



## **SIR CORP.**

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

**FOR THE 12 AND 36-WEEK PERIODS ENDED MAY 8, 2011**

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**TABLE OF CONTENTS**

|                                                        | <b>Page</b> |
|--------------------------------------------------------|-------------|
| Executive Summary                                      | 3           |
| Overview                                               | 4           |
| Seasonality                                            | 4           |
| Selected Consolidated Historical Financial Information | 5           |
| Results of Operations                                  | 6           |
| SIR Royalty Income Fund                                | 9           |
| Liquidity and Capital Resources                        | 11          |
| Contractual Obligations                                | 13          |
| Off-Balance Sheet Arrangements                         | 14          |
| Transactions with Related Parties                      | 14          |
| Discontinued Operation                                 | 15          |
| Critical Accounting Estimates                          | 16          |
| Recently Issued Accounting Pronouncements              | 16          |
| Financial Instruments                                  | 16          |
| Risks and Uncertainties                                | 17          |
| Outlook                                                | 17          |
| Forward Looking Information                            | 18          |

FOR THE 12 AND 36-WEEK PERIODS ENDED MAY 8, 2011

**Executive Summary**

SIR Corp.'s ("SIR's") third quarter of fiscal 2011 ("Q3") was from February 14, 2011 to May 8, 2011 inclusive. Highlights for SIR's third quarter include:

- **Consolidated revenue and Same Store Sales<sup>(1)</sup> ("SSS") (unaudited):**
  - Food and beverage revenue from corporate restaurant operations for Q3 was \$48.0 million and \$138.9 million year to date ("YTD"). This represents a \$1.4 million or 3.1% increase over the prior year for the quarter and a \$2.8 million or 2.0% increase over the prior year for YTD.
  - SIR experienced same store sales growth<sup>(1)</sup> ("SSSG") of 1.0% and 0.4% for the 12-week and 36-week periods ended May 8, 2011, respectively.
  - SIR's flagship Concept Restaurant brand, Jack Astor's<sup>®</sup>, that generates approximately 68% of YTD Pooled Revenue, had SSSG<sup>(1)</sup> of 1.1% and 0.7% for Q3 and YTD, respectively. Canyon Creek<sup>®</sup> had SSSG<sup>(1)</sup> of 4.3% and 1.4% for Q3 and YTD, respectively. Alice Fazooli's<sup>®</sup> had SSS<sup>(1)</sup> declines of 7.9% and 6.0% for Q3 and YTD, respectively. The downtown Signature Restaurants had SSSG<sup>(1)</sup> of 5.4% and 4.1% for Q3 and YTD, respectively.

**Investment in new and existing restaurants**

- During Q1, on October 25, 2010, SIR opened a new Jack Astor's restaurant in Boisbriand, Quebec. This restaurant was added to the Royalty Pooled Restaurants effective January 1, 2011.
- During Q2, SIR assumed a lease in London, Ontario, where two restaurants previously operated. SIR converted this site into a Jack Astor's that opened on May 2, 2011.
- SIR has secured two additional sites, at one location, at the corner of Yonge and Gerrard Streets in Toronto, Ontario, with expected opening dates in fiscal year 2013. SIR has also recently secured an additional site in Pickering, Ontario and expects to open a new Jack Astor's in the next fiscal year.
- SIR completed one renovation, during Q1, at the Alice Fazooli's located in Richmond Hill, Ontario
- During Q4 of Fiscal 2010, SIR completed renovations at the Jack Astor's in Brampton, Ontario and the Jack Astor's on Wellington Road South in London, Ontario.
- **Net Earnings (Loss)**
  - The net loss from continuing operations for Q3 of \$0.2 million is \$0.7 million unfavourable to the same period in the prior year.
  - The YTD net loss from continuing operations of \$2.4 million is \$2.8 million unfavourable to the same period in the prior year.
  - The unfavourable variances compared to the same periods in the prior year can be partly attributed to the following:
    - higher corporate costs, including higher salary and bonus expenses and higher consulting costs incurred related to manager development and branding initiatives;
    - higher costs of restaurant operations relative to revenue, mainly attributable to the opening of the two new Jack Astor's restaurants in Q1 and Q3;
    - higher labour costs, primarily due to the increase in the minimum wage in Q3 of fiscal 2010, and;
    - higher interest expense compared to the prior year because of the new increased debt that was obtained near the end of Q1 of fiscal 2010.

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<sup>(1)</sup> Same store sales includes revenue from all SIR restaurants except for those restaurants that were not open for the entire comparable periods in fiscal 2011 and fiscal 2010. The U.S. restaurant is not part of SSS. Same store sales growth ("SSSG") is the percentage increase in SSS over the prior comparable period. SSS and SSSG are non-GAAP measures that do not have standardized meanings prescribed by GAAP. However, SIR believes that SSS and SSSG are useful measures and provide investors with an indication of the change in year-over-year sales. SIR'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. Please refer to the reconciliation of consolidated revenue to SSS on page 6 and to the definition of SSS in the Revenue section on page 8.

- **Adjusted EBITDA<sup>(2)</sup>**
  - Adjusted EBITDA<sup>(2)</sup> for Q3 is \$4.3 million and \$4.4 million in the current and prior period, respectively.
  - YTD adjusted EBITDA<sup>(2)</sup> is \$10.5 million and \$11.8 million in the current and prior period, respectively.
- **Outlook**
  - While the economy is showing some signs of improvement, SIR remains cautious as it believes that the economic conditions may continue to impact its sales and profit prospects in the near future.
  - SIR continues to focus on sustaining and growing existing restaurant sales and profits while managing costs. SIR continues to carefully monitor the current economic environment and is considering new restaurant growth and renovations. In addition to the three restaurant sites already secured, new restaurant sites will be considered when appropriate and will be subject to raising acceptable long-term financing.

## **Overview**

SIR is a private company amalgamated under the Business Corporations Act of Ontario. As at May 8, 2011, SIR operates 47 Concept and Signature Restaurants in Canada (in Ontario, Quebec, Alberta and Nova Scotia). The Concept Restaurants are Jack Astor's, Canyon Creek and Alice Fazooli's. The Signature Restaurants are *reds*<sup>®</sup>, Far Niente<sup>®</sup>/FOUR<sup>®</sup>/Petit Four<sup>™</sup>, and the Loose Moose Tap & Grill<sup>®</sup>. As at May 8, 2011, 46 SIR Restaurants were included in SIR Royalty Pooled Restaurants.

SIR owns 100% of all its Canadian restaurants. SIR also has an investment in one Jack Astor's restaurant in the USA which is not included in Royalty Pooled Restaurants. SIR is currently seeking a buyer for this restaurant (See Discontinued Operation).

The new Jack Astor's in Boisbriand, Quebec, that opened on October 25, 2010 was added to the Royalty Pooled Restaurants on January 1, 2011. The new Jack Astor's restaurant in London, Ontario will be added to Royalty Pooled Restaurants on January 1, 2012.

On October 1, 2004, the SIR Royalty Income Fund (the "Fund") filed a final prospectus for a public Offering of Units of the Fund and the Offering closed on October 12, 2004. The net proceeds of the Offering of \$51.2 million were used by the Fund to acquire the SIR Loan and indirectly, through the SIR Holdings Trust (the "Trust"), the SIR Rights owned or licensed by SIR or its subsidiaries and used in connection with the operation of SIR's restaurants in Canada. In 2004, the Partnership 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 Partnership also issued its own securities to SIR in return for the SIR Rights acquired.

SIR's fiscal year is comprised of 52 or 53-week periods ending on the last Sunday in August. Fiscal quarters of SIR consist of accounting periods of 12, 12, 12 and 16 (or 17) weeks, respectively. The fiscal years for 2011 and 2010 consist of 52 weeks each.

## **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 on the last Sunday in August) when patios can be open. Certain holidays and observances also affect dining patterns both favourably and unfavourably.

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<sup>(2)</sup> References to EBITDA are to SIR's net earnings (loss) from continuing operations for the period before provision for (recovery of) income taxes, other expense (income) - net, provision for (recovery of) impairment of loans and advances, provision for long-lived assets, goodwill impairment, interest expense-net, unrealized foreign exchange (gain) loss, interest on loan payable to SIR Royalty Income Fund, non-controlling interest in SIR Royalty Limited Partnership, other amortization and amortization of restaurant assets. References to Adjusted EBITDA are to SIR's EBITDA plus pre-opening costs. Pre-opening costs are added back to EBITDA because Management views these costs as investments in new restaurants and not as on-going costs of operations. Management believes that, in addition to net earnings or loss, EBITDA and Adjusted EBITDA are useful supplemental measures in evaluating SIR's performance. EBITDA and Adjusted EBITDA are not financial measures recognized by Canadian generally accepted accounting principles ("GAAP") and do not have a standardized meaning prescribed by GAAP. Management cautions investors that EBITDA and Adjusted EBITDA should not replace net earnings or loss or cash flows from operating, investing and financing activities (as determined in accordance with GAAP), as an indicator of SIR's performance. SIR's method of calculating EBITDA and Adjusted EBITDA may differ from the methods used by other issuers. Therefore, SIR's EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. Please refer to the reconciliation of net earnings (loss) for the period to EBITDA and Adjusted EBITDA on page 6 of this document.

***Selected Consolidated Historical Financial Information***

The following tables set out selected financial information of SIR for the 12-week and 36-week periods ended May 8, 2011 and May 9, 2010, respectively. The unaudited consolidated financial statements of SIR are prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are presented in Canadian dollars. This information should be read in conjunction with the annual audited consolidated financial statements of SIR, including the notes thereto.

| <b><i>Statements of Operations</i></b>                               | 12-Week                                  | 12-Week                       | 36-Week                     | 36-Week                       |
|----------------------------------------------------------------------|------------------------------------------|-------------------------------|-----------------------------|-------------------------------|
|                                                                      | Period Ended<br>May 8, 2011              | Period Ended<br>May 9, 2010** | Period Ended<br>May 8, 2011 | Period Ended<br>May 9, 2010** |
|                                                                      | (in thousands of dollars)<br>(unaudited) |                               |                             |                               |
| <b>Corporate restaurant operations:</b>                              |                                          |                               |                             |                               |
| Food and beverage revenue                                            | 47,962                                   | 46,522                        | 138,867                     | 136,111                       |
| Cost of corporate restaurant operations                              | 43,259                                   | 41,458                        | 126,508                     | 122,847                       |
| <b>Earnings from corporate restaurant operations</b>                 | <b>4,703</b>                             | <b>5,064</b>                  | <b>12,359</b>               | <b>13,264</b>                 |
| <b>Net earnings (loss) from continuing operations for the period</b> | <b>(229)</b>                             | <b>492</b>                    | <b>(2,413)</b>              | <b>370</b>                    |
| <b>Net earnings (loss) for the period</b>                            | <b>(271)</b>                             | <b>452</b>                    | <b>(2,576)</b>              | <b>302</b>                    |

\*\* Prior period balances reflect the reclassification of the discontinued operation (see Discontinued Operation).

| <b><i>Balance Sheet</i></b> | May 8, 2011                              | August 29, 2010 |
|-----------------------------|------------------------------------------|-----------------|
|                             | (in thousands of dollars)<br>(unaudited) |                 |
| Total assets                | 64,142                                   | 67,566          |
| Total long-term liabilities | 77,334                                   | 77,865          |

***EBITDA<sup>(2)</sup> and Adjusted EBITDA<sup>(2)</sup>***

EBITDA<sup>(2)</sup> and Adjusted EBITDA<sup>(2)</sup> are non-GAAP measures used by SIR to supplement its reporting of net earnings (loss) and net cash flow. EBITDA<sup>(2)</sup> and Adjusted EBITDA<sup>(2)</sup> consist of net earnings (loss) from continuing operations for the period excluding certain non-cash expenses and other expenses that SIR considers not to be of an operating nature. SIR believes that EBITDA<sup>(2)</sup> and Adjusted EBITDA<sup>(2)</sup> are useful estimates of the core business' contribution to cash flow from operations and uses this measure as a supplemental measure of SIR's performance. Similarly, SIR believes that certain investors may also find this non-GAAP measure to be a useful measure for their independent evaluation of SIR's performance.

<sup>(2)</sup> See footnote <sup>(2)</sup> on page 4

The following table reconciles net earnings (loss) for the period to EBITDA<sup>(2)</sup> and Adjusted EBITDA<sup>(2)</sup>:

| Reconciliation of net earnings (loss) for the period to EBITDA <sup>(2)</sup> and Adjusted EBITDA <sup>(2)</sup>                                       | 12-Week                                  | 12-Week                       | 36-Week                     | 36-Week                       |
|--------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------|-------------------------------|-----------------------------|-------------------------------|
|                                                                                                                                                        | Period Ended<br>May 8, 2011              | Period Ended<br>May 9, 2010** | Period Ended<br>May 8, 2011 | Period Ended<br>May 9, 2010** |
|                                                                                                                                                        | (in thousands of dollars)<br>(unaudited) |                               |                             |                               |
| Net earnings (loss) from continuing operations for the period                                                                                          | (229)                                    | 492                           | (2,413)                     | 370                           |
| Add (deduct):                                                                                                                                          |                                          |                               |                             |                               |
| Provision for (recovery of) income taxes                                                                                                               | 19                                       | 10                            | 7                           | (33)                          |
| Other income - net                                                                                                                                     | (32)                                     | (83)                          | (101)                       | (328)                         |
| Recovery of impairment of loans and advances                                                                                                           | (100)                                    | (300)                         | (300)                       | (500)                         |
| Interest expense – net                                                                                                                                 | 532                                      | 548                           | 1,623                       | 1,424                         |
| Interest on loan payable to SIR Royalty Income Fund                                                                                                    | 690                                      | 690                           | 2,071                       | 2,071                         |
| Non-controlling interest in SIR Royalty Limited Partnership                                                                                            | 1,153                                    | 1,109                         | 3,291                       | 2,988                         |
| Other amortization                                                                                                                                     | 63                                       | 63                            | 191                         | 193                           |
| Amortization of restaurant assets                                                                                                                      | 1,723                                    | 1,742                         | 5,233                       | 5,335                         |
| <b>EBITDA<sup>(2)</sup></b>                                                                                                                            | <b>3,819</b>                             | <b>4,271</b>                  | <b>9,602</b>                | <b>11,520</b>                 |
| Pre-opening costs                                                                                                                                      | 439                                      | 93                            | 896                         | 239                           |
| <b>Adjusted EBITDA<sup>(2)</sup></b>                                                                                                                   | <b>4,258</b>                             | <b>4,364</b>                  | <b>10,498</b>               | <b>11,759</b>                 |
| Income from Class A & B GP Units of the Partnership <sup>(3)</sup><br>(Not included in EBITDA <sup>(2)</sup> and Adjusted EBITDA <sup>(2)</sup> above) | 1,017                                    | 979                           | 2,868                       | 3,064                         |
| 6% Royalty obligations under License and Royalty Agreement <sup>(4)</sup>                                                                              | 2,870                                    | 2,792                         | 8,278                       | 8,167                         |

\*\* Prior period balances reflect the reclassification of the discontinued operation (see Discontinued Operation).

## Results of Operations

| Reconciliation of Revenue from Consolidated Financial Statements to Pooled Revenue | 12-Week                                  | 12-Week                       | 36-Week                     | 36-Week                       |
|------------------------------------------------------------------------------------|------------------------------------------|-------------------------------|-----------------------------|-------------------------------|
|                                                                                    | Period Ended<br>May 8, 2011              | Period Ended<br>May 9, 2010** | Period Ended<br>May 8, 2011 | Period Ended<br>May 9, 2010** |
|                                                                                    | (in thousands of dollars)<br>(unaudited) |                               |                             |                               |
| Revenue reported in consolidated financial statements                              | 47,962                                   | 46,522                        | 138,867                     | 136,111                       |
| Less: Revenue from corporate restaurant operations excluded from the Royalty Pool  | (124)                                    | -                             | (892)                       | -                             |
| <b>Revenue for Restaurants in the Royalty pool</b>                                 | <b>47,838</b>                            | <b>46,522</b>                 | <b>137,975</b>              | <b>136,111</b>                |

\*\* Prior period balances reflect the reclassification of the discontinued operation (see Discontinued Operation).

| Reconciliation of Revenue from Consolidated Financial Statements to Same Store Sales <sup>(1)</sup> | 12-Week                                  | 12-Week                       | 36-Week                     | 36-Week                       |
|-----------------------------------------------------------------------------------------------------|------------------------------------------|-------------------------------|-----------------------------|-------------------------------|
|                                                                                                     | Period Ended<br>May 8, 2011              | Period Ended<br>May 9, 2010** | Period Ended<br>May 8, 2011 | Period Ended<br>May 9, 2010** |
|                                                                                                     | (in thousands of dollars)<br>(unaudited) |                               |                             |                               |
| Revenue reported in consolidated financial statements                                               | 47,962                                   | 46,522                        | 138,867                     | 136,111                       |
| Less: Revenue from corporate restaurant operations excluded from same store sales <sup>(1)</sup>    | (982)                                    | -                             | (2,164)                     | -                             |
| <b>Same store sales<sup>(1)</sup></b>                                                               | <b>46,980</b>                            | <b>46,522</b>                 | <b>136,703</b>              | <b>136,111</b>                |

\*\* Prior period balances reflect the reclassification of the discontinued operation (see Discontinued Operation).

<sup>(1)</sup> See footnote <sup>(1)</sup> on page 3

<sup>(2)</sup> See footnote <sup>(2)</sup> on page 4

<sup>(3)</sup> The 36-week periods ended May 8, 2011 and May 9, 2010 include the additional distribution paid to Class B GP Unitholders in December of each year, if any.

<sup>(4)</sup> See the SIR Royalty Income Fund section of this document for the Royalty calculation. Pooled Revenue includes revenue from all restaurants included in Royalty Pooled Restaurants. On January 1<sup>st</sup> of each year, New Additional Restaurants are added and New Closed Restaurants are removed from Royalty Pooled Restaurants. Royalty obligations equal 6% of Pooled Revenue plus any Make-Whole Payments.

**SIR CORP.**  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**

| Same Store Sales <sup>(1)</sup> by Segment | 12-Week<br>Period Ended<br>May 8, 2011   | 12-Week<br>Period Ended<br>May 9, 2010 | %<br>Fav. /<br>(Unfav.) | 36-Week<br>Period Ended<br>May 8, 2011 | 36-Week<br>Period Ended<br>May 9, 2010 | %<br>Fav. /<br>(Unfav.) |
|--------------------------------------------|------------------------------------------|----------------------------------------|-------------------------|----------------------------------------|----------------------------------------|-------------------------|
|                                            | (in thousands of dollars)<br>(unaudited) |                                        |                         |                                        |                                        |                         |
| Jack Astor's                               | 32,277                                   | 31,936                                 | 1.1%                    | 92,464                                 | 91,824                                 | 0.7%                    |
| Canyon Creek                               | 6,534                                    | 6,265                                  | 4.3%                    | 20,203                                 | 19,915                                 | 1.4%                    |
| Alice Fazooli's                            | 4,154                                    | 4,511                                  | (7.9%)                  | 12,438                                 | 13,235                                 | (6.0%)                  |
| Signature Restaurants                      | 4,015                                    | 3,810                                  | 5.4%                    | 11,598                                 | 11,137                                 | 4.1%                    |
| <b>Same store sales<sup>(1)</sup></b>      | <b>46,980</b>                            | <b>46,522</b>                          | <b>1.0%</b>             | <b>136,703</b>                         | <b>136,111</b>                         | <b>0.4%</b>             |

**Summary of Quarterly Results**

| Statement of Operations                                              | 3 <sup>rd</sup> Quarter<br>Ended<br>May 8,<br>2011<br>(12 weeks) | 2 <sup>nd</sup> Quarter<br>Ended<br>February 13,<br>2011**<br>(12 weeks) | 1 <sup>st</sup> Quarter<br>Ended<br>November 21,<br>2010**<br>(12 weeks) | 4 <sup>th</sup> Quarter<br>Ended<br>August 29,<br>2010**<br>(16 weeks) | 3 <sup>rd</sup> Quarter<br>Ended<br>May 9,<br>2010**<br>(12 weeks) | 2 <sup>nd</sup> Quarter<br>Ended<br>February 14,<br>2010**<br>(12 weeks) | 1 <sup>st</sup> Quarter<br>Ended<br>November 22,<br>2009**<br>(12 weeks) | 4 <sup>th</sup> Quarter<br>Ended<br>August 30,<br>2009**<br>(16 weeks) |
|----------------------------------------------------------------------|------------------------------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------|------------------------------------------------------------------------|--------------------------------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------|------------------------------------------------------------------------|
|                                                                      | (in thousands of dollars)<br>(unaudited)                         |                                                                          |                                                                          |                                                                        |                                                                    |                                                                          |                                                                          |                                                                        |
| <b>Corporate Restaurant Operations</b>                               |                                                                  |                                                                          |                                                                          |                                                                        |                                                                    |                                                                          |                                                                          |                                                                        |
| Food and beverage revenue                                            | 47,962                                                           | 46,100                                                                   | 44,805                                                                   | 62,207                                                                 | 46,522                                                             | 45,613                                                                   | 43,976                                                                   | 60,516                                                                 |
| Cost of corporate restaurant operations                              | 43,259                                                           | 41,523                                                                   | 41,726                                                                   | 56,424                                                                 | 41,458                                                             | 41,049                                                                   | 40,340                                                                   | 54,342                                                                 |
| <b>Earnings from corporate restaurant operations</b>                 | <b>4,703</b>                                                     | <b>4,577</b>                                                             | <b>3,079</b>                                                             | <b>5,783</b>                                                           | <b>5,064</b>                                                       | <b>4,564</b>                                                             | <b>3,636</b>                                                             | <b>6,174</b>                                                           |
| <b>Net earnings (loss) from continuing operations for the period</b> | <b>(229)</b>                                                     | <b>(208)</b>                                                             | <b>(1,976)</b>                                                           | <b>(151)</b>                                                           | <b>492</b>                                                         | <b>500</b>                                                               | <b>(622)</b>                                                             | <b>972</b>                                                             |
| <b>Net earnings (loss) for the period</b>                            | <b>(271)</b>                                                     | <b>(267)</b>                                                             | <b>(2,038)</b>                                                           | <b>(291)</b>                                                           | <b>452</b>                                                         | <b>472</b>                                                               | <b>(622)</b>                                                             | <b>984</b>                                                             |

\*\* Prior period balances reflect the reclassification of the discontinued operation (see Discontinued Operation)

**Selected Unaudited Consolidated Statement of Cash Flows Information**

| Selected Unaudited Consolidated Statement of Cash Flows Information | 3 <sup>rd</sup> Quarter<br>Ended<br>May 8,<br>2011<br>(12 weeks) | 2 <sup>nd</sup> Quarter<br>Ended<br>February 13,<br>2011**<br>(12 weeks) | 1 <sup>st</sup> Quarter<br>Ended<br>November 21,<br>2010**<br>(12 weeks) | 4 <sup>th</sup> Quarter<br>Ended<br>August 29,<br>2010**<br>(16 weeks) | 3 <sup>rd</sup> Quarter<br>Ended<br>May 9,<br>2010**<br>(12 weeks) | 2 <sup>nd</sup> Quarter<br>Ended<br>February 14,<br>2010**<br>(12 weeks) | 1 <sup>st</sup> Quarter<br>Ended<br>November 22,<br>2009**<br>(12 weeks) | 4 <sup>th</sup> Quarter<br>Ended<br>August 30,<br>2009**<br>(16 weeks) |
|---------------------------------------------------------------------|------------------------------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------|------------------------------------------------------------------------|--------------------------------------------------------------------|--------------------------------------------------------------------------|--------------------------------------------------------------------------|------------------------------------------------------------------------|
|                                                                     | (in thousands of dollars)<br>(unaudited)                         |                                                                          |                                                                          |                                                                        |                                                                    |                                                                          |                                                                          |                                                                        |
| <b>Net cash provided by (used in) continuing operations</b>         | 2,074                                                            | 808                                                                      | (1,765)                                                                  | 4,755                                                                  | 1,641                                                              | 751                                                                      | 2,879                                                                    | 3,875                                                                  |
| <b>Net cash used in continuing investing activities</b>             | (915)                                                            | (1,366)                                                                  | (1,685)                                                                  | (1,279)                                                                | (287)                                                              | (205)                                                                    | (395)                                                                    | (324)                                                                  |
| <b>Net cash used in continuing financing activities</b>             | (532)                                                            | (435)                                                                    | (438)                                                                    | (678)                                                                  | (502)                                                              | (792)                                                                    | (4,203)                                                                  | (203)                                                                  |
| Increase (decrease) in cash and cash equivalents during the period  | 552                                                              | (1,050)                                                                  | (4,086)                                                                  | 2,746                                                                  | 786                                                                | (314)                                                                    | (1,763)                                                                  | 3,308                                                                  |
| Cash and cash equivalents – Beginning of period                     | 4,450                                                            | 5,500                                                                    | 9,586                                                                    | 6,840                                                                  | 6,054                                                              | 6,368                                                                    | 8,131                                                                    | 4,823                                                                  |
| <b>Cash and cash equivalents – End of period</b>                    | <b>5,002</b>                                                     | <b>4,450</b>                                                             | <b>5,500</b>                                                             | <b>9,586</b>                                                           | <b>6,840</b>                                                       | <b>6,054</b>                                                             | <b>6,368</b>                                                             | <b>8,131</b>                                                           |

\*\* Prior period balances reflect the reclassification of the discontinued operation (see Discontinued Operation)

<sup>(1)</sup> See footnote <sup>(1)</sup> on page 3

### **Revenue**

There are a number of references to different revenue groupings used in the unaudited consolidated financial statements, the notes to the unaudited consolidated financial statements and the Management's Discussion and Analysis ("MD&A"). The following definitions are provided for greater clarification of these groupings:

- i. Revenue (per the SIR unaudited consolidated statements of operations) – this is the total consolidated revenue of all restaurants for the period. The restaurants include all SIR restaurants, except the U.S. Jack Astor's restaurant, which has been reclassified as a discontinued operation (see Discontinued Operation). For the 12-week and 36-week periods ended May 8, 2011, this revenue was \$48.0 million and \$138.9 million, respectively.
- ii. Same Store Sales<sup>(1)</sup> – this is a sub-set of i above used for tracking comparable year-over-year sales. For Q3 fiscal 2011 and 2010, SSS<sup>(1)</sup> includes all SIR Restaurants except the Jack Astor's in Boisbriand, Quebec, and the new Jack Astor's in London, Ontario because they were not open for the entire comparable period in fiscal 2010. The U.S. restaurant is not part of SIR Restaurants. For the 12-week and 36-week periods ended May 8, 2011, this revenue was \$47.0 million and \$136.7 million, respectively.
- iii. Pooled Revenue – this is the revenue subject to the License and Royalty Agreement – this includes revenue from all Royalty Pooled Restaurants. The Royalty Pooled Restaurants are adjusted on January 1<sup>st</sup> of each year for New Additional Restaurants and New Closed Restaurants. Currently, there are 46 Royalty Pooled Restaurants. For the 12-week and 36-week periods ended May 8, 2011, Pooled Revenue was \$47.8 million and \$138.0 million, respectively. The applicable Royalty payable to the Partnership on the Pooled Revenue for these same periods was \$2.9 million and \$8.3 million, respectively.

### **Same Store Sales<sup>(1)</sup>**

SIR had a SSSG<sup>(1)</sup> of 1.0% for the 12-week period ended May 8, 2011 and SSSG<sup>(1)</sup> of 0.4% for the 36-week period ended May 8, 2011. Year to date sales have been negatively affected by the more severe weather, in southern Ontario, in Q2 and early Q3 of fiscal 2011 compared to Q2 and early Q3 of fiscal 2010. In addition, Q2 and Q3 of fiscal 2010 benefited from the increased guest traffic, to watch events on television, during the Winter Olympics in that year. Jack Astor's, SIR's flagship Concept Restaurant brand, which generates approximately 68% of YTD Pooled Revenue, experienced a SSSG<sup>(1)</sup> of 1.1% and 0.7% for the 12-week and 36-week periods ended May 8, 2011, respectively. Canyon Creek had SSSG of 4.3% and 1.4% for the 12-week and 36-week periods ended May 8, 2011, respectively, while Alice Fazooli's experienced a SSS<sup>(1)</sup> decline of 7.9% and 6.0% for the 12-week and 36-week periods ended May 8, 2011, respectively. Contributing to the decline in YTD SSS<sup>(1)</sup> for Alice Fazooli's is the closure of the Alice Fazooli's in Richmond Hill for 11 days, for renovations, during Q1. In addition, Alice Fazooli's sales in the prior year were supported by aggressive discounting. The strategy in 2011 has been to reduce Alice Fazooli's discounting in favour of attracting guests through improved menu and feature beverage offerings. Management believes this is an appropriate long-term strategy for Alice Fazooli's, but in the short term, it is resulting in lower top-line revenues. The downtown Toronto Signature Restaurants had SSSG<sup>(1)</sup> of 5.4% and 4.1% during the 12-week and 36-week periods ended May 8, 2011.

Management believes that the current economic conditions and uncertainties are still having some effect on SIR's revenue. The Canadian Restaurant and Foodservices Association ("CRFA"), in its 2011 – 2015 Long Term Foodservice Forecast is forecasting that sales in calendar year 2011, in the full service restaurant industry, will have a modest increase. However, SIR remains cautious and continues to monitor the economy and consumer confidence.

### **Cost of Corporate Restaurant Operations**

As a percentage of revenue, costs of corporate restaurant operations for the 12-week and 36-week periods ended May 8, 2011 was 90.2% and 91.1%, respectively compared to 89.1% and 90.3% for the 12-week and 36-week periods ended May 9, 2010, respectively. Labour costs in the current year are the main driver of increases in costs of corporate restaurant operations over the prior year and are mainly attributable to the minimum wage increase in Q3 of fiscal 2010. The Q3 and YTD costs of restaurant operations are also negatively affected by the high labour and direct costs of restaurant operations in Q1 and Q3 associated with the opening of the two new Jack Astor's in Boisbriand, Quebec and London, Ontario, including year to date pre-opening costs of \$0.9 million. Higher operating costs and pre-opening expenses are typical of a new restaurant opening.

### **Corporate costs**

Corporate costs increased \$0.07 million and \$0.9 million for the 12-week and 36-week periods ended May 8, 2011 compared to the 12-week and 36-week periods ended May 9, 2010. The increases are mainly the result of higher salary and bonus costs and higher professional consulting fees incurred for manager development and branding initiatives.

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<sup>(1)</sup> See footnote <sup>(1)</sup> on page 3



***Interest expense - net***

Interest expense increased \$0.2 million for the 36-week period ended May 8, 2011 compared to the 36-week period ended May 9, 2010. A new credit facility was obtained near the end of Q1 of fiscal 2010 and therefore long-term debt and the related interest rates were higher during Q1 of fiscal 2011 compared to the prior year, resulting in higher YTD interest costs. The interest expense for Q3 of fiscal 2011 is relatively flat compared to the interest expense for Q3 of fiscal 2010.

***SIR Loan & non-controlling interest in SIR Royalty Limited Partnership***

On October 12, 2004, the Fund completed its initial public offering and used the proceeds to acquire the SIR Loan and invest in the Ordinary LP Units of the Partnership. In accordance with AcG-15, SIR has consolidated the Partnership and accordingly, the Fund's interest in the Partnership has been recorded as non-controlling interest.

Interest on the SIR Loan totalled \$0.7 million and \$2.1 million for both the 12-week and 36-week periods ended May 8, 2011 and the 12-week and 36-week periods ended May 9, 2010, respectively.

The Fund's share of the income of the Partnership for the 12-week and 36-week periods ended May 8, 2011 was \$1.2 million and \$3.3 million (12-week and 36-week periods ended May 9, 2010 - \$1.1 million and \$3.0 million) and has been recorded as non-controlling interest in the unaudited consolidated statements of operations.

***Recovery of impairment of loans and advances***

Prior to fiscal 2008, advances were made to U.S. S.I.R. L.L.C. and its subsidiaries to facilitate ongoing operations and the closure of certain restaurant operations. These advances are non-interest bearing, non-secured and due on demand. SIR has determined that these advances are impaired based on estimated future cash flows of the remaining U.S. operations. Accordingly, the loan and advances receivable are written down to their net realizable value of \$1.5 million, resulting in a recovery of the impairment of loans and advances of \$0.1 million and \$0.3 million for the 12-week and 36-week periods ended May 8, 2011, respectively (\$0.3 million and \$0.5 million in the 12-week and 36-week periods ended May 9, 2010, respectively). During the 12-week and 36-week periods ended May 8, 2011 \$Nil and \$0.3 million of these advances were repaid to SIR, respectively (\$0.2 million and \$0.4 million for the 12-week and 36-week periods ended May 9, 2010, respectively). While SIR has no obligation to fund the U.S. operations, it may do so if it considers that it would be in the interest of SIR; subject to the restrictions contained in its arrangements with the Fund (see Liquidity and Capital Resources section).

***EBITDA<sup>(2)</sup> and Adjusted EBITDA<sup>(2)</sup>***

EBITDA<sup>(2)</sup> is \$3.8 million and \$9.6 million for the 12-week and 36-week periods ended May 8, 2011, respectively and \$4.3 million and \$11.5 million for the 12-week and 36-week periods ended May 9, 2010, respectively. Adjusted EBITDA<sup>(2)</sup> is \$4.3 million and \$10.5 million for the 12-week and 36-week periods ended May 8, 2011, respectively and \$4.4 million and \$11.8 million for the 12-week and 36-week periods ended May 9, 2010, respectively. (See Selected Consolidated Historical Financial Information - Reconciliation of net earnings (loss) for the period to EBITDA<sup>(2)</sup> and Adjusted EBITDA<sup>(2)</sup>)

***SIR Royalty Income Fund***

The following is a summary of the accounting implications of the SIR Loan and non-controlling interest of the Partnership:

***(a) SIR Loan***

The \$40.0 million SIR Loan bears interest at 7.5% per annum and is due October 12, 2044. On November 13, 2009, the Fund entered into an agreement to subordinate and postpone its claims against SIR in favour of the new senior lender. The Partnership and the Fund have not guaranteed the credit facility (see Liquidity and Capital Resources section).

The debt 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 senior lender. 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 the trademarks 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.

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<sup>(2)</sup> See footnote <sup>(2)</sup> on page 4

Under the Subordination and Postponement Agreement, absent a default or event of default under the new credit facility, ordinary payments to the Partnership and the Fund can continue and the Partnership can exercise any and all of its rights to preserve the trademarks and related intellectual property governed by the License and Royalty Agreement. 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 senior lender is pursuing remedies). The Subordination and Postponement Agreement also contains various other typical covenants of the Fund and the Partnership.

Interest expense on the SIR Loan of \$0.7 million and \$2.1 million was charged to the unaudited consolidated statements of operations for the 12-week and 36-week periods ended May 8, 2011 (\$0.7 million and \$2.1 million for the 12-week and 36-week periods ended May 9, 2010, respectively).

SIR has the right to require the Fund to, indirectly, purchase their Class C GP Units of the Partnership and assume a portion of the SIR Loan as consideration for the acquisition of the Class C GP Units.

Financing costs of \$4.8 million incurred in fiscal 2005 in respect of the issuance of the SIR Loan and Partnership Units have been deferred and are being amortized over 40 years, the term of the SIR Loan, using the effective interest rate method. Amortization of \$0.006 million and \$0.02 million has been recorded as interest expense in the unaudited consolidated statements of operations for the 12-week and 36-week periods ended May 8, 2011 (\$0.005 million and \$0.02 million for the 12-week and 36-week periods ended May 9, 2010). The financing costs are netted against the SIR Loan in the unaudited consolidated financial statements.

*(b) Non-controlling interest in SIR Royalty Limited Partnership*

|                                                                                      | 12-Week<br>Period Ended<br>May 8, 2011   | 12-Week<br>Period Ended<br>May 9, 2010 | 36-Week<br>Period Ended<br>May 8, 2011 | 36-Week<br>Period Ended<br>May 9, 2010 |
|--------------------------------------------------------------------------------------|------------------------------------------|----------------------------------------|----------------------------------------|----------------------------------------|
|                                                                                      | (in thousands of dollars)<br>(unaudited) |                                        |                                        |                                        |
| Initial investment by the Fund                                                       | 11,167                                   | 11,167                                 | 11,167                                 | 11,167                                 |
| Non-controlling interest in earnings of the Partnership                              | 1,153                                    | 1,109                                  | 3,291                                  | 2,988                                  |
| Distributions declared on the Partnership units held by the non-controlling interest | (1,153)                                  | (1,109)                                | (3,291)                                | (2,988)                                |
| Non-controlling interest in the Partnership                                          | 11,167                                   | 11,167                                 | 11,167                                 | 11,167                                 |
| Pooled Revenue <sup>(5)</sup>                                                        | 47,838                                   | 46,522                                 | 137,975                                | 136,111                                |
| Partnership royalty income <sup>(6)</sup>                                            | 2,870                                    | 2,792                                  | 8,278                                  | 8,167                                  |
| Other income                                                                         | 8                                        | 6                                      | 23                                     | 17                                     |
| Partnership expenses                                                                 | (18)                                     | (20)                                   | (71)                                   | (61)                                   |
| Net earnings of the Partnership                                                      | 2,860                                    | 2,778                                  | 8,230                                  | 8,123                                  |
| SIR's interest in the earnings of the Partnership:                                   |                                          |                                        |                                        |                                        |
| Income from Class A & B GP Units of the Partnership                                  | (1,017)                                  | (979)                                  | (2,868)                                | (3,064)                                |
| Income from Class C GP Units of the Partnership                                      | (690)                                    | (690)                                  | (2,071)                                | (2,071)                                |
|                                                                                      | (1,707)                                  | (1,669)                                | (4,939)                                | (5,135)                                |
| Non-controlling interest in the Partnership                                          | 1,153                                    | 1,109                                  | 3,291                                  | 2,988                                  |

On October 12, 2004, the Partnership issued Ordinary LP and GP Units to the Fund for cash consideration of \$11.2 million. The holders of the Ordinary LP Units and the Class A GP Units, which are held by SIR, are entitled to receive their pro rata share of all residual distributions of the Partnership and the Class A GP Units are exchangeable into Units of the Fund.

In 2004, the Partnership 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").

<sup>(5)</sup> Includes revenue from the SIR Restaurants subject to the License and Royalty Agreement and excludes revenue from JACL. The Partnership owns 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.

<sup>(6)</sup> 6% of Pooled Revenue plus a Make-Whole Payment for closed locations, if applicable, included in Royalty Pooled Restaurants.

Under the terms of the License and Royalty Agreement, SIR may be required to pay a Make-Whole Payment in respect of the reduction in revenues for restaurants permanently closed during a reporting period. SIR is not required to pay any Make-Whole Payments in respect of a permanently closed restaurant following the date on which the number of 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 License and Royalty Agreement are adjusted for new SIR Restaurants opened for at least 60 days preceding such Adjustment Date. At each Adjustment Date, SIR will be entitled to convert its Class B GP Units to Class A GP Units based on the formula defined in the Partnership Agreement. Additional Class B GP Units may be converted to 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 may be payable to the Class B GP unitholders based on actual revenues of the new SIR Restaurants exceeding 80% of the initial estimated revenues or there may be a reduction in the distributions to the Class A GP unitholders if revenues are less than 80% of the initial estimated revenues.

On January 1, 2011, one (January 1, 2010 - nil) 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 one (January 1, 2010 - nil) new restaurants on January 1, 2011, as well as the Second Incremental Adjustment for the nil (January 1, 2009 - six) new SIR restaurants added to Royalty Pooled Restaurants on January 1, 2010, SIR converted its Class B GP Units into Class A GP Units based on the formula defined in the Partnership Agreement. The effect of these adjustments to the Royalty Pooled Restaurants was that SIR converted 137,000 (January 1, 2010 - 244,000) Class B GP Units into 137,000 (January 1, 2010 - 244,000) Class A GP Units on January 1, 2011 at an estimated fair value of \$1.4 million (January 1, 2010 - \$1.2 million). As a result of this exchange, SIR's interest in the Partnership increased to 36.7% effective January 1, 2011. In addition, the revenues of six new SIR Restaurants added to Royalty Pooled Restaurants on January 1, 2009 exceeded 80% of the Initial Adjustment's estimated revenues and, as a result, an Additional Distribution of \$0.3 million was declared in December 2009 and paid in cash the following January. There was no Additional Distribution declared in December 2010 because no new SIR Restaurants were added to Royalty Pooled Restaurants on January 1, 2010.

(c) *Amounts due to the Fund* – (see Transactions with the SIR Royalty Income Fund in the Transactions with Related Parties section)

### ***Liquidity and Capital Resources***

#### ***Selected Consolidated Statement of Cash Flows Information***

|                                                                    | 12-Week<br>Period Ended<br>May 8, 2011  | 12-Week<br>Period Ended<br>May 9, 2010** | 36-Week<br>Period Ended<br>May 8, 2011 | 36-Week<br>Period Ended<br>May 9, 2010** |
|--------------------------------------------------------------------|-----------------------------------------|------------------------------------------|----------------------------------------|------------------------------------------|
|                                                                    | (in thousand of dollars)<br>(unaudited) |                                          |                                        |                                          |
| Net cash provided by continuing operations                         | 2,074                                   | 1,641                                    | 1,117                                  | 5,271                                    |
| Net cash used in continuing investing activities                   | (915)                                   | (287)                                    | (3,966)                                | (887)                                    |
| Net cash used in continuing financing activities                   | (532)                                   | (502)                                    | (1,405)                                | (5,497)                                  |
| Increase (decrease) in cash and cash equivalents during the period | 552                                     | 786                                      | (4,584)                                | (1,291)                                  |
| Cash and cash equivalents – Beginning of period                    | 4,450                                   | 6,054                                    | 9,586                                  | 8,131                                    |
| Cash and cash equivalents – End of period                          | 5,002                                   | 6,840                                    | 5,002                                  | 6,840                                    |

\*\* Prior period balances reflect the reclassification of the discontinued operation (see Discontinued Operation).

Net cash provided by (used in) operating activities from continuing operations increased by \$0.4 million and decreased \$4.2 million for the 12-week and 36-week periods ended May 8, 2011 as compared to the 12-week and 36-week periods ended May 9, 2010. There was an unfavourable change in the net earnings/loss of \$0.7 million and \$2.8 million in the 12-week and 36-week periods ended May 8, 2011 compared to the same periods of the prior year. In Q3 of fiscal 2011, this change in net earnings/loss was offset by an increase in net change in working capital items of \$0.8 million. However, there was a decrease in net change in working capital items for the 36-week period ended May 8, 2011 of \$1.6 million. The change in working capital is mainly due to the timing of payments.

Net cash used in continuing investing activities was \$0.9 million and \$0.3 million for the 12-week periods ended May 8, 2011 and May 9, 2010, respectively. Net cash used in investing activities was \$4.0 million and \$0.9 million for the 36-week periods ended May 8, 2011 and May 9, 2010, respectively. Purchases of property and equipment amounted to \$0.9 million and \$0.4 million for the 12-week periods ended May 8, 2011 and May 9, 2010, respectively and \$4.3 million and \$1.0 million for the 36-week periods ended May 8, 2011 and May 9, 2010, respectively. The majority of the capital expenditures in the current year relate to construction costs incurred for the new Jack Astor's that opened in Boisbriand, Quebec, in Q1, 2011, the new Jack Astor's in London, Ontario, that opened in Q3, 2011 and the renovation costs related to the Alice Fazooli's in Richmond Hill in Q1, 2011. There were no major construction projects in the same comparable period of the prior year.

During fiscal years 2005 to 2010, and Q1, Q2 and Q3 of fiscal 2011, SIR has purchased property and equipment, in its continuing operations, totalling approximately \$65.6 million. This represents investments in new restaurants, major renovations of existing restaurants, certain other profit enhancing initiatives (such as new patios and patio expansions) and maintenance capital expenditures. Management expects that these investments in new and existing restaurants and the profit enhancing initiatives will help position SIR to work through this period of weaker economic conditions.

During Q1 of fiscal 2010, SIR acquired the rights to certain debts owed by U.S. S.I.R. L.L.C. from one shareholder of SIR for \$0.3 million. In addition, during the 12-week and 36-week periods ended May 8, 2011, SIR received \$Nil and \$0.3 million, respectively (12 and 36-week periods ended May 9, 2010 - \$0.2 million and \$0.4 million, respectively) in payments on its loans and advances from U.S. S.I.R. L.L.C. and its subsidiaries.

Net cash used in continuing financing activities was \$0.5 million and \$1.4 million for the 12-week and 36-week periods ended May 8, 2011, respectively. Net cash used in financing activities was \$0.5 million and \$5.5 million for the 12-week and 36-week periods ended May 9, 2010, respectively. Proceeds received from the credit facility obtained in Q1 of fiscal 2010 were \$26.0 million. These proceeds were used to repay \$12.7 million outstanding on the previous credit facility and to repurchase capital stock for \$16.8 million, including transaction costs paid of \$0.03 million. Principal repayments on long-term debt were \$0.5 million and \$1.2 million for the 12-week and 36-week periods ended May 8, 2011. Principal repayments on long-term debt were \$0.5 million and \$13.7 million, including the \$12.7 million repayment mentioned above, for the 12-week and 36-week periods ended May 9, 2010. Financing fees related to the current credit facility of \$1.1 million were paid during the 36-week period ended May 9, 2010.

The new Jack Astor's that opened in Boisbriand, Quebec, on October 25, 2010, was added to the Royalty Pooled Restaurants effective January 1, 2011. At that time, SIR received additional Class A GP Units in accordance with the formula for adjustment for the addition of restaurants added to Royalty Pooled Restaurants. Under the terms of the Exchange Agreement, SIR has the right to convert some or all of the net additional Class A GP Units into Fund Units on a one-for-one basis.

As of May 8, 2011, SIR had current assets related to continuing operations of \$12.8 million (August 29, 2010 - \$15.9 million) and current liabilities of \$27.4 million related to continuing operations (August 29, 2010 - \$27.5 million) resulting in a working capital deficit of \$14.6 million (August 29, 2010 - \$11.6 million). Revenues in the restaurant business are largely paid by cash and credit card whereas most suppliers offer credit terms for payment. Therefore, restaurants are able to pay their suppliers from the cash received on revenues in the following months, as the supplier payables are due. Cash balances are typically used to construct new restaurants or re-invest in existing restaurants to grow the business. As a result, SIR, like many other restaurant businesses would anticipate having a negative working capital balance in the foreseeable future.

Management believes that currently there are sufficient cash resources retained in SIR from its cash generated by operations to fund its working capital requirements.

During Q1 of fiscal 2010, on November 13, 2009, SIR entered into a Credit Agreement ("Credit Agreement") with a new senior lender, a copy of which is filed on SEDAR, to refinance its previous revolving line of credit and construction facility and to facilitate the repurchase of certain of its common shares. This new credit facility is a three-year facility for a maximum principal amount of \$26.0 million. Part of the proceeds from this facility was used to repay and replace the previous credit facilities of which \$12.7 million was outstanding. The remaining proceeds, as well as a portion of existing cash on hand, were used to repurchase 5.4 million common shares of SIR held by Ken Fowler Enterprises Limited ("KFEL") or its controlling shareholder Ken Fowler (representing approximately 35% of the shares 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 amount allocated to the share repurchase was \$16.8 million, including transaction costs of \$0.03 million. SIR also filed Articles of Amendment to authorize an unlimited number of Class S Special Shares. The Class S Special Shares have 1.0 million votes per share, are redeemable at the option of the holder for a redemption amount as defined in the Articles of Amendment and redeemable at the option of SIR, at any time following the third anniversary of the date of first issuance of any Class S Special Share, at the redemption amount. Following the repurchase of common shares, Peter Fowler Enterprises Limited ("PFEL") owns approximately 58% of the common shares of SIR.

Peter Fowler and PFEL have guaranteed SIR's obligations under the Credit Agreement and a guarantee fee of \$0.1 million and \$0.2 million was charged to the consolidated statement of operations for the 12-week and 36-week periods ended May 8, 2011 (\$nil and \$nil for the 12-week and 36-week periods ended May 9, 2010). SIR also issued warrants to Peter Fowler, which would, if exercised, represent a controlling voting interest in SIR. The warrants have an exercise price of \$1.00, expire on November 11, 2020 and can only be exercised upon an event of default by SIR with respect to the Credit Agreement. The warrants have also been pledged to the senior lender.

In addition, as part of this transaction, 0.8 million stock options with an exercise price of \$0.01 were forfeited by a shareholder of SIR.

The Credit Agreement provides for a maximum \$26.0 million senior term debt facility. This facility has a 3 year term and a 10 year amortization. Interest is the greater of 7.80% per annum and the three-month Canadian dollar bankers' acceptance rate plus 7.55% per annum, which on May 8, 2011 totalled 8.78%. Certain financial covenants apply to SIR, including a minimum fixed charge coverage ratio that SIR is in compliance with as at May 8, 2011. 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 have not guaranteed 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, as contemplated in the existing agreements, subordinated and postponed their claims against SIR to the claims of the new lender. The terms of the subordination are as contemplated in the previous agreements between the Fund, the Partnership and SIR. This subordination 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 trademarks and related intellectual property in return for royalty payments based on revenues and is effected pursuant to the terms of a Subordination and Postponement Agreement, a copy of which was filed on SEDAR. In addition, the original five year restrictions on repurchases of shares by SIR contained in the agreements between the Fund, the Partnership and SIR have expired.

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 are permitted. However, if a default or an event of default were to occur, then payments to the Fund and the Partnership are likely to cease and the related rights of the Fund and the Partnership will be subject to a "standstill" obligation for a period of up to 120 days (which may be extended if the senior 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).

As at May 8, 2011, SIR also had an obligation of \$0.09 million in capital lease arrangements. Amounts drawn on the above mentioned credit facility and capital lease arrangements are Permitted Indebtedness as defined in the SIR General Security Agreement and the Partnership General Security Agreement.

Management continues to monitor the economy and evaluate its potential impact on the Canadian business environment, particularly in relation to consumer confidence and unemployment rates. SIR believes that the economic conditions may continue to impact sales and profit prospects in the near future.

Certain loans were entered into by Jack Astor's Cary, LLC, a subsidiary of JACL, in fiscal year 2001 and are guaranteed by SIR. There is one loan remaining of \$0.9 million (U.S. \$1.0 million) and it is currently non-compliant with respect to certain financial and non-financial covenants. As a result, this loan is presented as a current liability in SIR's unaudited consolidated financial statements. All payments due on this loan have been made to date and the borrowers have not received any notices of default. The loan is secured by the assets of JACL and a pledge of the shares in JACL by SIR. SIR has plans to sell substantially all the assets Jack Astor's Cary, LLC and expects to receive sufficient proceeds to repay this loan (See Discontinued Operation).

### ***Contractual Obligations***

In 2004, the Partnership 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 restaurants included in Royalty Pooled Restaurants. Payment of the Royalty is secured by the Partnership General Security Agreement. On November 13, 2009, the Fund entered into an agreement to subordinate and postpone its claims against SIR in favour of the senior lender. The Partnership and the Fund have not guaranteed this credit facility (Please refer to SIR Royalty Income Fund section).

The security interest for all amounts payable by SIR to the Partnership under the License and Royalty Agreement, as set out in the Partnership General Security Agreement, is substantially the same as, and ranks equally with, the security interest granted by SIR to the Fund in respect of the SIR Loan. SIR consolidates the Partnership, and this transaction between SIR and the Partnership is eliminated in SIR's unaudited consolidated financial statements, however the obligation for payments remains.

Under the terms of the License and Royalty Agreement, SIR may be required to pay a Make-Whole Payment in respect of the reduction in revenue 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 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 License and Royalty Agreement are adjusted for new SIR restaurants opened for at least 60 days preceding such Adjustment Date. At each Adjustment Date, SIR will be entitled to convert its Class B GP Units to Class A GP Units based on a formula defined in the Partnership Agreement.

SIR and its subsidiaries have entered into operating leases relating to its head office and restaurant locations with minimum annual payments. SIR currently has two commitments to lease properties on which it plans to build three new restaurants. At the current date, SIR has not entered into any construction contracts for the three restaurants to be built, but expects to do so in the future. Final costs of construction are subject to uncertainties as to their amounts and timing. Such things as finalization of design and final construction quotations could change the total cost of these projects. SIR has entered into capital lease arrangements to lease restaurant equipment and as at May 8, 2011, SIR had an obligation of \$0.09 million. As at May 8, 2011, \$23.6 million was outstanding on SIR's current credit facility (see Liquidity and Capital Resources section).

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

SIR has off-balance sheet arrangements with respect to its operating leases. There have been no material changes in SIR's operating lease commitments since August 29, 2010. The reader will find this information in the annual MD&A for the year ended August 29, 2010.

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

SIR has entered into related party transactions with shareholders or companies controlled by shareholders of SIR and directors of SIR. The transactions are in the normal course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. Significant transactions with related parties include:

- Payment for operational services provided by two shareholders and directors of SIR in the amount of \$0.1 million and \$0.4 million for the 12-week and 36-week periods ended May 8, 2011 (\$0.1 million and \$0.4 million for the 12-week and 36-week periods ended May 9, 2010).
- Payment for design fees, charged to property and equipment, provided by one shareholder of SIR in the amount of \$0.1 million and \$0.4 million for the 12-week and 36-week periods ended May 8, 2011 (\$0.04 for both the 12-week and 36-week periods ended May 9, 2010).
- Payment for consulting fees provided by two shareholders and directors of SIR in the amount of \$0.03 million and \$0.08 million for the 12-week and 36-week periods ended May 8, 2011 (\$0.04 million and \$0.1 for the 12-week and 36-week periods ended May 9, 2010).
- Received repayment against loans and advances from a related company of \$nil and \$0.3 million for the 12-week and 36-week periods ended May 8, 2011 (\$0.2 million and \$0.4 million for the 12-week and 36-week periods ended May 9, 2010). SIR recognized interest income of \$0.04 million and \$0.1 million during the 12-week and 36-week periods ended May 8, 2011, respectively (\$0.04 million and \$0.1 million for the 12-week and 36-week periods ended May 9, 2010, respectively).
- Payment of a guarantee fee to one shareholder and director of SIR of which \$0.1 million and \$0.2 million was charged to the consolidated statement of operations for the 12-week and 36-week periods ended May 8, 2011 (\$nil for both the 12-week and 36-week periods ended May 9, 2010).

### ***Transactions with the SIR Royalty Income Fund***

Amounts due to (from) the Fund and its subsidiaries consist of:

|                                                | May 8, 2011               | August 29,<br>2010 |
|------------------------------------------------|---------------------------|--------------------|
|                                                | (in thousands of dollars) |                    |
|                                                | (unaudited)               |                    |
| Advances receivable                            | (1,934)                   | (1,987)            |
| Interest payable on SIR Loan                   | 310                       | 489                |
| Partnership distributions payable              | 2,939                     | 3,242              |
| Payable to the Fund and its subsidiaries – net | <u>1,315</u>              | <u>1,744</u>       |

Amounts due to (from) related parties are non-interest bearing and due on demand.

During the 12-week and 36-week periods ended May 8, 2011, distributions of \$1.1 million and \$3.3 million were declared to the Fund by the Partnership, respectively (\$1.1 million and \$3.0 million for the 12-week and 36-week periods ended May 9, 2010, respectively). The Fund, indirectly through the Trust, is entitled to receive a pro rata share of all residual distributions.

Interest expense on the SIR Loan totalled \$0.7 million and \$2.1 million for the 12-week and 36-week periods ended May 8, 2011, respectively (\$0.7 million and \$2.1 million for the 12-week and 36-week periods ended May 9, 2010, respectively). The SIR Loan bears interest at 7.5% per annum.

SIR, through 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 of the Partnership. The Partnership provided these services to the Fund and the Trust for consideration of \$0.006 million and \$0.02 million for the 12-week and 36-week periods ended May 8, 2011, respectively (\$0.006 million and \$0.02 million for the 12-week and 36-week periods ended May 9, 2010, respectively) which was the amount of consideration agreed to by the related parties.

### ***Discontinued Operation***

SIR has committed to a plan to sell, and is actively seeking a buyer for substantially all the assets of its restaurant operation in the United States, Jack Astor's Cary, LLC, a subsidiary of JACL. The proceeds from the sale of the assets will be used to repay the associated U.S. bank debt, which at May 8, 2011 was \$0.9 million (U.S. \$1.0 million). As such, the assets, liabilities and the results from operations related to this restaurant operation have been disclosed separately as a discontinued operation and prior period balances have been restated.

The net loss from discontinued operation for the 36-week period ended May 8, 2011 was \$0.2 million (2010 - \$0.07 million).

The summarized statement of operation and comprehensive loss for this discontinued operation is as follows:

|                                      | <b>12-week period ended</b>              |                        | <b>36-week period ended</b> |                        |
|--------------------------------------|------------------------------------------|------------------------|-----------------------------|------------------------|
|                                      | <b>May 8,<br/>2011</b>                   | <b>May 9,<br/>2010</b> | <b>May 8,<br/>2011</b>      | <b>May 9,<br/>2010</b> |
|                                      | <b>\$</b>                                | <b>\$</b>              | <b>\$</b>                   | <b>\$</b>              |
|                                      | (in thousands of dollars)<br>(unaudited) |                        |                             |                        |
| Food and beverage revenue            | 531                                      | 590                    | 1,606                       | 1,825                  |
| Net loss from discontinued operation | (42)                                     | (40)                   | (163)                       | (69)                   |

The summarized balance sheet for the discontinued operation is as follows:

|                                          | <b>May 8,<br/>2011</b>    | <b>August 29,<br/>2010</b> |
|------------------------------------------|---------------------------|----------------------------|
|                                          | \$                        | \$                         |
|                                          | (in thousands of dollars) |                            |
|                                          | (unaudited)               |                            |
| Current assets                           |                           |                            |
| Cash and cash equivalents                | 44                        | 32                         |
| Accounts receivable                      | 32                        | 31                         |
| Inventories                              | 28                        | 33                         |
| Prepays, deposits and other assets       | 17                        | 5                          |
| Property and equipment held for sale     | 2,295                     | -                          |
|                                          | <hr/> 2,416               | <hr/> 101                  |
| Property and equipment                   | -                         | 2,385                      |
|                                          | <hr/> 2,416               | <hr/> 2,486                |
| Current liabilities                      |                           |                            |
| Accounts payable and accrued liabilities | 77                        | 104                        |
| Current portion of long-term debt        | 928                       | 1,140                      |
|                                          | <hr/> 1,005               | <hr/> 1,244                |
| Net assets of discontinued operation     | <hr/> 1,411               | <hr/> 1,242                |

Current portion of long-term debt is a loan payable by Jack Astor's Cary, LLC, a subsidiary of Jack Astor's (Cary & Las Colinas) Limited for a total amount of \$0.9 million (U.S. \$1.0 million) (August 29, 2010 – \$1.1 million; U.S. \$1.1 million) that is currently non-compliant with respect to certain financial and non-financial covenants. As a result, this loan is presented as a current liability. All payments due on the loan have been made to date, and no notices of default have been received by the borrowers. The loan is collateralized by the assets of Jack Astor's (Cary & Las Colinas) Limited.

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

Management believes that there have been no substantial changes in the nature of critical accounting estimates since the year ended August 29, 2010. The reader will find this information in the annual MD&A for the year ended August 29, 2010.

### ***Recently Issued Accounting Pronouncements***

The Canadian Accounting Standards Board has finalized a new set of standards for private enterprises; the Company will adopt Accounting Standards for Private Enterprises effective for its fiscal 2012 year. Management is evaluating the new standards and has not yet determined the impact of this change on the Company's consolidated financial statements.

Business Combinations, Consolidated Financial Statements and Non-Controlling Interests: 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 IFRS 3, Business Combinations and IAS 27, Consolidated and Separate Financial Statements. CICA Handbook Section 1582 is effective for the Company for business combinations for which the acquisition date is on/after the reporting period beginning on or after August 29, 2011. CICA Handbook Sections 1601 and 1602 are effective for SIR for interim and annual consolidated financial statements relating to years beginning on or after August 29, 2011. Management has not yet determined the impact of this change in its consolidated financial statements.

### ***Financial Instruments***

Management believes that there have been no substantial changes in its financial instruments and other instruments since the year ended August 29, 2010. The reader will find this information in the annual MD&A for the year ended August 29, 2010.



## ***Risks and Uncertainties***

The performance of SIR is dependent on many factors. The restaurant industry generally, and in particular, the casual and fine dining segment of this industry, is intensely competitive with respect to price, service, location, food quality and qualified staff. Recently, competition has increased in the mid-price, full-service, casual and fine dining sectors in which many of the SIR Restaurants operate. In addition, factors such as business and economic conditions, availability of credit, inflation, increased food, labour and benefits costs, taxes, government regulations (including those governing alcoholic beverages), weather, seasonality, public safety issues and the availability and quality of food, services and products sold in the restaurants affect the restaurant industry in general and therefore SIR. Effective August 2, 2011, the Government of Ontario has passed amendments to Regulation 719 under the Liquor License Act. The amendments, among other things, remove the requirement for a licensed establishment to have the service and sale of food and liquor as their primary use. This may impact the competitive environment for the SIR Restaurants in Ontario. Please refer to the Fund's March 31, 2011 Annual Information Form for further discussion on risks and uncertainties related to SIR.

SIR is a holder of partnership interests in the Partnership. The Fund is also an indirect holder of partnership interests in the Partnership. The income of the Fund must be computed and will be taxed in accordance with Canadian tax laws. There is no assurance that Canadian federal income tax laws respecting the treatment of trusts will not be changed in a manner which adversely affects Unitholders.

As a result of certain legislative changes to the tax treatment of income trusts, commonly referred to as Specified Investment Flow Through tax ("SIFT Tax") effective January 1, 2011, corporate income taxes are applicable to the taxable income of the Fund beginning in calendar year 2011 (and subsequent years in which the Fund continues to operate as an income trust). The SIFT Tax applies to the Fund at the estimated prevailing corporate tax rate of approximately 28.25% for 2011 and, as a result, cash available for the Fund to distribute to Unitholders has been reduced by that amount. Therefore, the Trustees of the Fund reduced the monthly distribution to \$0.083 per Unit per month (approximately \$0.996 per Unit per year if annualized), beginning with the distribution relating to the distributable cash for the period January 1 to January 31, 2011, that was paid in February, 2011, to reflect the expected obligation of the Fund to make SIFT Tax payments. The Fund's distributions are subject to change based on a number of factors, including the cash reserves of the Fund, the SIR Holdings Trust and the SIR Royalty Limited Partnership. The Trustees will continue their practice of regularly reviewing the Fund's distribution levels.

Beginning with the Fund's distribution relating to the distributable cash from January 1 to January 31, 2011, paid in February, 2011), cash distributions to Unitholders are classified for tax purposes as eligible dividends. Unitholders who are Canadian residents and hold their Units in a non-tax deferred account may claim the dividend tax credit for eligible dividends, which would if applicable reduce the after tax impact of the SIFT Tax. Unitholders of the Fund have been advised to consult their own tax advisors to determine the impact of this change in tax laws on the distributions from their investment in the Fund.

These new rules may adversely affect SIR, as the holder of partnership interests which are convertible into units of the Fund, as well as the Fund and its Unitholders. SIR 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***

SIR competes within the full-service category of commercial foodservice in Canada. After reporting a decline in sales for the full service category during calendar 2009, the Canadian Restaurant and Foodservice Association estimates that sales in the category during 2010 grew by 1.3% and has projected that sales in the category will grow by a further 2.6% in 2011. Management believes that the results of SIR, like many other companies in our category, have been negatively affected by the adverse conditions in the Canadian economy. In the past, following economic downturns, sales in the full service category have recovered following improvements in the economy. Although there are many other factors that may affect growth of SIR's SSS<sup>(1)</sup>, assuming historical economic relationships are repeated, Management would expect that SIR's sales will recover following improvements in disposable income and consumer confidence. As it is not expecting a significant improvement in economic conditions in the near term, Management remains cautious and believes that sales growth will likely remain modest in the near term.

Management believes that currently there are sufficient cash resources retained in SIR from its cash generated by operations to fund its working capital requirements and scheduled debt repayments.

SIR continues to focus on sustaining and growing existing restaurant sales and profits while managing costs. SIR continues to carefully monitor the current economic environment and is considering new restaurant growth and renovations. In addition to the three restaurant sites already secured, new restaurant sites will be considered when appropriate and will be subject to raising acceptable long-term financing.

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<sup>(1)</sup> See footnote <sup>(1)</sup> on page 3

### ***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 Discussion and Analysis is provided as of June 15, 2011.

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, in estimating the revenues for the new Jack Astor's restaurant added to Royalty Pooled Restaurants on January 1, 2011, Management has assumed that they will operate consistent with other Jack Astor's restaurants. For more information concerning the Fund's risks and uncertainties, please refer to the October 2004 final prospectus, and/or its March 31, 2011 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 SIR, the Partnership and the Fund can be found at [www.sedar.com](http://www.sedar.com) and on SIR's website at [www.sircorp.com](http://www.sircorp.com)*