# SIR CORP.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

## FOR THE 16-WEEK AND 52-WEEK PERIODS ENDED AUGUST 28, 2011

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## TABLE OF CONTENTS


| | Page |
|---|---|
| Executive Summary | 3 |
| Overview | 4 |
| Seasonality | 5 |
| Selected Consolidated Historical Financial Information | 5 |
| Results of Operations | 6 |
| SIR Royalty Income Fund | 10 |
| Liquidity and Capital Resources | 12 |
| Contractual Obligations | 15 |
| Off-Balance Sheet Arrangements | 15 |
| Transactions with Related Parties | 15 |
| Discontinued Operation | 17 |
| Critical Accounting Estimates | 18 |
| Recently Issued Accounting Pronouncements | 18 |
| Financial Instruments | 19 |
| Risks and Uncertainties | 19 |
| Outlook | 20 |
| Forward Looking Information | 20 |

## FOR THE 16-WEEK AND 52-WEEK PERIODS ENDED AUGUST 28, 2011

## *Executive Summary*

SIR Corp.'s ("SIR's") fourth quarter of fiscal 2011 ("Q4") was from May 9, 2011 to August 28, 2011 inclusive. Highlights for SIR's fourth quarter include:

- ***Consolidated revenue and Same Store Sales[1] ("SSS") (unaudited):***
  - Food and beverage revenue from corporate restaurant operations for Q4 was $67.8 million and $206.7 million year to date ("YTD"). This represents a $5.6 million or 9.0% increase over the prior year for the quarter and an $8.4 million or 4.2% increase over the prior year for YTD.
  - SIR experienced same store sales growth[1] ("SSSG") of 3.1% and 1.3% for the 16-week and 52-week periods ended August 28, 2011, respectively.
  - SIR's flagship Concept Restaurant brand, Jack Astor's®, that generates approximately 70% of YTD Pooled Revenue, had SSSG[1] of 4.4% and 1.9% for Q4 and YTD, respectively. Canyon Creek® had a SSS[1] decline of 0.9% for Q4 and SSSG[1] of 0.8% for YTD. Alice Fazooli's® had SSS[1] declines of 4.0% and 5.4% for Q4 and YTD, respectively. The downtown Toronto Signature Restaurants had SSSG[1] of 7.8% and 5.1% for Q4 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.
- Subsequent to August 28, 2011, SIR opened a new Jack Astor's restaurant on Argentia Road in Mississauga, Ontario on November 14, 2011.
- SIR has secured two additional sites for Jack Astor's, one in Pickering, Ontario and one in Toronto, Ontario on Front Street, near the St. Lawrence Market. These restaurants are expected to open in fiscal year 2012. SIR has also 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 completed one renovation, during Q1, at the Alice Fazooli's located in Richmond Hill, Ontario and two renovations, during Q4, one at the Jack Astor's located in Calgary, Alberta and one at the Jack Astor's located in Vaughan, Ontario.
- Subsequent to year end, SIR completed three other Jack Astor's renovations, one at the location in Barrie, Ontario, one at the location on Front Street, in Toronto, Ontario and one at the location in Etobicoke, Ontario.

- ***Net Earnings (Loss)***
  - The net loss from continuing operations for Q4 of $1.1 million is $0.9 million unfavourable to the same period in the prior year.
  - The YTD net loss from continuing operations of $3.5 million is $3.7 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;
    - a provision for impairment of long-lived assets of $0.9 million in Fiscal 2011

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*[1] 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***[(2)]
  - Adjusted EBITDA[(2)] for Q4 is $5.6 million and $5.6 million in the current and prior period, respectively.
  - YTD adjusted EBITDA[(2)] is $16.1 million and $17.3 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.
  - On August 26, 2011, SIR entered into an Amended and Restated Loan Agreement (Amended Credit Agreement) that added a $12.0 million Development Loan to its existing $26.0 million Term Loan. The Development Loan will be used in the next six to nine months to finance the building of new restaurants and to renovate existing restaurants to increase SSS[(1)] and strengthen SIR's portfolio of restaurants. Under the Amended Credit Agreement, SIR may request an extension of the maturity date of the Term Loan from November 13, 2012 to be co-terminus with the maturity date of the Development Loan. While there can be no certainty that the lender will grant the extension, SIR has requested this extension.
  - 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 considers new restaurant growth and renovations, when appropriate and subject to acceptable long-term financing.

## *Overview*

SIR is a private company amalgamated under the Business Corporations Act of Ontario. As at August 28, 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*®, Far Niente®/FOUR®/Petit Four™, and the Loose Moose Tap & Grill®. As at August 28, 2011, 46 SIR Restaurants were included in SIR Royalty Pooled Restaurants.

SIR owns 100% of all its Canadian restaurants. SIR also had an investment in one Jack Astor's restaurant in the USA which is not included in Royalty Pooled Restaurants. This restaurant was sold on August 16, 2011 (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, that opened on May 2, 2011, will be added to Royalty Pooled Restaurants on January 1, 2012. The new Jack Astor's restaurant in Mississauga, Ontario, that opened on November 14, 2011 will be added to the Royalty Pooled Restaurants on January 1, 2013.

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.

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*(1) See footnote (1) on page 3*

*(2) 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.*

## 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.

## Selected Consolidated Historical Financial Information

The following tables set out selected financial information of SIR for the 16-week and 52-week periods ended August 28, 2011 and August 29, 2010, respectively. The audited 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.

| ***Statements of Operations*** | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010** | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010** |
|---|---|---|---|---|
| | (in thousands of dollars) (unaudited) | | | |
| **Corporate restaurant operations:** | | | | |
| Food and beverage revenue | 67,813 | 62,207 | 206,680 | 198,318 |
| Cost of corporate restaurant operations | 62,164 | 56,424 | 188,672 | 179,271 |
| **Earnings from corporate restaurant operations** | **5,649** | 5,783 | **18,008** | **19,047** |
| **Net earnings (loss) from continuing operations for the period** | **(1,061)** | **(151)** | **(3,474)** | **219** |
| **Net earnings (loss) for the period** | **(2,101)** | **(291)** | **(4,677)** | **11** |

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

| ***Balance Sheet*** | August 28, 2011 | August 29, 2010 |
|---|---|---|
| | (in thousands of dollars) (unaudited) | |
| Total assets | 60,509 | 67,566 |
| Total long-term liabilities | 76,191 | 77,865 |

## EBITDA[(2)] and Adjusted EBITDA[(2)]

EDITDA[(2)] and Adjusted EBITDA[(2)] are non-GAAP measures used by SIR to supplement its reporting of net earnings (loss) and net cash flow. EBITDA[(2)] and Adjusted EBITDA[(2)] 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[(2)] and Adjusted EBITDA[(2)] 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.

(2) *See footnote (2) on page 4*

The following table reconciles net earnings (loss) for the period to EBITDA[(2)] and Adjusted EBITDA[(2)]:

| **Reconciliation of net earnings (loss) for the period to EBITDA[(2)] and Adjusted EBITDA[(2)]** | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010** | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010** |
|---|---|---|---|---|
| | (in thousands of dollars) (unaudited) | | | |
| Net earnings (loss) from continuing operations for the period | (1,061) | (151) | (3,474) | 219 |
| Add (deduct): | | | | |
| Provision for (recovery of) income taxes | (12) | 37 | (5) | 4 |
| Other income - net | 107 | (39) | 6 | (367) |
| Recovery of impairment of loans and advances | (100) | (200) | (400) | (700) |
| Provision for impairment of long-lived assets | 935 | - | 935 | - |
| Interest expense – net | 663 | 817 | 2,286 | 2,241 |
| Interest on loan payable to SIR Royalty Income Fund | 921 | 921 | 2,992 | 2,992 |
| Non-controlling interest in SIR Royalty Limited Partnership | 1,595 | 1,630 | 4,886 | 4,618 |
| Other amortization | 78 | 84 | 269 | 277 |
| Amortization of restaurant assets | 2,407 | 2,318 | 7,640 | 7,653 |
| **EBITDA[(2)]** | **5,533** | **5,417** | **15,135** | **16,937** |
| Pre-opening costs | 61 | 165 | 957 | 404 |
| **Adjusted EBITDA[(2)]** | **5,594** | **5,582** | **16,092** | **17,341** |
| Income from Class A & B GP Units of the Partnership [(3)] (Not included in EBITDA[(2)] and Adjusted EBITDA[(2)] above) | 1,392 | 1,155 | 4,260 | 4,219 |
| 6% Royalty obligations under License and Royalty Agreement [(4)] | 3,927 | 3,732 | 12,205 | 11,899 |

*** 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** | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010** | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010** |
|---|---|---|---|---|
| | (in thousands of dollars) (unaudited) | | | |
| Revenue reported in consolidated financial statements | 67,813 | 62,207 | 206,680 | 198,318 |
| Less: Revenue from corporate restaurant operations excluded from the Royalty Pool | (2,367) | - | (3,259) | - |
| Revenue for Restaurants in the Royalty pool | **65,446** | **62,207** | **203,421** | **198,318** |

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

| **Reconciliation of Revenue from Consolidated Financial Statements to Same Store Sales[(1)]** | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010** | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010** |
|---|---|---|---|---|
| | (in thousands of dollars) (unaudited) | | | |
| Revenue reported in consolidated financial statements | 67,813 | 62,207 | 206,680 | 198,318 |
| Less: Revenue from corporate restaurant operations excluded from same store sales[(1)] | (3,654) | - | (5,818) | - |
| Same store sales[(1)] | **64,159** | **62,207** | **200,862** | **198,318** |

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

*(1) See footnote (1) on page 3*
*(2) See footnote (2) on page 4*
*(3) The 52-week periods ended August 28, 2011 and August 29, 2010 include the additional distribution paid to Class B GP Unitholders in December of each year, if any.*
*(4) 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 1st 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.*

| Same Store Sales[1] by Segment | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010 | % Fav. / (Unfav.) | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010 | % Fav. / (Unfav.) |
|---|---|---|---|---|---|---|
| | | | (in thousands of dollars) (unaudited) | | | |
| Jack Astor's | 46,628 | 44,667 | 4.4% | 139,092 | 136,491 | 1.9% |
| Canyon Creek | 7,670 | 7,742 | (0.9%) | 27,873 | 27,657 | 0.8% |
| Alice Fazooli's | 5,717 | 5,954 | (4.0%) | 18,155 | 19,189 | (5.4%) |
| Signature Restaurants | 4,144 | 3,844 | 7.8% | 15,742 | 14,981 | 5.1% |
| **Same store sales[1]** | **64,159** | **62,207** | **3.1%** | **200,862** | **198,318** | **1.3%** |

## *Summary of Quarterly Results*

| Statement of Operations | 4th Quarter Ended August 28, 2011 (16 weeks) | 3rd Quarter Ended May 8, 2011 (12 weeks) | 2nd Quarter Ended February 13, 2011** (12 weeks) | 1st Quarter Ended November 21, 2010** (12 weeks) | 4th Quarter Ended August 29, 2010** (16 weeks) | 3rd Quarter Ended May 9, 2010** (12 weeks) | 2nd Quarter Ended February 14, 2010** (12 weeks) | 1st Quarter Ended November 22, 2009** (12 weeks) |
|---|---|---|---|---|---|---|---|---|
| **Corporate Restaurant Operations** | | | | (in thousands of dollars) (unaudited) | | | | |
| Food and beverage revenue | 67,813 | 47,962 | 46,100 | 44,805 | 62,207 | 46,522 | 45,613 | 43,976 |
| Cost of corporate restaurant operations | 62,164 | 43,259 | 41,523 | 41,726 | 56,424 | 41,458 | 41,049 | 40,340 |
| **Earnings from corporate restaurant operations** | **5,649** | **4,703** | **4,577** | **3,079** | **5,783** | **5,064** | **4,564** | **3,636** |
| **Net earnings (loss) from continuing operations for the period** | **(1,061)** | **(229)** | **(208)** | **(1,976)** | **(151)** | **492** | **500** | **(622)** |
| **Net earnings (loss) for the period** | **(2,101)** | **(271)** | **(267)** | **(2,038)** | **(291)** | **452** | **472** | **(622)** |

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

| *Selected Unaudited Consolidated Statement of Cash Flows Information* | 4th Quarter Ended August 28, 2011 (16 weeks) | 3rd Quarter Ended May 8, 2011 (12 weeks) | 2nd Quarter Ended February 13, 2011** (12 weeks) | 1st Quarter Ended November 21, 2010** (12 weeks) | 4th Quarter Ended August 29, 2010** (16 weeks) | 3rd Quarter Ended May 9, 2010** (12 weeks) | 2nd Quarter Ended February 14, 2010** (12 weeks) | 1st Quarter Ended November 22, 2009** (12 weeks) |
|---|---|---|---|---|---|---|---|---|
| | | | | (in thousands of dollars) (unaudited) | | | | |
| **Cash provided by (used in) continuing operations** | 4,171 | 2,074 | 808 | (1,765) | 4,755 | 1,641 | 751 | 2,879 |
| **Cash used in continuing investing activities** | (2,089) | (915) | (1,366) | (1,685) | (1,279) | (287) | (205) | (395) |
| **Cash used in continuing financing activities** | (671) | (532) | (435) | (438) | (678) | (502) | (792) | (4,203) |
| Increase (decrease) in cash and cash equivalents during the period | 207 | 552 | (1,050) | (4,086) | 2,746 | 786 | (314) | (1,763) |
| Cash and cash equivalents – Beginning of period | 5,002 | 4,450 | 5,500 | 9,586 | 6,840 | 6,054 | 6,368 | 8,131 |
| **Cash and cash equivalents – End of period** | 5,209 | 5,002 | 4,450 | 5,500 | 9,586 | 6,840 | 6,054 | 6,368 |

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

*(1) See footnote (1) on page 3*

***Revenue***

There are a number of references to different revenue groupings used in the audited consolidated financial statements, the notes to the audited 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 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. This restaurant was sold during Q4 of fiscal 2011 and has been reclassified as a discontinued operation (see Discontinued Operation). For the 16-week and 52-week periods ended August 28, 2011, this revenue was \$67.8 million and \$206.7 million, respectively.

ii. Same Store Sales[(1)] – this is a sub-set of i above used for tracking comparable year-over-year sales. For Q4 fiscal 2011 and 2010, SSS[(1)] 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 was never part of SIR Restaurants. For the 16-week and 52-week periods ended August 28, 2011, this revenue was \$64.2 million and \$200.9 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 1st of each year for New Additional Restaurants and New Closed Restaurants. Currently, there are 46 Royalty Pooled Restaurants. For the 16-week and 52-week periods ended August 28, 2011, Pooled Revenue was \$65.4 million and \$203.4 million, respectively. The applicable Royalty payable to the Partnership on the Pooled Revenue for these same periods was \$3.9 million and \$12.2 million, respectively.

***Same Store Sales[(1)]***

SIR had a SSSG[(1)] of 3.1% for the 16-week period ended August 28, 2011 and SSSG[(1)] of 1.3% for the 52-week period ended August 28, 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 70% of YTD Pooled Revenue, experienced a SSSG[(1)] of 4.4% and 1.9% for the 16-week and 52-week periods ended August 28, 2011, respectively. Canyon Creek had a SSS[(1)] decline of 0.9% for the 16-week period ended August 28, 2011 and a SSSG[(1)] of 0.8% for the 52-week period ended August 28, 2011. Alice Fazooli's experienced a SSS[(1)] decline of 4.0% and 5.4% for the 16-week and 52-week periods ended August 28, 2011, respectively. 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. Although the closure of the Alice Fazooli's in Richmond Hill for 11 days, for renovations, during Q1 contributed to SSS[(1)] declines year to date, this restaurant along with the other Alice Fazooli's restaurant, located near the Square One shopping mall in Mississauga, Ontario, which was renovated in October 2008, has growing SSS[(1)] in both, Q4 2011 and YTD 2011. This growth, however, has been offset by net declines in YTD SSS[(1)] in the other three Alice Fazooli's locations that have not been renovated. The downtown Toronto Signature Restaurants had SSSG[(1)] of 7.8% and 5.1% during the 16-week and 52-week periods ended August 28, 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 16-week and 52-week periods ended August 28, 2011 was 91.7% and 91.3%, respectively compared to 90.7% and 90.4% for the 16-week and 52-week periods ended August 29, 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 partly attributable to the minimum wage increase in Q3 of fiscal 2010. In addition, increases in key commodities have negatively affected food cost as a percent of sales because the ability of restaurants to pass on these costs to consumers in the short term is more challenging in the current economic environment. The YTD costs of restaurant operations were also negatively affected by the high labour and direct costs of restaurant operations 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.

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*(1) See footnote (1) on page 3*

***Corporate costs***

Corporate costs decreased $0.1 million and increased $0.8 million for the 16-week and 52-week periods ended August 28, 2011 compared to the 16-week and 52-week periods ended August 29, 2010. The YTD increase is mainly the result of higher salary and bonus costs and higher professional consulting fees incurred for manager development and branding initiatives.

***Interest expense - net***

Interest expense decreased $0.2 million for the 16-week period ended August 28, 2011 compared to the 16-week period ended August 29, 2010 and increased $0.05 million for the 52-week period ended August 28, 2011 compared to the 52-week period ended August 29, 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. This is offset by lower amortization of deferred financing fees in fiscal 2011 compared to 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 $0.9 million and $3.0 million for both the 16-week and 52-week periods ended August 28, 2011 and the 16-week and 52-week periods ended August 29, 2010, respectively.

The Fund's share of the income of the Partnership for the 16-week and 52-week periods ended August 28, 2011 was $1.6 million and $4.9 million (16-week and 52-week periods ended August 29, 2010 - $1.6 million and $4.6 million) and has been recorded as non-controlling interest in the audited consolidated statements of operations.

***Provision for Impairment of long-lived assets***

SIR determined that the estimated future cash flow for four restaurants was not sufficient to recover the carrying value of the restaurants' long-lived assets and, accordingly, an impairment loss of $0.9 million was recorded to write down the assets to their fair values.

***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 one remaining U.S. operation. 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 $0.4 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.2 million and $0.7 million in the 16-week and 52-week periods ended August 29, 2010, respectively). During the 16-week and 52-week periods ended August 28, 2011 $0.3 and $0.6 million of these advances were repaid to SIR, respectively ($0.2 million and $0.5 million for the 16-week and 52-week periods ended August 29, 2010, respectively). While SIR has no obligation to fund the U.S. operation and is not expecting to do so, 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[(2)] and Adjusted EBITDA[(2)]***

EBITDA[(2)] is $5.6 million and $15.1 million for the 16-week and 52-week periods ended August 28, 2011, respectively and $5.4 million and $16.9 million for the 16-week and 52-week periods ended August 29, 2010, respectively. Adjusted EBITDA[(2)] is $5.6 million and $16.1 million for the 16-week and 52-week periods ended August 28, 2011, respectively and $5.6 million and $17.3 million for the 16-week and 52-week periods ended August 29, 2010, respectively. (See Selected Consolidated Historical Financial Information - Reconciliation of net earnings (loss) for the period to EBITDA[(2)] and Adjusted EBITDA[(2)]).

*[(2)] See footnote [(2)] on page 4*

## *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 bank. This agreement was amended on August 26, 2011 to incorporate the Development Loan under SIR's amended and restated credit facility. 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.

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 $0.9 million and $3.0 million was charged to the audited consolidated statements of operations for the 16-week and 52-week periods ended August 28, 2011 ($0.9 million and $3.0 million for the 16-week and 52-week periods ended August 29, 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 fees 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 $0.008 million and $0.02 million has been recorded as interest expense in the audited consolidated statements of operations for the 16-week and 52-week periods ended August 28, 2011 ($0.007 million and $0.02 million for the 16-week and 52-week periods ended August 29, 2010). The unamortized financing fees are netted against the SIR Loan in the audited consolidated financial statements.

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

| | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010 | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010 |
|---|---|---|---|---|
| | (in thousands of dollars) (unaudited) | | | |
| Initial investment by the Fund | 11,167 | 11,167 | 11,167 | 11,167 |
| Non-controlling interest in earnings of the Partnership | 1,595 | 1,630 | 4,886 | 4,618 |
| Distributions declared on the Partnership units held by the non-controlling interest | (1,595) | (1,630) | (4,886) | (4,618) |
| Non-controlling interest in the Partnership | 11,167 | 11,167 | 11,167 | 11,167 |
| Pooled Revenue [5] | 65,446 | 62,207 | 203,421 | 198,318 |
| Partnership royalty income [6] | 3,927 | 3,732 | 12,205 | 11,899 |
| Other income | 11 | 8 | 34 | 25 |
| Partnership expenses | (30) | (34) | (101) | (95) |
| Net earnings of the Partnership | 3,908 | 3,706 | 12,138 | 11,829 |
| SIR's interest in the earnings of the Partnership: | | | | |
| Income from Class A & B GP Units of the Partnership | (1,392) | (1,155) | (4,260) | (4,219) |
| Income from Class C GP Units of the Partnership | (921) | (921) | (2,992) | (2,992) |
| | (2,313) | (2,076) | (7,252) | (7,211) |
| Non-controlling interest in the Partnership | 1,595 | 1,630 | 4,886 | 4,618 |

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").

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 will be returned by SIR if the actual revenues of the new SIR Restaurants are less than 80% of the initial estimated revenues. In December of each year, an additional distribution will be payable to the Class B GP unitholders based on actual revenues of the new SIR Restaurants exceeding 80% of the initial estimated revenues or there will be a reduction in the distributions to the Class A GP unitholders if revenues are less than 80% of the initial estimated revenues.

[5] *Includes revenue from the SIR Restaurants subject to the License and Royalty Agreement and excludes revenue from Jack Astor's Cary, LLC. 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.*

[6] *6% of Pooled Revenue plus a Make-Whole Payment for closed locations, if applicable, included in Royalty Pooled Restaurants.*

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*** | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010** | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010** |
|---|---|---|---|---|
| | (in thousand of dollars) (unaudited) | | | |
| Cash provided by continuing operations | 4,171 | 4,755 | 5,288 | 10,026 |
| Cash used in continuing investing activities | (2,089) | (1,279) | (6,055) | (2,166) |
| Cash used in continuing financing activities | (671) | (678) | (2,076) | (6,175) |
| Increase (decrease) in cash and cash equivalents during the period | 207 | 2,746 | (4,377) | 1,455 |
| Cash and cash equivalents – Beginning of period | 5,002 | 6,840 | 9,586 | 8,131 |
| Cash and cash equivalents – End of period | 5,209 | 9,586 | 5,209 | 9,586 |

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

Cash provided by (used in) operating activities from continuing operations decreased by $0.6 million and $4.7 million for the 16-week and 52-week periods ended August 28, 2011, respectively as compared to the 16-week and 52-week periods ended August 29, 2010, respectively. There was an unfavourable change in the net earnings/loss from continuing operations of $0.9 million and $3.7 million in the 16-week and 52-week periods ended August 28, 2011, respectively compared to the same periods of the prior year. In both Q4 and YTD of fiscal 2011, this change in net earnings/loss was offset by a provision for impairment of long lived assets of $0.9 million. In addition, there was a decrease in net change in working capital items of $0.5 million and $2.1 million for the 16-week and 52-week periods ended August 28, 2011, respectively. The change in working capital is mainly due to the timing of payments.

Cash used in continuing investing activities was $2.1 million and $1.3 million for the 16-week periods ended August 28, 2011 and August 29, 2010, respectively. Cash used in continuing investing activities was $6.1 million and $2.2 million for the 52-week periods ended August 28, 2011 and August 29, 2010, respectively. Purchases of property and equipment amounted to $4.0 million and $1.5 million for the 16-week periods ended August 28, 2011 and August 29, 2010, respectively and $8.3 million and $2.4 million for the 52-week periods ended August 28, 2011 and August 29, 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 and the new Jack Astor's in London, Ontario, which opened in Q3, 2011. There were also renovation costs related to the Alice Fazooli's in Richmond Hill, Ontario in Q1, 2011 and the Jack Astor's in Calgary, Alberta and Vaughan, Ontario in Q4, 2011. There was less construction in fiscal 2010 with only two major renovations and some costs associated with the start of construction on the new Jack Astor's Boisbriand, Quebec location, in Q4, 2010.

Management expects that the investments in new and existing restaurants and other profit enhancing initiatives (such as new patios and patio expansions) and maintenance capital expenditures, 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 16-week and 52-week periods ended August 28, 2011, SIR received $0.2 and $0.6 million, respectively (16-week and 52-week periods ended August 29, 2010 - $0.2 million and $0.5 million, respectively) in payments on its loans and advances from U.S. S.I.R. L.L.C. and its subsidiaries.

Proceeds from the sale of discontinued operations for the 52-week period ended August 28, 2011, of $1.7 million (US$1.7 million) related to the proceeds of disposition of the assets of Jack Astor's Cary, LLC. The net proceeds from the sales have been used to repay the associated US bank debt of $0.9 million (US$0.9 million), which was outstanding at the time.

Net cash used in continuing financing activities was $0.7 million and $2.1 million for the 16-week and 52-week periods ended August 28, 2011, respectively. Net cash used in continuing financing activities was $0.7 million and $6.2 million for the 16-week and 52-week periods ended August 29, 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 $0.7 million and $1.9 million for the 16-week and 52-week periods ended August 28, 2011, respectively. Principal repayments on long-term debt were $0.7 million and $14.4 million, including the $12.7 million repayment mentioned above, for the 16-week and 52-week periods ended August 29, 2010, respectively. Financing fees of $0.01 million and $0.2 million related to the new Development Loan obtained subsequent to year end were paid during the 16-week and 52-week periods ended August 28, 2011, respectively. Financing fees related to the current credit facility of $1.1 million were paid during the 52-week period ended August 29, 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 at August 28, 2011, SIR had current assets related to continuing operations of $11.8 million (August 29, 2010 - $15.9 million) and current liabilities of $27.7 million related to continuing operations (August 29, 2010 - $27.5 million) resulting in a working capital deficit of $15.9 million (August 29, 2010 - $11.6 million). Revenues in the restaurant business are largely paid by cash and credit cards 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 $0.07 million and $0.2 million was charged to the consolidated statement of operations for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.03 and $0.03 for the 16-week and 52-week periods ended August 29, 2010, respectively). 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 ("Term Loan"). 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 August 28, 2011 totalled 8.72%.

On August 26, 2011, SIR entered into an Amended and Restated Loan Agreement (Amended Credit Agreement) with its senior lender to add a $12.0 million Development Loan to its existing $26.0 million Term Loan that was negotiated on November 13, 2009. The Development Loan will be used in the next six to nine months to finance the building of new restaurants and renovate existing restaurants to increase SSS(1) and strengthen SIR's portfolio of restaurants.

Subject to the terms and conditions of the Amended Credit Agreement, the lender agrees to make the Development Loan available to SIR by way of multiple Advances, disbursed on or prior to May 18, 2012 in accordance with the terms of the Credit Agreement. The Development Loan is a non-revolving credit facility and any repayments in whole or in part of the Development Loan may not be re-borrowed or utilized again hereunder and shall not entitle SIR to obtain further Advances in respect of such amounts repaid. The aggregate outstanding principal amount of all Advances under the Development Loan shall not exceed $12.0 million at any time. The lender will make available the Development Loan to SIR only for the purpose of financing: (a) costs incurred in connection with the acquisition of furniture, fixtures, equipment and leasehold improvements relating to new Locations; and (b) renovations and capital expenditure costs relating to existing Locations. The terms of the Amended Credit Agreement remain substantially consistent with the November 13, 2009 credit agreement. The Development Loan has a five-year term and a seven year amortization. The Development Loan has a variable interest rate that is lower than the variable rate on the existing Term Loan and is greater of 6.0% per annum and three-month Canadian dollar bankers' acceptance rate plus 5.75% per annum, which on August 28, 2011 totalled 6.92%. Under the Amended Credit Agreement, SIR may request an extension of the maturity date of the Term Loan from November 13, 2012 to be co-terminus with the maturity date of the Development Loan. While there can be no certainty that the lender will grant the extension, SIR has requested this extension. As at August 28, 2011, available drawings under the Development Loan total $12.0 million. SIR can also elect to fix the interest rate.

Under this Amended Credit Agreement, certain financial covenants apply to SIR, including a minimum fixed charge coverage ratio and a senior leverage ratio that SIR is in compliance with as at its last reporting date to the lender of October 23, 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 Amended Credit Agreement. The Amended 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 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 Amended 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). The Subordination and Postponement Agreement was amended on August 26, 2011 to incorporate the Development Loan under SIR's Amended Credit 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.

## *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 audited 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 has four commitments to lease new properties for five new restaurants, completed the construction of one restaurant subsequent to August 28, 2011, and plans to build four new restaurants. SIR is committed to fulfilling its purchase obligations for the one completed restaurant and incurred approximately $1.9 million to complete this restaurant. At the current date, SIR has not entered into any construction contracts for the four 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. As at August 28, 2011, $23.0 million was outstanding on SIR's current credit facility (see Liquidity and Capital Resources section).

SIR has the following contractual obligations as of August 28, 2011 (in thousands of dollars):

| | 1 Year | 2 – 3 Years | 4 – 5 Years | Thereafter | Total |
|---|---|---|---|---|---|
| Operating leases | 10,726 | 21,624 | 17,849 | 29,772 | 79,971 |
| Long-term debt repayments* | 2,630 | 24,262 | 8,173 | - | 35,065 |
| SIR Loan | - | - | - | 40,000 | 40,000 |
| | 13,356 | 45,886 | 26,022 | 59,772 | 155,036 |

*The long-term debt repayments reflect the estimated repayments on the Development Loan.

## *Off-Balance Sheet Arrangements*

SIR has off-balance sheet arrangements with respect to its operating leases. (See Contractual Obligations section).

## *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 $0.2 million and $0.6 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.2 million and $0.6 million for the 16-week and 52-week periods ended August 29, 2010, respectively).
- Payment for design fees and fixtures, charged to property and equipment, provided by one shareholder of SIR in the amount of $0.3 million and $0.7 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.2 million and $0.2 million for the 16-week and 52-week periods ended August 29, 2010, respectively).
- Payment for consulting fees provided by two shareholders and directors of SIR in the amount of $0.02 million and $0.1 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.04 million and $0.1 million for the 16-week and 52-week periods ended August 29, 2010, respectively).

- Received repayment against loans and advances from U.S. S.I.R. L.L.C. of $0.2 and $0.6 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.2 million and $0.5 million for the 16-week and 52-week periods ended August 29, 2010, respectively). SIR recognized interest income on those loans and advances of $0.06 million and $0.2 million during the 16-week and 52-week periods ended August 28, 2011, respectively ($0.05 million and $0.2 million for the 16-week and 52-week periods ended August 29, 2010, respectively). As at August 28, 2011, SIR has loans and advances of $1.5 million, net owing from U.S. S.I.R. L.L.C..
- Net loss from two trial seasonal restaurant operations operated by SIR for companies owned by a related party to a director of SIR for both the 16-week and 52-week periods ended August 28, 2011 were $0.1 million. SIR had sales of $0.05 million to these related companies. As at August 28, 2011, SIR has trade accounts receivable and advances of $0.1 million and accounts payable of $0.1 million recorded in its consolidated balance sheet from these restaurant operations.

Included in accounts payable and accrued liabilities are amounts due to one shareholder for design fees and fixtures provided to SIR as at August 28, 2011 of $0.1 million (August 29, 2010 - $nil).

***Transactions related to the November 13, 2009 Credit Agreement***

- Payment of a guarantee fee to one shareholder and director of SIR of which $0.07 million and $0.2 million was charged to the consolidated statement of operations for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.03 million for both the 16-week and 52-week periods ended August 29, 2010).
- Payment for the purchase of certain debts owed by U.S. S.I.R. L.L.C. of $0.3 million to one shareholder and director of SIR during the 52-week period ended August 29, 2010.
- Payment to one shareholder and director of SIR for the repurchase of common shares of $16.7 million during the 52-week period ended August 29, 2010.
- Payment for consulting services, charged to deferred financing fees (netted against the related long-term debt), provided by one shareholder and director of SIR in the amount of $0.06 million for the 52-week period ended August 29, 2010.

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

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

| | August 28, 2011 | August 29, 2010 |
|---|---|---|
| | (in thousands of dollars) (unaudited) | |
| Advances receivable | (2,021) | (1,987) |
| Interest payable on SIR Loan | 481 | 489 |
| Partnership distributions payable | 3,436 | 3,242 |
| Payable to the Fund and its subsidiaries – net | 1,896 | 1,744 |

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

During the 16-week and 52-week periods ended August 28, 2011, distributions of $1.6 million and $4.9 million were declared to the Fund by the Partnership, respectively ($1.6 million and $4.6 million for the 16-week and 52-week periods ended August 29, 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 $0.9 million and $3.0 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.9 million and $3.0 million for the 16-week and 52-week periods ended August 29, 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 $0.007 million and $0.02 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.007 million and $0.02 million for the 16-week and 52-week periods ended August 29, 2010, respectively) which was the amount of consideration agreed to by the related parties.

## *Discontinued Operation*

On August 16, 2011, SIR sold substantially all the assets of its restaurant operation in the United States, Jack Astor's Cary, LLC, a subsidiary of Jack Astor's (Cary & Las Colinas) Limited. The proceeds from the sale of the assets of $1.7 million (U.S. $1.7 million) were used to repay the associated U.S. bank debt, which at August 16, 2011 was $0.9 million (U.S. $0.9 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 was $1.0 million and $1.2 million for the 16-week and 52-week periods ended August 28, 2011, respectively ($0.1 million and $0.2 million for the 16-week and 52-week periods ended August 29, 2010, respectively).

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

| | 16-Week Period Ended August 28, 2011 | 16-Week Period Ended August 29, 2010 | 52-Week Period Ended August 28, 2011 | 52-Week Period Ended August 29, 2010 |
|---|---|---|---|---|
| | (in thousands of dollars) (unaudited) | | | |
| Food and beverage revenue | 466 | 740 | 2,072 | 2,565 |
| Loss from discontinued operation | (273) | | (436) | (208) |
| Loss on disposal of discontinued operation | (565) | | (565) | - |
| Currency translation adjustment | (202) | | (202) | - |
| Net loss from discontinued operation | (1,040) | (140) | (1,203) | (208) |

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

| | **August 28, 2011** | **August 29, 2010** |
|---|---|---|
| | **$** | **$** |
| | (in thousands of dollars) (unaudited) | |
| Current assets | | |
| Cash and cash equivalents | 24 | 32 |
| Accounts receivable | 179 | 31 |
| Inventories | - | 33 |
| Prepaids, deposits and other assets | - | 5 |
| | 203 | 101 |
| Property and equipment | - | 2,385 |
| | 203 | 2,486 |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 121 | 104 |
| Current portion of long-term debt | - | 1,140 |
| | 121 | 1,244 |
| Net assets of discontinued operation | 82 | 1,242 |

## *Critical Accounting Estimates*

The preparation of SIR's financial statements requires Management to make estimates and assumptions that affect income and expenses during the reporting periods, in addition to the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements. Actual results could differ materially from those estimates in the near term.

Under Canadian GAAP, goodwill is not amortized but is tested for impairment, at least annually. Management applies a fair-value-based test to the carrying value of each reporting unit. A goodwill impairment charge would be recorded if the amount of the recorded goodwill exceeds the difference between the fair value of the reporting unit and the carrying value of the net assets of each respective reporting unit. SIR determined that there was no impairment of goodwill in fiscal 2011 or fiscal 2010.

Under Canadian GAAP, an impairment charge is recognized for long-lived assets, including intangible assets with finite lives, when an event or change in circumstances causes an asset's carrying value to exceed the total undiscounted cash flows expected from its use and eventual disposition. As a result of a decline in sales and earnings from certain restaurants, SIR conducted an impairment analysis of these restaurants' long-lived assets. The analysis showed that the estimated future cash flows for three restaurants were not sufficient to recover the carrying value of the property and equipment. In addition, certain costs in respect of a restaurant were abandoned. Accordingly, an impairment provision of $0.9 million was recorded to write down these assets to their fair values. The fair values were determined using a depreciated replacement cost methodology or comparable historical transactions. There was no impairment charge required in fiscal 2010.

SIR adopted the provisions of CICA Handbook Section 3110, Asset Retirement Obligations effective August 30, 2004 with respect to estimated lease end remediation costs. SIR has estimated an asset retirement liability of $0.5 million (2010 - $0.4 million) and a corresponding leasehold improvement of $0.1 million (2010 - $0.1 million) as at August 28, 2011.

SIR follows the asset and liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that Management determines it is more likely than not that the future income tax assets will be realized. At August 28, 2011, SIR had approximately $29.3 million in non-capital losses carried forward in Canada available to reduce taxable income in future years. At August 28, 2011, SIR has not recognized the benefit of these losses in the financial statements. SIR recorded a valuation allowance of $9.5 million at August 28, 2011 against the net future tax assets. Future changes in the valuation allowance are thus expected based on changes in Management's assessment of the likelihood of realizing the future tax asset, and will directly impact income tax expense and therefore net income.

## *Recently Issued Accounting Pronouncements*

The Canadian Accounting Standards Board has finalized a new set of standards for private enterprises; SIR has adopted Accounting Standards for Private Enterprises (ASPE) effective for its fiscal 2012 year. Management is evaluating the new standards and has determined that the following standards will impact SIR's consolidated financial statements:

i) Financial instruments - SIR has elected to change from the effective interest method to the straight-line method to account for amortization of financing fees relating to its long-term debt and the loan payable to SIR Royalty Income Fund;

ii) Business combinations – SIR has elected under ASPE Section 1500, First-time Adoption, to be exempt from the retrospective application of business combinations; and

iii) SIR is evaluating the implications of ASPE Section 1602, Non-controlling Interests on its non-controlling interest in SIR Royalty Limited Partnership.

SIR continues to evaluate the implications of adopting ASPE on its consolidated financial statements, including quantification of adjustments for the above changes in accounting policies.

## *Financial Instruments*

SIR's financial instruments consist of cash and cash equivalents, accounts receivable, loans and advances, trade accounts payable and accrued liabilities, construction accounts payable and accrued liabilities, long-term debt, loan payable to the Fund and warrants. The fair values of these instruments approximate their carrying amounts due to their short-term maturity or, in the case of the loans and advances, the fair values of these items do not differ significantly from their carrying values. The fair value of the long-term debt is $23.0 million and the fair value of the warrants is nil. The fair value of the loan payable to the Fund could only be determined through the valuation of the debt. As a result, the determination of the fair value is not practical within the constraints of timeliness and cost.

SIR's financial instruments exposed to credit risk include cash and cash equivalents, accounts receivable and loans and advances. SIR places its cash and cash equivalents with institutions of high credit worthiness. Accounts receivable primarily comprise amounts due from major credit card companies, and as such, Management believes that its accounts receivable credit risk exposure is limited. SIR monitors the collectability of its loans and advances and establishes provisions when collection of the amounts becomes doubtful. SIR is exposed to interest rate risk with respect to its new credit facility because it has a floating interest rate. The loan payable to the Fund and the capital lease obligation have fixed interest rates. Accordingly, changes in interest rates for these liabilities would not impact the consolidated statements of operations and comprehensive loss or the carrying value of these financial liabilities. However the fair value of these financial liabilities will vary with changes in the interest rate. SIR has limited exposure to exchange rate risk in respect of transactions denominated in U.S. dollars.

## *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[1], 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.

On August 26, 2011, SIR entered into an Amended Credit Agreement that added a $12.0 million Development Loan to its existing $26.0 million Term Loan. The Development Loan will be used in the next six to nine months to finance the building of new restaurants and to renovate existing restaurants to increase SSS[1] and strengthen SIR's portfolio of restaurants. Subsequent to year end, SIR opened one new Jack Astor's restaurant in Mississauga, Ontario and renovated three existing Jack Astor's restaurants. Under the Amended Credit Agreement, SIR may request an extension of the maturity date of the Term Loan from November 13, 2012 to be co-terminus with the maturity date of the Development Loan. While there can be no certainty that the lender will grant the extension, SIR has requested this extension.

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 considers new restaurant growth and renovations when appropriate and subject to availability of acceptable long-term financing.

## *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 November 16, 2011.

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[1] *See footnote [1] on page 3*

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 revenue 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.

***Additional information related to SIR, the Partnership and the Fund can be found at www.sedar.com and on SIR's website at www.sircorp.com***