# SIR Royalty Limited Partnership

Financial Statements
(Unaudited)
**For the three-month and nine-month periods ended September 30, 2010 and 2009**

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# SIR Royalty Limited Partnership

Balance Sheets

(Unaudited)

| | September 30, 2010 $ | December 31, 2009 $ |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | 794,901 | 823,813 |
| Prepaid expenses and other assets | - | 11,360 |
| Amounts due from related parties (note 6) | 364,614 | 338,289 |
| | 1,159,515 | 1,173,462 |
| **Intangible assets** (note 4) | 69,845,481 | 68,608,860 |
| | 71,004,996 | 69,782,322 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Accounts payable and accrued liabilities | 183,821 | 155,125 |
| Amounts due to related parties (note 6) | 975,684 | 1,018,327 |
| | 1,159,505 | 1,173,452 |
| **Partners' Interest** (note 5) | 69,845,491 | 68,608,870 |
| | 71,004,996 | 69,782,322 |

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

# SIR Royalty Limited Partnership
Statements of Earnings and Comprehensive Income
(Unaudited)

| | Three-month period ended September 30, 2010 $ | Three-month period ended September 30, 2009 $ | Nine-month period ended September 30, 2010 $ | Nine-month period ended September 30, 2009 $ |
|---|---|---|---|---|
| **Revenues** | | | | |
| Royalty income (notes 1 and 6) | 2,998,252 | 2,912,339 | 8,914,471 | 8,619,462 |
| Administration fee (note 6) | 6,000 | 6,000 | 18,000 | 18,000 |
| Other income | 1,348 | - | 1,348 | 3,265 |
| | 3,005,600 | 2,918,339 | 8,933,819 | 8,640,727 |
| **Expenses** | | | | |
| General and administrative | 32,705 | 30,649 | 82,679 | 104,035 |
| **Net earnings and comprehensive income for the period** | 2,972,895 | 2,887,690 | 8,851,140 | 8,536,692 |

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

# SIR Royalty Limited Partnership

Statements of Partners' Interest
(Unaudited)

**Nine-month period ended September 30, 2010**

| | **Number of units** (note 5) | **Balance January 1, 2010 $** | **Issued during the period $** (notes 4 and 5) | **Net earnings for the period $** | **Distributions $** | **Balance September 30, 2010 $** |
|---|---|---|---|---|---|---|
| Ordinary LP units | 1,116,666 | 7,633,570 | - | 3,550,271 | (3,550,271) | 7,633,570 |
| Ordinary GP units | 100 | 11 | - | 45 | (45) | 11 |
| Class A GP units | 2,969,324 | 20,975,288 | 1,236,621 | 3,050,815 | (3,050,815) | 22,211,909 |
| Class B GP units | 97,625,861 | 1 | - | 9 | (9) | 1 |
| Class C GP units | 4,000,000 | 40,000,000 | - | 2,250,000 | (2,250,000) | 40,000,000 |
| | | 68,608,870 | 1,236,621 | 8,851,140 | (8,851,140) | 69,845,491 |

**Nine-month period ended September 30, 2009**

| | **Number of units** (note 5) | **Balance January 1, 2009 $** | **Issued during the period $** (notes 4 and 5) | **Net earnings for the period $** | **Distributions $** | **Balance September 30, 2009 $** |
|---|---|---|---|---|---|---|
| Ordinary LP units | 1,116,666 | 7,633,570 | - | 3,524,945 | (3,524,945) | 7,633,570 |
| Ordinary GP units | 100 | 11 | - | 45 | (45) | 11 |
| Class A GP units | 2,725,415 | 15,002,811 | 5,972,477 | 2,761,693 | (2,761,693) | 20,975,288 |
| Class B GP units | 97,869,770 | 1 | - | 9 | (9) | 1 |
| Class C GP units | 4,000,000 | 40,000,000 | - | 2,250,000 | (2,250,000) | 40,000,000 |
| | | 62,636,393 | 5,972,477 | 8,536,692 | (8,536,692) | 68,608,870 |

**Three-month period ended September 30, 2010**

| | **Number of units** (note 5) | **Balance July 1, 2010 $** | **Net earnings for the period $** | **Distributions $** | **Balance September 30, 2010 $** |
|---|---|---|---|---|---|
| Ordinary LP units | 1,116,666 | 7,633,570 | 1,193,171 | (1,193,171) | 7,633,570 |
| Ordinary GP units | 100 | 11 | 15 | (15) | 11 |
| Class A GP units | 2,969,324 | 22,211,909 | 1,029,706 | (1,029,706) | 22,211,909 |
| Class B GP units | 97,625,861 | 1 | 3 | (3) | 1 |
| Class C GP units | 4,000,000 | 40,000,000 | 750,000 | (750,000) | 40,000,000 |
| | | 69,845,491 | 2,972,895 | (2,972,895) | 69,845,491 |

**Three-month period ended September 30, 2009**

| | **Number of units** (note 5) | **Balance July 1, 2009 $** | **Net earnings for the period $** | **Distributions $** | **Balance September 30, 2009 $** |
|---|---|---|---|---|---|
| Ordinary LP units | 1,116,666 | 7,633,570 | 1,205,477 | (1,205,477) | 7,633,570 |
| Ordinary GP units | 100 | 11 | 15 | (15) | 11 |
| Class A GP units | 2,725,415 | 20,975,288 | 932,195 | (932,195) | 20,975,288 |
| Class B GP units | 97,869,770 | 1 | 3 | (3) | 1 |
| Class C GP units | 4,000,000 | 40,000,000 | 750,000 | (750,000) | 40,000,000 |
| | | 68,608,870 | 2,887,690 | (2,887,690) | 68,608,870 |

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

# SIR Royalty Limited Partnership

Statements of Cash Flows
(Unaudited)

| | Three-month period ended September 30, 2010 $ | Three-month period ended September 30, 2009 $ | Nine-month period ended September 30, 2010 $ | Nine-month period ended September 30, 2009 $ |
|---|---|---|---|---|
| **Cash provided by (used in)** | | | | |
| **Operating activities** | | | | |
| Net earnings for the period | 2,972,895 | 2,887,690 | 8,851,140 | 8,536,692 |
| Net change in non-cash working capital items (note 8) | (178,416) | (436,303) | 45,902 | (73,429) |
| | 2,794,479 | 2,451,387 | 8,897,042 | 8,463,263 |
| **Financing activities** | | | | |
| Distributions paid | (2,872,469) | (2,788,321) | (8,925,954) | (8,608,595) |
| **Change in cash and cash equivalents** | (77,990) | (336,934) | (28,912) | (145,332) |
| **Cash and cash equivalents - Beginning of period** | 872,891 | 1,407,656 | 823,813 | 1,216,054 |
| **Cash and cash equivalents - End of period** | 794,901 | 1,070,722 | 794,901 | 1,070,722 |

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

## 1 Nature of operations, basis of presentation and seasonality

### Nature of operations

SIR Royalty Limited Partnership (the Partnership) is a limited partnership formed under the laws of the Province of Ontario.

On October 1, 2004, SIR Royalty Income Fund (the Fund) filed a final prospectus for a public offering of units of the Fund. The net proceeds of the offering to the Fund of $51,166,670 were used by the Fund to acquire, directly, certain bank debt of SIR Corp. (the SIR loan) and, indirectly, through SIR Holdings Trust (the Trust), all of the Ordinary LP units of the Partnership. The Partnership owns the Canadian trademarks (the SIR Rights) formerly owned or licensed by SIR Corp. (SIR) or its subsidiaries and used in connection with the operation of the majority of SIR's restaurants in Canada (the SIR restaurants). The Partnership has granted SIR a 99-year licence 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 revenues of the restaurants included in the Royalty Pooled Restaurants (the Licence and Royalty Agreement).

### Basis of presentation

The disclosures contained in these unaudited interim financial statements do not include all requirements of generally accepted accounting principles for annual financial statements and should be read in conjunction with the 2009 audited annual financial statements and notes thereto. The financial performance of the Partnership for the interim periods is not necessarily indicative of the results that may be expected for the full year due to the seasonality of the Partnership's business.

### Seasonality

The full-service restaurant sector of the Canadian food-service 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 can be open. Additionally, certain holidays and observances also affect dining patterns, both favourably and unfavourably. Accordingly, royalty income recognized by the Partnership will vary in conjunction with the seasonality in revenues experienced by SIR.

## 2 Summary of significant accounting policies

The Partnership prepares its financial statements in accordance with Canadian generally accepted accounting principles. The accounting policies as disclosed in these unaudited interim financial statements are consistent with those followed in the 2009 audited annual financial statements.

## 3 Recently issued accounting pronouncements

The Canadian Institute of Chartered Accountants (CICA) Handbook Sections 1582, Business Combinations, 1601, Consolidated Financial Statements, and 1602, Non-Controlling Interests, replace the former CICA Handbook Sections 1581, Business Combinations, and 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 International Financial Reporting Standard 3, Business Combinations, and International Accounting Standard 27, Consolidated and Separate Financial Statements. CICA Handbook Section 1582 is effective for the Partnership for business combinations for which the acquisition date is on or after the reporting period beginning on or after January 1, 2011. CICA Handbook Sections 1601 and 1602 are effective for the Partnership for interim and annual financial statements relating to years beginning on or after January 1, 2011. Management has not yet determined the impact of the adoption of these changes on its financial statements.

## 4 Intangible assets

| | Nine-month period ended September 30, 2010 $ | Year ended December 31, 2009 $ |
|---|---|---|
| SIR Rights - Beginning of period | 68,608,860 | 62,636,383 |
| Adjustment to Royalty Pooled Restaurants | 1,236,621 | 5,972,477 |
| SIR Rights - End of period | 69,845,481 | 68,608,860 |

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 (2008 - three) new SIR restaurants added to the Royalty Pooled Restaurants on January 1, 2009, SIR converted 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 into 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 the 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 $1,236,621 (2009 - $5,972,477) (note 5).

## 5 Partners' interest

The authorized and issued capital of the Partnership consists of the following:

| | | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|---|
| **Class of unit** | **Authorized** | **Issued** | **Amount $** | **Issued** | **Amount $** |
| Class A LP units | Unlimited | - | - | - | - |
| Class C LP units | Unlimited | - | - | - | - |
| Ordinary LP units | Unlimited | 1,116,666 | 7,633,570 | 1,116,666 | 7,633,570 |
| Ordinary GP units | Unlimited | 100 | 11 | 100 | 11 |
| Class A GP units (note 4) | Unlimited | 2,969,324 | 22,211,909 | 2,725,415 | 20,975,288 |
| Class B GP units | Unlimited | 97,625,861 | 1 | 97,869,770 | 1 |
| Class C GP units | Unlimited | 4,000,000 | 40,000,000 | 4,000,000 | 40,000,000 |
| | | | 69,845,491 | | 68,608,870 |

Generally, the Partnership units have no voting rights, except in certain specified conditions.

**Ordinary LP units and Ordinary GP units**

The holders of the Ordinary LP units are entitled to receive a pro rata share of all residual distributions. The holders of the Ordinary LP units have the right to receive distributions in priority to the Class A GP units described below.

The Ordinary GP units have the right to receive distributions of $5 per month in aggregate.

SIR GP Inc., a direct subsidiary of the Fund, holds 99 Ordinary GP units and is the Managing General Partner. SIR holds the remaining Ordinary GP units and is the General Partner. The Fund and SIR have an 80% and 20% interest in the common shares of SIR GP Inc., respectively.

SIR Holdings Trust, a direct subsidiary of the Fund, holds all of the issued Ordinary LP units.

**Class A and Class B GP units**

The holders of the Class A GP units are entitled to receive a pro rata share of all residual distributions and the Class A GP units are exchangeable into units of the Fund.

Class B GP units are convertible into Class A GP units based on a conversion formula defined in the Partnership Agreement for each new restaurant opened in the previous fiscal year. On dissolution of the Partnership, the Class B GP units are entitled to receive $10 in aggregate.

On January 1 of each year, Class B GP units are converted into Class A GP units for new 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 $336,594 (2008 - $177,888) 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 (2008 - three) new SIR Restaurants added to the Royalty Pooled Restaurants on January 1, 2009, SIR converted 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 into 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 the 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 $1,236,621 (2009 - $5,972,477).

As a result of not adding any new SIR Restaurants to the Royalty Pooled Restaurants on January 1, 2010, there will not be an additional distribution declared in December 2010 nor a second incremental adjustment on January 1, 2011.

Class A GP units and Class B GP units are held by SIR.

**Class C GP units**

The holders of Class C GP units are entitled to receive a cumulative preferential monthly cash distribution equal to $0.063 per Class C GP unit held, payable on the dates that distributions are paid on the units of the Fund.

SIR has the right to require the Fund to, indirectly, purchase the Class C GP units and assume a portion of the SIR loan as consideration for the acquisition of the Class C GP units.

**Class A and Class C LP units**

The Class A and Class C LP units have similar attributes to the Class A and Class C GP units.

## 6 Related party balances and transactions

| | September 30, 2010 $ | December 31, 2009 $ |
|---|---|---|
| **SIR Corp.** | | |
| Royalties receivable | 999,889 | 1,345,982 |
| Advances receivable | 72,491 | 31,053 |
| Distributions payable | (707,766) | (1,038,746) |
| Amounts receivable from SIR Corp. - net | 364,614 | 338,289 |
| **SIR Royalty Income Fund and its subsidiaries** | | |
| Advances receivable | 1,913,346 | 1,614,537 |
| Distributions payable | (2,889,030) | (2,632,864) |
| Amounts payable to SIR Royalty Income Fund and its subsidiaries - net | (975,684) | (1,018,327) |
| Amounts due to related parties - net | (611,070) | (680,038) |

Advances receivable from related parties are non-interest bearing and due on demand. All advances were conducted as part of the normal course of business operations.

During the three-month and nine-month periods ended September 30, 2010, the Partnership earned Royalty income of $2,998,252 and $8,914,471, respectively, from SIR (three-month and nine-month periods ended September 30, 2009 - $2,912,339 and $8,619,462, respectively). The Partnership's Royalty income is determined based on 6% of the revenues from certain SIR restaurants subject to the Licence and Royalty Agreement between the Partnership and SIR. SIR makes 13 Royalty payments based on SIR's 13 four- or five-week period fiscal year and, as such, timing of these Royalty payments can fluctuate depending on how the four- or five-week periods coincide with the Partnership's calendar fiscal year. Under the terms of the Licence and Royalty Agreement, SIR may be required to pay a Make-Whole Payment in respect of the reduction in revenues for restaurants closed during a reporting period. SIR is not required to pay any Make-Whole Payment in respect of a closed restaurant following the date on which the number of restaurants in the Royalty Pooled Restaurants is equal to or greater than 68 or following October 12, 2019, whichever occurs first. On January 1 of each year (the Adjustment Date), the restaurants subject to the Licence and Royalty Agreement are adjusted for new restaurants opened for at least 60 days preceding such Adjustment Date in the previous fiscal year. At each Adjustment Date, SIR will be entitled to convert its Class B GP units into Class A GP units based on the conversion formula defined in the Partnership Agreement (note 5).

The Partnership has entered into an arrangement with the Fund and the Trust whereby the Partnership will provide or arrange for the provision of services required in the administration of the Fund and the Trust. The Partnership has arranged for these services to be provided by SIR GP Inc. in its capacity as the Managing General Partner, or SIR as the General Partner. SIR, on behalf of SIR GP Inc., also provides services to the Partnership for its administration. For the nine-month periods ended September 30, 2010 and 2009, the Partnership provided these services to the Fund and the Trust for consideration of $18,000 (three-month periods ended September 30, 2010 and 2009 - $6,000), which was the amount of consideration agreed to by the related parties.

## 7 Economic dependence

The Partnership earns substantially all of its revenues from SIR; accordingly, the Partnership is economically dependent upon SIR.

On November 13, 2009, SIR announced that it entered into a $26,000,000 new senior term debt facility (New Credit Agreement). Part of the proceeds from the New Credit Agreement was used to repay $12,740,000 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.

The New Credit Agreement has a three-year term with a ten-year amortization. Interest will be calculated as the greater of 7.80% per annum and the three-month Canadian dollar banker’s acceptance rate plus 7.55% per annum. 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 New Credit Agreement. The New 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 Licence and Royalty Agreement between the Partnership and SIR whereby the Partnership licenses to SIR the right to use trademarks and related intellectual property in return for royalty payments based on revenues, is 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 New Credit Agreement, ordinary payments to the Fund and the Partnership 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 the additional debt that SIR can incur without the consent of the Fund and the Partnership (which consent shall not be unreasonably withheld).

## 8 Net change in non-cash working capital items

Net change in non-cash working capital items comprises:

| | Three-month period ended September 30, 2010 $ | Three-month period ended September 30, 2009 $ | Nine-month period ended September 30, 2010 $ | Nine-month period ended September 30, 2009 $ |
|---|---|---|---|---|
| Prepaid expenses and other assets | 4,823 | 11,533 | 11,360 | 34,223 |
| Amounts due from related parties | (200,178) | (185,505) | 304,655 | 148,946 |
| Accounts payable and accrued liabilities | 70,144 | (9,595) | 28,696 | 11,712 |
| Amounts due to related parties | (53,205) | (252,736) | (298,809) | (268,310) |
| | (178,416) | (436,303) | 45,902 | (73,429) |