining segment of the industry, is intensely competitive with respect to price, service, location, food quality and qualified staff. There are many well-established competitors with greater financial and other resources than SIR. Competitors include national and regional chains, as well as individually owned restaurants. Recently, competition has increased in the mid-price, full service, casual and fine dining sectors in which many of the SIR Restaurants operate. Some of SIR's competitors have been in existence for a substantially longer period than SIR and may be better established in the markets where SIR Restaurants are or may be located. If SIR is unable to successfully compete in the casual and fine dining sectors of the restaurant industry, Pooled Revenue may be adversely affected, the amount of the Royalty reduced and the ability of SIR to pay the Royalty or interest on the SIR Loan may be impaired. Please refer to the March 31, 2010 Annual Information Form for further discussion on risks and uncertainties related to the Fund and SIR.

The income of the Fund must be computed and will be taxed in accordance with Canadian tax laws. On June 22, 2007, Bill C-52, which significantly modifies the income tax rules applicable to certain publicly traded or listed trusts and partnerships, received Royal Assent. In particular, certain income of (and distributions made by) publicly listed flow-through entities ("FTE's"), will be taxed in a manner similar to income earned by (and distributions made by) a corporation and investors in the FTE would be taxed as though the distributions would be dividends. Because the Fund was publically traded or listed prior to November 1, 2006, it is not subject to these new rules until its 2011 taxation year, so long as the Fund meets the requirements for "normal growth". On December 15, 2006, the Federal Department of Finance released guidance regarding the amount of growth that FTE's are permitted to experience without jeopardizing its deferral of these new proposed taxation rules. The 2011 date will hold for those FTE's whose equity capital growth does not exceed the greater of \$50 million and the FTE's market capitalization as of the end of trading on October 31, 2006. As a result of these new rules, the Fund has a future income tax liability in their financial statements.

On March 12, 2009, Bill C-10 – Budget Implementation Act 2009, which further modifies the rules applicable to certain publically traded or listed trusts and partnerships, received Royal Assent. In particular, Bill C-10 provides rules to facilitate the conversion of an income trust into a corporation on a tax-deferred basis (the “Conversion Rules”). The Conversion Rules provide income trusts with tax efficient structuring options to convert to corporate form in advance of their 2011 taxation year – at which time most income trusts would become subject to a new entity-level tax based on corporate income tax rates. However, the new income tax rules under Bill C-52 do not require certain publicly traded or listed trusts and partnerships to convert into a corporation prior to December 31, 2010. The Fund does not have any current plans to convert to a corporation. As a result, assuming no material changes in the Fund’s financial performance from its current levels, the Fund would be expected to reduce its distributions from their then current levels by approximately 30% commencing January 2011. The Fund is anticipating incurring increased professional fees during 2010, as a result of considering the possible impact of the new rules and reviewing its options.

The new rules may adversely affect the value and marketability of the Fund’s Units and the ability to undertake financings, and at such time as the new rules apply to the Fund, the distributable cash of the Fund may be materially reduced. The new rules may, as a result, adversely affect the Fund and its Unitholders as well as SIR, as the holder of Partnership interests, and the Fund intends to continue to assess and plan for their expected impact. Changes may prove necessary to seek to adapt to any new tax laws with a view to attempting, where practicable, to minimize their overall adverse effects.

### ***Outlook***

The CRFA, in its 2010 – 2014 Long Term Foodservice Forecast estimated that sales in 2009, in the full service restaurant industry declined and Management believes that the weaker economic conditions experienced in 2009 were the primary driver of the Royalty Pooled Restaurants’ decline in SSS<sup>(2)</sup> in 2009. However, there were some positive signs in the fourth quarter of 2009 as Jack Astor’s posted a 0.4% SSSG<sup>(2)</sup> and the other concepts experienced their lowest declines of the year. In the first two quarters of 2010, all but one concept experienced SSSG<sup>(2)</sup>. The remaining concept, Canyon Creek, has remained fairly flat, still experiencing a decline in SSS<sup>(2)</sup> of 0.3%. For 2010, the CRFA is projecting a modest increase in sales.

During the first half of 2009, SIR limited its mass media advertising. However, by Q3 2009, SIR had advised the Fund that it would be returning to its regular advertising initiatives including mobile phone applications, print, television, on-line, and radio advertising. SIR has continued with its regular advertising initiatives in YTD 2010.

The Fund has commenced the process to transition from Canadian GAAP to IFRS. Upon assessing the areas that had the most significant differences between Canadian GAAP and IFRS, the areas that were determined to have the most significant impact on the Fund’s accounting policies and financial reporting upon converting to IFRS were the classification of Fund Units and the accounting treatment of the investment in the Partnership. The Fund continues to analyze the impact on its consolidated financial statements, systems and internal control over financial reporting and intends to complete this analysis during fiscal 2010. Please see the Recently Issued Accounting Standards section for more details.

On March 12, 2009, Bill C-10 – Budget Implementation Act 2009, which further modifies the rules applicable to certain publicly traded or listed trusts and partnerships, received Royal Assent. In particular, Bill C-10 provides rules to facilitate the conversion of an income trust into a corporation on a tax-deferred basis (the “Conversion Rules”). The Conversion Rules provide income trusts with tax efficient structuring options to convert to corporate form in advance of their 2011 taxation year – at which time most income trusts would become subject to a new entity-level tax based on corporate income tax rates. However, the new income tax rules under Bill C-52 do not require certain publicly traded or listed trusts and partnerships to convert into a corporation prior to December 31, 2010. The Fund does not have any current plans to convert to a corporation. As a result, assuming no material changes in the Fund’s financial performance from its current levels, the Fund would be expected to reduce its distributions from their then current levels by approximately 30% commencing January 2011. The Fund is anticipating incurring increased professional fees during 2010, as a result of considering the possible impact of the new rules and reviewing its options.

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(2) See footnote (2) on page 2



SIR currently has 45 restaurants open in Canada and since October 2004, the Fund's Initial Public Offering, SIR has opened fourteen new restaurants to date. Two Jack Astor's restaurants were opened in fiscal 2005, three Canyon Creek restaurants were opened in fiscal 2006, three Jack Astor's restaurants were opened in fiscal 2007, and five new Jack Astor's restaurants and a new Canyon Creek restaurant were opened in fiscal 2008. In 2009, SIR advised the Fund of its intention to slow its growth from its previously stated goal of reaching a total restaurant count of 68 restaurants by December 2010. No new restaurants were opened in fiscal 2009 but SIR has secured three additional sites. Construction began late in Q2 at a Jack Astor's in Boisbriand, Quebec and is scheduled to open in Q4 of this fiscal year. The remaining two new sites at the corner of Yonge and Gerrard Streets, in Toronto, Ontario are estimated to open in 2012. Given the current economic environment, SIR has determined the most prudent course of action is to reduce its growth plans and control its leverage. Additional sites will be considered when appropriate. SIR's Management is committed to maximizing the performance of all of its restaurants.

On January 1 of each year, Class B GP Units are converted into Class A GP Units for SIR Restaurants added to the Royalty Pooled Restaurants based on 80% of the Initial estimated revenues and the formula defined in the Partnership Agreement. Additional Class B GP Units may be converted into Class A GP Units in respect of these new SIR Restaurants if actual revenues of the new SIR Restaurants exceeded 80% of the initial estimated revenues and the formula defined in the Partnership Agreement. Conversely, converted Class A GP Units may be returned by SIR if the actual revenues of the new SIR Restaurants are less than 80% of the initial estimated revenues. In December of each year, an additional distribution will be payable to the Class B GP unitholders provided that actual revenues of the new SIR Restaurants exceed 80% of the initial estimated revenues, or there will be a reduction in the distributions to the Class A GP Unitholders if revenues are less than 80% of the initial estimated revenues. In December 2009, an additional distribution of \$0.3 million (2008 - \$0.2 million) was declared and paid in cash in January 2010.

On January 1, 2010, nil (2009 - six) new SIR Restaurants were added to and nil (2009 - nil) closed SIR Restaurants were removed from the Royalty Pooled Restaurants in accordance with the Partnership Agreement. As consideration for the additional Royalty associated with the addition of nil (2009 - six) new restaurants on January 1, 2010, as well as the second incremental adjustment for the six (2009 - three) new SIR Restaurants added to Royalty Pooled Restaurants on January 1, 2009, SIR converted a portion of its Class B GP Units into Class A GP Units based on the formula defined in the Partnership Agreement. The number of Class B GP Units that SIR converted to Class A GP Units was reduced by an adjustment for the closure of nil (2009 - nil) SIR Restaurants during the prior year. The net effect of these adjustments to Royalty Pooled Restaurants was that SIR converted 243,909 (2009 - 1,076,871) Class B GP Units into 243,909 (2009 - 1,076,871) Class A GP Units on January 1, 2010 at an estimated fair value of \$1.2 million (2009 - \$6.0 million).

As a result of not adding any new SIR Restaurants to Royalty Pooled Restaurants on January 1, 2010, there will not be an additional distribution declared in December 2010 or a second incremental adjustment on January 1, 2011.

### ***Forward Looking Information***

Statements in this report, including the information set forth as to the future financial or operating performance of the Fund or SIR, that are not current or historical factual statements may constitute “forward-looking” information within the meaning of securities laws. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Fund, the Trust, the Partnership, SIR, the SIR Restaurants, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. When used in this document, such statements may include, among other language, such words as “may”, “will”, “expect”, “believe”, “plan”, “anticipate”, “intend”, “estimate” and other similar terminology. These statements reflect Management’s current expectations, estimates and projections regarding future events and operating performance and speak only as of the date of this document. Readers should not place undue importance on forward-looking statements and should not rely upon this information as of any other date. These forward-looking statements involve a number of risks and uncertainties. The following are some of the factors that could cause actual results to differ materially from those expressed in or underlying such forward-looking statements: competition; changes in demographic trends; changing consumer preferences and discretionary spending patterns; changes in consumer confidence; changes in national and local business and economic conditions; changes in availability of credit; legal proceedings and challenges to intellectual property rights; dependence of the Fund on the financial condition of SIR; legislation and governmental regulation; accounting policies and practices; and the results of operations and financial condition of SIR. The foregoing list of factors is not exhaustive. Many of these issues can affect the Fund’s or SIR’s actual results and could cause their actual results to differ materially from those expressed or implied in any forward-looking statements made by, or on behalf of, the Fund or SIR. Readers are cautioned that forward-looking statements are not guarantees of future performance, and should not place undue reliance on them. The Fund and SIR expressly disclaim any obligation or undertaking to publicly release any updates or revisions to any forward-looking statements contained herein to reflect any change in expectations, estimates and projections with regard thereto or any changes in events, conditions or circumstances on which any statement is based, except as expressly required by law. This Management’s Discussion and Analysis is provided as of August 9, 2010.

In formulating the forward-looking statements contained herein, Management has assumed that business and economic conditions affecting SIR’s restaurants and the Fund will continue substantially in the ordinary course, including without limitation with respect to general industry conditions, general levels of economic activity (including in downtown Toronto), regulations (including those regarding employees, food safety, tobacco and alcohol), weather, taxes, foreign exchange rates and interest rates, that there will be no pandemics or other material outbreaks of disease or safety issues affecting humans or animals or food products, and that there will be no unplanned material changes in its facilities, equipment, customer and employee relations, or credit arrangements. These assumptions, although considered reasonable by Management at the time of preparation, may prove to be incorrect. In particular, Management has assumed the tax effects on distributions will remain consistent with current pronouncements. For more information concerning the Fund’s risks and uncertainties, please refer to the October 2004 final prospectus, and/or its March 31, 2010 Annual Information Form, all of which are available under the Fund’s profile at [www.sedar.com](http://www.sedar.com).

*Additional information related to the Fund, the Partnership and SIR can be found at [www.sedar.com](http://www.sedar.com) under SIR Royalty Income Fund and on SIR’s website at [www.sircorp.com](http://www.sircorp.com)*